FLUENT

Transcript

Fluent, Inc. - Q2 FY 2021 Earnings Call

Ryan McCarthy Good afternoon and welcome. Thank you for joining us to discuss our second quarter 2021 earnings results. Joining me on today's call are Fluent's Interim CEO, Don Patrick, and CFO, Alex Mandel. Our call will begin with comments from Don Patrick and Alex Mandel followed by a question-and-answer session.

I would like to remind you that this call is being webcast live and recorded. A replay of the event will be available following the call on our website. To access the webcast, please visit our Investor Relations page on our website, www.fluentco.com.

Before we begin, I would like to advise listeners that certain information discussed by management during this conference call will contain forward looking statements covered under the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Any forward-looking statements made during this call speak only as of the date thereof. Actual results could differ materially from those stated or implied by our forward-looking statements due to risk and uncertainties associated with the Company's business. These statements may be identified by words such as expect, plans, project, could, will, may, anticipate, believe, should, intends, estimates, and other words with similar meaning. The Company undertakes no obligation to update the information provided on this call. For a discussion of the risks and uncertainties associated with Fluent's business, we encourage you to review the Company's filings with the Securities and Exchange Commission, including the Company's most recent Annual Report on Form 10-K and Quarterly Reports on Form 10-Q.

During the call, we will also present certain non-GAAP financial information relating to Media Margin, Adjusted EBITDA, and Adjusted Net Income. Management evaluates the financial performance of our business on a variety of indicators, including Media margin, Adjusted EBITDA, and Adjusted Net Income. The definitions of these metrics and reconciliations to the most directly comparable GAAP financial measure are provided in the earnings press release issued earlier today.

With that, I'm pleased to introduce Fluent's Interim CEO, Don Patrick.

Don Patrick Thank you, Ryan, and good afternoon. Thanks to everyone for joining us today.

Joining me today is Ryan Schulke, now our Chief Strategy Officer, Chairman of the Board, and Company Founder, as we've recently transitioned our roles. The key motivator to our recent executive changes is to position our founding team fully on the front lines of our business in order to harness their deep expertise and better align our executive team to drive our strategic agenda forward.

On prior calls, Ryan has articulated Fluent's three strategic growth pillars — our media footprint, our performance marketplace, and our platform — and how they best position us in the very dynamic and rapidly evolving marketplace in which Fluent operates. The success we've reflected upon in 2020 and beyond vis-à-vis onboarding and scaling larger, more sophisticated clients on our performance marketplace, while increasing and sustaining improved monetization on our platform, motivated us to further redesign our media footprint in the form of our Traffic Quality Initiative. We see higher quality as the road to sustainable long-term growth and are resolute in our belief it will better position us as an industry leader, even though through these more strategic media and client investments, we will knowingly forego some near-term margin. In our earnings release today, our numbers for Q2 reflect Revenue being up 3% year-over-year, Media Margin being down 19% year-over-year, at 27% of revenue, reflecting investments in the quarter which I'll discuss further, and Adjusted EBITDA representing 3% of Revenue.

We see our strategic north star as capitalizing on the demand for higher quality digital experiences for consumers and more effective and sustainable solutions for marketers. With quality as a foundational principle, we've been accelerating the strategic transition of our business — an unwavering commitment to and significant investment in quality across the performance marketplace. In practice, this means we're continuing to enhance our media properties and consumer experience in order to create more meaningful, enduring, and high-value connections for consumers with our top-tier clients and brands. The end goal of these efforts is to enhance Fluent's brands equity with our clients and in the marketplace by meeting and exceeding client ROI goals while building enterprise value for our stakeholders. And we believe we're already benefiting from these efforts as we've progressed our journey.

So, our current operating focus continues being anchored around our Traffic Quality Initiative. As Ryan has spoken to, in the latter part of 2020 and in Q1 of this year, we cut back significantly on affiliate traffic sources that did not meet our quality requirements. While we continually monitor traffic quality, with the steeper cuts largely in our rear-view mirror, our focus has been on growing traffic volumes with existing partners who share our commitment to quality, while testing new partners, strategies, and media channels.

Relative to our traffic volumes in early April, we are currently trending up about 25%. Underpinning the rebound in our volumes has been an accelerated expansion of traffic sourced from the big digital media platforms, including Facebook, Google, Snap, and TikTok. While on the last earnings call we indicated an expectation that Q2 revenue would decline 11 to 13% year-over-year, during the quarter, we found opportunities to more rapidly drive platform spend ahead of our prior expectations. However, this spend, along with investing in testing affiliate buying strategies, produced at considerably lower margins than the more established side of our traffic mix. As is typical in our business, a test-and-learn approach to validating scale then optimizing into profitability has positioned us to leverage our media investments with incremental margin as we move into the second half of the year.

