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Tremor Video, Inc.

Tremor Video First Quarter 2015 Earnings Conference Call

May 07, 2015

CORPORATE PARTICIPANTS

Andrew Posen, *Senior Director, Investor Relations*

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Todd Sloan, *Senior Vice President and Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Michael Graham, *Canaccord Genuity*

Jason Helfstein, *Oppenheimer & Co.*

Yoni Yadgaran, *Credit Suisse*

Murali Sankar, *Janney*

PRESENTATION

Operator:

Good afternoon and thank you for joining the Tremor Video First Quarter 2015 Earnings Conference Call. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. Should anyone need assistance during the conference call, they may signal an Operator by pressing star, and then zero on their telephone keypad.

At this time I would like to turn the conference over to Mr. Andrew Posen, Senior Director, Investor Relations. Please go ahead, sir.

Andrew Posen:

Good afternoon. Welcome to Tremor Video's First Quarter 2015 Earnings Call. Joining me today to discuss our results are Bill Day, President and CEO; and Todd Sloan, CFO.

Before we begin, I'd like to take this opportunity to remind you that during the course of this call, Management will make forward-looking statements, which are subject to various risks and uncertainties. Actual results and the timing of certain events may differ materially from the results or timing predicted or implied by such forward-looking statements and reported results should not be considered as an indication of future performance.

Further information regarding the factors that could affect the Company's financial results is included in filings it makes with the Securities and Exchange Commission from time to time, including the section entitled Risk Factors in the Company's 10-K filed with the SEC on March 16, 2015, as well as future filings and reports by the Company, including its Form 10-Q for the period ended March 31, 2015.

Also, I would like to remind you that during the course of this conference call, we will discuss non-GAAP measures in talking about the Company's performance. Reconciliations to the most directly comparable GAAP financial measures are provided in the tables in the press release, which is available on our website. This conference call is also being broadcast on the Internet and is available through the Investor Relations section of the Tremor Video website. Now, I'll turn the call over to Bill Day, Tremor Video's President and CEO.

Bill Day:

Thanks Andrew, and welcome to our first quarter 2015 earnings call. Our strong results today reflect the successful execution of our strategy and continued evolution of our business. Revenue was at the upper end of our guidance range, Adjusted EBITDA exceeded guidance, and we achieved the highest gross margin since Q3 2013, nearly 40%.

The dramatic shift in media consumption toward online video, projected to grow in the US from $5.8 billion today to $12.8 billion in 2018, creates a significant growth opportunity that we are well positioned to capture. We believe that the progress we are sharing today is the result of our ability to solve the biggest problem facing advertisers and publishers, how to improve the ROI brand advertising and increasingly fragmented viewing experience. Our premium video marketplace brings advertisers and publishers together by a programmatic technology platform to buy and sell brand effective video advertising anywhere they want, from fully managed service, to fully self-service, including our DSP and SSP.

Chief Marketing Officers are under increasing pressure to justify their spend and increase effectiveness and measurability of their advertising campaigns. That is our primary focus. Our holistic video advertising solution offers the five essential elements needed for advertisers to reach the full potential of their video campaigns; the first premium supply at scale, robust video analytics, all-screen video targeting capabilities, campaign transparency, and performance-based pricing models that directly target brand effectiveness. We are seeing the return on our technology investments that we made in 2014. A growing percentage of our revenue is coming from programmatic channels, 18% in Q1 2015, up from 14% in Q4 2014, and 4% in Q1 last year.

We expect the revenue contribution from these solutions to continue to grow throughout the remainder of the year as our DSP and SSP platforms continued to gain traction. Our programmatic platforms are seeing higher levels of liquidity and trading volume driven by publishers and agencies alike. We have over 70% publishers live on our SSP and another 30 signed, including Rovio and Warner Brothers, and we recently completed our integration with the Adap.tv as an additional inventory source for our DSP.

Our Managed Service Business delivered solid and consistent growth while providing an excellent foundation. We reached a major milestone this past quarter with our proprietary, higher margin all-screen and performance-based buying products representing nearly 55% of all revenue. We are focused on continuing to grow these products while also providing clients with more traditional models like demo-based buys. We recently announced a Linear TV partnership with placemedia, a programmatic platform for linear television. This partnership enables us to bring additional scale to our advertising clients by connecting them to engage consumers on the larger screen.

