



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

TTWO - NASDAQ (as of 2/8/17)	\$53.71
Price Target	N/A
52-Week Range	\$33.06 - \$56.71
Shares Outstanding (mil) (basic)	90
Market Cap. (\$ mil)	\$4,855
3-Mo. Average Daily Volume	1,319,744
Institutional Ownership	98%
Total Debt/Total Capital (12/16)	24%
ROE (TTM ended 12/16)	31%
Book Value/Share (12/16)	\$9.08
Price/Book Value	5.9x
Annual Dividend & Yield	Nil Nil
EBITDA Margin, estim. (TTM ended 12/16)	15%

EPS FY 3/31 (non-GAAP figures)

	FY16	Prior FY17E	Current FY17E	Prior FY18E	Current FY18E
1Q	\$0.31		(\$0.34)	A	
2Q	\$0.30		\$0.66	A	
3Q	\$0.89		\$0.99	A	
4Q	\$0.46	\$0.35	\$0.53		
Year	\$1.96	\$1.75	\$2.00	\$2.30	\$2.60
P/E	27.4x		26.9x		20.7x

Note: Quarterly EPS figures may not add to annual figure due to rounding & differing treatment of convertible securities from quarter to quarter.

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

	FY16	Prior FY17E	Current FY17E	Prior FY18E	Current FY18E
1Q	\$366		\$273	A	
2Q	\$365		\$479	A	
3Q	\$487		\$745	A	
4Q	\$342	\$298	\$344		
Year	\$1,560	\$1,760	\$1,840	\$2,100	\$2,200

Company Description: *Take-Two Interactive Software, Inc. is a global developer, marketer, distributor, and publisher of interactive entertainment software games for the PC and a variety of game systems. Popular franchises include Grand Theft Auto, BioShock, Borderlands, Civilization, Red Dead, NBA 2K, WWE 2K, and XCOM. The company is headquartered in New York City and its web site address is www.take2games.com.*

Take-Two Interactive Software, Inc.

TTWO — NASDAQ — Neutral-3

Strong Fiscal 3Q Results; Neutral Rating Based on Valuation

Investment Highlights

- Fiscal 3Q results were above expectations.** Non-GAAP revenues (adjusted for the change in deferred revenues) were approximately \$745 million compared to \$487 million in the year ago period, up 53%. The street consensus estimate was \$706 million. The release slate was more favorable than in the year ago quarter. This year's 3Q benefitted from several new releases (including *Mafia III*), as well as continued strength from games released in previous quarters. Key franchises continued to be *NBA 2K17* and *Grand Theft Auto*. Growth in digitally derived revenues rose significantly. Non-GAAP EPS of \$0.99 per share increased from \$0.89 a year ago. Street consensus was \$0.96.
- Guidance for 4Q was encouraging.** Non-GAAP revenues for 4Q are expected in a range of \$317-\$367 million, whereas our previous estimate was \$298 million. The quarter does not appear to have any major new releases, so the bulk of revenues should come from recently released games. Non-GAAP EPS are expected at \$0.49-\$0.56 versus \$0.46 a year ago. Our previous 4Q EPS estimate was \$0.35.
- In other news, TTWO recently purchased Social Point, a mobile videogame publisher based in Spain.** The purchase price of \$250 million is being funded by cash and stock. TTWO had a relatively modest mobile gaming business; this acquisition appears to represent a significant boost in a fast-growing segment of the industry.
- We have raised our financial estimates but still consider the stock fairly valued.** Our projections have increased for revenues and EPS in both FY17 and FY18. Fundamentals, in our view, are strong yet we simply prefer a lower entry point. We will monitor the stock closely for attractive risk/reward conditions and good buying opportunities in coming periods.

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

Exhibit 1**Non-GAAP Statements of Income** (figures in thousands except per share data and percentages)

	Three Months Ended		% chg
	<u>12/31/16</u>	<u>12/31/15</u>	
Net Revenue	\$744,823	\$486,791	53.0%
Gross Profit	321,645	218,175	47.4%
Income from Operations	143,904	88,396	62.8%
Net Income	<u>\$113,434</u>	<u>\$99,675</u>	13.8%
Diluted Earnings Per Share*	<u>\$0.99</u>	<u>\$0.89</u>	11.7%
Avg. Diluted Shares Outst.	115,300	113,290	1.8%
% of Net Revenue:			<u>bp chg.</u>
Gross Profit	43.18%	44.82%	(163)
Income from Operations	19.3%	18.2%	116
Net Income	15.2%	20.5%	(525)

Note: Non-GAAP presentation excludes items such as business reorganization and restructuring expenses, stock-based compensation, professional and legal fees, and the income tax effects of these items.

