

## Entertainment: Software

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### April 2013 NPD Preview: Expecting a Slight SW Sales Decline, Despite Stronger Recent Releases and Easy Comp; Sustained Growth Unlikely Before 2014

- We expect April U.S. retail video game software sales data to be released by the NPD Group after the market close on Thursday, May 16.
- We expect console/handheld software sales of \$300 million, down 2% compared to last year's \$307 million, as a strong new release schedule, solid catalog sales from a slew of high-profile releases last month (most notably late-March release Take-Two's *BioShock Infinite*) and an easy comparison (down 39%) mitigate continuing declines in a transition year. We expect these factors to almost offset the deterioration of catalog sales at this late stage of the console cycle. The industry hasn't seen a month of true growth (based on the same number of weeks in the month and its comparison period) since November 2011, and we expect sustained positive growth to remain elusive until 2014.

Exhibit 1: Estimated Console/Handheld Software Sales (by Publisher)

By publisher (\$ millions)	YoY		MoM
	Apr-13E	% change	% change
Activision Blizzard	\$40	-6%	-37%
Electronic Arts	\$42	-5%	-21%
Majesco	\$4	-37%	-14%
Nintendo	\$40	-3%	-31%
Take Two Interactive	\$45	89%	-53%
Ubisoft Entertainment	\$16	-13%	-38%
Covered Publishers	\$187	6%	-38%
<b>Overall Industry</b>	<b>\$300</b>	<b>-2%</b>	<b>-46%</b>
<i>Publishers as % of Market</i>	62%		

Source: The NPD Group/Retail Track and Wedbush Securities estimates.

- We expect April console/handheld software sales to be led by new releases Deep Silver's *Dead Island: Riptide* (360, PS3, PC) and Warner Bros.' *Injustice: Gods Among Us* (360, PS3, Wii U), as well as multiple March releases, including Microsoft's *Gears of War: Judgment*, Nintendo's *Luigi's Mansion: Dark Moon*, Sony's *God of War: Ascension*, Square Enix's *Tomb Raider*, and Take-Two's *BioShock Infinite*. We expect Activision Blizzard's *StarCraft II: Heart of the Swarm* and EA's *SimCity* to again lead PC sales.
- We expect hardware sales of 55,000 Wii U units in its sixth month (down 19% month-over-month), 75,000 Wii units (down 16% year-over-year), 205,000 Xbox 360 units (down 13% y-o-y), 165,000 PS3 units (down 5% y-o-y), 60,000 DS units (down 20% y-o-y), 185,000 3DS units (up 46% y-o-y), and 30,000 PS Vita units (down 57% y-o-y). In March, combined current-generation home console (PS3, 360, Wii, Wii U) hardware unit sales were down 28% y-o-y, while handheld hardware unit sales were down 37%, resulting in overall hardware unit sales being down 32% for the month. We expect negative momentum to continue for the most part until the release of the new consoles from Microsoft and Sony.
- We expect packaged goods weakness to persist for much of 2013, albeit with intermittent reversals. We next expect positive growth in September (the launch month of Take-Two's *Grand Theft Auto V*), and do not expect sustained growth until 2014, as new consoles from Sony and Microsoft are expected to launch late this year.

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**RISKS**

Risks to the attainment of our target prices for the companies we cover in this sector include changes to game release timing, greater-than-expected deterioration of the average selling price (ASP) for game software, the effects of competition, changing macroeconomic factors, and slower-than-expected consumer demand for video game hardware and software.

**ANALYSIS**

We expect NPD U.S. retail video game software sales data for the month of April (four-week period ending May 4, 2013) to be released on Thursday, May 16, after the market close.

Our forecast is based upon a combination of channel checks, company press releases, and intuition, with the greatest dependence upon intuition. Our channel checks are conducted by visiting a very small slice of the over 25,000 retail stores that carry video games in the U.S. We note that for a given game, a difference of only one unit per store per week could result in a difference of 100,000 units in volume, or \$3-6 million in retail sales for the month. Therefore, we caution investors to use our estimates as only one data point in a sea of information.

