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# Activision Blizzard, Inc. (ATVI)

Q1 2020 Earnings Call

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*Chief Financial Officer & President, Emerging Businesses, Activision Blizzard, Inc.*

**Rob Kostich**

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## OTHER PARTICIPANTS

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good afternoon, and welcome to the Activision Blizzard First Quarter 2020 Earnings Conference Call. All participants will be in a listen-only mode. [Operator Instructions] Please also note that today's event is being recorded.

At this time, I'd like to turn the conference call over to Chris Hickey, Senior Vice President of Investor Relations. Sir, please go ahead.

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### Christopher Hickey

*Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

Good afternoon, and thank you for joining us today for Activision Blizzard's first quarter 2020 conference call. With us are Bobby Kotick, CEO; Daniel Alegre, President and COO; and Dennis Durkin, Company's CFO and President of Emerging Businesses. And for Q&A, Rob Kostich, President of Activision; J. Allen Brack, President of Blizzard; and Humam Sakhnini, President of King, will also join us.

I would like to remind everyone that during this call, we will be making statements that are not historical facts. The forward-looking statements in this presentation are based on information available to the company as of the date of this presentation. And while we believe them to be true, they ultimately may prove to be incorrect. A number of factors could cause the company's actual future results and other future circumstances to differ materially from those expressed in any forward-looking statements. These include the impact of the COVID-19 pandemic, the risk factors discussed in our SEC filings, including our 2019 Annual Report on Form 10-K, and our first quarter 2020 10-Q, which will be filed shortly, and those on the slide that is showing. The company undertakes no obligation to release publicly any revisions to any forward-looking statements to reflect events or circumstances after today, May 5, 2020.

We will present both GAAP and non-GAAP financial measures during the call. We provide non-GAAP financial measures, which exclude the impact of expenses related to stock-based compensation; the amortization of intangible assets and expenses related to acquisitions, including legal fees, costs, expenses, and accruals; expenses related to debt financings and refinancings; restructuring and related charges; the associated tax benefits of these excluded items; and significant discrete tax-related items, including amounts related to changes in tax laws, amounts related to the potential or final resolution of tax positions, and other unusual or unique tax-related items and activities.

These non-GAAP measures are not intended to be considered in isolation from, as a substitute for, or superior to our GAAP results. We encourage investors to consider all measures before making an investment decision. Please refer to our earnings release, which is posted on [www.activisionblizzard.com](http://www.activisionblizzard.com), for a full GAAP-to-non-GAAP reconciliation and further explanation with respect to our non-GAAP measures. There's also an earnings presentation, which you can access with the webcast and which will be posted to the website following the call.

And now I'd like to introduce our CEO, Bobby Kotick.

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### Robert A. Kotick

*Chief Executive Officer & Director, Activision Blizzard, Inc.*

Thank you, Chris, and thank you for joining us today. Let me first convey our sympathies to those who have suffered during this difficult time. While very few of our own team members have contracted COVID-19, a number of our employees have been impacted by the illness and the passing of family members. Our thoughts and prayers are with them and everyone else affected by the pandemic.

Quite honestly, I've been awestruck during the last two months by the strength of our employees and their families managing through unprecedented challenges, from healthcare to child care. Our teams around the world have shown ingenuity and incredible resilience. And even faced with so many difficulties, our employees still ensured that the joy, the social connection and the unexpected benefits of gaming as a way to keep our 400 million players around the world connected and engaged and safely at home has continued without interruption.

Our employees and their families have shown incredible empathy for those affected by the pandemic in their communities and across the world. They've organized meal deliveries, care for the elderly, even the use of their own 3D printers to create high-quality facial protection for their colleagues. Our teams have shown unwavering support for the first responders, nurses, doctors and medical professionals working tirelessly in unimaginable conditions. Our corporate social responsibility initiatives have been expanded to support programs to provide healthcare professionals with a variety of resources including faster more effective testing and the use of tools like convalescent blood transfusion as a possible method of immunization. We've also increased our direct support for military families by millions of dollars.

Through our team's dedication and incredibly hard work under very difficult circumstances, we delivered results significantly above our outlook for the first quarter and this momentum will likely continue for the second quarter. I have conducted almost a hundred earnings calls and none was under a backdrop of so much uncertainty for the future.

Our mission to connect and engage the world through epic entertainment has never been more meaningful than it is today. At a time when so many forms of social interactions and entertainment experiences have been shut down, we're providing entertainment with positive impact for hundreds of millions of people through our games. Our content and connecting members of our communities around the world is critically important. Our development and commercial teams quickly adapted to this new work environment and as of now we're on track to deliver compelling new content including the World of Warcraft: Shadowlands expansion and the next premium Call of Duty release, both of which are planned for the second half of the year.

Our esports organization has quickly pivoted to remote production and continues to deliver live esports for both the Call of Duty League and the Overwatch League, a direct result of the hard work and flexibility of our team owners and our sponsors.

In the face of unprecedented circumstances, our extraordinary teams also delivered extremely strong first quarter financial results. We significantly exceeded our outlook for both revenue and earnings per share. We reached new heights for first quarter net bookings across each of mobile, console and PC and we exited the quarter with accelerating engagement and momentum across the business as people around the world turn to our content for entertainment and connection.

Performance in the quarter was led by Call of Duty, which is achieving tremendous scale and momentum across platforms, geographies and business models. Following industry-leading launches for Call of Duty: Mobile and Modern Warfare in the fourth quarter of 2019, the franchise raised the bar even higher with the launch of Warzone in March. With a free-to-play business model and cross-platform play Warzone expanded Modern Warfare's

reach, engagement and player investment. Warzone to-date has brought in over 60 million players since its launch.

The exceptional results for Call of Duty reflect our teams' remarkable execution as they innovate and take on new commercial challenges to grow and better serve our communities. Their success demonstrates that free-to-play experiences across mobile, console and PC not only extend the reach of a franchise but can also lead to strong in game monetization and sales of premium content. Call of Duty's success highlights the great potential across our portfolio as we continue to focus on extending our fully owned intellectual property through new platforms, new geographies and new business models.

