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Activision Blizzard, Inc. (ATVI)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Activision Blizzard Q4 2019 earnings conference call.

At this time, I would like to turn the conference over to Chris Hickey, Senior Vice President of Investor Relations. Please go ahead, sir.

Christopher Hickey

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

Good afternoon and thank you for joining us today for Activision Blizzard's fourth quarter 2019 conference call. With us are: Bobby Kotick, CEO; Coddy Johnson, COO and President; and Dennis Durkin, Company CFO and President of Emerging Businesses. And for Q&A: Rob Kostich, President of Activision; J. Allen Brack, President of Blizzard Entertainment; 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 risk factors discussed in our SEC filings, including our 2018 Annual Report on Form 10-K 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, February 6, 2020.

We will present both GAAP and non-GAAP financial measures during this 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, 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. In addition, we will also be posting a financial overview highlighting both GAAP and non-GAAP results.

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

Robert A. Kotick

Chief Executive Officer & Director, Activision Blizzard, Inc.

Thank you, Chris, and thank you all for joining us today.

Our fourth quarter results exceeded our prior outlook for both revenues and earnings per share. As we continue to transform the company, we've remained focused on the delivery of epic entertainment that connects and engages the world. We believe we can do this with greater speed and efficiency while maintaining our longstanding commitment to quality and excellence and providing superior returns to our shareholders.

We ended the year with over 400 million monthly active users, strong year-over-year engagement, and significant potential in monetization. We're in the privileged position of having a direct digital connection with hundreds of millions of players to whom we deliver some of the world's best professionally produced content. And we have the ability to provide our audiences with a variety of ways to enjoy our content, with monetization through subscriptions, premium digital purchases, digital native advertising, and a variety of other player investment mechanisms.

Each of our large franchises as well as our new potential franchises have greater opportunities than ever before. Using Call of Duty as an example, with the introduction of Call of Duty Mobile, we grew our player base from 40 million to 100 million players in less than a year, and we expect significant growth in the Call of Duty franchise in 2020 as compared to 2019 as a result of this and from other unannounced Call of Duty initiatives. Mobile in fact is now our leading platform.

The business model for Call of Duty Mobile is free to play, which enables the rapid development of a large community of players with the option to purchase digital items and services, as well as our ability to generate advertising revenues. Franchises like Call of Duty offer advertisers a very difficult to reach target. And today the ad load is extremely low, as we're experimenting with the best advertising solutions for our players and our advertising partners.

We successfully developed great games for mobile, our franchises have the power to attract far bigger audiences than previously. We're hard at work on high-quality mobile games for all of our most important franchises.

And with respect to esports, two weeks ago we debuted the Call of Duty League, with 12 city-based teams. Working closely with our experienced team owners and globally recognized sponsors, we're thrilled to celebrate our players and inspire our community with professional Call of Duty esports. And with our new strategic broadcast relationship with YouTube, over 200 million gamer viewers now have access to our world-class esports content for both Call of Duty League and Overwatch League.

Across console, PC, mobile, and touchpoints like esports, the momentum for Call of Duty could not be stronger. And this success illustrates the larger opportunities we have across our diverse and large wholly owned library of titles dating back to our founding 40 years ago. Having our franchises on all platforms in all geographies with a constant flow of content and leveraging the additional touchpoints we have available to us, like esports and advertising, continues to be our focus.

Another great example of our franchise transformation is what happened with Warcraft. We doubled the size of the active World of Warcraft community in the second half of 2019 by adding Classic to the WoW subscription offering. The remarkable growth of the WoW community represents an important proof point of the value and potential of our established franchises, and it has energized our development teams as we develop new content for all of our key franchises. These franchises form the basis of large, engaged communities of players and spectators, with whom we take our responsibility to deliver high-quality content very seriously.

Prioritization of opportunity and access to more talent are our challenges, but we are meeting these challenges with improved execution, and we expect to grow audiences, engagement, and monetization and provide superior shareholder returns as we have for the last 30 years.

As a final note, we wanted to acknowledge the tragedy of Kobe Bryant's untimely death. Kobe was a longtime friend of the company, starring masterfully in commercials for Guitar Hero and Call of Duty. He was a tireless supporter of our veterans employment initiative and always made himself available for all of our veterans events and activities. He will be greatly missed by all of us, and our thoughts and prayers are with his family.

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

Collister Johnson

President & Chief Operating Officer, Activision Blizzard, Inc.

Thanks, Bobby.

Strong execution in 2019 on our strategy enabled Activision Blizzard to exceed our fourth quarter outlook and enter 2020 with momentum. That momentum was created by the increased investment and focus on the creative and commercial resources of our biggest franchises and allowed us to accelerate progress against our four key growth pillars.