As we expand on this initiative, we believe that we will be able to bring similar optimizations in linear TV as we do with our existing solutions to effectively target our clients' brand performance goals on every screen. This is a natural extension of our all-screen solution and another step towards true convergence of video advertising. We continue to be a leader in driving transparency, brand safety, and viewability measurements and reporting. In 2013, we were the first to be accredited by the Media Ratings Council, or MRC, for average viewability percentage. This quarter we attained additional accreditation from the MRC from our measurement of video impression viewability.

Furthermore, DoubleVerify recently announced that we were the first to integrate their video quality solution to improve the accuracy and speed of bot detection. According to DoubleVerify's measure, we saw less than 1% bot traffic across all ad campaigns during our first month of use. We will continue to leverage our technology and seek out partners to extend our leadership in this critical area.

In summary, I'm pleased with our progress and excited about the opportunity ahead. The majority of our revenue is now being generated by our proprietary higher margin products and we are continuing to see an increased adoption rate for our programmatic platforms.

Before I turn the call over to Todd, I would like to thank him for all the work he has done over the last four years. As we've recently announced, Todd is stepping down as our Chief Financial Officer at the end of this month. In addition to being a great partner to me, he has built a very strong finance organization and led us successfully through our IPO. We all appreciate his many contributions to Tremor Video and wish him continued success.

Todd Sloan:

Thanks Bill, and thanks everyone for joining us today. Before I get started, I just wanted to say it has been a great four-year run for me at Tremor. I'm happy to say that I believe I'm leaving the Company in a great position to capitalize on its opportunity going forward. So thank you and thank the Tremor team for everything.

Now let me spend a few minutes walking you through the drivers of the quarter before I go into our outlook. Our first quarter continued the solid trends that we saw at the end of 2014; strength in our Managed Services Business and growing adoption of our programmatic solutions. Q1 revenue of $40.6 million increased 16% compared to $34.9 million in Q1 last year, which was at the upper end of our guidance range. Our all-screen product represented 45% of our total revenue and performance-based buying represented nearly 30%. Combined, eliminating the overlap, these proprietary higher margin products represented close to 55% of our Q1 revenues.

Adjusted EBITDA for Q1 was a loss of $3.9 million, ahead of our guidance and was better than the Adjusted EBITDA loss of $4.6 million in Q1 2014. Our gross margin for the quarter increased to nearly 40% compared to 34% in Q1 2014. Our higher margin this quarter was driven by continued improvements in execution and greater contribution from our proprietary higher margin products.

Net loss in the first quarter was $7 million compared to a net loss of $7.2 million in Q1 of 2014. Basic and diluted net loss per share for the quarter was $0.14, in line with Q1 2014. In Q1 2015 Adjusted EBITDA per share was a loss of $0.08 compared to a loss of $0.09 per share in Q1 2014. On a rolling 12-month basis ended Q1 2015, our retention rate for existing clients was 85%, and average spend per account was in line with the same 12-month period last year.

Our eCPMs for our Managed Services Business were 34% higher than the prior-year quarter. This significant price increase was driven by a growing percentage of revenue attributable to our higher margin performance base and all-screen campaigns, which, as we've stated before, represented nearly 55% of our revenue on a combined basis.

Total operating expenses for the quarter increased on an absolute dollar basis to $23 million from $19.1 million and as a percent of revenue to 57% in the quarter from 55% in 2014. The increase in our operating expenses was predominantly due to additional headcount to support our growing business.

I'd like to finish our call with our thoughts regarding Q2 and our expectations for 2015. We expect that our Q2 revenue will be in the range of $45 million to $47 million and that non-GAAP Adjusted EBITDA will be in the range of a loss between $2 million and $3 million. We are reiterating our guidance for the full year with revenue in the range of $195 million to $200 million and non-GAAP Adjusted EBITDA will be a loss for the year of $3 million to $7 million. Our guidance for 2015 reflects sequential growth in our DSP and SSP offerings, as well as a more typical seasonal spending pattern that is more heavily weighted towards Q3 and Q4. As our guidance suggests, we continue to expect to achieve positive Adjusted EBITDA as the year progresses. Weighted average basic share count is estimated to be $51.4 million for Q2 and $51.7 million for the year.

