M&A DEAL ANALYSIS
"The Gaming Shark"

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Microsoft

ACTIVISION | BLIZZARD

BOCCONI STUDENTS FOR COMMERCIAL AND INVESTMENT BANKING

M&A DIVISION

Table of Contents

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Acquirer: Microsoft Corp.
Target: Activision Blizzard Inc.
Deal value: $75.1 billion
Sector: Software-Gaming
Type of M&A: Strategic
Exit multiple: 20.2x
Announced date: 18/01/2022
Completed date: 13/10/2023

Acquirer details
Microsoft Corp.
Founding year: 1975
Headquarters: Redmond WA, United States
CEO: Satya Nadella (Feb 2014 - Present)
Number of employees: 221,000 (as of 2023)
Market Cap: $2.747tn
EV: $2.77tn

- LTM Revenues: $218.310bn
- LTM EBITDA: $108.531bn
- LTM EBITDA margin: 49.7%
- LTM EV/EBITDA: 25.55x
- LTM EV/Sales: 1.27x

(All financial data as of 30/09/2023)

Company industry: Technology, Computers & Electronics-Software

Target details
Activision Blizzard Inc.
Founding year: 2008(merge with Blizzard)
Headquarters: St. Monica CA, United States
CEO: Bobby Kotick (Jul 2008 - Present)
Number of employees: 9,500 (as of 31/07/2023)
Market Cap: $74.28bn
EV: $68.66bn

- LTM Revenues: $8.706bn
- LTM EBITDA: $2.331bn
- LTM EBITDA margin: 26.8%
- LTM EV/EBITDA: 29.46x
- LTM EV/Sales: 7.88x

(All financial data as of 30/07/2023)

Company industry: Software-Gaming

Deal Overview

Microsoft successfully completed its $75 billion acquisition of Activision Blizzard, marking the largest deal in a decade of transactions overseen by Chief Executive Satya Nadella. These strategic moves have firmly established the software giant at the forefront of the video games industry. The acquisition, the most significant in Microsoft's nearly 50-year history, required an extensive two-year charm offensive, including court hearings and modifications to the acquisition terms, to secure approval amid global concerns from policymakers.

The initial rejection of the deal by both the CMA and the U.S. Federal Trade Commission posed a significant hurdle. Microsoft secured the right to finalize the deal in the U.S. in June following a legal battle with the FTC in federal court.

The most recent approval, granted on Friday, October 13th, came from the U.K.'s Competition and Markets Authority (CMA). This approval followed Microsoft's restructured offer, which included the sale of specific gaming rights for popular Activision franchises such as Call of Duty to the French publisher Ubisoft Entertainment SA. The CMA affirmed that this arrangement effectively addressed all concerns related to competition. Essentially, the transfer of Activision's cloud gaming rights to Ubisoft was a persuasive factor for the British Authority. Microsoft will not exert control over the swiftly evolving market, and Ubisoft will hold the rights for all PC and console content produced by Activision for the next 15 years.

Microsoft has frequently faced criticism for trailing behind competitors such as Sony and Nintendo in terms of game quality, and it has lacked a significant presence in the rapidly expanding mobile gaming sector. The acquisition of Activision, with its portfolio of best-selling franchises like Call of Duty (which alone has generated over $30 billion in lifetime revenue) and Candy Crush, is poised to strengthen Microsoft's video game business by more than half, bringing it to over $24 billion.

This strategic addition will also shift the focus of the business away from Xbox consoles and towards gaming content that spans various platforms and devices. Activision's collection of popular titles, including Diablo and World of Warcraft, has the potential to enhance Microsoft's game subscription service, Xbox Game Pass, which includes features like *cloud gaming* and the streaming of video games, making it even more appealing.

Despite the substantial investment, Microsoft's video gaming business remains a relatively small part of the overall company. If Activision were included, gaming would have constituted approximately 10% of Microsoft's revenue in the latest fiscal year, up from the reported 7%. This reinforced focus on video gaming operations would place it on par with the Windows business, which was the foundation on which Microsoft was initially built.

