



Skillz, Inc.

Fourth Quarter 2020 Earnings Conference Call

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C O R P O R A T E P A R T I C I P A N T S

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C O N F E R E N C E C A L L P A R T I C I P A N T S

Michael Graham, *Canaccord Genuity, Inc.*

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P R E S E N T A T I O N

Operator

Welcome to Skillz Inc. Fourth Quarter 2020 Earnings Conference Call.

Please note that this conference call is being recorded today, March 10, 2021.

I will turn the call over to Mr. James Marsh.

James Marsh

Thank you, Operator, and good afternoon.

Everyone should have access to the Company's fourth quarter 2020 earnings release. The release can be found in the Investors section of the Skillz's website at www.skillz.com/investors.

Some of the Management's comments today will be forward-looking statements within the meaning of the Federal Securities laws. Forward-looking statements, which are usually identified by the use of the words such as will, expect, should, and other similar phrases, are subject to numerous risks and uncertainties that could cause actual results to differ materially from what we expect. Therefore, you should exercise caution in interpreting and relying upon them. We refer you to the Company's SEC filings for more detailed discussion of the risks that could impact future operating results and financial conditions.

During the call, Management will discuss non-GAAP measures, which we believe can be useful when evaluating the Company's operating performance. These measures should not be considered in isolation, or as a substitute for financial results prepared in accordance with GAAP. A reconciliation of these measures to the most directly comparable GAAP measure is available in our fourth quarter 2020 earnings release.

Hosting the call today, we have an Andrew Paradise, Chief Executive Officer, and Scott Henry, Chief Financial Officer of the Company.

With that, I'll turn it over to Andrew. Andrew?

Andrew Paradise

Thank you, James, and good afternoon, everyone. Welcome to our first earnings call as a publicly traded company.

We're incredibly proud of the strong results that we've delivered throughout this year, and are pleased to share some highlights.

Skillz is the predominant mobile eSports platform in the world, growing rapidly in a massive 2.7 billion gamer market. We continue to strategically invest in growth to deliver an incredible user experience and capitalize on our vision to build the competition layer of the Internet.

Q4 marked our twentieth consecutive quarter of sequential revenue growth. During the quarter, we expanded and enhanced our platform capabilities, added many new and engaging games, and most notably, we beat our revenue forecasts, all amidst the challenges brought on by the pandemic.

Before digging into the details, I wanted to take a moment to highlight a major milestone. We successfully went public after closing our merger with Flying Eagle. I want to thank Harry Sloan, Jeff Sagansky, and Eli Baker at Flying Eagle. They shared our vision for Skillz. They were amazing partners throughout the process.

I also want to take an opportunity to acknowledge and thank our amazing team at Skillz who designs, builds, and markets our platform that enables our game developer partners to achieve success. For all the innovators, the creators that make this possible, we love you and we will always be a shining bastion of the future state of tech for you to call home.

I'm also excited to welcome all of our new shareholders to our journey. One of our goals in going public was to make it possible for everyone to own a stake in the future of competition. We sincerely appreciate your support, and we're grateful to have you join us for this journey.

Finally, I wanted to take a moment to welcome our two new Board members. The first, as announced, is famed film and television producer Jerry Bruckheimer. Jerry is the only person in history to have three of the top 10 TV shows at the same. He has captivated global audiences and enriched the lives of billions of people, and we're thrilled to have him join us on our journey at this pivotal moment as we're helping accelerate the shift towards interactive entertainment.

We're also very fortunate to add Chris Gaffney, the Co-Founder of Great Hill Partners, to our Board. Chris is an early investor in Skillz, and he's been an incredible partner and supporter of Skillz ever since. Throughout his career, he served on 48 boards and he has participated in more than 100 acquisitions, and with this addition we're looking forward to having his expertise in gaming and in media on our Board.

We launched Skillz's eight years ago with a mission to enable developers to share the art with the world and to connect gamers to meaningful competition. In building the Skillz platform, we've remained focused on gaining and maintaining the trust of our users and developers. Winning this market is entirely about protecting the consumer from cheating and fraud, which is why our platform is underpinned by data science and has a robust portfolio of 58 pending and issued patents.

