

Activision Blizzard, Inc. (NASDAQ: ATVI)

United States | Technology | Software Products

November 23, 2020

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Opening Recommendation:

I recommend buying Activision Blizzard, Inc at \$75.92 because it is currently undervalued with an implied upside of 32.5% - 32.7% at a target price of \$101.37 - \$101.53. With lockdown restrictions tightening up around the world, people are more likely to stay home which gives them more access to the company's services. Furthermore, the recent release of Call of Duty: Cold War and the new PS5 and Xbox Series X are also catalysts for the company's future performance.

Company Overview:

Activision Blizzard Inc. is a leading video game developer and distributor that is worth almost \$60 billion USD, pulling in \$6.5 billion USD in revenue last year. It operates through 3 segments, Activision Publishing, Inc, Blizzard Entertainment, Inc, and King Digital Entertainment. Through these segments, the company provides a variety of games for users on consoles, computers, and mobile devices.

Investment Thesis:

- 1. The company possesses massive scale.** Activision Blizzard Inc's market size eclipses its competitors EA (\$35.33 billion USD) and Take-Two (\$18.75 billion USD) entirely. Furthermore, the company produces a wide breadth of sought-after games for any user, ranging from the first-person shooter Call of Duty series to the strategic World of Warcraft to the addicting puzzle of Candy Crush Saga.
- 2. Economically resilient.** The convenient and addicting nature of video games allow the company to hedge itself against certain economic crises such as the pandemic and engage users anywhere at anytime. Activision Blizzard's revenue in the quarter of the pandemic rose in comparison to last year's respective quarter. Their Q3 2020 revenue was \$1.954 billion USD in comparison to their Q3 2019 revenue of only \$1.282 billion USD.
- 3. Robust financials paired with efficient operations.** The company captures its audience through retail and digital channels in an extremely cost-efficient manner. They consistently boast gross and operating margins of over 60% and 20% respectively along with TTM ROA, ROE, and ROIC of 11.24%, 16.63%, and 13.76% respectively. Furthermore, the company's current, quick, and debt/equity ratios are 4.12, 3.67 and 0.25 proving how strong their balance sheet is.

Risks:

- 1. Everyone is eager to go out.** After being locked in for so long and with successful COVID-19 vaccine trials emerging, people are itching to leave their homes which may reduce time spent on Activision Blizzard's products.
- 2. Consumer preferences change suddenly.** Along with the recent NBA draft, also comes their flagship game, NBA2K21, which brings in new graphics, ratings, players, and features. The release of such popular video games may draw attention away from the company's current products.

Conclusion:

Activision Blizzard, a well-structured and innovative company that never lacks engagement is currently mispriced at \$75.92. A buy recommendation is placed on the company with a target price of \$101.37 - \$101.53, implying an upside of 32.5% - 32.7%

Pricing:

Target Price: \$101.37 - \$101.53

Price at Writing: \$75.92

Implied Upside: 32.5% - 32.7%

Financial Summary:

Market Capitalization: \$58.68 B

Enterprise Value: \$54.96 B

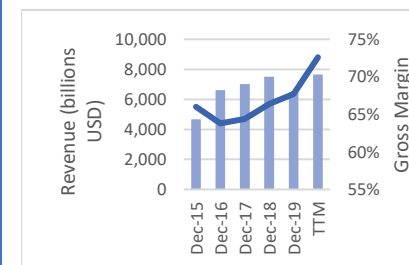
Total Debt: \$3604.00 B

Market Data:

52 Week Range: \$50.51 - \$87.73

Shares Outstanding: 772.86

Financial Performance:



Price Performance:




