

Unity Software Inc. NYSE:U

FQ1 2023 Earnings Call Transcripts

Wednesday, May 10, 2023 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2022-			-FQ1 2023-	-FY 2022-			-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.01	NA	NA	(0.03)	(0.35)	NA	NA	0.29
Revenue (mm)	438.05	NA	NA	479.83	1374.85	NA	NA	2124.05

Currency: USD

Consensus as of May-10-2023 1:38 PM GMT

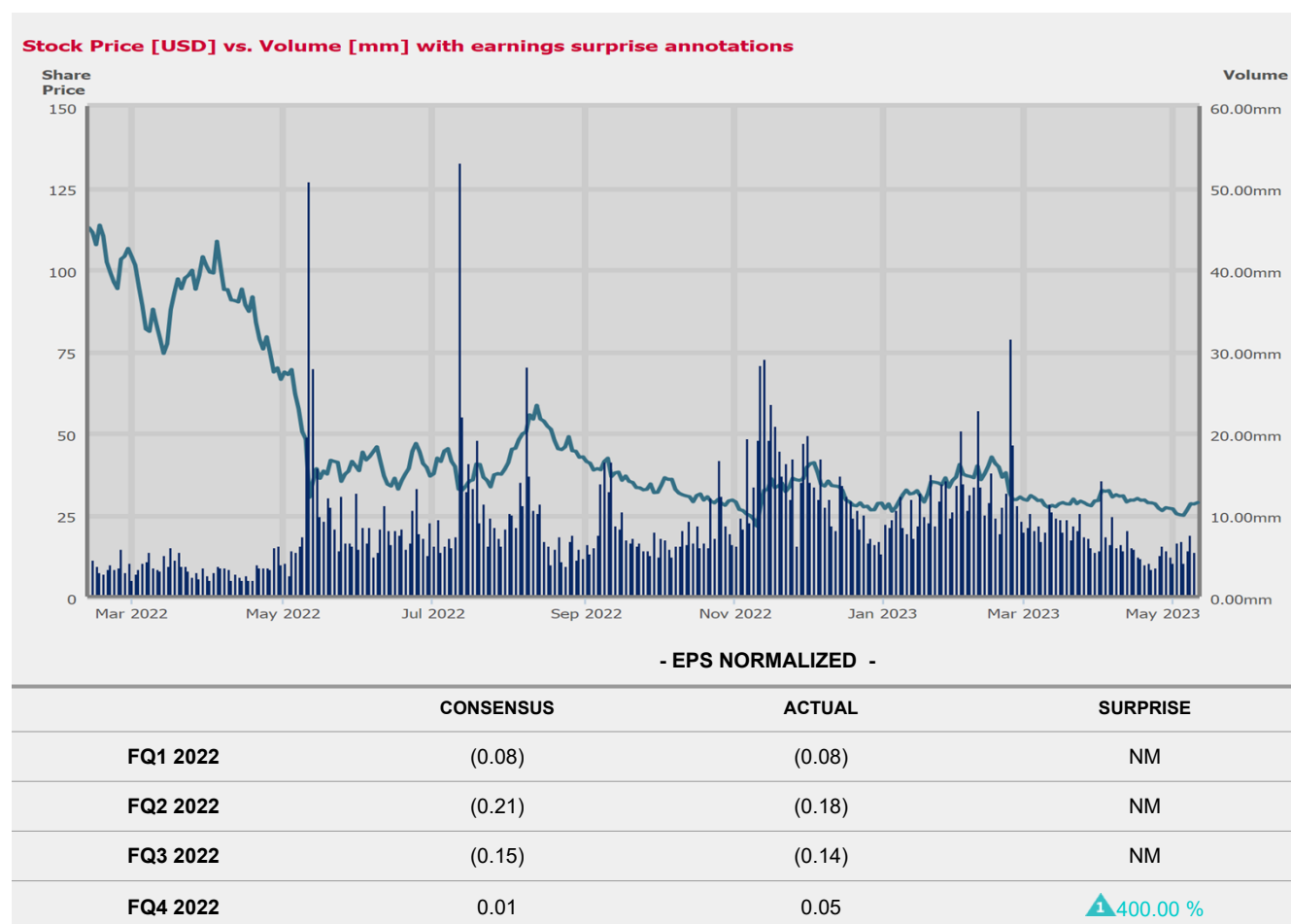


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Call Participants

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Presentation

Richard Hugh Davis

Vice President Investor Relations & Strategy

Welcome to Unity's First Quarter 2023 Earnings Call. After the closing of the market today, we issued our shareholders' letter. The material is now available on our investor website at investors.unity.com. Today, I'm joined by John Riccitiello, our CEO, President and Chairman; and by Luis Visoso, our CFO.

Now before we begin, I want to note that today's discussion contains forward-looking statements, including statements about goals, business outlook, industry trends, market opportunities, expectations for future financial performance and similar items, all of which are subject to risks, uncertainties and assumptions. You can find more information about these risks and uncertainties in the Risk Factors section of our filings at sec.gov. Actual results may vary, and we take no obligation to revise or update any forward-looking statements.

