In depth analysis of the Gaming Industry: Part 2

Sony's acquisition of Bungie

Less than 15 days after Microsoft dropped the news of an imminent $75bn acquisition of Activision Blizzard, tech giant and main Microsoft competitor Sony announced on the 31st of January its plan to acquire video game developer Bungie for $3.6bn. While the two deals differ profoundly in terms of size, their nature and rationale are very similar: seeking dominance in the video gaming industry by means of further consolidation.

Bungie is a private independent videogame developer founded in 1991 and based in Washington. While not as big as Activision Blizzard, mainly in terms of the number of prestigious gaming titles owned, the company is extremely well-respected and is known as the mother of viral gaming phenomena like Halo and Destiny. Nevertheless, it is important to note that Halo is today not part of Bungie's portfolio of games anymore. In fact, Microsoft retains rights on the military science fiction franchise after acquiring Bungie in 2000 and spinning it off in 2007. Certainly, the idea that the forefather of the most famous Xbox series will be soon acquired by Microsoft's main competitor does not appeal to loyal Xbox customers. However, Sony stated that it is planning to maintain a multi-player platform and that it will not shut out other consoles. Just like for the Activision Blizzard case, it is not possible to know whether this will be the case. Currently, Bungie is working on the development of first-person shooter game Destiny 2.

For what concerns the structure of the deal, the agreed $3.6bn valuation of Bungie includes purchase price and committed employee incentives and is subject to customary working capital and other adjustments. After the deal, in line with Bungie's commitment to "create meaningful entertainment experiences that span generations", in the words of Pete Parsons, CEO of Bungie, the video game developer will continue to operate independently. The company will hold on to its possibility to self-publish and reach out to players independently of the platforms they choose to play on. Similarly, also the board of directors and the management will remain unchanged, making Bungie an independent subsidiary of Sony in all respects.

Why is this acquisition taking place and why it is taking place now? While the market agrees in recognizing the wave of consolidation that is taking place in the video games industry in the attempt to capitalize on increased demand for gaming prompted by the pandemic, there is more to it. Sony will benefit from having access to Bungie's approach to live game services, technology expertise, and millions of loyal players. Nevertheless, some analysts believe that the acquisition goes beyond being a step forward in Sony's metaverse virtual world offerings. As reported by the Financial Times, "Pelham Smithers, an independent analyst, called the acquisition a defensive move". The idea is that Sony is looking for a weapon to fire should Microsoft ever decide to force Activision to make iconic titles like Call of Duty exclusive to Xbox. With the Bungie acquisition, Sony would be able to shoot back by threatening to make Destiny 3 a PlayStation-only game. Many gamers are not happy about the unravelling of events, as they generally wish to abandon the archaic and infamous "console wars" in favour of greater accessibility. Investors, on the other hand, liked the deal: stocks are currently up 5.49% from the low registered on the 27th of January in wake of the Microsoft Activision Blizzard mammoth deal.

Take-Two's acquisition of Zynga

While all eyes are turned to the two major players in the gaming industry announcing fight deals, Microsoft and Sony are not the only ones trying to capitalize on increased gaming demand. In fact, 8 days before Microsoft made its striking $75bn announcement, Take-Two Interactive game developer agreed to buy mobile gaming company Zynga for $12.7bn.

Take-Two Interactive Software is a leading developer, publisher, and marketer of video games. With around $3.4bn in revenues and an annual net income of $589m in 2021, the company makes most of its money from selling PC and console videogames. Take-Two is mostly famous in the industry for its iconic series including Grand Theft Auto, Red Dead Redemption and NBA 2K, but could make good use of a booster to its mobile offerings, which currently includes games such as Dragon City and Monster Legends.