Activision had previously refrained from including its flagship titles in a subscription platform, opting to sell them individually with the belief that it could maximize profits. However, Microsoft has signaled a different approach, stating that it has no reservations in this regard. Microsoft's gaming strategy is centered around its Game Pass offering, similar to Netflix, boasting over 25 million subscribers who pay approximately $10 per month for access to a game catalog. "With 25 million subscribers, they are incurring losses, but at 100 million, they are likely turning a profit; at 200 million, significant profits are anticipated," remarked tech analysts. "They recognize that achieving such numbers is unlikely without a game like Call of Duty."

Activision recently announced that it anticipates its games will be available on Game Pass sometime in the coming year.

The Activision deal, valued by Microsoft at $69 billion after accounting for the net cash of the video game maker, provides Microsoft access to an extensive library of titles catering to mobile gamers. Microsoft has expressed its intention to permit Activision to maintain its status as an independent studio. However, being under Microsoft's umbrella could potentially benefit both shareholders and the employees of the company.

Cloud Gaming

Cloud gaming is in its infancy today, but industry executives and analysts expect it to take over much of the videogaming market, in the same way Netflix and other streaming services have come to dominate video. The technology eliminates the need to spend hundreds of dollars on consoles or computers by offering instant access to games through phones, smart TVs and other internet-connected devices.

Regulators Insights

When Microsoft successfully concluded its substantial $69 billion acquisition of Activision Blizzard, overcoming a challenge from the federal government, the message conveyed through the merger's completion was unmistakable: Big Tech can still expand its reach.

Microsoft's acquisition of Activision marked the latest instance of a deal proceeding despite a series of unsuccessful challenges to mergers by the Federal Trade Commission (FTC) and the Justice Department. These agencies have been actively confronting major tech companies through lawsuits alleging violations of antimonopoly laws, attempting to block at least 10 other deals over the past two years.

The FTC argued that Microsoft, as the maker of the Xbox gaming console, could potentially harm consumers and competition by withholding Activision's games from rival consoles. Additionally, they contended that Microsoft might leverage the deal to dominate the emerging market for game streaming.

In the case of Microsoft's Activision deal, the FTC questioned the nature of the transaction as a "vertical" deal, referring to mergers between firms that are not direct competitors. Regulators typically hesitate to challenge such deals, assuming that they generally do not result in monopolies. However, "vertical" deals have been prevalent in the tech industry, with companies like Meta, Apple, and Amazon seeking to expand into new business lines to protect and grow their empires. The completion of the Microsoft-Activision deal reinforces the idea that vertical deals are generally not anticompetitive and can proceed with relatively little obstruction.

Despite the FTC proceeding with its challenge to the Microsoft-Activision deal, the completion of the acquisition signals that years of global scrutiny of big tech companies by governments have, so far, had limited impact on curtailing their power, growth, or their ability to engage in significant deals. Moreover, this deal may serve as a model for other big tech companies on successfully navigating regulatory intervention.

Industry Overview

The gaming sector, once considered primarily for children and overshadowed by other entertainment forms like TV, movies, and music, has rapidly transformed into the fastest-growing segment in the media industry. Surpassing age barriers, with the average player age exceeding 30, gaming has become the second-largest media sector, approaching a valuation of $200 billion. The significance of gaming intellectual property (IP) has grown, playing a crucial role in attracting diverse audiences and signaling substantial growth potential.

In 2020, the COVID-19 pandemic fueled growth in various media and technology sectors, with gaming outpacing others, experiencing an 8% growth rate and reaching a valuation of $198 billion. However, growth slowed in 2022 due to factors such as the conclusion of pandemic-related shutdowns, leading to a market size reduction to $184.4 billion, with mobile gaming contributing 50% of revenues.

Despite these challenges, the gaming industry is expected to recover in the mid-term as games become more integrated into daily life. Over the last five years, games consistently secured a 40% share of global mobile app downloads, reaching even higher figures, such as 45-50%, in the Middle East in 2020. Emerging markets, particularly in Latin America, Africa, and the Middle East, are witnessing significant gaming industry growth, driven by a youthful demographic and the rapid adoption of mobile technology. The GSMA Mobile Economy 2023 report projects that the number of unique mobile subscribers will surpass 5 billion by 2025, with a substantial portion of this growth from these regions.

