Strategic Review of Electronic Arts
Part 4: Leveraged Buyout

NATIONAL INVESTMENT BANKING COMPETITION & CONFERENCE

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Leveraged Buyout: Assumptions & Results

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Leveraged buyout of EA might be challenging given valuation, premium and size of equity check

	2010A	2011A	2012A	2013A	2014A	2015E	2016E	2017E	2018E	2019E	2020E
Historical & Forecasted EBITDA ($m)	$388	$493	$613	$631	$944	$1,037	$1,156	$1,261	$1,359	$1,447	$1,557

Key Assumptions	**Base Case**	**Upside Case**	**Notes & Constraints for Upside Case**
PF Leverage	6.0x	7.0x	Industry typically uses less debt
Premium	20%	15%	Could justify lower premium since assume sellers get 2015 dividend
Exit Multiple	10.0x	13.0x	Exit multiple exceeds current valuation
Senior / Junior Interest	5.0% / 7.0%	5.5% / 7.5%	Higher rates required for higher leverage
Transaction Date	FY2015 Year End		
Holding Period	5 Years		
Key Results	**Base Case**	**Upside Case**	
IRR	12.7%	25.4%	
Sponsor Check	$7,177m	$5,527m	
Senior / Junior Debt ($m)	$3,630 / $2,593	$4,148 / $3,111	
Implied Entry Multiple	14.4x		

IRR Sensitivity Analysis (from base case)

	Exit Multiple		
	9.0 x	**10.0 x**	**11.0 x**
Base Case	9.9%	12.7%	15.3%
Premium: 15%	11.7%	14.6%	17.2%
Premium: 25%	8.2%	11.0%	13.5%
Leverage: 5.0x	9.3%	11.8%	14.1%
Leverage: 7.0x	10.6%	13.8%	16.7%

Levered returns in expected base case and reasonable upside sensitivities is relatively low for attractive LBO candidate

Buyer would have to bank on exit multiple being significant on what will be a fairly mature company at the time

Leveraged Buyout: Transaction Structure

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Moderately rich valuation and limited leverage results in large quantum of required sponsor equity ($7,117mm)

Use of Funds		
Parent Equity Market Value at $35.96	11,363	76.1%
Parent Equity Premium (20%)	2,273	15.2%
Equity Value	13,636	91.3%
Debt Retired / Assumed	1,037	6.9%
Transaction Costs	261	1.7%
Total Funds Uses	**14,934**	**100%**

Source of Funds		
Senior Debt	3,630	24.3%
Junior Debt	2,593	17.4%
Revolver	-	-%
Assumed Debt	-	-%
Total Debt	*6,223*	41.7%
Sponsor Equity	7,117	47.7%
Excess Balance Sheet Cash (Shortfall)	1,594	10.7%
Total Funds Sources	**14,934**	**100%**

						Post-LBO Transaction				
***All dollar amounts in millions**	**2011**	**2012**	**2013**	**2014**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Revenue	3,828	4,186	3,793	4,021	4,132	4,501	4,742	5,017	5,301	5,622
Revenue Growth	*(8.0)%*	*9.4%*	*(9.4)%*	*6.0%*	*2.8%*	*8.9%*	*5.3%*	*5.8%*	*5.7%*	*6.1%*
EBITDA	493	613	631	944	1,037	1,157	1,261	1,360	1,447	1,557
EBITDA Margin	*12.9%*	*14.6%*	*16.6%*	*23.5%*	*25.1%*	*25.7%*	*26.6%*	*27.1%*	*27.3%*	*27.7%*
Taxes	(90)	(110)	(102)	(178)	(199)	(149)	(183)	(216)	(247)	(284)
Capex	(59)	(172)	(106)	(97)	(103)	(113)	(119)	(125)	(133)	(141)
Change in Working Capital	18	(131)	(97)	(102)	17	45	15	28	32	36
Adjusted EBITDA (CFADS)	**362**	**200**	**326**	**567**	**752**	**940**	**975**	**1,046**	**1,100**	**1,169**
Interest Expense on Existing Debt	10	(3)	(1)	(5)	(39)					
Senior LBO Debt Interest Expense	-	-	-	-	-	(181)	(153)	(121)	(83)	(42)
Junior LBO Debt Interest Expense	-	-	-	-	-	(181)	(181)	(181)	(181)	(181)
Mandatory Debt Service (Interest Expense)	**10**	**(3)**	**(1)**	**(5)**	**(39)**	**(363)**	**(334)**	**(302)**	**(265)**	**(223)**
Adj. EBITDA / Total Interest Expense						*2.6x*	*2.9x*	*3.5x*	*4.2x*	*5.2x*
Adj. EBITDA / Senior Interest Expense						*5.2x*	*6.4x*	*8.7x*	*13.2x*	*28.0x*
Debt/EBITDA						*4.9x*	*4.0x*	*3.1x*	*2.4x*	*1.6x*
Debt Repayment	-	(633)	-	-	-	-	-	-	-	-
Equity Issuance (Repurchase) including Restricted Cash Movements	-	(428)	(327)	67	-	-	-	-	-	-
Financing Drawn	**-**	**(1,061)**	**(327)**	**67**	**-**	**-**	**-**	**-**	**-**	**-**
Dividends	-	-	-	-	(1,978)	-	-	-	-	-
FCF for LBO Debt Repayment	**372**	**(864)**	**(2)**	**629**	**(1,265)**	**577**	**641**	**744**	**835**	**946**
Repayment of LBO Debt						(577)	(641)	(744)	(835)	(946)
CF from LBO Structure	**-**	**-**	**-**	**15,563**	**(1,264)**	**-**	**-**	**-**	**-**	**-**
Equity IRR										
LBO Sponsor Equity					(7,117)					
Sale Proceeds						-	-	-	-	15,573
Excess Cash						-	-	-	-	-
Repayment of Debt						-	-	-	-	(2,481)
Residual Cashflows						-	-	-	-	-
Transaction Costs (Exit)						-	-	-	-	(156)
Cash Flows to Equity **IRR:** 12.7%					**(7,117)**	**-**	**-**	**-**	**-**	**12,937**

