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MICROSOFT'S PURSUIT OF ACTIVISION BLIZZARD: EXAMINING DEAL
STRUCTURE AND FINANCING IN A PRE-ACQUISITION CONTEXT

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Abstract

This case study examines Microsoft's acquisition of Activision Blizzard from a corporate finance perspective, focusing on deal structuring and financing. The analysis compares an asset deal versus a share deal, concluding that a share deal is the most efficient approach, as it ensures full control over Activision Blizzard's assets while avoiding the complexities of asset-by-asset transfers. Further evaluation of payment methods favors an all-cash transaction over stock, preventing shareholder dilution and allowing Microsoft to retain the full value of expected synergies. For financing, internal funding is identified as the optimal solution, enabling swift execution, avoiding negative market signals, and eliminating borrowing costs. The findings confirm Activision Blizzard as a strategically and financially compelling target.

Keywords: Acquisition method, Financing method, Mergers & Acquisitions, Multiples, Payment method. Video Gaming Industry.

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1 Case Study (group part)

1.1 Introduction

In early December 2021, Phil Spencer, Head of Microsoft Gaming, and Satya Nadella, CEO of Microsoft, engaged in a series of in-depth discussions with Bobby Kotick, the long-time CEO of Activision Blizzard. These talks were initiated after several investment bankers approached Phil Spencer to highlight Microsoft's increasingly vulnerable position in the gaming sector. Central to these discussions was the growing dominance of key players like Sony and Tencent, whose substantial market shares and strategic product portfolios had firmly established their leadership in the industry. While Sony had solidified its position as the leader in console gaming, Tencent – recognized as the world's largest video game company by revenue – had significantly strengthened its position in both the PC and mobile gaming markets (Kent 2021). These developments, combined with the rapid growth of the global gaming market, which was projected to surpass \$150 billion in 2021 (**Case Exhibit 8**), put Microsoft under considerable pressure to consolidate its position in this highly competitive sector.

This situation posed a crucial question for Microsoft: how can the company sustainably improve its position in the gaming industry and increase its competitiveness against Sony, Tencent and other major players?

The investment bankers have already presented a possible answer to this question: the acquisition of Activision Blizzard, a leading publisher and developer in the gaming industry. Such a move would not only give Microsoft access to a portfolio of high-profile and established gaming brands, but also significantly expand its resources in game development and mobile gaming.

However, pursuing an acquisition of this magnitude – which would be considered the largest transaction in gaming history – also presents substantial challenges. First, the deal requires a significant financial investment, demanding careful consideration of its long-term profitability. Second, integrating a company of Activision Blizzard’s size could create not only opportunities for synergies but also significant costs, such as those associated with restructuring. Third, the scale of the transaction raises critical questions about its financing, including how Microsoft would structure such a large deal without compromising its balance sheet or liquidity. The complexity and scale of such a transaction highlight the importance of conducting a comprehensive and in-depth analysis to determine whether such an acquisition would ultimately be both strategically and financially justifiable in the long run.

2 Microsoft Corporation

2.1 Company History

Microsoft Corporation (hereinafter referred to as Microsoft) was founded in 1975, by Bill Gates and Paul Allen. The company’s name, derived from the words “microcomputer” and “software,” reflected its focus on developing software solutions for the emerging personal computer market. The breakthrough came in 1980 when Microsoft partnered with IBM to provide the MS-DOS operating system for IBM’s personal computers. This collaboration allowed Microsoft to benefit from IBM’s market presence and positioned MS-DOS as the software standard for IBM-compatible PCs. The widespread adoption of the operating system enabled Microsoft to gain a strong position in the expanding personal computer market, competing effectively with other industry players such as Intel and Apple (Good 2020).

In the following years, Microsoft expanded its influence with the introduction of Windows, a graphical operating system that played a central role in the company’s success. The release of Windows 95 in 1995 was particularly notable, as it popularized graphical user interfaces and

was well-received by consumers globally. Around the same time, Microsoft introduced its Office suite, which included applications such as Microsoft Word, Excel, and PowerPoint. These tools quickly became widely adopted in business and professional environments, further strengthening Microsoft's position in the software market (Good 2020).

Entering the 21st century, Microsoft expanded its business further. In 2001, the company launched the Xbox, marking its entry into the gaming industry. Simultaneously, Microsoft began focusing on cloud computing, and with the introduction of Microsoft Azure in 2010, it established itself as a leading provider of cloud services (Good 2020).

In 2014, Satya Nadella took on the role of CEO and gave Microsoft a new strategic direction, focusing on cloud computing, artificial intelligence, and advanced enterprise solutions (Tabrizi 2023). This shift strengthened the company's market position and also expanded its influence across a wide range of industries. Microsoft's mission – “to empower every person and every organization on the planet to achieve more” – highlights its commitment to fostering innovation and inclusivity. By developing products and services that empower individuals and businesses worldwide, the company continued to drive progress in the technology sector (Liu 2023).

Today, Microsoft has grown into one of the world's largest and most valuable companies, consistently maintaining a market capitalization in the trillion-dollar range (Poinski 2024). With a workforce comprising approximately 181,000 employees distributed across more than 190 countries, Microsoft's global presence underscores its role as a cornerstone of the modern economy. In 2021, the company generated over \$168 billion in revenue (**Case Exhibit 1**) and held approximately \$130 billion in cash reserves (**Case Exhibit 2**), ranking as the third largest among all S&P 500 companies in terms of cash holdings (Staley 2021). This financial strength enables Microsoft to invest heavily in research and development and to push ahead with new technologies such as artificial intelligence and cloud solutions, ensuring Microsoft remains a key player in the global technology sector.

2.2 Main business divisions

Microsoft's revenue is distributed across three primary segments: Productivity and Business Processes, Intelligent Cloud, and More Personal Computing (Good 2020). The Productivity and Business Processes segment, which accounted for approximately 32% of total revenue in 2021, includes a wide range of tools such as Microsoft 365, the Office suite, LinkedIn, and Dynamics 365. These offerings enhance productivity, communication, and business operations for individuals, small businesses, and enterprises. Microsoft 365 stands out for its cloud-based solutions, including Word, Teams, and Excel, which streamline workflows and improve efficiency. LinkedIn provides professionals with networking opportunities and delivers talent, marketing, and learning solutions. Dynamics 365, meanwhile, offers ERP and CRM tools that simplify complex business processes. In this space, Microsoft faces competition from Google, Apple, Salesforce, Slack, and Zoom. However, its emphasis on integration, robust security, and cross-platform compatibility has allowed Microsoft to maintain a competitive position in the market (Microsoft Corporation 2021).

The Intelligent Cloud segment, which contributed approximately 36% of Microsoft's total revenue in 2021, supports businesses and developers through a variety of offerings such as Azure, server products, and enterprise services (Microsoft Corporation 2021). Azure is a cornerstone of this segment, providing cloud computing, storage, and AI solutions that enable companies to innovate while minimizing infrastructure management burdens. Alongside Azure, tools like Dynamics 365 and Microsoft's server platforms further improve IT efficiency. Azure's ability to meet the rising global demand for cloud services has made it a major growth driver for Microsoft. Competing with Amazon AWS, Google Cloud, and IBM, Microsoft has leveraged its extensive global infrastructure and hybrid cloud capabilities to solidify its leading status in cloud computing (Microsoft Corporation 2021). The Intelligent Cloud segment plays

a central role in Microsoft's long-term strategy, reflecting the company's focus on scalable and future-oriented technologies.

Lastly, the More Personal Computing segment, which accounts for around 32% of revenue in 2021, includes products and services such as Windows, Surface devices, search advertising, and gaming. Windows remains a cornerstone of this segment, offering a secure and consistent operating system for millions of users worldwide. Surface devices, including premium laptops and tablets, reinforce Microsoft's presence in the hardware market. Bing's search advertising delivers tailored online ads through partnerships. Microsoft Gaming, led by Xbox, combines exclusive content, cloud gaming, and subscription services to engage users across multiple devices (Microsoft Corporation 2021).

2.3 Microsoft Gaming

In 2021, Microsoft Gaming generated \$15.37 billion in revenue, accounting for approximately 9.1% of Microsoft's total revenue. The revenue grew by 33%, significantly outpacing the company's overall revenue growth of 12%, underscoring the increasing importance of gaming within the company's More Personal Computing segment (**Case Exhibit 3**). Microsoft's gaming revenue is driven by two primary streams: hardware sales and Xbox content and services.

Hardware sales are centered around the Xbox family of gaming consoles. The Xbox is a video game console developed by Microsoft, primarily designed for gaming but also capable of streaming movies, series, and music. In 2021, this category contributed approximately \$3.1 billion in revenue (**Case Exhibit 3**).

Xbox content and services, the largest contributor, generated \$9.3 billion in 2021 (**Case Exhibit 3**). This category includes digital game sales, licensing revenue from third-party developers, in-game transactions, advertising, and cloud services. A key factor in Microsoft's

success in this area is its ability to offer both first-party and third-party titles, which appeal to a broad and diverse audience. By leveraging strategic partnerships and exclusive content, Microsoft has created a robust ecosystem that attracts gamers across various platforms (**Case Exhibit 4**).

A standout component of Microsoft's gaming strategy is the Xbox Game Pass, a subscription service introduced in 2017. Priced at \$9.99 per month, the Xbox Game Pass generated \$3.0 billion in revenue in 2021, demonstrating its significant contribution to the gaming segment (**Case Exhibit 3**). This service grants subscribers access to a rotating library of games for Xbox consoles and PCs. In 2021, this library offered an estimated total value of \$6,300 alone, giving subscribers a substantial return on their investment. This expansive and accessible model not only diversifies Microsoft's revenue streams through recurring subscription fees but also fosters higher levels of customer engagement by delivering a seamless and integrated user experience. By 2021, the Xbox Game Pass had attracted 25 million subscribers, underscoring its transformative impact on gaming consumption patterns (**Case Exhibit 15**).

2.4 Microsoft's acquisition history

Microsoft's history highlights a strategic use of acquisitions to adapt to technological advancements, secure market leadership, and influence the evolution of entire industries. This approach underscores the company's ability to identify transformative opportunities and effectively integrate them into its ecosystem, ensuring they contribute to long-term growth and align with Microsoft's broader objectives.

One of the earliest examples of this strategy was Microsoft's 1987 acquisition of Forethought, the maker of PowerPoint (Zonana 1987). Recognizing the potential of presentation software in the burgeoning productivity tools market, Microsoft transformed PowerPoint into a cornerstone

of its Office suite. This move strengthened its product ecosystem and established Microsoft as an indispensable partner for businesses worldwide.

In 1997, the acquisition of Hotmail enabled Microsoft to capitalize on the rising influence of the internet. At the time, web-based email was an emerging trend, and by integrating Hotmail into its offerings – eventually rebranding it as Outlook.com – Microsoft positioned itself as a leader in online communications, capturing a growing base of digital users (Microsoft Corporation 2022b).

As the tech industry advanced, Microsoft pivoted toward opportunities in professional networking and software development. The purchase of LinkedIn in 2016 exemplified this shift, allowing Microsoft to integrate LinkedIn's professional networking platform with its enterprise tools like Office 365. This strengthened Microsoft's position in the corporate sector and reinforced its role in professional connectivity (Hern, Kasperkevic 2017). Two years later, the 2018 acquisition of GitHub marked another significant milestone, bridging the gap between Microsoft and the open-source community. By acquiring GitHub, a platform central to millions of developers, Microsoft strengthened its position as a leader in software development tools and services (Weinstein 2018).

Microsoft's approach stands out for its ability to integrate acquisitions effectively and align them with long-term goals. By anticipating market trends and addressing integration challenges, Microsoft ensures each acquisition contributes to its broader ecosystem. This history highlights how Microsoft has used acquisitions as a strategic tool to adapt to industry shifts and strengthen its position in emerging markets.

2.5 Activision Blizzard

Activision Blizzard, a prominent player in the global entertainment industry, was founded in 2008 through the merger of Activision, a leading developer and publisher of video games, and

Vivendi Games, the parent company of Blizzard Entertainment (Sotamaa, Švelch 2021). Activision itself, established in 1979, was one of the first independent game developers in California, known for its early successes with games for consoles such as the Atari 2600 (Schreier 2024). Blizzard Entertainment was founded in 1991 under the name Silicon & Synapse and achieved significant success in the 1990s with games such as Warcraft, Diablo and StarCraft (Schreier 2024). The merger in 2008 brought together Activision's expertise in console gaming with Blizzard's strength in the PC gaming community, enabling the company to build a broad portfolio of successful game franchises.

