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Q3 2022 Creative Realities Inc Earnings Call

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CORPORATE PARTICIPANTS

Will Logan *Creative Realities Inc. - CFO*
Rick Mills *Creative Realities Inc. - CEO*

CONFERENCE CALL PARTICIPANTS

Brian Kinstlinger *Alliance Global Partners - Analyst*
Howard Halpern *Taglich Brothers - Analyst*

PRESENTATION

Operator

Good morning. At this time I would like to welcome everyone to the Creative Realities Inc. Third Quarter Earnings Conference Call. This call will be recorded. A copy will be available on the company's website at CRI.com following the completion of the call.

The company has prepared remarks summarizing the third quarter results, along with the additional industry and company updates. Joining me on the call today are Rick Mills, Chief Financial Officer; and Will Logan, Chief Financial Officer. Thank you very much. Mr. Logan, you may begin.

Will Logan ***Creative Realities Inc. - CFO***

Thanks, [DeeDee]. Good morning. This is Will Logan, Chief Financial Officer of Creative Realities. Welcome to our financial results and earnings call for the 3 and 9 months ended September 30, 2022. I would like to take this opportunity to remind you that our remarks today will include forward-looking statements.

The words anticipate, believes, expects, intends, plans, estimates, projects, should, may, propose and similar expressions of the negative versions of such words or expressions as they relate to us or our management are intended to identify forward-looking statements.

Actual results may differ materially from those contemplated by these forward-looking statements. Factors that could cause these results to differ materially are set forth in our quarterly financial statements on Form 10-Q and in our annual report on Form 10-K filed with the SEC on March 22, 2022.

Any forward-looking statements that we make on this call are based on assumptions as of today and we undertake no obligation to update these statements as a result of new information or future events. During this call, we may present both GAAP and non-GAAP financial measures.

A reconciliation of GAAP to non-GAAP measures is included in our public filings and in our earnings release that was released yesterday -- this morning. It is now my pleasure to introduce Rick Mills, Chief Executive Officer of Creative Realities.

Rick Mills ***Creative Realities Inc. - CEO***

Thanks, Will. Good morning, everybody. I want to start this call with a shout out to all the CRI employees. Wow. What a great quarter. I am pleased to announce our Q3 2022 results and our continued progress towards our goals this year. Let's start with a focus on 3 key points.

Number one, we had record revenue of $11.2 million during Q3. That represents an increase of $6.4 million or 135% year-over-year. Our year-to-date revenue is $32.9 million which is also a record for 9 months ended September 30 and represents an increase of 152% year-over-year. Our year-to-date revenue eclipses our pre-pandemic 2019 full year of 31.6% which was then a record for the company.

But now we've exceeded that in just the first 9 months of 2022. The combined company has grown organically greater than 50% as compared to the pro forma results of the combined company through September 30, 2021. The results are in line with our previously stated target of achieving at least $43 million of revenue in the current year, a 40% organic growth rate from the pro forma combined company results in 2021. Again, let me state that again. Our year-over-year organic growth rate exceeds 40%, inclusive of the prior year with reflect results included.

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Point number two, EBITDA and adjusted EBITDA for the third quarter of 2022 was $1.5 million and $1.2 million, respectively, improving our adjusted EBITDA margin from 8.5% in Q2 to 11.2% in Q3, bringing our year-to-date adjusted EBITDA for the 9 months ended September 30, 2022 to 8.6%.

The Q3 EBITDA and adjusted EBITDA results are also 194% and 328% improvement over the same period in 2021. On a year-to-date basis through the end of September, the adjusted EBITDA of $2.8 million is a 131% improvement over the same period in 2021. As discussed on our prior call, we expect to continue to drive improvements in adjusted EBITDA and adjusted EBITDA margins as we scale this business and complete the integration of Reflect.

Point number three, the key strategic initiative of this management team remains growing our annual recurring revenue, or ARR which is primarily comprised of Software-as-a-Service or SaaS subscriptions to our enterprise-grade software solutions. Our stated goal entering 2022 was to increase our ARR run rate by 25% from $12 million on a pro forma consolidated basis for CRI and Reflex exiting 2021 to $15 million entering 2023.

Through the September 30, we have grown our ARR run rate to be in excess of $14.5 million and we remain on track to achieve the growth targeted for the current year based on known and expected commitments anticipated for the fourth quarter of 2022.