On the last two calls, we indicated a view that our Traffic Quality Initiative would take a couple of quarters to re-establish prior trend levels, and we continue to maintain that outlook. We anticipate year-over-year top-line growth in each of the third and fourth quarters, albeit with profitability concessions as we invest to test and learn with new affiliate partners and continue to source more media from the digital platforms. However, we do anticipate sequential improvements in profitability relative to Q2.

And overall, we see the timelines and the arc of our Traffic Quality Initiative as directionally similar to the industry precedents that we've alluded to previously by leading public companies that proceeded to rebuild volume, profitability, and substantial enterprise value.

Certain strategically relevant yet smaller business units performed notably well in Q2. Our Jobs business was up two times year-over-year, as proliferation of vaccines spurred recruitment spend, and our AdParlor agency business also enjoyed similar growth. Our content site, branded TheSmartWallet, along with our programmatic data sales business were both up three times year-over-year. We foresee continued growth from these businesses in the second half of the year.

We also expanded our international media footprint by launching in Canada, where we have already validated market viability and are working to scale. We remain optimistic about our growth prospects here and are targeting further international expansion in the back half of the year.

Regarding our second growth pillar, our platform, we've mentioned for several quarters that monetization had increased significantly over the course of 2020, approximately doubling from Q1 to Q4. And I'm glad to share that our monetization remains robust, which we believe will continue through the second half. These results validate substantial return on the investments we made in our technology and analytics over the last couple of years.

Another aspect of our platform where we continue to invest is expansion of our CRM efforts, through which we've increased lifetime value of consumers on our properties by re-engaging them beyond what we call "day zero," or their initial visit to our websites. A key initiative on this front has been our investment in the Winopoly business, which provides live-agent telephony activations for Fluent leads and has grown considerably beyond initial expectations. This platform enables us to take a consumer from a digital experience to a live-call interaction, through which we can connect them to higher-consideration, higher-value transactions with top-tier brands in senior insurance, financial services, and home services.

Regarding our third pillar, our performance marketplace, we continue to see world-class brands leaning in with strong demand that well exceeds our available supply. These critical and valuable relationships enable our efforts to not only redefine our media footprint but drive the establishment of new media partnerships. In turn, this will drive margin expansion, greater predictability of earnings, and our longer-term growth opportunities.

In sum, our growth strategy remains well-grounded and intact, and we are well positioned in our dynamic marketplace. And our investment in our Traffic Quality Initiative is on track. As Ryan has previously noted, our approach to running the business is grounded in timeless principles: a sustainable growth strategy, leading-edge operating protocols, and best-in-class code of conduct. Our recent management shift further concentrates the operating focus of our organization to accelerate our strategic roadmap and growth agenda, leveraging the industry-renowned talents of our founders that are lead innovators and operators.

Thank you for your support as we continue to move full speed ahead on our mission.

And with that I'll turn it over to Alex to cover our financial results.

Alex Mandel Thanks, Don, and good afternoon.

As Don spoke to, our team, led by Fluent's founding executives, has been positioned on the front lines driving a strategic transition of our business, the foundation of which is a focus on quality across Fluent's performance marketplace.

At the time of our last earnings call in early May, we were coming off the lowest month of consumer traffic volume this year, having cut back significantly in the preceding couple of quarters on traffic solutions that didn't meet our requirements. At the time of that call, we were already hard at work rebuilding our supply base with sustainable sources of traffic that meet our protocols, and anticipated a reasonable timeframe would be needed to build our volumes back up. In that context, we anticipated Q2 revenue would be down year-over-year.

Through the course of Q2, as Don mentioned, our team found opportunities to deploy media spend beyond what we had anticipated, to accelerate our test-and-learn approach to supply discovery. This incremental volume was sourced primarily from the major digital media platforms, and we understood it would carry a lower margin profile but viewed this discovery as on-point with our rebuild efforts.

As such, our revenue for the quarter of $73.4 million represented growth of 3% year-over-year, exceeding prior guidance, while our media margin came in at 27.4% of revenue, reflecting the effect of lower-margin media spend to accelerate our supply discovery.

In the course of deploying this additional spend in Q2, we found success with link promotional campaigns which expanded our addressable audience and new means of cross promoting our programs across Fluent's owned media properties.

We've spoken over the last few quarters about testing enhancements to the design of our rewards programs, which had elevated the costs of fulfilling rewards earned by consumers. Per the outlook we indicated on our last earnings call, fulfilment expenses did moderate sequentially in Q2, benefiting our non-media cost of revenue.