In August 2015, Activision Blizzard became, alongside with Electronic Arts, one of only two game developers included in the S&P 500 Index. Three months later, in November 2015, Activision Blizzard made the announcement to acquire King Digital Entertainment for a sum of \$5.9 billion (Sotamaa, Švelch 2021). King, a company originally founded in Sweden in 2003, became widely known for its popular mobile games, including the globally successful Candy Crush Saga (Schreier 2024). This strategic move allowed the company to establish a significant presence across all three primary gaming platforms – console, PC, and mobile – thereby broadening its reach and diversifying its revenue streams **(Case Exhibit 5)**.

Today, Activision Blizzard's gaming operations are divided across three major brands: Activision, Blizzard Entertainment, and King. Each brand specializes in specific gaming genres and platforms, contributing to the company's extensive reach and diverse portfolio. **(Case Exhibit 6)**. The Activision segment is best known for the Call of Duty series, which has become a major force in the first-person shooter genre. The series is available on multiple platforms, including consoles, PCs and mobile devices, with titles such as Call of Duty: Warzone and Call of Duty: Mobile increasing its reach. The Activision segment also manages a range of esports initiatives, with one of the most prominent being the Call of Duty League. Launched in 2020, the Call of Duty League is a professional esports league centered around the

Call of Duty franchise, serving as a powerful marketing tool for the franchise, keeping it in the spotlight and maintaining its relevance in a highly competitive gaming market (Schreier 2024).

Blizzard Entertainment focuses on PC and console games and is known for franchises such as World of Warcraft, a well-known title in the Massively Multiplayer Online Role-Playing Games (MMORPG) genre. Other major franchises include Diablo and Hearthstone, which cover different game genres and maintain active player bases. Blizzard supports these games through its own Battle.net platform, which facilitates digital distribution and online services (Schreier 2024).

The King segment focuses exclusively on mobile gaming and is best known for the Candy Crush series, a globally recognized title that has consistently maintained its popularity since its release. Candy Crush has become a cornerstone of the casual gaming market, attracting a broad demographic of players with its accessible gameplay and free-to-play model supported by in-game purchases. King's portfolio also includes other casual mobile games such as Bubble Witch and Farm Heroes, which appeal to similar audiences (Schreier 2024).

In terms of financial performance, Activision Blizzard ranks among the world's leading game developers. The company achieved revenues of approximately \$6.5 billion in 2019, which rose to \$8.1 billion in 2020, and further increased to \$8.8 billion in 2021 (**Case Exhibit 9**). This consistent growth underscores Activision Blizzard's strength and relevance in the global gaming industry.

2.6 The global gaming market

The global gaming market has developed into one of the most dynamic and profitable sectors of the entertainment industry in recent decades. What once started as a niche industry has developed into three-digit billion-dollar industry, driven by technological innovations, changing consumer habits and the rise of new platforms (Wolf 2008). Today, the gaming industry is

broadly categorized into three primary segments: console gaming, PC gaming, and mobile gaming (GVR 2022).

2.6.1 Development of the console market

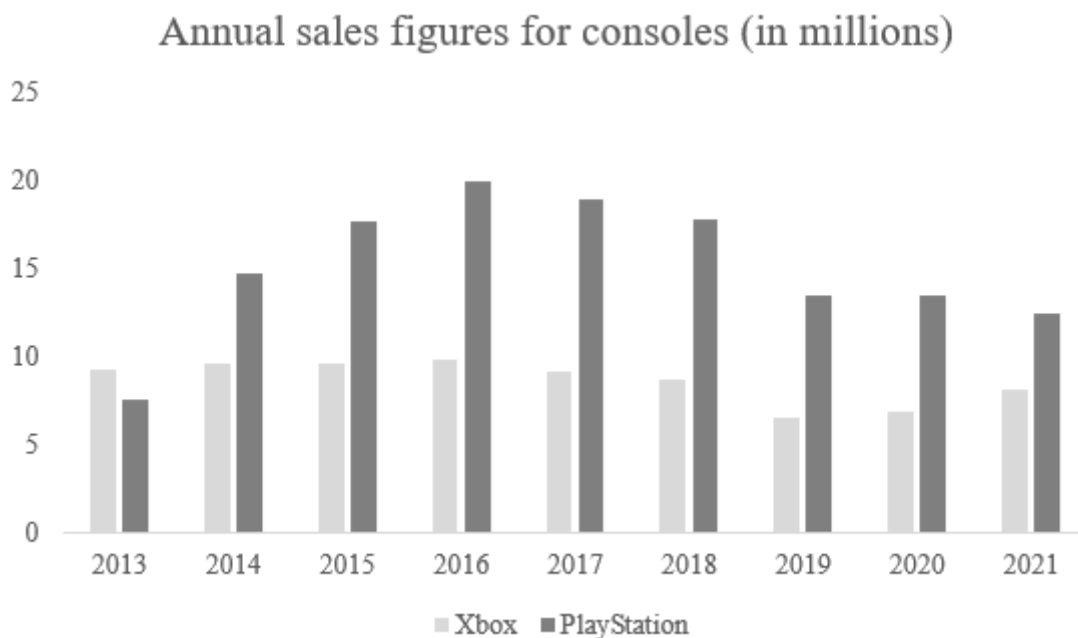
The beginnings of the video gaming market can be traced back to the 1970s when the first arcade games, such as Pong and Space Invaders, introduced a new form of entertainment. These early video games laid the foundation for home video game consoles, which entered the market in the late 1970s and early 1980s. One of the first companies to successfully market home consoles was Atari with its Atari 2600 console. This generation of consoles paved the way for the entry of major players such as Nintendo, and later Sony and Microsoft (Wolf 2008).

Nintendo entered the console market in 1983 with the Famicom (known in the United States as the Nintendo Entertainment System, or NES) and achieved worldwide success with games like Super Mario Bros and The Legend of Zelda. Nintendo quickly established itself as a leading player in the console market and continued to build its reputation as a developer of innovative gaming platforms over the following decades. The next major turning point in the history of the console market was Sony's entry with the PlayStation in 1994. The PlayStation revolutionized the industry with its powerful hardware and focus on 3D graphics, providing new opportunities for game developers. With popular titles like Final Fantasy VII and Gran Turismo, Sony set new standards and established the PlayStation as a leading platform in the console market (Wolf 2008).

In 2001, Microsoft entered the console market with the Xbox to position itself against Sony and Nintendo (Wolf 2008). The Xbox offered impressive technical specifications and was the first console with a built-in hard drive and a comprehensive online gaming service (Xbox Live), which allowed Microsoft a new way of building customer loyalty. Especially the game Halo: Combat Evolved was a groundbreaking title that increased the Xbox's popularity in the United States and laid the foundation for the platform's success (Wolf 2008).

During the 2000s, Sony and Microsoft engaged in a head-to-head competition in the console market. While Nintendo launched the innovative Wii (2006), a motion-sensor console that appealed to a wide audience, Sony and Microsoft focused on powerful hardware and exclusive content (Schreier 2017). The competition intensified with the introduction of the PlayStation 3 (2006) and the Xbox 360 (2005). Both consoles offered impressive graphics, a wide range of games, and the ability to use online services.

With the release of the next generation of consoles in 2013, Sony was able to significantly outpace Microsoft in the competitive console market. The PlayStation 4 achieved extraordinary success, selling over 116 million units worldwide, compared to just 50 million units for the Xbox One (Kent 2021). This dominance continued with the next generation of consoles, where Sony's PlayStation 5 consistently outperformed Microsoft's Xbox Series in sales, further solidifying its leadership position in the market.



Source: Sony Interactive Entertainment 2024, VGChartz 2024

A key factor behind Sony's success lies in the proprietary nature of gaming consoles. Unlike open platforms such as PC, consoles operate within a closed infrastructure, meaning that their

hardware is typically not compatible with competing platforms. As a result, the appeal of a console is heavily influenced by the exclusivity of its game library, as exclusive titles are often a decisive factor in consumers' purchasing decisions (Kent 2021).

Sony has effectively leveraged its exclusivity strategy to establish and maintain its dominance in the market. The PlayStation platform boasts a range of critically acclaimed and commercially successful exclusive titles, including Horizon Zero Dawn, Spider-Man, and God of War. These games have not only garnered widespread acclaim but have also cultivated a loyal fan base, significantly enhancing the appeal of the PlayStation ecosystem. Sony's exclusive titles have been instrumental in driving hardware sales and fostering long-term player retention, as many consumers are drawn to PlayStation specifically to access these high-quality games. This strategy not only differentiates Sony from competitors but also ensures sustained success in the console market (Kent 2021).

Microsoft, on the other hand, initially prioritized technical innovations over exclusive content during the Xbox One era. For instance, the Xbox Kinect, a motion-sensing device that enabled players to interact with games through body movements, was a significant technological advancement but failed to capture the sustained interest of a broad audience. Recognizing the importance of exclusive content in driving console sales, Microsoft eventually shifted its focus back to strengthening its game library. Despite this effort, the Xbox platform has struggled to rival the depth and appeal of Sony's exclusive lineup (Kent 2021).

This disparity in consumer perception and sales is evident in the market data. At a 2022 press conference in Brussels, Xbox CEO Brad Smith acknowledged that Sony dominates the European console market with an 80% share compared to Microsoft. In Japan, Sony's market share is even more pronounced, reaching 96%. Globally, Sony maintains a commanding market dominance of approximately 70% (Dring 2023). These figures underscore the effectiveness of Sony's exclusivity strategy.

2.6.2 Development of the PC gaming market

The PC gaming market has experienced remarkable growth and transformation since its beginnings in the late 1970s and early 1980s, evolving into a key segment of the gaming industry. Early titles such as Zork and King's Quest demonstrated the potential of personal computers as platforms for interactive entertainment. Although constrained by the hardware limitations of the time, these pioneering games laid the foundation for the PC gaming industry's future development (Wolf 2008).

The 1990s marked a turning point for PC gaming, driven by rapid advances in hardware and the increasing availability of PCs. The introduction of Microsoft Windows, particularly Windows 95, played a crucial role as it standardized the PC environment and made it more user-friendly for developers and consumers alike. At the same time, other companies such as Blizzard Entertainment, id Software and Valve rose to prominence with innovative games and new approaches to engaging audiences (Wolf 2008).

The late 1990s and early 2000s brought a revolution with the rise of the internet, which enabled online multiplayer experiences that became defining features of the PC gaming market. Games like Counter-Strike and World of Warcraft capitalized on this connectivity, fostering global communities and competitive ecosystems. This era also saw a significant shift in game distribution with the launch of Valve's Steam platform in 2003. Steam provided a centralized hub for purchasing, downloading, and managing games, revolutionizing the industry. While Steam quickly became the dominant digital distribution platform due to its extensive game library, Microsoft continued to hold a central role by providing the technological infrastructure for PC gaming through its Windows operating system (Wolf 2008).

By the 2010s, the PC gaming market was defined by its diversity and adaptability, catering to a wide range of audiences. Tencent emerged as a dominant force, particularly in the online gaming and free-to-play segments, thanks to titles like League of Legends and PUBG. Blizzard,

with hits such as World of Warcraft maintained its position as a major player, while Epic Games gained momentum with Fortnite and its aggressive push to compete with Steam via the Epic Games Store (Kent 2021).

Microsoft, which had so far only played an important role in the PC gaming sector by providing the Windows operating system, began to focus more directly on the gaming market during this period. With initiatives such as the Xbox Game Pass for PC – an alternative to platforms like Steam – and strategic acquisitions like Mojang (developer of Minecraft), the company sought to strengthen its position (Kent 2021).

Despite some successes, Microsoft has struggled to match the dominance of companies like Tencent and Valve in the PC gaming market. Tencent's leadership is underpinned by significant investments in a broad portfolio of game developers and its deep penetration of global markets. Valve, on the other hand, has maintained its dominance in digital game distribution through Steam, leveraging its early entry and a vast game library to secure a central position in the market (Kent 2021).

