



Strategic Review of Electronic Arts

Part 2: Industry Overview

NIBC

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COMPETITION & CONFERENCE

Executive Summary

Part 1: Company Analysis

Business Model, Operating Performance, Capital Requirements

▶ Part 2: Industry Analysis

Value Chain, Competitive Field, Corporate Finance Activity

Part 3: Valuation Analysis

DCF, Comparables, Precedents

Part 4: Leveraged Buyout

Transaction Structure, Returns, Viability

Part 5: Transaction Analysis

M&A Opportunities

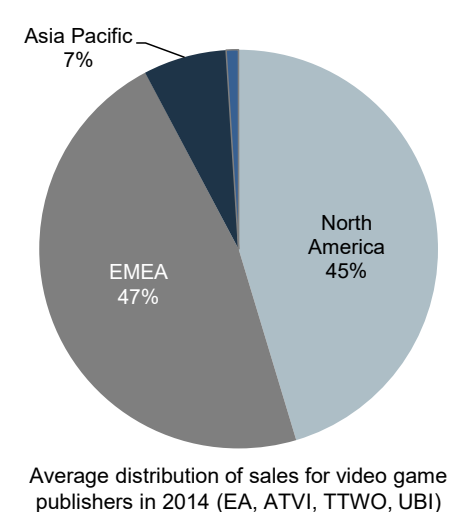
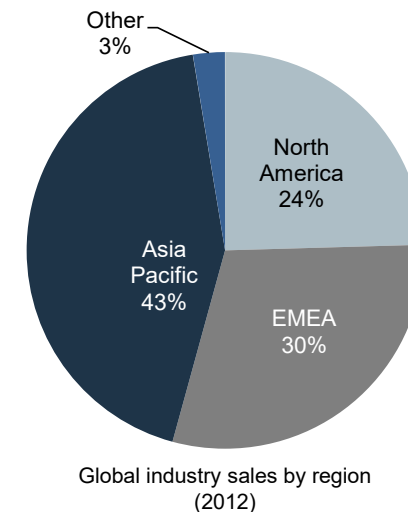
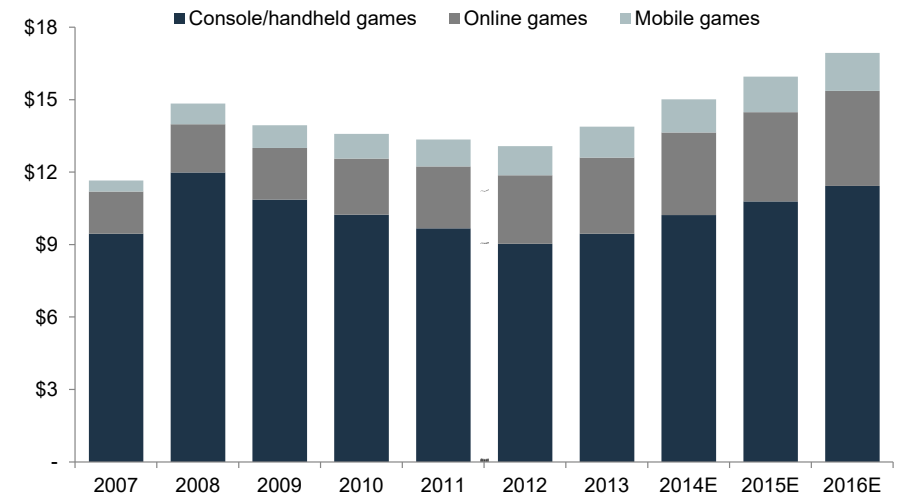
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\$68bn global industry projected to grow at 6.7% CAGR over next 5 years with market roughly split between Asia Pacific and North America plus EMEA

Industry Overview	
North America Revenue by Major Segment (2014)	
Physical games and software	\$16.9bn
Consoles	\$13.3bn
Online games and software	\$7.0bn
Total revenue	\$40.9bn
5-year revenue growth	6.1%
EBITDA margins	19.7% - 36.8%
North America Industry Characteristics	
Total Debt/EBITDA	3.5x
Total Debt/EV	0.1x
EBITDA margin	16.3%
EV/EBITDA	8.0 – 10.4x
Cash Ratio	1.1x
Market share held by 5 majors	40.7%
Global Industry	
Total revenues	\$68bn
Forecasted 5-year revenue growth	6.7%
Revenue Profile	
Market declined in 2008 onwards due to dependency on discretionary spending but has been relatively resilient	
Market has picked up in since 2012 due to improved confidence and growth in mobile/online segment	

