IAS Q2 2023 Prepared Remarks

Jonathan Schaffer, VP, IR

Thank you. Good afternoon, and welcome to the IAS 2023 second quarter financial results conference call. I'm joined today by Lisa Utzschneider, CEO, and Tania Secor, CFO.

Before we begin, please note that today's call and prepared remarks contain forward-looking statements. We refer you to the company's filings with the SEC, posted on our investor relations site at https://investors.integralads.com/financial-information/sec-filings, for more details about important risks and uncertainties that could cause actual results to differ materially from our expectations.

We will also refer to non-GAAP measures on today's call. A reconciliation of non-GAAP measures to the most directly comparable GAAP measures is contained in today's earnings release available on our investor relations site, https://investors.integralads.com/financials. All financial comparisons, unless noted otherwise, are based on the prior-year period.

With these formalities out of the way, I'd now like to turn the call over to our CEO, Lisa Utzschneider. Lisa, you may begin.

Lisa Utzschneider, CEO

Thanks Jonathan, and welcome everyone to our 2023 second quarter results call. We reported positive second quarter performance with revenue of $113.7 million dollars exceeding our prior outlook of $111 to $113 million dollars. Adjusted EBITDA increased to $37.4 million dollars ahead of our prior outlook of $35 to $37 million dollars at a 33% margin. We expect continued revenue growth and strong profitability in the second half of the year, and we are raising the midpoint of our full-year revenue outlook to $462 million dollars.

In June, we were delighted to host our first analyst and investor day. The event highlighted our talented IAS leadership team and showcased our differentiated technology through product demos of our Total Media Quality and CTV solutions. The day also featured partners including TikTok, Mindshare, and Haleon. IAS was thrilled to have these close partners participate as they affirmed our critical role in the digital media ecosystem.

Our partnership with Haleon, formerly GSK consumer healthcare, is a great example of how marketers place their trust in IAS. Haleon selected IAS as their global verification provider, going from four partners to one. Haleon leverages IAS's global scale and best-in-class technology for an end-to-end view of their portfolio of over 100 brands in 92 markets.

We also unveiled a refreshed brand strategy at the investor day. Our new branding reinforces IAS's standing as a leading global media measurement and optimization platform. Our mission is to provide global advertisers and publishers the most actionable data to drive superior results. As part of the rebranding, when speaking about our business we will refer to measurement, optimization, and publisher solutions which replace advertiser direct, programmatic, and supply side, respectively.

Building on our new business momentum from prior quarters, we continue to win major global client opportunities, often following head-to-head product and tech due diligence against other providers:

- We're excited to share the news of L'Oréal's selection of IAS as their global strategic partner for ad verification, expanding our reach to encompass over 45 markets worldwide. IAS will be leveraged for YouTube but also to bolster brand safety measures across various other channels, including TikTok and Amazon. L'Oreal's choice of IAS reflects our robust product roadmap's effectiveness, especially within Connected TV and social media platforms.
- During the quarter, we drove momentum in the APAC region with recent wins including LG Electronics, a global innovator in technology and consumer electronics, Singtel, the largest telecommunications company in Singapore, and Maruti Suzuki, India's largest automotive manufacturer.

We continue to see results as we focus on the right areas. In social media, we are laying the groundwork for accelerated revenue growth globally. As TikTok, Meta, and YouTube launch short form video-based products that are generating unprecedented user growth, we are providing critical solutions for their platforms. We are investing in differentiated technology that is getting smarter and creating a flywheel effect of accelerated growth and increased marketer demand.

