

# Investment in Gaming Industry – Not a Child’s Play

Special Report



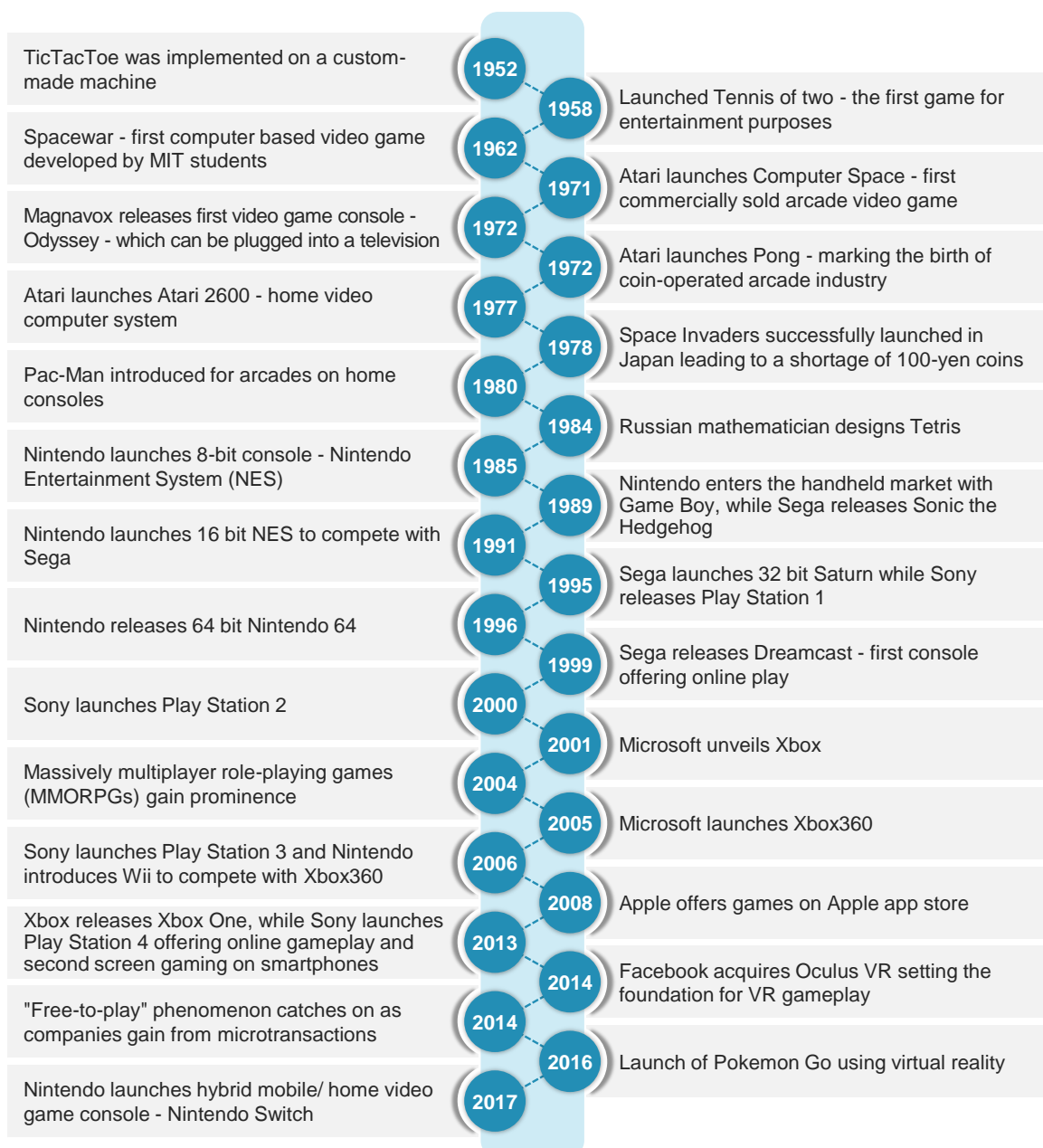
# Investment in Gaming Industry – Not a Child’s Play

Remember the gaming arcades of the 1970s? These ‘cool places to hang out’ were abuzz with noise from machines, coins clinking in the slots and kids shouting as they competed with each other. While the activity has become more individual-centric now, the enthusiasm continues. Games such as *PUBG*, *Angry Birds* and *Candy Crush* feature in almost every smartphone, while the age group of players has expanded.