Our operating expenses on a GAAP basis for Q2, compromising sales and marketing, product development, and G&A, grew in aggregate by $2 million, or 12% year-over-year, to $18 million. This increase primarily derives from the growth of the Winopoly business, which was nascent in Q2 of last year.

Adjusted EBITDA of $1.9 million in the quarter represented 2.5% of revenue, generally following the trendline of our media margin in the quarter.

Interest expense declined by $900,000 year-over-year, benefiting from the lower cost of debt under our new credit facility.

In Q2, we continued to be a non-cash Federal taxpayer, due to the pre-tax laws.

We reported GAAP net loss of $5.2 million in the quarter, and adjusted net loss, a non-GAAP measure, of $1.9 million. Our non-GAAP metrics are reconciled in today's earnings release and our 10-Q and 10-K filings.

Turning to the balance sheet, we ended the quarter with $26.6 million of cash and restricted cash. Working capital, defined as current assets minus current liabilities, ended the quarter at $44.4 million, up $13.9 million year-over-year.

Total gross debt at June 30th of $50 million included the funded term loan balance of $48.75 million, and the remaining $1.25 million note payable in connection with the 2019 AdParlor acquisition, which was subsequently funded on July 1st.

As we continue on our journey to strategically invest into quality across our business, to attract and retain the consumers, clients, and brands that we believe represent the future of our sustainable growth strategy, we recognize that our financial results reflect this transition. Our outlook for the balance of the year reflects continued progress operationally and financially, and we are motivated to achieve results that will convey meaningful value to the multitude of Fluent stakeholders.

We're glad to field questions at this time.

Operator Thank you. If you would like to ask a question, please press star followed by one on your telephone keypad. If you change your mind, please press star followed by two. When preparing to ask your question, please ensure your phone is unmuted locally. Our first question comes from Michael Graham from Canaccord. Michael, your line is now open.

Michael Graham Thank you for taking the questions, guys, and congrats on the progress with traffic growth. It's definitely good to see that expanding after kind of expecting a decline from the guidance previously, so that's great and that's really the core of some of my question.

You mentioned that you found some sort of rich veins in some of the bigger social media platforms. Do you think that that's going to be the profile of your media mix going forward? How far afield from those platforms are you going to be taking your testing, and can you just talk about any signs that you have that the quality of that traffic is actually better than what you had been getting before?

Don Patrick Hi Michael, thanks for the question. I'll put the Traffic Quality Initiative a little bit in sort of a framework, and then we'll kind of answer specific questions. So, we break it into three phases. The first one was the cutbacks of getting rid of traffic that was lower-quality with partners that would not meet our quality.

The second, sort of building back, which was primarily the easier part, was growing current partners that we have or current platforms or strategies that we currently can lean more heavily into and that's pretty much what we did in Q2 around the biddable platforms.

We've been on the platforms for a long time. We've been buying there. But we just really accelerated our testing and learning of how those properties and the creative and offers would work across those. So, specifically, we did lean heavily into that. As we did lean heavily into current affiliate partners that we have.

The second piece of that building back is obviously new partners and new strategies, new channels. We also were doing that heavily into Q2, but those take a little bit longer timeframe and a little bit longer of a cycle in terms of testing and learning. So, as we kind of look at the biddable platforms, these are critical to us, the monetization across those you can imagine are more variable than you would see in the affiliates or with our strategic partners because of the CPMs and how they move around.

So, when you see the CPMs go down and it's attractive, we lean heavily into it. When we see some of the seasonality or some of the things that come up on some of the platforms like we saw on Facebook with some of the iOS changes, you kind of lean back and go into the affiliate side a little bit more. Does that answer your question, Michael?

Michael Graham It does and thank you for that. And the follow on was just what signs do you have that the traffic is higher quality?

Don Patrick Our main metric is really around the monetization and monetization via that traffic source towards the audience and towards the brand. So, we sort of track those in a very, very granular level. We talked in aggregate about how the monetization has more than doubled over a year and has held steady.

And as Ryan has indicated, some of the traffic sources that we took off the board because of quality obviously had a little bit heavier monetization so the fact that we had that monetization stay steady from a portfolio perspective was positive for us.

Michael Graham And thank you for that and maybe just the last follow up and I'll go back in the queue is just can you sort of refresh us on how to think about the road map from here with respect to timing? You're going into that third phase of the rebuilding where you're going to be leaning into new partners and new sources now. Any thoughts on how long that takes and is there any sort of updated view on when you think the Traffic Quality Initiative is sort of done and you're back to business more or less as normal?

