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Activision Blizzard, Inc. (ATVI)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. And welcome to the Activision Blizzard First Quarter 2021 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Chris Hickey, Senior Vice President, Investor Relations. Please go ahead.

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 2021 conference call. With us are Bobby Kotick, CEO; Daniel Alegre, President and COO; Armin Zerza, CFO; and Dennis Durkin. 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'll 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 2020 annual report on Form 10-K and those on the slides that are shown. The company undertakes no obligation to release publicly any revisions to any forward-looking statements to reflect events or circumstances after today, May 4, 2021.

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 refinancing; restructuring and related charges; the associated tax benefits of these [indiscernible] (00:02:12) 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.

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. For more than a year now, amid very challenging conditions, the teams at Activision Blizzard have played an important role in supporting and serving our

community of 400 million players in 190 countries. Our teams have kept players connected using our platform to comfort, inspire and draw people together. Their hard work and dedication enabled us to deliver significantly better than expected first quarter results.

First quarter net bookings increased year-over-year by 36% to \$2.1 billion. Non-GAAP operating income grew 38% and non-GAAP earnings per share increased by 29%. Year-over-year performance was driven by our three largest franchises, Call of Duty, Warcraft and Candy Crush, with each delivering strong double-digit growth in net bookings.

This overperformance was well ahead of our expectations and confirms that our multiyear franchise strategy and continued execution is delivering value to our shareholders. With momentum continuing across our business, we're raising our financial outlook for the year.

In the last 20 years, we've delivered 21% compound rates of return as compared to the S&P 500 which delivered 8% compounded rates of return. \$1,000 invested in Activision in 2001 would be worth over \$45,000 today as compared to \$4,900 in the S&P 500.

This performance is possible because of our deep library of franchises. We own some of the most enduring and popular global entertainment franchises supported by the very best creative teams in our industry. Our strategy centers around our long-held view that wholly-owned entertainment franchises offer the opportunity for limitless innovation. We continue to increase investment in creative and commercial resources for our franchises and potential new franchises to deliver new compelling experiences for players and superior financial returns for our shareholders.

With free-to-play entry points across mobile, PC and console, Call of Duty experienced an increase of over 100 million players in a little over a year. Call of Duty is the template we're applying to our proven franchises as well as our new potential franchises as we attempt to grow our audiences to 1 billion players. Our increase in live operations is reflected in last quarter's results and our forward outlook as we've seen our business shift from a seasonal focus with a holiday emphasis to an always-on business model with far less seasonality.

This quarter also marked the five-year anniversary of our acquisition of King and the Candy Crush franchise. With the Candy Crush team delivering more year-round content to over 200 million monthly players, King's business is delivering excellent results. Segment revenue grew over 20% year-over-year to reach a new record in the first quarter. It's especially noteworthy that of the top 10 mobile franchises worldwide at the time we announced the acquisition of King, no other game has grown in-app revenues over the period or matched Candy's compound growth rate. King's advertising business continues to deliver spectacular results too with revenue growing 70% year-over-year in the first quarter.

As we look ahead, demand for our content has never been stronger. We continue to ramp our investment in creative and development talent, especially with increased competition from Chinese companies and platform providers. And this will allow us to better serve our players. From the start of 2020 through the end of next year, we intend to hire more than 2,000 developers. We plan to triple the size of certain franchise teams compared to those team sizes in 2019. And we have aggressive hiring plans around the world including new studios or major expansion in Poland, China, Australia and Canada.

And as our shareholders expect, we remain laser-focused on finding and retaining the best talent in the industry and always aligning performance and reward. From the extensive shareholder outreach we conducted this past

year, reaching well over 60% of our shareholders, we are pleased that our company-wide pay-for-performance compensation philosophy and ESG initiatives are aligned with the expectations of our shareholders.

This quarter, we'll release our first ESG report highlighting our commitment to the environment, human capital management, social good, the very best governance practices and their direct connection to the creation of shareholder value. While the report is new, our commitment to these practices and shareholder value creation is not.

In particular, we've long appreciated that the creation of broadly appealing games requires diverse views, diverse voices and diverse skills and an environment that fosters inclusion. And importantly, our ESG report will include our commitments to help ensure that our scale serves our players, our employees, our communities and especially our shareholders and that those commitments are embedded into and across our business.

Also in the service of our shareholders, I'm pleased to introduce Armin Zerza as our new Chief Financial Officer. Armin's deep experience as a global finance and operations executive and his contributions as Chief Operating Officer of Blizzard and Chief Commercial Officer of the company make him especially well suited to serve as our next CFO.

In his six years with the company, Armin has been a central figure in the company's continued growth and record financial results. He has the commitment to profitable growth and operational excellence that our shareholders have always recognized us for. And Armin comes to the role with an incredible team assembled by Dennis and Thomas over the last decade.

Dennis has been a key contributor in some of the most value-creating moments of our history including the buyback of control from Vivendi in 2013 and our expansion into mobile through the acquisition of King. Dennis' contributions have meaningfully shaped our culture, leaving the company in a much stronger position than when he joined 10 years ago. Dennis, on behalf of Brian, Thomas and our board of directors; I thank you for your friendship, your partnership and your leadership.

Dennis M. Durkin

Outgoing Chief Financial Officer, Activision Blizzard, Inc.

