



GAME SQUARE

GameSquare Esports Inc. Second Quarter 2022 Results Conference Call Transcript

Date: August 29th, 2022

Time: 8:00 AM ET

Speakers: **Kevin Wright**
President and Chairman
Justin Kenna
Chief Executive Officer

Operator:

Good morning and thank you for joining us to discuss GameSquare Esports' Second Quarter of Fiscal 2022 Financial Results Conference Call and Webcast.

On today's call we have GameSquare CEO Justin Kenna, CFO Paul Bozoki, and President and Chairman Kevin Wright. If you would like to join the conference by phone, please click on the link at the bottom of the webcast.

During the call, all participants are in listen-only mode. Following the presentation, we will conduct a question and answer session.

Before Management discusses the results, I would like to remind everyone that certain statements in this call may be forward-looking in nature. As such, any forward-looking statements are based on certain assumptions and are subject to risks and uncertainties and other factors that could cause actual results to differ materially from those expressed or implied in our forward-looking statements. Forward-looking statements speak only as of the date of this call, and there can be no assurance that the forward-looking statements will prove to be accurate, and you should not place undue reliance on such statements. Please refer to the forward-looking disclaimer in Risks and Factors in the Company's MD&A for the period ending June 30, 2022, which can be found on the Company profile at SEDAR.com and on the Company's website.

The Company undertakes no obligation to update such forward-looking statements except as required by applicable law.

I will now turn the call over to GameSquare's President, Kevin Wright.

Kevin.

Kevin Wright:

Great, thank you Ariel, and good morning to everybody. I'm Kevin Wright, President and Chairman of GameSquare Esports, and I'd like to welcome all of you to today's conference call to discuss

GameSquare Esports' Q2 2022 financial results for the period ending June 30, 2022, which we filed on SEDAR.com earlier this morning, along with our MD&A.

I'll highlight that, as of Q1 2022, the Company changed our presentation currency to U.S. dollars, which reflects our interest in pursuing a future U.S. listing of our stock and to reflect our focus on pursuing business opportunities in the very large and rapidly growing U.S. gaming and e-sports market.

Before we begin, I'll reiterate that during today's call, we'll be making some comments containing forward-looking information. I'd invite you to read our financial disclosure for some of the risks and uncertainties that may affect GameSquare's performance in the future, and as such, actual results may differ materially from the views expressed today. For further information on these risks and uncertainties, please consult our most recent MD&A and filings on SEDAR. Unless otherwise indicated, please note all figures are in U.S. dollars.

With that formality out of the way, I'd like to turn the call over to GameSquare CEO, Justin Kenna, to talk about our performance.

Justin.

Justin Kenna:

Thank you, Kevin.

Good morning and thank you for joining us.

Right off the top, I want to acknowledge the great employees that we have within our Company. Their hard work, sometimes sleepless nights, and commitment to success is showing industry-leading results. We have built a differentiated platform that connects brands to fans, which is unique within the e-sports and gaming and in the broader sports and entertainment sector.

We are making great progress. We're serving returning customers and adding new clients, which is driving growth. Not only are we winning clients, but we are executing flawlessly, which is driving repeat business, larger RFPs, and in turn leading to growing interest from brands that are seeing powerful

reach and engagement of our platform. We've made investments in people and processes and our model is highly scalable, which is being proven out quarter after quarter as we are posting rapid sales growth and margin expansion. We're in the early innings of a business with huge upside.

We made tremendous progress in the past 12 months, which has been reflected in each of the last three quarters. We've shown great progress in accelerating revenue growth within the businesses that we have acquired, and importantly, we have expanded gross margins significantly. While trends within the broader advertising market are facing headwinds, GameSquare companies, which include Complexity Gaming, GCN, Cut+Sew, Code Red, and Fourth Frame Studios, are not seeing a slowdown; in fact, quite the opposite is taking place. Each of these businesses has grown meaningfully. Additionally, the first half of the year is typically a seasonally slower period than the back half, so while year-to-date performance has been strong, I'm excited for our outlook for the remainder of 2022.

By comparing Q2 of 2022 to Q4 of 2021, we will see that we're nearly at revenue parity against our seasonally strongest quarter with significant expansion of gross margins, which were up more than 8% over Q4 and nearly 13% from Q1 of this year. This speaks to the enormous potential of our model, our execution and the quality of work that we are delivering to brands, sponsors and other e-sports organizations that are coming to us as a one-stop shop for marketing, advertising and content production within gaming, e-sports and, more broadly, sports and entertainment.