**We expect April console/handheld software sales of \$300 million, down 2% compared to April 2012's \$307 million.**

Exhibit 2: Estimated Monthly Software Sales (by Device)				
(\$ millions)				
	<b>Apr-13E</b>	<b>YoY % chg</b>	<b>MoM % chg</b>	<b>% of Total</b>
Wii	<b>\$24</b>	-54%	-33%	8%
Wii U	<b>\$12</b>	n/a	-22%	4%
PS3	<b>\$85</b>	10%	-54%	28%
Xbox 360	<b>\$127</b>	1%	-48%	42%
PS2	<b>\$0</b>	-64%	-18%	0%
PSP	<b>\$0</b>	-89%	-22%	0%
PS Vita	<b>\$4</b>	-20%	-17%	1%
DS	<b>\$17</b>	-37%	-32%	6%
3DS	<b>\$30</b>	75%	-32%	10%
<b>Industry</b>	<b>\$300</b>	<b>-2%</b>	<b>-46%</b>	<b>100%</b>

*Source: The NPD Group/Retail Track and Wedbush Securities estimates.*

We expect April console/handheld software sales to be led by new releases Deep Silver's *Dead Island: Riptide* (360, PS3, PC) and Warner Bros.' *Injustice: Gods Among Us* (360, PS3, Wii U), as well as multiple March releases, including Microsoft's *Gears of War: Judgment*, Nintendo's *Luigi's Mansion: Dark Moon*, Sony's *God of War: Ascension*, Square Enix's *Tomb Raider*, and Take-Two's *BioShock Infinite*. We expect Activision Blizzard's *StarCraft II: Heart of the Swarm* and EA's *SimCity* to again lead PC sales.

There were 20 SKUs that sold over 100,000 units in March, and we expect 10 in April (compared to 5 last year).

We expect hardware sales of 55,000 Wii U units in its sixth month (down 19% month-over-month), 75,000 Wii units (down 16% year-over-year), 205,000 Xbox 360 units (down 13% y-o-y), 165,000 PS3 units (down 5% y-o-y), 60,000 DS units (down 20% y-o-y), 185,000 3DS units (up 46% y-o-y), and 30,000 PS Vita units (down 57% y-o-y). We expect negative momentum to continue for the most part until the release of the new consoles from Microsoft and Sony. Overall, we expect hardware unit sales to be down 3% y-o-y, with current-generation console hardware unit sales flat and handheld hardware unit sales down 5%.

Last month, hardware sales were below our expectations and down from last year as we approach the next-gen console launches later this year. Although the Wii U outperformed our expectations, we believe that its fortunes appear unlikely to meaningfully improve for several months, even if Nintendo decides to drop price, as there are an insufficient number of core titles that have consumers interested in the console. In addition, we note that many Wii U titles from third-party publishers have significantly underperformed expectations, potentially negatively impacting publisher support for the new console. We think that core gamers are far more likely to turn their attention to the PS4 (due in the holiday season) and the next Xbox, which will be unveiled on May 21 and likely have a launch alongside that of the PS4. We believe that the long-term appeal of the Wii U will remain limited due to the perception that the PS4 and next Xbox will be much more powerful with greater online integration and multimedia functionality. Should the new consoles from Sony and Microsoft be price competitive, we expect Wii U sales to continue to stagnate.

Combined Wii U and Wii unit sales were down 9%. Combined 3DS and DS unit sales were down 5% compared to last March, and have not shown positive growth since October 2011. As expected, combined PSP and PS Vita unit sales were down significantly due to the limited appeal of the newer hardware device. We believe the popularity of the PS Vita has suffered from a high price point and a somewhat limited release slate.

Combined current-generation home console (PS3, 360, Wii, Wii U) hardware unit sales were down 28% year-over-year, while handheld hardware unit sales were down 37%, resulting in overall hardware unit sales being down 32% for the month. It is possible that game consoles are approaching full market penetration, given that total current generation console sales excluding handhelds are over 100 million units.