Blizzard also recorded strong growth in the first quarter led by World of Warcraft. After doubling in the second half of 2019, the WoW active community grew further in Q1. Blizzard is seeing strong increases in engagement across our franchises as people around the world stay home adding to business momentum as our game teams execute against the strongest pipeline of content in Blizzard's history.

At King, Candy Crush was again the top grossing game franchise across US app stores with engagement increasing sharply towards the end of the quarter. To enable our community to play even more as a part of the stay-at-home initiative, in late March King offered unlimited free lives across many of their titles resulting in the number of game rounds played in a single day shattering all prior records. Momentum continued to increase in April with strong year-over-year growth in reach, engagements and player investment.

As we build on our strong first quarter results and our continuing momentum, I'm excited to introduce our new President and Chief Operating Officer, Daniel Alegre. From his long tenure at Google, Daniel brings deep experience building direct digital relationships with consumers, fostering strategic relationships with key industry partners and driving rapid growth internationally and in early-stage businesses. His expertise and commitment to excellence and execution will be his focus.

I'd also like to thank Cuddy Johnson for his extraordinary contributions to the continued success of the company during his 12-year tenure and for being a truly, truly valued friend. Of course, our strong business performance wouldn't be possible without the efforts of our dedicated, talented and truly empathic teams around the world. We are so grateful for the work you're doing under extremely challenging circumstances. We're also appreciative of the continued support of our shareholders, partners and players and we wish you and your families health and safety through what remains a difficult time.

And now Daniel will review the highlights of our operations with you.

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## Daniel I. Alegre

*President and Chief Operating Officer, Activision Blizzard, Inc.*

Thank you, Bobby. I'm glad to be with you all for my first earnings call as COO and really proud to be part of a company so deeply connected to its mission during this really challenging time. I want to start by first expressing my deepest sympathies to all those affected by this health crisis and expressing thanks on behalf of the entire company to all those on the frontlines of the battle against the COVID pandemic.

I would also like to thank our employees for their commitment to our players and to each other, particularly under such a unique and difficult environment we're currently living in. But before I discuss our recent operational highlights, I'd like to share with you my focus and priorities. They are simple. Execution, execution and execution.

We have great franchises and we will get back to what we are known for, superb execution. As Bobby said, the health and safety of our employees and their families remains our priority. I'd like to expand on the measures we are taking to keep our employees and their families safe and address our expectations for our development pipeline for the remainder of the year.

All our offices had moved to work-from-home environments by mid-March and we are fortunate to have had very few cases of COVID-19 across the company. We are ensuring our employees and their family members are receiving the best possible care and we're covering all costs of testing and treatment for affected employees and their families. We have increased access to telehealth resources and contracted private doctors and medical support in regions where employees live and work.

We have had additional services to our already best-in-class health benefits and ensured that employees have access to the mental, and physical well being and support they need while at home. And we are continuing to find other ways to support our employees and their families, including services to help families balance work and home life.

Now turning to development. The digital nature of our content means our creative talent can continue to work on our product pipeline from home. Although the shift to remote working does add complexity and challenges in some areas of the game development process, including creative collaboration, motion capture, voice-over work, localization and quality assurance, we are implementing mitigation measures to each and to address each of these areas. Importantly, based on the work to-date we still expect to deliver a robust slate of content over the remainder of the year. This includes the next premium release of Call of Duty, two titles based on library IP from Activision, the World of Warcraft: Shadowlands, expansion, regional testing for new mobile titles, and ongoing live operations across our key franchises.

Regardless of location, our teams remain focused on executing against our four strategic growth pillars as Bobby laid out. First, delivering a strong, consistent cadence of major new content releases. Second, driving live operations with ongoing in-game content, services, features and events. Third, expanding King's industry-leading mobile success and extending our acclaimed console and PC franchises to mobile. And finally, building new engagement models around our franchises including advertising, esports and consumer-products.

Now more than ever, players new and existing are looking for connection through epic entertainment and our mission is to make that available to them in whatever form they find most convenient.

Now turning to our first quarter results. We significantly exceeded our outlook driven primarily by overperformance for Call of Duty: Modern Warfare throughout the quarter including a highly successful start for our new free to play Call of Duty Warzone. We also saw continued momentum for World of Warcraft and better-than-expected results for other key franchises in the second half of March as populations sheltering at home in many of our key regions turn to our content for entertainment and social connection. These trends have continued so far in the second quarter with business performance accelerating further in April.

Now starting with Activision, MAUs more than doubled over the prior year reaching 102 million as Call of Duty delivered remarkable growth across multiple vectors. As we've discussed on prior calls, we made significant changes with the launch of Call of Duty: Modern Warfare to enhance the player experience, expand the community and deepen engagement. We added cross-platform play, introduced a new in-game content system and removed the season pass to keep our players closer together.

Modern Warfare entered the year with strong momentum achieving substantial year-over-year growth in engagement, premium game sales and in-game net bookings in both January and February. And the launch of Warzone on console and PC on March 10 really took the franchise to new highs. Warzone is a massive free-to-play experience where up to 150 players compete in a range of modes on a vast map featuring cross play and in-game system entirely integrated with a Modern Warfare battle pass. Warzone adds yet more compelling content for our Modern Warfare community. It also enables an entirely new set of players around the world to experience Call of Duty for free.

This response has been incredible. Warzone has brought in more than 60 million players since the launch including many on the PC platform and in countries beyond Call of Duty's traditional regions. We are seeing the free-to-play experience driving strong incremental sales on the premium Modern Warfare title adding to its sales momentum entering the year and rising demand from stay-at-home conditions. Modern Warfare sell through in Q1 was the highest ever for a Call of Duty title outside of the launch quarter. Life-to-date Modern Warfare has sold through more units and has more players than any prior Call of Duty title at this point after its release.

Warzone also contributed to a further acceleration in Modern Warfare's in-game net bookings, which more than doubled year-over-year versus the prior game in Q1, even with the removal of the season pass. And this momentum has only strengthened. The third season of in-game content launched in April and is Call of Duty's best performing to-date for both engagement and player investment.

