

Zynga Inc. (ZNGA)

\$6.91 (As of 04/09/20)

Price Target (6-12 Months): **\$8.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/09/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:B

Value: D

Growth: A

Momentum: C

Summary

Zynga is benefiting from strength in live services, product introductions and growth in international markets. Robust performance of popular five franchises — *CSR Racing*, *Words With Friends*, *Zynga Poker*, *Empires & Puzzles* and *Merge Dragons!* — is driving the company's top line. The company's strengthening portfolio with *Words With Friends* and *Empires & Puzzles* witnessing record revenues and bookings and recent releases including *Merge Magic!* and *Farmville 3* are key catalysts for the long haul. Shares have outperformed the industry on a year-to-date basis. However, intensifying competition from the likes of EA and Activision is compelling the company to spend more on software development and marketing. This is keeping margins under pressure.

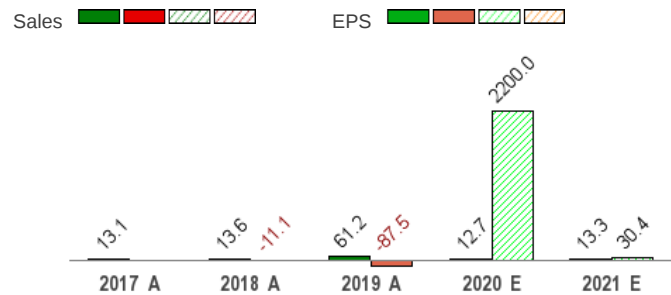
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$7.42 - \$5.22
20 Day Average Volume (sh)	22,786,890
Market Cap	\$6.6 B
YTD Price Change	12.9%
Beta	0.23
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Gaming
Zacks Industry Rank	Bottom 40% (151 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-33.3%
Last Sales Surprise	3.8%
EPS F1 Est- 4 week change	-21.8%
Expected Report Date	05/06/2020
Earnings ESP	-56.1%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	457 E	484 E	499 E	530 E	1,998 E
2020	403 E	423 E	453 E	484 E	1,763 E
2019	359 A	376 A	395 A	433 A	1,564 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.07 E	\$0.08 E	\$0.09 E	\$0.10 E	\$0.30 E
2020	\$0.05 E	\$0.05 E	\$0.06 E	\$0.07 E	\$0.23 E
2019	-\$0.12 A	-\$0.04 A	\$0.00 A	\$0.04 A	\$0.01 A

*Quarterly figures may not add up to annual.

P/E TTM	NA
P/E F1	30.0
PEG F1	2.1
P/S TTM	5.0

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/09/2020. The reports text is as of 04/13/2020.

Overview

Based in San Francisco, CA, Zynga Inc. is a leading developer, marketer, and publisher of social game services.

Zynga's gaming portfolio includes *CSR Racing 2*, *Empires & Puzzles*, *FarmVille*, *Merge Dragons!*, *Words With Friends*, *Mafia Wars*, *Zynga Poker* and *Treasure Isle*.

Zynga operates social games as live services, which means that it continues to support and update games after launch and gather daily, metrics-based player feedback that enables it to continually enhance games by adding new content and features.

The company publishes games on a number of global platforms including Facebook, MySpace, Yahoo, iPad, iPhone and Android devices.

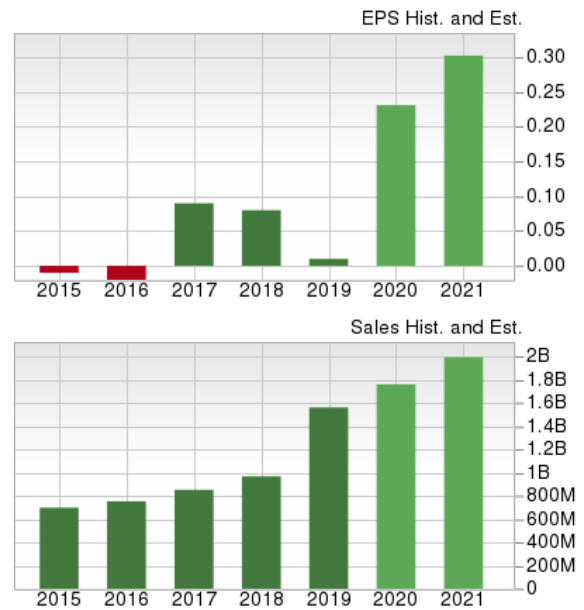
Zynga earns revenues from the sale of advertisement-free versions of mobile games, virtual currency that players use to buy in-game virtual items, licensing and advertising services.

