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COMPANY UPDATE / ESTIMATE CHANGE / RATING CHANGE

Key Metrics		
ATVI - NASDAQ (as of 11/7/17)		$60.96
Price Target		N/A
52-Week Range		$35.12 - $67.03
Shares Outstanding (mil) (basic)		755
Market Cap. ($mil)		$46,025
3-Mo. Average Daily Volume		5,840,000
Institutional Ownership ~		90%
Total Debt/Total Capital (9/17)		31%
ROE (TTM ended 9/17)		18%
Book Value/Share (9/17)		$13.20
Price/Book Value		4.6x
Annual Dividend & Yield	$0.30	0.5%
EBITDA Margin (TTM ended 9/17)		38%

EPS FY 12/31 (non-GAAP-based figures)

	2016	Prior 2017E	Curr. 2017E		Prior 2018E	Curr. 2018E
1Q	$0.23		$0.31	A		
2Q	$0.54		$0.43	A		
3Q	$0.52		$0.60	A		
4Q	$0.92	$0.89	$0.86			
Year	$2.20	$2.10	$2.20		$2.45	$2.53
P/E	27.7x		27.7x			24.1x

Notes: Quarterly EPS and revenue figures may not add to annual figure due to rouding.

Revenue ($mm) (non-GAAP-based figures)

	2016	Prior 2017E	Curr. 2017E		Prior 2018E	Curr. 2018E
1Q	$908		$1,196	A		
2Q	$1,609		$1,418	A		
3Q	$1,630		$1,902	A		
4Q	$2,452	$2,361	$2,384			
Year	$6,599	$6,700	$6,900		$7,225	$7,400

Company Description: *Activision Blizzard, Inc. is a worldwide online and console videogame publisher with leading market share positions across multiple product categories and geographies. It was created in 2008 from the combination of Activision, Inc. and Vivendi Games (parent of Blizzard Entertainment). Mobile game publisher King Digital Entertainment was acquired in early 2016.*

Activision Blizzard, Inc.

ATVI — NASDAQ — Neutral-2

Impressive 3Q Results; Moving to Neutral Rating

Investment Highlights

- **3Q results were strong.** Non-GAAP revenues of $1.902 billion were up 17% from a year ago, as each of the main operating segments (Activision, Blizzard, and King Digital) surpassed our expectation. The street consensus revenue estimate was $1.740 billion. One product highlight was *Destiny 2*, which was released in mid-September and sold encouragingly well, in our view.
- **Profits also exceeded expectations.** Gross margin was down due partly to initial disk-based sales and launch expenses for *Destiny 2*. However, operating expenses grew less than revenues, leading to a 15% gain in non-GAAP diluted EPS to $0.60 versus $0.52 a year ago. This was above company guidance of $0.45 and street consensus of $0.50. The company has produced considerable EPS "beats" in all three quarters of 2017.
- **The balance sheet remained solid.** Total cash and equivalents as of 9/30/17 were $3.576 billion. Total debt was $4.388 billion, or 31% of total capitalization. Interest coverage and leverage ratios were adequate, indicating additional borrowing power, if desired.
- **Management updated its financial guidance.** Non-GAAP revenue guidance for 2017 was set at $6.850 billion, up $275 million from the previous figure. Non-GAAP EPS guidance was set at $2.16, up $0.16 from the previous figure. We have fine-tuned our projections, which are slightly above company guidance.
- **We are raising our rating to Neutral from Underperform.** We are mindful of above-average valuations; however, we believe substantial long-term earnings power exists from nascent businesses such as e-sports (competitive gaming with worldwide viewing). Recent developments such as sales of team franchises and securing of corporate sponsorships could be viewed as favorable indicators for this initiative, in our view. Our Suitability rating remains 2.

Note Important Disclosures on Pages 6-7.
Note Analyst Certification on Page 6.

Exhibit 1
Non-GAAP Consolidated Statements of Operation (figures in millions except per share data and percentages)

