Goldman Sachs Technology and Internet Conference 2014
Transcript – Fireside Chat with blinkx

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Mohammed Moawalla: Good afternoon everyone. We are very pleased to have management of blinkx here with us today at the conference. Representing the company is the CEO, S. Brian Mukherjee, CFO, Ed Reginelli, and in the audience we also have Dan Slivjanovski who is the SVP of Marketing and Ryan Klinefelter, Head of IR. Guys, really pleased to have you here this year at the conference. I was thinking just in terms of starting off, and I know we have a lot to talk about, for the benefit of the audience, can you give us a quick overview of blinkx's kind of synopsis of the company, where you come from, and where you're sort of headed.

Brian Mukherjee: Sure. Sure. Thanks, Mo. Thanks for having us. We're grateful for the opportunity to be here with you guys and I can see some folks from the blinkx team in the audience too. I can see that (inaudible). Yes, let me give you a quick overview of the company. So blinkx is a tech media company. We were founded in 2004 and pioneered the concept of video search. Now, we were spun out of autonomy in 2007 with a perpetual license to the IDOL technology. We used that IDOL technology and built some proprietary IP around it and built what's known as CORE or concept recognition engine, which forms the basis and the core of what we actually do in terms of video search and discovery.

What the concept recognition engine does is takes three signals, image, text, and face [speech] recognition to deeply understand the content and the context of online video. And what the company did at that time is used that technology and essentially built a commercial model around it that was very similar to what happened in the text search space.

Now, fast-forward 10 years. If you look at where we are, today we are a B2B player where 95% of our revenue is generated from online advertising. Video is the arrowhead of what we do and it's what we lead with, but it's not the only thing that we do. In fact, we monetize through many, many different ad formats. Also, from a financial and operational standpoint, we are a stronger company today than we've ever been. We – just to dimensionalize the business, we have about just under 350 people across 15 or so offices in the US, UK, and Canada. We are headquartered in San Francisco and London and are traded on the AIM. And as a company, as an industry, what we're after is the coming convergence of video [linear] and digital TV spend, which we think is a $100 billion market that's ripe for disruption. That's a quick overview of the company.

Mohammed Moawalla: Great. So can you just tell us how you fit into what is this really wide ad tech ecosystem? And just where perhaps you started off and you've done some acquisitions to sort of diversify the platform. Exactly where are you in that stack?

Brian Mukherjee: Sure. Sure. And I'm sure with all of the interest around ad tech, it only gets more confusing, not less. Let me try to demystify it as much as I can. So advertising fundamentally works on the concept of fair value exchange, if you take it out of first principles, which is I'll give you something of value in exchange for looking at some ads. That's fundamentally how the whole ad ecosystem is setup. Now, if you look at that online, it broadly breaks down into two major or two component parts, the supply side and the demand side.

Now, what does that mean? If you look at it, fundamentally what people are trying to do is connect, everyone in the ad space, what they're trying to do is connect consumers with advertisers, in this case online, through some form of professional content, some content, whether it be an app, whether it be video, whether it be text, whatever it is. That's fundamentally how the whole ad ecosystem is setup.

Now, the way it is split up today is if you look at money flowing from the right side and eyeballs flowing from left side, the advertisers work with the agencies. Agencies have trading desks. Trading desks connect to DSPs or demand-side platforms, and demand-side platforms connect to exchanges. That's fundamentally, at a very elemental level, without getting into the complexity of technology, et cetera, how the demand-side is set up. The flipside of that is the supply-side. The supply-side starts off with a consumer that goes to a website or some Internet property. The website gets aggregated by ad networks. The ad networks connect to SSPs, the supply-side platforms, and the supply-side platforms connect to ad exchanges. And that's where the two ends of the demand and supply side meet up.

Now, the edges of this ecosystem tend to be high touch, agency that works with advertisers creating campaign strategies and so on, and so forth. It's really, really very high touch, very high value, high touch services oriented business. The left side, or the supply side, the edge of the supply side also tends to be high touch because what you're doing is building a website that takes a lot of time and so on, and so forth. The central part of that stack tends to be high tech and that's where you see a lot of these ad tech companies coming up and flourishing, et cetera.

Now, if you look at us, we are a B2B player, primarily focused on the supply side of the equation where we are -- we generate only a small fraction of the traffic that passes through our system. So we don't originate. We mostly optimize the traffic that we see through the value chain. And our expertise lies in doing that probably as well or better than some of the other guys out there. So that's fundamentally how the supply and the demand sides reactive ecosystems are set up.

