



Tremor Video

Third Quarter 2016 Earnings Conference Call

November 03, 2016

CORPORATE PARTICIPANTS

Bill Day, *Chief Executive Officer*

Andrew Posen, *Senior Director of IR*

John S. Rego, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Jason Helfstein, *Oppenheimer*

Austin Moldow, *Canaccord Genuity*

John Difucci, *Jefferies*

Murali Sankar, *Boenning & Scattergood, Inc.*

PRESENTATION

Operator:

Good day, everyone, and welcome to the Tremor Video Third Quarter 2016 Earnings Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Andrew Posen, Senior Director of Investor Relations. Please go ahead, sir.

Andrew Posen:

Good afternoon. Welcome to Tremor Video's third quarter 2016 earnings call. During the course of today's call, we may make forward-looking statements, including statements regarding Tremor Video's future financial and operating results, future market conditions, and Management's plans and objectives for future operations. These forward-looking statements are not historical facts but, rather, are based on the Company's current expectations and beliefs and are based on information current available to us.

The outcome of the events described in these forward-looking statements is subject to known and unknown risks and uncertainties that could cause actual results to differ materially from the results anticipated by these forward-looking statements, including, but not limited to, those factors contained in the risk factors section of the Company's most recent annual report on Form 10-K for the year ended December 31, 2015, filed with the SEC on March 15, 2016, its Form 10-Q for the periods ended March 31, 2016, and June 30, 2016, and in future SEC filings.

All information provided in this conference call is as of today, November 3, 2016. Except as required by law, we undertake no obligation to update publicly any forward-looking statements made on this call to conform the statement to actual results or changes in our expectations.

Our commentary today will include non-GAAP financial measures. We believe that the use of these non-GAAP financial measures provides an additional tool for investors to use in understanding Company performance, but note that these measures should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with GAAP. Reconciliations between GAAP and non-GAAP metrics for our reported results can be found in our earnings press release issued today, a copy of which can be found on our website.

Now, I'll turn the call over to Bill Day, Tremor Video's CEO.

Bill Day:

Thanks, Andrew, and welcome to our third quarter 2016 earnings call. Our results this quarter beat or met our expectations across all metrics and we feel very positive about how Q4 is trending. Throughout 2016, we have been focused on three primary initiatives: growth, profitability, and capital allocation.

Regarding growth, total spend is growing strongly at 25% year-to-date. This is powered by adoption of our SSP and higher function buying models. If you eliminate the headwind from our declining legacy media network, we have grown total spend over 50% through the first nine months. That's outstanding progress and ahead of our planned pace.

With respect to profitability, we delivered a profitable quarter in Q3. We've been able to increase our operating leverage by scaling the spend on our platform while decreasing our core operating expenses as the business trends towards self-service. From an operating standpoint, we are essentially cash flow break even.

Finally, we are focused on efficient capital allocation. Our business is not capex intensive and we continue to focus our investments on scaling our technology platform and international expansion. We have also allocated capital to buying back our shares, which we feel are undervalued by the market.

Looking back at our business over the past two years, we have been able to fundamentally transition from a managed service ad network to a premium video marketplace. Heading into 2015, nearly two years ago, we first began highlighting our programmatic business with the launch of our DSP and SSP. Since then, we have aggressively executed on our programmatic strategy, offering built-for-video, self-service platforms for both buyers and sellers. We believe that we have built the leading global video SSP and a highly differentiated video DSP and that we will continue to benefit from the secular shift of ad dollars to programmatic, which is forecast to grow by an incremental \$4.5 billion annually in the U.S., when comparing 2016 to 2018.

To put our transition in context, in 2014, less than 9% of our total spend was programmatic, all of which was conducted on a managed service basis. So far in 2016, more than half of our business is programmatic and over 85% of that is conducted on a self-service basis. As I mentioned, this shift towards a self-service platform allows us to achieve operating leverage and scale in a way that we were not able to do as a managed service oriented business. We have significantly grown the total spend transacted through our platform, while keeping headcount essentially flat for the past two years. During the first nine months of 2016, compared to the same period of 2014, our total spend has increased 44% while our core operating expenses have only increased by 18%. This operating leverage powered our ability to report positive EBITDA during the quarter and we are optimistic that we will continue this trend towards sustained profitability.

Our growth is no longer coming solely from the U.S., as we have taken significant steps to increase the international scope of our business. In 2014, substantially all of our spend was generated in the U.S. Today, nearly 12% of our total spend is generated internationally. Over the past two years, we have added a significant presence in the APAC region through acquisition of TVN in Australia followed by subsequent expansions in New Zealand and Malaysia. We also have opened an office in Brazil and have

refocused our U.K. office solely on programmatic. Self-service programmatic has allowed us to open new markets such as New Zealand and Brazil in a capital efficient manner.