With the new free-to-play experience contributing to massively expanded audience, unprecedented momentum in premium game sales and robust in-game growth, we expect Modern Warfare's net bookings this year to be the highest for a Call of Duty game in the year after launch. And looking ahead, the next premium release for Call of Duty already looks great and remains on track for release later this year.

On the mobile platform, the Call of Duty: Mobile team continued to build on last October's breakout launch with new content, features and events aimed at optimizing engagement, retention and player investment. The team started to deliver an accelerated cadence of content in March launching new seasonal events every four weeks, twice as frequently as previously. The combination of increasingly compelling content and events and stay-at-home dynamics drove the growth in reach and engagement in March. And player investment has followed with April's Season 5 delivering the highest monthly in-game net bookings since Season 1. With deep engagement, substantial content in the pipeline and opportunities to further refine the in-game system, we expect Call of Duty: Mobile to be an increasing contributor over time.

Q1 also saw the launch of the inaugural season of the professional Call of Duty League. Originally planned in a local city-based home stand format, we quickly pivoted all matches to online play and remote production for the remainder of the regular season to keep our players and fans safe while still delivering premium esports content to a global audience. With the Call of Duty demonstrating the power of our franchise model across platforms, geographies and business model and premium content on track for the fall, we really couldn't be more excited about the growth trajectory for 2020 and beyond.

Now turning to Blizzard, MAUs were 32 million in Q1 with each of Blizzard's key franchises experiencing a month-on-month increase in reach in March. World of Warcraft continued its strong momentum in the quarter as the team continued to deliver more content between expansions than ever before. Having doubled its active community in the second half of last year, the number of players on monthly or longer-term subscription plans increased further in Q1. Reach and engagement were particularly strong as regions introduced shelter-at-home measures through the quarter with momentum increasing further in April.

The community continues to engage deeply in Classic, a recreation of our original WoW from 15 years ago, which has delivered substantial content drops in recent months and has much more to come later in the year. Reach and engagement also increased for Modern WoW, which again received a major content drop in Q1. And this increased activity drove accelerating presales of Shadowlands, the next expansion for Modern WoW, which is slated for the second half of the year. Hearthstone continued to deliver improved engagement trends in the first quarter driven by the launch of the new Battlegrounds auto-battler mode in November and strong execution in live operations.

Overwatch also experienced a meaningful increase in engagement in March as its latest seasonal event coincided with stay-at-home effects and fans continued to engage with the franchise through the Overwatch League, which successfully moved to online play and remote production during the quarter.

And finally, Diablo Immortal is shaping up very well. We remain on track to begin regional testing for the game in the middle of the year. At King, MAUs were \$273 million, increasing 10% from the fourth quarter. MAUs grew month-on-month in January and February and then accelerated further in March as shelter-at-home conditions came into effect. King's key franchises, franchise Candy Crush, grew MAUs year-over-year in each month of the quarter with double-digit growth in March. And within the Candy franchise, the community played more rounds of games in any quarter since the 2016 acquisition.

Now in terms of player investment, Candy Crush Saga remained the top grossing title across US app stores, and the wider Candy franchise was once again number one. We've previously discussed King's initiatives to bring back last payers and attract new payers into the ecosystem, positioning the business for stronger growth over the medium and long term. And as expected, these initiatives dampened in-game net bookings again in Q1. But they contributed to ongoing improvement in payer trends in January and February before payer numbers stepped up further in both March and April. And with strengthening engagement in payer trends, we're seeing King's in-game net bookings grow by low double-digit percentage year-over-year in April.

While we saw improving trends in King's in-game business, which represents a significant majority of the segment's net bookings, the advertising business slowed towards the end of the quarter. Advertising grew over 75% year-over-year for the first quarter and then moderated a bit in April against the backdrop of the sudden decline in demand across the digital advertising sector, albeit still growing over 20% year-on-year in April. While we assume the environment will remain challenging, we do expect growth for the full year as we roll out more ads to more players, enhance our infrastructure to deliver the highest-value ads to each player and broaden both our base of advertisers and demand partners.

I also note that the combination of King's strong in-game trends and the current situation in the ad market is creating more opportunities for the business to cost-effectively bring players into the network, expanding its audience and further boosting its MAU trajectory. The same is true across our other business units.

So, in summary, we entered the year with strong momentum in some of our biggest franchises, which only increased further through the quarter. Our employees are showing remarkable dedication as they take on the responsibility of delivering the highest-quality content to our expanded community. And I couldn't be more excited to be part of this great and dedicated global team. I am focused on executing on our priorities as we deliver against a substantial opportunity to extend our largest IP across new platforms, geographies and business models; and work on the strongest pipeline in our company's history.

I will now hand over the call to Dennis to discuss our Q1 financial results and outlook. Dennis?

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## Dennis M. Durkin

*Chief Financial Officer & President, Emerging Businesses, Activision Blizzard, Inc.*

Thanks, Daniel. Today, I will review our Q1 2020 results as well as our outlook for 2020 and the second quarter. But before I start, I'd just like to echo Daniel and Bobby's sentiments about the unique environment we are in and share my sincerest sympathies to those who have been affected directly by it, as well as my thanks and gratitude to all our teams and employees who have so seamlessly transitioned into this new work environment we find ourselves in.

Our digitally native business model, both on the production and the distribution side of our business, makes us well positioned to deliver world-class content and experiences for our players. Our teams take our mission and our responsibility to deliver fun and social engagement to our players in this tough time very seriously. They really didn't miss a beat during all this transition, and you can see the strong results of those efforts in our Q1 results and increased full-year guidance.

Our first quarter revenue and earnings were well ahead of our prior outlook, primarily driven by our investment in creative and commercial initiatives for Call of Duty, delivering better-than-expected results throughout the quarter. In addition, World of Warcraft continued to overdeliver and other key franchises and catalog sales also exceeded our outlook, benefiting from stronger demand towards the end of the quarter as consumers sheltered at home in many of our key regions.