Appendices
Discounted Cash Flow Analysis

| Activision Blizzard, Inc. - FCF Projections: | Units: | Historical | | | Projected | | | | | | | | | |
|--|--------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| | | FY17 | FY18 | FY19 | FY20 | FY21 | FY22 | FY23 | FY24 | FY25 | FY26 | FY27 | FY28 | FY29 |
| Operating Income (EBIT): | \$ M | 1,297.0 | 1,948.0 | 1,607.0 | 2,466.4 | 3,143.2 | 3,329.0 | 3,638.4 | 3,855.4 | 4,046.9 | 4,193.4 | 4,328.7 | 4,461.5 | 4,598.4 |
| Operating Margin: | % | 18.5% | 26.0% | 24.8% | 34.8% | 41.1% | 40.8% | 42.1% | 42.3% | 42.5% | 42.7% | 42.9% | 43.1% | 43.3% |
| Growth Rate: | % | 231.6% | 50.2% | (17.5%) | 53.5% | 27.4% | 5.9% | 9.3% | 6.0% | 5.0% | 3.6% | 3.2% | 3.1% | 3.1% |
| (-) Taxes, Excluding Effect of Interest: | \$ M | (313.2) | (470.4) | (388.1) | (595.6) | (759.1) | (804.0) | (878.7) | (931.1) | (977.3) | (1,012.7) | (1,045.4) | (1,077.5) | (1,110.5) |
| Net Operating Profit After Taxes (NOPAT): | \$ M | 983.8 | 1,477.6 | 1,218.9 | 1,870.8 | 2,384.2 | 2,525.0 | 2,759.7 | 2,924.3 | 3,069.6 | 3,180.7 | 3,283.3 | 3,384.1 | 3,487.9 |
| Adjustments for Non-Cash Charges: | | | | | | | | | | | | | | |
| (+) Depreciation & Amortization: | \$ M | 888.0 | 509.0 | 328.0 | 212.6 | 191.2 | 179.3 | 172.8 | 136.7 | 95.2 | 98.2 | 100.9 | 103.5 | 106.2 |
| % Revenue: | % | 12.7% | 6.8% | 5.1% | 3.0% | 2.5% | 2.2% | 2.0% | 1.5% | 1.0% | 1.0% | 1.0% | 1.0% | 1.0% |
| (+/-) Deferred Income Taxes: | \$ M | (181.0) | (35.0) | (352.0) | (818.1) | (1,042.7) | (1,104.3) | (1,206.9) | (1,278.9) | (1,342.4) | (1,391.0) | (1,435.9) | (1,480.0) | (1,525.4) |
| % Income Statement Taxes: | % | (20.6%) | (120.7%) | (270.8%) | (137.4%) | (137.4%) | (137.4%) | (137.4%) | (137.4%) | (137.4%) | (137.4%) | (137.4%) | (137.4%) | (137.4%) |
| Net Change in Working Capital: | \$ M | 1,352.0 | (1,134.0) | 93.0 | (53.8) | (44.8) | (35.2) | (29.5) | (23.6) | (16.3) | (11.9) | (10.8) | (10.5) | (10.7) |
| (-) Capital Expenditures: | \$ M | (116.0) | (131.0) | (116.0) | (248.1) | (229.4) | (203.8) | (172.8) | (182.3) | (142.8) | (147.3) | (151.4) | (155.3) | (159.3) |
| Unlevered Free Cash Flow: | \$ M | \$ 2,926.8 | \$ 686.6 | \$ 1,171.9 | \$ 963.3 | \$ 1,258.4 | \$ 1,361.1 | \$ 1,523.3 | \$ 1,576.2 | \$ 1,663.2 | \$ 1,728.6 | \$ 1,786.2 | \$ 1,841.9 | \$ 1,898.7 |
| Growth Rate: | % | N/A | (76.5%) | 70.7% | (17.8%) | 30.6% | 8.2% | 11.9% | 3.5% | 5.5% | 3.9% | 3.3% | 3.1% | 3.1% |
| Discount Period: | # | | | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Discount Rate (WACC): | % | | | | 4.58% | 4.58% | 4.58% | 4.58% | 4.58% | 4.58% | 4.58% | 4.58% | 4.58% | 4.58% |
| Cumulative Discount Factor: | # | | | | 0.956 | 0.914 | 0.874 | 0.836 | 0.800 | 0.765 | 0.731 | 0.699 | 0.669 | 0.639 |
| PV of Unlevered FCF: | \$ M | | | | \$ 921.2 | \$ 1,150.7 | \$ 1,190.1 | \$ 1,273.7 | \$ 1,260.3 | \$ 1,271.7 | \$ 1,263.8 | \$ 1,248.8 | \$ 1,231.4 | \$ 1,213.8 |
| EBITDA: | \$ M | \$ 2,185.0 | \$ 2,457.0 | \$ 1,935.0 | \$ 2,679.0 | \$ 3,334.4 | \$ 3,508.3 | \$ 3,811.2 | \$ 3,992.1 | \$ 4,142.2 | \$ 4,291.6 | \$ 4,429.6 | \$ 4,565.0 | \$ 4,704.6 |
| Growth Rate: | % | N/A | 12.4% | (21.2%) | 38.4% | 24.5% | 5.2% | 8.6% | 4.7% | 3.8% | 3.6% | 3.2% | 3.1% | 3.1% |

