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Tremor Video

Third Quarter 2015 Earnings Conference Call

November 5, 2015

CORPORATE PARTICIPANTS

Andrew Posen, *Senior Director, Investor Relations*

Bill Day, *Chief Executive Officer*

John Rego, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Corey Werbelow, *Jefferies*

Jason Helfstein, *Oppenheimer & Co.*

Yoni Yadgaran, *Credit Suisse*

Austin Moldow, *Canaccord Genuity*

PRESENTATION

Operator:

Greetings and welcome to the Tremor Video's Third Quarter 2015 Earnings Conference Call. At this time all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is been recorded.

I would now like to turn the conference over to your host, Mr. Andrew Posen, Senior Director of Investor Relations. Thank you. You may begin.

Andrew Posen:

Good afternoon. Welcome to Tremor Video's Third Quarter 2015 Earnings Call. Joining me today to discuss our results is Bill Day, President and CEO; and John Rego, our Chief Financial Officer.

Before we begin I would 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 and 10-Q filed with the SEC on May 11, 2015, and 10-Q filed with the SEC on August 10, 2015, as well as future filings and reports by the Company including its Form 10-Q for the period ended September 30, 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 Third Quarter 2015 Earnings Call. For the eighth consecutive quarter we are delivering results that are inline or better than our guidance and reflect the successful execution of our strategy as the premium video marketplace.

We reported revenue of $49.3 million and gross profit of $17.6 million for the quarter. Our Adjusted EBITDA was a loss of $1.5 million and we continue to expect to achieve near breakeven or positive Adjusted EBITDA by year end.

Our growth this quarter was driven by strength in both our programmatic platforms and our proprietary higher function all-screen and performance based products which, reflects ROI in the technology investment we made in 2014.

We have enhanced our disclosure this quarter with a supplemental table in our earnings release that breaks out the major components of our revenue and highlights these key drivers. Specifically, we are now detailing the breakdown between our programmatic revenue, non-programmatic revenue from our proprietary higher function products, and our non-programmatic media network revenue.

John will go into more detail on the numbers but I'd like to emphasize that our programmatic revenue now represents 35% of our total revenue compared to 10% of total revenue in the same period a year ago.

Through the first nine months of the year, programmatic is now nearly 30% of our business compared to 7% of our revenue through the first nine months of 2014.

EMarketer is predicting that programmatic spend in the US will increase significantly in each of the next two years, from under $1 billion in 2014 to nearly $7.5 billion in 2017. We are well positioned to capitalize on this trend and believe that programmatic revenue could contribute up to 50% of our revenue by the end of 2016.

Our supply side platform continues to demonstrate strong traction with over 250 publishers currently live, up significantly from when spoke last to you. To underscore the market adoption of our SSP, we recently entered in to a strategic relationship with DISH Network covering their OTT advertising inventory including Sling TV and DISH Anywhere.

Our SSP will power their programmatic efforts to monetize this premium television content. OTT services like Sling TV and DISH Anywhere represent a tremendous incremental growth opportunity from video consumption, and we believe that our long standing relationships with premium publishers makes us an ideal partner in this space.

We are also making great progress on our DSP and recently signed an MSA with Amnet which is the trading desk arm of the Dentsu Agency. We continue to work towards agreements with several of the other major agency holding companies.

Each additional MSA we signed highlights the strength of our differentiated platform including the robust targeting optimization and premium supply that we bring to the market. Our DSP uniquely serves the premium end of the market going past TV GRPs and video completions to optimized programmatic buys for advanced brand performance metrics, such as engagement, brand lift, and viewability.

Our second powerful growth driver proprietary higher function product continues to show real strength in the quarter with revenue up 31% from the same period last year and up 11% from last quarter.

While we expect these products to continue to increase as a percentage of our non-programmatic business. We are also in the process of extending these capabilities into our programmatic platform.

Last quarter we announced our acquisition of TVN as a key step in our international expansion. We are very pleased with how quickly this acquisition has been integrated into our platform providing us with a key SSP hub in high-growth Asia Pacific region.

We also recently announced our expansion into Brazil another fast growing market further adding to our international presence and enabling more programmatic partners to buy and sell this video inventory through our marketplace.

In conclusion, I am very pleased with our results this quarter and the traction we are seeing in our business. The investments we made last year are now clearly showing up in our results as we see continued growth in both programmatic revenue and higher function buying products.

