

Activision Blizzard (ATVI)

\$63.52 (As of 02/14/20)

Price Target (6-12 Months): **\$67.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/05/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:F

Value: D

Growth: D

Momentum: F

Summary

Activision Blizzard's fourth-quarter 2019 results were negatively impacted by lack of a major game release from Blizzard segment and intensifying competition in the video game space. This led to earnings and revenue decline on a year-over-year basis. Except mobile, revenues declined in all other platforms. Nevertheless, expanding *Call of Duty: Modern Warfare*, *World of Warcraft* and King's *Candy Crush Saga* user base suggests an improving user engagement level, which is a major growth driver for the company. Moreover, *Hearthstone's* engagement increased, which is a positive. Further, growing popularity of *Call of Duty Mobile* and esports initiatives are expected to help the top line grow in the near term. Notably, shares have outperformed the industry in the past year.

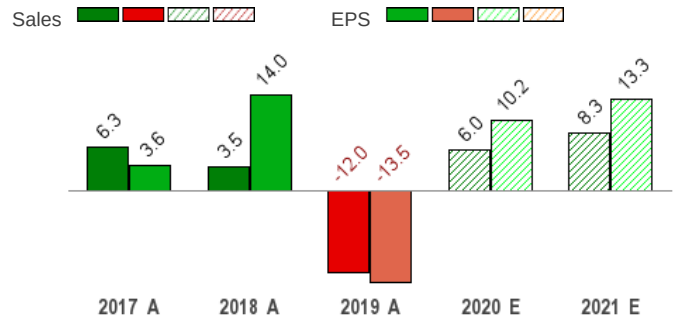
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$63.54 - \$40.89
20 Day Average Volume (sh)	6,207,285
Market Cap	\$48.8 B
YTD Price Change	6.9%
Beta	0.87
Dividend / Div Yld	\$0.41 / 0.6%
Industry	Toys - Games - Hobbies
Zacks Industry Rank	Bottom 14% (219 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.5%
Last Sales Surprise	1.4%
EPS F1 Est- 4 week change	-2.3%
Expected Report Date	NA
Earnings ESP	0.0%
P/E TTM	28.4
P/E F1	25.6
PEG F1	2.5
P/S TTM	7.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,491 E	1,542 E	1,415 E	2,871 E	7,331 E
2020	1,299 E	1,278 E	1,417 E	2,778 E	6,772 E
2019	1,258 A	1,207 A	1,214 A	2,708 A	6,388 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.48 E	\$0.55 E	\$0.47 E	\$1.33 E	\$2.81 E
2020	\$0.38 E	\$0.37 E	\$0.46 E	\$1.28 E	\$2.48 E
2019	\$0.31 A	\$0.38 A	\$0.32 A	\$1.23 A	\$2.25 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 02/14/2020. The reports text is as of 02/17/2020.

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 \$6.49 billion in 2019. International revenues accounted for 48.5% of revenues.

Activision Blizzard operates under three major segments and incorporates studio, media networks 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.

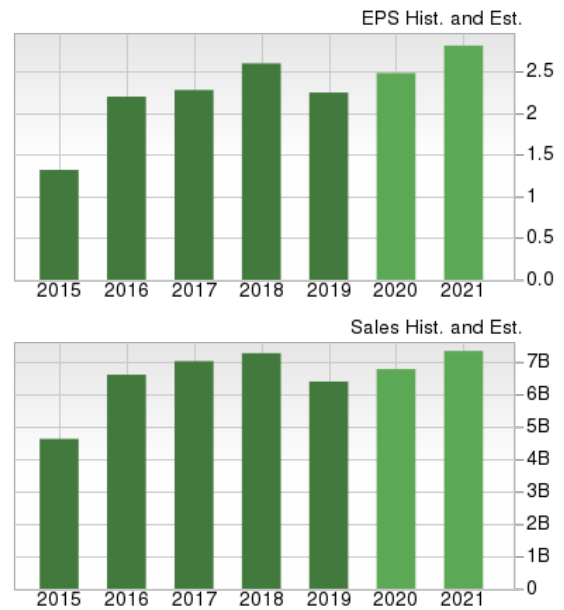
Activision Publishing generated revenues of \$2.22 billion and accounted for almost 37.2% of revenues.

