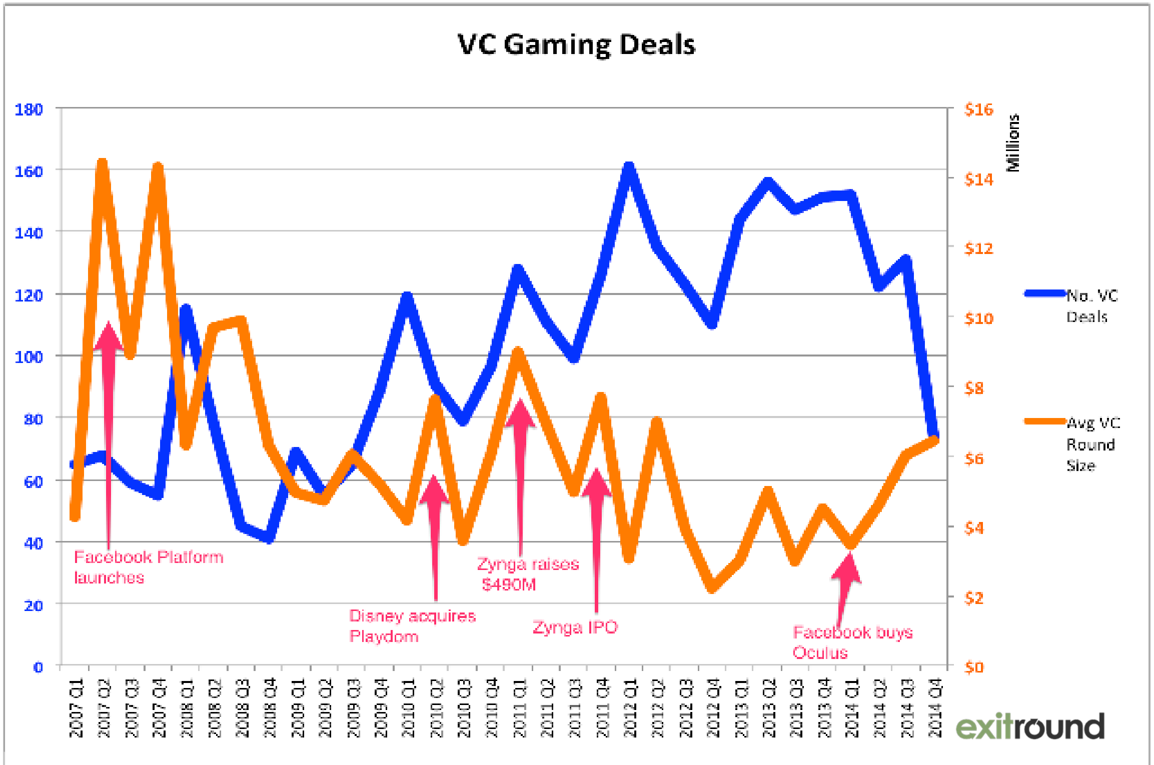
exitround

M&A and VC Trends in the Gaming Market

By Tomio Geron, Exitround



Introduction

Like many other sectors in and around technology, the gaming industry has in recent years seen some massive hits as well as the vast majority of companies that are building and looking for an eventual successful exit.

On the one hand, distribution is getting more expensive and consumers are demanding higher quality games that are more costly to produce. Yet on the other hand, there are more sources of capital, from Kickstarter to AngelList. But are gaming companies actually able to raise institutional venture capital and generate exits?

Exitround examined trends in the gaming industry to see where the market is moving and what trends are driving the market.

