

Digital Entertainment and Internet eCommerce

Industry Rating: Outperform

June 7, 2013

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E3 Preview – Here Comes Next-Gen!

The Electronic Entertainment Expo begins in Los Angeles on Tuesday June 11 running through Thursday June 13. As usual, we expect to hear more about new product introductions and game titles from the various hardware companies and software publishers. However, E3 2013 promises to be one of the most significant in years with Sony and Microsoft facing off with their new consoles – the PlayStation 4 and Xbox One. We expect E3 this year to not only highlight heavily anticipated games that harness the full power of the existing PlayStation 3 and Xbox 360, but to also showcase the new PlayStation 4 and Xbox One, and to offer a glimpse at what the next generation of games can look like on the new consoles. Highly anticipated titles to be showcased include Activision's *Call of Duty: Ghosts*, EA's *Battlefield 4*, and Ubisoft's *Watch Dogs* and *Assassin's Creed IV: Black Flag*. Take-Two's *Grand Theft Auto V* is a confirmed no-show for E3, but that's not to say the company can't release a trailer during the week...

As evidenced by the reported March-quarter results, we believe digital sales will continue to grow and expand operating margins for the traditional publishers in our coverage universe. Accordingly, reported NPD figures are becoming less indicative of total company revenues.

Summary

- E3, the biggest conference in the interactive entertainment industry, begins in LA next week.
- The PlayStation 4 and Xbox One should be the highlight of the show; we expect Sony will unveil what the PS4 will actually look like and that both Sony and Microsoft will release final specifications for their new hardware systems.
- Although we believe the new consoles will be hubs for media entertainment – bringing together games, video, music, and online services through a single device – we expect both companies to focus on games at E3.
- We believe the category is poised to show some renewed strength – principally driven by a strong software line up and the launches of next-gen consoles from Microsoft and Sony.
- We expect Outperform-rated EA and UBI to use E3 to showcase a strong line up of titles for the balance of this year – as well as to highlight some of the ways that they will harness the power of the next-generation consoles.

Refer to pages 21 to 22 for Important Disclosures, including Analyst's Certification.

E3 – What to Expect

The 19th annual Electronic Entertainment Expo (E3) runs from June 11-13 at the Los Angeles Convention Center. This annual trade show brings together tens of thousands of people from within the global interactive entertainment industry. Many of the companies will host media events throughout the week – focusing principally on products that will make their way to consumers later on this year. As usual, we expect to hear more about new product introductions and game titles from the various hardware companies and software publishers. However, E3 2013 promises to be one of the most revelatory in years with Sony and Microsoft facing off with their new consoles – the PlayStation 4 and Xbox One. During the last console cycle, Microsoft's Xbox 360 (which launched in 2005) had a one-year head start over Sony's PlayStation 3 (which launched in 2006), but their successors are both scheduled to launch this holiday season. We anticipate renewed strength in the category, principally driven by the new console platforms.

We expect E3 this year to not only highlight heavily anticipated games that harness the full power of the existing PlayStation 3 and Xbox 360, but to also showcase the new PlayStation 4 and Xbox One. By providing a glimpse at what the next generation of games can look like, we expect the hardware companies to provide a clear reason as to why gamers will want to upgrade their consoles. We expect the next wave of set-top consoles to follow in the footsteps of their prior launches through the introduction of faster hardware, better graphics, and a more engaged online community. We believe the new consoles will build upon the existing systems by acting as comprehensive hubs for media entertainment – bringing together games, video, music, and online services through a single device. In addition, we expect to see further signs of the industry accelerating digital sales of entertainment content.

The following are key questions that will affect the publicly traded interactive entertainment companies that may get answered at E3.

1. What are the launch details for the Xbox One and PlayStation 4 – price, date, quantity?

Our view: The consoles will launch in mid to late November. With a retail price point (at least for a base SKU) of \$399, we expect supplies to be somewhat limited this holiday, and for demand to outpace supply.

2. Why does the consumer need to upgrade their console to the new system? We know it will be bigger, better, and faster – but Nintendo has already shown that the best graphics does not lead to the most hardware unit sales.

Our view: This still needs to be clarified – we believe the power of the consoles will allow for a different dynamic of gameplay. For example, maybe every time you play a game the environment will change. Maybe the online environment can make trying games easier. Thus far we believe that neither Microsoft nor Sony have shown us why the new consoles need to be purchased.

3. Software business models – how are they changing? After years of growing digital revenues, it appears as though both consoles are designed to take advantage of digital downloads. This shift could materially affect the operating margin structure of the publishers.

Our view: Downloads, downloads, downloads. While games will still principally be distributed by a physical disk, we expect significant increased monetization of digital

content. This should allow publishers with big hits to become even more profitable – further exacerbating the hit driven nature of the industry – and boosting operating margins for the publicly traded publishers throughout the next few years.

4. Used games – exactly what will the used business model look like for the next generation of hardware? How will the licensing model that Xbox One is using actually work?

Our view: Microsoft continues to provide some increased clarity on the licensing terms. You'll be able to share the game with your friends, your family can still play your games...but it still feels like it's going to be different with the potential of negatively affecting the used business. Increased visibility around this topic will be critical for GameStop.

Hardware

- Sony/Microsoft – The PlayStation 4 and Xbox One should be the highlight of the show. We expect Sony will unveil what the PS4 will look like and that both Sony and Microsoft will release final specifications for their new hardware systems. We expect the consoles to launch in the fall – in mid to late November – and to have a retail price point of approximately \$399. We see price points above \$399 as being too high to allow the consoles to appeal to a broad audience. In our view, Sony will market the PS4 first and foremost as a gaming machine game while Microsoft's focus for the Xbox One will be as an all-in-one multimedia device. Within our coverage universe, we continue to expect the console platforms from Sony and Microsoft to generate the vast majority of revenues for the four traditional publishers (Activision Blizzard, EA, Take-Two, and Ubisoft) and GameStop.
- Nintendo – Nintendo has decided to forgo its usual E3 press conference in favor of hosting a few smaller events with playable demos specifically focused on the company's software lineup for the US market. Additionally, the company has signed a deal with Best Buy to make a select list of its E3 games playable at more than 100 Best Buy locations across North America. Given the anticipated intensity of the media focus on Sony and Microsoft's new consoles, we believe Nintendo's decision to opt out of a large press conference and focus on more intimate sessions for industry insiders while offering some games that historically have only been playable at E3 to the general public, is a prudent move for the company as it aims to garner more consumer interest in the Wii U.

Software

- *Call of Duty: Ghosts* will likely be heavily showcased as Activision Blizzard plans to release the tenth installment in its best-selling series as a new subseries coinciding with the launch of next-generation consoles (the game will be released on existing consoles as well). In our view, the new title from Infinity Ward could breathe new life into the franchise, featuring a new story (written by Academy Award winning writer Stephen Gaghan of *Traffic* fame), setting, and cast of characters, along with a new canine companion, dynamic multiplayer maps, and full character customization options.
- *Battlefield 4* is, in our view, one of the most anticipated launches of 2013. The game is coming to market following the blockbuster success of *Battlefield 3* two years ago and the

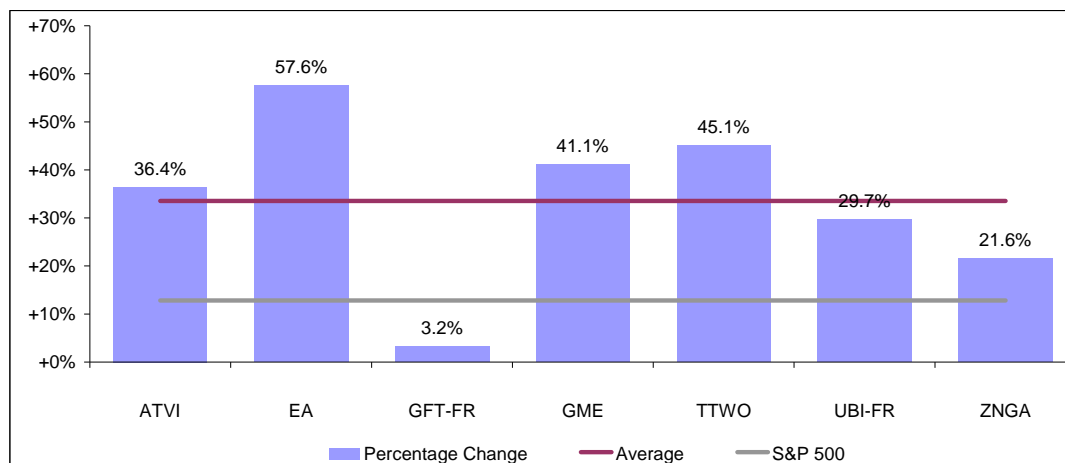
Medal of Honor flop last year. We expect EA to use E3 to showcase the game – as well as its extensive portfolio of next-generation game content.

- We believe Ubisoft may grab headlines at E3 with possibly the strongest line-up of several potential blockbuster titles in 2013 – *Watch Dogs*, *Assassin's Creed 4: Black Flag*, *Tom Clancy's Splinter Cell: Blacklist*, *Rayman Legends*, and *South Park: The Stick of Truth*.
- Take-Two's *Grand Theft Auto V* is a confirmed no-show for E3, but that's not to say the company can't release a trailer during the week...

