Unity Software Inc. NYSE:U

FQ2 2021 Earnings Call Transcripts

Tuesday, August 10, 2021 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2021-			-FQ3 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.12)	(0.02)	NM	(0.09)	(0.34)	(0.17)
Revenue (mm)	242.75	273.56	▲12.69	254.10	1013.33	1286.11

Currency: USD
Consensus as of Aug-05-2021 9:04 PM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations

- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2020	(0.15)	(0.09)	NM
FQ4 2020	(0.15)	(0.10)	NM
FQ1 2021	(0.12)	(0.10)	NM
FQ2 2021	(0.12)	(0.02)	NM

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Call Participants

EXECUTIVES

John S. Riccitiello
CEO, President & Executive Chairman

Luis Felipe Visoso
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Richard Hugh Davis
Vice President Investor Relations & Strategy

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Presentation

Richard Hugh Davis
Vice President Investor Relations & Strategy

[Audio Gap]

and Luis Visoso, Senior Vice President and Chief Financial Officer. So as we did last quarter, we will open with introductory remarks by John and Luis, and then we have collected and sorted questions from our analysts and investors. And the goal here, as you know, is to really help investors understand our business model and outlook in the most efficient way possible. And finally, time permitting, we'll have the last 10 minutes or so for panelists to ask additional questions.

So on to the always popular safe harbor statement. I'd like to remind participants that during this conference call, we will be making forward-looking statements, including our financial outlook for the third quarter and full year of fiscal '21, as well as statements about goals, business outlooks, 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. We remind everyone that our actual results may differ, and we take no -- undertake no obligation to revise or update any forward-looking statements.

We will also be discussing non-GAAP financial measures today, and reconciliations between our GAAP and non-GAAP financial results and a discussion of the limitations to our non-GAAP financial measures can be found in our earnings press release, which was issued earlier today and is available on our Investor Relations website.

And then finally, we will continue our investor conference schedule for the balance of the year. Tomorrow, we will present at Oppenheimer's Virtual Conference, and we will also present and attend dinners at Piper Sandler's Conference on September 14 in San Francisco and Boston. And then in December, we will present at Credit Suisse and Barclays.

Now with that, let me turn it over to John for some introductory remarks.

John S. Riccitiello
CEO, President & Executive Chairman

It's a pleasure to have you on this call with us today. Unity reported a 48% year-over-year increase in revenue to $274 million for the quarter. This quarter was the first in Unity's history as we crossed a $1 billion revenue run rate.

We also raised our revenue guidance for the year by another $45 million to a range between $1.045 billion and $1.060 billion. We generated strong growth across all our product lines and geographies with important growth in both Operate and Create. Within Operate, both monetization and Multiplay services posted strong growth. And within Create, we saw strong growth both in games and nongame verticals.

As I've said before, we believe in the emergence of the metaverse and that Unity will be a major player in defining and help lead its creation and operation. We believe the adoption of real-time 3D will change the way people interact with digital content and entertainment. Just as digital replaced analog, HD replaced standard definition, in the coming year, 5G will place 3G or 4G, and real-time 3D will replace linear and flat 2D digital content. We expect more of the world's content to be 3D, real-time and interactive. We believe this cycle will create an addressable market that presents us with decades of opportunity at Unity.

Now for me, the word metaverse is plural. When I say this, I'm trying to make an important point. We don't think that one company will represent the metaverse as, say, for example, it was imagined in Ready Player One. We believe there's going to be hundreds of thousands of destinations in the metaverse. Games like Roblox; creation destinations from companies like NVIDIA, Unity and Adobe; social communication destinations from companies like Snap, Facebook and some new companies. At Unity, we believe in

interoperability and in an open Internet, even as the Internet becomes more 3D, more real-time, more interactive and more like the metaverse we imagine.

Unity's mission and world view centers on a belief that the world is a better place with more creators. At Unity, we intend to support and shape the metaverse. We will emphasize content creation, cross-platform access and narrowing the distance and reducing the friction between creators and consumers.

Now let's drill down on the quarter. In gaming, on the Create side, we enjoyed a share exceeding 50% overall of the year ending 2020. And as you know, our market share is even higher in the fastest-growing subsegments of mobile gaming in VR/AR. Each month, people in more than 190 countries around the world download over 5 billion applications built with Unity. We're growing faster than the industries in which we compete, and we're gaining share on our key markets.

We sometimes get the question that if more than 50% of all games are built using Unity, isn't our growth prospect limited? Well, no. We believe we can 5x our penetration in games. Growing our penetration with artists is key to this effort.

Let me pause and explain. When I worked in gaming, the ratio of artists to technical personnel and game teams was about 1:1. Today, artists outnumber technologists at least 2:1, and it's quickly heading to 5:1 or more. As gaming devices become more powerful, more powerful GPUs, more memory, 5G networks, developers compete by making bigger, richer, more art-filled games. The war among developers and publisher to win with consumers is over the best content. And in this war, the ammunition is art.

This quarter, we won new customers in nongaming industries. We added 3 new automotive manufacturers and 3 leading consumer product companies. In this quarter, we also offered -- added 3 leading aerospace and defense manufacturers. Looking at this from a geo basis, we had some nice wins in Asia, one in Singapore and another in Korea.

As we look forward to the future with Create, our view is that the creative process was -- will evolve from on-premise devices to flexible and cost-effective cloud architectures. There are 3 major trends driving this change. The workplace is becoming more flexible. Teams are getting larger. Creators bring a myriad of new devices to the creation process, including tablets, Chromebooks and even smartphones. This is why we're investing in collaboration and moving more of our capabilities to the cloud.

Now let's turn our sight to the Operate business. If I had to distill the business challenge most game developers face every day, it's one equation: it would be how to ensure that the cost of the user -- the cost of user acquisition is less than his or her lifetime value to the game. That's cost to acquire has got to be below LTV. This is not an easy equation to master. Our operations solutions help developers solve this vision. We offer an end-to-end platform for content creators to deliver the best player experience and build robust and profitable businesses. We provide a growing suite of services that content creators can use to acquire new users, optimize user engagement and LTV by our monetization platform.

