

Take-Two Interactive [NASDAQ: TTWO]

Initiate at BUY | PT: \$237

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CIMG investment Research

World-class IP and exposure to secular gaming trends make Take-Two a Rockstar

Take Two Interactive offers the best investment for exposure to secular trends in the gaming market. Their superior catalog of games, successful M&A track record, and pipeline of games in production sets up TTWO to capitalize on industry growth over the next decade.

Investment Thesis

Take-Two's existing revenue streams will carry them through 2023-24, when a huge wave of new content will hit the market. Take-Two's current development pipeline is double that of their closest competitor, Electronic Arts. TTWO plans to release nearly 20 games in 2022, 40 in 2023-2024, and 30 after FY 2025. To achieve this expansion, TTWO is operating at historically high levels of R&D (11.3% of revenue), but in the meantime, there is ample new content coming to market like GTA VI and a remastered GTA trilogy, as well as RDR 2 Online.

Expect strong cash flow growth thanks to TTWO's game pipeline, secular digital gaming trends, and a reversion back to a historical expense environment. The gaming industry has seen a massive shift from physical to digital distribution. 65% of TTWO's sales were digital in the last FY, up from 35% in FY17, and projected to reach 80% in FY30. Additionally, increased microtransaction volumes have allowed TTWO to monetize their games for years after their initial release. R&D expenditure for in-game add-ons is meaningfully lower than new game creation and should help margins and free cash flow as micro transaction topline contributions outpace development costs.

The current console market has exacerbated concerns on concentration and game delays. The console market is still undersaturated thanks to a supply crunch created by the global chip shortage. Sony and Microsoft are signaling that issues may not abate until mid-late 2022. Despite possible delays, our model yields favorable upside even with conservative release dates for hit games like GTA VI.

Valuation

We valued TTWO using a 9-year DCF. Our WACC is 8.5% and LTGR of 2.5% reflects their position in a rapidly growing industry. TTWO's value is derived from margin expansion driven by shifts to digital sales and MTX and variable top line growth. Even in our risk case where multiple game releases flop, and secular trends do not impact margins as we expect, we only have 5% downside, and we believe TTWO offers a great margin of safety.

Company Overview

Take-Two Interactive is one of the three largest pure play video game development companies in the world. They publish and distribute their content worldwide. Distribution comes through several channels, with their portfolio servicing console, PC, and mobile gamers. Some of their notable IP includes the Grand Theft Auto franchise and the Red Dead Redemption franchise, both produced by subsidiary Rockstar Games. They also make several sports titles under their subsidiary, 2K, including an NBA, WWE, and PGA game.

Take-Two also has an internal publishing team called Private Division that acts as an incubator and publisher of niche gaming titles that have large franchise potential. Take-Two now has a growing footprint in mobile as well due to three highly successful acquisitions. These mobile gaming developer purchases include Socialpoint (2017), Playdots (2020), and Nordeus (2021) for a total price tag of \$675M.

Telecommunications, Media, & Entertainment

Reid Blackmon – Committee Head
mrblackmon@crimson.ua.edu

Judson Lindley – Analyst
jglindley@crimson.ua.edu

Michael Burke – Analyst
mcburke2@crimson.ua.edu

Carter Murray – Analyst
cmurray4@crimson.ua.edu

Drew Goodwin – Analyst
dbgoodwin4@crimson.ua.edu

Figure 1: TTM Stock Chart & Volume



Price	\$177
Dividend Yield	n/a
PT	\$237
Upside	34%
52-Week Range	\$144 - \$215
Dil Shrs Outstand	116,803,000
Mkt Cap	\$19.3bn
Ent Value	\$17.3bn
P/E	34.8x
EV/EBITDA	19.5x
FY 2021 Revenue	\$3.37bn
Operating Margin	18.7%
Net Margin	17.5%

Industry Overview

Take-Two operates in the rapidly growing global gaming market. A pure play game developer, Take-Two's closest competitors are the larger EA and Activision. EA has well known gaming franchises such as FIFA, Madden, and Battlefield. Activision produces the wildly popular Call of Duty franchise. In contrast, larger players such as Microsoft and Nintendo have other business segments and exposure to hardware sales. The gaming industry is highly fragmented and full of smaller players with only 20% of developers having over 500 employees.

In 2021, the global gaming market had a record 2.7B gamers worldwide and the size of the industry is predicted to grow at a 12% CAGR through 2025. The average gamer is 34 years old, and 45% of US gamers are women. The stereotype of a young single male gamer is a thing of the past as gaming continues becoming the preferred method of entertainment for a growing population.

The industry is expected to grow due to a few key trends TTWO stands to benefit from. The first trend includes the shift to higher margin digital distribution and take rates being lowered in PC markets. Next, mobile gaming is projected to grow faster than PC and Console gaming as more casual gamers become monetized through their mobile devices. Traditional barriers to gameplay are also being stripped away as cross play options between PC and Console, and now even mobile, are becoming more common. This creates a stronger sense of community amongst gamers and allows for more MTX revenue as this trend continues. Finally, monetization strategies are shifting towards a Free-to-Play (F2P) model and an emphasis on MTX as more companies look to the success of F2P smash hit Fortnite.