

A Work Project, presented as part of the requirements for the Award of a Master's degree in  
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**SKYPE – LESSONS LEARNED FROM A HISTORY OF SUCCESS AND FAILURE IN  
MERGERS AND ACQUISITIONS**

Strategic Initial Public Offering (IPO) Registration Statement Filing in Facilitating Company  
Sale - PATRICK WILLNAUER - 58123

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**Abstract (100 words maximum)**

The eventful acquisition history of Skype first gained attention in 2005 with eBay's \$2.6 billion takeover of the then-unprofitable VoIP technology company. After failed attempts to integrate the software into eBay's bidding platform and an associated \$1.4 billion write-down, legal disputes over the technology's source code with Skype's co-founders exposed the importance of intellectual property in the context of Mergers & Acquisitions. A subsequent majority stake sale to private equity investors at a \$2.75 billion valuation and two attempted public floats later, Microsoft announced the staggering \$8.5 billion acquisition that further illuminated challenges around intangible asset valuation and regulatory approval.

**Keywords (minimum of four):**

Mergers & Acquisitions (M&A), Corporate Finance, Synergies, Case Study, Company Analysis

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### **Part A: Case Study**

*“This is a big day for Skype and this is a big day for Microsoft. We are adding a new division and a new promise to our customers, the promise of universal next-generation communications. Microsoft and Skype together will bring together hundreds of millions, or as Tony said, billions of consumers and empower them to communicate in new and interesting ways.”*

Steve Ballmer, Microsoft CEO (Microsoft Corp. 2011a)

*“We really appreciate the fact that, Steve, you have put your faith in us. We think there is a tremendous amount of opportunities as we look forward. We think this allows us to extend now from hundreds of millions to literally billions. We believe that this is a platform and a set of services that can reach everyone on the planet.”*

Tony Bates, Skype CEO (Microsoft Corp. 2011a)

On May 11<sup>th</sup>, 2011, the top executives of Microsoft and Skype hosted a call to announce Microsoft’s \$8.5 billion acquisition of the rapidly expanding communications service company. The move came after its owners, a private equity consortium led by Silver Lake, published a preliminary IPO prospectus with plans to float Skype just one year earlier, as well as reported talks with both Facebook and Google about an acquisition in the week leading up to the announcement (Halliday 2011). While this made it apparent that Skype was a contended asset in a reviving tech market in the aftermath of the great financial crisis, big question marks kept surrounding the deal. Most importantly, was Skype worth \$8.5 billion, a staggering 10 times sales and 32 times EBITDA, considering its turbulent acquisition history and most recent valuation of \$2.75 billion just three years earlier? Would this acquisition – by far Microsoft’s largest at the time – aid the maturing company that was struggling to catch up with its fast-growing, dynamic peers such as Apple and Google?

***Microsoft Corporation***

Founded in 1975 by Bill Gates and Paul Allen, Microsoft quickly rose to prominence as a global technology leader, revolutionizing personal computing with its Windows operating system and Office productivity suite. Throughout the 1980s and 1990s, the company dominated the software market, establishing itself as a household name and one of the most valuable companies in the world.

In 2011, Microsoft was a dominant yet somewhat stagnant player in the technology industry. Despite being highly profitable, with strong revenue streams from its Windows operating system and Office suite, the company was increasingly viewed as a mature giant struggling to innovate in a rapidly evolving tech landscape. Microsoft's core business remained focused on enterprise solutions and PC software, but it faced significant challenges in emerging markets like mobile computing and cloud services, where competitors such as Apple, Google, and Amazon were gaining ground (Zachary, Hall, and Montevirgen 2024).

Investor sentiment reflected these concerns, with Microsoft's stock having remained relatively flat for much of the previous decade. Although the company had vast cash reserves, which allowed for strategic acquisitions like Skype, there was growing skepticism about its ability to remain competitive and innovative, particularly in the consumer tech space. In contrast, companies like Apple were thriving on the success of the iPhone and iPad, Google was rapidly expanding with Android and cloud services, and Amazon was making significant strides with AWS. In its 2010 Annual Report, Microsoft similarly tried to convince investors of its innovation capabilities in core focus areas such as communication and collaboration at work, foreshadowing the Skype deal:

*“We continue to develop innovative software applications and solutions that we believe will enhance information worker productivity, improve communication and collaboration in work*

## GENERAL PART

*groups, aid business intelligence, and streamline processes for small and mid-sized businesses.*“ (Microsoft Corp 2010)

### ***Skype Global S.á.r.l.***

Founded in 2003 by Niklas Zennström and Janus Friis, Skype transformed the telecommunications landscape with its pioneering use of voice-over-internet protocol (VoIP) technology, allowing users to make voice and video calls over the internet. This innovation significantly altered global communication by enabling free or low-cost calls worldwide. Skype quickly grew into a major player in digital communication, attracting millions of users in a short period and establishing itself as a key platform for both personal and business use.

By 2011, Skype had more than 660 million registered users and had become a leader in online communication. However, it faced increasing competition from newer platforms such as Google Voice and Apple’s FaceTime. While Skype had successfully moved into mobile communication and video calling, concerns persisted about its business model, particularly its reliance on a small number of paying users while most accessed its services for free. The company’s peer-to-peer infrastructure, though innovative, also presented challenges in monetizing its vast user base. (Skype S.á.r.l. 2010)

Skype's history of mergers and acquisitions reflected its strategic importance in the tech industry. In 2005, eBay purchased Skype for \$2.6 billion, with the intention of integrating its communication features into eBay’s e-commerce operations. This vision, however, did not deliver the expected benefits, leading eBay to take a \$1.4 billion write-down two years later. In 2009, eBay sold a 65% stake in Skype to an investment group led by Silver Lake Partners for \$1.9 billion, retaining a 35% minority stake. The deal valued Skype at \$2.75 billion, allowing it to operate with more independence and focus on growth. Skype continued to expand under this new ownership, but with competition intensifying, it became the subject of acquisition

## GENERAL PART

interest from major companies like Google and Facebook, ultimately paving the way for its acquisition by Microsoft in 2011. When the news broke on 30th April 2011 that Microsoft would pay a staggering \$8.5 billion for the communication company, those previous valuations numbers were still in people's minds. Wall Street's generally negative perception of the deal was quickly reflected in the stock price in the days after the announcement, losing 4.3% in the first week (Appendix 3). How the tech giant came up with a valuation that equaled 10 times sales and 32 times EBITDA, representing almost \$1,000 for each of the 8.8 million monthly paying users, was a much-discussed subject (J. Shan 2013).

### ***Industry Outlook***

Skype's noteworthy rise in popularity took place against a backdrop of rapid technological advancements in broadband and Voice over Internet Protocol (VoIP) technology as well as intensifying competition and consolidation in the software & internet services industry.

Significant increases in in-home broadband internet adoption led to an average penetration rate of 24% in OECD countries by the end of 2010 (OECD 2003-2012) (Appendix 1). Elsewhere in tech, the smartphone was taking the world by storm while mobile broadband adoption rates nearly eclipsed 50% in OECD countries by mid-2011 laying the groundwork for Skype's launch on iOS and Android devices in 2010 and 2011 respectively (OECD 2003-2012).

In addition to increased broadband penetration rates Skype deployed an innovative Peer to Peer (P2P) infrastructure distributing the communication load between user's computers which increases call reliability and quality while cutting down on infrastructure costs such as servers (Baset and Schulzrinne 2004), (Wang 2005). Furthermore, video and voice compression algorithms allowed for high quality calls even with lower bandwidths (Anderson 2016).

## GENERAL PART

As VoIP technology matured alongside broadband adoption, significant challengers to Skype's competitive position emerged in the form of other VoIP providers, big-tech and social media companies as well as traditional telecommunications firms.

While Skype, launched in 2003, was an early adopter of internet telephony software, it was never alone in the space which was pioneered by VocalTec, offering internet telephony, and Net2Phone, which bridged the gap from PCs to landlines, in 1995 and 1996 respectively. Another significant VoIP competitor Vonage, which also offers hardware solutions, was launched in 2001 and quickly became a household name in the space. What allowed Skype to stand out among its peers was its scalability (P2P) and freemium business model which offered user to user calls for free and user to landline calls at affordable rates. Further distinguishing factors helping Skype maintain its competitive position were the program's ease of use and user-friendly interface as well as innovations such as the adoption of group video calls.

Traditional telecommunication giants with a large customer bases and plentiful funding also created VoIP offerings such as AT&T's U-verse Voice and Comcast's Xfinity Voice which amassed 2.1 million and 8.6 million users respectively by 2011 and 2010 (AT&T 2011), (Comcast 2011). A new wave of challengers approached from the Silicon Valley shortly before Skype's acquisition by Microsoft. Google Voice (2009) and Google Hangout (2011) as well as Apple's Facetime (2010) and Facebook's Messenger application all offered voice and video call features. Shortly after this launch wave of new VoIP programs Skype itself was acquired by Microsoft and integrated into its ecosystem which already included the Windows Live Messenger (formerly MSN) communication platform.

In 2012 Skype reached 167 billion minutes of international telephone traffic, excluding PC to PC calls. At the time this represented 33% of international phone traffic disrupting the traditional telecommunication industry (Exhibit 1).

## GENERAL PART

The merger was part of an uptick in M&A activity in terms of transaction volume following the 2008 financial crisis. After the total transaction value in the Software & Internet Services sector bottomed out at \$42 billion in 2009 it recovered to \$79 billion in 2011 (Institute for Mergers, Acquisitions & Alliances 1997-2013) (Appendix 2).

### *Deal Talks Begin*

Based on the industry outlook and the services and products Microsoft and Skype offered, the deal talks begin. Steve Ballmer stated that the takeover of Skype will bring together the best world of both companies, since Microsoft offers a large variety of products like its office and home services, which are going to be enhanced through the communication technology of Skype. Therefore, Microsoft's dream about building experiences that aren't limited by distance or device could be achieved by bringing people together, whether it is on a single screen, a smartphone, a PC, a slate, or the simple TV through the achieved synergies by the acquisition of the established and well-known brand Skype. Moreover, Mr. Ballmer pointed out that Skype has more than 660 million registered users and a growth of 600,000 customers per year, which indicated the importance and the upside potential of modern communication technology. Furthermore, Microsoft was aware that its main competitors would also take steps towards the communication market or have already done so. Therefore, the company did not want to be in the position of being unable to compete (Microsoft Corp. 2011a). Tony Bates also made clear that Skype, which is headquartered in Luxembourg, is growing at rapid speed, fueled by several key opportunities. First, the core communications technology was highly synergetic with Microsoft's current products and services. Second, the large and engaged user base may be utilized as a key part of the company's new monetization strategy by adding a premium subscription packages layer, new advertising avenues and more. Furthermore, Skype's profitable sound business will add to Microsoft's bottom line and cash flow (Microsoft Corp.

## GENERAL PART

2011a). The two companies had high hopes that an acquisition would bring advantages to both sides and that their strategies could be implemented more quickly by the knowledge the other offers. On top of that, the traded all-cash purchase price of \$8.5 billion seems attractive for Skype's current investors.

Now the question arises for Microsoft's management: are the parties deceived by only looking at positive aspects, or is the high purchase price justified for a company with a difficult acquisition and valuation history?