## Evolution of gaming industry

The gaming industry has evolved significantly over the last few years. Internet penetration and largescale usage of mobile phones have freed gaming from the confines of arcades and living rooms, broadening its horizon.

### Exhibit 1: History of Gaming



Source: Media articles

Today, gaming is an intrinsic part of a young adult's life. It is a cultural milestone in the generation growing up as digital natives. From digital pets such as *Tamagotchi* and nannies like *Alexa* who can tell you bedtime stories, the impact of digitization is clear. The gaming industry is media-oriented now. Players are aware of how to market themselves and influence followers. From catchy names to providing a sample, they go an extra mile to get their game to the user. Games like *PUBG*, *Candy Crush* and *Angry Birds* have achieved unprecedented popularity. *Fortnight* is an interesting example of how to create suspense and hype among users. The widely popular game with thousands of followers suddenly went offline following a barrage of criticism. Followers are now glued to the screen waiting eagerly for its next.

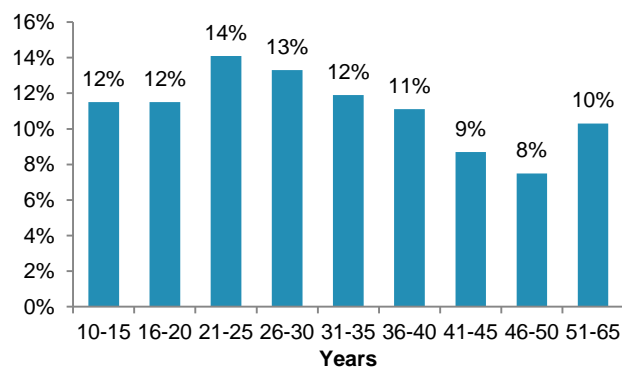
## Profile of new age gamers

The new age gamer is not a high school nerdy teenager anymore. Demographics have changed drastically as has the appearance of a typical gaming fan. Studies show that the average gamer of today is approximately a 34-year old with house and kids. Today, most users are multi-gamers, proficient in more than one game.

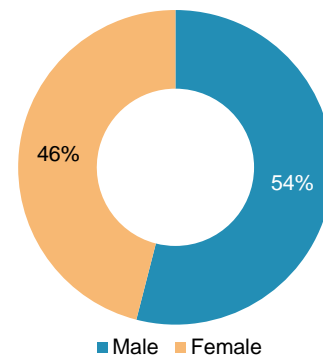
As far as gender is concerned, men score over women marginally, constituting 54% of the overall gaming population vis-à-vis women at 46%. Games like *Bejeweled* and *Candy Crush* have more women followers than men.

In the under 18 crowd, kids below 5 years score over other age groups as far as screen time is concerned. A contributing factor to this is emergence of games designed to increase focus and concentration among kids.