2.6.3 Development of the mobile gaming market

After dominating most of the gaming industry until the 2000s, the console and PC market saw the rapid rise of mobile gaming in the 2010s. Advances in smartphone and tablet technology opened up new possibilities for game developers, and mobile gaming quickly became one of the most profitable segments of the gaming market. The breakthrough came with the launch of the iPhone in 2007 and the App Store in 2008, which allowed developers to sell their games directly to users (Kent 2021). Games like Angry Birds and Candy Crush became worldwide hits and set the standard for the 'free-to-play' model, in which games are offered for free but monetized through microtransactions (Activision Blizzard 2020).

Leading companies in the mobile gaming market include Tencent, King, and NetEase (Kent 2021). Tencent, the world's largest gaming company, has leveraged its stronghold in China to generate substantial revenue from blockbuster games such as Honor of Kings and PUBG Mobile. King, best known for the enduring success of Candy Crush, has firmly cemented its place as a cornerstone of the mobile gaming sector (Activision Blizzard 2020). Meanwhile, NetEase has emerged as another major player, creating and distributing popular mobile titles both within China and globally (Kent 2021).

By 2021, mobile gaming accounted for over 50% of global gaming revenue, firmly establishing itself as the dominant segment of the industry (Kent 2021). It is projected to remain the fastest-growing sector in the coming years, underscoring its evolution from a niche category into a core component of the gaming ecosystem. Asia, widely regarded as the epicenter of mobile gaming, represents a particularly lucrative market. High smartphone penetration and widespread internet access have allowed developers to reach millions of users in the region, fueling unprecedented growth (Kent 2021).

2.6.4 Future outlook of the gaming market

The gaming market has experienced remarkable growth in recent years, particularly in the years 2019 to 2021, which were heavily impacted by the COVID-19 pandemic. As governments worldwide imposed lockdowns and social distancing measures, millions of people turned to gaming as a primary form of entertainment and social interaction. This period saw an extraordinary surge in demand across all major segments – console, PC, and mobile gaming – spurred by the need for accessible, engaging, and home-based activities during a time of restricted movement. The pandemic created a unique environment in which gaming not only thrived but also reached new audiences, with consumers spending more time and money on gaming than ever before (World Economic Forum 2022).

The compound annual growth rates (CAGR) for this period illustrate the pandemic's transformative impact on the industry. Console gaming grew at a CAGR of 5.1% (**Case Exhibit 8**), supported by the heightened interest in gaming consoles as a key source of home entertainment and the release of next-generation consoles such as the PlayStation 5 and Xbox Series X/S. Similarly, PC gaming expanded at a CAGR of 8.0% (**Case Exhibit 8**), driven by increased investments in gaming hardware as more people upgraded their setups to engage with high-quality online multiplayer games and immersive experiences.

However, the most substantial growth occurred in the mobile gaming segment, which achieved a remarkable CAGR of 16.9% (**Case Exhibit 8**). This was fueled by the widespread adoption of smartphones and tablets, as well as the growing popularity of free-to-play games supported by in-app purchases. Mobile gaming also benefited significantly from its accessibility, allowing a diverse range of players – including those in emerging markets – to engage with gaming content from virtually anywhere.

Looking forward, the gaming market is expected to continue growing, but at a more moderated pace as demand normalizes following the pandemic-driven spike. Between 2021 and 2026, projections indicate a significant deceleration in growth across all segments, reflecting a return to more sustainable levels of expansion. Console gaming is forecasted to grow at a CAGR of 2.2% (**Case Exhibit 8**), as the initial rush for next-generation consoles subsides and the market stabilizes. PC gaming is expected to achieve a CAGR of 4.6% (**Case Exhibit 8**), maintaining steady growth through ongoing technological advancements and the platform's broad appeal to both casual and dedicated gamers. Mobile gaming, while still the largest and most lucrative segment, is projected to grow at a slower CAGR of 3.8% (**Case Exhibit 8**). This moderation follows its unprecedented boom during the pandemic but is supported by continued growth in emerging markets and innovations in smartphone technology, particularly the adoption of 5G (Global Newswire 2024).

2.7 Future industry trends

The future of the gaming industry will be shaped by a series of interconnected trends that are transforming the entire ecosystem. One of the most significant drivers of this transformation is the rapid growth of the smartphone and tablet gaming market, particularly in emerging economies like India and China. These regions, with their large, tech-savvy populations, represent some of the most lucrative opportunities for the gaming sector.

The demand for affordable games is rising rapidly, driven by a young population eager to engage in accessible entertainment (Statista Market Insights 2024). Advances in mobile technology, such as more powerful devices with expanded storage and better internet connectivity, are further enabling this trend. The release of Pokémon Go in 2016 served as a landmark moment, demonstrating the immense potential of mobile gaming to reach global audiences and reshape consumer behavior (Mahoney, Tang 2021).

This shift toward mobile platforms is closely tied to another pivotal change: the decline of physical game purchases in favor of digital distribution. As consumers increasingly opt for downloading games rather than buying physical copies, the industry has accelerated its transition to fully digital distribution models. This shift is particularly pronounced in mobile gaming but has also become a dominant force in the console and PC markets. Digital distribution not only reduces production and logistical costs but also aligns with players' growing preference for convenience and instant access to content (Valuates Reports 2024).

A further evolution within the gaming industry is the rise of subscription-based models, which are redefining how players consume games. By paying a recurring monthly or annual fee, users gain access to expansive libraries of games at a fraction of the cost of purchasing individual titles. Subscriptions also encourage players to experiment with new titles, driving game discovery and engagement. For developers and publishers, the model provides predictable

revenue streams and opportunities to build long-term relationships with players. Companies increasingly bundle subscriptions with exclusive content, early access, and integrated cloud gaming, making the service more attractive for consumers. As competition intensifies, continued innovation will be key to differentiating offerings and retaining subscribers (GamesIndustry.biz 2021).

Simultaneously, significant investments in virtual reality (VR) and augmented reality (AR) technologies are revolutionizing the gaming experience. These technologies allow for immersive, interactive, and realistic environments that go beyond the limits of traditional gaming. By enabling deeper interaction, these technologies are opening new possibilities for game design, storytelling, and player engagement. The adoption of VR and AR is expected to grow substantially as hardware becomes more affordable and developers leverage the technology to create more sophisticated and captivating experiences (Mordor Intelligence 2024).

Underlying and amplifying these trends is the emergence of cloud gaming. Cloud technology has the potential to transform the industry by eliminating the need for expensive gaming hardware. Players can stream high-quality games on a variety of devices—such as smartphones, tablets, and low-end PCs—by leveraging cloud servers to handle processing power. This innovation reduces barriers to entry for consumers and democratizes access to premium gaming experiences globally. For regions with limited access to powerful hardware, cloud gaming represents a game-changing solution. As infrastructure for high-speed internet continues to improve, particularly with the expansion of 5G, cloud gaming is expected to grow in accessibility, ultimately redefining the market dynamics of the global gaming industry (Lewis, Keohane 2024).

These interconnected trends – mobile gaming expansion, digital distribution, subscription services, VR/AR integration, and cloud gaming – are collectively shaping the future of gaming.

Together, they reflect a fundamental shift in how games are produced, distributed, and consumed, opening new opportunities while challenging companies to innovate and adapt in an increasingly competitive market.

2.8 The proposed Acquisition

2.8.1 Microsoft's position in the gaming market

In mid-October 2021, a team of investment bankers from Goldman Sachs delivered an in-depth presentation to Microsoft's executive board, precisely examining the company's position within the rapidly evolving and increasingly competitive gaming industry. This presentation provided a detailed overview of the challenges Microsoft faced, as well as the opportunities available to strengthen its foothold in the sector. Through a strategic analysis, the bankers offered valuable insights into Microsoft's standing across the three key segments of the gaming market: console gaming, PC games, and mobile gaming.

Console market challenges

The presentation underscored Microsoft's ongoing challenges in competing with Sony's dominant position in the console market. Sony, with a commanding global market share of 70%, has secured its lead primarily through an extensive portfolio of high-quality exclusive titles. In contrast, Microsoft's efforts to compete have been hindered by a comparatively underwhelming library of exclusive, platform-defining content. This gap has constrained Microsoft's ability to attract and retain console users, limiting its growth within the highly competitive console ecosystem (Kent 2021).

The investment bankers further cautioned that these weaknesses would become even more pronounced with the release of the next console generation. If Microsoft fails to significantly strengthen its exclusive content pipeline, Sony is poised to capitalize on its established momentum, attracting an even larger share of the market and further solidifying its dominance.

Beyond the immediate threat to console sales, the bankers also highlighted a growing concern related to the rise of subscription-based models in the gaming industry. Sony's PlayStation Plus service has already gained significant traction, offering a robust subscription platform with competitive content that enhances user retention. Should Microsoft fail to close the gap in terms of its games library, Sony could extend its lead not only in console sales but also in the increasingly critical subscription market.

This dual threat – spanning both hardware and subscription services – underscores the urgency for Microsoft to adopt a focused and aggressive content strategy. Without such a shift, the Xbox Game Pass risks being overshadowed by Sony's offerings, making it even more difficult for Microsoft to compete effectively in future console cycles and in the rapidly growing subscription-based gaming segment.

PC gaming market observations

In the PC gaming market, Goldman Sachs highlighted Microsoft's strong foundation as the provider of the Windows operating system, which remains the backbone of the gaming ecosystem. However, despite this central role in infrastructure, Microsoft faces increasing competition from key players that are rapidly pulling ahead in this segment. Valve, through its dominance with Steam, and Tencent, with its global reach and extensive game portfolio, have positioned themselves as market leaders, leaving Microsoft struggling to establish a comparable level of influence.

Adding to this competitive pressure, Epic Games has emerged as a formidable player in recent years with its Epic Games Store, successfully building a strong presence in the digital distribution market. These competitors have attracted vast user bases and strengthened their platforms with extensive game libraries and exclusive titles.

The bankers warned that Microsoft's current challenges in the PC gaming segment closely mirror its struggles in the console market against Sony. If Microsoft fails to address these gaps, there is a significant risk that these competitors will further entrench their dominance, making it increasingly difficult for Microsoft to attract customers to the Xbox Game Pass on PC.

Mobile gaming market weakness

Lastly, the presentation of the investment bankers also placed particular emphasis on Microsoft's glaring absence in the mobile gaming market, which remains the fastest-growing and most lucrative segment of the gaming industry. Mobile gaming has not only surpassed console and PC markets in revenue generation but also broadened its appeal by providing affordable and accessible entertainment to billions of users worldwide (Shorthouse 2019).

Competitors such as Tencent and NetEase have seized this opportunity by adopting highly targeted strategies that cater to regional preferences and technical limitations. Tencent, for instance, has made substantial inroads into emerging markets by offering lightweight versions of its popular games, such as PUBG Mobile Lite, which are optimized for low-spec smartphones. This approach has enabled Tencent to achieve tens of millions of downloads in regions like Brazil, Indonesia, Thailand, and India, where affordability and accessibility remain key factors for success (Shorthouse 2019).

In contrast, Microsoft's mobile gaming portfolio remains barely existent, leaving the company unable to tap into the massive and still-growing global player base or the substantial revenue streams generated by microtransactions and in-app purchases. The investment bankers identified this deficiency as Microsoft's most significant strategic weakness in the gaming sector. They further cautioned that if Microsoft continues to overlook the mobile gaming market, it risks missing out on one of the industry's most critical areas of growth and allowing competitors to solidify their dominance.

2.8.2 Leveraging acquisitions as a strategic solution

The presentation from Goldman Sachs provided a sobering assessment of Microsoft's current position within the gaming industry, underscoring the critical need for decisive action to address its existing challenges. The investment bankers recommended bold strategic measures, including targeted acquisitions, as a viable solution to strengthen Microsoft's competitive position. They emphasized that in the rapidly evolving gaming market, acquisitions have proven to be one of the most effective strategies for gaining a sustainable edge.

Drawing on Microsoft's strong track record of executing successful acquisitions, the bankers expressed confidence in the company's ability to leverage this approach effectively. They pointed to Microsoft's history of integrating acquired companies, such as LinkedIn and GitHub, to bolster its market position and open doors to new opportunities. These examples demonstrate how Microsoft has consistently turned strategic purchases into long-term value drivers by enhancing its product offerings and expanding its influence in key markets.

