

Unity Software Inc. NYSE:U

FQ2 2023 Earnings Call Transcripts

Wednesday, August 2, 2023 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2023-			-FQ2 2023-			-FY 2023-	-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS
EPS Normalized	(0.03)	NA	NA	0.08	0.23	▲187.50	0.46	NA
Revenue (mm)	479.83	NA	NA	517.35	533.48	▲3.12	2153.09	NA

Currency: USD

Consensus as of Jul-30-2023 10:40 PM GMT

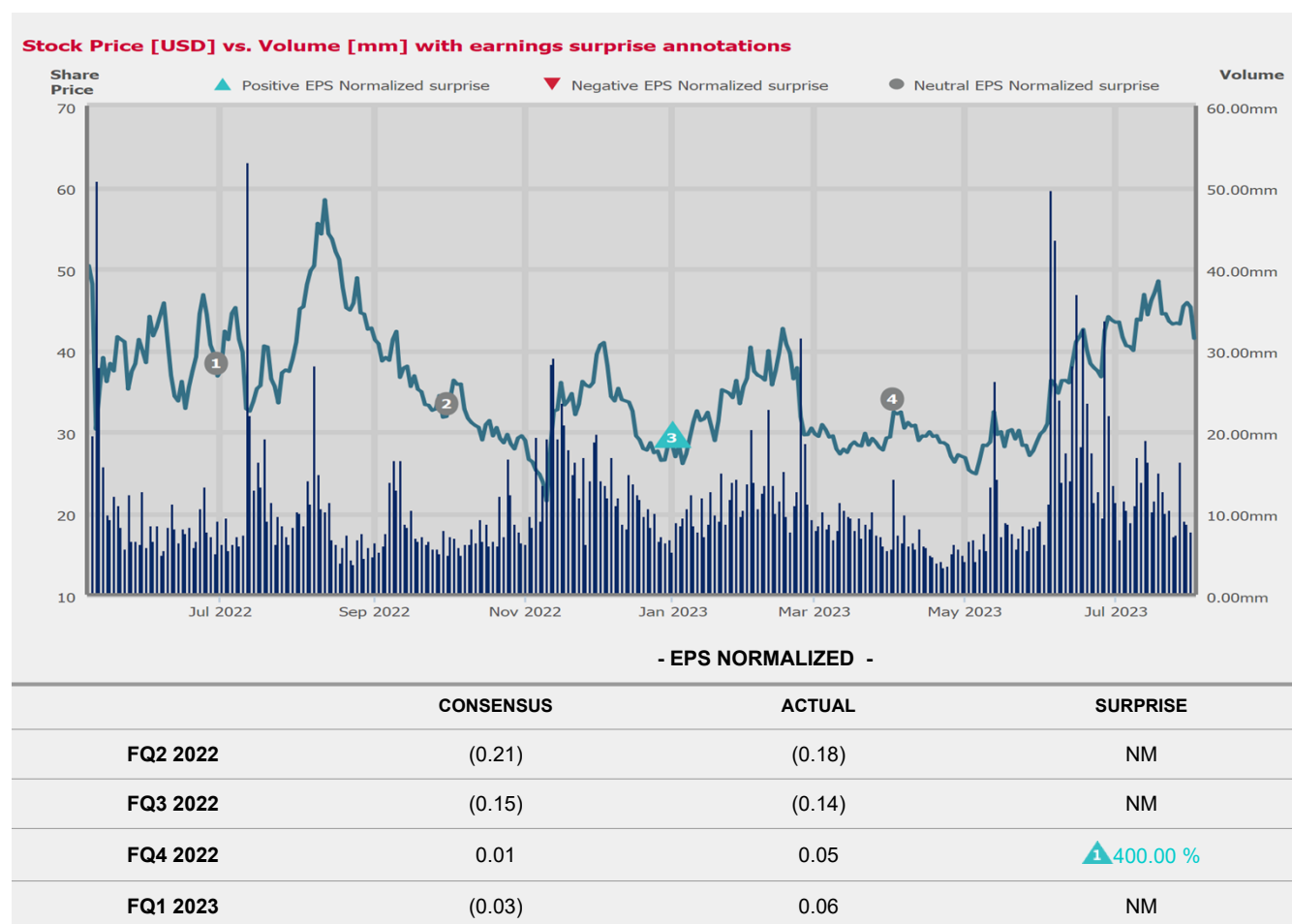


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Call Participants

EXECUTIVES

John S. Riccitiello
CEO, President & Executive Chairman

Luis Felipe Visoso
EVP & CFO

Richard Hugh Davis
Vice President Investor Relations & Strategy

Unknown Executive

ANALYSTS

Brent Alan Bracelin
Piper Sandler & Co., Research Division

Brian Nicholas Fitzgerald
Wells Fargo Securities, LLC, Research Division

Dylan Tyler Becker
William Blair & Company L.L.C., Research Division

Gili Naftalovich
Goldman Sachs Group, Inc., Research Division

Matthew Andrew Cost
Morgan Stanley, Research Division

Timothy Wilson Nollen
Macquarie Research

William Lampen
BTIG, LLC, Research Division

Presentation

Richard Hugh Davis*Vice President Investor Relations & Strategy*

Welcome to Unity's Second Quarter 2023 Earnings Call. After the close of the market today, we issued our shareholders' letter. That 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.