Thanks for the kind words, Bobby. I did want to take this opportunity to personally say thank you to you, Bobby, to the incredible people and teams at Activision Blizzard and to the board for all the wonderful support and partnership over the last nine years. It's truly been an incredible journey and one I will never forget. I'll also miss my interactions with all our great analysts and investors. I really appreciate all our dialogue over the years. You pushed us and made me and our business better. So thank you.

While it's tough to go, I'm pleased to be leaving at a time when the business has never been stronger. And I can't wait to see the results as the company continues to execute against our strong pipeline. And I know the business is in good hands with Armin, who I've known for a long time. I know that he will continue to bring our disciplined and prudent approach and commitment to shareholder value creation that investors expect from Activision Blizzard.

I'll sign off by saying one last thank you. I truly am grateful for it all. I'll now hand it over to Daniel to go through the highlights from the quarter. Daniel.

Daniel I. Alegre

President & Chief Operating Officer, Activision Blizzard, Inc.

Thank you, Dennis. And I would like to add my own appreciation for all your contributions to the company. I will certainly miss our partnership, although I am thrilled to continue my close working relationship with Armin in his new role.

As you've just heard, Activision Blizzard significantly exceeded its prior outlook for the first quarter, delivering very strong growth across our largest franchises. These results confirm that our strategy is working, creating new experiences for our franchises across platforms alongside engagement and player investment opportunities that appeal to the broadest audience. It is incredible to see with the backdrop of ongoing challenges from working from home, our teams have risen to the occasion and they really continue to deliver exceptional results.

Our increased investments in our largest franchises are enabling us to connect and engage people in more ways than ever before. Shelter from home has accelerated a trend we have been seeing where consumers around the world are turning to gaming for entertainment, connection and community. Our successful growth initiatives in our largest franchises, vibrant and active communities and our strong pipeline position us to continue driving strong results this year as regions start to reopen.

Aligned with our overall strategy, we also continue to enhance our Battle.net platform as we build on our direct digital relationship with our players. In the first quarter, we rolled out the biggest frontend upgrade to Battle.net in years, delivering improved navigation, enhanced social features and a rich storefront contributing to strong year-over-year growth in sales per visitor for the platform in the quarter. And as we look into 2022 and beyond, our teams continue to make great progress on a pipeline that includes Diablo IV, Overwatch 2, and multiple Warcraft mobile titles which we expect to deliver substantial growth for the company.

Now turning to our franchise and operational highlights across our business units, starting with Activision which had a record 150 million monthly active users in Q1. Our Call of Duty free-to-play Warzone and mobile experiences have transformed the franchise, more than tripling the number of monthly players over the last two years and adding over \$1 billion of operating income to Activision segment results last year. The franchise once again delivered fantastic year-over-year growth in reach, engagement and player investment in the first quarter. MAUs increased sequentially and grew over 40% year-over-year both on console, PC and mobile. Time spent grew even faster year-over-year, again, to a new quarterly record for the franchise.

Now, moving to console and PC. Since we integrated Warzone with Black Ops Cold War in December, we've continued to see a strong conversion to the premium game. Q1 premium sales were well above the levels typically seen in the first quarter. And in-game player investment trends similarly remained robust. In-game net bookings on console and PC grew more than 60% year-over-year in the first quarter. And the first two seasons of Black Ops Cold War and Warzone content were both in the top three seasons in Call of Duty history for in-game net bookings. And Season 3, which launched just two weeks ago alongside a major refresh of the Warzone experience, is sustaining this strong run rate tracking in line with the first two seasons.

On mobile, Call of Duty Mobile saw strong year-over-year growth in reach, engagement and player investment in the first quarter benefiting from the team's ongoing enhancements to the game in the West and the launch of the title in China. The team continues to make great progress optimizing the game in the West with the March season concluding at the highest for player investment yet. And momentum has continued into the second quarter with the April season now the top grossing to date at this point after launch.

And in China, Call of Duty Mobile brought tens of millions of new players to the franchise following its launch in late December. Player investment in China in the first quarter was on par with the rest of the world combined. Similar to the Western launch 18 months ago, the team is now focused on refining gameplay and content for local tastes to build durable engagement and monetization in 2021 and beyond.

With the 2021 season of Call of Duty League also off to a great start enjoying strong year-over-year growth in average minute audience through the first two stages of competition, it is clear that there is ongoing momentum across the entire franchise. And there is so much more to come for Call of Duty. We continue to invest to grow our creative teams, successfully adding hundreds of developers to the franchise in the last year and enabling us to deliver even more compelling experiences in coming quarters.

And in particular, we are very excited for this year's premium Call of Duty release. Development is being led by Sledgehammer Games. And the game is looking great and on track for its fall release. This is a built-for-next-generation experience with stunning visuals across campaign, multiplayer and cooperative modes of play designed to both integrate with and enhance the existing COD ecosystem. We look forward to sharing more details with the community soon.

Now turning to Blizzard, where the teams continue to make great progress on a rich pipeline of premium releases and extending key franchises to mobile. MAUs were 27 million. In the Warcraft franchise, the World of Warcraft Shadowlands expansion continued to drive strong results following its record-setting release in November with WoW net bookings growing sharply year-over-year.

