



Q2 2023 Earnings Conference Call Script

August 14, 2023

Speaker: Matt Chesler, FNK IR

Thank you, Operator.

Good afternoon, everyone, and welcome to the Enthusiast Gaming Second Quarter 2023 Results Conference Call. I'm Matt Chesler of FNK IR.

With me today is our Chief Executive Officer, Nick Brien, and our Chief Financial Officer, Alex Macdonald.

We'll begin with some prepared remarks and then open the floor to questions. Before we begin, I'd like to remind everyone that today's presentation contains forward-looking information that involves known and unknown risks and uncertainties and other factors that could cause actual events to differ materially from current expectations.

These statements should not be read as assurances of future performance or results. Such statements involve known and unknown risks, uncertainties, and other factors that may cause actual results, performance, or achievements to be materially different from those implied by such statements. A more complete discussion of the risks and uncertainties facing the Company appears in the Company's Management discussion and analysis for the three-month period ending June 30, 2023, which are available under the Company's profile on SEDAR and EDGAR, as well as on the Company's website at enthusiastgaming.com.

You're cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this presentation. The Company disclaims any intention or obligation, except to the extent required by law, to update and revise any forward-looking statement as a result of new information, future events, or for any other reason.

Now, I'd like to turn the call over to Nick Bryan, CEO of Enthusiast Gaming. Take it away, Nick.

Speaker: Nick Brien

Thanks, Matt, and welcome to everyone participating on our earnings call.

I joined Enthusiast Gaming as its Chief Enthusiast Officer five months ago, and my conviction continues to be that the gaming media sector is a huge growth opportunity for us. As the number one gaming property in the U.S. as measured by Comscore.

Throughout the course of my remarks, I'll share concrete examples of our recurring and new business momentum that strengthens my conviction on a daily basis.

I'm excited to share with you the strong progress we have achieved over the past quarter, as the Management team has focused diligently on executing the strategic initiatives developed as part of our

2023 Transformation Velocity plan. I'll discuss these in detail, but I first want to share some important industry context.

The video gaming industry demonstrates continued momentum in terms of exciting new game launches, such as Diablo 4 and Baldur's Gate 3, and continued user growth across the mobile gaming sector. Gaming is an entertainment industry that's significantly expanding year-on-year, projected to be worth \$366 billion by the end of the year. Massive tech and entertainment companies see the value and opportunity of entering the gaming space as they expand their footprint in gaming through organic growth and acquisitions.

The U.S. media industry continues to rapidly evolve from the dominance of the walled garden digital players such as Meta and Google, the high growth innovative digital media sectors such as CTV, retail media and commerce media. Yet the disruption of legacy media players continues, as Amazon posted a 22% gain this quarter, Discovery posted a 13% decline. These newer media players continue to attract advertising dollars, as they provide marketers with scaled audiences, first party data, and brand safe environments. Uber is on its way to building a billion-dollar ad business within the next year.

My visit to the annual Cannes Lion Advertising Festival in June reinforced the strong interest from industry leaders in the gaming media sector, given the scale and breadth of the gaming audiences and the remarkably high user engagement metrics they offer. Major brands and leading agencies know that gaming audiences are the future customers they must reach. But these same brands remain largely uninformed and confused about how to engage the gaming audiences with respect, relevance, and critical authenticity can connect in exciting and effective ways.

During the week at Cannes, I met with many of the largest global marketers, including P&G, Unilever, Intel, PepsiCo, Microsoft, Pfizer, Diageo, and Lenovo, and the message was consistent. For gaming to become an established media sector, attracting large advertising budgets, we must offer these mega brands several things:

- First, we must offer scale audiences, not niche gamers.
- Second, we must ensure brand safe environments to protect their brand equity while respecting the gaming audience's attention.
- Third, it is critical that we provide independent measurement to prove ROI.

When we and our peers deliver against these criteria, gaming media will move swiftly from being a nice to have to becoming a must buy.

Enthusiast Gaming is uniquely resourced to provide leading brands and agency partners with strategic planning, content creation, first party audience targeting and marketing campaign measurements to meet industry standards while providing necessary innovation and ROI. While media channels and marketing approaches continue to evolve, the mission for CMOs remains the same; to build brands and fuel growth. The industry has historically been highly fragmented. Enthusiast Gaming was no different with several businesses operating completely independently and insufficient communication or coordination. Our strategy of breaking down silos and creating comprehensive brand solutions, at scale, operating on a single tech stack to ensure brand safety, and providing real time feedback, is exactly what these mega brands are looking for.

Our reorganization efforts at Enthusiast Gaming reflect these opportunities.