Last quarter, we indicated that we had reached our internal Q2 revenue target with a month left in the quarter. Having recently raised our revenue guidance by roughly 20% to a range of \$27.5 million to \$30 million USD, I'm pleased to once again share that we have met our internal sales target for Q3 with one month remaining in the third quarter. We are very pleased with the sales execution, and there are some great opportunities within our sales pipeline across all of our businesses, and we are seeing conversion of first-time customers to reoccurring and recurring customers.

We continue to work with leading brands such as Lenovo, the U.S. Army, Jack-in-the-Box, (inaudible 0:06:00), Herman Miller, U.S. Polo, the Dallas Cowboys, Miller Lite, (inaudible 0:06:06) and Kraft Heinz brands including MiO Liquid Water Enhancer and Bagel Bites, and many more. Expanding the scope of work with existing brands and adding new customers is resulting in a larger pipeline and bigger deal

sizes. These trends are also helping us to add more recurring and predictable revenues. We expect to provide more colour around our growing base of recurring revenue in the coming quarters.

We've talked about launching new businesses that capitalize on the growing commercial activity and brand involvement within e-sports and gaming, and earlier this year we launched our first new business, Fourth Frame Studios. Fourth Frame Studios is a first of its kind content production and creative studio at the intersection of gaming and culture and is led by Femi Okusanya, who previously ran content at FaZe Clan. While Fourth Frame Studios is in the early stages of growth, the recent announcement that United Talent Agency, or UTA, is taking Fourth Frame to its clients validates the need and demand for top tier talent that understands gaming, e-sports and youth culture. We plan to launch more businesses that we can rapidly scale to profitability by leveraging our platform and core capabilities while reducing third-party spend as we in-source expenses that would have historically reduced our margins. I look forward to sharing the launch of new, low-capital intensity businesses in the coming weeks that can profitably serve e-sports and gaming markets as we seek to offer customers more choices and great outcomes.

Turning to operational efficiency, last quarter we shared that we are optimizing our business with a focus on eliminating expenses that are not supporting the high revenue growth that we're showing across the Company. We are making progress on this front, and the improvement in our cash flow from operations is evidence of this progress. We have contained costs, which is reflected in a number of our expense categories, while also investing in sales to drive higher margin growth. This is a key focus for our Company for the remainder of 2022 and throughout 2023 and 2024.

Over the near term, we are investing in outsized revenue growth with a focus on margins and expenses. We are attracting extremely talented people from premier e-sports and gaming companies, because they see the tremendous power of our platform that we are building to connect brands and fans. Expect announcements in the coming weeks.

I'll reiterate what we said last quarter. We believe that we have built a best-in-class platform with great people doing great things. Our audience of more than 220 million is leading to more brand opportunities, as evidenced by the outstanding global brands that we work with. The trends in e-sports

point to growing engagement by global brands and we believe the GameSquare family of companies is at the intersection of culture, commerce, and investment.

With that, I'll turn it back to Kevin to run through our financial performance.

Kevin Wright:

Good morning. Once again, I just want to point out that these are in U.S. dollars, which reflects our focus on pursuing business opportunities in the very large and rapidly growing U.S. gaming and e-sports market, and that most of our revenue is expected to be in U.S. dollars.

As a reminder, we do operate in an industry which exhibits seasonality where Q3 and Q4 are typically stronger than Q2. We're pleased with the sequential growth that we reported this quarter. Revenue for the three months ended June 30, 2022, was \$6.7 million, a 30% improvement over last quarter. Gross margin for Q2 was 45.3%, which showed significant expansion over Q1 2022 of 32%. Quarter-over-quarter improvement was driven by strong performance in the agency category as digital spend increased, and within the team segment. This is the first quarter that includes the previously announced sponsorship by Lenovo of our headquarters in Frisco, Texas, which has been renamed the Lenovo Legion Esports Center, which helped improve our margins.

The Company generated an adjusted loss for the three months of \$1.5 million and reduced our net cash from operations loss to \$700,000 in Q2 from \$4 million in the first three months of the year. We continue to look for areas to intelligently reduce costs without tempering our ability to grow, while looking to deploy capital in other areas to accelerate our growth.

The Company ended the quarter with \$3 million of cash, working capital of roughly \$4.5 million, access to a \$5 million line of credit, and added an additional \$1.3 million subsequent to the quarter through a private placement which we recently closed. This positions us extremely well from a balance sheet perspective.