In summary, Q1 was another quarter highlighting our ability to deliver on our guidance and execute on our strategy of building a premium video marketplace. We will now open the line for questions. Operator?

Operator:

Thank you. We'll now begin the question-and-answer session. Anyone who wishes to ask a question may press star, one on their touchstone telephone. If you wish to remove yourself from the question queue, you may press star, and two. Anyone who has a question may press star, and one at this time. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we take the poll for the questions.

The first question is from Brian Pitz, Jefferies. Please go ahead sir.

Corey:

Hi guys, it's Corey (phon) on for Brian. You've been talking a lot about this whole viewability issue lately. I was just wondering, have you a seen a high number of your advertisers actually optimizing against that metric, since it's been introduced and most recently accredited?

Bill Day:

Yes, it's Bill. We have seen a number, I'm not sure I want to say a high number because it's recently new and I think advertisers are still understanding how they want to take advantage of the new information to optimize, but yes it certainly is a topic that's very top of mind for them in terms of where the focus is and it positions us well because of the capabilities that we have.

Corey:

Maybe, just a follow up, is that kind of a direct sign as you guys are looking at for ad dollars shifting away from TV and maybe a direct correlation on to video?

Bill Day:

I don't think viewability actually relates to a TV shift per se. I think it's much more maturation of the online video, so consider (phon) the digital video marketplace towards quality. Historically lack of transparency kept buyers in the dark where they really couldn't appreciate frankly some of the things that we do very well, whether it's the placement premium, the premium by the partners we have, or the size of the ads that we deliver or the placement on the screen and the high viewability percent. So as now those things have been overcome and you see things like viewability becoming something that advertisers can measure and sort of adjust or spend accordingly, we feel very strongly that Tremor Video is very well positioned to benefit from that.

Corey:

Great, and then just one more question if you don't mind. You guys mentioned that 18% of revenue is being sold programmatically, is that entirely through the DSP and the SSP, or is some of that from your Managed Services that's just being sold programmatically, just a little clarification there.

Todd Sloan:

Yes, this is Todd. So it is a combination of the DSP, the SSP, and the what we refer to as Programmatic Managed Services. So yes the opportunity comes to us in many different ways.

Corey:

Okay, great. Thanks a lot.

Operator:

Next question is from Michael Graham. Please go ahead sir.

Michael Graham:

Thank you. Todd, wish you all the best, sorry to see you go. Just two questions, one is on the placemedia deal that you just mentioned Bill, just trying to picture how that works, maybe you can give an example regarding how you can take ad placements from your advertisers and get them on to a linear TV program, just maybe some examples, how that could work would be helpful and then just wondering on Managed Services, do you still think that that business can grow in the 20% range for the foreseeable future? Thank you.

Bill Day:

Yes, so I will—first to answer back to say, yes we do with respect to Managed Services and that's why we reiterated our guidance. Managed Service business is still, we feel very strongly a growth business, we see a bit different colorization (phon), perhaps as we get larger, I see our business sort of reverting to the norm if you will, with respect to quarterly timing but we still feel very, very good about the growth of the Managed Service Business.

If you think about placemedia, the simplest way, and if this isn't clear I'll clarify. So think of them as a SSP that's delivering inventory opportunities for us to target ad into from linear television, and so as we integrate with them, we'll look for ways to incorporate those placements into the overall mix of how we deliver ads through our all-screen product, and that's what I think is so powerful here. I think as you know right now our all-screen product encompasses a desktop video, mobile, tablet, and connected television, and so think of this as we work on it encompassing linear television as well. We actually believe over the top will also be part of the offer. It positions us well to sell in a very consistent way. We don't have to learn how to sell television, if you will, to incorporate this inventory into our sales model that we've already built and are executing very strongly against, as Todd referenced, with 55% of total revenue being attributed to all-screen and to performance-based mine (phon) model. So we can adjust this new inventory into our model, leverage our existing sales force we believe very successfully against selling that inventory, and look to target against brand results into linear television. Those results initially may focus on things like completions and things like that but certainly we believe over time they'll get more sophisticated as we've been able to do in mobile and other platforms whether it's through our data or through external data partnerships. Is that helpful to sort of explain how that would work?

