



FIFA (Electronic Arts)



Grand Theft Auto (Take-Two Interactive)

## NIBC Final Round Case Brief

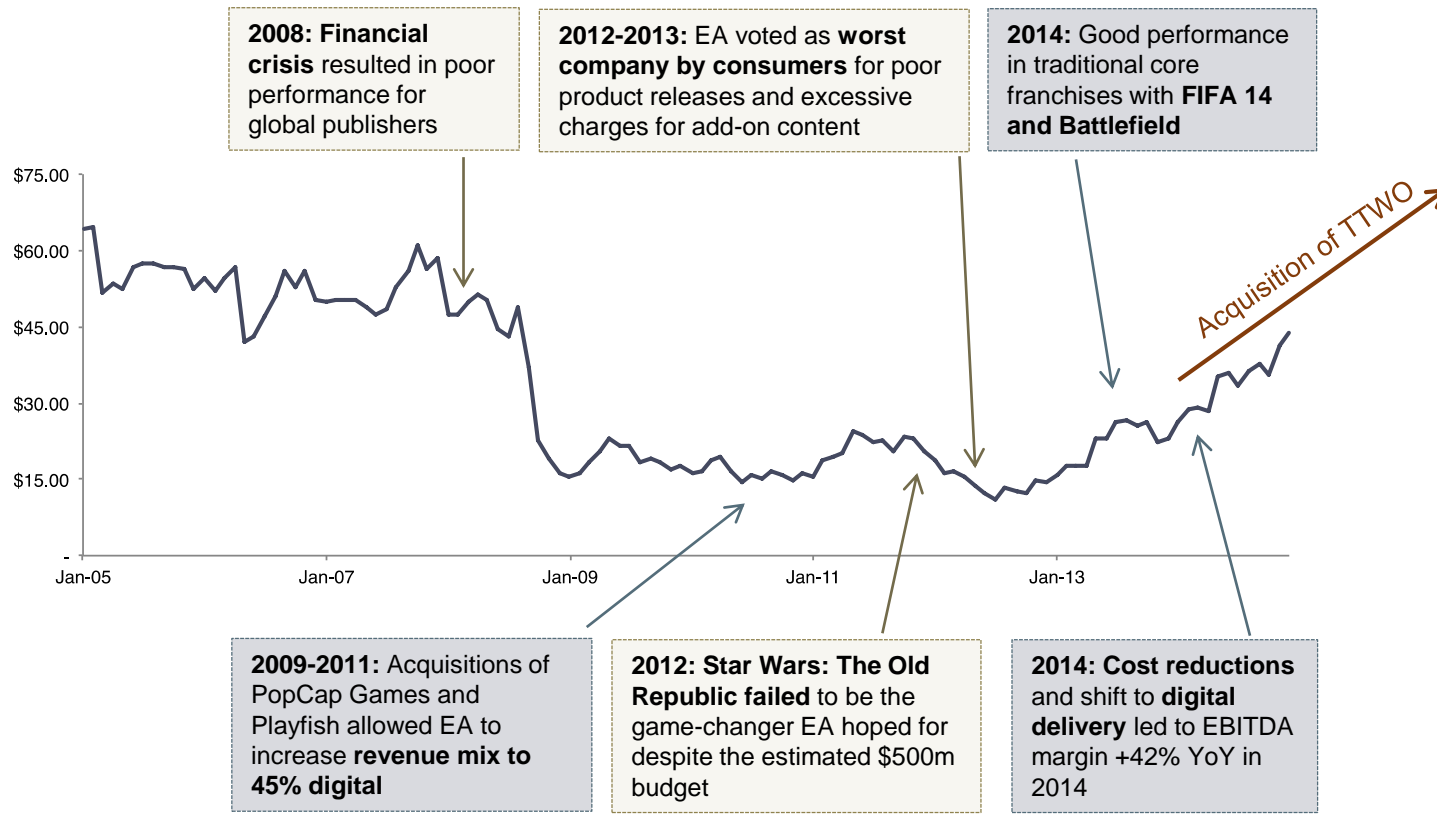
### Acquisition of Take-Two by Electronic Arts

