Magnite, Inc. (MGNI)

Well placed to benefit from secular growth in digital advertising

Magnite, previously known as The Rubicon Project, offers a Sell-Side Platform (SSP) or ad exchange where buyers and sellers transact digital advertisement inventory. Thanks to its merger with Telaria in April 2020, Magnite has made in-roads in the fast-growing Connected TV (CTV) digital media industry and has become one of the few omnichannel SSPs in the programmatic advertising space. More recently, the company has experienced demand erosion as global advertisers have cut their advertising budgets or postponed planned ad campaigns due to economic uncertainties in the post-pandemic world. Not surprisingly, the company's stock has corrected from its pre-COVID levels. In this report, we analyze Magnite's business model, its market opportunity, challenges, current valuation, and conclude with our opinion on whether now is a good time to consider an investment in the stock.

Key Takeaways:

- Post-merger with Telaria, Magnite has become the largest independent omni-channel Sell-Side Platform (SSP).
- Digital advertising will experience continued secular growth at least for the next few years.
- Being the largest SSP, Magnite is expected to make strong gains from the shift to Supply Path Optimization (SPO) by Demand Side Platforms (DSPs).
- Coronavirus impact is expected to be short term with strong rebound expected in 2021.
- At current valuations, the stock provides investors a positive risk reward opportunity.

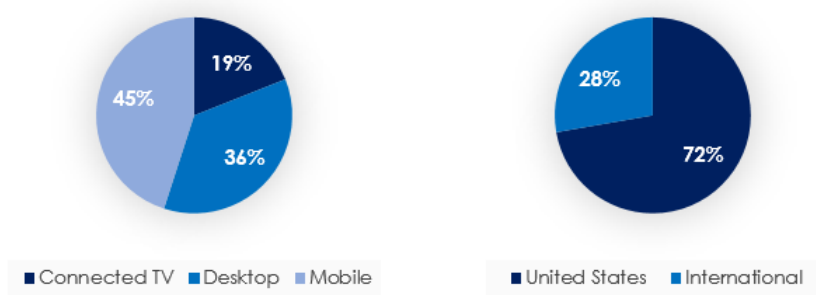
Overview:

Magnite is the world's largest sell-side platform that facilitates buying and selling of advertisement inventory available across several ad channels such as mobile or desktop websites, applications, or Connected TV. The company was earlier known as The Rubicon Project until its merger with Telaria in April this year. Telaria is focused on the Connected TV advertisement business and through this merger, Magnite has become one of the only omnichannel digital advertising SSPs. Magnite's technology solution offers a transparent and independent advertisement marketplace that connects buyers and sellers together, facilitates intelligent decision making, and automates the entire transaction process.

Revenue is generated in the form of service fees which are calculated as a percentage of the total amount of volume transacted on its platform, also known as the take rate. Magnite also generates revenue from fees charged for its Demand Manager product offered to ad publishers. Demand Manager offers configuration tools and analytics to publishers to better optimize and effectively monetize their ad inventory. Channel-wise, Mobile ads contribute the largest share of overall revenue at 45%, whereas, Desktop and Connected TV contribute 36% and 19%

respectively. Going forward, CTV is expected to be the major growth driver for Magnite as it continues to expand at a much faster rate in comparison to both mobile and desktop mediums. While geographically, the US is the largest market for Magnite contributing 72% of the top-line, the company has made considerable progress in expanding into international markets in the last few years.