Additionally, our Multiplay services continue to reliably support some of the most notable cross-platform game launches, including Knockout City and [indiscernible]. What is most important in our Operate Solutions are the connections between these components. Foundational elements such as privacy controls, identity, payments, billing, security are embedded in our offerings to make sure that each of these products work seamlessly with each other.

Another critical part of this integrated system has been our ability to leverage contacts and data insights effectively through ML-driven optimization from a reach of 3.4 billion monthly active users as of June '21 and can deliver the best ROI for our customers. This, combined with the tight linkage to our Create platform, have enabled us to gain share across these important markets.

At Unity, we have durable -- we have a durable business designed to deliver many years of exceptional growth. We enjoy fundamental advantages on our scale in gaming, our ease of use and our extensibility for nongame verticals, a massive scale of our data footprint and the linkage between our Create and Operate platforms. These advantages have led to 11 consecutive quarters of greater than 30% growth and as of late, growth exceeding 40%.

We're proud of our performance this year and the years prior, and I want to thank all of our customers who are helping us get where we are today. We look forward to our journey together. And I very much want to thank Unity's 4,600-plus employees. It's an honor to work with such a dedicated, talented and amazing team.

And speaking of teams, today, we're taking great pleasure in announcing the addition to Unity, Keisha Smith-Jeremie as a new Board member. Keisha brings decades of experience in human resources and talent management to our Board. She is the Chief People Officer of Tory Burch, the iconic American lifestyle brand; and previously served as a Chief Human Resource at News -- Human Resource Officer at News Corp.; and the Global Co-Head of Talent Management at Morgan Stanley. She will serve on our Compensation Committee. Having Keisha on our Board is a reflection of our understanding that Unity's innovative, hard-working, problem-solving people are, in fact, our most important competitive advantage. Keisha, welcome to team Unity.

Now let me turn the call over to Luis who will briefly run through our financial results.

Luis Felipe Visoso
Senior VP & CFO

Thank you, John. We delivered another strong quarter with excellent execution by the Unity team, beating both guidance and Street expectations. The strong momentum and health of our business is enabling us to raise revenue guidance for the full year by another $45 million. Q2 '21 revenue of $274 million increased by 48% year-over-year.

While we saw a strong performance across the board, I want to especially call out the outstanding work from the Operate team. As I mentioned last quarter, we were well prepared for the Apple's privacy changes. And as a result of excellence in execution, we built market share this quarter. We're proud to help customers thrive during the uncertainties of our platform change. Our advanced analytics, context and insights are proving to be a competitive advantage.

Create also had a strong quarter with revenue of $72 million, up 31% year-over-year. Operate revenue of $183 million was up 63% year-on-year. And Strategic Partnerships revenue of $18 million was up 9% year-over-year.

We continue to add new customers during the quarter, with 888 customers each generating more than $100,000 of revenue in the trailing 12 months as of June 30, 2021, up from 716 a year earlier. And our dollar-based net expansion rate as of June 30, 2021, was 142%, equal to last year.

Unity's customer base is becoming more diverse as we expand from games into other verticals at a fast pace. We expect to continue to see good progress in bringing real-time 3D to new industries.

Non-GAAP gross margin of 81% was up 300 basis points on a sequential basis and on a year-on-year basis as we operate more efficiently and benefit from product mix. We remain confident that we can sustain gross margins above 70% for the long term.

Q2 2021 non-GAAP operating loss was $3.2 million compared to $8.7 million last year as we benefited from strong revenue growth. We will continue to invest in our business with emphasis on R&D as we have many attractive opportunities to go after.

We generated Q2 '21 free cash flow margin of minus 12% compared to minus 43% in Q1. This quarter includes a onetime cash outlay for the termination of a lease agreement for previously planned occupancy of new office space.

We had 4,613 employees at the end of the quarter, up from 3,379 a year ago.

This brings me to guidance. Given the strong business momentum, we are again raising revenue guidance for the full year from a range of $1 billion to $1.015 billion to a range of $1.045 billion to $1.060 billion, which represents 35% to 37% revenue growth year-on-year. This is a $45 million increase from prior guidance.

With the offset in revenue, we are also increasing our non-GAAP income as we are reducing our fiscal year loss guidance from a range of $90 million to $100 million to a range of $55 million to $65 million. We will continue to invest in driving the business with a focus on long-term value creation.

For Q3, we expect revenue of $260 million to $265 million, which represents 29% to 32% revenue growth year-over-year. This year's Q3 compares against the 2020 quarter during which shelter-in-place orders boosted engagement more than in prior years.

For Q3, we expect non-GAAP operating loss for the quarter to be between $15 million and $20 million. We remain committed to reaching non-GAAP profitability in 2023, while we continue to invest to extend our technological lead and reach more customers.

In terms of share count, we are forecasting 327 million fully diluted shares outstanding for the quarter and 328 million for the full year.

With that, I want to welcome Pixyz and SpeedTree to Unity. We closed the acquisition of Metaverse Technologies, providers of Pixyz, a 3D data preparation and optimization software, in Q2. The acquisition means professional creators can more easily and quickly import 3D data into Unity and optimize models for real-time development. And we closed the acquisition of Interactive Data Visualization, Inc., the popular SpeedTree environment creation suite, in July. The acquisition enables a deeper integration of SpeedTree into the Unity ecosystem, enhancing artists authoring workflows and environment creation capabilities. This is another great step to enable artists with Unity.

In summary, we're very pleased with our performance and prospects. We're building a sustainable business with massive scale opportunities. The strong first half gives us confidence to raise our guidance for the year and make us optimistic about 2022.

With that, let me turn it back to John who will announce another addition to the Unity family to enable creators, which is now pending customary closing conditions that we expect to close in Q3. This acquisition will not have a material impact to our fiscal year results.

