S&P Global
Market Intelligence

Unity Software Inc. NYSE:U

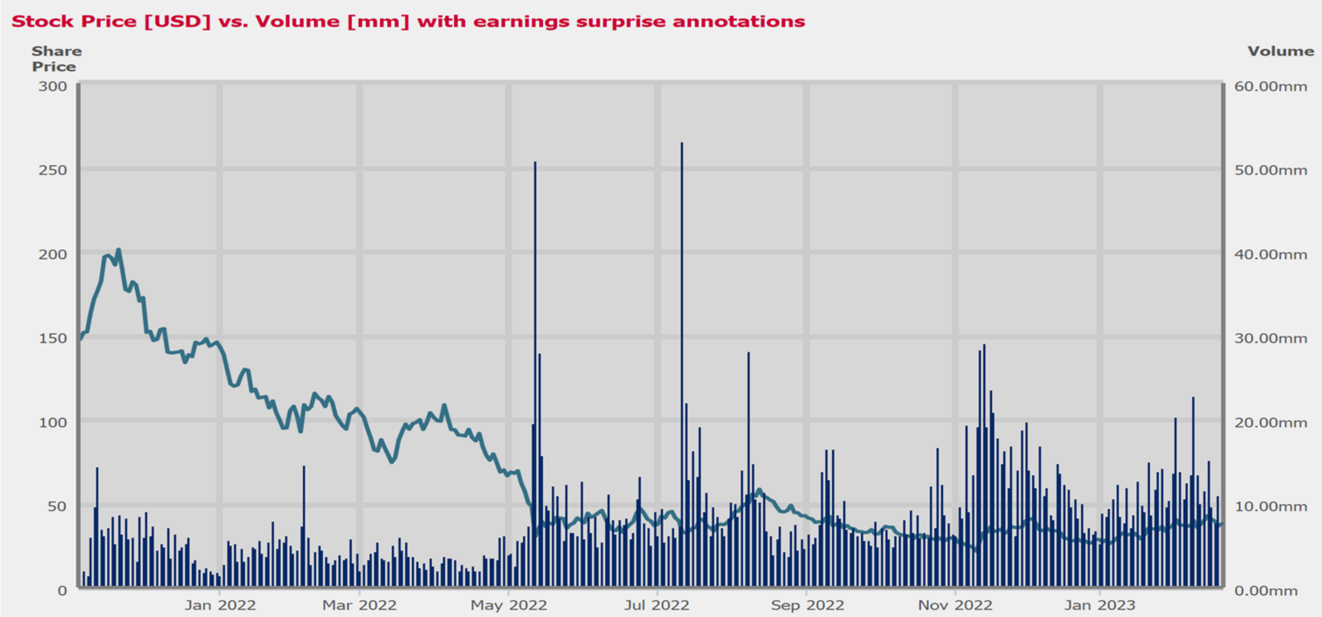
FQ4 2022 Earnings Call Transcripts

Wednesday, February 22, 2023 10:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2022-			-FQ4 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.15)	(0.14)	NM	0.01	(0.35)	NA
Revenue (mm)	325.68	322.88	▼ (0.86 %)	438.05	1374.85	NA

Currency: USD
Consensus as of Feb-21-2023 12:06 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2021	(0.07)	(0.05)	NM
FQ1 2022	(0.08)	(0.08)	NM
FQ2 2022	(0.21)	(0.18)	NM
FQ3 2022	(0.15)	(0.14)	NM

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EXECUTIVES

John S. Riccitiello
CEO, President & Executive Chairman

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Richard Hugh Davis
Vice President Investor Relations & Strategy

ANALYSTS

Brent Alan Bracelin
Piper Sandler & Co., Research Division

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

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D.A. Davidson & Co., Research Division

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Goldman Sachs Group, Inc., Research Division

Jason Boisvert Bazinet
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Jeffrey Parker Lane
Stifel, Nicolaus & Company, Incorporated, Research Division

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Kasthuri Gopalan Rangan
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Morgan Stanley, Research Division

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Unknown Analyst

X. Lu
Barclays Bank PLC, Research Division

Presentation

Richard Hugh Davis
Vice President Investor Relations & Strategy

Welcome to Unity's Fourth Quarter 2022 Earnings Call. After the closing of the market today, we issued our earnings press release and shareholders' letter. These materials are now available on our investor website at investors.unity.com. Today, I'm joined by John Ricatello, 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. 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.

Now as in prior quarters, we are providing both GAAP and non-GAAP financial measures. And unless otherwise noted, we will be speaking to the non-GAAP financial measures when describing our results. The shareholder letter and press release are available on the Unity Investor Relations tab as well as sec.gov and includes full GAAP to non-GAAP reconciliations.
Great. Thank you very much. As you all have seen, we've published a shareholders' letter this afternoon. And before we go into Q&A, let's start with -- we're going to open it up to open Q&A. But before we get to that, we've gotten a handful of questions that we're getting from investors.

Question and Answer

Richard Hugh Davis
Vice President Investor Relations & Strategy

And the first one is for you, John. John, we've received a lot of questions about the macro environment, specifically in the mobile game market, in industries and digital twins side of our business. So again, before we go into broader Q&A, maybe you could explain how you kind of see the macro environment playing out for Unity. And then I'll have 1 quick question for Luis as well.