North America Video Game Software Industry by Segment (\$bn)



Key stakeholders include developers, publishers, distributors and retailers; EA is involved in all stages of the value chain except for physical retail



Develop video games and related content

Perform financing, manufacturing and marketing functionalities to prepare games for launch

Distribute games to major retailers via physical or digital channels

Deliver games and software to customers

- **Majors have multiple in-house game development studios**
EA Studios (Electronic Arts), 2K (Take Two)
- **Independents receive advances from Majors for game development costs and royalties for sales**
Arkane Studios (Call of Duty), Bethesda Softworks (Fallout), Mojang (Minecraft)

- **Major publishers and banks finance game development**
Activision Blizzard, Electronic Arts
- **Ancillary services are provided**
Market research and technology assistance
- **Console manufacturers charge publishers a royalty for each game manufactured**
Nintendo, Sony, Microsoft

- **Major publishers often distribute their own games**
Activision Blizzard, Electronic Arts
- **Digital distribution is growing through multiple digital marketplaces**
Xbox Live Arcade, PlayStation Network, Wii Ware, Origin (Electronic Arts)
- **Independent publishers rely on third party distributors**
Synnex, Ingram Micro

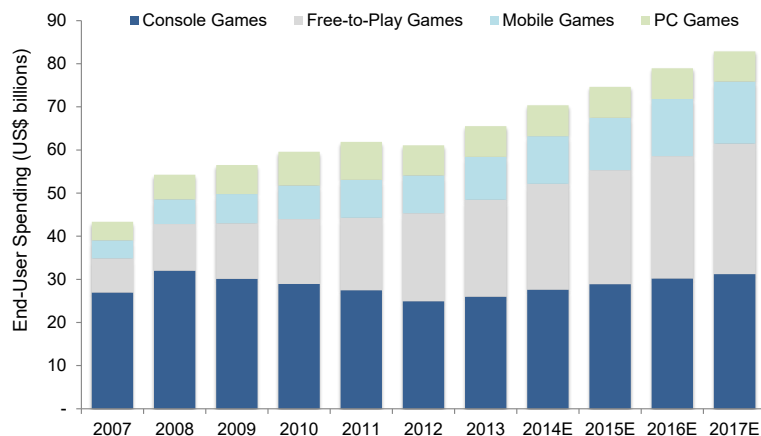
- **Physical retailers generate more sales from used rather than new software**
GameStop, Walmart
- **Digital retailers include mobile storefronts and web retail**
App Store, Amazon

Industry trends include focus on blockbuster releases as well as rise of mobile, online social media, casual and free-to-play games as well as digital distribution of conventional console games