We will get into the Q3 results in more detail. But before I do, I want to speak on a few important events for the company. The Bowling transaction. We've talked about this in the past and we have received an anticipated deployment schedule from the customer and are in process today of updating the final pricing and contract.

This has been a 3-year journey and the customer has reconfirmed its commitment to CRI as its vendor of choice and has provided a preliminary deployment schedule beginning in Q2 next year. Stay tuned for a press release with more information but we anticipate to execute an agreement in the fourth quarter and begin deployment in 2Q of 2023.

Let's also talk about RFP activity. CRI continues to win in the market. We have been actively engaged in a number of RFP processes over the past quarter, many for nationally known venues, brands and chains. During the third quarter, we competed in an RFP process for a national QSR chain and were recently informed that we were selected as the go-forward digital signage provider for the chain.

The ultimate scope of work, scale of the deployment and timing remain subject to active discussions with the customer but we anticipate this will be announced prior to filing our annual financial statements and that this will be a significant win for our company and our shareholders. We are currently prohibited from naming the customer but are working through the legal and marketing processes in an effort to jointly announce.

Bridge loans. I want to take another moment to address the additional debt transaction announced on October 31. We borrowed $2 million on a short-term amortizing loan from our current lender. The company was afforded an opportunity to accelerate a material software development project for which there is currently pent-up unaddressed demand in the market with an existing customer. We believe the opportunity represents incremental SaaS-based software subscription revenues in excess of $5 million annually.

In Q1 of 2023, the company expects to collect $5 million of its annual SaaS billings which we anticipate will solve for these short-term incremental investments. However, we wanted to accelerate the development project and we borrowed funds with full anticipation we will repay this loan in the short term. Given the unreasonably low share price, we did not believe it was appropriate to sell equity to capture this significant opportunity. We anticipate material increases in our ARR from this existing customer beginning in January of 2024.

And finally, 2023 guidance. We have completed our initial 2023 budget process and I'm pleased to announce our 2023 revenue and adjusted EBITDA targets or guidance. Based on known and anticipated customer commitments for the coming year, we are increasing our previously communicated revenue target to $54 million, representing a 25% organic growth rate incremental to the 40% organic growth rate we have achieved in 2022.

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With the expected integration savings and increases in ARR, we expect adjusted EBITDA to grow to 15% in 2023. As you can see from these announcements, Creative Realities is well positioned to exploit high-growth opportunities in the marketplace. Now for the full Q3 2022 review, I will turn it back to Will Logan.

Will Logan *Creative Realities Inc. - CFO*

Thanks, Rick. I will now summarize our financial results for the 3 months ended September 30, 2022, as compared to the same period for 2021.

Regarding the 2022 results, we note that the MD&A section of our quarterly report on Form 10-Q which we filed this afternoon, provide unaudited quarterly financial information derived from the company's annual and quarterly financial statements. We've also provided a reconciliation of GAAP net income to non-GAAP quarterly EBITDA and adjusted EBITDA for the current and previous 4 quarters therein. Investors are encouraged to review such reports and reconciliations.

With respect to revenue, gross profit and gross margin. Revenues for the 3 months ended September 30, 2022, were $11.2 million, representing an increase of $6.4 million or 135% as compared to the same period in 2021, driven in part by the acquisition of Reflect on February 17, 2022 and the company's successful sales activities as a combined company post-merger.

During the 3 months ended September 30, 2021, the pro forma combined results of CRI and Reflect produced $7.7 million in revenues. The current year combined company results for the 3 months ended September 30, 2022, representing an increase of $3.5 million or 45% over the pro forma combined results for the same period in 2021. This year-to-date organic revenue growth rate was 53% as compared to the pro forma combined 2021 9 months ended September 30, 2021.

Hardware revenues were $5 million in the 3 months ended September 30, 2022, representing an increase of $2.8 million or 126% as compared to the prior year, driven by continued large-scale LED deployments in the quarter by multiple customers. Services and other revenues were $6.2 million in the 3 months ended September 30, 2022, an increase of $3.6 million or 143% with the inclusion of Reflect operations in the company's consolidated results for the full reporting period.

Managed services revenue which includes both our SaaS and help desk technical subscription services were $3.9 million in the 3 months ended September 30, 2022, as compared to $1.4 million in the same period in 2021, driven by the continued expansion in our SaaS software subscription base.

