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Insights

M&A, VIDEO GAMES AND THE NEXT BIG THING

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SUMMARY

M&A in video gaming is not slowing down any time soon because investors are finally starting to recognise that gaming is a gateway into other sectors, the obvious beneficiaries being fintech, infrastructure, big data, and real estate

When I heard in April that Sony had its sights on FromSoftware, the developers of the *Souls* franchise and this year's hugely lauded *Elden Ring*, the first thing I did was dust off the PlayStation and embark on my fifth run-through of *Dark Souls*. Since then, I have defeated Gwyn, the Lord of Cinder, and a PlayStation executive has gone on record to deny the speculation.

Unsurprisingly, that denial has done nothing to quench the M&A rumours on Reddit wish lists and social media boards. Self-anointed insiders point fervently to the recent announcement from Sony that it had more studio acquisitions planned in 2022. Obviously, Sony's plans to buy the Bungie game studio for US$3.6 billion, first announced in January and one of the many marquee gaming deals this year, has also given credence to those rumours.

Increasing deal volume and quality

The backdrop, of course, is that the first quarter of 2022 saw nearly US$100 billion in reported M&A activity in the games industry. Much of that deal volume can be attributed to Microsoft's US$68.7 billion deal for Activision Blizzard and Take-Two Interactive's US$12.7 billion deal for Zynga. There has also been a spate of smaller, but equally notable, transactions in the mobile gaming space. One of the standout stories this year was the acquisition by the New York Times of Wordle, a puzzle game with no revenue streams but which had access to a sizeable group of word-loving customers i.e., potential readers with whom the New York Times could associate. Even after accounting for the mega-deals, M&A in gaming is expected to continue trending upwards. Some commentators predict that deal volume will exceed US$150 billion this year.

That prediction does not include deals in the wider, trillion-dollar technology and telecommunications space. This year, for example, we have seen M&A transactions involving online

gambling and casinos, data centres, cryptocurrency-mining technology, process optimisation and process mining, cloud management, and chatbot developers. Many of these deals have implications for gaming and the continued growth of the industry. When Nvidia announced its acquisitions of Bright Computing and Excelero, both of which specialise in high-performance computing, the expectations from the gaming community was that there would be positive knock-on effects on Nvidia's gaming presence, including on its line of handheld consoles and its cloud gaming service.

Further consolidation expected

The drivers for continued consolidation in gaming are clear. In an industry where talent attrition is the norm, it makes business sense for both conglomerates and growing developers and software providers to shun in-house, organic growth and opt instead for acquisitions and buying instant capability and market access.

More importantly, the gaming industry has traditionally been an incubator for innovation and concept-development and, therefore, represents an entire ecosystem with countless potential business and market spin-offs. Virtual reality, now a mainstay and necessary corollary of the metaverse, started life as clunky headsets in labs and only gained commercial acceptance after years of being hothoused and refined in gaming studios. Virtual land in the metaverse, sales of which topped US$85 million in January this year, had its beginnings in gaming simulations and only began to find traction with the advent of in-game purchases, cryptocurrency and the often-misunderstood non-fungible token, or NFT.

Investors are starting to recognise that gaming is a gateway into other sectors, the obvious beneficiaries being fintech, infrastructure, big data, and real estate. It is precisely for this reason that gaming companies are becoming attractive targets. Investors and dealmakers are circling not only because such companies may have developed blockbuster gaming franchises or next-generation hardware, but because their users and their reputations within the gaming community represent a share of markets that have yet to fully materialise. These are significant transactions, not just in terms of deal value but in terms of how transformational they can be as investors look for the next big thing.

Investing in the metaverse

The metaverse, together with the connected Internet of Things, has been endorsed for some time as that next big thing. And in some ways, it is literally THE market. When Facebook rebranded to Meta, it was thought there would be some concerted push towards creating the infrastructure that would make an alternate world or digital economy a real possibility. When GameStop announced its own online marketplace for NFTs, it was recognition that the digital ecosystem could be a real revenue alternative for legacy bricks-and-mortar businesses.

Clearly, there is some way to go before we get there. Happily, the building blocks in the metaverse architecture are also the fundamentals that make video game companies attractive M&A targets. Increasingly, we see deals being rationalised, and boards and investment committees being asked to sanction them, on the open secrets in the industry: (1) the move to subscription-based revenue over volatile income streams dependent on one-time purchases, (2) live-service games where DLCs, or new content, is added from time to time, (3) revenue longevity through the issue of sequels and prequels, remasters, and re-releases, (4) market diversification as gamers seeking portability and mobility look to supplement hardware with software, backed by the cloud, and (5) increasing cross-sector proliferation as gaming makes inroads into other markets (e.g., the introduction of games on TV streaming platforms like Netflix).

And, to borrow Tolkien, the one ring that will bind them all is cryptocurrency, for so long heralded as the universal solution that will support and underpin transactions in the metaverse. While by no means universally accepted, cryptocurrency is starting to benefit from an industry-wide push to address volatility and security vulnerabilities in a meaningful and coordinated way. It has also been some comfort to investors that regulators, including the Financial Conduct Authority in the UK, have begun exploring ways to manage and regulate trading in cryptocurrencies.

What next?

For so long as these fundamentals remain, M&A in gaming will continue. Independent houses and entrepreneurs will continue to look for partners and investors, while conglomerates and cash-rich investors will continue seeking out opportunities to consolidate across sectors and products. What will be interesting to watch is whether the platform for such M&A moves into the metaverse.

It is already possible to buy a virtual home next to your favourite celebrity, so that, for example, you could conceivably live next to Paris Hilton or Snoop Dogg, both of whom have created virtual abodes in the metaverse where they, by all accounts, host remarkably well-attended parties. In a fully-functioning metaverse where money is perfectly fungible and where different goods and services are portable across platforms and worlds, one might posit that it is entirely possible to establish, operate and grow a company or business and then subsequently sell that company or business. That is, in short, M&A.

Kurt was quoted by Agenda, a division of the Financial Times, in July 2022 and this article was published in International Investment in August 2022.

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