The Middle East, with its unique market conditions, stands out, driven by a young population and widespread tech-savviness. Governments in the GCC region are investing heavily in the gaming industry, recognizing its potential. In Saudi Arabia, a National Gaming Strategy aims to create jobs and develop games by 2030.

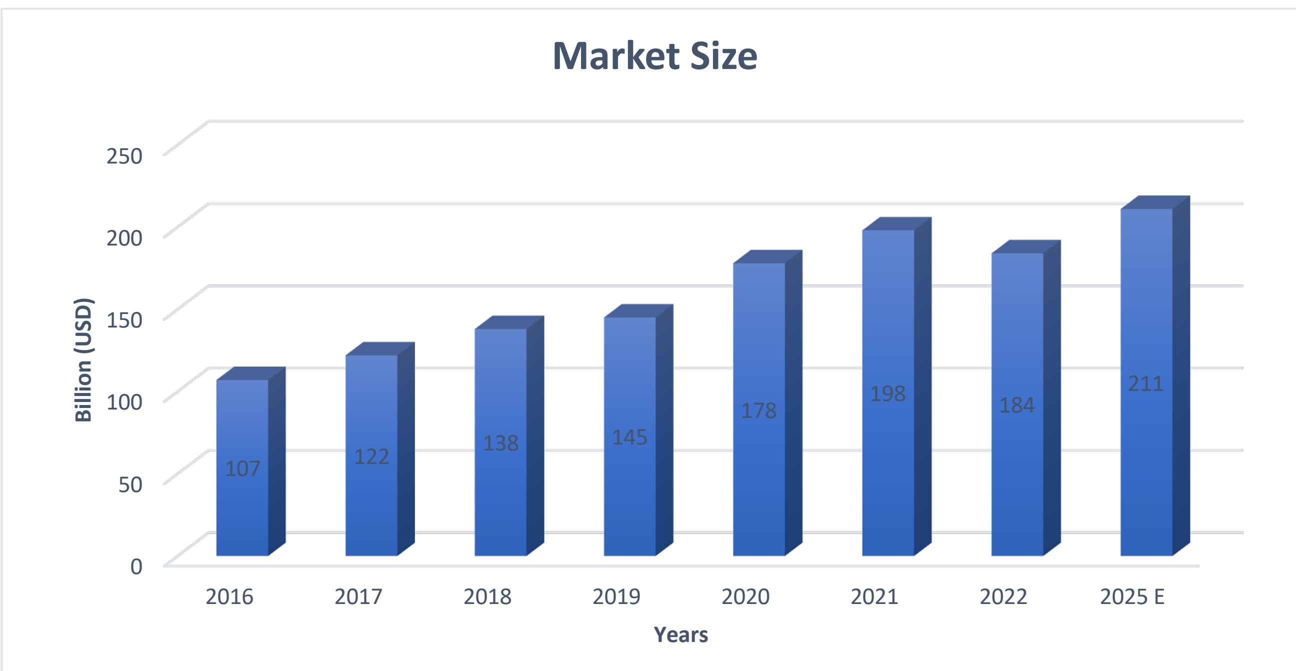
The mobile gaming industry has seen remarkable growth, propelled by smartphone adoption and increased mobile computing capabilities. PC and console game publishers are actively involved, and key factors contributing to this growth include:

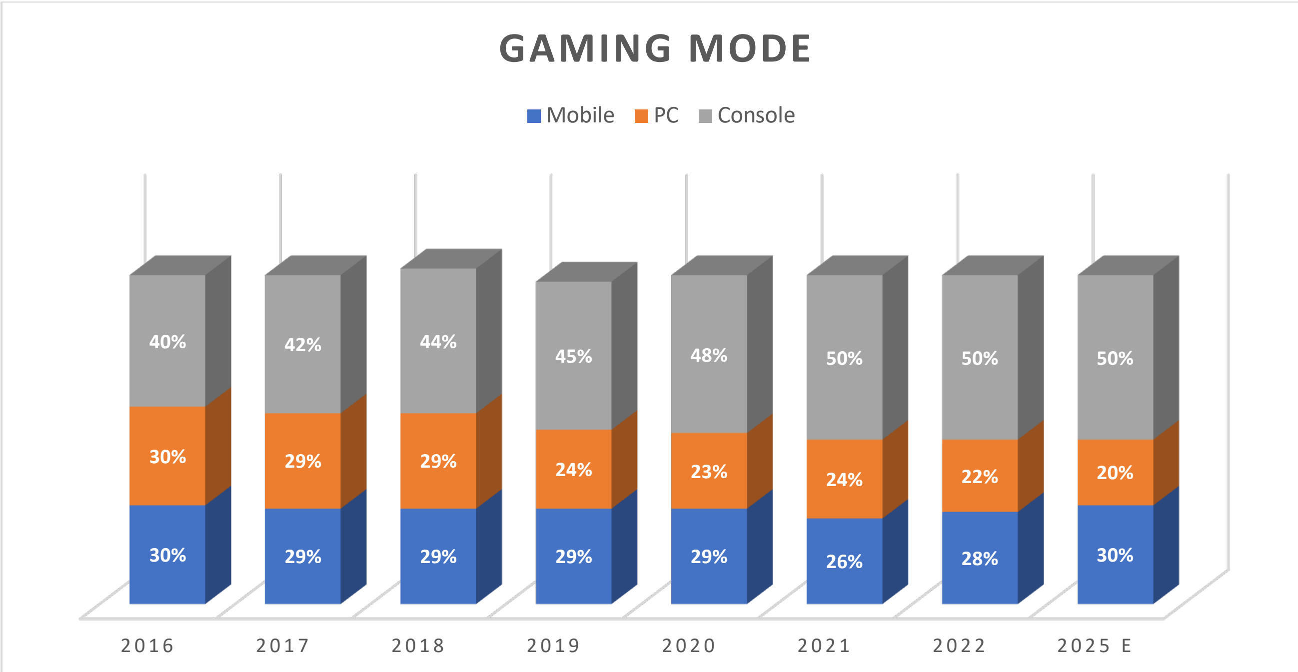
- **Accessibility:**
  Mobile gaming has surged ahead, especially since the introduction of smartphones over the past two decades.
- **Convergence:**
  Platforms are converging, leveraging the same gaming IP, with expectations of accelerated convergence through cloud computing in the mid- to long-term.
- **Business Model:**
  The rise of casual games designed for short play sessions has led to innovative monetization methods, primarily through advertising, offering a technically free experience for players.

Given these dynamic industry shifts, game publishers and developers are adapting strategies to new business models. The evolution in the mobile market has encouraged exploration of innovative monetization methods, notably the "free-to-play" model with in-game monetization instead of upfront purchases.

Looking ahead, the gaming sector's future evolution will be influenced by technological, demographic, and media industry trends. Four key factors are expected to have a significant impact:

- **Audience Growth and Demographic Shifts:**
  The gaming industry's expansion appeals to a broader demographic, with mobile gaming attracting audiences of all ages, particularly in Western markets. Gen Z, in particular, is dedicating the most time to gaming.
- **Innovation Driven by Players:**
  Uniquely, innovation in the gaming sector often originates from consumers rather than major developers, with the gaming community actively shaping the industry.
- **Mergers and Acquisitions (M&A) Activity:**
  The gaming industry's high level of consolidation is projected to continue, with major players acquiring studios and gaming-related assets globally. Presently, the top 10 players control over 70% of the market, with the top 3 players (Tencent, Sony, and Microsoft) accounting for approximately 40%, contingent on Microsoft's completion of the acquisition of gaming company Activision-Blizzard.





Sources: NewZoo, OVUM, Consortium analysis

Deal rationale

Microsoft's acquisition of Activision Blizzard is a huge step forward in the gaming industry. This is critical for Microsoft to get closer to its gaming competitors like Sony, Nintendo, and Electronic Arts.