Moreover, our SSP is increasingly a global platform for our partners, as evidenced by our recent deals with the BBC and Unity. We continue to show strong client adoption, building out our longstanding position as the trusted partner to premium sellers. We had a number of big publisher wins in the quarter, adding LeEco, a major content and technology provider in China, which recently acquired Vizio, and is now launching in the U.S. market. We also added E.W. Scripps, Silver Chalice, MailOnline, and Boingo Wireless, to name a few. In addition to increasing the number of clients using our platform, we are also seeing significant growth in spend from existing clients, highlighting the stickiness of the platform. Spend from clients that initially adopted our SSP has increased threefold from the first quarter of 2015, which is when the SSP launched, to the current quarter, when you examine these clients as a cohort.

The leading market position of our SSP gives us unique insights into the needs of sellers as the industry evolves. For instance, we are currently working with our partners to understand how header bidding fits into their monetization strategy for video. We are committed to providing our clients with maximum transparency and controls to improve their yield, and are always looking for ways to gain access to increased premium inventory supply and to embed ourselves more deeply into the ad decision process.

In addition to growing our programmatic business, we have also significantly advanced the breadth and differentiation of our higher function products. These offerings are a source of innovation, allowing us to introduce new features and tools as clients' needs and demands evolve over time. Our All-Screen product continues to be a significant component of our high function buying offering, which drives a substantial proportion of our managed service spend to mobile. In Q3, mobile video represented more than 40% of our total spend.

Higher function buying encompasses not only our proprietary outcome based buying and our All-Screen product, but it's also increasingly focused on leveraging strategic partnerships for advanced data targeting solutions. For example, last quarter we introduced our partnership with Alphonso, a TV data company that listens for TV viewing to synchronize offline and online behavior. The demand for targeted data solutions such as Alphonso is obvious and we continue to see very strong adoption. For all these reasons, we believe that higher function buying will be a growth vehicle in line with our long-term objectives.

Combined, our programmatic and higher function products represented more than 90% of our total spend this quarter and grew 47% year-over-year. We believe this growth will continue to drive our topline and in conjunction with our increasing operating leverage, position us well to deliver profitable results.

Now, I'd like to turn the call over to John, who will walk you through the financials before we take questions.

John S. Rego:

Thanks, Bill. Q3 was a strong quarter for us. Total spend was \$63.5 million, in line with our expectations and reflecting 29% growth year-over-year. Revenue was \$41.3 million above our guidance and Adjusted EBITDA was above breakeven and in line with our expectations. The back half of the year is on track to significantly outpace the first six months. As you saw in our earnings release, we are tightening our full year guidance for Adjusted EBITDA, which underscores our expectations for strong growth and another profitable quarter.

Our programmatic and higher-function spend continued to grow at an impressive rate, up 47% year-over-year and 53% year-to-date. Programmatic spend, driven by strong growth in our seller platform, was \$35.5 million in Q3, which was more than double the same period last year. Total spend from our higher function products was \$22.2 million, in line with Q3 last year. Collectively, programmatic and higher-

function buying represented 91% of our total spend in the third quarter, with our legacy and video network representing 9%.

Revenue decreased 1% year-over-year to \$41.3 million, while our gross profit increased 6% year-over-year to \$18.6 million. Our gross margins increased to 45%, compared to 42% for the prior-year period. As we have mentioned on prior calls, our year-over-year revenue growth, as well as our comparative gross margins are impacted by the mix shift of our business towards our seller platform, which is reported on a net basis. Our take rates for the quarter remain stable within each of our businesses and we are not seeing any pricing pressure.

In the third quarter, we reported an adjusted EBITDA profit, a significant improvement from last year's loss of \$1.5 million. The improvement in our adjusted EBITDA reflects real operating leverage as our business continues to scale programmatically. Total core operating expenses for the quarter, excluding non-cash items, decreased to \$19.0 million, from \$20.4 million in Q3 last year, and dropped as a percent of total spend to 30% in the quarter, from 41% in the third quarter of 2015.

Our net loss in the quarter was \$3.6 million compared to a net loss of \$28.6 million in the same quarter in 2015, which included a non-cash impairment charge of \$22.7 million related to our goodwill and certain identifiable long-lived assets. Basic and diluted net loss per share for the quarter was \$0.07.