Shadowlands is building on the momentum seen since the 2019 introduction of Classic drove a substantial increase in scale and an enhanced financial trajectory for WoW. The team's work to deliver a high-quality expansion is being recognized by the community. First quarter reach was sustained at a higher rate than we typically see following expansion launches accompanied by deep engagement.

And Blizzard saw a particularly high number of new players joining the WoW community in the quarter, boosted by its initiatives to enhance the onboarding experience. And World of Warcraft also saw strong participation in value-added services further bolstering year-over-year growth in net bookings. Blizzard is building on this momentum with further content for the modern game and the upcoming introduction of The Burning Crusade, the expansion first launched in 2007 through WoW Classic.

The Burning Crusade was critically acclaimed at launch. And we expect the upcoming release to more deeply engage current subscribers, bring back lapsed Classic fans and also bring entirely new players into WoW Classic. With the expanded development team executing well against a strong pipeline, WoW remains positioned for a much stronger annual financial performance than is typical outside of a modern expansion year.

Now, staying within the Warcraft universe, Hearthstone is seeing encouraging trends as the team executes on a strong pipeline of new in-game content, features and game modes. Hearthstone's latest expansion, Forged in the Barrens, was released at the end of the first quarter with the game on track to deliver expansion, overexpansion, net bookings growth for a second consecutive release. And Blizzard expects to sustain this trajectory with more new content including mercenaries, an innovative new mode in the popular role-playing genre planned for the coming months.

And the Diablo franchise is nearing the start of its reincarnation. Blizzard announced the launch later this year of Diablo II: Resurrected, the return of one of the most acclaimed titles in PC gaming history. The game received

very positive feedback during early testing in April. And online viewership of the alpha test was the highest Blizzard has ever seen for a game test, illustrating the community's anticipation for this release.

On mobile, after highly successful regional testing last December, Diablo Immortal has just entered its second phase of testing and is on track for global release later this year. We expect Diablo Immortal to broaden Diablo's reach ahead of the launch of Diablo IV on PC and console. Diablo IV development is progressing very well with a significantly expanded team focused on not only launching an epic new experience but also following this up with robust in-game content to sustain community.

In Overwatch, the team is making good progress on Overwatch 2 and is looking forward to sharing more frequent updates with the community in the near future. April saw fans around the world return to celebrate our players and city-based teams in the opening weekend of the 2021 season of the Overwatch League. The league also signed a multiyear partnership with Bilibili Esports for exclusive rights to broadcast league games to the platform's passionate and growing Overwatch League fan base in China.

Now turning to King, which continued to benefit from strong execution on growth initiatives in the first quarter. MAUs were 258 million, exhibiting better seasonality than we typically see following the fourth quarter led by its most important franchise, Candy Crush. For a number of quarters, King has been pursuing initiatives to broaden the payer base, deliver for frequent seasonal events and introduce compelling new features into Candy Crush as well as portfolio titles.

This work again delivered excellent results in Q1 with in-game net bookings growing high teens year-over-year and accelerating further relative to Q4. Candy Crush grew in-game net bookings very strongly year-over-year and was once again the top grossing gaming franchise in the US app stores. Farm Heroes, King's second largest franchise, also grew sharply year-over-year.

King built on this strength to increase investment in growing the Candy and Farm audiences in key regions. We expect the ROI-positive investment to contribute to King's operating income performance in the coming quarters. As King continues to execute against its strategy, in-game net bookings have remained strong into the second quarter, continuing to grow well year-over-year in April even against tough comparables from the start of lockdown in the year-ago quarter.

Late in Q1, King launched Crash Bandicoot: On the Run!, a new mobile title based on the beloved Activision franchise. The game has been downloaded over 30 million times to date. And the team is now focused on optimizing the game for retention and engagement. That said, we continue to assume limited contribution for the game in our full year outlook.

Along with the strong performance for in-app purchases, King again delivered significant growth in advertising across both direct and partner sales channels. As the mobile advertising backdrop continues to evolve; the team is expanding its partner network and is growing its direct sales force, building advertiser awareness for its differentiated brand-safe platform and positioning the business for ongoing growth throughout the year.

In summary, we are executing well against our strategy. While the business is delivering strong results, we believe we are only at the beginning of unlocking the full potential of our portfolio. And we look forward to demonstrating further progress against this potential in the coming quarters and beyond.

Now, I will hand over to Armin who will provide more color on our financial results. Armin.

Armin Zerza

Chief Financial Officer, Activision Blizzard, Inc.

Thanks, Daniel. I'm glad to be with you all for my first earnings call as CFO and would like to echo Bobby's and Daniel's comments in thanking Dennis. He has been a fantastic mentor and partner over the years and I wish him all the best for the future.

Now, let me review our record first quarter results as well as outlook for 2021 and the second quarter. Our first quarter revenue and earnings per share were well ahead of our prior outlook driven by better-than-expected performance for Call of Duty and Candy Crush. Net bookings grew 36% year-over-year to \$2.07 billion and segment operating income grew 59% to \$863 million. Total segment operating margin expanded 6 percentage points year-over-year, reflecting the high incremental margin associated with digital revenue stream.

