IAS Q3 2021 Prepared Remarks - FINAL

VP, IR, Jonathan Schaffer

Thank you. Good afternoon and welcome to the IAS 2021 third quarter financial results conference call. I am joined today by Lisa Utzschneider, CEO, and Joe Pergola, CFO.

Before we begin, please note that today's call contains forward-looking statements. We refer you to the company's filings with the SEC for more detail about important risks that could cause actual results to differ materially from our expectations.

On today's call, we will also refer to non-GAAP measures. A reconciliation of non-GAAP measures to the most directly comparable GAAP measures is contained in today's earnings release available on the company's IR site: investors.integralads.com.

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.

CEO, Lisa Utzschneider

I. Thanks Jonathan. I'd like to welcome everyone joining today's call. I'm delighted to be here to discuss our strong third quarter results. Based on our performance to date, combined with solid business momentum, we are raising our outlook for the full year.

II. We have a lot to share on our progress as we advance our global leadership in digital media quality. As a reminder, IAS enables marketers to improve ROI by protecting and amplifying their brands, eliminating fraud, reducing media waste, and driving better engagement and outcomes. Our solutions are global, scalable, and available across all devices and channels, including all major demand-side platforms, or DSPs, and proprietary platforms. This allows for a seamless global customer experience.
IAS's end-to-end approach to digital media quality is based on verification, contextual targeting and optimization:
    a. We provide verification services according to our proprietary, Media Rating Council or MRC-accredited Quality Impressions metric. We ensure our marketers' ads are seen by real people in brand-safe, brand-suitable environments and in the right geographies.
    b. We offer contextual targeting to marketers and publishers which extends our media quality capabilities beyond verification. Our customers are able to avoid undesirable contexts and target content that drives better outcomes for their businesses. We do this with a granularity and precision that is unmatched in the industry.
    c. We also deliver campaign optimization via our Total Visibility solution which we believe, is one of a kind. Total Visibility provides an understanding of both the quality of programmatic media and the supply path costs for ad impressions in Google DV360. As a result, marketers can find the highest quality ad placements at the most efficient price within programmatic environments.

III. The voice of the customer informs everything we do. Our brand and agency customers continue to stress the importance of effectively communicating their company values and identifying the best environments for their digital campaigns. Leading-edge marketers understand that Quality Impressions drive better outcomes. Recently, IAS hosted two live panel discussions at Advertising Week in New York City with senior executives from Group M, Mars, and Samsung. The themes of quality, trust and transparency, all of which are essential to our mission, were reinforced in these panels.

IV. Turning to a few highlights from the third quarter:
   a. We exceeded our guidance for revenue and EBITDA in the period. Revenue grew 32% year-over-year to $79.0 million. Growth was across all products and segments, with demand extending well beyond our core verification services into the new, rapidly growing products we've introduced in the last year.
   b. We also generated strong profitability with gross margins of 82%. Adjusted EBITDA reached $25.4 million at a 32% margin.
   c. We achieved these financial results while accelerating our business momentum in several key areas including: 1) driving customer adoption of our contextual targeting solutions in programmatic across brands, industry verticals, and geographies 2) acquiring Publica which transforms our connected TV or CTV capabilities and establishes IAS as a clear leader in the space and 3) scaling our infrastructure for long-term success by welcoming over 100 new employees to IAS in the period, which doubled our hiring in the second quarter.

V. Now let's discuss how we're going to grow. On last quarter's call, I outlined four key growth pillars for IAS: programmatic, social, CTV, and international. I'd like to review each of these areas and discuss our recent progress.

VI. Our first growth pillar is our programmatic business, which achieved record performance in the quarter. We experienced incredible customer adoption of Context Control, our contextual targeting solution, in the third quarter, which resulted in 49% growth in our programmatic business.

Launched in 2020, Context Control helps marketers avoid undesirable content and, increasingly, target content that is suitable for their campaigns and better aligns with their brand values. Context Control uses our Natural Language Processing and machine learning knowledge graph to classify content across over 300 contextual segments based on the semantics and emotion of a page. Recent IAS research confirms that when ads run next to contextually relevant content, 73% of consumers find the ads 'more appealing.'

HBO Max is a great example of the power of Context Control for brands. They understand that not all contexts are equal for driving advertising outcomes. The flexibility of a solution like Context Control provides HBO Max and others the ability to balance the values of their brand while simultaneously finding those contexts where their ads resonate most.