John?

John S. Riccitiello
CEO, President & Executive Chairman

Thanks, Luis. I'm excited to announce that we have reached a definitive agreement with the intent to acquire Parsec. I'll fill you on what Parsec does in just a minute, but an important reason we're optimistic and confident about the combination with Parsec is that it had become truly viral inside of our development organization. And when we looked at some of our largest customers that saw the same rapid adoption curve with Parsec, we knew we had found something special.

Now for those of you who are not familiar with Parsec, they are a remote desktop and streaming company that allows individuals and companies to work together from anywhere. What Parsec has done is deeply innovative because they have built a platform that can support the rigorous requirements of creative professional applications. As you likely can imagine, the work of game development and creative professionals is incredibly complex. It's high fidelity, it's immersive, rich in detail, it's interactive. And it's only going to get more complex as creators shift more and more to real-time 3D. Creators need low-latency, ultra-high-definition desktop streaming, and Parsec delivers this in spades, delivering very little lightning sleeve streaming at 4K 60 frame per second.

But they also need more. Parsec provides rich detail with the same sampling rate for all images like 4:4:4 color space and the privacy security, quality of life management tools needed for companies to support fleets of computer resources for all of their creators. And with companies and their employees collaborating and working in fundamentally different ways, whether it's hybrid, remote or distributed work environments, Parsec has addressed the unique requirements to support this top of high-performance processing no matter where they are.

So Parsec and their founders and leaders, Benjy Boxer and Chris Dickson, have been both highly innovative impression with their technology.

Parsec also focuses on simplicity and access. You can get started with a full professional-grade creative class remote desktop link with just a push of a button. And as individuals and companies use Parsec, they can drive a sort of incremental virality and further adoption with coworkers, peers and partners.

As a result of their unique capabilities and the shift in new ways of working, Parsec's for Teams subscription business is growing over 150% year-over-year with aggressive plan to accelerate even further next year. Subscription growth was driven by strong net dollar expansion rate of nearly 200%. They have a loyal customer base.

Even before we entered into this agreement with Parsec, as I've mentioned, our own internal developers were adopting Parsec but were hardly alone. Parsec has a strong relationship with gaming companies like EA, Ubisoft, Square Enix and many of the industry verticals where we sell solutions, including media and entertainment, architecture, design and more.

We see an opportunity to drive shared momentum with these customers through targeted cross-selling and bundled solutions.

Parsec is a key step towards Unity's expanded cloud vision. Based on our shared understanding that creators expect to be able to work from anywhere on any device and will acquire rich and powerful tools and cloud infrastructure to deliver real-time 3D experiences in the future.

When we think about the future through the lens of Create, our view is that creative process will evolve from on-premise devices to flexible and cross cost-effective cloud architectures. This is why we're investing in collaboration and moving more of our capabilities to the cloud. We'll share more details after we close the transaction.
And with that, I'll turn the call over to Richard who will run us through our questions.

Question and Answer

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Thanks very much. So we'll move on to the Q&A section. And so as we did land in the last call, we collected and sorted questions from analysts, and this allows us to get through almost twice as many questions as you get on a normal telephone call-up. Then at the end, we're going to open it up for open questions and stuff that you guys might have for us as well. So as we approach the open-question section, just raise your hand on the virtual system, and then we'll call on you guys.

So first question, we'll start with financials. So this call is about earnings, so let's do some financials to start with. So we've remained, as you've just heard, active on the M&A front during the quarter, and Mario Lu at Barclays honed in on this with a couple of good questions. Specifically, do you see potential for further M&A to drive growth? We've just announced some. Any updates on recent acquisitions with regard to RestAR and Artomatix? And then also, he asked about Pixyz, the software partnership with NVIDIA and Microsoft. Is there a possibility to expand there?

And then finally, Brent Bracelin at Piper asked with regard to kind of how we're doing on Pixyz as well. So how are we doing cross-sell and things like that. So Luis, if you want to roll with the M&A questions, that'd be great.

Luis Felipe Visoso
Senior VP & CFO

Yes. Thank you, Richard, and thanks for the question, Mario Lu and Brent. We believe that M&A will continue to play a role in our future. We use a disciplined approach to evaluate opportunities through what I would say, 3 lenses. First, does the acquisition significantly accelerate our capabilities and our key strategic focus areas to strengthen our position in the market? Second, can we generate an attractive return on our investment? And third, can we execute with excellence?

We track the performance of our acquisitions. In fact, we completed the last update about a month ago. Overall, our acquisitions are, in aggregate, performing in line with expectations we set when we sign the deals. And we believe that many of these acquisitions have potential to accelerate our growth even further. As you would expect, there are some opportunities where we can do better, and we have plans to do so.

On the point on Pixyz, Pixyz has been part of our offering for many years. And as I mentioned in my prepared remarks, Pixyz enables professional creators to more easily and quickly import 3D data into Unity and optimize models for real-time development. Said differently, Pixyz offers best-in-class tools to digest and optimize 3D data for real life. This is a great capability that enables creators both in games and other verticals with strong customers across several industries. And to your point, we look forward to strengthening our partnership with Microsoft and NVIDIA.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. And then another question for Luis. Gal Munda at Berenberg has a good question. It says, "Now that you've been in the job for more than a quarter, what are some of the early observations of the low-hanging fruit that you've seen and that you can focus on in the near term, either from a purely financial or strategic perspective?"

Luis Felipe Visoso
Senior VP & CFO

Yes. Thank you, Gal. It seemed like I've been here for a little bit longer than that, but it's been a lot of fun. I'm very happy to be at Unity. As I've said before, I believe that this is what I would call a once-in-a-lifetime opportunity. The team is outstanding with technical depth mastery, deep business expertise. The culture is really unique and fantastic, and the passion for winning is as high as I have ever seen.

