

ACTIVISION BLIZZARD

IE Investment Club
Stock Pitch Competition 2nd edition
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ACTIVISION BLIZZARD, INC (ATVI)

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COMPANY

ATVI is an American video game holding company, headquartered at Santa Monica, California. In 2008 AB was founded from the merger of Activision Inc. and Vivendi Games, and now, serving a community of 400 million players in 190 countries, it's the largest game company in the Americas and Europe in terms of market capitalization and revenues. Its five business units that focus on games development are Activision Publishing, Blizzard Entertainment, King, Major League Gaming, and Activision Blizzard Studios. The company's key product franchises include Call of Duty, World of Warcraft, Diablo, Hearthstone, Overwatch, and Candy Crush.

Strengths:

- **Long-held view** that offers the opportunity for limitless innovation.
- **Free-to-play offerings** across mobile, PC, and consoles.
- **Automation** of activities brought consistency of quality and enables the company to scale up and scale down based on the demand.
- **Strong free cash flows** that provide resources to expand into new projects.
- Reliable **distribution network** that can reach the majority of its potential markets.
- Highly successful at **Go To Market strategies** for its products that has always generated good returns on capital expenditures by building new revenue streams.

Weaknesses:

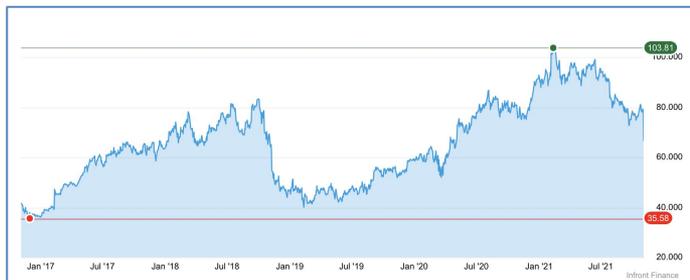
- **Dependence on a few core products** that had made it difficult to the company in moving into other product segments.
- Reliance on **third-party platforms** such as Sony's Playstation, and Microsoft's Xbox.
- **Seasonality in sales** correlated to holidays that increase forecasting issues and risks.

Capital Structure (28/10/2021)

	(\$)
Share price	78.19
Shares outstanding	778M
Market cap	60.81B
Entrepreneurial value	55.21B

LMT Financials (\$)

Revenues	8.938M
Operating Income	3.235M
Operating Margin	36.17%



INDUSTRY

Electronic Gaming & Multimedia Industry

- Valued at USD 173.70 Billion in 2020, expected to reach USD 314.40 Billion by 2026.
- CAGR : 9.24% over 2021-2026.
- Highly competitive and fragmented market without dominant players.
 - Main players by revenues: Activision Blizzard (6%), Electronic Arts(4%), Take-Two Interactive (2%), Ubisoft (2%), Nintendo (1%).

INDUSTRY TRENDS:

- **Mobile gaming**, attracted an increasing number of users over the last year (+12%). They are easy to develop, lead to lower costs, and generate revenues by offering free games with in-app purchases. Only in 2020, there have been 1.5 million s mobile players.
- **Cloud Gaming**, allows users to stream high-end games across hand-held devices, such as tablets and mobiles, thereby eliminating the need of gaming consoles/PCs/laptops.
- **AR & VR, and 5G**, increased in popularity due to the high demand for mobile games and mobile versions. They are leading important innovations in the gaming sector.
- **Free to Play**, pricing model with unlimited development potential. It helps players understand if they want to spend time and money, and tends to accrue higher revenues.
- **Esports tournaments**, anticipated to increase sales of video games and accessories along with gaming hardware and software. As competitive video games continue to integrate into popular culture, global investors, brands, media outlets, and consumers are paying attention to their rise in popularity (474 millions global followers in 2021).