To underscore the opportunity ahead of us, Magna Global recently projected that digital spending will surpass TV spending in 2016, one year sooner than their projection last year. Digital video is powering this acceleration. The marketing world is changing rapidly and it is driven by programmatic buying and brand performance. We expect these trends to continue to drive growth in our business next quarter and into next year.

Now I'd like to turn the call over John who will walk you through the financials in more details before we open the line for questions.

John Rego:

Thank you, Bill. I am really pleased to be here this afternoon and I am excited to join the Team at Tremor Video. I believe we have a great opportunity to continue growing our Company, leveraging our programmatic technology while driving our results to the bottom line.

As this is my first Tremor Video earnings call I really felt strongly that now would be a great time to enhance our disclosure around our various revenue components, including breaking out the contribution from our programmatic business and our higher-function non-programmatic products.

We have included a new table in our press release and a supplemental presentation that is available on our Investor Relations website. It provides quarterly data going back to Q1, 2014 and highlights the trends of these two key components of our business and shows the evolution of our Company towards a programmatic premium video marketplace.

Both revenue lines are key drivers of our growth and we expect them to continue to become an even more significant part of our overall business.

In presenting these trends, we have made a change to the way we report our higher function products to exclude any of the programmatic revenue in this category. We made this adjustment to give a clear sum of the parts so that you could see the impact of our investments in these areas relative to our non-programmatic media network business.

We reported strong results in the quarter.

Q3 revenue of $49.3 million increased 26% compared to $39 million in Q3 last year. Revenues through the first nine months of the year was $135.9 million, an increase of 16% from the first nine months of 2014. The increase in our revenue through the first nine months of the year was driven by the increase in our programmatic business which grew throughout the year and contributed 28% to the first nine months of 2015 compared to 7% to the same period year last year.

Programmatic revenue was $17 million in Q3 2015, up $3.1 million or 22% from last quarter and more than three times from Q3 2014.

Our higher function products increased 11% from last quarter to $22.4 million, up 31% from Q3 last year.

Collectively, these products represented 80% of our third quarter revenue, up significantly from 53% in the same period last year.

The final revenue bucket that we now sharing is our non-programmatic media network business, which has been trending lower as spend migrates to programmatic and higher function products.

Non-programmatic media contributed 20% of our revenue but declined to $9.9 million, an 18% decrease from last quarter and a 46% decrease from last year. While this business is declining, it is more than offset by the growth of our other revenue streams.

This quarter our gross profit was $17.6 million up 17% from Q3, 2014. For the first nine months of the year, our gross profit was $51.8 million, an increase of 24% from the first nine months of 2014. Our gross margin for the quarter decreased to 36% compared to 38% in Q3 2014 and was largely driven by an increase in our programmatic revenues.

Adjusted EBITDA for Q3 was a loss of $1.5 million at the upper end of our guidance and better than the Adjusted EBITDA loss of $2.3 million in Q3 of 2014.

At the end of the quarter, we recorded a non-cash impairment charge of $22.7 million related to our goodwill and certain identifiable long-lived assets. In simple terms, the market capitalization of our Company was less than the carrying value of our net assets. This was a non-cash charge that does not affect our revenue or cash flows. US GAAP requires us to take the charge. However, we do not believe it is indicative of our operating performance.

Including this non-cash charge, our net loss in the third quarter was $28.6 million compared to a net loss of $5.5 million in Q3 of 2014. Basic and diluted net loss per share for the quarter was $0.55, which includes $0.44 per share for the impairment charge compared to a loss of $0.11 per share in Q3 2014.

In Q3 2015, Adjusted EBITDA per share was a loss of $0.03 compared to a loss of $0.04 per share in Q3 2014.

Total operating expenses for the quarter, excluding the non-cash impairment charges, increased to $23.6 million from $20.4 million but decreased as a percentage of revenue to 48% in the quarter from 52% in 2014.

The increase in our operating expenses was predominantly due to the headcount that we added in the first half of 2014, to support our new programmatic platforms. We have largely kept our headcount flat since the middle of last year.

I'd like to finish our call with our thoughts regarding our expectations for 2015.

We are confident and are reiterating our revenue guidance for the full year with revenue in the range of $195 million to $200 million, and we are tightening the range for non-GAAP Adjusted EBITDA for the year to a loss of $5 million to $7 million.