Now let me turn to our segment results. Each of Activision, Blizzard and King contributed to top and bottom line growth in the quarter. Activision revenue was \$891 million, growing 72% year-over-year. Growth was driven by Call of Duty: Black Ops Cold War and Warzone in-game revenues, premium sales and Call of Duty Mobile. Operating income more than doubled year-over-year to \$442 million with an operating margin of 50%, 14 percentage points higher year-over-year.

Blizzard revenue was \$483 million, increasing 7% year-over-year with very strong growth for World of Warcraft partially offset by product timing. Operating income was \$208 million and Blizzard's operating margin was 43%, broadly consistent year-over-year.

King's revenue grew 22% year-over-year to \$609 million. This is a new record led by strong in-game revenue growth for Candy Crush. And advertising revenue grew 70% year-over-year. Operating income was \$203 million, growing 30% year-over-year even after increased investment in user acquisition. And King's operating margin was 33%, 2 percentage points higher year-over-year. Finally, across all segments, in-game net bookings grew 40% year-over-year to \$1.34 billion representing 65% of overall net bookings with each of Activision, Blizzard and King contributing to the strong performance.

Okay. Now let's turn to our overall consolidated results. And unless otherwise indicated, I'll be referencing non-GAAP figures. As always, please refer to our earnings release for a full GAAP to non-GAAP reconciliation.

Now, for the quarter, we generated Quarter 1 GAAP revenues of \$2.28 billion, \$260 million above our February outlook. This includes the net recognition of deferrals of \$209 million. And net bookings of \$2.07 billion were \$316 million above our outlook. And we generated GAAP EPS of \$0.79 and Quarter 1 non-GAAP EPS of \$0.98, which was \$0.14 above our February outlook. These figures include the net recognition of deferrals of \$0.14.

Now turning to cash flow and the balance sheet. Our strong business fundamentals also drove substantial cash flow generation in the quarter. We delivered operating cash flow of \$844 million, significantly higher year-over-year reflecting higher operating income, tax settlements in the year-ago quarter and changes in working capital. Our cash and investments at the end of March were approximately \$9.5 billion. And we ended the quarter with a net cash position of approximately \$5.9 billion. And as previously announced, this week we'll pay an annual dividend of \$0.47 per share, 15% higher year-over-year.

Now let me turn to our outlook for Quarter 2 and the full year. Regarding the slate, our expanded teams are focused on delivering epic in-game and upfront content. This means that we'll continue to support our franchises with new in-game content, events and features, all of which are critical elements of our business as we focus on keeping our communities engaged and drive year-round player investment.

In terms of upfront releases, we will release WoW: Burning Crusade Classic in the coming months. And we are looking forward to launching Diablo II: Resurrected and the latest premium release of Call of Duty in the second half of the year. And on mobile, we continue to plan for the launch of Diablo Immortal in the second half, although it is customary we do not include meaningful contributions from new mobile launches in our outlook.

Now, before I discuss the specifics of our outlook, let me provide some context. The year is off to a very strong start. Our growth initiatives continued to deliver great results in the first quarter and our momentum has continued across all of our key franchises into the second quarter.

Competition for talent remains high. And in this context, we have been increasing our investment in creative and commercial talent to deliver even more compelling experiences across our portfolio for the remainder of the year. As a result, we feel great about our ability to continue delighting and engaging our community. So while it is still early in the year and we remain prudent in our assumptions, we are raising our outlook for full year net bookings and earnings per share.

From a [ph] phasing (00:30:12) perspective, as discussed on the last earnings call, Call of Duty faces a difficult year-over-year comparison in Q2 since premium services a year ago benefited from the launch of Warzone, product timing and the introduction of shelter from home mandates. We also intend to take advantage of our strong business momentum to increase marketing around new content in Q2. We therefore continue to expect total segment operating profits to be lower year-over-year in the second quarter with stronger year-over-year performance in the second half of the year as we deliver against our second half pipeline.

Now let me get into the specifics. For Quarter 2 on a GAAP basis, we expect revenues of \$2.14 billion including the net recognition of deferrals of \$285 million. We expect net bookings of \$1.85 billion. We expect a GAAP operating margin of 39%, a tax rate of 21%, GAAP and non-GAAP sharecount of 785 million and EPS of \$0.81. For Quarter 2 on a non-GAAP basis, we expect a tax rate of 18% and non-GAAP EPS of \$0.91 including the net recognition of deferrals of \$0.21.

Now turning to the fiscal on a GAAP basis for 2021, we now expect revenues of \$8.37 billion including net deferrals of \$230 million. We now expect net bookings of \$8.6 billion. We expect a GAAP operating margin of 36%, a GAAP tax rate of 22%, GAAP and non-GAAP sharecount of 787 million and GAAP EPS of \$2.91. For 2021 on a non-GAAP basis, we expect a tax rate of 20% and non-GAAP EPS of \$3.42 including net deferrals of \$0.28.

So to close, in Q1, we continued to deliver strong results across our largest franchises and our momentum has continued into Q2. We are making great progress on our pipeline which includes key content that we expect to deliver another step change in financial performance in 2022 as well as unannounced initiatives that we expect to drive longer-term growth for the company.

We have a combination of leading owned franchises, best-in-class developer and commercial talent and expertise across platforms and business models, all of which create a powerful platform for sustained financial performance. We remain focused on execution and operational discipline and committed to profitable growth to drive shareholder value over the long term.