Stock Performance and Valuation

Year to date, shares of nearly every interactive entertainment company in our coverage universe have outperformed the S&P 500. EA (+58%), TTWO (+45%), GME (+41%), ATVI (+36%), UBI (+30%), and ZNGA (+22%), have all posted significant gains exceeding the S&P 500 (+13%). Although shares of GFT are up just 3% in 2013, they have risen 18% since mid-April with a promising outlook. The strength in the stocks reflects, in our view, optimistic sentiment in the category as investors turn their attention to the opportunity from the next generation of hardware while looking through the challenges of the current operating environment. (This is tied to the companies in the traditional console business and has no impact on Gameloft or Zynga). In our view, shares of GFT have climbed as the company is poised for strong growth in 2013 driven by paymium and freemium games on smartphones and tablets, as well as increased operating leverage. We believe ZNGA's performance was largely driven by developments with real money gaming, although the stock has fallen 16% since announcing a major restructuring plan, that includes cutting 18% of its workforce, to shift its business away from web-based social PC games in an attempt to narrow its focus on mobile gaming.

Year-to-Date Stock Performance



Source: Thomson Reuters and BMO Capital Markets, as of June 6, 2013.

On a valuation basis, share prices of interactive entertainment companies in our coverage universe are now trading at or near historically median multiples, whether we look at P/E, EV/EBITDA, or EV/Sales. Given current valuations coupled with highly liquid balance sheets, we expect many of the companies to buy back stock. However, given substantial cash that is held overseas, their ability to buyback stock may be somewhat curtailed until (and if) they are able to repatriate their cash.

Valuation Multiples (2008 – 2013)

Historical Forward 12 Month P/E

	Quartiles			Current	
	First	Median	Third	2013	2014
Activision Blizzard	11.5	13.0	14.3	17.2	13.1
Electronic Arts	15.0	17.8	20.5	13.8	17.3
Gameloft	15.4	17.2	19.9	18.3	13.0
Take-Two Interactive	5.7	8.3	14.0	5.3	13.2
Ubisoft	11.7	16.7	23.1	12.6	10.5
Zynga	N.M.	N.M.	N.M.	N.M.	N.M.
GameStop	7.0	7.6	8.8	11.3	10.5
Publisher Average	11.9	14.6	18.4	13.4	13.4

Historical Forward EV/EBITDA

	Quartiles			Current	
	First	Median	Third	2013	2014
Activision Blizzard	6.5	7.3	8.4	8.1	6.2
Electronic Arts	6.5	7.9	10.4	8.3	10.4
Gameloft	10.5	12.2	13.2	9.7	6.6
Take-Two Interactive	3.8	12.1	18.0	3.7	7.4
Ubisoft	1.6	2.2	4.1	8.2	7.1
Zynga	N.M.	N.M.	N.M.	47.1	10.4
GameStop	3.5	3.9	5.0	4.6	4.5
Publisher Average	5.8	8.3	10.8	14.2	8.0

Historical Forward EV/Sales

	Quartiles			Current	
	First	Median	Third	2012	2013
Activision Blizzard	2.2	2.4	2.7	2.7	2.3
Electronic Arts	0.9	1.0	1.4	1.3	1.4
Gameloft	1.8	2.0	2.2	1.6	1.4
Take-Two Interactive	0.6	1.0	1.1	0.8	1.0
Ubisoft	0.6	0.8	1.2	0.8	0.7
Zynga	N.M.	N.M.	N.M.	1.7	1.5
GameStop	0.3	0.3	0.5	0.4	0.4
Publisher Average	1.2	1.4	1.7	1.3	1.3

Source: Company documents and BMO Capital Markets estimates.

We are raising our price target for UBI to €12 (from €10) with greater confidence in our FY2014 estimates, reflecting the company's prospects with its strong pipeline of games and a higher target multiple owing to improving investor sentiment for the category as a whole. Our €12 target represents a multiple of approximately 15x our FY2014 EPS estimate.

Release schedule. Following the launch of Take-Two's *BioShock Infinite* at the end of March, we expect a light release schedule through the June quarter until the summer's releases, starting off with Sony's *The Last of Us*. The PS4 and Xbox One launch this holiday period and kick off the beginning of a new console cycle from Sony and Microsoft that we believe will be a key catalyst for the interactive entertainment companies in our coverage universe.

Upcoming Key Launches

Title	Publisher	Release Date	Platforms
<i>The Last of Us</i>	Sony	Jun 14	PS3
<i>Disney Infinity</i>	Disney	Aug 18	360, PS3, Wii U/Wii, 3DS, PC
<i>Splinter Cell: Blacklist</i>	Ubisoft	Aug 20	360, PS3, Wii U, PC
<i>Saints Row IV</i>	Deep Silver	Aug 20	360, PS3, PC
<i>Madden NFL 25</i>	EA	Aug 27	360, PS3
<i>Rayman Legends</i>	Ubisoft	Sep 3	360, PS3, Wii U
<i>Grand Theft Auto V</i>	Take-Two	Sep 17	360, PS3
<i>FIFA 14</i>	EA	Sep	360, PS3, PC
<i>NBA 2K14</i>	Take-Two	Oct 1	TBA
<i>Beyond Two Souls</i>	Sony	Oct 8	PS3
<i>Assassin's Creed IV: Black Flag</i>	Ubisoft	Oct 29	360, PS3/4, Wii U, PC
<i>Skylanders SWAP Force</i>	Activision	Fall 2013	360, PS3, Wii U/Wii, 3DS
<i>Call of Duty: Ghosts</i>	Activision	Nov 5	360, PS3/4, Wii U, PC
<i>Watch Dogs</i>	Ubisoft	Nov 19	360, PS3/4, Wii U, PC
<i>NBA Live 14</i>	EA	4Q	360, PS3
<i>Battlefield 4</i>	EA	4Q	360, PS3, PC
<i>Need for Speed</i>	EA	4Q	360, PS3, PC
<i>Elder Scrolls Online</i>	Bethesda	2013	PC
<i>Destiny</i>	Activision	TBA	360, PS3/4

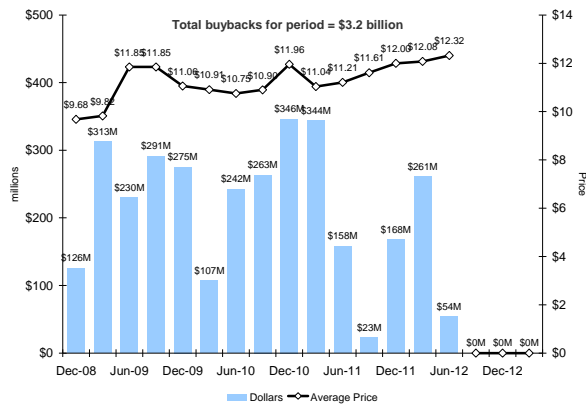
Source: The NPD Group; release dates are 2013.

Buybacks and Dividends

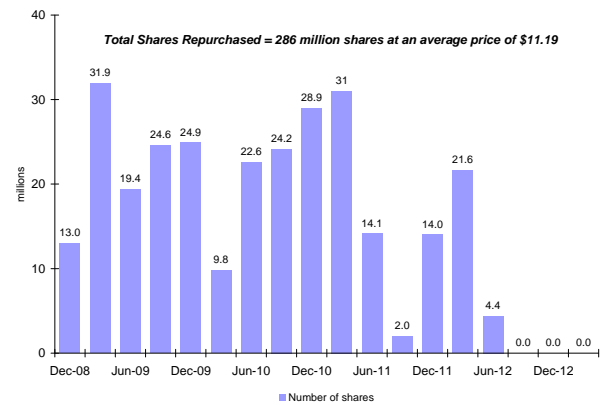
- Activision Blizzard did not repurchase any shares in the March quarter, representing the third consecutive quarter that buybacks were not executed against the remaining \$946 million in the current \$1 billion authorization from February 2012. No update was provided on the company's capital allocation plans, except to say that the company may take on debt to buy back stock, pay a dividend, or make an acquisition. We continue to believe that the management team and the board will look at ways to use the balance sheet to enhance shareholder value. Hypothetically, at today's closing price of \$14.62, \$946 million could reduce the company's float by 64.7 million shares, or 15% of its float (Vivendi owns 61% of ATVI outstanding shares).
- During the quarter, Activision Blizzard paid a cash dividend of \$0.19 per share, totaling \$217 million and represented a 6% increase over the dividend paid in the year-ago period. At yesterday's closing price, the dividend yield is 1.3%.
- Electronic Arts repurchased 0.9 million shares totaling \$13.0 million in the March quarter; \$222 million remains in the \$500 million buyback program initiated in August 2012. At yesterday's closing price of \$23.28, that could reduce the company's outstanding shares by 9.5 million shares, or 3% of the existing share base.
- GameStop repurchased approximately one million shares totaling \$25.5 million during the April quarter; \$400 remains in the current authorization. We believe the company remains committed to returning 100% of free cash flow to shareholders through dividends and share buybacks. At yesterday's closing price of \$34.62, that could reduce the company's outstanding shares by 11.6 million shares, or 10% of the existing share base.
- During the quarter, GameStop paid a cash dividend of \$0.275 per share, representing an 83% increase over the dividend paid in the year-ago period. At the current quarterly run rate and yesterday's closing price, the dividend yield is 3.2%.
- Zynga repurchased 1.0 million shares totaling \$2.4 million in the March quarter; \$186 million remains in the \$200 million buyback program initiated in October 2012. At yesterday's closing price of \$2.85, that could reduce the company's outstanding shares by 65.3 million shares, or 8% of the existing share base.