As in prior quarters, we are providing both GAAP and non-GAAP financial measures. And unless otherwise noted, we will be speaking to the non-GAAP financial measures when describing our results. The shareholder letter and our filings on sec.gov provide full GAAP to non-GAAP reconciliations.

Okay. Great. Thank you. So first, let me turn the call over to John for just some brief highlights of our results. John?

John S. Riccitiello

CEO, President & Executive Chairman

So look, we're very pleased with our Q1 results and happy about our guide. And I want to start by just thanking all of our colleagues at Unity. They've done a fantastic job to get us off to a great start in 2023.

Now I have to say that our results, these strong numbers reflect great synergy between our 2 main businesses, Create and Grow. We're a true platform. And by platform, what I really mean is that our customers get every day from us something that is more than the sum of the parts. They get more value than they would from individual products. And that's being proven truer and truer by the day. And it's from this that our customers win and Unity wins. Now all of this allows us to put Unity at a place where we can serve our creators in a great way and to be on a strong path towards continued profitable growth.

Now I think it's obvious that there's a subject that's on everybody's mind. It's certainly on every other question you read or every press article. AI. And I know you saw in our shareholder letter a long conversation about AI. And I have to tell you, I'm excited about it. We've been working on it for several years at Unity. We've got advanced products that we've been deploying for years now and more coming, and we've announced a number of beta products.

But here, I want to make a couple of key points so it's not lost. First, I think AI is positive for our industry and positive for our creators. Second, Unity has sustainable competitive advantages in and around AI, not just because of what we're building in AI, because of the very nature of our platform. The very nature of our platform will benefit from AI tools and content creation, and we're uniquely able to enable creators to make things where worlds come alive or digital twins coming live in ways that were never possible before. These things, to us, seem like a strong tailwind in quarters and years to come, and we couldn't be more excited about our future.

So thank you, everyone. Thanks for being here.

Question and Answer

Richard Hugh Davis

Vice President Investor Relations & Strategy

Great, John. So like always, we're going to open up the call in just a bit, but maybe to get things rolling, let me kick off the question-and-answer session with like a couple of questions that are on investors' minds. The first one would be for Luis. And look, with a strong first quarter in the books, how does the balance of the year look?

Luis Felipe Visoso

EVP & CFO

Thank you, Richard. You're right. It was a strong first quarter. And frankly, as John said, it was driven by strong execution by the Unity team. We beat the high end of the revenue guide by \$20 million. We beat the high end of the EBITDA guide by \$20 million as well. And if you compare this to the first quarter of 2022, that's a \$55 million EBITDA improvement.

We're also pleased with the Unity and ironSource integration. The teams are working very well together, and we're starting to share and reapply best practices between teams. And we believe that we're performing better than the market. So yes, it was a very good first quarter.

But back to your question, so how does the balance of the year look? Well, we expect growth and profitability to accelerate throughout the year. We're guiding Q2 above consensus for both revenue and EBITDA. And for the full year, we're being prudent. I mean we all read the same news, and the economic environment is still volatile and uncertain. So what we did is we raised the low end of the revenue guide by \$30 million, and we raised the low end of the EBITDA guide by \$20 million. And we expect to continue to perform better than the market. And while you did not ask, we are still committed to our \$1 billion EBITDA run rate by the end of 2024.

So with that, I'll turn it back to you, Richard.

Richard Hugh Davis

Vice President Investor Relations & Strategy

And then, John, you did touch on it a bit in your introduction kind of summary. But maybe if you just unpack a little bit, discuss how kind of Unity sees the emergence of AI tools and platforms? And then we'll open it up to a full Q&A for everyone.

John S. Riccitiello

CEO, President & Executive Chairman

Sure. So in general, at least as I see it, AI in the world we live in, the world of real-time 3D, has some important provable points. In general, I think you could break it down to 2 ideas. What you can do with the editor and what you can do in content creation, it's going to be faster and cheaper. So developers will do more on our platform. And that applies to the game development side and the digital twin side. We're seeing a lot of interest in our platform, and part of that is because of AI. We've always seen that interest is strong. Obviously, our shares are very strong across the board.

So it's developers embracing AI to produce better content, faster, better, cheaper. That's always a good thing in our world. The second aspect of this is that they can do things that were never before possible. And this is where it gets really exciting. It's when nonplayer characters and games speak to you like they do in a ChatGPT app. They're intelligent. They have ambitions. They're not just scripted dialogues from a writer. And their actions also are freer. And what that results in, I think, is worlds on the gaming side, they're going to be so compelling that it's going to drive an inflection point in growth in gaming.

The second aspect of this is that same idea applies to digital twins. And we've always felt that real-time digital twins was a big advantage. Real time makes a difference. What we get to now is AI-enhanced real time, and we wrote about that in our shareholder letter. What that gives you is a digital twin which is just not catching you up for the moment but helping you do next what is necessary to run your factory better, to design a better building, to teach people in a better way, to run a better airport or at least a smarter airport. All the things people are using us for now gets better, faster and more future looking in a way that really enhances their business. So we feel great about AI. We're going to be able to help developers do more, bigger, better, faster. And we're going to enable them to do things that were never possible before.