### *Timeline of Events (Intellectual Asset Management Magazine 2011)*

- |                       |   |
|-----------------------|---|
| <i>August 2003</i>    | Skype is founded by Niklas Zennström and Janus Friis  |
| <i>April 2005</i>     | Skype user base grows rapidly, hitting the 100 million downloads mark   |
| <i>September 2005</i> | eBay announces the acquisition of Skype for \$2.6 billion   |
| <i>October 2007</i>   | eBay takes a \$1.4 billion write-down on Skype, stating that “the company’s handling of the Skype buy-out had been a mistake”   |
| <i>April 2009</i>     | eBay announces the planned IPO of Skype, detailing that although it is a great standalone business ... Skype has limited synergies with eBay  |
| <i>September 2009</i> | Skype IPO is called off after a series of legal disputes with co-founders relating to IP. Zennström and Friis allege that Skype is in breach of a licensing agreement with Joltid, a company owned by the co-founders that owns the IP for Skype’s peer-to-peer technology. |
| <i>November 2009</i>  | eBay gives up a 14% stake in Skype to Joltid as part of a settlement and sells a majority stake to a private equity consortium for \$2.75 billion   |

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*August 2010* Skype announces plans to float in an IPO, publishing a preliminary prospectus that contains valuable information for potential buyers about the private company

*May 2011* Microsoft announces the acquisition of Skype

## INDIVIDUAL PART - PATRICK WILLNAUER

### ***Strategic Initial Public Offering (IPO) Registration Statement Filing in Facilitating Company Sale***

After eBay's unsuccessful acquisition of Skype in 2005 - which led to a \$1.4 billion write-down in 2007 due to misalignment between the two businesses, operational inefficiencies, and integration challenges - a group of investors led by Silver Lake Partners acquired a 65% stake in the company for \$1.9 billion, valuing Skype at \$2.75 billion in 2009 (Swarit Advisors 2021). The primary reason for eBay's divestment was its decision to refocus on its core e-commerce business, acknowledging that Skype's growth potential could be better achieved as an independent entity. The shift allowed Skype the freedom to develop and scale its product offerings without the constraints of eBay's broader strategy. During this period, Skype was also burdened with ongoing legal challenges related to intellectual property, which added complexity to its operations. The company faced patent disputes and competition in the VoIP and video conferencing markets, complicating its path forward. The new owners sought to address these legal hurdles while investing in innovation to expand Skype's user base and improve technical systems. Their approach emphasized strategic autonomy, enabling Skype to refine its business model and focus on customer acquisition, rather than navigating eBay's broader corporate framework. By 2010, with Skype gaining momentum because of its growth potential, the new majority shareholders considered various strategic options. Ultimately, in August 2010, they pursued an IPO, capitalizing on a growing market prospect for tech stocks,

particularly those in the digital communications space. The decision was driven by both the desire for greater flexibility and control over Skype's future, as well as the opportunity to capitalize on the favorable market conditions for tech IPOs during that period of time (Alvarez & Marsal and Henley Business School 2015). However, in May 2011, Skype's shareholders received a takeover offer from Microsoft, presenting an alternative path forward.

**a. A Strategy Emerges**

In August 2010, Skype's shareholders decided to carve out the company from its existing corporate structure and file an IPO registration statement. This decision was made despite the challenges in accurately valuing Skype at the time, as the performance of one competitor, Vonage Holdings Corp., might deter investors. Vonage's share price had dropped significantly from \$17 in 2006 to \$2.34 in 2010, following its IPO (Reuters 2010). However, the potential for high growth in the tech sector, coupled with the increasing demand for digital communication tools, may have driven Skype's shareholders to pursue this route. To enhance the signaling effect and provide credibility to the deal, prestigious underwriters were selected, including J.P. Morgan, Goldman Sachs, Morgan Stanley, and Barclays Capital (Appendix 6). Moreover, market timing appeared favorable for the initiative, as numerous tech IPOs had taken place in the years leading up to Skype's planned carve-out. In 2009, analysts were already divided over eBay's proposal to spin off Skype via an IPO. While some saw the potential for significant value, especially in Skype's growing user base and revenue opportunities in the digital communications space, others raised concerns about the timing and market conditions (Sage 2009). This mixed outlook prompted a necessary debate about whether the IPO was the best route for Skype's investors or if other potential opportunities for both inorganic and organic growth should be discussed.

**b. Potential New Paths Open Up**

Following the publication of the IPO statement filing, along with the associated growth potential, financial figures (Exhibit 3 and 5), and valuation parameters (Exhibit 13), the opportunities for Skype's shareholders shifted. As a result, the company attracted greater attention from the M&A market and potential investors. The time arrived for the owners to evaluate the potential of an acquisition of Skype. For various reasons, the prospective IPO plans could have placed pressure on the market and its participants, as the timing and market conditions could have led to volatility, affecting investor sentiment. Additionally, a profitable acquisition would occur at a timely and advantageous moment for the private equity investors, allowing them to capitalize on the growing demand for digital communication platforms, particularly as Skype's user base and technology were positioned to attract high-value bidders. Furthermore, Skype would not be exposed to the risks associated with an IPO, such as potential underperformance in a fluctuating market or costs of the process. This further heightened the appeal of an acquisition over a public offering. This shift in focus reflects the growing recognition that an acquisition could align more effectively with the interests of all stakeholders, offering a guaranteed return while preserving Skype's market position. Consequently, the strategic alternative to an IPO of achieving a quicker and more attractive acquisition deal started to be discussed internally.

**c. The Deciding Point and Microsoft's Offer**

After discussions regarding the potential for a profitable acquisition while preparations for the IPO continued, Skype's shareholders found themselves with a broader range of strategic options. In May 2011, Skype's owners received an offer from Microsoft to acquire the company for \$8.5bn in an all-cash transaction. Microsoft, known for its strong position in the tech

## INDIVIDUAL PART – PATRICK WILLNAUER

industry, brought both prestige and valuable expertise, particularly in software development, enterprise solutions, and digital communications to the table.

Now the shareholders of Skype had to decide: **Acquisition or IPO?**

## Exhibits

Exhibit 1: International Telephone & Skype Traffic between 2005-2012 in Billion Minutes (Crabtree 2013)



Exhibit 2: Development of Number of Users concurrently online on Skype during peak Activity between 2004-2013 in Millions (Richter 2013)

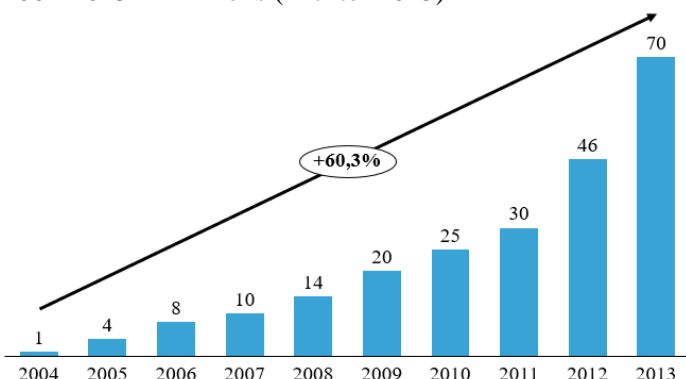


Exhibit 3: Skype's selected Balance Sheet Data (in \$000s)

	2006	2007	2008	2009	2010
<b>ASSETS</b>					
Cash and cash equivalents	\$92 837	\$115 884	\$260 187	\$114 077	\$142 465
Total current assets	\$121 953	\$154 234	\$319 804	\$202 445	\$243 387
Property and equipment	\$7 123	\$9 075	\$6 040	\$13 238	\$36 523
Goodwill	\$2 575 931	\$1 919 341	\$1 836 562	\$2 372 779	\$2 372 779
Intangible assets, net	\$235 711	\$188 204	\$112 934	\$788 118	\$637 688
<b>Total assets</b>	<b>\$2 944 758</b>	<b>\$2 275 410</b>	<b>\$2 282 535</b>	<b>\$3 409 704</b>	<b>\$3 317 855</b>
<b>LIABILITIES AND EQUITY</b>					
Accrued expenses and other current liabilities	\$39 658	\$46 359	\$65 159	\$90 952	\$121 100
Deferred revenue and user advances	\$56 219	\$89 419	\$108 012	\$142 600	\$176 681
Total current liabilities	\$111 740	\$170 463	\$219 893	\$302 246	\$353 726
Long-term debt	\$0	\$0	\$0	\$772 220	\$686 348
Total liabilities	<b>\$150 730</b>	<b>\$186 007</b>	<b>\$222 493</b>	<b>\$1 172 131</b>	<b>\$1 071 165</b>
Total stockholders' equity	\$2 794 028	\$2 089 403	\$2 060 042	\$2 237 573	\$2 246 690
Total Liabilities and Equity	<b>\$2 944 758</b>	<b>\$2 275 410</b>	<b>\$2 282 535</b>	<b>\$3 409 704</b>	<b>\$3 317 855</b>

Sources: Skype's IPO registration statement filing

#### Exhibit 4: Skype's user matrix (Skype S.à.r.l. 2010)

<b>Users matrix (in millions, besides the \$)</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Registered users	325	474	663
Average monthly connected users	75	105	145
Average monthly paying users	5,8	7,3	8,8
Average communications services revenue per paying user	\$102	\$98	\$97
Communications services billing minutes	6900	10700	12800

Sources: Skype's IPO registration statement filing

#### Exhibit 5: Skype's selected Statement of Operations (in \$000s) (Skype S.à.r.l. 2010)

	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b>Net revenues</b>	<b>\$193 696</b>	<b>\$381 551</b>	<b>\$551 364</b>	<b>\$718 903</b>	<b>\$859 815</b>
<b>Cost of Revenues</b>	<b>\$140 107</b>	<b>\$229 496</b>	<b>\$293 201</b>	<b>\$343 981</b>	<b>\$415 702</b>
<b>Gross Profit</b>	<b>\$53 589</b>	<b>\$152 055</b>	<b>\$258 163</b>	<b>\$374 922</b>	<b>\$444 113</b>
<b>Operating Expenses</b>					
Sales and marketing	\$59 787	\$64 304	\$83 222	\$120 989	\$131 939
Product development	\$38 900	\$22 857	\$33 599	\$45 027	\$72 263
General and administrative	\$37 865	\$42 423	\$48 648	\$160 962	\$104 954
Amortization of acquired intangible assets	\$60 156	\$65 514	\$69 832	\$68 737	\$114 308
Litigation settlement	\$0	\$0	\$0	\$343 826	\$0
Impairment of goodwill	\$0	\$1 390 938	\$0	\$0	\$0
<b>Total operating expenses</b>	<b>\$196 708</b>	<b>\$1 586 036</b>	<b>\$235 301</b>	<b>\$739 541</b>	<b>\$423 464</b>
<b>Loss/Income from Operations</b>	<b>-\$143 119</b>	<b>-\$1 433 981</b>	<b>\$22 862</b>	<b>-\$364 619</b>	<b>\$20 649</b>
Realized loss on amended credit agreement	\$0	\$0	\$0	\$0	-\$13 513
Interest income and other (expense), net	\$2 029	\$5 303	\$10 297	\$2 943	\$4 817
Interest expense	\$0	\$0	\$0	-\$10 387	-\$68 645
<b>Loss/Income before taxes</b>	<b>-\$141 090</b>	<b>-\$1 428 678</b>	<b>\$33 159</b>	<b>-\$372 063</b>	<b>-\$56 692</b>
Income tax (benefit)/expense	-\$22 044	-\$23 342	-\$8 447	-\$3 259	-\$49 787
<b>Net Income</b>	<b>-\$119 046</b>	<b>-\$1 405 336</b>	<b>\$41 606</b>	<b>-\$368 804</b>	<b>-\$6 905</b>
<b>Weighted number of shares, basic and diluted (Class A through J):</b>				<b>9 414 600</b>	<b>9 433 743</b>
<b>Fully Diluted Earnings Per Share before effect of charges</b>					

Sources: Skype's IPO registration statement filing

Exhibit 6: Skype's adjusted EBITDA calculation (in \$000s) (Skype S.à.r.l. 2010)

	2008	2009	2010
Net (loss)/income	\$41 606	-\$368 804	-\$6 905
Income tax (benefit)/expenses	-\$8 447	-\$3 259	-\$49 787
Interest expenses	\$0	\$10 387	\$68 645
Interest (income) and other expense, net	-\$10 297	-\$2 943	-\$4 817
Depreciation and amortization	\$75 534	\$79 049	\$161 297
Stock-based compensation	\$12 826	\$14 746	\$15 950
Realized loss on credit agreement	\$0	\$0	\$13 513
Management Services Agreements with shareholders	\$0	\$1 685	\$14 835
Acquisition transaction fees	\$0	\$98 715	\$1 229
Skype Acquisition transaction bonuses	\$0	\$3 647	\$0
Transition Services Agreement	\$0	\$1 118	\$2 463
Excluded bonus and severance	\$0	\$1 755	\$15 315
Joltid litigation settlement	\$0	\$343 826	\$0
Other litigation settlements	-\$410	\$2 928	-\$784
Separation costs		\$2 054	\$11 312
Foreign exchange gains and losses prior to invoice receipt and related to hedging instruments	-\$334	-\$8	\$12 165
Duspute with payment service provider	\$0	\$0	\$9 247
Non-capitalizable expenses attributable to this offering of securities	\$0	\$0	\$669
<b>Adjusted EBITDA</b>	<b>\$110 478</b>	<b>\$184 896</b>	<b>\$264 347</b>

Sources: Skype's IPO registration statement filing

Exhibit 7: Microsoft's consolidated Balance Sheet (in \$ millions)