Exhibit 3: Estimated Monthly Hardware Sales (by Device)

(# of units)	Wedbush		EEDAR	
	Apr-13E	YoY % chg	Units	YoY % chg
	Wii	75,000	-16%	80,000
Wii U	55,000	n/a	60,000	n/a
PS3	165,000	-5%	190,000	10%
Xbox 360	205,000	-13%	230,000	-2%
PS2	100	-99%	n/a	n/a
PSP	6,500	-72%	n/a	n/a
PS Vita	30,000	-57%	30,000	n/a
DS	60,000	-20%	50,000	-33%
3DS	185,000	46%	200,000	58%
<b>Industry</b>	<b>781,600</b>	<b>-3%</b>	<b>840,000</b>	<b>4%</b>

Source: The NPD Group/Retail Track, EEDAR, and Wedbush Securities estimates.

## CONCLUSION

The video game industry has historically seen console and handheld hardware and software sales decline in transition years. In contrast to prior transitions, this transition year follows an unprecedented four consecutive years of software sales declines, so we believe it is likely that the transition year impact on software sales demand will be more muted than in the past. In contrast, console pricing has remained sticky, and handhelds are competing with smartphones and tablets for wallet share, suggesting that this year's hardware sales may continue to decline at a more rapid pace than in past transitions. Of course, once the pricing of new consoles from Microsoft and Sony is announced at E3, it is possible that current generation consoles will see another price cut, which could spur both hardware and software sales later this year.

The impact of NPD results on video game publishers is more muted in 2013 than in any year in our memory (we have covered the sector since 2001). Investors appear to expect persistent software sales declines, and recent solid performance by several game publishers suggests that investors have increasing confidence that the next generation of consoles will usher in newfound enthusiasm from gamers and corresponding growth in software sales. We think that this confidence is well-placed, and expect the next-generation consoles from Microsoft and Sony to impress and delight consumers. With that said, we continue to believe that Nintendo misfired with the Wii U, and believe that the next generation of consoles will see a market share shift from Nintendo platforms to Microsoft and Sony platforms.

In the aggregate, we think that the installed base of next generation of home consoles will be smaller than the current generation, likely by 10 – 20%. However, the composition will be much different, with Sony and Microsoft each selling 85 – 100 million home consoles (compared to approximately 75 million each in the current cycle) and Nintendo selling 50 million or fewer (compared to approximately 100 million in the current cycle). The 50 million decline in our forecast for Nintendo's home console installed base reflects defections of more non-traditional gamers to social and mobile games. The 20-50 million increase in our forecast for Sony's and Microsoft's combined installed base reflects our view of healthy growth for the addressable market plus some market share gains from Nintendo's historical base of more traditional gamers. The market share gains we have forecast should be beneficial for game publishers focused on the Sony and Microsoft platforms, and includes all three of our OUTPERFORM rated publishers (Activision, Electronic Arts and Take-Two).

In contrast, we think that handheld hardware sales are destined to decline over the next few years, as many non-traditional gamers consider smartphone and tablet games a perfect substitute for casual games played on dedicated handheld hardware. While this news is bad for third-party game publishers focused on the Nintendo 3DS, there are few publishers remaining who are focused in any meaningful way on the 3DS. At least one publisher formerly focused on the Nintendo handhelds is bankrupt (THQ), and another (Ubisoft) has managed to shift its focus from handheld games to a broader hard core offering. Our OUTPERFORM-rated publishers have little exposure to Nintendo's handheld platforms.

This year is shaping up to be quite exciting, with an "Xbox Reveal" event next week and many high profile announcements expected at this year's E3 Expo from June 10-13. We think that investors should pay attention to the Microsoft event on May 21, and those interested in investing in the games sector should plan on attending E3 in June.

**INDIVIDUAL PUBLISHERS**

This note provides our forecast for the major publishing companies we cover, with comments about major titles released during the month and estimates for units sold. All dollar amounts represent retail sales, and not wholesale revenues realized by the publishers.