The bankers further highlighted the transformative potential of acquisitions within the gaming industry. Acquiring established studios or publishers could provide Microsoft with immediate access to exclusive content, a critical factor in competing against market leaders like Sony and Tencent. Additionally, acquisitions could enable Microsoft to expand into high-growth segments such as mobile gaming, where it currently lags behind competitors. By acquiring companies with expertise in mobile game development or distribution, Microsoft could not only address its glaring absence in this lucrative market but also create synergies with its existing Xbox games, thereby enhancing its cross-platform ecosystem.

The presentation concluded with a clear message: if Microsoft aims to avoid falling further behind in an industry that is increasingly driven by content and platform strength, proactive measures are essential. While Microsoft remains a formidable player with significant resources, maintaining its relevance and competitiveness will require deliberate actions to address its

current weaknesses and capitalize on emerging opportunities. By leveraging its proven acquisition capabilities, Microsoft has the potential to secure a stronger position in the market and ensure it does not lose ground to more aggressive competitors in the years to come.

2.8.3 Activision Blizzard as a Strategic Target

Based on their analysis of Microsoft's position in the gaming market, the investment bankers at Goldman Sachs presented the acquisition of Activision Blizzard as a particularly promising solution to address the company's competitive challenges.

The bankers' recommendation was grounded in a detailed assessment of Activision Blizzard's strategic assets and its potential to strengthen Microsoft's position across the console, PC, and mobile gaming markets. The investment bankers outlined how an acquisition of Activision Blizzard would provide Microsoft with the critical content, market reach, and capabilities needed to close competitive gaps in all three segments and position itself for long-term success in the gaming industry.

1. Strengthening the console gaming segment

In the console market, Activision Blizzard's flagship franchises would provide Microsoft with highly sought-after exclusive content. Especially Call of Duty is one of the most successful gaming franchises globally, with a loyal player base and annual releases that consistently generate billions in revenue. By acquiring Activision Blizzard, Microsoft would gain control over these high-profile titles and could leverage them to enhance the appeal of the Xbox ecosystem. For example, making future Call of Duty installments Xbox-exclusive or providing early access on Xbox platforms could attract significant numbers of players, directly countering Sony's dominance in the console market. Moreover, integrating these titles into Xbox Game Pass subscription service could significantly boost its value proposition, driving subscription growth and user retention.

2. Strengthening the PC gaming segment

In the PC gaming market, Activision Blizzard's extensive portfolio, including World of Warcraft and Diablo would allow Microsoft to establish a stronger foothold as both a content creator and distributor. These titles, particularly World of Warcraft, have demonstrated exceptional longevity and revenue potential, with strong player engagement through expansions, subscriptions, and in-game purchases. By integrating these franchises into the Xbox Game Pass for PC, Microsoft could attract a broader audience, increase subscriptions, and position itself as a direct competitor to dominant platforms like Valve's Steam.

3. Expanding into the mobile gaming segment

In the mobile gaming market, Activision Blizzard's ownership of King, the developer behind Candy Crush, represents a critical opportunity for Microsoft to enter and compete in the fastest-growing segment of the gaming industry. Candy Crush remains one of the most recognizable and profitable mobile games, generating substantial revenue through microtransactions and boasting a massive global player base. Moreover, drawing on King's extensive expertise in mobile game development and monetization, Microsoft could reimagine its flagship franchises, such as Halo or Forza, for the mobile platform, unlocking access to a broader audience. Additionally, King's proven capabilities could accelerate the creation of original mobile-exclusive titles, positioning Microsoft to appeal to both casual players and the growing community of competitive mobile gamers. The investment bankers emphasized that this would provide Microsoft with an immediate presence and proven capabilities to capitalize on the growing trend of mobile gaming, particularly in emerging markets where smartphones are the primary gaming platform.

The bankers also emphasized two additional factors that added urgency to the opportunity. First, they noted the growing trend of consolidation within the gaming industry, where major players regularly acquire game developers to secure exclusive content and gain competitive advantages.

Given Activision Blizzard's extensive portfolio and market leadership, it is highly likely that other major players are also considering a move to acquire the company. If Microsoft hesitates, it risks losing out on this opportunity to a competitor.

Second, the bankers raised concerns about the increasing prominence of regulatory scrutiny surrounding large-scale acquisitions. They highlighted the increasingly challenging regulatory environment for mergers and acquisitions within the technology sector, that is driven by global concerns over market concentration, competitive fairness, and the growing dominance of cash-rich Big Tech companies. Therefore, in late 2021, regulatory bodies across the globe intensified their scrutiny of large-scale deals as governments aimed to prevent monopolistic behavior and address systemic risks posed by market consolidation (La Monica 2022).

In the United States, the bankers pointed to key developments that signal a stricter antitrust landscape. On the regulatory front, the selection of Lina Khan to lead the Federal Trade Commission (FTC) and Jonathan Kanter to head the Antitrust Division at the Department of Justice (DOJ) signifies a notable turn toward more stringent antitrust enforcement. Both leaders are focused on tightening scrutiny of mergers, particularly those involving vertical integration, where ownership of platforms combines with content production or distribution (Hyman et al. 2021). Given the interconnected nature of the gaming industry, such regulatory concerns are particularly relevant to Microsoft, as its acquisitions could raise questions about ecosystem dominance or barriers to competition.

The bankers also noted that increased funding for both the FTC and DOJ underscores the U.S. government's commitment to more rigorous antitrust enforcement. Enhanced financial and human resources are expected to improve the agencies' ability to investigate, evaluate, and challenge major acquisitions (Hyman et al. 2021).

On a global scale, the bankers highlighted that regulators in key markets, including Europe and Asia, are also adopting a stricter stance on acquisitions (Hyman et al. 2021). This reflects a

coordinated international effort to address concerns around market consolidation and platform dominance. Given the scale of a potential acquisition like Activision Blizzard, the bankers warned that Microsoft could face intense regulatory scrutiny across multiple jurisdictions.

The bankers concluded by emphasizing the sense of urgency surrounding acquisitions in the current environment. The increasing pressure from regulatory authorities, combined with Microsoft's financial strength, offers only a small window of opportunity for a deal of this scale. If Microsoft delays its decision, impending regulatory changes could make future approvals much more difficult or even impossible. The bankers pointed out that other cash-rich companies are already accelerating their M&A activities to stay ahead of these challenges, creating a highly competitive environment for strategic targets (La Monica, 2022). This trend highlights the importance of Microsoft acting quickly and decisively before other major players express interest in acquiring Activision Blizzard.

For Microsoft, the bankers point out, that a strategic acquisition of Activision Blizzard would not only resolve key competitive weaknesses across the console, PC, and mobile gaming markets but also act as a safeguard against evolving regulatory constraints. By acting now, Microsoft could secure a critical asset that would be far more difficult to pursue in the near future.

2.8.4 The board meeting: discussing the banker's recommendation

In late November 2021, Microsoft's executive board convened to discuss the potential acquisition of Activision Blizzard, building on the detailed presentation previously delivered by Goldman Sachs. From the outset, there was broad consensus on one key point: the strategic alignment between Activision Blizzard and Microsoft's gaming division was clear. The company's portfolio of renowned franchises, strong foothold in mobile gaming, and established market reputation made it an attractive target to address Microsoft's challenges in the gaming sector.

However, as the discussion progressed, differing views emerged regarding the timing and execution of such a significant acquisition. A faction within the board, led by senior executives from Microsoft's gaming division, argued for a fast-track analysis phase to quickly prepare and present an offer. They pointed to the investment bankers' warning that other major players, including Tencent, Amazon, and even Sony, had expressed interest in Activision Blizzard. This created a sense of urgency, as prolonged inaction could risk Activision Blizzard entering negotiations with competitors. Proponents of this approach emphasized that a swift move could position Microsoft as the frontrunner in what would likely become a bidding war.

Additionally, they underscored the growing concerns surrounding regulatory issues, which the bankers had cautioned. This added another layer of urgency, as waiting too long could allow evolving regulations to further complicate or prevent the acquisition altogether.

Opposing this sense of urgency, a more cautious faction within the Board expressed concerns about the scale and complexity of the deal. They raised issues related to the substantial acquisition cost and the operational challenges of integrating a company as large as Activision Blizzard. Further concerns were voiced about cultural misalignment and the reputational risks stemming from Activision Blizzard's recent controversies surrounding workplace misconduct. This group highlighted past acquisitions in the gaming industry that failed to deliver on their promise, warning that not all large-scale deals translate into financial or strategic success. One skeptical member remarked, "The gaming industry has seen its fair share of acquisitions that looked brilliant on paper but ultimately became costly mistakes. We need to ensure we're not setting ourselves up for the same outcome."

As the discussion grew increasingly heated, Microsoft CEO Satya Nadella intervened to restore order. Recognizing the validity of both perspectives, he emphasized the need for a data-driven approach before making any further decisions. Nadella stated, "We cannot let urgency or fear

drive this decision. Before we move forward, we need to put concrete numbers and analyses on the table.”

To address the varying viewpoints and ensure a thorough evaluation, Nadella ordered an in-depth analysis of Activision Blizzard, focusing on three critical areas: Valuation, Synergies, and Deal Structure and Financing. To guide this process and ensure a structured approach, a steering committee was established to oversee the analysis.

With this directive in place, the Board agreed to suspend further debate until the results of the analysis were available. This structured evaluation would provide the necessary foundation to make an informed decision about pursuing the acquisition, ensuring that Microsoft could act boldly but prudently in a moment that could shape its future in the gaming industry.

Teaching Note III: Deal structure and financing (Susanna Engl)

Case synopsis

After completing the valuation of Activision Blizzard (ATVI) and identifying potential synergies, Microsoft's steering committee reconvened to address the next critical step: determining the deal structure and securing the necessary financing. They recognized that securing adequate financial resources and selecting the optimal structure were vital before proceeding with an offer to ATVI.

A clear acquisition price was deemed essential for this analysis. The steering committee acknowledged that Microsoft (MSFT) would likely be unable to negotiate a price lower than the recommended implied equity value of \$72.96 billion, as derived from the valuation analysis (TN I). Consequently, they decided to base the deal structure and financing analysis on this figure. Their goal was to identify the payment and financing structure that would be most advantageous for MSFT.

Before progressing into the detailed analysis, a steering committee member posed a critical question: "Given the scale of this acquisition, is it necessary to purchase the entire company through a share deal? Could we instead consider selectively acquiring key assets, such as ATVI's subsidiary King or the intellectual property for Call of Duty?" This inquiry prompted a focused discussion on the strategic and financial implications of pursuing an asset deal versus a share deal, adding a crucial dimension to the committee's considerations.

An investment banker from Goldman Sachs intervened: "The valuation of individual assets, especially intellectual property, would be highly complex and costly. I recommend that we first assess the overall advantages and disadvantages of an asset deal versus a share deal before investing resources into such a detailed assessment."

MSFT's CFO Amy Hood agreed: "Let's begin by analyzing the implications of the acquisition, payment and financing methods to establish a clear understanding before proceeding with a detailed analysis."

Amy Hood outlined the framework to structure the discussion: "First, we need to assess the implications of acquiring specific assets versus the entire ATVI entity. Second, we must analyze the choice between the two primary payment methods – cash or stock. Finally, we need to evaluate the financing options for the acquisition."

With this plan in mind, the team set out to identify the deal structure that would maximize the chances of the acquisition's long-term success.

Learning objectives

- Understanding the implications of structuring a deal as either an asset or a stock purchase.
- Comprehending the factors influencing the choice between cash and stock payment in an acquisition.
- Recognizing the differences between internal and external financing sources for funding an acquisition.

Target audience

This case is designed for graduate students in MSc or MBA programs focused on finance, strategy, or management, as well as executive education participants looking to deepen their understanding of deal structure and financing in mergers and acquisitions.

Teaching Plan

The case study is designed to be completed as a semester-long group assignment. Students will conduct a pre-acquisition analysis to ultimately determine whether ATVI represents an

attractive target for MSFT. This decision will be based on the analysis of three key areas: Valuation (TN I), Synergies (TN II), and Deal Structure and Financing (TN III).

For the deal structure and financing, students will apply class materials alongside additional literature and industry insights to analyze the implications of acquisition method, payment method, and financing method to determine the optimal approach for MSFT. Their analysis, conducted from MSFT's perspective, will incorporate relevant legal and accounting standards and require independent research to provide recommendations.