Richard Hugh Davis

Vice President Investor Relations & Strategy

Great. Well, thank you very much, John. So now let's move on to the Q&A session. As with previous quarters, remember, please raise your virtual hand and we'll call on you, at which time unmute, obviously, unmute your microphone and turn on your video.

And I think the first question came from Matt Cost, if we can pop him into the process here.

Matthew Andrew Cost
Morgan Stanley, Research Division

Okay. Great. So I guess just 2 questions. The first one is on Create. And I apologize if I misunderstood in the shareholder letter, but there was a reference to the reason that Create decelerated and was down quarter-on-quarter, having to do with strategic partnerships. But I guess just to put simply, what was lower inside of Create that caused it to decline quarter-on-quarter? And then I have one follow-up.

Luis Felipe Visoso
EVP & CFO

Yes, Matt, what we tried to do in the shareholder letter is provide you a few numbers. So 14% is the growth of Create including strategic partnerships. As we said, we're looking at the businesses together. But we also provide you a perspective of what would Create be without strategic partnerships, and that's 17%.

And then we explained to you why that number is a little bit lower than what we've seen in the past, and that's really driven by we're reducing our reliance on Professional Services as we drive digital twins. We've talked about that, and we're actually super excited about the launch of Industry, the Industry SKU, which will enable us to drive that business even faster. So that's really the reason,

Matt.

I want to make sure we're clear on a few points. One is we're seeing a very low churn rate. It's actually improving over time. So that is not an issue at all. And we're seeing the pricing benefits exactly as we expected.

John S. Riccitiello
CEO, President & Executive Chairman

Let me add a little bit on that one. So if you -- ex strategic side of the business, 17% growth. One of the reason that number is just a little bit lower than it has been in previous quarters is, frankly, a simple issue of denominators and numerators. So we now have what are fully in the denominator in the base period, and we're still growing 17%. It'd be measurably higher without that in the base.

The second thing is we've talked a lot about introducing ratable revenue streams associated with cloud, associated with AI service, et cetera. Those are yet to kick in. The new SKU is yet to kick in. Weta is signing new customers, which is a key part of Create. So we're very optimistic. 17% stand-alone that we reported is a good quarter. We're excited about accelerating from here on the basis of all the things that are coming in front of us in the next couple of quarters.

Matthew Andrew Cost
Morgan Stanley, Research Division

Great. And then just a second one on Grow. I think you mentioned in the letter that you expect it to accelerate throughout the year. Are there any specific strategic initiatives that you would call out there? And in particular, I'm curious about LevelPlay. Is that an area where you see the ability maybe to invest in signing up new customers upfront to sort of gain market share?

John S. Riccitiello
CEO, President & Executive Chairman

Yes. Your question is on Grow, Matt?

Matthew Andrew Cost
Morgan Stanley, Research Division

Yes. That's right.

John S. Riccitiello
CEO, President & Executive Chairman

Let me take the top of that. I think we have a poor network today because I'm watching Luis break up a little bit today. Hopefully you're not seeing the same on your end. Look, strategic initiatives, one is the combination of ironSource and Unity has brought more

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data. More data has enhanced the performance of both networks. Earlier, I had mentioned that we were seeing synergies between Create and Grow, which we are. But we're also seeing synergy between what was the Unity Operate and is now Grow as ironSource and Unity networks work together.

A couple of really important ones. The strength we're getting out of neural networks and AI tool and the system we've been using for a couple of years now on the Unity side is being applied network-wide. And we're also seeing enhancements from what we're getting from great strengths and understanding of header bidding that is part of the ironSource historical technology stack.

So there's a whole bunch of initiatives, but the thing that's driving us right now were gains in mediation, benefits as a result of increased quantum of data and then technology transitions around the best of what ironSource used to do is now applied to the rest of Unity and what Unity used to do is applied to that, which was previously ironSource.

These are all growth drivers. And as we've mentioned, we expect to see Q2 -- at least so far, we feel very good about Q2 and the balance of the year because these are driving market share gains for us. We are gaining in a market that's essentially at this point treading water, and we feel great about that. There's nothing about gaining market share that makes me feel any other way than great.

Luis Felipe Visoso
EVP & CFO

And Matt, these things that John mentioned are happening already now. We're not expecting them to happen in a few quarters. We're already starting to see the benefits, as John mentioned.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Clark Lampen.

William Lampen
BTIG, LLC, Research Division

Great. I wanted to follow up, John, on your comments around AI. And hopefully, it won't sound sort of too myopic posing this question. But at a point where AI technology is proliferating and sort of being adopted at a rapid rate and the velocity of development isn't really slowing down, what leaves you comfortable right now when it comes to the sort of potential for new entrants or threats to your position in the engine market? And if I could ask for maybe a sort of more specific point on product, is there a time line? Or have you guys thought about sort of releasing low or no-code versions of the product for lower-end developer segments in the market?

