

THE DEAL DESK

GFMC Newsletter

The Netflix of Games: Microsoft's Ambitious Bid for the Future

Aniq Ali

In a groundbreaking move, Xbox, a division of Microsoft, announced its acquisition of Activision Blizzard King (ABK) for a staggering \$68.7 billion in January 2022, marking the largest acquisition deal in Tech history. This strategic move aimed to propel Microsoft to the forefront of the \$175 billion gaming market, which has expanded exponentially over the past 15 years from a mere \$10.5 billion. With this bold acquisition, Microsoft seeks to solidify its position as a major player in the gaming industry, where innovation and content are crucial to success, and stay ahead of Sony, its main competitor in the space with their popular PlayStation platforms.

What's more remarkable is that the deal is all cash, with Microsoft paying \$95 per share for the ABK, a premium of 45% over its trading price on the day the deal was announced. ABK's shares post-announcement began trading at a 25% premium, with MSFT (Microsoft) down 2% during the same time.

Key Financials for MSFT and ABK

US \$ in Million	Activision Blizzard Inc	Microsoft
	Fiscal year, 31 Dec 2022	Fiscal Year, 31 Dec 2022
Total Revenue	7,528.00	211,915.00
EBITDA	2,075.00	103,555.00
Market Capitalization	72,924.08	2,495,806.23
Cash & Equivalent	13,084.00	111,262.00

Source: Refinitiv Eikon

About ABK

Activision Blizzard King (ABK), headquartered in Santa Monica, California, has been a gaming industry mainstay since its inception in 1979. Distinguished by its vast and diverse gaming portfolio, ABK caters to a global audience across platforms such as consoles, PCs, and mobile devices. Its revenue streams encompass subscriptions, full-game sales, in-game transactions, and lucrative licensing agreements. Iconic franchises like Call of Duty, World of Warcraft, Diablo, Hearthstone, and Candy Crush maintain global appeal.

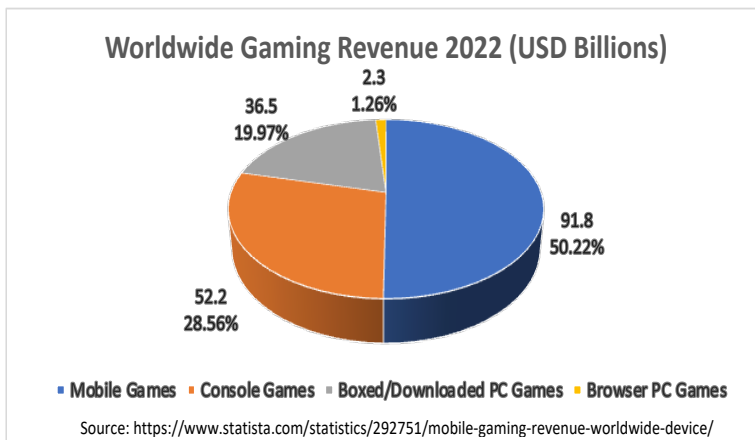
At the heart of ABK's digital strategy is Battle.net, a proprietary online gaming service that promotes community interaction and content distribution. Additionally, the company has ventured into esports through the Overwatch League, expanding its influence in gaming. ABK's extensive distribution network, including mass-market retailers, consumer electronics stores, and specialty game shops, continues leading the industry, shaping how players engage with virtual worlds.

Why ABK? Why Now?

At the heart of Microsoft's grand vision lies the future of cloud streaming for gaming, and it's equipped with the perfect infrastructure—the Azure cloud service. The company also boasts the famous Xbox Game Pass, a subscription service that revolutionizes how users access games, like how Netflix transformed the entertainment landscape. Embracing this cloud and subscription-focused model, Microsoft's Xbox division is gradually shifting from relying on traditional console sales, setting itself apart from rivals Sony and Nintendo.

What makes ABK an irresistible target for Microsoft is its impressive portfolio of iconic franchises. Call of Duty, a consistent bestseller game, has a robust live service component that allows continuous monetization. Blizzard adds the cherished World of Warcraft game and the newly released Diablo 4 to the mix, all aligning seamlessly with the Xbox Game Pass service, which requires a catalog of content to appeal to enough users to reach critical mass.

Also, the acquisition grants Microsoft ownership of King, a major player in the mobile gaming market, which accounted for \$91.8 billion in 2022, or around 50% of the entire market, as shown in the graph below. With games like Candy Crush amassing hundreds of millions of downloads annually, tapping into the mobile realm becomes essential for achieving critical mass with the Game Pass model. As mobile gaming rapidly outpaces consoles and gaming PCs, Microsoft positions itself to harness this burgeoning market.



Moreover, bolstering its content library supports Microsoft's vision for cloud gaming—a future where games are streamed over the internet, eliminating the need for local machines. Like Netflix, a strong content lineup is vital to attract users and drive success. With ABK and its previous acquisitions and in-house game developers, Microsoft emerges as one of the world's largest game publishers.