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 \$1.72 billion and accounted for 28.8% 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 \$2.03 billion and accounted for 34% 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. The segment also consists Activision Blizzard Distribution business.



Reasons To Buy:

- ▲ 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 10 of the last 11 years. The latest title, *Call of Duty: Modern Warfare* instantly became a hit as it sold more units than *Call of Duty: Black Ops 4*. Activision stated that it will make frequent content updates to *Call of Duty* and expand the franchise's presence across platforms and geographies. *Call of Duty Mobile*, launched in October 2019, played an important part in driving user base. For the quarter ended Dec 31, 2019, overall Activision Blizzard Monthly Active Users (MAUs) were 409 million. The success of *World of Warcraft Classic* also indicates an expanding portfolio, which will benefit the company's top line in the long haul.
- ▲ 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 76% of total revenues in 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.
- ▲ King's dominance in the lucrative mobile gaming arena has improved Activision's prospects. Per Newzoo, by 2022, more than 50% of game market revenues will come from mobile games. Notably, King's *Candy Crush* remained the top-grossing franchise in U.S. app stores in 2019. Moreover, *Candy Crush Saga* was the top-grossing title in U.S. app stores in 2019, per data from App Annie, cited by Activision. King continues to emphasize on growing *Candy Crush's* reach and monetize the game by providing exciting in-game content. Solid growth in advertising net bookings (up 80% year over year in the fourth-quarter) that surpassed \$150 million in 2019 is very much encouraging. King's innovative pipeline of games is a key catalyst.
- ▲ Activision Blizzard has long been eyeing the lucrative esports market. With continued increases in viewership, corporate sponsorships and growing media coverage, esports is here to stay. Newzoo expects the esports industry to generate revenues of \$1.8 billion by 2022. The company is ramping up investments in esports, live services and other tools to boost user engagement. In the first quarter of 2020, the *Call of Duty League* was launched with 12 city-based teams and YouTube as Activision's new broadcasting partner for esports leagues and events. Additionally, in February 2020, the popular *Overwatch League* will return with 20 established teams from around the world.

Activision's enviable IP, innovative gaming pipeline, strength in digital business and foray into e-sports bodes well for long-term growth.

Reasons To Sell:

- ▼ 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*, *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 2019 decreased due to the lack of major game releases
- ▼ 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.

Activision's dependence on a few franchises is concerning. Plus, hit driven and competitive nature of video game industry may negatively impact the company's growth.

Last Earnings Report

Activision's Q4 Earnings Decline Y/Y on Weak Revenues

Activision Blizzard reported fourth-quarter 2019 non-GAAP earnings of 62 cents per share that declined 31.1% year over year.

Consolidated revenues declined 16.6% year over year to \$1.99 billion. Adjusting for revenues from non-reportable segments, net effect from the recognition of deferred revenues and intersegment elimination segment revenues declined 4.4% to \$2.52 billion.

For the quarter ended Dec 31, 2019, overall Activision Blizzard Monthly Active Users (MAUs) were 409 million.

Quarter Ending 12/2019

Report Date	Feb 06, 2020
Sales Surprise	1.41%
EPS Surprise	2.50%
Quarterly EPS	1.23
Annual EPS (TTM)	2.24

Top-Line Details

Segment-wise, product sales (35.2% of consolidated revenues) were \$699 million, down 13.5% year over year. Subscription, licensing and other revenues (64.8% of revenues) decreased 18.2% to \$1.29 billion.

Based on distribution channels, Activision Blizzard reported retail channel sales of \$310 million, down 9.6% year over year. Other revenues decreased 5.2% year over year to \$237 million. Moreover, digital online revenues of \$1.44 billion fell 19.5% from the year-ago quarter.

Further, on the basis of platforms, revenues from mobile and ancillary (31.9% of consolidated revenues) rose 6.2% year over year to \$633 million. However, revenues from console (30% of consolidated revenues) decreased 26.4% year over year to \$595 million. Additionally, PC revenues (26.2% of consolidated revenues) declined 28.3% year over year to \$521 million.

On a geographic basis, revenues from the Americas (47.1% of consolidated revenues) decreased 18% year over year to \$935 million. Europe, the Middle East and Africa (EMEA) revenues (35.9% of consolidated revenues) declined 15.5% year over year to \$713 million. Moreover, revenues from the Asia Pacific (17% of consolidated revenues) fell 14.9% to \$338 million.