Terminal Value - Multiples Method:

| | |
|------------------------------------|--------------------|
| Discount Rate (WACC): | 4.58% |
| Median EV / EBITDA of Comps: | 21.9 x |
| Baseline Terminal EBITDA Multiple: | 21.0 x |
| Baseline Terminal Value: | \$ 98,796.3 |
| Implied Terminal FCF Growth Rate: | 2.6% |
| (+) PV of Terminal Value: | 63,158.9 |
| (+) Sum of PV of Free Cash Flows: | 12,025.3 |
| Implied Enterprise Value: | \$ 75,184.3 |
| Implied Equity Value: | 78,470.1 |

Diluted Shares Outstanding: 772.860

| | |
|---|------------------|
| Implied Share Price from DCF: | \$ 101.53 |
| Premium / (Discount) to Current: | 32.7% |

Terminal Value - Perpetuity Growth Method:

| | |
|------------------------------------|--------------------|
| Discount Rate (WACC): | 4.58% |
| Expected Long-Term GDP Growth: | 3.0% |
| Baseline Terminal FCF Growth Rate: | 2.6% |
| Baseline Terminal Value: | \$ 98,602.0 |
| Implied Terminal EBITDA Multiple: | 21.0 x |
| (+) PV of Terminal Value: | 63,034.7 |
| (+) Sum of PV of Free Cash Flows: | 12,025.3 |
| Implied Enterprise Value: | \$ 75,060.0 |
| Implied Equity Value: | 78,345.0 |

Diluted Shares Outstanding: 772.860

| | |
|---|------------------|
| Implied Share Price from DCF: | \$ 101.37 |
| Premium / (Discount) to Current: | 32.5% |



Comparable Companies Analysis

| Operating Statistics: | | Capitalization | | | | | EBITDA | | | Net Income | | Projected Revenue Growth | Projected EBITDA Growth | Source: Company Filings EBITDA Margin | |
|-------------------------------------|--------------------|-------------------|-------------------|-------------------|-----------------|-------------------|-----------------|--------------|--------------|--------------|--------------|--------------------------|-------------------------|---------------------------------------|--|
| Company Name | Equity Value | LTM | FY20 | FY21 | LTM | FY20 | FY21 | FY20 | FY21 | LTM | FY20 | FY21 | | | |
| Electronic Arts Inc. | \$ 35,327.2 | \$ 1,652.0 | \$ 1,816.0 | \$ 2,056.0 | \$ 1,019.0 | \$ 3,039.0 | \$ 1,007.0 | 4.5% | 13.2% | 28.5% | 30.2% | 32.7% | | | |
| Take-Two Interactive Software, Inc. | 18,745.3 | 544.3 | 740.0 | 692.0 | 334.0 | 404.0 | 394.0 | 12.7% | (6.5%) | 16.1% | 24.7% | 20.5% | | | |
| Zynga Inc. | 8,869.4 | (5.5) | 508.0 | 625.0 | 473.0 | (414.0) | 148.0 | 21.2% | 23.0% | (0.3%) | 22.9% | 23.2% | | | |
| NetEase, Inc. | 65,499.9 | 2,594.1 | 2,811.2 | 3,258.8 | 3,069.3 | 2,217.4 | 2,500.9 | 15.6% | 15.9% | 27.4% | 26.6% | 26.7% | | | |
| Maximum | \$ 65,499.9 | \$ 2,594.1 | \$ 2,811.2 | \$ 3,258.8 | \$ 3,069.3 | \$ 3,039.0 | \$ 2,500.9 | 21.2% | 23.0% | 28.5% | 30.2% | 32.7% | | | |
| 75th Percentile | 42,870.4 | 1,887.5 | 2,064.8 | 2,356.7 | 1,531.6 | 2,422.8 | 1,380.5 | 17.0% | 17.7% | 27.7% | 27.5% | 28.2% | | | |
| Median | \$ 27,036.3 | \$ 1,098.2 | \$ 1,278.0 | \$ 1,374.0 | \$ 746.0 | \$ 1,310.7 | \$ 700.5 | 14.2% | 14.6% | 21.7% | 25.7% | 25.0% | | | |
| 25th Percentile | 16,276.3 | 406.9 | 682.0 | 675.3 | 438.3 | 199.5 | 332.5 | 10.7% | 8.3% | 12.0% | 24.3% | 22.6% | | | |
| Minimum | 8,869.4 | (5.5) | 508.0 | 625.0 | 334.0 | (414.0) | 148.0 | 4.5% | (6.5%) | (0.3%) | 22.9% | 20.5% | | | |

