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Jan 09, 2020

Activision Blizzard (ATVI)

$59.88 (As of 01/08/20)

Price Target (6-12 Months): **$69.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 01/07/20) Prior Recommendation: Neutral	**Outperform**
Short Term: 1-3 Months	**Zacks Rank:** (1-5) Zacks Style Scores: Value: F | Growth: F	**1-Strong Buy** VGM:F Momentum: F

Summary

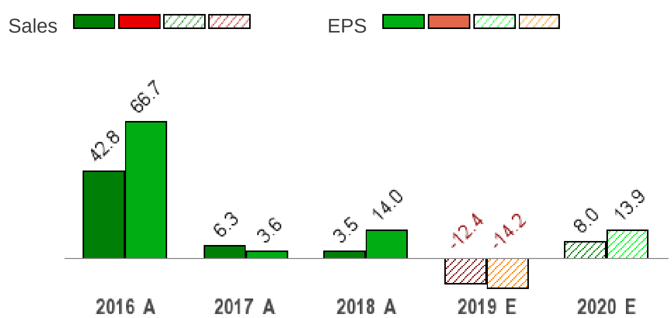
Activision's top line is expected to benefit from an expanding user base of *Call of Duty, Hearthstone* and King's *Candy Crush*. The availability of the much-awaited *Call of Duty: Modern Warfare* and *World of Warcraft Classic* is expected to expand the company's user base in the near term. Additionally, the availability of *Overwatch Legendary* edition on Nintendo Switch, the *Warcraft III: Reforged* beta and the newest additions to *StarCraft II* and *Heroes of the Storm* are key growth drivers. Activision's enviable IP, strength in popular gaming franchises, and foray into e-sports bode well for long-term growth. However, intensifying competition in the video game space is a concern. Notably, shares of the company have outperformed the industry in a year's time.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$60.89 - $39.85**
20 Day Average Volume (sh)	**4,321,273**
Market Cap	**$46.0 B**
YTD Price Change	**0.8%**
Beta	**0.83**
Dividend / Div Yld	**$0.37 / 0.6%**
Industry	**Toys - Games - Hobbies**
Zacks Industry Rank	**Top 42% (106 out of 254)**
Last EPS Surprise	**28.0%**
Last Sales Surprise	**3.4%**
EPS F1 Est- 4 week change	**-0.1%**
Expected Report Date	**02/11/2020**
Earnings ESP	**3.2%**
P/E TTM	**26.0**
P/E F1	**23.6**
PEG F1	**2.3**
P/S TTM	**6.7**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	1,281 E	1,292 E	1,488 E	2,796 E	6,873 E
2019	1,258 A	1,207 A	1,214 A	2,684 E	6,363 E
2018	1,384 A	1,385 A	1,658 A	2,835 A	7,262 A

EPS Estimates

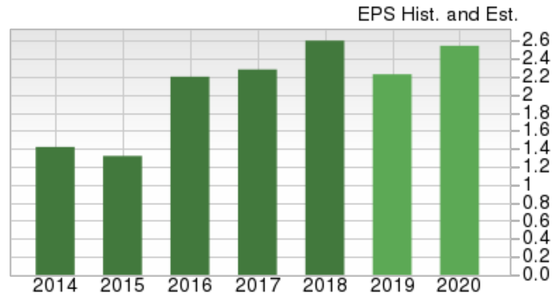
	Q1	Q2	Q3	Q4	Annual*
2020	$0.35 E	$0.37 E	$0.49 E	$1.32 E	$2.54 E
2019	$0.31 A	$0.38 A	$0.32 A	$1.21 E	$2.23 E
2018	$0.38 A	$0.41 A	$0.52 A	$1.29 A	$2.60 A

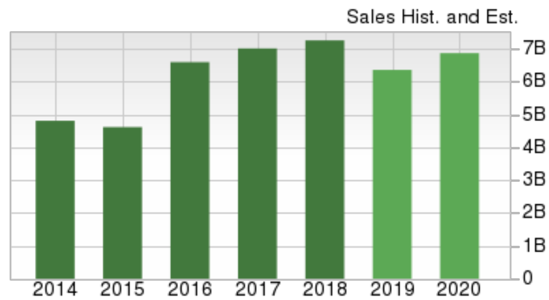
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/08/2020. The reports text is as of 01/09/2020.

