

Research on the Risk and Investment Value of Microsoft's Acquisition of Activision Blizzard

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Abstract: On January 18, 2022, Microsoft announced its plan to acquire gaming company Activision Blizzard for \$68.7 billion in cash. This news immediately caught the attention of the world. If Microsoft completes the acquisition, it will become the largest acquisition in the history of the electronic gaming industry. However, due to various issues and obstacles, Microsoft has not yet completed this acquisition. This study aims to analyze the risks and benefits of Microsoft's acquisition, as well as the investment value of Microsoft under the impact of the acquisition case. After analysis, it will be difficult for Microsoft to complete the acquisition of Activision Blizzard in the short term. At the same time, as this is a critical period for the acquisition, the stock prices of Microsoft and Activision Blizzard are highly sensitive and unstable to any news, and investors should carefully consider their risks.

Keywords: acquisition, metaverse, antitrust, CMA, FTC

1. Introduction

1.1. Background

In recent years, due to the global impact of COVID-19, information technology and the online industry have experienced unprecedented development. People's time spent online has continued to increase, which has forced many companies to expand their online services and product lines to keep up with the trend of this era. Microsoft, as one of the most valuable companies in the world today, naturally will not miss this opportunity. On January 18, 2022, Microsoft suddenly announced its plan to acquire electronic gaming company Activision Blizzard for a total acquisition amount of \$68.7 billion, which will be all cash. Although Microsoft has been expanding its electronic gaming business in recent years by acquiring gaming companies and studios, such a huge amount is also a one-time acquisition. If this acquisition is approved, it will be the largest acquisition in the history of the gaming industry. Although Microsoft has always stressed that the purpose of this acquisition is to prepare for its strategy of developing the Metaverse, it has attracted many organizations to question whether this acquisition of Microsoft involves monopoly, which has also led to the fact that this acquisition is still not completed, but its trend is still constantly exerting a huge impact on the market.

1.2. Related Research

Pales analyzed the acquisition of Activision-Blizzard from the perspective of game industry, it offered an in-depth study of the current situation of the gaming market, It also discussed the favor and opposed opinion that the market has about the acquisition. It also estimated the impact of antitrust laws on acquisitions and the impact on the market after the successful acquisition and indicated that the deal's grave anti-competitive impacts will endanger the welfare of consumers [1]. He and Liu focused on the impact of the acquisition of Activision-Blizzard on Microsoft's strategy for developing the Metaverse. The author used two scientific analysis methods, which are SWOT Analysis and PEST Analysis, to explain the pros and cons that this acquisition may bring to Microsoft. It also offered a very positive prediction about the acquisition results [2]. Clare focused on the discussion of the impact of antitrust laws that may affect the result of the acquisition and also how it can affect the consumers. And by analyzing the current market of Microsoft from the perspective of products and labor, It also offered some proposals about the future behavior of Microsoft if the acquisition succeeded [3].

Zhang researched the share price and market of Activision Blizzard. the SWOT model and data from forecasting calculations are used to examine the probable future game industry. The findings indicate that Activision Blizzard will experience consistent growth in earnings over the coming years based on how the gaming industry is now developing and how those similar firms are faring. Therefore, investing in it is worthwhile [4]. Weise wrote a newsletter about the information of the acquisition of Activision-Blizzard, it offered a very comprehensive overview of the basic information of the acquisition, and the Changes in Microsoft's market and stock price after the announcement of the acquisition. It also includes some professionals' comments on this acquisition. At the same time, it also discussed the current situation of Activision-Blizzard and the difficulties it is facing [5]. Nagy analyzed the competition in the IT industry of Microsoft from the perspective of finance, the author used Alphabet as the main competitor. It compare their business model of them and discussed how these two companies create value in the market. At the same time, it also calculated financial ratios to explain how Covid-19 impacted the financial condition of those companies [6].