Activision Blizzard Buybacks

Dollar Amount and Average Price



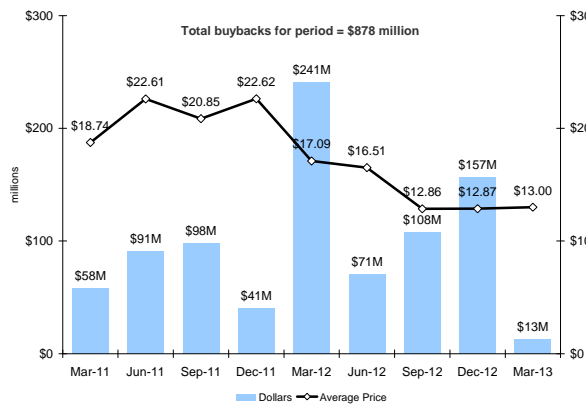
Number of Shares Repurchased



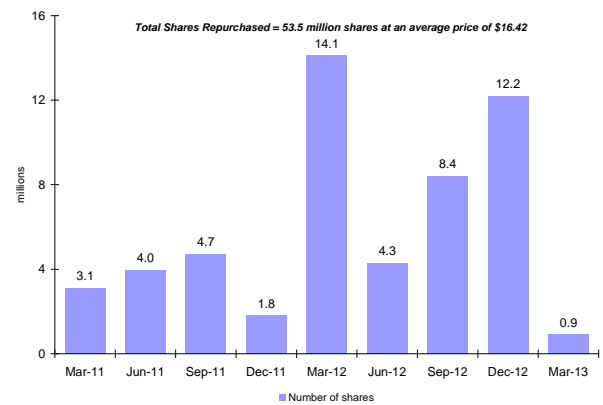
Source: Company documents and BMO Capital Markets estimates.

Electronic Arts Buybacks

Dollar Amount and Average Price



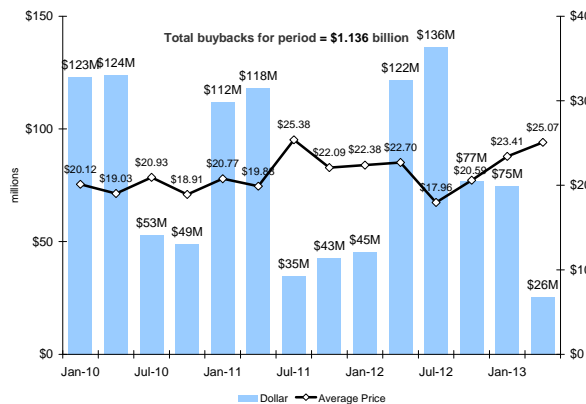
Number of Shares Repurchased



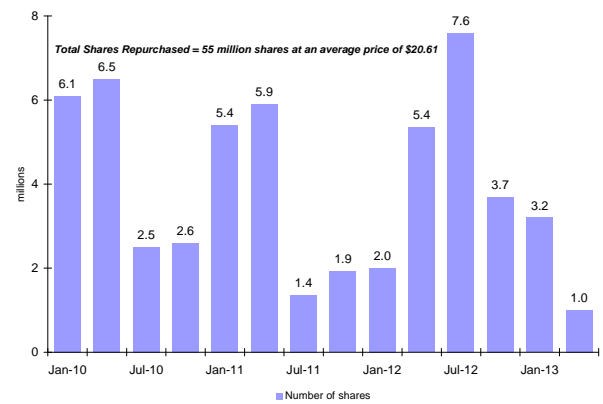
Source: Company documents and BMO Capital Markets estimates.

GameStop Buybacks

Dollar Amount and Average Price



Number of Shares Repurchased



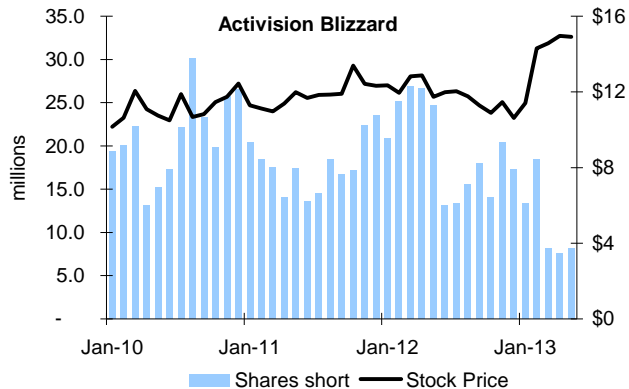
Source: Company documents and BMO Capital Markets estimates.

Short Interest

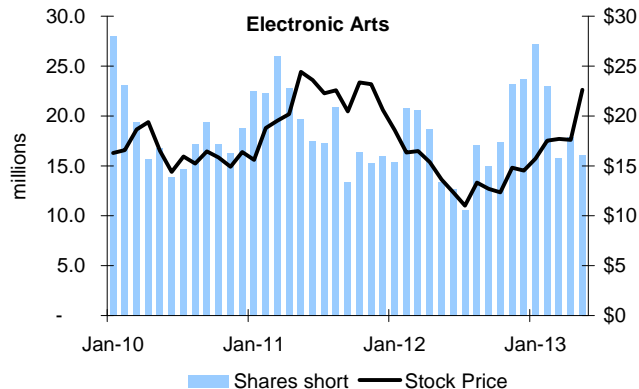
Short interest levels for the interactive entertainment companies in our coverage universe vary widely from 1% for ATVI to 29% for GME, reflecting investor concerns with the threat of digital distribution and restrictions on used games to the company's long-term viability. EA and ZNGA have relatively low short interest as well, 5% and 3%, respectively, while TTWO remains elevated. What the traditional publishers have in common is that they have all seen the number of shares short decline over the past few months as investors look ahead to what should be a period of sustained growth in the years following the new console launches from Microsoft and Sony.

Short Interest and Share Prices

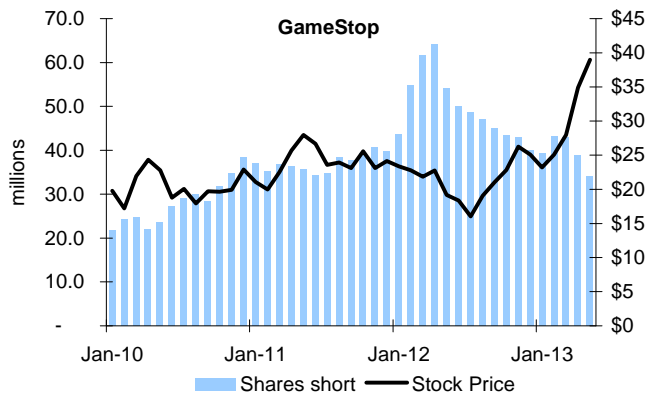
Activision Blizzard



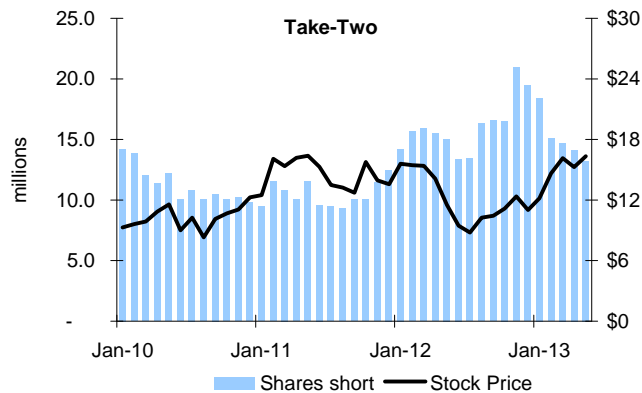
Electronic Arts



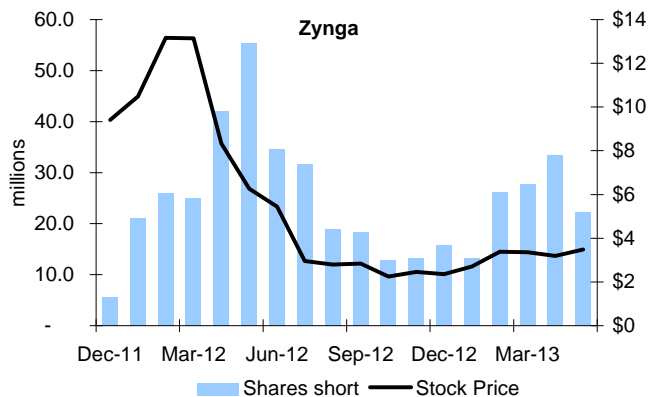
GameStop



Take-Two



Zynga



Source: Thomson Reuters and BMO Capital Markets, as of May 15, 2013.

Looking Back: March-Quarter Revenues

Collectively among the six interactive entertainment publishers in our coverage universe, total revenue was up 16%. Activision Blizzard, Electronic Arts, Gameloft, Take-Two, and Ubisoft posted gains while Zynga had a decline. In that same time period, retail sales of console software, according to NPD, were down 10%.