* EPS for three month period ended 12/31/16 and 12/31/15 includes add-back of interest expense assuming conversion of convertible securities.

Source: Take-Two Interactive Software, Inc.

Note: March fiscal year

Further comments on fiscal 3Q results. We were impressed with TTWO's fiscal 3Q results. New release *Mafia III* was a major contributor to the quarter, with other meaningful contributions coming from *WWE 2K17* and *Sid Meier's Civilization VI*. In addition, *NBA 2K17* continued to sell well and the *Grand Theft Auto* franchise remained a significant contributor. Digitally derived revenues grew 64%, a reflection of industry trends and TTWO's product portfolio. Non-GAAP EPS of \$0.99 were above the year ago figure of \$0.89, our estimate of \$0.90, street consensus of \$0.96, and company guidance of \$0.83-\$0.93.

Financial condition. The balance sheet remained solid, in our view. Cash, cash equivalents, and short-term investments at December 31, 2016, were \$1.443 billion. Inventories and accounts receivable were at reasonable levels, in our view. The current ratio was 1.32-to-1. Long-term debt (primarily a convertible note) booked on the balance sheet stood at \$258 million, about 24% of total capitalization. The decline in this figure from prior levels reflects the recent maturity of another convertible note. Shareholders' equity at quarter end was \$820 million.

Acquisition. On 2/1/17, TTWO announced the purchase of privately held mobile game developer Social Point S.L. for \$250 million, plus earn-out consideration of \$26 million. TTWO had a relatively modest mobile gaming business, but this acquisition clearly boosts its presence. Social Point was founded in 2008 and is headquartered in Barcelona, Spain. Popular mobile games include *Dragon City* and *Monster Legends*.

The transaction is expected to be immediately accretive to net revenue and net cash provided by operating activities, and is expected to be accretive to EPS (excluding transaction costs and amortization of intangible assets) in the fiscal year ending March 31, 2018. Social Point has been consistently profitable since 2013 and has grown net revenue at a 29% CAGR from 2013 through 2016. For the trailing twelve months ended December 31, 2016, Social Point generated net revenue of \$90.8 million and EBITDA of \$19.9 million. We view this transaction favorably yet have made conservative assumptions in our financial model regarding its future contributions.

Outlook. We continue to view TTWO's outlook favorably and believe it has some of the highest quality videogame franchises in the industry. We particularly like that the portfolio has grown in size, quality, and profitability over the years. The dominant franchise continues to be *Grand Theft Auto*, and we believe it will be important every year due to catalog sales of older titles and online revenue generation from *GTA Online*. We are comfortable with a potential release pattern that could bring a new full-length *GTA* console game perhaps every five or six years; the most recent full-length game release was *GTA V* in September 2013. Meanwhile, *NBA 2K* and *Mafia* have grown into major franchises for TTWO and have produced some of the company's highest rated games.

Also, *Red Dead Redemption 2* should add a significant boost to the portfolio with its long-awaited release in fall 2017 (TTWO's FY18). We expect this game to possibly become the company's second-best selling title of all time. The franchise last made an appearance in 2010 with the critically acclaimed *Red Dead Redemption*. We believe the combination of pent-up demand, effective marketing, and the high quality reputation of developer Rockstar Games bode well for this future game.

The near-term product pipeline looks a bit bare relative to past views. There have been numerous recent releases and there are some major titles planned for fall 2017. Over the next six months or so, however, we see some tough year-over-year comparisons in terms of product releases. As a result, we believe revenues could be flat or down for the next several quarters, compared to year ago figures.

Exhibit 2

Near-term Product Pipeline (selected titles only)

<u>Title</u>	<u>Platform</u>	<u>Release Date</u>
<i>WWE 2K17</i> - new downloadable content	multi-platform	January 17, 2017
<i>Mafia III</i> – new downloadable content	multi-platform	throughout 2017
<i>WWE 2K18</i>	tba	2017
<i>NBA 2K18</i>	multi-platform	Fall 2017
<i>Red Dead Redemption 2</i>	PS4, Xbox One	Fall 2017

Source: Take-Two Interactive Software, Inc.