Mohammed Moawalla: So as you talked about this very broad ecosystem, there are clearly issues around traffic, viewability, verification, et cetera. And the ad tech industry to many people is still a bit of a black box given the multiple participants you talked about. Can you just help tell us what the, A, the industry is doing or not doing in sort of reassuring investors around some of these issues? And specifically, there's clearly been some controversy around blinkx in recent publications. What are these controversies and what is your response to that?

Brian Mukherjee: Sure. Sure. Happy to answer that. So on the traffic viewability, et cetera, it's important to realize that, look, I've been in the industry 15 plus years now, and these issues around privacy, around traffic quality, around measurement have continued to be there for the last 15 years. And it's going to continue there for some more time. I think what you'll find, the subject of viewability and verification is about as hot a topic in the industry today as there is. And as an industry, from our standpoint, our view is, like others in the industry, by the way, is that if we are to attract and accelerate any meaningful ad dollars from offline and TV sources into the -- either the video ecosystem or online, we will have to make it simpler to buy and easy to measure.. I mean that's fundamentally, what we have to do as an industry.

And if you look at the standards today, there are a massive patchwork of different standards. Everyone has a slightly different way of doing things, et cetera. And it's not, there's no coagulation around a common set of standards. I think that's one thing. I think the industry is going to work really hard this year to try and make that happen. So that's fundamentally the way we see the industry progressing. And from our standpoint, we are leading and we are trying to work with some of the leaders in the space, the long established leaders in the space, particularly the ones that have an online/offline presence, to try and do our part to lean in and whether it be to provide code, or provide our expertise in that debate, if you will.

Now, let's talk about the controversy part that you talked about. So for the benefit of your audience, I think what you're referring to was a recent blog post that highlighted, an unflattering blog post, I should add, that highlighted certain product lines in the company and resulted in a precipitous drop in our stock prices. Now, from our standpoint, our response to that has been very clear and deliberate. And a lot of the controversy, the misconceptions, the inaccuracies, et cetera would have been easily clarified by a quick phone call to us. Now, I know there's been a lot been written in the financial press about this and we are not here to speculate about what the motivation and interest of those parties might be.

However, post facto, we have reason to believe that the blog was aggressively marketed to the investment community. In addition to that, it was, we feel, we think that we have been the target of these expert network techniques that have come under some serious scrutiny in the US recently. Having said all that, where are we, what are going to do about this? From our standpoint, we are grateful for the opportunity to participate in the capital markets and we take the responsibility very seriously. And our focus and our reaction to this is to make sure that we have focused all our energies around continuing to build shareholder value.

Having said that, I will tell you this too that we are pleased to see that Harvard has taken this issue as seriously as we have.

Mohammed Moawalla: So if I look at and read some of these blogs, I mean essentially they touch on three things. One, a question mark over your business model. Secondly, a question mark over certain product lines. And then thirdly around this whole area of transparency and disclosure. So what is your response to these issues?

Brian Mukherjee: Sure. So let's take each of those separately and I'll try to address it as best as I can. So let's take the question of business model. Lets look at the two criticisms around the business model. One is that we are not who we say we are. And the second is that we have grown through acquisition. So let's take a look at that specifically. So you just heard me say this before and if you talk to other investors that we've spoken to before, you will see, you will hear that we've always said that we are a B2B tech media company on the supply-side with unique strengths and skills in video. But video is not the only thing that we do. In fact, we monetize many, many different forms of online advertising and we will continue to do so.

The second argument or the second assertion was around growth through acquisitions. Yes, we have grown through acquisitions. Some have been previous my time with the company, but we've made five acquisitions in the last year, in the last five years. And acquisitions, if you ask any operator they will tell you they are notoriously difficult to do. They talk easy but work hard. And I think if you look at our history with the acquisitions and the success that we've had, we feel that we have developed a (inaudible) core competency around it in finding the right assets, paying the right price for it, and more importantly, integrating it well within our broader ecosystem to gain scale, scope, reach efficiencies and synergies out of those acquisitions. Expect us to do more as we've continued to look at the expanding our footprint within the broader ad tech ecosystem.

Now, let's take a look at product and I think if you look at product; perhaps the two most -- product lines, the two most important ones there, the two most, the bigger points there was one around traffic quality and the other around ad fraud and over counting. So let's take a look at that more specifically. On the issue of traffic quality, as I said, this has been an issue in the industry probably since the beginning of time. And it is here to stay. It's not going to go away, but I think you realize that the entire industry is working to make it better, more transparent, et cetera, across the board.