But 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. Now you can find more information about these risks and uncertainties in the Risk Factors section of our filings at sec.gov. Actual results may differ, and we take no obligation to revise or update any forward-looking statements.

As in prior quarters, we will be 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 include full GAAP to non-GAAP reconciliations.

Okay. Thank you very much. So as we did last time, let's start off with two brief questions before we open up to regular Q&A. So for John, you've seen a lot of trends in cycles over your career. What are you kind of most excited about when you think about where Unity is today and where we're heading?

John S. Riccitiello*CEO, President & Executive Chairman*

Well, first off, I want to congratulate my colleagues on delivering strong execution and a great quarter in our second fiscal quarter. Really appreciate it. Great work. Congratulations. Now when I look at Unity today, I really feel fantastic about the company and where it's heading. And there's a number of factors that make me feel great about Unity both near term, but really importantly, long term for revenue growth and profit growth in a way that's super healthy, and I believe will deliver in huge ways for our customers and our shareholders.

First, you've heard about Unity PolySpatial. Now it was great to be on stage with Apple at WWDC. Since then, we've seen substantial interest from our developers in the PolySpatial platform. And I think it represents another reason for developers to look to Unity to be the go-to platform for all real-time 3D development. We cover the platform better than anyone, and we cover them spectacularly well with new platforms as they come out. And a great example of that is what Apple just announced just recently.

The second is the Unity Cloud. We put that in market in a closed beta recently, expect to go general availability later this year. This is a platform that connects all of our services to our product. If you want to think about this in a way, the go-to-market motion just collapsed from people getting in a plane, taking a cab or an Uber, knocking on a door to a click inside the editor. We like that. It makes it easy. It makes it simple. We think it's going to drive increased adoption. And for us, this is substantial. It's going to lead to increases in consumption and ratable revenue in addition to subscription, the artist seats and usage and all that goes with that. You've seen lots of announcements from us recently on Weta, Ziva, SpeedTree. We expect that's going to continue and drive increased artists picking up the number of our -- picking up our platform. And again, net new revenue, net new SaaS revenue, net new consumption revenue.

Digital twins acceleration. This is really important. I hope you'll listen carefully. We're getting great traction in the market, and we're now focused on delivering repeatable solutions, high-margin solutions that deliver ratable revenue streams and consumption revenue streams.

We have made a decision to deemphasize our growth on the professional services side, a lower-margin business, and we're really thrilled to be able to rely on partners like Capgemini and Booz. So this is a great move for Unity. It adds significantly over time to our bottom line, a little bit less professional services growth, but it's a good strategic trade for the margin and for the business on a strategy perspective for how we're going to build our position in the marketplace.

One platform. This is the synergy story. This is why Unity Create and Unity Grow are together in a way that delivers better for our customers and better for our investors. Here, we're getting deep integration between advertising, mediation, publishing, UA tools inside the editor. We're working through some really important incremental synergy programs, and we'll be sharing more about that

later in the year. But you should start thinking about with all the synergy we're already getting, there's more to come. And there's an advantage in being the place where our customers build their products and monetize their product.

And I couldn't be more excited about the two AI products that we announced some weeks ago, a huge amount of interest from our customers. We're there on the creation side and the operations side for applications with Muse and Sentis. We'll be looking at a business model for these as much like what Microsoft has announced with some of their AI products. And again, incremental revenue around SaaS and incremental revenue around consumption. And here, we have a particularly specific set of opportunities because people forget that Unity has a large number of free users. Well, these users are going to want to use AI because it will significantly expand their ability to build what they have in their mind's eye to get it on the screen to get in the hands of their customers. So we're super excited about that.

So there a handful of reasons, all product innovation driven, that will put us in a great position for growth both on top and bottom line.

Richard Hugh Davis

Vice President Investor Relations & Strategy

Great. Thank you very much. Luis, we'll look at the -- we're at the halfway point in 2023. So it'd be kind of great to highlight how things have played out in those first 6 months and as we kind of look forward to the rest of the year.

Luis Felipe Visoso

EVP & CFO

Yes. Thank you, Richard. We are actually very happy with our results. If you look at it, and I'm sure everybody has read our shareholder letter, we had a record quarter. We were ahead of expectations. And as John just mentioned, we're bringing a ton of innovation to the market, which we believe will position us well into the future. So we're very happy overall.

