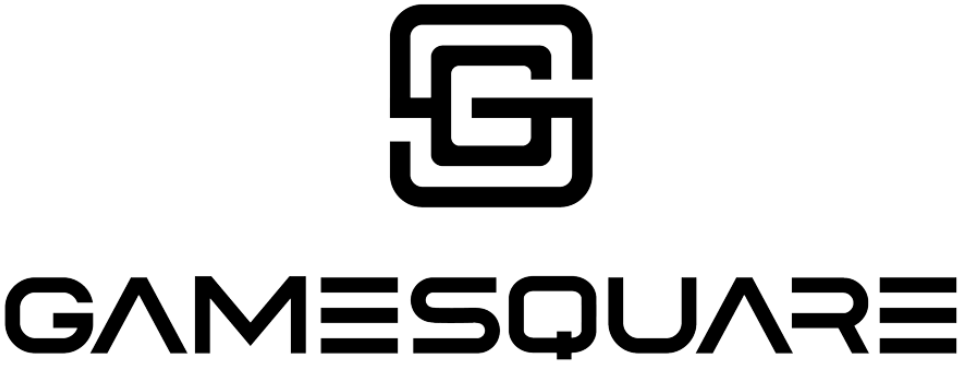


GameSquare Holdings Inc.
Second Quarter 2023 Results Conference Call Transcript

Date: **August 14th, 2023**

Time: **5:00 PM ET**

Speakers:

Justin Kenna
Chief Executive Officer

Lou Schwartz
President

Paul Bozoki
CFO of GameSquare eSports, Inc.

Mike Munoz
CFO of GameSquare Holdings, Inc.

Operator:
Good afternoon. And thank you for joining us for the GameSquare Holdings Second Quarter 2023 Results Conference Call. On the call today we have Justin Kenna, GameSquare's CEO; Lou Schwartz, President; and Mike Munoz, CFO of GameSquare Holdings.

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

Before Management discusses their results, I'd like to remind everyone that certain statements in this call may be forward-looking in nature. These include statements involving known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those expressed or implied in our forward-looking statements. For information about forward-looking statements and risk factors, please see our MD&A for the quarter ended June 30, 2023, which can be found on our Company profile at sedar.com and on the Company's website.

I will now turn the call over to Justin Kenna, GameSquare's CEO. Justin, please go ahead.

Justin Kenna:
Thank you. And good afternoon to everyone joining us on today's call.

This is an exciting time at GameSquare as we completed a transformative merger with Engine Gaming in April. As a result, GameSquare and Engine Gaming's financial results are now presented on a consolidated basis for the second quarter and first half ended June 30, 2023.

Since completing the merger, we have focused on successfully integrating the two companies. Combining our capabilities and talent and implementing synergies focused on driving efficiencies and reducing expenses. I want to use my time today to provide an update on the integration and how our blended capabilities are supporting significant opportunities in the seasonally strong second half of the year. I'll then turn the call over to Mike to give a recap on our financial results.

Closing merger and getting the integration right were critical components of our performance during the second quarter and I'm pleased with how our teams responded. During the quarter, we removed an estimated $5 million of annualized costs associated with duplicative corporate expenses, including legal, public company and other business related costs. We believe there are additional opportunities to

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take more expenses out of the business and have identified a total of $8 million of annualized cost savings that we expect to be realized before the end of the year.

As a result, we saw our Adjusted EBITDA in the second quarter improve by approximately $1.1 million from the first quarter. We expect our Adjusted EBITDA to improve significantly in the third and fourth quarters as we benefit from higher sales, a more profitable mix of business and additional merger-related synergies and cost cutting actions.

Integration efforts will also focus on centralizing business functions around one accounting system, one CRM and most importantly, one sales team. As a result, we have started to refine our go-to-market and commercialization strategies to highlight our end-to-end platform and the expanded value we offer brands.

