

April 4<sup>th</sup>, 2019

**Company Name: ZNGA**

Awa Jobe

**Sector: Entertainment**

**Industry: Online Games & Content**

**Current Price: \$5.38**

**Target Price:**

**Company Description:** Zynga Inc. is headquartered in San Francisco, California. The company develops, markets, and operates social games as live services in the U.S. and Internationally. The company's games are played on mobile platforms, such as Apple iOS and Google's Android operating systems, as well as on social networking sites, such as Facebook. Zynga makes money from selling virtual goods in online games and by selling advertising. Their most popular games include FarmVille, Zynga Poker, Words With Friends, Hit it Rich! Slots and CSR.

**BUY**

Current Price: \$5.40  
 Target Price: \$8.11  
 Market Cap: 4.9B  
 Beta: 0.8  
 ROIC: 0.23%  
 WACC: 8.1%  
 EV/EBITDA: 92.78  
 Short Interest: 3.05 Days



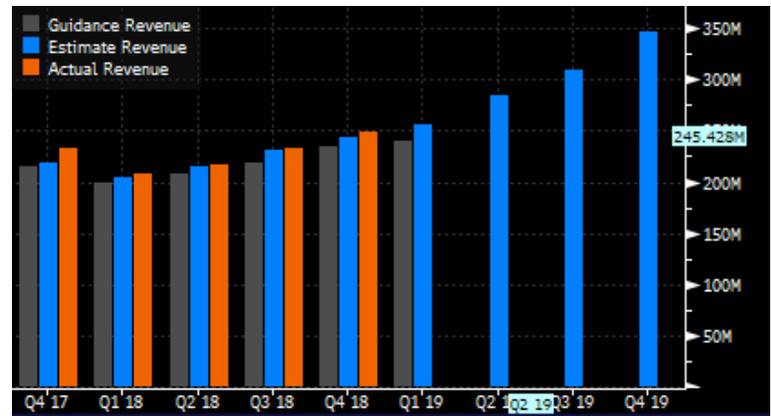
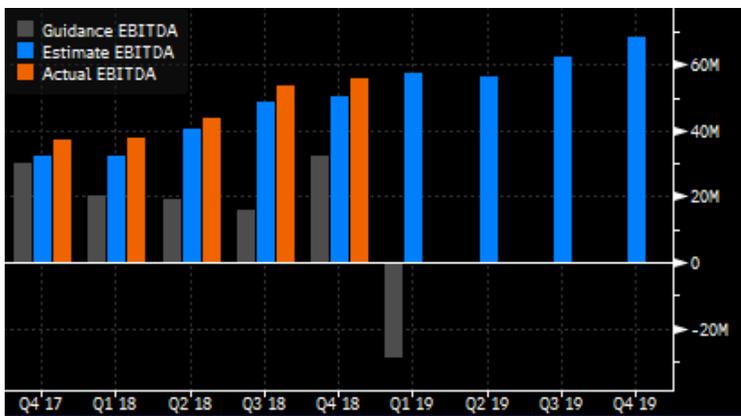
**Thesis:** ZNGA has a lot of growth prospects and considering its price to the stock market and its pipeline of games we can clearly assess that the stock is undervalued. The company outperformed both the Entertainment industry and the US markets which respectively returned 14.9% and 9.4% over the past year. With a great focus in technology, the company has the means to pursue its expansion and double its current market share. With more than one billion people that have played their games, there are widely available on a number of global platforms including Facebook. Zynga's games are always improving, aiming to give gamers a better experience and adapting movies like Harry Potter, Game of Thrones into games to attract a broader audience.

**Catalysts:**

- Short Term(within the year): Acquisition growth from Small Giant and release of a Game of thrones and Harry Potter adaptation game
- Mid Term(1-2 years): Licensing deals with production studios like Warner Bros.
- Long Term(3+): Successful ongoing acquisitions

## Earnings Performance:

In the last four quarters, the company has both beat their revenue and EBITDA estimates. The revenue and the EBITDA are improving on a quarterly basis and looking at the company's perspectives, I believe the company will continue to grow. Looking at its financial results, the company beat its guidance, as the revenues were 248.69 M and EBITDA 55.68M at Q4 compared to its expected revenue of 244.09M and 50.53M EBITDA giving the company a YoY growth of respectively 22.9 % and 52.5%. 2017 was the first year since 2010 that the company did not incur losses. Before 2016, the company was nearly dead, realizing losses during 5 consecutive years. Since then, the company has been on a turnaround. As of Dec 2019, forecasted earnings are expected to increase 575 %. EPS increased by 9.3% on a one-year period. Next earnings is expected to be reported on May 01st, 2019.