	Quarter Ended			Nine Months Ended		
	9/30/17	9/30/16	% chg	9/30/17	9/30/16	% chg
Console	$794	$417	90.4%	$1,400	$1,184	18.2%
PC	469	691	(32.1%)	1,381	1,623	(14.9%)
Mobile and Ancillary	550	455	20.9%	1,521	1,171	29.9%
Other	89	67	32.8%	214	169	26.6%
Total Revenues	1,902	1,630	16.7%	4,516	4,147	8.9%
Cost of Sales	593	425	39.5%	1,266	1,081	17.1%
Gross Profit	1,309	1,205	8.6%	3,250	3,066	6.0%
Product Development	258	238	8.4%	709	639	11.0%
Sales & Marketing	266	257	3.5%	657	630	4.3%
General & Admin.	160	135	18.5%	438	382	14.7%
Total Operating Expenses	684	630	8.6%	1,804	1,651	9.3%
Income from Operations	625	575	8.7%	1,446	1,415	2.2%
Net Income	$458	$397	15.4%	$1,027	$974	5.4%
Diluted Earnings Per Share	**$0.60**	**$0.52**	15.0%	**$1.34**	**$1.29**	3.9%
Avg. Diluted Shares Outst.	766	756	1.3%	764	753	1.5%
% of Net Revenues:			**bp chg.**			**bp chg.**
Gross Profit	68.82%	73.93%	(510)	71.97%	73.93%	(197)
Product Development	13.56%	14.60%	(104)	15.70%	15.41%	29
Selling & Marketing	13.99%	15.77%	(178)	14.55%	15.19%	(64)
General & Admin.	8.41%	8.28%	13	9.70%	9.21%	49
Income from Operations	32.86%	35.28%	(242)	32.02%	34.12%	(210)
Net Income	24.08%	24.36%	(28)	22.74%	23.49%	(75)

Source: Activision Blizzard, Inc. Note: December year end

Additional comments on 3Q results. Our presentation and analysis of results focuses on non-GAAP figures. This excludes changes in deferred revenues and related costs with respect to certain online-enabled videogames, stock-based compensation expenses, restructuring and impairment charges, and income tax adjustments associated with these factors.

We were positively surprised by ATVI's 3Q results, as revenues and profits exceeded our expectations. New videogame release *Destiny 2* in September garnered generally favorable reviews and demand from retail, while player engagement levels for established franchises such as *Overwatch* and *Call of Duty* were strong. *Overwatch* was released in May 2016 for consoles and PC, and comparisons remain a bit difficult to first-year sales. However, it has become Blizzard's fastest game ever to reach 30 million registered players.

At mobile game developer King Digital (a February 2016 acquisition), total revenues were up, the number of paying players rose for the first time since 1Q 2016, and gross bookings per player (a modified revenue measure) grew for the ninth consecutive quarter. *Candy Crush* has been the steadiest contributor during that period. In addition, product development efforts are robust at King Digital.

Overall, we liked ATVI's operating performance for the quarter, with revenues and earnings surpassing year ago and guidance levels. We note the company's monthly average user figure of 384 million, a healthy figure we believe may bode well for the future. We also liked the continued strength in higher margin digital business; revenues through digital/online channels represented 77% of 3Q revenues, a relatively high figure considering post-launch physical disc sales of *Destiny 2*.

Financial condition. We consider ATVI's balance sheet to be in good shape, with strong cash flows leading to significant year-over-year improvement. Net debt (after considering the cash balance) at 3Q period end was about $800 billion. This figure was $2.440 billion one year ago and $1.642 billion at 12/31/16. Net debt divided by twelve-month trailing adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) was a conservative 0.3x, down from 1.2x one year ago. We believe ATVI has considerable borrowing capacity, if needed. Shareholders' equity at 3Q end was $9.967 billion.

E-sports update. A major achievement in the recent 3Q period, yet not reflected in the financial results, was further development of the company's e-sports initiatives. The inaugural season of the company's *Overwatch League* will begin in January 2018. Franchises have been sold to 12 teams, with owners/buyers including some high-profile figures with sports/entertainment/business backgrounds. In addition, ATVI recently announced league sponsorship deals with HP and Intel. The *Overwatch League* will involve world-class players/teams competing against each other, with viewing options either live (ex: Blizzard Arena in Los Angeles) or worldwide streaming (ex: gaming consoles/Internet). Also, the 11th annual BlizzCon event was held in early November in Anaheim, where festivities including final rounds of several e-sports tournaments based on Blizzard franchises. Finally, plans continue for the upcoming season of *Call of Duty World League* in December, featuring the largest prize pool in franchise history.

As a refresher, we note e-sports essentially entails competitive gaming with key roles coming from participants, event organizers, team leaders/owners, viewers, and advertisers. This is a nascent initiative that is beginning to grow rapidly, and the videogame industry's size and demographics could help this turn into a meaningfully positive business model, in our view. Further, we believe ATVI has numerous videogame franchises well-suited for competitive dynamics and global viewership. Associated revenue streams from competitive gaming leagues could be multi-fold, in our view, including live streaming media rights, franchise fees, sponsorship deals, and advertising.

At this time, we believe it is difficult to quantify the near-term impact of e-sports, including revenue and expense levels, but we are generally bullish on the long-term potential. ATVI management stated that revenue recognition of team/franchise sales will be partially offset by investments required to launch operations, including marketing expenses related to the inaugural season. Management has repeatedly stated it is building the e-sports business for the long-term, but acknowledged some 2017 revenue recognition is likely, with break-even EPS impact for the year. We will be closely monitoring the company's and industry's e-sports initiatives.