To review the quarter, I will start with our segment results. Activision revenue was \$519 million, growing 64% year-over-year. Growth was driven by Call of Duty: Modern Warfare and Warzone in-game revenues, strong game sales of premium Modern Warfare and the addition of Call of Duty: Mobile. Operating income was \$184 million, with an operating margin of 35%, 12 percentage points higher year-over-year.

Blizzard revenue was \$452 million, increasing 31% year-over-year, reflecting strong growth for World of Warcraft and the release of Warcraft III: Reforged in the quarter. Operating income was \$197 million. Blizzard's operating margin was 44% significantly higher year-over-year primarily due to strong revenue growth.

King's revenue of \$498 million was roughly flat sequentially and lower year-over-year driven primarily by King's actions to prioritize mobile payer engagement in the quarter. The ads business grew over 75% year-over-year. Operating income was \$156 million with an operating margin of 31% lower than a year ago due to lower revenues and higher operating expenses, as King made disciplined investments in expanding its player network. Across our segments, in-game net bookings grew 20% year-over-year to \$956 million.

Now let's turn to our overall consolidated results. Unless otherwise indicated I will be referencing non-GAAP figures. Please refer to our earnings release for full GAAP to non-GAAP reconciliations.

For the quarter we generated Q1 GAAP revenues of \$1.79 billion, \$148 million above our February guidance. This includes the net recognition of deferrals of \$266 million. Net bookings of \$1.52 billion were \$247 million above our February outlook. We incurred GAAP-only restructuring and related charges of \$23 million and we generated Q1 GAAP EPS of \$0.65, and Q1 non-GAAP EPS of \$0.76 which was \$0.10 above guidance. These figures include the net recognition of deferrals of \$0.18.

In terms of cash flow, the increasingly digital recurring and cash generative nature of our business remains one of our fundamental strengths. This powers a strong balance sheet which continues to be an important strategic asset for the company especially now.

In Q1 we delivered operating cash flow of \$148 million, lower year-over-year despite higher operating income due to cash payments for tax settlements and working capital timing. Our cash and investments at the end of March were approximately \$6 billion and we ended the quarter with a net cash position of approximately \$3.3 billion. And as previously announced, this week we will pay an annual dividend of \$0.41 per share, 11% higher year-over-year.

Now let's turn to our outlook for Q2 and the full year. In Q2, Activision plans to deliver two seasons of in-game content for Modern Warfare and Warzone versus one season in the first quarter. Season 3 has already launched very successfully in April. Activision also released Call of Duty: Modern Warfare II Remastered on PC and Xbox One following the PS4 release in late Q1 and they plan to continue delivering new features, events and seasons for Call of Duty: Mobile.

In April, Blizzard launched its latest Hearthstone expansion, Ashes of Outland, and through the quarter will continue to support other key franchises with in-game content. And King will continue to deliver innovative features, events and live ops across its portfolio.

Turning to the second half of the year, our plan slate includes new Call of Duty premium title, two releases based on our extensive library of IP from Activision and Blizzard's Shadowlands expansion for World of Warcraft. We will also continue to deliver in-game experiences for our other key franchises across our portfolio. And we continue to expect to begin regional play testing for Diablo Immortal and certain other mobile titles, although as discussed last quarter, we don't include any material revenue from these new mobile titles in our guidance.

Before I discuss the specifics of our outlook, I'll provide some context. The full extent of the impact of the pandemic on our financial results will depend on numerous evolving factors that we are not able to fully predict at this time. While we have seen a positive impact on demand, there are also risks related to the global economic weakness, rising unemployment, pressures on retail channel, pricing and other factors where we have limited visibility currently. We have tried to be prudent in our guidance to account for these effects and we believe there's a potential for overperformance if these risks do not materialize.

Now the addition of the Warzone free-to-play experience has further increased the reach, engagement and player investment in Call of Duty, building on existing strengths for Modern Warfare and creating a strong foundation for future financial performance. As discussed, we are also seeing increased demand for our other franchises as interest in gaming grows.

The current environment creates the potential for a structural opportunity to bring more players into our communities who we can then engage and retain for the long term, and to accelerate the continuing shift towards digital sales in our business. We have attempted to be conservative in our assumptions around the impact of these trends beyond the second quarter, but the backdrop does create greater potential for operating overperformance later this year.

Since we provided our initial guidance in February, the strengthening dollar has resulted in an additional FX headwind to full year net bookings of approximately \$100 million. And the combination of FX and lower interest income from declining interest rates represent in aggregate approximately \$0.08 of headwind to our full-year GAAP and non-GAAP EPS versus our prior outlook. Overall, though with strong momentum across the business, we are raising our outlook for net bookings, revenue and EPS for the year. And in the case of EPS we are raising by an amount greater than our first quarter overperformance despite the FX and interest rate headwinds I just described.

Now let me get into specifics. For Q2 on a GAAP basis, we now expect revenues of \$1.69 billion including the net recognition of deferrals of \$15 million. We expect net bookings of \$1.68 billion, product costs, game operations and distribution expenses of 19% and operating expenses including software amortization of 48% and a GAAP-only restructuring charge of approximately \$20 million. We expect a tax rate of 21%, GAAP and non-GAAP share count of 776 million and EPS of \$0.54.

For Q2 on a non-GAAP basis, we now expect product costs, game operations and distribution expenses of 19% and operating expenses including software amortization of 43%. We expect a tax rate of 19% and non-GAAP EPS of \$0.64 including net deferrals of \$0.01.

On a GAAP basis for 2020, we now expect revenues of \$6.8 billion, including net deferrals of \$100 million. We now expect net bookings of \$6.9 billion for the year, product costs, game operations and distribution expenses of 19%, operating expenses including software amortization of 48% and a GAAP-only restructuring charge of approximately \$50 million. We now expect a GAAP tax rate of 20%, GAAP and non-GAAP share count of 778 million and GAAP EPS of \$2.22.

For 2020 on a non-GAAP basis we expect product costs, game operations and distribution expenses of 20% and operating expenses including software amortization of 42%. We expect a tax rate of 19% and non-GAAP EPS of \$2.62 including the net recognition of deferrals of \$0.02.