Before I talk about our outlook, I want to spend a couple of minutes on our balance sheet. We ended the quarter with \$91.9 million of available liquidity, including \$59.4 million of working capital and our \$32.5 million line of credit.

During the third quarter, we repurchased over 621,000 shares at an average price of \$1.86 and we expect to continue executing on the program, as we think our shares remain meaningfully undervalued by the market. We believe that our strong balance sheet and cash position enables us to return value to shareholders through these share repurchases while still affording us the ability to pursue disciplined investments in our future growth.

I would like to finish with our expectations for our full-year results. We are maintaining our guidance for Total Spend and Revenue and tightening our guidance for Adjusted EBITDA. For the year, we expect total spend to be between \$245 million and \$255 million, up 23% year-over-year at the midpoint, and revenue to be between \$155 million and \$160 million. We have tightened the range for Adjusted EBITDA to between a loss of \$2.5 million and break even. Weighted average basic share count is estimated to be \$51.8 million for Q4 and \$52.3 million for the year.

We are pleased with the results from our business this quarter and in particular, the continued success of our seller platform. We believe that our programmatic business and higher-function products will continue to drive our results and, combined with our continued expense management, will enable us to deliver strong growth and another profitable quarter.

We are now going to open up the line for questions.

Operator:

Thank you. If you would like to ask a question please signal by pressing star, one on your telephone keypad. If you're using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Again that's star, one to signal for questions.

We'll go first to Jason Helfstein with Oppenheimer.

Jason Helfstein:

Hey, guys. How are you?

Bill Day:

Good.

John S. Rego:

Great.

Jason Helfstein:

Not sure how you did it but you picked a night where no one else is reporting, where yesterday we had I think seven companies reporting. So, nice work. So, just a question, the non-programmatic higher functioning kind of is all over the place the last few quarters, up to 14 and down 1. Can you give us a sense of kind of what's causing the volatility there? Is that just more of a function of just volatility around advertiser budget? Then, can you go—can you break down programmatic between desktop and mobile? That would be helpful, thanks.

Bill Day:

Sure. So, high-function, as you said, has jumped around a bit and as we said in the prepared remarks, I think we feel very strongly about it being in line with the long-term guidance and the long-term financial model that John has shared in the past and we think this can be a 10% to 20% grower year-over-year. That doesn't mean that we won't see specific sort of volatility in any particular quarter.

I will say, just looking forward, though, that the vein—historically, we've been very capable around outcome based pricing, going back to cost for engagement pricing, that sort of thing. As you know, in All-Screen pricing models really opening up mobile spend in a big, big way. Our push into data, deeper into data, is starting to really pay off. So, we've seen tremendous traction. As we've said, Alphonso being the one we speak about more often, but we have a number of different models that underpin this part of higher function behind it.

So, we expect future growth to be strong for higher-function buying based on the progress that we're making right now. We have a good pipeline of new product in that area now going into 2017 and it's also always starts with where the dollar is going. You've got to sort of fish where the fish are. E-marketer is still showing \$4 billion of U.S. ad spend traveling non-programmatically over the next several years. So, there's plenty of money, I think, for us to go after from that standpoint.

So, net-net, while it does move around a lot, we feel good about it as a growth catalyst in the future and I think it will be a nice, nice complement to what we've already been showing from the programmatic spend line. John, any comment on splitting the two?

John S. Rego:

No, not really at this point.

Bill Day:

Yes, we don't, from a mobile standpoint, we don't provide a specific breakdown. I think the color behind mobile and programmatic is that we're all set. So, on a managed service basis, we're all stars. All-Screen is very, very effective at taking a manual process of planning dollars into mobile and really letting the algorithm decide when the ad should appear on the mobile device and it's worked brilliantly, well over \$100 million of spend through that product over the quarters that we've offered it.

The capability set around mobile on both the buy and the sell side, our DSP and SSP, again, is very strong. So, we're fully supportive. It's been more an industry thing where buyers in a self-service programmatic way have been slower to move to mobile because there's certain measurement limitations in mobile that don't exist in desktop. I've publicly been out there talking about how this—we need to solve this because it makes no sense in mobile from our standpoint and many others. It's the highest impact place that you can show an ad.

So, we're ready and working to drive that to the extent that we can. I would expect over time we'd see a mobile pick up on programmatic as strongly as we've seen it pick up in a managed service environment.

Jason Helfstein:

Just maybe one more, just doing any work with social platforms right now, Facebook, Instagram, Snap?