The long tail of hardware ultimately continues to drive these SaaS revenues higher period-over-period. This represents a year-over-year growth rate of 150% in our higher margin typically subscription-based managed services revenue.

Gross profit increased by $2.2 million or 92% during the 3 months ended September 30, 2022, as compared to the same period in 2021, driven by an increase in revenue but offset by a reduction in gross profit margin.

Gross profit margin decreased to 40.4% from 49.4% driven by less favorable revenue mix during the 3 months ended September 30, 2022, related to several material customer hardware rollouts during the year that had a lower gross profit margin than our software services. We expect this contraction in gross profit margin to be less severe as we move beyond 2022. We believe the gross profit margin for the 3 months ended September 30, 2021, to be more representative of our normalized long-term gross profit margins.

With respect to our operating expenses, sales and marketing expenses generally include the salaries, taxes and benefits of our sales and marketing personnel as well as trade show activities, travel and other related sales and marketing costs.

Sales and marketing expenses increased by $388,000 or 118%, driven primarily by the acquisition of Reflect via the merger on February 17, 2022 and our continued enhancement in investments into sales and marketing activities post Covid-19 pandemic.

Immediately following the merger with Reflect the company integrated the sales and marketing functions and did not disaggregate

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expenses between the two legacy companies. Following the merger and through the integration activities, the company has adopted certain tools, technologies and processes, particularly with respect to lead generation and brand marketing that we believe were undercapitalized historically by the company and are now paying dividends.

Additionally, the company engaged an Investor Relations firm and has increased its IR activities, including conferences and presentations. As a result, we expect the sales and marketing expenses of the company for the 3 months ended September 30, 2022, to adequately reflect the pace for spend in these areas in future reporting periods.

Research and development expenses generally include personnel and development tools and costs associated with the continued development of the company's content management systems and other related application development.

Research and development increased by effectively 5% in the 3 months ended September 30, 2022, as compared to the same period in 2021. The prior year included a benefit of $50,000 related to ERC credits, resulting in a net reduction in R&D expenses year-over-year for the 3 months ended September 30, 2022.

Through the merger with Reflect, we acquired a fully staffed experienced software development team and elected to keep that team intact, particularly given employment market conditions with respect to talented software engineers. We have integrated the pre-existing CRI development team with the acquired team and have experienced enhanced speed to market on new features and functionality development activities from increasing this resource pool.

Company's gross spending on research and development activities has increased in the current year as a result. However, the capitalized portion of those activities has also increased, specifically related to the investment into development and enhancement of specific products, features and functionality associated with our customer acquisition strategy in key vertical markets, including the specific opportunity that Rick spoke to previously. We expect an elevated level of expense throughout the remainder of '22 and '23 as we develop our current and future product set.

General and administrative expenses increased $1 million or 54%, driven primarily by the acquisition of Reflect in February of 2022 and the prior year inclusion of approximately $200,000 of a benefit from employee retention credits.

While the company anticipates carrying higher G&A moving forward as a result of the acquisition subsequent expansion in our organic revenues, the company continues to execute integration activities, including but not limited to consolidation of CMS tools, cloud hosting environments, IT tools and rightsizing of our leases and office space that we expect to be realized by the end of 2022 and into 2023. The company has improved EBITDA margins throughout the year as a result of these integration activities.

With respect to operating loss, net loss and EBITDA, operating loss was $284,000 during the 3 months ended September 30, 2022 which includes $800,000 and $500,000 in noncash charges for both the amortization of intangible assets and noncash employee and director stock compensation, respectively.

Net loss was $600,000 during the 3 months ended September 30, 2022 which included a $400,000 gain on marking outstanding contingent liabilities to fair value and $800,000 in interest expense, including $400,000 in amortization of debt discount included within interest expense. EBITDA was $1.5 million and adjusted EBITDA was $1.2 million for the 3 months ended September 30, 2022. The adjusted EBITDA margin was 11.2% during this period.

One other item of note in the financials, we did have a change in the fair market value of our contingent consideration during the 3 months ended September 30, 2022, with a mark-to-market contingent consideration issued in the Reflect merger which resulted in a gain of $442,000, primarily driven by an increase in interest rates and volatility in the period.