- Activision Blizzard reported better-than-expected revenues and earnings driven by its pillar *Call of Duty*, and *Skylanders* franchises, along with the release of *Starcraft: Heart of the Swarm*. Digital sales, boosted by digital revenues from *Call of Duty* and the PC launch of *Starcraft II: Heart of the Swarm*, grew 44% versus a year ago; accounting for approximately 53% of revenue versus 51% last year. *World of Warcraft* subscribers fell 14% to 8.3 million subscribers from 9.6 million subscribers in the prior quarter with the majority of the decline from China. On a trailing 12 months basis, Activision revenues for the period ending March 2013 were up 20%.
- EA posted better-than-expected top-line results boosted by the revenue recognition of the full year's *Battlefield 3* Premium subscriptions and the launch of *SimCity*. Digital revenues climbed 45% to \$618 million, representing 59% of total revenue versus 57% last year, with strong growth – consoles (up 58% to \$243 million), PC (up 46% to \$271 million), and smartphones/tablets (up 27% to \$79 million). Feature phones climbed 4% to \$25 million. On a trailing 12 months basis, EA revenues for the period ending March 2013 were down 9%.
- Gameloft posted strong revenues driven by iOS and Android smartphones and tablets (+71%), as well as sales growth across every region, led by EMEA (+53%) and LATAM (+22%). Micro-transactions and advertising continue to be key drivers of revenue growth – 67% of smartphone and tablet revenues in the March quarter, similar to the prior quarter, but up from 39% a year ago. On a trailing 12 months basis, Gameloft revenues for the period ending March 2013 were up 21%.
- Take-Two posted significantly better-than-expected top-line results, principally driven by the strong launch of *BioShock Infinite* (which has sold in more than 3.7 million units). Boosted by full-game downloads and DLC, digital sales nearly tripled y/y, accounting for 27% of revenues. On a trailing 12-months basis, Take-Two revenues for the period ending March 2013 were up 48%.
- Ubisoft posted better-than-expected revenues, driven by its pillar *Assassin's Creed*, *Just Dance*, and *Far Cry* franchises, along with strong growth in online/digital sales. On a trailing 12-months basis, Ubisoft revenues for the period ending March 2013 were up 18%.
- Zynga reported bookings ahead of expectations, but down significantly (-30%) from a year ago driven by a smaller portfolio of games, lower engagement on Facebook games, and the ongoing transition to mobile. Mobile contributed 22% of bookings, up from 12% a year ago. That said, mobile DAUs were flat sequentially at 20 million, while mobile MAUs declined from 72 million to 65 million as only one mobile game launched in the quarter (*What's the Phrase?*). Advertising revenues grew 21% to \$34 million, representing 13% of total revenues in the quarter, up from 9% a year ago. On a trailing 12-months basis, Zynga revenues for the period ending March 2013 were down 13%.

- GameStop's revenues were higher than expected, but down from a year ago primarily driven by slower console hardware sales reflecting consumer pull-back for current legacy systems ahead of the upcoming launches of Sony's PS4 and Microsoft's Xbox One – both of which are expected for this holiday season. That said, we believe the company continues to gain share – new SW sales were down 3.8%, while new HW sales were down 30.6%. Both segments posted materially higher results than the new SW and HW sales declines of 14.2% and 35.8%, respectively, reported by NPD for the period. Digital sales continued to see strong momentum in the April quarter (up 47%); PC digital sales grew 54%, console digital sales grew 44%, and Kongregate grew by 57%. On a trailing 12-months basis, GameStop revenues for the period ending March 2013 were down 6%.

Interactive Entertainment Revenues

	Total Revenues (millions)			Trailing 12-Months		
	Mar-12	Mar-13	% Change	Mar-12	Mar-13	% Change
Activision Blizzard	\$587	\$804	+37%	\$4,321	\$5,204	+20%
Electronic Arts	\$977	\$1,040	+6%	\$4,186	\$3,793	-9%
Gameloft	€ 37	€ 50	+35%	€ 151	€ 183	+21%
Take-Two	\$148	\$303	+105%	\$826	\$1,222	+48%
Ubisoft	€ 161	€ 175	+9%	€ 1,061	€ 1,256	+18%
Zynga	\$329	\$230	-30%	\$1,198	\$1,048	-13%
GameStop	\$2,002	\$1,865	-7%	\$9,271	\$8,750	-6%

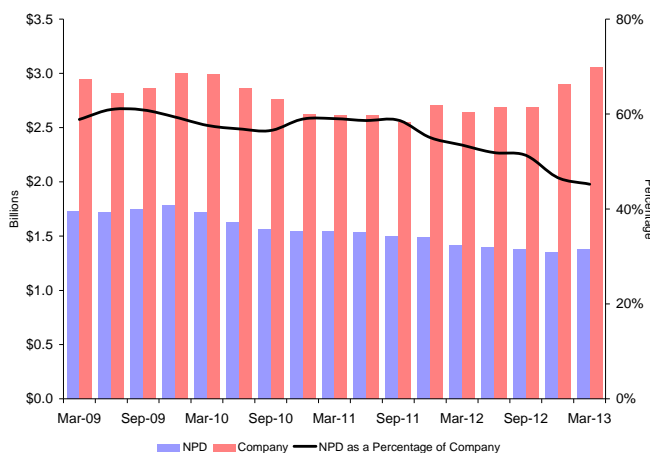
Source: Company documents and BMO Capital Markets. Zynga figures are bookings and GameStop figures are April-quarter end.

NPD Data

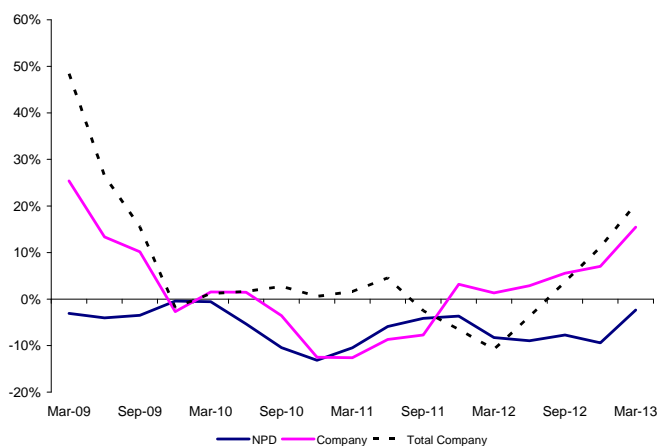
Although there is a high correlation between reported NPD sell-through trends relative to console and handheld growth rates of the publishers in our universe in the comparable periods, we believe packaged goods sales are becoming less significant relative to overall sales and the reported NPD figures will be less indicative of total company revenues. The charts below illustrate this point for several publishers in our coverage universe, particularly with Activision Blizzard and Electronic Arts. For instance, retail software sales on consoles and dedicated handhelds for EA declined 31% for the 12 months ending March 2013 according to NPD. However, the company reported console and dedicated handheld software revenue that declined 17% over the equivalent period, while the company's consolidated revenue for the period saw a lower decline of 9%. We believe this divergence will widen as digital revenue streams not captured by NPD data continue to grow for game publishers.

Publisher Revenues versus NPD Sell-Through

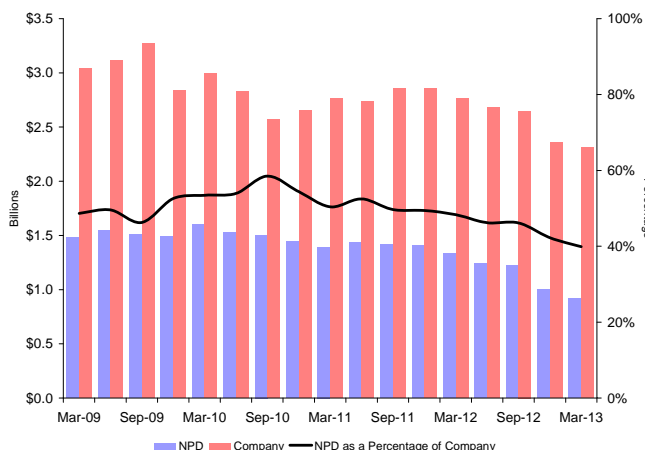
Activision Blizzard Console and Handheld Software Sales



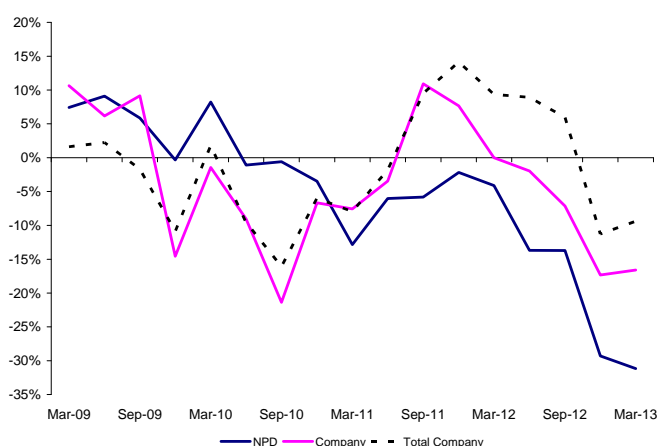
Activision Blizzard % Y/Y Change



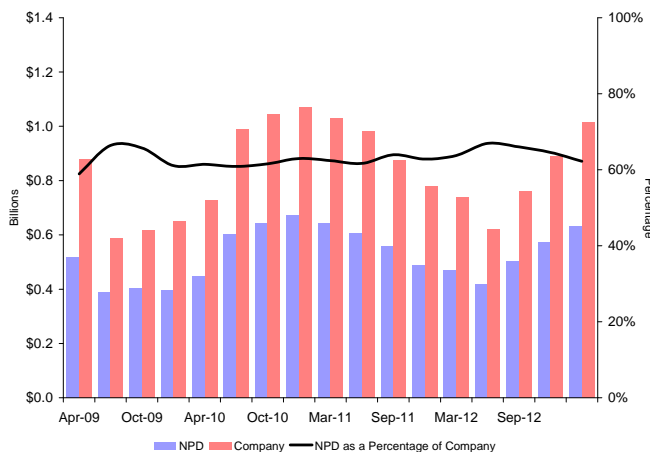
Electronic Arts Console and Handheld Software Sales



