

Versus Systems (VS.CA): Next Generation Gaming Advertising Solution (06/14/2020)

Business Description: Versus Systems Inc (VS). operates a business-to-business software platform that allows video game publishers and developers to offer prize-based matches of their games to their players. Its Winfinite platform, an in-game prizing, and promotions engine that allows video game publishers and developers to offer in-game prizing to their players through mobile, console, PC games, and streaming media.
- *TIKR.com*

Thesis: VS is about as close to venture capital in public markets as you can get. The company barely generates revenues, sports a history of operating losses and finances the company through equity/debt issuance. That said, VS' in-game advertising system is unlike anything on the market. In-game rewards-based advertising improves brand ROI >3x, increases gameplay time 34%, and leaves the user feeling better about their in-game experience. Insiders own 25% of the company. Interests are aligned.

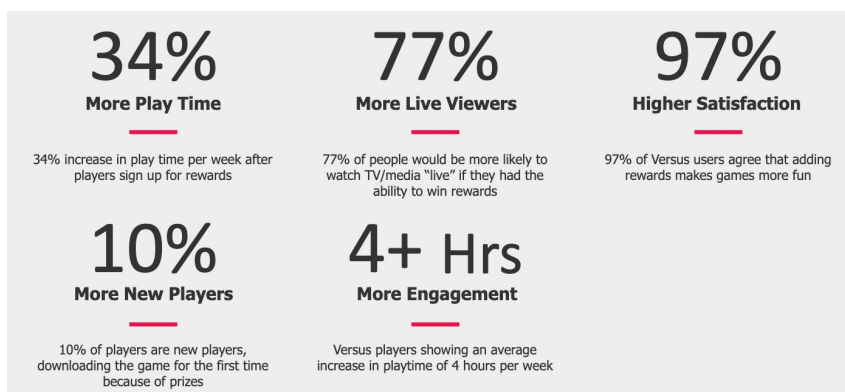
The Power of Rewards-Based Advertising

People love choice. They love the feeling of deciding the outcome of something. If there's one thing that we feel we have no control over, it's ads. We hate ads. Especially when we want to do something else (like crush those candies). Anecdotally this is true. Whenever I see an ad pop-up on an app or on a website, the first thing I do is find the "X".

Every ad is 100% opt-in. Players choose to experience the ad for the chance to win real-world company prizes.

That's why Versus' patented software *Winfinite* is so powerful. Now, brands can advertise in-game through achievement-based rewards programs. In other words, kill "x" amount of people in Fortnite and win a coupon for a free White Castle burger. The rewards are built into each specific game's regular incentive structure. NASCAR's Heat Mobile game is a good example. If you win the race, the rewards-based advertisement would reward you with whatever prize you chose. It's built-in to the mechanics of the game.

Versus is shifting the ad game from forced watching to voluntary selection based on a user's preference and taste. This is a big deal. Why? People *love* rewards. Who wouldn't want a free cup of coffee if they place 3rd or higher in a solo Fortnite match?



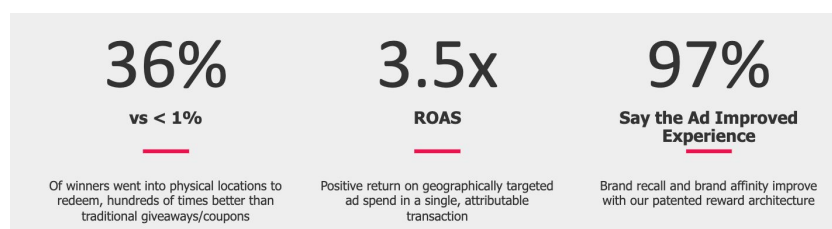
Rewards-based advertising creates a win-win-win for the advertiser, brand, and game developer. The advertiser wins through the gamer's increased engagement with their product/brand. The gamer wins because he/she wins real-world prizes on the things they *enjoy*. Finally, the developer wins because gamers now spend *more* time in the game and on their platform.

This win-win-win scenario creates a tremendous incentive for developers *and* advertisers to join the platform.

Increased ROI For Advertisers

Versus helps companies increase engagement on their advertising campaigns.

Versus' Rewards-based advertising prompted 36% of winners to travel to a company's physical store to redeem what they won in the game. Compare that to a <1% conversion rate for other ad platforms.



Second, advertisers receive 3.5x ROA on a single, geographically-targeted transaction within the Versus platform. In other words, advertisers receive \$3.50 for every \$1 they spend advertising in Versus.