John S. Riccitiello
CEO, President & Executive Chairman

Sure. So broadly, the macro environment remains surprisingly resilient. If you look at the gaming industry, we're seeing our developers are as productive as they've been before. They're producing a huge number of games. Their investment against game development is holding up well.

We're seeing strong DAUs or users in our network, suggestive of overall gameplay that remains strong. And then within the industry side, where we reported over 100% growth last year in digital twins, there continues to be very robust demand. And so maybe some elongated sales cycles, where people take a little bit longer to decide, but you've got demand far in excess of our ability to supply. We're in a pretty good spot, and we're not feeling a pinch.

So all in, the market seems stronger. And I'd offer than you might expect, especially when we're indexing against such unusual years, the work-from-home or learn-from-home era. But a couple of very specific points. The ads market has stabilized as of the middle of 2022 and continues to be stable now.

What's actually happening is strong user engagement, offset by weaker eCPMs than we've historically see, but again, it's been stable. At some point, that flips, and we're not expecting it to flip. We're using that in our models looking forward. We want to be conservative. But all in, the markets are solid. There's not a lot of concern here.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Thanks very much. And Luis, this question that we get oftentimes for you would be, how are you thinking about balancing growth and profitability? And kind of how does that fit into the guidance that we issued tonight?

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Yes. Thank you, Richard. So what I would say is, on the revenue side, just like John just mentioned, we're taking a prudent assumption on the market, and that is reflected in our revenue guide. It is clearly better to plan this way in this environment.

Now on the cost side, we're taking very clear actions to improve profitability. And this includes things like the elimination of close to 300 roles that we announced before, being very selective in any future new hires that we add to the company, being more focused in our investments and reducing the number of beds that we make at Unity, raising the bar on cost, and we've been turning every stone once or twice and finding new opportunities in a few places.

And that, frankly, includes reducing the number of shares that we grant as part of compensation. So we're taking a very holistic view on cost and making sure that costs are adding value. And as a result, you should expect to see costs relatively flat during the year as revenue grows quarter-over-quarter. Now what happens then is that we expect to significantly improve profitability in 2023.

If you look at -- we had a loss of $90 million non-GAAP in 2022, and we expect adjusted EBITDA to be about somewhere in the range of $230 million to $300 million in 2023. So very significant swing from 1 year to another. Now what's interesting is in 2022, we were only profitable in Q4. In 2023, we expect, obviously, to be profitable every single quarter.

And one more point I would like to make is that the profitability improvement that you see year-over-year comes about 50-50 from Create and Grow. So we're making progress across the board. We're taking, as John said, more conservative assumptions on the market and being very proactive on cost with decisive actions to improve profitability in this environment.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Thank you very much. Well, now we can open it up to questions from the analysts on the call. [Operator Instructions] Here we go. First question from Matt Cost at Morgan Stanley.

Matthew Andrew Cost
Morgan Stanley, Research Division

Everybody, can you hear me?

John S. Riccitiello
CEO, President & Executive Chairman

Yes.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Yes.

Matthew Andrew Cost
Morgan Stanley, Research Division

Great. So maybe just one thing in the letter. You mentioned the drivers that create revenue growth being pricing, China and digital twins. Should we assume that, that seat growth is kind of going to be under pressure or stable this year because of some of the issues going on in just the -- in your customer base in the mobile gaming market? That's the first question.

The second question is just when we look at the ramp in EBITDA, I think the guidance for the first quarter is $7 million to $12 million. The full year number is $230 million to $300 million. So that's pretty significant step-up in just dollars of EBITDA as we move through the year. What should we think about as the drivers of that?

John S. Riccitiello
CEO, President & Executive Chairman

Luis, do you want to start with this one?

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Yes. On the second part of your question, Matt, as I just said, we expect cost to be relatively flat during the year. As you know, we have a very healthy gross margin. And as you get the revenue growth quarter-over-quarter, you get into those profitability levels.

So that is basically the assumption and where we're working against. Very importantly, Matt, some of the actions that we've taken on costs don't fully impact Q1. They only impact Q1 partially, and they obviously have a full quarter impact in Q2, Q3 and Q4.

John S. Riccitiello
CEO, President & Executive Chairman

In terms of seats, we don't normally and haven't been guiding the seats, so we don't call it out in particular. But what we're -- our intent going forward, obviously, is increase the number of users, game industry and continue to be strong. and our shares across every platform continued to be very strong.

We called out, in particular, pricing in China because those are important drivers of our sequential growth, Matt. One of the areas I expect to see strong growth over time around seats is professional artistry. And you can -- we can talk a little bit more about that, but how tools like Weta and Ziva and the things that we've acquired are coming to market in the coming year. And with that, new customers, new seats, et cetera. So we don't feel like there's any issue around the seat side. It's really -- we're calling out particular growth drivers.

Richard Hugh Davis
Vice President Investor Relations & Strategy

And Jason Bazinet from Citi.

Jason Boisvert Bazinet
Citigroup Inc., Research Division

I just had a simple question. Just maybe this is for Luis. Sequentially, new Create grew about $9 million. And I think older Create grew about $13 million, which implies either strategic partnerships or UGS maybe contracted a bit. Is there anything that is noteworthy there or anything that you'd call out?