Now, I'll ask our business leaders, Rob, Humam, and J. to join Bobby, Daniel and myself to answer your questions. Operator.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Tyler Parker with KeyBanc Capital Markets. Please go ahead.

Tyler Parker

Analyst, KeyBanc Capital Markets, Inc.

Q

Great. Thanks for the question. I just wanted to ask about consumer behavior as we reopen and vaccines start to roll out or are rolling out more significantly. The question is are we seeing any effects on engagement outside of the typical seasonal trend? Thanks.

Daniel I. Alegre

President & Chief Operating Officer, Activision Blizzard, Inc.

A

I'll take that and thanks, Tyler. Thanks for the question. But first and foremost, it is clearly great news that the regions are starting to reopen. It's great to see people out and about and obviously healthy. We've been looking at engagement trends very, very closely. And as you'd probably expect, the trends vary between the franchises depending on the nature of the audience and also the type of the game.

Now we do see some variation between regions that are reopening versus those that are locking back down. But overall, as we continue to execute against our strategy, we really continue to see strong engagement across each of our largest franchises. And importantly, player investment really remains very consistent across regions and that's important to note.

Now I'd reiterate while we have seen some benefit from sheltering from the home similar to the rest of the gaming industry, we do believe that much of the expansion that we've seen in our largest franchises is due to product initiatives that we've implemented be it the launch of Warzone and Call of Duty Mobile or the introduction of Classic and a great WoW expansion in Shadowlands or our work to grow the payer base and deliver more frequent compelling content in Candy. And I think some of the comments you heard today support that in terms of how April went for us even as some of the regions have continued to open.

For instance, Call of Duty Season 3 is on a similarly strong trajectory as we've seen for Season 1 and Season 2. The current season of Call of Duty Mobile is tracking as the best yet in terms of player investment in the West. And World of Warcraft is performing very well with strong engagement ahead of the upcoming launch of Burning Crusade Classic. And you can't ignore Candy. Candy is continuing to grow year-over-year against really tough comps.

So these trends really do show our ability to build on the expansion that we've already seen in some of our franchises even as regions reopen. And as we look forward, we see a long-term trend of more people gaming than ever before in more geographies and on more platforms. And that's been going on for decades. And we only see that continuing with gaming becoming an even more significant form of social connection and obviously entertainment.

So it's great to see so many people being vaccinated around the world and some regions reopening. And we're encouraged by the fact that we're seeing engagement as economies reopen. But as ever, we remain prudent on our outlook and I appreciate your question. Hopefully that answers it. Next question.

Operator: Your next question comes from Alexia Quadrani with JPMorgan. Please go ahead.

Alexia S. Quadrani

Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. Can you discuss the ongoing integration of Warzone with Black Ops? And maybe circling back to your comments on the launch of Call of Duty Mobile in China, any more color you can provide perhaps on terms of engagement and monetization there or perhaps if you can touch on where you see the opportunity longer term.

Rob Kostich

President-Activision, Activision Blizzard, Inc.

A

Hey, Alexia. It's Rob Kostich. I'll take this one. Well, I guess before I get into those questions directly, I do think it's worth stepping back and noting some of the incredible milestones we've hit across the Call of Duty ecosystem which is what we've been focused on building more holistically.

Warzone, which you've probably seen, which has obviously been transformational to our business in so many ways, has now crossed 100 million players. Our premium Call of Duty games have now sold over 400 million copies life-to-date on the franchise. And Call of Duty Mobile has now crossed over 500 million downloads. So remarkably, after all these years, the franchise has never been stronger or more widely played. And for that, we are just super thankful for the community's ongoing support. And we're more committed than ever to provide them with the best possible experiences in the years that lie ahead.

Now with respect to the integration of Warzone and Black Ops, we're really pleased with the integration. You've heard some of the financial results already on the call. Season 3 has maintained the great momentum of Seasons 1 and 2. And when you look at even other factors, Season 3 set a new viewership record for us at reveal with over 2 million streaming viewers. And this is higher than even Warzone's launch in March of last year. And this just continues to demonstrate the strength of our direct connection we have with our players. And with all that said, we still truly and fundamentally believe we are just scratching the surface of what Warzone can expand into for the community and that's the exciting part. And thanks to our world-class development and publishing teams, we certainly believe the future of Warzone has never looked better.

Now as we look ahead for Warzone later this year, there'll be some other really fun integrations with the great work that Sledgehammer Games is leading for this year's new premium release. And Daniel mentioned this already. It's worth noting that Sledge as a studio now is also stronger than ever. The studio has expanded its very talented team across its Foster City and Melbourne locations and now is even expanding further with Sledgehammer Toronto. Most importantly, at the end of the day, we believe fans are going to be really, really excited and are going to love what the studio is building. That's what it's all about in this business. And we can't wait to share more on this front.

And finally, back to just your question on mobile. We talked about a lot of the data, I think, on the call a little bit. But mobile is live in China as you know, doing very well. The West continues to perform very strongly. And globally to date, Call of Duty Mobile has now crossed over \$1 billion in player investment in addition to the over 500 million downloads around the world. The current season is referenced Tokyo Escape is tracking to the – as the highest grossing to date. So what I would say is overall our teams are just continuing to execute really well across the East and the West and we continue to see really strong opportunities in all regions. And we'll remain very, very excited for the future of this platform and the broader Call of Duty ecosystem. Thank you for the question.