So in closing, our business has accelerating momentum from the dual tailwinds of strong execution in our largest franchises following last year's investments and increased development capacity and expanded reach and engagement as people turn to our interactive content as they shelter-at-home. We are humbled that so many people are turning to our content for solace, joy and connection in this challenging time and we'll continue to stay focused on delivering the high-quality experiences that they have come to expect from us.

Now Bobby, Daniel and our business leaders Rob, Humam and Jay and I are happy to answer your questions.  
Operator?

## QUESTION AND ANSWER SECTION

**Operator:** [Operator Instructions] And our first question today comes from Mario Lu from Barclays. Please go ahead with your question.

**Mario Lu**

*Analyst, Barclays Capital, Inc.*

Q

Great. Thanks for taking the question. Amazing quarter and I hope everyone and their family is safe. So I know it's hard to parse out due to the increased engagement from COVID and social distancing but can you provide any color in terms of how accretive Call of Duty: Warzone has been to Modern Warfare unit sales? And what should we expect the success to have on the new Call of Duty 2020 premium title sales later this year? Thank you.

**Rob Kostich**

*President, Activision, Activision Blizzard, Inc.*

A

Hey, Mario. This is Rob. Thanks for the question and also for your note upfront. I think the short answer to the question is that Warzone has definitely been accretive to the franchise. And it's become and it is a really important part of the overall franchise ecosystem that we're creating. And I think it's worth just talking about that a bit. Since the last few calls, we've been discussing bringing our community together through a number of player-focused initiatives and that started with cross play, so all the friends can just get together no matter what platform you're on. It was about the free content to our community at the same time and it was about kind of the new deterministic content system we put in the game. And, of course, in the backdrop here you have Modern Warfare, which has been just a fantastic game that gets better over time.

And then what we really did is amplified all this with the launch of Warzone, our massive scale Battle Royale experience. And when you look at Warzone it was definitely built to provide endless fun on its own and to stand on its own as a great game, but Warzone and Modern Warfare are also obviously connected in many ways, including through shared progression systems, game systems and content offerings, and what we're seeing right now in Warzone is a large number of players choosing to upgrade to the premium Modern Warfare game and experience everything that the Modern Warfare universe has to offer. And so far the number of upgrades to premium that we're seeing are definitely above our initial expectations and that's really great to see.

And also across this universe, the Modern Warfare universe from an engagement perspective, we're also seeing franchise highs now in daily average, unique players, peak concurrent players and overall player investment as has been indicated on the call so far. So regarding the future of Warzone, we know how much the community is loving it. We know how much they are enjoying the experience so far. So we're going to continue to invest in this significantly in terms of content, events, new modes, new ways to play and really just a ton more in the future.

And to follow-up on the last part of your question, I think what I would say is, yes, we believe it has the potential to positively impact future premium games as well, and so we're excited about that opportunity.

And before I jump off, I would also just like to thank all our Activision Publishing development teams and all our employees for keeping all of our critical projects on track. This shift to work-from-home has been a massive logistical exercise across the organization and the teams have done just an outstanding job, and I just wanted to close this question by a big thank you to them. But again, Mario, thanks for the question. I appreciate it.

**Mario Lu**

*Analyst, Barclays Capital, Inc.*

Great. Thank you.

Q

**Christopher Hickey**

*Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

Operator, can we have the next question, please.

A

**Operator:** Our next question comes from Gerrick Johnson from BMO Capital Markets. Please go ahead with your question.

**Gerrick L. Johnson**

*Analyst, BMO Capital Markets Corp.*

Thank you. Good afternoon. Hey, so do you guys think increased engagement with videogames owing to the stay-at-home trend in COVID-19 will be sustainable? Do you see a swing perhaps back in the other direction once we return back to normal?

Q

**Dennis M. Durkin**

*Chief Financial Officer & President, Emerging Businesses, Activision Blizzard, Inc.*

Hey, Gerrick. It's Dennis. Thanks. That's obviously a super important question and really applicable. Clearly, it's obviously a scenario we'd all love to see which is life returning back to normal as soon as possible. But the reality is that we really don't know what that new normal will look like once that comes to pass. It does seem like that there is a likelihood that even once shelter-at-home ends, that it may be a fair amount of time before people are really returning to normal as we know it. So we do think that there is potentially an acceleration to the structural change that we've seen in consumer entertainment, consumption patterns that we've already been seeing in gaming, and that trend could persist for the long term which would obviously benefit social, yet socially distant categories like gaming.

A

We've already seen this with the younger generation of consumers where gaming is more an integrated part of their social and entertainment fabric, and times like these will make that activity, we believe, even more mainstream. We're obviously trying to lean into this and welcome as many players into our ecosystem as possible, and bring more gamers into our communities and give them a compelling experience that hopefully turns them into long-term fans.

We don't really have any great data points right now on what happens to consumption when people return from shelter-at-home, but we have seen in Asia that the strong momentum continues even as they started to transition back. So we hope that's a sign of the similar opportunity we may have in other parts of the world as they start to return to normal as well.

So generally speaking we think there's a pretty big opportunity here to see an acceleration in the long-term structural shifts that we've already seen from the existing heightened engagement, but as usual we are always trying to be prudent how we model that because we know there are still so many unknowns at this time.

**Gerrick L. Johnson**

*Analyst, BMO Capital Markets Corp.*

Great. Thank you very much.

Q

**Christopher Hickey**

*Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

A

Operator, can we have the next question, please.

**Operator:** Our next question comes from Ryan Gee from Bank of America. Please go ahead with your question.

**Ryan Gee**

*Analyst, BofA Securities, Inc.*

Q

Hey. Good afternoon. Thanks for the question. Fantastic quarter, you guys. I was hoping you could provide a little more color on the subscriber trends for WoW during the period, and specifically how you see the opportunity to sustain this larger base post-Classic as you move towards the Shadowlands expansion. Thanks.