Historical Performance

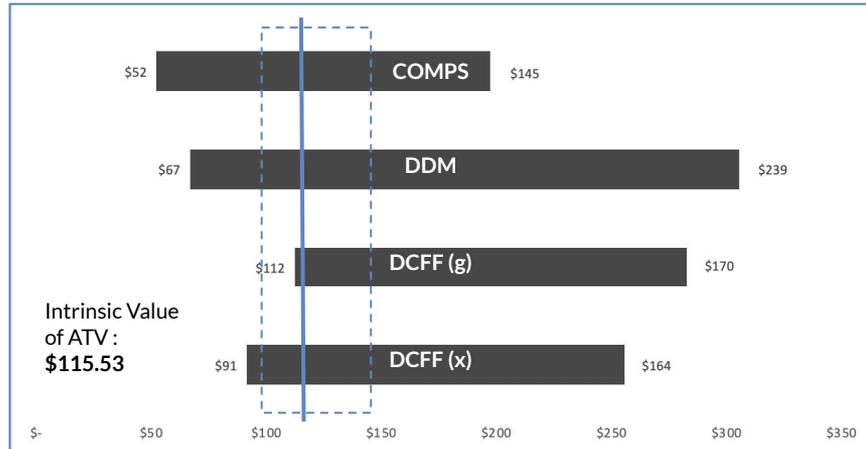
Beta 5 years	0.62
Revenue CAGR 3 years	11.83%
Q. Revenue Growth yoy	5.80%
2 years stock return	43.99%
6 months stock return	-10.12%

TRADING COMPARABLE ANALYSIS

Trading Comparables Analysis	EV / Sales	EV / EBITDA	P/S	P/E	P/B
Electronic Arts	6.67x	32.88x	7.14x	60.19x	5.16x
Ubisoft	2.63x	6.40x	2.57x	53.21x	3.40x
Take-Two Interactive	5.59x	19.03x	6.27x	32.21x	5.83x
Zynga	3.25x	63.99x	3.26x	27.25x	2.72x
Activision (ATVI)	6.18x	15.15x	6.80x	23.31x	3.73x
Mean (exc. ATVI)	4.54x	30.58x	4.81x	43.22x	4.28x
Mean (inc. ATVI)	4.86x	27.49x	5.21x	39.23x	4.17x
Median (exc. ATVI)	4.42x	25.96x	4.77x	42.71x	4.28x
Median (inc. ATVI)	5.59x	19.03x	6.27x	32.21x	3.73x

- **EV/Sales:** Looking at the benchmark, ATVI might seem slightly overvalued, but it is still in line with the values of main similar competitors such as EA and TTWO.
- **EV/EBITDA:** The high ratio shows that the industry has a fast-paced growth. Nonetheless, ATVI has a multiple half of the benchmark average, showing that the market is highly undervaluing the company, making it attractive for investments.
- **P/E:** the fact that ATVI presents the lowest PE shows that the stock price is very low to its earnings. This is an indicator of the company being strongly undervalued.
- **P/B:** ATVI shows a solid P/B ratio, lower than the average market figure. This is indicator of the company being undervalued.
- **Financials:** Compared to its competitors, ATVI reports very high solvency and liquidity. This has been crucial in sustaining the fundamental strength ensuring growing dividends to shareholders during the late periods of turbulence. On the other hand it has led to strong investments in R&D to innovate the business.

FOOTBALL FIELD VALUATION



Valuation	Min	Avg	Max
DCFF (xEBITDA)	\$ 91.34	\$ 126.80	\$ 164.33
DCFF (Growth)	\$ 112.17	\$ 130.62	\$ 170.46
DDM	\$ 66.70	\$ 107.66	\$ 239.03
Trading Comparables	\$ 52.12	\$ 97.04	\$ 144.97
Final Valuation	\$ 115.53		