Assignment questions

Question 1: Acquisition method¹

- a) What are the implications of an asset deal compared to a share deal when acquiring ATVI?²
- b) Based on these implications, which acquisition method would you recommend to MSFT?

Question 2: Payment method¹

- a) What factors influence the decision between cash payment and stock payment when acquiring ATVI?²
- b) Considering these factors, which payment method would you recommend to MSFT?

Question 3: Financing method¹

- a) What are the implications of financing the acquisition of ATVI through internal versus external sources for MSFT?²
- b) Based on these implications, which financing method would you recommend as the most suitable for MSFT in this case?

1) Students are expected to use the annual financial statements as of 31.12.2021 for both MSFT and ATVI when conducting their analyses.

2) Students do not need to consider mixed payment, acquisition, or financing options.

Case Analysis

Question 1a: Implications of asset versus share deal

There are two main approaches for MSFT to structure the purchase of ATVI: the purchase of selected assets (Asset Deal) and the purchase of shares (Share Deal) (Dreher & Ernst 2021).

Share Deal

A share deal would involve MSFT acquiring ATVI's shares, either entirely or as a majority stake (Dreher, Ernst 2021). Under this arrangement, ATVI would remain intact as a legal entity, with all its assets, liabilities, and obligations transferring automatically to MSFT (Wirtz 2012). This structure has significant risk and tax implications, which will be examined in the following analysis (**TN III Exhibit 1**).

Focusing on risk implications, a share deal presents significant challenges for MSFT, as it would inherit all existing and potential risks and liabilities, both known and unknown, from ATVI (Dreher, Ernst 2021). This increased risk exposure requires MSFT to undertake comprehensive due diligence to mitigate the inherent information asymmetry. Furthermore, a detailed investigation into ATVI's liabilities is essential, as MSFT would bear full responsibility for any unresolved financial or legal issues, including hidden or contingent liabilities (Wiehl 2022).

ATVI's balance sheet shows total liabilities of \$7.46 billion, including current liabilities, long-term debt, and deferred income taxes. Referring to **Case Exhibit 9**, ATVI's debt obligations include \$6.33 billion in long-term contractual commitments, covering leases, developer agreements, and marketing expenditures. These represent significant financial commitments that would require ongoing cash outflows from MSFT over the coming years. For instance, ATVI's long-term debt obligations, primarily maturing after 2026, would necessitate substantial repayments amounting to \$4.10 billion (**Case Exhibit 9**).

Legal and regulatory challenges further heighten the risks of a share deal. ATVI is involved in multiple high-profile cases, including employment-related lawsuits, shareholder derivative actions, and SEC investigations. Notably, the company faces a pending \$18 million settlement with the EEOC related to employment practices and multiple shareholder claims alleging corporate misconduct. Additionally, unresolved tax liabilities totaling \$483 million, including a transition tax liability of \$142 million, present further financial risks (**Case Exhibit 9**).

When considering tax implications, a share deal could offer MSFT certain advantages. By acquiring ATVI's shares, MSFT would inherit valuable tax attributes, such as net operating loss (NOL) carryforwards, which could offset future taxable income, and unused tax credits, which could reduce tax liabilities (Egan et al. 2003). However, these benefits are often limited by legal restrictions in many jurisdictions. Similarly, in the case of this acquisition, restrictions would apply to MSFT: In the United States, Section 382 of the Internal Revenue Code imposes restrictions on NOL usage, limiting the annual amount that can be applied to offset future taxable income when there is a significant change in ownership (King 2024).

Asset deal

In an asset deal, MSFT would selectively acquire specific assets from ATVI – such as intellectual property, game franchises, technologies, or infrastructure – rather than taking over the entire company. Under U.S. law, such transactions require each asset to be individually identified and transferred in compliance with specific legal requirements, which vary depending on the asset type (Glazer 2011). According to Engelhardt (2017), this approach allows MSFT to ‘cherry-pick’ assets that align with its strategic goals, such as acquiring ATVI's subsidiary King or the Call of Duty intellectual property to strengthen its position in the mobile and console gaming segment.

From an accounting perspective, one of the main advantages of asset deals is the direct effect on MSFT's balance sheet. Under US GAAP, which is the applicable accounting standard for

MSFT, the acquired assets are recorded at fair market value (EY 2020). This process enables the recognition of hidden reserves – assets that were previously undervalued or unrecorded in the ATVI’s financial statements – providing a more accurate representation of these financial positions after the acquisition (Dreher, Ernst 2021).

These accounting outcomes also have significant tax implications. By acquiring assets at their market value, MSFT increases their tax basis to reflect the purchase price. This ‘stepped up’ basis allows for higher tax depreciation and amortization, thereby creating a tax shield: Over time, the increased basis results in greater depreciation deductions, which will lower MSFT’s future taxable income (Egan et al. 2003).

When it comes to risk implications, the structure of an asset deal offers MSFT substantial protection by enabling the selective acquisition of specific assets while avoiding ATVI’s unknown or contingent tax liabilities. This strategy effectively minimizes exposure to legacy risks and mitigates financial and tax-related vulnerabilities (Wiehl 2022).

However, a key challenge of MSFT acquiring ATVI through an asset deal lies in the significant procedural and legal complexity involved. Each asset must be carefully identified, documented, and transferred in compliance with legal requirements. This process is especially complex because MSFT’s main interest lies in ATVI’s intangible assets, such as intellectual property and proprietary know-how. For example, transferring intellectual property under U.S. federal law requires written agreements, patents must be registered with the USPTO, and copyright transfers require signed documents (Glazer 2011; Wiehl 2022).

Moreover, the process of identifying and assigning transaction costs to individual assets adds another layer of complexity. This requires individual valuations and specific accounting treatments for each asset, leading to substantial administrative and professional fees. Consequently, this complexity is likely to result in higher transaction costs and time effort for MSFT (Paul et al. 2020).

Additionally, contracts like licensing agreements and partnerships require counterparty consent. Due to confidentiality, this consent is often unattainable before signing, potentially leaving essential agreements with ATVI. While employment relationships would transfer automatically by law, employees have the right to object, creating additional uncertainty (Wiehl 2022).

TN III Exhibit 1 shows an overview of the implications of each acquisition method.

Question 1b: Recommendation of acquisition method

An asset deal would allow MSFT to selectively acquire specific assets, excluding unwanted liabilities and benefiting from a stepped-up tax basis. However, for a transaction of this size, this approach is highly complex because each asset would need to be individually transferred, requiring consents and individual fair market valuations. This would significantly increase costs and lead to delays.

In contrast, a share deal simplifies the process by transferring ownership of the entire company, including all assets and liabilities, as a single legal entity. While this method carries higher risk due to the automatic assumption of liabilities, these risks can be mitigated through comprehensive due diligence. Additionally, a share deal enables MSFT to inherit valuable tax attributes, such as net operating losses, which can provide substantial financial advantages.

Considering the scale and complexity of the acquisition, a share deal is recommended as the more efficient and effective option. It avoids the procedural hurdles and costs associated with an asset deal and ensures access to all critical assets. Therefore, the upcoming analyses will assume that MSFT would acquire all shares of ATVI at a price of \$72.69 billion.

Question 2a: Factors influencing the payment method

MSFT has two options in compensating ATVI: cash, which involves an immediate transfer of funds, or stock, where shares of the combined entity are offered as payment (Sankar, Leepsa 2018).

Cash payment

Cash is the most commonly used payment method in mergers and acquisitions because it offers simplicity and provides clear valuation transparency (Sankar, Leepsa 2018). The preference for cash payments in acquisitions is shaped by several key factors, including the desire to avoid ownership dilution, which can arise from issuing new shares in stock payments, as well as considerations of available cash reserves and leverage levels, which influence the feasibility of a cash transaction.

The implications of a cash payment for the ATVI acquisition are closely tied to MSFT's financial position. Companies with substantial cash reserves or strong free cash flow are better positioned for such transactions (Jensen 1986). At the close of the 2021 fiscal year, MSFT reported \$130.33 billion in cash, cash equivalents, and short-term investments, with an operating cash flow of \$76.74 billion, underscoring its ability to finance the acquisition without significant financial pressure (**Case Exhibit 2**). MSFT's liquidity ratios further support its financial resilience. The current ratio of 2.08 shows that MSFT holds more than twice the assets required to meet its short-term obligations. For a more conservative measure, the quick ratio, which excludes inventories, stands at 2.05 (**TN III Exhibit 3**).

With a \$72.69 billion acquisition paid in cash, MSFT's liquidity ratios would be significantly impacted: Post-acquisition, the current ratio would decrease from 2.08 to approximately 1.26, and the quick ratio would similarly adjust from 2.05 to around 1.23. According to Breuer et al. (2012), a healthy liquidity position is indicated by ratios above 1. As both adjusted ratios remain above the threshold, MSFT's liquidity would stay robust even when paying for ATVI in cash.

A key advantage of using cash payments in MSFT's case is the ability to prevent shareholder ownership dilution, a common concern in stock-based transactions where issuing new shares

diminishes the influence and control of existing shareholders (De Bodt et al. 2022). Whether dilution occurs depends on whether MSFT reissues treasury shares or issues entirely new shares (Paton 1969). Issuing new shares would directly dilute the ownership and control of existing investors, a drawback that could be avoided with a cash payment. In contrast, using treasury shares would not lead to dilution, as no additional shares would need to be issued.

Another factor in favor of cash payment is that, according to Andrade et al. (2001), cash-financed takeovers consistently outperform equity-financed ones in the long term. While share-based transactions often result in negative returns, opting for cash would statistically position MSFT to achieve significantly better abnormal returns over time (**TN III Exhibit 8**).

Additionally, cash payments are often preferred when the acquirer is confident about realizing expected synergies, as they allow the firm's shareholders to retain all potential gains (Rappaport, Sirower 1999). As discussed in TN II, MSFT is optimistic about realizing both cost and revenue synergies, with a total net present value (NPV) of \$8.21 billion. Paying in cash would allow MSFT to capture all projected synergies without sharing them with ATVI's shareholders.

In general, highly leveraged firms may avoid cash payments to minimize financial strain and the need for further borrowing, as explained by Hansen's signaling model (1987). To assess the extent of MSFT's leverage, its debt to assets is examined. The formula is defined by Vatansever & Hepsen (2013):

$$\text{Debt to Asset Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

Based on this definition, MSFT's leverage ratio is approximately 57.5% (**TN III Exhibit 4**). Compared to the global technology industry's average debt-to-assets ratio of 26% in 2020 (Statista 2023), MSFT's leverage is significantly higher. While prior analysis indicates that MSFT has sufficient liquidity to fund a cash payment without borrowing, its elevated debt level

raises concerns, making debt-financed cash payments less attractive. It follows that the choice of payment method and its implications depend largely on how the deal is financed.

Stock payment

Stock payment represents another method for MSFT to pay for the ATVI acquisition. This approach would involve MSFT issuing shares to ATVI as compensation, with both parties sharing the outcomes of the transaction (Sankar, Leepsa 2018). MSFT could execute the payment either by issuing new shares, which would increase the total number of outstanding shares, or by utilizing previously repurchased treasury shares (Paton 1969).

One option for MSFT is to utilize its treasury shares, which have accumulated significantly in recent years through extensive share buyback programs (La Monica 2022). For instance, in 2021, MSFT repurchased 101 million shares at a cost of \$22.97 billion, using its substantial cash reserves for buybacks to enhance shareholder value by reducing the number of outstanding shares and increasing earnings per share (La Monica 2022). While reissuing these treasury shares to finance the ATVI acquisition is theoretically possible, such an approach would counteract the purpose of the buybacks.

Conclusively, if MSFT intends to finance the acquisition with stock while preserving the benefits of its share buyback programs, the more viable option would be the issuance of new shares, making the determination of a fair exchange ratio essential (Sankar, Leepsa 2018). MSFT may opt for the issuance of new shares for various reasons, such as preserving cash for strategic priorities like R&D, market expansion, or investments, leveraging high stock valuations, or managing risks from information asymmetry.