Amongst the things that I talked to earlier was the absence of standards. So that's one of the first things that we have to -- all of us have to agree on setting the right standards for this. Now, if you look at traffic quality, as I said before, we are a B2B offering on the supply side of the business, which means fundamentally that a majority of the traffic that we have is sourced from third parties. We don't originate the traffic. We filter, screen and optimize the traffic. Now, we hardly do so, we do so just like others by sourcing this traffic from thousands of different sources that could be publishers, ad networks, aggregators, exchanges, applications, and so on and so forth. So we're not the only ones in the industry. There are tons of people in the industry that do it and that's when you were talking about this whole black box concept, I think that, when you look at the center part of the ecosystem, that's what this relates to.

Now, the way we go about that is, and probably we're not alone in this. A lot of other plays in the industry are like that too, is, it is almost impossible given the volumes involved and the way the Internet morphs all the time, to track at source. So what you do then is track them or try to optimize them when it hits your servers. Now, the way we do it is we've got probably over four dozen filters that we use to try and understand what the traffic is, filter, screen, and optimize it for the use for advertisers.

Now, we didn't -- and a lot of other guys do it too. We're not the only ones who do it. Look, at the end of the day, to make this sustain in the long run, you have to make sure that you're providing quality traffic across the network. Now, we have specifically taken a somewhat hardline stance around filtering out bad traffic and particularly adult traffic. Because, as you know, because of the video heritage of our company, the last thing you want to do is have a brand ad showing up against objectionable content. We've taken some very specific steps around that.

And we work with our customers on a daily basis, our partners on a daily basis to continuously improve these self-learning algorithms and these self-learning processes you work with third parties to help us continuously improve this. And I think that process is going to continue. Now, as it relates to the second piece around the product about ad fraud and over counting, again, this is also another industry level issue or category level issue. But let me try and throw some light on that. Fundamentally to do the over counting or -- you have to be able to generate traffic. The generators are guys who are able to typically indulge in things like that. Now, what happens is, as I said, we only generate a very tiny fraction of the traffic that we see, probably in two ways. One, as blinkx.com and then secondarily, through some of the applications, the ad supported applications that we have both on the desktop as well as on the mobile side.

Now, that traffic has the following characteristics, and it's important to understand that. One, it is traffic that we own. We control that fully and because of that, we remain hyper vigilant about how that traffic is used. Secondly, what you will find is from what that traffic works for, it works much better for DR or direct response advertising. It does not economically work for video advertising. But we've not been able to crack the code on that. And the advertisers don't want to buy that traffic either, despite of how good the viewability and verification metrics might be.

Let me also give you somewhat of a perspective on the industry on that. Now, what that kind of traffic is built off of is this whole concept of ad-supported software. And if you look at the mobile economy, mobile app economy, it's essentially driven off of that concept. Now, the important thing to understand here in this situation is that the standards that existed eight to ten years ago have nothing to do with the way business is conducted today. Why and how? Why? You have to have open and a consent process. You have to give advertisers or the user a choice of either taking the paid version or the free version. You have to have a very easy uninstall process and so on and so forth. So that entire industry has sort of self-adjusted to this and if you think about the entire mobile app economy is based on this concept. If you think about how many apps are sold on a paid basis or an ad supported basis, it is a dramatically high number that is actually free.

Ed, you want to take the questions on the financial stuff?

Ed Reginelli: Sure. So there was to issues that were brought up in the blog in the financial arena and one dealt with the financial metric of revenue per employee. So first of all, the numbers mentioned in the blog were not correct. Our actual numbers of revenue per employee is about $700,000 per employee. And that is better than our competitors, but there's reasons for that. So the first reason, remember blinkx was a spinout, not a startup. So we had access to the IDOL technology license, which gave us a huge competitive advantage and a huge head start.

Secondly, as Brian mentioned, we have grown through acquisition. So if we would have stacked all the employees from the acquisitions up, we'd have over 500 employees today. But we don't. We have about 350 and that was achieved through operational excellence and financial discipline. And we're very proud of that. We don't shy away from this and it's something that we drive. We actually have an internal metric where we want to get $1 million of rev per employee. But we still have a lot of work to go.