## COMPETITION:

Gaming is an integral and ever-developing segment of the global media and entertainment. The company has no debt. This is different from its competitors, which have on average 12% debt in their capital structure. ZNGA has a slightly lower WACC at 8.1% than its competitors WACC at 8.6%. This is largely due to the company's lower cost of debt because of its high credit rating of AAA. ZNGA comparison to its competitors are shown in the chart below. The company has a lower EBITDA margin at 6.64 than the median of its competitors at 14.24. The company has the opportunity to increase its ROE of 5.1%. The median of its competitors has a higher ROE of 5.1%. Compared to its competitors, we can clearly assess that the company is running behind. However, the company has gone from a restructuring to a growing tendency. The company has a R&D/Sales ratio of 29.80 compared to the median of its competitors at 13.63. This proves that management is committed to increase the company's competitive advantage. Furthermore, ZNGA is financially well positioned for future acquisitions that may require taking on additional debt and therefore more room for growth. This will result in greater free cash flow for the company, thus a higher valuation.

Name (BICS Best Fit)	Mkt Cap (USD)	Last Px	Chg Pct 1D	Chg Pct 1M	Rev - 1 Yr Gr:Y	EPS - 1 Yr Gr:Y	P/E	ROE	Dvd 12M Yld
Median	4.96B	59.02	-1.81%	5.31%	32.17%	41.46%	125.13	5.10%	0.79%
00) ZYNGA INC - CL A	4.96B	5.34	-2.02%	2.69%	5.32%	-33.18%	208.08	1.51%	--
01) ACTIVISION BLIZZARD ...	35.87B	46.96	-1.45%	12.37%	6.88%	49.77%	20.72	16.79%	0.79%
02) CDK GLOBAL INC	7.36B	59.02	0.79%	0.94%	2.39%	33.15%	17.14	--	1.02%
03) REALPAGE INC	5.83B	62.24	-1.81%	5.31%	29.59%	562.51%	125.13	5.84%	--
04) ENVESTNET INC	3.14B	65.25	-1.73%	6.27%	18.82%	199.65%	135.45	4.36%	--
05) ZENDESK INC	8.90B	82.10	-3.90%	6.61%	39.19%	8.42%	--	-30.42%	--
06) SS&C TECHNOLOGIES H...	15.94B	63.23	-1.82%	2.05%	104.21%	27.04%	55.82	7.50%	0.52%
07) PLURALSIGHT INC - A	4.14B	30.16	-5.90%	-8.58%	39.09%	-23.14%	--	--	--
08) SMARTSHEET INC-CLAS...	4.05B	38.58	-4.05%	3.65%	59.75%	77.89%	--	--	--
09) APPFOLIO INC - A	2.76B	80.32	-1.40%	16.98%	32.17%	98.88%	143.10	22.62%	--

(Accounting Adjustments: Adjusted for Abnormal Items When Applicable)