In the last 18 months, we integrated Context Control with all major DSPs, including Google DV360, The Trade Desk, and Xandr. Recently, we enhanced discoverability of Context Control for programmatic within our DV360 integration. Context Control is now available in more than 50 countries in more than 30 languages to meet increased global demand for our solutions that drive outcomes not reliant on consumer data or third-party cookies.

Last month, we launched IAS Signal -- our new, unified reporting platform that delivers the data and insights advertisers and publishers need to easily manage their digital campaigns. IAS Signal is our latest product innovation, incorporating several feature updates into one powerful platform, while setting a strong foundation for further enhancements coming soon.

VII. Additionally, we are forging deeper relationships with programmatic marketers through Total Visibility, our optimization solution. As more budgets shift to programmatic, marketers require greater media quality and transparency. Total Visibility provides marketers with actionable insights to optimize their campaign spend and drive higher yield by focusing on the most efficient and cost effective pathways. Available currently in Google DV360 with plans to extend to additional DSP partners, Total Visibility has provided added value for marketers within programmatic increasing both customer engagement and stickiness. It is also yet another example of our strategic partnership with Google that includes Channel Science for YouTube and Automated Tag, the only automated tagging solution available in Google Campaign Manager.

VIII. The growth of social platforms is another important growth pillar for IAS. On our last call, we discussed our beta program with TikTok to provide a pre-bid, brand safety solution for in-feed video ads. Our technology provides precise scoring for content in TikTok's live feed including frame-by-frame video, text, and audio and offers controls consistent with Global Alliance for Responsible Media, or GARM, categories. Since then, we've launched our brand safety solution available to all marketers on TikTok in Germany, France, and the U.S. with more markets expected soon. This is game changing for the industry because we're delivering unique technology that marketers need to protect their brand reputations while keeping up with TikTok's dynamic platform. I'm so proud of the IAS team as it's an excellent demonstration of our ability to lead the industry, innovate on behalf of our customers and launch differentiated products.

We look forward to continuing to innovate with TikTok, providing a safe and targeted ad experience for marketers in the live feed. We're also energized by future opportunities to apply this brand safety technology, which we developed internally, to other social media platforms. Last year, our research found that just 17% of industry experts believed social platforms provide enough transparency around issues such as brand risk and viewability. As more social platforms open up to third-party measurement, IAS is well positioned to remove the black box for marketers and ensure they have visibility into their ad campaigns on social platforms.

Last week, we announced that we achieved MRC accreditation for integrated third-party measurement on Facebook. This milestone underscores how customers rely on our advanced technology to drive transparency and greater outcomes for their campaigns across the largest digital platforms including Facebook. The MRC accreditation includes impression and viewability measurement and reporting of display and video ads across both Facebook and Instagram.

IX. CTV, our third growth pillar, represents a fundamental shift in TV viewing and ad-supported content. That's why we're taking a unique approach to building products that address the needs of CTV advertisers and publishers to power the user experience. There are four key advantages to CTV over linear TV including: Flexibility, Optimization, Data & Insights and Targeting & Control which includes consumer addressability. We call this TV 2.0 as our role evolves from ad verification to ad intelligence.

We're very pleased with the initial onboarding of Publica acquired during the third quarter. As a reminder, Publica is a leading video ad platform for CTV that delivers the quality of linear TV advertising across programmatic CTV environments. Independent of demand relationships, Publica helps CTV publishers improve yield and monetization by unifying their direct campaigns and programmatic demand.

Where IAS has historically been weighted towards marketers on the buy-side, Publica has deep rooted supply-side partnerships with leading global CTV publishers like ViacomCBS, Samsung, and Philo along with integrations with over 30 of the largest supply-side platforms, or SSPs. Publica is demand agnostic and completely independent of media execution. This is one of the many reasons so many publishers have adopted their technology; they are free to service the sell side without any bias towards demand. Publica also brings an ad server and unified ad auction that gives us the ability to move further upstream into CTV programmatic for both publishers and marketers.

Since acquiring Publica, we've been heads down on our long-term integration plans. We're excited to leverage assets from both companies to build the most innovative and relevant products for the CTV ecosystem. At the same time, we will maintain IAS's neutrality and standing as an independent third-party verification provider. The trust of our partners is paramount and will remain so.

Our current CTV offerings, with Publica, include CTV fraud detection covering general invalid traffic or GIVT as well as the ability to measure video rendered, video viewable, and video viewable completion rates -- currently available in a beta version. In addition, we have CTV app level transparency live in reporting. And with our Innovid integration, we now have CTV and mobile in-app measurement capabilities. We just released app-level monitoring and blocking in video for CTV that includes brand-safety monitoring and video filtering. We also plan to introduce new features that provide greater visibility for marketers. In the fourth quarter, we expect to launch new solutions that offer granular insights into where CTV ad impressions have played including on which channel and even on which show. This level of supply transparency is unheard of in the CTV universe and represents a major competitive differentiator for IAS in CTV.

