

Electronic Arts Inc. (EA)

\$112.93 (As of 01/17/20)

Price Target (6-12 Months): **\$119.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 06/20/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:F

Value: D

Growth: F

Momentum: A

Summary

EA's net bookings and live services revenues are expected to benefit from portfolio strength from franchises including *Apex Legends*, *Ultimate Team* in *FIFA* and *Madden NFL*, *The Sims 4* and *FIFA Online*. Moreover, the company is witnessing growth in active player accounts, owing to increased engagement in popular franchises like *FIFA*, *The Sims 4* and *Apex Legends*. Live services growth is a key catalyst. Notably, *EA SPORTS FIFA 20*, launched in October, is a hit. Moreover, EA has a strong slate of releases for the rest of fiscal 2020. Notably, shares of the company have outperformed the industry in a year's time. However, *Apex Legends 2*, launched in July, was a disappointment. Moreover, it faces intense competition from the likes of Activision and Take-Two.

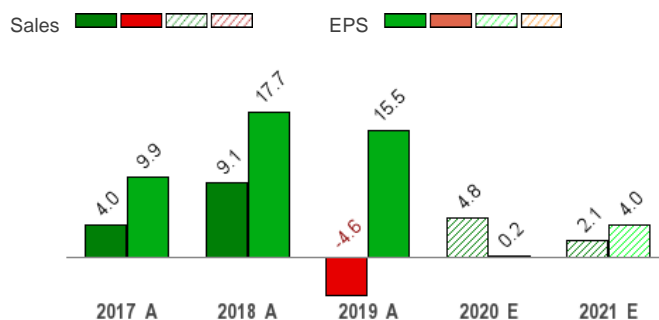
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$112.99 - \$78.00
20 Day Average Volume (sh)	1,667,455
Market Cap	\$33.0 B
YTD Price Change	5.0%
Beta	0.93
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Toys - Games - Hobbies
Zacks Industry Rank	Bottom 6% (238 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	12.9%
Last Sales Surprise	2.9%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	01/30/2020
Earnings ESP	1.6%
P/E TTM	25.5
P/E F1	24.0
PEG F1	4.2
P/S TTM	6.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	841 E	1,297 E	1,786 E	1,350 E	5,288 E
2020	743 A	1,277 A	1,960 E	1,187 E	5,180 E
2019	798 A	1,222 A	1,609 A	1,364 A	4,944 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.30 E	\$1.01 E	\$2.25 E	\$1.25 E	\$4.89 E
2020	-\$0.02 A	\$0.96 A	\$2.51 E	\$0.95 E	\$4.70 E
2019	\$0.26 A	\$0.98 A	\$2.08 A	\$1.41 A	\$4.69 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 01/17/2020. The reports text is as of 01/20/2020.

Overview

Headquartered in Redwood City, CA, Electronic Arts is a leading developer, marketer, publisher and distributor of interactive games (video game software and content).

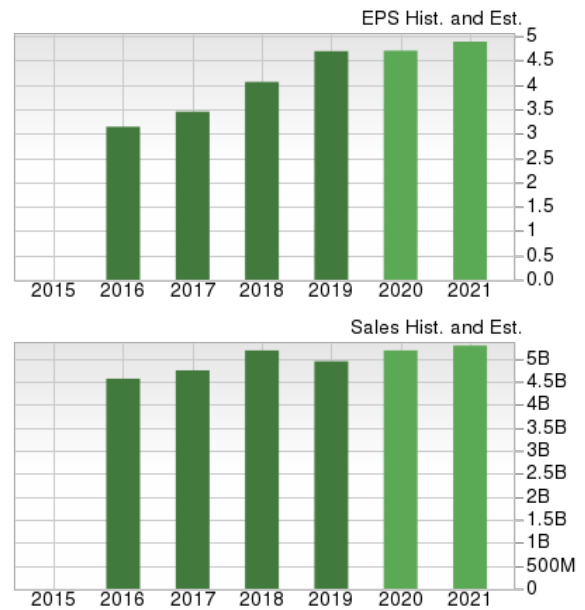
Electronic Arts, popularly known as EA, distributes its gaming content and services through multiple distribution channels and directly to consumers (online and wirelessly) through its online portals Origin and Play4Free.