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Yes. Jason, good point. You may remember, in Q3, we had a very strong Strategic Partnerships business. We actually commented on that in this call. And that is a business that will have ups and downs just based on when deals are signed. So -- that's why I think it's super important to look at the Create numbers on a stand-alone basis where you actually see, as you just mentioned, an acceleration from Q3 to Q4 in terms of number of dollars added Q-on-Q. But that's the way I would think about it, Jason. Just take the -- that's the view, the clean view apples-to-apples.

Jason Boisvert Bazinet
Citigroup Inc., Research Division

Okay. And do you mind if I ask 1 follow-up? It just seems like the tensions with China, whether it's them sort of advising not to use the big 4 accounting firms or some of the changes that we made related to chip exports are sort of increasing. And I know China isn't the biggest business geographically for you, but is that a concern investors should have? Or do you think it's sort of ring-fenced to manufacturing and big 4 accounting firms.

John S. Riccitiello
CEO, President & Executive Chairman

Let me take the top of that one, Luis.

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Yes.

John S. Riccitiello
CEO, President & Executive Chairman

So China is the biggest gaming market in the world. So let's just start with that. The second thing, we're the market leader in China in the businesses we operate there. So super -- it is important to us. Apologies, getting over a cold, guys.

But third observation I'll make here, we have made a change in our structure in China that we think better, if you will, sets us up for long-term growth in China versus the structure we had previously. Luis can get in that in a minute.

And then fourth, China after, I don't know, nearly 1.5 years, not issuing new licenses. We started to issue licenses again. And then lastly, we're seeing a lot of interest and demand on digital twins. So to us, China is important, and we've set ourselves up for long-term growth there.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. I think the next call should be from Goldman Sachs. Are you guys on? Check to see if it's Kash Rangan.

All right. Well, let's go to Brent at the moment. Brent Bracelin at Piper, please.

Brent Alan Bracelin
Piper Sandler & Co., Research Division

Great. Can you hear me okay?

John S. Riccitiello
CEO, President & Executive Chairman

Yes.

Brent Alan Bracelin
Piper Sandler & Co., Research Division

Perfect. I guess, John, maybe we'll start with you. I mean, mediation was one of those missing pieces of the Unity Gaming Services offering, I think, that you addressed with ironSource. What have you learned so far in kind of Q4 as you think about some of the functionality they bring to these services? And kind of maybe give us a sneak peek into what mediation can help with as you think about the ad market in 2023 here?

John S. Riccitiello
CEO, President & Executive Chairman

So thank you for asking that question because it allows me to address something I wanted to say on the call. What we're seeing is that there's strong interest in the combined offering that we have with the collection tools like LevelPlay and the 2 Ad Networks.

We are seeing market share growth. We're picking up customers under our mediation platform. And of course, that drives increased share of wallet. Now these things are not instantaneous. You come to an agreement to do these things. It takes some engineering time and effort to bring them on to our platform and that it's typically phased.

And so there's not a significant impact in our Q1 from the market share gains we're seeing, but we are expecting to gain market share in Q1 and throughout the year, which is why we were confident in predicting growth for the business for the year. It's -- essentially, what we're trying to say is we're seeing, starting in the middle of last year, a stable market for the advertising business. We do expect that to pick up at some point.

Luis and I made a hard call a while back to say, no matter what anybody tells us, we're not going to predict a recovery in 2023, even though there's a fair amount of folks that would argue there should be. But by the end of this year, we've chosen not to do that because it enable us to put a stronger focus on cost and get the EBIT leverage that comes from that.

So within that stable market, we're predicting market share growth, and we're seeing it already in the marketplace, and we expect to see that throughout the year. So all in all, the integration, ironSource-Unity is going well. As an example, we haven't lost a single executive. That is typically not the case in these things.

And so there's a lot of work that Tomer on the Grow side and Marc on the create side are working to drive synergies between the platforms. And in terms of how we go to market and how we bring customers onto our platform, we think that's going to pay a lot of dividends over time.

The word synergy, you guys are going to get sick of it over the next several quarters as we talk about how we're generating better outcomes for our customers. And better outcomes for us is a combination of a singular end-to-end platform. We talked about that in the shareholder letter.

It's going to be a theme song for us because we got exactly what we were looking for, if you will, a hand-in-glove combination of tools and services that make the entire platform much stronger than just the additive combination of the 2 businesses. So market share growth through the year, heavy emphasis on synergy going forward. And with that, the EBIT leverage that Luis talks about.

Brent Alan Bracelin
Piper Sandler & Co., Research Division

Helpful color. And then just 1 quick follow-up for Luis here. If I look at the net retention number, ex ironSource, it down ticked a little bit this quarter versus last quarter. What do you view baked into the 2023 outlook, either on a combined basis or an ex ironSource basis? Just trying to think through what's contemplated from a net retention perspective in the guide.

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Yes. Now you want me to guide on our expansion rate. So Brent...

Brent Alan Bracelin
Piper Sandler & Co., Research Division

You always want more, Luis.

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

I think, overall, I'll just repeat what John just said, which is we are expecting to expand market share, both in Q1 and Q2. Now what that would imply to me, Brent, is we should be seeing net expansion rate above 100%, clearly, for the year.

I don't want to give you a precise number, unless with and without IronSource. But yes, that's what it implies. We expect to grow market share, both in Q1 and for the year, and therefore, we should be seeing a positive number in net expansion rate.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. We should have -- here we go. Gili for Kash. I can see you there. So Goldman Sachs, are you guys ready? Okay.

