

ELECTRONIC ARTS INC (EA)

Consumers



OVERVIEW

- Electronic Arts Inc. (NASDAQ: EA): Global Developer, Marketer, Publisher and Distributor of Video games and Digital Content.
- Platforms: Consoles, PCs, mobiles, tablets.
- Popular brands: EA Sports FC, Apex Legends.



01

Investment Mechanics

- Recommendation: £714 long position in EA at £130.
- Rationale: Robust financial health, diversity of revenue streams, focus on innovation and appealing capital structure.

02

Target Share Price

- Valuation: Target share price of £189.94.
- Expected increase: 47% based on forecasted earnings growth and market position.

03

Stop Loss

- Risk management: Stop-loss price set at £117 per share, limiting potential losses to approximately 10%.

Appealing Qualities

- Share price has changed around 20% over the last year (current share price c. £130)
- Revenue sources: game titles, licensing agreements, DLCs
- Forecasted revenue growth by 5.4% per annum
- Extensive and unique games portfolio, notable recognition for sport titles
- Health: Total assets at \$13.1 billion and total liabilities at \$5.7 billion
- Expenditure: R&D and Sales and Marketing helps with an advertisement advantage.
 - Advertising which surpassed consumer spending in 2023, is projected to top US \$1 trillion in 2026

DCF VALUATION

| Unlevered Free Cash Flow (mm) | | | | | | | | | | |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|----------|----------|
| Fiscal Year | 2020A | 2021A | 2022A | 2023A | 2024E | 2025E | 2026E | 2027E | 2028E | 2029E |
| Unlevered Free Cash Flow | 1,657 | 1,810 | 1,711 | 1,343 | 2,116 | 2,529 | 2,319 | 2,488 | 2701.506 | 2916.022 |

| Projection Year | 1 | 2 | 3 | 4 | 5 |
|---------------------------------|-------|-------|-------|-------|-------|
| Present Value of Free Cash Flow | 1,257 | 1,854 | 2,074 | 1,781 | 1,789 |

| Implied Share Price Calculation | |
|---------------------------------|---------------|
| Sum of PV of FCF | 8,755 |
| Growth Rate | 3% |
| WACC | 6.8% |
| Terminal Value | 78,511 |
| PV of Terminal Value | 56,435 |
| Enterprise Value | 65,190 |
| (+) Cash | 2,900 |
| (-) Debt | 1,748 |
| (-) Minority Interest | |
| Equity Value | 66,342 |
| Diluted Shares Outstanding (mn) | 274.22 |
| Implied Share Price | 241.93 |
| Current share price | 165 |
| upside | 47% |

| Sensitivity Table | | | | | | |
|-------------------|--------|-------------|--------|--------|--------|--------|
| | | Growth Rate | | | | |
| | | 2.00% | 2.50% | 3.00% | 3.50% | 4.00% |
| WACC | 241.93 | | | | | |
| | 5.83% | 250.69 | 284.02 | 329.13 | 393.64 | 493.49 |
| | 6.33% | 221.12 | 246.26 | 278.96 | 323.23 | 386.54 |
| | 6.83% | 197.70 | 217.26 | 241.93 | 274.02 | 317.47 |
| | 7.33% | 178.69 | 194.28 | 213.48 | 237.69 | 269.19 |
| | 7.83% | 162.96 | 175.64 | 190.94 | 209.79 | 233.56 |

| Weighted Average Cost of Capital (WACC) | |
|---|-------------|
| Equity (mm) | 41,143 |
| Debt (mm) | 1,748 |
| Cost of Debt | 3.3% |
| Tax Rate | 19.0% |
| D/(D+E) | 4.1% |
| After Tax Cost of Debt | 2.7% |
| Risk Free Rate (10-Yr Treasury Yield) | 4.2% |
| Expected Market Return | 7.8% |
| Market Risk Premium | 3.6% |
| Levered Beta | 0.78 |
| E/(D+E) | 95.9% |
| Cost of Equity | 7.0% |
| WACC | 6.8% |

TARGET PRICE -
\$241.93/ 189.94



An Intrinsic Calculation For Electronic Arts Inc. (NASDAQ:EA) Suggests It's 30% Undervalued

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In This Article:

EA -0.19%

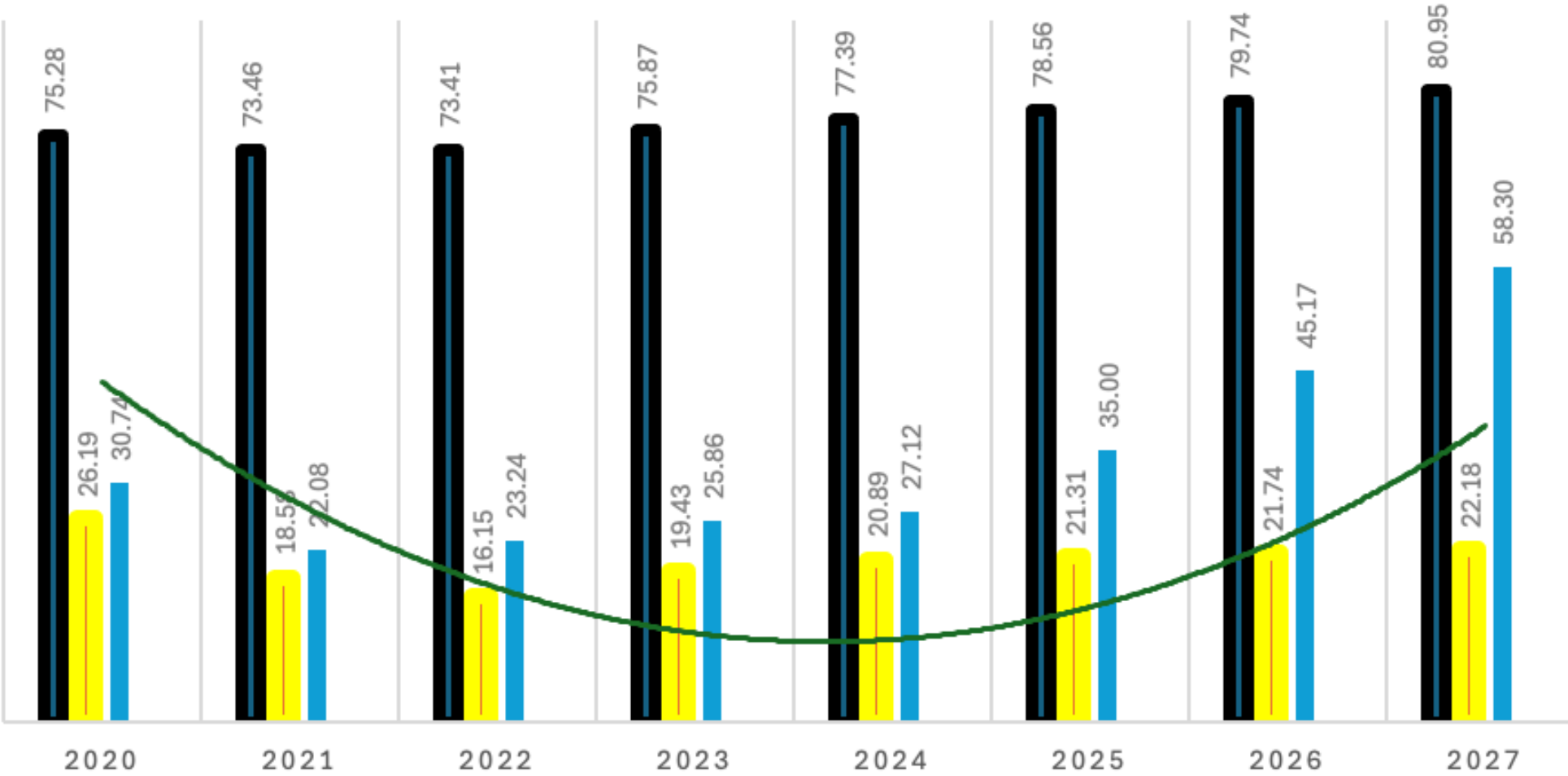
Key Insights

- The projected fair value for Electronic Arts is US\$240 based on 2 Stage Free Cash Flow to Equity