Transaction Rationale	Valuation & Financial Analysis	Commercial Issues
<p><b>Electronic Arts (EA)</b></p> <ul style="list-style-type: none"> <li><b>AAA Titles:</b> Provide required enhancement to core console business by acquiring most successful role play franchise GTA</li> <li><b>Synergies:</b> Generate synergies through shared overhead and lower cost structure</li> <li><b>Competition:</b> Reclaim #1 market position from rivals Activision (#1) and Microsoft (#2)</li> <li><b>Asia:</b> Leverage TTWO's recent expansion into rapidly-growing Asia market</li> </ul> <p><b>Take Two (TTWO)</b></p> <ul style="list-style-type: none"> <li><b>Diversification:</b> Utilize integrated platform to smooth GTA revenues which formed 80% of cumulative EBITDA on 5-year cycles</li> <li><b>Digital / Mobile:</b> TTWO has low digital revenues and no exposure to mobile games</li> <li><b>Cost Structure:</b> TTWO has high cost structure and struggled with negative EBITDA</li> </ul> <p><b>Share Price &amp; Forecast</b></p> <ul style="list-style-type: none"> <li>EA (13.1x) and TTWO (12.3x) require strong growth to justify record EBITDA multiples</li> </ul>	<p><b>Valuation</b></p> <ul style="list-style-type: none"> <li><b>Comparison:</b> EA and TTWO have similar return profile with some common investors</li> <li><b>TTWO Valuation:</b> Record high but mostly due to GTA release in 2014 and relies on ability to smooth revenues and control costs</li> <li><b>EA Valuation:</b> High on back of growth in digital and mobile success but requires strong titles in key console genres</li> </ul> <p><b>Synergies</b></p> <ol style="list-style-type: none"> <li><b>Costs:</b> TTWO can significantly lower G&amp;A and distribution while marketing and R&amp;D are franchise-specific and COGS are outsourced</li> <li><b>Revenue:</b> Franchise-specific but could leverage digital, mobile and Asia platforms</li> <li><b>Culture:</b> Developer team culture is critical so corporate change will likely meet resistance</li> </ol> <p><b>Transaction Financing</b></p> <ul style="list-style-type: none"> <li><b>Stock:</b> EA has high debt capacity as well as share price which could be attractive to TTWO shareholders and limit capital structure impact</li> </ul>	<p><b>Stakeholder Concerns (Ranked)</b></p> <ol style="list-style-type: none"> <li><b>EA Shareholders:</b> Likely concerns around dilution, but have cross-ownership between Vanguard and BlackRock and can highlight valuation impact from improved strategic positioning in core console segment</li> <li><b>TTWO Shareholders:</b> May expect higher premium but shareholders bought in low and have been waiting for payout, or might be interested in combined entity</li> <li><b>TTWO Management:</b> Same team that rejected 2008 bid has significant influence on board, which extended contract until 2019</li> <li><b>TTWO Customers:</b> Fan base loyal to TTWO product quality so need to maintain brand and slowly integrate into EA platform</li> <li><b>Alternative Recommendation:</b> EA could acquire smaller targets at 7-8x EV/EBITDA in growing mobile/casual gaming space</li> <li><b>Competing Bids:</b> Activision just bought back shares from parent Vivendi and few acquirers except Microsoft focus on similar segment</li> </ol>

