IAS Q1 2023 Prepared Remarks

Jonathan Schaffer, VP, IR

Thank you. Good afternoon, and welcome to the IAS 2023 first 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 first quarter earnings call. We accelerated our business momentum in the first quarter as demand for our mission-critical products increased. Results exceeded our prior guidance for both revenue and adjusted EBITDA. In addition, we are raising our financial outlook for the full year.

Revenue increased 19% to $106.1 million dollars in the first quarter ahead of our forecast of $102 to $104 million dollars. We benefited from strong seasonal demand from marketer campaigns in support of March Madness, tax preparation, and new content releases across our streaming partners. In addition, recent new business wins contributed to performance in the period. Adjusted EBITDA reached $34.1 million dollars at a 32% margin. We also achieved net income profitability for the fifth straight quarter.

IAS is a customer obsessed, global technology company. We are launching innovative and scalable products at high velocity, and we continue to invest in engineering and data science talent. Science is in our name, and we are leading with the most advanced AI and ML technologies. Everything we build is global, scalable and repeatable. A great example of this is the roll-out of our Total Media Quality (TMQ) solution which delivers comprehensive analysis of content across major platforms in over 90 languages.

- Our partnership with TikTok ramped up in the first quarter driven by marketer adoption of our end-to-end measurement solutions. Active post-bid campaigns were up 33% in the first quarter compared to the fourth quarter of 2022. We currently operate in 7 markets and 3 languages with TikTok. We are expanding rapidly into over 30 new markets over the next several weeks, well ahead of our prior expectation of an additional 20 markets by year end.

- Earlier this week, IAS announced that its brand safety and suitability reporting on YouTube will now be aligned to the Global Alliance for Responsible Media, or GARM, framework. As a result, IAS will offer more granular reporting for campaigns on YouTube.
- With Meta, we're excited to continue our partnership and value their commitment to implementing suitability controls and verification for Feed. We look forward to the expansion of Feed verification to all badged partners later this year.
- Last quarter, we announced our expansion into third-party brand safety and suitability measurement in Twitter's live feed in the U.S. We look forward to expanding our capabilities with Twitter globally into new markets including Australia, the U.K., and Canada.

We are investing in ease-of-use and activation of our programmatic solutions. We are enhancing the customer experience via a superior user interface, increased functionality, and expanded reporting capabilities. During the first quarter, we integrated our Quality Sync pre-bid product into DSPs including Yahoo! and MediaMath, joining other major DSPs. Quality Sync helps marketers optimize media spend and campaign outcomes by reaching higher quality impressions. In addition, strong adoption of Context Control continues to fuel our programmatic growth.

We're also developing attention metrics to help marketers better optimize their media spend and achieve targeted outcomes, while building a framework of strategic partners whose unique strengths will further enhance our product offerings. This week, IAS announced a strategic partnership with U.K.-based Lumen Research, a global attention technology company specializing in cutting edge eye tracking solutions. By combining IAS's attention capabilities and actionable data with Lumen's eye-tracking expertise, our customers will have an even more powerful way to track which impressions have captured attention and are likely to drive a business result. We are also actively participating in the IAB working groups and with the Media Rating Council, or MRC, on the ongoing development of expanded standards in this area.

In our recent whitepaper "Taking Action on Attention," we analyzed millions of advertising data signals refined by machine-learning models. The report concluded that comprehensive media quality measurement and optimization solutions that leverage visibility, the surrounding ad environment, and ad interaction signals are core to driving attention. IAS currently provides a custom report in our Signal UI that helps marketers understand these three components across their programmatic media spend.

We are building on our leadership in ad verification in CTV. We believe we have the most robust and forward-thinking product portfolio, as well as global breadth and depth across all the major CTV ad-supported platforms. By combining IAS and Publica data, we provide marketers with transparency on where their ads are running in programmatic CTV. Publica was recently named Best Video Ad Platform in Digiday's Video & TV Awards.

- In March, IAS launched viewability and invalid traffic verification for Netflix's ad-supported plan. IAS is ensuring that advertising campaigns running on Netflix are delivered fraud-free and are seen by real viewers. Verification on Netflix is now available in 12 markets globally and across all platforms.
- We're also excited to announce that Publica renewed its exclusive partnership with Samsung to be their primary CTV ad server helping them to power their ad break decisioning across Samsung TV Plus globally.

- Our pre-bid solutions are now live with Xandr Invest DSP. These offerings ensure a marketer's ads stop playing when the TV screen is off and provide metadata to better understand programmatic CTV spend.
- Beyond CTV, we're pleased to announce that Mail Metro Media, the U.K.-based global news publisher, is now using IAS Context Control as well as our publisher verification and optimization products. IAS is ensuring that ads running on Mail Metro's digital platforms can be properly seen by audiences, are fraud-free, and brand safe for advertisers.