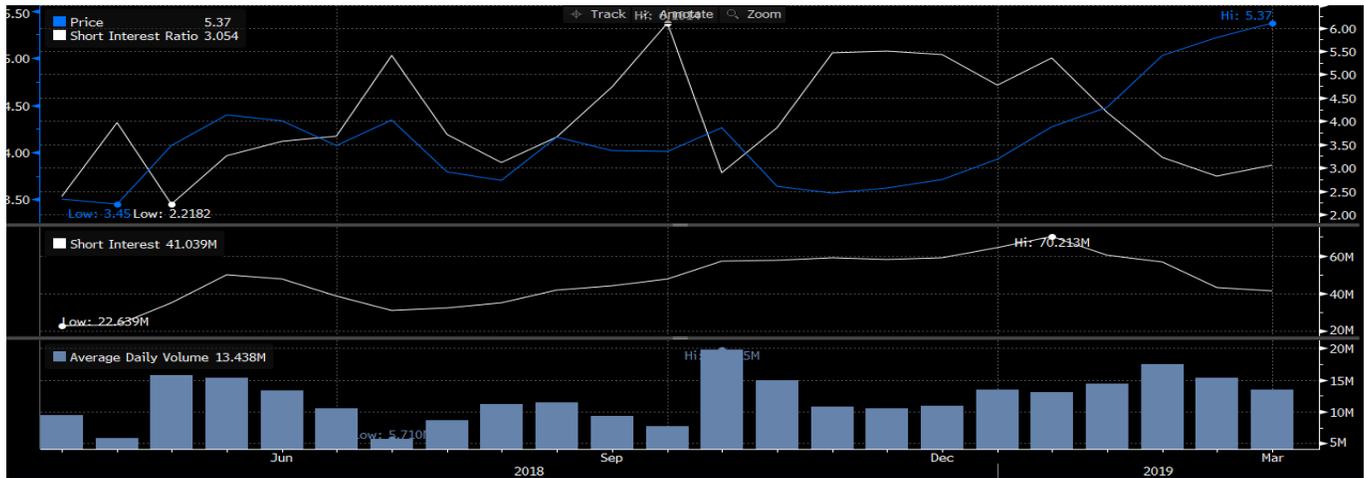
10 Analyze List

## OWNERSHIP/MANAGEMENT:

The Ownership chart for ZNGA with their one-year change is shown to the right. The majority of the company's shares are held by investments advisors at 68%, hedge fund managers at 17.15% and individuals at 8.17%. The high ownership by investment advisor which has been increasing by 6.77% on a one-year period show how this stock is considered as promising with it being outperforming the online gaming industry this past year. Since the appointment of Frank D. Gibeau, former executive Vice President of EA mobile, as CEO of the company, the company went from a lowest stock price of \$1.83 on February 2nd 2016 to \$5.34 today.

54) Ownership Type	03/25/18	Curr	Change
41) Investment Advisor	61.23	68	+6.77%
42) Hedge Fund Manager	29.72	17.15	-12.57%
43) Individual	1.03	8.17	+7.14%
44) Pension Fund	4.64	2.53	-2.11%
45) Sovereign Wealth Fund	1.2	1.16	-0.04%
46) Brokerage	0.18	1.13	+0.95%
47) Private Equity	1.46	1.05	-0.41%
48) Insurance Company	0.05	0.41	+0.36%
49) Government	0.2	0.22	+0.02%

He went from restructuring to growing the company. Gibeau has expressed the goal to sustain a 20% profit margin. With a new management team in place and ongoing acquisitions, I believe the company is ready to reach a new level. "2018 is all about live operation. 2019 will be about new games" said Gibeau. Zynga has a good momentum so far and it should substantially increase in the following months. The company has 927.93M shares outstanding with an equity float of 844.28M and 13.43M shares are traded daily. The short interest chart is shown below. It takes 5.37 days to cover short interest. It has recently come down from a high of 6.1 days in September 2018, where the stock price fell the following month. There has been a decline in the volume of the short interest by 2,190,723.

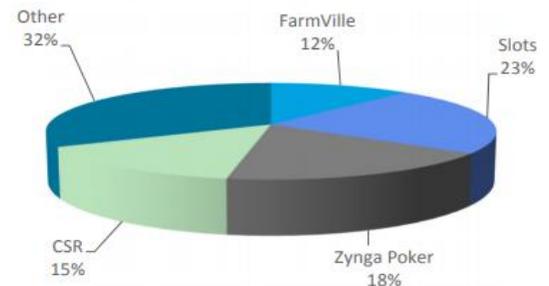


## Business Description:

Zynga primarily makes money from micro-transactions. The games are free to download and play on all platforms. Players buy in-game currency or in-game items. Another type of monetization is from subscriptions for membership in “VIP” clubs. Its more popular games are shown in the right.