Every day more and more global brands are turning to GameSquare to help them navigate a myriad of issues, including; the inability to reach youth audiences at scale; the difficulties in developing intimate relationships with these audiences; challenges understanding nuances across platforms, such as Twitch, social media platforms like TikTok, Instagram and so forth; complexities of integrating campaigns across platform types such as Web, CTV and mobile; the failure to assess the ROI of their investment will have quantifiable benchmarks; and lastly, difficulties finding long-term strategic partners to help navigate an emerging and rapidly changing media marketplace.

GamesSquare’s complete end-to-end platform is unique because it solves these major pain points for brands by leveraging our market-leading analytics and technology as a key input to drive client go-to-market strategies, consumer activations, media advertising, content development, as well as maximize brand ROI and overall success.

Our platform also simplifies the process by providing a one-stop shop for our customers with solutions that span media agencies, gaming and e-sports organizations, creative services and with the addition of Engine Gaming, best in class technology assets. After only a couple of months, Engine Gaming's technology assets have provided GamesSquare with powerful market intelligence and AI-driven solutions that we are leveraging to provide greater value and expanded services to our clients.

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We have also created a compelling performance marketing platform that is quickly gaining market acceptance, because we are helping brands improve their customer acquisition costs while expanding the effectiveness of our influencer network and creating more impactful campaigns.

While it's been a relatively short amount of time since we have blended our capabilities and teams, we've already started to see an increasing demand for our services. As a result, both the number and average value of our deals within our pipeline have increased since April.

Highlights of recent wins and activations include a multimillion dollar multiyear deal with an emerging healthcare company, new campaigns with both the U.S. Army and U.S. Navy and expansion of our long-standing relationship with Dairy MAX and the launch of Dallas Cowboys Game Time, which is the official gaming platform and community of the Dallas Cowboys.

During the quarter, we also entered the $250 billion Creator Economy by launching the GameSquare Creator Network. We formed a new partnership with BEONDTV and signed with UTA, a leading global talent, entertainment and sports company, to develop and secure brand partnerships across the Company's platform.

Finally, I'm thrilled to announce two potentially transformative relationships that we expect to close and announce shortly. First, we have a verbal agreement that once finalized will represent one of the largest contracts in GameSquare's history. This expected multimillion dollar multiyear relationship is with a rapidly growing online casino and betting company. We expect the campaign to launch later in 2023 with revenue expected to be recognized quarterly over a multiyear period. Under the expected terms of this campaign, GameSquare will provide services across our marketing, influencer and technology assets.

Separately, we have a large scale performance marketing test underway with one of the leading global meal subscription businesses in the world. If the test is successful and enters production, this will be the largest contract in our history representing eight figures of annual recurring revenue. We expect the test to be completed by the end of August. And if all goes well, we expect this relationship will go into activation later in the third quarter.

Both of these new large scale relationships are possible because of the April merger with Engine Gaming as we now have the end-to-end resources and experience within the Company to create a

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powerful performance marketing platform. They also demonstrate our growing success in converting our pipeline into larger multiyear deals.

Overall, momentum in our business remains strong and we are excited by the growing pipeline we have as we enter the seasonally strong second half of the year.

Before I provide an update on our expectations for the remainder of the year, I want to turn the call over to Mike Munoz, our CFO, to review our Q2 financial results in more detail.

Mike Munoz:
Thanks, Justin.

Comparing our second quarter results to our first quarter results on a pro forma basis, total revenue increased by approximately $0.5 million to $14.2 million in Q2 '23 from $13.7 million in Q1 '23. Gross margin for the second quarter of 2023 amounted to $4.1 million or 29% compared to $4.2 million or 30% in the first quarter of 2023. Gross margin is expected to improve during the year as we see accelerated growth in our higher margin offerings.