Michael Graham:

Yes, it is. Thank you very much for that.

Operator:

Next question is from Jason Helfstein, Oppenheimer. Please go ahead sir.

Jason Helfstein:

Thanks. Can you kind of talk a bit more about the gross margins? So basically in the quarter you grew revenue 16%, you grew gross profit, 36%. The guidance implies revenue slows in the second quarter to 5%, you guys view 40% gross margin, that will be 24% year-over-year growth. Then effectively if you straight line that gross margin against the guidance, basically something like 37% revenue growth in the back half, so maximum television revenue, and at 40% gross margin that's something like 45% increase in gross profit. So can you help us understand why you're confident in the back half revenue numbers and if ultimately this is more of a gross profit story and less of a revenue story, do you see the margin improving in the back half? So even if you missed your full year revenue, you would still ultimately hit the gross profit which is absolutely what matters. So can you just dig deeper and then maybe consider going forward guiding on a gross profit basis to begin, that's what seems to matter more. Thanks.

Bill Day:

So I'll start and I think both Todd and I can address that sort of across the board to give you the full answer, Jason. You have to remember how our business works right now, as we've made progress into programmatic we still—the largest chunk of our business is the Managed Service business, and the Managed Service business think of as a summation of a number of very strong client relationships where they have initiatives that are timed around their specific initiatives they have for this year and the things they do in 2014 don't necessarily line up with how they do things in 2015. So that's why we have always said, hey, focus on annual growth not quarterly growth because even though we believe we have very, very strong relationships with a number of the Fortune 100 advertisers, how they spend their money through the year varies year in, year out. Through that in our relationship with them and our understanding how they are going to spend it, we have great deal of confidence around the timing that we are suggesting based on the numbers that you sort of mentioned, the idea that the second half growth will be stronger than the first half growth.

If you take that fact and then layer on top of that that the programmatic platform revenue we are seeing, which as we have said has a longer sales cycle, we believe will increase sequentially and year-over-year at a pretty strong rate throughout all the quarters this year. So that lays on top of the trend we're seeing in Managed Service to produce the sort of revenue profile that you described. Todd, in terms of the gross margin comments?

Todd Sloan:

Yes, so there is a mix of products here. So the products come in at different margin characteristics. So I think we've said that on the programmatic margins, the way you're seeing things in the market play out, on some of the more pure play programmatic offerings is not too dissimilar from what our expectations are as we continue to bring product in that area, and it starts to become a little bit more revenue contribution if you will. Yes, to your point about it being a gross profit story, I think that's what we've been saying for a while, we are going to take spend however it comes into the market and if people want to spend it programmatically and it has a different characteristic—margin characteristic that's okay. It's about gross profit dollars that contribute to our bottom line. So yes that's our focus.

Jason Helfstein:

Can you comment—I mean, are you expecting gross margin to accelerate in the rest of the year?

Todd Sloan:

So we don't give gross margin guidance but again as programmatic revenue starts to have a bigger absolute dollar contribution, it has an impact on margin mix if you will. So the media—the Managed Service business does have higher margins than the programmatic businesses. So as the mix starts to shift a little bit, it will have some impact on margin and that's how we're projecting the rest of the year.

Jason Helfstein:

I mean, just to keep going on, I mean what you're basically saying is if you look back to 2013, you guys did in that year about 54% of revenue in the back half of the year, whereas last year you guys did 51%, so kind of to the point of you could have a seasonally stronger back half in 2015 and 2014. But if it's more towards Managed Service, then that's actually going to take the gross margin the other way. So I'm just looking for some more color how to think about it.