### Q4 2018 ONLINE GAME REVENUE

Total Amount: \$177 million



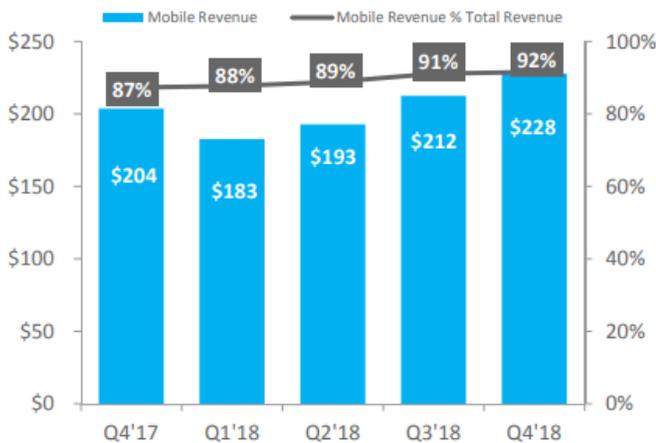
Zynga is Facebook’s outsourced games arm. We have seen an increase in online gaming on the Facebook platform and this makes the company an acquisition target, particularly for Facebook. The company also makes money from advertising. From representing approximately 10% of ZNGA’s revenue until 2013, advertising revenue is rapidly growing and now represents 26% of total revenue. Zynga Poker, CSR Racing 2, Farmville and Slots generate about 68% of online game revenue

Zynga is finding ways for games like CSR Racing 2, Zynga Poker, and FarmVille to grab more attention from current players and attract new players through social media interactions with current players. Zynga introduced features to its Poker games such as leagues, world tournaments, and jackpots that it says keeps players playing and spending. The company intends to establish new long-term franchises through licensing agreements. . The company signed a multi-year licensing deal to develop a mobile game based on the Star Wars movies; Warner Bros for a mobile game based on Harry Potter and will adapt Game of Thrones into a game. Zynga has also added new modes of play to increase player engagement. It introduced a team-based synchronous multiplayer mode for its hardcore players.

Zynga has made acquisitions to expand globally and help it become less dependent of the US market. Below is a graphic representation of the company’s revenue.