We are realizing strong adoption of our Total Media Quality, or TMQ, product for social media platforms as we expand availability into new markets. TMQ uses AI and ML to provide insights into video content in the social media live feeds through frame-level analysis of image, audio, and text. Marketers have the ability to monitor the quality of their media buys on social media live feeds and ensure their ads are appearing next to content that is brand safe and suitable. By leveraging AI, we now support over 90 languages globally, up from just four languages earlier this year. In terms of other recent highlights:

- During the quarter, IAS announced a significant expansion with TikTok of our TMQ brand safety and suitability measurement product. TMQ is now available to advertisers in more than 30 markets. Post-bid TikTok campaigns were up 78% in the second quarter from the first quarter of 2023.
- In June, IAS rolled out Viewability measurement tools for Facebook and Instagram Reels. IAS will now provide viewability and invalid traffic measurement, or IVT, for Meta's rapidly growing Reels video feed inventory. Advertisers can verify that their ads are seen by real users. Separately, we look forward to the expansion of brand suitability verification on Feed to all Brand Safety and Suitability partners later this year.
- We continue to expand our YouTube measurement products to provide advertisers with greater insight into the type of content their ads are shown. We've expanded our TMQ solution capabilities to YouTube Shorts and Google Video Partners, or GVP.
    - IAS is now providing viewability and IVT measurement for YouTube Shorts' inventory.
    - IAS is first to market providing GARM-aligned brand safety and suitability measurement on GVP inventory. Our solution with GVP enables advertisers to share video ads on publisher websites and mobile apps beyond YouTube with confidence.

Retail media advertising is one of the fastest-growing channels and has become a valuable medium for marketers. IAS provides coverage across 9 of the top 10 retail media networks, and we are actively expanding our measurement capabilities and innovating in the space for marketers. We are excited to partner with Uber's advertising division to help validate performance and effectiveness of Journey Ads campaigns on Uber advertising. IAS will verify viewability, fraud, and brand safety to enable further transparency to Uber’s brand clients.

In addition, we announced our first-to-market partnership with Criteo. IAS will enable onsite viewability and IVT measurement across Criteo’s network of retail media partners, so that marketers can reach real users and maximize engagement across this critical channel.

In optimization, we welcomed Sam Cox to IAS as SVP of Product Management. Sam oversees global product strategy and execution for IAS’s programmatic and optimization solutions. He brings deep experience in advertising technology and exchange-based trading, and joins us most recently from Amazon and Google.

We continue to develop our attention metrics to help marketers optimize their media spend and achieve targeted outcomes. In May, we announced a strategic partnership with Lumen Research to combine IAS's attention capabilities and actionable data with Lumen's eye-tracking expertise. In June, we launched our Quality Attention post-bid measurement product. Quality Attention is focused on driving quality impressions, boosting higher engagement rates without scale issues, and driving higher conversion.

In CTV, the industry continues to grow as more consumers adopt ad-supported platforms. On the measurement side:

- IAS has received the industry's first accreditation for CTV viewable impressions from the Media Rating Council (MRC). IAS is the only company to date to have earned this accreditation as well as also receiving MRC accreditation for CTV-rendered impressions.
- IAS partnered with IRIS.TV to launch TMQ for CTV brand safety and suitability, the industry’s first video-level brand suitability measurement for CTV. IAS will provide marketers with reporting on CTV buys aligned to the GARM framework.
- We partnered with Roku to help advertisers accelerate their shift to TV streaming with confidence. IAS integrated its IVT pre-bid filters on Roku’s OneView DSP. In addition, IAS supports Roku’s Advertising Watermark to combat device spoofing on CTV.

By leveraging our unique Publica assets including an ad server, unified ad auction, and SSAI stitching capabilities, we are helping our publisher customers optimize yield on their inventory by providing consumers a familiar, TV-like, ad-break experience:

- We are excited that Publica is one of the first to be certified as part of Amazon Publisher Services Ad Server Certification Program for streaming TV.
- DraftKings recently announced the launch of DraftKings Network and has selected Publica as their primary CTV ad server as they launch into the streaming landscape.
- Vevo, the world’s leading music video network, has selected Publica to help them power their programmatic ad break decisioning globally.