Just to go a little bit deeper, what we've committed and talked to several of you is about creating shareholder value by driving three things. One is revenue growth, expanding margins and efficient use of cash. So if I touch on each of them, on revenue growth, we accelerated growth to 11% this quarter. So great improvement quarter-over-quarter. And we're winning with customers in games and in industries. And frankly, I would say this is still in what I would call a challenging economic environment. Some of our game customers are not adding headcount, some of our sales cycles in industries are still a little bit longer as we need to prove value.

China Create market continues to be soft overall and the ad industry has been relatively stable with not much seasonality so far this year. And very importantly, we're winning in this environment. And we estimate that we're growing faster than the markets in which we compete. So overall, on revenue side, we feel pretty good. But that's not it, right?

We deliver all this acceleration while significantly improving our profitability, with strong progress on a GAAP and non-GAAP basis. EBITDA was \$99 million. We need to get a few hundred thousand more to get to \$100 million, but we're very close to running to that magic number. 18.5% margin is a good place to be, particularly when we look at where we were just 4 quarters ago. In Q2 of last year, we were minus 13%. So from minus 13% to almost 19% just in a year. And that's driven by choices we've made. There are portfolio choices we've talked about before. We reduced hierarchy, we're driving cloud efficiencies. We're reducing our office footprint. Just a lot of decisions we've made to really make us a sustainable and profitable company. And as John mentioned, we're reducing our reliance on professional services as we build that scale to be a profitable business.

And third, on cash flow, we are now positive. We delivered \$33 million in the quarter. But more importantly, we're now where we believe to be sustainably on the positive side on the cash generation. Obviously, there will be normal quarterly fluctuations based on payment schedules and those type of things, but we're clearly now on the positive side. So with all of this, I'm actually very optimistic about the year. If you look at where we guided at the beginning of the year, for the midpoint of our revenue guide for the full year, that number was \$2.125 billion. Last quarter, we added another \$15 million to the midpoint of our guidance range. And now we're adding another \$20 million. So we're now guiding the midpoint of our revenue guide at \$2.16 billion, right? So we're making progress. We're feeling more confident about where we are in the full year, and that's encouraging.

So before I turn it back to you, let me just talk a little bit about Create and Grow. On Create, one key number is our core subscription growth, excluding China, 22%. That is a very healthy number. Our actions are working. Our price increase has been -- is clearly flowing through. So very happy with our core subscription, excluding China. Industry is 30% of total Create despite our reduction of our reliance on professional services, as John mentioned. And there is just a ton of innovation.

If you look at the letter, industry SKU, Unity 2022 LTS, Unity PolySpatial, Unity Cloud, AI pricing opportunities and just a lot going on, which gives us confidence that we will be able to sustain this growth for the foreseeable future. But Grow is just as exciting. We're seeing some of the industry leaders such as Supercell, Sega joining LevelPlay. Now they are making the choice to move to

LevelPlay because they believe that's a better play for them. Supersonic continues to do very well. We're adding new titles to our portfolio. And remember, Supersonic has published almost the most downloaded games in the U.S. and key markets. So very, very strong performance there.

And we talk about AI within Create but AI is also helping us on Grow. Now we are using AI and machine learning to strengthen our algorithms to deliver better ROI for our customers. And frankly, I think we're just getting started. There is more to come, more synergies to come over the next few quarters and years. Overall, the integration between ironSource and Unity is going well.

So Richard, if I had to summarize and answer to your question, I would say we're very happy with where we started now in the year, and we look forward a strong Q3 and Q4.

Richard Hugh Davis

Vice President Investor Relations & Strategy

Great. Thank you very much. [Operator Instructions]. So Thomas, do we have our people here that want to ask questions?

Question and Answer

Unknown Executive

Clark, go ahead.

William Lampen
BTIG, LLC, Research Division

I've got two. The first one is for John, the second one for Luis. John, I'm going to pull us back a little bit and talk about AI. I guess as we think about some of the tools that you announced intra-quarter being commercialized, are those ones that are designed for the lower end of the market that maybe doesn't monetize as you were talking about a little bit earlier? And I guess as these tools start to permeate the market, how do you think about either potential growth in the developer community overall or the volume and velocity of creation impacting the market and some of your existing customers?

Luis, I just wanted to clarify, I guess, on cost-cutting trajectory. Last quarter, we talked about, I think, half of the cost synergies are so, you initially identified being realized. Would it be possible to give us a rough update of what's -- where we are today?

John S. Riccitiello
CEO, President & Executive Chairman

Thanks for the questions. And let me try to address some. First off, on AI, we've introduced product on two sides of [indiscernible]. On one side is to help people create content, and then the second aspect, that's called news. And the second that we put out there is Sentis, which allows games and real-time applications to do things they've never want, never been possible before.

