Agenda

- Company Overview
- Thesis
  - Blizzard Synergies
  - Solid Pipeline 09-10
  - Competitive Advantage
- Risks
- DCF
Company Overview

- World’s largest third-party game publisher
- Developer
  - Develops games for PC, Consoles (Nintendo Wii, Microsoft Xbox 360, Sony PlayStation 3), handheld systems (PSP, Nintendo DS)
- Publisher
  - Market, distribute games developed either in-house or by other developers
    - Strategic relationships with small game development studios
Activision
- Publishes and distributes games developed directly, through licenses, or through third party publishers
  - Guitar Hero and Call of Duty are its major franchises

Blizzard Entertainment
- Develops games internally
- Developer of multi-award winning franchises:
  - *StarCraft*, *Diablo*, *Warcraft* franchises, including the online *World of Warcraft*

Distribution
- Distribution of interactive entertainment software and hardware in Europe
Revenue Breakdown by Business Segment (2008)

- 65% Activision
- 27% Blizzard
- 8% Distribution
Massively Multiplayer Online (World of Warcraft) 20%

Console 59%

Handheld 8%

PC 3%

Revenue Breakdown by Platform (Q4 2008)
Revenue Breakdown by Geographic Region (Q4 2008)

- North America: 55%
- Europe: 40%
- Asia Pacific: 5%
Activision: Product Strategies

- Blockbuster franchise games
  - Draw customer loyalty, large hard-core fan bases
  - Current market environment ➔ customers will buy games they’re sure they will like
- Games based on movies
  - Sales from these games are not meant to be sustainable
  - Require licensing
  - Source of extra revenue
Activision: Guitar Hero

- Acquired RedOctane to obtain Guitar Hero franchise for $100 million

- **Guitar Hero 2** (2006)
  - 3 million units have been sold to date

- **Guitar Hero 3** (2007)
  - #1 combined platform sales in 2007
  - 1st game to generate over $1 billion in revenues

- **Guitar Hero World Tour** (2008)
  - 3rd best-selling game for PS3 in November 2008

- Downloadable songs for Guitar Hero games ($2), soundtracks for MP3 (iTunes distribution)
Activision: Call of Duty

- First-person shooter series
  - Started on PC, expanded to consoles
- Call of Duty 4 (2007)
  - Most successful game of the series
  - Sold over 10 million copies to date
  - #2 combined platform sales in 2007
- Call of Duty: World At War (2008)
  - Best-selling game for PS3 and Xbox 360 for Nov. 2008
Massively Multiplayer Online Role-Playing Game (MMORPG)
  - World of Warcraft

Subscription based service using the Internet for distribution
  - Recurring revenues
Blizzard: World of Warcraft

- 62% of the MMOG market (world's largest)
- 11.5 million subscribers worldwide & growing
- Up from 10 million subscribers in Jan. '08
- Subscription-based/recurring revenues ($15/mo)
- Projected to generate ~50% of Activision's 2009 earnings (~$0.30)
- 2 expansion sets released since: The Burning Crusade, Wrath of the Lich King
## Sales Rankings, November 2008

<table>
<thead>
<tr>
<th>Console</th>
<th>Title</th>
<th>Publisher</th>
</tr>
</thead>
<tbody>
<tr>
<td>360</td>
<td>Call of Duty: World at War</td>
<td>Activision</td>
</tr>
<tr>
<td>2.</td>
<td>Gears of War 2</td>
<td>Electronic Arts</td>
</tr>
<tr>
<td>3.</td>
<td>Left 4 Dead</td>
<td>Microsoft</td>
</tr>
<tr>
<td>Wii</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>Wii Fit</td>
<td>Nintendo</td>
</tr>
<tr>
<td>2.</td>
<td>Wii Play</td>
<td>Nintendo</td>
</tr>
<tr>
<td>3.</td>
<td>Mario Kart</td>
<td>Nintendo</td>
</tr>
<tr>
<td>PS3</td>
<td>Call of Duty: World at War</td>
<td>Activision</td>
</tr>
<tr>
<td>2.</td>
<td>Resistance 2</td>
<td>Sony</td>
</tr>
<tr>
<td>3.</td>
<td>Guitar Hero World Tour</td>
<td>Activision</td>
</tr>
<tr>
<td>PS2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>Guitar Hero World Tour</td>
<td>Activision</td>
</tr>
<tr>
<td>2.</td>
<td>Rock Band (Special Edition)</td>
<td>Electronic Arts</td>
</tr>
<tr>
<td>3.</td>
<td>WWE Smackdown vs. RAW 2009</td>
<td>THQ</td>
</tr>
<tr>
<td>Handhelds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>Pokemon Ranger</td>
<td>Nintendo</td>
</tr>
<tr>
<td>2.</td>
<td>Mario Kart</td>
<td>Nintendo</td>
</tr>
<tr>
<td>3.</td>
<td>Guitar Hero: On Tour Bundle</td>
<td>Activision</td>
</tr>
</tbody>
</table>
Industry Trends

- Combined video game unit sales for US, UK, & Japan (world’s largest markets) grew **11%** in 2008 to 410 million units
  - U.S. console software sales grew **22%** in 2008
  - U.K console software sales grew **38%** in 2008
- **WSJ:** Increasing usage of online games among those who are out of work
  - Unemployment makes us happy
  - Number of online game visits increased **27%** from last year
The Cost of Entertainment in dollars per hour ($/hour)