In our first growth pillar, delivering a consistent cadence of major new content to grow our reach, our expanded Call of Duty development team launched a very successful Modern Warfare, the unit sell-through in Q4 increasing by a double-digit percentage versus the prior year across console and PC combined.

And the team followed up with great execution on our second growth pillar, live operations for in-game content, services, features, and events to drive engagement and recurring revenues. Modern Warfare's first season of follow-on content rolled out a new, more engaging in-game system, which drove both engagement and net bookings up significantly year over year.

Similarly, the World of Warcraft team followed up on the remarkable Q3 launch of WoW Classic with substantial content updates that kept the community engaged and the subscriber base well above pre-Classic levels. On Hearthstone, we've seen increased engagement upon the launch of the latest expansion and the rollout of the new Battleground game mode in Q4.

As for our third pillar, extending our acclaimed console and PC franchises to mobile, the October launch of Call of Duty Mobile was one of the most successful in the industry's history, driving Activision publishing to record monthly active users. It also highlighted the opportunity for our other large franchises to reach hundreds of millions of new players once they expand onto mobile.

And finally, as we build and enhance new engagement models for our franchises, our advertising business again grew rapidly, and we further strengthened our leadership in esports. We expect to build on this momentum in 2020, with each of these pillars driving net bookings growth for the company this year.

I'll now provide more detail on our Q4 results and recent developments across our franchises. Starting with Activision, Q4 was a fantastic quarter. Monthly active users tripled from Q3 to reach 128 million. Call of Duty continued its leadership on console, with Modern Warfare driving year-on-year sell-through growth and generating more upfront console sales than any other franchise worldwide, a feat the franchise has now accomplished for 10 of the last 11 years.

Modern Warfare also saw strong growth in full-game downloads, with console digital mix at almost 50%, and we ended Q4 with the retail channel at its tightest level in many years, positioning us well for ongoing catalog sales in 2020.

The franchise also expanded its audience on PC, with Q4 PC sell-through on Battle.net growing 50% year over year. This growing cross-platform Call of Duty community received in early December the largest free content offering in franchise history, alongside a new system for player investment. And as a result, Q4 in-game net bookings grew by a double-digit percentage year over year, despite the later launch of in-game system and despite the removal of the season pass. Now the second season of Modern Warfare follow-on content launches next week. And the team has more great experiences and surprises in store both for that season and throughout 2020, which we expect to drive strong in-game net bookings growth year over year.

And of course, the Call of Duty franchise saw breakout success in Q4 with the launch of Call of Duty Mobile. The game has received widespread acclaim, and with over 150 million installs, has brought a huge number of new players into the franchise and given existing players a new way to experience Call of Duty. Engagement is strong, which the teams from Activision and Tencent Gaming TV Studio intend to sustain for the long term, with a substantial pipeline of features, events, and content, benefiting from over 15 years of Call of Duty releases. The title outperformed our net bookings expectations in Q4, ranking it in the top 15 grossing games in US app stores, and the third season is already well underway and tracking well.

So across console, PC, mobile, and esports, the Call of Duty franchise has never been better positioned for growth, and there's more to come, including entirely new experiences within the Modern Warfare universe, and then of course in Q4 of this year, a new premium Call of Duty release, which is already generating excitement in our play tests.

Finally, across the Activision portfolio, we were honored to see the teams focused on high-quality, world-class content recognized by the industry at the 2019 Game Awards. Call of Duty Mobile won Mobile Game of the Year. Crash Team Racing won Best Game in the Sports and the Racing category. And FromSoftware's Sekiro: Shadows Die Twice won Game of the Year.

Turning to Blizzard, monthly active users were 32 million in the fourth quarter. World of Warcraft monthly active users were higher sequentially, reflecting sustained engagement of players following the August launch of WoW Classic, Blizzard's re-creation of the original WoW from 15 years ago. As you may remember, in Q3 WoW added more monthly or longer-term subscription plans than in any prior quarter in franchise history. That momentum continued into Q4 with Blizzard's sustained engagement, a robust slate of content for both Modern and Classic WoW, and exited the year with an active community more than twice the size of its Q2 ending level.

That strong cadence of content will continue in 2020 with a great series of in-game releases for Classic and a strong Shadowlands expansion coming for Modern WoW in the second half of the year. Shadowlands will have new regions to explore, new ways to customize characters, and our revamped leveling system to help onboard new players.

