Reactivating Activision (NASDAQ: ATVI)

David Gardner | February 7, 2003

I don't usually add to my losers. When a stock of mine gets in a bad place, I'm inclined to let it extricate itself on its own. "You got yourself into this mess!" I fume, the scolding parent. "*Now get yourself out of it*."

As a rule, I much prefer to add to (not to mention talk about) my winners. I've seen people go broke adding to their losers. So why am I selecting Activision?!

A bit of background: I initially recommended **Activision** (NASDAQ: ATVI) at around $27 for our September issue. I thought I had a bargain. The company was flush with good news, and the stock had drifted nicely from a secondary offering above $30. Around Halloween, coincident with a strong Q2 earnings report, management bumped its guidance for the year. It all seemed so fine and dandy.

A month or so later, I faced the unenviable task of relaying the news that Activision would *lose* money in Q4! I didn't relish the duty. I stand by my conviction that business conditions change, and that none of this was "illegal" or cause for litigation. At the same time, I couldn't defend the actions of Activision management.

Nor do I presume for a second that the resulting loss of credibility hasn't exacerbated the ensuing sell-off. As it stands today, the game developer and publisher is down about 50% since my original recommendation. Ladies, gentlemen, and Fools, this hasn't been pretty to watch.

ACTIVISION BLIZZARD, INC. IN 1 MINUTE

What It Does

Activision Blizzard is a leading publisher of video games, notably World of Warcraft, Call of Duty, Guitar Hero, and Tony Hawk.

Company Guide

- **Industry:** Entertainment
- **Asset Class:** Large
- **Region:** US
- **Price on June 21, 2020:** $ 76.12

Key Data

- **Headquarters:** Santa Monica, CA, US
- **Sector:** Unknown

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So why would I recommend it now? For one thing, company execs began buying the stock with gusto for their personal accounts in December at around $12.50 to $13 per share. Perhaps more importantly, the company itself activated a stock repurchase program, announcing it would look to accumulate and retire its own shares. All told in the quarter, Activision picked up 1.8 million shares at an average $13.15 per share.

In the wake of bad news, there's a tendency to look backward rather than forward. I'm here to remind you that Activision's drop is in the past, and that the market neither knows nor cares what price you or I originally paid for the stock. All that matters now is what ATVI does from its present perch at around $14, going forward.

And as we discussed in our December update, a $14 purchase of ATVI still buys you nearly $7 in cash. And that's accounting for the losses this quarter. Put another way, once you subtract out the cash, you're paying less than $7 per share for a company that presently projects 2004 sales at $750 million and $0.70 per share in earnings.

Now granted, these are company projections, and if you're skeptical, I can respect that. Personally, I think they're attainable, and a price-to-earnings ratio of around 10 for a strong growth company suffering an off year seems awfully reasonable to me.

In Activision, you also get a diverse product lineup that, while admittedly lacking in hit titles, remains solid. *Tony Hawk 4*, which still lags *Hawk 3*, continues to sell well and pull strong reviews. Activision also announced plans in the year ahead for a Disney-character skateboarding game using the *Hawk* engine.

(I still see a hit in *Doom III*, but it's not a high-margin title for Activision since it's produced out-of-house with Activision acting as a distributor.)

Activision also inked a firmer deal with *Motley Fool Stock Advisor* superholding Marvel to feature more Marvel superheroes (particularly from coming movie attractions) in Activision videogames. As for a possible breakout in 2003, look for *True Crime: Streets of LA*, which mimics the monster *Grand Theft Auto* series.

For all that, the visibility for new titles is pretty high is this business. We won't likely be treated to surprise breakthrough releases. In Wall Street jargon, ATVI lacks a near-term catalyst (but isn't this always the case with out-of-favor stocks?).

If Ya Liked Me at $27...

Nonetheless, Activision remains a solid, cash-rich company operating in a relevant industry. It remains profitable on an annual basis. More to the point, it's well out of favor, trading at half its price of just six months ago. A lot of bad news is already factored in; I think this stock beats the market over the next 35 years.

But patience is key: ATVI could prove sleepy (jargon alert: *dead money*) for the next six months, as management works to regain investor confidence and develop titles of the quality consistently put out by Electronic Arts. Then again, I'm investing for years, not months.

Activision, you got yourself into this mess, now you get yourself out of it! My reputation is banking on it.