Notable Deals

May 2007: Facebook launches 3rd party Platform

Nov 2009: EA acquires Playfish for $400M

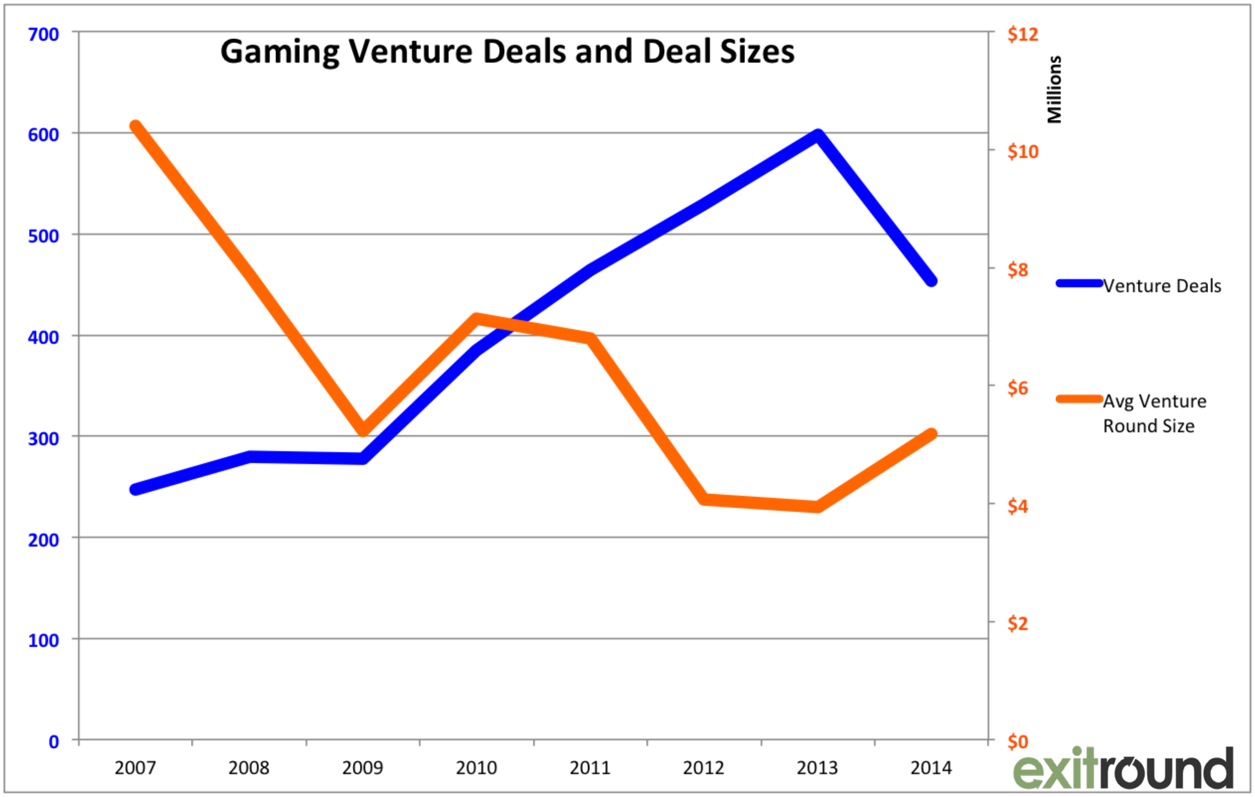
July 2010: Disney acquires Playdom for $763M