Success for Unity is to enable more creators as the metaverse evolves. And as a result, we believe that we can sustain revenue growth at or above 30% per year for the long term. And we will do so while creating leverage to improve our operating margins and free cash flow over time. This requires us to operate with clear strategies and discipline and allocate resources to those ideas and projects that can generate businesses at scale.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. So now we're on the monetization. And as usual, we have several questions on IDFA. So we're going to hand these over to John. So we have a handful of questions. So we'll start with Stephen Ju over Credit Suisse asked the following: what is Unity's relative advantage and making sure that publishers are well and/or better compensated over time versus other networks?

John S. Riccitiello
CEO, President & Executive Chairman

So thanks, Stephen. Look, we started a monetization business 7 years ago with the thesis that the whole legacy buy low, sell high model and advertising at best delivered short-term success was reality -- in reality kind of a broken business model. Our monetization is -- program is based on a deep, deep understanding of user-level LTV and engagement, and we succeed when we deliver superior ROI for customers. This means it's really about data.

We leveraged 3 billion. You heard me announce earlier, it was 3.4 billion at the end of last quarter. 3 billion MAUs producing petabytes of data for Unity's SDKs and integration with our engine. And we apply advanced analytics and machine learning algorithms to create and manage a true ROI on behalf of our customers. So what we're optimizing for is engagement in LTV, not spread. It's a really different business.

Now there's more going on out there. It's complicated and really intermediate lately. It seems like the world may be moving into more of a closed and silent platform based on first-party data. Here, we have advantage. We've got our own proprietary data. But I believe creators want options, so they can choose the tools, services and monetization partners that are best for them.

It's important to note that our monetization tools are open. We have over 50 partners at our unified option, and we have the goal of maximizing revenue for publishers. That's our North Star. And at Unity, we believe more choices are better than less, better than fewer. And ultimately, if we optimize for the success of our creators, our publishers will be rewarded with their business growth. We saw that this last quarter and the last several years. Our near- and long-term results have improved, but it's true so far, and we continue down that path.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. All right. Another question, John. This one comes from Matt Cost over at Morgan Stanley, who asked about industry-wide trends and ad spending. Because if you listen to different conversations and press releases and things, some people say it was pulled forward, while other people say that it was reduced because of difficulty over attribution. So what's going on there? It seems like there's a lot of cross cards.

John S. Riccitiello
CEO, President & Executive Chairman

Well, we're definitely hearing some confusing stories from individual publishers. Each has their own truth, and I'm sure they're living their own truth. Look, if there's anything that's constant in gaming or constant in monetization, it's change. Sometimes the changes are small, sometimes they're big, but they happen every quarter, every year.

What I would say really on this is, longer term, investment in advertising can't go a different direction than revenue in the industry. Attrition is a reality in the video game world, and people need to invest in user acquisition in order to continue to have successful thriving game businesses. And of all the things I'm

Sidebar

confident of is that gaming is going to continue to be a successful thriving businesses for companies based in North America, Europe and Asia.

Now our view is advertisers, publishers are going to continue to spend as long as they're getting quality payers at a positive ROI. That's what we do. In fact, we've got tools like Audience Pinpointer that allows advertisers to find what ROAS they'd like to target or based on retention or [IIP] or ad revenues, so they can get a guaranteed return regardless of what's happening or changes in attribution. That's what we're delivering. Our results reflect continued increase in ad spending on the Unity network, something we've been consistent with.

But again, I don't think there can be maybe a quarter or 2 at a time, but there can't be material divergence between user acquisition spend and industry growth. They go hand in hand.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. And then one last question on monetization. So Bhavan Suri at William Blair asks, how big of a factor is conversion postbacks now that advertising level with the iOS 15 update this fall? And to what extent does that impact companies like Facebook? It seems to have a big impact on them. But how does that play out for firms like Unity?

John S. Riccitiello
CEO, President & Executive Chairman

Well, look, I wouldn't want to get the figures to try to step into the Facebook executive team's view as to what -- how this affects them. But it's a good question, I'll give you my point of view. We've always been a open attribution ecosystem and supported all attribution providers from day 1 in monetization. For Unity, adding another provider a protocol is a normal course of business. And when it comes to SKAd, postbacks or other systems, we're there and ready to implement. And we're pleased to see a more level playing field and the move-away of self-attributing networks.

We believe content creators and advertisers should have choices on what services they use, and that includes having an open ecosystem of attribution providers rather than a single standard attribution authority. But that's consistent with who we are. We believe in open systems, competition, choice. And no surprise we worry about here, too.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Okay. We'll now move on to kind of some macro discussions and kind of return to normalcy. So we got similar questions or at least thematically from Ophir Gottlieb and -- from Capital Markets Laboratories and Bhavan over at William Blair. And it was basically, the comment was, can you talk about overall engagement trends that you see? Some people have concern -- expressed concerns about how reopening might impact gaming. Other anecdotal people say the shift is sustainable. Maybe you could just give some color on what you're seeing and what you expect over the next few quarters. And maybe, Luis, if you could run with that one.

Luis Felipe Visoso
Senior VP & CFO

Sure. Thank you, Ophir and Bhavan, for the question. We're actually very pleased with the engagement metrics that we see. Globally, we're seeing more unique active users than ever before. And if I look back and look at 2020, the pandemic spike started to decline a little bit in the fall of 2020, but then quickly ramp back up over the wintertime and led to 2021 having all-time high unique user count globally. And what we're seeing year-to-date, these monthly active users have continued to grow somewhere in the excess of 20% year-on-year. We're seeing particularly growth in APAC, Japan, Korea during 2021. Europe is also doing great. America is a little bit behind but also growing very nicely. So we're seeing good growth across the board.

Richard Hugh Davis

Vice President Investor Relations & Strategy

Great. We have a question on ESG. ESG has become an important topic of late. In fact, William Blair has a section on every report about ESG, and Bhavan Suri asked about kind of what we're doing on the ESG front. So maybe, Luis, if you want to run with that one?