In Hearthstone, the competitive environment remains intense, though we did see sustained improvement in engagement following the release of the Descent of Dragons expansion and the new Battlegrounds auto-battler mode in Q4. Q4 net bookings were lower year over year but grew sequentially, and the Hearthstone team continues to iterate quickly. They launched a new game store in December and will release a number of new content and engagement model enhancements in 2020.

Q4 also saw the launch of Overwatch on the Nintendo Switch, further expanding a community that has now surpassed 50 million players since the 2016 launch. And next weekend, the Overwatch League returns, with 20 teams from around the world competing in a homestand format for the first time.

Blizzard's teams, as you know, are working on the broadest pipeline in its history, including Overwatch 2 and Diablo 4 on PC and console. And Diablo Immortal, a mobile game developed in partnership with NetEase, continues to make great progress, and it will move into the testing phase with its first regional test planned for the middle of the year.

Turning to King, monthly active users were 249 million, increasing 2 million from the third quarter. On a year-over-year basis, we saw declines in web and smaller mobile titles. But importantly, Candy Mobile reach was little changed and benefited from growth in King's largest title, Candy Crush Saga. In the second half of 2019, King introduced new initiatives to grow payer conversion targeting lapsed payers as well as converting new payers into the ecosystem, and these initiatives led to encouraging payer engagement trends in the last two quarters.

While these initiatives dampened in-game net bookings in Q4 and will continue to do so in Q1, we believe a broader and more engaged payer base positions the franchise for growth over the medium and long term. And even with these actions, Candy Crush Saga remained the top grossing title in US app stores, and the wider Candy franchise was once again number one.

King's advertising business grew net bookings over 80% year over year, with strong growth in ad-enabled users, volume, and pricing. Both direct and indirect sales grew sharply. For the full year, ad net bookings exceeded $150 million, with the business set for robust growth again in 2020.

Throughout this year, King will continue to optimize the economy within Candy, launching ongoing features, services, and events to drive player engagement and investment. And having previously narrowed its pipeline to focus on the highest potential projects, King is investing in several promising new titles, including content based on Activision's beloved catalog IP. Regional testing with some of these new titles will begin in 2020.

So in conclusion, our strategy to focus on our growth pillars and invest in the creative and commercial resources and initiatives of our biggest franchises is delivering results. In 2020, we will continue that focus, with releases and pipeline initiatives highlighted today to further expand our reach, engagement, and player investment, and to extend our largest IPs across new platforms, geographies, and business models. We plan to reach more players on more platforms in more regions than ever before.

To do so, we'll also further increase investment in our technology capabilities, technology platforms, and data analytics. We'll fund these investments with an ongoing focus on efficiency and organizational optimization to leverage our scale across the business. And we know that some of our investments won't bear fruit until next year or later, but we're confident in our growth trajectory this year and our growth plans, and we enter 2020 with momentum.

I'll now hand the call over to Dennis to discuss our Q4 and full-year financial results and outlook. Dennis?

Dennis M. Durkin

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

Thanks, Coddy. Today, I will review our Q4 2019 results as well as our outlook for 2020 and the first quarter. Q4 GAAP and non-GAAP EPS were ahead of our prior outlook, reflecting better than expected results for Call of Duty and World of Warcraft and a lower tax rate. To review the quarter, I'll start with our Q4 segment results.

Activision revenue was $1.43 billion, led by Call of Duty growth in both upfront and in-game revenues on console and PC and the addition of Call of Duty Mobile. Operating income was $696 million with an operating margin of 49%. As expected, Call of Duty Mobile was not a material contributor to operating income in Q4 despite a great launch, as we invested to build our player base and position the title for long-term success.

Blizzard revenue was $595 million, lower year over year, as growth for World of Warcraft and Overwatch was offset by a decline for Hearthstone and Diablo. Operating income was $260 million, with the revenue decline more than offset by lower costs. Blizzard's operating margin was 44%, significantly higher year over year due to mix and lower costs.

King revenue of $503 million was flat sequentially and lower year over year, driven primarily by King's actions to prioritize mobile payer engagement in the quarter as well as year over year decline in web titles. The ads business grew more than 80% year over year.

Operating income was $197 million, with an operating margin of 39%, 1 point higher year over year, driven by high incremental margins from advertising. Across our segments, in-game net bookings were $1.1 billion.

Now let's turn to our 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 Q4 GAAP revenues of $2.0 billion, $174 million above our November guidance. This includes the net deferrals of $722 million. Net bookings of $2.7 billion were $62 million above our November outlook.

We incurred GAAP-only restructuring and related charges of $30 million, and we generated Q4 GAAP EPS of $0.68 and Q4 non-GAAP EPS of $0.62, which was $0.19 above guidance. These figures include the net deferrals of $0.61.