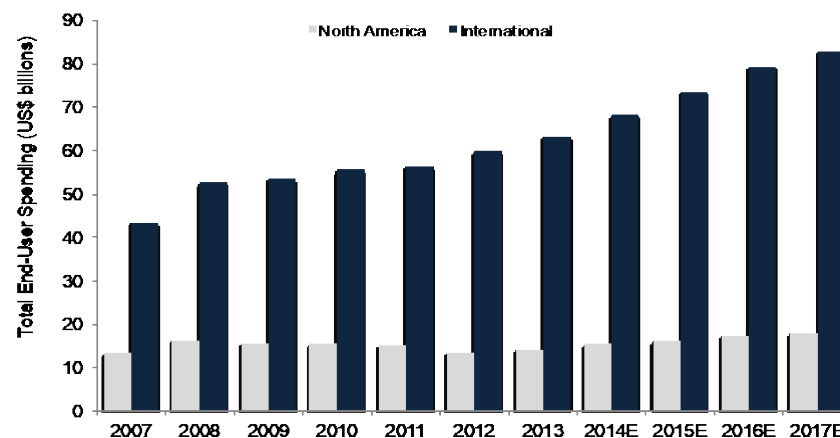
Industry Trends

- **Blockbuster releases:** Emphasis by large companies on fewer game releases and significant marketing campaigns, which lead to revenue fluctuation and lower operating costs if successful
- **Mobile and online gaming:**
 - Sales by independent developers are up 37.2% from 2013 to \$29.5bn in 2014
 - Online platforms create lower barriers to entry for game developers
- **Digital Distribution:** Improved online games stores and increased access to broadband is driving digital distribution of console games, which has led to closures in physical video manufacturing facilities
- **Social and casual gaming:** Recent innovations in new platforms allow companies to appeal to broader demographics with more accessible and less complex casual and social games
- **Console games:** Sophisticated console games continue to be in high demand with PlayStation 4 selling more units than any predecessor model and the open-world game Destiny (ATVI) being the most expensive game ever developed
- **Platforms:** Console platforms are likely to remain highly relevant platforms since mobile and tablet devices have limited capabilities, although PC platforms are becoming more powerful
- **Genres:** Multi-player first-person shooter games have become most successful genre (Counter-Strike, Halo) but open-world role playing games (ability to use and access everything like in GTA) have become very popular as well; sports games continue to exhibit steady demand while arcade games have decreased in popularity

Total Global Consumer Spending on Video Games by Platform



Total Consumer Spending on Video Games



Performance of industry players is somewhat volatile, driving trend towards M&A activity to gain economies of scale and mitigate risk

Financial Aspects	<ul style="list-style-type: none"> ■ Hit-driven profit: Profit is fairly volatile and margins are expected to grow based on lower cost of online distribution and increased sales due to intensive marketing for fewer Blockbuster releases ■ Labor costs: Talented software developers are in high demand, resulting in high spending on labor costs reaching approximately \$0.08 spent in capital for every \$1 spent in wages ■ Technological advances: The industry is transitioning into a generation of new consoles, the anticipation of which generally stalls new games and present-generation console sales in the two years leading up to the release ■ Console cycle: Video game sales have historically ramped up in the 3rd year of a console cycle (will be 2016 in the current cycle) as price points become more manageable for consumers ■ Cyclicality based on disposable income: Video game revenue is dependent on consumer discretionary spending
Corporate Finance Activity	<ul style="list-style-type: none"> ■ Content Acquisition: Difficult to develop blockbuster titles in-house <ul style="list-style-type: none"> – Vertical integration: With lower barriers to entry created by online gaming development, quality developers with attractive games are in strong demand as larger publishers want exclusive access to their game pipeline ■ Expansion Into Market Segment: Easier to expand into new segment like mobile / online gaming via acquisition ■ Consolidation: Trend towards creating a competitive advantage via gaining market share <ul style="list-style-type: none"> – Horizontal mergers: Major players look to become fully-functional companies that publish, develop and market directly to customers instead of operating as pure-plays ■ Expansion of Distribution Channels: Growing increasingly important to have distribution channels expanding into new markets ■ LBOs: The industry has not seen much activity in LBOs, with only two deals making recent headlines
Regional Characteristics	<ul style="list-style-type: none"> ■ International Markets: Expected to be grow at a faster rate than North America ■ Japanese Game Developers: Have fallen behind Western manufacturers and lack the ability to developer first-person shooter games ■ Western Game Developers: Derive most revenues from North America and Europe with Japan and the broader Asia Pacific region accounting for relatively small share
Key Players (% US Video Game Market, CY 2013)	<ul style="list-style-type: none"> ■ GameStop (16.2% - retail) ■ Microsoft (11.6% - console platform) ■ Activision Blizzard (5.5% - publishing) ■ Nintendo (4.1% - console platform) ■ Electronic Arts (3.3% - publishing) ■ Sony (3.1% - console platform)