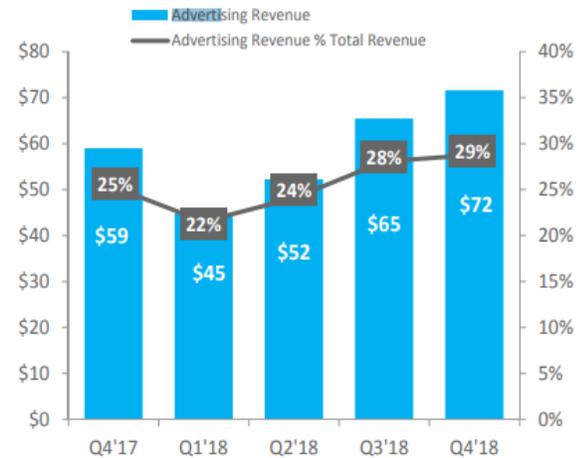
### MOBILE REVENUE

92% OF TOTAL IN Q4'18



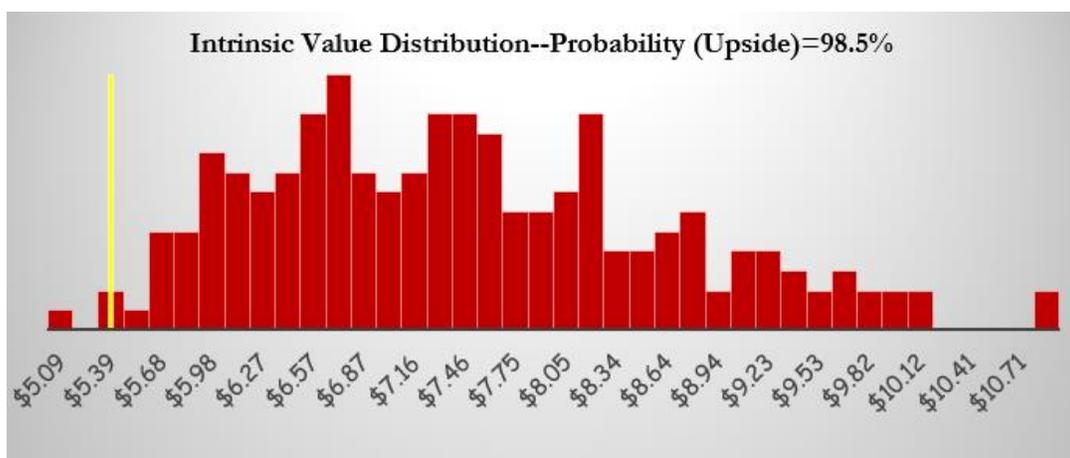
### ADVERTISING REVENUE

29% OF TOTAL IN Q4'18



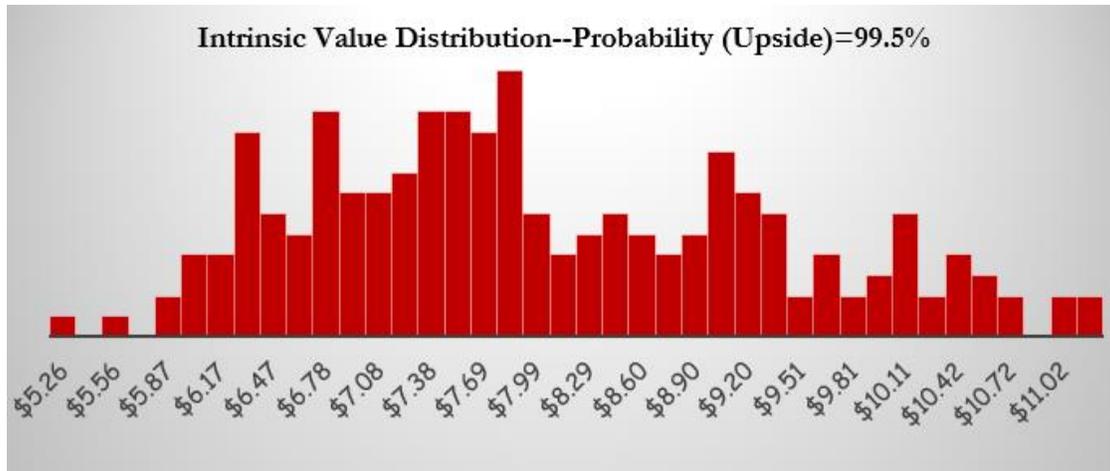
### Bear Case:

Considering everything, there is a possibility that ZNGA sees a decrease of 3% in its revenue. This would not stop the company from seeing its stock price increased. In order for this slow growth in revenue to happen, there would have to be three distinct triggers. The first of these triggers would be U.S. revenue growth decrease due to macro effects leading to a flat or decrease in sales level. Second, advertising revenue, representing almost a third of the company's total revenue, would decrease and therefore revenue growth would slow. Last and most important would be if acquisitions were not well integrated in the company's operations. There would be a negative move in revenue but still a large positive move in price. The result of all of this would be a 1-year price target of \$7.85, which would result in a 45% gain.



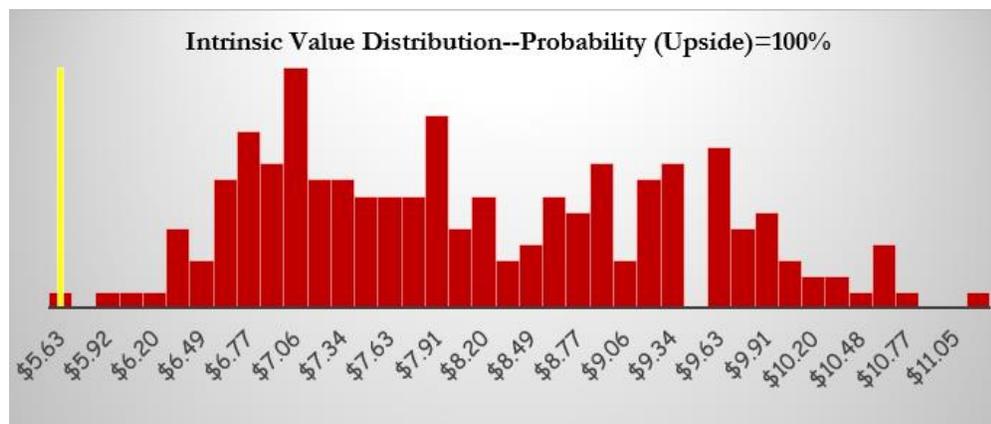
## Realistic Case:

The more realistic case for ZNGA is that the trends in growth and margin stays at the same level. The online gaming market has increased last year and it is expected to maintain course. This would be shown by another small beat on EBITDA and revenue guidance and a beat in the estimated EPS. This would mean that the company would continue to grow and outperform the entertainment industry. This would result from higher margin in both the international and the U.S. portion of business, which will lead to a 1-year target price of \$8.11 for a gain of 50%.