The second issue was around disclosure and it was specifically around disclosing the revenue of the entities that we acquire in our financials. Well, first of all, nobody in the industry does that. So from a philosophical, a commercial, and an operational perspective, we don't feel that we have to do that either. That's not how we view the business. We work really hard to integrate these businesses immediately to get the efficiencies of the synergies and we kind of view it as holistic business. We don't look at it as pieces and parts.

And then finally, the concern around [disclosures]. We are absolutely compliant with all reporting requirements that we are obliged under the IFRS. We also believe that we meet and exceed the standards of the industry that some of the industry giants have set. And we believe that we're reporting what we should report.

Mohammed Moawalla: Finally, before maybe we move off this, can we just talk a bit about the traffic quality measurements, the revenue recognition? Because clearly, in this sort of black box, questions are raised that blinkx's revenue base or profit base is inflated. What are some of the initiatives that you've take -- that you do? Are there any third parties involved and just tell us how you recognize the revenue and get paid on this?

Brian Mukherjee: Sure. Let me take the first part and maybe you take the revenue recognition part of it. So across the board, and it's not just, I think everyone in the industry at some level there is a validation that takes place around what is being served at the accounting standpoint. And it happens in one of two buckets. Either the, on the advertiser's side, they will use some third party, typically of their choosing, to validate whether you've delivered what you say you've delivered. And there's always the discrepancy that you might say, hey, I delivered 100. I only see 94. I'm going to pay you for 94 and that discrepancy is something the industry deals with all the time. And it's the cost of doing business. That's just the way it is.

So there's a validation around that, that happens right off the bat. The other option -- the other thing that happens is a self-replicating methodology where people obviously are using -- they may or may not use a third party, but it is fed back into the pricing. You particularly benefit -- a lot of these are driven by auctions, a lot of the buying and selling happens on an auction basis. And if the traffic does not work, we're not going to be paying you the dollar, whatever, or $10 on a CPM basis. That price automatically starts going down. So it's somewhat of a, on the one hand you have third party validation when available, when used, which is typically the industry standard. Or there is, on an auction basis, the best validation, you essentially put your money where your mouth is in terms of where the price that you pay is reflected back in the auction price that the advertiser would pay.

So one way or the other, it gets validated. As far as revenue recognition, you want me to start with the policy that we have?

Ed Reginelli: Sure, I mean we do not recognize revenue unless -- a customer gets to choose whichever verification they want to use. They can use our serving platform or they can use a third-party platform and we bill whatever the customer agrees to in the insertion order. So if somebody wants to bill off of a third-party number, that's what we bill off of. And we do not record revenue until the transaction is completed.

Mohammed Moawalla: Essentially, what you're saying is you will not get paid or recognize any revenue until a third party has verified those impressions?

Ed Reginelli: That is correct.

Mohammed Moawalla: Okay. So maybe just sort of moving off of this now just in terms of the business. Can you just sort of talk through the competitive landscape, because obviously again, this is a fairly broad space. Who -- there's obviously giants like Google in this space, but you're focused on that, sort of the long tail in many ways. So who are the competitors that you see and I suppose your IDOL core platform is a unique differentiator. How long would it take for someone to perhaps catch up? I mean if HP tomorrow decided to license IDOL to somebody, what sort of lead-time and advantage do you have?

Brian Mukherjee: So if you look at -- I think the best way to look at competition is, in our view, to look at who's going after the same revenue dollar. And if you look at the head end of our business, particularly the video part of our business, anyone who is, if you look at it in four concentric circles, right, the innermost one being anyone who is in the business of monetizing professional content online. So all of the networks, et cetera, or the dot com versions of them would be in that. The second level out would be anyone who is monetizing online video and all of the UGC platforms and others would feature in that.

The third level out is, as I said, because we also monetize non-video assets or non-video ad units, anyone who's in the ad space. And we can think of any name in there would obviously feature to that. And there's a small portion of our business, which is primarily the tech and services business where we have some legacy tech business that we run around video, video transcoding, and so on and so forth, and also an agency business that came from one of the acquisitions. Small but fairly important part of our business because it gives us insight into some leading edges of what's going on in the Internet.

So that's how we see the internet growing. Now, if you look at what's going on in the industry too is that we have been in this space since 2004 when the word association with online video was buffering and we never gave up on it. We think that that is the future. We are absolutely convinced that that is the killer ad format of the future. Why? Simply because it's completely device agnostic. Right, it's unlikely that you're going to read the newspaper on TV, but you're likely to watch a video ad on your mobile device that acts as a gateway for you to access some quality app. And we think that's where the world is going.