| | | | | | | | | | | | | |
|----------------------------------|--------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------|-------------|--------------|--------------|--------------|
| Activision Blizzard, Inc. | \$ 59,131.5 | \$ 1,935.0 | \$ 3,334.4 | \$ 3,508.3 | \$ 1,503.0 | \$ 1,958.0 | \$ 2,094.0 | 7.9% | 5.2% | 29.8% | 47.0% | 45.9% |
|----------------------------------|--------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------|-------------|--------------|--------------|--------------|

| Valuation Statistics: | | Capitalization | | | Enterprise Value / Revenue | | | Enterprise Value / EBITDA | | | P / E Multiple | |
|-------------------------------------|--------------------|--------------------|--------------|--------------|----------------------------|---------------|---------------|---------------------------|---------------|---------------|----------------|--|
| Company Name | Equity Value | Enterprise Value | LTM | FY20 | FY21 | LTM | FY20 | FY21 | LTM | FY20 | FY21 | |
| Electronic Arts Inc. | \$ 35,327.2 | \$ 30,529.6 | 5.3 x | 5.1 x | 4.9 x | 18.5 x | 16.8 x | 14.8 x | 34.7 x | 11.6 x | 35.1 x | |
| Take-Two Interactive Software, Inc. | 18,745.3 | 16,533.2 | 4.9 x | 5.5 x | 4.9 x | 30.4 x | 22.3 x | 23.9 x | 56.1 x | 46.4 x | 47.6 x | |
| Zynga Inc. | 8,869.4 | 8,846.9 | 5.5 x | 4.0 x | 3.3 x NM | 17.4 x | 14.2 x | 18.8 x NM | 21.3 x | 29.5 x | 59.9 x | |
| NetEase, Inc. | 65,499.9 | 55,982.7 | 5.9 x | 5.3 x | 4.6 x | 21.6 x | 19.9 x | 17.2 x | 21.3 x | 29.5 x | 26.2 x | |
| Maximum | \$ 65,499.9 | \$ 55,982.7 | 5.9 x | 5.5 x | 4.9 x | 30.4 x | 22.3 x | 23.9 x | 56.1 x | 46.4 x | 59.9 x | |
| 75th Percentile | 42,870.4 | 36,892.9 | 5.6 x | 5.4 x | 4.9 x | 26.0 x | 20.5 x | 18.9 x | 40.0 x | 38.0 x | 50.7 x | |
| Median | \$ 27,036.3 | \$ 23,531.4 | 5.4 x | 5.2 x | 4.7 x | 21.6 x | 18.7 x | 16.0 x | 28.0 x | 29.5 x | 41.3 x | |
| 25th Percentile | 16,276.3 | 14,611.6 | 5.2 x | 4.8 x | 4.3 x | 20.0 x | 17.3 x | 14.7 x | 20.7 x | 20.6 x | 32.9 x | |
| Minimum | 8,869.4 | 8,846.9 | 4.9 x | 4.0 x | 3.3 x | 18.5 x | 16.8 x | 14.2 x | 18.8 x | 11.6 x | 26.2 x | |

| | | | | | | | | | | | |
|----------------------------------|------------------|------------------|--------------|--------------|--------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Activision Blizzard, Inc. | \$ 59,132 | \$ 55,809 | 8.6 x | 7.9 x | 7.3 x | 28.8 x | 16.7 x | 15.9 x | 39.3 x | 30.2 x | 28.2 x |
|----------------------------------|------------------|------------------|--------------|--------------|--------------|---------------|---------------|---------------|---------------|---------------|---------------|