**J. Allen Brack**

*President, Blizzard Entertainment, Activision Blizzard, Inc.*

A

Hi. This is J. Thank you for the question. Before I answer, I want to take a step back and just say we're really thankful that our games are able to play a part in helping bring people together during what's really an unprecedented and challenging time for us all. In the World of Warcraft, it's been fortunate to be engineered as a very social experience and that's as true today as the day we launched. Over time we listened to feedback from the community and the game has evolved to what we now call the modern game, which has really expand the breadth and the depth of game play as well as making it easier to kind of find friends, group up, make progress, or play alone, all within the social environment.

At the same time, we've seen a lot of good work and good returning experience for players returning to the Classic WoW experience. So today we think about World of Warcraft as a single community under one subscription where players can enjoy both WoW Classic and Modern WoW and we release a steady stream of content to both. In a variety of different experiences, there's always been a strength of the game and it's been good to see players resonate and resonate with players and they see a lot of what they're looking for in World of Warcraft.

We've seen particularly strong engagement with Classic in the East and the momentum has continued in those regions even as they are starting to come back to work. And we saw Western subscribers grow in March driven by players returning to Modern WoW primarily. And this has contributed to strong presales for Shadowlands. The momentum we saw in March across both modes continues with the active community growing faster than it ever has and that's outside of an expansion launch period.

On the development side, our teams have done a really good job in shifting to work from home. We're able to welcome select players into the closed alpha for Shadowlands last month and thanks to the hard work of the team, Shadowlands is on track to launch in Q4 of this year. And lastly before I hand off the call, I'll hand off to the next question I really want to thank all the Blizzard employees during this difficult time. It's been really amazing to kind of see everyone come together in a positive way. Thank you.

**Christopher Hickey**

*Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

A

Thanks, Ryan. Operator, can we have the next question, please?

**Operator:** Our next question comes from Doug Creutz from Cowen. Please go ahead with your question.

**Doug Creutz**

*Analyst, Cowen and Company*



Hey. Thank you. You talked a bit about the pressure on the ad side of King as the economy slows down. I was wondering if you could maybe go into a little more detail there and what are you seeing in terms of your CPMs? And then along with that is there any offset on your user acquisition side because presumably you're acquiring users through a lot of the same channels – similar channels to your advertising. Thanks.

**Humam Sakhnini**

*President, King Digital Entertainment, Activision Blizzard, Inc.*



Hey, Doug. This is Humam. Thanks so much for the question. So we exited 2019 as you heard with strong momentum in the ads business and that's continued in Q1 where we saw in the quarter that we delivered over 75% year-on-year growth. And as you mentioned in the question, we saw deceleration towards the end of March within the broader advertising ecosystem, but the business did grow 20% year-on-year in April or over 20% in April. So let me answer your question by talking a little bit of what we're doing going forward.

I think about the things that we're already doing and what must continue and that's about rolling out more ads to more players, broadening our advertiser base and working with more partners as we continue to build our tech infrastructure. But now we're actually increasing some focus areas that we see as kind of in the short and medium term will provide opportunities. So we're going to the brand advertisers and doubling down on the relationships and those sectors that aren't experiencing slowdowns and they are experiencing actually sustained demand for their products. So the team is quite active there.

We're also starting to leverage quite a bit of advertiser interest in very differentiated products like the sponsorship product that we have, which was new to our ecosystem and seeing some really nice advertiser interest. And that really amplifies the value proposition of the King network in this environment. And then we are rolling out new technology in our games and that's become the focus that allows us to really optimize our demand and get higher CPMs for the ads that we are showing. And that's been a focus in this quarter and continues to be for the year.

So if you add that plus you look at our network, which is truly global and international, what we're doing is we're looking at it as a pretty diversified set of opportunities. So when regions are starting to experience some recovery before others, we focus our efforts there, as the opportunity may sit geographically in some places at a certain point in time. So with all of that my expectation is that the Advertising business does deliver growth this year.

On your point on acquisition costs, that's a flip side of that, so what we're seeing is while we see that some advertisers [indiscernible] (44:24) King are seeing an opportunity to bring new players more efficiently than ever [ph] for a (44:31) network, and we coupled that with a very different approach [indiscernible] (44:38) for the medium and long term. So when we do that, of course, that reinforces kind of both the [ph] game and ad (44:46) side of the house, the game business, and the advertising number as we continue to invest in the network.

So, again, kind of to echo a lot of what my colleagues have said. And before I hand it off to the operator, I just want to involve the King team and the employees across King for [indiscernible] (45:05) as we have experienced something quite remarkable and going to work from home pretty quickly, and so a big thanks from me for the team and the incredible work that they're doing.

**Doug Creutz**

*Analyst, Cowen and Company*



Thank you.

**Christopher Hickey**

*Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

A

Operator, can we have the next question, please.

**Operator:** Our next question comes from Kunaal Malde from Atlantic Equities. Please go ahead with your question.

**Kunaal Malde**

*Analyst, Atlantic Equities LLP*

Q

Hi. Thanks for taking the question. There's clearly very strong momentum in the business right now, but given the broader economic pressures from COVID-19, how are you thinking about the potential risks to consumer spending trends over the next few quarters?

**Christopher Hickey**

*Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

A

Dennis?

**Dennis M. Durkin**

*Chief Financial Officer & President, Emerging Businesses, Activision Blizzard, Inc.*

A

Thanks for the question. Obviously, we're in kind of uncharted waters, and there's not really any precedent for what's going on right now in the economy, which definitely makes us cautious and careful, maybe more so than normal. Relatively speaking, however, we do feel pretty good about the value proposition of our content, even in tough times. There's not great past precedents, obviously, for where we are, but you can look at least back to the past two market dislocations in 2001 and 2008 for at least some directional indication of how gaming has performed in challenging economic times.

And what we've seen is the consumer recreational spending in the US for example, was fairly resilient during those downturns. And if you hone in a little more specifically on entertainment, the global gaming industry – gaming industry fared extremely well and actually grew low to mid single-digits in these time periods, whereas broader consumer recreational spending declined low single-digits. And we think that's driven by the low cost per hour of gaming, which makes it a great value versus other forms of entertainment.