## Bull Case:

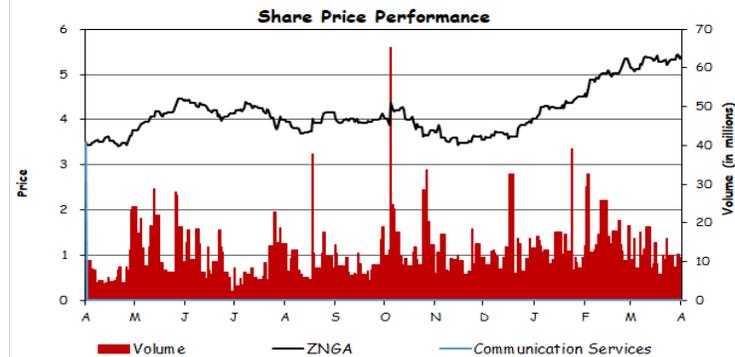
The bull case for PVH would come if the company can exceed expectations in the coming year. This would need to be a beat and raise for ZNGA. If the U.S and international segments saw an additional accelerated growth of 2% while keeping margins constant. This would result from the release of new games paired with an increase in revenues of already successful games. Management raising full year guidance or signs that the online gaming industry continues to perform. If this were the case, the 1-year price target would be \$8.57 for a return of 58%.



## Conclusion:

In conclusion, I recommend Zynga as buy at the current price of \$5.40. I have provided a one-year target price of \$8.11 generating a one-year target return of 50%. Based on my analysis, I have project Zynga to experience higher than expected growth in revenue and the industry itself is predicted to experience growth in upcoming quarters. Improving existing and creating new games will highly contribute to the growth of margins. Zynga has a strong representation on Facebook, Google and App store. Meeting customers changing needs, entering in long-term licensing with entertainment companies, the company is well positioned to better compete with giants of the industry.

Zynga Inc.	Symbol: ZNGA
Analyst	JOBE
Buy below	\$6.49
Sell above	\$9.33
Probability of Price Increase	100%
Last Price	\$5.40
Intrinsic Value	\$7.46
Target Dividends	\$0.00
Target Price	\$8.11



**Description**

Zynga Inc. develops, markets, and operates social games as live services in the United States and internationally.

Sector	Communication Services
Industry	Entertainment
Last Guidance	December 11, 2018
Next earnings date	NM

**People**

Pincus, Mark, Founder & Non Executive Chairman  
 Gibeau, Frank, CEO & Director  
 Griffin, James, Chief Financial Officer  
 Bromberg, Matthew, Chief Operating Officer  
 Phillips, Phuong, Chief Legal Officer & Secretary  
 Kim, Bernard, President of Publishing

**Top Competitors**

Activision Blizzard, Inc.	Netmarble Corporation
The Allstate Corporation	NetEase, Inc.
DoubleUGames Co., Ltd.	Take-Two Interactive Software, Inc.
Electronic Arts Inc.	Vivendi SA
Glu Mobile Inc.	--

**Market Statistics**

Market Capitalization (mil)	\$4,955.15
Last Price per share	\$5.40
52 week high	\$5.55
52-week low	\$3.32
Volatility	34.69%
Daily volume (mil)	3.40
Short interest	4.42%
Days to cover short interest	2.96
Beta	0.73

**Ownership** Change in Ownership (March 2018)

Shares outstanding (mil)	927.93	
Diluted shares outstanding (mil)	889.58	
Options and Warrants (Shares equivalent)	21.26	
% shares held by institutions	79%	<b>4.72%</b>
% shares held by investments Managers	54%	<b>6.78%</b>
% shares held by hedge funds	17.01%	<b>-12.58%</b>
% shares held by VC/PE firms	0.041%	n/a
% shares held by insiders	4.65%	-4.53%
Poison Pill Type	NONE	

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**Quarterly Earning Surprises (Actual Vs. Median Estimates)**

Revenue	
12/31/2017	7.50%
3/31/2018	3.05%
6/30/2018	2.69%
9/30/2018	5.76%
12/31/2018	2.13%
Mean (Standard Error)	4.23% (1.03%)

**EBITDA**

12/31/2017	-1.69%
3/31/2018	-2.02%
6/30/2018	-39.49%
9/30/2018	-26.04%
12/31/2018	-42.75%
Mean (Standard Error)	4.23% (7.73%)