Activision Blizzard's net bookings declined 4.5% year over year to \$2.71 billion. Net bookings from digital channels were \$1.88 billion, unchanged year over year.

Notably, in-game net bookings were \$1.09 billion, down 9.9% year over year.

Segment Details

Activision (56.5% of segment revenues) revenues increased 1.1% year over year to \$1.43 billion. The division had 128 million MAUs as of Dec 31, 2019.

Call of Duty Mobile installs exceeded 150 million. The game ended the fourth quarter as one of the top 15 grossing games in the U.S. app stores.

Call of Duty: Modern Warfare unit sell-through increased a double-digit percentage compared with *Call of Duty: Black Ops 4*, with growth across PC and console. PC sell-through on Battle.net grew 50% year over year.

Moreover, *Modern Warfare* saw strong growth in full-game downloads, with console digital mix at nearly 50%. In-game net bookings grew a double-digit percentage versus *Black Ops 4*.

Blizzard (23.6% of segment revenues) revenues of \$595 million declined 13.3% from the year-ago quarter. Blizzard had 32 million MAUs as of Dec 31, 2019.

Hearthstone's Descent of Dragons expansion pack and the new Battlegrounds game mode drove sequential growth in engagement in the reported quarter. Net bookings also grew sequentially for the franchise.

Additionally, *Overwatch* was launched on Nintendo's Switch, further expanding a community that has surpassed 50 million players globally since launch.

King's (19.9% of segment revenues) revenues of \$503 million declined 7.4% year over year. MAUs were 249 million as of Dec 31, 2019.

Candy Crush Saga mobile reach grew year over year. Moreover, *Candy Crush* was once again the top-grossing franchise in the U.S. mobile app stores in the fourth quarter and 2019.

Advertising net bookings grew more than 80% year over year in the fourth quarter and exceeded \$150 million in 2019.

Operating Details

Product development expenses declined 9.6% year over year to \$283 million. Also, sales & marketing and general & administrative expenses increased 6.3% and 0.6% year over year to \$339 million and \$176 million, respectively.

Total costs & expenses on a non-GAAP basis declined 9.6% year over year to \$1.40 million in the reported quarter.

On a non-GAAP basis, operating income was \$591 million, down 29.5% year over year.

Guidance

For first-quarter 2020, Activision Blizzard expects non-GAAP revenues of \$1.64 billion and earnings of 66 cents per share. Net bookings are expected to be \$1.28 billion.

For 2020, Activision Blizzard anticipates non-GAAP revenues of \$6.45 billion and earnings of \$2.22 per share. Net bookings are expected to be \$6.73 billion.

Recent News

On Feb 11, Activision announced Call of Duty: Modern Warfare Season Two content. Throughout Season Two, players across all platforms can continue the fight alongside their favorite operators in all new and returning fan-favorite maps, fresh in-game challenges and rewards, limited-time game modes, and playlists among the community celebrations.

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*.

Valuation

Activision shares are up 32.5% in the past six-month period and 42.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Discretionary sector are up 14.6% and 22.5%, respectively, in the past six-month period. Over the past year, the Zacks sub-industry and the sector are up 16.6% and 29.8%, respectively.

The S&P 500 index is up 16.2% in the past six-month period and 21% in the past year.

The stock is currently trading at 25.15X forward 12-month earnings, which compares to 27.58X for the Zacks sub-industry, 20.31X for the Zacks sector and 19.36X for the S&P 500 index.

Over the past five years, the stock has traded as high as 31.09X and as low as 16.88X, with a 5-year median of 23.24X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$67 price target reflects 26.48X 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	25.15	27.58	20.31	19.36
	5-Year High	31.09	30.46	23.35	19.36
	5-Year Low	16.88	19.51	16.16	15.18
	5-Year Median	23.24	24.57	20.07	17.47
P/S F12M	Current	7.13	5.21	2.32	3.58
	5-Year High	8.02	5.98	3.19	3.58
	5-Year Low	3.46	3.23	1.81	2.54
	5-Year Median	5.28	4.52	2.54	3
P/B TTM	Current	3.81	4.12	3.56	4.36
	5-Year High	6.25	6.55	5.04	4.42
	5-Year Low	2.24	3.16	3.13	2.85
	5-Year Median	3.47	4.06	4.26	3.62