**Exhibit 2: Gamer Profiling by Age**



**Exhibit 3: Gamer Profiling by Gender**



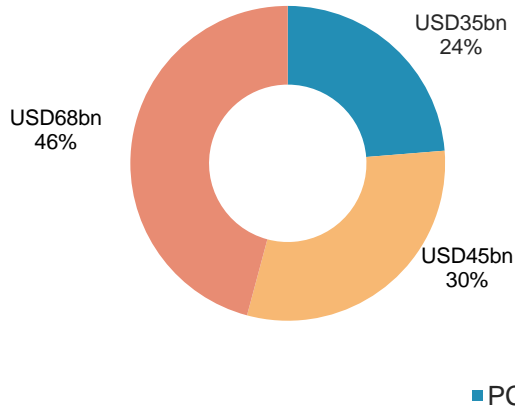
Source: Newzoo

## Investment scenario

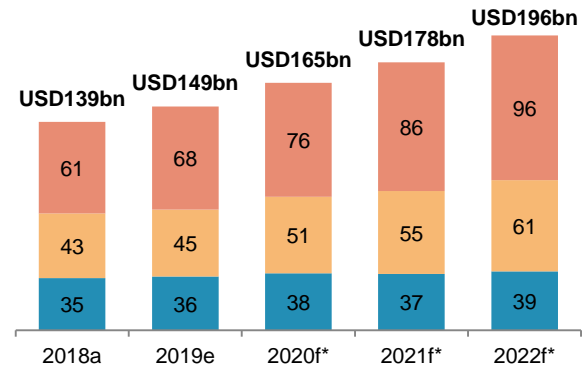
Currently, the industry is pegged at USD149bn, largely dominated by mobile gaming (46% market share), followed by consoles (30%) and PC (24%). The overall market is expected to grow at a CAGR of 9.6% to USD196bn in 2022, led by a robust CAGR of 12.0% in mobile gaming during the period (accounting for 49% of the global gaming market in 2022). In terms of geographies, Asia Pacific and North America are the main contributors to growth in the industry. The APAC gaming industry has grown at a breakneck speed owing to increased use of mobile phones in this region. However, the freeze on licensing and initiatives to control screen time of individuals under the age of 16 in China are expected to restrict revenue growth. The North American market is expected to expand at a CAGR of 9.9% to USD51bn during 2019–22, accounting for 26%

of the global market, followed by the APAC region (expected CAGR of 9.6% to USD94bn; 48% of the global market).