- To double down on brand solutions, previously, called direct sales.
- To create high quality environments that excite and delight the enthusiasts who come to our gaming site to play, learn, create, and connect, and
- To work with leading creators to develop exciting content tent poles and live experiences that delight their communities and attract leading brands.

Even in these early days, this reorganization is driving improvements. Our aggregate monthly average users (MAUs) across our network of gaming sites has increased to nearly \$56 million, the largest scaled audience in aggregate of any U.S. gaming property - bigger than the likes of Twitch, Roblox and Activision Blizzard.

Our continued focus is to strengthen our operating model and refine our go-to-market positioning. We are building a solid foundation of robust martech technology and first party data to ensure that yield optimization is embedded into everything we do. Our enterprise technology platform is now centrally managed across the entire organization by Shinggo Lu and Alan Liang, recently promoted to Chief Product Officer and Chief Technology Officer, respectively. This extremely talented team of gaming leaders has now extended their highly successful U.GG product, become a platform that offers similar player statistics and gaming information for World of Warcraft and Valorant. At the same time, U.GG has just released its first stand-alone desktop app and downloads have exceeded expectations on our target to reach 500,000 by the year-end with no paid marketing support. This “product-to-platform” initiative is now being implemented across The Sims Resource, Icy Veins, and select casual games and community sites within Addicting Games.

We all know that delivering ad tech excellence is a prerequisite for building a profitable media business in today's programmatic media mind world. So too is offering the market exciting integrated solutions that enable brands to collaborate with leading creators to develop the gaming content and experiences they're seeking to differentiate from their competitors.

Our content division has delivered such creative projects on behalf of major brands such as NFL, XBOX, State Farm, and Mondelez among others. To highlight our commitment to creative excellence, we have now rebranded our content division “Final Boss Studios”, led by our gaming-obsessed Executive Creative Director, Roarke Boes. He and his talented team are busy developing the content tent pole roadmap to build on our continuing success of the NFL Tuesday Night Game. We are now in active negotiations with two other major U.S. sports leagues to create unique content platforms involving their top players competing against the most influential creators.

We have just sold our largest brand deal ever for major sponsorship of the NFL Tuesday Night Gaming for Season 2, and our pipeline is full of significant blue-chip brands, including a number of returning sponsors renewing and expanding their commitments from Season 1. This achievement, coupled with the increased contribution of brand solutions as a percent of our consolidated revenue, further demonstrates the progress we are making. We are rapidly moving beyond selling ads, only selling ads, and instead selling integrated solutions. This is especially important considering the continued industry headwinds in the programmatic ad business.

We have signed several of the biggest streamers in the world as Team Captains for Season 2, the identity of which will be announced shortly with the launch of a new season. Season 2 of NFL Tuesday Night Gaming will now be streamed on Twitch, the biggest live streaming platform for games, by more than 12 times over YouTube and Facebook combined in total hours streamed and more than three times bigger in hours watched.

As we analyze our sales pipeline, we're excited to see 78% recurring revenue for 2023, as well as an impressive asset-mix diversification, with over 80% of our Brand Solutions utilizing more than two of our assets, and over 50% utilizing more than three.

The breadth of Enthusiast's diversified portfolio across the gaming ecosystem allows us to productize our innovative brand solutions, offering marketers the opportunity to do so much more than only push display or video ads. Media placements, usually accompany our large sponsorship deals and creative properties, such as the Fortnite map we've just produced for Shell, in conjunction with Team Unite and WPPs Essence agency.

To drive Enthusiast Gaming's transformation from being a loosely-affiliated portfolio of sites for operating as a centrally-managed Company with a diversified network of gaming assets, and continue to upgrade our management team and recruit proven industry experts to help accelerate our growth momentum and operational excellence.

We recently hired a sales analyst, a product & pricing specialist, a data analytics expert, and a product marketing genius to ensure that our sellers are knowledgeable about every single product we are developing across our network. To ensure that our programmatic media offering is securing the highest CPMs possible, we're now in the process of finalizing the hiring of a senior ad tech engineer to strengthen all SSP, DSP and ad server integrations. There can be no room for error as we fight to optimize the yield of our precious media inventory.

At the same time, as we shared on our last earnings call, we are determined to drive more growth from our highly profitable subscriptions revenue. To unlock this subscriber growth and strengthen our gaming communities overall, we have hired a leading consultant from Microsoft to drive this important initiative.