John S. Riccitiello
CEO, President & Executive Chairman

So a couple of things. So one observation is I think most professional game development in both professional digital twin development is going to use a blend of deterministic tools and AI tools or natural language tools. Let me unpack that a little bit. It's possible that somebody out there messed around with ChatGPT or you've messed around with some of the generative art tools that are out there. What you get sometimes is a first draft. You don't get the newspaper or article you're going to publish. You go back and forth between Word, the deterministic tool, and what you prompted and got from a natural language tool to synergize around what you think is an edited publishable product.

What happens in the Unity Editor is the character designers and the level designers and the animators and the lighting people and the physics people and the dialogue people, they work in concert to produce a product. And what you can see us -- what you will see us doing, and I mean this year, in the near term, is introducing natural language interface within the Editor to allow people to go back and forth between using a relatively complex tool that is deterministic where they have to work with it to yield an outcome and natural language which would give them a first draft in what they're trying to do.

In some cases, the deterministic tool will be easier to use. If you're trying to create -- apology for the development lesson here, but if you try to create something like volumetric fog inside of a digital twin or inside of a game, you see all that atmospheric stuff that is so typical of movies and games, et cetera. Personally, I find it easier to take the sliders because I don't even know how to describe volumetric fog, how dense it should be, how viscous it should be, how reflective it should be, how rapidly it would be moving. A couple of sliders, you get what you want.

If I was trying to create another effect, it might be easier to start with something natural language. I want a lion or a fence or a house or a window or a door or if it's in your inventory that is being built by the team that's working on the digital twin, I want this particular

manufacturing piece that we manufacture. I want it right here. That will be much easier on a natural language interface, and I expect people to work back and forth.

So that was just one part of our advantage that I mentioned, is that we're obviously, by far, the leading platform for this type of content creation. And what we expect is people to use both because just using natural language is really almost impossible and it's likely to be impossible for a very long time to be able to create something that benefits from team production processes and get something that is consumer ready.

Now in addition to that, you can -- we are definitely going to build applications that lead to the Editor, connect to the Editor for people that are entirely nontechnical so they can use natural language to impact content inside the editor. That is relatively easy for us to do. It's worked well advanced, and I feel very good about that. But that is net new users, and there's a large, large number of net new users available to us.

So what I expect from this, and just looking at the editor alone, one piece of what we're talking about, I expect to see more usage to be edited by professional because they'll be more productive using the combination of deterministic and natural language tools. And they can use that for scripting, C# scripting, for example, using Copilot and then edit inside of Unity.

The other side of this is new users coming to the platform because the most prolific and most widely used tool on the planet for professionals gets easier and easier to use for nonprofessionals or artists that just don't want to interact with the developer's tool. So we feel great about AI. I don't want to take the next 45 minutes and speak to all of the points that I'd like to talk about and go through our road map, but that's just tip of the iceberg and it's positive.

William Lampen
BTIG, LLC, Research Division

That's super helpful. And if I could maybe sort of dovetail on the comments around sort of the lower end of the market for a moment, maybe on pricing for Create, you guys just took price when I think the industry might have been at its weakest point. And it sounds like from a lot of our checks that there was basically no developer attrition. And I think at a high level, that sort of suggests that the price/value relationship probably still sits in the developer's favor.

I'm curious how you guys think about maybe striking more of a balance and then specifically addressing the low end of the market where a lot of your users are still unpaid. Is that something that you guys would think about exploring over the course of the year, next year? Anything specific you could say on that front would be appreciated.

John S. Riccitiello
CEO, President & Executive Chairman

So yes, and your observation is correct. We still have pricing flexibility. And we didn't get a lot of negative feedback when we took pricing recently around our new pricing approach for the Editor across different classes of users. Here's what I would tell you, is what I expect right now to go from here, how do we get paid?

I'll use the game industry. We get paid because of our grow business, which is the larger of the 2 businesses today, same customers paying us. We paid SaaS revenue on the tools today. And then we get paid for UGS more usage. What I expect AI does is it causes a lot of workload in the cloud, a lot of workload on Unity's servers. But in addition to that, cloud services that we're building around Weta tools, for example, or others within the Unity tool, like Unity tool plays like SpeedTree, for example. So I see a lot of opportunity for us to add ratable revenue as our developers start to use more AI tools and to build more complex and richer, more advanced world.

So what I expect, pricing will kick in later this year as our customers come off their prior contracts onto the new pricing level. That will lift revenues in the balance of this year, added cloud revenue for more usage. And while I didn't speak to this yet, the run time represents significant opportunity for us as well. And here, we have an advantage. Almost all AI work that's cross-platform is going to end up being done on the server side. And that's expensive for our customers.

We've announced Barracuda, which is a tool set that enables an inference engine to be run on a handheld device or a computer or a PC or a console. And we think there's opportunity in there. Of course, we want them to use our servers, but they can run local is a big advantage for Unity over all other alternatives for this type of AI work.

Richard Hugh Davis
Vice President Investor Relations & Strategy

We'll turn to Dylan Becker at William Blair.

