

NYSE: ATVI

Price: 89.67

Target Price: 99.85 – 107.23 (11.4%-19.58%)

Market Cap: 69,549.4 (mm)

Shares out.: 772.9 (mm)

52-week range: 50.51-92.99

1 Year Price Performance:



Company Overview:

Activision Blizzard Inc. , a California based entertainment company, develops and publishes video games. The company's products cover diverse game genres, including action, racing, role playing, simulation, first-person shooting, strategy, and card games. Games are played on PCs, consoles, and mobile phones. The company operates in three segments/studio: Activision, Blizzard, and King studio. Furthermore, the company also runs esports league and digital advertising within their content.

Breaking down revenue by segment:

1. Activision's main franchises are Call of Duty (COD), Sekiro, etc. Activision accounts for around 35% of revenue.
2. Blizzard's many franchises are World of Warcraft (WoW), Overwatch, Hearthstone, Diablo, etc. Blizzard accounts for around 25% of revenue.
3. King studio designs more family-friendly games like Candy Crush and many Facebook games. King accounts for almost 30% of the revenue.

Investment Thesis:

1. Global lockdown from Covid Pandemic: As outdoor activities are limited or even banned, consumers seek online entertainments such as video game at home. This has generated engagement and increase in new players, elevate industry growth. As of Q3 2020, the company has 390 million monthly active users. Furthermore, with growing player base, it becomes easier and cheaper for the company to gain new customers, because people want to play with their friends and play what others are playing.
2. Blizzard business model: Unlike EA or Ubisoft, Blizzard continue to produce expansions and new add-ons to many existing games, such as WoW and Hearthstone. In so doing, it minimizes both R&D and SG&A cost and increase margins. Activision studio's COD franchise surpassed \$3 billion in net bookings over LTM, revenue grew 270% Y/Y.
3. Financial Highlight: The company is constantly beating earnings estimate this year. Q3 EPS is \$0.88 vs \$0.75 predicted by analysts; furthermore, operating margin is also an impressive 39%. The company spends around 15% of revenue for future product's R&D and announced three new releases in 2021 and 2022. The company has a low D/E ratio of 0.5 and a high current ratio of 4.11. Allowing the company to take on new debt if needed. The company's current WACC is around 6.6% and increase debt will lower this name further. A low WACC will give a higher market value of the company if it was overlooked by the market.

Risks and Catalyst:

Catalyst:

1. The company has announced three upcoming hits: COD 2021, Overwatch 2(2021) and Diablo 4(2022).
 - a. I forecast the COD 2021 will sell 28.414 million units, an average of the top 5 best-selling COD games sales minus 1 million, a conservative estimate. Assuming a unit sale for \$69.99, then that is 1.99 billion dollars in revenue over 2 to 3 years.

- b. Overwatch 2 should generate continuous revenue unlike COD's one-time sale model. However, a new Overwatch game will decrease the existing Overwatch's player base. Nevertheless, I estimate a \$500 million revenue from Overwatch 2 release. It is based on the \$565 million revenue generated by Overwatch 1's initial release in 2016. Due to the game genre of Overwatch, its sales will continue in our model.
- c. In 2012, the release of Diablo 3 earned \$2.2 billion dollars for the first six months of the fiscal year. 10 years later, I predict it will generate \$2.5 billion dollars over 2022 and 2023.
2. New-gen console sales: As Xbox2 and PS5 have begun to ship. Both consoles have faster processors, redesigned hardware, large storage and memory optimized for video games. Allowing ATVI to develop better visual and audio, immersive and compelling gaming experience.
3. Growing esports market: More players are joining the party during the pandemic. This could mean greater engagement for the billion-dollar esports industry. For 2020, the company had to pause their esports operation, one of the biggest in the esports world; yet there is not a significant impact on their balance sheet.
4. The Return of Esports: Starting in 2022, I expect the Covid-vaccines would be distributed around the world, and esports industry can start again and recover. In 2019, it was a \$1 billion market, with expected CAGR of 27%. ATVI should have around 20-30% of that market share. With the current surging player count, it is a long-term bullish signal.

Risk:

1. New games might underperform: There are lots of alternatives to video game and many alternative video games. Thus the company's upcoming games might underperform.
2. Competition: There is lots of video game studios both big and small publishing new video games into the market. Disruptive game genres like battle royale affect the company's classic shooting games negatively in 2018.
3. Recession affects video game sales: The economy is surviving on government stimulus, businesses forced to shut down and workers losing their jobs. Overall economic showdown will decrease video game industry as well.

Valuations:

Assumptions:

1. Assumed revenue growth of 15%/10%/10% for Activision, Blizzard, and King respectively. -1% YoY growth Rate, 4% minimum growth rate.
2. Current EV/EBITDA multiple is 22.6x, assumed baseline Terminal EBITDA multiple of 22x.
3. Bloomberg Terminal determines the WACC to be 6.6%, assumed 2% Baseline Terminal FCF growth rate and 3% long-term GDP growth.