Outlook. Major contributors in 4Q are expected to include *Destiny 2* (September 2017 release), *Call of Duty: WWII* (November 2017 release), continued success from numerous Blizzard franchises, and greater revenue generation from King Digital's mobile platform. Financial guidance for 2017 was raised from previous figures, based mostly on strong 3Q results. Although it came as no surprise to us given the conservative tendencies of management, 4Q guidance was a bit below recent street consensus figures. Management projects full-year 2017 non-GAAP revenues of $6.850 billion and non-GAAP EPS at $2.16. Our new estimates for these metrics—$6.900 billion in revenue and $2.20 in EPS—are above company guidance, which we view as conservative. This would set a new record for revenues and match last year's record EPS.

We have also raised our 2018 outlook. We project non-GAAP revenues of $7.400 billion and non-GAAP EPS of $2.53 compared to our previous figures of $7.225 billion and $2.45, respectively. At this point, we have not factored e-sports into our 2018 outlook to a meaningful degree. Once the league launches and economics (revenues and expenses) are clearer, we could update our outlook.

We continue to believe the videogame industry is at a favorable point in its business cycle. We consider ATVI's fundamentals to be strong with a growing portfolio of successful franchises and a continued focus on higher margin digital business. Furthermore, we view the longer term as particularly interesting, as the company has recently launched several new businesses that could add to long-term growth. These include e-sports, consumer products, movies, and television.

Stock valuation. ATVI shares are currently trading at approximately 28x and 24x our 2017 and 2018 non-GAAP EPS estimates, respectively. This translates into an approximate 25x multiple on our estimate of forward twelve-month EPS. According to Thomson Reuters, the forward multiple range for ATVI over the past five years is 10x-28x, with a median of 18x. However, multiples in recent years have typically been in the upper end of that range; we believe this is directly related to the company's strong operating results and expanding growth opportunities.

Opinion. We believe 2017 is likely to be a good year for ATVI. Prospects for 2018 also seem attractive considering the product pipeline and new businesses being launched. We believe there are some uncertainties, such as those associated with the e-sports initiative (economics and magnitude of the business, the competitive environment, and long-term viability).

We believe ATVI is a best-in-class operator with an exciting growth-oriented future. The company's fundamental outlook is strong and its cash flow generation potential is healthy, in our view. Substantial year-to-date price appreciation has kept ATVI shares out of our buying range. With a recent pullback in the stock price, and considering a potentially new wave of growth on the horizon in the form of e-sports, consumer products, movies, and television initiatives, we believe a Neutral rating is more appropriate than our previous Underperform rating.

Suitability. Our Suitability rating on ATVI is 2 on a 1-to-4 scale (1=most conservative, 4=most aggressive). Factors on which our Suitability rating is based include earnings history, market capitalization, financial condition, and the cyclical nature of the industry.

Risks. Factors that could affect the outlook for the company and the stock price include overall indebtedness to support recent growth initiatives; potential uses for the company's cash balance and future cash flow; the industry's hardware replacement cycle including consumer demand for current and future consoles; creative and financial abilities to bring popular games to market; healthy relationships with the major hardware manufacturers; consumer sentiment toward the company's key franchises; prospects for competitive gaming/e-sports, general economic conditions, and consumer spending habits.

Exhibit 2
Non-GAAP Consolidated Statements of Income (figures in millions except per share data and percentages)