Our success in the platform has brought on a surge of copycats and clones (inaudible) way, and for all of those who are newer to our Company and our story, our number one value is honor. We plan to vigorously defend our intellectual property against these criminals who represent the tearing down of the very pillars of the foundation of capitalism.

Today, gaming is larger than movies, music, and books. At \$86 billion today, mobile's the largest segment in gaming, and the fastest-growing market in media and entertainment. Our current forecasts show that by 2025, the mobile gaming market will reach 161 billion, driven by the proliferation of mobile devices. Smartphones and tablets are expected to double by 2025. Mobile gaming is interactive content built for interactive devices, and that's what makes it the future of entertainment. We power more than two billion tournaments a year, enabling developers to monetize through competition. Our developer partners are building successful businesses with us. They generated 1.6 billion in GMV, or gross marketplace volume, for 2020.

The Skillz platform delivers superior player engagement and monetization. In 2020, 2.6 million monthly active users, or MAU, enjoy games on our platform, a 62% increase over 2019. Our users are deeply engaged in our platform. The average paying users spend roughly an hour per day on the platform. We continued to improve our value proposition, and will continue to do so into the future for the gamer and for the developer. We're becoming more effective at converting playing users into paying users.

In 2020, 13% of our users engaged in prize competition versus 2% for the average mobile game for in-app purchases. This high level of engagement, together with the increased number of payers, powered our revenue to grow to \$238 million for the year and \$68 million for the quarter, representing 92% and 95% growth respectively over those prior periods. As we look ahead, we will continue to prioritize our developer success, drive innovation, and expand the reach of our platform.

Today, I want to highlight three areas for investing in to support these goals.

First, in-partner enablement. Over the past year, of the many areas we've continued to invest in is our synchronous gameplay ecosystem. We're expanding the reach of the platform to enable new gaming genres ranging from real-time strategy, to fighting, to racing, to first-person shooters. These are incredibly popular genres, and Skillz is uniquely positioned to deliver the same fidelity, trust, and reliability that have been the hallmarks of our platform since inception. Synchronous content will deliver even higher player engagement than we've seen before and will further expand our universe of players, and more importantly, perhaps, payers.

Second, in highly-scalable technology infrastructure. We've made significant investments in our fault tolerant and microservices architecture, our fast data architecture, and automated incident response systems. These enable us to efficiently scale our platform with cutting edge performance and resilience, while continuing to deliver industry-leading reliability of over 99.9% uptime as we scale, and results in less than half of the outages of a typical gaming company. Our fast data architecture in the future will continue to unlock new opportunities for AI, such as greater personalization. Our modern technology infrastructure and scalable architecture are very much the key to achieving our 95% gross margins.

Third, in talent. We have a proven and scalable approach for talent acquisition that yields superior hiring outcomes; a stronger, happier workforce; and best-in-class retention. In Q4, we grew headcount by 16%,

making high-impact talent additions across the Company. This new talent strengthens our benches to continue our journey to build a 100-year independent Company. We're building a dynamic ecosystem with powerful network effects.

The challenge facing many developers today is that scaling a mobile game requires significant capabilities that are beyond the reach for many of the world's 10 million game developers. Our platform is easy to integrate and provides developers with a powerful set of analytics, payments, customer service, and live operation solutions that they need to deliver a fun and fair competitive gaming experience to their users. With Skillz, developers can focus on what they do best, which is making great games.

I'm going to share a recent example, so you can get a sense of the power of the platform.

Big Run Studios is a gaming studio founded by industry veteran Andrew Bell. Andrew worked on some of the top games at LucasArts before leading production design for FarmVille at Zynga. He then left Zynga and he built Harry Potter: Wizards Unite for Warner Brothers. He spent four years there, and then he quit his job. Why? To found a gaming studio dedicated to building Skillz games for under-represented audiences. He decided to raise his first venture capital. The round was oversubscribed so quickly, when I introduced arm investors, they couldn't get in. Three months later, their first game, Blackout Bingo, was one of the top 20 free games on the iOS App Store. Off that success, they raised another venture financing, a Series A, to continue building nothing but Skillz content.