This liability is associated with the company's share price and will be mark-to-market quarterly until final assessment on February 17, 2025, the 3-year anniversary of the Reflect merger. At this point, I'll turn the call back over to our Chief Executive Officer, Rick Mills.

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Rick Mills ***Creative Realities Inc. - CEO***

Thanks, Will. Now that you all have the Q3 financial update, I want to take a moment to revisit our value creation points and how we are fulfilling and building on them. Point number one, grow revenue and that's a commitment we made to our shareholders. Q3 and the year-to-date period each represent all-time records at $11.2 million and 32.9%, respectively.

Again, surpassing the previous quarterly record revenue produced in Q2 of this year. So we're gaining from quarter-to-quarter. We again reiterate our previously provided fiscal year 2022 guidance of at least $43 million in revenue which does represent a 40% organic growth rate. And then today, we have announced our expectations to grow revenue at least 25% organically in 2023 and to exceed $54 million for 2023.

Point number two, improved margins. Our adjusted EBITDA has risen 2.6% sequentially quarter-over-quarter in both 2Q and 3Q of the current year, achieving 5.6% in Q1 and then growing that to 11.2% in the third quarter of 2022.

With our increased revenue guidance issued today of $54 million for 2023 and the anticipated growth in our ARR, we anticipate expanding our adjusted EBITDA margins to 15% in 2023. At scale which we define as $100 million in revenue, we believe this is a 30% plus adjusted EBITDA margin business that will deliver significant free cash flow.

Okay. Point number three, grow annual recurring revenue translate ARR to EBITDA and free cash flow. We have grown our ARR from a $12 million run rate at the end of 2021 to an excess of $14.5 million as of quarter end September 30. We remain on target to achieve our 25% growth rate to a target run rate of in excess of $15 million by the end of the year. Scaling our revenue and ARR run rate continues to translate to adjusted EBITDA at an increasingly marginal rate. Again, in 2023, we expect to exceed 15%.

Point number four, pursue review our capital stack for optimal structure and growth. As previously stated, the majority of our debt is non-amortizing for 2022. We have about $1 million in cash as of the end of Q3 which in addition to the $2 million loan closed in October, provides us a runway to realize the aforementioned effects to grow revenue and improve EBITDA. We will continue to evaluate our capital structure for opportunities to capture the unprecedented opportunities for growth while seeking to protect shareholder interest.

Point number five, scale high-margin services and media. We have previously discussed how the company is much more than a pure-play digital signage infrastructure company, especially given our expanded product set with high-margin services and media sales. This is a competitive advantage over the majority of pure infrastructure competitors for a variety of reasons.

Many enterprise customers require a one-stop shop and single vendor model for their digital signage and place-based media needs which our competition simply cannot offer. These enterprise customers require business solutions beyond a basic digital sign and CRI provides such integrated offerings and can upsell and cross-sell other products for a competitive advantage. Given our solutions and extended capabilities, we believe the company is best viewed as a sum of highly synergistic parts well beyond hardware sales.

And then finally, point number 6, opportunistically pursue accretive M&A. The platform for organic growth is in place with significant prospects to scale. As we execute our plan, the company continues to evaluate opportunistic strategic plays that are accretive. I previously communicated a vision to scale the business and our management team is focused on value creation in conjunction with this growth.

Will Logan ***Creative Realities Inc. - CFO***

[DeeDee], I believe that's the end of our prepared remarks. We'd like to open the lines for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Brian Kinstlinger of Alliance Global Partners.

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Brian Kinstlinger ***Alliance Global Partners - Analyst***

Nice results. I have a handful. The project related to the $2 million loan. I may have missed it. Can you just add a little bit more detail about this project and timing of adding that annual recurring revenue?

Rick Mills ***Creative Realities Inc. - CEO***

Yes. Brian, this is Rick Mills. I'll take that. So it's a specific platform that we have one customer on and the customer, we have internationalized the platform which was really what the project was all about. The customer has been on the platform in the U.S. centric for a number of years, wanted to expand and added Canada which we had previously announced press release and is now looking to add multiple countries around the globe and go global with the project.

We believe we will be releasing the finished product in May of 2023 which there'll be some user testing around the world, et cetera. But in the fall of 2023, we expect to be signing up new subscriptions for other countries that will adopt at wholesale and we expect those countries to bring additional SaaS revenue starting January 1, 2024. We may get some on at the end of Q3, 2023 but we want to be conservative, so we're assuming that the revenue increase will occur in early 2024.