Sensitivity Analyses

| | | Weighted Average Cost of Capital (WACC): | | | | | | | | | | |
|--|----------------|--|---------------|---------------|---------------|---------------|---------------|--------------|--------------|--------------|--------------|--------------|
| | | 3.25% | 3.50% | 3.75% | 4.00% | 4.25% | 4.58% | 4.83% | 5.08% | 5.33% | 5.58% | 5.83% |
| Terminal EV / EBITDA Multiple (Terminal Value) | 22.00 x | \$ 118.25 | \$ 115.69 | \$ 113.20 | \$ 110.78 | \$ 108.41 | \$ 105.38 | \$ 103.16 | \$ 100.99 | \$ 98.87 | \$ 96.81 | \$ 94.80 |
| Calculated | 21.75 x | 117.14 | 114.61 | 112.15 | 109.75 | 107.41 | 104.41 | 102.21 | 100.06 | 97.97 | 95.92 | 93.93 |
| Using the Multiples Method) | 21.50 x | 116.03 | 113.53 | 111.10 | 108.72 | 106.41 | 103.44 | 101.26 | 99.13 | 97.06 | 95.04 | 93.07 |
| | 21.25 x | 114.93 | 112.45 | 110.04 | 107.69 | 105.40 | 102.47 | 100.31 | 98.21 | 96.15 | 94.16 | 92.21 |
| | 21.00 x | 113.82 | 111.38 | 108.99 | 106.66 | 104.40 | 101.49 | 99.36 | 97.28 | 95.25 | 93.27 | 91.34 |
| | 20.75 x | 112.72 | 110.30 | 107.94 | 105.64 | 103.39 | 100.52 | 98.41 | 96.35 | 94.34 | 92.39 | 90.48 |
| | 20.50 x | 111.61 | 109.22 | 106.88 | 104.61 | 102.39 | 99.55 | 97.46 | 95.42 | 93.44 | 91.50 | 89.62 |
| | 20.25 x | 110.51 | 108.14 | 105.83 | 103.58 | 101.39 | 98.58 | 96.51 | 94.50 | 92.53 | 90.62 | 88.75 |
| | 20.00 x | 109.40 | 107.06 | 104.78 | 102.55 | 100.38 | 97.60 | 95.56 | 93.57 | 91.63 | 89.73 | 87.89 |

| | | Weighted Average Cost of Capital (WACC): | | | | | | | | | | |
|---|--------------|--|---------------|---------------|---------------|---------------|---------------|--------------|--------------|--------------|--------------|--------------|
| | | 3.25% | 3.50% | 3.75% | 4.00% | 4.25% | 4.58% | 4.83% | 5.08% | 5.33% | 5.58% | 5.83% |
| Terminal FCF Growth Rate (Terminal Value) | 3.00% | \$ 756.08 | \$ 379.52 | \$ 254.00 | \$ 191.25 | \$ 153.60 | \$ 122.15 | \$ 105.87 | \$ 93.51 | \$ 83.81 | \$ 75.98 | \$ 69.54 |
| Calculated | 2.90% | 545.54 | 319.43 | 226.34 | 175.56 | 143.59 | 115.96 | 101.32 | 90.04 | 81.09 | 73.80 | 67.76 |
| Using the Gordon Growth Method) | 2.80% | 428.58 | 276.52 | 204.49 | 162.48 | 134.96 | 110.47 | 97.22 | 86.88 | 78.58 | 71.78 | 66.10 |
| | 2.70% | 354.15 | 244.33 | 186.81 | 151.42 | 127.44 | 105.56 | 93.51 | 83.98 | 76.27 | 69.90 | 64.54 |
| | 2.60% | 302.61 | 219.29 | 172.20 | 141.93 | 120.84 | 101.15 | 90.12 | 81.32 | 74.12 | 68.14 | 63.09 |
| | 2.50% | 264.83 | 199.26 | 159.93 | 133.71 | 114.99 | 97.17 | 87.03 | 78.86 | 72.13 | 66.50 | 61.71 |
| | 2.40% | 235.93 | 182.88 | 149.48 | 126.52 | 109.77 | 93.55 | 84.19 | 76.58 | 70.28 | 64.96 | 60.42 |
| | 2.30% | 213.11 | 169.22 | 140.47 | 120.18 | 105.09 | 90.24 | 81.58 | 74.47 | 68.54 | 63.52 | 59.20 |
| | 2.20% | 194.65 | 157.67 | 132.62 | 114.54 | 100.86 | 87.22 | 79.16 | 72.51 | 66.92 | 62.16 | 58.05 |