Bill Day:

We have nothing to announce this quarter although it is a focus area for us. We fully believe that, I'll call it Facebook because they've been I think the partner that's been most open with APIs to get access to them, that we fully believe it's part of what our offering should be and so we're working against it. But nothing specific to announce this quarter.

Jason Helfstein:

Thank you.

Bill Day:

Yes. Thanks.

Operator:

We'll go next to Michael Graham with Canaccord.

Austin Moldow:

Hey, it's Austin on for Mike. Just one question on the DSP. It looked like maybe it was somewhat flat year-over-year by our estimates and I'm wondering if the strength came maybe from the higher function buying, switching over to DSP, or maybe some of the MSAs kicked in. But any color on the DSP and timing on some of the MSA contribution from last quarter would be helpful. Thanks.

Bill Day:

So, it's Bill. I'll answer that but as you know, we don't break out specifically DSP versus SSP, so in my answer I'll say that I'm answering the question without sort of confirming your sort of presumption. So, the DSP is making progress, as we said last quarter, with a number of MSAs. Those MSAs have launched, meaning we have launched campaigns running across all of those partners. So, clearly, progress from that standpoint.

As you might imagine, and as they said in the past, the sales cycle from initial awareness, to getting MSA, to drive trial and then drive broader adoption, we're well underway there. But it is an enterprise sale and in some ways, a slower enterprise sale than on the sell side with the SSP. So, I think good progress, clearly reflected in the numbers. I think also, frankly, lots of headroom for us to gain a lot of share and report bigger progress in the future. So, I think that's where I can help you. Hopefully that's helpful.

Austin Moldow:

Yes, thank you.

Operator:

We'll go next to Brian Fitzgerald with Jefferies Banking.

John Difucci:

Hey, guys. This is John on for Brian. Thanks for taking my question. You guys mentioned just a little bit about international there in the call. Just curious if you guys see the opportunity that is there and kind of how that—the investment there is going to ramp. Then, I've got a follow-up for you as well. Thanks.

Bill Day:

Sure. Great. So, it is one of our four growth initiatives we're focused on. For a long time, we were very U.S.-focused and I think properly so because most video spend, closely attached to TV spend, is U.S.-centric. But we do find that there are a number of markets that are—have started to trend, strongly programmatic and that's our interest. International markets where we can capitalize on programmatic.

We have no interest in entering international markets on a sort of like managed service or legacy and/or basis. Our programmatic offering allows us to leverage the same tech stack we have and essentially leverage it across new geographies and that's very capital-efficient. So, we've found that the incremental investment required to get into new markets is small because essentially, you establish a selling presence for the platform and off you go. Very quickly, you can drive towards break even or even positive cash flow.

So, we've analyzed a ton of markets. I won't speak to all of them because obviously some of them we haven't launched yet, but we have a very careful process that's driven by data based on the scale of the market, the broadband penetration, the scale of the TV market and the adoption of programmatic that's allowed us to rank those markets. You can see what we've done so far. We've taken a strong presence in Southeast Asia and we feel very good about that, and our market share and competitive position. We believe we're the leading VO SSP in that region.

We—a Greenfield start in Brazil. We think Brazil is the largest, most interesting LatAm market and so we're focused on building that out right now. We shifted, as we said, the U.K. presence. The U.K. has always been a very strategically important market and a large one, too, towards programmatic and specifically the sell side programmatic, our SSP. That's gone very well.

So, look for us to do more in the future. It is an area that we think can drive incremental growth and drive incremental growth with high flow through. So, they're very productive markets for us to move into right now. What was your second question?

John Difucci:

Great. Yes, and then the second question I have is just you mentioned that you started to have conversations with clients about header bidding and video. So, maybe just knowing that it's still very early days and hasn't really started to spread yet to video. But how do you characterize those conversations and what kind of the feedback has been so far.

Bill Day:

It is early, right. I mean, header bidding was sort of a response to issues that started in display and really have taken root, I think pretty strongly, in display. So, we're well aware of that, but I think it always starts by focusing on the client needs, not necessarily running to the solution. A big chunk of the client needs in

display driving to revolve around transparency, revolve around control, meaning the seller having control over their inventory and feeling that they're getting all the demand they should in to look at that supply in a high that yields highest results.

So, we've always felt like our server-side technology, and again, our SSP differs from competitors because of the service-side connection we've taken to build with all the demand sources we've worked with—provides a lot of those benefits directly. Right now, it's a much easier add ops process and without the latency. So, the latency that's annoying, perhaps, or a nuisance in display, can become critically problematic in video and particularly in mobile video, right. I mean, we're always looking—everything we do from a product standpoint now is really oriented around mobile video because we're mobile first from a product standpoint.