From a financial standpoint, Microsoft's all-cash deal also indicates the strategic utilization of its massive cash reserves, which amounted to more than \$130 billion at the time of the deal's announcement, which as of the end of 2022, stood at \$111 billion as shown in the table above. Microsoft has one of the most significant cash balances among its competitors in the Tech space. While not the primary motivator, this cash deployment significantly influences the deal's structure and potential outcomes.

Smooth Sailing Or Rough Seas Ahead?

The road to this game-changing deal was not without challenges. The acquisition has faced intense regulatory scrutiny from authorities worldwide, including the UK's Competition and Markets Authority (CMA) and the US Federal Trade Commission (FTC). Nevertheless, Microsoft is pushing ahead with its ambitious plan, recognizing the unparalleled value that ABK brings to the table.

Navigating through regulatory challenges is a paramount concern for Microsoft. To appease antitrust fears, concessions have been made, such as licensing ABK software to other cloud providers for a decade and ensuring that popular franchises like Call of Duty remain accessible on rival platforms, thus avoiding monopolistic practices. While these concessions address regulatory issues, they limit content exclusivity, impacting Microsoft's platform appeal and content strategies. Even with these concessions, the Competition Markets Authority (CMA) in the UK has yet to finalize the deal, and workarounds for a key market in the UK may be necessary, leading to further complications for the move.

Another crucial consideration is culture integration. ABK faced allegations of a toxic workplace and sexual harassment, including members of their senior leadership and CEO Bobby Kotick himself, with a lawsuit filed by the state of California still ongoing against the company. This mirrors some of the issues Microsoft has encountered within its organization. Integrating a company with such challenges into the corporate structure poses significant complexities and risks, potentially impacting talent retention and synergy extraction, which will be critical to the deal's success, given the premium Microsoft is paying.

Lastly, the success of Microsoft's "Netflix for games" model is contingent on consistently delivering high-quality content. Unlike movies and TV shows, game development is a more complex, specialized, and time-consuming process, with a more limited and less commoditized talent pool compared to unionized crew and production labor in films. Maintaining a robust production pipeline for subscription models might not align seamlessly with Microsoft's vision and may not be sustainable within a subscription and cloud-based model, warranting a closer examination of their strategy.

Conclusion

This landmark acquisition is set to redefine the Tech Industry, not only due to its staggering value but also its colossal impact. Microsoft's visionary approach, driven by its cloud streaming dreams and subscription-based gaming, sets the stage for an intriguing future in the gaming landscape. The regulatory and cultural challenges will undoubtedly test Microsoft's prowess in successfully integrating ABK and realizing its ambitious goals.

Competitors like Sony are gearing up for their strategic moves. With Amazon already in the cloud gaming arena through Luna and Google seeking to revive Stadia, the gaming market promises to be a hotbed for significant M&A activity in the coming decade. The game is on, and the world awaits the unfolding of a new era in gaming technology.

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Trivia Quiz

1. If you want to find out your credit score, there are three agencies you can check with. The first two are Equifax and Experian. What's the third? -
2. FICO, a score widely used to assess creditworthiness, is an abbreviation of an old company name, "Fair ___ Corporation." What name, which is also a man's first name, goes in the blank?
3. Which type of stock is higher up on the chain of claim than common stock but not as high up as bonds?

Answers to Trivia Quiz – Issue 12

1. Promissory Note
2. Liquidity
3. Blue

About the Author



Aniq Ali
Graduate Student

Aniq is currently pursuing a Master's in Financial Technology and Analytics, specializing in machine learning and general artificial intelligence. Concurrently, he serves as an ML Engineer Intern at Sport Clips, focusing on optimizing queuing algorithms to enhance operational efficiency. Outside of his academic and professional commitments, Aniq enjoys immersing himself in video games and is an avid fan of the anime series 'One Piece'. He also maintains a disciplined fitness routine. Upon completing his graduate studies, Aniq aspires to further contribute to advancing his knowledge and skills for building AI technology.

Alumni Spotlight



Pranjal Bhatt
MBA and MS Finance
2022

Pranjal Bhatt is a seasoned professional currently serving as an Associate within Houlihan Lokey's Strategic Finance practice. His prior experience includes a summer internship with the Strategy & Transactions team at Ernst & Young, with expertise in transaction advisory and strategy development. Additionally, he contributed as a fall intern at ValueScope Inc., specializing in business valuations and transaction advisory services, adding solid financial acumen.

Pranjal advises students pursuing their education to tap into the extensive resources available on campus. He emphasizes the significance of active participation in live case competitions like StockTrak or Financial Modeling, which offer invaluable hands-on experience. Additionally, Pranjal encourages students to delve into financial databases within the Finance Trading Lab, a practice that significantly enhances employability in the financial industry. A standout lesson from Pranjal's own journey through the MSF program at UTD is the importance of nurturing meaningful relationships. Pranjal advocates connecting with peers, alumni, and faculty members while also seeking a mentor to guide during challenging times.

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Contact:

GFMC email id: gfmcc2019@gmail.com

Varsha B R, Deal Desk Officer: Varsha.BR@utdallas.edu

Garima Gupta, President: Garima.Gupta3@utdallas.edu

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