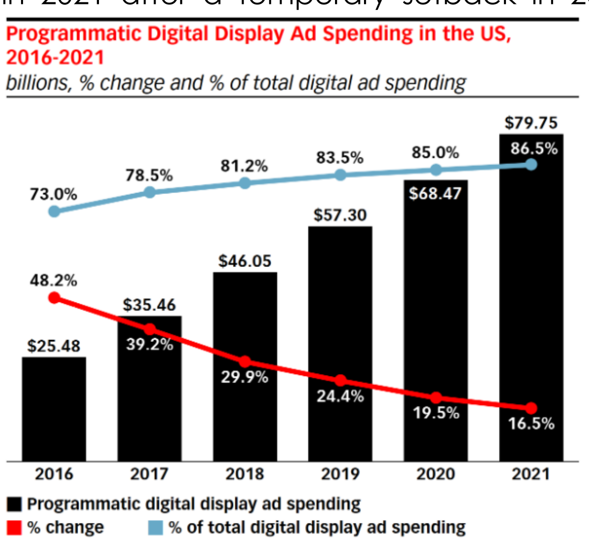
Revenue Mix

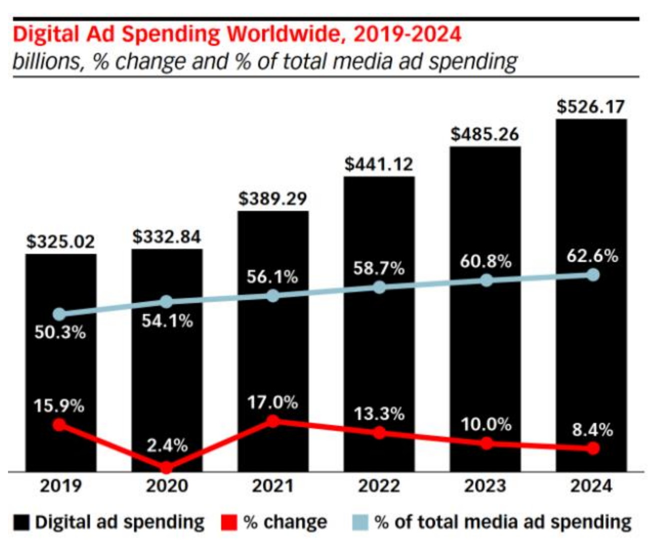


Source: Magnite, Inc.

Despite headwinds, long-term secular growth expected

Digital advertising has experienced strong structural growth over the last few years and is expected to continue its upward trajectory in 2021 after a temporary setback in 2020 due to the coronavirus pandemic. As per an eMarketer 2019 report, US digital ad spend totaled $69 billion in 2019 and was expected to increase to over $92 billion by 2021. Currently, 83.5% of US digital display ad dollars are transacted using programmatic advertising technology which is estimated to expand to 86.5% in the next 2 years.



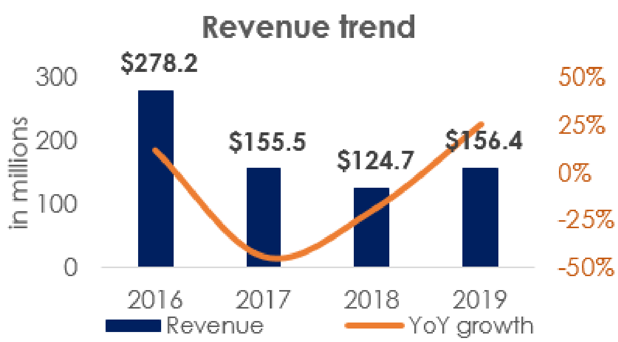


Source: eMarketer

In a more recently updated report incorporating the effects of the pandemic, eMarketer estimated that worldwide digital ad spending will grow by just 2.4% in 2020, its slowest on record but will sharply rebound to 17% in 2021. As per the forecast, global digital ad spending is on track to cross $500 billion by 2024. Magnite being an omnichannel SSP provider will gain from this structural shift. Investors must note that the walled gardens including Facebook, Google, and Amazon together occupy over 50% of the global digital ad spend, excluding China.

Regaining momentum after a business overhaul

Magnite faced financial and operational challenges in the pre-pandemic period, particularly after the introduction of header bidding technology in 2015. Header bidding brought a substantial change in the overall ad inventory auction process. Header bidding is a programmatic bidding technology in which publishers or sellers can offer the same inventory for auction to multiple ad exchanges. Prior to this, each SSP would enter into contracts with publishers to carry their inventory exclusively on their exchanges. Further, SSPs would separate premium ad spaces for advertisers as part of direct deals. The less valuable ad inventory would be left for open auctions on which the price would be decided through bids. Introduction of header bidding leveled the playing field amongst SSPs. The size advantage that larger SSPs, including Magnite enjoyed by getting exclusive access to premium ad inventory were gone as the same inventory was now available on several ad exchanges at the same time. Earlier Magnite used to generate an average take rate of 25% from both ad buyers and sellers, whereas post header bidding, company's business was cut in half as it had to reduce fees to maintain its relevance in the industry.