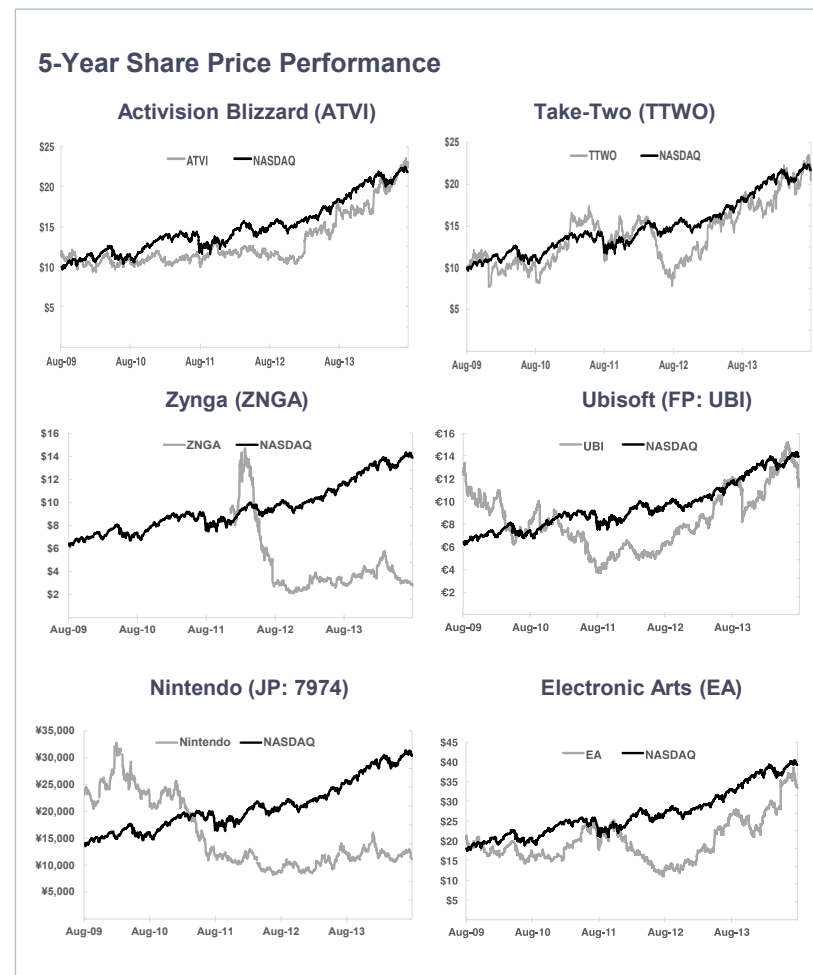
Major Industry Players

Activision Blizzard and Ubisoft's operating and stock price performance have lagged, while Take-Two had the strongest stock price performance and Zynga leading with highest revenue growth

Business Model		FY2013 Regional Revenue		
Revenue Segments		N. America	Europe	Asia
ATVI	• Franchise console games and MMORPGs	\$2,436	\$1,968	\$452
TTWO	• Two major franchises for console games	\$565	\$649	
ZNGA	• Multiple social gaming hits	\$520	\$353	
UBI	• Few popular franchises for console games	\$687	\$915	\$113
Nintendo	• Console hardware and software developer	\$2,512	\$1,803	\$2,218
EA	• Known for sports and simulation franchises	\$1,701	\$2,096	

Operating Performance							
(US\$m)	Revenue CAGR (5yr)		CAGR (2yr)	EBITDA CAGR (5yr)		CAGR (3-5yr)	Margin
	LTM*	Historic	Forecast	LTM*	Historic	Forecast	FY 2013
ATVI	\$4,290	9.9%	1.6%	\$1,368	19.8%	0.5%	36.8%
TTWO	\$2,333	(11.6)%	69.8%	\$254	(342.2)%	(20.2)%	20.9%
ZNGA	\$700	131.1%	(23.1)%	\$(55)	(0.7)%	44.3%	8.4%
UBI	\$1,350	2.1%	-2.4%	\$607	4.6%	(1.2)%	37.5%
Nintendo	\$5,592	(10.9)%	(16)%	\$(288)	(138.2)%	NA	(3.7)%
EA	\$4,090	79.7%	55.0%	\$995	51.7%	66.3%	9.2%

Capital Structure and Valuation*							
(US\$m)	EV	Market Cap	Debt	Cash	Net Debt/EV	EV/EBITDA	P/E
ATVI	\$15,364	\$15,247	\$4,321	\$4,199	0.8%	11.2x	14.7x
TTWO	\$1,573	\$1,955	\$459	\$822	(23.1)%	2.3x	21.9x
ZNGA	\$1,808	\$2,535	\$0	\$136	(7.5)%	ned	neg
UBI	\$1,794	\$1,779	\$253	\$229	1.3%	4.0x	neg
Nintendo	\$8,600	\$15,607	\$22,645	\$4,390	(51)%	neg	neg
EA	\$9,512	\$11,242	\$586	\$1,554	(10.2)%	9.6x	19.9x



Sources: Bloomberg, CapIQ
*LTM as of Sep 26th 2014

Corporate Finance Activity

Most prevalent transactions consist of conglomerates acquiring small developers although consolidation in traditional console and growing digital segments have become more common