Brian Kinstlinger ***Alliance Global Partners - Analyst***

When is the debt due, the $2 million?

Will Logan ***Creative Realities Inc. - CFO***

The debt amortizes over the next year, so it will close by the end of September 2023. And we looked at this as an incremental bridge between the material annual SaaS billings that we have at the beginning of the year. The Reflect structure was much more annual build SaaS upfront. The CRI model has been monthly and quarterly. So that's the -- the position.

Brian Kinstlinger ***Alliance Global Partners - Analyst***

Great. Yes. And then can you comment on two things, first, the Freddy's contract as well as the amusement park systems upgrade. Is there a major contribution this quarter from both? And maybe talk about the expectations of ramping in the case of Freddy's or the cadence in -- as it relates to using parts over the next few quarters?

Will Logan ***Creative Realities Inc. - CFO***

I'll take the first piece of that. There was about $1 million of revenue in the quarter from incremental theme park customer activities. We expect that to probably increase in 2023. Fourth quarter tends to be a little bit slower for those folks but there was about $1 million added in the current year. Rick, do you want to comment to the go forward on the Freddy's side in 2023?

Rick Mills ***Creative Realities Inc. - CEO***

Yes. I'm happy to. So Freddy's, they have adopted --, as we announced, they have adopted our drive-thru. And so, it's easy to say that in 2023, will be our largest revenue year with Freddy's by a long shot. We have a double-digit number of drive-thrus on order and anticipate -- of course, that follows a construction schedule.

But right now, we believe we have 50 to 60 drive-throughs on the upgrade path over the next 12 to 18 months and to put that in perspective, Brian, just as a ballpark that in itself is $2 million worth of revenue, something like that. And then plus, you add all the inside work and Freddy's is continuing to grow. I hope that answers the question.

Brian Kinstlinger ***Alliance Global Partners - Analyst***

Very helpful. And then as it relates to the customer, you can't name that you're set to hopefully win and sign a contract with. I think if we shouldn't assume that begins ramping until around the second quarter. And then is there any way to size that? Is it bigger than Freddy's? Is it about the same size? How should we think about that?

Rick Mills ***Creative Realities Inc. - CEO***

Look. That's a great comment or great question, Brian. I can tell you how we look at it as the company. Based upon the preliminary discussions with them and the RFP process and what they ask us for, we believe the revenue opportunity is between $30 million and $40

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million over the next 2 years. So it is significantly larger -- this is one of the top 5 fast casual chains in the nation, maybe top 10, certainly with over 2,000 locations and over 1,000 of those will contain drive-throughs.

So the drive-through revenue alone is north of $30 million. We're really, really excited about it. We are converting the proof-of-concept stores are all being converted as we speak. Will Logan and his team are working on the statement of work and the contract with the customer. We expect those to be executed certainly pre-Christmas, if not post-Christmas and we look forward to a strong start in 2023.

Will Logan ***Creative Realities Inc. - CFO***

And Brian, I think your assumptions on timing are correct. We believe that this would begin in earnest in 2Q.

Brian Kinstlinger ***Alliance Global Partners - Analyst***

I have one more question, I'll get back in the queue with my others in case and others have. In terms of challenges with all this going on, can you talk about your ability to source media players and if it remains a challenge and I know it's been somewhat in the last quarter or so or two. Are there alternative suppliers you can work with to make sure you can meet the surge in demand?

Rick Mills ***Creative Realities Inc. - CEO***

Yes, there's alternative suppliers, number one. However, on a hardware-based media player. We standardized and we have really 2 form factors. One is a company called BrightSign which is also transitioning its product line. So they have some sourcing issues or supply chain challenges but they're also switching product line.

The new product line will be fully introduced and fully available in March of 2023. We see no obstacles between now and March that we can't overcome. We also -- a number of our deployments use a software-based player, if you will, or SOC system on a chip. And so, Freddy's and our other QSR significant customer that we've just talked about, both use SOC, software on chips, so there will be no supply issues there.

Brian Kinstlinger ***Alliance Global Partners - Analyst***

Great. I have another question or two but I'll see if others have and I'll get back in the queue.