The company reported revenues of \$1.32 billion for 2019. International revenues accounted for approximately 37% of revenues.

In the mobile and social gaming market, Zynga competes with the likes of Glu Mobile, NetEase Games, SciGames Interactive and EA Mobile.

The company also 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.

Zynga acquired 80% of Small Giant Games for \$560 million in a deal that closed at the beginning of 2019, thus adding *Empires & Puzzles* as a new forever franchise to its live services portfolio.



Reasons To Buy:

- ▲ Zynga's growth is primarily driven by strength in its diversified portfolio of live services. Also known as forever five franchises — *CSR Racing*, *Words With Friends*, *Zynga Poker*, *Empires & Puzzles* and *Merge Dragons!* — are the key growth drivers for the company.
- ▲ Zynga's expanding mobile gaming portfolio is expected to drive growth. Tremendous initial response from soft launches of games such as *Farmville 3* and *Merger Magic!* from Gram Games and *Puzzle Combat* from Small Giant Games are positives. Mobile sales accounted for 95.7% of total revenues for Zynga in fourth-quarter fiscal 2019.
- ▲ Zynga has been benefiting from acquisitions and partnerships. The company's stellar sales growth in 2019 can be attributed to two acquisitions. Zynga acquired Gram Games for \$250 million in May 2018 and 80% of Small Giant Games for \$560 million in a deal that closed at the beginning of 2019. The latter purchase alone added \$130 million of revenues to Zynga's top line, boosting its year-over-year growth. Moreover, Zynga introduced *Fast & Furious: Hobbs & Shaw* in partnership with Universal Games and Digital Platforms. Such key partnerships and continued featuring of exclusive content from automotive brands made *CSR2* a popular and engaging racing game.
- ▲ China, South Korea, and Japan are among the biggest markets in the world for mobile gaming. The company recently entered the Asian markets launching *Empires & Puzzles* with self-publishing model in South Korea and Japan. International expansion thus creates huge growth opportunities for Zynga in the near term.
- ▲ Zynga has a strong balance sheet and generates significant cash flow, which makes it an attractive stock for investors. The company had cash and cash equivalents of \$1.36 billion at the end of fourth-quarter 2019. Free cash flow amounted to \$89.2 million. We believe that its ability to generate strong cash flows will help it to make further investments in product development and acquisitions in the long haul.

Zynga benefits from the popularity of *CSR Racing*, *Words With Friends* and *Merge Dragons!* franchises, expanding mobile gaming portfolio and global footprint.

Reasons To Sell:

- ▼ Active user addition is key to healthy growth of any gaming company. Zynga's top line is driven by increase in user spending rather than a growing player base, which is a concern. The company's daily active users in fourth-quarter 2019 were about 20 million, down 1% year over year. Monthly active users declined 10% to 66 million in a year's time.
- ▼ The video game industry is inherently hit driven and highly competitive. Though Zynga 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. This keeps the margins under pressure
- ▼ Zynga is losing opportunities in the rapidly growing e-sports market to the likes of Take Two Interactive and Activision Blizzard. With continued increase in viewership, corporate sponsorships and growing media coverage, e-sports is here to stay. Per the latest report from Newzoo, e-sports industry will reach \$1.8 billion by 2022.

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

Last Earnings Report

Zynga Q4 Earnings Break Even, Revenues Rise Y/Y

Zynga reported breakeven earnings in fourth-quarter 2019, flat year over year.