Today, as of Q4, I'm excited to share that Big Run's games is now the number one game on our platform. Skillz makes this path accessible to any game developer whether they're independent or currently at a big studio. We stand for anyone who wants to bring their art to the world and enable these creators to build long-term, independent companies.

As we advance our mission, there's a long runway ahead of us and many opportunities to drive growth. We've captured just a fraction of the market at 0.1% of the world's gamers on our platform.

Next, I'd like to share four investment initiatives that are incremental to our forecast; content, distribution, international expansion, and brand integration.

First on content. We still have not had a true blockbuster game. Certainly, Big Run was number 17 when it launched, but we've never had a number one hit on either App Store. This is one of the most exciting things I look forward to. We have a significant opportunity to bring new content offerings to consumers. To that end, this quarter, the popular arcade game, Big Buck Hunter, announced that they're building the next version of their game on Skillz. This is really exciting because they were an early partner in 2014. They didn't see success in their first version, but they've come back to build again. It's a strong testament to the growing power of the platform that they've come back to us, and we're all wishing them a lot of success with their next mobile version of the popular arcade game. Additionally, this partnership expands our content to the first-person shooter genre, one of the most popular categories in modern gaming.

Second, on distribution. I wanted to talk about the new multiyear agreement with the NFL. We're giving mobile game developers a path to develop an NFL-branded mobile eSport using Skillz platform. The NFL is one of the most iconic brands in the world. We're honored to bring it to the Skillz platform. In Q2, the NFL and Skillz will launch a developer challenge, but it'll take multiple quarters before our winning games in market. The winning developer will have joint marketing support from both the NFL and Skillz, and with a fan base of hundreds of millions, promotional marketing from the NFL represents a unique distribution opportunity that's not in our forecast.

Third, on international expansion. Today, more than 90% of our revenue comes from North America, and the international market is four times the size of that. Our first international market outside of North

America is India, and we expect to launch that market later this year. India's mobile gaming market has already reached 137 million gamers and is expected to grow at 26% per year. With that perspective, the U.S. market today is approximately 210 million gamers, and it's growing 6% per year. India is already two-thirds the size of the U.S. market, but it's growing four times faster.

Fourth, and finally, we see significant opportunity in working with brands. Integrated brand partnerships create value both for the consumers seeking new experiences, and also for the brand looking to reach their fans and customers through new channels. In 2020 alone, we paid out \$1.3 billion in consumer prizes. If brands had sponsored 10% of prize pools, we would have generated \$130 million in incremental revenue, nearly all of which would have dropped to the bottom line.

I've talked before about our 100-year journey. This is year 8 of 100. There are many exciting quarters and chapters yet to be written, so I'd just like to thank everyone here on the call today for joining us on our journey. Together, we're defining a pivotal moment in the history of gaming, and more broadly, in the future of media.

For many years, the independent game makers have been held back by systemic advantages controlled by a select few. By democratizing this market, together, we're leveling the playing field by enabling those creators to compete. We are making gaming better for everyone, everywhere. Together, we will realize our mission of eSports for everyone.

I'll now turn over the call to Scott, our CFO, to discuss the financials.

Scott Henry

Thanks, Andrew, and thank you all for joining us on our first earnings call.

This is an exciting time in our business, and I'm very pleased to start our life as a public company with such a strong quarter. Before digging into the results, I thought it could be helpful to provide a brief overview of our financial model.

We have a transaction-based business where we take a percentage commission on every contest running across our platform. The average entry fee is about \$3 per person, so based on a 14% take rate, we're earning \$0.84 of revenue for two-player contests. We're running millions of these micro transactions each day, which provides us with high revenue predictability. There are many levers that drive our revenue, including the number of paying users, the number of paid contest entries per day, the number of days played per month, the average entry fee per contest, and the take rate. All these factors boil down to paying monthly active users and average revenue per paying user.

Now, we can turn our attention to the results.