Becker evaluated the equity of Activision Blizzard, It mainly used the DCF model. This valuation tried to put the DCF's assumptions to the test by contrasting them with Activision Blizzard's recent market price. As a result, Activision Blizzard is valued at US \$97.12 per share in the DCF method [7]. Bloom indicated that the acquisition of Activision-Blizzard is " A test case for the leaders of US antitrust agencies who have vowed to tackle Big Tech's market power", It focused on explaining the public opinion's concerns about this acquisition from the perspective of antitrust. It also offered lots of comments from people in different social classes [8]. Eckert wrote a newsletter that discussed the impact that the acquisition of Activision-Blizzard could have on Sony. And also talked about how Microsoft could benefit from this acquisition. It also provided some previsions of the future of the game industry, Microsoft's share price, and the current changes in Microsoft and Activision-Blizzard's share price in 52 weeks [9]. Bloom evaluated the effects of COVID-19, data from a survey of about 2,500 US small enterprises who opted in were used. According to the research, there was a considerable decline in sales that peaked in the second quarter of 2020, which is a 29% average loss. It also discover that the smallest offline companies saw sales declines of over 40% as opposed to the biggest online companies, which saw declines of less than 10% [10].

1.3. Objective

The purpose of this article is to analyze the current situation of Microsoft's acquisition of Activision Blizzard. The second part will mainly focus on Microsoft's acquisition motivation. This part will cut into two perspectives: Microsoft's claimed preparation for the metaverse and media and institutional

speculation about market share. It will discuss the motivation behind this acquisition. The third part will mainly compare and analyze the financial performance of Microsoft and Activision Blizzard, And try to identify the advantages and potential risks that this acquisition case will bring to Microsoft.

2. The Motivation for the Acquisition

2.1. Seize the Gaming Market

Based on Microsoft's actions in recent years, there are two possible motivations for Microsoft's acquisition. The first is to seize the share of the gaming market. The potential of the game industry is huge nowadays, it contains over 180 billion of annual revenue around the world and over 60 billion in the US, with a growth rate of about 10% yearly, the gaming business is also one in entertainment with the quickest growth [1]. Microsoft's enthusiasm for the gaming market in recent years is obvious to all, this may be due to its increasing industry saturation in other fields, In its main products, whether it is Windows systems or software, most of them have already achieved a leading or even dominant position in its market. However, in the electronic game market, Microsoft still faces many powerful competitors, such as Sony and Nintendo, its market share it owned in the game console market is about 27%, it's not a low number but still has huge growth potential, in this situation, the development of the gaming industry is an effective strategy for Microsoft to continue increasing its size. Moreover, in recent years, Microsoft seems to have gradually ceased to be satisfied with only developing in the home console market and began to expand its industry more into the PC gaming market. Whether porting many of its games to PC platforms or incorporating Xbox game passes, which were originally only available on Xbox, into Windows' default software, this clear intention can be seen in many of Microsoft's strategies. Meanwhile, even though Activision-Blizzard has been deeply embroiled in various issues and scandals recently, it remains one of the giants in the game development field, especially its famous IP: The Call of Duty series. In 2022, the newest game of the series: Call of Duty: Modern Warfare II created over \$1 billion in revenue in only 10 days, its potential is undoubtedly enormous [11].

2.2. Metaverse Development

However, when Microsoft itself talks about this acquisition case, it often claims that its purpose is actually to prepare for Microsoft's future metaverse development strategy. Although many people believe that this is a statement prepared by Microsoft in response to antitrust laws, the possibility of its true existence cannot be completely denied. The metaverse is defined "as a graphically rich virtual space, with some degree of verisimilitude, where people can work, play, shop, socialize — in short, do the things humans like to do together in real life" Broadly [1]. Undoubtedly, the potential of the metaverse is enormous, Gartner, a market research organization indicated that there will be over 25% of people spend at least an hour a day on their online lives, no matter whether it's shopping, working, gaming, or doing something else. Meanwhile, the value of the metaverse market around the world will reach over 800 billion in 2024 [2]. For Microsoft, this may indeed be a good development direction. However, even though many companies tend to develop the metaverse nowadays, so far no company has made breakthrough progress, and even the entire industry has not reached a consensus on the definition of the metaverse. It can be said that it is still in its early stages. This allows the definition of the metaverse to be infinitely extended, anything that works on the internet could be a part of the metaverse, even ice cream shops that allow online ordering can be examples of the metaverse, in this case, although Activision Blizzard is a gaming company, it is still described by Microsoft as part of its metaverse strategy. This is also why many people believe that Microsoft's rhetoric about the metaverse is some kind of misleading and perhaps more to avoid being obstructed by antitrust laws in this acquisition.