**Exhibit 4: 2019e Sales by Segment**

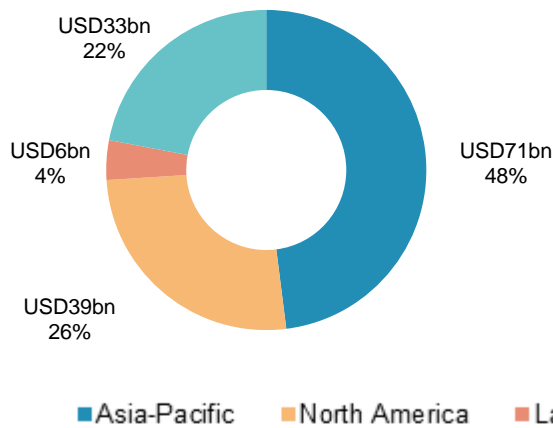


**Exhibit 5: Segment Mix (2018–22)**

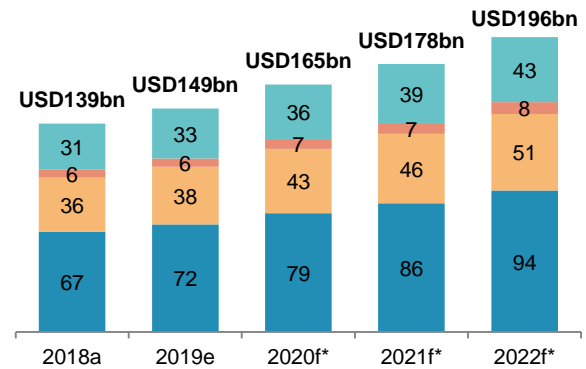


Source: Newzoo, \*estimates from Newzoo Global Games Market Report 2019

**Exhibit 6: 2019e Sales by Geography**



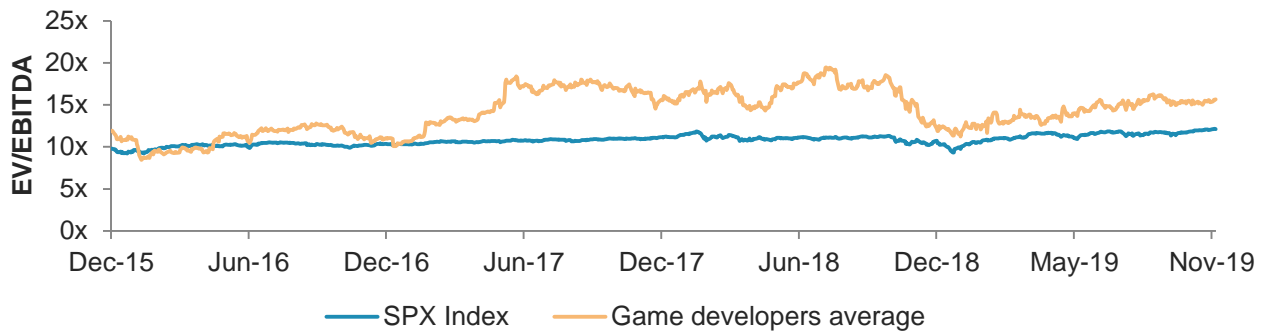
**Exhibit 7: Geographic Mix (2018–22)**



Source: Newzoo, \*estimates from Newzoo Global Games Market Report 2019

The growth momentum is mainly due to high investments in innovations in this sector by game developing companies. Given the focus on innovations, gaming companies command premium valuation, trading at a higher EV/EBITDA multiple compared to S&P 500. Game developers pique the interest of venture capitalists due to their knack to introduce newer and better technologies. Hence, it looks like an ideal investment option. However, this is just one side of the story.

### Exhibit 8: Game Developers Traded at Premium Valuation vis-à-vis SPX



Source: Bloomberg –till 29<sup>th</sup> November 2019; \*Game developers average includes Activision, EA, and Take Two Interactive

### Is investing in gaming industry viable?

Risks associated with high returns are also high. The risk of losing the top spot is constant as innovation does not guarantee sustained competitive advantage. The developer of a popular game will rake in the moolah till the next exciting game enters the market and dislodges current favorites. Also, consumer appetite for games is erratic, changing rapidly and abruptly. Multiplayer online battle royale games took markets by storm, denting the demand for other gaming formats.

### Exhibit 9: Top 10 Games by Sales Indicating Change in Preferences

<b>2017</b>	<ol style="list-style-type: none"> <li>1. Call of Duty: WWII</li> <li>2. NBA 2K18</li> <li>3. Destiny 2^</li> <li>4. Madden NFL 18</li> <li>5. The Legend of Zelda: Breath of the Wild*</li> </ol>	<ol style="list-style-type: none"> <li>6. Grand Theft Auto V</li> <li>7. Tom Clancy's Ghost Recon: Wildlands</li> <li>8. Star Wars: Battlefront II 2017^</li> <li>9. Super Mario Odyssey*</li> <li>10. Mario Kart 8*</li> </ol>
<b>2018</b>	<ol style="list-style-type: none"> <li>1. Red Dead Redemption II</li> <li>2. Call of Duty: Black Ops 4^</li> <li>3. NBA 2K19</li> <li>4. Madden NFL 19^</li> <li>5. Super Smash Bros. Ultimate*</li> </ol>	<ol style="list-style-type: none"> <li>6. Marvel's Spider-Man</li> <li>7. Far Cry 5</li> <li>8. God of War 2018</li> <li>9. Monster Hunter: World</li> <li>10. Assassin's Creed: Odyssey</li> </ol>
<b>2019 YTD</b>	<ol style="list-style-type: none"> <li>1. Call of Duty: Modern Warfare 2019</li> <li>2. NBA 2K20</li> <li>3. Madden NFL 20</li> <li>4. Borderlands 3</li> <li>5. Mortal Kombat 11</li> </ol>	<ol style="list-style-type: none"> <li>6. Kingdom Hearts III</li> <li>7. Tom Clancy's The Division 2</li> <li>8. Super Smash Bros. Ultimate*</li> <li>9. Star Wars Jedi: Fallen Order</li> <li>10. Anthem</li> </ol>

Source: Forbes, NPD; \* Digital not included ^ PC sales not included

Therefore, innovation is a double-edged sword for the industry. History is rife with such examples – Nintendo overthrew Atari and Google displaced Yahoo to take the top spot. At that time, shareholders of Atari or Yahoo would have incurred huge losses, despite the overall industry doing well. They were discarded simply because something more interesting came along. Likewise, if the gaming industry is doing well, it does not necessarily mean the picture for investments would also be rosy.

