Analysts Agree: Zynga May Be the Best (Video Game) Stock on the Market

Description

Every day, Wall Street analysts upgrade some stocks, downgrade others, and "initiate coverage" on a few more. But do these analysts even know what they're talking about? Today, we're taking one high-profile Wall Street pick and putting it under the microscope…

Raise your hand if you remember **Zynga** (NASDAQ: ZNGA)?

Once considered the best way to invest vicariously in a then-still-private **Facebook**, Zynga faded in relevance after the Facebook IPO. But 2019 has seen a dramatic comeback at Zynga, where revenue is rocketing, profits are flowing — and analysts are naming it their favorite stock in the (video gaming) world.

Last month, for example, investment banker Wedbush doubled down on its long-standing love of Zynga and put the stock its "best idea" list. And today we learn that Zynga has another fan who likes it just as much.

Here's what you need to know.

Everybody loves Zynga

Early this morning, investment bank Stephens joined Wedbush in naming Zynga stock its "Best Idea" in video gaming.

Stephens has an overweight rating and a $8.25 price target on the stock, according to our friends at TheFly.com. And with Zynga selling for less than $6 a share, that makes for a potential 38% profit from today's prices.

But Stephens' recommendation of Zynga is about more than just the stock price.

Zynga: Empire builder

As Stephens explains in its note: “We believe the next 6-18 months will be a period of consolidation as established mobile players further leverage their core publishing infrastructure by acquiring sub-scale studios to drive growth,” and Zynga itself “is well positioned [to lead any such] consolidation in the mobile gaming market.”

“Zynga has … proven [its] ability to successfully execute this strategy,” argues the analyst, having spent close to $600 million on acquisitions over the past two years, according to data from S&P Global Market Intelligence. In so doing, the company has transformed itself from a business that was burning more than $50 million in cash annually as recently as just a few years ago into one generating positive free cash flow of more than *$200* million ($213.5 million, to be precise) over the last 12 months.

At this rate, Zynga’s last two years of acquisitions could pay for themselves in less than three years.

What comes next

And Zynga probably isn’t done acquiring, either. At the heart of Stephens’ recommendation today lies the banker’s belief that “the potential for future deals along with the current state of their portfolio make for a very compelling risk/reward profile.”

I think the analyst might be right about that.

Just three months ago, Zynga announced the issuance of a batch of “convertible senior notes” expected to raise anywhere from $584.5 million to $672.3 million in “net proceeds” after deduction of fees. Some of this money will go to corporate purposes like paying the cost of “capped call transactions” designed “to reduce potential dilution to Zynga’s common stock.” But the company noted at the time that it may also use the money to pay for “potential acquisitions and future transactions” — a clear indication that Zynga has mergers and acquisitions on its mind.

The upshot for investors

As of today, Zynga’s balance sheet looks well-positioned to support such an acquisitions-based strategy, boasting nearly $830 million in cash versus total debt of only $585 million, and with more cash flowing in by the day. Growth trends look strong — even without factoring the potential for accretive acquisitions — with analysts forecasting that the company will post $0.06 per share in GAAP earnings this year, double that figure in 2020, and then grow these earnings to as much as $0.43 per share by 2023.

Although Zynga isn’t GAAP-profitable at present, its cash flow statement confirms that the business is in fact generating copious amounts of cash. At a price-to-free-cash-flow ratio of less than 26 (and even cheaper with net cash factored in), I see the shares as attractively priced given the company’s growth prospects.

If the stock can grow even faster than analysts are predicting by rolling up competitors along the way, Zynga could do even better.

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