Taboola

Q3 2023 Earnings Call

Thank you, and good morning everyone. And welcome to Taboola's third quarter 2023 earnings conference call. I'm here with Adam Singolda, Taboola's Founder and CEO; and Steve Walker, Taboola's CFO. The company issued earnings materials today before the market and they are available in the Investors section of Taboola's website.

Now, I'll quickly cover the safe harbor. Certain statements today, including our expectations for future periods are forward-looking statements. They are not facts and are subject to material risks and uncertainties described in our SEC filings. These statements are based on currently available information and we undertake no duty to update them, except as required by law. Today's discussion is also subject to the forward-looking statement limitations in the earnings press release. Future events could differ materially and adversely from those anticipated.

During this call, we will use terms defined in the earnings release and refer to non-GAAP financial measures. For definitions and reconciliations to GAAP, please refer to the non-GAAP tables in the earnings release posted on our website.

With that, I'll turn the call over to Adam.

Adam Singolda Prepared Remarks:

Thanks Jessica. Good morning everyone and thank you all for joining us for our third quarter call.

Before we talk about the business, I want to first address the war in Israel. These last few weeks have been incredibly hard for us as we continue to face unimaginable events. The safety and well-being of our employees is our very top priority and we have implemented multiple initiatives to support our people and their families during this crisis.

I'm very very proud of Taboolars' tremendous resilience during this difficult time. Their work has been instrumental in keeping Taboola safe and in implementing our business continuity plans, and it shows in our confidence in our future.

As I think about our mission, it is clear to me ….now more than ever how essential…. professional journalism is. Society needs thriving sources of truth we can count on. And Taboola has always been, and forever will be - the biggest supporter of open web publishers …. and our commitment to them is more necessary than ever. Our alignment, and win/win approach makes it such that -- when we do well, the open web does well too.

And now, let's turn into our business results which I'm really proud of.

Financially, we had strong performance in Q3, beating the high end of our guidance across all metrics. We achieved $125 million in ex-TAC Gross Profit, $23 million in Adjusted EBITDA and $23 million in Free Cash Flow. We're also excited to raise the midpoint of our full year 2023 guidance for Adjusted EBITDA and Non-GAAP Net Income.

Free Cash Flow over the last 12 months is $55M, which is three times what it was a year ago for the same time period.

2024 is basically here, and given how we are executing on our key business priorities, we're reiterating our 2024 guidance of over $200M in Adj. EBITDA and over $100M of Free Cash Flow.

Last year, when we launched our new bidder platform with Microsoft as our design partner, many investors asked us how this new AI technology would affect Microsoft. We said we believe it will make it a growing part of our business, and in Q3 I'm happy to share that Microsoft is nearly 2x what it was last year at the same time.

Yahoo integration is going well and is on track. Now … I care about it not only because it's good for Taboola, and for our advertisers, but because it is also a big step forward towards Taboola becoming the first open web "must buy" ad platform. Google for search, Meta for social, Taboola for the Open Web.

These were just some highlights from this quarter, and why I'm happy with our momentum as a company.

There are two main factors that drive Taboola's revenue:

(1) The first is our ability to reach users and deliver engaging experiences in the open web so they spend more time with us, and engage with our recommendation engine.
(2) The second is our ability to monetize our interaction with consumers, also referred to as our yield. I said before that with just investing in yield, on the same user base we have now -- I believe we can double and triple Taboola's revenue. There is a lot of growth to be had here.

Let's dive in .. and start with our ability to reach users and create engaging experiences:

In our core business, working with publishers all over the world - we've seen strong momentum with publishers continuing to trust us and sign long term partnerships. We saw strong renewals and net new wins such as Nexstar, Absolute Sports, Excite Japan, and more. Many of our existing long term partners renewed their partnership with us - publishers like Gannett, Cox Media Group, Sport 1, McClatchy, NDTV and more.

Our core is going to get even stronger as part of our 30-year partnership with **Yahoo**, the 5th largest media property in the US. As of Q3, Taboola is now offering exclusive access to 100% of Yahoo's global native supply, which means advertisers can now start buying on Yahoo through Taboola, and this is our main focus - migrating Yahoo native advertisers, and onboarding new ones.

In addition, Yahoo DSP now has Taboola Ad Console integrated inside, and it looks great … That was an initial part of enabling Yahoo Omnichannel advertisers to migrate to Taboola. I can share with you that early results of migrated Omnichannel advertisers are very promising.