## ETFs mitigate risk arising from volatility

Gaming stocks must be tapped into, but prudently. One option is to invest via ETFs rather than in specific company stocks to diversify the high risks. A diversified portfolio offers better chances for benefiting from growth.

A number of ETFs focusing on gaming stocks have been launched in the recent years, given the strong growth momentum in the sector. This also provides the investor with a diversified exposure to different regions and sub-segments in the gaming industry.

### Exhibit 10: Snapshot of Prominent ETFs Focused on Gaming

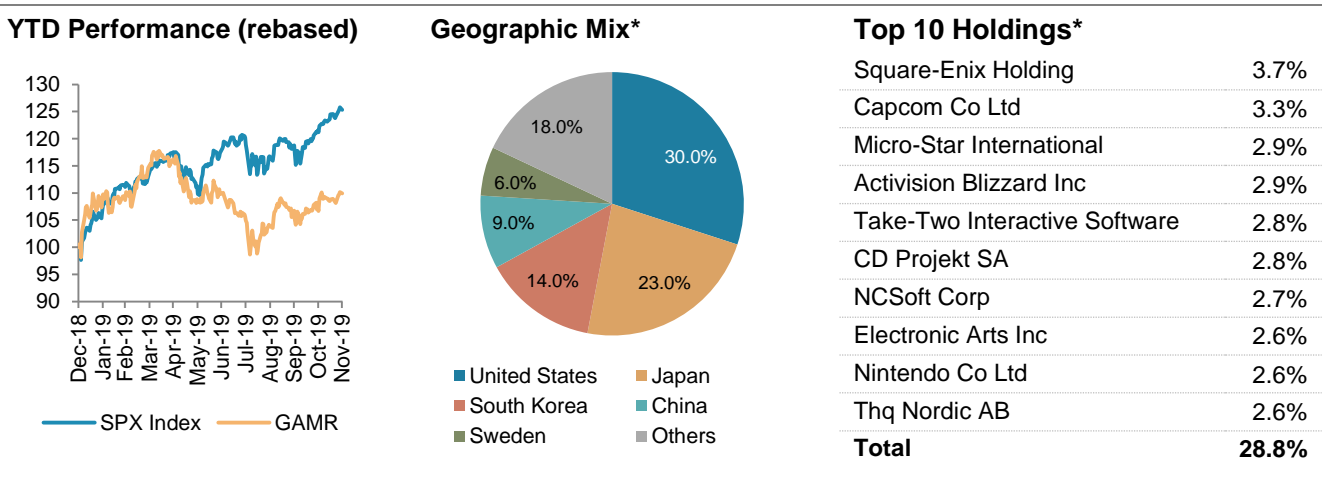
Name	AUM	Number of holdings	YTD returns	Annualized returns since inception
<b>GAMR</b>	USD81.3mn	85	10%	23%
<b>ESPO</b>	USD51.9mn	25	34%	23%
<b>NERD</b>	USD10.3mn	25	2%*	7%
<b>VIDG</b>	USD3.6mn	47	24%	-4%

Source: Bloomberg as of 29<sup>th</sup> November 2019; \* since inception in June 2019

## ETFMG Video Game Tech ETF (GAMR: +10% YTD)

ETFMG Video Game Tech ETF, the first dedicated video game ETF, was launched in 2016. With a diversified portfolio of 85 stocks from 16 countries, the fund tracks growth in the global video game industry. In addition to conventional gaming, the fund provides exposure to mobile gaming and digital downloads.