3. Financial Performance and Potential Risks

Generally speaking, the impact of acquiring a company is directly reflected in the financial performance of the acquiring party, and this impact is often a double-edged sword for the acquiring party. Firstly, here is a comparison of the current performance between the two. Due to the significant difference in size, only some key financial ratios are used for comparative analysis here, as shown in Table 1.

Table 1: Key Ratios [12, 13].

2023-03-31	Microsoft	Activision Blizzard
Long-term Debt / Capital	0.1773	0.1522
Debt/Equity Ratio	0.2476	0.1795
Gross Margin	69.4875	72.094
Net profit margin	34.6198	31.0533
Asset Turnover	0.1391	0.087
Receivable Turnover	1.4125	3.1191
ROE - Return On Equity	9.3994	3.6788
ROA - Return On Assets	4.8144	2.7014
ROI - Return On Investment	7.7326	3.1189

According to the key financial ratios, it is easy to find that Microsoft has better financial performance. There are several key points worth noting, when Activision Blizzard earns a higher gross margin which is 72.094, it still has a lower net profit margin compared to Microsoft, this may reflect some issues in its operation. Also, for ROE, ROA, and ROI, Microsoft has about twice the value of Activision Blizzard, this also reflects the huge gap in financial performance between the two.

3.1. Advantages

Acquiring can bring lots of financial benefits to Microsoft, the first to bear the brunt is more revenue and market share. Through this acquisition, Microsoft will acquire the user base and products of Activision Blizzard in the gaming market. According to statistics, as of December 31, 2022, the number of Activision Blizzard users is approximately 389 million, and the net income is about 1.513 billion, once the acquisition is completed, it will be integrated into Microsoft's financial performance [13]. But at the same time, it needs a long term to show out. Another advantage is cost synergies, though the acquisition Microsoft will be able to unify the management and the operation of the acquired company, Microsoft will have the opportunity to improve its work efficiency, such as reducing the work pressure of similar departments or providing support to the acquired company through existing resources to improve its profitability. In this case, the company's cost can also be reduced in a disguised manner. However, similar to market share and profit, these advantages usually require a longer period to manifest, which usually depends on when the profits generated by the acquired company can exceed the expenses of the acquisition, i.e. its break-even point.

3.2. Potential Risks

If most of the advantages Microsoft can gain from this acquisition are long-term, then the risks it faces are concentrated in the short term. The most obvious one is the direct cost of the acquisition, Microsoft has announced that it will use approximately \$68.7 billion in cash to acquire Activision Blizzard [5]. Looking at the history of the entire gaming industry, this is also an extremely large amount. Generally speaking, such behavior will cause financial pressure on the company in the short

term, not to mention that this is an all-cash transaction. However, as of the first quarter of 2023, Microsoft's market cap has reached approximately \$2.31 trillion, which means that this transaction only accounts for 2.5% of its total, which may not cause significant pressure on Microsoft [12]. Meanwhile, as shown in previous comparative analysis, Activision Blizzard has a significantly weaker financial performance than Microsoft, which means that Microsoft may need to provide a significant amount of resources and effort to rectify and integrate it in order to achieve its expected effect after the acquisition. Furthermore, due to various obstructions of a series of European countries led by the United Kingdom based on the anti-monopoly law, the acquisition of Activision Blizzard has now reached an impasse again [3]. In this case, Microsoft has to continue to invest huge energy, and at the same time, it needs to maintain a high cash ratio to prepare for the acquisition. The opportunity cost arising from this will be extremely huge, I'm afraid the day of a successful acquisition is still far away.