Non-player territories and games could feel alive, almost like they're supporting their own ChatGPT interaction. But that can be physical, too, the way they move around and walk around or interact with one another right around players, but it also is super relevant inside of digital twins, where an agent inside of a digital twin can predict what's going to happen next to run scenarios around simulation.

We feel great about that. That's ratable and consumption revenue, but that's actually not what you asked about, but I wanted to make sure I got that out there. So you didn't think my focus on Muse was exclusive, and that's all we're doing. Muse on contract creation. I think it does -- it really addresses in a way three audiences.

Now what it allows you to do by way of example is you can use your finger to If you've got a touch devices input to draw something. It might look like anything from a bunny to a wagon to a car, and the engine can understand that and turn that into professional art. It could also be word prompts, like a large language model, my digest or Generative Art for my digest. It also might be code.

And so for our developers, and again, we're training against Unity data. So when it produces code, it can generate the right kind of C# script that is right for use inside of Unity. No one else can train against that. Now that's for the professional developer and for the second group, we're going to talk about. This is going to make them more productive. And in being more productive, and of course, they'll be using servers, there will be some cost but we're quite confident we can price above our cost on a consumption, on a subscription basis. But the key there is more revenue out of existing users.

The second group of people out there are those that are small enough and they're large in number, but small enough so that they qualify for a personal edition and/or edge users, and there's millions of them. These users are presently using our asset store and other digital assets online to sort of create content. It is a very hard thing to do to find the assets or draw the assets to create them. And what will you do if you want an environment with a river, maybe a stream coming off the side of it, a mountain, clouds, et cetera? That could take somebody weeks, if not months, to create in a real-time 3D digital asset collection. Guess what? You can use the words I just used to describe that, and it will show up in your [sand], hugely valuable to them. And so for these users, these customers that are not presently paying off, there's a reason to pay off, and it's a really important reason. They may not want to pay us \$10 or \$20 or \$30 or \$50, whatever the amount of money is over a period of time. But it might be better been spending 2 months on something. It's a huge value for the value we can bring to them.

And then the last group are those that are presently not using Unity because it's too complex. We get several thousand people per day that company Unity download it, look at the editor and say, "Wow, this looks like a 747 control panel without autopilot." It is complicated. Real-time treaty is complicated. For them, where they need art assets or lighting assets or other things to advance into the game or scripts, they can just ask for them. It radically will simplify and bring new users on to the platform.

Now do I expect an inflection point on new users just because of AI like in December? No. But I believe, over time, we'll capture a much larger portion of the people that hit the top of the funnel for us and begin their journey on real-time 3D creation. And for those of you who know the reference point, getting their own Unity logo tattooed on their elbow or somewhere else. So we think this is a great invitation to the large mass of people that want to be creators and up until now, that was a little bit beyond their counter-capability.

Luis Felipe Visoso
EVP & CFO

Clark, to the second part of your question, we've captured about 2/3 of the benefit in Q2. So you should expect a little bit more to come. Just keep in mind that we also had a merit increase and a few other things. So it's not as easy and straightforward to do the forecast, but to answer your question directly, it's about 2/3 of the benefits are in Q2.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Thanks. Okay. Well, we have one of our newer analysts covering us, Brian Fitzgerald.

Brian Nicholas Fitzgerald
Wells Fargo Securities, LLC, Research Division

It looks like industry grew in line with broader Create segment. So just curious about how you're defining the industry, given you only recently introduced an industry SKU and whether that definition may change. And a follow-on to that is any early read on the adoption of industry by online customers since its launch? Or perhaps the use cases that those online customers may be looking at. You've spoken before about automotive, but we're curious if there are any new emerging use cases you're sorting out or beginning to see traction with.

John S. Riccitiello
CEO, President & Executive Chairman

Yes. So let me step back a little bit, and Luis, feel free to add on to what I'm talking about. So in general, we generate revenue in digital twins from three activities. We generated from professional services engagements that enable a customer to get that real-time digital twin. And this can be an airport or a city, a manufacturing facility for high-end watches or for automotive or for any other number of things that could be for a retailer. And we're seeing strong demand from all of the sectors I just mentioned. And so the first step for many of them is to get up and running on Unity. And for that, we often have a professional services engagement.

The second component is also now it's at scale as well, which is the seats that they consume. And originally, they consume the same professional or the proceeds that a game developer would use. But what we've done with our industry SKU is married to that all the tools or many of the tools that they would need for their specialized use cases around changing bio sizes and level of detail and stuff that are super important if somebody might want to step down 3 billion poly model into something that is a fit to that footprint. So it can be edited or moved or carried on something like a hard drive smaller than a small pickup truck.

So that level of transformation is super important. But there's a number of other things that are certainly important to this customer base that is not important or as important to game customers. So that's why it's a premium SKU with added value to it.