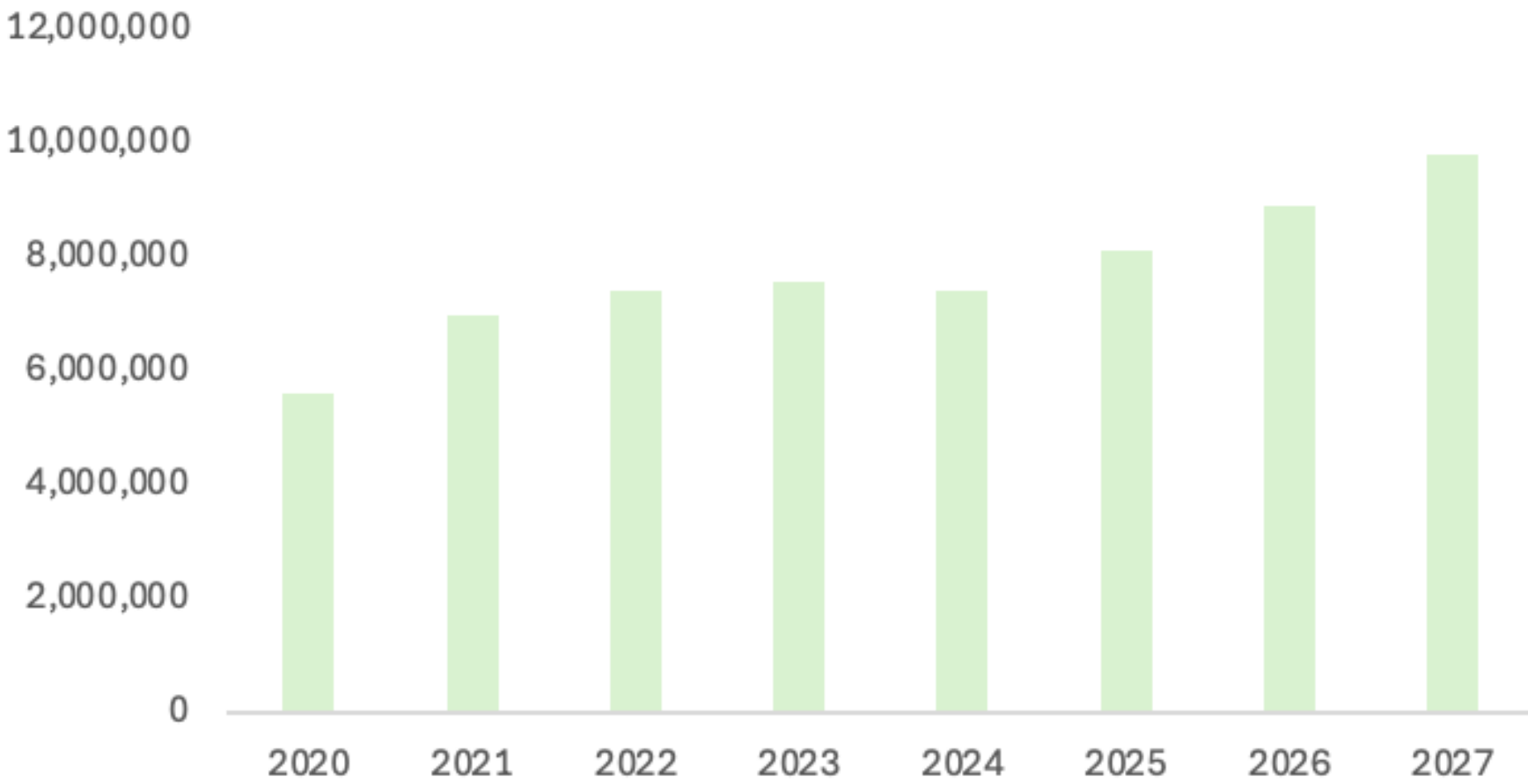
FINANCIAL ANALYSIS

PROFIT MARGINS

Gross margin (%) Operating margin (%) EBITDA margin (%)
Poly. (Net margin (%))