For the year, we generated GAAP revenues of $6.5 billion. This includes the net recognition of deferrals of $101 million. Net bookings were $6.4 billion. We incurred GAAP-only restructuring and related charges of $137 million and generated GAAP EPS of $1.95 and non-GAAP EPS of $2.31. These figures include the net recognition of deferrals of $0.06.

From a cash flow perspective, our business delivered Q4 operating cash flow of $918 million. Annual operating cash flow was $1.8 billion, higher year over year due to lower working capital and cash taxes.

Our cash and investments at the end of December was approximately $5.9 billion, and we ended the year with a net cash position of approximately $3.2 billion.

Turning to capital allocation, we enter 2020 with a strong balance sheet and significant flexibility. As always, we continue to take a disciplined and balanced approach to capital allocation. And with this in mind, our board has authorized an 11% increase in our annual dividend to $0.41 per share, payable in May.

As we look back over the last year, we are pleased with the company's operating discipline, commercial execution, and content delivery during a period where we refocused the business and increased investment in key franchises to position us for future growth.

Now let's look forward to our outlook for 2020, first, regarding our slate and plans for each business unit. Activision enters the year with strong momentum for Call of Duty across upfront sales, in-game, mobile, and esports. Along with a tight retail channel that should benefit catalog sales, this positions us for strong growth in the franchise, particularly in the first half of the year.

In Q4, we plan to launch the next premium release of Call of Duty. We can't wait to unveil what our team has been working on, and we feel great about the content. Although as is customary, we are prudently assuming lower sell-in for Q4 versus Modern Warfare this past year.

Turning to Blizzard, which just last week released Warcraft III: Reforged, Blizzard will build on World of Warcraft's momentum with ongoing content for Classic and the Shadowlands expansion in the second half of the year. The Hearthstone and Overwatch teams will support their communities with ongoing content and services that drive engagement and player investment. And as Coddy mentioned, Diablo Immortal is planned to enter regional testing towards the middle of the year, though we don't have any material revenue from that title in our guidance.

King will continue to release content, features, services, and events across its portfolio, with an ongoing focus on optimizing reach, engagement, and player investment for Candy, and the Advertising business is set to deliver another year of strong net bookings growth. At the same time, King will continue to invest in several promising new titles in its pipeline. And although we expect regional play testing for certain titles, similar to Diablo Immortal, our outlook does not include material revenue from these titles.

In addition, our business units will continue to tap into our portfolio of beloved IP to bring several remastered and reimagined experiences to our players in 2020, which we will announce closer to launch.

Bringing all this together, our outlook reflects 5% year-over-year growth in net bookings. We expect Activision to experience the strongest net bookings growth amongst our segments, both in dollar terms and on a percentage basis. We expect solid net bookings growth from Blizzard for the year. And our outlook reflects a flattish performance at King, with year-over-year trends improving in the second half of the year. From a margin perspective, our outlook reflects GAAP and non-GAAP operating margin increasing year over year.

Now let's turn to the numbers. On a GAAP basis for 2020, we expect revenues of $6.45 billion, including net deferrals of $275 million. We expect: net bookings of $6.73 billion; product costs, game operations, and distribution expenses of 22%; operating expenses, including software amortization, of 50%; and a GAAP-only restructuring charge of approximately $50 million. We expect a tax rate of 19%, GAAP and non-GAAP share count of 778 million, and GAAP EPS of $1.85.

For 2020 on a non-GAAP basis, we expect product costs, game operations, and distribution expenses of 23%, operating expenses including software amortization of 44%. We expect a tax rate of 19% and non-GAAP EPS of $2.22, including net deferrals of $0.13.

Now let's turn to our Q1 outlook. On a GAAP basis for Q1, we expect revenues of $1.64 billion, including the net recognition of deferrals of $365 million. We expect net bookings of $1.28 billion, product costs, game operations, and distribution expenses of 21%, operating expenses including software amortization of 48%, and a GAAP-only restructuring charge of approximately $35 million. We expect a tax rate of 17%, GAAP and non-GAAP share count of 775 million, and GAAP EPS of $0.55.

For Q1 on a non-GAAP basis, we expect product costs, game operations, and distribution expenses of 21% and operating expenses, including software amortization, of 41%. We expect a tax rate of 17% and non-GAAP EPS of $0.66, which includes the net recognition of deferrals of $0.31.