Turning to other areas of the business:

- IAS strengthened our partnership with Anzu to provide the industry's first measurement solution for 3D in-game advertising. IAS will help marketers monitor and improve their campaign performance by authenticating viewability in 3D environments.

- Sustainability is a priority for IAS. Recently, IAS and Scope3 partnered to provide transparency into sustainability reporting. With IAS, marketers can collect and leverage their carbon emissions data to reduce their own carbon footprint and optimize campaign spend to lower emissions.
- In addition, Publica, in partnership with The Trade Desk and Index Exchange, released research findings powered by Scope3 data. The results highlighted the benefits of adopting OpenRTB 2.6 to support sustainability in programmatic CTV advertising, indicating an 84% decrease in ad selection carbon emissions for those participating in the study.
- We also joined Ad Net Zero, advertising's not-for-profit coalition that is working to reduce the carbon footprint for the advertising industry. Through this partnership, IAS will work alongside the biggest platforms and advertising agencies to drive change, and help the advertising industry to reduce the carbon impact to net zero.

In today's environment, marketers are placing even greater scrutiny on media quality and ROI with increased efficiency on every invested ad dollar. We heard this repeatedly at Cannes Lions in June with tremendous excitement around how we are leveraging AI and ML to increase accuracy and efficacy.

Our goal is to meet our customers' evolving needs with a broad product portfolio based on increasingly actionable data. The major media platforms in fast-growing channels like social media and CTV are innovating to create greater engagement for consumers, particularly in video. We are accelerating our product roadmap with these platforms to drive adoption of our offerings. We believe that this may translate into even greater opportunity for IAS at massive scale over time.

To conclude, we exceeded our expectations for the second quarter and look forward to delivering profitable revenue growth in the second half of the year. And with that, I'll turn the call over to Tania to review the financials.

Tania Secor, CFO

Thanks Lisa and welcome everyone. We're coming off another solid quarter of profitable growth, ahead of our prior outlook. During the second quarter, we generated double-digit revenue growth and a 140 basis point improvement year-over-year in adjusted EBITDA margin to 33%.

Total revenue in the second quarter increased 13% to $113.7 million dollars. We realized growth across optimization and measurement revenue in the second quarter. Revenue mix for the second quarter reflects increased marketer demand for our measurement products, most notably with the adoption of our social media products outpacing industry growth trends.

Optimization revenue, formerly known as programmatic revenue, grew 10% year-over-year in the second quarter to $52.8 million dollars. Optimization revenue growth in the period reflects maturing Context Control growth in-line with our prior expectations, the contribution from new logo wins, and strength in the CPG vertical partially offset by slower demand from tech/telco clients. We are investing in optimization to drive continued adoption of our offerings. We are enhancing both our product capabilities and go-to-market engine.

Measurement revenue, formerly known as advertiser direct revenue, grew to $44.9 million dollars, a 23% year-over-year increase and an acceleration from growth of 18% in the first quarter of 2023. The impressive growth in measurement revenue was attributable to ongoing adoption of our social media products, the contribution from new and large existing advertisers, higher CTV volumes as marketers increase spend, and open web growth. Social media revenue grew 33% and represented 47% of measurement revenue in the second quarter, up from 43% in the first quarter of 2023. Year-over-year growth was driven by our measurement solutions for TikTok as well as double-digit revenue growth in Meta and YouTube. Social media revenue represented 18% of total revenue in the second quarter, up from 16% in the first quarter of 2023. Video, which commands a pricing premium to display, grew 31% in the second quarter. Video accounted for 50% of measurement revenue in the second quarter, up from 47% in the first quarter of 2023. On a combined basis, total revenue from advertisers, including optimization and measurement revenue, represented 86% of second quarter revenue.

Publisher revenue, formerly known as supply side revenue, increased to $15.9 million dollars in the second quarter. Publica revenue growth was offset by the performance of our non-CTV supply side businesses. Publisher revenue represented 14% of total second quarter revenue.