Our newly created Strategic Partnership division led by EVP, Matt Goodman, continues to develop exciting and unique properties such as NFL Tuesday Night Gaming, while increasing our dialogue and ideation with leading players across sports, music, fashion, and retail. Many of the world's biggest brands are seeking meaningful engagement in the gaming sector, beyond running pre-roll video ads or simply sponsoring a creator. Long-term partnerships involve thoughtful strategic planning and clear performance indicators to evaluate ROI for both brand building and lead generation. We could not be more excited with the momentum in this critical area of our business.

We've improved our pipeline visibility and revenue forecasting, enabling us to invest more wisely and more precisely guide the Company towards profitability for the first time in its history. The pipeline for quarter three, and especially for quarter four, is robust with 55 potential new logos in the second half pipe, representing 45% of the overall pipeline. Our client continues to be well diversified across industry verticals, with CPG being at the top at 20%. Entertainment continues to be a strong for us, signifying that Enthusiast Gaming remains a key destination despite this industry's vertical head winds.

We've just signed a large deal with Dove, representing our first win with Unilever, as we continue to secure new brand assignments from Coke, Mondelez, Google, and AT&T.

I see massive untapped opportunity in other key industry verticals that are poised for growth, such as travel, food & beverage, and retail. Under the expert leadership of Amanda Rubin, EVP, Brand Solutions, we have reorganized our overall sales efforts by industry vertical and agency holding company, as well as the independent agency sector.

We expect to convert our strong second half pipeline of existing and new logos, while cementing these clients' convictions that the gaming media sector represents the most innovative and efficient way for brands to reach their future customers, while extending their brand vitality in the most dynamic and culturally connected entertainment sector that exists today.

I will now hand over to Alex McDonald, our CFO, to discuss the details of our quarter two earnings.

Thank you, Alex?

Speaker: Alex Macdonald

Thank you, Nick, and thank you to all our shareholders, analysts, lending partners, and other stakeholders for joining us today to discuss the progress we made in this second quarter of 2023.

During the second quarter, we advanced the initiatives Nick has been speaking about since becoming our Chief Enthusiast Officer. We are focusing on profitable revenue streams and margin expansion as well as creating comprehensive brand solutions and leveraging our diverse assets as a platform. As the digital ad market begins to normalize, the second quarter results are beginning to reflect the work we are putting in place to ensure a swift transition to profitability. I'll speak on the numbers shortly, but first, here are my usual notes.

I note that our results are presented in Canadian dollars. The significant majority of our revenues and expenses are measured in U.S. dollars and are translated into Canadian dollars for presentation in our financial statements. The exchange rate between the U.S. dollar and our presentation currency of the Canadian dollar should be monitored and considered when analyzing or forecasting results.

I note that our business is affected by seasonal trends in digital advertising with sequential increases each quarter throughout the year, driven by increasing ad prices and demand, which peaks in Q4. This seasonality is isolated to our media and content revenue streams.

Now, let's get back to the financial results. Q2 revenue was \$42.6 million, which is down 17% year-over-year, but roughly flat versus Q1. Q2 revenue by source was as follow:

- media and content \$36.9 million,
- subscription \$4 million, and
- esports and entertainment \$1.7 million.

The Q2 media and content revenue of \$36.9 million compares to \$45.4 million reported in Q2 2022, a decrease of 19%. The decrease was primarily driven by a decrease in RPM caused by lower CPMs in the programmatic markets.

Our web RPMs were down 28% while our video RPMs were down 13% in Q2 year-over-year. These year-over-year RPM declines improved in Q2 compared to Q1 and we expect them to continue to narrow with further improvements being noticeable subsequent to June 30.

Q2 media and content revenue was also impacted by lower video views year-over-year with 5.7 billion video views being measured in Q2 2023, as compared to 7.1 billion video views in Q2 2022. The lower video views related to specific low margin channels, which we elected not to renew, as we focused on more profitable revenues and improving our portfolio, as Nick discussed.

Q2 media and content revenue was also impacted by the rescheduling of all NFL TNG episodes originally scheduled for Q2 to later in the NFL TNG Season 2. This was done to better service our customers objectives. This had an impact on brand solutions revenue for Q2, however, these episodes will now air in season with the related revenue being recognized in those periods.

Q2 subscription revenue remained at an all-time high of \$4 million, up 14% from approximately \$3.5 million in Q2 last year. This increase was largely driven by an increase in paid subscribers, which were 272,000 as of June 30, 2023, as compared to 258,000 as of June 30, 2022. The yield on a per subscriber basis was also slightly higher year-over-year.

Q2 esports and entertainment revenue was \$1.7 million, down 23% from \$2.2 million in Q2 of last year. The decrease in esports and entertainment revenue is mainly attributable to decreased esports sponsorship activities, which was offset by an increase in event revenue.

