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Activision-Blizzard Likely Redeemed by Microsoft Acquisition

Price \$79.81

Growth Purchase

July 20, 2022

- Microsoft proposed all cash acquisition at \$95 per share.
- Some of the largest and best-selling entertainment intellectual properties of all time, with nearly 400 million monthly active users across all IPs.
- New product launches including several new mobile iterations to expand on total addressable market and free-to-play iterations to help drive player conversion.

Investment Thesis

Activision Blizzard (ATVI) is a developer and publisher of video games and other interactive entertainment products and associated services. ATVI has some of the most successful intellectual properties of all time under its belt and boasts nearly 400 million monthly active users.

While the acquisition of ATVI by Microsoft is the primary driver behind our purchase, we do believe that ATVI is trading at a discount relative to its intrinsic value and the company is strong underneath.

Activision-Blizzard	E2022	E2023	E2024
Price-to-Sales	7.9	6.6	6.2
Price-to-Earnings	27.7	20.7	19.5
EV/EBITDA	18.0	14.0	13.0

Acquisition by Microsoft

On January 18, 2022, Microsoft announced its intent to acquire Activision-Blizzard. The details of the deal involve a stock buyout for the equivalent of \$95/share, all-cash transaction expected to close in FY2023. At the time of



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the announcement, it was a 48% premium and is still near a 20% premium. After takeover, ATVI will merge into Microsoft's Gaming business segment.

ATVI products have nearly 400 million monthly active players and Microsoft has around 25 million Xbox Game Pass subscribers, which is a software as a service (SaaS) platform providing subscribers with access to games for a monthly fee. Therefore, it is likely that Microsoft will leverage ATVI's extensive publishing and game development experience to bring more products to their Game Pass service in order to gain synergies with ATVI. Additionally, ATVI is facing significant community backlash due to a legal debacle discussed more in-depth in the risk section. This means that Microsoft could capitalize significantly on players returning to the IPs after distancing itself from ATVI's current management and workplace reputation.

However, with an FTC chair appointed for their promises to [take on an antitrust campaign on tech](#). This \$69 billion merger could potentially face a significant legal barrier if it is classed as a tech acquisition and not an entertainment one.

While intense regulatory scrutiny on the deal is probable, we do not believe that the deal will be blocked. The market for gaming is diverse with even the largest companies facing strong competition amongst each other and even competition from much smaller indie developers. Microsoft acquiring ATVI would likely not meaningfully impact the addressable market for gamers and this is most likely a move by Microsoft to bolster its existing first mover advantage for cloud-based gaming. There is already meaningful competition in the market of cloud-based gaming through public and private companies, like Valve, Epic Games, Google, Sony, and Nintendo. While Microsoft may seek to make popular game titles like Call of Duty or Overwatch Xbox/PC exclusives to draw users away from their competitors, this has previously been approved as an acceptable competitive practice.

Regulatory concerns aside, the upside possibility is good for existing ATVI shareholders at the existing price.

Should the deal fall through in the end, ATVI is a strong firm with good fundamentals despite present legal risk and we believe that the risk is already priced into the current stock price.

Present Operations

ATVI maintains a large catalog of very successful intellectual properties including Call of Duty, Warcraft, Candy Crush, and Overwatch. Overall, ATVI



maintains 372 million monthly active users across all business segments (Split into Activision, Blizzard, and King). However, revenue has fallen 22% year over year. This is primarily driven by a significant decrease in monthly active users which has fallen 15% year over year. While player counts and revenue can be cyclical (concentrating in 2H of the year) it is difficult to ignore the impact on goodwill the legal debacle has had, discussed more in-depth in the Risk section, has had on the company.

The present internal strategic growth drivers are to expand audience reach and increase player investment in games. Many of ATVI's properties are so-called "freemium" games, where the game is free to download and play but many expansions or other content enhancements remain behind a subscription model or bolt-on purchases, which can increase the longevity of the products. One new addition to this model is the very popular Call of Duty franchise, which will see an improved free-to-play version at the end of 2022. Call of Duty maintains roughly 120 million monthly active users with high levels of retention. Much of this retention is also driven by conversion from free-to-play customers to premium customers.

Call of Duty development resources remain very high within the Activision segment, primarily due to the expected launch of a mobile version of the popular "Warzone" game and a new release which will be a sequel to the 2019 Modern Warfare, the most successful Call of Duty title to date with over 30 million units sold.