	Financing Assumptions		Synergy Run-Rate Assumptions		Key Results		2016	2017	2018	2019	2020
<b>Base</b>	% Stock Consideration	50.0%	Incremental Revenue	0.0%	<b>Accretion / (dilution)</b>	(5.9)%	(2.2)%	3.7%	4.5%	5.0%	
	Premium Paid	25.0%	Cost of Revenues / R&D	0.0%	<b>Debt / EBITDA</b>	1.6 x	1.0 x	0.9 x	0.8 x	0.8 x	
	Transaction Costs	3.0%	Marketing & Sales	1.0%	PF EBITDA w/o Synergies	1,384	1,508	1,628	1,738	1,869	
	PF Minimum Cash	2,000	General & Administrative	3.0%	EBITDA from Synergies	16	50	71	74	77	
					Incremental Interest	(91)	(93)	(93)	(92)	(90)	
<b>Optimistic</b>	<b>Financing Assumptions</b>		<b>Synergy Run-Rate Assumptions</b>		<b>Key Results</b>		<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
	% Stock Consideration	25.0%	Incremental Revenue	2.0%	<b>Accretion / (dilution)</b>	(2.3)%	5.1%	13.2%	14.5%	15.0%	
	Premium Paid	20.0%	Cost of Revenues / R&D	1.0%	<b>Debt / EBITDA</b>	2.1 x	0.9 x	0.8 x	0.7 x	0.7 x	
	Transaction Costs	3.0%	Marketing & Sales	2.0%	PF EBITDA w/o Synergies	1,384	1,508	1,628	1,738	1,869	
	PF Minimum Cash	2,000	General & Administrative	5.0%	EBITDA from Synergies	33	102	145	157	163	
				Incremental Interest	(133)	(136)	(135)	(134)	(131)		

# EA Strategic Objectives

While EA has overcome recent challenges and had a notably successful FY 2014, EA could unlock further potential with the addition of TTWO's AAA title franchises, strong gamer following and international market share



**Titles:** TTWO would provide EA with most successful open world role play franchise GTA and other valuable franchises

**Growth:** TTWO is a growth company and GTA franchise has untapped potential which would match EA's stock profile

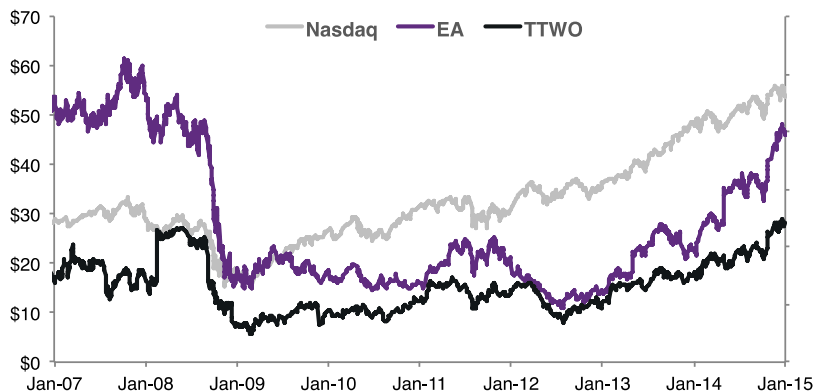
**Market Share:** Combined with TTWO, EA would reclaim its #1 position in console segment and overall games market

**Asia:** EA could take advantage of TTWO's relationships in Asia to expand outside of core North American market

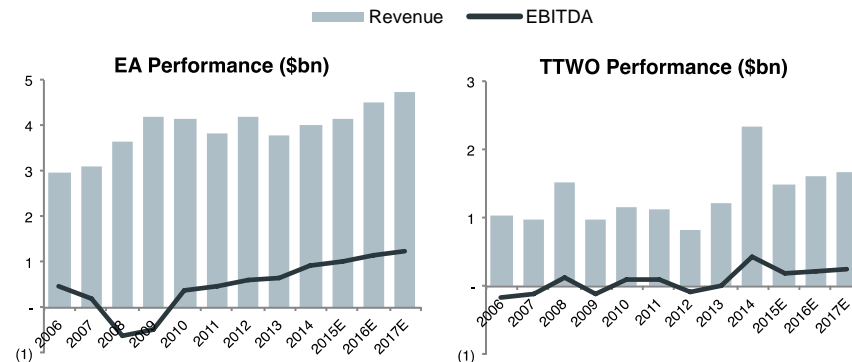
**Accretion:** 2018 accretion of 3.7% to 13.2% possible based on synergies from shared processes