Source: Magnite, Inc

Despite being one of the largest ad tech companies, Magnite was slow in reacting to the changing trends in its industry. This hiccup led to a major restructuring with several top executives being asked to leave. Even the company's founder Frank Addante, who served as CEO was replaced by Michael Barrett. Frank had earlier served as the CEO of Millennial Media and AdMeld which were sold off to AOL and Google respectively under his watch. This led to speculation that Magnite was getting itself ready to sell, however, those speculations did not materialize. Since then, Magnite has recovered to a large extent after adjusting its business model to the changing competitive environment.

"Even though with the header bidding piece is quite a little bit of a hiccup for us, our ability to turn that around so quickly, I think it makes us more bullish about our ability to continue to deploy new products in the market in the future" – Frank Addante, Former CEO in Q4 2016 earnings call.

Well placed to leverage its omnichannel presence and grow market share when SPO comes into effect

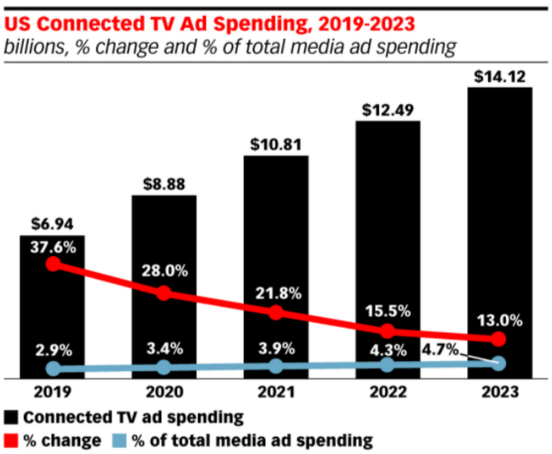
The ad tech industry is on the move again with rise of Supply Path Optimization (SPO). Although publishers are able to generate higher revenues for their ad inventory with the use of header bidding technology, it has led to several challenges for demand side platforms. Since most ad inventory is available across several exchanges, DSPs have to process far more impressions than their infrastructure can handle to buy an ad space programmatically. This slows down the entire automated transaction procedure which increases latency and reduces efficiency. Additionally, as per 2018 eMarketer survey, it was found that only 40% of the transacted amount on the exchange actually goes to the ad publisher. With SSPs and DSPs taking a cut of 10% each of the ad spend on average, 40% goes towards tech charges to support the technology platform, which given the nature of the header bidding supply chain is difficult to track and cap.

Supply path optimization (SPO) is a process through which a DSP narrows down the number of SSPs it wants to transact with to only those SSPs that offer most efficient and cost-effective path to securing ad inventory. Magnite, being one the largest sell side platform that carries ad inventory in all the 4 channels of digital media, including CTV, is well placed to make significant gains from this structural shift in programmatic advertising industry. In a recent press release, OpenX which is another omnichannel SSP and a prime competitor of Magnite stated that they have started to benefit from the SPO process and have entered into new as well as renewed direct partnerships with several DSPs. Below is a comment on SPO by Magnite:

"On the SPO front, we have seen a flight to quality that has benefited Magnite. DSPs, agencies, and publishers are narrowing their programmatic partners to a handful of full-service omnichannel players with sufficient resources to weather the COVID impacted economy. We expect this trend to accelerate in the coming quarters, and are also seeing a pickup in ad spend as a result of larger DSPs, consolidating spend with us away from smaller industry players through SPO." – Michael Barrett, CEO in Q2 2020 earnings call.