Christopher Hickey

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

A

Thanks, Alexia. Can we have the next question please?

Operator: The next question is from Ryan Gee with Bank of America. Please go ahead.

Ryan Gee

Analyst, BofA Securities, Inc.

Q

Hey. Good afternoon, everyone. Great results. Thanks for taking the question. Last quarter you guys talked about the breadth of content in the Blizzard pipeline. So it would be great if we could get an update on how the Blizzard teams are progressing on the projects you've already announced, namely, Overwatch 2 and Diablo IV. And then if you could talk a little bit more about what else might be in the pipeline, that would be great. Thank you.

J. Allen Brack

President-Blizzard Entertainment, Activision Blizzard, Inc.

A

Hi there. This is J. Thanks for the question. When we look at sort of the Blizzard development population, we've added hundreds of developers across our key franchises over the last few years. And we continue to invest in world-class development working to bring talent in from all around the globe. And the goal here is to execute on the plans that we have to create continuous content for players across all of our games.

Speaking of Overwatch 2, we got some great feedback from the player community around the development progress that we showcased in February at BlizzConline. And we feel really confident in both the game and the team. And they're going to continue to share updates about Overwatch 2 progress, new features to the live game going forward.

With Diablo, there's a lot of strong momentum right now. We have public testing that's taken place in both April and May for both Immortal and Diablo II: Resurrected. And we also have a lot of community interest around the development of Diablo IV as you mentioned. We're also continuing to make progress across multiple mobile titles that we've alluded to in the past. We really want to bring authentic Blizzard-quality experiences to all of the games that we have. And so for us, it's a pretty exciting time as we continue to work on PC, console and mobile expressions of all of our franchises. We feel like the IP and the franchises that we have are really full of a lot of potential. And we look forward to sharing more as these projects progress and we make more progress going forward. Thanks for the question.

Christopher Hickey

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

A

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

Operator: The next question is from Mike Hickey with The Benchmark Company. Please go ahead.

Mike Hickey

Analyst, The Benchmark Co. LLC

Q

Hey, guys. Congrats on your quarter. Thanks for taking my questions. And Dennis, best of luck to you. You will be missed. Great job. I guess on King, very strong performance you noted. I guess how sustainable do you see these trends in particular as you navigate the rollout of IDFA? Thanks, guys.

Humam Sakhnini

President-King, Activision Blizzard, Inc.

A

Hey. Thanks for the question, Mike. This is Humam. So as you noted, Q1 was a great quarter for King. We marked the five-year anniversary of King's acquisition and we did that with record financial performance across the business including our best revenue quarter ever. Now, as you've heard, we have momentum across both our in-game and advertising sides of the business and we expect that momentum to continue.

So on IDFA, I believe we're very well equipped as the industry navigates those IDFA changes. And we're equipped on both the advertising side and also on the user acquisition side. So let me give you a little bit of color on each of those. On the advertising side, with our Q1 [ph] exit (00:44:29) trajectory and including kind of the continued momentum we see in our direct business, that positions us well as we navigate those advertising changes. And as we look ahead, we are adding to that momentum with initiatives underway along some examples and product innovation where we're expanding kind of the number of ad products that we have in our network. We're expanding our partner network and our direct sales force. And we're broadening the categories of the advertisers that we work with.

And so when you put all those together, we believe we still have a long runway for growth in the advertising side. And we're constantly bringing in new brands, I should say, as we develop deeper and deeper relationships with brands across the category. As just one example, in the United Kingdom, we worked with Sky across three parts of three different areas of their business in Q1. And we were able to drive significant improvement in their brand metrics across recall, consideration and association of their brand. So with all of that, we continue to believe that there is a good trajectory there as the industry navigates with IDFA.

Now, as I turn on the other side which is our user acquisition, we have strong momentum in our in-app business. And we continue to leverage the strength of our brand as we invest in our live ops. And we invest also in ROI-positive marketing to deliver new installs and bring back returning players. So more broadly, as we put more live events like Candy Crush All-Stars and as we add more social features – as an example, the March launch of our competitive mode in Candy Soda – we are bringing more exciting moments that help us on that user acquisition. So all in all, current momentum is really good as you saw and we expect that momentum to continue. And we have confidence in our ability to deliver that over the next few quarters.

Christopher Hickey

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

A

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

Operator: Yeah. The next question is from Kunaal Malde with Atlantic Equities. Please go ahead.

Kunaal Malde

Analyst, Atlantic Equities LLP

Q

Hi, Armin. Congrats again on your new role. I was wondering if you could give us some color on your areas of focus going forward and what you might be looking to do differently than Dennis.

Armin Zerza

Chief Financial Officer, Activision Blizzard, Inc.

A

Yeah, thanks, Kunaal. Look, for me, it all comes down to execution. We have an incredible team. And as you've heard today, we also have an incredible pipeline. And we know when we execute that well; we not only delight our

players, but we also create attractive returns for our shareholders. So what you should expect from me is to focus on a few key areas.

Look, it all starts with a focus on shareholder value creation. This has always been a focus for the company. And frankly, we have never been better positioned. As you have heard today, all of our franchises have incredible potential. So I'm very focused on working with the teams to prioritize investment and resources towards our biggest value creation opportunities.