Dylan Tyler Becker

William Blair & Company L.L.C., Research Division

Appreciate it. Maybe to give you another couple of minutes on that AI pedestal and platform, John, and you called out the Barracuda piece. I wonder, are there any parallels that you guys can kind of call out as you've seen, again, creation tools moving from static 2D to interactive 3D, now embedding these within generative AI, maybe more personalized efforts and what that can mean for content delivery, but some of the lessons and learnings as you guys kind of already have led this transition in one form or the other?

John S. Riccitiello

CEO, President & Executive Chairman

Wow, I could talk about that for an hour or more. And so let me just make some observations. So how do either of the current art tools that are out there that allow you the generative art or the large language models work? They study lots of examples for things. And then based on prompts, they give you a best fit or 5 best fits or 10 best fits that either represent an answer to what -- you asked for a girl on a bike in a wheat field and the style of van Gogh, you get a picture of that, or you describe a poem you want or a dialogue you want or a script you want. And it's not very hard to imagine.

For example, these models, both on the content side or the frames and art side and the dialogue side for bringing that together. And if you look at a film, for example, television and film is typically 20 frames a second. And it's not impossible. It's actually quite easy to scan every frame, scan the dialogues, scan the sound. You have to listen to it. You have to play it. And in some future, future destined place, we're going to see the possibility where you're going to see not just the sort of the miserable examples of doctored video that's come out so far. You're going to see some decent work that comes out of the film side.

Now the observation I would make for you here is games are really different. Games are very different. So if you're calling -- if you're playing a game with me and you hit the Xbox and you shoot me in the shoulder and -- we're playing a shooter, and I hit the triangle button and ducked, but I ducked just a little bit too late. So I get hit -- I get winged in the shoulder, and I spin around. And I fall to the ground, and there's blood and all the rest of it that goes on in the video game.

Now what's actually happening there is different than what you can scan. You can scan that outcome. But what you need to be able to scan if you're going to train that is your input, my input, the frames and the sound, the physics and the lighting and the code that drove the light and the physics because those frames are never going to be repeated again. They are unique to where you hit me. They are unique to the timing of you hitting the X button. They are unique to the timing of me hitting the triangle button.

And so the challenge around this is where can you train to do that, where can you train to create an outcome that advances content creation. Now in the Editor -- and I'm guessing a bunch of you haven't opened the Editor, but we're at the -- you open the Editor. You would see a screen that is your creation screen where you're dragging and dropping and putting stuff up there. You'd see a run time screen, which is how it would look if you provided those types of triangle and X inputs. That's a run time screen. There's only one place you can train on that, inside the Unity Editor. You can read the code. You can read the run time screen. You can read the input that the creator used.

So content creation in the gaming world, where it's not the artifact can be scanned, it's happening in real time. Now I have no doubt that pure natural language will be able to produce really simple games as long as enough rules are put into the tool to create it, but the rich content that we've gotten used to is going to be harder to train. Now it doesn't mean it won't get trained. But companies like Unity are going to be deeply involved in that process, and others are going to be outside looking at it.

And so I feel very confident in our position as Unity where by way of example, in terms of third-party tools outside of Asia, north of 70% of games are built in Unity. Our next largest Western competitor is less than 1%. And so we're in this position where we're, if you will, the de facto tool for doing this kind of work. And as we bring these tools, these AI capabilities into the Editor, I think we can win for our customers and win for ourselves.

I think though that AI is going to have a profound effect on the industry. First, it's going to lead to inflection up and growth as game types are built that were not previously possible. And secondly, we're going to see, I believe, some of the crazy expense that goes on in some high-end production come down some. It's a favorable part for the game industry for growth, and I think it's going to be very favorable for Unity as we drive some of these changes through the industry.

Dylan Tyler Becker

William Blair & Company L.L.C., Research Division

Got it. I appreciate the depth of the answer there. Maybe one quick clarification one for Luis. On the financial side, looking at the balance sheet here, I guess thinking about capital allocation. I know you guys have the buyback in place. You've got about a \$3 billion roughly in converts out there. I guess as we're ramping the margin profile, just kind of any thoughts on capital allocation?

Luis Felipe Visoso
EVP & CFO

Yes. Dylan, similar to what we talked last time, we're looking at the market, and there is a credit crunch out there. So we're happy with \$1.6 billion that we have in the bank. We'd be generating cash this year, but we want to be very prudent. So don't expect anything dramatic there.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Okay. Yes. So let's go to Gili at Goldman Sachs, please.

Gili Naftalovich
Goldman Sachs Group, Inc., Research Division

Gili on for Kash. Congrats on the results. I'll give you guys a break around AI, even though I agree with everybody on the call that it's very exciting and it's -- we're all waiting to tune into what you guys do. But my question is more around the health of the industry or the non-gaming selling motion. Given the tight budgets in labs continue to be a common headline across industries in 1Q, any color you can provide around new business or renewal trends in that part of the business would be great.

John S. Riccitiello
CEO, President & Executive Chairman

So first off, we're really proud of our digital twin business and the new customers coming to our platform literally every week, and we've made a number of announcements. I wish more than we're further in the development process because we could show you the beautiful and incredible things that they're building. But again, we've made announcements in the shareholder letter, and they keep coming.