Revenue nearly doubled during the fourth quarter to \$67.7 million, up 95% over the same period last year. For the year, our revenue was \$230.1 million, up 92% over the prior year. This exceeded the full year guidance we provided in our Q3 earnings release of \$225 million. Our revenue growth for the year was powered by 101% increase in paying monthly active users.

For the quarter, we continued to have a strong gross margin of 95%. Most of our cost of revenue consists of payment processing, end user support, and server costs, which are all variable expenses.

Adjusted EBITDA for the quarter was a negative \$23.8 million versus a negative \$7.8 million last year, driven largely by higher sales and marketing investment. An important metric that we track in our business is Adjusted EBITDA before user acquisition marketing, or EBITDA before UA. We think of this

as a proxy for the profitability of the existing users on the system. We then decide each month how much we'll invest to acquire new users based on the ROI we expect to generate. User acquisition marketing in the quarter increased to \$40.5 million, up from \$16.3 million in the prior period.

For the quarter, Adjusted EBITDA before UA increased 98% over the prior year. As a percentage of revenue, that was 25%, which is consistent with the prior year. We are more focused on growth in Adjusted EBITDA before UA dollars than margin, and expect margin to fluctuate from quarter-to-quarter, based on the timing of investments we are making in headcount and engagement marketing.

Now, let me discuss some of our key operating expense lines, all of which will be discussed on a non-GAAP basis, which means that it excludes stock-based compensation expenses, depreciation and amortization, and one-time transaction-related expenses. We believe this is useful to help understand underlying trends.

For the quarter, R&D grew 46% over the prior period. This was primarily driven by headcount as we continue to invest in the platform features that drive user engagement; retention and payer conversion, which are core to our superior monetization of the models that rely on ads and in-app game purchases. As a percentage of revenue, R&D was 7% for the quarter, down from 10% in the prior-year period, highlighting the scalability of our platform and the opportunity for investment to accelerate our product roadmap.

For the quarter, sales and marketing grew 129% over the prior period. This was driven by investment in user acquisition marketing to accelerate market penetration, and in marketing programs to drive end user engagement. As a percentage of revenue, sales and marketing was 113% for the quarter, up from 96% in the prior period. As a reminder, our sales and marketing is comprised of user acquisition marketing costs and end user engagement marketing, in addition to salaries and related expenses. These end user engagement marketing programs target existing users on the platform to increase their engagement and retention. Our user acquisition marketing programs target the acquisition of new users to the platform. We can shift spend between those marketing programs to generate activity within our existing player community or increase the number of users on the platform.

For the quarter, G&A grew 73% over the prior-year period. As a percentage of revenue, G&A was 11% for the quarter, down from 12% in the prior-year period.

We ended the year with an average three year LTV to CAC of 3.8 times, down from 4.5 times as of Q3, driven by rising ad costs. We believe this is an industry-leading metric, and we have a plan to improve it. We've never had a cohort stop paying, and for seven years now, every cohort has continued to grow. As a result, we've realized an additional 102% of LTV after the first three-year period, which is not captured in that metric.

We ended the year with \$262.7 million of cash and no debt on the balance sheet. I would also like to point out that it is our intention to exercise a redemption right on the public warrants promptly after the effectiveness of the S1 registration statement for the shares underlying those warrants. Assuming all the public warrants exercise on a cash basis, that would generate an additional \$198.4 million of cash for our balance sheet.

Now let's move on to guidance.

As set forth in our press release, today, we are initiating our full year 2021 revenue guidance at \$366 million. This represents 59% growth on a year-over-year basis over our 2020 results.

In closing, we executed well and are proud of the results we delivered in our first quarter as a public company. Our combination of high growth at scale and strong operating discipline is unique. The large and rapidly-growing market opportunity we see ahead of us is very exciting. We'll continue to use our ROI-based framework to take advantage of opportunities to accelerate growth.

With that, thank you for joining us this afternoon, and we're happy to answer any questions.

Operator, please open the line for questions.

Operator

Thank you, sir.

Presenters, our first question comes from the line of Michael Graham from Canaccord. Your line is open. You may ask your question.