Next, as I mentioned, expect a very strong focus from me on execution excellence both creatively and commercially. And in that context, I do believe that the CFO has an important role to play in not just overseeing the achievement of our financial targets but also the progress against our operating and commercial plans. So you should expect me to leverage my experiences as Chief Commercial Officer of the company and Chief Operating Officer of Blizzard to help make sure that all of our franchises are set up for success. And then, of course, you should expect continued focus around financial discipline and organizational excellence.

Ultimately, our culture is centered around growth, operational discipline and financial conservatism and that won't change. So from an organizational perspective, finally, I continue to be focused on building a world-class team in order to support our growth plans that we have discussed today. So I hope that gives you a sense of how I'm approaching the role. But really what I'm looking forward to is getting out there and meeting all of you in the coming months. Thanks for your question, Kunaal.

Christopher Hickey

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

A

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

Operator: The next question is from Brian Nowak with Morgan Stanley. Please go ahead.

Brian Nowak

Analyst, Morgan Stanley & Co. LLC

Q

Thanks for taking my question. I want to ask one about Diablo mobile. Curious to hear about any learnings thus far from the Diablo mobile beta, things that are sort of working particularly well versus areas where you see room for further innovation. And then it's sort of a bigger picture one on Diablo. Talk to us about sort of the – how you think about the importance of a sequenced approach to having Diablo remaster, followed by mobile, followed by part IV to sort of really maximize the gamer interest. Thanks.

J. Allen Brack

President-Blizzard Entertainment, Activision Blizzard, Inc.

A

Yeah, thanks a lot for that question. I personally am a massive fan of Diablo. I have put in thousands of hours into various Diablo games over the decades. And we're all very excited about the overall strategy and the direction of the games that you mentioned.

When we think and look at Diablo, we've got three upcoming releases that we expect to really expand the audience and really delight the community and exceed their expectations. So Diablo II: Resurrected is bringing – we think of this as really a true classic in gaming into the modern gaming world for both new fans and fans that really are going to come back and play it again.

Diablo Immortal, the point there or the goal there is to broaden the audience, bring an authentic version of Diablo to mobile. And then with Diablo IV, that's going to be our next mainline title that we feel is going to advance the art of the action RPG genre. And so it's really never been a better time in the history of Diablo to be a Diablo fan. We've seen positive reception to the development progress that we shared this year for Diablo IV. We announced a new class, the rogue, at BlizzConline. And the team is continuing to progress through important internal development milestones.

With Diablo Immortal, it's currently in the second phase of testing. We've introduced another new class. We've introduced new zones. And we've also introduced first time to the public the high end in-game and PvP content. And we've seen the community respond pretty positively thus far, particularly around the systems design. And we're looking forward to more of their feedback as testing continues. On top of being an authentic Diablo experience on mobile, Immortal is also bridging a narrative gap between the events of what happened at the end of Diablo II and the start of Diablo III. And so that's bringing additional storytelling into the franchise.

And then lastly, Diablo II: Resurrected recently completed its first public test and the reception that we received was really great. The original Diablo II is a landmark game in Blizzard's history that we're really happy that we've been able to kind of reintroduce this experience to new players and spark renewed passion in players who really love the original. And so the overall strategy for Diablo is to really provide players with different ways to engage in the franchise on their platform of choice. And we think that this will welcome all kinds of people all around the world into the Diablo player community. Thanks for the question.

Christopher Hickey

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

A

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

Operator: And the next question is from Andrew Uerkwitz with Jefferies. Please go ahead.

Andrew Uerkwitz

Analyst, Jefferies

Q

Hey. Thanks for taking the question. There has been quite a few game delays in 2020 and so far in 2021. Obviously, consoles are very hard to find. Could you talk about how this may have impacted game development for you or is impacting game development? Are you hiring more? Are you limiting scope? Are you pushing out timelines? And then, lastly, how are you balancing all of this with crunch and kind of the other mental aspects for all of your employees working from home? Thank you.

Daniel I. Alegre

President & Chief Operating Officer, Activision Blizzard, Inc.

A

This is Daniel again and thank you, Andrew, for the question. First of all, our focus is absolutely ensuring the health and safety of our employees. This means both physical and psychological. And we've been in constant touch with our team managers to ensure that our employees are kept safe and also that they're able to find the time that they really need to recharge when needed.

Early on in the pandemic, Bobby shared his personal telephone number with each and every employee for them to reach out if they needed any help. And I'm personally very proud of our company's response and also just amazed by the talent in our organization who have adopted to so many curveballs that this pandemic has really thrown at people.

As for your question on game development, we are fortunate that to date we really haven't seen any significant impact to game development with our current games in pipeline because we're really meeting our pre-COVID milestones. And as we have seen in 2020 and also in early 2021, we've delivered the games that our players have expected and with the quality that really defines our company. And we also have been very fortunate that we haven't had to compromise game scope. And our players have as a result gotten just the best value for the money. So it's been incredible to see.

Now, as mentioned in previous earning calls, we have reopened some of our studio capabilities in a limited fashion for areas that really needed it like motion capture, for instance. And that was really to ensure that we just stayed on top of our milestones. And in each case, we obviously ensured strict adherence to heightened COVID testing and separation protocols that have ensured that our employees were kept safe.