And they come to us for a variety of things, whether it's high-end watch companies around the manufacturing process and the marketing process, the auto industry around manufacturing process, large facilities, including cities like Orlando and airports in terms of how to run safely and effectively in a large environment, buildings, architecture, engineering, construction, also in the energy field.

Now the fundamental advantage Unity brings versus most tools that are out there is that we're real time. And what that means is instead of looking in the rearview mirror, you're looking at exactly where you are today. It's more of like the dashboard of your car, which is another place Unity is increasingly used today in terms of [plays] in cars. But you're looking at the present. And that is a huge advantage, a huge advantage relative to the traditional companies that compete in the digital twin rate, which is why we're getting so much interest.

Now I have to admit, and I'm glad you asked the question, that when I greenlit the Barracuda project 5 years ago to be able to do this, I did not anticipate that we'd have a scaled digital twin business in the way that we do. And I frankly didn't anticipate the actual use case. So I thought AI on a device was going to be really, really cool. And I didn't -- me and my team and one of my colleagues, Sylvio, that put this in place, he ran labs at the time, we knew there'd be something cool. We didn't know exactly what it is. I'm very glad we did it.

And this allows us to not look at the present. It allows us to run a massive amount of simulation in the cloud but then run on device. So all of these people that work on the factory floor in a large auto company can get -- they can anticipate what they should do next based on what's happening in the present, run simulation for lots of different scenarios. And it can propose and advance the workflow in virtually any environment.

And I think that's actually going to be a deciding point for digital twins going forward at a massive scale because right now, what they do is they largely look backwards and they try to come to their own intelligence and then change things. We're going to be able and can use data in the present to help shape the future. And I think that's always been the promise of digital twins. It's just a promise as of yet, not delivered.

And Unity has the advantage of being able to do that on device. So most digital twins today sadly are constrained on a big manufacturing floor, the manager that's up in the booth overseeing thousands of people in the manufacturing facility. Where we're carrying this is it's on a device that every person on the factory floor has it and is using it to enhance what they're doing in the present.

The guy in the factory, overlooking the factory, that's the past. We're in the present. And as we bring AI to these people on the factory floor or in any other environment, they're looking into tomorrow. They're getting something better than they've ever had before. And that's really an unlock of, I think, huge value.

And the other angle of this is when I talk to customers on the digital twin side to say, but isn't that going to give me a staggering phone bill? In other words, aren't I going to have to pay the various cloud providers in an enormous way? I read about OpenAI spending so much money on training their algorithms that it's frightening to imagine what the cost will be. And we say, well, it might. But this allows you to run it on device.

Having a large number of people that are training on device, on the cell phones or tablets or other things they're using to interact with this data, they can run it for free. And that's a big advantage. We've all seen that you can aggregate a bunch of PCs to replicate a supercomputer. This is a similar thesis. You can do things on device in a way that makes that load less expensive.

And I think that's another competitive advantage for Unity, and we're unique in having built that. So I feel great about this side of the business as well. And we are in the process of using for scaling on that side of the business. And you'll see more about that in the course of the next weeks.

Richard Hugh Davis
Vice President Investor Relations & Strategy

We'll go to Stephen Ju, Credit Suisse.

Stephen D. Ju
Crédit Suisse AG, Research Division

All right. Great. So I want to get us back on the AI train here. I just wanted to follow up on your comments.

John S. Riccitiello
CEO, President & Executive Chairman

I think we should have had this call run by ChatGPT. Great questions about AI. Yes. All right. Stephen, I'll give it back to you.

Stephen D. Ju
Crédit Suisse AG, Research Division

All right. So around the Unity Editor, and I get that we're not going to get there all at once, but what you're describing here makes us want to think about the potential for a one-man game development company, which is the verbal prompts from the rider driving all the content creation. It does sound like longer term, this has the potential to increase the number of creators but maybe also decrease the number of developers who can interact with Create. So versus sort of a historical 1.5 million people that we have been thinking about, can you think about the puts and takes here? Because thinking about this as just a positive -- net positive just seems too good to be true.

And also, can you help us think about what this does for -- to your earlier commentary about digital twins and 3D creation outside the game industry? Does this help you significantly expand the addressable market sooner? So maybe longer term, the puts and takes just inside the game sector maybe just does not matter.

And I guess, Luis, bringing this back down to earth a little bit and the present, I think you recently announced a reduction in force. So can you talk about the dollar impact to OpEx and EBITDA for the year?

John S. Riccitiello
CEO, President & Executive Chairman

I think that's the longest question we've had for several quarters. Thank you, Stephen, for that one. Puts and takes. So first off, there are already lots of single-person game development organizations out there. And I can -- Flappy Bird as an example was made by one person. And some of the most successful sort of runner-type games and puzzle games are built by 1, 2, sometimes 3 people. A lot of hyper casual games are today built by 1, 2 or 3 people. So that already exists as a phenomenon. And they're pleasantly almost always using Unity, which is something we make -- we're very happy about.