Luis Felipe Visoso
Senior VP & CFO

Sure. We're committed to ESG, to have a positive impact on the communities, employees, creators, customers, the environment, our shareholders. And we have to recognize we're in the early stages of building our ESG program. We're conducting our materiality assessment and aligning with the global reporting initiative and sustainability accounting Board frameworks, so that we can better understand our current position and opportunities to reach our goals.

We have an internal team dedicated to measuring and coordinating our efforts, and we have a full list of programs listed on our Investor page. But let me highlight a few just for this call. So on the environmental side, we're currently conducting our greenhouse gas assessment. We're also supporting Unity customers to become more sustainable and, thus, make the world more sustainable with the power of our technology.

On social impact, we empower employees and creators of all backgrounds to foster a more inclusive sustainable world. In fact, we have donated time, technology and shares now valued at over $75 million to enable positive change in education and economic opportunities, sustainability and health.

On governance, we're committed to an inclusive workplace and governance approach granted in our values of empathy, respect and opportunity.

We know that there is a lot more work to be done, but we continue to be committed on this front, and we'll be sharing more details at a later date.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Well, why don't we move on to Operate beyond monetization. So Ophir Gottlieb at Capital Markets Labs picked up on the theme of social gaming and how that might play out in the broader addressable market. His question is, can you comment on the progress of social games as it relates to Multiplay, Vivox and deltaDNA? And more broadly, how should we think about the opportunity as you involve and extend Multiplay, so that, that becomes a backbone of a broader cloud product offering for both games and industry verticals? John, why don't you take that one?

John S. Riccitiello
CEO, President & Executive Chairman

So first off, just a little sort of backdrop. If you go back on the order of 20 years, you'd see that most PC and console game for single-player games you play it against the machine, and you later play socially on the couch, sports game with the forefront of that. But gaming was largely a solo activity. Has console and PC games got ready for -- have the capability to get into the multiplayer products, that took over. And it's the dominant form of gameplay for most games out there in the world of PC and console.

Mobile has lagged that partly because they're not on broadband networks, and they haven't had the CPG performed with the technology to support it. That's changing. Social games and mobile games are becoming multiplayer. And with that, we see very substantial opportunity for Unity because we're a leading provider of the back-end resources, the operator resources enable multiplayer and multi-user gaming.

These services, as you mentioned, they include Multiplay, Vivox, [ads maker]. And we're seeing healthy growth on this front with more casual games, Knockout City, [Economics], Super Bomberman, and many, many others, and they tend to use hosting, matchmaking voice services.

But there's also a lot of tricky bits to this. One area in particular is networking code. It's a very difficult thing to master for many mobile game developers. Sudden traffic spikes. And they get -- they find themselves to have a hit, and they need 10, 15, 20x the hosting capacity than they planned for.

And then there's management of toxicity. And we see that everywhere in our environment, but it's also true in chat and gaming as those people come together, and so we're building new tools on top of what we have at Multiplay to make it just as easy for 2-person teams to create these types of games to succeed as it is with 100-person studio.

So it's a great question because social and mobile are becoming a much bigger multiplayer experience than they've ever been before. And I think it's an unstoppable trend, and it speaks to opportunity on the Operate side.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. We've got to pivot over to Create for games. So we have another question from Matt Cost over at Morgan Stanley, and he asked, "A large competitor recently took their game engine open source. How is the competitive landscape with other engines changing in gaming? And do you believe the market will continue to consolidate to a small number of players?"

John, you have some obvious good perspective on this one, so maybe if you could play this one out.

John S. Riccitiello
CEO, President & Executive Chairman

Well, yes, Matt, I'll start by saying, what do you mean by large, the company that owned them or both of the games that were using that game metric? So I'm not sure that I'd call that a large competitor, but I appreciate the opportunity for humor. I hope you take it that way.

But open source has been a business model in technology, and it's always going to be around. Godot has been around forever, and that's an open-source engine. The reality is game management is really hard. Scalability, stability requires ongoing investment, commitment to QA.

Another key bit is we're often working with builders of new platforms or existing platforms on hardware innovations that are going to take place next year or the year after and the year after that. We master those now, so that when software creators or game developers show up with a product that's supposed to be optimal for the new hardware, it works on the new hardware.

That's really hard for an open-source player to really get in front of that. We're embedded in these companies, and it's nearly impossible for both on the open-source side to do that. They have a role to play, but I think it's really tough.

And then the competitive context, the landscape in gaming has been tough. We saw KING externalize their engines several years ago. Autodesk used to be a direct competitor. I believe you're referring to Amazon a little while ago with Lumberyard. It's not an easy industry. And we think that our investment goes such that we believe we can continue to gain.

We told you we've got 71 share of the top 1,000 games in mobile. Our next [nearest competitor] are far behind. We have a very strong position in Nintendo on all the consoles, PC, AR/VR, and we keep upping our R&D efforts. So we think we're in a really good position to deal competitively in the market. I believe we're going to see continued market share growth.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. We have a question from Brent Bracelin at Piper Sandler, and he's done some good fundamental work and asks, "Based on new hiring intentions for Unity developers at Apple, Facebook and Walmart to build new AR/VR applications that we've picked up on, could you spend some time articulating the opportunity for Unity within the AR/VR space and the pace of adoption you're seeing?"

John, if you could run with that one.

John S. Riccitiello
CEO, President & Executive Chairman

Yes. I mean look, I'm going to step back and calm a little bit. Several years ago, I gave a presentation on -- called the gap of disappointment, which basically said that analysts were projecting staggering growth in the world of AR and VR, particularly on the consumer side. I don't think that was going to happen that because we didn't really have the right combination of hardware, ease-of-use, content library, killer apps.

I see that starting to change. And you see that starting this change as well. And the confidence that companies like Facebook and others, you mentioned Walmart, all sorts of companies across many of our verticals, are getting really excited about AR/VR because they're starting to see traction on the selling of hardware.