	2006	2007	2008	2009	2010
<b>ASSETS</b>					
Cash and cash equivalents	\$6 714	\$6 111	\$10 339	\$6 076	\$5 505
Short-term investments	\$27 447	\$17 300	\$13 323	\$25 371	\$31 283
Accounts receivable	\$9 316	\$11 338	\$13 589	\$11 192	\$13 014
Inventories	\$1 478	\$1 127	\$985	\$717	\$740
Deferred income taxes	\$1 940	\$1 899	\$2 017	\$2 213	\$2 184
Other current assets	\$2 115	\$2 393	\$2 989	\$3 711	\$2 950
<b>Total current assets</b>	<b>\$49 010</b>	<b>\$40 168</b>	<b>\$43 242</b>	<b>\$49 280</b>	<b>\$55 676</b>
Property and equipment	\$3 044	\$4 350	\$6 242	\$7 535	\$7 630
Equity and other investments	\$9 232	\$10 117	\$6 588	\$4 933	\$7 754
Goodwill	\$3 866	\$4 760	\$12 108	\$12 503	\$12 394
Intangible assets, net	\$539	\$878	\$1 973	\$1 759	\$1 158
Deferred income taxes	\$2 611	\$1 389	\$949	\$279	\$0
Other assets	\$1 295	\$1 509	\$1 691	\$1 599	\$1 501
<b>Total assets</b>	<b>\$69 597</b>	<b>\$63 171</b>	<b>\$72 793</b>	<b>\$77 888</b>	<b>\$86 113</b>
<b>LIABILITIES AND EQUITY</b>					
Accounts payable	\$2 909	\$3 247	\$4 034	\$3 324	\$4 025
Short-term debt	\$0	\$0	\$0	\$2 000	\$1 000
Accrued compensation	\$1 938	\$2 325	\$2 934	\$3 156	\$3 283
Income taxes	\$1 557	\$1 040	\$3 248	\$725	\$1 074
Short-term unearned revenue	\$9 138	\$10 779	\$13 397	\$13 003	\$13 652
Securities lending payable	\$3 117	\$2 741	\$2 614	\$1 684	\$182
Other	\$3 783	\$3 622	\$3 659	\$3 142	\$2 931
<b>Total current liabilities</b>	<b>\$22 442</b>	<b>\$23 754</b>	<b>\$29 886</b>	<b>\$27 034</b>	<b>\$26 147</b>
Long-term debt	\$0	\$0	\$0	\$3 746	\$4 939
Long-term unearned revenue	\$1 764	\$1 867	\$1 900	\$1 281	\$1 178
Deferred income taxes	\$0	\$0	\$0	\$0	\$229
Other long-term liabilities	\$5 287	\$6 453	\$4 721	\$6 269	\$7 445
<b>Total liabilities</b>	<b>\$29 493</b>	<b>\$32 074</b>	<b>\$36 507</b>	<b>\$38 330</b>	<b>\$39 938</b>
Total stockholders' equity	\$40 104	\$31 097	\$36 286	\$39 558	\$46 175
<b>Total Liabilities and Equity</b>	<b>\$69 597</b>	<b>\$63 171</b>	<b>\$72 793</b>	<b>\$77 888</b>	<b>\$86 113</b>

Sources: Microsoft's 2006, 2008 and 2010 Annual Reports

## Exhibit 8: Microsoft's Income Statement (in \$ millions)

	2006	2007	2008	2009	2010
<b>Revenue</b>	<b>\$44 282</b>	<b>\$51 122</b>	<b>\$60 420</b>	<b>\$58 437</b>	<b>\$62 484</b>
<b>Operating Expenses</b>					
Cost of revenue	\$7 650	\$10 693	\$11 598	\$12 155	\$12 395
Research and development	\$6 584	\$7 121	\$8 164	\$9 010	\$8 714
Sales and marketing	\$9 818	\$11 455	\$13 260	\$12 879	\$13 214
General and administrative	\$3 758	\$3 329	\$5 127	\$3 700	\$4 004
Employee severance	\$0	\$0	\$0	\$330	\$59
<b>Total operating expenses</b>	<b>\$27 810</b>	<b>\$32 598</b>	<b>\$38 149</b>	<b>\$38 074</b>	<b>\$38 386</b>
<b>Loss/Income from Operations</b>	<b>\$16 472</b>	<b>\$18 524</b>	<b>\$22 271</b>	<b>\$20 363</b>	<b>\$24 098</b>
Other income (expense)	\$1 790	\$1 577	\$1 543	-\$542	\$915
<b>Loss/Income before taxes</b>	<b>\$18 262</b>	<b>\$20 101</b>	<b>\$23 814</b>	<b>\$19 821</b>	<b>\$25 013</b>
Provision for income taxes	\$5 663	\$6 036	\$6 133	\$5 252	\$6 253
<b>Net Income</b>	<b>\$12 599</b>	<b>\$14 065</b>	<b>\$17 681</b>	<b>\$14 569</b>	<b>\$18 760</b>
<b>Weighted number of shares outstanding:</b>					
Basic	10438	9742	9328	8 945	8 813
Diluted	10531	9886	9470	8 996	8 927
<b>Earnings per share:</b>					
Basic	<b>\$1.21</b>	<b>\$1.44</b>	<b>\$1.90</b>	<b>\$1.63</b>	<b>\$2.13</b>
Diluted	<b>\$1.20</b>	<b>\$1.42</b>	<b>\$1.87</b>	<b>\$1.62</b>	<b>\$2.10</b>
Cash dividends declared per common share	\$0.35	\$0.40	\$0.44	\$0.52	\$0.52

Sources: Microsoft's annual reports 2006, 2008 and 2010

## Exhibit 9: Selected financial data

	Week Ending April 29, 2011
<b>Yields on U.S. Treasury Bills, Notes, and Bonds</b>	
3-month	0.04%
6-month	0.11%
1-year	0.22%
2-year	0.61%
3-year	1.97%
10-year	3.32%
30-year	4.40%
<b>Spreads on Long-term Corporate Bonds</b>	
Aaa	0.59%
Aa	1.01%
A	1.31%
BBB	1.85%
<b>Interest Rates</b>	
Federal Funds	0.09%
3-month Commercial Paper	0.13%
3-month Certificate of Deposit	0.23%
Prime Rate	3.25%
<b>Equity Betas</b>	
Microsoft	0.93
8x8	0.54
BroadSoft, Inc.	0.93
Akamai	1.22
Vonage Holdings Corp.	0.87
Verisign	1.11
ShoreTel, Inc.	1.68
<b>Market Risk Premium</b>	
Market Risk Premium	14.73%
<b>Information out of the IPO Filing</b>	
WACC of Skype	17.00%
<b>Target D/V Ratio of Skype</b>	
Target D/V Ratio	29.33%

Sources: Fred, Federal Reserve Economic Data, Skype's IPO Filing

## Exhibit 10: Revenue Synergies (in \$000s)

	Dec 2012E	Dec 2020E
<b>Display marketing services and other revenue</b>	376.500	3.900.000

Exhibit 11: Skype Comparable Companies, 2010 (S&P Capital IQ)

Comparable Companies	Company Description
<b>8x8 Inc.</b>	A VoIP and cloud communications provider with a subscription-based model, directly comparable to Skype's core business.
<b>BroadSoft Inc.</b>	A provider of software solutions enabling telecom service providers to offer VoIP and unified communication services.
<b>Akamai Technologies Inc.</b>	A global leader in content delivery networks (CDN) and cloud services
<b>Vonage Holdings Corp.</b>	A consumer and business-focused VoIP provider, with a subscription-based revenue model similar to Skype.
<b>VeriSign Inc.</b>	A provider of domain name registry services and internet security solutions
<b>ShoreTel Inc.</b>	A company specializing in business-focused unified communication solutions

Exhibit 12: Skype Comparable Companies Financials, 2010 (in \$000s) (S&P Capital IQ)

Company	8x8, Inc.	BroadSoft, Inc.	Akamai Technologies, Inc.	Vonage Holdings Corp.	VeriSign, Inc.	ShoreTel, Inc.
<b>Shareprice (in \$)</b>	3,11	45,48	92,90	5,16	180,77	10,45
<b>Shares outstanding</b>	62.436.804	26.166.000	150.226.986	223.490.000	96.100.000	46.146.000
<b>Market Cap</b>	194.178	1.190.030	13.956.090	1.153.208	17.372.000	482.226
<b>Interest bearing Debt</b>	0	1.970	0	212.452	80.388	0
<b>Cash and Cash Equivalents</b>	18.056	47.254	1.243.985	78.934	1.559.628	68.426
<b>Pfd Eqty &amp; Mnrty Int</b>	0	0	0	0	0	0
<b>Sales</b>	63.396	95.623	1.023.586	885.042	680.578	148.464
<b>EBITDA</b>	4.973	12.692	369.604	125.525	316.799	-10.240
<b>EBIT</b>	3.975	10.344	253.162	95.773	249.144	-13.044

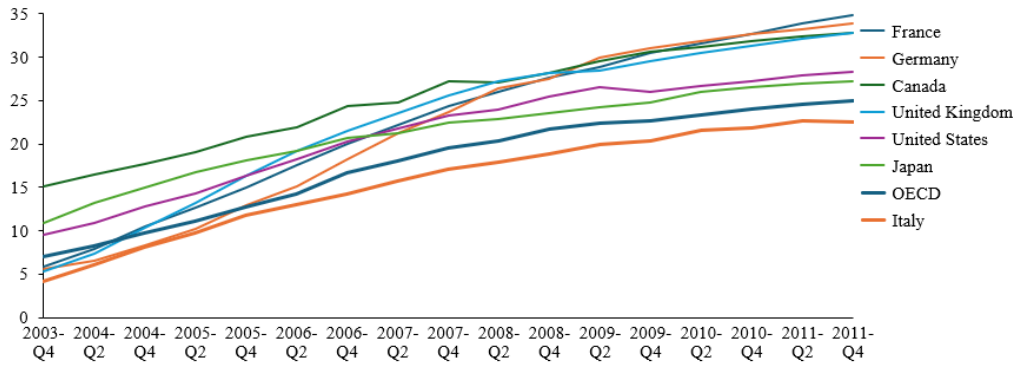
Exhibit 13: Valuation Parameters of Skype's planned IPO (Skype S.à.r.l. 2010)

Valuation Date	April 1, 2010	July 1, 2010	October 1, 2010	January 1, 2011
Long-term Expected Annual Growth Rate	5%	5%	5%	5%
Discount Rate	18%	17%	17%	17%
Market Comparable Method Median Multiples				
Last Twelve Months Revenue	4.6x	4.2x	5.1x	5.4x
Projected Revenue	3.8x	3.2x	4.1x	4.3x
Last Twelve Months EBITDA	16.4x	17.7x	23.5x	23.2x
Future Twelve Months EBITDA	10.1x	11.9x	12.8x	13.3x
Weighting of Outcomes of Valuation Methods				
Income Approach	50%	50%	50%	50%
Market Comparable Method	50%	50%	50%	50%

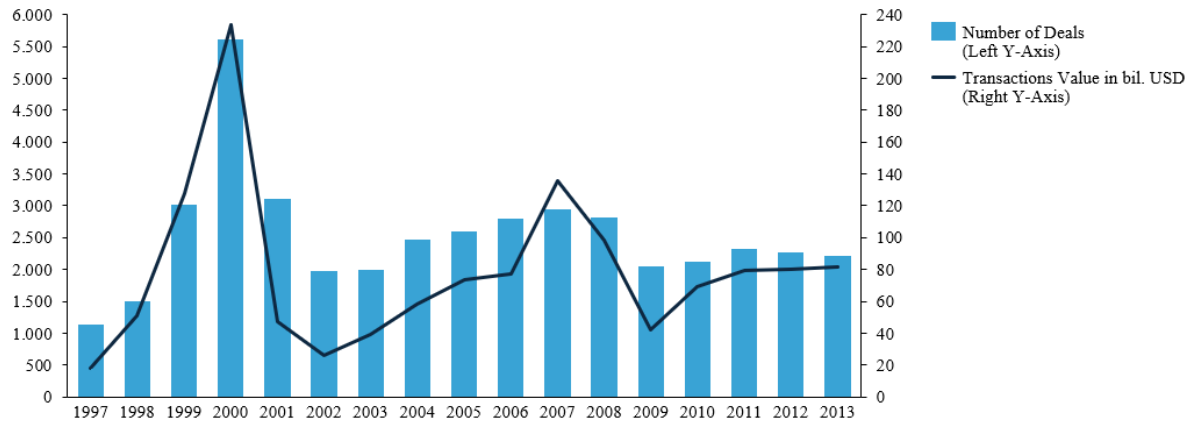
Sources: Skype's IPO registration statement filing