In summary, there is still a lot of work to do, but I feel really good about the progress so far and continue to expect to be fully ramped up by mid 2024.

Beyond our core, working with publishers -- we reach consumers on Android OEM devices as part of Taboola News.

This business is becoming an important part of how Taboola reaches consumers and creates engaging experiences for them. **Taboola News** grew strong-double digits in Q3 and is on track to approach $100 million in revenue in 2023. In the quarter, we rolled out a partnership with RealMe, one of the world's fastest growing smartphone brands, adding more than 6M devices to our existing reach. This is on top of existing partnerships with companies like Xiaomi, Samsung, Oppo and others.

Finally, we found ways to engage with even more consumers through our **bidding technology**. Advancing our bidding technology and getting more advertisers benefiting from it in Q3 provided us with ex-TAC improvement in the quarter. We've shared with investors that last year, in April, Microsoft will be moving to our new bidding technology which they helped us design and it will help us make Microsoft grow. And indeed, in Q3, as a result, their revenue was nearly 2x higher than Q3 of last year.

Now that I've reviewed the first part of how Taboola grows its revenue by reaching consumers, and creating engaging experiences which is essentially our supply -- let me move into the second way we grow revenue -- which is by improving yield.

As you know, half of our R&D is working on AI technology, helping advertisers to succeed with us. In Q3, "Max Conversions" went into General Availability, which is a way for advertisers to share with us their objective as a business, and let Taboola AI do the rest. No need anymore for them to guess a CPC or anything of that kind, which is how Google and Meta do it today. We're working deeply with the NVidia research team to advance our AI capabilities even further.

I’m happy to say that Max Conversions is now -- one of our fastest adopted technologies ever and we’ve seen encouraging results. In Q3, we saw meaningful improvement in Net Dollar Retention for campaigns using Max Conversions, which is exactly the leading indicator we want to see and track. I believe the majority of our revenue will be using this sophisticated AI in 2024.

Our investments into **Generative AI** technology have had a good impact as well.

We made our Gen AI offering available in July, helping our advertisers (many of which are self service) to create titles and thumbnails. I’m happy to say that Gen AI already represents over 2% of revenue from the ads created in Taboola Ads. This week, we introduced a new feature called Taboola Generative AI Admaker, which allows advertisers to edit existing creative automatically… instead of just creating images from scratch. As we’ve shared before, about a third of our revenue came from self service advertisers, so we care to make this as easy and effective-process as we can. While over 2% of our revenue is using GenAI, 25% of all ad creatives from self service advertisers are made with our Gen AI. So overall, we’re seeing clients adopting our Gen AI capabilities which contributes to our efforts to grow yield.

Finally, one of our big investments to bolster monetization and drive yield growth is eCommerce. In Q3, we saw double digit growth in **eCommerce** driven by strong momentum in Europe as part of our international expansion, and Yahoo now becoming a new supply channel for our retailers in the US. Overall, we’re seeing well over 100% NDR among top advertisers which is unbelievable.

In summary, I’m **very** happy with where we are as a company, our performance in Q3 and our momentum heading into 2024 which is a big year for us. With that, let me pass the call over to Steve to review our financials and outlook in more detail.

Stephen Walker Prepared Remarks:

Thanks Adam and good morning everyone. Before I dive into our financial performance, let me reiterate what Adam said about the war in Israel. It is so hard to hear the stories of this conflict, but like Adam, I am amazed every day by the resilience of Taboolars in Israel and the way our employees have continued to run our business under such trying circumstances. Israel is our largest global office with over 600 employees and we have had over 100 who either were called into action in the reserves or had a significant other called into action.

In terms of our business exposure, in Q3 we reported that approximately 10% of our revenue comes from advertisers with billing addresses in Israel. However, most of that revenue is what we call “export” revenue and is actually targeting consumers and publishers outside of Israel. In fact, less than 2% of our revenue is what we would consider “domestic” Israel revenue, meaning advertisers spending on Israeli publishers and targeting Israeli consumers. It is because of the diversity of our revenue model, business continuity plans, and the amazing efforts of our employees globally that we have not seen a material impact on our business, though we obviously continue to monitor the situation.

Now let me turn to our Q3 results and forward looking guidance.

As Adam noted, our Q3 results beat the high end of our guidance on all metrics. We are also raising the midpoint of our full year 2023 guidance for Adjusted EBITDA and Non-GAAP Net Income and reiterating our 2024 expectations of over $200 million in Adjusted EBITDA and over $100 million in Free Cash Flow.