As a reminder our year-to-date Adjusted EBITDA loss is $6.8 million, meaning, we expect to achieve near breakeven or positive Adjusted EBITDA by year end.

We believe that this tighter range of guidance on the Adjusted EBITDA provides a better view of where we think we will end up this year.

Our revenue guidance reflects another quarter of sequential growth on our programmatic offerings as well as a more typical seasonal spending pattern that is heavily weighted towards the end of the year.

In fact, our revenue guidance implies an increase of at least 41% year-over-year in Q4 and full year growth of approximately 23% over 2014.

Weighted average basic share count is estimated to be $52.1 million for Q4 and $51.7 million for the year.

In summary, Q3 was another strong quarter, highlighting our ability to delivering on our guidance, and execute on our strategy as the premium video market player. We are seeing momentum in our programmatic business and further traction with our proprietary higher function products.

Now, why don’t we open up the line for questions?

Operator:

Thank you. At this time we’ll be conducting a question-and-answer session. If you would like to ask a question please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue.

You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Our first question is from Brian Fitzgerald with Jefferies. Please proceed with your question

Corey:

Hi guys. It's Corey Werbelow on for Brian. Maybe one for Bill and then one for John. Bill at the forward Summit, I think you called about ad blocking as the biggest potential challenge to the industry.

How do you view ad blocking impacting your business and how does that impact, kind of, the overall video ad landscape?

Bill Day:

Okay, so thanks. So first of all, it's an important issue and we are monitoring it closely but we currently see no current impact to the business and I think that's for several reasons right. The video space and particularly the video we work with is I think is somewhat immune because I think there is a better quid-pro-quo with respect the content you want gain access to and the ad you seek to gain access to it versus some of the other intrusive forms of advertising. They tend to mostly be in the display area.

So I think that's beneficial from that standpoint and we believe that the publishers we work with and publishers are definitely thinking about this and strategizing around it.

In case it does become a bigger part of video landscape, say in 2016, the premium publishers have we believe they're good to reach sort of the right balance between advertising and the value of the content you're getting for the advertising and given your time.

I think also just on business model, we are well positioned as a platform because it diversifies us against the rest of any particular publishers may see from that prospective and so as I said just to sort of end-cap it. Really I think there is a lot of discussion about it in the video space right now but I have not heard anyone really talk about a lot of the current impact and for us particularly we're watching it but there is no current impact.

Go ahead for the question for John.

Corey Werbelow:

Yes, great. Thanks and then John, just thanks a lot for that additional breakout this quarter. I think that's really helpful. One question—I think you touched on it, just a clarification—right now you said none of that, kind of, all-screen performance based is within programmatic, are you selling any of that programmatically and...

John Rego: Yes, yes, great question. Let's be clear. The way this was disclosed in the past, there was this concept of the overlap. What I have done here is, I'm only including in that blue line the all-screen and high performance based products that are not sold in programmatically which means that some of those products are also sold programmatically.

I'm looking for a way to make this simpler for us all to understand. So I'm making three desperate lines. So to say that one more time, within programmatic, there are all-screen and there are high performance transactions in there as well. What you see on that line is the part that is not and that is growing pretty rapidly.

Corey Werbelow:

Okay, so the programmatic just one more time, that programmatic line is the part that is not all-screen or performance based?

John Rego:

That programmatic line is result of our DSP and SSP included in that will be some all-screen and some high performance lines as well.

Corey Werbelow:

Okay.

John Rego:

The blue line is the piece that is not included in programmatic.

Corey Werbelow:

Gotcha.

John Rego:

If we recall from prior calls that was this concept of the overlap and over-under it's hard to get to that number. I'm trying to give you numbers that are easy to get to.

Corey Werbelow:

Gotcha and do you have any sense in that programmatic piece percentage wise? You know, which is being sold of those all-screen and performance and which is not.

Bill Day:

Yes, we don't release that. We think we've taken a great step forward with this degree of disclosure. We don't break it down any further than that.

Corey Werbelow:

Alright, great. Thanks guys.

Bill Day:

Okay.

Operator:

Our next question is from Jason Helfstein with Oppenheimer. Please proceed with your question.

