Take-Two Interactive

David Gardner | December 19, 2007

CURRENT PRICE: [TTWO] $ 140.40 ↑ $ 0.53 (0.4%)

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- Turnaround is under way and should unlock shareholder value.
- Vivendi deal reshapes the video game industry and raises possibility of further acquisitions.
- Grand Theft Auto IV will launch in the spring and boost returns.

- Nasdaq: TTWO
- www.take2games.com
- Ph: 646-536-2842

Recent Price: $11.82-$24.80

I'm not the kind of guy who walks into a restaurant and orders "the usual." There are just too many new things to try -- and it's often the same with stocks. Outside of our annual review issues, I haven't rerecommended many of my own stocks in *Rule Breakers* -- there are just too many great companies and opportunities out there. But our goal is to maximize returns, and when I look over our scorecard's menu of stocks, I see that sometimes the best opportunities turn up in the stocks you already know and, I hope, own.

I believe that's the case with **Take-Two Interactive** (NASDAQ: TTWO). I originally recommended this video game software company in our October 2007 issue as a turnaround play, after a long series of missteps and mismanagement caused the stock to shed half its value.

Certainly, three months isn't a long time for a turnaround. But recent developments in the industry lead me to believe that there's more upside to Take-Two's stock than its very recent past suggests -- and that it could come sooner than expected.

The Landscape Changes

Global entertainment powerhouse Vivendi announced on Dec. 2 that it was acquiring a controlling interest in gaming software creator **Activision** (NASDAQ: ATVI). As we noted in a recent *Rule Breakers* update, the result will be a new company called Activision Blizzard that combines the considerable catalog at Activision -- including iconic hits like the *Guitar Hero* and *Tony Hawk* franchises -- with Vivendi's massively popular online game *World of Warcraft* and its catalog from Sierra Games.

The result is a $19 billion juggernaut that will rival gaming granddaddy **Electronic Arts** (Nasdaq: ERTS) in valuation and stature. I'm watching this closely, because both Activision and Electronic Arts are recommendations of mine in *Stock Advisor*.

So where does Take-Two fit in? Strictly speaking, exactly where it did before. The company is working to fix a number of problems. As I said back in October, I think the stock could potentially double just by regaining Wall Street's confidence that it's under solid, stable management with a focus on maximizing shareholder value.

One reason for a little extra confidence, however, is that renewed attention is now falling on Take-Two's considerable assets. While I have no reason to think an acquisition is imminent or even under discussion, there's no doubt that Take-Two would be a valuable addition to a larger game maker -- especially one like Electronic Arts, which is now feeling heat from its closest rival. Electronic Arts in some ways has the opposite problem of Take-Two: Operationally strong, the company has often relied on old franchises and hasn't been as creative as many smaller players. A fresh infusion of Take-Two attitude could be just what it needs.

I'm not basing this rerecommendation purely on speculation that Electronic Arts (or another company) will snap up Take-Two. It remains a distinct possibility, however, and one that should focus investors' attention more closely on a company that, while still troubled, trades at a substantial discount to its peers.

On the other hand, Take-Two could choose the path of pursuing organic growth or even becoming an acquirer itself. That's fine. I still believe all the growth drivers I outlined three months ago are in place.

Blockbusters on the Way

Bioshock has been a big hit for Take-Two, with millions of copies of the first-person underwater shooter sold since its launch this summer. *Bioshock 2* is already in the planning stages -- and this will indeed become the new franchise I predicted.

The company's Sid Meier games, including the *Civilization* line, will continue to fuel growth, and the new *Don King Presents: Prizefighter*, due in the spring, might even help revitalize the 2K game division's lackluster sports line. But what everyone's really waiting for is *Grand Theft Auto IV*.

When I made the original recommendation, we already knew that *GTA IV* wouldn't be ready for Christmas -- a disappointment that was factored into the price at the time. But this is a huge franchise, and I expect it to meet or exceed lofty expectations when it finally launches in the spring. Barring some unseen further delay or unprecedented disaster, the approach of the launch alone will, I think, boost the stock.

The just-released earnings project a weaker first quarter, but I think that with *GTA* on the way, 2008 should be a nicely profitable year for Take-Two. The stock has risen a little more than 3% since I first tapped it as a Rule Breaker. That's certainly better than what we've seen from the S&P 500, but it's just a small taste of what I think is still to come. If you bought Take-Two in October, consider adding more here. If you didn't buy, don't feel like you've missed the boat. The game's still not over.

David owns shares of Activision and Electronic Arts.

For more, join us on the RBS: Take-Two discussion board.