The third, and this is really more nascent for us, is ratable revenue once they've got their digital twin up and running, where they're using us for simulation or they're using us for rendering or they're using us for computer vision, where it's essentially a cloud model. And hence, the importance of the cloud platform that I mentioned earlier in the call today.

Now where we are right now is a situation where our largest revenue stream is professional services. Our next largest revenue stream, seats; and our third and more nascent is ratable. The reason that we brought customer partners like Capgemini and Booz to the platform is our own professional services business, our own capacity on that front, is something that we did not want to increase. In fact, we might want to decrease it a little bit and rely more on our own services for Lighthouse customers. And once the model is proven to partner with third-party systems integrators like Booz and like Capgemini, to scale more rapidly.

That would result in less professional revenue -- professional services revenue, more seats, obviously, with more customers and more -- as they get to their operation, more ratable revenue streams. So we've been transforming our business from a business model perspective sort of under the covers to make sure that we're scaling, makes a huge amount of sense for us longer term.

Now in terms of demand, frankly, we've been supply constrained, not pushing a lot for demand, and it's the sectors that you know. We're very keen on government. There's a lot of interest there, and I'll get into that if you want to. Another area where there's large interest is manufacturing, particularly the automotive industry, but also specialty manufacturers in the watch marketplace, which I've mentioned.

There's a fair amount of interest on the retail side, and there's a lot on architecture, engineering and construction. What we're working to do between now and the end of the year is to bring it down more so to a handful of turnkey solutions that we can scale rapidly. We think that's the best way to scale this business into a very high-margin contribution to Unity because it leads to the two high-margin businesses we like, which is SaaS revenue and consumption revenue. So that's the evolution.

We always mentioned customers as we did this time in our shareholder letter. We typically don't go beyond the ones we listed in our letter because a lot of these are work in progress, where their customers haven't given us their IR permission to reference them on a call until the product is delivered.

Luis Felipe Visoso
EVP & CFO

Brian, just to add a few pieces since you probably don't have all the background here. So when we -- if you think about Create, we're splitting it in two when we talk to you. One is games and the rest is industries. We used to call it nongames, but frankly, that's not a good name. So whenever we talk about industry represents 30% of total Create, that's what we're talking about. Everything that has nothing to do with games. All the customers that John was just referring to. So just from a definition point of view, that's what industries refers to.

The industry SKU is specifically designed for these customers. And as you saw in the letter, it's the fastest SKU ever. And very importantly, it's a little bit over 2x the price of the games equivalent SKU.

Richard Hugh Davis
Vice President Investor Relations & Strategy

I will go to Tim Nollen.

Timothy Wilson Nollen
Macquarie Research

Two questions, both I think kind of clarification or a bit more color on some previous points you've made. John, I heard that you were explaining about the kind of shift away from professional toward more seats and more ratable services. A couple of things in your slide that were interesting. You talked about an AI marketplace and about Unity Cloud, which you also referred to. I'm just wondering, how much of these like new significant upsell opportunities, i.e., can you charge incremental fees for these the way I think you were saying you were looking to be able to charge more for AI services in your various businesses? So is it kind of like incremental charge points that you can add on to your subscription levels?

And then another question for Luis would be, I heard what you're talking about, your comments around the Grow business. You had a pretty good swing from minus 7% in Q2 to plus 9% pro forma in Q3. Could you talk a bit more about where this is coming from? Is this volume or price or market share gains? Or growth maybe perhaps beyond gaming into other industries?

John S. Riccitiello
CEO, President & Executive Chairman

So on the AI side, what I've addressed so far is subscription plus ratable for the tools we make, Muse and Sentis. Muse will likely be more subscription, but also ratable because there -- obviously, there will be some volume levels, we're going to charge more. And Sentis will be largely incremental ratable revenues. The marketplace, we've got a fairly large number of partners here.

And I'm sure it's missed by no one on this call that the market frenzy around new AI start-ups is spectacular. And one of the things I find super interesting is they have a huge number of people that want to write them checks for [100 tons] the year after next year's revenue, and they don't have any customers. And which makes estimating the year after next year's revenue a little more challenging than it might otherwise be. And that's actually obviously an exaggeration. A lot of our partners do have customers. But you understand my point.

What Unity does with marketplace is we take the universe -- by far, the largest universe of real-time 3D creators and connects them to the people that make AI tool, whether it be for creation or any other purpose. We're a huge believer in this idea.

We think we've got the right products in Muse and Sentis but this augments that, and these are mostly rev share deals for us. So if the partner is working on a per seat basis, then it's some share of that for a defined period of time, and these are typically negotiated. And my sense is that AI providers that are out there, they're going to move around a lot. But we've had years of doing this with the App Store -- or the assets or excuse me, where we generated a revenue share based on what's transaction side of the store. We expect that will continue longer term here.