Total Revenue



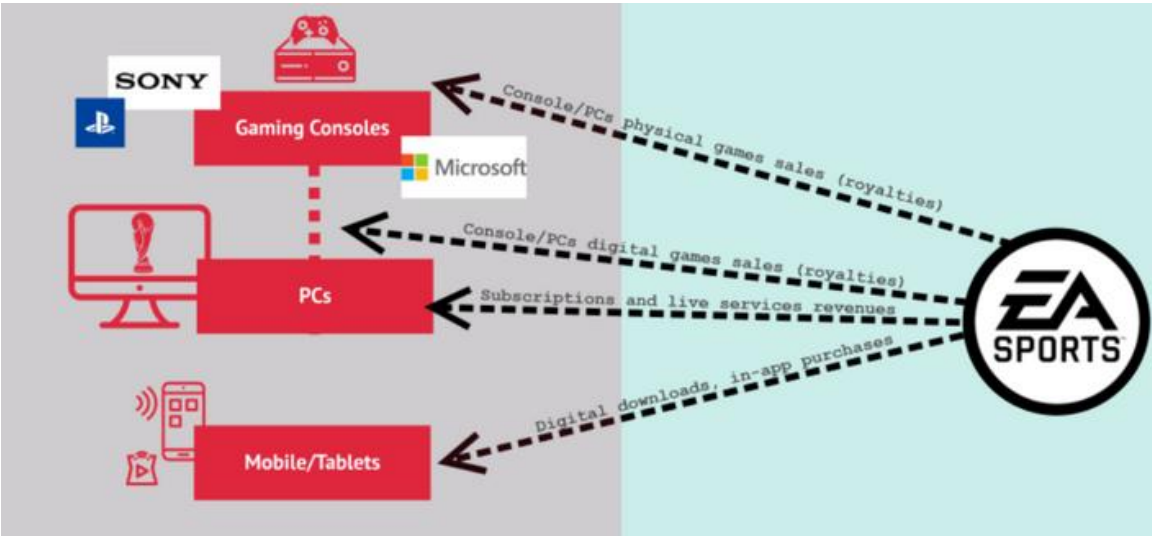
Financial Efficiency

| | | | | | |
|------------------------|--------|------------------------|-------|--------------------------|--------|
| Return on Equity (ROE) | 14.01% | Return on Assets (ROA) | 7.96% | Return on Capital (ROIC) | 11.30% |
|------------------------|--------|------------------------|-------|--------------------------|--------|


CORE OPERATIONS

Business model

- Multiple studios worldwide - EA Sports, EA Tiburon, EA DICE
- Game development
- Publishing
- Live services
- Utilises platforms such as Origin, Steam to distribute digital content
- Liscenising deals with the likes of FIFA, the NFL, and the NHL

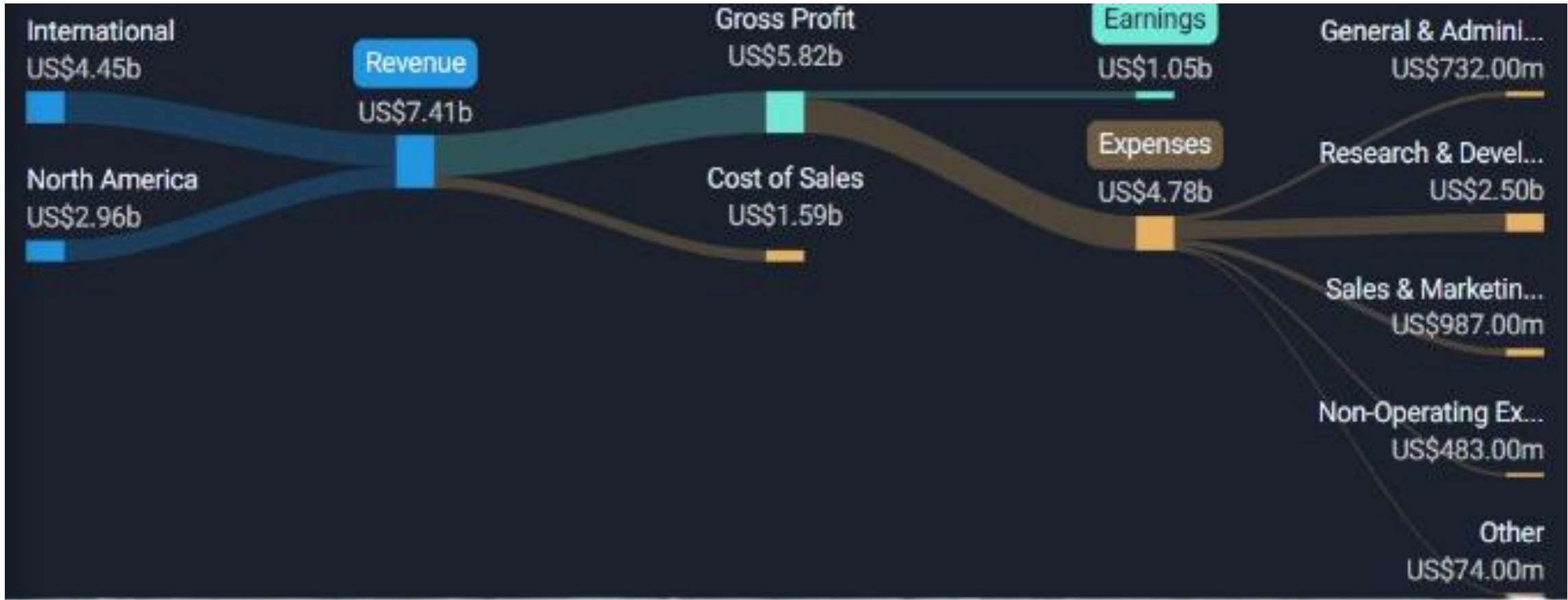
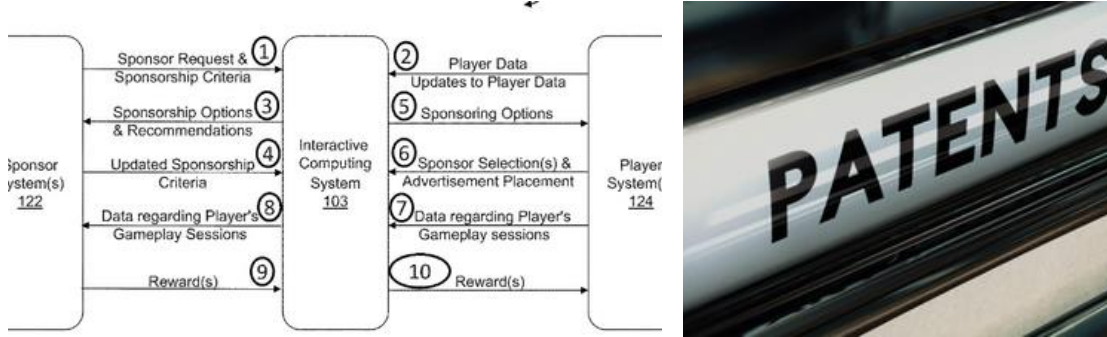