### Exhibit 11: GAMR Fund Performance and Holding Details



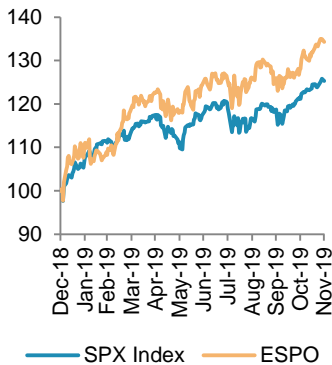
Source: Bloomberg, Factsheet \* Portfolio as of 30th September 2019, data till 29<sup>th</sup> November 2019

## VanEck Vectors Video Gaming and eSports ETF (ESPO: +34% YTD)

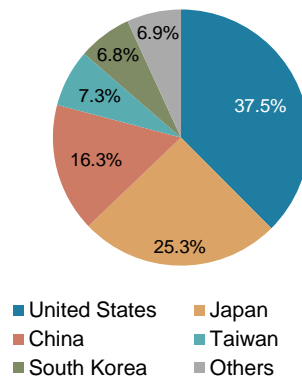
The fund was launched in October 2018 with exposure to the video games and rapidly growing e-sports markets. It only covers companies generating more than 50% of revenue from video games or e-sports. The fund also includes video game developers as well as semiconductor and console manufacturers. ESPO tracks the Global Video Gaming and eSports Index. However, unlike NERD, ESPO largely covers game publishers and a few hardware names such as NVIDIA and Advanced Micro Devices.

### Exhibit 12: ESPO Fund Performance and Holding Details

#### YTD Performance (rebased)



#### Geographic Mix\*



#### Top 10 Holdings\*

NVIDIA Corp	9.0%
Advanced Micro Devices Inc	7.6%
Tencent Holdings Ltd	7.3%
Activision Blizzard Inc	6.7%
Nintendo Co Ltd	6.3%
NetEase Inc	5.5%
Electronic Arts Inc	5.4%
Sea Ltd	5.1%
Zynga Inc	4.5%
Bandai Namco Holdings Inc	4.5%
<b>Total</b>	<b>62.1%</b>

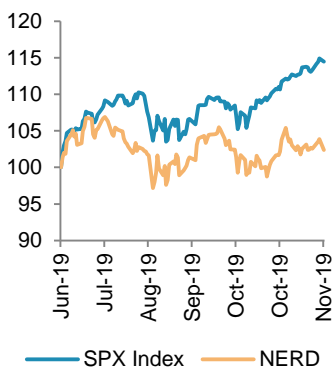
Source: Bloomberg, Factsheet, \*Portfolio as of 30th November 2019, data till 29<sup>th</sup> November 2019

## Roundhill Bitkraft Esports and Digital Entertainment ETF (NERD: +2% since inception)

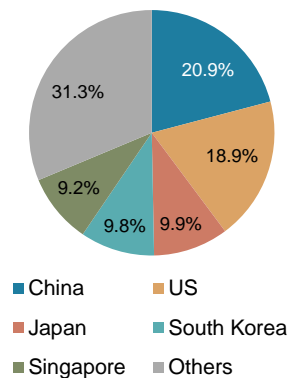
The fund, which began trading on the NYSE in June 2019, is the latest addition to the gaming ETF space. It has 26 stocks in the portfolio, spanning game publishers, hardware manufacturing companies and e-sports companies. Publishers include Activision Blizzard and Take-Two, while well-known hardware companies such as chipmaker NVIDIA also feature in it. Furthermore, the ETF tracks key players in streaming network.