One implication of using stock payment for MSFT is that they allow the company to preserve its cash reserves, ensuring liquidity remains unaffected. This enables MSFT to allocate funds toward other critical initiatives, such as R&D or capital-intensive projects (Sankar, Leepsa

2021). In its annual report of 2021, MSFT highlighted its intention to significantly increase investments in R&D, particularly in artificial intelligence and cloud technologies, over the coming years (**Case Exhibit 12**). By leveraging stock payments, MSFT can strategically direct its cash resources to support these growth initiatives.

An advantage of issuing new shares to pay for an acquisition, particularly for companies with overvalued stock or those anticipating strong growth, is the ability to capitalize on inflated stock prices (Myers, Majluf 1984; Swan 2018). MSFT's annual report confirms the company anticipates significant growth in the coming years, but the potential for overvaluation must still be assessed. Kopcke (1997) suggests that a common method for identifying overvaluation is comparing the current Price-to-Earnings (P/E) ratio to industry benchmarks. A notably higher P/E ratio, particularly without corresponding earnings growth, may signal overvaluation.

To assess whether MSFT could benefit from using stock payments due to overvaluation, its P/E ratio as of December 31, 2021, was compared to the technology sector benchmark to evaluate potential overvaluation. The NASDAQ-100, used as a benchmark due to its composition of 56% technology companies, had an average P/E ratio of 24.25 between 2006 and 2021 (Lin 2021; Tretina 2023). On December 31, 2021, MSFT's stock closed at \$336.32, with a diluted EPS of \$8.05, resulting in a P/E ratio of 41.78 - nearly twice the industry average (Yahoo Finance 2021). This suggests MSFT's elevated stock valuation and strong growth prospects could be leveraged by using stock as currency for the ATVI acquisition.

Furthermore, information asymmetry reinforces the case for using stock payments in this context. Hansen (1987) argues that bidders favor stock financing when there is high information asymmetry, particularly when the buyer's stock may be overvalued. By paying with stock, MSFT would share the risk of its overvaluation with ATVI's shareholders, who would retain partial ownership in the combined entity (Sankar, Leepsa 2021).

An overview of factors influencing payment method can be found in **TN III Exhibit 2**.

Question 2b: Recommendation of payment method

Based on the analysis of the two primary payment options, a clear recommendation emerges for MSFT: cash payment is the most suitable choice. It enables MSFT to utilize its substantial cash reserves without significantly impacting liquidity ratios and avoids shareholder dilution, ensuring existing investors retain full ownership. Additionally, research shows that cash payments are more likely to generate positive long-term abnormal returns. However, the benefits of a cash payment are closely linked to the chosen financing method for the acquisition (as discussed further in Question 3a).

While a stock payment could capitalize on MSFT's high valuation, preserve its cash reserves, and share the risk of overvaluation with ATVI's shareholders, it would also mean splitting the benefits of synergy realization – an outcome MSFT is likely unwilling to accept.

Question 3a: Implications of internal versus external financing

To proceed with an offer of \$72.96 billion for ATVI, MSFT must first ensure it has the necessary financing in place to support this significant commitment. The four primary options for financing an acquisition are internal funds, debt, equity, or a combination of debt and equity (Merkoulova, Zivanovic 2022).

In corporate takeovers, a key distinction exists between financing a transaction entirely through internally generated funds and relying on external financing methods. Internal funds involve utilizing a company's cash reserves or treasury stock, while external financing requires raising capital through debt issuance or equity issuance, thereby involving third parties in the transaction (Martynova, Renneboog 2009).

To assess the most suitable financing method for MSFT, the capital structure irrelevance theorem by Modigliani & Miller (1963) serves as a theoretical foundation. The theorem states that in a perfect market, a firm's capital structure does not influence its value. However, in

practice, factors like taxation, bankruptcy costs, and information asymmetry influence the feasibility of financing options and must be considered when selecting the financing strategy.

External financing

External financing can take the form of issuing equity or taking on debt. Focusing first on debt, the decision to utilize debt financing primarily depends on the associated tax advantages, the risk of financial distress, and MSFT's ability to take on additional leverage (**TN III Exhibit 7**).

According to Modigliani & Miller (1963), additional debt offers a significant advantage through tax shields, as interest payments are tax-deductible, effectively lowering the overall cost of capital. This makes debt financing particularly appealing for a highly profitable firm like MSFT, which generates substantial taxable income.

However, it is important to note that excessive reliance on debt could increase the risk of financial distress and bankruptcy (Modigliani, Miller 1963). Given MSFT's relatively high debt to assets ratio of 57.5%, further leveraging could heighten this risk and offset the tax benefits of additional debt.

Martynova & Renneboog (2009) emphasize that debt capacity is another key factor when determining whether the acquisition should be financed through debt. Turnbull (1979) defines debt capacity as the 'maximum amount of credit that lenders are willing to extend to a firm'. According to Woodruff (2007), the most important factor determining a firm's debt capacity is the proportion of Property, Plant, and Equipment (PPE) to Total Assets, as these tangible assets can serve as collateral, thereby increasing the firm's ability to secure additional credit.

Applying this to MSFT, as of December 31, 2021, the company reported a PPE to Total Assets ratio of 17.9%, with PPE of \$59.72 billion and Total Assets of \$333.78 billion (**Case Exhibit 2**). Compared to its main competitors – Apple (11.2%), Alphabet (27.2%), and Amazon (35.2%)

– MSFT’s ratio is moderate, placing it around the average (**TN III Exhibit 5**). This suggests that MSFT has a sufficient level of PPE to support adequate debt capacity.

When considering the issuance of new equity as a source of external financing, the dilution of existing shareholders presents a significant drawback for MSFT. Moreover, the impact of information asymmetry and its signaling effects on external stakeholders is critical: Similar to the evaluation of the payment method, information asymmetry plays a central role in financing decisions by shaping how external investors interpret a firm’s funding choices, which could lead to misperceptions about its true valuation (Martynova, Renneboog 2009). According to Myers & Majluf’s (1984) Pecking Order Theory (**TN III Exhibit 6**), issuing equity is typically the least preferred option in financing, as it often signals to the market that the company’s shares may be overvalued. Based on the analysis in Question 2a, there is a risk that MSFT could be perceived as overvalued, and financing through new equity would further reinforce this signal.

Internal financing

Internal financing refers to using either the company’s own liquid assets or payment through treasury shares. However, using repurchased shares, which were recently acquired through extensive buyback programs aimed at increasing earnings per share, would not be appropriate, as reselling these shares would undermine the initial purpose of the buybacks. Therefore, MSFT could leverage its substantial cash reserves, which are more than adequate to finance the \$72.69 billion acquisition. This approach aligns with Myers & Majluf’s (1984) theory, which suggests that internal funds are the preferred option for financing investment opportunities.

Fishman (1989) points out that using internal cash reserves allows for a faster and more efficient transaction process. This is particularly relevant for MSFT at the end of 2021, as the Federal Trade Commission began reviewing antitrust guidelines, signaling heightened scrutiny of large acquisitions (Duffy 2022). With growing concerns over market concentration in the tech sector, MSFT is likely driven to secure the deal quickly before new regulations delay the process.

Moreover, financing through internal cash reserves eliminates the need for external parties, avoiding the complexities and costs associated with issuing new equity or debt. Myers & Majluf (1984) highlight that financing with internal funds would result in lower transaction costs compared to external financing methods for MSFT.

An overview of financing method implications can be found in **TN III Exhibit 7**.

Question 3b: Recommendation of financing method

In line with the Pecking Order Theory, internal financing through MSFT's substantial cash reserves emerges as the most efficient option for funding the acquisition of ATVI. It enables swift execution, which is critical given the deal's urgency amid potential regulatory changes.

In contrast, external financing presents notable drawbacks. Issuing new equity would preserve cash reserves but risk negative market signaling and shareholder dilution. While debt financing offers tax advantages through interest deductibility, it adds time and complexity by requiring lender negotiations. Although MSFT has the capacity for additional debt, increased leverage would unnecessarily raise bankruptcy risk, an avoidable concern given its strong internal funds.

What actually happened

On October 13, 2023, Microsoft completed its acquisition of Activision Blizzard for a total purchase price of \$75.4 billion. The deal, originally announced on January 18, 2022, valued Activision Blizzard at \$68.7 billion and was structured as an all-cash share deal, with Microsoft purchasing all outstanding shares at \$95 per share. The acquisition was entirely financed through Microsoft's internal cash reserves, providing a structured payout to Activision Blizzard shareholders, and ensuring a clear and decisive transaction while allowing Microsoft to retain full control of post-acquisition synergies (Roush 2023).

3 Disclosure Statement

During the preparation of this work project, I used Chat GPT 4.0 to improve readability and language of the work project. After using this tool, I reviewed and edited the content as needed and take full responsibility for the content.

Lisbon, 17th of December 2024.

Susanna Engl

4 Appendix I: Case Exhibits (group part)

Case Exhibit 1: MSFT Profit and Loss Statement MSFT 2017-2021

Microsoft Corporation Profit & Loss Statement	2017	2018	2019	2020	2021
<i>in mUSD</i>					
Revenue	96,571	110,360	125,843	143,015	168,088
Gross Margin	62,310	72,007	82,933	96,937	115,865
<i>in % of Revenue</i>	64.52%	65.25%	65.90%	67.78%	68.93%
Operating Expenses	32,979	36,949	39,974	43,978	45,940
Research & Development	13,037	14,726	16,876	19,269	20,716
<i>in % of Revenue</i>	13%	13%	13%	13%	12%
Sales & Marketing	15,461	17,469	18,213	19,598	20,117
<i>in % of Revenue</i>	16%	16%	14%	14%	12%
General & Administrative	4,481	4,754	4,885	5,111	5,107
<i>in % of Revenue</i>	5%	4%	4%	4%	3%
Operating Income	29,331	35,058	42,959	52,959	69,925
<i>in % of Revenue</i>	30%	32%	34%	37%	42%

Source: Microsoft Corporation Annual Report 2021, Microsoft Corporation Annual Report 2019, Microsoft Corporation Annual Report 2017.

Case Exhibit 2: Balance Sheet MSFT 2017-2021

Microsoft Corporation Balance Sheet <i>in mUSD</i>	2017	2018	2019	2020	2021
Assets					
Current assets:					
Cash and cash equivalents	7,663	11,946	11,356	13,576	14,224
Short-term investments	125,318	121,822	122,463	122,951	116,110
Total cash	132,981	133,768	133,819	136,527	130,334
Accounts receivables	22,431	26,481	29,524	32,011	38,043
Inventories	2,181	2,662	2,063	1,895	2,636
Other current assets	5,103	6,751	10,146	11,482	13,393
Total current assets	162,696	169,662	175,552	181,915	184,406
Property and equipment	23,734	29,460	36,477	44,151	59,715
Operating lease right-of-use-assets	6,555	6,686	7,379	8,753	11,088
Equity investments	6,023	1,862	2,649	2,965	5,984
Goodwill	35,122	35,683	42,026	43,351	49,711
Intangible assets, net	10,106	8,053	7,750	7,038	7,800
Other long-term assets	6,076	7,442	14,723	13,138	15,075
Total assets	250,312	258,848	286,556	301,311	333,779
Liabilities					
Current liabilities:					
Accounts payable	7,390	8,617	9,382	12,530	15,163
Short-term debt	9,072				
Current portion of long-term debt	1,049	3,998	5,516	3,749	8,072
Accrued compensation	5,819	6,103	6,830	7,874	10,057
Short-term income taxes	718	2,121	5,665	2,130	2,174
Short-term unearned revenues	24,013	28,905	32,676	36,000	41,525
Other current liabilities	7,684	8,744	9,351	10,027	11,666
Total current liabilities	55,745	58,488	69,420	72,310	88,657
Long-term debt	76,073	72,242	66,662	59,578	50,074
Long-term income taxes	13,485	30,265	29,612	29,432	27,190
Long-term unearned revenue	2,643	3,815	4,530	3,180	2,616
Deferred income taxes	5,734	541	233	204	198
Operating lease liabilities	5,372	5,568	6,188	7,671	9,629
Other long-term liabilities	3,549	5,211	7,581	10,632	13,427
Total liabilities	162,601	176,130	184,226	183,007	191,791
Commitments and contingencies					
Stockholders' equity					
Common stock and paid-in capital	69,315	71,223	78,520	80,552	83,111
Retained earnings	17,769	13,682	24,150	34,566	57,055
Accumulated other comprehensive income	627	-2,187	-340	3,186	1,822
Total stockholders' equity	87,711	82,718	102,330	118,304	141,988
Total liabilities and stockholders' equity	250,312	258,848	286,556	301,311	333,779

Source: Microsoft Corporation Annual Report 2021, Microsoft Corporation Annual Report 2019, Microsoft Corporation Annual Report 2017.