Overview

Based in Santa Monica, CA, Activision Blizzard, Inc. is a leading developer and publisher of console and online games. The company reported revenues of $7.5 billion in 2018. International revenues accounted for approximately 54% of revenues.





Activision Blizzard operates under three major segments and incorporates newly announced studio and distribution businesses under the Others segment.

Activision Publishing creates and publishes games for consoles, desktops, mobile and tablet. Franchises under this segment include *Call of Duty*, *Crash* and *Spyro*. Effective Dec 31, 2018, Activision and Bungie mutually agreed to terminate their publishing relationship (signed in 2010) related to the *Destiny* franchise.

Activision Publishing generated revenues of $2.46 billion and accounted for almost 36% of revenues.

Blizzard Entertainment publishes games particularly for the PC format. It also maintains a proprietary online gaming service, Blizzard Battle.net, which facilitates digital distribution of Blizzard content and selected Activision content, online social connectivity, and the creation of user-generated content. The *Overwatch* League and Major League Gaming (MLG) business also come under this segment.

The segment generated revenues of $2.29 billion and accounted for 33.5% of revenues. Franchises under this segment include *Overwatch*, *Diablo*, *World of Warcraft*, *Heroes of the Storm*, *Hearthstone* and *StarCraft*.

King Digital Entertainment was acquired in February 2016 for more than $5.9 billion. It operates as an independent unit. The segment generated revenues of $2.09 billion and accounted for 30.5% of revenues. Franchises under this segment include *Candy Crush*, *Farm Heroes* and *Bubble Witch*.

The Other division includes Activision Blizzard Studios that makes original film and television content based on the company's huge IP library. In September 2018, the company released the third season of the animated TV series *Skylanders Academy* on Netflix. The segment also consists Activision Blizzard Distribution business.

Reasons To Buy:

> Activision's enviable IP, strength in digital business, creation of a studio and foray into e-sports bodes well for long-term growth.

- Activision popularity is primarily driven by its well-known franchises, which will continue to fuel top-line growth. *Call of Duty* is one of the biggest growth drivers for the company. The game has been the top-selling console franchise for Activision in nine of the last ten years. The latest title, *Call of Duty: Black Ops 4* instantly became a hit as it sold more units than *Call of Duty: Black Ops III*. Additionally, the *Overwatch League* Season Two average minute audience grew 18% year over year. Moreover, *Call of Duty: Black Ops 4* net bookings from in-game items grew sharply compared with *Call of Duty: WWII* in the third quarter. Activision stated that it will make frequent content updates to *Call of Duty* and expand the franchise's presence across platforms and geographies. Additionally, the company will soon bring the game to mobile by partnering with Tencent. Moreover, the company's city-based *Call of Duty* league sold its first five franchise teams to its existing *Overwatch League* team owners in the cities Atlanta, Dallas, New York, Paris and Toronto.

- Compared with the physical platform, digital games are more profitable due to minimum packaging cost. This cost effectiveness will help publishers to use the digital format to keep a popular franchise running profitably over a longer period of time. Notably, Digital revenues contributed 79.1% of total revenues in third-quarter 2019. Additionally, Activision has been trying to adopt an all year-round model instead of a launch-based model in which majority earnings and profits are derived in the first week to boost engagement. This bodes well for long-term performance.

- The King Digital Entertainment acquisition is boosting the company's presence in the lucrative mobile gaming arena. As per Newzoo, by 2020, more than 50% of the revenues will come from mobile games. King had two of the top 10 highest-grossing titles on U.S. mobile app stores for 22 quarters in a row. King Digital monthly active users (MAUs) were up 1.5% sequentially for the second time in a row since the business was acquired in first-quarter 2016. This was due to increased monetization and retention with *Candy Crush Friends Saga*. Further, given the strong performance of *Candy Crush Friends Saga*, King Digital is expected to boost its marketing initiatives in 2019. King Digital will also emphasize on growing *Candy Crush*'s reach and monetize the game by providing exciting in-game content.

- Activision Blizzard has long been eyeing the lucrative e-sports market. E-sports refer to live video game tournaments. With continued increases in viewership, corporate sponsorships and growing media coverage, eSports is here to stay. Per latest report from Newzoo, e-sports industry will reach $1.7 billion by 2020. Expanding broadcasting and digital distribution of eSports is a major catalyst for the company. Additionally, the second season of the *Overwatch League*, which began in the reported quarter, witnessed higher viewership levels. Further, the company is ramping up investments in e-sports, live services and other tools to boost user engagement.