Note: March fiscal year

Guidance. Management updated its guidance for FY17. Non-GAAP revenues for fiscal 4Q (March period end) are expected at \$317-\$367 million. Non-GAAP EPS are expected at \$0.49-\$0.56. Our new non-GAAP revenue estimate for 4Q is \$344 million, up \$46 million from our previous figure. Our non-GAAP EPS estimate for FY17 is \$0.53, up \$0.18 from our previous estimate.

For all of FY17, non-GAAP revenues are expected at \$1.815-\$1.1865 billion, while non-GAAP EPS are expected in a range of \$1.95-\$2.02. Our new non-GAAP revenue estimate is \$1.840 billion, up \$80 million from our previous figure. Our non-GAAP EPS estimate for FY17 is \$2.00, up \$0.25 from our previous estimate.

Our FY18 outlook has also increased. This is primarily due to growing confidence in *Red Dead Redemption 2* and contribution from the recently acquired mobile game developer, Social Point. Our FY18 non-GAAP revenue estimate is \$2.20 billion, up from our previous figure of \$2.10 billion, while our non-GAAP EPS estimate is \$2.60, up from our previous estimate of \$2.30.

Valuation. We previously found a historical price/earnings multiple analysis for TTWO not very meaningful due to an erratic earnings history that included some past net losses. The company had found profitability a bit challenging and often elusive in years without a new, full-length *GTA* game. This is no longer the case. We have been impressed with the development of the product portfolio, which now includes roughly a dozen major franchises. Furthermore, catalog sales of older *GTA* games and new revenues from *GTA Online* each year can help the company smooth its earnings. We have been impressed with earnings following the “spike” FY14 year when the *GTA V* launch helped lead non-GAAP EPS to a record \$4.26. Now that the company is soundly profitable in years without a new *GTA* game, we are comfortable looking at price/earnings multiples based on EPS over a one or two-year period rather than our prior approach of taking a four-year average.

TTWO shares are currently trading at 26.9x and 20.7x our new FY17 and FY18 EPS estimates, respectively. This translates to an approximate 22x multiple on expected forward earnings. The S&P 500 is currently trading at 18.2x expected forward earnings and the NASDAQ Composite is trading at 23.5x expected forward earnings.

Although we are comfortable with a one or two-year time frame for an EPS figure, we note TTWO shares are trading at 25.2x our projected four year (FY15-FY18) average EPS figure of \$2.14 and 21.0x a five-year (FY14-FY18) EPS average of \$2.56 that includes the *GTA V* launch year of FY14.

Opinion. Recent price appreciation has kept TTWO shares out of our preferred buying range; over the past twelve months, the stock price is up approximately 60%. We find the current valuation somewhat expensive, though remaining mindful of the strong fundamental outlook based on the strength of the product portfolio, our view of upcoming key releases, and historical valuation levels.

We believe the company and the videogame industry have bright long-term futures. We would consider upgrading our rating on TTWO with a lower valuation or with greater information on the future product slate, given no change in company fundamentals.

Suitability. Our Suitability rating on TTWO is 3 on a 1-to-4 scale (1=most conservative, 4=most aggressive). This reflects the company’s earnings history, product portfolio, and financial condition, among other factors. Recent improvements in earnings quality (such as profitability in years without a new, full-length *GTA* game) have led us to consider a more conservative Suitability rating, yet we maintain our 3 rating at this time due largely to market capitalization and balance sheet factors.

Risks. In addition to the importance of the *Grand Theft Auto* franchise, other investment considerations include general risks associated with a hit-driven business; the pace of production on games in development; overall debt levels; legal risks; potential uses for the company’s current cash balance and future cash flow; the industry’s hardware replacement cycle including supply and demand for consoles; creative and financial abilities to bring popular games to market; healthy relationships with the major hardware manufacturers; and general economic and consumer spending conditions.

Exhibit 3**Non-GAAP Statements of Income** (figures in thousands except per share data and percentages)