Appendix 1: DCF Assumptions

Activision Blizzard - DCF Assumptions & Output:			
Company Name:	Activision Blizzard	Terminal Value - Multiples Method:	Terminal Value - Perpetuity Growth Method:
Ticker:	NASDAQ:ATVI	Median EV / EBITDA of Comps:	Expected Long-Term GDP Growth:
Current Share Price:	\$ 89.67	Baseline Terminal EBITDA Multiple:	Baseline Terminal FCF Growth Rate:
Diluted Shares Outstanding:	772.900	Baseline Terminal Value:	Baseline Terminal Value:
		Implied Terminal FCF Growth Rate:	Implied Terminal EBITDA Multiple:
Tax Rate:	21.0%	(+) PV of Terminal Value:	(+) PV of Terminal Value:
Discount Rate (WACC):	6.60%	(+) Sum of PV of Free Cash Flows:	(+) Sum of PV of Free Cash Flows:
Last Fiscal Year:	2019-12-31	Implied Enterprise Value:	Implied Enterprise Value:
Current Equity Value:	\$ 69,305.9	% of Implied EV from Terminal Value:	% of Implied EV from Terminal Value:
(-) Cash & Cash-Equivalents:	(7,415.0)	(+) Cash & Cash-Equivalents:	(+) Cash & Cash-Equivalents:
(-) Other Non-Core-Business Assets:	-	(+) Other Non-Core-Business Assets:	(+) Other Non-Core-Business Assets:
(+) Total Debt:	4,304.0	(-) Total Debt:	(-) Total Debt:
(+) Other Funding Sources:	-	(-) Other Funding Sources:	(-) Other Funding Sources:
Current Enterprise Value:	66,194.9	Implied Equity Value:	Implied Equity Value:
Game Sales Forecast		Diluted Shares Outstanding:	Diluted Shares Outstanding:
Activision Revenue Growth Rate:	15.00%		
Blizzard Revenue Growth Rate:	10.00%	Implied Share Price from DCF:	Implied Share Price from DCF:
King Revenue Growth Rate:	10.00%	Premium / (Discount) to Current:	Premium / (Discount) to Current:
YOY change Growth Rate	(1.0%)		
Minimum Growth Rate	4.0%		

Appendix 2: Unlevered Free Cash Flow

Revenue and Expenses:		Historical			Projected						
	Units:	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26
Projected Income by segment											
Revenue by Segment for Continuing Operations:				(Q4 forecasted)							
Activision	\$ M USD	2,627	2,458	2,220	2,923	3,362	3,832	4,331	4,850	5,384	5,922
Blizzard	\$ M USD	2,139	2,290	1,717	1,796	1,976	2,154	2,326	2,489	2,638	2,770
King	\$ M USD	1,998	2,085	2,031	2,131	2,344	2,555	2,504	2,429	2,332	2,215
Total Revenue From Continuing Operations:		6,764	6,833	5,968	6,850	7,682	8,541	9,160	9,768	10,354	10,907
Free Cash Flow (FCF) Projections:		Historical			Projected						
	Units:	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26
Total Revenue:	\$ M USD	6,764.00	6,833.00	5,968.00	6,850.43	7,681.63	8,541.06	9,160.46	9,767.83	10,353.52	10,907.22
Operating Income (EBIT) :	\$ M USD	1324.00	1998.00	1744.00	2,053.25	2,359.99	2,688.09	2,951.73	3,220.70	3,491.47	3,759.99
Operating Margin Margin:	%	19.57%	29.24%	29.22%	29.97%	30.72%	31.47%	32.22%	32.97%	33.72%	34.47%
(-) Taxes, Excluding Effect of Interest:	\$ M USD	(278.0)	(419.6)	(366.2)	(431.2)	(495.6)	(564.5)	(619.9)	(676.3)	(733.2)	(789.6)
Net Operating Profit After Taxes (NOPAT):	\$ M USD	1045.96	1578.42	1377.76	1622.06	1864.39	2123.59	2331.87	2544.35	2758.26	2970.39
Adjustments for Non-Cash Charges:											
(+) Depreciation & Amortisation:	\$ M USD	888.00	509.00	328.00	234.00	244.00	254.00	264.00	274.00	284.00	294.00
	%	13.13%	7.45%	5.50%	3.42%	3.18%	2.97%	2.88%	2.81%	2.74%	2.70%
(+/-) Deferred Income Taxes:	\$ M USD	(179.00)	(28.00)	(353.00)	(186.67)	(189.22)	(242.96)	(206.28)	(212.82)	(220.69)	(213.27)
Net Change in Working Capital	\$ M USD	683.00	607.00	913.00	529.46	498.72	515.66	371.64	364.42	351.42	332.22
% Change in Revenue:	%	N/A	879.71%	-105.55%	60.00%	60.00%	60.00%	60.00%	60.00%	60.00%	60.00%
%Revenue:	%	10.10%	8.88%	15.30%	7.73%	6.49%	6.04%	4.06%	3.73%	3.39%	3.05%
(-) Capital Expenditures:	\$ M USD	166.0	126.0	327.0	223.264	270.965	349.210	332.072	366.004	395.529	406.924
%Revenue:	%	2.5%	1.8%	5.5%	3.3%	3.5%	4.1%	3.6%	3.7%	3.8%	3.7%
UnLevered Free Cash Flow:	\$ M USD	2,604.0	2,792.4	2,592.8	2,422.1	2,688.9	2,999.5	3,093.3	3,336.0	3,568.5	3,790.3
Growth Rate:	%	N/A	7.2%	(7.2%)	(6.6%)	11.0%	11.6%	3.1%	7.8%	7.0%	6.2%
Discount Period:	#				1	2	3	4	5	6	7
PV of UFCF:	\$ M USD				2272.15	2366.21	2476.15	2395.48	2423.45	2431.89	2423.09
EBITDA:	\$ M USD	2,212.0	2,507.0	2,072.0	2,287.2	2,604.0	2,942.1	3,215.7	3,494.7	3,775.5	4,054.0
Growth Rate:	%	N/A	13.3%	(17.4%)	10.4%	13.8%	13.0%	9.3%	8.7%	8.0%	7.4%