And so, if you compare that to the situation we're in now where other forms of location-based entertainment like going to movies, concerts, sporting events, whatever those may be, and they may not be available for some time to – for consumers for some period of time. This may also drive some share shift to gaming from those other categories. And, thankfully, in contrast to other forms of media, we're very fortunate that the digital nature of our business enables us to not only to distribute content remotely but to produce it remotely. So, obviously, an advantage for us to keep our content fresh.

Another point is in those past recessions in 2001 and 2008, gaming's come a long way since then. Obviously, it's much more social and more connected and more mainstream, and our business is much more diversified too across platforms, geographies, types of games, which is helpful when times get challenging.

On the flip side, there obviously are more free ways for players to play games than there have been. So, there could be more engagement with slightly weaker monetization. But in the long term, we kind of view that as an opportunity as well because that usually normalizes itself.



So I'd say there's puts and takes across the spectrum, which is why, with all this uncertainty in the economy, we try to reflect these risks as we think about forecasting the business. But the strong momentum we're seeing gives us, obviously, confidence in raising our outlook even with this challenging backdrop.

**Kunaal Malde**

*Analyst, Atlantic Equities LLP*

Thank you.

Q

**Christopher Hickey**

*Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

Thanks, Kunaal. Operator, can we have the next question, please.

A

**Operator:** Our next question comes from Eric Handler from MKM Partners. Please go ahead with your question.

**Eric O. Handler**

*Analyst, MKM Partners LLC*

Thank you very much for the question and glad everyone is healthy. To follow-up on Call of Duty, I wonder if you could talk a little bit how the funnel of players has widened for Call of Duty with the release now of Mobile and Warzone. And along those lines, how much overlap is there for players between the three games, and what does that mean for overall spending? Basically, what I'm trying to get at is, is the spending per player additive when they play multiple games?

Q

**Rob Kostich**

*President, Activision, Activision Blizzard, Inc.*

Hey, Eric. It's Rob. Thanks. I'll take the question. I think it's important to probably first just step back and think about what our goal has been through all this, and the goal has been pretty simple one. And what we wanted to do is provide players around the world a real fun, high-quality, and I think importantly an authentic Call of Duty experience regardless of what platform you play on, where you happen to live, or what business model really motivates you to play.

A

And that's exactly what we have delivered across mobile, across console, and across PC. And if you look at some of the metrics over the last six months, if you've seen, in Q4 and both in Q1 we've crossed over 100 million MAUs and dramatically increasing our player base and a lot of that's been driven by Mobile and Warzone of course as is the ongoing success in Modern Warfare driving that.

But through the Mobile and Warzone, we're definitely reaching new audiences and new geographies in ways that we just haven't before, and as I look at Call of Duty right now, it's more global today than at any point in time in its history in terms of audience profile and that's pretty exciting for us to see.

So a little bit on your question on engagement, and for us when it comes to engagement what we've seen really time and time again is that engagement just tends to drive engagement. And so for us exposure on what platform is driving engagement across other platform and other experiences, so we actually like to see that crossover a lot.

And in terms of the investment part of your question, that also is looking additive to us across this ecosystem as well. In the previous question I talked about Warzone and how we're seeing that as being accretive to the

franchise overall and with respect to CoD: Mobile, then specifically when you take a look at it, we're seeing really great momentum there.

It was referenced earlier that season five just concluded, and it's our best performing season in terms of engagement and in-game performance since the first season, and season six just launched on May 1, and so that's off to a really strong start as well.

So for me when I look at it and I see the positive trends on Mobile, as a platform coming at a time we're having record engagement and record performance across console and PC, and to me that's a pretty clear indication that what we're seeing on Call of Duty: Mobile is delivering incremental results for the franchise as well. So the echo system the way we're looking at it right now seems to be working incredibly well. And in terms of Mobile, in terms of our strategy, it remains a critical part of our overall plans going forward and a key investment area for us.

And just speaking to the echo system, I'd probably just close by obviously a very exciting time for everyone on the franchise right now, and our teams are hyper-focused and passionately focused most importantly on delivering great new content and seasons and games to our growing community around the world that we're seeing right now. And I guess I would just close by saying we couldn't be more thankful for the incredible and growing community that we're seeing out there around the world, for their trust and support, and we look forward to everything that's to come in the future. So thanks for the question.

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**Christopher Hickey**

*Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

**A**

Thanks, Eric. Can we have next question, please?

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**Operator:** Our next question comes from Alexia Quadrani from JPMorgan. Please go ahead with your question.

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**David Karnovsky**

*Analyst, JPMorgan Securities LLC*

**Q**

Hi. This is David Karnovsky on for Alexia. Thanks so much for taking the question. Can you just expand a little bit on what impact you're seeing to your pipeline both near and long term from having developers work at home? Thanks.

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**Daniel I. Alegre**

*President and Chief Operating Officer, Activision Blizzard, Inc.*

**A**

Sure and this is Daniel. Thanks for the question. Look, the vast majority of our developers, they moved to remote work by mid-March as I mentioned in my opening remarks, and really just credit to all those involved, it was such a huge undertaking, multifunctional teams across facilities, IT, HR, security operations, and other groups really rallied together to make it all happen.

And we're really fortunate to be in a truly digital business where the majority of our content creation really can be performed across any location. So the vast majority of our developers, they took their computers home, plugged into secure access and just kept creating. So in some cases we've had to move high-end computing and graphic rigs to our developer's homes as well, but we were able to do that relatively quickly, so our development teams working on everything from design, to art, to engineering, to production, really had most of what they needed to keep working.

That being said, it's not easy, and there are aspects of building our games that are more challenging via remote work, like collaborative design, in-person user research, motion capture, voice-over and QA. So we've really had to find some creative solutions to work through these like for record voice-overs, we did that remotely. We've also enabled new secure access systems for some of the functions where large groups are engaging.

But so far and based on what we can see and with true ingenuity and creativity from the teams, we're managing through this as best as we can and what's really important is we just need to continue to provide our communities with the innovative content and features that they love and that they want to keep playing. So that's why I said in my prepared remarks that we're currently still on track to deliver our key content in the second half of this year and my primary focus is to ensure that we continue to execute on these top priorities.