Social game services provider Zynga on the other hand is mainly focused on mobile gaming. Its focus is on free-to-play mobile games and it has become renowned for titles like FarmVille and Harry Potter: Puzzles & Spells. The company has also recently been on its own acquisition spree. Acquiring Turkey's Peak Games and Echtra Games in 2020 and 2021, the company strengthened its games portfolio. In addition, the acquisition of advertising technology company Chartboost allowed Zynga, which gets about a fifth of its sales from ads shown on its free-to-play games, to internally produce and tailor game ads in wake of Apple's change in privacy tracking rules. While it registered revenues at 13% higher year-over-year, and advertising & other bookings up 46% year-over-year in 2021, the company remains loss-making.

According to the terms of the transaction, Zynga will be bought for $12.7bn enterprise value, accounting for an EV/EBITDA multiple of about 20x. While it is debatable whether this is too high or not for a loss-making company, this is in line with Take-Two's 19x today and 22x at the time of announcement. Zynga's shareholders will receive $3.50 in cash and $6.36 in Take-Two stock for each of their shares. These numbers value the mobile games company at $9.86 per share, which is a premium of 64% to its closing price prior the announcement. For what concerns management, Take-Two CEO Strauss Zelnick will lead the combined group and Zynga CEO Frank Gibeau will oversee the mobile business. Zynga will also be granted 2 out of 10 seats in the board of directors. The two companies also released several expectations, which sum up to approximately $100 million of annual cost synergies within the first two years after closing and more than $500m of annual Net Bookings chances over time.

Although highly tied to the post-pandemic consolidation acquisition wave that also Microsoft and Sony are experiencing, the nature of this deal is rather different. As a game developing company, Take-Two is focused on competing with large traditional incumbents such as Activision Blizzard and Electronic Arts (EA). By joining forces with Zynga, Take-Two declared they could generate $6.1bn in annual revenues. While revenues would still be lower than Activision Blizzard's $8.8bn declared for 2021, the deal would put Take-Two just above EA's 2021 revenues of $5.6bn, establishing one of the largest publishers of mobile games. However, Take-Two's main competitors have been shopping quite extensively in the past few years and Take-Two does not want to be outdone. EA alone acquired Glu Mobile, known for Kim Kardashian's mobile game, for $2.4bn in 2021 and F1 passionate racing game developer Codemasters for $1.2bn in 2020. As the mobile gaming industry is expected to reach a CAGR of 12.3% during 2021-2026 thanks to the growing smartphone coverage and technological advancement, Take-Two followed suit and strengthened by selecting Zynga as the best tool to penetrate the industry. The market however has rather mixed feelings about the deal. While some suggest that the acquisition was far too pricey, especially considering that Take-Two is not sitting on cash and has a market capitalization of $19.5bn today, Zynga's shares surged 52% in pre-market trading. Take-Two, on the other hand, registered a 15% slump in share price right after the announcement. As suggested by the Financial Times, "the market's view of this deal would appear to echo that of character Trevor in GTA […]: "I told you to get something nice, not something expensive"..

The Metaverse

The metaverse is a virtual world where virtual avatars can work, shop, play, and interact in ways that are not otherwise possible - avatars come together to engage in online communities and explore digital spaces. Tim Berners-Lee launched the World Wide Web in 1989 and soon after, the term 'metaverse' was coined by science fiction writer Neal Stephenson in 1992 to describe a 3D virtual realm. In 2022, the metaverse can be seen as a digital environment constructed with the help of several technologies such as Virtual Reality (VR), Augmented Reality (AR), cryptocurrency, and the Internet.

When Facebook rebranded itself as Meta Platforms Inc. (now widely known as Meta) in October 2021, the term officially entered the mainstream. Some on Wall Street view Facebook's transition to the name Meta, along with its third-quarter announcement that it would spend around $10bn on its metaverse subsidiary in 2021, to be a defining moment for metaverse awareness. The company aims to be known as a "metaverse" corporation rather than just providing social networking services. And rather than managing the Facebook app, Zuckerberg wants a more significant role in those new endeavours. The corporation is also looking for a way out of the scrutiny and distrust associated with Facebook.