Well, do we have Thomas, do we have other people on the -- there we go. Dylan Becker at William Blair, please.

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

Hopefully you guys can hear me. Maybe John, starting off, I think there was an announcement not too long ago. And we spent a good bit of time talking about what live and interactive games can look like for the industry. But how important is that partnership you guys announced with Google and expanding the opportunity for UGS and maybe the ability to improve monetization for developers looking to capitalize there.

John S. Riccitiello
CEO, President & Executive Chairman

Well, look, I'd say that Google is one of our best partners. So we partner with them on a number of fronts, as we do with a number of the major mega caps. So we're deeply partnered there, and it's super important to us. The second thing is we have massive faith in the long-term growth prospects for UGS. And it is in the fullness of time, it is going to be a very major business for us, and it's already a substantial business for us.

So it's an area where we're focused on for growth. We've got a really strong general management team, that's Jeff under Marc. And they're driving it for growth right now. We're working on bringing more customers onto the platform, and we feel good about the offering. It is a very competitive offering in terms of high performance and a good cost equation for our customers.

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

Super helpful. Maybe if we can talk on it, we haven't spent a ton of time on the Aura piece of the business as well. Maybe some near-term device headwinds there, but how do you guys think about the opportunity for global connectivity going forward and potential monetization opportunity and touch points being afforded by being embedded across a lot of -- a significant number of those devices as well.

John S. Riccitiello
CEO, President & Executive Chairman

Aura is a -- for those of you who don't know, it's a very strategic business for us. It came along with the ironSource acquisition. It's a device management business. They operate at the carrier level, but around the app store. And it's a business where we drive a great deal of data, but we also drive meaningful revenue from it.

Our offering, we believe, is well differentiated from the principal competitor in this space, Digital Turbine. And it's another area where we can't get too specific because when we talk about winning market share, it's like winning a major national carrier. So these deals are not like you pick up 0.5 point a day, these are -- or 0.5 point a quarter. These are material trends. And we are confident that we're gaining here. We have been, prior to Unity's ownership, and we expect to going forward.

I would love to show you what our pipeline looks like. It would make you happy, I think, to hear what our pipeline looks like. But it's something I can't get into further detail on, but we feel really good about that business.

It's -- if you think about if you're a Unity, we'd love -- if you take, for example, a mobile ecosystem, we love that we're the leading platform for creation on both the app stores. We'd love that we're one of the leading monetization user acquisition platform across the entire industry. We love that we've got a meaningful device management business, for the same devices.

We love that these things come together to create an end-to-end platform that makes what our customers do more successful when they use our platform. It's that end-to-end, highly synergistic platform that differentiates Unity from anyone and from everyone. And we feel really good about our ability to bring all that together synergistically. And again, as I said, Luis and I are going to be singing about synergies now for years to come. It is a -- it's our theme song.

Richard Hugh Davis
Vice President Investor Relations & Strategy

And we won't ask you to do a -- do it in here, but maybe later. So Gili at Goldman Sachs. I think we got you on there now.

Gili Naftalovich
Goldman Sachs Group, Inc., Research Division

Yes. It's Gili on for Kash. Thanks so much for circling back, and congrats on the strong 4Q. Can we just quickly touch on any customer behavior you are seeing now they have Unity and ironSource under the same hood? And the decision to ultimately keep Supersonic in your growth category, kind of what was the rationale behind that?

John S. Riccitiello
CEO, President & Executive Chairman

I'm not sure I quite get -- like customers that we're getting because of were together?

Gili Naftalovich
Goldman Sachs Group, Inc., Research Division

Yes. Or any synergies you're seeing between creating growth at this point if the ironSource deal kind of helped you in getting customer synergies, just to utilize that word as well.

John S. Riccitiello
CEO, President & Executive Chairman

Okay. So let me give you this in a sort of a time-phased way. In the present moment, we are winning customers in mediation, which is a very lucrative outcome for us, an important driver of the EBIT performance we're going to see through the year. That added market share and not added share of wallet yields a more profitable Unity.

Now it's happening precisely right after the acquisition because what we are carrying to market is a message. And the message is the power of the combined data platform, the power that drives a better performance for our customers. Now these are things that are, if you will, that come about as a result of a presentation.

Now the second thing we're doing now is we are engineering in. For example, Supersonic indoor editor to make it an easy platform for our customers to take their products directly to market without ever leaving the environment. There's a lot of places where the tool set, whether it's Luna or it's Supersonic, or it's parts of LevelPlay and the integration and where it shows up into the mix, where our customers are going to take advantage of a more performance platform for them to create, to publish, user acquire or monetize directly.

And there are some things we can do there, which is more about engineering in, and that's what we're working on right now. That combination of we're a better story, they want to be part of something that's bigger and better, is the starting point.

The second point is to engineer in the advantages that our customers need and want. And it's more than just supersonic and LevelPlay, it's the 2 networks, ironSource, et cetera. So also all of the Create tools, for example, whether it's artistry, as we bring AI to the equation, as we bring simulation to the equation, things that they need for better content creation, more cost-efficient content creation.