As of 02/14/2020

Industry Analysis Zacks Industry Rank: Bottom 14% (219 out of 255)



Top Peers

Electronic Arts Inc. (EA)	Neutral
Glu Mobile Inc. (GLUU)	Neutral
Hasbro, Inc. (HAS)	Neutral
JAKKS Pacific, Inc. (JAKK)	Neutral
Mattel, Inc. (MAT)	Neutral
Nintendo Co. (NTDOY)	Neutral
Take-Two Interactive Software, Inc. (TTWO)	Underperform
Zynga Inc. (ZNGA)	Underperform

Industry Comparison Industry: Toys - Games - Hobbies				Industry Peers		
	ATVI Neutral	X Industry	S&P 500	EA Neutral	HAS Neutral	MAT Neutral
VGM Score	F	-	-	C	B	C
Market Cap	48.80 B	8.59 B	24.61 B	31.77 B	12.34 B	4.84 B
# of Analysts	14	5	13	14	5	5
Dividend Yield	0.58%	0.00%	1.78%	0.00%	2.78%	0.00%
Value Score	D	-	-	D	C	F
Cash/Price	0.12	0.12	0.04	0.18	0.08	0.04
EV/EBITDA	21.15	21.21	14.06	22.20	25.35	203.60
PEG Ratio	2.53	1.89	2.09	1.77	1.58	NA
Price/Book (P/B)	3.81	4.12	3.29	4.39	4.12	10.66
Price/Cash Flow (P/CF)	22.63	22.67	13.65	24.40	18.76	NA
P/E (F1)	25.61	23.37	19.21	23.22	19.00	NA
Price/Sales (P/S)	7.52	3.22	2.70	5.90	2.61	1.07
Earnings Yield	3.90%	4.08%	5.19%	4.30%	5.26%	-0.50%
Debt/Equity	0.21	0.18	0.71	0.14	1.35	6.30
Cash Flow (\$/share)	2.81	2.40	6.92	4.50	5.21	-0.35
Growth Score	D	-	-	B	D	C
Hist. EPS Growth (3-5 yrs)	14.16%	15.28%	10.85%	16.39%	7.52%	-38.87%
Proj. EPS Growth (F1/F0)	10.38%	19.31%	7.17%	0.73%	26.08%	78.00%
Curr. Cash Flow Growth	-24.13%	11.18%	8.56%	11.18%	-10.17%	22.75%
Hist. Cash Flow Growth (3-5 yrs)	9.90%	13.51%	8.36%	17.13%	3.99%	NA
Current Ratio	2.50	1.64	1.23	2.84	5.37	1.60
Debt/Capital	17.28%	15.53%	42.91%	12.09%	57.46%	86.30%
Net Margin	23.18%	11.42%	11.81%	52.52%	11.03%	-4.90%
Return on Equity	13.16%	14.23%	16.86%	18.86%	25.57%	-23.64%
Sales/Assets	0.36	0.75	0.54	0.53	0.77	0.86
Proj. Sales Growth (F1/F0)	6.03%	6.14%	3.85%	3.55%	14.50%	1.12%
Momentum Score	F	-	-	B	A	A
Daily Price Chg	1.49%	0.00%	0.06%	0.78%	0.74%	-3.13%
1 Week Price Chg	5.22%	0.00%	2.47%	1.08%	-2.09%	-3.76%
4 Week Price Chg	5.11%	-0.43%	0.59%	-1.41%	-5.70%	-0.43%
12 Week Price Chg	18.31%	0.57%	6.98%	10.79%	2.40%	22.05%
52 Week Price Chg	39.82%	-1.96%	16.62%	4.22%	8.87%	-17.50%
20 Day Average Volume	6,207,285	167,822	2,020,569	2,624,089	1,225,314	4,550,603
(F1) EPS Est 1 week change	-3.98%	0.00%	0.00%	0.00%	8.18%	0.00%
(F1) EPS Est 4 week change	-2.28%	-0.83%	-0.05%	0.18%	11.62%	43.33%
(F1) EPS Est 12 week change	-2.36%	0.09%	-0.17%	0.91%	1.86%	33.66%
(Q1) EPS Est Mthly Chg	3.28%	0.00%	-0.24%	4.31%	6.90%	0.00%

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	D
Growth Score	D
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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