## Appendix

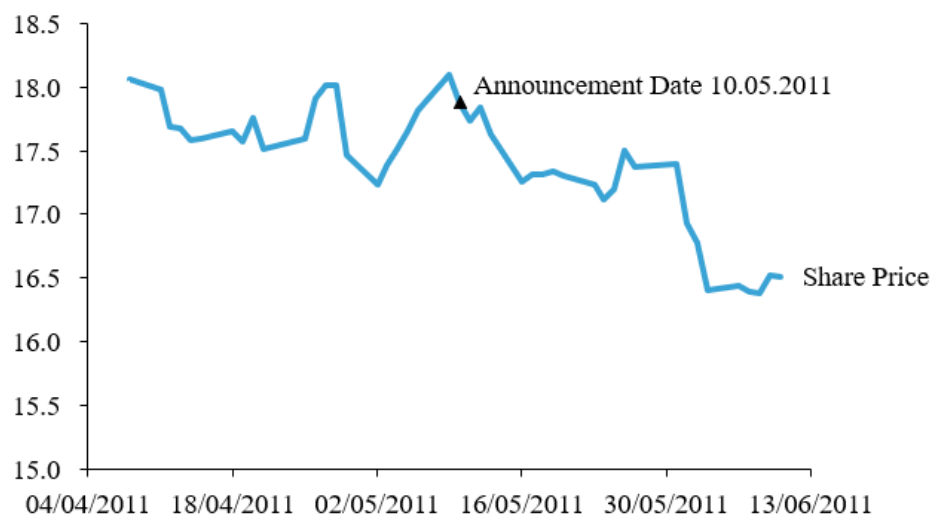
Appendix 1: Historical fixed broadband penetration rate of the G7, 2003-2012 (OECD 2003-2012)



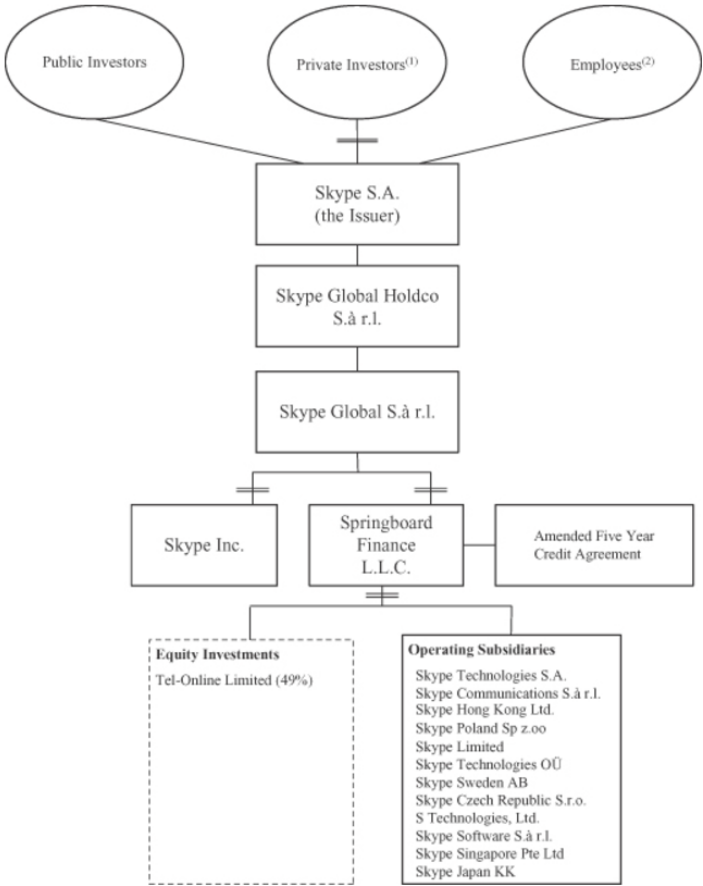
Appendix 2: Software & Internet Services M&A deal number and transaction volumes, 1997-2013 (Institute for Mergers, Acquisitions & Alliances 1997-2013)



Appendix 3: Microsoft Stock Price one Month prior and one Month post Announcement (S&P Capital IQ)



Appendix 4: Skype Shareholder Structure prior to the Microsoft Merger (Skype S.à.r.l. 2010)



(1) Includes Silver Lake, CPP Investment Board Private Holdings Inc., Andreessen Horowitz, eBay, Joltid, Charleston Investment Holdings Limited and certain of their affiliates. See "Principal and Selling Shareholders."

(2) Prior to this offering, employees, directors and consultants who invested in Skype Global or who acquired ordinary shares pursuant to the exercise of any stock option granted under the Skype Equity Incentive Plan held their equity interest in Skype Global through Skype Management, L.P. ("Skype Management"), an exempted limited partnership organized under the laws of the Cayman Islands, which is a shareholder in Skype Global, primarily to enable Skype Global to comply with the limitation on the number of record holders of its ordinary shares under applicable law. Skype Management received such acquired shares on behalf of the employees, directors and consultants and issued a corresponding number of partnership units to the employees, directors and consultants. In connection with this offering, the partnership will terminate and be wound up and Skype Management's ordinary shares in Skype Global will be distributed to the employees, directors and consultants according to their respective numbers of partnership units.

Appendix 5: Key Differences between Hubris and Strategic Mismanagement

Aspect	Hubris	Strategic Mismanagement
<b>Definition</b>	Overconfidence by managers in their ability to create value through an acquisition.	Poor alignment between the acquiring company's strategy and the target company's business model.
<b>Main Cause</b>	Managerial overestimation of potential synergies and value creation, driven by arrogance or ego.	Lack of thorough strategic analysis to ensure compatibility between the acquirer and the target.
<b>Focus</b>	Focus on immediate perceived gains and the managers' belief that they can outperform expectations.	Focus on acquiring assets or companies without fully understanding how they fit within the broader corporate strategy.
<b>Decision-Making Process</b>	Driven by gut feelings, overconfidence, and a disregard for risks or challenges in integration	Driven by incomplete or faulty strategic analysis, often missing key areas like market fit or operational integration.
<b>Due Diligence</b>	Often rushed or superficial due diligence, with key risks overlooked or dismissed.	More thorough, but the analysis may be flawed or incomplete, particularly in assessing strategic alignment.

<b>Risk Awareness</b>	Managers may acknowledge risks but believe they can overcome them through superior leadership.	Managers may not fully understand or anticipate the challenges that will arise due to the misfit between the two companies.
<b>Acquisition Price</b>	Companies often overpay for the target due to overconfidence in their ability to generate synergies	Companies may also overpay, but the issue is more related to a failure in valuing the strategic fit, not necessarily overconfidence.
<b>Cultural Integration</b>	Overconfident in their ability to merge different corporate cultures or believe culture is irrelevant.	Misjudgment of how the target's culture will integrate with the acquirer's, leading to friction and inefficiency.
<b>Key Outcome</b>	Failure to realize anticipated synergies, overvaluation of the target, and potential financial losses.	Failure to realize synergies due to the strategic misalignment of the two companies' business models.

## Appendix 6: Underwriters of Skype's IPO

### Underwriters

Goldman, Sachs & Co.  
 J.P. Morgan Securities Inc.  
 Morgan Stanley & co. Incorporated  
 Merrill Lynch, Pierce, Fenner & Smith Incorporated  
 Barclays Capital Inc.  
 Citigroup Global Markets Inc.  
 Credit Suisse Securities (USA) LLC  
 Deutsche Bank Securities Inc.  
 Lazard Capital Markets LLC  
 RBC Capital Markets Corporation  
 UBS Securities LLC  
 Allen & Company LLC  
 Evercore Group L.L.C.

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Sources: Skype's IPO registration statement filing

## **Part B: Teaching Note**

### **SYNOPSIS**

On May 10, 2011, Microsoft announced the \$8.5 billion acquisition of Skype, making headlines as one of the largest technology deals of its time. This case study explores the key motivations behind the acquisition, the challenges Microsoft faced during the integration, the broader implications for the tech industry as well as the financial rationale behind this acquisition.

The case study begins by analyzing Skype's acquisition history, from its foundation in 2003 to its acquisitions by eBay in 2005 and Silver Lake Partners in 2009. In a further step, the focus is shifted to the VoIP and broader technology sector at the time of the Microsoft acquisition which is then followed by an account of possible merger motives of Microsoft. This all leads to answering the main question at hand, whether Microsoft overpaid for Skype.

In addition, the case study contains one separate component to complement the main part. An IPO valuation based upon initial plans by Skype to go public will provide a contrast to the actual merger purchasing price showcasing and evaluating whether pursuing an IPO or accepting Microsoft's offer was in favor of the company.

### **POSITIONING**

This case study is designed for master's level university courses that focus on Mergers & Acquisitions or related topics in Corporate Finance. To get the most out of it, students should already have some basic knowledge of Corporate Finance, including common merger motives, caveats and synergies.

Although the valuations in this case study are simplified, it can also be used to introduce students to common valuation techniques like Discounted Cashflow Analysis (DCF),

## GENERAL PART

Comparable Transactions Analysis (CTA), Comparable Company Analysis (CCA) as well as an IPO valuation. If there is enough time, instructors can guide students through these methods.

### **LEARNING OBJECTIVES**

Throughout the preparation of the case study, students will:

- Understand the key milestones in Skype's acquisition history, from eBay's purchase in 2005 to its sale to Microsoft in 2011, and evaluate the strategic decisions and challenges that shaped its journey through different ownerships.
- Analyze the VoIP market and broader technology sector, focusing on the rapid advancements in communication technology, rising competition, and the strategic positioning of Skype as an acquisition target.
- Assess the strategic drivers behind Microsoft's decision to acquire Skype, including competitive pressures, anticipated synergies, and its vision for integrating Skype into its ecosystem to strengthen its product offering.
- Perform various valuation methods including a Discounted Cash Flow valuation and a comparable company analysis to explore if the anticipated growth potential, market conditions and synergy expectations reflect and justify Microsoft's acquisition price.
- Analyze Skype's IPO registration statement as a strategic move to position the company for a sale. Students will explore how IPO readiness enhances transparency, attracts buyers, and boosts perceived value, serving as both a capital-raising tool and a step toward acquisition, particularly in competitive tech industries.

### **SUBSTANTIVE ANALYSIS AND TEACHING PROCESS**

#### *i. Introduction*

## GENERAL PART

While parts of the case study can be omitted at the discretion of the instructor, a comprehensive solution and debriefing of the case will likely require at least three hours of class time and a significant additional asynchronous time commitment by the students. Two classes of one and a half hours might be favorable over one three-hour long class as it allows students to delve into the case and later still have an opportunity for clarifications regarding any doubts. The teaching note includes suggested board plans to help the instructor reiterate important concepts visually. In the case study students take the position of the Head of Business Development and M&A at Microsoft who faces the difficult decision of whether to advise the CEO to proceed with the acquisition of Skype or not, a decision which shall be supported by quantitative and qualitative analysis.

The instructor can start off the discussion by asking students about their general knowledge about Skype. With the information provided in the case study, they should be able to reflect on Skype's history of rapid growth in user numbers and the technical revolution and market conditions up until the decision point. At this stage, it is appropriate to shift the discussion to an overview of Skype's business model as well as give an account of its tumultuous past which should give the students an idea about why Skype might have been an interesting asset and highlight the potential caveats of a deal.

To aid the transition through the topics and spark discussions with the students, the following list of standard questions is proposed. The instructor is free to modify them as they please:

- Do / Did you use Skype? Why?
- What were some of the main contributors to Skype's rapid growth?
- What were the competitive advantages that put Skype ahead of its competitors?

Next, the instructor could focus on the acquirer by discussing Microsoft's market position and product portfolio and then discuss how Skype might fit into the realm of Microsoft in terms of potential synergies. At this point, the instructor can transition to a high-level discussion of the

## GENERAL PART

pros and cons of consummating the merger which are encouraged to be consolidated in a list on the board (Exhibit 1). This serves as a good basis to build upon and delve deeper into the subsequent sections making up the case.

The following list of standard questions is proposed. The instructor is free to modify them as they please:

- Have any of you heard about the Microsoft - Skype or eBay - Skype mergers?
- What is your opinion about Microsoft? Do you use their products / services?
- Do you believe Microsoft is a good suitor for Skype?

### *ii. M&A History of Skype*

To analyze the M&A history of Skype, students need a comprehensive understanding of the strategic decisions and outcomes of each acquisition. This part delves into the significant phases of Skype's ownership, exploring the motivations behind each deal, the challenges faced, and the ultimate outcomes. In this part the students will learn how to perform a functional analysis of the industry forces and how insights about the M&A history of a company will support the examination of whether a company is a suitable target or not. By examining eBay's acquisition in 2005, the sale to Silver Lake Partners in 2009, and Microsoft's acquisition in 2011, students will gain insights into the complexities of corporate acquisitions in the tech industry. This analysis will encourage critical thinking about merger motives, such as synergies and strategic fit, and prompt discussions on the successes and missteps of these transactions. By examining Skype's M&A history, students will be better equipped to analyze the acquisition of Skype by Microsoft, understanding the multifaceted considerations and strategic decisions that shape such high-stakes corporate transactions.