Revenues jumped 62.6% year over year to \$404.5 million driven by strength in live services, and robust growth in international markets.

In particular, *Words With Friends*, *Empires & Puzzles*, and contribution from *Merge Magic!*'s first full quarter post launch drove top-line growth in the reported quarter.

The Zacks Consensus Estimate for earnings and revenues was pegged at 6 cents per share and \$418 million, respectively.

Total bookings came in at \$433 million, up 62.2% year over year driven by strong mobile bookings. The consensus mark for bookings was pegged at \$418 million.

Quarter Details

Zynga's online game revenues (80.3% of total revenues) increased 83.5% year over year to \$324.7 million on the back of its popular five franchises — *CSR Racing*, *Words With Friends*, *Zynga Poker*, *Empires & Puzzles* and *Merge Dragons!*.

Notably, *Words With Friends* and *Empires & Puzzles* both witnessed record revenues and bookings in the reported quarter.

Advertising revenues (19.7% of total revenue) and advertisement bookings (18.5% of total bookings) increased 11.1% and 12.7%, respectively year over year to \$79.7 million and \$80 million. Growth was driven by strong payer engagement throughout the holiday season, as well as one-time benefits from advertising network deals.

Mobile revenues (95.7% of total revenue) and mobile bookings increased 69.7% and 67.7%, respectively year over year to \$387 million and \$416 million. The increase was driven by robust live services performance.

In addition, *Game of Thrones Slots Casino* saw positive player reception for the new high limit area, The Highgarden Club, in addition to social features that drove player interaction in the fourth quarter.

On a geographic basis, revenues from the United States (61.1% of total revenues) increased 52.5% year over year to \$247 million.

Moreover, International revenues (38.9% of total revenues) increased 80.5% to \$157 million. The company benefited from self-publishing of *Empires & Puzzles* in South Korea, Japan and Taiwan in the third quarter.

User-Base Details

In the fourth quarter, user pay revenues were \$325 million, up 84% year over year, and user pay bookings were \$354 million, up 80% year over year.

However, Zynga's average mobile daily active users (DAUs) decreased 1% year over year to 20 million. The addition of *Empires & Puzzles* and *Merge Magic!* was more than offset by decreases in older mobile titles such as *Zynga Poker* and chat games.

Moreover, average mobile monthly active users (MAUs) decreased 10% year over year to 66 million in the reported quarter, primarily due to declines in *Zynga Poker*, chat games and older mobile titles, partially offset by the additions of *Empires & Puzzles*, *Merge Magic!* and *Merge Dragons!*.

Average mobile daily bookings per average mobile DAU (ABPU) grew 72% year over year to \$0.223 in the reported quarter.

Operating Details

GAAP gross margin contracted 200 basis points (bps) year over year to 65% due to a higher user pay bookings mix as well as increased amortization of acquired intangible assets.

Non-GAAP operating expenses (51.3% of total revenue) increased 46.7% year over year to \$207.4 million in the reported quarter primarily due to the increase in sales and market investments.

Non-GAAP general & administrative (G&A), research & development (R&D) and sales & marketing (S&M) expenses increased 5.4%, 8.1% and 93.6% year over year, to \$20.5 million, \$62 million and \$124.9 million, respectively.

Adjusted EBITDA increased 103.1% year over year to \$74.4 million. Adjusted EBITDA margin expanded 370 bps year over year to 18.6%.

Balance Sheet

As of Dec 31, 2019, Zynga had cash and cash equivalents & short-term investments of approximately \$1.36 billion compared with \$1.38 billion as of Sep 30, 2019.

Cash flow from operating activities in fourth-quarter 2019 was \$94 million compared with \$69 million in third-quarter 2019. Free cash flow was \$89.2 million in the fourth quarter compared with \$59.7 million in the previous quarter.