Following lumpy cashflows and modest share price recovery after the financial crisis, EA and TTWO are now trading at 5-year highs but would benefit from strategic and operational synergies to support their valuations

EA & TTWO Stock Price Performance



EA & TTWO Operating Performance



## Acquirer Valuation (Electronic Arts)

- ✓ Improved margins from shift to **digital revenue mix** and **fewer titles**
- ✓ High industry growth in **mobile, social and casual gaming**
- ✓ Continued **cost-cutting initiatives**, which have proven successful
- ✗ **Inconsistent success of AAA titles** and **customer satisfaction**
- ✗ Competition from **consolidated competitors** with stronger titles
- ✗ EA's market leadership primarily in **console games segment**

**Acquisition of TTWO:** Maintaining **high multiple** of 13.1x (EV/EBITDA 2015E) relies on achieving an **ambitious forecast** and **strong growth in AAA franchises** which could be augmented by TTWO

## Target Valuation (Take-Two)

- ✓ Proven, **high-quality franchises** provide visibility and fanbase
- ✓ **GTA Online** with ongoing micro-transactions as **near-term driver**
- ✓ Expansion initiatives into vast and still untapped **Asian market**
- ✗ **Major reliance on GTA** with long-dated release cycles
- ✗ **Lacks consistent positive cashflows** despite strong franchises
- ✗ **Minimal exposure** to growing **mobile, social and casual gaming**

**Acquisition by EA:** Current **multiple looks rich** at 12.3x (EV/EBITDA 2015E) on back of **GTA V release in 2014** but integration with EA could enhance **risk pooling, cost savings** and **ongoing digital revenues**



EA shareholders are likely to questions might acquisition multiple while TTWO shareholders may find a 20-25% premium to be at the lower end for a strategic transaction, although most of them bought in at substantially less

	Expected Sentiment Towards Transaction	Potential Mitigants
TTWO Shareholders	<ul style="list-style-type: none"> <li>+ <b>Strong Valuation:</b> Second-largest shareholder Greenlight Capital (6% stake) and others took significant stake in 4Q 2013, when TTWO was trading in mid-teens and could realize large profits</li> <li>+ <b>Appetite for Merger:</b> TTWO stock has shown momentum since GTA V release in Fall 2014 but TTWO shareholders may be interested in combined EA / TTWO stock plus premium as both stocks have similar risk and growth profiles with EA perhaps having higher risk-adjusted returns</li> <li>+ <b>2008 Lawsuit:</b> Shareholder lawsuit was filed after 2008 rejection of EA's offer of \$26 per share and adoption of golden parachute for Chairman Strauss Zelnick and then-CEO Benjamin Feder</li> <li>- <b>Upside Expectations:</b> TTWO has performed well recently and both management and shareholders likely have strong expectations for significant further growth</li> </ul>	<ul style="list-style-type: none"> <li>Reasonable Premium</li> <li>Significant Stock Consideration</li> </ul>
TTWO Management	<ul style="list-style-type: none"> <li>+ <b>Exit:</b> ZelnickMedia took its stake 7 years ago and may be receptive to a good exit opportunity</li> <li>- <b>Management Contract:</b> Same team that rejected 2008 bid has golden parachute and significant influence on board, which extended contract until 2019</li> <li>- <b>CEO:</b> ZelnickMedia has become the driving force behind TTWO as capital investor and management vehicle, and CEO intends to stay on until at least 2019 as per a management agreement</li> <li>- <b>History:</b> The majority of management and board members who rejected EA's bid in 2008 as being low and opportunistic are still with TTWO and may feel reluctant to accept a similar offer</li> </ul>	<ul style="list-style-type: none"> <li>Vesting of Large Restricted Stock Plans</li> <li>Management Compensation Package</li> <li>Independent Business Unit</li> </ul>
TTWO Developers	<ul style="list-style-type: none"> <li>- <b>Culture:</b> A takeover would have a major impact to TTWO developers given that culture is very important to vide game developers</li> <li>- <b>Resistance:</b> Particular sources of resistance may stem from EA's poor reputation for quality development as well as their recent layoffs (significant layoffs at PopCap after it was acquired by EA)</li> </ul>	<ul style="list-style-type: none"> <li>Maintain Business Units and Brands</li> <li>Phase-in Cost-Cutting by Attrition</li> </ul>
EA Shareholders	<ul style="list-style-type: none"> <li>- <b>Dilution:</b> EA shareholders will be concerned about target valuation, short-term dilution and potentially only modest medium-term accretion</li> <li>- <b>Skepticism:</b> Shareholders may be skeptical about strategic and financial merits of transaction given valuation and large size compared to other potential acquisitions with mobile / social focus</li> </ul>	<ul style="list-style-type: none"> <li>Synergy Due Diligence</li> <li>High EA Share Price</li> <li>Strategic Benefit</li> <li>Valuation on Revenues</li> </ul>
EA Management	<ul style="list-style-type: none"> <li>+ <b>Transformational Transaction:</b> Likely to be supportive as acquisition would be transformational and usher in EA as #1 video gaming company in US by market share</li> </ul>	