EA games can be played on video consoles, personal computers, mobile devices, tablets & electronic readers. The company earns revenues from the sale of disk-based video game products (known as packaged goods), downloadable contents (DLCs), subscription, micro-transactions and advertising.

EA earned revenues of \$4.95 billion in fiscal 2019 of which Digital net revenues contributed 74.9%, while the remaining came from packaged goods and others.

EA operates in three divisions: EA Studios, Maxis and EA Mobile. EA Studios includes DICE (Sweden), EA Canada (Canada), Tiburon (United States), BioWare (Canada and United States) and Visceral (United States).

EA faces substantial competition from console and personal computer game publishers and diversified media companies including Sony, Microsoft, Nintendo, Activision Blizzard, Take-Two Interactive, THQ Ubisoft, Time Warner and Viacom. In the mobile and social gaming market, EA also competes with Glu Mobile and Zynga.



Reasons To Buy:

- ▲ EA has been the primary beneficiary of the ongoing shift from physical to digital versions of video games. The company expects the digital business to continue to grow beyond fiscal 2019, primarily on the back of live services and a strong mobile business. Moreover, compared with the physical platform, digital games are more profitable due to minimum packaging cost. In addition, the company's freemium and extra content services are generating significant market traction, which is driving the top line. Esports is also helping the company to grow internationally in regions like China, Korea, the Middle East and more. Apart from expanding its presence, esports is enabling the company to expand global user base.
- ▲ EA's popularity is primarily driven by its well-known franchises, which will continue to fuel the top line. EA SPORTS titles along with *Battlefield*, *Titanfall* and *Star Wars* are some of its biggest franchises. Additionally, the video game company is gaining traction with *The Sims* franchise, which is a positive. The company plans to bring at least 20 new content drops and expansion packs to *The Sims* franchise in fiscal 2020.
- ▲ EA's expanding mobile gaming portfolio is expected to drive growth. Moreover, the company is receiving sponsor engagements and partnerships with industry leaders such as Eleague, Gfinity and PGL for FIFA Global series, which bode well. EA is also foraying into the world of AR/VR games.
- ▲ EA's latest battle royale (BR) game — *Apex Legends* — is an instant hit. The game has smashed the records of Epic Game's *Fortnite* in this genre. The company is in talks with Tencent to bring the game to China. Notably, EA lacks significant presence in China apart from *FIFA* and a few mobile games. Thus, *Apex Legends* will boost EA's footprint in China's PC-gaming market, which is a positive. In July, the company released Season 2 of *Apex Legends*..

EA has been the primary beneficiary of the ongoing shift from physical to digital versions of video games. Core franchises like *FIFA* and *The Sims* are driving growth.

Reasons To Sell:

- ▼ Video games are hit driven. Though EA has a powerful line up of games that can be repeatedly upgraded, there is no assurance that a particular game will be a hit. Moreover, the video game business is highly cyclical and heavily dependent on time-to-time upgrade/introduction of new game software and hardware systems.
- ▼ The video game publishing industry is intensely competitive. The resultant pressure could tell on margins and also lead to market share losses. Lower volume of packaged goods sales adds to the pressure on margins. EA's continued investment in the digital market may also hurt its profitability in the near term.
- ▼ Electronic Arts' much-awaited shooter looter game *Anthem* received lukewarm response from critics as well as players. The early release of *Anthem* was plagued with serious flaws, which resulted in the underperformance of the game. Notably, the PC version of *Anthem* had an average critic score of 61 out of 100 on Metacritic compared to *Apex Legends* score of 88. Sluggish performance of the game can take a toll on the company's results in the near term.

The video game industry is inherently hit driven and highly competitive. EA faces significant competition from the likes of Take Two Interactive and Activision Blizzard.

Last Earnings Report

Electronic Arts Q2 Earnings Decline Y/Y, Revenues Rise

Electronic Arts reported second-quarter fiscal 2020 adjusted earnings of 78 cents per share, which excluded tax benefits worth \$2.11.