Gross profit was \$15 million in Q2, which was similar to the \$15.3 million of gross profit reported in Q2 2022.

However, gross margin increased 520 basis points to 35.2% from 30%. This gross margin increase reflects the greater contribution of brand solutions and subscription revenue to our overall revenue profile, as well as the elimination of certain unprofitable products and channels, as well as the year-over-year decline in market driven CPMs. In other words, our strategy to reduce our reliance on network programmatic revenue and focus on profitable revenue is driving improvements in our margin profile.

Total operating expenses were \$24.6 million, down 15.6% from the second quarter last year, and down modestly from the \$25.2 million we expensed in Q1. Operating expenses in Q2 include non-cash items of amortization and depreciation of \$2.9 million and share-based compensation of \$1.8 million.

Notably, operating expenses also include approximately \$1 million of expenses relating to restructuring, which are included in salaries and wages and will be non-recurring. The decrease in cash-based Opex year-over-year was primarily due to decreases in esports player team and game expenses of \$900,000 and decreases in office and general expenses, which decreased by \$800,000.

In addition, Q2 of last year included \$2.2 million related to the annual general meeting legal and advisory costs with such costs being nominal this year. We expect somewhat higher operating expenses in the third and fourth quarters, as the NFL TNG Season 2 kicks off in mid Q3, with the related revenues also coming back online.

Net loss narrowed 40% to \$10.2 million in Q2, down from \$16.9 million in Q2 2022, resulting in a net loss per share, both basic and diluted, of \$0.7 in Q2 down from \$0.12 in Q2 2022.

Turning to the balance sheet.

The Company ended the quarter with \$2.7 million in cash and in addition had an available operating line of \$5 million, for total available cash of \$7.7 million as of June 30, 2023. The change in cash during the quarter was largely due to \$1.4 million in cash generated by operating activities offset by \$1.3 million used in financing activities, mostly relating to repayments on the Company's term facility and \$800,000 used in investing activities, which is attributable to an earn out payment relating to the acquisition of Fantasy Football Scout in April, 2022.

Subsequent to the quarter end, we are in advance discussions with our lender to document an amendment to our credit facilities to provide additional liquidities through our operating line. Given the improving trends we are seeing in our business and industry, along with the benefit of the amendment to our operating line, we are confident we have sufficient liquidity to execute our near-term objectives. We continue to believe we will exit 2023 and enter 2024 as a profitable business.

Now, I wish to speak about the primary drivers for the rest of the year. The best way to do that is to use this second quarter as a baseline. Q2 this year, was relatively flat compared to Q1, with some modest margin compression. But there are some significant differences that need to be considered when analyzing this, and these same items will be the primary drivers of revenue, gross margin, and gross profit lift for the rest of the year.

- Number one is of course seasonality, which is expected to significantly impact both CPMs and brand solutions. While CPMs remained challenged in Q2 and are still down year-over-year, we do expect a significant lift in the second half, similar to what we have all heard from the earnings commentary of other large digital publishers over the last few weeks. As ad spending increases in the second half, we also expect a positive impact on brand solutions.
- Second, is NFL TNG. NFL TNG had no episodes in Q2 as it is currently in the off season. NFL TNG has a material impact on brand solutions revenue and will return in September.

- Third, is events. The Company does not have any major events in Q2, like the Pocket Gamer Connects London event, which was held in Q1. Our large events will return in Q3, with Pocket Gamer Connects Helsinki scheduled for September. These events are accretive to gross margins.
- These items combined with our product initiatives, including U.GG's, expansions into Valance and World of Warcraft, Icy Veins quickly becoming the primary destination for fans of the newly launched blockbuster title the Diablo 4, and TSR undergoing a complete subscription upgrade, drive increased Management confidence about the second half. While our product offerings continue to entertain our communities of gaming fans, our brand solutions continue to help brands reach our coveted audiences and the stats about our repeat business speak for themselves.
- In this second quarter, repeat business accounted for 62% of total direct sold deals and 66% of total brand solutions revenue. This means that a customer of Enthusiast Gaming is likely to come back, and when they do, they're likely to spend more. Therefore, it should be no surprise that we continue to set records with the single largest direct sold deal in Company history being sold subsequent to the second quarter.

For all these reasons, we believe we have a clear sight line to a successful and profitable second half, particularly in Q4. I wish to thank my team for their work on the quarter and I also wish to congratulate Nick on his first full quarter as our Chief Enthusiast Officer. We've been very hard at work and are glad to bring this quarter to market and are looking forward to getting back to our business.

Of course, ladies and gentlemen, our business is the business of gaming.

Thank you. Operator, I kindly turn it back to you.