Appendix 3: Sensitivity Analyses:

Sensitivity Analysis:													
Weighted Average Cost of Capital (WACC):													
Terminal EV / EBITDA Multiple (Terminal Value Calculated Using the Multiple Method)	24.00 x	6.10%	6.20%	6.30%	6.40%	6.50%	6.60%	6.70%	6.80%	6.90%	7.00%	7.10%	
		\$ 114.41	\$ 113.82	\$ 113.25	\$ 112.67	\$ 112.10	\$ 111.53	\$ 110.97	\$ 110.41	\$ 109.86	\$ 109.30	\$ 108.75	
		23.00 x	110.73	110.17	109.61	109.06	108.51	107.96	107.42	106.88	106.34	105.81	105.28
		22.00 x	107.05	106.51	105.98	105.44	104.91	104.39	103.86	103.34	102.83	102.31	101.80
		21.00 x	103.38	102.86	102.34	101.83	101.32	100.81	100.31	99.81	99.31	98.82	98.33
		20.00 x	99.70	99.20	98.70	98.21	97.72	97.24	96.75	96.27	95.80	95.32	94.85
		19.00 x	96.02	95.54	95.07	94.60	94.13	93.66	93.20	92.74	92.28	91.83	91.38
		18.00 x	92.35	91.89	91.43	90.98	90.53	90.09	89.64	89.20	88.77	88.33	87.90
17.00 x	88.67	88.23	87.80	87.37	86.94	86.51	86.09	85.67	85.25	84.84	84.43		
16.00 x	84.99	84.58	84.16	83.75	83.34	82.94	82.54	82.14	81.74	81.34	80.95		

Weighted Average Cost of Capital (WACC):													
Terminal FCF Growth Rate (Terminal Value calculated Using the Gordon Growth Method)	2.40%	6.10%	6.20%	6.30%	6.40%	6.50%	6.60%	6.70%	6.80%	6.90%	7.00%	7.10%	
		\$ 121.30	\$ 118.19	\$ 115.24	\$ 112.44	\$ 109.77	\$ 107.23	\$ 104.80	\$ 102.49	\$ 100.28	\$ 98.16	\$ 96.14	
		2.30%	118.71	115.74	112.92	110.24	107.69	105.25	102.93	100.71	98.58	96.55	94.60
		2.20%	116.25	113.41	110.72	108.15	105.71	103.37	101.14	99.00	96.96	95.00	93.12
		2.10%	113.91	111.20	108.62	106.16	103.82	101.57	99.43	97.37	95.40	93.51	91.70
		2.00%	111.68	109.09	106.62	104.26	102.01	99.85	97.79	95.81	93.91	92.08	90.33
		1.90%	109.57	107.08	104.71	102.45	100.28	98.20	96.21	94.31	92.47	90.71	89.02
		1.80%	107.55	105.16	102.89	100.71	98.62	96.62	94.71	92.86	91.10	89.39	87.76
1.70%	105.62	103.33	101.14	99.05	97.04	95.11	93.26	91.48	89.77	88.12	86.54		
1.60%	103.78	101.58	99.47	97.45	95.52	93.66	91.87	90.15	88.50	86.90	85.37		