Revenue synergies

Microsoft agreed to pay $95 per share in January 2022. During this time, Activision was trading at around $60 per share. But Microsoft was confident that the added benefits of Activision's portfolio would cover the extra price paid. The highest historical share price of Activision Blizzard was $105 per share, this was right before the scandal with CEO Bobby Kotick was announced. Microsoft could have believed that Activision Blizzard was undervalued to have paid such a high premium. Moreover, Microsoft's 2023 gaming revenue is estimated at $16.9 billion and Activision Blizzard's at $10.3 billion.

With this deal, Microsoft will become the third-largest gaming company by revenue, behind Tencent Holdings Limited and Sony Group Corporation. 2023 EPS on an adjusted basis for Microsoft would be 2.57%, or 30 cents accretive. In 2023, Microsoft is expected to see $219 billion in revenue, and an extra $10 billion from this deal, with only an added $3 billion in costs. These attribute better access to increased future spending, with a higher net income Microsoft can spend more on R&D and have larger amounts of cash on hand.

Game pass

Microsoft's acquisition of Activision Blizzard represents a great strategic move in the gaming industry, particularly in boosting revenue synergies through its Game Pass service. This acquisition brings a vast portfolio of popular games under Microsoft's umbrella/offering. The integration of these titles into the Game Pass subscription service is expected to significantly enhance the value proposition for subscribers. The move is likely to drive an increase in Game Pass subscriptions, which in turn, offers a recurring revenue stream while simultaneously expanding Microsoft's reach in the gaming community. Furthermore, the addition of these high-profile games to the Game Pass library can potentially increase user engagement and the user retention rate, leading to longer subscription lifecycles and additional revenue from in-game purchases and expansions. In essence, this acquisition is not just about adding popular titles to Microsoft's catalog; it's about leveraging these assets to enhance and expand its gaming ecosystem, making Game Pass an even more essential service for gamers worldwide.

Source: Investopedia

Customer base-Cost synergies

The acquisition will lead to accelerated growth in Microsoft's gaming business across mobile, PC, console, and cloud, and will provide building blocks for the metaverse. It will bolster Microsoft's Game Pass portfolio with plans to integrate Activision into the Game Pass. Activision has nearly 400 million monthly active players in 190 countries and three billion-dollar franchises.

Game Pass will become one of the most diverse and attractive gaming content line-up in the industry. Microsoft will see an increase from synergies. These will come in the form of $1.2 billion in cost savings, and a $7.6 billion in gross profit. This will increase Microsoft's operating efficiency ratio to 27.58% for 2023.

Deal Structure

On January 18, 2022, Microsoft Corp. agreed to acquire Activision Blizzard in an all-cash deal worth $68.5 billion. This was "inclusive of Activision Blizzard's net cash." But Microsoft agreed to pay $95 per share of Activision, with a 26% premium on the latest market price which brings the total transaction value to around $75 billion. On the day of the announcement, the value of ABK (Activision Blizzard) shares grew by 40%, but Microsoft's stock ended the day 2.5% below opening price. After the deal was announced, Activision started trading at around $80 per share, 19% below Microsoft's $95 per share offer.

The Activision acquisition gives Microsoft a varied and heavy portfolio of video game franchises including Call of Duty, StarCraft, Warcraft, etc. Activision generated $7.5 billion in revenue in its latest fiscal year, while the Microsoft giant brought in $212 billion in sales.
Activision ended the second quarter of 2023 with $587 million in net income on $2.2 billion in revenue, which was up 34% YoY.

The deal closed on 13th October 2023, almost 20 months after it was announced. This was due to intense scrutinization by the FTC. When it was first announced, there were concerns about the FTC's uncertainty around this deal. Both companies lead their respective industries and there was a risk of anti-competitive behaviour. Especially recent times has been unfavourable for tech mergers as seen in the case of the $40 billion NVIDIA-Arm deal, which was scrapped due to "significant regulatory challenges."

An important update in Activision's management is the predicted departure of their CEO, Bobby Kotick after a 32-year tenure. His step-down is marked by the July 2021 court case which alleged a culture of "constant sexual harassment" that involved many top-level executives.