Our leading-edge technology, along with our energized sales effort, is driving increased customer adoption and higher conversion of multi-year, multi-million dollar new business opportunities.

On last quarter's call, I highlighted several major global brand wins including Ford, Hershey, Kering, and Bel. We are winning these deals after extensive head-to-head product and tech due diligence. We're also focused on activating these wins faster which is reflected in our first quarter results.

Most recently, Canva has selected IAS based on our actionable attention data, ability to drive greater efficiencies across programmatic buying, and enhanced CTV offerings as Canva shifts more budget to the space.

In addition, we won several new accounts outside the U.S. In Europe, BT selected IAS based on our differentiated product innovation. In APAC, we're delighted to welcome Singapore Airlines and Panasonic. Our global presence stands as a key differentiator for IAS as marketers consolidate their buying decision around one provider across geographies. In the first quarter, we accelerated revenue growth with double-digit gains in the Americas, EMEA, and APAC.

Expanding on our existing relationship with Amazon, we announced recently that IAS is the first verification vendor whose suite of publisher optimization solutions are now available via Amazon Publisher Services' (APS) Connections Marketplace. By leveraging their existing APS connection, publishers can easily discover and onboard new tech solutions with a streamlined and more efficient adoption and integration process.

In March, the MRC granted continued accreditation of IAS's core digital ad verification service. Since appointing Kevin Alvero as Chief Compliance Officer, we've intensified our efforts to grow our MRC accreditations. Kevin is a widely renowned industry authority who was at Nielsen for 20 years prior to joining IAS. We look forward to continuing to work closely with the MRC.

Finally, IAS went live with our previously announced partnership with Good-Loop. We are working with Good-Loop to enable marketers to measure the carbon emissions of their digital ad campaigns.

We're off to a strong start in 2023 with first quarter results ahead of our prior expectations. We are delivering superior products to our customers, and we are investing in our technology to support future growth initiatives with data as the foundation. We have a robust new business pipeline, and we are benefiting from our enhanced go-to-market strategy.

We are excited to host our first analyst and investor day on June 13th. We encourage you to join us in person at the Nasdaq MarketSite in New York City. The event will be a great opportunity to meet and hear from several members of the IAS senior leadership team on our strategy and vision. We'll feature product demos that highlight our robust technology. We will also host an expert panel to provide insights into IAS and the broader digital media industry.

I'd like to thank everyone on today's call for your ongoing support. I'll now hand it over to Tania to review our financial results in detail.

Tania Secor, CFO

Thanks Lisa and welcome everyone. We exceeded our expectations in the first quarter highlighted by accelerated year-over-year revenue growth of 19% and adjusted EBITDA margin expansion to 32%. As a result of our positive business momentum, we are raising our financial outlook for the full year.

Total revenue in the first quarter increased to $106.1 million dollars. Our revenue growth rate of 19% for the period accelerated from the 15% growth rate in the fourth quarter of 2022. We generated increased marketer demand across our product offerings in social media, video, and open web with a strong contribution from seasonal campaigns in the period. In addition, recent new business wins added to our results. CPG, auto, and finance verticals performed well in the period.

Programmatic revenue for the first quarter grew 26% year-over-year to $51.0 million dollars, primarily attributable to Context Control. Context Control represented a similar percentage of programmatic revenue as in the fourth quarter of 2022. Non-contextual programmatic revenue increased at a double-digit rate in the first quarter. Programmatic reached 56% of total revenue from advertisers in the first quarter versus 54% in the prior year period. We see opportunity for expansion of our Context Control business beyond the top 100 accounts, particularly in the midmarket, both in the U.S. and internationally. We are also further developing other areas within programmatic, including our Total Visibility offering.

Advertiser direct revenue, which includes social media platforms and open web, increased 18% year-over-year to $40.7 million dollars. Social media revenue grew 25% and represented 43% of advertiser direct revenue in the first quarter, up from 42% in the fourth quarter of 2022. Year-over-year growth was driven by customer adoption of our post-bid solutions for TikTok as well as revenue from our existing partnerships with Meta and YouTube which continue to diversify and scale. Video, which commands a pricing premium to display, grew 25% in the quarter. Video accounted for 47% of advertiser direct revenue in the first quarter, unchanged from the fourth quarter of 2022. On a combined basis, total revenue from advertisers, including programmatic and advertiser direct revenue, represented 86% of total first quarter revenue.

Supply side revenue from publishers increased 2% to $14.4 million dollars in the period. Gains in Publica were partially offset by the performance of our non-CTV supply side businesses. Total supply side revenue represented 14% of total first quarter revenue.