We've made significant strides in improving our operating cash burn figures. On a combined basis, Adjusted EBITDA loss for the second quarter of 2023 amounted to $4.1 million, down $1.1 million or 21% from $5.1 million in the first quarter of 2023. The reduction in Adjusted EBITDA loss is driven largely by our focus on cost reductions through creating further efficiencies in our operations, finalizing integrations from prior period acquisitions, as well as the start of integrations between GameSquare and Engine. We anticipate the integration activities between GameSquare and Engine once fully implemented will yield annualized cost savings of approximately $8 million.

With this overview, I'll turn the call back over to Justin to review our guidance for the remainder of 2023.

Justin Kenna:
Thanks, Mike.

Before I turn the call over for questions, I want to review our guidance for the remainder of 2023.

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I'm pleased to report that as we talk here today, we've seen steady improvements in our pipeline, deal closures and revenue growth and we are tracking well against that guidance. In fact, closed deals quarter to date already exceed second quarter revenue with approximately six weeks remaining in the quarter. Accelerating sales growth in the third and fourth quarters follows historical seasonal trends in our business as 60% of annual sales typically fall in the second half. In addition, strong second half growth reflects the strength of our pipeline, multiple deals closed for the remainder of the year, larger deal values and the combination of creative events, software services.

As a result, we believe sales in the second half will be between $47 million and $52 million, which combined with first half pro forma sales of $28 million, are expected to produce full year 2023 pro forma sales of between $75 million and $80 million. We also expect annual gross margins in 2023 to range between 30% and 35%, which combined with additional cost saving actions, are expected to help us reach profitability in the fourth quarter.

As I mentioned earlier, our Adjusted EBITDA in the second quarter improved by approximately $1.1 million from the first quarter. We expect our Adjusted EBITDA to improve significantly in the third and fourth quarters as we benefit from higher sales and more profitable mix of business and additional merger-related synergies and cost-cutting actions.

While we still have work to do to integrate the merger, drive sales and accelerate our path towards profitability, I'm extremely encouraged by the significant progress we continue to make. I'm excited by the direction that we are headed, and I look forward to updating you on the continued progress that we are making. On behalf of the company, I want to thank you all for joining this call and for your continued support.

With that, I'll turn it over to the Operator to take your questions.

Operator:
Thank you. We will now begin the question-and-answer session. To join the question queue, you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two. We'll pause for a moment as callers join the queue.

The first question comes from Jason Tilchen of Canaccord Genuity. Please go ahead.

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Jason Tilchen:

Great. Thanks for taking the question. Two, if you will. First, could you just talk a little bit more about the relationship with UTA that was announced back in June, how this has progressed so far, what are some of the benefits you expect to the different parts of your business over time? And what the timeline for when we could start to see a material benefit from this relationship in the financial performance? Thanks.

Justin Kenna:

Yes, absolutely. Yes, UTA for those that aren't aware, in terms of sort of the big four agencies really are number one in the gaming space. They've invested heavily in this space. They have a partnership from a sales perspective with FaZe Clan and also now with GameSquare. So we are one of two major clients in this space and they've closed a number of really large multiyear deals. I think having the backing of UTA and that name out in market for us in such an early stage of our business really gives us a lot of credibility in market with these deep brand relationships.

So we've been progressing really well, we are a couple of months into that relationship now. I'm actually meeting with their senior team and our CRO and a couple of our marketing leads this week in Los Angeles. We've refined our kind of go-to-market strategy with them and have a lot of new brand materials, so it's been working really well. They're actually behind—this test that we have from a performance marketing standpoint that we talk to in the script, there are a number of other sort of multiyear larger deals that they have in the pipeline for us.

So yes, I would expect there will be an impact on the Q3 numbers for sure from a UTA perspective. But I would expect back half of the year into next year and beyond, they very much are aiming at those multiyear multi-million dollar partnerships for us. They obviously don't happen overnight but I'd say a lot of positive movement. And they're very much helping us on the performance marketing front. So I'd expect to see a lot of revenue from UTA coming in in the back half of the year in 2024.