The metaverse combines two concepts: virtual reality and digital second life. For decades, technologists have speculated about a time when our virtual lives are just as significant as our physical ones. Meta has already established itself as a pioneer in the virtual reality business, shipping over 10mn Oculus Quest 2 VR devices in the last year. It is now the world's best-selling standalone VR headset, but it still has a considerably smaller following than the Nintendo Switch. Nintendo already has a sizable user base. However, Nintendo's metaverse strengths are unlikely to outweigh its near-term obstacles, including Switch supply chain bottlenecks and difficult year-over-year comparisons in a post-pandemic market.

What makes the metaverse appealing to so many is uncertainty and innovation. Mark Zuckerberg, the CEO of Meta, predicts that future work gatherings will take place in the metaverse, where you'll be able to view digital replicas of co-workers to your left and right. According to this definition, its benefits include improving existing social media experiences and digital communication, establishing new business options, creating a valuable virtual economy, and augmenting blockchain technology capabilities. The downsides of the metaverse and the challenges and critiques at it revolve mainly around the fact that present online-enabled platforms are still unstable. Security and privacy concerns, the social and cultural influence of today's digital communication, and the limited availability of technology are among the main issues.

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Metaverse: A Battleground for Big Tech companies

Sony, the creator of the PlayStation VR, has the most inventions among the metaverse's significant corporations, followed by Microsoft, the creator of the Xbox system. As a result, the two most potent patent holders also control the two most powerful gaming platforms. Overall, Meta is ranked fifth, behind Samsung and Google. However, Meta has made the most recent advancements in the field. Canon, IBM, and LG are also in the top ten corporations. Apple and Magic Leap are projected by some to take the lead due to current product development predictions.

The primary gaming, AR, and VR market currently stands at $413bn. According to Bloomberg analysts, the core metaverse income opportunity for video game developers is mainly comprised of the existing gaming software and services industry, followed by hardware, such as consoles. Software and services income and in-game advertising revenue accounted for almost 70% of the total market size in 2021, which is projected to reach $412.9bn in 2024, compared to $274.9bn in 2020. Even though software has a more significant portion of the market, entering the metaverse could not be possible without the backing of hardware innovation.

Gaming Industry Scrutiny

Microsoft Corp.'s $75bn acquisition of Activision Blizzard Inc. is likely to be scrutinized closely by antitrust regulators in the United States and overseas at a time when they have increased scrutiny of potential mergers, particularly in the technology industry.

The agreement comes when Washington is arguing over whether the government should do more to rein in the nation's largest and most influential technology businesses. Despite its size and importance in the US economy, as well as its past in the antitrust crosshairs in the 1990s, Microsoft has escaped the limelight this time. Instead, the Justice Department, the Federal Trade Commission, and members of Congress have concentrated on claimed competitive risks posed by Google, Amazon.com, Apple Inc., and Meta Platforms Inc.'s FB.

Investors who trade on deal news are anxious after a record run for mergers. Activision Blizzard Inc., Spirit Airlines Inc. (SAVE) -1.55%, and Zynga Inc. (ZNGA) -1.09% are trading significantly below their agreed-upon purchase prices, indicating that investors are concerned that the acquisitions may fall through.

Antitrust scholars say courts have been sceptical of large merger challenges in recent years. Under Biden administration appointees, both the Justice Department and the Federal Trade Commission have expressed interest in reviewing and possibly challenging a broader range of M&A deals because of the threat posed to maintaining competition in the market. Investors' anxiety stems from a growing belief that global regulators are preparing to scrutinize more deals on antitrust grounds. Their concerns were fulfilled earlier this week when Nvidia Corp. and SoftBank Group Corp's Arm scrapped a $40bn deal questioned by regulators. Investors lost confidence that the semiconductor giant would merge after the Federal Trade Commission sued to block the merger in December.

TAGS: Gaming, Sony, Microsoft, Technology, Xbox, PS5