The company had reported earnings of 83 cents per share in the year-ago quarter.

The Zacks Consensus Estimate for earnings was pegged at 85 cents.

Notably, EA recognized an income tax benefit of \$1.705 billion in fiscal 2020, out of which \$625 million was recognized in the second quarter.

Revenues increased 4.8% year over year to \$1.35 billion. Product revenues (42.1% of total revenues) decreased 8.8% to \$568 million. Service and other revenues (57.9% of total revenues) increased 17.6% to \$780 million.

Excluding deferred revenues of \$35 million and mobile platform fees of \$36 million, net bookings increased 4.5% to \$1.277 billion.

Digital net bookings were \$790 million, up 24% year over year. Additionally, digital net bookings were \$3.883 billion over the last 12 months, increasing 8% year over year and representing 78% of total net bookings.

Quarter Details

EA's digital revenues (68.4% of total revenues) increased 18.2% year over year to \$922 million. Packaged goods and other segment revenues (31.6% of total revenues) decreased 15.8% year over year to \$426 million.

Further segregating digital revenues, full game download revenues increased 22% year over year to \$180 million. Net bookings increased 11.5% year over year to \$175 million.

Live services revenues increased 39% year over year to \$573 million. Net bookings surged 50.3% year over year to \$493 million, driven by *Apex Legends*, *Ultimate Team* in *FIFA* and *Madden NFL*, *The Sims 4*, and *FIFA Online*.

FIFA Online 4 performed well in Korea and saw growth in China during the quarter. *Madden* and *FIFA* benefited from early access sales on PlayStation through EA Access. Both were up in double-digit percentages year over year.

Mobile games revenues decreased 23% year over year to \$169 million driven by aging titles. Net bookings declined 19.7% year over year to \$122 million.

Based on its platforms, revenues from console increased 1% year over year to \$923 million. Revenues from PC/browser were up 62% year over year to \$242 million. Other revenues surged 100% year over year to \$6 million.

However, revenues from mobile platform decreased 20% year over year to \$177 million.

Important Game & Player Metrics

During the quarter, total players in *FIFA* increased nearly 15% year over year, and with the addition of the VOLTA Football street soccer experience, new-to-franchise players grew 7% year over year. The number of *FIFA Ultimate Team* unique players increased 22% year over year.

Moreover, unique players increased 12% year over year across the *Madden* franchise. Games played in franchise mode more than doubled to around 100 million in the second quarter. Also, the number of *Madden Ultimate Team* unique players increased 19% year over year.

Notably, the *Sims 4* monthly average players increased more than 40% year over year in the second quarter. The *Sims* franchise surpassed \$5 billion in lifetime sales.

Further, *Apex Legends* has 70 million players life to date. *FIFA Mobile* had been downloaded more than 250 million times life to date.

The company launched games such as *FIFA 20*, *Madden NFL 20*, *NHL 20* and *Sea of Solitude* during the quarter.

Notable game launches in the next quarter include *Need for Speed Heat*, *Plants vs. Zombies: Battle for Neighborville* and *Star Wars Jedi: Fallen Order*.

Operating Details

EA's GAAP gross profit increased 8.6% from the year-ago quarter to \$943 million. Gross margin expanded 250 basis points (bps) on a year-over-year basis to 70%.

Operating expenses increased 10.7% from the year-ago quarter to \$675 million. As a percentage of revenues, operating expenses expanded 260 bps to 50.1%.

As a percentage of revenues, marketing & sales (M&S) declined 10 bps. However, research & development (R&D) and general & administrative (G&A) expenses expanded 230 bps and 40 bps, respectively.

Operating income increased 3.9% year over year to \$268 million. Operating margin contracted 20 bps to 19.9% in the reported quarter.

Quarter Ending 09/2019

Report Date	Oct 29, 2019
Sales Surprise	2.92%
EPS Surprise	12.94%
Quarterly EPS	0.96
Annual EPS (TTM)	4.43

Balance Sheet and Cash Flow

As of Sep 30, 2019, EA had \$4.88 billion in cash and short-term investments compared with \$5.19 billion as of Jun 30, 2019.