X. Lastly, I'd like to highlight international growth which represents our fourth growth pillar. Our revenue mix of Americas vs. rest-of-world was 64/36 for the third quarter including Publica which primarily serves U.S. publishers today. International revenue growth continues to outpace growth in the Americas as we increase our strong footholds in EMEA and APAC, while investing in LatAm and Southeast Asia.

As mentioned, everything we build is designed to be global, scalable and repeatable. That includes Context Control which is seeing tremendous adoption across all regions. During the period for example, we secured a global mandate for Context Control with Jaguar Land Rover.

As our digital media quality solutions have expanded in scope and become more strategic, more global marketers are looking to IAS to meet their needs at scale across all channels and markets. Our combination of innovative solutions and global reach uniquely positions IAS in the market. During the quarter, we expanded our agreement with Pernod Ricard as their exclusive media quality partner, and now activate in their largest global markets including the U.S. and the U.K.

Our international growth is also being driven at the local level through integrations with global and region-specific platforms. In addition, we continue to build relationships with local brands and their agencies in all of our markets. Our new customer Alibaba is a great example from the quarter that was developed through our exclusive partnership with Omnicom Group in France.

XI. Moving forward, we will continue to invest in these growth pillars and wherever we see potential to extend our position in the market. Emerging categories like audio and gaming, for example, may offer additional opportunities to expand our portfolio and drive customer engagement. Podcasts, music streaming, and gaming platforms represent potential new formats where our technology may help ensure fraud-free, brand safe, and targeted environments for marketers.

XII. At IAS, we are focused on innovation and profitable growth. That requires having the right team which is why we prioritize talent acquisition and retention. During the third quarter, we added over 100 new employees. That's more employees than in any quarter in the last two years. Our recent hires have been across functional areas including sales, engineering, and customer success with 51 new employees in Europe and APAC. We have focused on adding expertise in video programmatic. We have also prioritized senior-level leaders with track records of driving scaled growth including the appointment of a new SVP of Product Engineering and a new VP of Data Engineering during the period. There's always more to do and we continue to focus on building our team, but we are excited by our recent progress.

XIII. And finally, we are customer obsessed! In October, we held our first customer advisory council meeting. These meetings will be held quarterly with just an incredible roster of council members from iconic Fortune 500 brands representing key verticals including CPG, financial services, automotive, technology, and healthcare. I was so impressed at our first meeting by the commitment of the council members to brand safety and suitability and to tackling issues for the broader industry. I was also honored by their partnership with IAS which we greatly appreciate.

XIV. Thank you for your ongoing support and interest in IAS. We're very pleased with our recent performance, excited about our prospects as we move into the busiest period of the year, and committed to delivering results for all of our stakeholders. And with that, I'll turn it over to Joe to review the financials.

CFO, Joe Pergola

I. Thank you, Lisa, and welcome everyone joining today's call.

II. We delivered a very strong third quarter. I'm pleased to walk you through our results and our increased outlook for the full year. As a reminder, IAS has an agile and scalable business model, focused on high revenue growth and margins. We have significant re-occurring revenue that provides us with predictability in our forecasting. We partner closely with our advertisers and publishers to build multi-year, minimum impression commitments, as well as fixed fee agreements. We command premium CPM rates for our solutions including: Context Control, Video, and CTV products.

III. Turning to our results for the third quarter, revenue increased by 32% year-over-year to $79.0 million dollars, which exceeded our upwardly revised guidance for the period of $75 to $77 million dollars. That's nearly 4% over the midpoint of our revised guidance range, and just over 5% above the midpoint of our initial range of $74 to $76 million dollars.

IV. Expanding on our revenue performance:

   a. Our Advertiser Direct revenue, which includes the open web and social platforms, increased 15% year-over-year due to higher impression volume from key accounts

including Nestle, Coca-Cola, Disney, Mars, Samsung, Sanofi, American Express, Bayer, LVMH, and Adidas.
Social Platforms continued to perform well representing an increased component of our Advertiser Direct mix for the period. Over time, we expect Social Platforms to increase from 38% of Advertiser Direct revenue today to reach 50/50 parity with open web.
Another key part of Advertiser Direct is video, which spans across both open web and social platforms. Video continued its strong growth in the quarter and accounted for 42% of our total Advertiser Direct revenue.

b. For Programmatic, our revenue increased 49% versus the prior year. Programmatic continues to benefit from ongoing customer adoption of our Context Control solutions, which represented 36% of Programmatic revenue in the period compared to 30% in the 2021 second quarter. Programmatic accounted for 43% of total revenue for the quarter.

c. Lastly, Supply Side revenue from publishers increased to $10.8 million dollars. That includes a $3.2 million dollar contribution from Publica, which was acquired midway through Q3. Publica is on track to contribute $7 million dollars in the fourth quarter, in what will be its first full quarter as part of IAS.