This quarter is showing that we have built a strong foundation for growth. There is very little incremental investment required, which means that as we drive revenue growth in seasonally busier quarters and focus on margin expansion within each business, we expect to see the positive impact of operating

leverage. In addition, we expect to improve profitability further as our base of recurring and reoccurring revenue grows within our high margin agency businesses and as we monetize the high margin content inventory within our team segment.

With that, I'll turn it back to Justin.

Justin Kenna:

I'm extremely pleased with the foundation that we have built to accelerate revenue growth in the back half of 2022 and the significant organic growth that we can achieve in 2023 and beyond. Our pipeline is growing quickly, we are converting on large opportunities, and across the Company we are focused on monetizing our distinct high margin inventory. As a Company, we are creating incredible outcomes for clients, which is leading to repeat business, and we are competing for and winning larger RFPs.

We've recently increased revenue guidance to US \$27.5 million to \$30 million, an increase of over 20% over previous guidance, and with \$11.7 million already reported this year, I'm confident that we can comfortably achieve these targets while maintaining healthy gross margins.

On behalf of the Company, I want to thank you for joining this call and for your continued support. With that, I'll turn the call over to the Operator to take your questions.

Operator:

Thank you. We will now begin the question-and-answer session. (Operator instructions 0:12:52)

Our first question comes from Robert Young of Canaccord. Please go ahead.

Robert Young:

Hi, good morning.

Maybe the first place I'll start, you said you're not seeing any slow down or any pressure from macro changes. I'd like to dig into that just a little bit. Maybe you could just talk about are you seeing any changes in buying behaviour, or are you seeing slower deal closings, pricing changes, any

consolidation of ad spend on larger platforms (inaudible 0:13:48) maybe you guys are working through an intermediary, is there any change in behaviour that you can call out?

Justin Kenna:

Yes, thanks for that, Rob.

There has been, for sure. I would say, overall, we've been impacted positively. I think that has to do with the incredible sales resources that we've been able to put together, so we've seen a continued growing pipeline, and I think the reality is that this space is continuing to grow rapidly, so overall, we're actually seeing increases in the size of RFPs.

That's not to say that there hasn't been any impact at all. Obviously certain brands and clients that we work with are impacted, so we have—you know, we've certainly had to be flexible and pivot on certain RFPs, but the reality is that the overall value of these RFP is exponentially greater than it was 12 months ago, than it was 24 months ago, and so forth. Overall, it's definitely a net positive impact, but I'd be remiss to say that there hasn't been any impact.

I think our team's been really, really good at understanding client needs, being flexible, having the ability to pivot on scope of RFPs, and ensuring that we can still deliver value, even if we do need to be flexible, so there has been a need to show flexibility in certain areas with some of the supply shortages for some of our clients and things like that, but overall it's been an overall positive.

Robert Young:

Okay, thanks for that. Second question around repeat business, is it fair to say that the repeat business is leading to larger deals? I mean, is there an opportunity to grow faster than the market, just because the first deals are experiments and then the second deals are larger? Can you just talk about what you're seeing around that?

Justin Kenna:

Yes, I think that's right. I think our attitude has been to try and bring brands into the GameSquare platform, this incredible ecosystem that we're building, and what we've found, Rob, is by being able to do so through a brand like a Lenovo, who is the naming partner at our building here at the Star in

Frisco, we have this incredible suite of services to be able to look at them being able to up-sell to brands, and there's plenty of these examples. Dairy MAX is another really good example, who is a sponsor of Complexity who we've been able to up-sell into our other services as well as close a bigger sponsorship deal through Complexity because of that aggregate following that we've been able to continue to grow.

Yes, I think bringing clients in, showing them the value that we bring overall as a fully integrated GameSquare platform, is really important, and we're seeing repeat business, we're seeing those deal sizes increase once we prove out our value, but I think not only that, we're becoming really good at sort of cross-selling across the group and working as this large team with hyper focused expertise and hyper focused skills that can obviously up-sell brands, provide value, and keep margin in-house. That's proving out to be really valuable.

Robert Young:

Okay, and then you said that you'd met the internal sales target for Q3. I'm trying to—maybe you can help me with understanding the cadence of the quarter. I know that you'd already bumped your guidance, and I'm trying to understand if the guidance bump was related to that internal sales target being met and exceeded already, or was this—did that type of pace continue at a stronger rate than you expected?