In closing, in 2019 we have come a long way in refocusing the business on our biggest franchises and opportunities. The momentum for World of Warcraft, Call of Duty, and our new engagement models highlights the growth potential for our broader portfolio of durable fully owned franchises when we apply our top creative talent and commercial talent against our biggest opportunities. We are encouraged by our 2019 results. And as we return to growth in 2020, the opportunity set for our business across platforms, geographies, and business models has never been greater.

Going forward, we will maintain our operating discipline and focus as we execute against a great content lineup this year and a pipeline that includes Overwatch 2, Diablo 4, Diablo Immortal, and multiple unannounced initiatives, including several mobile titles. We remain confident that ongoing execution against our plan will position us to deliver growth to our shareholders over the long term.

Now, I welcome our business leaders, J., Humam, and Rob as they join us for the Q&A portion of the call. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll take our first question from Mario Lu with Barclays.

Mario Lu
Analyst, Barclays Capital, Inc.

Q

Hi, thanks for taking the questions. I have a couple on Call of Duty: Modern Warfare. How has not having a season pass affected user behavior thus far compared to years past? And secondly, any color you can provide regarding its impact on in-game revenue growth and what we can expect in 2020? Thanks.

Rob Kostich
President, Activision, Activision Blizzard, Inc.

A

Hey, Mario, it's Rob. thanks for the question. I think before I touch on season pass specifically, it's important that we kind of step back for a second and look at some of the macro changes that we made, and season pass was one of them. Our intent was just to create a better overall experience for our player community, and we think we've done that. The first big thing we did was bring in cross-play and cross-progression, enabling friends to play together no matter what platform they're on. In the case of Modern Warfare, it was just great to see players come back together after so many years of experiencing the franchise in the past. Now with season pass, it kind of played a similar role, right? So instead of certain portions of the audience having certain content, we're focused now on free content for the entire community to drive engagement with the overall community.

And I say the last big change that we made was really focusing on the new Battle Pass and Item Shop system in the game, giving players kind of more transparency to the content they're after and obviously focusing more on cosmetic content. And I suppose the best way to judge all of it is just what's the player behavior and what the community is saying. And when we look at engagement and you look at daily average uniques, our engagement is up significantly year over year, and that's really great for us to see so many people enjoying and playing this fantastic game.

And then on the player investment side, I'd say fans certainly seem to be appreciating the new system quite a bit. We mentioned kind of the growth year on year, but one other thing I might add is that we're also seeing increased attach rates in-game to the new system, which I think is a very, very positive sign for us. And for us, this all signals to a really healthy ecosystem within Modern Warfare, one that we think we can build on and create momentum with our community.

It's really on us from now on to really build great content, which we intend to do for the long haul on this game. A great pipeline of content is coming starting with season two next week, and we have some surprises in store beyond that. So I'd say overall, what we expect is a healthier Call of Duty in 2020 versus the previous year, and we look forward to sharing more in the future, but thanks for the question.

Mario Lu
Analyst, Barclays Capital, Inc.
Q

Great, thank you.

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

Thanks, Mario.

Operator: Thank you.

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

Operator, can we take the next question, please?

Operator: We'll take our next question from Benjy Scurlock with Arete Research.

Benjy Scurlock
Analyst, Arete Research Services LLP
Q

Hi, thanks for taking my question, just one on King. So when do you expect to see engagement and monetization stabilized and the King segment start to reaccelerate? Thanks.

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

Hey, thanks for the question. This is Humam. So overall growth is impacted by some of our smaller titles and on what platform. We also had a number of initiatives more recently aimed at driving payer conversion and bringing back lapsed payers. And that presented a near-term trade-off, but it's the right thing to do for the medium term and beyond, and we're continuing to see some of those trade-offs in Q1.

But with all that said, when I look forward, I see a number of growth areas at King. First and foremost is Candy. Candy continues to be an incredibly durable franchise, and we see growth just through the slate of new features, all the services we're releasing, and the in-game events that we hold. More recently, we're also thinking quite a bit about our social features. We've seen that really work in different battles and in different genres. And when I think about how that could be in Candy and the size of Candy, that could be a big unlock for us.

Another thing that I look to for growth is our Advertising business. So as you heard, that's really coming along really nicely, and we built a really large and high-margin business, and I see growth there. And then additionally, I see growth in our pipeline. We reset our pipeline recently, and we're starting to see some really good results in our prototypes. And we will start doing some regional testing on some of those this year.

So when I put all that together, I look to the medium term and beyond, and I think we have some really good growth opportunities here.

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

A

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

Operator: Thank you. Our next question comes from Matthew Thornton with SunTrust.