Case Exhibit 3: MSFT Gaming Profit and Loss Statement MSFT 2019-2021

Microsoft Gaming Profit & Loss Statement	2019	2020	2021
<i>in mUSD</i>			
Revenue	11,386	11,575	15,370
Hardware	2,814	1,575	3,070
Content & Services	8,572	10,000	12,300
First & Third-Party Titles	7,373	7,483	9,303
Game Pass Subscriptions	1,199	2,517	2,997
Gross Margin	7,504	7,846	10,595
<i>in % of Revenue</i>	<i>66%</i>	<i>68%</i>	<i>69%</i>
Operating Expenses	3,617	3,559	4,201
Research & Development	1,527	1,560	1,894
<i>in % of Revenue</i>	<i>13%</i>	<i>13%</i>	<i>12%</i>
Sales & Marketing	1,648	1,586	1,840
<i>in % of Revenue</i>	<i>14%</i>	<i>14%</i>	<i>12%</i>
General & Administrative	442	414	467
<i>in % of Revenue</i>	<i>4%</i>	<i>4%</i>	<i>3%</i>
Operating Income	3,887	4,286	6,394
<i>in % of Revenue</i>	<i>34%</i>	<i>37%</i>	<i>42%</i>

Source: Own figure, based on Microsoft Corporation Annual Report 2021, Microsoft Corporation Annual Report 2019, Cryer 2021.

Case Exhibit 4: MSFT active user base 2019-2021

Microsoft Gaming active customers	2019	2020	2021
<i>in m#</i>			
Estimated active users p.a.	57	65	100
<i>Based on company information (Q2 2023) and Statista Market Insights</i>			

Source: Microsoft Corporation 2023.

Case Exhibit 5: ATVI revenue split by distribution platform 2019-2021

Activision Blizzard revenue by distribution platform	2019	2020	2021
<i>in mUSD</i>			
Total revenue	6,489	8,086	8,803
Console	1,920	2,784	2,637
<i>in %</i>	<i>30%</i>	<i>34%</i>	<i>30%</i>
PC	1,718	2,056	2,323
<i>in %</i>	<i>26%</i>	<i>25%</i>	<i>26%</i>
Mobile	2,203	2,559	3,182
<i>in %</i>	<i>34%</i>	<i>32%</i>	<i>36%</i>
Other*	648	687	661
<i>in %</i>	<i>10%</i>	<i>8%</i>	<i>8%</i>

**Net revenues from "Other" primarily includes revenues from our Distribution business, the Overwatch League, and the Call of Duty League*

Source: Activision Blizzard 2021, Activision Blizzard 2019.

Case Exhibit 6: ATVI game catalog value 2021

Activision Blizzard game catalogue value 2021 in USD		2021
Premium titles		
Call of Duty: Black Ops Cold War	\$	60
Call of Duty: Modern Warfare	\$	60
Crash Banicoot 4: It's about Time	\$	60
Crash Banicoot N: Sane Trilogy	\$	40
Tony Hawk's Pro Skater 1 + 2	\$	30
Sekiro: Shadows Die Twice	\$	60
Spyro Reignited Trilogy	\$	30
Diablo III	\$	30
World of Warcraft	\$	30
World of Warcraft Shadowlands	\$	30
Subscription-based games		
World of Warcraft	\$	180
Free-to play		
Call of Duty: Warzone	-	
Hearthstone	-	
Candy Crush Saga	-	
Legacy titles		
Diablo II	\$	20
Total	\$	630

Source: Own figure, based on Activision Blizzard information depicting the current game catalog, prices in USD as of 2021. In-game prices and game extensions and or DLCs are excluded.

Case Exhibit 7: ATVI Balance Sheet 2017-2021

Activision Blizzard Balance Sheet	2017	2018	2019	2020	2021
<i>in mUSD</i>					
Assets					
Current assets:					
Cash and cash equivalents	4,713	4,225	5,794	8,647	10,423
Accounty receivables	918	1,035	848	1,052	972
Inventories, net	46	43			
Software development	367	264	322	352	449
Other current assets	476	539	328	514	712
Total current assets	6,520	6,106	7,292	10,565	12,556
Software development	86	65	54	160	211
Property and equipment, net	294	282	253	209	169
Deferred income taxes, net	459	403	1,293	1,318	1,377
other assets	440	482	658	641	497
Intangible assets	1,106	735	531	451	447
Goodwill	9,763	9,762	9,764	9,765	9,799
Total assets	18,668	17,835	19,845	23,109	25,056
Liabilities					
Current liabilities:					
Account paybale	323	253	292	295	285
Deferred revenues	1,929	1,493	1,375	1,689	1,118
Accrued expenses and other liabilities	1,411	896	1,248	1,116	1,008
Total current liabilities	3,663	2,642	2,915	3,100	2,411
Long-term debt, net	4,390	2,671	2,675	3,605	3,608
Deferred income taxes, net	21	18	505	418	506
Other liabilities	1,132	1,147	945	949	932
Total liabilities	9,206	6,478	7,040	8,072	7,457
Additional paid-in capital	10,747	10,963	11,174	11,531	11,715
Less: Treasury stock	5,563	5,563	5,563	5,563	5,563
Retained earnings	4,916	6,558	7,813	9,691	12,025
Acumulated other comprehensive loss	-638	-601	-619	-622	-578
Total shareholder's equity	9,462	11,357	12,805	15,037	17,599
Total liabilities and shareholder's equity	18,668	17,835	19,845	23,109	25,056

Source: Activision Blizzard Annual Report 2021, Activision Blizzard Annual Report 2019, Activision Blizzard Annual Report 2017.

Case Exhibit 8: Market growth

Market growth rates	2019	2020	2021	2022	2023	2024	2025	2026
<i>in mUSD</i>								
Console games	25,600	28,600	28,300	29,200	30,000	30,600	31,100	31,500
in %		-11.7%	1.0%	-3.2%	-2.7%	-2.0%	-1.6%	-1.3%
PC games	28,900	31,300	33,700	35,200	36,900	38,600	40,400	42,200
in %		-8.3%	-7.7%	-4.5%	-4.8%	-4.6%	-4.7%	-4.5%
Mobile games	68,000	77,000	93,000	92,000	90,000	98,000	105,000	112,000
in %		-13.2%	-20.8%	1.1%	2.2%	-8.9%	-7.1%	-6.7%

Source: World Economic Forum 2022, Knezovic 2024.

Case Exhibit 9: ATVI Profit and Loss Statement 2017-2021

Activision Blizzard Profit & Loss Statement	2017	2018	2019	2020	2021
<i>in mUSD</i>					
Revenue	7,017	7,500	6,489	8,086	8,803
Product Sales	2,110	2,255	1,975	2,350	2,311
In-game subscriptions, other revenues	4,907	5,245	4,514	5,736	6,492
COGS	2,501	2,517	2,094	2,260	2,317
Product Sales	1,033	1,090	896	974	995
In game, subscriptions	1,468	1,427	1,198	1,286	1,322
Gross Profit	4,516	4,983	4,395	5,826	6,486
SG&A	3,077	2,857	2,664	2,975	3,122
Product development	1,069	1,101	998	1,150	1,337
Sales & Marketing	1,378	1,062	926	1,064	1,025
General & Administrative	630	684	608	667	683
Restructuring Cost		10	132	94	77
EBITDA	1,439	2,126	1,731	2,851	3,364
Depreciation	130	138	124	117	105
EBIT	1,309	1,988	1,607	2,734	3,259
Interest & other expenses (Income) net	146	71	-26	87	95
Loss on extinguishment	12	40		31	
Income before income tax expense	1,151	1,877	1,633	2,616	3,164
Income tax expense	878	29	130	419	465
Net income	273	1,848	1,503	2,197	2,699

Source: Activision Blizzard Annual Report 2021, Activision Blizzard Annual Report 2019, Activision Blizzard Annual Report 2017.

Case Exhibit 10: ATVI Debt Obligations 2022-2026

Commitments and Obligations

In the normal course of business, we enter into contractual arrangements with third parties for non-cancelable operating lease agreements for our offices, for the development of products which may include obtaining rights to intellectual property, and for hosting services to support our games and our administrative functions. Under these agreements, we commit to provide specified payments to a lessor, developer, or hosting provider, as the case may be, based upon contractual arrangements. The payments to third-party developers are generally conditioned upon the achievement by the developers of contractually specified development milestones. Further, these payments to third-party developers typically are deemed to be advances and, as such, are recoupable against future royalties earned by the developer based on sales of the related game. Additionally, we also enter into arrangements in which we commit to spend specified amounts for marketing to support and promote our content and services. Assuming all contractual provisions are met, the total future minimum commitments for these and other contractual arrangements in place at December 31, 2021, are scheduled to be paid as follows (amounts in millions):

Contractual obligations	Facility & Equipment	Developer & Hosting	Marketing	Long-term debt obligations	Total
<i>in mUSD</i>					
For the years ending December 31,					
2022	86	149	167	105	507
2023	81	104	115	105	405
2024	64	12	-	105	181
2025	43	-	-	105	148
2026	21	-	-	955	976
Thereafter	15	-	-	4,102	4,117
Total	310	265	282	5,477	6,334

- (1) We have omitted uncertain income tax liabilities from this table due to the inherent uncertainty regarding the timing of the potential issue resolution of the underlying matters. Specifically, either (a) the underlying positions have not been fully developed under audit to quantify at this time or (b) the years relating to the matters for certain jurisdictions are not currently under audit. At December 31, 2021, we had \$483 million of net unrecognized tax benefits included in “Other liabilities,” in our consolidated balance sheet.

Additionally, at December 31, 2021, we have a remaining net Transition Tax liability of \$142 million associated with the U.S. Tax Reform Act. The remaining Transition Tax liability is payable over the next five years and is not reflected in our Contractual Obligations table above.

Source: Activision Blizzard Annual Report 2021

Case Exhibit 11: Biggest M&A Transactions in the Gaming Industry

Year	Acquirer	Target	Deal Value (bn USD)	EV/EBITDA Multiple
2021	Byte Dance	Moonton	4.0	n/a
2021	Embracer Group	Asmodee	3.1	n/a
2021	Electronic Arts	Glu Mobile	2.1	82.28x
2021	Embracer Group	SpinX games	2.2	n/a
2021	Tencent	Playdemic	1.4	n/a
2020	Microsoft	Gearbox Software	1.3	n/a
2020	Electronic Arts	Codemasters	1.2	n/a
2020	Microsoft	ZeniMax	7.5	n/a
2020	Flutter Entertainment	FanDuel	4.2	n/a
2016	Tencent	Supercell	8.6	58.22x
2015	Activision Blizzard	KING	5.9	6.21x
2014	Microsoft	Mojang Studios	2.5	n/a
2014	Meta (former: Facebook)	Oculus VR	2.0	n/a

Source: Orbis 2024, Statista 2024.

Case Exhibit 12: MSFT R&D Initiatives 2021

RESEARCH AND DEVELOPMENT

Product and Service Development, and Intellectual Property

We develop most of our products and services internally through the following engineering groups.

- *Cloud and AI*, focuses on making IT professionals, developers, and their systems more productive and efficient through development of cloud infrastructure, server, database, CRM, ERP, management and development tools, AI cognitive services, and other business process applications and services for enterprises.
- *Experiences and Devices*, focuses on instilling a unifying product ethos across our end-user experiences and devices, including Office, Windows, Enterprise Mobility + Security, and Surface.
- *AI and Research*, focuses on our AI innovations and other forward-looking research and development efforts spanning infrastructure, services, applications, and search.
- *LinkedIn*, focuses on our services that transform the way customers hire, market, sell, and learn.
- *Gaming*, focuses on developing hardware, content, and services across a large range of platforms to help grow our user base through game experiences and social interaction.

