

Evolve E-Gaming Index ETF

HERO invests in equity securities of companies listed domestically and globally with business activities in the electronic gaming industry.



HERO (Hedged)

MACROECONOMIC HIGHLIGHTS:

Final 2020 tallies for the gaming industry were released in January by NPD Group, and showed record US games spending of \$56.9 billion during the year. That represents a 27% increase year-on-year from 2019. These figures were driven in part by increasing numbers of people turning to gaming as a pastime during the pandemic lockdowns.

Software represented the lion's share (86%) of this figure, with game content spending reaching \$48.9 billion in 2020. Software sales included physical and digital games, DLC, and subscription across console, cloud, mobile, portable, PC and VR platforms. This represents a 26% increase over 2019 software sales.

Hardware sales saw even bigger growth on a percentage basis, with console revenue of \$5.3 billion last year, up 35% from \$3.9 billion in 2019. 2020 was the best year for console sales since 2011 when the Xbox 360 and Nintendo 3DS released.

Gaming accessories sales also increased 21% in 2020, for a total of \$2.6 billion.

Call of Duty: Black Ops Cold War (published by Fund holding Activision Blizzard) was the best-selling game of 2020—the 12th year in a row for a game in the Call of Duty franchise. In all, games by companies held in the Fund represent all 5 of the top 5 best-selling games of 2020, as well as 8 of the top 10, and 13 of the top 20.

While not directly affecting the holdings of the Fund, the gaming industry was roiled in January by the trading saga of GameStop stock. Online investment communities, driven primarily by the WallStreetBets subreddit, took advantage of an unusually high number of short sellers betting against the gaming retailer to buy shares en masse and drive up the price, as well as short-seller losses. At one point, GameStop's share price spiked 135% in less than 24 hours and was up more than 700% in less than a week.

Amidst the volatility Melvin Capital, the hedge fund singled out by the online investors for its shorting of GameStop stock, was forced to close out its entire position, taking a massive loss.

President Joe Biden signed an executive order in February ordering a 100-day review of supply chains for four critical products, including semiconductor chips. The ongoing pandemic-induced shortage of semiconductor chips has affected various industries reliant on the components, including the electronic

gaming industry. The newest generation of game consoles from Playstation and Xbox, and high-end graphics cards used in PCs, are suffering in light of the shortage. Supply constraints with semiconductor chips have held back sales of both new PlayStation and Xbox consoles. As a result, neither is outpacing sales of the previous iterations of the consoles. Microsoft's chief financial officer Amy Hood said the company expects Xbox sales to "still be constrained by supply" during the first quarter of 2021.

The 11th Annual Game Publisher Rankings were released in March by review aggregator site Metacritic. Metacritic's ranking is calculated based on four factors: average Metascore, percentage of scored products with good reviews, percentage of scored products with bad reviews, and number of "great" titles (Metascore of 90 or higher). Three of the Fund's holdings ranked in the top five, with Sega at number one, alongside Capcom (#3) and Activision Blizzard (#5).

A new report from Accenture estimates the value of the global gaming industry already exceeds \$300 billion—surpassing the movies and music industry combined and resonating with all ages and demographic groups. Roughly \$200 billion of this is in direct spending on consoles, software and subscriptions, in-game purchases, and mobile advertisement revenues, while another \$100 billion comes from mobile devices, gaming PCs, peripherals, and gaming-related products and services. The fastest-growing segment of the gaming industry is mobile gaming, thanks to the widespread adoption of smartphones globally coupled with increasingly easy access to high-speed internet. App Annie's State of Mobile Gaming 2021 report indicates that casual mobile games led the way in terms of downloads, comprising 78% of all game downloads compared with 20% for core games and 2% for casino.

In related news, Newzoo released a study estimating that cloud gaming should generate \$1.4 billion by the end of 2021, which is twice the research firm's estimate for 2020. The increase is attributed to the growth in the number of users, the increase in cloud services from companies like Microsoft, Amazon, and Facebook, and increased interest from consumers in cloud gaming as a result of the pandemic. Newzoo further predicts that the market will be \$5.14 billion by the end of 2023.

In June, investment bank Drake Star Partners reported that acquisitions, public offerings, and other investments in the games industry reached \$60 billion during the first half of 2021, nearly doubling the \$33.6 billion invested in all of 2020.

Of the 635 deals announced and/or closed during the first six months of 2021, the 169 mergers and acquisitions represented the highest value, with a total of \$23 billion US. By segment, there were 51 M&As in the PC/console sector, 44 in mobile, 38 in esports, 28 in hardware/tools, and 8 in platform.

Among the acquisition highlights of the first half of the year, the report cites the closing of the \$7.5 billion Microsoft acquisition of Zenimax (first announced in September 2020), EA's acquisition of Glu for \$2.1 billion, EA's June all-cash acquisition of Playdemic for \$1.4 billion, the \$43 billion WarnerMedia/Discovery deal, and Take-Two's \$378 million acquisition of Nordeus.

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PERFORMANCE ATTRIBUTION:

For the first six months of 2021, Sea Ltd made the biggest contribution to the Fund, followed by Bilibili Inc, and NetEase Inc. By weight, the Fund's largest exposure over the first six months of 2021 was to Sea Ltd, NetEase Inc, and Activision Blizzard Inc.

SOURCES:

<https://www.gamesindustry.biz/articles/2021-01-15-2020-sees-record-us-games-spending-at-usd56-9bn-us-annual-report>
<https://www.gamesindustry.biz/articles/2021-01-27-gamestop-stock-up-135-percent-in-24-hours-biden-administration-monitoring-the-situation>
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