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**Robert A. Kotick**

*Chief Executive Officer & Director, Activision Blizzard, Inc.*

A

And I would just add, I think that our teams are doing an extraordinary job right now on continuing to stay focused, work hard, deliver great content but it is a challenging process. We still have a lot of uncertainty for the future and I think that it's hard to know a year from now or two years from now what the impacts of all of this will be on our development processes, on the way we go to market, on the economics of selling games. So more to come as we have more clarity over the next few months but we remain focused on execution of our strategy and I think that our teams are doing a truly extraordinary job of accomplishing that.

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**Christopher Hickey**

*Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

A

Operator, can we have the next question, please?

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**Operator:** Our next question comes from Alex Giaimo from Jefferies. Please go ahead with your question.

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**Alex Giaimo**

*Analyst, Jefferies LLC*

Q

Great, thanks for taking the question. I was hoping to get a bit more color on the Hearthstone franchise maybe if some of the recent updates you've rolled out have been well received and if you're seeing any notable change within the competitive landscape? Thank you, guys.

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**J. Allen Brack**

*President, Blizzard Entertainment, Activision Blizzard, Inc.*

A

Thank you for the question. This is J. I want to take those in reverse order. So when you think about competition Blizzard is full of gamers and we're always excited when new games release. We think new titles are good for players, they bring fresh ideas and that's always something that everyone benefits from. The industry is big enough for lots of different teams to be successful. And we found that if we are focused on game play first and then we continue to listen to our community feedback, we experience great results. And so I'm really proud of the Hearthstone team and what they've accomplished, especially recently.

Under the leadership with an expanded development team, they've delivered larger content updates to players and have really maintained a high quality environment that we set for ourselves. We rolled out the first major new game mode, which was Battlegrounds in November that we talked about, and we've seen it bring players back and continue to drive renewed engagement in the game.

And then last month we launched the latest expansion, which was Ashes of Outland and that's the first game that we've launched while we were in a working from home environment. And that expansion introduced the game's first new class, the first new class that had ever been added to the game since launch, the Demon Hunter and brought about really some of the biggest fundamental changes that the game has seen to date.

The sentiment around the new features and the new content is very positive, and as a result of the steady updates in the game we saw increased engagement in Q1 versus Q4 with further upticks in April. The Hearthstone team is looking to build on that momentum with a really good pipeline of content still later to come this year. And then one of the things we've learned is that Battlegrounds has proven that new modes can drive meaningful engagement. And so the team is thinking about that as part of their future planning going forward.

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**Alex Giaimo***Analyst, Jefferies LLC*

Q

Thank you.

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**Christopher Hickey***Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

A

Thanks. Operator, we have time for one last question.

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**Operator:** Our final question today comes from Brian Nowak from Morgan Stanley. Please go ahead with your question.

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**Brian Nowak***Analyst, Morgan Stanley & Co. LLC*

Q

Thanks for taking my question. Hey, guys, good to hear your voices. I just had one on King. The user number was really strong. I think you added over 20 million, I think 24 million users quarter-over-quarter. Maybe talk to us how you think about some of the key strategies you have to sort of develop and rollout to really retain those new players. And then how do you think about converting those new players into payers over time?

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**Humam Sakhnini***President, King Digital Entertainment, Activision Blizzard, Inc.*

A

Hey, Brian. It's Humam. Thanks for the question. So let me first step back and set the context of what we're seeing here in Q1. You heard us talk about it, which is in the past few quarters we've been focusing on growing that audience of players and also payers. And so in Q3 and Q4 last year we grew the Candy player base and then in Q3 we started introducing initiatives that are aimed at broadening the payer reach across the network, which started improving the payer conversion mechanics in the second half of last year. So back then when we did that, you heard me talk about that there would be a trade-off in the near-term bookings. But we thought that's the right thing to do for the business for the long-term health of that business.

So we've seen that through the introduction of the right content and timely offers, contextually placed, more players start coming into the ecosystem and more payers start coming into the ecosystem. So in Q1, we went further with that approach, both on content and on offer management. And we started broadening our reach of the player investment initiatives. So we started building on top of that momentum in Candy. And we started expanding to all of our network in Q1.

And so as that player base started growing steadily in the quarter, we started seeing kind of that momentum build. And in March we saw even further acceleration. And then on the payer conversion we started seeing some really

encouraging results in Q1. And, in fact, kind of in Q1 we saw the strongest sequential improvement in payers that we've seen in many years. So the trends have really kind of started looking very favorable, and that's improved in April.

So I'm really pleased with how the ecosystem has been building up, not just in Q1, but all the things that we've been doing from a content perspective and from a player engagement mechanics perspective in the past few quarters to get to here. So when I look ahead, you'll expect us to continue to do this. You'll expect content from us. You'll continue to expect more ways that we optimize offerings for different players to kind of go after those broader motivations. And the good news here is that you won't see the drag on Q2 bookings that we would have otherwise expected because of this really strong engagement that we're seeing. And then we add on top of that that we can grow this network now more efficiently, as I just answered before.

So I think the combination of all of those really kind of tend to the network. And then where we continue to keep the players active is really about what the King team does incredibly well, which is innovating the content pipeline and the features within what's happening in the game to keep these players engaged and continue to kind of drive towards players and payer numbers increasing over time. So that's kind of I think what you're seeing now. But it's kind of the combination of everything that we've been building over the past few quarters.

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**Brian Nowak**

*Analyst, Morgan Stanley & Co. LLC*



Great. Thank you.

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**Christopher Hickey**

*Senior Vice President, Investor Relations, Activision Blizzard, Inc.*

All right. Thank you. Yeah, thanks, Brian, and thanks Humam. Thanks everyone for joining us today. We greatly appreciate your interest and participation and look forward to speaking with many of you throughout the quarter. Please do stay safe, and we'll hopefully see you all in game. Thank you.

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**Operator:** Ladies and gentlemen, this does conclude today's conference call. We do thank you for joining. You may now disconnect your lines.

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