# Base Case and Optimistic Case

Increased cost synergies in the optimistic case contribute to approximately 2/3 of increased accretion to 13.2% in 2018 versus 3.7% in the base case

<b>BASE CASE</b>	<p><b>Represents conservative set of assumptions under which this transaction could potentially be achieved</b></p> <ul style="list-style-type: none"> <li>While EA could achieve these assumption, they likely offer insufficient value to EA for the high valuation of TTWO</li> </ul>
<b>OPTIMISTIC CASE</b>	<p><b>Represents a more aggressive set of assumptions under which this transaction would be more likely to occur</b></p> <ul style="list-style-type: none"> <li><b>Premium Paid:</b> Modestly reduced from 25% to 20% to shift value to EA shareholders but expect TTWO shareholders to push back</li> <li><b>Consideration:</b> Reduced stock consideration from 50% to 25% but expect EA shareholders to be somewhat sensitive to excessive leverage to make deal accretive considering historical volatility of TTWO cashflows, although EA made 100% cash offer in 2008</li> <li><b>Synergies:</b> Applied full forecast for all revenue and cost synergies, which appear potentially plausible based on industry margins</li> </ul>

## Inputs and Outputs for Base Case and Optimistic Case

Key Results (2018)	Base	Optimistic
Revenue Synergies	-	35
Cost Synergies	71	137
<b>TTWO EBITDA</b>	<b>339</b>	<b>413</b>
<i>TTWO EBITDA Margin</i>	<i>19.2%</i>	<i>23.0%</i>
PF Diluted EPS	\$3.01	\$3.29
<b>PF Accretion / (Dilution)</b>	<b>3.7%</b>	<b>13.2%</b>

