IAS Q3 2023 Prepared Remarks

Jonathan Schaffer, SVP, IR

Thank you. Good afternoon, and welcome to the IAS 2023 third 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 third quarter call. We reported strong results that exceeded our prior expectations. Revenue increased 19% to $120.3 million dollars and adjusted EBITDA reached $40.6 million dollars at a 34% margin. We are raising our financial outlook for the full year to reflect our positive third quarter performance and business momentum in the fourth quarter. Tania will provide a detailed review of our financial results and increased outlook for the full year.

Let me start by highlighting some key wins and expansions that reinforce the value of our AI-backed products, platform integrations, superior service, and geographic reach.

- BMW named IAS as its global verification partner. BMW selected IAS for our technology innovation with products like Total Media Quality, or TMQ, vertical expertise in the auto sector, extensive international footprint, and high-quality service.
- We are delighted that Ferrero, a global sweet-packaged food company, has named IAS as its exclusive global measurement and optimization provider.
- We secured a major renewal and expansion of our partnership with Mars, the home of iconic brands including M&M'S, SNICKERS, KIND, and Pedigree. This multi-year, exclusive agreement includes IAS's leading market measurement and optimization offerings with annual minimum impression commitments. The renewal also expands our relationship with Mars to new markets including Mexico, Brazil, Germany, and the APAC region.

During the third quarter, we generated a 41% year-over-year increase in social media revenue, surpassing 33% social media growth in the second quarter. The accelerated growth in social media reflects the investments we're making in our technology and integrations with the major social platforms. Our TMQ product identifies higher quality media at a 3x rate which leads to higher returns on advertising spend for marketers. As TMQ is AI backed, the data becomes more accurate and adds greater value over time.

We frame the social media opportunity for IAS in terms of big building blocks which are the live feeds and the medium building blocks of short-form video. Let me update you on the latest initiatives underway:

- Since expanding inventory coverage on our Total Media Quality for YouTube product suite, impression growth and active accounts have doubled in September from July. We've seen strong customer adoption of TMQ in YouTube from clients including Dyson, Volvo, and Kimberly-Clark.
- Advertisers using our TMQ product on YouTube now have access to a suitability dashboard that allows them to analyze brand suitability trends and create a custom suitability profile.
- During the quarter, we expanded our brand safety YouTube product suite capabilities to Google Video Partners, or GVP. IAS is now providing viewability and invalid traffic, or IVT, measurement for YouTube Shorts' inventory, and offers brand safety, suitability, viewability and IVT measurement across GVP.
- In addition, we enhanced our integration with Google Campaign Manager 360. Marketers now have the ability to wrap tags, create, and launch campaigns with ease. This enhancement ensures advertiser data is automatically populated in IAS Signal, our UI dashboard, and creates greater efficiencies and reduced campaign creation time.
- We continue to drive customer adoption of our TMQ brand safety and suitability measurement product on TikTok. TMQ is now available to advertisers in 50 markets, up from 30 at the end of the second quarter, and ahead of our expectation of 40 markets by year-end. Active measurement campaigns on TikTok have more than doubled year-to-date and impressions have quadrupled.
- In August, IAS announced an exclusive, first-to-market partnership with X to provide pre-bid brand safety and suitability for video across the social platform. We’re currently in beta testing and expect to move quickly to launch in the coming weeks with a host of blue chip clients. IAS was selected by X based on the sophistication of our TMQ product. With this expansion, IAS leads the industry in providing end-to-end support for marketers on X, with a full array of solutions from measurement to optimization.
- IAS plans to offer brand suitability verification on Meta for both Facebook and Instagram Feed and Reels. We remain on track to begin client testing in Q4 of this year.

Turning to optimization, we are prioritizing ease-of-activation and transparency which are particularly important for mid-tier, performance-based marketers. We are driving product adoption and streamlining customer activation with a single point of integration. Our differentiated Total Visibility product enables marketers to optimize campaign spend with greater insights into the quality, supply path, and cost of programmatic ads, and now with an overlay of marketing outcomes. We've expanded our Total Visibility offering with our new performance dashboard, which allows marketers to analyze metrics, such as success rate over time and cost per action, alongside financial and media quality insight. We are also increasing the number of contextual segments which allows for higher avoidance and targeting customization.

Lastly, we are expanding our reach via increased DSP coverage. We are excited to announce that we have enhanced our integration with Amazon Ads to include our Context Control pre-bid segments. In addition to our standard pre-bid segments within Amazon's DSP, customers can now easily discover and avoid unsuitable content and reach contextually relevant content.