Anthony Duplisea
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Hey, this is Anthony on for Matt. Thanks for taking the question. Do you have any color on how successful World of Warcraft has been in 4Q and into 2020 in retaining users from the Classic mode launch? And the relatedly, also on Warcraft, there's been some negative press on Warcraft III: Reforged lately. Can you tell us what you're doing to address that? Thanks.

J. Allen Brack
President, Blizzard Entertainment, Activision Blizzard, Inc.

A

Hi, this is J. I'll take the World of Warcraft question first. So as a reminder, when we designed the model for World of Warcraft Classic, it was important that players have a single existing subscription to support both games. And we think about the WoW community as supporting both, even though Classic and Modern are very distinct experiences. And we're committed to continuing to support both of those experiences over the long term.

Given the content updates for Modern WoW and the cadence that we have for Classic, we exited our year with a subscriber base that was double what it was at the end of Q2, and we also see players remaining engaged in both versions of the game. We launched Visions of N'Zoth, which is a content patch for Modern WoW, in January.

The engagement with Classic has been particularly strong in the East, and we see very high levels of player retention there. And our next update for Classic is going to be Phase 3, which is Blackwing Lair. It's one of my favorites, and we're planning on launching that on February 13.

Concerning Warcraft III: Reforged, honestly, it's been a bit of a hard week. Our community has come to expect really amazing things from us, and we've heard from them that we did not achieve that bar. But we stand behind our games and have consistently shown that not only do we support them, but we continue to build on them even after launch, and we're committed to doing that here as well. And so we're going to continue to update the game and we'll continue to update the community with our plans going forward. Thanks for the question.

Operator: Thank you. We'll take our next question from Ben Sherlund with Bank of America.

Benjamin Sherlund
Analyst, BofA Securities, Inc.

Q

Hi, guys. Thanks for taking the question. You now have about $3 billion of net cash on the balance sheet, and you've got the annual dividend, have done some buybacks in the past, some acquisitions. Maybe just an update on the thoughts around capital allocation and uses of cash against the opportunities ahead. Thanks.

Dennis M. Durkin
Chief Financial Officer & President, Emerging Businesses, Activision Blizzard, Inc.

A

Yeah. Thanks for the question. Obviously, we do view a strong balance sheet as a really important strategic asset for the company, and having that gives us considerable flexibility to invest in the business, do buybacks and return capital, or pursue M&A when we see attractive opportunities. And our track record probably somewhat speaks for itself as you look at that over a long period of time. We borrowed, I'd say, very fortuitously to finance our Vivendi transaction and our King transaction, and then subsequently paid down that debt. So we paid down more than $4 billion since we financed those transactions and actually have climbed our way up the investment-grade ratings grid.

And then we've returned over the last decade more than I guess around $10 billion of capital back to our shareholders, about $8 billion through share repurchases, and we still do have our $1.5 billion authorization, and then about $2 billion over that time period in dividends, which has increased double digits I'd say probably on average over the course of that period and again this year with the $0.41 dividend, which we announced today.

M&A is always something we keep our eye on, and we have our radar detectors up. And we always look at a lot of things, but I'd like to think we're pretty disciplined about our process. We do have a pretty rigorous process, and we try to look for a few criteria of things when we are considering it. We're always trying to find great franchises or technology that could add to our portfolio and make our business and our franchise portfolio stronger. We like to see a track record of profitability or path to profitability, a strong leadership team that's aligned around growing the business. And then lastly, and this one's been more challenging, is finding things at a valuation that make sense. So it's not easy to find all those things, and so you have to be very disciplined and patient as you think about those inorganic opportunities.

So that gives you a little bit of an overview in terms of how we've approached it. I think our past track record and philosophy on this is probably the best indicator of how we think about it and how we'll allocate capital in the future.

Operator: Thank you. Our next question comes from Michael Ng with Goldman Sachs.

Michael Ng
Analyst, Goldman Sachs & Co. LLC

Q

Hey, thanks for the question. Could you just give us an update on Diablo Immortal and discuss how that informs your go-forward mobile strategy for Blizzard? Thanks.

J. Allen Brack
President, Blizzard Entertainment, Activision Blizzard, Inc.

A

Absolutely. So as you know, we've been working closely with NetEase on the development of the game, and our goal is to deliver an authentic and deep Diablo experience for mobile. We did show an updated version of the game at BlizzCon last year, and we saw a lot of excitement. We've also begun doing internal playtests or additional internal playtests since that time, and the results are encouraging. We're getting ready to move to the next phase of development with some regional alpha testing later this year. Player feedback is invaluable. And as we continue to work on building the game, we will be looking to that feedback to make sure that we're making really a great Diablo experience.