Jason Helfstein:

Thanks. So for the best you can, can you talk directionally, magnitudely about how each of these segments, the margin profile and how they might differ on a gross profit basis? Or however you want, but just help us understand the relevant takeaway gross profit in each these profit lines. And then secondly, help us understand, kind of, product road map. I mean obviously the non-programmatic, you know, media network that will eventually kind of go to zero and then you know you said programmatic kind of 50% by the end of next year. Kind of where does the product road map lead us, kind of given the consolidation in the aspect? Thanks.

Bill Day:

Yes, do you want to—I can take that. Just because I think some of that speaks a little bit to the forward-looking nature and John you can pile on it if I miss something.

There's a little bit of a care I think to take between percent and actual dollar. I think it will be quite some time before the non-programmatic network—media network, goes to zero from a dollar standpoint. There is just too many buyers who have still an interest in conducting pre-roll buying or straight mobile buying or demographic based buying. So our demographic based buying goes into that bucket and we're breaking new accounts and when you break those new accounts sometimes they start with pretty simple buying and takes a while to upgrade them.

So, I think we expect you know growth that continue to be strong. As we always said, we thought the first half of 2014 was going to be slower than the second half. I think our Q3 results and Q4 guidance now reiterates that. So as a percent you'll that it's on the chart that green line go down but it will still be I think a material amount of money.

We're not particularly targeting new products there as you say but our existing products work pretty well and think they're pretty sellable. Clearly we are investing heavily in capabilities around our all-screen product allowing you to basically buy across the different screens and that's what we're actually looking at, our ability to lever in OTT and Linear TV over time and the pure programmatic platforms and as we said trying to build as much of our capabilities around brand performance in to these platform.

So if someone wants to conduct transactions driven by their own management, they can take advantage of—I'm not sure I can say all of what we do in the all-screen and high performance buckets, but a significant amount what we do from that standpoint.

From—I will start the margin answer. Without again particular giving as you said sort of giving more directional guidance, I think, I mean everybody inside this space can understand that the programmatic business and the take rates as a result from that look in general lower than the take rate that's lower than take rate is in the sort of managed service business, a non-programmatic business and we see that too. Our take rate in programmatic we believe is about consistent with the other public players who report results in the market.

That said, I think we have the ability I think to sort of outpace the market over time specifically in programmatic. Really as I mentioned, because of our efforts to build the proprietary capabilities into these platforms, because we plan both the buy and the sell side, we believe at least for some of the transactions as our DSP and SSP continues to gain traction, we'll be able to capture a take rate on both sides of that transaction that we—we'll do well over time.

That's why we've predicted stability in margins over time, at least going forward through 2016.

I think last thing's really on a like-for-like basis so things looking at just the green or the blue or the red sections. The margins are pretty stable. So we haven't seen from a same-store sales standpoint is that margins are collapsing rising or changing pretty dramatically. The categories performed pretty well and stably so it's just a mix shift and to the extent that programmatic just explodes as a percent of our revenue, my sense is we will be reporting revenue well north of our guidance.

Jason Helfstein:

Right.

Bill Day:

...and focus more on gross profit at that point as opposed to percent margin and that's still a pretty compelling story. John, anything to add there?

John Rego:

Yes, I think, Jason if you look at the revenue contribution charge you're going to see how this thing breaks out. So even though this a more historical piece of our business is in decline, you know these high growing products are growing at a much faster pace and the mix shift will create a different margin dynamic. But the thing to remember is that the gross profits are going up. So gross profit year-on-year is up like 17%.

So mix shift will have a lot of meaning here and but I think as you can see the business is growing rather nicely.

Jason Helfstein:

Then just a follow-up and just one more question, so can you just compare the take rate of non-programmatic to the ad network? Is it fair to say that non-programmatic overall is the higher functioning non-programmatic has a higher take rate than the media network?

Bill Day:

Where I think we'll leave it at, the order as we've said is that probably the highest take rates we see in the higher function products and in general the lower take rate tends to be in either the media network or the programmatic product.

I think it's important to know, I will expand for a second on something I think gives you some insight into how we see the business right now. As we've opened these programmatic channels, as you said to some extent the take rate can be lower than some of the higher function products, but we've seen a pretty sizable jump in the number of clients. Sorry, in advertising clients, because in essence we have more ways for them to do business right now.