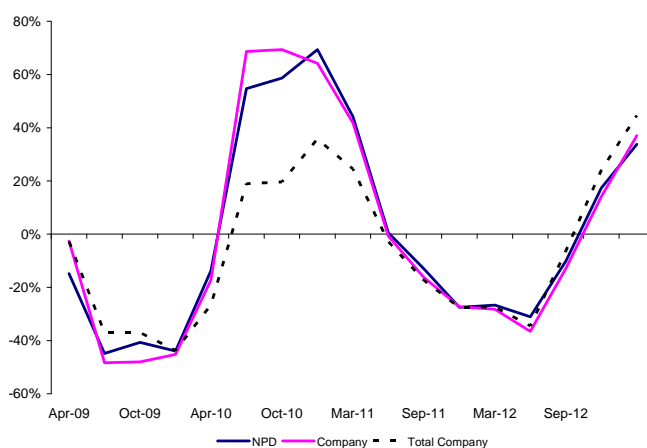
Electronic Arts % Y/Y Change



Take-Two Console and Handheld Software Sales

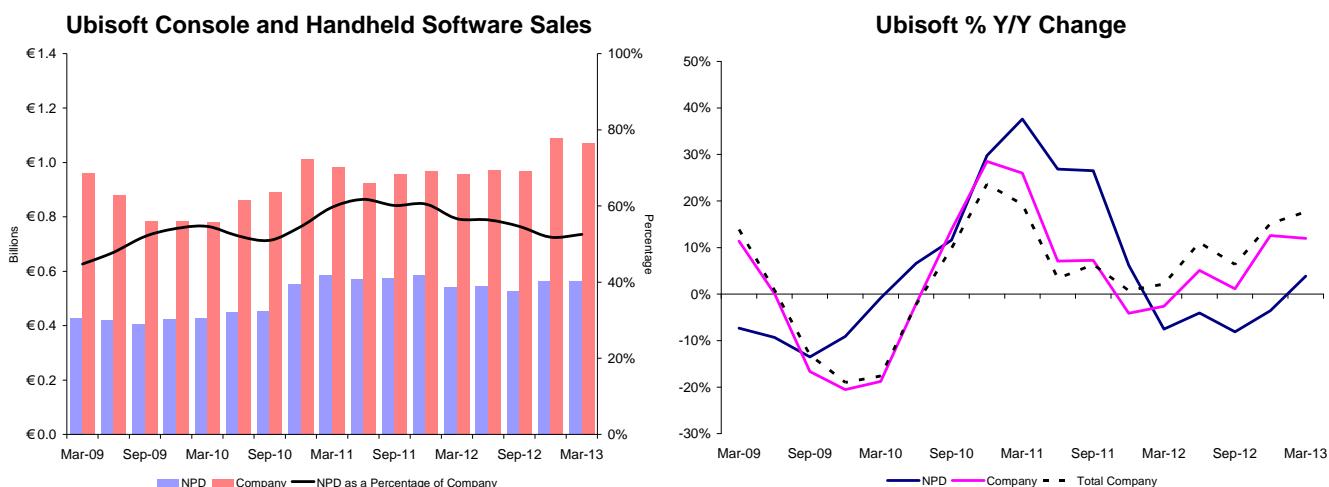


Take-Two % Y/Y Change



Source: NPD Group/Retail Tracking Service, company documents, and BMO Capital Markets estimates.

Publisher Revenues versus NPD Sell-Through (continued)



Source: NPD Group, company documents, and BMO Capital Markets estimates. Ubisoft reported figures are in euros.

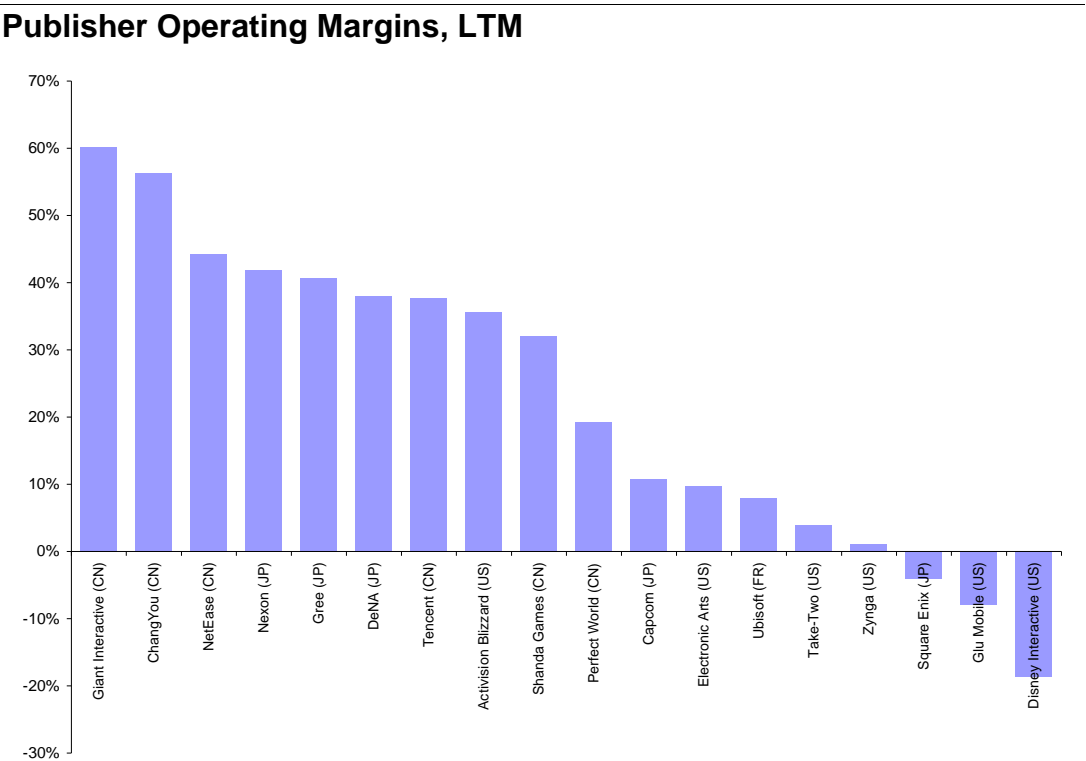
Operating Margins

Across our coverage universe for the five interactive entertainment companies that have reported bottom-line results for the March quarter, operating margin performance has generally improved, partially owing to release schedules. Take-Two experienced a significant spike in operating margins as overall gross margins grew 2,772 basis points to 49.6%, primarily driven by lower license expense with the expiration of the company's previous contract with Major League Baseball. Zynga also posted a significant decline in operating margins as the company saw weaker-than-expected player engagement and continues to invest heavily in mobile. We expect operating margins to improve as publishers continue to focus on digital sales and fewer, better, and bigger console titles to lower their cost structures, particularly with research and development expenses. The Asian game companies remain considerably more profitable, but we expect that gap to narrow over time as the Western companies increase their digital revenue streams and the Asian companies further invest in development and marketing.

Interactive Entertainment Operating Margins

	Quarter			Trailing 12-Months		
	Mar-12	Mar-13	Change	Mar-12	Mar-13	Change
Activision Blizzard	15.3%	30.7%	+15.4%	28.5%	35.6%	+7.2%
Electronic Arts	7.9%	22.4%	+14.5%	9.5%	9.7%	+0.2%
Take-Two	-34.5%	14.9%	+49.5%	-6.0%	4.0%	+10.0%
Ubisoft	13.0%	16.2%	+3.3%	5.3%	8.0%	+2.7%
Zynga	17.4%	-1.4%	-18.9%	14.3%	1.1%	-13.2%
GameStop	5.7%	4.7%	-1.1%	6.0%	-0.8%	-6.8%

Source: Company documents and BMO Capital Markets. Ubisoft's March margins are semester figures. GameStop margins are April quarter figures.