#### *1. Skype's Acquisition by eBay (2005)*

## GENERAL PART

**Teaching Objective:** This section examines eBay's rationale for acquiring Skype and the key challenges that led to the acquisition's failure. Students will analyze the strategic fit and explore why the expected synergies did not materialize. Nevertheless, this topic will be dealt with in more detail in a later section.

**Background:** In 2005, Skype had over 54 million users, positioning itself as a leader in VoIP technology. eBay acquired Skype for \$2.6 billion, hoping to integrate its communication services into the auction platform to improve user interaction and global reach (The Wharton School of the University of Pennsylvania 2005).

**Challenges and Outcome:** However, the anticipated synergies between eBay and Skype failed to take shape. By 2007, Skype's financial underperformance led to a \$1.4 billion write-down. Misalignment between the two businesses and operational issues compounded the integration challenges. As a result, eBay sold a majority stake in Skype in 2009 (Swarit Advisors 2021).

**Discussion Points:** What were the core strategic missteps in eBay's acquisition, and how could the integration have been handled differently?

### 2. Sale to Silver Lake Partners and Other Investors (2009)

**Strategic Reassessment and Decision to Divest:** By 2009, eBay decided to refocus on its core e-commerce business and recognized that Skype's growth potential might be better realized as an independent entity. Skype also faced legal challenges related to intellectual property (Alvarez & Marsal and Henley Business School 2015).

**The Deal:** In November 2009, eBay sold 65% of Skype to an investor group led by Silver Lake Partners for \$1.9 billion, valuing the company at \$2.75 billion. eBay retained a 35% stake (Swarit Advisors 2021).

**Intention Behind the Sale:** The new owners aimed to drive innovation, expand Skype's user base, and resolve legal disputes with Joltid, ensuring technical stability (Alvarez & Marsal and

Henley Business School 2015). By 2011, Skype had grown substantially, setting the stage for its acquisition by Microsoft.

3. *Acquisition by Microsoft (2011)*

***Strategic Vision and Integration:*** Microsoft viewed Skype as a key asset to strengthen its communication tools across its product ecosystem, including Windows, Office, and Xbox. The acquisition aimed to enhance Microsoft's enterprise communication offerings and integrate Skype's capabilities into its broader portfolio. Before Microsoft's acquisition, Skype engaged in negotiations with both Google and Facebook, underscoring its significance as a strategic asset within the tech industry. These discussions reflect the competitive landscape that likely motivated Microsoft to act decisively in securing the deal (Bright 2011).

***The Deal:*** In May 2011, Microsoft acquired Skype for \$8.5 billion in cash, making it one of Microsoft's largest deals. This move underscored the company's commitment to making Skype a central part of its communication strategy (Shan 2013).

***Intention Behind the Acquisition:***

- **Product Integration:** Embedding Skype into Windows, Office, and Xbox to boost collaboration and communication.
- **Strengthening Enterprise Tools:** Leveraging Skype's technology to enhance Microsoft's Lync, later rebranded as Skype for Business.
- **Competitive Positioning:** Acquiring Skype also helped Microsoft eliminate a strong competitor in the communication space (Microsoft Corp. 2011).

***Integration Strategy and Challenges:*** Microsoft integrated Skype as the default messaging service for Windows and Office but faced challenges aligning Skype's peer-to-peer infrastructure with its cloud-based architecture. Significant effort was required to transition Skype to a scalable, cloud-based system (Shan 2013).

- ***Continued Evolution:*** Skype continued to evolve under Microsoft, with improvements in features and integration across its product ecosystem. Despite rising competition from platforms like Zoom and Slack, Skype maintained a strong user base in both consumer and enterprise markets (Microsoft Corp. 2011).

### ***iii. Industry & Market Environment***

In a next step, it is appropriate to provide students with more color surrounding the industry and market environment Skype faced in the years leading up to the merger which were characterized by rapid technological advancements in broadband and Voice over Internet Protocol (VoIP) technology, intensifying competition and a post-crisis rebound in M&A activity. Students are expected to recognize how an increase in bandwidth (Case Study Appendix 1) combined with a Peer to Peer (P2P) architecture was a crucial enabler for critical improvements in VoIP technology including reduced latency, better voice quality and the capacity to handle video calls (Wang 2005). Such improvements made VoIP services a viable alternative to traditional phone calls. Among Skype's technological advancements, the P2P infrastructure was most crucial to its excellent scalability which becomes apparent in Skype's peak user numbers shown in Exhibit 2 of the case study, which grew from 1 million people being online during peak activity in 2004 to 70 million in 2013, representing an impressive compound annual growth rate (CAGR) of 60% (Baset and Schulzrinne 2004).

When looking at Skype's history and competition, students are expected to make a judgment on the credibility of threats posed by competitors to Skype and Microsoft which did not operate a strong communication platform, (Windows Live Messenger and Lync) and whether such a threat could entice Microsoft to make a move on Skype. Despite their access to an established infrastructure, a large existing customer base and funding, offerings by traditional telecommunication firms such as AT&T and Comcast could not match Skype's global reach

## GENERAL PART

and user numbers were rather insignificant as becomes evident in their mentioned user numbers when compared to Skype's 663 million registered users by the end of 2010 (Appendix 1). On the other hand, students are expected to point out how big tech giants such as Google, Apple and Facebook were agile, tech savvy and boasted large user bases. Integration in existing hard- and software ecosystems reduced switching friction and provided them with synergy effects making them credible challengers for Skype. Showing students Exhibit 1 of the case study should highlight the extent of Skype's rise against the established telecommunications sector and how Microsoft might have felt pressure to participate in such a revolutionary development in communication services.

Lastly, the above-mentioned developments provide some evidence of technological shock being a driver of the rebound in merger activity after a low in 2009 shown in Appendix 2 of the case study, representing another pressure for Microsoft to keep up with the rapid technological evolution. As mentioned by Steve Ballmer in a press conference on the day after signing of the definitive merger agreement, Skype's established user base and proven technology made it an attractive asset to participate in this rapidly evolving field (Microsoft Corp. 2011a). Additionally, it gave Microsoft a head start by not having to spend considerable time and resources to build a platform from scratch while the technology keeps evolving. Moreover, beyond showing students this deal in the context of M&A activity in the same sector, Appendix 2 in the case study lends itself to discussing how increases in merger activity tend to coincide with rich equity valuations as was the case in the dot-com bubble and 2008 financial crisis (Gugler, Mueller, and Weichselbaumer 2012).

This section, relaying information about the industry and market environment around the time of the merger, is suitable for making students appreciate the disruptive nature of technological advancements and how Skype navigated these issues to become one of the most important online communication platforms of the 2000s. Additionally, the information provided on

## GENERAL PART

industry and market developments serves as an aid for students in their argumentation for or against Microsoft's acquisition of Skype and highlights the pressures that might have convinced Microsoft to strike a deal.

The following list of standard questions is proposed. The instructor is free to modify them as they please:

- What were the short- and long-term pressures of Microsoft to acquire Skype?
- What group of competitors of Skype posed the most credible threat to its market position and why?
- What factors can contribute to the formation of a merger wave?

### *iv. Deal Structure and Form of Consideration*

The Skype deal was by far Microsoft's largest acquisition at that point in time and continued to be so until the LinkedIn acquisition in 2016 for \$26.2 billion. Microsoft's 10Q filing for Q3 2011 states that they acquired all outstanding shares of Skype Global S.á.r.l., which was the TopCo that owned all Skype entities at the time. Appendix 4 of the case study shows Skype's shareholder structure prior to takeover.

There are important lessons to be learned from the deal structure, most notably by analyzing the well-documented and publicized form of consideration. On the M&A announcement call, Microsoft's CFO Peter Klein confirmed the total consideration of \$8.5 billion in an all-cash transaction, adding that overseas cash will be used to make this transaction (Microsoft Corp. 2011a). This was a sensible decision, considering that Microsoft had \$50 billion of cash & cash equivalents as per their 2011Q1 filing, of which \$42 billion was outside of the US and subject to "material repatriation tax effects" (Microsoft Corp. 2010). Later on, in the Q&A section of the call, CEO Steve Ballmer explained that using overseas cash is appropriate given that Skype

## GENERAL PART

is a Luxembourg company, adding that there are additional benefits from a shareholder and balance sheet perspective. This – among others – allowed Microsoft to obtain an effective tax rate of 17.5% in 2011, substantially lower than the statutory 35% and 9.5% lower than in 2010 (Microsoft Corp. 2011b).

Analysts on Wall Street agree according to Forbes (Savitz 2011):

- Kirk Materne, Evercore Partners, stated that using offshore cash is a “big plus over a comparable-sized domestic acquisition of the same size”.
- Kevin Buttigieg, Collins Stewart, said that the transaction “utilizes international cash balances which Microsoft otherwise couldn’t leverage without a large tax hit”.
- Ed Maguire, CLSA Asia-Pacific Markets added that “concerns over valuation need to be weighed against alternative uses of cash”.

This represents a text-book example of a common issue that international corporations face: how to make the best use of offshore cash. Besides making acquisitions such as in this case, companies also opt for investing offshore or hoping for a tax holiday on repatriated cash. Using the cash for dividends or stock repurchases would trigger a huge tax hit and is therefore unfavored (Savitz 2011).

The following list of standard questions is proposed. The instructor is free to modify them as they please:

- Do you think that Microsoft would have pursued the deal also if Skype was a US company?
  - Students should provide a qualitative answer along the lines of considering alternative uses for cash, e.g repatriating the cash, triggering a tax hit; investing in CapEx overseas; pursuing other (overseas) acquisitions

## GENERAL PART

- Conclusion: Microsoft probably wouldn't have been willing to pay such a high price if it weren't for the overseas cash
- Why is it common for private equity-owned firms to be registered in Luxembourg?
- In what other ways besides overseas acquisitions do corporations deploy offshore cash to avoid repatriation under high tax burden?

### *v. Synergies*

To analyze the acquisition of Skype by Microsoft properly, students need to understand all the merger motives behind the deal. Therefore, a deep dive into the considerations of the shareholders of Skype and the management of Microsoft is needed. This part is anticipated to initiate an in-class discussion about the completion of the acquisition and what the key drivers behind the purchase could have been. Typically, students will consider the classic merger motives like synergies, diversification intentions and market undervaluation, but students are also expected to think critically about the decision to acquire Skype, the thought process of the two parties and the acquisition price. Therefore, listing and classifying them into different tables and charts on the whiteboard will prove useful to not lose track of the arguments (Exhibit 1). The participants of the course will most likely consider positive thoughts about the acquisition, without the in-depth consideration of bad motives to merge like Winner's Curse and Hubris as well as Agency Problems and Managerialism. Especially, Winner's Curse and Hubris will be an interesting point to discuss, since it was the most expensive acquisition Microsoft had carried out. The high goodwill amount which resulted out of the purchase may also raise doubt about the deal.

First, it is needed to break down the acquirer's motives. Microsoft, one of the leading tech firms in the world, offered a diverse array of software products, services, and solutions aimed at empowering individuals and businesses to achieve their full potential. Its flagship products,

## GENERAL PART

Microsoft Windows and Microsoft Office, were market leaders in the fields of personal computer operating systems and office suites. Therefore, from a strategic view, Skype could fit well to Microsoft's already established products. The following motives played a role for Microsoft acquiring Skype:

- 1. Achieving synergies through tax considerations and savings:** As detailed in the Deal Structure & Form of Consideration paragraph, the first motive has nothing to do with the technology between the product range of Microsoft and Skype and will not be the go-to answer students will talk about, but it should be a point to discuss and to learn from. Microsoft, like most big tech companies, had billions of dollars in profits held offshore, which could not be brought back to the US without incurring taxes. Consequently, these funds could not be used to pay dividends, buy back shares, or hire employees in the US. Skype was based outside the US, allowing Microsoft to use these offshore funds for the acquisition. As Damodaran stated, when considering possible tax savings and the resulting synergies, a seemingly high purchase price becomes more understandable (Damodaran 2005).
- 2. Enhancing Microsoft's communication technology position by adopting a competing technology and preventing the acquisition by other competitors:** Skype was a popular platform providing internet-based voice and video calling services. By acquiring Skype, Microsoft aimed to solidify its standing in the communication technology market and better compete with tech giants like Google and Apple, which potentially could have also been interested in acquiring Skype (Halliday 2011). Moreover, Skype's technological growth by itself threatened Microsoft, so the motive for a strategic takeover to adopt competing technology was given. Furthermore, by preventing competitors from entering its focused product market space, Microsoft may preserve the firm's high growth phase for longer (Damodaran 2005).