V. We saw significant year-over-year growth across all international markets in the period. International revenue grew 25% in the third quarter and represented 36% of total revenue. Our geographic revenue splits were as follows:
   a. For the Americas, total revenue for the quarter was $50.3 million dollars, up 36% year-over-year.
   b. EMEA was $20.2 million dollars, up 21%.
   c. And APAC was $8.5 million dollars, up 36%.

VI. Before moving on from our revenue performance, I'd like to comment on our supply-side and geographical mix following the Publica acquisition:
   a. Our supply-side revenue is expected to increase due to the contribution from Publica. As a result, we expect our segment mix will reflect higher supply-side revenue.
   b. In addition, Publica to date has operated primarily in the U.S. While we plan to leverage IAS's international footprint to expand Publica's global reach, we expect their revenue contribution will increase the share for the Americas in our reported geographic mix for the foreseeable future.

VII. Gross profit increased 31% to $65.2 million dollars with an 82% gross margin comparable to the prior year period.

VIII. Non-GAAP operating expenses, which exclude stock-based compensation expenses for comparability, increased at a rate significantly below our top line growth, reflecting our efficient operating model as well as lower costs due to Covid. Total operating expenses increased by $14.0 million dollars, which includes higher G&A costs related to hiring talent and professional fees, to support our growth as a public company. Stock-based compensation expense for the period was $8.1 million dollars which includes additional expenses related to Publica.

IX. Turning to our non-GAAP measures and KPIs:

a. Adjusted EBITDA for the third quarter, which excludes stock-based comp and other one-time items, increased 38% year-over-year to $25.4 million dollars, or a 32% margin. The combination of our strong adjusted EBITDA margin performance and top-line growth enabled us to exceed the Rule of 60 for the period.
b. Our third quarter net revenue retention, or NRR, was 129% compared to 107% in the prior year period, which was significantly impacted by the Covid-19 pandemic.
c. Total advertising customers grew 11% year-over-year to 2,045 advertisers.
d. Our total number of large advertising customers with annual revenue over $200 thousand dollars grew by 14% year-over-year to 183.

X. IAS is well capitalized to fuel the company's long-term growth. We received approximately $282 million dollars in net proceeds from the IPO in the third quarter. As we outlined in our prospectus, we are committed to reducing our long-term debt exposure. At the end of the third quarter, we replaced our existing credit facility. In doing so, we reduced our long-term debt by nearly $121 million dollars, or 1/3rd overall, and lowered our interest rate on our revolver by more than half. Our cash balance at the end of the quarter was $63.7 million dollars which includes cash from the IPO, gives effect to the cash used for the Publica acquisition and to repayment of the prior credit facility.

XI. Based on the outperformance in the third quarter and the momentum in our business, we are increasing our financial outlook for the fourth quarter and full year 2021 including Publica:
a. For the fourth quarter, we expect revenue of $94 million to $96 million dollars with adjusted EBITDA of $28 million to $30 million dollars.
b. For the full year, we expect revenue of $315 million to $317 million dollars with adjusted EBITDA of $98 million to $100 million dollars. The midpoint of our upwardly revised full year revenue guidance range represents anticipated growth, including Publica, of approximately 31% year-over-year.

XII. A few additional modeling points:
a. For the fourth quarter, we expect stock-based compensation of $9 to $10 million dollars.
b. We expect shares outstanding for the fourth quarter of approximately 153.5 million to 155 million.
c. As Lisa referenced, we continue to hire at a record pace, and we do expect adjusted EBITDA margins to reflect additional headcount in future quarters.

XIII. In closing, we're coming off a strong third quarter with double-digit revenue growth across all categories and adjusted EBITDA performance reflecting, in part, the benefits of greater scale and efficiencies in our model. As our increased guidance highlights, we expect to end 2021 on a high note, with anticipated momentum in our business in the fourth quarter, especially in programmatic, as we expect continued customer adoption of our contextual targeting solutions. This should position us well heading into 2022.

XIV. Lisa and I are now ready to take your questions.