Facebook has announced some great numbers around Quest 2. I know there's been some setbacks at different points in time. But based on what I see coming from hardware players, I think this is about that. I mean not tomorrow. But over the course of the next 3 to 4 years, we're going to see a sizable market in AR/VR. And there's nothing that makes me happier is a sizable market [for AR and VR] where we have a very, very, very strong reputation. So people are hiring. This time it's real. I think the next 3 to 4 years would be really fun to watch.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. We have a question on new entrants and cloud opportunities. Bhavan Suri asks, "Microsoft cloud gaming. Microsoft recently announced the extension of their xCloud offering. Would love to get your thoughts on the cloud gaming opportunity, especially because there's been several attempts in the past with mixed levels of success and what that could mean for Unity with Project Tiny, et cetera."

And in a similar vein, Mario Lu asked, "How do we look at the entry of Netflix into the market?" So maybe I'll run with this one.

So thank you both, Bhavan and Mario, for these 2 good questions. So look, first, at this -- at a high level, we'll start then we'll drill down as of context. First off, we benefit when new forms of connectivities the games emerge. More people come into the market, that means more games need to be built to fulfill the new entertainment needs, and so that's generally good for Unity because we -- they build games, we do better.

So when we see a company like Netflix enter the market, we view that as a good thing. Now double-clicking down on the subscription question, game subscriptions have scaled out slower than we've seen in music and streaming services. So let's think about why that would be the case.

Without going too far into the weeds, we believe there's really technical hurdles that have made it difficult to cost effectively deliver great user experience to consumers that evolve their consumption patterns. So as opposed to right now, what you have is basically delivering the same games to play in the same way. So think about how the way you consume movies and music differently now than the days when you bought a CD at a store and went to the movie. So far, we just have not seen that evolution in game consumption.

But at Unity, we believe we have a lot of the technological tools that solve those challenges. And subsequently, we will give game developers opportunities to change how they -- how games are consumed. And if we do that, we will unlock new business models and consumption patterns for millions of more people.

So for example, our portfolio, as you know, includes UTiny, Furioos, DOTS and several other modules that, among other things, help make streaming game less CPU- and GPU-intensive. So the big answer to the question is basically, the takeaway is that we're broadly optimistic about the rise in gaming subscription services and the ability for Unity to help in that area.

And then Create for verticals, and as always, we saved the best question for last. And that comes from the team of Tom Roderick and Max Osnowitz at Stifel. "You often get asked about when verticals are going to be bigger than gaming. If you have an update on that trend line, this will be great. But maybe a more interesting question is what revenue model will get you there right now because you have Create, which is seat count-based growth subscriptions, but you also have Operate, which is chugging along with a usage-based model like we see from Snowflake, Stripe and others."

John, that's kind of, I think, a good question right up your alley. And that will be our last question before open mic.

John S. Riccitiello
CEO, President & Executive Chairman

Sure. So it's a great question because it really speaks to a lot of what we're working in -- working on internally with several of our initiatives. So you heard me earlier announce several new customer adds, a significant number of major new customers on the vertical side. So we're seeing the uptake. And today, we generate outside gaming, primarily a SaaS business and professional services business. You're right, we sell seat licenses, and we sell onetime applications like Forma and Reflect to our customers. These companies also typically need help getting up and running with their new applications.

And so with companies like Walgreens and Lowe's and The Nature Conservancy and many, many others, we offer professional services. You -- in prior question, we talked about how they're hiring Unity developers in a lot of these companies as they are, but they often need professional services from Unity to augment a more -- a smaller scale team that they have internally to build what it is they want, hence, they engage with us on professional services.

But I do think you hit on a really important thing. When it comes to these verticals, they're not likely to scale in the same way the game companies are with thousands and thousands of developers. And here, you'll see more usage-based models. We already work on a consumption model with Furioos. We -- pretty much all of our Operate services are based on a consumption model. When we price -- and this is early stages around simulation or visual twin parts of our business, we tend to focus on thinking about an individual server as a seat. That makes it a consumption model on the basis of compute applied to the problem.

So I would say that as we continue to evolve and grow and scale, we're going to continue to see strong growth on the vertical side. And we'll see a shift over time from professional services and seat licenses to consumption models. It will be based on a variety of metrics, sometimes how many servers are being used for something, and other will be for streaming. And there'll be a series of users who would think of consumption models being significantly additive to verticals in time.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Okay. Now we'll open it up to direct questions. I mean, I guess, we can start with the Matt Cost at Morgan Stanley, if you want to open up your video, ask a question, then we'll roll to the other folks as well, too.

Matthew Andrew Cost
Morgan Stanley, Research Division

Great. Thanks a lot for the question, guys. So I guess, Operate obviously came in very strong for the quarter. You mentioned share gains that you picked up on that side of the business to do with monetization. I was just curious, what were the drivers in your opinion of those share gains? And what trends did you see over 2Q? And can you give an update kind of quarter-to-date in Q3 on how those trends in the monetization side are going?

John S. Riccitiello
CEO, President & Executive Chairman

So I'm going to reset my speakers, and Luis, you wanted to take that because that came across pretty jumbled for me. So Luis, can you pick that up? And I'll open and close my audio driver and see if that helps.

Luis Felipe Visoso
Senior VP & CFO

Sounds good. Yes, Matt, great question. And we talked about IDFA last quarter. And if you remember what I said back then is that we prepare for IDFA for over 2 years. And I also mentioned that our Operate organization captures and analyzes 50 billion in-app events each day. And that's, whatever, 35 million every single minute. So that's pretty amazing. And we do that across these 20 platforms.

And I mentioned that our spending across our platform was really strong, and I expected some market growth. And really, the reason for that is our contextual models, which actually do not rely on IDFA, were working very well. Our scale and depth provides us access to vast amounts of data, which is really based on end user's engagement and platform performance data. And the feed that we were getting even back then was very strong from our customers.

Now I think some of our customers were saying things like, "Hey, we partner with every single network out there, and Unity's readiness and guidance are far above anybody else." And that allowed us a quarter ago to raise our guidance by about $50 million.