And so it's UGS, which is part of the platform, which is what's enabled us to find success in that space. So really, what it's about, and I hate to wax on about synergy. Synergy is partly about the story, but it's more about engineering a simpler, single source of truth, single source of opportunity, single platform for our customers to leverage to find a more successful business for themselves. As I said, we'll be talking about this each and every quarter for probably years to come.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Well, I mispronounced your name [indiscernible] from Wolfe.

Unknown Analyst

Can you guys hear me?

Richard Hugh Davis
Vice President Investor Relations & Strategy

Yes.

John S. Riccitiello
CEO, President & Executive Chairman

Yes.

Unknown Analyst

This is [indiscernible] on for Gal. I wanted to ask whether you could parse out roughly what the growth of nongaming Create was, excluding Weta and UGS, in 4Q? And then I had a quick follow-up.

Brent Alan Bracelin
Piper Sandler & Co., Research Division

Luis, you have that?

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Yes, we're not providing it by quarter, right? As we put in the node, you see very strong growth. 18% is the exact number for the year for nongaming. That includes the weather growth, which we isolated before. We told you at the beginning of the year, that would be about $70 million.

The other thing that you saw is an increase as a percentage of our business. On a comparable basis, we went from 40% that we announced 6 months ago to about 41%. So that would be on a comparable basis based on the old structure that we've been reporting before. So we're clearly seeing an acceleration in that business, and we expect that to continue into 2023.

Unknown Analyst

That's helpful. And then just quickly on one of the metrics in terms of customers over $100,000 and the contribution from ironSource, I believe that the last published number for ironSource for customers contributing over 100,000 was $446 million and that number is now $284 million backing that out. Is that just due to the revenue recognition for ironSource due to the timing of the acquisition? Or was there some kind of churn that happened in ironSource relative to what they last published in 2Q '22?

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

No, it's not that. What happens is, obviously, some of the larger customers were also large customers for us. So you cannot just add the numbers. So some customers just became even larger for us, but they were already counted in our customers above $100,000. You see that?

Unknown Analyst

Yes. Perfect. Makes sense.

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Which is a good combination, right? Because basically, what it does is we acquire new customers, which is terrific, but we also penetrated some customers even more, which is also very helpful. So we had a healthy combination of both.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Do we have any other questions from folks in the audience? Mario from Barclays.

X. Lu
Barclays Bank PLC, Research Division

I just have 1 on the seasonality of the joint business now. In terms of what we saw in the fourth quarter, you guys said it was $518 million on the combined financials versus the guidance of 1Q of $475 million. So just curious, is that sequential step down mostly from the Create side of the business? Or is it on the Grow segment?

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Yes -- do you want me to take that, John?

John S. Riccitiello
CEO, President & Executive Chairman

Go ahead, Luis. Yes.

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

So Mario, it's very difficult to talk about seasonality over the last few years given all the factors that John explained, right? I mean COVID, the economy, I mean, just name it. But to answer your question, yes, we are taking a prudent view on the market, and it's for both businesses, but particularly for the Grow business. That's where we are being even more conservative on the business.

And I don't want to give you a forecast for each of them. But yes, we are being prudent there on the assumptions in the market. You will see normally in Q4 kind of a strong professional services business. So that will be one thing to always watch in Q4, and then seasonality, driven by the other factors that we mentioned. So that's the way to think about it, Mario.

John S. Riccitiello
CEO, President & Executive Chairman

Seasonality right now just in terms of speaking to it is I've continued to say today that we've seen stabilization in the Ads business starting in the middle of last year. The beginning of last year was exceptionally strong. We had the second wave of COVID. People returned home or went home from school. And we had very elevated Q1s in the industry.

And so it's very hard to read seasonality. In a normal year, you'd say, across the Grow side of the business, Q4 is the strongest quarter. Q1 is the second strongest quarter, essentially staying a little bit elevated after the Christmas holidays and then a little bit of growth as you go to Q2 to Q3.

And then within the Game side of the business, you'd say it's a business that is similar with Q4 as the strongest, although in mobile, it tends to be more even, but there is increased consumption in the fourth quarter. That's been true for many, many years. And then through this fairly subtle world of seasonality, where the fourth quarter can be 10% and 15% higher than the third quarter, that type of outcome, what you -- what we did is we drove a truck through it like 3 different ways: COVID, work-from-home, issues around a recession.

And so it's been very hard to read the underlying signal. Again, which is why we're emphasizing right now, what we're seeing is really strong consumer engagement in Games, really strong pipeline outside of Games and Create, stabilization in the Ads business based on strong consumer engagement and slightly weaker eCPMs, which is typical of a recessionary period, around which you some -- we recover at some point.

So we've been trying to keep you as much of that understanding as we can. We see a lot of data. We've modeled the h*** out of it, and we understand it, we think, pretty d*** well, but it is definitely a challenging time to sort of be an econometric-type person in this space.

X. Lu
Barclays Bank PLC, Research Division

Great. That's very helpful. And maybe just a quick follow-up. In terms of the commentary of the game as market being approximately down 10% this year, year-on-year. That's some other companies are saying it's stabilizing to improving. But is your point, just the first half is just a very tough comp.

John S. Riccitiello
CEO, President & Executive Chairman

So precisely, you've got that right. So we've added more color than others. Yes, it's stabilized the middle of last year. The beginning of last year was exceptionally strong. And so the market in the first quarter of last year was up in the mid-20s in terms of growth, in terms of sort of served advertising business in the first quarter across the industry.