**Activision Blizzard**

Releases during April included: None.

We estimate Activision generated \$40 million in sales for the month, down 37% from last month and down 6% compared to last April. We believe console/handheld sales were led by *Call of Duty: Black Ops II* and *The Walking Dead: Survival Instinct*, with 250,000 and 150,000 units, respectively. We believe PC sales were led by March release *StarCraft II: Heart of the Swarm* with 75,000 units, down almost 70% sequentially; however, as a PC game, it will be excluded from NPD's console/handheld sales data. We believe catalog sales were led by *Skylanders Giants*.

**Electronic Arts**

Releases during April included: None.

We estimate that EA generated \$42 million in sales for the month, down 21% from last month and down 5% compared to last April. We believe sales were led by a slew of games, including a pair of March releases (*Army of TWO: The Devil's Cartel* and *SimCity*) and a pair of February releases (*Crysis 3* and *Dead Space 3*), although none likely sold over 100,000 units. In addition, as a PC game, *SimCity* will be excluded from NPD's console/handheld sales data. We believe catalog sales were led by *Battlefield 3* and its sports titles, including March release *Tiger Woods PGA Tour 14*.

**Majesco**

Releases during April included: None.

We estimate that Majesco generated \$4 million in sales for the month, down 14% from last month and down 37% compared to last April. We expect sales were again led by *Zumba Fitness Core* with 30,000 units. We believe catalog sales were led by the earlier *Zumba* games and *Monster High Skultimate Roller Maze*.

**Nintendo**

Releases during April included: None.

We estimate that Nintendo generated \$40 million in sales for the month, down 31% compared to last month, and down 3% compared to last April. We estimate Wii U hardware sales of 50,000 units in its sixth month, down over 25% sequentially. We believe March release *Luigi's Mansion: Dark Moon* led sales with 250,000 units. We believe fellow March releases *LEGO City Undercover* and *Pokémon Mystery Dungeon: Gates to Infinity* sold 75,000 units each. We believe catalog sales were led by *Fire Emblem: Awakening* and a slew of *Mario* games.

**Take-Two Interactive Software**

Releases during April included: None.

We estimate that Take-Two generated \$45 million in sales for the month, down 53% from last month and up 89% compared to last April. We believe sales were led by March release *BioShock Infinite* with 300,000 units, helped by outstanding reviews and a late-March release date. We believe catalog sales were led by *NBA 2K13* with 225,000 units, down under 30% sequentially, helped by the start of the NBA Playoffs, and March release *Major League Baseball 2K13*.

**Ubisoft Entertainment**

Releases during April included: None.

We estimate that Ubisoft generated \$16 million in sales for the month, down 38% from last month, and down 13% compared to last April. We believe sales were led by *Just Dance 4* and *Far Cry 3* with 125,000 units and 100,000 units, respectively. We believe catalog sales were led by *Assassin's Creed III*.

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**Covered Companies Mentioned in this Report (priced intraday May 13, 2013)**

COMPANY	TICKER	RATING	PRICE	PRICE TARGET
ACTIVISION BLIZZARD	ATVI	OUTPERFORM	\$14.64	\$22
ELECTRONIC ARTS	EA	OUTPERFORM	\$21.82	\$26
GAMESTOP	GME	OUTPERFORM	\$38.45	\$33
MAJESCO ENTERTAINMENT	COOL	NEUTRAL	\$0.73	\$1
NINTENDO	7974.JP	NEUTRAL	¥10,940	¥10,000
TAKE TWO INTERACTIVE	TTWO	OUTPERFORM	\$16.21	\$19
UBISOFT ENTERTAINMENT	UBI.FP	NEUTRAL	€8.57	€9

**Analyst Certification**

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Neutral: 44%	Neutral: 2%
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Company	Disclosure
Activision Blizzard	1
Electronic Arts	1
GameStop	1
Majesco Entertainment Co.	1
Nintendo	1
Take-Two Interactive Software	1
Ubisoft Entertainment	

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