And really, what we continue to see is exactly the same things as we saw last quarter, the same advantages. And as John mentioned, IDFA is clearly having an impact in the industry, but it's impacting different players in different way. Some of them are accelerating. Some of them are decelerating. We are fortunate to be prepared and to have the data and all of this analytics, Audience Pinpointer being 1 at Q1, where we're actually accelerating. And that is, again, allowing us to raise our guidance by this $45 million that we talked earlier.

So it's the same message that we talked, Matt, a quarter ago. We just continue to see it play out. And it's -- we're performing very strongly in this environment.

John S. Riccitiello
CEO, President & Executive Chairman

And just to build on Luis' point, now I better understand the question. Earlier, we got this question about -- on the advertising business, and I connected advertising revenues to the industry, the gaming industry. I really think the best way to think about this, and we have deep experience from what happened in Europe around GDPR, is disruptions affect relative market share. They affect one publisher different than another. We're a proxy on an industry while gaining market share.

So I think, at the aggregate level, it's doubtless in my mind that we're going to see growth in the ads market. Will it affect every publisher the same? No, because the CAC-to-LTV calculation is different, not just for every publisher or for every game within every publisher and often in every major geography for every game and every publisher.

The aggregate is there. The harsh reality is when you change some of the monetization mechanisms that are out there as IDFA did and as GDPR did before, it affects the relative fortunes who's at the top of the stack, who's second, who's third.

I'm happy to say through this, whether it was GDPR or IDFA, we've anticipated well enough to be net winners in those equations. But I do expect to see some shuffling on some other networks or some own networks having more difficulty adapting to these rules. And on a relative basis, different publishers are going to end up with different stories.

Luis Felipe Visoso
Senior VP & CFO

If I can just add, Matt, just to complement. Our unique context and insight are really the competitive advantage for us, developers continuity first when they are making their games, not to other platforms.

Our run time is in the app, in addition to many of other Operate services. So we have the scale, and that's all coming together very nicely.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Tom Roderick, do you want to hop in?

Thomas Michael Roderick
Stifel, Nicolaus & Company, Incorporated, Research Division

Outstanding. Okay. Can you hear me okay?

John S. Riccitiello
CEO, President & Executive Chairman

Hey, Tom, I can hear you perfectly.

Thomas Michael Roderick
Stifel, Nicolaus & Company, Incorporated, Research Division

Wonderful. All right, away we go. So John, Luis and Richard, I think maybe I'll try to put an even finer point on Matt's question because I think it's a great question, and there's all these cross-currents that everybody is trying to figure out. And when I weigh what's clearly a monster quarter that you just put up, really just tremendous trends there, and then sort of measure that against the forward guidance where you're looking at a sequential down number. And so I guess, the question you're going to undoubtedly get with a finer point on it from a lot of people is, should we be nervous about that? Is that a reflection of sequential trends on engagement that are tougher? Is it a reflection of just uncertainty around the advertising ecosystem? Or is it just, "Hey, we just put up a monster quarter, don't kill us. We're going to be a little bit conservative and keep the horse in the barn a little bit."?

John S. Riccitiello
CEO, President & Executive Chairman

So I'm going to waste the 30 seconds of an answer to give Luis time to prepare one, but I can assure you, Tom, we are not nervous. And if we're not nervous, I would not encourage you to be nervous. We feel great about our business. There's nothing about sequential guidance that has us feel any less good about where we are, where we're going in our long-term growth and our short-term growth opportunity.

So with that pre-mumble, Luis might want to speak to seasonality and sequential quarter and how guidance works.

Luis Felipe Visoso
Senior VP & CFO

Yes. I mean if we were nervous, Tom, we would not be raising $45 million again after doing that just a quarter ago. So we're not nervous. We are very bullish in the business.

If you look at 2 years ago and you look at Q3 relative to Q2, you'll see that the real seasonality last year, seasonality was obviously impacted by COVID. So it's a little bit misleading. So we just -- we know that that's how the business operates. Summer and holiday seasons have traditionally been peak months for us, particularly in the Operate business, which is more of a consumption-based model. So that's what's impacting us. But we're very -- we feel very good about the health of the business, as we've said many times in the call.

John S. Riccitiello
CEO, President & Executive Chairman

Yes. So I want to add to this specifically, Tom, the lower months are summer vacation months for a bunch of different reasons. But it's -- we've seen such dramatic growth that it's sometimes hard to parse seasonality from sequential growth.

Thomas Michael Roderick
Stifel, Nicolaus & Company, Incorporated, Research Division

Very fair. Okay. And then a really quick one, Luis, you touched on it. Just on Parsec, there's probably a Millennium Falcon joke to make in there. I'll let Richard make it later. But you mentioned it's not material, which I get, but that materiality has a lot of different levels. Is there any revenue associated with it at all inside of the guidance? If so, can you just kind of give us a sense of that? Or is this strictly a product company that you're bolting on to the vision here?

Luis Felipe Visoso
Senior VP & CFO

Yes. There is very, very little revenue this year, Tom. Nothing material in any way. So no, I wouldn't -- it's that -- if the question is, is that why you were raising your guidance? Absolutely no. It's a great company. We love it. The technology is amazing, as John explained. We think that the future is very -- is great, but the impact to this year is very, very small.

John S. Riccitiello
CEO, President & Executive Chairman

To put a point on it, Luis and I never discussed Parsec while we were working on our guidance. Also, we don't -- we try not to include in the guidance anything that's not closed.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Hey, Brent Bracelin, are you up?

Brent Alan Bracelin
Piper Sandler & Co., Research Division

Two quick ones here. You've got to start with Operate. Obviously, crushing numbers here for 3 consecutive quarters in the face of IDFA. Pretty impressive. I just wanted to ask, given the guide, which is pretty consistent here in the last 3 quarters, over 30%, and actuals are much stronger, but what was linearity, monthly linearity in the quarter? Did you see kind of the operate business start to trend on a year-over-year basis down in month 3? Or was it kind of stronger in month 3? Any sort of color on Operate linearity as we just think about kind of how it performed in the quarter and as IDFA kind of started to be implemented?