4. Previsions and Recommendations

4.1. Prevision

Based on the current progress of the acquisition, it may not be completed in a very short period. As mentioned earlier, the strong opposition of the Competition and Market Authority (CMA) in the UK has led to very slow progress in the current acquisition process. At the same time, the UK is one of the legal areas that Microsoft must pass to acquire Activision Blizzard. This attitude of the CMA immediately reduces the likelihood of the acquisition being successful. [3]. However, although the current situation is very stagnant, there may still be a lot of optimism about the success rate of this acquisition. After all, even under such obstacles, Microsoft has gained the support of most countries, including the European Union, by proposing remedial measures. Now, as long as they can persuade the CMA and the Federal Trade Commission (FTC), Microsoft can complete this acquisition, Under the continuous promotion of Microsoft's huge capital, perhaps the question will be more about "how much cost it will take" than "whether it will succeed". However, it is undeniable that Microsoft still needs more time, and this time will not be too short.

4.2. Recommendations for Investors

For investors, due to the impact of this acquisition, the risks and uncertainties of both Microsoft and Activision Blizzard's current investments are enormous. Every time new news about this acquisition is released, its stock price fluctuates significantly. For example, when CMA announced its opposition to the acquisition earlier, Activision Blizzard's stock price fell by nearly 11%, which can be said to be extremely sensitive. Due to the stalemate between Microsoft and CMA, this situation may continue, and Microsoft has mentioned that it will file a lawsuit in the short term. At that time, regardless of the outcome, it will inevitably have a huge impact on its stock price again. Therefore, investors who want to invest soon must be more careful when considering it. At the same time, due to the confrontation with antitrust law issues, both Activision Blizzard and Microsoft choose statements that are conducive to their adoption of antitrust laws when releasing relevant announcements. These statements are often misleading and may mislead some investors who are not familiar with the situation, such as the metaverse strategy mentioned by Microsoft and its vague definition, or Microsoft also has repeatedly mentioned in public that its performance in the gaming console industry is far inferior to that of Sony and others. It is more to adopt an antitrust law response measure, and investors need to carefully screen and research that information.

4.3. Future Trends

If Microsoft's acquisition of Activision Blizzard is successful, it will inevitably have an impact on the industry's operational strategies and trends. Some top companies with huge capital like Microsoft may imitate this investment model of acquiring to quickly develop and occupy the market. They will no longer need long-term independent development and a long time to compete with existing companies in the market, thereby rapidly expanding their size and product line. At the same time, Microsoft's main competitors such as Amazon and Apple are bound to not allow Microsoft to seize the market. In order to contain Microsoft, they may also start using the same methods to confront, which may be devastating for antitrust.

5. Conclusion

This research mainly analyzes Microsoft's acquisition motivation, the financial performance of the acquiring and acquired parties, as well as the potential advantages and risks that may arise from the acquisition case. Also predicted the future direction of the acquisition and provides some relevant suggestions for investors based on those analyses.

Overall, Microsoft is indeed able to gain significant benefits through this acquisition, both in terms of profitability and market share, but these advantages may take a longer period to manifest. The biggest problem it currently faces is still how to block it through antitrust laws. The opposition attitude of CMA and FTA is still very firm, which may make it difficult for Microsoft to break through its obstruction and complete the acquisition in a short period. At the same time, in such a stalemate situation, Microsoft cannot continue to invest time and funds and also has to maintain a high cash holding rate in preparation for the acquisition case, The opportunity cost generated from this is very significant. However, on the other hand, except for a small number of institutions led by CMA and FTA, which still hold opposition, this acquisition has been recognized by most countries and institutions, and it can even be said that the acquisition has reached its final stage. Perhaps Microsoft still needs more time, but driven by its huge capital, the situation of this acquisition may still be optimistic. However, at the same time, it can be said that this is a critical period for the acquisition case, and any related news may have a huge impact on the market and stock prices of Microsoft and Activision Blizzard. It can be said that they are very sensitive and extremely unstable now. In this situation, investors will need to become more cautious, or temporarily wait and see what happens is also a good choice.

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