

Company Overview

Activision Blizzard, Inc. is an international gaming firm which publishes, develops, and distributes interactive entertainment software and peripheral products in three segments: Activision Publishing, Inc. (console); Blizzard Entertainment, Inc. (PC); and King Digital Entertainment (mobile). Its most popular games are Call of Duty, Candy Crush, World of Warcraft and Overwatch. It has a global presence, with its main focus on the Americas and EMEA regions.

Revenue breakdown in 2017

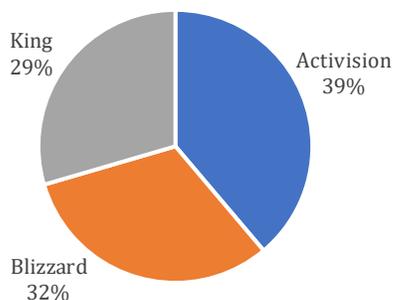


Figure 1. Revenue by Segments

\$ in mil USD	2016	2017	2018 (F)	2019 (F)
Revenue	\$ 6,608	\$ 7,017	\$ 7,410	\$ 7,847
Growth Rate	41.7%	6.2%	5.6%	5.9%
EBITDA	\$ 3,746	\$ 3,707	\$ 3,919	\$ 4,248
Net Income	\$ 1,660	\$ 1,597	\$ 1,811	\$ 1,917
ROA	5.0%	6.4%	2.8%	11.6%
ROE	9.6%	12.1%	5.1%	21.4%
Gross Profit Margin	63.8%	64.4%	65.6%	67.0%
Earnings Per Share	\$ 2.27	\$ 2.19	\$ 2.47	\$ 2.61
P/E Ratio	39.2	39.0	34.6	31.7

Figure 2. Activision's Key Financials

Investment Thesis

1. Unimpacted by tighter Chinese regulations: The volatility of the new Chinese government regulations have caused a dent in multiple gaming companies' projected earnings – for example, Tencent's stock price has dropped more than 18% in 2018. However, ATVI is relatively unaffected by the increasing regulation on Chinese market as only a small portion (7%) of their revenue is derived from China in comparison with its largest competitor Electronic Arts.

2. Potential for video game streaming: ATVI is in talks with global-computing providers that will enable ATVI to have a Netflix-like streaming service for games, especially for the ones followed by wide range of audience such as in E-Sports events. Despite potential hurdles, a breakthrough could mean that they will be able to expand its audience to a group of individuals who previously could not afford access to expensive gaming computers.

3. Intergenerational Franchises: ATVI has a larger customer lifetime value than its competitors due to customer loyalty to its intergenerational franchises (Starcraft, Warcraft, CoD). This is especially important given that the popularity of gaming is becoming more uniform throughout different age groups, and multiple target segments become increasingly more important for video gaming companies. Coupled with the increase in consumer spending, the established franchises are likely to continue increasing their value.

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Industry Outlook



Figure 3. Industry Outlook, Gaming Industry 2018

Source: CNBC

1. Greater regulations in China: Investor confidence has been hit in the largest gaming market in the world as the Chinese government has ordered a bureaucratic overhaul in the video gaming industry. This led to the halting of approval for over 3000 new games, with many being stalled for months. Analysts predict that this will precede a slowdown in the US\$38bn China gaming market.

2. Growth of E-Sports: Besides just making physical video games, companies are shifting towards competitive gaming, known as E-Sports. The E-Sports market was worth \$700m in 2017, and Goldman Sachs suggests that E-Sports annual revenues could eclipse those of all major US sports within the next 5 years. Companies which are able to televise E-Sports through streams – much like regular soccer games – will be able to cash in on this industry tailwind.

3. Booming growth for the gaming industry: Video game consumer spending is showing continued growth of 13.3% yoy. New products and technology are expected to drive gaming revenues to US\$138b by the end of 2018.

Valuation

Our 12-month price target from date of coverage is **US\$85**, representing a 15.5% upside. Our DCF model assumes a **WACC of 7.24%** and a **terminal EV/EBITDA multiple of 11.0x**.

Our assumption is based on the belief that company's diversification will fully reflect the video gaming industry becoming more competitive on all fronts (PC, console and mobile). Strong customer loyalty and limited exposure to market risks lend further support to our target price.

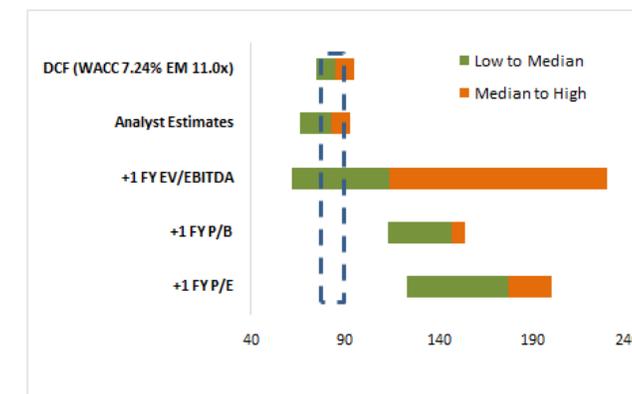


Figure 4. Football Field Valuation Summary

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