| | Sep 2024 | 5-quarter trend |
|--------------------------|-----------|-----------------|
| Capital Expenditures | -50.00 M | |
| Free Cash Flow | +184.00 M | |
| Cash Flow Per Share | +4.66 | - |
| Free Cash Flow Per Share | +4.28 | - |

**OAKWOOD**

Revenue

- 25% selling games
- 75% gained through live services of in-game sales (\$2.835 billion made from microtransactions over the last 12 months accruing \$361 million in profits)



R&D

- Around 35% of EA's total expenditure goes towards R&D. EA reported the organization spent \$1.7 billion on its internal technologies and infrastructure

Convenience

- Ability to install on multiple platforms - mobile, Xbox, PlayStation
- Cross-play services

Engagement metrics

- Net bookings for the recent 12 months was \$7.077 billion - increasing by 27%
- Approx 100 milliong players have engaged actively across all platforms with Apex Legends and The Battlefield 2042 in the first six months of the fiscal year (reaching highest active players since Season 1)

SWOT ANALYSIS

Strengths

Financial Robustness: Strong financial health

Strong portfolio of established franchises: FIFA, Battlefield, The Sims, Need for Speed

Increased focus on innovation and diversifying their digital platforms: Digital downloads, Subscription services, Live service games, Microtransactions

Weaknesses

Dependence on successful franchise releases: Increase risk taking on new projects

Inconsistent performance in non-sport titles: Market competition

Vulnerability to changes in gaming trends and high development costs: From emergence of new games to technological advances

Opportunities

Expansion into new market and genres: Mobile gaming, virtual worlds AR

Integration of AI in game development: Dynamic NPC behaviour, personalised gameplay, game testing

Increasing digital transformation and live services revenue: Streaming platforms, cloud gaming

Threats

Intense competition in the gaming industry: Brand loyalty not as prevalent, who's best wins

Potential market saturation in key genres: Many established players

Regulatory challenges related to in-game monetization: Loot boxes, limitation of purchases for unders 18s

PORTERS 5 FORCES

Threat of new entrants

- **Low barriers to entry**
- Intellectual capacity to develop a new idea/concept more valuable than access to resources

Bargaining power of buyers

- **Video games are highly discretionary** - consumers can choose where to spend their money
- **Gamers tend to have a pack mentality** - critics and their reviews can have major influence over a game's success
- Buyers sensitive to pricing strategies

Bargaining power of suppliers

- Suppliers provide both physical and intellectual property
- **Wide range of suppliers providing a wide range of resources**, if one or two were to raise prices it would only slightly increase costs

Rivalry among existing competitors

- **Brand loyalty is not as prominent in the gaming industry** - people change depending on who supplies 'the best'
- In order to stand out EA must continue to put out high quality rival

Threat of substitutes

- Biggest substitute would be **games playable on smartphones or tablets** - not only are they more accessible but usually marginally cheaper
- But, EA's USP?

ESG: AA MSCI ESG rating

Environmental

- Committed to being carbon neutral by 2027
- 93% of EA operations covered by renewable energy
- 100% carbon neutral (scope 1 and 2 emissions) for North America and European Operations

Social

- FC FUTURES
- 42% of EA charitable contributions are directed towards educational partnerships
- \$5.6 million in charitable givings

Governance

- Transparency issues regarding social and environmental metrics
- Audit committee and Nominating and Governance Committee reviews the people and culture initiatives

THANK YOU

FOR LISTENING