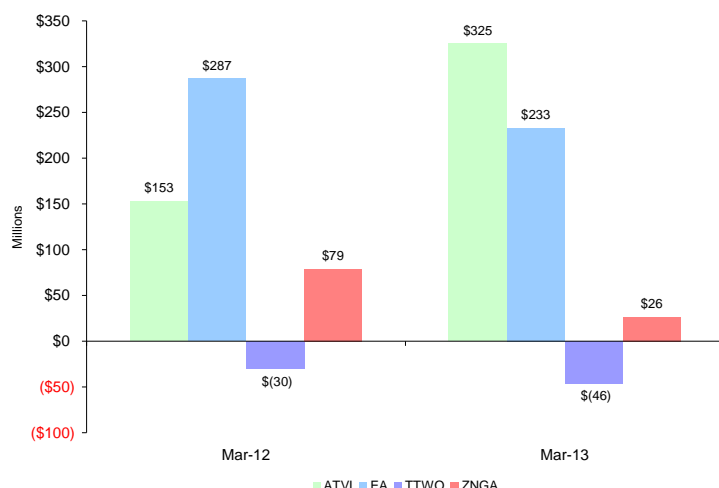
Source: Company documents, Thomson Reuters, and BMO Capital Markets.

Operating Cash Flow

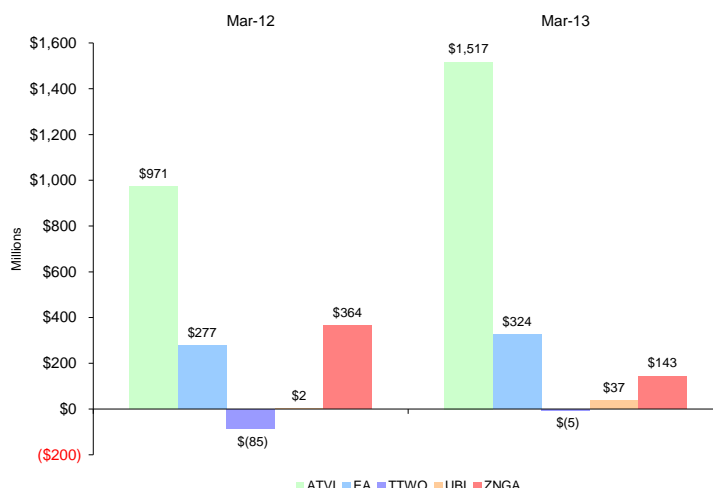
March quarter cash flow from operations highlights the lumpiness of cash flow for the companies based on release schedules. Activision Blizzard's robust trailing 12-month cash flow reflects the strength of the company's key pillars (*World of Warcraft* and its recurring subscription fees and *Call of Duty*) that help drive the company's steady cash flow from operations.

Interactive Entertainment Operating Cash Flow

Operating Cash Flow, March Quarter



Operating Cash Flow, TTM



Source: Company documents and BMO Capital Markets. GME figures are estimates as of April quarter end.

Balance Sheet Highlights

We believe the publishers are mostly well capitalized with healthy balance sheets, with several having significantly high cash balances (Zynga, Activision Blizzard, and Electronic Arts). Zynga's high proportion of cash as a percentage of the company's market capitalization highlights a depressed valuation at current share prices.

Electronic Arts and Take-Two hold convertible debt. As of March 31, EA had \$559 million in 0.75% convertible senior notes due 2016 (July 15) with an initial conversion price of \$31.74. Take-Two has two tranches of convertible debt – \$125 million in 4.375% convertible notes due 2014 (June 1) with an initial conversion price of \$10.68 and \$210 million in 1.75% convertible notes due 2016 (December 1) with an initial conversion price of \$19.09.

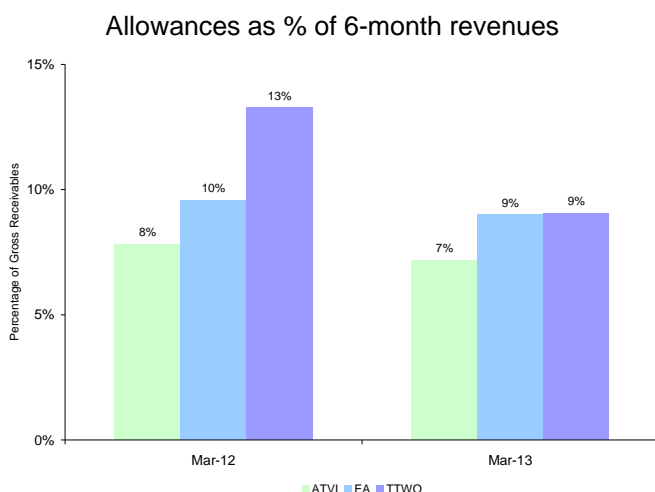
Cash and Debt Positions

	Cash		Debt		Net Cash/Share		Net Cash as % of Market Cap
	Mar-12	Mar-13	Mar-12	Mar-13	Mar-12	Mar-13	
ATVI	\$3,476	\$4,618	\$0	\$0	\$3.08	\$4.12	26%
EA	\$1,849	\$1,680	\$539	\$559	\$3.95	\$3.68	16%
GME	\$329	\$246	\$0	\$0	\$2.44	\$2.06	6%
TTWO	\$420	\$403	\$316	\$335	\$1.23	\$0.56	3%
UBI	€ 176	€ 238	€ 93	€ 133	€ 0.87	€ 1.07	1%
ZNGA	\$1,521	\$1,671	\$0	\$100	\$1.80	\$1.90	56%

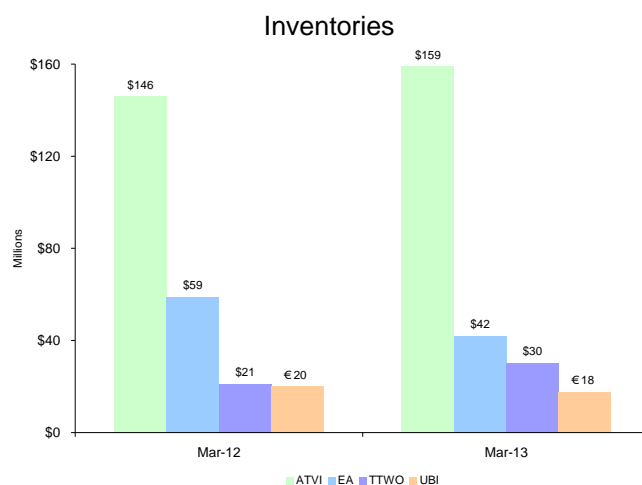
Source: Company documents and BMO Capital Markets. In millions except for per share figures.

Allowances as a percentage of gross receivables for the publishers in our coverage universe were generally lower versus a year ago; in addition, inventories were also generally lower with the exception of Activision Blizzard. This can be attributed to the timing of various release schedules, but we also believe this highlights the growing strength of digital sales, which have no physical inventory requirements and do not necessitate allowances. That said, we believe the rise in inventory levels at Activision Blizzard (to \$159 million from \$146 million) was driven by higher levels of physical *Skylanders* toys.

Balance Sheet Charts and Metrics



Source: Company documents and BMO Capital Markets.



Source: Company documents and BMO Capital Markets.

A Look East

Many of the Japanese and Chinese game companies that have a largely digital distributed revenue stream have reported their March quarter results. While individual performances vary, of course, collectively the companies continue to post strong operating margins. In general these robust operating margins reflect the benefits of the digital revenue stream. While we do not expect the Western companies to match their Asian counterparts with margins, we believe that as the direct to consumer business grows, we should generally see an improving trend in operating margins for traditional US publishers. As for the Asian game publishers, we expect their higher operating margins (versus US publishers) to decline over time with rising development and marketing costs to support higher quality, differentiated games.

In particular, we believe the strength of Tencent's platform augurs well for two companies in our coverage universe – Activision Blizzard and Take-Two, both of which are partnering with Tencent to bring some of their bigger brands to the Chinese market. We also expect the relationship between EA and Nexon to be helpful with the launch of *FIFA Online 3* in Korea – the title is the top-ranked sports game in the country.

Key Metrics for Select Asian-based Game Companies

	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	% change
ChangYou (Currency in millions of USD)						
TTM Revenues	\$516	\$550	\$588	\$623	\$664	29%
TTM Operating Income (Non-GAAP)	\$304	\$320	\$340	\$354	\$374	23%
TTM Operating Margin	59%	58%	58%	57%	56%	
DeNA (Currency in billions of Japanese Yen)						
TTM Revenues	¥146	¥159	¥175	¥193	¥203	38%
TTM Operating Profit	¥60	¥64	¥69	¥76	¥77	28%
TTM Operating Margin	41%	40%	40%	40%	38%	
Giant Interactive (Currency in millions of Chinese Yuan)						
TTM Revenues	¥ 1,898	¥ 1,990	¥ 2,075	¥ 2,152	¥ 1,643	-13%
TTM Operating Income	¥ 1,147	¥ 1,219	¥ 1,264	¥ 1,305	¥ 988	-14%
TTM Operating Margin	60%	61%	61%	61%	60%	
GREE (Currency in billions of Japanese Yen)						
TTM Revenues	¥139	¥158	¥166	¥164	¥155	12%
TTM Operating Profit	¥74	¥83	¥82	¥75	¥63	-14%
TTM Operating Margin	53%	52%	49%	46%	41%	
NetEase (Currency in millions of Chinese Yuan)						
TTM Revenue	¥ 7,938	¥ 8,164	¥ 8,202	¥ 8,380	¥ 8,634	9%
TTM Operating Income	¥ 3,605	¥ 3,702	¥ 3,607	¥ 3,711	¥ 3,826	6%
TTM Operating Margin	45%	45%	44%	44%	44%	
Nexon (Currency in billions of Japanese Yen)						
TTM Revenues	¥97	¥100	¥100	¥108	¥122	26%
TTM Operating Income	¥46	¥48	¥47	¥47	¥51	12%
TTM Operating Margin	47%	48%	47%	44%	42%	
Perfect World (Currency in millions of Chinese Yuan)						
TTM Revenues	¥ 2,983	¥ 2,880	¥ 2,867	¥ 2,771	¥ 2,677	-10%
TTM Operating Income	¥ 1,070	¥ 894	¥ 801	¥ 624	¥ 517	-52%
TTM Operating Margin	36%	31%	28%	23%	19%	
Shanda Games (Currency in millions of Chinese Yuan)						
TTM Revenues	¥ 5,419	¥ 5,229	¥ 4,956	¥ 4,682	¥ 4,377	-19%
TTM Operating Income	¥ 1,806	¥ 1,760	¥ 1,651	¥ 1,559	¥ 1,402	-22%
TTM Operating Margin	33%	34%	33%	33%	32%	
Tencent (Currency in millions of HK \$)						
TTM Revenues	HK\$31,806	HK\$35,594	HK\$39,663	HK\$43,894	HK\$47,793	50%
TTM Operating Income (Non-GAAP)	HK\$14,159	HK\$15,183	HK\$16,247	HK\$17,053	HK\$18,045	27%
TTM Operating Margin	45%	43%	41%	39%	38%	