Operator

(Operator Instructions) Our next question comes from Howard Halpern of Taglich Brothers.

Howard Halpern ***Taglich Brothers - Analyst***

And my question is in terms of the advertising now piece of the business which you're starting to ramp, what is the current pipeline or backlog that you see going forward on the existing screens that you have?

Rick Mills ***Creative Realities Inc. - CEO***

That business is -- we acquired that as part of Reflect. We have now evaluated, we've retooled it. We've added additional resources to it as we come into 2023. We expect some growth in 2023, Howard.

But in all honesty, we expect moderate growth in 2023, where we expect significant growth is in 2024 because you need to invest 6 to 8 months in advance because in the summer of 2023, we will be selling 2024 contracts. So today, our media business is maybe 3 million, 3.5 million a year ballpark is somewhere in there but we expect that to explode in 2024. So we're making significant investments now that will be ready for 2024.

Howard Halpern ***Taglich Brothers - Analyst***

Okay. And are there -- are you seeing any kind of maybe acquisition tuck-in acquisition opportunities to help advance the growth in that particular segment?

Rick Mills ***Creative Realities Inc. - CEO***

I would not call them additional tuck-in acquisition opportunities. That's really about finding the "right" employees, sales staff and also the right partners -- and so we are -- we've expanded our contractor relationship and partner relationship to drive results in that area.

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Now if a tuck-in acquisition came along with $4 million, $5 million, $6 million in media sales, we jump on it. But today, currently, none in our active pipeline.

Howard Halpern ***Taglich Brothers - Analyst***

Okay. And since I'm still relatively new to the story, are there -- is there any sequential seasonality between the third and the fourth quarter in terms of, I guess, it would be more in terms of the hardware deployments that would occur?

Will Logan ***Creative Realities Inc. - CFO***

Yes, Howard, I think historically, the -- on the retail side of the house, there has been a bit of a moratorium in certain areas through the holiday season. So post-Thanksgiving into Christmas, there is significantly less installation activity. As we've grown and scaled, we haven't seen as material of an impact in that regard. But it is still there. There is still some...

Rick Mills ***Creative Realities Inc. - CEO***

And Howard, I would add on to. I mean if you think about it, between Thanksgiving and Christmas and New Year's, life gets busy for a whole lot of people, including our customers. So just generally speaking, I probably don't install it quite as many C-stores. I probably won't install quite as many Bowling alleys, right? Just stuff like that, it gets in because people are on vacation. That's all.

Howard Halpern ***Taglich Brothers - Analyst***

Okay. And just one last one with what you talked -- what Will talked about in his prepared remarks about gross margin, is what's going to also help gross margin on your new large contract. You talked -- you just talked about the software on the chip. Is that something that will help in the initial deployment phase, will also help gross margin out as we look at 2023?

Will Logan ***Creative Realities Inc. - CFO***

Yes, that tends to mean that there is less hardware in the transaction in aggregate, right? It takes a component out of play. So yes, generally speaking, that drives the percentage of hardware as a total of the sale lower improvement of the mix and improves the margin.

Operator

One moment for our next question. And our next question is from Jack Fred and he is a private investor.

Unidentified Participant ***Unknown Company - Private Investor***

Anything on the acquisition side? Can you give us any update on that?

Rick Mills ***Creative Realities Inc. - CEO***

We could spend the day talking about it. So let's just say this, we have a very, very active pipeline of companies that we are in discussions with. CRI is kind of winning everywhere in the marketplace. People want to align themselves with winners. A lot of the marketplace now CRI is truly being one of the real enterprise suppliers across the North America. So a lot of interest -- our challenge today simply is a reflection of our share price.

Our market cap today is really disconnected from the true intrinsic value of the company, right. So we're looking at buying companies 10%, 15% of our size. And to buy them, the market cap or the dollar amount we have to pay, darn near equals our entire market cap as a company today. So there's just a disconnect. And as that disconnect improves, expect us to be more active with accretive transactions only.

Will Logan ***Creative Realities Inc. - CFO***

Yes, Jack, I would add that the volume of activity in the markets and in our industry remains high. There are several companies out there seeking potential partners. And we have not seen the impact in pricing that the public markets have seen. Most of these are private transactions, right?

We don't have many peer public companies. And we've seen a dislocation even between what the public markets are doing and what the private transaction market is doing. So we continue to evaluate.