Internal development allows us to maintain competitive advantages that come from product differentiation and closer technical control over our products and services. It also gives us the freedom to decide which modifications and enhancements are most important and when they should be implemented. We strive to obtain information as early as possible about changing usage patterns and hardware advances that may affect software and hardware design. Before releasing new software platforms, and as we make significant modifications to existing platforms, we provide application vendors with a range of resources and guidelines for development, training, and testing. Generally, we also create product documentation internally.

We protect our intellectual property investments in a variety of ways. We work actively in the U.S. and internationally to ensure the enforcement of copyright, trademark, trade secret, and other protections that apply to our software and hardware products, services, business plans, and branding. We are a leader among technology companies in pursuing patents and currently have a portfolio of over 65,000 U.S. and international patents issued and over 21,000 pending worldwide. While we employ much of our internally-developed intellectual property exclusively in our products and services, we also engage in outbound licensing of specific patented technologies that are incorporated into licensees' products. From time to time, we enter into broader cross-license agreements with other technology companies covering entire groups of patents. We may also purchase or license technology that we incorporate into our products and services. At times, we make select intellectual property broadly available at no or low cost to achieve a strategic objective, such as promoting industry standards, advancing interoperability, supporting societal and/or environmental efforts, or attracting and enabling our external development community. Our increasing engagement with open source software will also cause us to license our intellectual property rights broadly in certain situations.

While it may be necessary in the future to seek or renew licenses relating to various aspects of our products, services, and business methods, we believe, based upon past experience and industry practice, such licenses generally can be obtained on commercially reasonable terms. We believe our continuing research and product development are not materially dependent on any single license or other agreement with a third party relating to the development of our products.

Source: Microsoft Corporation Annual Report 2021.

Case Exhibit 13: Activision Blizzard unsecured senior notes

Unsecured Senior Notes	Interest Rate	Semi-Annual Interest		At December 31, 2021	
		Payments Due on	Maturity	Principal (\$m)	Fair Value (\$m)
2026	3.40%	Mar. 15 & Sep. 15	Sep. 2026	850	912
2027	3.40%	Jun. 15 & Dec. 15	Jun. 2027	400	430
2030	1.35%	Mar. 15 & Sep. 15	Sep. 2030	500	463
2047	4.50%	Jun. 15 & Dec. 15	Jun. 2047	400	480
2050	2.50%	Mar. 15 & Sep. 15	Sep. 2050	1,500	1,320

Source: Activision Blizzard Annual Report 2021.

Case Exhibit 14: Overview of main players in the gaming industry

in mUSD	Revenue		EBITDA		EBIT	
Company	2021	2020	2021	2020	2021	2020
Electronic Arts Inc.	6,991	5,629	1,615	1,227	1,129	1,046
Ubisoft Entertainment	2,359	2,607	1,032	1,118	276	346
Sony Group Corporation	81,593	81,289	16,647	14,967	9,823	8,468
Nintendo Co., Ltd.	13,851	15,889	4,929	5,885	4,869	5,808
NetEase, Inc.	13,752	11,273	2,745	2,408	2,577	2,225
Take-Two Interactive Software Inc	3,505	3,373	802	862	474	629
CD Project S.A.	223	571	95	384	59	308
BANDAI NAMCO HOLDINGS INC.	7,265	6,693	1,254	1,009	1,003	620
Tencent Holdings Limited	108,044	78,712	47,292	31,073	36,883	22,599
Keywords Studios plc	604	478	98	81	57	49
Nexon Co., Ltd.	2,407	2,843	900	1,253	800	1,077
Roblox Corporation	1,919	924	-419	-221	-495	-266
Unity Software Inc.	1,111	772	-461	-228	-532	-275

in mUSD	Net Profit		Enterprise Value		Net Debt	
Company	2021	2020	2021	2020	2021	2020
Electronic Arts Inc.	789	837	34,393	34,446	-1,184	-4,490
Ubisoft Entertainment	88	121	6,238	9,666	686	267
Sony Group Corporation	7,207	9,301	137,627	133,389	6,471	1,302
Nintendo Co., Ltd.	3,903	4,339	51,455	57,778	-13,978	-15,740
NetEase, Inc.	2,646	1,846	57,261	53,992	-12,524	-11,785
Take-Two Interactive Software Inc	418	589	15,192	17,620	-2,552	-2,732
CD Project S.A.	51	306	4,621	7,184	-166	-173
BANDAI NAMCO HOLDINGS INC.	758	442	14,742	14,166	-2,111	-1,663
Tencent Holdings Limited	35,292	24,461	571,514	702,489	8,932	4,734
Keywords Studios plc	39	26	2,938	2,752	-77	-91
Nexon Co., Ltd.	1,006	543	14,176	24,665	-3,319	-2,541
Roblox Corporation	-492	-253	51,239	n.a.	-2,017	-894
Unity Software Inc.	-533	-282	40,863	39,804	-34	-1,752

Source: Orbis 2024.

Case Exhibit 15: Overview of main players in the gaming industry

Microsoft Gaming Xbox Game Pass	2019	2020	2021
Subscribers (in Mio)	10	21	25
Average Price (USA) p.a.	119.88	119.88	119.88

Source: Cryer 2021, Maas 2024, Microsoft Corporation 2023 Note: The Standard Game Pass is depicted, as MSFT does not provide detailed subscriber data for each Game Pass tier.

5 Appendix IV: TN III Exhibits (Susanna Engl)

TN III Exhibit 1: Implications of acquisition methods

Purchasing method	Positive implications	Negative implications
Asset purchase	Mitigation of tax and financial vulnerabilities and reduction of legacy risks (Wiehl, 2022)	Added procedural and legal complexity (Wiehl, 2022)
	“Cherry-picking strategy”: Exclusion of unwanted assets and liabilities (Engelhardt, 2017)	Higher overall transaction costs (Paul, Ohl, Rhine, and Blacker, 2020)
	Valuation of acquired assets at fair market value (“stepped-up basis”), allowing for higher depreciation (Rugg, 2020)	Counterparty consent required for several contracts such as licensing agreements and partnerships (Wiehl, 2022)
	Inheritance of tax attributes such as net operating losses and unused tax credits (Egan et al., 2003)	Higher risk exposure due to inheritance of all existing risks and liabilities, both known and unknown (Dreher & Ernst, 2021; Engelhardt, 2017)
Stock purchase	- Target’s retention as a legal entity (Wirtz, 2012) - Reduced complexity and faster transaction process (Dreher & Ernst, 2021)	Comprehensive due diligence required to investigate all financial hidden or contingent liabilities (Wiehl, 2022)

Source: Own illustration.

TN III Exhibit 2: Implications of payment methods

Payment method	Positive implications	Negative implications
Cash Payment	Prevention of shareholder dilution (de Bodt et al., 2022)	Significant reduction of financial resources and negative impact on liquidity ratios (Jensen, 1986; Sankar & Leepsa, 2018)
	Positive signaling about acquirer’s confidence towards the realization of synergies (Rappaport & Sirower, 1999)	Increased risk for financial strain and further need for borrowing (Hansen, 1987)
Stock Payment	Preservation of cash for other strategic initiatives such as R&D (Sankar & Leepsa, 2021)	Negative signaling of potential overvaluation to external stakeholders (Hansen, 1987; Myers & Majluf, 1984)
	Opportunity to capitalize on inflated stock prices (Myers & Majluf, 1984; Swan, 2021)	Dilution of existing shareholders (de Bodt et al. 2022)

Source: Own illustration.

TN III Exhibit 3: Liquidity ratios MSFT as of 31.12.2021

Microsoft Liquidity ratios - Pre Acquisition

in mUSD

Current Ratio as of 31.12.2021

Total current assets	184,406
Total current liabilities	88,657
Current Ratio	2.08

Quick Ratio as of 31.12.2021

Total current assets	184,406
(-) Inventories	2,636
Adjusted current assets	181,770
Total current liabilities	88,657
Quick Ratio	2.05

Microsoft Liquidity ratios - Post Acquisition

in mUSD

Current Ratio as of 31.12.2021

Total current assets	111,715
Total current liabilities	88,657
Current Ratio	1.26

Quick Ratio as of 31.12.2021

Total current assets	111,715
(-) Inventories	2,636
Adjusted current assets	109,079
Total current liabilities	88,657
Quick Ratio	1.23

Source: own calculation, based on MSFT Annual Report 2021

TN III Exhibit 4: Debt to assets ratio MSFT as of 31.12.2021

Microsoft Debt to assets ratio	
<i>in mUSD</i>	
Debt as of 31.12.2021	
Current liabilities	88,657
Long-term liabilities	103,134
Debt	191,791
Total assets as of 31.12.2021	
Current assets	184,406
Long-term assets	149,373
Total assets	333,779
Debt to assets ratio	57.46%

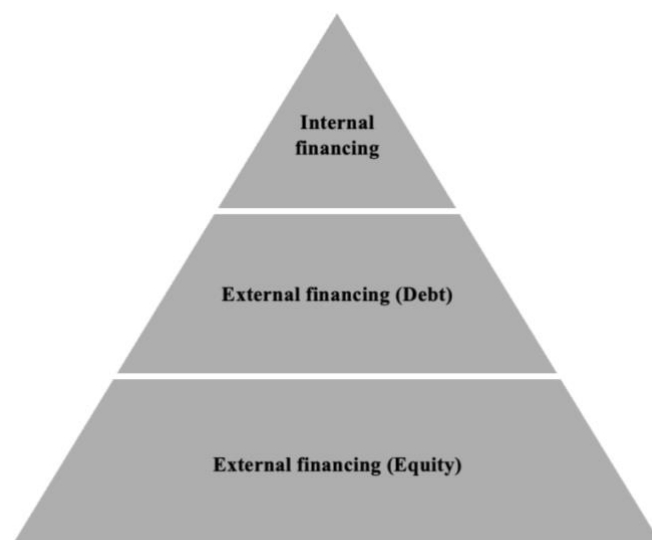
Source: own calculation, based on MSFT Annual Report 2021

TN III Exhibit 5: PPE to Total Assets MSFT as of 31.12.2021

PPE to Total Assets Analysis	
<i>in mUSD</i>	
Microsoft PPE to Total Assets as of 31.12.2021	
Property and equipment	59,715
Total assets	333,779
PPE to total assets	17.89%
Apple Inc. PPE to Total Assets as of 31.12.2021	
Property and equipment	37,815
Total assets	337,158
PPE to total assets	11.22%
Amazon.com PPE to Total Assets as of 31.12.2021	
Property and equipment	113,114
Total assets	321,195
PPE to total assets	35.22%
Alphabet Inc. PPE to Total Assets as of 31.12.2021	
Property and equipment	97,599
Total assets	359,268
PPE to total assets	27.17%

Source: MSFT Annual Report 2021; Apple Inc. Annual Report 2021; Amazon.com Inc. Annual Report 2021; Alphabet Inc. Annual Report 2021

TN III Exhibit 6: Pecking Order Theory



Source: Myers & Majluf 1984

TN III Exhibit 7: Implications of financing methods

Financing method		Positive implications	Negative implications
Internal financing	Cash	Reduced complexity, time requirements and costs to complete the deal (Fishman, 1989; Myers & Majluf, 1984)	Depletion of cash reserves and negative impact on liquidity ratios (Jensen, 1986; Sankar & Leepsa, 2018)
	Treasury stock	Advantages of stock payment without the risk of ownership dilution (Paton, 1969)	Reversal of the effect of share buyback programs (La Monica, 2022)
External financing	Debt	Tax advantages due to tax deductibility of interest payments (Modigliani & Miller, 1963)	Increased risk of financial distress and bankruptcy (Modigliani & Miller, 1963)
	Stock	Risk sharing of overvaluation (Sankar & Leepsa, 2021)	Negative signaling to external stakeholders about potential overvaluation (Myers & Majluf, 1984)

Source: Own illustration

TN III Exhibit 8: Abnormal returns of payment methods

Three-Year Post-Merger Abnormal Returns for Acquiring Firms, 1961 to 1993

<i>Portfolio Composition</i>	<i>Equal-Weight</i>	<i>Value-Weight</i>
Full Sample	-5.0% ^a	-1.4%
Financed with Stock	-9.0% ^a	-4.3%
Financed without Stock	-1.4%	3.6%
Growth Firms	-6.5%	-7.2%
Value Firms	-2.9%	1.1%

Source: Mitchell & Stafford 2000

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