Luis Felipe Visoso

EVP & CFO

Yes. I think Tim, to your second question, first of all, Q1 of 2022 was huge, right? That's still when eCPMs were very high and inflated. So we're comparing against a very high Q1 of last year when you look at that minus 9% for growth for Q1. So I think the most important metric to look at is the quarter-over-quarter growth, which is about 13%. So we're very happy with the improvement we're seeing quarter-over-quarter and therefore, year-over-year with Q2.

Where is that coming from? I think overall, the market, we're seeing good engagement but eCPMs are lower than they were at their peak, right? So the flat market is good engagement, but a little bit lower eCPMs. And therefore, our growth is clearly ahead of the market. Now what we're seeing is, as I said earlier, some customers migrate to LevelPlay, and that's driving our growth. So we believe we -- based on our analysis, that we're growing faster than the market. More units in a still tough ECPM environment.

John S. Riccitiello

CEO, President & Executive Chairman

You guys -- for those of you that haven't been tracking our commentary on the ads as carefully, on the ad side as carefully. What Luis said was correct, as we entered -- exited COVID, the last boon quarter was Q1, although Q2 last year was really strong as well. And the market slowed down in the second half of last year. And our guidance for this year was based on the expectation that the market would level out based on trend lines we saw at the end of Q3 and Q4. And that's been borne out.

Although we've seen some modest oddities around seasonality, there wasn't as much positive seasonality when kids got out of school. And I think it's going to take a little bit of time for us to completely read the market. But we based our guidance on the market leveling out, basically being in a stasis mode for a period of time. We have all expectations. The market will turn north again around eCPMs. There's a lot of interest or developers for launching new products. That's usually what drives it. But we based our full year on modest seasonality impact, particularly around the holidays, but stasis for the year, and that's proved to be approximately correct. So our growth in Q2 was very pleasing for us to see against the strong prior year comp. And the sequential growth was very good for us to see.

Richard Hugh Davis

Vice President Investor Relations & Strategy

So we have a quick question from Dylan Becker.

Dylan Tyler Becker

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

John, maybe another way to kind of ask the AI question, too, and as it pertains to kind of the idea of the tethering between Create and Operate. I wanted to focus on the Luna offering and maybe the importance of creative management, automating kind of within the actual creation tool itself and how AI can augment the capability to provide more tailored experiences and engagement for campaign management.

John S. Riccitiello

CEO, President & Executive Chairman

So as you know, we don't break out Luna. It's a relatively small business. We are very pleased around a couple of aspects strategically of Luna. And for those of you who don't know, what Luna is, is it's user acquisition platform that a developer can use not only to identify opportunities to build their business inside of gaming inventories, so whether game ads, but also within social networks or within the App Store and other ad opportunities, opportunities to see.

So what this tool does is that allows a developer to test creative against specific audiences in and outside of game inventory. In a way, it's sort of like a more strategic version of a DSP except that what it aggregates is just one sector of gaming developers, but there are a few outside of gaming, but it's primarily game developers. And part of the business model is we get paid by the targeted media. And

so by way of example, we are very much a favorite partner to Apple, which makes us feel great to be a favorite partner of Apple in this ecosystem.

And so I didn't quite discern a question in what you brought up. So I'm just framing what the -- how this works and why we feel good about it. We've been successful to add new ad inventory over which we generate revenue share when people place through Luna. And so we feel very good about that. The business model transformation that we've been introducing subtly was you pay for Luna versus Luna basically pays for itself. We think that's a more scalable model that's been introduced and it is working well for us. It's still relatively small, but it's got good trend lines.

The other thing I would throw in there for you is you're 100% right on the notion of AI will facilitate more opportunity to create more diversity in the ad offerings testing different types of ads over time. And that will allude, I think, to more optimized spend opportunities or UA opportunities for our customers, which is why we built it to begin with.

Richard Hugh Davis

Vice President Investor Relations & Strategy

I'll switch over to Brent Bracelin.

Brent Alan Bracelin

Piper Sandler & Co., Research Division

Yes, I really wanted to maybe start with Luis here. Obviously, Grow was really strong, \$27 million sequential increases, certainly above normal seasonality for you. How much of that do you think is maybe an industry recovery? Or are you seeing evidence of share gains?

Luis Felipe Visoso

EVP & CFO

Yes. I mean I would say same as what I said earlier. I think we're growing faster than the market. We're seeing key customers move to LevelPlay, and that's a great sign of our growth. Would look at -- we really have this ability to a portion of the market, obviously, right? But whatever -- what we see is encouraging and would point to market share gains. We can see mediation, we can see LevelPlay, and we're performing very strongly there. And one of the reasons is the AI efforts that we put in place, as I mentioned earlier, which are driving better return for our customers' investments. And as I also said, that's just getting started, it will get better over time.