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Operator

Our next question, we have a follow-up again from Brian Kinstlinger of Alliance Global Partners. Mr. Kinstlinger line is open.

Brian Kinstlinger ***Alliance Global Partners - Analyst***

Can you hear me?

Operator

Now, I can.

Brian Kinstlinger ***Alliance Global Partners - Analyst***

Got it. Okay. Yes. So I apologize, I don't know why it wasn't on mute. But can you talk about the services margin, why it was low in the third quarter compared to historical, how that balances back? And then on the hardware margin, it improved but with the easing of supply chain and the lower international freight costs that most companies are seeing right now, should we see improvement there as well?

Will Logan ***Creative Realities Inc. - CFO***

So two components there, right? I think that the hardware side of the house, we expect to continue to stay relatively consistent in the low 20s, 18 to 22 tends to be the sweet spot. There are certainly transactions above or below that, depending on the scale.

The freight market has not typically moved our margins materially given the way that we purchased just-in-time and then also sell through on a just-in-time basis for the vast majority of the transactions. On the services side of the house, we continue -- as Rick mentioned on the media side, while it's still a smaller component of our revenue, that's grown in the third quarter and will in the fourth quarter as well.

We still have some legacy contracts that we're working to evaluate, renew and alter some of the economics. They're not exactly where we think they should be in the long term from those inherited contracts. So we'll see a little bit of lumpiness on that side, depending on how large the media revenues are in a given quarter. Those are the 2 kind of main things in 3Q but expect that to rightsize moving into 2023 as we renew contracts and alter economics.

Brian Kinstlinger ***Alliance Global Partners - Analyst***

Sorry, just to be clear, the third quarter services margin was down because you had more -- I was confused -- by the third...

Will Logan ***Creative Realities Inc. - CFO***

We had an increased percentage of media revenues, Brian which have -- which -- given the customers that they came from in the current quarter had some downward pressure on the margin. Just a...

Brian Kinstlinger ***Alliance Global Partners - Analyst***

We shouldn't think about that going forward in the 50s, if you get back to the 60s.

Will Logan ***Creative Realities Inc. - CFO***

I believe that is correct.

Operator

That completes the questions from the line today, Mr. Logan. Are there any additional inquiries from the Investor Relations in box that you would like to address?

Will Logan ***Creative Realities Inc. - CFO***

Sure. It looked like we had just two quick ones. The first question was with respect to kind of the market cap of the company and the dynamics at play, have we received inquiries or are people reaching out with respect to the acquisition of CRI? I think as everybody is aware on this call, the equity markets have been very challenging throughout 2022, seeing significantly reduced valuations.

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We're a nano-cap company. We're a tech company. Both have been challenged in the current year. We continue to believe that the public markets are not properly valuing our equity despite our growth and our efforts to educate the market on the true value of the company. In our specific industry, we've seen a lot of companies pursuing combination, other M&A strategies.

As we've disclosed in our own public filings with the SEC, we want to be a part of the consolidation efforts. At this time, CRI has not received any offers or overtures with respect to an acquisition of our business. But I think, in part, that's because we posited ourselves as an enterprise player that wants to be an acquirer.

The only other question that's come in, we previously, I think, probably about 12 months ago, had talked about an award-winning deployment with a customer Petco and whether there were any specific plans around that customer to deploy further? I think as with any customer where we've done a proof of concept and we've been successful; we pushed those customers as hard as we can.

We're working with them as a strategic adviser trying to translate that POC into a national rollout. And we're still the cell provider of choice. There's nothing else going on that front. But at the current moment, no announced plans for further expansion of that program. It remains in the pipeline and we continue to work it but nothing specific at this time.

Rick Mills *Creative Realities Inc. - CEO*

This is Rick. I'll just add on to that. We've had discussions about potentially a flagship New York City location. They're considering it but at this time, have not made a decision to move forward. And we've partnered -- we have a strong partnership on that account with Samsung, who is our partner at Petco.

Will Logan *Creative Realities Inc. - CFO*

So those are all the questions from the IR inbox. Let me conclude the call by thanking all of our shareholders, clients, partners and employees for their continuing efforts, commitment and support as we work together to transform CRI into the leading brand in digital signage solutions. This concludes the CRI 2022 third quarter earnings call.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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