Revenue grew in all three regions in the first quarter. Revenue growth in the Americas accelerated to 23%, ahead of 19% growth in the fourth quarter of 2022, driven by gains in Context Control, TikTok, and Publica. International revenue growth, excluding the Americas, accelerated to 11%, outpacing growth of 6% in the fourth quarter of 2022 fueled by new business wins, adoption of our offerings, and investments in emerging markets.

Gross profit margin for the first quarter was 80% compared to 81% in the prior year period. Gross profit margin performance in the first quarter reflects investment in our data infrastructure and increased hosting costs. Gross profit margin was in-line with our prior outlook of 78-80% which we continue to forecast throughout 2023. We expect to optimize the gross profit margin of our offerings as we scale over time.

Sales and marketing, technology and development, and general and administrative expenses combined increased 10% in the first quarter compared to the prior year period. Slower expense growth reflects our streamlined operations resulting from our recent restructuring efforts. We continue to prioritize our hiring as we focus on profitable growth. Higher stock-based compensation also drove the year-over-year increase. Stock-based compensation expense for the period was $11.3 million dollars in-line with our prior expectation of $11 to $13 million dollars.

Adjusted EBITDA for the first quarter, which excludes stock-based compensation and one-time items, increased 37% year-over-year to $34.1 million dollars. Adjusted EBITDA margin was 32% and exceeded expectations. Higher-than-expected revenue for the period, as well as increased operating efficiencies, contributed to our strong adjusted EBITDA margin in the first quarter. In addition, long-term investments in our technology and improved productivity of our engineering team resulted in increased capitalized expenses which contributed to margin performance. Net income for the first quarter was $3.1 million dollars, or $0.02 cents per share. This marks our fifth consecutive quarter of net income profitability.

Turning to our performance metrics:

- First quarter net revenue retention, or NRR, was 118% reflecting our ability to grow with our customers.
- Total advertising customers was 2,100, essentially unchanged from the prior-year period.
- Total number of large advertising customers with annual revenue over $200,000 dollars increased to 204 compared to 184 last year and up sequentially from 199 in the fourth 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. Cash and cash equivalents at the end of the first quarter were $94.4 million dollars. During the quarter, we reduced our long-term debt by $10 million dollars to $215 million dollars, resulting in net debt of $121 million dollars.

We are increasing our revenue and adjusted EBITDA outlook for the full year to reflect our first quarter outperformance and positive business momentum.

- For the second quarter ending June 30, 2023, we expect total revenue in the range of $111 to $113 million dollars, or 12% year-over-year growth at the midpoint of the range.
- Adjusted EBITDA for the second quarter is expected in the range of $35 to $37 million dollars.
- For the full year 2023, we now expect total revenue in the range of $457 to $465 million dollars, or 13% year-over-year growth at the midpoint of the range, up from our prior guidance of $453 to $463 million dollars.
- Adjusted EBITDA for 2023 is expected in the range of $147 to $153 million dollars, up from our prior guidance of $141 to $149 million dollars, which reflects a slight improvement in adjusted EBITDA margin compared to our prior outlook.

- Our updated adjusted EBITDA guidance reflects our increased revenue outlook, financial discipline driving organizational efficiencies, and an increase in the level of capitalized technology and development expense as a result of investments in our technology platform. We are reinvesting some of these benefits into strategic initiatives to support our long-term growth.

A few additional points:

- We expect second quarter year-over-year revenue growth of 12% at the midpoint, compared to higher Q1 growth which benefited from seasonal campaigns as discussed.
- Advertiser direct revenue in the second quarter is expected to benefit from the ongoing ramp in adoption of our leading social media products as well as demand for our open web products from new advertiser customers. Balancing this, programmatic revenue growth in the second quarter is expected to reflect moderating Context Control growth as the business increases scale.
- As mentioned, we expect gross profit margin in the range of 78-80% throughout the year.
- Second quarter stock-based compensation expense is expected in the range of $15.5 to $17.5 million dollars. Full-year stock-based compensation expense is expected in the range of $61 to $64 million dollars, lower than our previous guidance of $62 to $66 million dollars.
- We expect weighted average shares outstanding for the second quarter in the range of 155 to 156 million shares, and 155 to 157 million shares for the full year.

To conclude, we are pleased with our first quarter performance which sets the stage for profitable growth in 2023. We are generating positive business momentum highlighted by major wins that are already contributing to our results. We are excited to advance our partnerships with the major platforms which expand our addressable market opportunities. And we are realizing operating efficiencies while reinvesting in the business for long-term sustainable growth to benefit our customers and shareholders.

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