Justin Kenna:

Yes, so I think (multiple speakers 0:18:24) as we mentioned—sorry Kevin, I'll kick off, and then you can close out.

As we've mentioned, seasonality is a real thing when it comes to ad dollars in this space, as well as from a gaming and e-sports perspective, continuing to ramp throughout the year with more e-sports tournaments, with the increase in merchandise sales and so forth. Seasonality is a real thing, we've spoken to that with Q1 being the softest and Q4 being the strongest quarter as we move throughout the year. We've seen clear investment into our sales resources, obviously earlier in the year. Our pipeline is continuing to increase, we're continuing to close larger and larger deals, so we haven't spoken specifically to a Q3 target number to market, but if you look at the Q2 number and obviously continued

to increase as you work back from that increased guidance, that would give you a pretty good indication of what that Q3 target is.

As we mentioned in the call, we've hit and exceeded that number with a month to go, so we're in really good shape in relation to hitting that overall increased revenue guidance, and as you indicated, Rob, that increased pipeline, that continuation of sales team executing, is a clear indicator for increasing guidance, which obviously we've done twice this year.

Kevin Wright:

Yes, and what I'd add to that, Rob, is certainly the performance in Q3 that we've seen internally contributed to the increase in that guidance. Like we said, we're very comfortable with that range of \$27.5 million to \$30 million based on where we're at for Q3 already realized and then what we see in the pipeline for Q4, and so with having just increased guidance last month based on the performance that we've seen in Q3, we're certainly not ready to say we're going to be better than the guidance that we've put out there, but there's certainly potential to exceed that in the future, but we're very happy with the track that we're on.

Robert Young:

Okay, last question, and then I'll pass it to someone else. You'd said that you are optimizing the cost structure for a little while now, and just curious what your thoughts are around breaking through into positive profitability, whether it's income or EBITDA or whatever metric—I don't think you've share any timeline or specific targets, but I was curious if you'd just give a little more colour, and then within that, understanding the seasonality of the Q3, Q4 build and then Q1 likely weaker, maybe you could just talk about the seasonality of profitability going forward as well, and then I'll pass the line.

Justin Kenna:

You know, I can kick off, and then, Kev, jump in.

Look, overall we're really, really pleased with the trajectory that we're on with a net cash flow loss of \$700,000 compared to a loss of \$4 million in the first quarter, so we're making progress. It's a metric we're paying close attention to. As we've talked about, we've added in some real sales heads to

continue to grow revenue, which you'll see and which is going to really affect that margin expansion positively as we focus on these larger agency deals that we've talked to.

Profitability is extremely important. We are absolutely on track, but I've spoken to this before, we're not going to allow profitability to stunt growth of the business. So while profitability is important and I think we're showing real steps in that regard, we could be profitable tomorrow but handcuff growth and handcuff our revenue and our model which we're proving out, so. I wouldn't expect to see profitability in the third quarter, but this is a near-term goal, and we'll come out and give more clarity over the next couple of quarters there in terms of guidance, which we haven't given guidance to the market in terms of profitability, but expect to see some more updates on that front. But overall, I'd say we've made huge inroads on that front, but we do still have some investment obviously in growth as we continue to grow and scale out our model.

What I would say again, and I often talk about, is we really view this as a consolidated entity. It's year two, it's early days, we're proving out our model. I think we're doing that really well and making really material in-roads.

Robert Young:

Okay, thanks a lot, and I'll pass the line.

Operator:

Once again, to join the question queue over the phone, click the link at the bottom of the webcast. Once connected, press star then one on your telephone keypad. You may also type in your question in the Ask a Question box.

There are no other questions on the phones at the moment. I would like to turn it back to Management for webcast questions.

Kevin Wright:

Ariel, I don't see any other webcast questions, so I'll turn it over to Justin for any closing remarks, and thank everybody for participating.

Justin.

Justin Kenna:

Thanks, Kev.

Yes look, again I'd like to say thanks to everyone for their continued support. To sort of reiterate, we feel really, really strong about the progress that we've made in a short space of time and really comfortable, obviously, with the revenue guidance with this continued pipeline to continue executing and continue proving out this model that we've built.

Thank you very much for joining the call. Thank you very much for the continued support, and we're very much looking forward to continuing to update you with really positive announcements. Thanks very much.

Operator:

This concludes the question-and-answer session and today's conference call for GameSquare Esports Incorporated Second Quarter and Fiscal 2022 Financial Results. You may disconnect your lines. Thank you for participating, and have a pleasant day.