What we basically do within that overall theme is we look at our top 50 clients, so top 50 biggest spenders with us—we're seeing about a 25% year-over-year increase in spending growth off that top 50 cohort. Again, we believe that's attributable to the fact that we have opened up our business now so that we can do business across these three lines of business rather than historically the one green line of business in the presentation. That's to me is as important or more important than the take rate.

Jason Helfstein:

Then just on free cash flow, you know you expect to be positive or breakeven or positive free cash flow in the fourth quarter and then general free cash flow outlook for next year. (Inaudible) cap ex.

John Rego:

Well, we'll give you next year guidance on the Q4 call. I think what we're calling for Q4 end of the year is to get to EBITDA breakeven or slightly north of EBITDA breakeven, which is different from cash flow.

Jason Helfstein:

Okay. Thank you.

John Rego:

You're welcome.

Operator:

Our next question is from Yoni Yadgaran with Credit Suisse. Please proceed with your question.

Yoni Yadgaran:

Hey, guys. So two questions if I may, and you guys just to John actually on the latter question. But first off, in terms of supply. We're curious as you guys are kind of obviously rolling out programmatic and have grown that quite well over the last year, how much of that is coming from your existing partnerships and are you guys seeing maybe some level of demand on the supply side for your programmatic offering on SSP? In addition to that, on the advertiser side, are you guys seeing kind of a growing propensity for people to buy those performance products as they utilize and adopt the programmatic offering? Or is it more of a just education process that is kind of in tandem and kind of separate from this general programmatic adoption? Thanks.

John Rego:

Okay. I got it. So the first one on supply, as we've said growth and I'll take growth. The particular metric we report is live clients. At 250, the growth has been very, very strong. And that's both, I think is answer to your question. It's leveraging existing client relationship. So we spoke in the past about companies like Warner Brothers who are partners of ours from an SSP standpoint, have been traditionally a long-term partner of ours in the business for years.

But there are many, many additional publishers that are content creators who are participating with us on the SSP side that we had not worked with prior and so it's very analogous so what I was just talking about on the demand side where it's opened up the number of clients we do business with very scale-ably, significantly.

On the demand side I will just say, it's early. Early specifically for building capabilities and the performance based sort of capabilities into the platform and getting clients to adopt them. So the simplest way to say that is for the growth we are seeing right now which is exciting 35% programmatic growth in Q3, is not right now but predominantly or even materially driven by those capabilities. That's up side that we see in the future as clients adopt programmatic and start to understand not just that they can automate and use the infrastructure for conducting trades electronically but they can also start to do that on some higher function metrics. That's an opportunity to talk more in the future.

Yoni Yadgaran:

Got it. Cool. Thanks a lot guys.

Operator:

Our next question is from Michael Graham with Canaccord Genuity. Please proceed with question.

Austin Moldow:

Hi. It's Austin on for Mike. I just have some questions on your DSP. For the MSA with Amnet, how long has that been in place? For your last one with Varick are you able to share how much of your programmatic revenue is coming through them? And just to close, what would you expect the cadence of signing future MSAs to be? Thanks.

Bill Day: Great. So first of all for various reasons including competitive, we don't give a breakdown of programmatic revenue by like MSA or something like that. We've been operating, as you know, first with Varick and now with Amnet. Amnet really only for about a month, month and a half so it's reasonably new. In terms of it setting proper expectations here the MSA is probably the sales cycle on the DSP into a MSA, probably longest sales cycle we face across the three different revenue lines and so where we are talking to all the other players, there are effectively four other players that we don't have an MSA with right now, to gain agreements with them and we'll report them as we get them in the future.

But we have seen in the past and we expect to see that once we achieve the MSA with the usual time to sell in, and educate, training, and things like that, that we can scale revenue pretty solidly off of that. And so the news on Varick and certainly now Amnet is very heartening but the payoff in terms of growth is largely ahead of us as opposed to in Q3. Other question?

Operator:

There are no further questions. At this time, I'd like to turn the conference back to Bill Day for closing remarks.

Bill Day:

So great. Thank you, Operator. I want to thank everyone for joining us here today. As I said in the beginning of the call, we're pleased with our results today and for the first nine months of the year.

We've seen real traction and momentum in our programmatic business and continuing to push for profitability. We look forward to speaking with many of you over the coming months. Thanks again.

Operator:

This concludes today's teleconference. Thank you for your participation. You may disconnect your lines at this time.