- 3. Integrating Skype into Microsoft's already existing division structure and product and service lines (strategic alliances):** Microsoft identified an opportunity to incorporate Skype into its existing products and services, such as Microsoft Office and Xbox. It was not planned to hold Skype in a separate company, but rather to integrate it in its already existing division structure. Therefore, Skype became a distinct division within Microsoft, with Tony Bates, the former CEO of Skype, serving as the head of this unit (Appendix 3). The integration was intended to improve user experience and add value for Microsoft's customers (Kolakowski 2011).
- 4. Leveraging Skype's user base:** At the time of the acquisition, Skype boasted around 660 million users worldwide (Appendix 1). Acquiring Skype gave Microsoft access to this extensive user base, presenting opportunities for monetization through advertising, premium services, and other revenue streams.
- 5. Strategic importance of voice and video communication:** With the increasing importance of voice and video communication in the tech industry, particularly due to the rise of smartphones and the popularity of video calling, Microsoft positioned itself to capitalize on this trend and broaden its communication offerings by acquiring Skype.

First, it is advised that the instructor directly asks the students which motives could have played a role for Microsoft's interest in acquiring Skype. As already stated, it is expected that most of the answers will relate to synergies and diversification aspects. These answers based on the above listed motives are correct, but students are expected to go more in-depth and analyze the product portfolio of Microsoft to understand which products and services of Microsoft could be enhanced (Exhibit 2) by the acquisition of Skype. Although, the case is a typical example of a strategic acquisition, students are expected to defend their arguments and give deeper insights to the synergies they came up with. Moreover, participants will undoubtedly analyze the price Microsoft paid and the high goodwill amount, which resulted out of the acquisition. Therefore,

## GENERAL PART

students may state that there could have been an overpayment and refer to Winner's Curse & Hubris, which is not a main motive in our case. It would be interesting for the instructor to ask which evidence students have for the Winner's Curse & Hubris motive and why they think Microsoft overpaid, since it is hard to measure Skype's real value. Furthermore, a discussion about integration problems should be held (Arthur 2013). An interesting point that could be introduced is the aspect of synergies through tax considerations and savings (Damodaran 2005). Since the expected focus of students will be the above-named motives, this could be a valuable learning experience. Subsequently, it could be interesting to give a hint to the high levels of cash Microsoft held as described in more detail in the Deal Structure & Form of Consideration section, which is a common phenomenon for the tech industry, and to ask what the students' opinion on the all-cash transaction is. Furthermore, at this stage it should be discussed that having a lot of cash on hand can cause agency problems, which may lead to value destroying actions, like overpayment in an acquisition deal (Jensen 1999).

The following list of standard questions is proposed. The instructor is free to modify them to better fit to the specific course and students:

- What were the main motives of Microsoft to acquire Skype?
- Which of Microsoft's services or products could be enhanced by the technology Skype offers?
- Why does the business model of Skype fit more to Microsoft compared to eBay?
- Was it only about synergies or were legal aspects also involved?
- Was Skype's user base important to Microsoft?
- Was it a move to prevent the acquisition by its competitors, or saw Microsoft other opportunities in Skype?
- What could be motives of an all-cash transaction?

- What were the potential risks and considerations Microsoft was facing?

After pointing out Microsoft's perspective, it is important to have a look on the other side of the table, the view of Skype's shareholders. Before the acquisition by Microsoft, Skype was held by an investor group led by Silver Lake Partners and eBay. The motives of the shareholders to sell Skype to Microsoft were the following:

- 1. Profit Realization:** The sale presented an opportunity for Silver Lake Partners and other investors to secure a substantial return on their investment. Having acquired a majority stake in Skype from eBay in 2009, the \$8.5 billion deal with Microsoft represented a significant profit of more than \$5 billion (Reuters 2011).
- 2. Strategic Focus:** For eBay, divesting Skype allowed the company to concentrate more on its core e-commerce and payment businesses. Skype was not a natural fit with eBay's primary operations, and selling it helped streamline their business strategy.
- 3. Legacy considerations:** Some investors may have believed that Skype could achieve greater integration and value under Microsoft's ownership. Microsoft's extensive software and hardware ecosystem offered synergies that were less achievable while Skype was independent. Therefore, some shareholders may have searched for an adequate takeover to extend Skype's reach and preserving its relevance. There were no statements regarding that point when the acquisition took place, but it's still worth mentioning.
- 4. Market Conditions:** The timing of the sale was favorable. The technology market was strong, and Microsoft was keen to enhance its position in communication technology. This made Microsoft a motivated buyer willing to pay a premium.

## GENERAL PART

The instructor and the group of students should speak about the position of the sellers and their motives, but the focus should be on the decision of Microsoft to acquire Skype. The following whiteboard activities are recommended to foster student interaction:

- Draw a table on the whiteboard with two columns: one labelled "Merger motives of Microsoft" and the other "Merger motives of Skype" (Exhibit 1).
- Invite students to suggest both obvious and hidden motives for each party, recording these ideas in the respective columns.
- Facilitate a discussion on the various motives and their potential implications for each group.

After a hopefully exhausting, insightful, time-consuming, and valuable debate it is important to give students the opportunity to process what they have learned and recollect their thoughts. Therefore, the perfect timing for the instructor to give students a break has arrived.

### *vi. Valuation*

The goal of this valuation exercise is to understand whether Microsoft's payment for Skype was justified based on conventional intrinsic and extrinsic valuation methods. Having in mind Skype's extensive M&A history and previously published valuations in this context (Exhibit 3), the instructor can elect to spend more time on this chapter by performing more detailed calculations of key variables such as discount rates and cash flows. It is worth noting that a considerable part of Skype's valuation and balance sheet came in the form of intangible assets such as goodwill and intellectual property, which will be discussed in further detail in subsequent sections. This part focuses on a more high-level approach to valuing Skype from Microsoft's perspective with traditional valuation methods. This involves forecasting Skype's standalone business prospects, as well as accounting for possible synergies and new revenue streams such as advertising, that Skype had announced in its IPO filing. For the scope of this

## GENERAL PART

case study, students are expected to perform a high-level DCF and comparable company valuation (CCA), critically using the data in the student excel resource. The excel provided to the instructor contains a free cash flow forecast based on Skype's historical financial data and forward-looking statements disclosed in its April 2011 amended IPO filing as well as new advertising revenue from a 3<sup>rd</sup> party analyst research report (Winslow, Dennis, and Panigrahi 2011). With the information made available in the case study text and exhibits, students are expected to derive an appropriate method to forecast Skype's top-line growth, include new revenue streams/synergies, assume prudent margin levels and extrapolate historical line items to arrive at a sensible free cash flow. Notable differences to the model valuation could stem from (i) assumptions regarding top-line growth such as the development of paying users and revenue per user as well as other revenue growth, (ii) inclusion or exclusion of new advertising revenue streams, (iii) EBITDA margin forecast, (iv) D&A assumptions with regards to the amortization of acquired intangible assets resulting from purchase price accounting/ write-up of the private equity transaction, and (v) WACC and terminal value assumptions. Specifically, for the WACC students are to elect between the Skype WACC and the Microsoft WACC at the time, concluding that it is more accurate to apply the Skype WACC as cash flows with a certain risk profile (i.e. that of the company Skype) should be discounted at a rate reflecting the cost of such risk. While there is no right or wrong answer as intrinsic valuation is widely considered more art than science, the forecast at hand serves as a blueprint that a prudent investor from Microsoft's perspective would have likely considered.

In addition, a CCA based on public competitors as well as multiples disclosed in the IPO prospectus is made available to the instructor. With the data at hand, Students are expected to recognize which peers shall be considered to further analyze Skype's value based on multiples. They will be provided with a list of potential peers and their necessary financial data. Two unsuitable peers not active in the VoIP sector are provided and should be excluded from the

## GENERAL PART

valuation to arrive at an enterprise value of \$6.359 billion with Skype's 2010 financials and USD \$9.107 billion in 2011.

With exception of data in the IPO filing, market data was collected based on the valuation date of 30 April 2011, the day of the acquisition announcement. The resulting valuations are displayed in a football field chart (Exhibit 5) and range from \$3.122 billion to \$12.216 billion. Considering a weighing of 15% for EV / Sales and EV / EBIT multiple, 20% for EV / EBITDA and 50% for the DCF, representing a standard even split between market and intrinsic valuation in the absence of more detailed cash flow forecast and a more suitable peer group, the associated control premium is 10.4%.

The following list of standard questions is proposed. The instructor is free to modify them as they please:

- Which valuation methods would be suitable for Microsoft to apply?
- Does the purchase price represent a premium to Skype's intrinsic value and what factors might justify this premium?
- What are the potential synergies that Microsoft expected from this deal?

### ***vii. Decision Point***

At this point, decision makers are well aware of the tumultuous acquisition history of Skype and have studied in detail the context of the VoIP and broader technology sector sentiment at the time of the acquisition. In addition, the Head of Business Development and M&A thought extensively about merger motives from Microsoft's perspective, the contemplated deal structure, as well as applying a variety of valuation techniques to find a fair value for Skype.

## GENERAL PART

At this point, they are challenged with the decision of whether to proceed with the acquisition or not.

## INDIVIDUAL PART – PATRICK WILLNAUER

### *viii. Strategic Initial Public Offering (IPO) registration statement filing in facilitating company sale*

This case study dives into how an IPO registration statement filing may be employed as a strategic tool to increase a company's market visibility, improve its valuation prospects, and strengthen its position in negotiations for a potential sale. It focuses on Skype's decision to file an IPO registration statement and the role this played in its eventual acquisition by Microsoft. By examining the intent, timing, and results of this strategy, students gain valuable insight into how companies can use IPO filings as more than a traditional fundraising method, but rather as a catalyst for achieving broader strategic goals.

#### **a. Introduction**

Microsoft's \$8.5 billion acquisition of Skype in 2011 remains one of the most significant technology deals of the 21st century. A key factor that facilitated this transaction may have been Skype's strategic decision to file an Initial Public Offering (IPO) registration statement in 2010. Although IPOs are typically associated with raising funds, achieving growth, and transitioning to public ownership, Skype's IPO filing may have been considered for a different purpose – positioning the company to attract buyers, enhance its valuation, and expedite its sale (Lian and Wang 2007).

#### **b. Learning Objectives**

After working on the case study students are expected to develop the following competencies:

- Understanding the circumstances under which pursuing an IPO would be a strategic decision in the context of mergers and recognizing the key differences, advantages, and disadvantages of an acquisition versus an IPO.
- Applying the concepts of inorganic and organic growth to real-world scenarios.
- Analyzing how IPOs may increase merger valuations from the perspective of an acquirer and comparing the financial implications of a merger premium with IPO valuation metrics.

At the end students will address the central question: **Should Skype continue with an Acquisition or IPO?**

**c. Teaching Plan**

The following teaching plan is recommended for the instructor's use:

- Explaining the theory between inorganic and organic growth.
- Giving instructions of an IPO, how the process looks like and what strategic thoughts may be behind it.
- Working out differences between an IPO and merger.
- Teaching the fact that an IPO may higher the valuation of an acquirer, by examining the case of Skype.
- Preparing the students to carry out a valuation of the IPO scenario and comparing it to the standalone valuation and Microsoft's offer price.
- Forcing students to think critically about the question: Acquisition or IPO?

**d. Skype's Strategic Thoughts and Plans behind going Public and the Link to the Theory of Inorganic and Organic Growth**

In August 2010, Skype filed for an IPO, it was planned to raise \$100 million, by performing a carve-out from its current holders. At that time analysts argued that Skype's private equity owners might be pursuing an IPO to recover part of their investment of over \$2 billion made in 2009, or as a strategic move to publicize the company in hope that other technology or telecom companies get more interested in a potential acquisition deal. Moreover, the plans of going public could have been seen as a signaling action regarding the valuation of the company, since Skype was a very difficult business to value, even though its growth was impressive at that time (Reuters 2010). Furthermore, another point, which could further strengthen the planned signaling effects was the underwriters of the IPO: J.P. Morgan, Goldman Sachs, Morgan Stanley, Barclays Capital, and others which brought a high level of reputation to the plans of Skype (Skype S.à.r.l. 2010). However, the performance of one competitor, Vonage Holdings Corp, might also deter investors. After its May 2006 IPO at \$17 per share, Vonage's stock price dropped significantly and was trading at \$2.34 on the New York Stock in August 2010 (Reuters 2010). Therefore, it could be argued that it was an eventually risky move to file for an IPO. By reading the case study and performing additional research, students should be able to conclude the underlying reasons for the decision of Skype trying to go public. Some of them are straight forward, while others will bring new perspectives to the course participants and are compiled as follows:

- ***Raising capital:*** The IPO had the potential to provide Skype with additional capital to expand its services and strengthen its infrastructure. The funds raised could also have been invested in research and development to advance the company's technology, ensuring it remained attractive, competitive, and relevant in the rapidly evolving market (Balasubramaniam 2024).
- ***Increasing market share:*** The additional funds could be directed toward marketing efforts and strategic partnerships to grow Skype's user base. Furthermore, the capital

could facilitate international expansion, particularly in emerging markets (Balasubramaniam 2024).