Risks and Implications

Short Term

Microsoft's bold move in acquiring Activision Blizzard marks a pivotal moment, reshaping the gaming industry's landscape and setting a new example in tech and gaming acquisitions.

Market Dynamics and Competitive Edge:

The immediate impact of the acquisition echoes through the gaming sector. By gaining control of iconic titles like Candy Crush, Call of Duty, and DJ Hero, Microsoft significantly enhances its gaming portfolio. However, this expansion has led to investor uncertainty, stemming from concerns over the challenges of integrating these diverse games into Microsoft's ecosystem, potential market reactions, and business model. To navigate these complex waters, Microsoft faced extensive legal scrutiny and litigation, particularly under "The Sherman Antitrust Act," which prohibits market monopolization. A critical aspect of meeting regulatory requirements was Microsoft's decision to offer exclusive streaming rights for key titles to Ubisoft, especially in the cloud gaming arena. This strategic decision was designed to alleviate antitrust concerns, balancing the need to expand its gaming influence with the imperative to maintain a healthy market competition.

Strategic Implications of the Acquisition:

Microsoft's acquisition of Activision Blizzard represents a transformative strategy in the gaming industry, giving this acquisition a greater meaning beyond a mere expansion of its gaming library. This strategic move positions Microsoft at the forefront of the gaming world, leveraging Activision Blizzard's rich portfolio of iconic games to bolster Xbox's offerings. As we all know, new technological innovation we see today is a byproduct of the advancements in coding. Beyond enhancing its immediate gaming portfolio, this acquisition allows Microsoft to tap into Activision's deep well of intellectual property, setting the stage for future innovations and potentially groundbreaking gaming experiences. The integration of these popular titles into Microsoft's existing business model, particularly its cloud gaming platform, is poised to offer a competitive edge in a rapidly evolving digital entertainment landscape. This acquisition isn't just about growing Microsoft's gaming footprint; it's a step forward in aligning with the company's broader business strategy. By coupling Activision's creativity with Microsoft's technological infrastructure and extensive global reach, the potential for success is monumental. The move is an indication of Microsoft's vision to not only lead in the gaming sector but to redefine it.

Long Term

This acquisition is not just a current market shake-up; it's a strategic placement for the future landscape of entertainment and technology.

Expanding Gaming Horizons: By adding Activision's blockbuster titles to Xbox Game Pass, Microsoft is not just enlarging its gaming library but setting the stage for a transformative era in digital entertainment consumption, where all products and services are available all at once. This aligns with broader industry shifts toward subscription-based cloud gaming models.

Leadership and Innovation in the Industry: With this move, Microsoft cements its commitment to gaming, a sector characterized by the increased technological evolution and changing consumer behaviors. This positions Microsoft not just as a market leader but as a visionary, and a player in shaping the future of gaming and cloud services.

Market reaction

Investor Sentiment and Market Confidence: The deal's finalization was met with investor optimism, which was seen by a positive trend in Microsoft's stock. Ever since the announcement of the acquisition in January 2023, Microsoft has experienced a 50% price increase in its stock. This economical response signals confidence in Microsoft's strategic direction and long-term vision for integrating gaming into its broader ecosystem.

Impacts on Other Gaming Stocks: The acquisition has had an immense ripple effect across the gaming industry. Other major players like Take-Two Interactive and Electronic Arts have also experienced positive market reactions, highlighting a now scarcer landscape of major independent gaming publishers and the great potential for increased valuations.

Setting a New Bar in Tech Mergers: This acquisition could potentially usher in a new wave of mergers and acquisitions within the tech sector. Microsoft's success in navigating the complex web of regulatory and market challenges sets a precedent for future tech mega-deals, indicating a possible increase in similar strategic moves by other tech giants.

Deal Advisors

Activision
Financial advisors: Morgan Stanley, Allen & Co.
Legal advisors: Skadden Arps Slate Meagher & Flom, White & Case

Microsoft
Financial advisor: Goldman Sachs
Legal advisor: Osler Hoskin & Harcourt, Sidley Austin, Simpson Thacher & Bartlett

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