Dec 2011: Zynga IPO

March 2012: Zynga buys OMGPOP

July 2012: Sony buys Gaikai for $380M

March 2014: Facebook buys Oculus



VC Funding

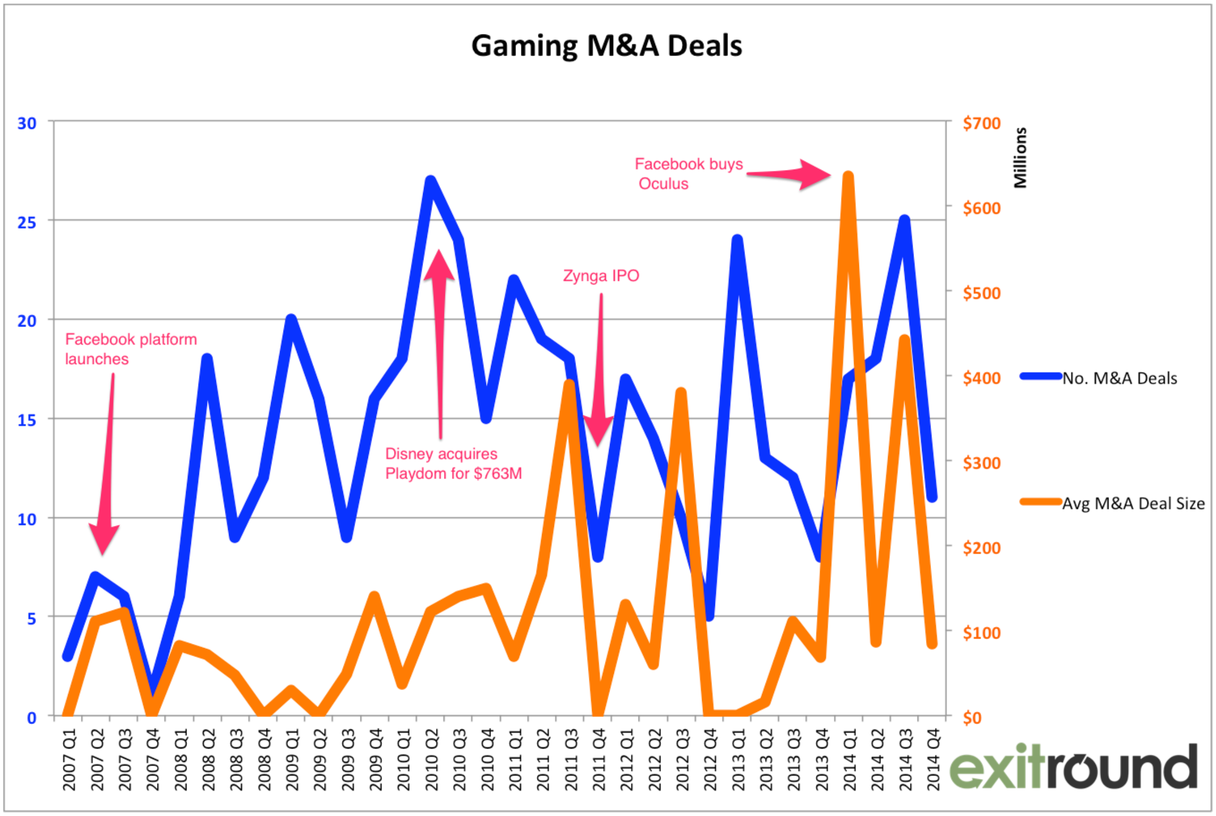
Driven by large trends affecting the industry such as social, mobile, cloud and virtual reality, institutional venture capital funding has flowed into the gaming industry. However, VC funding for gaming companies has dipped in recent years. Data shows that, particularly by dollars invested, venture capital investment has dropped. Average VC round sizes have dropped roughly in half from more than $10 million in 2007 to close to $5 million in 2014.

Total venture dollars invested however, dipped less - between 2007 and 2014 - it dropped 16.2% from $2.22 billion to $1.86 billion. This suggests venture investors are still investing in gaming but are opting for smaller, earlier stage rounds. Perhaps investing in later stage momentum deals such as Zynga and others has scared off investors from investing in growth or late stage gaming deals, given the challenges facing gaming companies seeking an IPO today. Instead, investors are looking to get in early with gaming companies, which provides better returns for M&A deals in case IPOs don't materialize.

M&A Trends

Meanwhile, M&A has a slightly different story - which can be seen in different time periods. From 2007 to 2010 the number of gaming M&A deals spiked. This was driven by factors such as the growth of Facebook games, cheaper distribution, lower development costs and the emergence of mobile games. However, as described below, the industry was stung by saturation in certain sectors and the performance of some companies - and the number of deals then dropped from 2011 to 2012. Deal flow then picked up again somewhat in 2013 and 2014.

Meanwhile median disclosed M&A deal prices generally stayed in the $50 million to $100 million range over this



time period. (Many deal prices that are lower are not reported publicly. This drives up deal prices listed here. Exitround estimates that actual average and median M&A deal prices - if one includes all deals that were not announced publicly - are about 50% of these public numbers. For more on this see Exitround's 2014 Exit Report.)

Platforms: Social, Mobile, Virtual

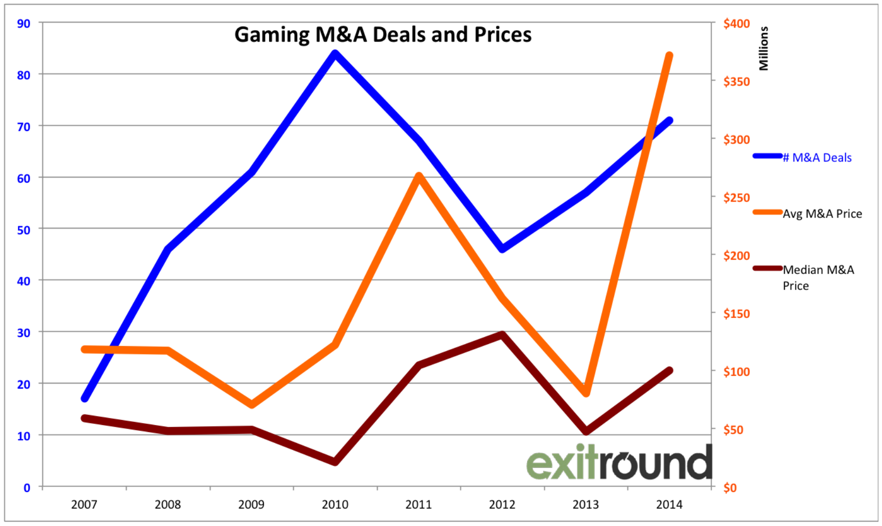
Both VC funding and M&A deals have come in particular waves for the gaming industry. These waves correspond to major platform trends affecting the industry.