So when we're looking at stabilization from the middle of last year, what it is in the first half of 2023 was we're lapping a stronger period. Even though it's stable, we're lapping a stronger period. In the second half of this year, we're not forecasting recovery, went out going to be comparing to the second half of 2022, which was flatter. It wasn't as strong.

And so we're going to get -- if you want to think about it, the first half of the year, call it down, and the second half of the year, call it flat. So that's where we get to minus 10% in aggregate if you're modeling the whole year. We're saying exactly the same thing. The market is stabilized. We're adding the added color that the year-over-year indexes for total served ads will be down in the first and second quarter. It's year-over-year versus a quarter-over-quarter view, Mario.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. Parker Lane .

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

Luis, circling back to net expansion rates for a moment. I was wondering if you can give us a qualitative sense of how Grow is compared to Create recently? And then if I look at the nongaming segment, in particular, what impact and future impact do you expect from the introduction of new pricing initiatives and perhaps consumption models on the nongaming side? How much of a tailwind can that be to expansion going forward?

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Yes. So if I look at the Create side, the net expansion rate has been fairly stable and very healthy, right? So the reductions that you've seen over the last 2 quarters have come mainly from the growth side. And we talked about before in the last quarter, and what we're seeing in this quarter is fairly consistent with that.

The pricing that we've taken -- so to your second question, the pricing that we're taking is mostly on the game side, right? The nongaming side of the business has really different business models, different monetization models, and we keep on improving how we monetize each of our customers.

But it's -- the pricing plans that we've talked in the last call have mainly focused on the gaming side on the number of seats. So you're going to see another effort on the nongaming where we're really trying to monetize our customers much better, and that includes subscription businesses that includes consumption business models and really better -- getting more of the value that we're creating for our customers.

John S. Riccitiello
CEO, President & Executive Chairman

What we've -- I want to just add a little color to that. So it may seem counterintuitive that we increased price last year in the Game sector, but we expect that to drive sequential quarter-to-quarter growth through 2023. We honor existing contracts at the price that the existing contracts were signed. So as existing contracts reach their termination date, and we renew our customers, they renew at a higher price.

So it's -- pricing is one of the things that's driving growth for us this year despite the fact that pricing was taken last year because of when our customers come on to it. Second thing, and I think it was in the third quarter call, I framed up our digital twin platform, which, at that point, has just gone into general availability. What that is, it's a ratable use-based platform for our digital twins.

And we've got lots of customers coming on to that. And that is incremental ratable revenue that we expect is going to be a major business for us in the quarters and years to come. So there's additive in that way, too. So that's -- I hope that gets to a little what you're asking a little more insight.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Okay. Stephen Ju, over at Credit Suisse.

Stephen D. Ju
Crédit Suisse AG, Research Division

All right. So I was wondering if you can give us the latest in terms of expectations on the time line for the productization of Weta. And I guess, bidding game in, I guess, media sectors will probably be the first adopters, but which additional sectors can you see that you can onboard here who you might not have seen before? And also directionally, I think this is a product that's had a client base of one.

So from a pricing perspective, go-to-market sales motion, if you can just add a little bit there. Maybe it's a little bit too early to talk about that now, but just sort of initial sort of commentary that you might be able to offer as you think about going to market with what will be your productized Weta?

John S. Riccitiello
CEO, President & Executive Chairman

So I can take part of that. Luis, you might want to add. But -- when we're talking about productizing for professional artistry, we mean more than just Weta, although Weta is obviously the substantial portion of it, but also for tools like Ziva and SpeedyTree add to our portfolio in professional artistry.

Second point is, there's a number of the products that we've been talking about, Marc talked about a couple of calls ago, within the Weta portfolio that we are commercializing this year. And we're already in customer conversations. The most interest right now is a combination of the film industry and the game industry. Big surprise. That's where you'd expect it to be.

What I won't do for you on this call is in conversations that are in-flight to close around those products this year to tell you who we're talking to, but it's the likely suspects that you would expect, but we don't preannounced deals that we're now in the process of negotiating. But we see, at least according to our own internal plan, we're tracking well.

The products are coming to commercial opportunity and the time frame we had anticipated, if not a tad bit earlier. And we're finding good interest in the primary markets that we had anticipated. So in a word, I'd say, or in a short sentence, it's going as we anticipated when we made the announcement around why don't we announce to acquire them. And it feels good to us right now. Luis, old you want to add anything?

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

No. I would just say, John, that it's 100% consistent with what we said before. It would take us 2 years. It's a lot of work to bring the tools to the cloud and make them available to many customers from one, and we're making the progress that we expected. So you should hear news about this business soon.

Richard Hugh Davis
Vice President Investor Relations & Strategy

I think we have another 4 or 5 minutes, but Tim Nollen from Macquarie.

Timothy Wilson Nollen
Macquarie Research

Can you guys hear me?

Richard Hugh Davis
Vice President Investor Relations & Strategy

Yes.

Timothy Wilson Nollen
Macquarie Research

I've got 2 or 3 quick ones on the ironSource deal. I wonder maybe first off, could you give us a bit more color on the integration effort? I know you said that it's all going well and the synergies all look good. I just wonder things like will you keep a couple of DSPs separately? Or will you combine them in terms of any technology integration issues that may come up? Anything you can give us in terms of color because I can imagine that it's not necessarily easy to always do these sorts of things.