Outstanding Debt Balance	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Senior Debt at 5.0%	3,630	3,053	2,413	1,669	834	-
Junior Debt at 7.0%	2,593	2,593	2,593	2,593	2,593	2,481
Revolver Debt at 0.0%	-	-	-	-	-	-
Assumed Debt at 4.7%	-	-	-	-	-	-
Total Debt	**6,223**	**5,646**	**5,005**	**4,261**	**3,427**	**2,481**

Leveraged Buyout: Viability Analysis

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Several industry and company factors make an LBO challenging eventhough the environment is favorable

LBO Viability

- **Macro environment favorable towards LBO transactions**
  - Relatively low financing rates
  - Significant dry powder held by financial sponsors
- **Company economics are somewhat supportive of LBO**
  - Recent growth in EBITDA with sizeable cash flows and expected growth trajectory driven by margin expansion
  - Proven franchises and strong market position support likelihood of continued revenue growth
  - Pure-play nature and strong franchises increase attractiveness to strategic buyer in exit
  - Clean balance sheet with net cash position
- **Several factors could constrain LBO structure**
  - Lack of track record of stable free cash flows forecasted in future
  - Forecast already includes significant revenue growth and margin improvement which limits further upside
  - Nature of industry is considered volatile given hit-driven nature of game releases, not many LBOs in video games or entertainment
  - Stock price at 5-year high and valuation at a premium to console peers suggests the stock might be expensive
  - Uncertain prospects about achieving exit multiple that is similar to entry multiple considering mature cycle of company
  - Debt capacity restricted by future cash flow uncertainty, which constrains IRR depending on premium
  - Large capitalization requires large equity check, which could be prohibitive for any single sponsor (club deals have become less prevalent)
  - Key question is size of equity premium and how much cash on hand and from operations will be paid as dividend

Assumptions

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Category	Input Values	Comments
Leverage (2015 Debt / EBITDA)	6.0x	• Lack of track record of stable free cashflows combined with volatile nature of industry limit debt capacity • Unpredictable changes in technology could significantly impact the industry and further limit debt capacity • However, debt capacity is supported by forecasted free cashflows expected to stabilize and grow through margin expansion • Sizeable cashflows enable rapid deleveraging to 1.6x by 2020 assuming 6.0x pro forma leverage • Interest coverage at 6.0x pro forma leverage is sufficient, with 2016 Adj. EBITDA / Interest Expense at 2.6x and 2016 Adj. EBITDA / Senior Interest Expense at 5.2x • Lack of notable precedent LBOs in industry limit comfort around high leverage • Close comps' low-to-mid-range leverage do not demonstrate ability of video game developers to take on high degrees of leverage (2013 Debt / EBITDA of Activision Blizzard at 2.8x and Take Two at 0.7x) • Tranching at 1.4 : 1 senior debt : junior debt ratio
Interest Rates	5.0% senior 7.0% junior	• Benchmarked to Activision Blizzard (3.5% term loan and 6.125% ten-year notes); assumed higher rates given higher leverage and less historical cashflow stability
Premium	20%	• Typical premium for current LBO transactions • Note that underlying EA cashflow model assumes seller receives levered dividend recapitalization on back of strong results in 2015 in which case seller may accept lower premium • However, EA has also significant upside potential in short to medium-term
Exit Multiple	10.0x	• Implied entry multiple is 13.3x; exit multiple conservatively assumed to be slightly lower given current valuation is moderately rich and significant multiple expansion is unlikely • Activision Blizzard's current LTM multiple is 11.8x • Significant EBITDA margin improvements already assumed in forecast
Synergies	None	• Significant EBITDA margin improvements already assumed in forecast