Bill Day:

Yes, I think as we've said, right now I think the best statement we can make to you is that we feel that we have continued plan in the Managed Service side of the business meaning that 55% is in the top of where we can drive our sort of proprietary and higher margin adoption for that business and so that's good news. As Todd said, we also believe strongly we're going to have increasing mix of programmatic as revenue marches throughout this year quarter-by-quarter and sort of just comparatively those models have a lower margin compared to our Managed Service business. So our thinking is pretty consistent with where we are right now as opposed to dramatically higher or lower.

Jason Helfstein:

Thank you.

Todd Sloan:

Just to add to that a little bit, yes we do expect, as Bill said earlier, that our programmatic business will climb sequentially and it will make up a bigger percentage mix of the revenue in the back half of the year, so that has margin implications.

Jason Helfstein:

Thank you.

Operator:

We have a question from Yoni Yadgaran, Credit Suisse. Please go ahead sir.

Yoni Yadgaran:

Hey guys. So two questions if I may. The first one is given what's been happening recently in the upfronts as well this general kind of acceleration of adoption on the advertisers side, both programmatic and just general online video, we're wondering if you guys have been observing a general change in client behavior with respect to how far ahead they're planning their video ad budgets; more specifically are you seeing kind of shift from an annual budget to more of a quarter-to-quarter type buying dynamic?

I guess, second to that would be are you guys seeing that on the programmatic side as that business grows, does that give you additional visibility that you can then leverage in terms of what advertisers are looking for they can leverage on the non-programmatic or non-performance business to kind of I guess expand gross margin in some way just using that additional insight in terms of like what type of inventory advertisers would potentially want?

Bill Day:

I think the digital business where we've grown off right has always been a shorter lead time business. We have, and I think this is true for almost everybody in the digital space, not benefited from an upfront, and so have had to run our businesses and things that have closer visibility than the sort of upfront implied and so I don't see anything happening with television. It changes that, I think more and more the world is going that direction and the advantage we have is that we know how to operate in that world and operate in that world as opposed to having grown up in the opposite and having to deal with (inaudible) change that might be happening there.

But there's nothing about our business I think that's decreasing our visibility more or sort of timelines that I'm looking to things like that. It's very similar to what we consistently had from a digital space. I think programmatic, I'm not sure yet we have all the experience to speak with respect to how it impacts our visibility. I will say that I think there's a degree of flexibility that programmatic has added to our business with respect to the supply we now touch through our SSP and the demand that we touch through our DSPs and the partner DSPs that we've integrated with.

As we've said, nine of the ten largest video spenders are integrated with us now. That allows us to feel very confident that we touch, spend whether it's spend through our sales force and through other sales force that we touch a much greater pool of liquidity on the supply side that allows us to run our business, I think financially more successfully and you're seeing that. The other thing is I think, while programmatic spending varies, that stickiness of the partnerships, the best of the integration we're building with some of these companies is hard to, I'll say unwind if you will, and that stickiness I think will aid in our ability to continue to build the motor (phon) on our business as well as perhaps in the future increase visibility in to the programmatic channel. It was sort of like a long question so I want to make sure I get to the heart of what you're asking.

Yoni Yadgaran:

Yes, that was pretty much it, I was—it was basically more along the lines of—okay so with programmatic you gave more details, both here in terms of like what exactly on both the supply side and demand side, advertisers and publishers are providing and want and you can then use that to go backwards and when you kind of negotiate supply on the non-programmatic side, you can actually have additional visibility in terms of pricing and what people might want and therefore use that that to kind of leverage gross margins?

Bill Day:

Yes, so there are limits to that, right. We run our business very carefully because we cater to both the sort of self-service and the Managed Service side, so actually we don't share data between those two sides, so that partners that work with us on the self-service side of our business are assured and actually sign contracts that assure that their data and what they do in terms of leveraging our platforms isn't something that we leverage as part of our Managed Service. I will say though that it's a little bit the opposite. The beauty of Managed Service is that we can do things like all-screen for customers that you cannot do through programmatic channels, and that's the power of Managed Services, the ability to do that and get a higher take rate if you will, higher margins for doing that, then if someone wants to turn the dials and do the work themselves.