Risks

- Video games are hit driven. Though Activision has a powerful line-up of games that can be repeatedly upgraded, there is no assurance that a particular game will be a hit. The video game business is highly cyclical and heavily dependent on time-to-time upgrade/introduction of new game software and hardware systems. Activision's costs are likely to shoot up in the near term as the company is trying to deliver popular franchises quickly than expected to aid 2019 results.

- Activision's dependence on handful of its franchises namely *Call of Duty (COD)*, *World of Warcraft*, *Overwatch* and King Digital's *Candy Crush* that make up more than 70% of its revenues remains a concern. Underperformance of any title is bound to negatively impact revenues. Moreover, Blizzard's revenues and monthly active users (MAUs) in third-quarter 2019 decreased due to the lack of major game releases. Further, Blizzard revenues are expected to decline owing to no major releases in 2019. Additionally, management expects softness in in-game revenues.

- Activision's 2018 performance was below expectations and it failed to grow at the same rate of the industry as it could not achieve reach, engagement and player investment targets that it set for itself. This is likely to continue well into 2019 owing to no major game releases. Therefore, Activision expects in-game monetization to be lower in 2019.

- The video game publishing industry is intensely competitive. The resultant pressure could tell on margins and also lead to market share losses. On the other hand, continued investment in the digital market may also hurt its profitability in the near term.

Last Earnings Report

Activision's Q3 Earnings Decline Y/Y on Weak Revenues

Quarter Ending	09/2019
Report Date	Nov 07, 2019
Sales Surprise	3.36%
EPS Surprise	28.00%
Quarterly EPS	0.32
Annual EPS (TTM)	2.30

Activision Blizzard reported third-quarter 2019 non-GAAP earnings of 38 cents per share that declined 9.5% year over year.

Consolidated revenues declined 15.2% year over year to $1.28 billion. Adjusting for revenues from non-reportable segments, net effect from recognition of deferred revenues and intersegment eliminations segment revenues declined 28.3% to $1.10 billion.

The Zacks Consensus Estimate for earnings and revenues was pegged at 25 cents and $1.17 billion, respectively.

Top-Line Details

Segment-wise, product sales (20.3% of consolidated revenues) were $260 million, down 1.1% year over year. Subscription, licensing and other revenues (79.7% of revenues) decreased 18.2% to $1.02 billion.

Based on distribution channels, Activision reported retail channel sales of $93 million, up 22.4% year over year. Other revenues increased 9.4% year over year to $175 million. However, digital online revenues of $1.02 billion fell 20.5% from the year-ago quarter.

Further, on the basis of platforms, revenues from mobile and ancillary (41% of consolidated revenues) increased 0.4% year over year to $525 million. However, revenues from console (18.8% of consolidated revenues) decreased 30.5% year over year to $241 million. Additionally, PC revenues (26.6% of consolidated revenues) declined 29.3% year over year to $341 million.

On a geographic basis, revenues from Americas (51.1% of consolidated revenues) decreased 15.4% year over year to $655 million. Europe, Middle East and Africa (EMEA) revenues (35.3% of consolidated revenues) declined 15.4% year over year to $452 million. Moreover, revenues from the Asia Pacific (13.7% of consolidated revenues) fell 14.2% to $175 million.

Activision Blizzard's net bookings decreased 27.1% year over year to $1.21 billion. Net bookings from digital channels were $980 million, down 31.9% from the year-ago quarter.

Notably, in-game net bookings were $710 million in the reported quarter.

Segment & User Base Details

Activision Blizzard had 316 million monthly active users (MAUs) at the end of the reported quarter.

Activision (18.9% of segment revenues) revenues decreased 47.4% year over year to $209 million. The division had 36 million MAUs.

Call of Duty: Black Ops 4 net bookings from in-game items grew sharply versus *Call of Duty: WWII* in the third quarter of 2018.

Crash Team Racing: Nitro-Fueled generated strong sales, particularly through the digital channel.

Blizzard (35.7% of segment revenues) revenues of $394 million declined 38% from the year-ago quarter. Blizzard had 33 million MAUs.