- **Market Value:** \$78.19
- **Upside:** 47.76%
- **Intrinsic Value:** \$115.53

ASSUMPTIONS

- **Tax rate:** 27% (US corporate marginal tax rate)
- **WACC:** 6% (Kd: YTM of ATVI 2047 bond; Ke: 5Y beta and Mkt Rp vs S&P 500)
- **Perpetual Growth Rate:** 0.25% (< 3% avg US GDP growth; low due to seasonality)
- **EV/EBITDA multiple:** 12.00x (measured by Equidam on industry)
- **Dividend growth rate:** 2.74% (5Y sector dividend growth as benchmark)

RISKS

- **Lawsuits due to discriminatory and harassing behaviour**
 - California Department of Fair Housing and Employment filed a lawsuit against ATVI alleging “a sexist culture” discriminating women and people of colour. Results were employees protesting, and media and streamers halting coverage of Activision games.
 - Mitigant: The company has taken steps to improve its culture and address allegations by firing high level management, working with regulator agencies, and creating an \$18 mill fund to compensate claimants and support women-centric video games charities.
- **Delays of the release of Blizzard titles**
 - The challenges faced by Blizzard Entertainment, the recent shift in leadership, and company culture caused two of the most anticipated Blizzard games to be delayed.
 - Mitigant: The company has been working on repairing the brand image and attracting new talents to release a package of games by 2022.
- **Steady decline in monthly active users of Blizzard titles**
 - Increasing competition, delays in the games release, and other unclear reasons have caused the total number of Blizzard Entertainment monthly active players to halve, compared to 2017.
 - Mitigant: Blizzard accounts only for 7% of the company user base, and this downturn is mainly temporary due to the step down of some key individuals, but is expected to become again one of the company’s core growth engine in 2022 with the release of the new titles.

CATALYSTS

- **Mixed demographics**
 - The video games and mobile games industry has been able to attract new generations, and as gamers grow older they do not leave the system behind, resulting in a mixed and growing playing field.
 - In fact, in the United States, 40% of gamers are between 18 and 35 years old, but 21% of them are under 18 years old, and 21% is over 50 years old.
- **Esports growing success**
 - Global competitive entertainment accounts for more than 10% of ATVI revenues. With Call of Duty League and Overwatch League, enables its fans to enjoy the thrill of live match streams with the convenience and accessibility of video-on-demand content. It also operates other tournaments and Tespa, the leader in collegiate esports.
 - Activision Blizzard esports segment has grown by 82% in the past 3 years, and the whole market is expected to grow at a CAGR of 14.5% for the coming 5 years.
- **Expansion into mobile gaming**
 - Mobile revenues are generated through users’ upgrades and in-app purchases. 32% of ATVI overall sales revenues come from mobile (+12% in LTM) and *Call of Duty*, *Diablo immortal*, *Candy Crush*, and *Bubble Witch* mobile downloads accounts for a 40% increase of mobile revenues in just the last quarter.
 - ATVI has been investing heavily in mobile gaming (just acquired Digital Legends mobile developer) with the aim of bringing all its franchises on the most accessible device.

INVESTMENT THESIS

- We recommend to long ATVI stock, and hold the investment for more than 5 years. This choice is justified by the short term and temporary risks that the company is facing and the optimal growth trend followed as well as the industry growth expectations in the segments where ATVI is leader.
- The high liquidity and low debt will ensure the company to sustain its performance, and invest in new content to beat the competition. It will also help it to easily overcome the lawsuit that has forced the company to rebuild its reputation and internal culture.
- The expansion into the mobile gaming represent an outstanding opportunity to increase the company’s revenues over the next years, and improve its global reputation through the transition to mobile of its franchises and the launch of new games.
- Hedge position: put option at \$60, to prevent losses greater than 25%. Invest in a non-cyclical index, such as Dow Jones US Utilities Index due to the negative correlation with cyclical industries such as the gaming one. Place 20% of the investment in Electronic Arts, to increase exposure to the mobile gaming segment, as it’s the main focus of the company.