But having said that, we recognized with our strategy of increasing game content and frequency as well as doubling down on live operations, we must and we have to continue to grow our developer base. And this is why we recently announced, as Bobby alluded to in his opening remarks, the goal to hire 2,000-plus developers over the coming few years. And we're actively hiring around the globe and we have the benefit of having studios in cities across Asia, Europe and of course across the Americas. So our teams are really adept at working across geographies. And you'll see us opening or expanding studios in locations such as Poland and Toronto, for instance, to give us access to some of the great pools of talent to really help us deliver on even more content in the years ahead. Thanks again, Andrew.

Christopher Hickey

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

A

Operator, can we have the next question please?

Operator: The next question is from Gerrick Johnson with BMO Capital Markets. Please go ahead.

Gerrick L. Johnson

Analyst, BMO Capital Markets Corp.

Q

Good afternoon. Thank you. So your peers have been active – some of your peers have been active in M&A recently. What is your perspective on inorganic growth now that we're sitting here five years after the King acquisition? Thank you.

Armin Zerza

Chief Financial Officer, Activision Blizzard, Inc.

A

This is Armin. Thanks, Gerrick. Look, we haven't changed our approach. We have a very strong track record of being balanced and disciplined in how we allocate capital across investing into organic business growth, returning capital to shareholders via buybacks and dividends as well as strategic M&A. And on M&As specifically, we have completed several transactions that have created significant value. As you mentioned, King is a great example of that. We mentioned today that we just celebrated the fifth anniversary of its acquisition, which gave us a leadership position in mobile at a valuation that delivered significant value to our shareholders as you know.

Now, when we look at the industry today, we do continue to see scale benefit. Look, as you know, we are still only 4% of a very fragmented market even though we are the leading standalone game publisher in the West. But we will and we can afford to be disciplined in our approach around the key criteria which we believe are essential for value creation through M&A. And among those, we generally look for large established franchises or technologies

that have the potential for scale. We also look for strong leadership teams with a strong track record of profitability. And then, of course, we look for an attractive valuation that [ph] keeps (00:58:57) our return threshold.

That's a pretty high bar and it can be difficult to find the right target that meets these criteria, especially as you mentioned with so much capital in the industry right now. But as I mentioned, we can afford to be and we will stay disciplined, frankly, even more so with the significant organic growth opportunities we have. So we will remain patient for the right opportunities. It's an approach that has served the company well for the last 30 years and we believe will serve us well into the future. Again, thanks for your question.

Christopher Hickey

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

A

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

Operator: And that question will come from Colin Sebastian with Baird. Please go ahead.

Colin Alan Sebastian

Analyst, Robert W. Baird & Co., Inc.

Q

Thanks and good afternoon. First, just to congratulate Armin on the new position and to wish Dennis all the best in what's next.

I know you touched on some of this already. But I wanted to follow up a bit more on the broader mobile development strategy including the genres and types of mobile games that you may be exploring both within the existing franchise base as well as extending out perhaps to new experiences. Thanks.

Daniel I. Alegre

President & Chief Operating Officer, Activision Blizzard, Inc.

A

Great. Thanks, Colin. And I'll take this last question. It's Daniel again. Look, we believe our franchises absolutely have to be accessible wherever the players are. And that obviously includes mobile not only in developed countries but even more so in developing countries. And mobile is just the ultimate driver of reach with almost 3 billion smartphones worldwide and that's forecasted to increase to 4 billion in the next five years. We are really doing ourselves and a community a disservice if our games are not on those platforms. And that's why this is so critical to our strategy.

And the opportunity is crystal clear. A little known fact is most of the top 10 franchises on mobile worldwide are actually based on existing PC or console IP. And our franchises are in genres that are just particularly well suited for mobile. And they are amongst the few franchises in the industry to really have the appeal around the world including regions where mobile is the main way that people play core games. And as a result, we really want all of our franchises to be on mobile. And in some cases, there might be several different ways in which a franchise can be represented on mobile. You may have reimaginations of an IP on mobile in addition to games that are just more similar to an existing console or a PC experience.

And as a core part of our strategy, to make our franchise available across platforms, we've done a number of things. So obviously, we acquired King and that brought tremendous mobile talent which has proven to be the case through a continuing momentum in that business exemplified by what you just saw in our Q1 results. And we've also – as a company, we've leveraged the learnings from King across the business, platform engagement, live ops, user acquisition or managing game economies.

And across Activision and Blizzard; we started with Call of Duty Mobile, following up with Diablo Immortal that J. was just referring to. And we're also working on a number of Warcraft mobile titles and have some unannounced initiatives as well underway. So players will increasingly be able to enjoy these franchises they love on console, PC and on the mobile experiences we're building. So as you can tell, this is a real priority for us, a lot of investment. We're hiring hundreds of mobile developers to achieve these targets. And you should continue to see the results of this work in the coming quarters. Thanks, Colin.

Armin Zerza

Chief Financial Officer, Activision Blizzard, Inc.

Thanks, Daniel. Thank you all for your interest and participation. This concludes our call for today. And as I mentioned, I'm really looking forward to getting out there and meeting all of you in the coming months. Stay healthy.

Operator: The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.

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