In Q3, Revenues were $360.2 million versus the midpoint of our guidance of $344 million; Gross Profit was $100.7 million versus the midpoint of $89 million; ex-TAC Gross Profit was $128.4 million versus the midpoint of $118 million; Adjusted EBITDA was $22.8 million versus the midpoint of $4 million; and Non-GAAP Net Income was $6.7 million versus the midpoint of a loss of $14 million. I will note that the Revenue performance shows a return to year over year growth of 8%. Our ex-TAC Gross Profit was roughly inline with last year, reflecting some margin compression due to the ad rate declines in 2022, which have since stabilized in 2023. We continue to expect ex-TAC to return to positive growth in Q4.

Positive Free Cash Flow of $22.8 million in Q3 was stronger than anticipated. Three main factors drove this overperformance. First, our stronger-than-forecasted ex-TAC Gross Profit contributed to our Adjusted EBITDA beat. Second, we did a good job of controlling operating expenses, which further enhanced our Adjusted EBITDA performance. Both of these factors flowed through to Operating Cash Flow and to Free Cash Flow. Lastly, our Q3 Free Cash Flow also benefited from the timing of our payables and from a delay in some capital expenditures. Both of these were temporary benefits that will reverse in Q4.

As Adam said, our strong Revenue and ex-TAC Gross Profit performance was driven by strength in our eCommerce, Bidding and Taboola News businesses, as well as relatively stable yields in our core business. eCommerce had double-digit growth in Q3, driven by strong momentum in Europe and the US. Revenue retention was well over 100% among top advertisers. In addition, we are seeing great success ramping Taboola’s Feeds and now Yahoo, as a supply channel for our retail advertisers. Taboola’s Feed supply is now a top 10 traffic source globally. We continue to forecast that Taboola News will approach $100 million in Revenues this year versus over $50 million in Revenues in 2022. Finally, our bidding offerings continue to gain momentum. Microsoft registered nearly 2 times more ex-TAC in Q3 2023 versus the same quarter last year, thanks to advances in our AI-powered bidding technology.

Our teams have achieved this strong revenue and ex-TAC performance while improving cost efficiency, indicated by our Adjusted EBITDA margin in Q3 exceeding the margin that was implied by the mid-point of our Q3 guidance.

Operating expenses were $119.4 million in the quarter, down $4.7 million year over year. This decrease was primarily the result of our focus on cost reductions that we announced in Q3 of last year. Our headcount is down approximately 6% from its peak in July of 2022. With our ongoing expense discipline and our strong growth expectations, we expect that in 2024, we will make significant progress toward our long-term Adjusted EBITDA margin target of over 30%.

GAAP Net Loss for the quarter of $23.1 million included Amortization of intangibles of $16.0 million, Share-Based Compensation expenses of $13.6 million and Holdback Compensation expenses related to the Connexity acquisition of $2.6 million, all of which were excluded from Non-GAAP Net Income. Our Non-GAAP Net Income of $6.7 million was above the high end of our guidance range.

In terms of cash generation, we had approximately $32.5 million in operating cash flow in Q3, with Free Cash Flow of around $22.8 million. This includes net publisher prepayments, which were a source of cash this quarter of $7.2 million, and interest payments on our long term debt, which were a use of cash of $4.8 million. I would like to note that net publisher prepayments were a source of cash for the second consecutive quarter. This was due to the fact that new prepayments were lower than the quarterly amortization of historical prepayments.

Let’s turn to the balance sheet. You can see that our net cash balance remains healthy. Cash and cash equivalents plus our Short-term investments increased from $246.9 million at the end of Q2 to $250.7 million at the end of Q3, and remained above our debt principal balance of $202.7 million. I would note that the $202.7 million debt balance reported at the end of Q3 was before we repaid an additional $50 million in Q4, which I will discuss in a moment. The increase in our Cash and cash equivalents balance was driven by our strong Free Cash Flow performance of almost $23 million, and includes approximately $19 million of share repurchases.

I also want to provide an update on our share buyback and debt repayment programs. As you probably recall, we announced that we would buy back up to $40 million of shares in 2023 and that we intended to repay up to an additional $50 million of our long-term debt in the second half of the year.