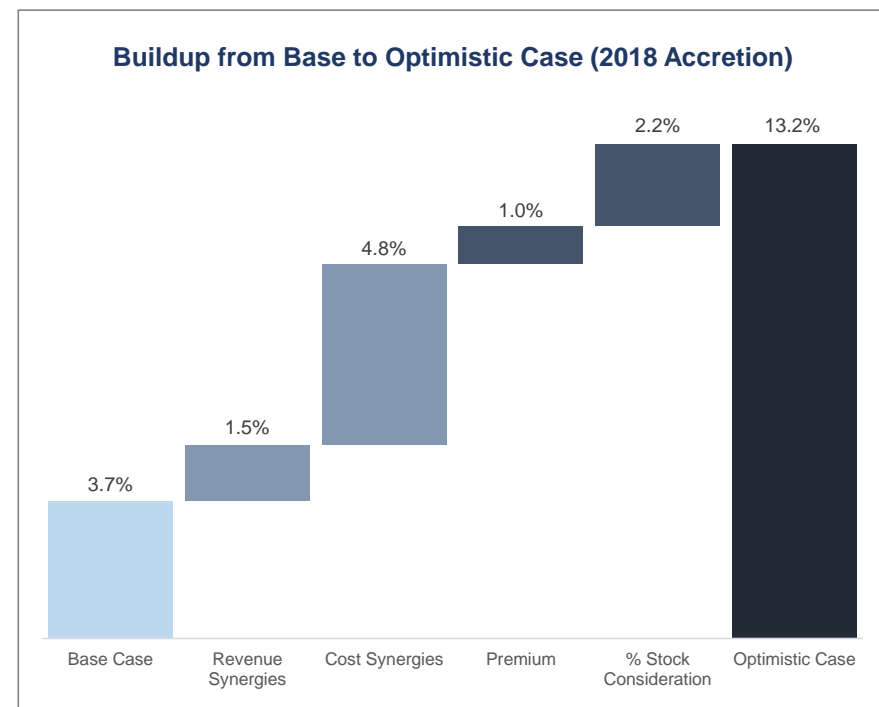
## Transaction Assumptions

Premium Paid	25.0%	20.0%
Stock Consideration	50.0%	25.0%

## Synergy Assumptions (Margin Δ)

Incremental Revenue	0.0%	2.0%
Cost of Revenues / R&D	0.0%	1.0%
Marketing & Sales	1.0%	2.0%
General & Administrative	3.0%	5.0%

## Valuation Build Up from Base Case to Optimistic Case



# Optimistic Case Pro-forma Cashflows

Optimistic Case is 13.2% accretive in 2018 with 20% premium over TTWO share price primarily due to significant synergy forecast and marginal improvement from increased leverage

Pro Forma Financial Summary					
(\$ millions)	Projected Fiscal Years Ending March 31				
	2016	2017	2018	2019	2020
EA Revenues	4,501	4,742	5,017	5,301	5,622
TTWO Revenues	1,599	1,679	1,763	1,851	1,925
Revenue Synergies	8	25	35	37	39
<b>Total Revenue</b>	<b>6,108</b>	<b>6,446</b>	<b>6,815</b>	<b>7,190</b>	<b>7,586</b>
Growth		5.5%	5.7%	5.5%	5.5%
EA EBITDA	1,157	1,261	1,360	1,447	1,557
TTWO EBITDA	227	247	268	291	312
Cost Synergies	32	97	137	148	154
<b>Total EBITDA</b>	<b>1,420</b>	<b>1,619</b>	<b>1,784</b>	<b>1,907</b>	<b>2,045</b>
Growth		14.0%	10.2%	6.9%	7.2%
Total Margin	23.3%	25.1%	26.2%	26.5%	27.0%
EA Margin	25.7%	26.6%	27.1%	27.3%	27.7%
TTWO Margin Post-Synergies	16.2%	20.5%	23.0%	23.7%	24.2%
Depreciation & Amortization	(224)	(210)	(204)	(202)	(204)
Interest Expense on Existing Debt	(27)	(9)	-	-	-
Interest Expense on Transaction Debt	(133)	(136)	(135)	(134)	(131)
One-time Integration Costs	(50)	(50)	-	-	-
<b>Earnings Before Taxes</b>	<b>987</b>	<b>1,214</b>	<b>1,445</b>	<b>1,571</b>	<b>1,709</b>
Taxes	(234)	(291)	(349)	(380)	(415)
<b>Net Income</b>	<b>753</b>	<b>923</b>	<b>1,097</b>	<b>1,191</b>	<b>1,295</b>
PF Diluted Shares Outstanding	333	333	333	333	333
<b>PF Diluted EPS</b>	<b>\$2.26</b>	<b>\$2.77</b>	<b>\$3.29</b>	<b>\$3.57</b>	<b>\$3.88</b>
Standalone Diluted Shares Outstanding	316	316	316	316	316
Standalone Diluted EPS	\$2.31	\$2.63	\$2.91	\$3.12	\$3.38
<b>Accretion / (Dilution)</b>	<b>(2.3)%</b>	<b>5.1%</b>	<b>13.2%</b>	<b>14.5%</b>	<b>15.0%</b>
<b>Debt / EBITDA</b>	<b>2.1 x</b>	<b>1.4 x</b>	<b>1.3 x</b>	<b>1.2 x</b>	<b>1.1 x</b>
<b>Alternative Financing: 100% Stock</b>					
<b>Accretion / (Dilution)</b>	<b>(4.4)%</b>	<b>0.9%</b>	<b>6.9%</b>	<b>7.3%</b>	<b>6.9%</b>
<b>Debt / EBITDA</b>	<b>0.4 x</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Alternative Financing: 100% Cash / Debt</b>					
<b>Accretion / (Dilution)</b>	<b>(1.6)%</b>	<b>6.7%</b>	<b>15.6%</b>	<b>17.3%</b>	<b>18.1%</b>
<b>Debt / EBITDA</b>	<b>2.7 x</b>	<b>1.9 x</b>	<b>1.7 x</b>	<b>1.6 x</b>	<b>1.4 x</b>