Relatedly, you did, I think, mentioned the data ingestion issues from last year at 1 point. Are those completely gone now? Do we need to know anything more about that? Did ironSource help in any way with that? Or was that after the fact?

And then lastly, maybe 1 more on Aura, I guess, is maybe where this comes in. You and ironSource both are very heavily into the gaming sector. You have a lot of nongaming businesses on the Create side. I guess, ironSource is mainly gaming, but are there opportunities now to expand your ad tech services given the broader client base that you can offer as well as what Aura could bring in given the other sectors that it touches.

John S. Riccitiello
CEO, President & Executive Chairman

First off, you get credit for a 12-part question.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Three-part.

John S. Riccitiello
CEO, President & Executive Chairman

We'll do our best to remember it all as we respond. The first one to get out of the way is the data issue was out of the way before we completed our merger, in fact, before we announced it. So that was in the rearview mirror. The second thing on integration. We've already largely integrated teams. And so Tomer, by way of example, is essentially the Chief Revenue Officer for Grow. And so we consolidated 2 sales organizations under him. He's been running able leadership.

We also consolidated products and engineering under Ingrid and [Eyal] and Matt team. So we brought teams together to achieve singular focus on delivering the right outcomes for our customers. These are -- the engineering teams are working together. The product teams are working together. The sales teams are working together.

In terms of engineering and data, we've already accomplished essentially the primary data merge. So that can yield better outcomes for our customers there because assessing more data around the same questions around user acquisition yields a better outcome for our customers.

So we've achieved -- that's part of what we've already done. And we're now starting to see situations where we're applying a tool that might have been in the Unity Ad Network to the ironSource network or a practice or an approach technically that was in the ironSource network to arena. I won't get into the specifics of that because, first off, it would take me 5 minutes to define most of what these tools do, and that seems like an unnecessary way, way into this conversation.

But just this morning, I was going through 1 tool in particular that we expect to have a favorable outcome for our combined Ad Network based on bringing a tool from 1 side of the equation to the other side of the equation. And then beyond that, Create to Grow, they're doing the exact same thing at a higher level. So that's happening.

Aura. You talk about Aura relative to nongaming. For those of you that don't know, part of what Aura does is it drives installs of game and nongame applications on Android devices around the world based on carrier relationships. That essentially puts us in the ads business payment. And I believe you are absolutely right to point out that driving installs outside of gaming represents a significant opportunity for Unity, and some of those are going to be our Create customers. But that is something that we don't have a specific plan for today, although we've certainly talked about it.

So we've been focusing on the very obvious and most important synergies for that end-to-end platform. And there's a few things that are sort of next quarter's conversation and that particular one is more of next quarter's conversation internally to Unity.

Richard Hugh Davis
Vice President Investor Relations & Strategy

I'm going to try to slip in 2 more and finish up. So first, we'll start with Jonathan, and then we'll conclude with Franco.

Jonathan Allan Kees
Daiwa Securities Co. Ltd., Research Division

Great. Can you hear me?

John S. Riccitiello
CEO, President & Executive Chairman

Yes.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Yes.

Jonathan Allan Kees
Daiwa Securities Co. Ltd., Research Division

Great. Let me get in here and ask my questions. Actually, most of them have already been answered. Just wanted to ask then the rationale behind combining strategic partnerships into Create. I mean, it makes sense that you would have Create add some of the stuff from Operate and Operate will become Grow, but why would you not leave strategic partnerships separate like you have before?

John S. Riccitiello
CEO, President & Executive Chairman

The majority of the revenue is very Create-centric, pretty simple. These are often deals where revenue is derived from a platform holder to enable Create to work better for their platform. And so it was more powder matching here. It was like this is very much like a Create business.

We've held it out separately because it had a different sales cadence and a very different type of deal structure. But when we tried to figure out where to put all the different pieces post merger, this was the obvious place for it. Luis, you might want to add to that?

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

Yes, I totally agree, John. And we manage the teams together, and that's the focus of the synergies because 1 drives the other. So we thought that would be the most natural thing to do, Jonathan, but we'll be transparent as I was at the beginning of this call and where we see volatility driven by strategic partnerships that we need to call out.

Richard Hugh Davis
Vice President Investor Relations & Strategy

All right. Not the least, not the -- but the last, Franco, why don't you tee it up to finish this up.

Franco Rafael Granda Penaherrera
D.A. Davidson & Co., Research Division

Right. Yes, John. So on LevelPlay, you talked about some of the showcase you have, and you rightfully noted the variability and the lead times. Can you speak to whether this is from developers that are new to -- brand new to the market or are you leveraging the relationships on the ironSource side and getting someone that is perhaps a bigger scale, more mature players. And I guess, what is your strategy to gain business from some of the large publishers that are currently in other platforms?

John S. Riccitiello
CEO, President & Executive Chairman

For some reason, that broke up a lot from me on my end of hearing that. There's like half the words. Richard, did you catch the question and can summarize it back?

Richard Hugh Davis
Vice President Investor Relations & Strategy

Franco, why don't you summarize again because I lost the same thing so...

Franco Rafael Granda Penaherrera
D.A. Davidson & Co., Research Division

Okay. Well, I need to get a new headset. The question was really around LevelPlay. Are the customers bringing it to the market? Or are they more mature, bigger in scale? And what is your strategy to gain big publishers from other platforms?