In retail media, IAS is a leader in independent verification with coverage for viewability, fraud, and brand safety with the top retail media networks. Year-to-date revenue from retail media networks has grown nearly 150%. We are delighted to partner with Instacart and bring a new level of transparency to Instacart Ads, the company's advertising products and solutions. IAS will provide viewability and IVT measurement on Instacart Ads which reaches more than 5,500 CPG brands. At Advertising Week in New York City, I hosted a panel that included Tim Castelli, VP, Global Advertising Sales at Instacart. Tim spoke to Instacart's ability to see across the grocery sales ecosystem and to provide actionable data for marketers. We look forward to helping Instacart optimize the Instacart Ads experience for our brand partners.

We launched our previously announced first-to-market partnership with Criteo's Commerce Media Platform in September. IAS's partnership with Criteo allows brands and agencies to measure viewability and IVT on a retailer's site across any onsite ad format and in Criteo's network of 210 retail partners. Marketers can be assured their media buys are driving engagement and validating real users. We also launched eight pre-bid brand safety content categories to allow marketers the ability to optimize their programmatic buying in Criteo's Commerce Max DSP.

We've discussed how we are harnessing AI to accelerate the roll out of new markets and advance capabilities for products such as Context Control and TMQ. In addition, our product development is fueled by AI which is a major point of differentiation for IAS and a game changer for our customers. AI is a critical component of the new products we're launching in emerging areas including attention and made for advertising, or MFA.

Our Quality Attention measurement product helps advertisers assess campaign performance and unlock superior results. We launched a Quality Attention beta in August which generated a high level of interest from advertisers. Over 1.5 billion impressions have already been measured using multivariable models that identify which signals are most relevant to optimize the insights being delivered. In our early beta analysis, we found that higher attention can lead to a nearly 3x lift in success rates and 98% better cost efficiency. We launched the second phase of the measurement beta last week which includes Lumen's eye tracking technology.

In October, IAS announced its new MFA site detection and avoidance solution to align with our customers' media strategies related to this type of content. Leveraging AI and ML, IAS technology aims to improve transparency into advertiser campaign quality, identify where spend is allocated, and inform optimizations to minimize waste. According to the ANA's Programmatic Media Supply Chain Transparency Study from June, 21% of all advertisement impressions measured were served on MFA sites. The IAS MFA product is available now as a beta measurement offering with general availability expected in early 2024.

In our CTV publisher business, Publica is integrating with TV OEMs which serve as the entry point into the CTV ecosystem and the live TV experience. OEMs often build their own proprietary advertising businesses and provide their ad serving technology to a growing number of streaming services. During the quarter, Vizio selected Publica to help operate its global CTV advertising business. We look forward to expanding our partnership with Vizio and our previously announced exclusive renewal with Samsung in addition to exploring new OEM opportunities.

Publica recently announced a direct integration with Yahoo Backstage. Via this server-to-server connection, publishers using the Publica Ad Platform can now access ad budgets from the Yahoo DSP directly within the Publica Unified Auction.

During the third quarter, we earned our first certification from TrustArc which conducts annual, privacy focused third-party attestations. The TRUSTe Enterprise Privacy seal certifies that IAS's data privacy policies and practices align with the standards set by the leaders in governance and compliance.

To conclude, I am proud of the team for delivering a strong quarter, and we are excited about our positive outlook for the fourth quarter. We are executing against our product roadmap with highly differentiated technology in fast-growing channels, including short-form video. As we begin our planning process for 2024, we intend to prioritize investment in innovation that leverages AI to bring the most advanced products to our customers.

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 pleased to report another strong quarter of profitable growth. We accelerated our revenue growth in the third quarter to 19% and adjusted EBITDA margin reached 34%. We are raising our full-year outlook to reflect our outperformance in the third quarter and positive business momentum in the fourth quarter.

Total revenue in the third quarter increased to $120.3 million dollars, well ahead of our prior outlook of $112 to $114 million dollars. Both optimization and measurement revenue reported growth in excess of 20% for the quarter.

Turning to our business lines, optimization revenue grew 21% to $57.0 million dollars. Optimization revenue benefited from increased product adoption and enhanced DSP integrations. In addition, we experienced a larger contribution from our T&E vertical which we expect to moderate in the fourth quarter. CPG performed well and tech/telco improved from the second quarter. Context Control revenue grew at a double-digit rate as a result of accelerated mid-tier growth which more than doubled versus the second quarter. We are expanding our mid-tier presence by adding new product capabilities, enhancing our go-to-market with the hiring of new programmatic specialists, and establishing new partnerships with mid-tier agencies.