The Blizzard segment, thanks to the acquisition of the mobile developer King, is testing its popular Warcraft franchise on mobile. Whether this will be a conversion of existing content, or a new IP remains to be announced.

The King segment was at the top of the charts, with Candy Crush being the top grossing app in the United States for the 19th consecutive quarter, increasing player counts year over year.

Risks

ATVI is in the midst of one of the largest probes in the California Department of Fair Employment and Housing's history (including other complaints with the SEC and Federal Labor Standards board), with allegations including sexual harassment and a toxic work environment which culminated in the suicide of an employee, and an alleged coverup. This led to several high-profile consequences for ATVI including a boycott and the delay of several partner projects. This has undoubtedly hurt the public image of ATVI with condemnations of the executives and CEO Bobby Kotick being all-but-



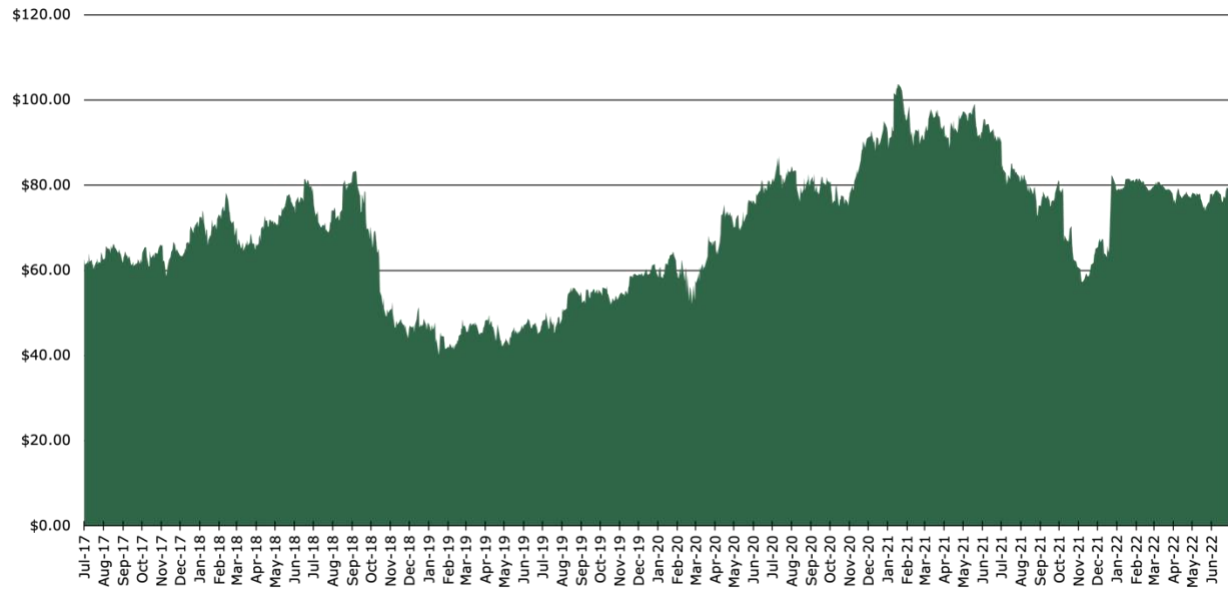
universal in the gaming world – including the Microsoft Gaming boss Phil Spencer. While many of the complaints have been settled out of court, it is unclear if outstanding lawsuits will pause the acquisition or result in further regulatory probes. It is unclear how things will shake out in the end but if the acquisition does go through, Microsoft will have a long road of rehabilitating ATVI's intellectual property image, given the association.

Additionally, the games industry is heavily reliant on player satisfaction to maintain revenue. If ATVI does not deliver products that receive positive feedback, it is likely that players will seek alternative titles.

Competitive Comparisons

Estimated Next 12 Months	Dividend Yield	EV/EBITDA	Price-to-Sales	Price-to-Earnings
Activision-Blizzard (ATVI)	0.6%	14.9	6.9	22.6
Electronic Arts (EA)	0.6%	11.5	4.2	16.5
Nintendo (NTDOY)	3.2%	10.1	4.5	15.9
Playtika Holding (PLTK)	0.0%	6.5	1.8	14.3
Take-Two Interactive (TTWO)	0.0%	11.7	2.8	19.3

Activision Blizzard (ATVI)



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