Net cash from operating activities in the reported quarter was \$37 million compared with \$158 million in the previous quarter.

EA repurchased 3.3 million shares for \$306 million in the reported quarter. The company has \$674 million available under its current program.

Guidance

For the third quarter of fiscal 2020, EA expects GAAP revenues of \$1.510 billion. Net bookings are expected to be \$1.940 billion.

EA anticipates operating expenses to be \$733 million. GAAP earnings are expected to be 92 cents per share.

For fiscal 2020, EA expects GAAP revenues of \$5.410 billion and net bookings of \$5.125 billion. Digital net revenues are expected to be \$4.230 billion. Packaged goods & other net revenues are anticipated to be \$1.180 billion.

Management continues to expect *The Sims 4* and *Apex Legends* to deliver net bookings of \$300-\$400 million each.

Moreover, EA anticipates operating expenses of \$2.746 billion for the fiscal.

Additionally, earnings are expected to be \$9.57 per share, including \$5.74 of income tax benefits.

Operating cash flow is estimated to be around \$1.625 billion.

Recent News

On Dec 17, EA and Respawn Entertainment announced the launch of the *Apex Legends Global Series*, the first International Esports tournament for the Franchise.

On Nov 26, EA and its studio, Firemonkeys announced a first-time licensing partnership with Formula 1 and launched *Real Racing 3's* newest update with F1 content.

On Nov 20, EA announced it will bring *CONMEBOL Libertadores*, South America's biggest club tournament, exclusively to EA SPORTS FIFA 20 as a free content update in March 2020 for PS4, Xbox One, and PC.

On Nov 15, EA announced the release of its highly anticipated story-driven action adventure game, *Star Wars Jedi: Fallen Order* available worldwide on Xbox One, PS4 and PC via Origin and Steam.

On Nov 8, EA's studio, Ghost Games announced the launch of *Need for Speed Heat* available worldwide on PS4, Xbox One and Origin for PC.

On Oct 29, EA and Valve announced a partnership to launch EA Access Subscription and EA Games on the Steam platform.

On Oct 22, EA and Maxis announced that *The Sims 4 Discover University* Expansion Pack will be available on PC and Mac from Nov 15 and on PlayStation4 and Xbox One from Dec 17.

On Oct 18, EA studio PopCap announced the launch of *Plants vs. Zombies: Battle for Neighborville* in stores and for digital download on PlayStation4, Xbox One, and PC via Origin.

On Oct 10, EA announced that *EA SPORTS FIFA 20* recorded 10 million players in the game since EA Access and Origin Access launch.

On Oct 7, EA and Fédération Internationale de Football Association (FIFA) announced the launch of the EA SPORTS FIFA 20 Global Series ahead of the FIFA eWorld Cup. It is a nine-month competition with a prize pool exceeding \$3 million.

Valuation

Electronic Arts shares are up 28.2% in the six-months period and 22.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Discretionary sector are up 19.7% and 9.8% in the six-months period, respectively. Over the past year, the Zacks sub-industry is up 18.3% while the sector is up 20.9%, respectively.

The S&P 500 index is up 12.3% in the six-months period and 23.8% in the past year.

The stock is currently trading at 23.29X forward 12-month earnings, which compares to 29.04X for the Zacks sub-industry, 20.88X for the Zacks sector and 19.2X for the S&P 500 index.

Over the past five years, the stock has traded as high as 33.49X and as low as 18.01X, with a 5-year median of 25.16X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$119 price target reflects 24.54X forward 12-month earnings.