Measurement revenue increased 23% to $47.8 million dollars in the third quarter. The increase in measurement revenue was attributable primarily to accelerated growth in social media of 41% compared to 33% in the second quarter. We continue to increase adoption of new and existing social media products with expanded market reach. During the quarter, we increased customer uptake of TMQ in both TikTok and YouTube, including YouTube Shorts. In Meta, we saw an increase in existing products with impression growth in Reels. Social media measurement revenue represented more than half of total measurement revenue for the first time at 51% in the third quarter, up from 47% in the second quarter of 2023, with the balance being open web which continued to grow. Social media revenue represented 20% of total revenue in the third quarter, up from 18% in the second quarter of 2023. Video, which commands a pricing premium to display, grew 40% in the third quarter as a result of growth in social media. Video accounted for 54% of measurement revenue in the third quarter, up from 50% in the second quarter of 2023. On a combined basis, total revenue from advertisers, including optimization and measurement revenue, increased 22% and represented 87% of third quarter revenue.

Publisher revenue increased to $15.5 million dollars in the third quarter. Publica revenue growth was partially offset by the performance of our non-CTV supply side businesses. Publica represented more than half of publisher revenue in the quarter. We continue to innovate and deepen our integrations with publishers and platforms including Samsung and Vizio as we continue to build our pipeline to support Publica's growth. Publisher revenue represented 13% of total third quarter revenue.

International revenue, excluding the Americas, accelerated to 17% year-over-year growth from 10% in the second quarter of 2023. EMEA revenue growth was particularly strong at 20% due to the contribution from previously announced new global and regional wins. Additionally, increased adoption of our TMQ social media product drove measurement revenue internationally. While international revenue represented 31% of total revenue in the third quarter, 42% of measurement revenue came from outside of the Americas.

Gross profit margin for the third quarter was 79%, which keeps us on track to deliver on our full-year margin expectation of 78-80% and reflects investment in our data infrastructure and increased hosting costs.

Sales and marketing, technology and development, and general and administrative expenses combined only increased 2% year-over-year as a result of increased efficiency and productivity through streamlined operations. In addition, lower expense growth reflects higher capitalization of internally developed software related to long-term investments in our technology and improved productivity of our engineering team.

Adjusted EBITDA for the third quarter, which excludes stock-based compensation and one-time items, increased 35% year-over-year to $40.6 million dollars. Our strong adjusted EBITDA margin of 34% was due to higher-than-expected revenue for the period as well as increased operating efficiencies. We remain focused on continuing to invest in the long-term growth of the business. Net loss for the third quarter was $13.7 million dollars, or $0.09 cents per share. Net loss for the quarter was driven by the timing of our income tax provision related to stock-based compensation from the return target options expensed in the second quarter.

Turning to our performance metrics:

- Our third quarter net revenue retention, or NRR, increased to 116% versus 115% in the second quarter due to higher product adoption.
- The total number of large advertising customers, which includes both mid- and top-tier clients with annual revenue over $200,000 dollars, increased to 219, up 19% compared to 184 last year and up sequentially from 208 in the second quarter of 2023.
- Revenue from large advertising customers was 85% of total advertising revenue at the end of the period, up from 84% at June 30th and up from 81% at the end of the third quarter of 2022.

We maintain a healthy balance sheet with strong cash flow conversion that enables us to lower our debt and provides us with financial flexibility to invest in the long-term growth of the business. Cash and cash equivalents at the end of the third quarter were $92 million dollars. During the quarter, we reduced our long-term debt by $20 million dollars to $175 million dollars, resulting in net debt of $83 million dollars. Year-to-date, we've reduced indebtedness by $50 million dollars. Our net debt to trailing twelve month adjusted EBITDA is currently 0.5x.

Turning to guidance, for the fourth quarter ending December 31, 2023, we expect total revenue in the range of $130 to $132 million dollars, a 12% year-over-year growth rate at the midpoint. Adjusted EBITDA for the fourth quarter is expected in the range of $45 to $47 million dollars, or a 35% margin at the midpoint of the range. For the full year 2023, we are increasing our revenue and adjusted EBITDA ranges to reflect our strong third quarter results and fourth quarter outlook. We are raising the midpoint of our full year outlook by $9 million dollars and now expect total revenue in the range of $470 to $472 million dollars, or 15% year-over-year growth at the midpoint of the range**.** We are increasing the midpoint of our adjusted EBITDA outlook for the full year 2023 by $7 million dollars to $157 to $159 million dollars, or approximately 34% adjusted EBITDA margin at the midpoint of the range.

A few additional modeling points:

- We continue to expect gross profit margin in the range of 78-80% for the full year.
- Fourth quarter stock-based compensation expense is expected in the range of $15 to $16 million dollars. Full-year stock-based compensation expense, which includes the RTO expense, is now expected in the range of $81 to $82 million dollars.
- We expect weighted average shares outstanding for the fourth quarter in the range of 157.5 to 158.5 million shares, and 156 to 157 million shares for the full year.

We delivered strong revenue growth and adjusted EBITDA profitability in the third quarter. As a result of our third quarter performance and business momentum in the fourth quarter, we are raising our full-year outlook. We're in a healthy financial position and we will continue to invest in the business to drive long-term growth to enhance shareholder value.

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