Don Patrick Great question, Michael. We've been really pushing internally here that the Traffic Quality Initiative is part of our DNA going forward, and it'll never go away, but the key part is that third phase which will be more around how do you optimize and how do you accelerate and how do you strengthen the quality on an every single day basis.

But specifically the phase two, we have leaned into the existing partners and platforms. The new partners and the new channels that we've been going after, we've seen some nice acceleration. We've also seen some elongated sales cycles. So, admittedly, there's some variability here as we establish those new relationships and we raise the bar on our current partners.

But we look at it from an overall perspective as we do see sequential growth in Q3 and Q4 on improving our margin which we believe will continue to accelerate that phase too.

Michael Graham Thanks so much.

Operator As a reminder, to ask any further questions please press star followed by one on your telephone keypad. Our next question comes from Jim Goss from Barrington. Jim, please go ahead.

Jim Goss Thank you. This first question might probably reflect or relate to the last question. You mentioned that you had sourced some new business from these large digital providers but at lower margins, and I'm wondering what level of margin that was at and does that reflect to the benefits you got from the higher quality traffic? And were the margins lower because they held the upper hand in those negotiations or was there some other reason? And I've got a couple of others.

Don Patrick Hi, Jim. Thanks for the question. The bottom line, putting one framework here, is that obviously we have a baseline of profitability that we have to hit, and regardless of the sources and how much we're investing, there's a profitability threshold that we make across all of our media sources.

As we lean in and we try testing things, we know that we might lose money or might break-even at the beginning, but that has to scale and scale aggressively over time, and we monitor that by source and by traffic. So, the only thing that's different as mentioned is the biddable traffic variability in pricing that is beyond us.

It's a marketplace, and we know that things that happen on those channels could move the pricing one way or another, and we watch it on a minute-by-minute basis to make sure we make the changes too.

Jim Goss A couple of others that might sort of be grouped. I know Ryan Schulke is one of the founding executives involved in this. You mentioned there that there were several others. I'm wondering if you could say who is in that mix in this strategic process? How do you move from testing the strategies to executing them and how is that process coordinated between the strategic team and the new executive team? And then are there relative impacts plus or minus in certain key verticals or is it pretty much across the board?

Don Patrick So, just when we talked about the founders, Jim, in a couple of releases that we had there's really four key ones. There's Ryan, who's Chief Strategy Officer, there was Matt Conlin who is Chief Customer Officer, Sean Cullen is EVP of Insights, who may look at the data and see the insights across the various properties, and then Matt Koncz, who's President of the Performance Media Group.

So, when we talk about them being down into the business, it's really around them connecting that strategy to the execution. So, they're hands-on, they're detailed into the mix and looking at the numbers along with our teams to make sure that we're interpreting it the right way and moving and making the right moves to support that.

So, you can imagine the industry's rapidly developing. It has lots of changes to it, and having that type of experience in the mix that has over ten years plus and seeing how a performance marketplace works really accelerates that learning and accelerates that ability to scale or realize that that a new traffic source is not and moving onto the next one.

Jim Goss And then coordinating what they're doing on the strategic front versus what you are doing on the execution front, how does that work exactly?

Don Patrick So, Jim, just your question is how do we connect strategy to execution?

Jim Goss Yes, basically. I know there are some things you're trying and trying to determine the best ways of doing things but then there has to be a control element, and you're not a huge company so you're probably talking every day with each other but I suppose you might talk about that process.

Don Patrick So, obviously what you're really pointing towards here in my mind is how is the team working and how effective is it and how granular are we getting. One of the real strengths of Fluent has been our reporting and our numbers and how we look at things. So, on a minute-by-minute basis you can see how things are performing, how the consumers are acting, how the media is working and how it's connecting to the advertisers.

So, what we really have done is just brought more experience to the current operating systems and numbers that we have. So, the connection there has been the senior team, which is that team, along with me and Alex and a couple of others in terms of how we run the business on a day-by-day basis. And then the execution side has been those four getting in with the team on an operating basis to move those basically core strategic growth initiatives forward.

Jim Goss And there's not really a change to the key vertical orientation you've developed in recent years?

Don Patrick No, it hasn't. We did talk a little bit about the Winopoly call center and how we've started to connect to higher-consideration, higher-value transactions with brands in insurance and in financial services, home services. It has great growth possibilities from a vertical, Jim, but in Q2 vertical mix was as strong as it was in Q1.

Jim Goss Thank you, Don.

Don Patrick Thanks, Jim.

Operator As a final reminder to ask any further questions, please press star followed by one on your telephone keypad.

We currently have no further questions so I will now hand back over to the host for any closing remarks.

Don Patrick Thank you everyone for joining with us today and for the Q2 earnings call. We are committed to moving forward with our mission and appreciate all your support. Thank you.