The table below shows summary valuation data for EA

Valuation Multiples - EA					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	23.29	29.04	20.88	19.2
	5-Year High	33.49	30.46	23.35	19.34
	5-Year Low	18.01	17.34	16.16	15.17
	5-Year Median	25.16	24.02	20.11	17.44
P/S F12M	Current	6.26	5.39	2.4	3.57
	5-Year High	8.01	5.98	3.19	3.57
	5-Year Low	3.38	3	1.81	2.54
	5-Year Median	5.18	4.48	2.54	3
EV/Sales TTM	Current	5.53	5.16	3.37	3.34
	5-Year High	8.4	6.72	4.02	3.34
	5-Year Low	2.68	2.84	2.7	2.16
	5-Year Median	4.62	4.49	3.43	2.8

As of 01/17/2020

Industry Analysis Zacks Industry Rank: Bottom 6% (238 out of 254)



Top Peers

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

Industry Comparison Industry: Toys - Games - Hobbies				Industry Peers		
	EA Neutral	X Industry	S&P 500	HAS Underperform	MAT Neutral	TTWO Neutral
VGM Score	F	-	-	F	F	B
Market Cap	32.97 B	9.11 B	24.65 B	13.27 B	4.95 B	14.74 B
# of Analysts	14	6	13	4	3	21
Dividend Yield	0.00%	0.00%	1.73%	2.59%	0.00%	0.00%
Value Score	D	-	-	F	F	F
Cash/Price	0.15	0.13	0.04	0.08	0.04	0.15
EV/EBITDA	23.76	23.76	14.11	23.01	206.72	25.44
PEG Ratio	4.16	1.85	2.08	2.18	NA	2.13
Price/Book (P/B)	4.65	4.83	3.39	7.21	10.91	6.75
Price/Cash Flow (P/CF)	25.12	22.54	13.81	18.17	NA	20.65
P/E (F1)	24.03	24.07	19.19	24.03	NA	26.77
Price/Sales (P/S)	6.49	3.47	2.69	2.84	1.09	4.63
Earnings Yield	4.16%	4.10%	5.21%	4.17%	-0.84%	3.74%
Debt/Equity	0.14	0.22	0.72	0.92	6.30	0.05
Cash Flow (\$/share)	4.50	2.86	6.94	5.79	-0.35	6.30
Growth Score	F	-	-	B	C	B
Hist. EPS Growth (3-5 yrs)	16.76%	16.17%	10.56%	7.52%	-38.87%	33.73%
Proj. EPS Growth (F1/F0)	0.26%	16.46%	7.57%	15.28%	73.13%	-19.47%
Curr. Cash Flow Growth	11.18%	11.18%	14.73%	-18.74%	22.75%	98.75%
Hist. Cash Flow Growth (3-5 yrs)	17.13%	17.55%	9.00%	3.99%	NA	0.39%
Current Ratio	3.32	1.60	1.24	2.33	1.60	1.48
Debt/Capital	12.20%	17.93%	42.99%	47.96%	86.30%	5.16%
Net Margin	54.01%	8.37%	11.14%	5.59%	-4.53%	11.14%
Return on Equity	17.54%	13.94%	17.16%	30.40%	-26.03%	26.81%
Sales/Assets	0.53	0.80	0.55	0.90	0.87	0.72
Proj. Sales Growth (F1/F0)	3.75%	5.72%	4.16%	5.18%	0.55%	-2.86%
Momentum Score	A	-	-	F	D	A
Daily Price Chg	1.50%	0.00%	0.27%	1.46%	1.93%	1.86%
1 Week Price Chg	1.30%	0.00%	0.39%	-3.21%	4.38%	3.72%
4 Week Price Chg	5.21%	4.73%	2.95%	0.72%	9.51%	6.72%
12 Week Price Chg	17.66%	6.67%	7.76%	9.33%	41.81%	4.56%
52 Week Price Chg	26.45%	24.19%	22.29%	18.94%	12.71%	23.38%
20 Day Average Volume	1,667,455	98,459	1,536,375	976,498	3,537,367	944,701
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-4.74%	-14.29%	0.00%
(F1) EPS Est 4 week change	0.00%	-0.19%	0.00%	-5.38%	-14.29%	0.00%
(F1) EPS Est 12 week change	0.44%	-6.61%	-0.40%	-18.68%	-20.00%	2.05%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-23.68%	0.00%	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	D
Growth Score	F
Momentum Score	A
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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