Michael Graham

Hi. Thank you, and congrats on getting public and on getting these numbers out. It's exciting.

I wanted to start off with a question just about game concentration and revenue concentration. Through your own disclosures, we know that you have a lot of concentration of revenue and a few games. I think that's been by design, just sort of marketing around those games to grow the ecosystem there, but I just wonder if you can comment on your philosophy there, in general, and then I believe there was a third-party report out there, suggesting that download activity might be slowing down a little bit in some of those key games, and I just wonder if you could maybe talk about what you're seeing there, and how that's shaping the business going forward? Thanks so much.

Andrew Paradise

Sure, happy to answer your question. This is Andrew Paradise, so thank you for that, Michael.

In terms of developer concentration, I know we're a newly public Company, so people aren't as familiar with how our business mix has always worked. Media businesses always have concentration because consumers seek out the best experiences. The most popular content has the biggest audience, but generally, the rising tide lifts all boats. Our previous number on titles, they've actually all continued to grow in GMV, even after being displaced from their position. The concentration has shifted from developer to developer over time, so for those listening who are familiar with Tether, previously, our largest customer, they joined our platform, actually, in 2017. There was the largest customer ahead of Tether, in fact. As of now, actually Big Run, which joined us in 2019, Big Run changed over to being the number one title on our platform. I can tell you candidly today and in the future, we won't know who will be the next number one title, but we can be certain that it will shift over time, as we've seen time and again.

Michael Graham

Okay. Thanks so much. I appreciate that. I'll turn it over to the queue.

Operator

Thank you. We do have another question from the line from Drew Crum from Stifel. Your line is open. You may ask your question.

Drew Crum

Okay. Thanks. Hey, guys. Good afternoon.

You've discussed Android as a growth driver for the business. With Google recently updating their terms of service to permit the distribution of licensed gambling applications via the Play Store, is there any update you can share with respect to eSports, and any read through as to what the implications are for Skillz.

Then separately, maybe for Scott, you shared the annual revenue guidance for the year. Can you talk about how we should be modeling or thinking about the quarterly phasing for revenue in '21? Thanks.

Andrew Paradise

Sure. Thanks for the question, Drew. Again, this is Andrew here.

In terms of the Google Play Store changes, so Google recently updated their terms of service to permit the distribution of licensed gambling applications, as you referenced. This update doesn't actually directly impact Skillz, but I would say it's indicative of a broader positive trend towards enablement of emerging content categories. I would point out that even without the Play Store, we've been growing Android revenue, and our installed base are at twice the rate of iOS on alternative app stores.

Scott Henry

Hey, Drew, I'll tackle your second question about guidance, right, and how you should think about phasing.

As we indicated, \$366 million is the revenue guidance for the year. Typically, in our business, we see a fairly significant increase in the first quarter, and then we see a flattening out over Q2, Q3, and Q4, but as you see, we're making significant investments. We see an opportunity to make significant investments to grow share and drive long-term value, and that investment should steepen our longer-term revenue growth trajectory, and actually, you'll be able to see—the exit velocity in 2021 will be noticeable from that investment.

Drew Crum

Got it. Okay. Thanks, guys.

Operator

Thank you, sir. We do have another question from the line of Eric Sheridan from UBS. Your line is open.

Eric Sheridan

Thanks, guys. Appreciate it.

Just going back to the answer in the commentary on sales and marketing, can you give us a little bit, whether it's either qualification or qualification, of how we should think about the way in which in the past quarter you spent sales and marketing dollars towards a mix of user acquisition and user incentives? Obviously, the user number came in a little weaker than some of us had modeled, but the revenue number was a little bit better, so just trying to understand a little bit of the dynamics of pushing and pulling on certain levers in the business, and then the second part of it would be leaving the December quarter

behind, how should we think about—philosophically, you're thinking about the mix of those sales and marketing levers, not only in Q1, but as we move through '21? Thanks so much.

Andrew Paradise

Eric, thank you for the question.