Key Assumptions		
Transaction Assumptions		Comments
% of TTWO Purchased	100.0%	- EA has ample financial capacity
% Stock Consideration	25.0%	- Historically have very low leverage
Premium Paid	20.0%	- Shareholders not desperate to sell
Transaction Costs	3.0%	- Combination of financing and advisory fees
PF Minimum Cash	2,000	- Volatile and capital-intensive business
PF Debt / 2015 EBITDA	1.9 x	
Transaction close	31-Mar-15	
Synergy Assumptions		
Run-rate Synergies		
Incremental Revenue	2.0%	- EA & TTWO forecasts already aggressive
Cost of Revenues / R&D	1.0%	- Cultural barriers and aggressive forecast
Marketing & Sales	2.0%	- Usually very title or franchise-specific
General & Administrative	5.0%	- Likely to share reasonable overhead
2016 Ramp	25.0%	- 2-year transition and integration period
2017 Ramp	75.0%	

**OPTIMISTIC CASE**

- **Significant upside if broader synergies** can be realized, which depends on ability to **integrate culture** and **leverage mobile and digital platform**
- EA could consider **leveraging balance sheet** further to reclaim strategic **market leadership in core console segment**
- TTWO shareholders may view **holding EA-TTWO stock plus 20% premium** preferable to holding TTWO stock so prefer stock

# Take-Two Grand Theft Auto Franchise

Grand Theft Auto is TTWO's largest and most successful franchise, therefore leaving the company highly dependent on the lifecycle of the game



## Description

- Open world, action-adventure video game developed by **Rockstar North** and published by **Rockstar Games**
- Gameplay focuses on an open world where the **player can choose missions to progress an overall story**, as well as engaging in **side activities**, all consisting of **action-adventure, driving, third-person shooting**
- Revenues generated for **GTA IV and V within 24 hours** of release were **\$310m and \$800m** respectively
- **Extremely loyal fan base**, no incumbent, cannot be replaced
- **Huge marketing budget** impacted EBITDA during years of release, often negatively, despite strong sales
- **GTA Online** is the online multiplayer mode developed in tandem with the single-player mode; the game runs on the proprietary **Rockstar Advanced Game Engine (RAGE)**
- **Production lifecycle of 5 years** introduces significant volatility to TTWO's revenue profile

Publisher	US Video Game Publishing
1 Activision	\$2,172
2 Microsoft	\$1,577
3 Electronic Arts	\$1,359
4 Nintendo	\$865
5 Sony	\$680
6 Take-Two	\$648
7 Ubisoft	\$451

EA Key Franchises	Platform
FIFA	Console/PC/Mobile
Madden NFL	Console
NBA Live	Console
Need for Speed	Console/PC
SimCity	PC
Battlefield	Console/PC

TTWO Key Franchises	Platform
Grand Theft Auto	Console
NBA	Console/PC
Borderlands	Console/PC
WWE	Console
BioShock	Console/PC
Evolve	Console/PC

\* All revenues are for 2013 and in \$m