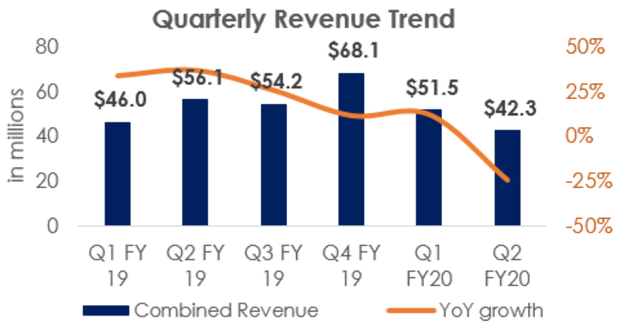
Connected TV is the next big opportunity

Post-merger with Telaria, Connected TV will be a key growth driver for the company. Faster internet speeds through the development of 4G and 5G have resulted in more digital content being viewed through TVs connected with the internet as compared to cable sets. As per June 2020 study by Leichtman Research Group, 80% of the US TV households now have at least one CTV, whereas eMarketer has estimated that around 50 million people in the US have already cut the cord i.e. canceled pay-TV services by 2019 and shifted to CTV. Connected TV ad spend was around $7 billion in 2019 and is expected to reach over $14 billion by 2023, growing at a CAGR of over 20%. CTV is the fastest growing digital platform and Telaria being a market leader is poised to benefit from the structural growth. In fact, since the start of Q3 2020, Magnite has experienced accelerated revenue growth of 50% in CTV business on a YoY basis.



Robust liquidity position provides enough cushion to ride through the current storm

Q2 2020 was a challenging quarter for the company as it was severely impacted by the aftermath of coronavirus pandemic. This happened when Magnite had just started to enjoy benefits of structural changes it made to adapt its business to the header bidding technology. Revenue stood at $42 million in Q2 2020, which represents a YoY increase of 12%. This increase was primarily because of inclusion of Telaria's revenue. Excluding the effect of the merger, top line was down 23% on a YoY basis. However, the company recently indicated that business is returning to normalcy in Q3 2020. Revenue levels in August have almost reached last year's levels, with connected TV outperforming all other digital channels. Although the company may have a rough quarter or two in the near term because of global economic challenges, we expect Magnite to experience strong growth over the long term as a result of adoption of supply path optimization processes by DSPs and secular growth in CTV.



Source: Magnite, Inc

Magnite reported an adjusted EBITDA loss of $3.5 million for Q2 2020 as compared to profit of $5.4 million in Q2 2019 for the combined entity. The loss was primarily a result of the macro economy led revenue declines. The company expects to become adjusted EBITDA positive in Q3 as revenue starts to return to normal levels and cost synergies from the merger kick in. Besides Magnite boasts a robust balance sheet with liquidity of $107 million at the end of the most recent quarter. Given that the company does not carry any debt, we believe the current cash position provides enough cushion to the company to navigate through the tough economic environment.

Trading at an attractive valuation, after the recent sell-off

Magnite's stock price has remained volatile in the past few years. It lost a significant portion of its market cap when its revenue declined as header bidding was introduced in the programmatic advertising industry. However, it regained investor confidence as it made substantial changes to its organizational structure and streamlined its business. Magnite's stock is currently trading at a price to sales ratio of 3.1 times, which is well below the pre-COVID level of 4.4 times. The current valuation seems attractive given the company's future growth potential.

Source: Seeking Alpha

Competition

Perhaps the biggest threat for Magnite is competition. Magnite operates in the highly competitive ad tech industry which is constantly evolving. It has faced difficulties in the past because of its inability to adapt to changing market trends. Failure to consistently innovate could lead to market share losses. Having said that, we believe the company is now in significantly better shape than it was a couple years back thanks to its new leadership, recent omnichannel upgrade, and significantly more attractive valuation and cash availability.

Conclusion

Post the acquisition of Telaria, Magnite has become the largest and one of the few omnichannel SSP vendors globally. Although the coronavirus pandemic is expected to cause near-term headwinds, we believe that Magnite will see significant gains from structural shifts towards SPO as well as secular growth in digital ad industry, especially connected TVs. These shares have dramatic, albeit volatile, upside price appreciation potential.