The second thing is once you get up from the single player -- the single person making this stuff, my expectation, I just need to think about for a minute, is whether you're making a movie or a game or anything, the primary issue is whether you're successful or not. The revenue is supposed to exceed cost by a lot. And it's a very competitive market for high-quality product that's out there.

And I don't foresee a place or a time where an individual that is great at level design is likely to be great at character design and likely to be great at animation or lighting or physics or all of the things that yield balance in a game, et cetera. That doesn't mean that a developer isn't going to get a crisp choice here, and I believe they will. Do I want to make a game twice as good with the same number of people? Or do I want to make a game just as good with half the people? And that is definitely going to be a choice.

Now how does that frame up against Unity? We're already on -- 2/3 of our revenue is, from one level or another, is usage of games, the play of games, the interactions on a server from games. So as an observation, that's not necessarily bad for us. It might be good for us if that's where it goes.

The second thing I would tell you is I think that a lot of developers, I think, are going to opt for the same number of more developers making better products because the prices are huge. I think if you look at the marketplace today and say, what entertainment products have ever generated \$10 billion in revenue? And the first, I don't know, 25 things you'd come up with are all games. It is a very lucrative market for people to produce better and more differentiated products.

And the third thing, as we've been talking a lot at Unity about and with all of you, is a lot of our revenue that we see revenue growth in Unity is going to come from cloud-based usage, how the tools are used, how the rendering works, how the build process works and less than seats. We believe most of our revenue and revenue growth from Unity is more around usage than it is around seats.

So the gaming side, I think you can do puts and takes and you can have your own window on what you might think those things balance out to. I think they're pretty positive for Unity's revenue streams, very positive, which is why we're confident enough in a world where this is all happening to raise our guidance and not lower it.

The second point on digital twins. This is an industry that is much larger than the game industry, writ large, looking over the entirety of it. And we're uniquely positioned to deliver AI-enhanced run time to enable real-time 3Ds that are driven -- real-time simulation that's driven off device, which is a huge positive. I can see nothing there, but it's not just pure positive.

And here, one of the reasons we built the usage-based platform, one is it solves a problem for our customers. But secondly, we anticipated that we wanted the majority of our revenue, if not almost the entirety of our revenue, in time to come from usage based, not from seats because we don't see a major luxury watch company having 50 developers and sustaining that. They might have 50 watch designers, but they're not going to have people doing like what you do in the game industry. So I don't see this as much any other way than positive, and I think it's positive short and long term.

Luis Felipe Visoso
EVP & CFO

Stephen, to your second question, and thanks for inviting me into the conversation, we -- if you were to isolate this effect, it's about \$18 million per full quarter.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Okay. We'll turn it over to Bernie McTernan.

Bernard Jerome McTernan
Needham & Company, LLC, Research Division

Sticking on AI, I think I know the answer. Just wanted to put a finer point on it. Are there opportunities to upsell some of these capabilities as far as the goal to really make them more ubiquitous and continue to democratize the technology?

John S. Riccitiello
CEO, President & Executive Chairman

I didn't quite catch that question. I'm sorry, I had a blip in my network here.

Bernard Jerome McTernan
Needham & Company, LLC, Research Division

Just all the different AI -- different products that you're rolling out, do you think [those about] upsell opportunities or opportunities to charge more for your service? Or is the goal just to continue to democratize the tools and AI is just another example of that?

John S. Riccitiello
CEO, President & Executive Chairman

Right. So if I were to do a quick listing, one is AI is already driving outperformance on our ad network. That's a positive. I think it is going to democratize and bring more people into the tool set. We typically capture the majority of the developers and a smaller portion of the artists. Natural language will bring artists into the tool. I

[Audio Gap]

Web app approach I talked about before or directly into the Editor using natural language. So I think it's a positive there. And that, I think, fits under the notion of democratization.

And then the area I'm most excited about and one I think is probably the biggest growth driver for us is the fact that our run time, while it was a massively pervasive tool that's being used on 4 billion devices today, gets increasingly powerful to enable a game play or digital twins that are more advanced than maybe Gene Roddenberry saw it coming, but not many people did. I'm so excited about that. I think it's going to drive users to our platform in a huge way, and it's uniquely ours. So I feel great about it.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Parker Lane.

Jeffrey Parker Lane
Stifel, Nicolaus & Company, Incorporated, Research Division

Perfect. John, I'll skip AI for this one. I want to go back to last quarter's theme, which was synergies. And you just discussed it a little bit there, Luis. But when we think about synergies in the context of the adjusted EBITDA ramp here, how far along are we in the identification and execution against the synergies post IS?

John S. Riccitiello
CEO, President & Executive Chairman

How far along? 25%. I don't know. Less than half, a lot more to go. But I can say with no hesitation that it's driving revenue now. We didn't just add A plus B to get AB. We're getting more than we had in the combination, and that's mostly on the growth side. But we're also seeing the Create side enable revenue streams better on the Grow side, and we're seeing uptick in tool usage from Grow from the endorsement of Unity and for being part of the Editor.