	FY14	FY15	FY16	FY17E	FY18E
Net Revenue	\$2,413,720	\$1,668,765	\$1,560,626	\$1,840,000	\$2,200,000
Total Cost of Sales	1,411,176	861,008	838,947	860,000	1,070,000
Gross Profit	1,002,544	807,757	721,679	980,000	1,130,000
Total Oper. Expenses	468,501	498,214	483,467	689,000	735,000
Operating Income	534,043	309,543	238,212	291,000	395,000
Interest Expense & Other	10,800	14,417	6,700	8,800	6,500
Pre-tax Income	523,243	295,126	231,512	282,200	388,500
Income Taxes, estim.	12,521	75,882	13,214	56,440	85,470
Net Income	\$510,722	\$219,244	\$218,298	\$225,760	\$303,030
Non-GAAP Diluted EPS	\$4.26	\$1.98	\$1.96	\$2.00	\$2.60
Avg. Shares Used in EPS Calc.	122,608	106,822	110,424	115,500	118,000
% Yr Over Yr Chg.					
Total Revenue	97.5%	(30.9%)	(6.5%)	17.9%	19.6%
Gross Profit	94.5%	(19.4%)	(10.7%)	35.8%	15.3%
Total Operating Expenses	0.4%	6.3%	(3.0%)	42.5%	6.7%
Operating Income	998.9%	(42.0%)	(23.0%)	22.2%	35.7%
Net Income	1443.9%	(57.1%)	(0.4%)	3.4%	34.2%
% of Net Revenue:					
Gross Profit	41.54%	48.40%	46.24%	53.26%	51.36%
Total Oper. Expenses	19.41%	29.86%	30.98%	37.45%	33.41%
Operating Income	22.13%	18.55%	15.26%	15.82%	17.95%
Net Income	21.16%	13.14%	13.99%	12.27%	13.77%

Note: Presentation of earnings per share (EPS) is a function of the potential dilutive/anti-dilutive impact of a convertible note in each period. Our annual EPS figures for the presented years assume conversion of the note due to projected levels of profitability. This has the effect of increasing the fully diluted share count and adding back related annual interest, net of tax. Some periods, such as FY13 (not shown in the exhibit above), may not reach the profitability threshold and therefore would not reflect conversion.

Source: Take-Two Interactive Software, Inc. and Hilliard Lyons estimates

Note: March fiscal year

Additional information is available upon request.

Prices of other stocks mentioned: Microsoft Corp. - MSFT - \$63.34 - Neutral
 Sony Corp. - SNE - \$31.83
 WWE, Inc. - WWE - \$19.28 - Neutral

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.

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

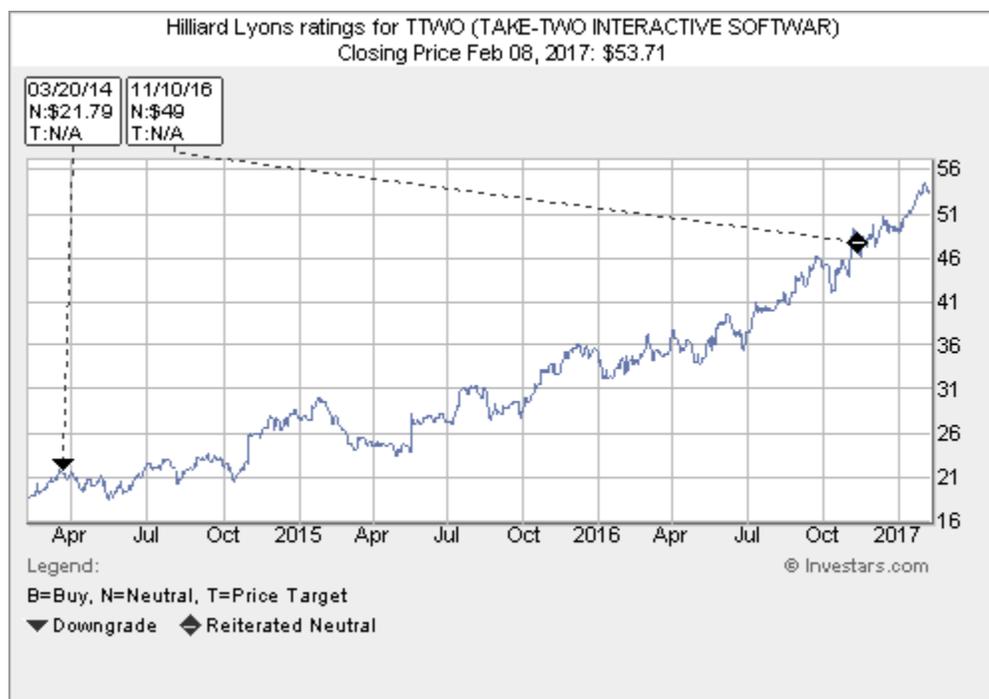
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

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.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Rating				
Buy	36	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017



Note: Price chart is current as of most recent calendar quarter end. 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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