Quarter Ending 12/2019

Report Date	Feb 05, 2020
Sales Surprise	3.78%
EPS Surprise	-33.33%
Quarterly EPS	0.04
Annual EPS (TTM)	-0.12

Guidance

For first-quarter 2020, Zynga expects revenues of \$385 million and bookings of \$400 million.

Management expects the top-line to benefit from mobile live services with expected sequential growth across its five forever franchises.

Operating expense is expected to increase sequentially. Adjusted EBIDTA is expected to be \$57 million. Net loss is expected to be \$26 million.

For 2020, management expects revenues of \$1.6 billion and bookings of \$1.75 billion.

Recent News

On Mar 28, Zynga announced collaboration with 17 global games industry leaders to launch a program, encouraging players to follow health and safety guidelines against coronavirus.

On Mar 5, Zynga announced the soft launch of Harry Potter: Puzzles & Spells in select markets. The magical match-3 mobile game is officially licensed from Warner Bros. Interactive Entertainment.

On Feb 26, Zynga released Elite Customs feature in its mobile drag racing game, CSR2. Elite Customs gives players access to exclusive custom paints, liveries and interior options, license plate mods and wheel upgrades.

On Dec 4, Zynga launched an event series in partnership with the hyper sports car manufacturer Bugatti in its mobile drag racing game, CSR2. The event series, which celebrates Bugatti's 110th anniversary, will give players the opportunity to collect and compete with the world's most powerful and exclusive hyper sports cars in CSR2.

On Nov 22, Zynga announced an in-game license deal with Adult Swim to bring characters from the Emmy Award-winning TV series, *Rick and Morty* to Gram Games' *Merge Dragons!*.

On Nov 18, Zynga's subsidiary Small Giant Games launched Hero Costumes, a new feature for its popular franchise *Empires & Puzzles*. The feature provides the heroes in the game with new costumes that grant exclusive skills and increased power.

On Nov 6, Zynga launched a 'Best of British' event series in CSR2 featuring British hypercars such as the McLaren Senna, Noble M600 Carbon Sport, Ginetta Akula, Ultima RS and TVR Sagaris among others. The event comprises a 50-race ladder on a brand new track, ending with a finale that unlocks the McLaren Speedtail exclusively in CSR2.

Valuation

Zynga's shares are up 12.9% in the year-to-date period and 26.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Discretionary sector are down 37.6% and 24.2%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are down 36.8% and 19.2%, respectively.

The S&P 500 index is down 13.7% in the year-to-date period and 4.5% in the past year.

The stock is currently trading at 3.61X forward 12-month sales, which compares to 1.67X for the Zacks sub-industry, 1.81X for the Zacks sector and 3.07X for the S&P 500 index.

Over the past five years, the stock has traded as high as 4.14X and as low as 2X, with a 5-year median of 3.3X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$8 price target reflects 4.19X forward 12-month sales.

The table below shows summary valuation data for ZNGA

Valuation Multiples - ZNGA					
		Stock	Sub-Industr	Sector	S&P 500
P/S F12M	Current	3.61	1.67	1.81	3.07
	5-Year High	4.14	2.82	3.19	3.44
	5-Year Low	2	1.43	1.67	2.54
	5-Year Median	3.3	2.23	2.52	3.01
P/B TTM	Current	3.33	2.55	2.57	3.69
	5-Year High	3.53	4.99	5.04	4.55
	5-Year Low	0.92	1.8	2.17	2.84
	5-Year Median	1.96	3.58	4.24	3.63
EV/Sales TTM	Current	4.02	2.54	2.56	2.77
	5-Year High	6	4.38	4.02	3.46
	5-Year Low	0.85	2.09	2.26	2.16
	5-Year Median	3.02	3.36	3.4	2.83

As of 04/09/2020

Industry Analysis Zacks Industry Rank: Bottom 40% (151 out of 253)