Source: Company documents, gamerankings.com and BMO Capital Markets.

Bestsellers at GameStop, Amazon, and Wal-Mart

Looking at the bestseller lists this week, the lists included several upcoming key titles, including *The Last of Us* (Sony), *Call of Duty: Ghosts* (Activision Blizzard), and *Battlefield 4* (Electronic Arts). *Skylanders Giants* continues to be littered among the Top 10 lists across all the major console platforms (including all 10 spots on the Wii U at GameStop) as the hybrid action figure toy and video game continues to resonate well with children – this augurs well for the upcoming *Skylanders SWAP Force* sequel scheduled to be released later this fall. We are also seeing a number of titles appear on the Top 10 lists that are digitally distributed, including *Minecraft*, *Huntsman – The Orphanage*, *16 Bit Arena*, and *Runescape*.

Retail Best Sellers

GameStop – All Platforms

<u>Rank</u>	<u>Platform</u>	<u>Title</u>	<u>Publisher</u>	<u>Price</u>
1	PS3	<i>The Last of Us</i>	Sony	\$59.99
2	PS3	<i>The Last of Us Survival Edition</i>	Sony	\$79.99
3	3DS	<i>Animal Crossing: New Leaf</i>	Nintendo	\$34.99
4	Collectible	<i>Assassin's Creed IV Hidden Blade</i>	McFarlane Toys	\$39.99
5	PS3	<i>The Last of Us Post-Pandemic Edition</i>	Sony	\$159.99
6	360	<i>Injustice: Gods Among Us Collector's</i>	Warner	\$99.99
7	360	<i>Minecraft (Xbox Live)</i>	Ubisoft	\$19.99
8	360	<i>State of Decay</i>	Microsoft	\$19.99
9	360	<i>Minecraft</i>	Ubisoft	\$19.99
10	360	<i>Call of Duty: Ghosts</i>	Activision	\$59.99

GameStop – Xbox 360

<u>Rank</u>	<u>Title</u>	<u>Publisher</u>	<u>Price</u>
1	<i>Injustice: Gods Among Us Collector's</i>	Warner	\$99.99
2	<i>Minecraft (Xbox Live)</i>	Ubisoft	\$19.99
3	<i>State of Decay</i>	Microsoft	\$19.99
4	<i>Minecraft</i>	Ubisoft	\$19.99
5	<i>Call of Duty: Ghosts</i>	Activision Blizzard	\$59.99
6	<i>Battlefield 4</i>	Electronic Arts	\$59.99
7	<i>Injustice: Gods Among Us</i>	Warner	\$59.99
8	<i>Grand Theft Auto V GameStop Excl.</i>	Take-Two	\$149.99
9	<i>Trials Evolution - Xbox 360 Live</i>	Microsoft	\$4.99
10	<i>Call of Duty Black Ops II Uprising Map</i>	Activision Blizzard	\$14.99

GameStop – PS3

<u>Rank</u>	<u>Title</u>	<u>Publisher</u>	<u>Price</u>
1	<i>The Last of Us</i>	Sony	\$59.99
2	<i>The Last of Us Survival Edition</i>	Sony	\$79.99
3	<i>The Last of Us Post-Pandemic Edition</i>	Sony	\$159.99
4	<i>Call of Duty: Ghosts</i>	Activision Blizzard	\$59.99
5	<i>Kingdom Hearts HD 1.5 ReMIX</i>	Square Enix	\$39.99
6	<i>Battlefield 4</i>	Electronic Arts	\$59.99
7	<i>Tales of Xillia Limited Edition</i>	Namco Bandai	\$59.99
8	<i>Grand Theft Auto V GameStop Excl.</i>	Take-Two	\$149.99
9	<i>Injustice: Gods Among Us</i>	Warner	\$59.99
10	<i>Call of Duty Black Ops II Uprising Map</i>	Activision Blizzard	\$14.99

GameStop – Wii U

<u>Rank</u>	<u>Title</u>	<u>Publisher</u>	<u>Price</u>
1	<i>Skylanders Giants Thumpback</i>	Activision Blizzard	\$14.99
2	<i>Skylanders Giants Eye-Brawl Individual</i>	Activision Blizzard	\$14.99
3	<i>Skylanders Giants Trigger-Happy "S2"</i>	Activision Blizzard	\$9.99
4	<i>Skylanders Giants Double Trouble "S2"</i>	Activision Blizzard	\$9.99
5	<i>Skylanders Giants Triple Pack</i>	Activision Blizzard	\$24.99
6	<i>Skylanders Giants Hex "S2" Individual</i>	Activision Blizzard	\$9.99
7	<i>Skylanders Giants Lightning Rod "S2"</i>	Activision Blizzard	\$9.99
8	<i>Skylanders Giants Fright Rider</i>	Activision Blizzard	\$9.99
9	<i>Skylanders Giants Hot Head Individual</i>	Activision Blizzard	\$14.99
10	<i>Skylanders Giants Prism Break</i>	Activision Blizzard	\$11.99

Amazon – All Platforms

<u>Rank</u>	<u>Platform</u>	<u>Title</u>	<u>Publisher</u>	<u>Price</u>
1	PS3	<i>The Last of Us</i>	Sony	\$59.99
2	3DS	<i>Animal Crossing: New Leaf</i>	Nintendo	\$34.96
3	360	<i>Minecraft</i>	Microsoft	\$19.96
4	360	<i>Call of Duty: Black Ops II</i>	Activision Blizzard	\$38.14
5	PC	<i>Huntsman - The Orphanage</i>	Shadowshifters	\$4.95
6	360	<i>BioShock Infinite</i>	Take-Two	\$39.99
7	360	<i>Halo 4</i>	Microsoft	\$27.99
8	PS3	<i>Call of Duty: Black Ops II</i>	Activision Blizzard	\$39.41
9	Wii	<i>Just Dance 4</i>	Ubisoft	\$27.97
10	PC	<i>16 Bit Arena</i>	16BitArena	\$0.00

Amazon – Xbox 360

<u>Rank</u>	<u>Title</u>	<u>Publisher</u>	<u>Price</u>
1	<i>Minecraft</i>	Microsoft	\$19.96
2	<i>Call of Duty: Black Ops II</i>	Activision Blizzard	\$38.14
3	<i>BioShock Infinite</i>	Take-Two	\$39.99
4	<i>Halo 4</i>	Microsoft	\$27.99
5	<i>Batman: Arkham City</i>	Warner	\$14.96
6	<i>Borderlands 2</i>	Take-Two	\$24.99
7	<i>Madden NFL 25 Anniversary Edition</i>	Electronic Arts	\$99.99
8	<i>NBA 2K13</i>	Take-Two	\$39.96
9	<i>Elder Scrolls V: Skyrim</i>	Bethesda	\$29.96
10	<i>Assassin's Creed III</i>	Ubisoft	\$27.99

Amazon – PS3

<u>Rank</u>	<u>Title</u>	<u>Publisher</u>	<u>Price</u>
1	<i>The Last of Us</i>	Sony	\$59.99
2	<i>Call of Duty: Black Ops II</i>	Activision Blizzard	\$39.41
3	<i>Batman: Arkham City</i>	Warner	\$14.96
4	<i>BioShock Infinite</i>	Take-Two	\$39.99
5	<i>Kingdom Hearts HD 1.5 ReMIX</i>	Square Enix	\$39.99
6	<i>FIFA Soccer 13</i>	Electronic Arts	\$41.48
7	<i>God of War: Ascension</i>	Sony	\$38.72
8	<i>Final Fantasy XIV: A Realm Reborn</i>	Square Enix	\$79.99
9	<i>MLB 13: The Show</i>	Sony	\$41.97
10	<i>Tomb Raider</i>	Square Enix	\$39.95