Finally, 97% of gamers surveyed said a rewards-based ad actually *improved* the in-game experience.

Integration with HP Omen & Chinese Market

The real growth driver for Versus is their integration with the HP Omen gaming laptop series. The company signed a multi-year contract with HP making Versus' *Winfinite* software the *default* rewards-based advertising platform in each Omen laptop/desktops.

Omen users can opt to play in the Omen Rewards platform. This platform allows users to win real-world rewards from games they already were going to play. And the list of rewards-enabled games is big:

- Overwatch
- Fortnite
- League of Legends
- PUBG

The HP integration matters for one big reason: **Switching costs**. Gamers can't opt-out of using Versus' system *if they want* in-game rewards. Also, it'll be hard to replace Versus' system after the initial deal runs course.

If players grow accustomed to the in-game rewards and hardware sales rise, why would HP opt for another in-game rewards system? Again, it goes back to switching costs. Even if another competitor had a cheaper software solution, it's expensive to rip software out of every gaming laptop and desktop.

HP Omen is also expanding into China. Normally it makes me cringe when I hear micro-caps mention “China” in their pitch decks. But this one makes sense. China is the leader in esports/gaming.

Transaction-Based Revenue Model

The company operates a cost-per-engagement (CPE) pricing model. This is different from a standard cost per click (CPC) model used by companies like Facebook and Google.

CPE models offer advertisers tangible returns on their spending that CPC programs can't match. The difference between CPE and CPC models lies in what the advertiser pays for.

- CPE: Advertisers pay when a user *engages* with the ad (hitting like, entering an email, sharing the ad on social media)
- CPC: Advertisers pay when a user clicks on the ad

Versus charges \$0.50/engagement. Much lower than Facebook's \$1.74 CPC offering. Yet Versus delivers a much better engagement proposition with advertisers.

According to VS' financials, the revenue model breaks down to this:

“Versus sells the opportunity to place in-game prizes to advertisers who wish to place product in-game, sharing a certain portion of the gross receipts with the content and game owners. Current agreements range from 50% to 60% of revenue being shared with the publisher/developers, with the remaining 50% to 40% of gross receipts belonging to Versus.”

Here's some stats to back up that claim:

- 44% more sessions per player on Winfinite than standard gaming mode
- Gamers interact with advertisements an average of 14.8 minutes per campaign
- Email open rates of 54%

Thinking About Revenue Growth

The company is still in its developmental stage with barely any revenue coming through the door. Like we mentioned, it's as close to venture in public markets as you can get. That said, what would revenues look like over the next 3-5 years?

The company generated over \$700K in TTM 2019 revenues. But that was before integrating with HP and entering the Chinese markets.

An honest answer to the question: “how much revenue can they generate in five years” is **I have no idea**. That's the trouble with developmental-stage companies. But let's try. The company did \$700K in receipts form TTM 2019. Given their revenue splits, that means they generated \$1.4M in sales split between the publisher and Versus. That's for two (small) games: NASCAR Mobile and Emoji Charades.

Editor's Note: As of writing this I am trying to get in touch with VS investor relations to better understand the unit economics of its business. Will update with new information.

Now, HP's Omen series provides Versus an audience of over 100M monthly users. The best part, Versus pays \$0 for these customers. Game developers and publishers spend all the acquisition cost to get the user on their game.

Analysts expect \$10M in revenue for 2020, a gigantic leap. But given the recent developments, it's not too hard to imagine that.

Going forward, we think VS can double revenue in 2021 and reach \$30M in top-line by 2024. If that happens (and again, a **huge** if), you'd pay around 1x sales for a company growing top-line over 100% CAGR.

Risks

Where do we begin with risks? The company's barely made revenues, generates massive operating losses, and needs equity/debt markets to fund its operations. VS also trades on the Canadian exchange, flying under the radar of most US-based investors.

If the company doesn't **massively** grow top-line revenue then there's a non-zero chance this is worth \$0. That's where position size comes in. Treat VS like a call-option. We recommend no more than 1-2% of capital at this stage.

Technical Analysis

Monthly Chart



VS is range-bound between \$0.375 and \$0.175. If we get a retracement to the lower-bound of this rectangle it would create an ideal reward/risk initial set-up. We're also looking for the breakout to the upside of the pattern.

Weekly Chart

Stock remains below its 50MA on the weekly chart. This gives us a higher probability chance we'll see the stock test its support level.