Top Peers

Electronic Arts Inc. (EA)	Outperform
Nintendo Co. (NTDOY)	Outperform
Activision Blizzard, Inc (ATVI)	Neutral
Facebook, Inc. (FB)	Neutral
Glu Mobile Inc. (GLUU)	Neutral
Microsoft Corporation (MSFT)	Neutral
Take-Two Interactive Software, Inc. (TTWO)	Neutral
Tencent Holding Ltd. (TCEHY)	Underperform

Industry Comparison Industry: Gaming				Industry Peers		
	ZNGA Neutral	X Industry	S&P 500	ATVI Neutral	EA Outperform	TTWO Neutral
VGM Score	B	-	-	D	D	D
Market Cap	6.58 B	1.31 B	19.66 B	46.51 B	30.65 B	13.54 B
# of Analysts	10	4	13	13	13	21
Dividend Yield	0.00%	0.00%	2.18%	0.61%	0.00%	0.00%
Value Score	D	-	-	F	D	F
Cash/Price	0.22	0.25	0.06	0.13	0.19	0.18
EV/EBITDA	40.94	8.51	11.72	20.09	21.27	22.57
PEG Ratio	2.08	1.39	2.04	2.00	2.62	3.07
Price/Book (P/B)	3.32	1.66	2.66	3.63	4.27	5.64
Price/Cash Flow (P/CF)	269.05	7.24	10.44	21.54	23.53	18.96
P/E (F1)	30.04	19.27	17.51	24.38	21.43	27.74
Price/Sales (P/S)	4.97	0.79	2.12	7.17	5.69	4.72
Earnings Yield	3.33%	4.38%	5.65%	4.10%	4.67%	3.60%
Debt/Equity	0.35	1.36	0.70	0.21	0.14	0.06
Cash Flow (\$/share)	0.03	1.36	7.01	2.81	4.50	6.30
Growth Score	A	-	-	D	C	C
Hist. EPS Growth (3-5 yrs)	NA%	5.53%	10.92%	14.16%	16.39%	29.79%
Proj. EPS Growth (F1/F0)	2,210.00%	-10.47%	-1.14%	10.22%	4.75%	-8.08%
Curr. Cash Flow Growth	-57.58%	4.99%	5.93%	-23.97%	11.18%	98.75%
Hist. Cash Flow Growth (3-5 yrs)	19.28%	9.64%	8.55%	9.90%	17.13%	0.39%
Current Ratio	1.99	1.25	1.24	2.50	2.84	1.64
Debt/Capital	26.18%	62.89%	42.36%	17.28%	12.09%	5.93%
Net Margin	3.17%	0.83%	11.64%	23.18%	52.52%	11.81%
Return on Equity	-10.12%	2.75%	16.74%	13.16%	18.86%	15.30%
Sales/Assets	0.40	0.45	0.54	0.36	0.53	0.63
Proj. Sales Growth (F1/F0)	12.74%	0.00%	0.45%	6.27%	3.22%	-6.56%
Momentum Score	C	-	-	A	B	A
Daily Price Chg	1.92%	3.09%	2.48%	-1.00%	-0.94%	0.25%
1 Week Price Chg	-0.90%	-7.09%	-4.40%	5.30%	7.82%	6.08%
4 Week Price Chg	14.40%	4.31%	11.26%	10.81%	13.34%	10.19%
12 Week Price Chg	1.47%	-35.86%	-20.02%	0.05%	-4.91%	-6.46%
52 Week Price Chg	26.09%	-36.80%	-11.31%	28.17%	5.19%	25.33%
20 Day Average Volume	22,786,890	220,780	3,931,994	10,788,890	5,157,015	2,629,007
(F1) EPS Est 1 week change	0.00%	0.00%	-0.12%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-21.82%	-24.27%	-5.78%	0.06%	-0.35%	-0.33%
(F1) EPS Est 12 week change	-31.06%	-31.06%	-7.64%	-1.35%	0.06%	-7.21%
(Q1) EPS Est Mthly Chg	-23.08%	-47.55%	-10.13%	-0.28%	20.64%	-1.40%

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	A
Momentum Score	C
VGM Score	B

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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