John S. Riccitiello
CEO, President & Executive Chairman

So what is the strategy for other platforms relative to LevelPlay? So again, I'm not fully blocking your question, so I apologize if I don't answer it correctly. But I'd mention a couple of things. One is that prior to the merger, you could argue that LevelPlay was more richly successful with smaller, more independent players and Unity had relative strength with the larger players. And what we're now doing is closing more of the larger players. So that feels like somewhat of a synergy with LevelPlay.

If you're thinking about the synergy of Create to LevelPlay, integrating LevelPlay into Unity is a winning strategy because, remember, 70-odd percent of mobile games are built in Unity. That's a very obvious thing to do. And it was very evident at one of their launch events last year in September. I was there speaking to many hundreds of LevelPlay customers. And one of the things they've never done is said how many of you are Unity customers? And it turned out when I asked for a show of hands, 100% of them in the room were Unity customers.

And so there's big synergy in that direction as well because they all weren't yet LevelPlay customers. They were their shopping at LevelPlay, but they're all already Unity customers. So does that get to what you were asking me about, though? Because, again, we might have a network issue here. I got a bit of a garbled version of your question.

Franco Rafael Granda Penaherrera
D.A. Davidson & Co., Research Division

Yes. No worries. I could take it offline. Appreciate it, though.

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

I think, Franco, if your question is why do we expect LevelPlay to grow market share, it's frankly, we believe that it's the better mediation [indiscernible] out there in the market. And we are -- that's what you saw before everything changed in the market, and we continue to believe it's the best performing, and that will attract our customers back.

John S. Riccitiello
CEO, President & Executive Chairman

Luis and I just did a portfolio review with the team yesterday. And by name, by customer, we're seeing customers coming to the platform. So we're not believing it, we think it's better for our market share overall, although we think that's why we're looking at the exact customers coming over and our migrations that our engineering teams are implementing. Like for us, it's proof that they're coming to our platform for those reasons.

Luis Felipe Visoso
Senior VP, CFO & Principal Financial Officer

And that's why we can talk about market share gains, both in Q1 and for the year.

Richard Hugh Davis
Vice President Investor Relations & Strategy

All right. We -- Kash Rangan from the top double black diamond slope. So Kash, [indiscernible] second question.

Kasthuri Gopalan Rangan
Goldman Sachs Group, Inc., Research Division

Congrats on the quarter. I'd like to echo Gili's comments. John, as you take a step back, now your index to the opportunities in Weta, a little bit over-indexed to the pickup in the advertising market through the acquisition of ironSource. And you're also indexed to what's going on in the Create side with digital twins.

How should we think about how you as CEO are prioritizing your investments so you get the best bang for the buck in each of these markets, depending upon the relative importance and what it could mean for what really drives Unity in the future?

John S. Riccitiello
CEO, President & Executive Chairman

Look, first off, if you want to know what drives me as the CEO towards prioritization, it's -- at this company, it's a very rich conversation between Luis and May and the principal C-level officers looking at the opportunity in front of us. Now one of the things that have been frustrating is we've shifted from a go-go market to a tough recessionary environment and the market correction in the second place is there were programs that we liked in a different economic environment that are no longer funded.

An example of that is what we're doing with sports and live entertainment. It's a beautiful technology that customers want. But we deprioritized that in a different economic environment, and there were several other things that we did that were like that. Now we didn't de-prioritize Weta because there's already a meaningful revenue stream there, and there's a meaningful and a very great opportunity for that run professional artistry to grow a bigger and better business.

And remember, most creators in the world are not coders, they're artists. They want those artist tools. So that made the cut for us. But in general, I would tell you that if you look at our 2 businesses, right, Create and Grow. Grow is a business where the engineering cycles for product development are typically inside a couple of quarters and certainly inside of a year. Many times, on the Create side, the creation cycle for meaningful new technology can be multiple years, certainly multiple quarters.

So for example, when we created the digital twin platform that will allow us to generate ratable revenue, cloud-based revenue for digital twins, that was 18 months in process. And so we have to look at them through a different lens in terms of ROI time frame. Now the reason we invested in the cloud platform for digital twins and the very similar thing around UGS for games is because we believe in the fullness of time. The best way to drive revenue or Unity on Create is through the addition of ratable revenue streams based on usage.

We're already paid by the seat for people creating things. We were looking for a second revenue stream and in solving a major problem for our customers. And so when we look at our businesses today, things like LevelPlay and our Ad Networks are profitable, our core games businesses, a lot of things are very profitable for us. Some remain in that investment. And we prioritize them based on what we believe to be strong ROI thresholds.

Now personally, I'm from the gaming industry. I've spent decades in the gaming industry. I am intellectually in love with digital twins. I'm emotionally connected to games. But our resource allocation isn't based on emotion, it's based on math. And we look hard at it in this environment to make sure we're making the right investments for the right ROI, which is how and why we're reporting even with modest revenue growth, really strong profit growth year-over-year. We think that's important. We prioritize that, and we're going to deliver that.

Richard Hugh Davis
Vice President Investor Relations & Strategy

Great. All right. Well, thank you so much. We got done a little bit late, but that was pretty quick and efficient. So thank you all, and we'll hope to see you on the road or at various conferences. Thanks a lot.

John S. Riccitiello
CEO, President & Executive Chairman
Thanks all.