Microsoft's acquisition of Activision Blizzard

Deal Spotlight



WARWICK M&A GROUP

Transaction Overview

- **Announcement date:** 18th January 2022
- **Offer per share:** $95.00
- **Transaction value:** $68.7bn
- **Implied Premium:** 45.3% above closing price on 14th Jan 2022
- **Acquirer adviser(s):** Goldman Sachs
- **Target adviser(s):** Allen & Company



- **Transaction Summary:**
  - On January 18th 2022, Microsoft announced it will acquire Activision Blizzard for $68.7bn in an all-cash transaction, the highest price ever paid by a US tech company in a takeover.
  - This acquisition aims to accelerate Microsoft's gaming business across a wide range of devices (mobile, PC, cloud) and will provide foundations to the firm's metaverse ambitions.
  - Following a 27% drop in 2021 due to several internal culture controversies, Activision' shares jumped by almost 30% after the deal announcement.
  - The takeover, subject to shareholders and regulators approval, should be completed in 2023 and would position Microsoft as the third-largest gaming firm by revenue, behind Tencent and Sony.

Rationale and Outlook

- With more than 3 billion people actively playing games worldwide, gaming has become a major and rapidly growing segment of the entertainment market. Acquiring a giant in the development of game content and interactive entertainment will not only expand Microsoft's portfolio of massive game franchises but also bring 10,000 highly skilled employees who will contribute to the Xbox brand's dominance in the video game market.
- Microsoft will benefit from 9 additional studios that will join its existing 23 game development houses under the name "Xbox First-Party Studios", a massive family contributing to the development of blockbuster franchises and specialising in a variety of different games and genres. It is also an opportunity for the video game publisher to catch up with Sony's lead with the PS5, which sold twice as many units as the Xbox Series X and S.
- Many studios that are acquired produce games such as Call of Duty or World of Warcraft that are full of additional content. Players no longer purchase the game once, but are encouraged to spend money on battle passes, cosmetics and exclusive downloadable contents (DLCs) to fully benefit from the game. These games tend to be much more profitable from an additional stream of recurring revenue.
- By acquiring major franchises that attract millions of fans, Microsoft hopes to increase the number of Xbox Game Pass subscribers, a $15 monthly membership that gives access to a catalogue of hundreds of branded games. This recurring paid subscription, which continues automatically unless manually cancelled, is a way for Microsoft to build customer loyalty while generating predictable and stable monthly revenues. The firm's strategy has recently shifted from selling individual products to focusing on its Game Pass, which now rents access to over 25 million users.

Valuation

Activison Blizzard Inc.,

Amounts in $mn, except per share figure

Financial Forecast and DCF Valuation

	2021A	2022E	2023E	2024E	2025E	2026E
Revenue	$8,354	$9,186	$10,267	$11,476	$12,826	$14,336
Less: COGS	(2,189)	(2,407)	(2,690)	(3,007)	(3,361)	(3,756)
Gross Profit	$6,165	$6,780	$7,577	$8,469	$9,466	$10,580
% Margin	*73.8%*	*73.8%*	*73.8%*	*73.8%*	*73.8%*	*73.8%*
EBITDA	$3,452	$3,858	$4,312	$4,820	$5,387	$6,021
% Margin	*41.3%*	*42.0%*	*42.0%*	*42.0%*	*42.0%*	*42.0%*
Less: D&A		($182)	($204)	($228)	($255)	($286)
EBIT		$3,676	$4,108	$4,592	$5,132	$5,735
EBIT (1-t)		$3,136	$3,504	$3,917	$4,377	$4,892
Tax Rate		14.7%	14.7%	14.7%	14.7%	14.7%
Plus: D&A		$182	$204	$228	$255	$286
Less: Capex		(111)	(123)	(136)	(151)	(167)
Less: (Increase) / Decrease in NWC		(526)	(1,467)	(1,650)	(1,856)	(2,087)
Free Cash Flow (FCF)		$2,681	$2,119	$2,359	$2,626	$2,924
Weighted Average Cost of Capital		6.25%	6.25%	6.25%	6.25%	6.25%
PV of FCF (incl. Terminal Value)		2524	1877	1966	2060	56098
Perpetual Growth Rate (US GDP growth rate 2019)	2.16%					
Enterprise Value	$64,526					
Total Debt	$3,608					
Cash and Cash Equivalents	$10,423					
Equity Value	$71,341					
Shares outstanding (mn)	779.1					
Value Per Share	$91.6					
Operating Assumptions						
Revenue % Growth		*10.0%*	*11.8%*	*11.8%*	*11.8%*	*11.8%*
COGS % of Revenue	*26.2%*	*26.2%*	*26.2%*	*26.2%*	*26.2%*	*26.2%*
D&A % of Revenue		*2.0%*	*2.0%*	*2.0%*	*2.0%*	*2.0%*
Capex % of Revenue		*1.2%*	*1.2%*	*1.2%*	*1.2%*	*1.2%*