There are so many things I'd like to tell you about, but we tend not to describe what's going to happen the day after tomorrow or the month after next. But there are some really substantial programs under development at Unity that will generate increased synergy for our customers and increase revenue for Unity because of the combination.

And so here's what I'll hold you to. Ask me in the December -- I guess end of November, December call about synergies because right now, I'm describing great performance today because of it with more to come. And in December, that's going to be a much more fun conversation to have based on work we have underway and product we have coming to market.

Jeffrey Parker Lane
Stifel, Nicolaus & Company, Incorporated, Research Division

Got it. I'll make sure to circle back later this year. If I could sneak one more in here on digital twins. I noticed you guys talked about reducing your reliance on Professional Services to drive adoption there. Can you just dive into that dynamic a little bit more and the implications of that and the go-to-market strategy?

John S. Riccitiello
CEO, President & Executive Chairman

Luis, you or me?

Luis Felipe Visoso
EVP & CFO

Yes. Go ahead, John.

John S. Riccitiello
CEO, President & Executive Chairman

All right. So first off, let me just describe the life cycle of a digital twin customer with Unity. And the life cycle is they usually start with what feels a bit like an RFP process where they say, I want a digital twin. They might even not call it a digital twin. I want automation here. I want something. But it always fits into our rubric of digital twin, which is bringing the physical world into a digital world, simulating that driven by data, typically IoT data, significant real-time ingested data to yield it out for them.

So the first innings are about scoping it. It's amazing how much science fiction these people consume because they've always got ideas that are amazingly ambitious. The next stage is building it. Now this is where digital twin customers differ from game customers. When we talk to Activision or in Japan the Square who we talk to, Ubisoft who we talk to, any of the major mobile publishers out there, King, et cetera, and Zynga, they've already got an army of developers. They typically got thousands of developers in their company using Unity. So we're talking to them about what they might do next and adding to that.

Inside of the city of Orlando or the airports where we do business with, the car companies, they might have a couple of dozen developers, but they don't have a lot. And so what typically starts our relationship is a Professional Services agreement where we build for them, with their people on our team, the first cut at that digital twin. And then as that digital twin gets built, it gives way to an ongoing usage-based revenue stream from our -- from the cloud side of our business, where we ingest the digital twin data, the IoT data in order to run that application for them.

And then we always keep seats because they want to be able to mess with it over time. But when Luis said in the prepared remarks or in his response to one of the questions that we want less reliance on Professional Services, we never envisioned or theorized that we're going to grow our Professional Services business to \$1 billion business someday. It doesn't mean that it might not be there when Unity is a \$15 billion company. But it's not how we saw this going.

We've always seen this going where the lion's share of our digital twin business is cloud-based ratable revenue for operating the digital twin, not Professional Services revenue for creating the digital twin. It doesn't mean Professional Services goes away. It's still a growth line for us. But we're not emphasizing that as a growth vector, which is one of the reasons we signed partnerships with people like Booz Allen and with Capgemini. We're very happy to allow them to do the building of that digital twin. One, Booz more in the government side of things and Capgemini across a number of sectors and energy as an example.

And so we're very happy to have these integrators work towards creating cloud-based high-margin revenue for Unity. And so what we see happening on the digital twin side is we have a lot of demand at the top of the funnel. And frankly, we have to turn away business at the top of the funnel because we don't intend to scale our Professional Services business as rapidly as we otherwise could, getting our use cases out there and then shifting each one to ongoing ratable revenue, which -- because it's fundamental to their workflows and fundamental to how they operate their businesses, they look to me like the closest thing to permanent revenue that I can see.

So I feel very good about this transformation. Add AI to that and you have the opportunity for more revenue on the ratable side, and secondly, greater and more positive differentiation versus traditional tools.

Richard Hugh Davis
Vice President Investor Relations & Strategy

All right. Well, we've -- like in a football game or a hockey game where the Bruins are losing overtime, I had to throw in Boston sports, we've come to the end of this call. But thank you all so much. Thank you for your interest. Thank you for your very good questions. We really appreciate it. And I'll turn it over to John to finish it up. But we'll see you again soon, I'm sure.

John S. Riccitiello
CEO, President & Executive Chairman

All right. So thanks for sticking with us. You definitely beat my estimation on AI questions. I thought it was going to be half the call. It didn't occur to me that it might be 3/4 of the call. But look, I feel very good about Unity. We had a great first quarter. We're guiding for more great quarters for the balance of the year. We feel really good about our business. Because we're a platform, because we're generating strong synergy, there is massive energy inside this company to serve our creators in ways that they haven't even imagined yet.

Part of that is AI. And I believe AI is going to be positive for the industries we compete in. And it's going to be positive for Unity's market share in those industries. And it's going to be positive for the revenue that we yield from those market share point gains. So we feel good about where we are, and thanks for your patience today. Appreciate all the good questions.

Luis Felipe Visoso

EVP & CFO

Thank you, everyone.

Richard Hugh Davis

Vice President Investor Relations & Strategy

Thanks.

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