- ***Enhancing brand visibility:*** An IPO could enhance the company's visibility and credibility in the open market, potentially attracting more users and business clients. Additionally, going public often elevates a company's profile, leading to increased brand recognition and trust (Balasubramaniam 2024).
- ***Increasing the company value, by the carve-out:*** An interesting phenomenon is the potential for a company's share price to increase after a carve-out. In some cases, the standalone valuation of a company may exceed its valuation within a larger corporate structure. This may have been the case for Skype, where its true potential could have been overlooked (Wagner 2005).
- ***Providing liquidity for investors and benefiting employees:*** The IPO would offer the private equity owners an exit strategy, enabling them to recover their investment. Additionally, as a strategic move, an IPO could provide employees with stock options, potentially boosting retention and morale.
- ***Competitive pressure:*** The decision to seek additional capital through an IPO may have been driven by the need to outpace competitors such as Vonage, Google Voice, and traditional telecom companies. Increased funding would enable Skype to maintain its competitive edge through continuous innovation and enhanced services.
- ***Strategic flexibility:*** Pursuing an IPO while simultaneously considering acquisition offers would provide Skype with greater strategic flexibility, allowing it to take advantage of the most favorable market opportunities. This approach, known as the Dual-Track strategy, will be explored in more detail in the subsequent chapters of this case study. Furthermore, showcasing the readiness to proceed with an IPO signals

strength, potentially enhancing Skype's negotiating position and leading to a more favorable acquisition deal (Lian and Wang 2007).

- **Market timing:** The market conditions in 2009 and 2010 appeared favorable for a tech IPO, as investor interest in technology companies was resurging in the aftermath of the financial crisis. The prospect of achieving a higher valuation through an IPO compared to private funding or a direct sale may have been a key factor in the decision-making process (Exhibit 6).

Students must be capable of finding most of the strategic considerations Skype was going through when it planned the IPO. Moreover, it is important for the instructor to discuss these in-class, to bring different views and opinions to the table and rank them according to their importance for the plans of the firm to go public, this could be done on a whiteboard. Furthermore, it is important for course participants to realize that an IPO is always combined with risk. There are many examples of companies in the past, in which they did not reach their set objectives or their price per share dropped massively after going public. At this point, the instructor should advise students to analyze the market environment of recent IPOs, what the main reasons for past IPOs were and how the share prices of these have evolved (Exhibit 6). Moreover, the IPO process in general may also be discussed, so the attendees learn about the procedure itself. Out of this task, students are expected to grasp why IPOs are made, what could go wrong and how share prices may evolve. After getting a sense of IPOs, the gathered learnings should be applied to Skype and how Skype's plan of going public may differ from past analyzed ones.

This section should be mainly focused on the strategic considerations behind going public, but the instructor may also link it to the theoretical concept of inorganic and organic growth. Here, the professor is advised to mention other alternatives to raise capital like strategic acquisitions

or private funding and talk briefly and generally about the cons and pros of these options, the whiteboard is recommended to list different arguments (Exhibit 7).

Furthermore, the instructor may explain the differences between organic and inorganic growth and list advantages and disadvantages of the two options, to give information about this theoretical model. First, the professor may start by explaining that organic growth refers to the expansion of a company through internal efforts, such as increasing its output, improving processes, or boosting sales. Furthermore, the instructor should give the information that this approach is generally seen as more sustainable over time, though it tends to be slower compared to other growth methods, as it relies on the company's existing resources and capabilities. Afterwards, the concept of inorganic growth should be discussed. It is a strategy which is driven by mergers, acquisitions, and joint ventures. Students should realize that this approach allows a company to expand rapidly and make a significant impact in a short period of time, even though control of the company may be gone, and substantial resources and effective management is needed to ensure success (Vance 2020). After these explanations students are expected to understand the theoretical concepts and give arguments to the question why Skype was aiming for an IPO, instead of other options.

The following list of standard questions is proposed. The instructor is free to modify, so the questions fit better to the specific course and students:

- Which general strategic thoughts are behind an IPO?
- Which of the general strategic thoughts can be applied to our case and what are the specialties in the case of Skype?
- What are the risks of an IPO?
- What were the private equity investors seeking?
- How is an IPO process structured?

- What are the reasons for doing a carve-out?
- Is Skype's IPO plan comparable to previous tech IPO filings?
- Are the underwriters playing a big role in an IPO process?
- Was an IPO Skype's best option to take?
- What are the differences between inorganic and organic growth?

**e. Initiating an IPO to Increase Interest of the M&A Market and the Company's Valuation (Dual Tracking Phenomenon)**

The so-called dual tracking phenomenon in the context of corporate finance arises when a company files for an IPO, while also exploring potential acquisition offers and later getting acquired in the M&A market. This phenomenon can be further categorized into private dual tracking and public dual tracking. Private dual tracking occurs when the acquisition happens before the IPO, meaning the company is still privately held, which was the case for Skype. Thus, dual tracking allowed Skype to explore the best possible option, whether it would have been going public or being acquired, based on market conditions, and offers received. After this section, students are expected to understand that the IPO statement filing may have allowed Skype a higher M&A valuation and what advantages as well as disadvantages dual tracking introduces.

After reading and working on the case, the course participants should recognize that an important gain of this phenomenon is to put pressure on potential buyers in following form:

1. ***Increasing competition:*** The dual-track strategy can attract interest from multiple potential buyers, and in the case of Skype, Microsoft faced competition from other major players such as Google and Facebook, which were reportedly interested in acquiring the company. This competition pressured Microsoft to present a highly compelling offer to secure the deal.

2. ***Pressuring the valuation:*** As Skype prepared for its IPO, a clear valuation benchmark emerged. Microsoft had to make a sufficiently compelling offer to convince Skype's stakeholders to favor an acquisition over going public.
3. ***Pressuring the deal terms:*** With the dual-track strategy, Skype could negotiate more favorable terms, such as better deal conditions. Microsoft had to offer terms that were not only financially attractive but also advantageous in other aspects.
4. ***Pressuring the timing:*** To stop Skype from moving forward with the IPO, Microsoft needed to act swiftly and decisively, finalizing the deal before the IPO preparations progressed too far.
5. ***Pressuring regulatory scrutiny:*** The dual-track approach could lead to increased regulatory scrutiny. Microsoft needed to address any antitrust or regulatory issues effectively to prevent delays or complications in the complex acquisition process.

Moreover, students need to understand the dual tracking phenomena and most of the benefits and drawbacks it may have brought to Skype, as well as how it influenced Microsoft and the market. Therefore, to deepen the course participants' understanding and logic of the dual tracking process it is important for the instructor to let the students work on their own first. After a break or in the next session the professor should highlight the general advantages and disadvantages it raises. The recommendation is to use the whiteboard or a graphic, where a list of pros and cons of dual tracking can be created. The following points should be discussed in class and used as an indicator:

**Advantages:**

1. ***Reduced Dependence on Market Conditions and Increased Flexibility:*** The IPO process can be highly sensitive to market fluctuations. Favorable conditions at the start of an IPO roadshow can quickly shift, which might adversely affect the offering's pricing. Although companies and underwriters attempt to time IPOs to avoid major

macroeconomic announcements, the market's reaction to earnings reports or other significant news can still impact the offering. The lengthy SEC review process adds another layer of uncertainty, making it harder to take advantage of favorable market conditions. By employing a dual-track strategy, companies can mitigate some of this unpredictability, giving them the option to pursue a sale if market conditions deteriorate (Diamond, Kiernan and Mickelsen 2011).

2. ***Enhanced Leverage in the Sale Process:*** An impending IPO can provide private companies with valuable leverage during acquisition negotiations. The dual-track approach creates urgency, as potential buyers recognize that the opportunity to acquire the company might diminish once the IPO process begins. If the company goes public, it may no longer be available for sale, or the terms of the deal, particularly the price, may become less favorable. Public companies also face more stringent price checks compared to private ones, prompting buyers to act more quickly. Studies indicate that companies pursuing a dual-track process often secure sale premiums 22% to 26% higher than those of companies not considering an IPO (Brau, Francis and Kohers 2003).
3. ***Achieving a Full Exit and Maintaining Control:*** An IPO often offers only partial liquidity for investors, rather than a complete exit. Investors might face restrictions on selling shares immediately or may only be able to sell a limited number through an over-allotment option if the share price rises after the IPO. This limitation poses a challenge for venture capital and private equity investors who seek full liquidity from a single transaction. Post-IPO, investors might still hold a significant stake with limited ability to sell without impacting the share price. Moreover, private equity shareholders may encounter new restrictions on their influence over the now-public company (Diamond, Kiernan and Mickelsen 2011).

**Disadvantages:**

1. ***Management Distraction and Risk to Business:*** Preparing for an IPO takes up a lot of management's time and focus. While there are times, like during SEC reviews, when management can shift their attention back to running the company, the IPO process still demands significant effort. Managing a company sale also requires considerable time and resources, involving senior executives and other staff in due diligence, negotiations, and document preparation. This process is often fast-paced and relentless until the deal is complete and publicly announced. Trying to handle both an IPO and a sale at the same time can severely limit the management's ability to concentrate on customers, products, and strategic planning. This can risk harming the business, which might negatively affect the success of both the IPO and the sale (Diamond, Kiernan and Mickelsen 2011).
2. ***Competing Priorities and Potential Issues:*** Timing for the IPO and the sale process might not always align perfectly, leading to potential complications. For example, the most challenging period often arises toward the end of the SEC review, just before launching the IPO roadshow. If the IPO is postponed to continue acquisition talks, the market conditions might change, or the company's performance could decline. Moreover, delays might occur if the IPO prospectus needs updates due to ongoing acquisition discussions. Poorly managing these two processes simultaneously can strain the company and affect the outcome of both the IPO and the sale (Diamond, Kiernan and Mickelsen 2011).

After bringing up and discussing potential benefits and constraints about filing for an IPO and being engaged in the M&A market, the instructor is recommended to ask the students to think critically about Skype's decision-making. Therefore, students are expected to look-up the dual tracking phenomenon in-depth on their own and should be able to answer the question if the IPO was purely to raise capital or if the method was also used to create the opportunity for a highly valued merger.

The following list of standard questions is proposed. The instructor is free to modify, so the questions fit better to the specific course and students:

- What are the advantages and disadvantages of dual tracking?
- Did Skype focus purely on raising capital, or was the company always thinking about the chance of getting acquired?
- What are the expected reactions of the market?
- Did Skype benefit from the dual-tacking phenomenon?
- Did Microsoft feel the pressure to acquire Skype, due to this phenomenon?

**f. IPO Valuation versus Standalone Valuation and Microsoft's Offer Price**

This chapter of the case study is designed to give students an overview of how Skype's valuation might have differed if it had not been acquired by Microsoft for \$8.5 billion. The lecturer is recommended to utilize the information provided in Skype's IPO filing. Additionally, the instructor should highlight that an IPO valuation is a distinct and more complex subject. The materials provided can be used to dive deeper into the company's IPO valuation, considering the unique factors and methodologies specific to IPO assessments. The instructor may choose to allocate more time to this chapter by conducting detailed calculations of critical variables such as discount rates and cash flows. Moreover, it is important to discuss Skype's turbulent M&A history, as it provides valuable context for understanding its valuation. All key assumptions suggested for both course participants and the instructor can be found in the instructor Excel and may be adapted as needed. This valuation task is not intended to be an overly complex assignment, as this was already carried out in the general part of the case study. A comparison between the standalone M&A valuation of Microsoft is to be presented, thereby illustrating how much synergies and the merger premium could have accounted for. Both the

lecturer and the students will recognize that the IPO DCF valuation of Skype is higher than the standalone company DCF valuation Microsoft would have carried out, due to a lower WACC and less conservative approaches in revenue growth and margins. Moreover, to test the robustness of the IPO DCF model, a second valuation was conducted using the parameters and assumptions applied by Damodaran in his analysis of Skype, which is included in the instructor's Excel spreadsheet (Damodaran 2011b). The professor may use this additional valuation to show the students that the IPO valuation using other assumptions and parameters would still be higher than the standalone valuation but below Microsoft's offer price. After completing this section of the case study, students should recognize a possible link between Microsoft's high offer price and the pressure created by Skype's IPO filing (dual tracking) to surpass its valuation.