Valuation (cont'd)

Company Name	Stock Symbol	Currency	Market Data Price	Market Cap mm	EV mm	Financial Data 2021 EBITDA mm	Valuation EV/EBITDA
Electronic Arts Inc.	NasdaqGS:EA	USD	136	38,187	37,414	1,234	30.3x
Take-Two Interactive Software, Inc.	NasdaqGS:TTWO	USD	172	18,859	16,638	759	21.9x
NetEase, Inc.	NasdaqGS:NTES	USD	108	70,243	61,069	2,868	21.3x
Zynga Inc.	NasdaqGS:ZNGA	USD	9	10,367	10,708	467	22.9x
Playtika Holding Corp.	NasdaqGS:PLTK	USD	18	7,251	8,793	751	11.7x
Aristocrat Leisure Limited	ASX:ALL	AUD	42	27,922	29,034	1,343	21.6x
Nexon Co.	TSE:3659	JPY	2,445	2,173,682	1,634,166	100,009	16.3x
Bandai Namco Holdings Inc.	TSE:7832	JPY	8,136	1,787,620	1,590,673	111,647	14.2x
Ubisoft Entertainment SA	ENXTPA:UBI	EUR	50	6,129	6,711	455	14.8x
Konami Holdings Corporation	TSE:9766	JPY	6,920	924,379	792,038	55,722	14.2x
Corsair Gaming, Inc.	NasdaqGS:CRSR	USD	21	2,010	2,246	183	12.3x
						Average	18.3x
						Median	16.3x

Activision Blizzard EBITDA	$mm	3,452
Enterprise value Avg	$mm	63270
Enterprise value Med	$mm	56406
Net debt	$mm	(6,815.0)
Equity value Avg	$mm	70,085
Equity value Med	$mm	63,221
Number of shares outstanding	mm	779
Value per share Avg	$	89.96
Value per share Med	$	81.15

- Trading comparables gives us a valuation of about $90/share, the DCF model returns a value of $91.60/share, both significantly higher than the $65.39 ATVI shares traded at close prior to the announcement.
- The $68.7bn price tag for Activision seems like a fair price to pay for a company with strong franchises like Call of Duty, Overwatch and significant room for growth in their business.

Acquirer and Target Profiles

Acquirer

Microsoft Corporation (NASDAQ: MSFT) is a multinational technology corporation and one of the FANGAM group of major tech companies. The firm is made up of over 180,000 employees and specialises in software, consumer electronics, cloud services and videogames.

Microsoft's major gaming product is the Xbox console that was first released in 2001 and has sold over 172 million units. The firm's gaming division, Xbox Game Studios, hosts renowned franchises such as *Minecraft*®, *Ages of Empires*®, *Forza*® and *Halo*®.

- **Market Cap:** $2.3tn (As of 17th January 2022)
- **Net Debt:** $44.9bn
- **LTM Revenue:** $184.9bn
- **LTM EBITDA:** $90.8bn
- **Enterprise Value:** $2.3tn
- **EV/ LTM Revenues:** 12.6x
- **EV/ LTM EBITDA:** 25.2x

Target

Activision Blizzard, Inc. (NASDAQ: ATVI) is one of the world's largest interactive entertainment firms. The company was created 13 years ago (2008) through the merger of Activision, Inc. and Vivendi Games. The company has five major divisions across a range of both console and mobile games. The firm has also invested heavily in the development of esports initiatives, particularly for its flagship games *Overwatch*® and *Call of Duty*®.

It has developed a large number of franchises and its major intellectual properties include *Call of Duty*®, *Candy Crush*™, *World of Warcraft*® and *Overwatch*®.

- **Market Cap:** $50.9bn (As of 17th January 2022)
- **Net Debt:** $6.7bn
- **LTM Revenue:** $8.8bn
- **LTM EBITDA:** $3.5bn
- **Implied Enterprise Value:** $68.9bn
- **Implied EV/ LTM Revenues:** 7.8x
- **Implied EV/ LTM EBITDA:** 19.4x