So I'll leave you with the thought then, we believe the Company is super well positioned because of the fact that at this point whether it's a buy side or sell side, managed service or self-service, we offer it all and within streaming video are really the only premium player that has the ability to work with anybody that wants to leverage any of our capabilities and we increasingly see clients that don't want to do one thing. They want to come in and they want to talk to our DSP and our Managed Service and a package deal if you will and it gives us a strategic advantage versus other players that just do some of the parts of the close to all the parts like we do.

Yoni Yadgaran:

Got it. Thanks guys.

Operator:

We have a question from Murali Sankar, Janney. Please go ahead, sir.

Murali Sankar:

Yes hi, thank you for taking my questions. I actually have two as well. My first question is on programmatic, I'm trying to understand a little bit better where the growth is coming from. I did some back of the envelope calculations and it actually looks like—it implies that your programmatic revenues are 18% of revenues now, it kind of implies that your non-programmatic revenues have declined a little bit year-over-year. I'm trying to understand, so what exactly is the dynamic there, is our budgets kind of shifting from non-programmatic to programmatic, and it is essentially the same pool or the same clients or is truly kind of incremental in your view?

I also have another question on per revenues or per client spending which is flat the second quarter in a row versus the prior quarters seeing pretty good growth. I'm trying to understand a little bit better what's driving that. Thank you.

Bill Day:

Okay. I guess what I am reading right now your second one. Okay, let's start with the first one. So think of it this way all right, the Managed Service—so don't think of our Managed Service business as non-programmatic. Think of the Managed Service business as ingesting spend that's both programmatic and non-programmatic. As Todd said, our definition of programmatic spend includes platforms which tend to be almost entirely self-service, that's the DSP and SSP, as well as the business we do at trading desk. That business with trading desk again can include Managed Service offerings from that standpoint. So I think your analysis is right. If you look at the business and you strip the programmatic trading desk out of the business that if it's about flat, in today's world that's doing very well given the sort of focus on programmatic.

Our belief long-term is that more and more we'll go programmatic, but a ton of that will be Managed Service. So the real distinction that's more productive over time to pay attention to isn't programmatic and non-programmatic, it will actually flip to Managed Service versus self-service. We have the capability to work with people across (inaudible) however they want to operate. Clearly people right now are spending money in Managed Service, outside of the trading desk. We do that very well. They're spending money in Managed Service through the trading desk, that's growing very rapidly as we lead, I'm sure s little bit of price and they're leveraging platforms to spend money directly on a self-service basis and we're well positioned to capitalize on that.

So actually internally we don't think about trying to split the Managed Service business into sort of programmatic and non-programmatic. Our sales people are trained to sell programmatic and they can do that easily as sell the sort of traditional IO, but that's what the clients wants to do. I think that's the key thing is, we're following where the client want to spend money and able to pivot however they need to as time marches on. I think Todd, do you want to speak to our client's spend in terms of spending trends.

Todd Sloan:

I assume the metric you are referring to is the spend per client on the rolling 12-month basis. Is that correct?

Murali Sankar:

Yes.

Todd Sloan:

It is flat, it is a solid number, it’s in excess of $100,000 per client. So we're not troubled by that metric. We think it's pretty solid spending pattern that we have with our existing clients.

Murali Sankar:

What exactly is driving that? I am just comparing your growth in the prior three quarters. So I guess 1Q ’14 to 3Q ’14, so 22%, 11%, and 30% and for the last two quarters you've said essentially flat. I’m just trying to understand what changed?

Todd Sloan:

Nothing, again so in terms of the size of the spend per client in excess of $100,000 per client, it's a pretty solid number. So maybe it's a Q1 impact but it's pretty—we're not uncomfortable with that metric.

Murali Sankar:

Okay. Thank you.

Operator:

Mr. Posen, there are no more questions at this time. I'd like to turn the floor back over to you for closing comments. Please go ahead, sir.

Andrew Posen:

Yes, so thanks again for allowing us to share our Q1 results. We're excited about growth potential as well as the growth that we reported. We're excited about the increasing progress we're making towards programmatic spending as part of our overall mix and we're excited by the progress we've made on margins and our guidance for breakeven and positive EBITDA margin in the second half of the year. Thank you again.

Operator:

Ladies and gentlemen, the conference is now complete. You may disconnect your telephones. Thank you very much for calling.