The following list of standard questions is proposed. The instructor is free to modify, so the questions fit better to the specific course and students:

- Did Microsoft's valuation of Skype get influenced, because of the IPO filing?
- In which price range should the IPO be valued?

**g. The Decision Point**

After working on all three previous sections the decision point has arrived. At this stage, the professor is advised to repeat and clearly explain all the important topics that have been discussed over the last course units. The most effective approach is to utilize teaching tools like a whiteboard or a well-organized PowerPoint presentation. Points that should be addressed and considered are the following:

- The theory of inorganic vs organic growth.
- The structure of an IPO process.

## INDIVIDUAL PART – PATRICK WILLNAUER

- The general strategic considerations behind an IPO and Skype's view.
- Advantages and disadvantages of an IPO vs Acquisition
- Opportunities and risks of dual tracking and its potential effect on a M&A valuation.
- IPO valuation versus Microsoft's offer price.

Finally, the moment arrives: students must evaluate whether Skype had always intended to use an IPO as a strategic move to enable an acquisition before fully completing the process. Furthermore, the course participants should assess whether Skype should actively pursue Microsoft's acquisition offer or continue with its plans for an IPO.

The following list of standard questions is proposed. The instructor is free to modify, so the questions fit better to the specific course and students:

- Was Skype always pursuing an IPO as a strategy to facilitate an acquisition before fully completing the process?
- Should Skype continue with an Acquisition or IPO?

*ix. Epilogue*

After Microsoft acquired Skype in 2011 for \$8.5 billion, the platform initially thrived. Skype saw rapid integration into Microsoft's services, replacing Windows Live Messenger by 2013 and becoming a key feature in Office 365, Xbox, and Windows devices. It remained a leading communication tool for personal and business use during its early years under Microsoft. However, competition soon emerged, notably from Zoom and Slack- Furthermore, Microsoft Teams, launched in 2017, began to overshadow Skype. Teams' success, especially during the COVID-19 pandemic, relegated Skype to a less central role (Novet 2023). While Skype remains available, its market share and relevance have significantly declined as Microsoft shifted its focus to Teams for enterprise and collaborative communication (French 2020).

Whether Microsoft's acquisition of Skype was worth it at all and if so, whether the astronomical price tag was justified, remains debated. Initially, the deal appeared successful, as Skype integrated into windows and replaced Messenger, gaining millions of users. Microsoft likely derived some strategic value, particularly through Teams' success, which incorporated lessons from Skype. Despite that, the acquisition is often viewed as overvalued given the high price not justified by common valuation methods as well as Skype's fading prominence (French 2020).

## Exhibits

Exhibit 1: Board Plan for the Merger Motives of both Parties

Merger motives of Microsoft	Merger motives of Skype
<ul style="list-style-type: none"> <li>Achieving synergies through tax considerations and savings</li> <li>Enhancing Microsoft's communication technology position by killing a competing technology and preventing the acquisition by other competitors</li> <li>Integrating Skype into Microsoft's already existing division structure and product and service lines (strategic alliances)</li> <li>Leveraging Skype's user base</li> <li>Strategic importance of voice and video communication</li> </ul>	<ul style="list-style-type: none"> <li>Profit Realization</li> <li>Strategic Focus</li> <li>Legacy Considerations</li> <li>Market Conditions</li> </ul>

Exhibit 2: Relationship between Skype and Microsoft's Products and Services (Shan 2013)



Exhibit 3: Skype Valuation History (own calculation)

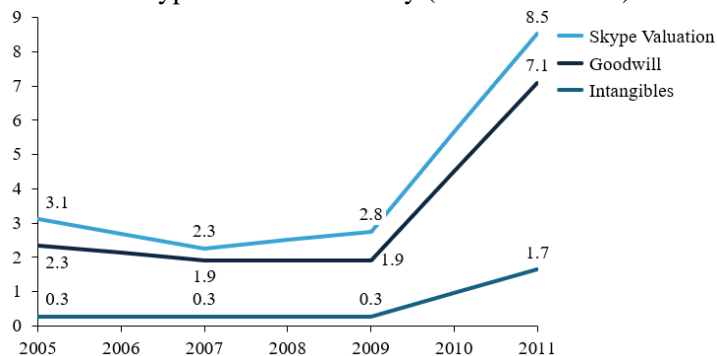


Exhibit 4: Skype Comparable Companies, 2010 (S&P Capital IQ)

Comparable Companies	Company Description	Exclusion Criteria
<b>8x8 Inc.</b>	A VoIP and cloud communications provider with a subscription-based model, directly comparable to Skype's core business.	Included
<b>BroadSoft Inc.</b>	A provider of software solutions enabling telecom service providers to offer VoIP and unified communication services.	Included

<b>Akamai Technologies Inc.</b>	A global leader in content delivery networks (CDN) and cloud services	Size and Industry
<b>Vonage Holdings Corp.</b>	A consumer and business-focused VoIP provider, with a subscription-based revenue model similar to Skype.	Included
<b>VeriSign Inc.</b>	A provider of domain name registry services and internet security solutions	Size and Industry
<b>ShoreTel Inc.</b>	A company specializing in business-focused unified communication solutions	Included

Exhibit 5: Football Field Chart

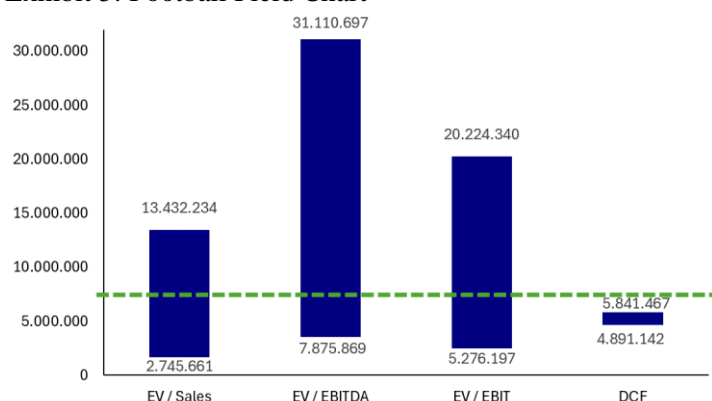


Exhibit 6: Technology IPO Filings in the Years leading up to Skype's Plan

	Google (Mc Kenna 2004)	Salesforce (Cowley 2004)	Vonage (Reuters 2010)	NetSuite (Lessner 2007)	VMware (Reuters 2007)
IPO Date	August 19, 2004	June 23, 2004	May 24, 2006	December 20, 2007	August 14, 2007
Initial Price per share	\$85	\$11	\$17	\$26	\$29
Approximate Valuation	\$23bn	\$1.1bn	\$2.6bn	\$1.5bn	\$10.9bn

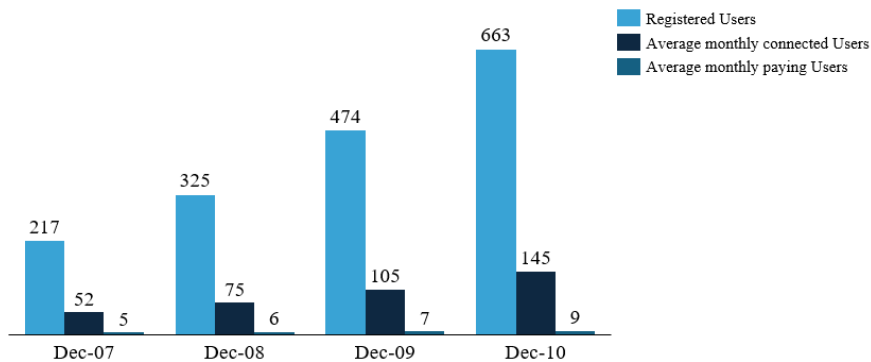
Exhibit 7: IPO, Acquisition and Private Funding

	Pros	Cons
Initial Public Offering (IPO)	<p><b>Raising Capital:</b> An IPO can bring in significant funds for growth, research, and other projects.</p> <p><b>Markt visibility:</b> Going public increases brand visibility and credibility in the market.</p> <p><b>Liquidity:</b> Provides liquidity options for early investors and employees with stock options.</p> <p><b>Higher valuation potential:</b> Public markets might offer a better valuation than private funding.</p> <p><b>Reducing Corporate Debt:</b> Public companies can use proceeds from an IPO or subsequent share offerings to pay down debt (Cook 2023).</p>	<p><b>High Costs and Complexity:</b> The process is expensive and involves ongoing compliance and regulatory requirements.</p> <p><b>Market volatility:</b> The company becomes subject to market fluctuations and investor sentiment.</p> <p><b>Short-term pressure:</b> There is constant pressure to meet quarterly financial expectations.</p> <p><b>Mandatory Disclosure:</b> A need to publicly disclose detailed financial and business information (Cook 2023).</p>
Acquisition	<p><b>Immediate Capital:</b> Acquisitions can provide large amount of capital without the IPO process.</p> <p><b>Strategic Synergies:</b> Opportunities for synergies with the acquiring company such as technology integration or market access.</p> <p><b>Reduced Pressure:</b> Less immediate pressure to meet market expectations.</p>	<p><b>Cultural integration:</b> Challenges in merging with the acquirer's corporate culture.</p> <p><b>Valuation issues:</b> Might not achieve the desired valuation.</p> <p><b>Employee uncertainty:</b> Employees may feel uncertain about their future, leading to turnover (Wozniak 2023).</p>

	<i><b>Simpler process:</b></i> Generally quicker and less complex than an IPO (Likos 2022).	
Private Funding	<p><i><b>Retained Control:</b></i> Allows the original owners to maintain control and make independent decisions.</p> <p><i><b>Operational Flexibility:</b></i> More freedom in terms of financial reporting and operational choices.</p> <p><i><b>Long-term investors:</b></i> Typically involves investors with a longer-term view who can offer strategic support.</p>	<p><i><b>Limited Capital:</b></i> The amount of capital raised might be less than what an IPO could generate.</p> <p><i><b>Valuation constraints:</b></i> Private funding might not offer as high a valuation as public markets.</p> <p><i><b>Multiple rounds needed:</b></i> Often requires several rounds of funding, which can dilute ownership.</p> <p><i><b>Higher cost of capital:</b></i> The cost of capital might be higher compared to public market funding.</p>

## Appendix

### Appendix 1: Skype User Metrics in Millions (Shan 2013)



### Appendix 2: Merger Decision Pros & Cons List

Pros	Cons
<b>Large User Base:</b> Skype had over 660 million users, giving Microsoft access to a massive, global audience.	<b>Integration Challenges:</b> Skype's peer-to-peer architecture might clash with Microsoft's centralized cloud infrastructure.
<b>Synergies with Existing Microsoft Products:</b> Skype could be integrated into Office, Windows, and Xbox, improving collaboration and productivity.	<b>Competition in VoIP Market:</b> Despite the acquisition, Microsoft faces competition from Google Voice, FaceTime, and Zoom.
<b>Strengthening Presence in VoIP Market:</b> The acquisition allows Microsoft to enter the growing VoIP market, competing with Google and Apple.	<b>Risk of Overpayment (Hubris):</b> Suffering from the "winner's curse" there is always a risk of overpayment
<b>Defensive Move Against Competitors:</b> Microsoft blocks Google and Facebook from acquiring Skype, protecting its position in communications.	<b>Revenue Model Limitations:</b> Skype struggled to monetize its largely free user base in the past.
<b>Enterprise Communication Enhancement:</b> Skype technology has the ability to boost Microsoft's enterprise communication platform, rebranded as Skype for Business.	<b>Shifting Market Dynamics:</b> Skype lost market leadership to competitors like WhatsApp, FaceTime, and Zoom.
<b>Global Brand Recognition:</b> Skype's strong global brand adds credibility to Microsoft's product portfolio.	<b>Missed Mobile Opportunities:</b> Skype's mobile apps were slow to develop compared to WhatsApp and FaceTime
<b>Boost for Cloud and Mobile:</b> Skype can help Microsoft expand its cloud services and support mobile platforms.	<b>Cultural and Organizational Fit Issues:</b> Skype's integration into Microsoft's corporate structure faces challenges, eventually hindering innovation.
<b>Tax Efficiency:</b> Microsoft can use offshore cash reserves to make the acquisition, minimizing tax costs.	
<b>Increased Use in Remote Work and Education:</b> Skype is a key tool for remote communication during the rise of remote work.	
<b>Monetization Potential:</b> Skype was seen as a platform with strong monetization potential through ads and premium subscriptions	

Appendix 3: Post-Acquisition Structure of Microsoft (Mc Guinness 2011)



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