

Electronic Arts: Gunning For A Strong Holiday Season

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Despite tough comps, Electronic Arts managed to deliver again a solid quarter with FY17 Q1 revenue only slightly down year-on-year (-2%) and earnings well ahead of expectations (\$0.07 vs. -\$0.02).

"FIFA Ultimate Team", mobile game "Star Wars: Galaxy of Heroes" and market strength offset "Mirror's Edge's" poor performance (we suspect that this quarter's main title sold less than 1m units, well below last year's "Battlefield Hardline") while continued financial discipline (underlying expenses were down year-on-year) sparked some earnings upside.

EA's focus on GAAP guidelines for Q2 and FY17 is likely to create some confusion among investors who have historically handled non-GAAP numbers, even if the FY17 GAAP guidance was globally left unchanged (\$4.75bn revenue and \$2.56 EPS vs. \$2.53 previously). In our view, investors should mainly pay attention to management's high level of confidence about the company's outlook during the conference call, suggesting that the risk is skewed to the upside: "We tend not to try to raise guidance too early in the year. We would like to see a little more demand metrics on all of our products, particularly Battlefield and Titanfall, before we make that decision."

More specifically, management hinted at ~15m shipments for "Battlefield 1" (in-line with our expectation, see our revenue model in our previous comment) and ~9-10m shipments for "Titanfall 2" (well ahead of our 5m forecast). Management comments about Pokémon not having any material impact on the company's mobile revenue trends in early Q2 were also encouraging.

A detailed analysis of the company's product lineup suggests that EA could record \$600m more revenue in FY17 than in FY16. This compares to \$350m additional revenue in EA's guidance and represents 5% revenue upside.

Indeed, the sales potential of EA's major titles this year is pretty impressive. While "Star Wars Battlefront" arguably represents a tough comp (15m units), "Battlefield 1" could deliver the same kind of performance this year based on its historical sales numbers. And interestingly, "Star Wars Battlefront" could remain a major contributor to revenues through the sale of digital content (we estimate that 20% of "Star Wars Battlefront" players will buy the [season pass](#) that gives access to all additional content) and the release of a [Virtual Reality version](#) of the game.

Other major titles this year include "Mass Effect", "Titanfall 2" and "Mirror's Edge" whose sales potential is way above "UFC 2", "Need for Speed" and "Plants vs. Zombies". Notably, historical sales data suggests that "Mass Effect" and "Titanfall 2" could ship between 5m and 10m units each, compared to 2-3m units on average for last year's games.

Overall, EA's major titles could ship 12 or 13m more units than last year and generate ~\$500m more revenue.

EA's catalog sales represent a second source of revenue growth. While healthy sales of PS4 and Xbox One and the expected release of a new Nintendo console are likely to keep expanding the video game market and, as a result, EA's catalog sales, the presence of "Star Wars Battlefront" in the catalog should be an additional boost (we estimate the game could sell at least 2m copies in FY17).

In all, we remain constructive on EA, considering that its valuation multiples (21x 2017 adjusted EPS) are well supported by its double-digit earnings growth outlook in both FY17 and FY18.

Comparing EA's FY16 and FY 17 lineups

<i>FY17</i>	<i>FY16</i>	<i>FY17 vs. FY16 sales potential comparison</i>
New major titles	New major titles	
Battlefield 1	Star Wars Battlefront	Flat sales (around 15m units)
Mirror's Edge	UFC 2	1m units vs. 2m
Mass Effect	Need For Speed	5m units vs. 3m
Titanfall 2	Plants vs. Zombies	9m units vs. 1.5m
Star Wars Battlefront DLC season pass	-	3m units
Star Wars VR and other VR titles	-	1m units
Total	12-13m more units in FY 17, or ~\$500m revenue	
Catalog	Catalog	
FIFA 2017	FIFA 2016	Flat or slightly higher sales
Madden 2017	Madden 2016	Flat or slightly higher sales
Star Wars Battlefront	-	2m units (after the 15m units shipped in FY16)
Other catalog titles	Other catalog titles	Slightly higher sales thanks to continued market expansion
Total	At least 2-3m more units in FY17, or ~\$100m revenue	

Source: Company, AtonRā Partners