And so from a competition standpoint, if you look at what's going on, video advertising online has really started taking off about in 2012 really. That's where it's really started to really take off in a big way. And our view is that a lot of the giants in the industry are getting into it. It is going to be a crowded space but I think it underlies the importance and the opportunity that there is for everyone. Because there's an opportunity to not only repurpose conventional or what we call banner ads into video, but if you can provide a much better video experience for the user, I think that's where the industry is going to go and that's what we see.

So we see both the industry giants getting into the space. We see startups in the space. It's a fairly wide spectrum and we welcome that because I think it helps validate the industry and hopefully keeps growing.

Mohammed Moawalla: I just wanted to just then turn to sort of the growth levers. The video search market has been growing pretty nicely at a sort of 30%, 40% clip. You have outgrown the market. Do you think that you can sustain this growth ahead of the market going forward? And what are sort of the key drivers? I know you've made this acquisition of Rhythm in the mobile space. At the same time, I think you've got a couple of new products coming up. So can you just walk us through what these drivers will be?

Brian Mukherjee: Sure. So as you know, Mo, we don't provide guidance and we are not going to get in the habit of doing that either. But if you look at the overall industry growth rate, there are two ways of looking at it. One is there is structural tailwinds that are taking dollars from offline world and coming into online. I think that's going to continue. And within the online stack, there's always a mix shift that goes on between video, between social, between search, between display, between mobile, et cetera. And that is a little harder to tell you exactly how which one is going to grow in which way.

What we are seeing, though, is two things. One is mobile and the other is programmatic which is growing in a big way. As you can imagine, both organic and inorganic efforts are focused on these two areas for us. Now, our vision ultimately is to connect consumers and advertisers through professional content across any device anywhere in the world. And that's fundamentally what we're looking to do. And in that context, what the Rhythm acquisition does for us is enables us to replicate the online or the desktop ecosystem in the mobile world. Right, and because these thing are going to start to converge.

So amongst the things to consider on the mobile, yes, the entire industry is going to grow but there is, remember, there's always a mixed shift that happens. There's going to be cannibalization that happens from the online as people -- as the eyeballs start moving more and more to mobile, which is where most of the growth is going to come. So it's hard to give an exact number, but rest assured that we'll be working as hard as anyone else, and perhaps even harder to try and keep our fair or unfair share of the market, if you will.

Now, if you look at the Rhythm acquisition that we made, that really represents the future of the company because this is where we feel that the online and the mobile worlds start to combine, right. So when you look at campaigns today, Rhythm is the ultra-premium, as you know, the ultra-premium mobile video advertising technology company. And our view is that if you believe in video being the killer ad format that transcends all of these different devices, agnostic of form factors, that's where we see this thing going. And what we are looking to do is put our energies behind, try to take this company in that direction too.

Mohammed Moawalla: Okay. And we probably have time for a question from the audience.

Brian Mukherjee: Yes, sir?

Unidentified Audience Member: I'm just curious, could you estimate what percent of revenues is actually in streaming video as opposed to the other forms, which you monetize?

Brian Mukherjee: What's your estimation?

Ed Reginelli: Let me answer it this way. Instead of in stream, I'll just say overall video. Video is over 50% of our overall revenue stream.

Brian Mukherjee: Either on our sites or partner's sites

Mohammed Moawalla: Any more questions from the audience? Just end with one last one. Ed, just on the margins, there's been quite good operational leverage coming through in the business. How much further room is there for the margins to further rise?

Ed Reginelli: Sure. So if you look at it in maybe a two-step process. So our gross margins. So we're somewhat protected in that 50%, low 50% range because all of our traffic acquisition is really based on revenue share with our content and publishing partners. So the legacy blinkx business is in that low 50% range. Now, that might change a little bit with the Rhythm acquisition. They have a similar business model but lower margins. So as we reported, they're in the probably 42% to 44% range in their margins. So we have some work there to get those margins up. And if you look at operating profit margins, we've seen a very nice increase in blinkx' operating margin over the last few halves that we have reported. And I would expect that to continue with, again, the exception of Rhythm. So when we purchased Rhythm that business was generating an operating loss. So we're working on right now trying to make that profitable to break even within the next 12 months. So I believe that those trends of operational gearing are still there and we should continue to see those trends with the exception of Rhythm.

Mohammed Moawalla: Great. Brian, Ed, thank you very much.

Ed Reginelli: Thanks, Mo.