International revenue, excluding the Americas, grew 10% year-over-year as a result of new business wins, adoption of our offerings, and investments in emerging markets. Europe, in particular, performed well fueling a 12% increase in EMEA revenue in the period. The second quarter global wins that Lisa referenced earlier including L'Oreal, LG Electronics, Singtel and Maruti Suzuki, reflect the strength of our international presence.

Gross profit margin for the second quarter was 79%, keeping us on track to realize our full-year expectation of 78-80% and reflecting investment in our data infrastructure and increased hosting costs. We expect to optimize the gross profit margin of our offerings as we scale over time.

During the quarter, we recognized $23.5 million dollars of stock-based compensation expense related to the return target stock options, or RTOs. The expense was triggered by the filing of a shelf registration statement on Form S-3 in May changing the implied performance of the RTOs to be probable. The RTOs were fully expensed in the second quarter, and no RTOs vested or were exercised during the period. Excluding the $23.5 million dollar expense, stock-based compensation for the period was in-line with our prior expectation. Sales and marketing, technology and development, and general and administrative expenses combined increased to $95.2 million including the $23.5 million dollar RTO expense in the second quarter.

Adjusted EBITDA for the second quarter, which excludes stock-based compensation and one-time items, increased 18% year-over-year to $37.4 million dollars. Adjusted EBITDA margin was 33%, ahead of the midpoint of our prior outlook. Net income for the second quarter was $7.7 million dollars, or $0.05 cents per share, which includes the $23.5 million dollar RTO expense as well as a tax benefit of $29.1 million dollars in the period.

Turning to our performance metrics:

- Second quarter net revenue retention, or NRR, was 115% reflecting our ability to grow with our customers.
- The total number of large advertising customers with annual revenue over $200,000 dollars increased to 208 compared to 173 last year and up sequentially from 204 in the first quarter of 2023.
- Revenue from large advertising customers was 84% of total advertising revenue at the end of the period, unchanged from March 31st, and up from 80% at the end of the second quarter of 2022.

We maintain a healthy balance sheet with strong cash flow conversion that provides us with financial flexibility to invest in the long-term growth of the business while lowering our debt. Cash and cash equivalents at the end of the second quarter were $99 million dollars. During the quarter, we reduced our long-term debt by $20 million dollars to $195 million dollars, resulting in net debt of $96 million.

- Turning to guidance, for the third quarter ending September 30, 2023, we expect total revenue in the range of $112 to $114 million dollars, a 12% year-over-year growth rate at the midpoint.
- Adjusted EBITDA for the third quarter is expected in the range of $35 to $37 million dollars, or a 32% margin at the midpoint of the range.
- For the full year 2023, we are increasing the midpoint of our revenue and adjusted EBITDA ranges. We now expect total revenue in the range of $459 to $465 million dollars, or 13% year-over-year growth at the midpoint of the range.
- We expect adjusted EBITDA for the full year 2023 of $149 to $153 million dollars, or a 33% adjusted EBITDA margin at the midpoint of the range.

A few additional points:

- We continue to expect gross profit margin in the range of 78-80% for the full year.
- Third quarter stock-based compensation expense is expected in the range of $13 to $14 million dollars. Full-year stock-based compensation expense, which includes the RTO expense, is now expected in the range of $80 to $82 million dollars.
- We expect weighted average shares outstanding for the third quarter in the range of 157 to 158 million shares, and 155 to 157 million shares for the full year.

We're pleased to have exceeded our outlook for the second quarter with double-digit revenue growth and expanded adjusted EBITDA margin. We're excited to build on our partnerships in the back half of the year, and we've increased the midpoint of our full-year revenue outlook to reflect continued momentum in our business. We continue to invest in long-term sustainable growth while efficiently managing our cost structure and strengthening our financial condition.

Lisa and I are now ready to take your questions. Operator?