When we think about mobile overall for Blizzard, we have our roots in PC gaming, and we're going to continue to be deeply committed to the PC. But we do think there are opportunities for additional experiences and in different ways for players to engage on different kinds of devices. And we see mobile as also a way to attract players that we don't currently reach on PC and console. So we think the mobile opportunity for Blizzard overall is very substantial. And Diablo Immortal will be our first release as a mobile-first game, and we continue to work on multiple mobile initiatives across Blizzard in addition to the PC and console games.

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

A

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

Operator: Our next question comes from Colin Sebastian with Baird.

Colin Alan Sebastian
Analyst, Robert W. Baird & Co., Inc.

Q

Thanks. Digging down a little bit more into your relationship with Google, I'm wondering what the key factors behind the decision to partner with GCP. And then as well with YouTube Gaming, are there as well there considerations or implications embedded that could increase your level of support for Stadia? Thank you.

Collister Johnson
President & Chief Operating Officer, Activision Blizzard, Inc.

A

Sure. Hey, this is Coddy. I'll take that. I'm going to say first, as Bobby mentioned earlier today in an interview, we've had a longstanding relationship with Google. It's been great. We are thrilled to formalize that into a deeper partnership over multiple years. And as you said, there are really two big pieces to it. The first is on the global IP infrastructure, and the second is on what really is just a fantastic concept platform on YouTube.

On the first piece, what we have the opportunity to do now is have a more efficient and better delivery of the back-end services and infrastructure handled by a partner where that is their great expertise. And what it allows us to do is it frees up our resources and developers and mindshare to focus on what we do best, which is making the content and getting it out into the hands of our players at a faster cadence. That's a great balance of trade for us, and we feel really good about the depth of that partnership and how it will carry us going forward.

On the content side, on YouTube, there are 200 million game reviewers on YouTube, and it's just a tremendous opportunity to bring our platform to new audiences there, we think not only just in a way that players can experience it today but with new modes and formats. And also YouTube is a great on-demand viewing platform, and we think viewers might be increasingly interested in viewing our content that way.

There are other pieces to this deal, where there's real value we think in terms of how we utilize their platforms and how they help us build more reach and engagement in our ecosystem. Not in this deal, and you mentioned it, is Stadia. There are cloud game streaming experiences that are directly to the consumer. We continue to watch with interest, and we'll make appropriate assessments as we go forward to figure out our own next steps there.

But I think what it points to is just, as a last thought, a broader point, which is over the last two years we've been talking about these large technology players that are coming into our space at scale. What we've said is we see this tremendous opportunity as a content provider to take advantage of where we sit in the space, and this Google deal is an example. It drives a large amount of value for us as we go forward, and we think we're only even better positioned for other partnerships as we take the next steps. Thanks.

Operator: Thank you. Our next question comes from Eric Sheridan with UBS.

Eric J. Sheridan
Analyst, UBS Securities LLC

Q

Thank you so much for taking the question. Can you provide us an update on how Call of Duty Mobile is trending in terms of engagement, retention of users, how we should be thinking about future content as a driver of monetization for that property going forward?

And second part, any key learnings that we should be aware of as you're learning to develop mobile games at that sort of scale and how it might be applied to other parts of the portfolio? Thanks so much for the color.

Rob Kostich
President, Activision, Activision Blizzard, Inc.

A

Hey, Eric. It's Rob. Thanks for the question. Let me start with the last part of your question on the key learnings, and I apologize for being a little redundant on this. But I think a key theme throughout our call is that I think what we learned more than anything else is that the market is certainly ready for our franchises on mobile. When we make a great game and kind of stay true to the core tenets of what made the franchise great in the first place and we executed on that, now we can reach just millions and millions of people around the globe that may have never experienced our franchise before. And that's just – that's very exciting for us as an organization because that obviously is true not just for just Call of Duty but also for the many great franchises that we have in the organization.

If I return back and talk about Call of Duty Mobile a little bit in terms of engagement and retention, like you asked, look, I'd say it's still in the early days, but we've seen a number of encouraging signs. Obviously, the installs at the beginning, which we reported on, have been fantastic. But also in terms of our daily engagement, looking at our dials, Mobile hit levels that were multiples higher than any other title in franchise history. So that engagement base is really, really exciting for us to work from.

Now for us, the content now becomes on the content pipeline to sustain and build on that. In Mobile, we have a game and a platform essentially that we want to build on for a really long time to come. So we're hyper-focused on our content pipeline, our monthly, weekly, and daily events as they come into the game to make sure we drive the best possible experience for our player community there.