World of Warcraft Classic subscribers increased as the company added a record number of subscription plans in the third quarter.

The *Overwatch League* Season Two average minute audience grew 18% year over year.

King's (45.3% of segment revenues) revenues of $500 million declined 1.2% year over year. MAUs were 247 million. *Candy Crush* MAUs increased year over year, driven by growth in *Candy Crush Saga* and the addition of *Candy Crush Friends Saga*.

Notably, King's *Candy Crush* was the top-grossing franchise on U.S. mobile app stores in the reported quarter, per App Annie Intelligence, quoted by Activision.

Candy Crush franchise revenues grew year over year with the ads business almost doubling over the same period.

Operating Details

Product development expenses declined 20.2% year over year to $210 million. Also, sales & marketing and general & administrative expenses decreased 30.8% and 14.9% year over year to $182 million and $177 million, respectively.

Total costs & expenses on a non-GAAP basis declined 16.1% year over year to $930 million in the reported quarter.

On a non-GAAP basis, operating income was $352 million, down 12.7% year over year.

Guidance

For fourth-quarter 2019, Activision Blizzard expects non-GAAP revenues of $1.81 billion and earnings of 43 cents per share. Net bookings are expected to be $2.65 billion.

For 2019, Activision Blizzard anticipates non-GAAP revenues of $6.31 billion and earnings $2.13 per share. Net bookings are expected to be $6.33 billion.

Recent News

On Dec 18, Activision announced that *Call of Duty: Modern Warfare* recorded new multiplayer highs in hours played, hours per player and average daily players in the first 50 days of release. The game was launched worldwide on platforms like PlayStation 4, Xbox One and PC on Oct 25.

On Dec 10, Activision's Blizzard Entertainment division launched the new 135-card expansion pack, Descent of Dragons for its digital card game *Hearthstone.*

On Dec 3, Activision announced *Call of Duty: Modern Warfare* Season One, featuring the new Battle Pass and its largest free content offering available for players across PS 4, Xbox One, and PC platforms.

On Nov 3, Activision's Blizzard segment revealed new games at Blizzcon 2019, which included new installments in the *Overwatch* and *Diablo* franchises, the upcoming expansions for *World of Warcraft* and *Hearthstone*, the *Warcraft III: Reforged* beta, and the newest additions to *StarCraft II* and *Heroes of the Storm*.

On Nov 1, Activision's Blizzard segment revealed *World of Warcraft: Shadowlands*, the latest expansion for the company's multiplayer online role-playing game, which will be available on or before Dec 31, 2020.

On Nov 1, Activision's Blizzard segment announced *Diablo IV*, the next entry in its genre-defining action–role-playing series, which is currently in development and will be coming to PC, PlayStation 4, and Xbox One.

On Oct 29, Activision's Esports announced the inaugural season of the *Call of Duty League*, which will begin with the *Call of Duty League* Launch Weekend at the Minneapolis Armory from Jan 24 to 26, 2020, in Minneapolis, MN.

Valuation

Activision shares are up 27.8% in the six months period and 16.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Discretionary sector are up 13.8% and 5%, respectively, in the six months period. Over the past year, the Zacks sub-industry and the sector are up 14.5% and 21.4%, respectively.

The S&P 500 index is up 9.3% in the six months period and 24.3% in the past year.

The stock is currently trading at 23.49X forward 12-month earnings, which compares to 28.29X for the Zacks sub-industry, 20.45X for the Zacks sector and 18.82X for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.09X and as low as 13.41X, with a 5-year median of 22.99X. Our Outperform recommendation indicates that the stock will perform better than the market. Our $69 price target reflects 27.06X forward 12-month earnings.