The share buyback program was initiated on June 1 and as of September 30th we repurchased a total of approximately 6.7 million shares at an average share price of $3.45. We continued to repurchase shares in Q4 and, as of Friday, November 3rd, we had repurchased a total of approximately 3.3 million additional shares at an average share price of $3.69. Additionally, in October we voluntarily prepaid another $50 million of our long-term debt, which means that we have voluntarily prepaid a total of $141M since Q4 2022.

We are also announcing an expansion of our share repurchase program of up to an additional $40 million, as well as our intention to pay down up to $30 million more of our long-term debt in the first half of 2024. Both the share repurchase program and the debt pay down are contingent upon the availability of sufficient working capital. As an Israeli company we are also required to obtain Israeli court approval for share repurchases. Our current approval expires November 16 and courts are currently operating at a limited capacity due to the war, but we expect to obtain approval once Israeli courts are back to normal operations.

Now let me shift to our forward looking guidance.

For the full year 2023, we are raising the mid-point of our Adjusted EBITDA and Non-GAAP Net Income guidance due to our strong operating performance year-to-date. We believe it is prudent to reiterate our full year 2023 Revenue, Gross Profit and ex-TAC guidance given our desire to be more conservative in the face of greater near-term uncertainty given what is going on in Israel.

We expect Revenues of $1,438 million to $1,469 million, Gross Profit of $420 million to $436 million, ex-TAC Gross Profit of $531 million to $546 million. We are raising our Adjusted EBITDA range to $75 million to $82 million, and our Non-GAAP Net Income to $7 million to $12 million. I will also note that despite 2023 being a year of strategic investment in Yahoo and in our growth initiatives, we expect to generate positive Free Cash Flow for the full year.

We continue to be very excited by the addition of Yahoo to our business. Adam mentioned earlier that 100% of Yahoo's global supply is now available to advertisers through Taboola's platform, and we continue to focus on migrating advertisers. As we have previously stated, we expect the revenue to start ramping in Q4 in the low double-digit millions, and will reach full run rate by the middle of 2024.

Finally, we are issuing Q4 guidance. For Q4 2023, we expect Revenues of $418 million to $449 million, Gross Profit of $132 million to $148 million, ex-TAC Gross Profit of $164 million to $179 million, Adjusted EBITDA of $26 million to $33 million, and Non-GAAP Net Income of negative $3 million to positive $2 million.

Let me finish by saying that we are happy with our third quarter performance and to be able to raise the mid-point of our guidance on Adjusted EBITDA and Non-GAAP Net Income for the full year. We are also excited about the step change we are expecting in our business, as reflected by reiterating our 2024 targets of at least $200 million of Adjusted EBITDA and at least $100 million of Free Cash Flow. Perhaps most importantly, though, we are excited about the momentum we are building in our business. It is really amazing to start to see advertisers who previously spent their native budgets through Yahoo starting to use the Taboola platform and hearing them talk about their great experience. It is also great to hear stories of Taboola advertisers starting to spend money on the Yahoo supply and being excited about the performance they are able to achieve. The additional scale that Yahoo will bring and the growth of our core business is helping us in progress towards becoming a “must buy” for advertisers looking to reach consumers in the Open Web.

With that let me pass it back to Adam for some closing remarks.

Adam Singolda Summary Remarks:

Thanks, Steve.

You’ve heard Steve and I share our point of view of this quarter and how excited we are about our momentum:

- We **beat** the high end of guidance on all metrics in Q3.

- We’re **laser** focused on growing our reach and engagement with consumers, as well as our yield and we’re doing a good job progressing those.

- Yahoo integration is **going well** and on track.

- Advertiser success and yield growth gets a lot of our attention, with Max Conversions being **adopted faster than anything we’ve done to date.**

- 2024 is around the corner, and we’re reiterating over $200M in EBITDA which is **nearly 3 times our EBITDA guidance this year**, as well as over $100M in free cash flow, another big step up from this year.

- All of which supports our plan to buy more shares back, and prepay more debt.

Taboola’s mission is to make the open web strong - to empower editorial teams all over the world, to provide trusted content in an engaging way that drives exciting growth to publishers **and** advertisers.

As I stated in my shareholder letter, supporting the open web has never been as important as it is now.

I’m proud to be part of Taboola.
I’m proud of our execution this year and our employees working passionately to pursue our mission.

I’m sending our employees in Israel my prayers. My heart is with them every moment of the day.

Thank you for joining us today, we look forward to interacting with many of you over the next few weeks. With that, let’s open it up to questions, operator.