Jason Tilchen:

Great. Really was helpful. And just one more from me. You also announced back in June the launch of the GameSquare Creator Network. I'm just wondering, first, if you could just talk to how important having a Sideqik asset in your portfolio has led to the launch of that network and also what are some of the different ways that you expect to monetize this Creator Network over time?

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Lou Schwartz:

Let me jump in there, Jason. This is Lou. Listen, we're super excited about the whole Creator Network initiative. One, it gave us sort of an opportunity to amalgamate all of the Creator relationships that we have, right, within the portfolio, including some of the macro creator leaders that we've affiliated with as well as those that have become sort of part of our leadership team. It's a critical sort of piece of our going forward strategy, right, being able to connect brands to the reach, the audience reach, of these influencers that are trusted and have loyal sort of followings, enable us to quickly activate these brands and connect them with very targeted sort of audiences.

Justin had mentioned in the script this multi seven figure, upwards of eight figures opportunity in the performance marketing space if we perform and execute sort of properly is really sort of based wholly on our ability to leverage our influencer marketing pipeline, which is Sideqik, right, the ability to not only leverage this network of creators, connect them with brands and performance marketers, be able to track and manage all the attribution and be able to manage all the payouts is the intended feature set of Sideqik.

And so it's a very critical sort of piece for us in terms of activating sort of brands, supporting these performance marketing sort of campaigns and being able to demonstrate expanded reach within our targeted demo.

Jason Tilchen:

Great. Thanks. And one quick follow-up to that, within the revenue guide that you reiterated just earlier in the script, to what extent are the deals, that the two specific deals that were called out earlier contemplated, what sort of contribution was contemplated within that guide relative to maybe some upside that you could see if those deals do come through?

Justin Kenna:

Yes. Those deals, in terms of the tests that we spoke to in relation to performance marketing, that's not baked into that back half of the year. Meaning if that all goes well and the sort of contract size that's potentially on the table will and truly kind of blow through that back half of the year sort of forecast. So the forecast certainly not reliant on any one deal. We have a really, really large pipeline, I think, with plenty of upside in there. Again, if you sort of look historically at Engine and GameSquare, you will see that Q3 and Q4 are seasonally the largest quarters by some margin and we expect that to be the same.

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We mentioned in the script we've already surpassed Q2 revenue, we've got six weeks to go in Q3 and a really strong pipeline, a really exciting test on the performance marketing front, a number of other sort of brands that are interested in that program as well and a couple of other sort of really large contracts and opportunities that we spoke to. But they're really more an upside rather than being reliant on those deals to kind of close on. They're not baked into that sort of revenue amount for Q3 that's already at Q2, so plenty of upside there. The team's sort of working around the clock to ensure that we're delivering for our clients and importantly taking those clients to those multiyear deals, which we're starting to see more of.

Jason Tilchen:
Great. Thank you very much.

Operator:
Once again, if you have a question, please press star, then one.

The next question comes from Sean McGowan of ROTH MKM. Please go ahead.

Sean McGowan:
Thank you. Good afternoon guys. I have a couple of questions. Could you give us some sense of how the revenue in the quarter matched up against your internal projections?

Justin Kenna:
Revenue for Q2 was just under where we were hoping to get to, but we are ahead of where we were hoping from a cost perspective. So more of a timing issue than anything. Some of these larger deals and sort of tests opportunities that we have, they're still on the table and they're closing. We've just found the first half of the year probably being a little slower than historically because of some of these headwinds that we've all seen.

So just under where we were targeting internally. But I would say we're ahead from a cost perspective and extremely well set up for a big second half of the year. So we feel really good about the guidance that we've given to market.

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Sean McGowan:

Good. Thank you. And on the two big deals that you've kind of teased out a little bit so far for this year. How would you characterize the nature of that revenue, kind of like which of the revenue buckets would that be in and how would you characterize them in terms of relative profitability, gross margin profitability compared to the overall average?