The table below shows summary valuation data for ATVI

Valuation Multiples - ATVI

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	23.49	28.29	20.45	18.82
	5-Year High	31.09	30.46	23.34	19.34
	5-Year Low	13.41	17.34	16.17	15.17
	5-Year Median	22.99	24.02	20.09	17.44
P/S F12M	Current	6.68	5.29	2.38	3.49
	5-Year High	8.02	5.98	3.19	3.49
	5-Year Low	2.79	3	1.81	2.54
	5-Year Median	5.18	4.48	2.54	3
P/B TTM	Current	3.76	4.1	3.57	4.44
	5-Year High	6.25	6.55	5.04	4.45
	5-Year Low	1.84	2.84	3.13	2.85
	5-Year Median	3.44	4.03	4.29	3.61

As of 01/08/2020

Industry Analysis **Zacks Industry Rank:** Top 42% (106 out of 254)

Top Peers

Changyou.com Limited **(CYOU)**	Neutral
Electronic Arts Inc. **(EA)**	Neutral
Microsoft Corporation **(MSFT)**	Neutral
Nintendo Co. **(NTDOY)**	Neutral
Take-Two Interactive Software, Inc. **(TTWO)**	Neutral
Zynga Inc. **(ZNGA)**	Neutral
Glu Mobile Inc. **(GLUU)**	Underperform
Tencent Holding Ltd. **(TCEHY)**	Underperform

Industry Comparison Industry: Toys - Games - Hobbies

Industry Peers

	ATVI Outperform	X Industry	S&P 500	EA Neutral	GLUU Underperform	TTWO Neutral
VGM Score	F	-	-	F	D	C
Market Cap	46.00 B	9.07 B	23.84 B	31.97 B	871.80 M	14.49 B
# of Analysts	14	6	13	14	7	21
Dividend Yield	0.62%	0.00%	1.79%	0.00%	0.00%	0.00%
Value Score	F	-	-	D	D	D
Cash/Price	0.11	0.11	0.04	0.16	0.11	0.16
EV/EBITDA	14.82	22.98	13.88	22.94	2,492.48	24.94
PEG Ratio	2.33	1.80	2.02	1.78	1.59	2.09
Price/Book (P/B)	3.75	4.60	3.33	4.51	4.68	6.64
Price/Cash Flow (P/CF)	16.08	22.33	13.76	24.35	554.45	20.30
P/E (F1)	23.57	23.43	18.76	23.30	23.92	26.32
Price/Sales (P/S)	6.68	3.50	2.63	6.29	2.21	4.55
Earnings Yield	4.24%	4.21%	5.32%	4.29%	4.18%	3.80%
Debt/Equity	0.22	0.22	0.72	0.14	0.21	0.05
Cash Flow ($/share)	3.72	2.86	6.94	4.50	0.01	6.30
Growth Score	F	-	-	F	B	B
Hist. EPS Growth (3-5 yrs)	15.57%	16.17%	10.56%	16.76%	NA	33.73%
Proj. EPS Growth (F1/F0)	14.22%	19.92%	7.46%	0.18%	-3.31%	-19.47%
Curr. Cash Flow Growth	2.15%	11.18%	14.83%	11.18%	-102.78%	98.75%
Hist. Cash Flow Growth (3-5 yrs)	17.97%	17.55%	9.00%	17.13%	215.18%	0.39%
Current Ratio	3.43	1.60	1.23	3.32	1.32	1.48
Debt/Capital	17.93%	17.93%	42.99%	12.20%	17.02%	5.16%
Net Margin	23.66%	8.37%	11.08%	54.01%	-0.82%	11.14%
Return on Equity	13.91%	13.94%	17.16%	17.54%	0.22%	26.81%
Sales/Assets	0.39	0.80	0.55	0.53	1.08	0.72
Proj. Sales Growth (F1/F0)	8.02%	6.03%	4.16%	3.75%	9.08%	-2.86%
Momentum Score	F	-	-	C	F	C
Daily Price Chg	-0.75%	0.00%	0.39%	1.01%	-5.38%	1.84%
1 Week Price Chg	-0.87%	0.00%	-0.30%	-1.13%	3.85%	-1.82%
4 Week Price Chg	6.02%	4.43%	2.38%	6.09%	6.98%	4.43%
12 Week Price Chg	7.72%	7.72%	6.40%	13.79%	0.34%	5.51%
52 Week Price Chg	17.80%	22.32%	22.97%	23.15%	-32.81%	18.95%
20 Day Average Volume	4,321,273	79,669	1,610,101	1,695,674	2,085,823	987,396
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-4.88%	0.00%
(F1) EPS Est 4 week change	-0.12%	0.00%	0.00%	0.00%	-4.88%	0.00%
(F1) EPS Est 12 week change	0.02%	-2.49%	-0.50%	0.35%	-45.46%	2.05%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	-25.00%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	F
Momentum Score	F
VGM Score	F

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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