- Football Game: $21
- Bar: $6
- Movie: $4.5
- DVD Rental: $2
- Video Game: $.60
Total US Console Video Game Software Sales (Retail Sales $)
Thesis

- Solid diversified revenue base
- Merger synergies with Vivendi Games
- Strong, diverse 2009-10 pipeline
- Competitive Advantage
Recent Business Highlights

- **July 9\textsuperscript{th} 2008:** Activision combined with Vivendi Games and its subsidiary Blizzard Entertainment in a “reverse acquisition”
  - Activision Blizzard is the surviving entity

- **February 11\textsuperscript{th} 2009:** Reported Q4 earnings (first financial report for the combined company)
Merger with Blizzard: Strategy

- Franchise + License + Subscription = WOW
  - Franchise games
    - Sequels of past blockbuster hits
  - Licensed games
    - Usually based on popular movies
  - Subscription-based online games
    - Online community, monthly user subscription
    - Steady, growing revenue source

- Most diversified revenue sources vs competition
  - EA: Mostly licensing
Integration of Vivendi Games continues to exceed expectations
  - Management expects annual cost savings could now end up at the high end of its $100-$150 million range
The company has already locked in a run rate of $100 million in savings with the European integration still to come
  - Cost savings (Marketing, Sales, General, Admin)
Focus on finding the next best thing
- Expertise in scouting for potential blockbusters
- $3 billion in cash allows them to invest in small game developers
  - Looking to create another huge franchise

**November 10th 2008:** Acquired Budcat Creations – a small game developer focused on games for Nintendo Wii’s
Complete domination of MMORPG market
  - 62% market share with 11 million subscribers
  - Subscriber base growing 15% annually

Guild Wars is the second biggest MMORPG with 4.5 million players
Vicious Lifecycle of MMORPG Addiction

Noob Phase

"This game has so much content!"

"my old game suxxored"

Fanboy Phase

Gets all friends to start playing

"LOL grinding sucks."

"/sigh game blows but my guild makes it good"

Terminal Phase

(quits) "I found a WAY better game!"
March 2009: Guitar Hero Metallica
2010: StarCraft II
Pipeline: Short Term

- DJ Hero (Wii, 360, PS3)
- Transformers: Revenge of the Fallen
- Marvel Ultimate Alliance
- Tony Hawk
- Prototype
  - 3rd person action game where the main character changes form by eating people
- Monsters vs. Aliens
- 007 (2010)
Pipeline: Long Term

- Diablo 3
- Starcraft MMORPG
Solid Q4 ’08 Earnings

- Reported GAAP revenues of $1.68 billion and non-GAAP revenues of $2.3 billion
  - Analysts predicted non-GAAP Revenues of $2.2B

- Reported GAAP EPS of a loss of 5 cents and non-GAAP EPS of a gain of 31 cents
  - Analysts predicted non-GAAP EPS of 29 cents

- Non-GAAP is the more accurate measure
  - Excludes deferred revenue, acquisition related charges and charges from non-core exit operations
Competitive Advantage

- Activision vs. Electronic Arts
  - EA’s entire franchise based on licensed games
    - Mainly relies on sports licenses, like *Madden* series
    - Little potential for future growth
  - Rock Band 2
    - Didn’t sell as well as original Rock Band
    - Knock-off of Activision’s *Guitar Hero*
  - Warhammer Online
    - Not nearly as popular as Blizzard’s *World of Warcraft*
    - 800k subscribers vs. 11.5 million for WoW
<table>
<thead>
<tr>
<th></th>
<th>Activision</th>
<th>Electronic Arts</th>
<th>THQ</th>
<th>Take Two</th>
<th>Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>3B</td>
<td>1.3B</td>
<td>91.5M</td>
<td>280M</td>
<td>-</td>
</tr>
<tr>
<td>Debt</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>70M</td>
<td></td>
</tr>
<tr>
<td>Operating Margin</td>
<td>6.4%</td>
<td>-17.9%</td>
<td>-42.3%</td>
<td>7.5%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Net Margin</td>
<td>11.0%</td>
<td>-25.5%</td>
<td>-43.8%</td>
<td>6.3%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Revenue Growth (y/y)</td>
<td>26.0%</td>
<td>18.6%</td>
<td>0.4%</td>
<td>56.6%</td>
<td></td>
</tr>
<tr>
<td>Return on Assets</td>
<td>2.3%</td>
<td>-19.6%</td>
<td>-39.0%</td>
<td>10.1%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>2.7%</td>
<td>-31.0%</td>
<td>-63.0%</td>
<td>17.9%</td>
<td>4.7%</td>
</tr>
</tbody>
</table>
Risks

- Reliance on small number of franchises
  - 75% of net revenues were derived from 3 franchises
- Future success depends on ability to release popular products
  - High level of sales in first few months, sharp decline in sales afterwards
- Dependence on platform sales
  - Difficult to predict platform performance
Key Takeaways

- Merger synergies with Vivendi Games
- Strong, diverse 2009-10 pipeline
- Competitive Advantage