Luis Felipe Visoso
Senior VP & CFO

Yes. What I would say, Brent, is while we don't disclose that we are very -- the linearity was good during the quarter. I mean we feel very good about the linearity. And again, if it was not, we would not have raised guidance for the year by as much as we did, right? So we feel good about the health of the business. We looked at it by geo, by business, by month. Any way you look at it, we feel good about it. So not a concern there, Brent.

Brent Alan Bracelin
Piper Sandler & Co., Research Division

Got it. Well, you're clearly gaining share kind of post IDFA. I guess my last question for you, John, on Parsec, as you think about that opportunity, do you think that's going to be like part of the subscription offering and functionality of the base package? Do you plan to kind of operate that as a separate kind of subscription offering? What are your initial thoughts? I'm sure it will change over time. But what are the initial thoughts on packaging and bundling of Parsec?

John S. Riccitiello
CEO, President & Executive Chairman

Well, first off, both. And let me trace back to that question. Remember, Brent, about half hour ago, I mentioned, we said we can 5x our coverage out of the gaming industry, can pick up artist. There's a boatload of artists that are using Parsec now. Weirdly enough, I think, with a lot of customers, they can draw Unity into the seat more than the other way around because they're $30 a month, it's an easy and essential component for a game developer to have a remote system.

The other thing is a lot of developers are [and artists], they need something like Parsec to be able to come in and use their tablet to do any sort of creation, and Parsec provides for that. And so my sense is that it's just one of those Goldilocks deals where we can pull them into customers, they can pull us into customers, and we can bundle and gain penetration with customers that we both share with significant penetration.

And with Benjy and Chris, I met -- I mean, I wish I was half as smart as they are when I was their age. They're just killing it with deep insight and just execution that I stand back and marvel on. I feel really, really good about this one.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Hey, Stephen Ju, are you available?

Stephen D. Ju
Crédit Suisse AG, Research Division

Yes, sir. All right. So I guess, following up on the questions around the advertising business. There's the marketing spend from the video game developers, but there's also the larger opportunity from a broader set of advertisers across more verticals. So can you talk about what you're doing to onboard more of nonendemic nonvideo game advertisers?

John S. Riccitiello
CEO, President & Executive Chairman

Yes. Sure. So first off, we're experimenting at the margins on the supply side for nongame advertisers. Think of us as being supply-side game industry and demand-side anybody but mostly on the game side. And then we've got big partnerships with a number of aggregators that buy into our network, most notably Google, and they bring a lot of brand advertising among other things.

So I frankly expect -- and based on what I see out there, is that we're seeing more and more sophistication on nongame advertising is buying into game industry networks. And so we'll probably see more there. But it's still -- the lion's share of this is still game advertising on both sides of the equation. But again, we're open to both sides.

Does that get to your question, Stephen? You went mute on me. Okay.

Stephen D. Ju
Crédit Suisse AG, Research Division

Sorry. Yes, I'm just thinking about the longer-term opportunity because...

John S. Riccitiello
CEO, President & Executive Chairman

I think the longer term -- let me be really clear. I think the longer term for Unity is a bigger box than we're operating with in monetization. We're experimenting constantly. The -- we have a more data-centric play in advertising that all but a few of the players you learned to love and admire like a Google and a Facebook. There are precious few companies anywhere with our sophistication around advertising and data. And those are skills that we want to apply more broadly and will. But when you're posting 60% quarters, you're focused on the core, and that's what we're doing now outside of our business.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. And then Ophir Gottlieb?

Ophir Gottlieb
Capital Market Laboratories, LLC

Thanks for the format, Richard.

Richard Hugh Davis
Vice President Investor Relations & Strategy

You're welcome.

Ophir Gottlieb
Capital Market Laboratories, LLC

I want to -- I was hoping you guys could talk about DBNER. And I ask because in Q2 and Q3 of last year, the COVID quarters, we saw this -- Unity saw the spike, right, low 140s, mid-140s. And it didn't seem sustainable per se. Here we are in Q2 2021, and it's 142% again. Can you talk a little bit about what's driving that? Maybe an update on Q3 or even longer-term guardrails on that metric?

Luis Felipe Visoso
Senior VP & CFO

Luis or me -- do you want to go, John?

John S. Riccitiello
CEO, President & Executive Chairman

Sure. Look, one of the things that helps with our dollar-based net -- so look, dollar-based net expansion, I always look at these things a little bit like whenever there's more than 2 numbers involved and you're doing multiplication and division, you have to understand what some of the underlying trend lines are. What's helping us keep that number up is we keep graduating customers from below the 100 threshold above the 400 threshold and then they can bring a lot of growth. And then the second thing that's happening is we are taking our larger customers and continuing to grow them. So we're seeing growth at the bottom of the stack, at the top of the stack that we keep bringing people into the stack.

To be honest with you, when we set up the guide for this year, we were guiding materially lower than we're currently realizing in our revenue number. And a lot of that is our continued success with our customers above our plan and above our expectations. And so it's what you want to see as a CEO. It's kind of pleasant to wake up in the morning and you see something, and it's usually good news, almost always good news. And our -- we're bringing new customers on the platform rapidly. And when they get to the platform, we're growing them rapidly. It's a good time to be at Unity. It's why we're as bullish as we are.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. And then we're just about done. [Kash], did you have a question? Or do you want to chat when we do the callbacks? Which is better for you?

Unknown Analyst

I'll chat on the callback. Thank you so much.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Perfect. All right. Great. Well, that wraps it up. We did it in 61 minutes, so that's not too bad. So we appreciate everyone being on the call, and we definitely look forward to seeing you either at conferences or on our next earnings call. But thank you very much, and we appreciate your interest and support.

John S. Riccitiello

CEO, President & Executive Chairman

Thank you.

Luis Felipe Visoso
Senior VP & CFO
Thanks, everyone.