We're in the middle of season three right now, and that's tracking really well. And I think what you're going to see is we're learning a lot real time and the learnings are great. And you'll see us adjusting our content and continuing to make the best possible experience we can for our fans as we move forward in the future. So I'd say right now we're off to really a nice start that I'm excited about, and we'll be reporting on our progress as we head into the future, but thanks for your question.

Operator: Thank you. Our next question comes from Mike Olson with Piper Sandler.

Michael J. Olson
Analyst, Piper Sandler & Co.

Q

Hey, good afternoon and thanks for taking the question. You touched on it a bit, but could you update us on anything further related to the status of King advertising? How has it ramped throughout 2019, and what's your thinking on potential for 2020? Thanks.

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

A

Hey, this is Humam again. Thanks for the question. So, look, I think advertising has been a real success story for King, as we saw in 2019. It's really both a durable business here, and it's a high-margin one. And the way I think about it is with our scale of monthly trading allows us to get the benefits of having such a large audience. As you know, a small fraction of them participate in our in-game economy.

So now it's become a needle-mover for us. We've crossed $160 million in net bookings in 2019, and it's truly a testament to a great collaboration between the product teams and the game teams, the advertising teams, and really all of them thinking about what's a great player experience and how do we deliver something very differentiated for our advertisers. And so when I look to 2020 and beyond, I see continued growth there, many avenues of that growth. First and foremost, we're going to continue to roll out advertising to more and more of our players.

And then I think the teams will continue to innovate. They already, as I said, have an incredibly differentiated product that advertisers are really attaching to, but we can continue to make it better. A good example of this was in Q4, was some of the – what we delivered to Sony Pictures on the Jumanji film launch. And there, we not only had our flagship Rewarded Video product, but we did something truly differentiated in the marketplace where we put an in-game integration. We put some of the film characters in our game, so it was greatly engaging for our players. And it delivered tens of millions of views to Jumanji, and it truly moved the needle for them too.

So I think about continuing to move down that journey, and as we do that, we unlock more demand, and we are working very closely with our agencies, while we also continue to build our direct sales team and continue to build the infrastructure around it. So all in all, I think that strategy that's been working continues to bear fruit for us, and I think there's plenty of growth ahead of us and some big runway.

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

A

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

Operator: Thank you. We'll take our final question from Mike Hickey with Benchmark.

Mike Hickey
Analyst, The Benchmark Co. LLC

Q

Hey, guys. Congrats on the quarter. Thank you for taking my question. You made a lot of changes, obviously, to Call of Duty this year. You introduced the cross-platform, new in-game system, you launched Mobile. Obviously, that was a huge success, and esports. I guess to what extent do we expect to see similar moves over the rest of your key franchises? Thank you.

Robert A. Kotick
Chief Executive Officer & Director, Activision Blizzard, Inc.

A

Thanks for the question, Mike. It's Bobby. I think one of the things that we found with the launch of Call of Duty Mobile, with games like Hearthstone, our designers and developers have gotten a lot more excited about reaching bigger, broader audiences, and we've seen that across the whole company. And so I think what you're going to continue to see is a commitment to innovation on all of our franchises, and that now includes commitment to innovation with mobile devices. And I think that as long as we can deliver new, innovative game play with great user experiences on mobile devices, you'll see more franchises taking advantage of that as a platform.

I think the other thing we've seen is that people want to reach more customers in more countries. And especially when you look at some of the things that we're doing esports, being able to build these big, inclusive communities around the world, and today our mobile games are played in almost 200 countries, that's been a real catalyst for us to really rethink the way that we're approaching our franchise development.

So you can expect, as J. pointed out, obviously as Humam can attest to, and as we view the team in the Activision business with the success of Call of Duty Mobile, mobile is now our largest platform. And you'll continue to see us with not just mobile touchpoints, but all the other important touchpoints that we've now added into the business, expanding the reach of our franchises, the engagement of our franchises, and the monetization of our franchises. So we couldn't be more enthusiastic about the prospects that we have going forward.

We've talked a little bit about the challenges, which is prioritization of opportunity and making sure that we have the right talent aligned with those opportunities, but those are the challenges we've managed for a long time. So it's a great question, and I think you can expect that all of our franchises are investing in all of these new opportunities.

Dennis M. Durkin
Chief Financial Officer & President, Emerging Businesses, Activision Blizzard, Inc.

All right. Thanks, Bobby. Thanks, everyone, for joining us today. We'll look forward to speaking with many of you this quarter, and if not, we'll see you on our next earnings call in late April or early May. Thank you.

Operator: Thank you. Ladies and gentlemen, this concludes today's call. We thank you for your attendance and participation. You may now disconnect.