John S. Riccitiello

CEO, President & Executive Chairman

If you recall, when we did the acquisition or the merger with ironSource, we said that the combination of Unity and ironSource alluded to market share growth on combined mediation and not to revenue growth for us. That's exactly what's happening.

Brent Alan Bracelin

Piper Sandler & Co., Research Division

Maybe, John, for you, just double-clicking into large [deals] like Sega, leaning in and embracing LevelPlay. What's driving that? Can you maybe double-click on why the interest is picking up here? I think you talked a little bit about in-app bidding. I'm not sure if that's a material differentiator. What seems to be resonating in on LevelPlay where you're attracting some of the larger studios?

John S. Riccitiello

CEO, President & Executive Chairman

Well, look, I would say that there's a strategic argument and then there's a lot of noise, so to be perfectly frank. A lot of noise if there are incentives that go back and forth for people to move from one platform to another. And that is hard to discern which way that's going at any given moment in time. It's a competitive marketplace where Unity is one of the leaders, but there are a few other players in the market that are also out there competing to win.

What I think is driving the trend line towards Unity and the larger gains, it's a consequence of the fact that I think it's fairly obvious that Unity was a major player on the data side. ironSource was a major player on the data side. The gap on Unity's data was no visibility on the mediation component, which is a very important part, where advantage lived if we had a very strong ROAS we'll set. And so we took two large data sets and pulled them together under one roof, which allows us to target users better.

Both in-app purchase spenders, which are very important, if you will, whales within the ecosystem of gaming that developers very much want to target, but also those that are going to click through on ads and ultimately do installs because the ad business is about generating not just installs but high-value installs. And so I think our marketplace, our customer base recognizes that strategic argument. I'll admit partly because we keep reminding them that, that's the reason they should believe in us. But then we show them data in case studies and they buy into it. So we believe we're on a long-term trend line that's favorable for Unity in the space.

Richard Hugh Davis

Vice President Investor Relations & Strategy

Gili at Goldman.

Gili Naftalovich

Goldman Sachs Group, Inc., Research Division

Congrats on the quarter. John, I think you touched on this a bit earlier, and I want -- I was hoping maybe you can elaborate on the flywheel between Create and Grow and how that's trending. Maybe said in another way, are you seeing more customers leveraging both sides of your platform? Is there any given trend, whether it be Create users engaging with ironSource or ironSource using users adopting Create that you're seeing traction over the last 6-or-so months? And then I had one follow-up for Luis.

John S. Riccitiello

CEO, President & Executive Chairman

Okay. So first off, we've achieved a lot in the way of synergy, and I would say we're just scratching the surface. And so there is something sort of chocolate and peanut butter about having the content creation platform and the data that, that spreads off the customer relationships that spins off and the opportunity for those users to consumer purchase other services from us. The cloud platform is an example. When we're trying to sell UGS before the cloud platform, it literally required us to get a plan and talk to somebody and show them a demo. It's literally -- it can literally be a checkbox for so many of our services, including our Grow services.

And so at the first level, the synergy we're getting, I don't know if I had to measure it, but we're probably getting 10% or 15% of what's potential as we do deeper integration, deeper business model integration, deeper technical integration, more one-click or no-click product integration so that our customers find the one platform thesis, high ROI for them. And we've been pressing on that for years, talking about it, making it happen.

The introduction of a mediation platform is a big step up because people -- developers didn't directly embrace an ad network generally without mediation in front of it, so that was a big step in the right direction. And this quarter, we announced some wins and they go in both directions. And I expect in the balance of this year, first quarter next year, the things we're working on that I'd like to share with you but won't on this call will be well described in later quarterly calls and/or publicly released announcements. But we feel really good about how 1 and 1 is 3.5 here.

The value of a platform, probably the most overused word in Silicon Valley, a platform, it's mostly a PowerPoint thesis for most companies that describe it. Here, it is substantive. It is real. It matters to our customers, and we're building more value in it. So yes, we are seeing customers come to the platform because of the combination as they move from a Grow service to a Create or Create service to a Grow service.

Gili Naftalovich

Goldman Sachs Group, Inc., Research Division

Super helpful. I appreciate the response. And one for you, Luis, around full year guide. I mean given the strength this quarter and the potential upside from new products such as visionOS and some of the others that you highlighted today, how much revenue growth are you currently incorporating in your full year guide from these services? Or how should we think about the cadence in which they'll start being layered into the growth algorithm?

Luis Felipe Visoso

EVP & CFO

Yes, not too much, Gili. I mean they will -- I think they are huge. I think they can make a very significant difference for us on an ongoing basis, but I think they will ramp in 2024. So I don't have too much in 2023, but we should be getting some traction. And as John said, customers love them. We're getting good traction on Muse, good traction on Sentis, and they should be scaling next year.