Justin Kenna:

Yes, absolutely. On the partnership that we spoke to in relation to the betting company, that will be coming out of Complexity. So there's a big interest in the betting world in terms of Counter-Strike. We do have one of the big Counter-Strike teams that are competing in the majors and doing really well on that front. We've been in that game for a really long time. So that will be a part of a sponsorship with Complexity and then also will be part media. So using our creators, some of our e-sports pros to create real content and then to age gate (phonetic 21:45) and target specific demographics through our media networks.

So it'll be sort of part out of the e-sports bucket and then part out of the media bucket in relation to that deal. We would expect margins around 40% for that deal in that the blended sort of e-sports inter-media opportunity.

And then on the performance marketing front, that will be part platform, which is very exciting. It will be utilizing the skills at Code Red, our influencer agency in the UK who have done a number of successful performance marketing programs and really building out a product with now having Stream Hatchet and Sideqik in-house gives us the capability to actually build out a real product and offering.

So that'll be a small part agency and will be a larger part of revenue to the platforms. The initial test from a margin perspective will likely be a little lower than a move-forward performance marketing program, just ensuring that we're absolutely delivering and reducing our customers' costs of acquisition and really helping them convert and so forth.

So we would expect that to be in the sort of 20% to 30% range. But on a move-forward basis, I think a healthy sort of 30% to 35% move forward could be expected and once we get really efficient even beyond.

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Sean McGowan:

Okay. And either way, I think you said earlier, these are not baked into your guidance?

Justin Kenna:

Correct.

Sean McGowan:

Okay. That's helpful. Maybe taking a step back, could you comment on changes you've seen positive or negative in your view of the overall macroeconomic environment? It seemed like at the beginning of the year there's a bit more concern about how advertising would hold up and maybe there is right now. But could you share some thoughts you have there on how you think the overall, the market for advertising is going to be this year?

Justin Kenna:

Yes, for sure. I think end of last year and to the start of this year was definitely difficult. There were a lot of budgets that were put on hold and a lot of advertising spend that quite frankly budgets didn't necessarily go away but they certainly got pushed to later in the year, and it was more of a wait and see kind of attitude. I think Q2 we started to see that interest come back. We've had—we spoke to it in the script but we have a extremely strong pipeline that a number of deals we expect to close very imminently here as we spoke to a number of deals have closed that have helped us sort of get to a really strong sort of Q3 revenue number by this point in time.

So we are starting to see these budgets come back and start to spend money again. I think, we were seeing in the space a couple of years ago brands that were really interested in connecting with e-sports fans and gaming fans and a lot of sort of sponsorships and sponsored streams and putting their logos on jerseys. I think those days are gone. Brands are much more educated now in the space. And I think that positions us well, right, in terms of our ability to come up with creative campaigns, our ability to access, obviously, talent that we have in-house and then importantly, our access to the data to obviously back up our strategies and hold ourselves accountable in real ROI for brands and I think that does differentiate us.

So that's starting to resonate. I think the performance marketing example is a really good one, right, of us showcasing the GameSquare and Engine capabilities combined to build a product to help brands reduce their cost to customers.

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So that's another good example. But yes, I think the first half of the year has been difficult in the space for sure. You've seen that a lot of news has come out about what's going on in the space. I think we've navigated it really well. We've reduced costs. We have a lot—we're starting to build that recurring revenue base, so we have a lot of these longer standing brand relationships that are really starting to convert. But yes, I think we've seen in sort of the last couple of months, brand budgets really starting to come back online and we expect to benefit from that in Q3 and Q4.

But yes, I think start of the year much more difficult, a lot of budgets put on hold. But we've definitely started to see a shift in a positive direction.

Sean McGowan:
Great. All right. Thank you very much Justin. Talk to you later.

Operator:
Once again, if you have a question, please press star, then one.

This concludes GameSquare's Second Quarter 2023 Financial Results conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.

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