For example, in 2007, one can see spikes in average VC round size as investors looked to capitalize on the emergence of social gaming, particularly on the Facebook platform, which launched in May 2007. At the same time, the average gaming VC round size jumped in Q2 and Q4 of 2007 and the number of gaming deals spiked in Q1 2008. Meanwhile, to show a cycle in the industry, you can see the acquisitions of companies in the social gaming space peak a couple of years later in 2009 to 2010. In particular, EA's acquisition of Playfish and Disney's acquisition of Playdom for $763 million were two high points. As a result, on the M&A chart, gaming M&A deals peaked in Q2 2010 with 27.

Meanwhile in Q3 2011, as part of a push into digital, EA acquired PopCap Games for $750 million in deal that could be worth up to $1.3 billion. That drove a spike in average M&A deal size in Q3 2011 to close to $400 million. PopCap was both a social and mobile target for EA. But PopCap can be seen as part of a broader trend of large companies buying mobile gaming companies.

The rush towards mobile gaming resulted in a number of other acquisitions. In March 2012, Zynga acquired OMG-

POP, maker of Draw Something, for about $200 million. The deal ended up being a miss for Zynga, with the company writing off $95 million related to the deal in October 2012 and later shutting it down in June 2013.



A third wave, in virtual reality, is a nother example of large incumbents seeking to jump on the next major platform. In March 2014 Facebook agreed to acquire Oculus for $2 billion. The move may not be strictly categorized as a gaming deal. Still, it is an example of a large company seeking to move into a new platform before that sector takes off. We can see that on the chart in Q1 2014 with a spike in average deal price to more than $600 million.

Public Markets

In addition to these waves of new platforms affecting the gaming industry, the public markets also have a major impact. Zynga's IPO in December 2011 marked a milestone for social gaming companies. But its immediate fall in the public markets had an effect on other social gaming companies. The cold reception Wall Street gave to Zynga meant that other gaming companies could not so easily expect a massive IPO—and that Zynga's multiples were too generous - particularly its pre-IPO valuations. Wall Street was wary of companies with one major hit, without easily repeatable franchises. And Zynga's path to mobile games didn't appear clear.

After Zynga's IPO, in 2012 and 2013, average VC round size dropped substantially, perhaps as investors looked for earlier stage deals. Meanwhile, M&A deal sizes also dropped, with the exception of Sony's acquisition of cloud gaming company Gaikai for $380 million--part of a broader move toward cloud gaming. This drop in deal size also could be seen as buyers looking for more reasonable valuations after Zynga's IPO.

In March 2014, King priced its IPO at $22.50 per share and ended its first day of trading at $19, despite an opening market capitalization of $7 billion — which was cheaper, on a price to sales basis, than Giant Interactive and Zynga. It was lately trading at about $16. Perhaps spooked by Zynga, investors are not yet convinced that King can churn out new hits.

Conclusion

Overall, venture capitalists and corporate acquirers have grown more cautious about gaming companies. While there have still been some major gaming exits for investors, investors are wary of "hit-driven" companies because of the difficulty of replicating hit games. As a result, gaming companies that have shown innovation in technology or in business model have drawn interest. Corporate buyers often have similar concerns, though they are more concerned with filling specific holes in their company. Still, as the data shows, whenever a new platform emerges, there are breakout hits and exits which keep entrepreneurs, investors and corporate buyers active.

Exitround is the private, anonymous marketplace for buyers and sellers of technology companies from the small to mid-market. Using its proprietary software algorithms, Exitround provides greater efficiency and intelligence enabling buyers and sellers to reach far beyond the traditional boundaries of sector, geography and personal networks. Exitround's broad user base spans from the SMB to the Global 2000, including corporate and private equity partners looking for financial transactions.

For more information:
www.exitround.com
415-735-1941
support@exitround.com
@exitround