Financials			
Profitability	ZNGA (LTM)	ZNGA Historical	Peers' Median (LTM)
Return on Capital	2.6%		
Adjusted EBITDA Margin	13.1%	49.21%	64.77%
Return on Equity	1.3%		
Adjusted Net margin	4.6%		
Invested Funds	ZNGA (LTM)	ZNGA Historical	Peers' Median (LTM)
Cash/Capital			
NWC/Capital			
Operating Assets/Capital			
Goodwill/Capital			
Capital Structure	ZNGA (LTM)	ZNGA Historical	Peers' Median (LTM)
Total Debt/Market Cap.			
Reported Cost of Borrowing			3.8%
Cash Interest/Total Debt			4.8%
CGFS Credit Rating	AAA		BB
Credit Model Rating			bbb-
Probability of Default	0.01%		0.04%
Cost of Capital	CGFS Credit Rating	Credit Model Rating	Probability of Default
Implied Cost of Borrowing (ZNGA)	3.6%		3.8%
Implied Cost of Borrowing (Peers)	5.2%	5.8%	5.3%
Cost of New Debt Estimate	3.6%		
Market Risk Premium Estimate	5.7%		
Cost of Equity Estimate	9.3%		
WACC Estimate	9.1%		

**Valuation**
**DCF Valuation**

	Revenues	EBITDA Margin	UFCF	WACC	ROIC	Price Per Share
Base Year (Actual)	\$907.21	13%	\$250.55	9.14%	2.56%	\$5.42
year 1	\$1,221.10	48%	\$432.81	9.14%	13.33%	\$5.79
year 2	\$1,539.30	21%	\$249.56	9.14%	8.94%	\$6.16
year 3	\$1,716.90	23%	\$304.08	9.15%	10.09%	\$6.55
year 4	\$1,907.23	31%	\$462.80	9.15%	13.36%	\$6.93
year 5	\$1,998.47	31%	\$480.59	9.16%	12.61%	\$7.32
year 6	\$2,081.98	31%	\$541.52	9.17%	12.55%	\$7.70
year 7	\$2,039.03	0%	\$79.72	9.18%	3.80%	\$8.08
year 8	\$2,111.51	0%	\$71.79	9.18%	3.67%	\$8.50
year 9	\$2,187.23	0%	\$69.35	9.18%	3.52%	\$8.96
year 10	\$2,262.27	3%	\$119.43	9.18%	4.06%	\$9.46
year 11	\$2,336.38	7%	\$124.05	9.18%	4.44%	\$10.01
year 12	\$2,409.29	10%	\$116.83	9.18%	4.75%	\$10.60
year 13	\$2,480.73	14%	\$111.30	9.19%	5.01%	\$11.24
year 14	\$2,550.45	17%	\$106.35	9.19%	5.18%	\$11.94
year 15	\$2,618.17	24%	\$191.86	9.19%	6.05%	\$13.05
Continuing Period	\$2,683.62	24%	\$583.03	9.19%		

**Relative Valuation**

	EV/Rev (FW)	EV/EBITDA (FW)	P/BV (TTM)	P/E (FW)	Recovery Rate	100%
Multiple					Capital	\$4,535.03
Median (Peers)	3.2x	16.2x	3.0x	23.8x	Intangibles	\$1,052.79
Base	Revenue (NTM)	EBITDA (NTM)	Book Value (LTM)	Net Income (NTM)	Claims	\$123.31
ZNGA	\$1,303.92	\$514.94	\$3,274.70	\$399.91		
Implied EV	\$4,208.80	\$8,347.38				
Total Net Claims	-\$831.71	-\$831.71				
Implied EQ	\$5,040.51	\$9,179.08	\$9,884.22	\$9,504.47		\$3,358.94

**Valuation Summary**

Model	Intrinsic Value	Target Price	Weight
DCF Valuation	\$5.42	\$5.79	50.00%
EV/Rev (FW)	\$5.53	\$6.04	0.00%
EV/EBITDA (FW)	\$10.08	\$11.00	50.00%
P/BV (TTM)	\$10.85	\$11.84	0.00%
P/E (FW)	\$10.43	\$11.39	0.00%
Asset Based Valuation	\$3.69	\$4.02	0.00%
Price per Share	\$7.75	\$8.40	100%