So, header bidding and mobile video, at least as historically been architected, don't really go well together because of the latency factor there. So, very involved from that standpoint. Feel like we addressed a lot of the root issues. The flip side is, if you look at it, I think it's an opportunity and so header bidding will, by design, bring additional premium inventory that was historically sold on a direct basis into the programmatic realm. So, this is inventory we don't necessarily see, or if we do it's just in us sort of supporting a direct sale as opposed to leveraging programmatic against it.

There's a feeling, I think, by some people who have been header bidding longer than I have that it expands the amount of inventory accessible by programmatic and that's—that will be very powerful to us, right. Because again, we drive margins that way and we drive stickiness that way. Then the other thing is it allows us to get more artful in terms of how we can help sellers construct more complex ad decisioning. So, look for us to roll out header bidding support. But at this juncture, we don't see it as sort of ground-changing from that standpoint. We think it's incremental. There will be some clients that likely take advantage of it but we think a lot of our clients are very happy with the capabilities we provide right now.

John Difucci:

Thanks.

Operator:

We'll go next to Murali Sankar with Boenning.

Murali Sankar:

Right. Thank you for taking my question. If you look a little bit further out into 2017, obviously without providing guidance, what are your expectations around industry growth and what are you doing today to maximize your participation, especially considering how people perceive the growth of the walled gardens, and kind of—are you kind of—whether you're participating in the non-walled garden opportunity and how does that impact your view on growth for next year?

Bill Day:

It's a good question. We think about it a lot because there's been a lot of conversation about this. I think a little bit—I'm not going to call it misinformation because I think they're complex topics. But I think it's just a little bit of sort of running to conclusions without digging in. We spend a lot of time analyzing this, and this is—you're specifically referring to this often-quoted statistic that Facebook and YouTube take 85% of each incremental ad dollar and limit our growth opportunity.

Here's why we think it won't. First of all, we don't think the analysis is exactly right, or at least you need to dig in more and understand the fact that Google probably takes 98% of each incremental search ad dollar. So, to the extent that Facebook and Google take this proportion of shares, particularly true for

search and display and video, less likely to be true, right. So, we think that the video world right now, in terms of spend based on scarcity of inventory and the fact that Google and Facebook inventory, while valuable, is still understood by buyers to be not as valuable as, say, a sort of premium publisher inventory with pre-roll in front of it, creates an opportunity where spend is more democratized from that standpoint.

So, we crunch the numbers and we feel pretty confident that the trends we see are consistent with about 50% of spend going to walled gardens of Facebook and Google, and by Google, I mean Google broadly not just YouTube, and about 50% outside of the walled garden in video, and that represents a large market. Particularly because if you look at the growth of overall planned digital video, it's a strong growth rate and 50% of that is a big market.

I think separately, too, the strategy we've adopted really I think—I think as you've seen from our results, done a strong job of executing against, of being a platform, allows us to work with any and all players who are outside of those walled gardens who more than ever now want to—they may be happily working with Facebook and Google from a media standpoint, but want a platform solution from an independent company, one that isn't a walled garden that will potentially compete with them directly. So, we've been able to leverage that, I think, in a big, big way to drive adoption, particularly on our SSP, first and foremost, and will allow us to benefit for the broadest share of that 50% that isn't inside the walled garden.

If the walled gardens become more open and I said some of Facebook's work suggests that they're open to partnerships and we certainly see that as an opportunity, we'll take advantage of that also. But in the scenario where the walled gardens end up pretty walled off, we feel confident that there's plenty of scale driven by programmatic and our platform strategy to grow well into any foreseeable future. Helpful?

Murali Sankar:

Very.

Operator:

With no further questions in the queue, I'd like to turn the conference back over to Mr. Bill Day for any additional or closing remarks.

Bill Day:

Okay. So, thank you very much and thanks, everyone, for joining us today. In closing, we are extremely pleased with our progress through the first nine months of this year, building on the transformation that we began two years ago. Our team has been focused on three primary initiatives; topline growth where we are, where we saw total spend from our two biggest drivers, programmatic and higher-function buying grow over 50% year-to-date, profitability, where we took advantage of increased operating leverage and delivered a profitable quarter, and capital allocation, where we focused our investments in scaling our programmatic platform and returning value to shareholders through our share buyback program.

Our execution on these initiatives provide significant momentum as we look forward to the fourth quarter and next year. I look forward to speaking with many of you over the coming months. Thanks again.

Operator:

Again, that does conclude today's presentation. We thank you for your participation.