### Exhibit 13: NERD Fund Performance and Holding Details

#### YTD Performance (rebased)



#### Geographic Mix\*



#### Top 10 Holdings\*

Sea Ltd	6.9%
AfreecaTV Co Ltd	6.3%
Activision Blizzard Inc	6.0%
Modern Times Group MTG AB	5.7%
Turtle Beach Corp	5.0%
DouYu International Holdings Ltd	4.7%
NetEase Inc	4.7%
HUYA Inc	4.5%
Asustek Computer Inc	4.4%
CD Projekt SA	4.4%
<b>Total</b>	<b>52.7%</b>

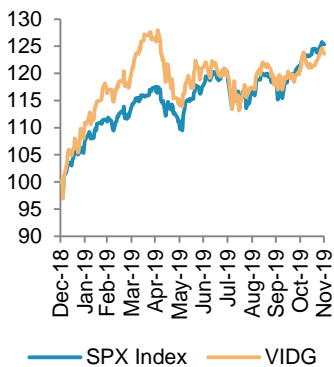
Source: Bloomberg, Factsheet, \*Portfolio as of 30th November 2019, data till 29<sup>th</sup> November 2019

## Defiance Next Gen Video Gaming ETF (VIDG: +24% YTD)

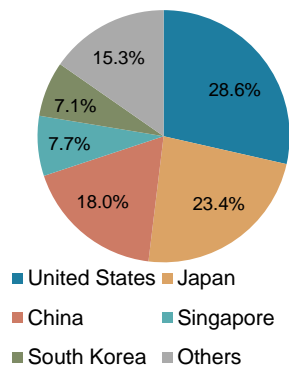
The VIDG ETF portfolio consists of a wide range of promising stocks from sections such as e-sports video games specialists, media companies and hardware producers. The fund gives you an option to invest in equity securities of prestigious global companies whose products or services are popular among consumers, such as interactive entertainment. This includes video games, interactive media and e-sports streaming, among others, equipped with augmented or virtual reality features. It also covers mobile or wearable devices with virtual or augmented reality features, video processing semiconductors and other semiconductors used in electronics for gaming, and online casinos.

### Exhibit 14: VIDG Fund Performance and Holding Details

#### YTD Performance (rebased)



#### Geographic Mix\*



#### Top 10 Holdings\*

Nintendo Co Ltd	5.2%
Tencent Holdings Ltd	5.1%
Activision Blizzard Inc	5.0%
Electronic Arts Inc	4.9%
NetEase Inc	4.8%
Take-Two Interactive Software	4.0%
Microsoft Corp	3.1%
Bandai Namco Holdings Inc	3.1%
NCSOFT Corp	2.8%
Ubisoft Entertainment SA	2.8%
<b>Total</b>	<b>40.8%</b>

Source: Bloomberg, Factsheet, \*Portfolio as of 30th June 2019, data till 29<sup>th</sup> November 2019

### Profiles of Top Game Developers

	 <b>Activision Blizzard</b>	 <b>Electronic Arts*</b>	 <b>Take Two Interactive*</b>
<b>Mcaps</b>	USD41.4bn	USD29.4bn	USD13.8bn
<b>Key Financials (2018)</b>	Revenue: USD 7.5bn Net Profit: USD 1.8bn	Revenue: USD 5.0bn Net Profit: USD 1.0bn	Revenue: USD 2.7bn Net Profit: USD 0.3bn
<b>ROA</b>	10%	29%	8%
<b>Notable Titles</b>	CALL OF DUTY  OVERWATCH	BATTLEFIELD EA SPORTS FIFA 20 EA STAR WARS NEED FOR SPEED	grand theft auto RED DEAD REDEMPTION II BORDERLANDS

Source: Bloomberg, data till 29<sup>th</sup> November 2019, \* Year ending March 2019



## Conclusion

Investment strategies are focused on companies in the growth phase to generate higher returns. However, with most investment ideas maturing and growth stabilizing, the gaming industry, due to its inherent growth potential, provides an alternative investment opportunity. Growth in the gaming industry will be led by technological advancements and innovations that are increasingly appealing to individuals across age groups, genders and nationalities. This only indicates what the future would be like in terms of growth. However, innovation, serving as the double-edged sword, needs to be treated with caution. While new ideas could mean more revenues, there is also the fear of existing games being rendered obsolete. In this backdrop, ETFs have emerged as a means to mitigate the risk and volatility associated with individual stocks.



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Valuation  
Advisory



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