John S. Riccitiello

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CEO, President & Executive Chairman

Yes. We're giving you more visibility on things that in prior versions of Unity talking to investors, look like the next 2-year revenue ramp product drive models, and they're all available now. So we're sort of at a great spot where we've got more reason to believe in the tailwinds than we have in years past.

Richard Hugh Davis

Vice President Investor Relations & Strategy

And for the closer here, we'll have -- and we'll connect with all of you that had additional questions subsequently too as well. But Matt Cost, if you're available, we'll let you come in and close the session. Matt, you may need to unmute yourself, perhaps.

[Technical Difficulty]

John S. Riccitiello

CEO, President & Executive Chairman

Get the AI bot to stand up and say something.

Luis Felipe Visoso

EVP & CFO

We cannot hear you, Matt.

Unknown Executive

Looks like Matt is having some issues with his mic.

Matthew Andrew Cost

Morgan Stanley, Research Division

Can you hear me now? Got it. Okay. I pulled it out of the fire and I'm here to close. Okay. So I guess just starting on the pro services side, I mean, you talked about how there's a margin sort of differential between pro services and the rest of the Create business.

So understanding that, what is the strategic reason? Why operationally is it better not to do pro services? And then is that something that's going to have an ongoing impact for a couple more quarters in terms of like weighing on Create growth? Or is that something we've more or less seen? And then I have one follow-up.

John S. Riccitiello

CEO, President & Executive Chairman

Well, I mean, as a starting point, I never intended to scale professional services to a large business. It was definitely a need to do. But until we were approving things, partners like a Capgemini or a Booz weren't interested in us. So we needed to pave the way we needed to show the way. And we will continue to pave the way and show the way. But I find if we -- as we pull off the transition I'm prescribing with business model, I believe that the SaaS seats plus ratable revenue can scale faster than I can hire people to build low-margin products.

And honestly, from a managerial focus perspective, it is an enormous amount of energy that goes into each one of those projects. And it's -- I don't know if I've got a good way to analogize us. But I don't think a lot of the German street U.K. tailors that make custom suits have great margins. And they were doing one-offs. That's not the vision I have for Unity. I want to scale. We have a couple of cities, for example, that are running digital twins in Unity. I want to get all of them on Unity, not just the three I can build city twins for or the five that I might be able to do next year. I want to scale with partners. Both Capgemini and Booz outnumber us by a wide margin.

And so I want to leverage that infrastructure to deliver for more customers and at the same time, allow us to transform our P&L towards higher margin. So this isn't driven by, primarily, at least by a cost of capital perspective. It's driven by the complexion of business we want, where our value add is at its best. Now having said that, we did restructure our professional services business in the last couple of quarters, anticipating what we wanted to do. And yes, we could have generated more revenue this quarter if we hadn't have done that. We deliver a little bit more money, more revenue next quarter if we didn't do that and in the fourth quarter.

My sense is as we plow through 2024, there'll be more revenue from this decision, not less. And one of the things that managers get paid to do is sometimes may -- it's always fun to talk about top line revenue and the growth number and bringing it down a point or

so or whatever that impact would be in order to transform a business in the right way for long-term profitable growth. That's the right decision. But sometimes it's made with a jealous eye to a little bit more growth that would make the minute-to-minute feel better. But we're not here for tomorrow, we're here for the long term.

Luis Felipe Visoso
EVP & CFO

Matt, just a few additional points of clarification. One is we're not walking away from professional services, right? We are reducing our reliance on professional services, which is a very important distinction. We continue to believe that professional services to the degree that they are scalable, as John mentioned, are important, right? Why? Because some customers come and they say, "I need a digital twin, but I have no clue how to do it." And in some cases, where, as John mentioned, we can build a scalable and profitable business, we will be there.

And -- but the end game is to move those customers into a subscription business with consumption elements, super, super important. So I don't want you to think that professional service is going to go to 0. It remains strategic. We just need to do it right in a way that it scales to subscription and consumption models, super important.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Well, that wraps up the Q&A session. John, if you want to close, I appreciate it. But thank you all for being on the call, for sure.

John S. Riccitiello
CEO, President & Executive Chairman

So first off, thank you for listening to us for 46 minutes. We appreciate it. The second thought I'll give you is we're very pleased with the quarter. We're really sort of pleased as we can be about our long-term perspective. And of course, it's our job to [strengthen] the short term and the long term together in a way that works. We're happy to see the strong margin growth, hitting 18.5% EBIT margins in the second quarter. I think it's ahead of all -- most people's expectations, and frankly, if I asked me 6 months ago, even my expectations. So we feel good about what we're able to do there. So all in, we like our print, we like our guide, we like our future. And we genuinely love the world with more creators at it. It's our job to deliver for them.

Luis Felipe Visoso
EVP & CFO

Thank you, everyone.

Richard Hugh Davis
Vice President Investor Relations & Strategy
 Thanks.

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