Amazon – Wii U

<u>Rank</u>	<u>Title</u>	<u>Publisher</u>	<u>Price</u>
1	<i>New Super Mario Bros. U</i>	Nintendo	\$41.97
2	<i>New Super Luigi U</i>	Nintendo	\$29.99
3	<i>Lego City: Undercover</i>	Nintendo	\$39.99
4	<i>Sonic and All-Stars Racing Transformed</i>	Sega	\$27.29
5	<i>Nintendo Land</i>	Nintendo	\$38.21
6	<i>Game & Wario</i>	Nintendo	\$39.96
7	<i>Just Dance 4</i>	Ubisoft	\$30.27
8	<i>Scribblenauts Unlimited</i>	Warner	\$38.21
9	<i>Pikmin 3</i>	Nintendo	\$59.96
10	<i>Monster Hunter 3 Ultimate</i>	Capcom	\$57.07

Source: Amazon.com and GameStop.com, as of June 6, 2013

Retail Best Sellers (continued)

Walmart – All Platforms

Rank	Platform	Title	Publisher	Price
1	Various	<i>Skylanders Giants - Scarlet Ninjini+1</i>	Activision Blizzard	\$24.96
2	360	<i>Call of Duty: Black Ops 2</i>	Activision Blizzard	\$38.14
3	360	<i>Minecraft</i>	Microsoft	\$19.95
4	Wii	<i>Kirby's Epic Yarn</i>	Nintendo	\$9.59
5	PC	<i>Jagex Runescape - \$25 card</i>	Jagex	\$25.00
6	Various	<i>Skylanders Giants - 3 pack</i>	Activision Blizzard	\$19.96
7	PS3	<i>Call of Duty: Black Ops 2</i>	Activision Blizzard	\$41.97
8	Wii	<i>Just Dance 4</i>	Ubisoft	\$27.97
9	360	<i>Injustice: Gods Among Us</i>	Warner	\$49.98
10	3DS	<i>Luigi's Mansion: Dark Moon</i>	Nintendo	\$38.28

Walmart – Xbox 360

Rank	Title	Publisher	Price
1	<i>Call of Duty: Black Ops 2</i>	Activision Blizzard	\$38.14
2	<i>Minecraft</i>	Microsoft	\$19.95
3	<i>Injustice: Gods Among Us</i>	Warner	\$49.98
4	<i>Defiance</i>	Trion	\$39.94
5	<i>Zumba Fitness Core</i>	Majesco	\$24.20
6	<i>NBA 2K13</i>	Take-Two	\$39.96
7	<i>Lego: Marvel</i>	Warner	\$49.95
8	<i>Battlefield 4</i>	Electronic Arts	\$59.96
9	<i>MLB 2K13</i>	Take-Two	\$52.52
10	<i>UFC Undisputed 3</i>	THQ	\$14.95

Walmart – PS3

Rank	Title	Publisher	Price
1	<i>Call of Duty: Black Ops 2</i>	Activision Blizzard	\$41.97
2	<i>Injustice: Gods Among Us</i>	Warner	\$49.98
3	<i>The Last of Us</i>	Sony	\$59.96
4	<i>Lego: Marvel</i>	Warner	\$49.95
5	<i>MLB 13: The Show</i>	Sony	\$39.98
6	<i>NBA 2K13</i>	Take-Two	\$39.96
7	<i>FIFA Soccer 13</i>	Electronic Arts	\$41.97
8	<i>UFC Undisputed 3</i>	THQ	\$14.96
9	<i>NCAA Football 14</i>	Electronic Arts	\$59.96
10	<i>Batman: Arkham City</i>	Warner	\$14.96

Walmart – Wii U

Rank	Title	Publisher	Price
1	<i>New Super Mario Bros. U</i>	Nintendo	\$41.97
2	<i>Lego City: Undercover</i>	Nintendo	\$39.98
3	<i>Lego: Marvel</i>	Warner	\$49.95
4	<i>Call of Duty: Black Ops 2</i>	Activision Blizzard	\$38.34
5	<i>Injustice: Gods Among Us</i>	Warner	\$41.97
6	<i>Epic Mickey 2</i>	Disney	\$25.24
7	<i>Scribblenauts Unlimited</i>	Warner	\$38.21
8	<i>Skylanders Giants Starter Pack</i>	Activision Blizzard	\$59.95
9	<i>Monster Hunter 3 Ultimate</i>	Capcom	\$57.06
10	<i>ZombiU</i>	Ubisoft	\$39.31

Source: Walmart.com, as of June 6, 2013

Digital Entertainment and Internet eCommerce	Rating	6-Jun		EPS			P/E			Div	Yld	Book	Mkt Cap (\$mm)
		Price	Target	2012E	2013E	2014E	2012E	2013E	2014E				
Activision Blizzard (ATVI)	Outperform	\$14.62	\$17	\$1.18	\$0.84	\$1.10	12.4	17.4	13.3	\$0.18	1.2%	\$9.41	16,374
Amazon.com (AMZN)	Market Perform	\$267.83	\$260	-\$0.09	\$0.84	\$3.10	nm	nm	86.4	\$0.00	0.0%	\$16.67	124,005
Bally Technologies (BLY)	Outperform	\$56.23	\$60	\$2.45	\$3.44	\$3.85	23.0	16.3	14.6	\$0.00	0.0%	\$4.77	2,311
eBay (EBAY)	Outperform	\$51.52	\$64	\$2.36	\$2.72	\$3.20	21.8	18.9	16.1	\$0.00	0.0%	\$16.12	66,796
Electronic Arts (EA)	Outperform	€23.28	€24	€0.85	€0.84	€1.20	27.4	27.7	19.4	€0.00	0.0%	€6.90	7,100
Gameloft (GFT.PA)	Outperform	\$5.47	\$6	\$0.11	\$0.30	\$0.42	49.7	18.2	13.0	\$0.00	0.0%	\$1.12	461
GameStop (GME)	Market Perform	\$34.62	\$34	\$2.87	\$3.17	\$3.11	12.1	10.9	11.1	\$1.10	3.2%	\$22.24	4,134
International Game Technology (IGT)	Outperform	\$17.38	\$20	\$1.04	\$1.36	\$1.46	16.7	12.8	11.9	\$0.32	1.8%	\$4.74	4,625
Mood Media (MM)	Outperform(S)	\$1.13	\$2	-\$0.16	-\$0.09	-\$0.03	nm	nm	nm	\$0.00	0.0%	\$0.89	194
Netflix (NFLX)	Market Perform	\$217.74	\$205	\$0.29	\$1.65	\$3.38	nm	nm	64.4	\$0.00	0.0%	\$13.40	13,217
Pandora Media (P)	Outperform	\$14.31	\$22	-\$0.05	-\$0.07	\$0.04	nm	nm	nm	\$0.00	0.0%	\$0.58	2,765
Rovi(ROVI)	Market Perform	\$25.73	\$24	\$2.12	\$2.14	\$2.30	12.1	12.0	11.2	\$0.00	0.0%	\$15.19	2,596
Synacor (SYNC)	Market Perform	\$3.57	\$6	\$0.14	\$0.03	\$0.04	25.5	nm	89.3	\$0.00	0.0%	\$1.87	102
Take-Two Interactive (TTWO)	Market Perform	\$16.08	\$20	-\$0.71	\$0.36	\$2.35	nm	44.7	6.8	\$0.00	0.0%	\$6.60	1,925
TiVo (TIVO)	Outperform(S)	\$13.71	\$15	\$0.80	-\$0.03	-\$0.33	17.1	nm	nm	\$0.00	0.0%	\$2.71	1,664
Ubisoft Entertainment (UBI.PA)	Outperform	\$10.25	\$12	\$0.40	\$0.71	\$0.80	25.6	14.4	12.8	\$0.00	0.0%	\$8.07	997
WMS Industries (WMS)	Market Perform	\$25.33	\$26	\$1.31	\$0.91	\$1.17	19.3	27.8	21.6	\$0.00	0.0%	\$16.45	1,368
Zynga (ZNGA)	Market Perform	\$2.85	\$4	\$0.07	-\$0.08	-\$0.01	40.7	nm	nm	\$0.00	0.0%	\$2.38	2,289

Source: BMO Capital Markets estimates and company reports.

Important Disclosures

Analyst's Certification

I, Edward S. Williams, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Company Specific Disclosures

For Important Disclosures on the stocks discussed in this report, please go to http://researchglobal.bmocapitalmarkets.com/Public/Company_Disclosure_Public.aspx.

Distribution of Ratings (March 31, 2013)

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	Starmine Universe
Buy	Outperform	37.3%	16.5%	53.8%	38.2%	51.3%	53.2%
Hold	Market Perform	58.0%	8.8%	44.6%	56.8%	47.7%	41.1%
Sell	Underperform	4.7%	3.7%	1.5%	4.9%	1.0%	5.7%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.

** Reflects rating distribution of all companies from which BMO Capital Markets Corp. has received compensation for Investment Banking services as percentage within ratings category.

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Rating and Sector Key (as of April 5, 2013)

We use the following ratings system definitions:

OP = Outperform - Forecast to outperform the analyst's coverage universe on a total return basis;

Mkt = Market Perform - Forecast to perform roughly in line with the analyst's coverage universe on a total return basis;

Und = Underperform - Forecast to underperform the analyst's coverage universe on a total return basis;

(S) = Speculative investment;

NR = No rating at this time; and

R = Restricted – Dissemination of research is currently restricted.

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http://researchglobal.bmocapitalmarkets.com/documents/2013/prior_rating_system.pdf

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