	2013	2014	2015	2016	*2017E*	*2018E*
Console	$2,895	$2,686	$2,700	$2,220	*$2,360*	*$2,500*
PC	1,124	1,720	1,565	2,428	*2,100*	*2,225*
Mobile & Ancillary	0	0	0	1,586	*2,000*	*2,200*
Other	323	407	356	365	*440*	*475*
Net Revenue	4,342	4,813	4,621	6,599	*6,900*	*7,400*
Cost of Sales	1,479	1,684	1,477	1,919	*2,020*	*2,060*
Gross Profit	2,863	3,129	3,144	4,680	*4,880*	*5,340*
Product Development	551	549	621	911	*975*	*1,035*
Sales & Marketing Exp.	599	704	725	928	*980*	*1,045*
General & Admin. Exp.	358	349	332	507	*565*	*590*
Total Oper Exp.	1,508	1,602	1,678	2,346	*2,520*	*2,670*
Operating Income	1,355	1,527	1,466	2,334	*2,360*	*2,670*
Int. Inc. (Exp.) & Other	(53)	(202)	(200)	(214)	*(180)*	*(160)*
Income Before Taxes	1,302	1,325	1,266	2,120	*2,180*	*2,510*
Provision for Taxes	303	268	277	450	*501*	*577*
Net Income	$999	$1,057	$989	$1,670	*$1,679*	*$1,933*
Diluted EPS	**$0.94**	**$1.42**	**$1.32**	**$2.20**	***$2.20***	***$2.53***
Wtd. Diluted Shares Outst.	1,035	726	739	753	*764*	*765*
% Year Over Year Chg.						
Net Revenue	(12.93%)	10.85%	(3.99%)	42.80%	*4.56%*	*7.25%*
Gross Profit	(14.54%)	9.29%	0.48%	48.85%	*4.27%*	*9.43%*
Operating Income	(20.53%)	12.69%	(3.99%)	59.21%	*1.11%*	*13.14%*
Net Income	(26.38%)	5.81%	(6.43%)	68.86%	*0.51%*	*15.14%*
As a % of Net Revenue:						
Gross Profit	65.94%	65.01%	68.04%	70.92%	*70.72%*	*72.16%*
Product Development	12.69%	11.41%	13.44%	13.81%	*14.13%*	*13.99%*
Sales & Marketing Exp.	13.80%	14.63%	15.69%	14.06%	*14.20%*	*14.12%*
General & Admin. Exp.	8.25%	7.25%	7.18%	7.68%	*8.19%*	*7.97%*
Operating Income	31.21%	31.73%	31.72%	35.37%	*34.20%*	*36.08%*
Net Income	23.01%	21.96%	21.40%	25.31%	*24.33%*	*26.12%*
Tax Rate	23.27%	20.23%	21.88%	21.23%	*23.00%*	*23.00%*

Source: Activision Blizzard, Inc. and Hilliard Lyons estimates Note: December fiscal year

Additional information is available upon request.

Prices of stocks mentioned: Vivendi SA - VIVHY - $24.85
HP Inc. - HPQ - 21.38
Intel Corp. - INTC - $46.78 - Long-term Buy

Analyst Certification

I, Jeffrey S. Thomison, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

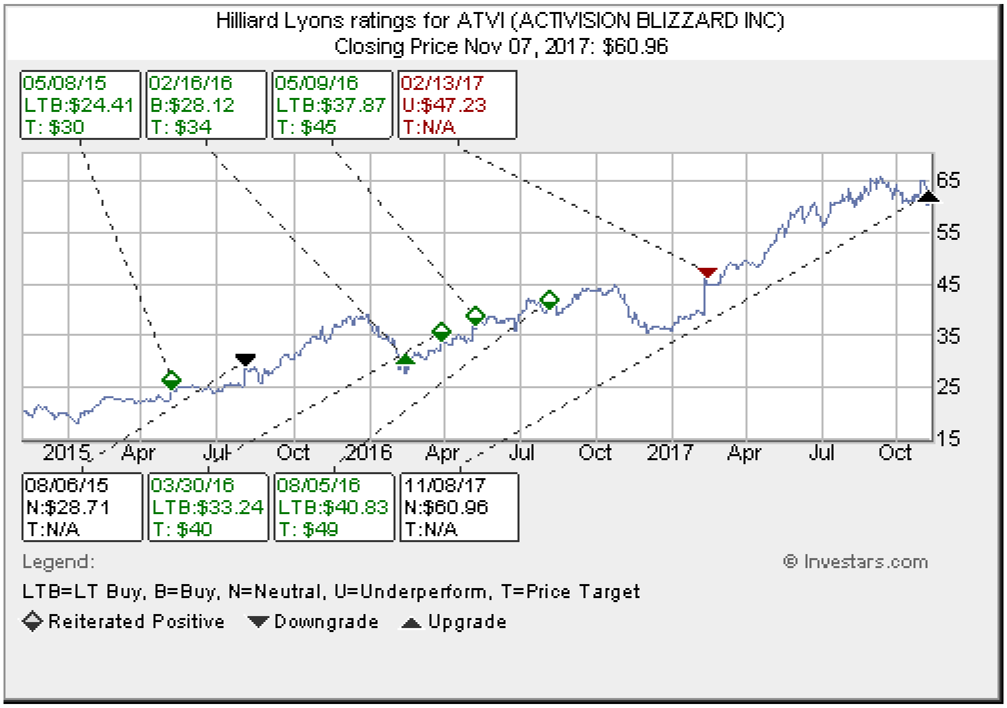
The author of this report or members of his household have a long position in the common stock of Activision Blizzard, but may not engage in buying or selling contrary to the recommendation.

Investment Ratings
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings
1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	39	32%	8%	92%
Hold/Neutral	74	60%	9%	91%
Sell	8	7%	0%	100%
Restriction	2	2%	100%	0%

As of 5 October 2017



Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings reflect a two to three year time period.

Other Disclosures

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