I think the way to think about is, we're the clear leader in what we see as a trillion dollar market, and now's the time to invest in capturing that market through a portfolio of investments with both near-term and long-term horizons. I'd remind everyone on the call, we built a \$230 million revenue business with \$128 million of capital deployed as of year-end 2020. We're a ROI-driven culture, and our plan, very much for the next \$128 million, is very similar to our plan for the first.

Scott Henry

Yes, and Eric, I'll tackle your next—your second question there, right?

You have to keep in mind, right, we make money from paying users, right, which is why we focus on growing our paying now, not necessarily growing our now, so in Q4, paying now is up 121% year-over-year and 13% quarter-over-quarter, so when we make money from our non-paying now, we'll focus a little bit more on that metric, right, but for now, right, the driver that really moves the needle in our business is paying attention to our paying now. Engagement marketing increased, right, as we invested in a variety of different things to test in dry player conversion, and that's why we were able to hit a record in Q4. Sixteen percent of our users we were able to convert to payers. That's up from 10% in Q2.

Eric Sheridan

Great. Thank you.

Operator

Thank you, sir. We have another question from the line of Brian Fitzgerald from Wells Fargo. Your line is open.

Brian Fitzgerald

Thanks, guys. Couple of questions.

Maybe first up, it's related to Eric and Drew's questions, and that's on Android, but also IDF. Can you talk to us about the channels for CAC that work best for you right now, and how you see that changing? Maybe they do, maybe they don't as the economy opens, and then also as important—I think we're going to ask this a lot—how does IDFA impact you in terms of iOS, and then the second question, sorry, was just about can you—how do you feel about your ability to scale the number of players and the number of tournaments and the ability to match like skill sets as you scale users, right? There is some trade-off between, hey real-time matches are fun, but you want to be matched up against somebody who's a like-for-like skill set, and so sometimes you step in the games where we're like saying, we don't have somebody that's of your ilk, and so hold what you got and we're going to come back to you, and so there's a balance between driving the engagement, and—but also driving the matchability, if you understand that? Thanks.

Andrew Paradise

Sure, Brian. Thank you for the questions. This is Andrew again.

First, I think to kind of break this part, one question—one is about IDFA, and how that will impact advertising. Question two is discussing the data science on the platform in terms of fairness as we scale, so let me hit the first one, which is IDFA.

We don't really expect a material negative impact on our business from IDFA changes. It could be a small positive for our business, in fact. If you think about IDFA, what's happening is it's making ad targeting less precise, and that has two implications for Skillz.

First, you have more limited targeting, which likely means lower CPMs, which challenges ad support business models and actually makes Skillz' monetization even more attractive to the developer community, so, it'll actually accelerate adoption for us.

Second, IDFA, it's exposing businesses that are reliant on targeting niche audiences, so if you think about us as a platform with thousands of games, we actually cut across many different demographics. We can buy broad audiences that others can't in our sector, and we'll be happy to do so at lower prices as other bidders are dropping out of the market.

Separately, to answer your second question, which was on data science and about fairness, we are only seeing, actually, faster and fairer matching at continuous scale. Actually, the system functions at pretty low levels of daily audience per game. We designed it so that it could auto scale from very small games up to very large ones, and so as we're seeing games pushing that headroom and becoming bigger and bigger, we're actually seeing improvements in our ability to deliver a fair outcome, and it's a system I point out to those who are newer to the story. The data science investments in our Company have been deep and significant for, actually, the life of the business.

When I came in seven years ago, we were a five-person team. We had three data scientists on the team, and we've only scaled up from there. It's been, I'd say, a very important defining feature of Skillz to invest in data science and to really focus on how to deliver fair, fun, and meaningful competition.

Brian Fitzgerald

Awesome. Thanks, Andrew

Operator

Thank you. There are no further questions at this time, presenters. I would now like to turn back the call to the CEO and Founder, Andrew Paradise, for closing remarks. Sir?

Andrew Paradise

Well, I just wanted to thank everyone for attending the call today. We really appreciate your time. We look forward to providing an exciting update on our continued progress when we report our first quarter results, and hope you'll tune in then.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect. Thank you for joining us. You have a good day.