NETFLIX AND ELECTRONIC ARTS MERGER

M&A Strategic Analysis

WESTPEAK
RESEARCH ASSOCIATION
EST. 2014

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*Note: All figures in USD

Electronic Arts

M&A Strategic Alternatives and Analysis

Company Overview

Overview: Electronic Arts (NASDAQ: EA) is an American video game company headquartered in Redwood City, California. The company offers innovative games and experiences for consoles, mobile devices, and personal computers boasting nearly 600 million active players globally. Top brands include FIFA, Battlefield, Apex Legends, F1, and NFL Madden.

Current Strategy: EA's strategy is to build games and experiences that grow global online communities, building re-occurring revenue from annualized franchises and live services. Live services include extra content, subscription revenue, and revenue generated in addition to base games.

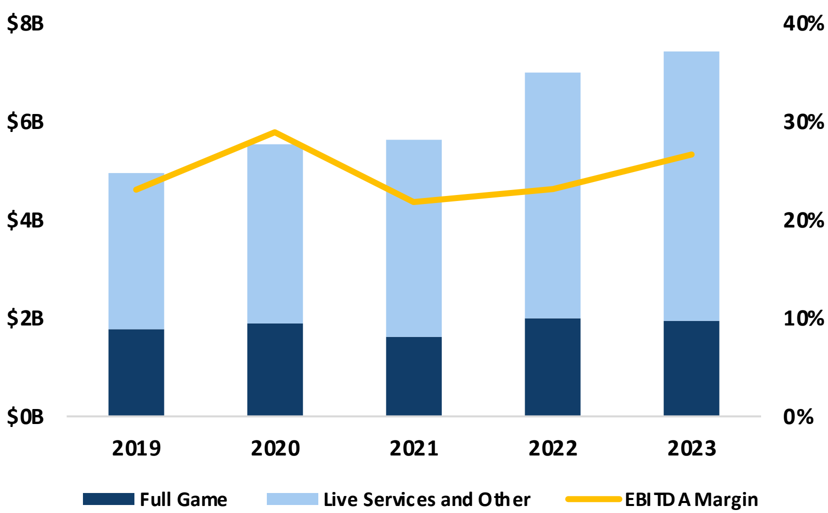
M&A Rationale: EA has reportedly held talks with potential acquirers due to the significant consolidation in the gaming industry. With the recent Activision Blizzard acquisition among others, EA has become an attractive target due to strong IP in their portfolio.

Current Market Data (mm)

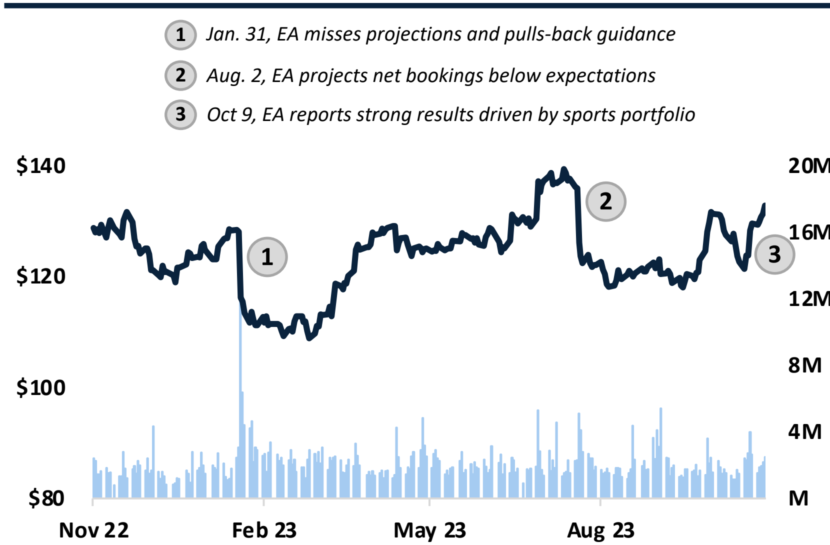
Market Cap	$36,496	Revenue (FY23)	$7,426
Enterprise Value	$36,420	EBITDA (FY23)	$1,979
Share Price	$135.61	EBITDA Margin	26.6%
52 week-high	$143.47	EV/EBITDA	18.66x
52 week-low	$108.53	Forward P/E	17.67x
Cash (2Q23)	$2,767	Debt (2Q23)	$1,880

*Currency in USD

Revenue Breakdown



Historic Share Price



Sources: S&P Capital IQ, Bloomberg, Company Filings

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Netflix

M&A Strategic Alternatives and Analysis

NETFLIX

Company Overview

Overview: Netflix (NASDAQ: NFLX) is one of the largest entertainment services with approximately 247 million subscribers across over 190 countries. Netflix develops and offers TV series, films, and games across many different genres and languages on their streaming network.

Current Strategy: Netflix's strategy is to grow their business globally by developing compelling content while maintaining their operating margin target of 18%-20%. They strive to create conversation around their content and continually improve the user interface to enhance member's experience.

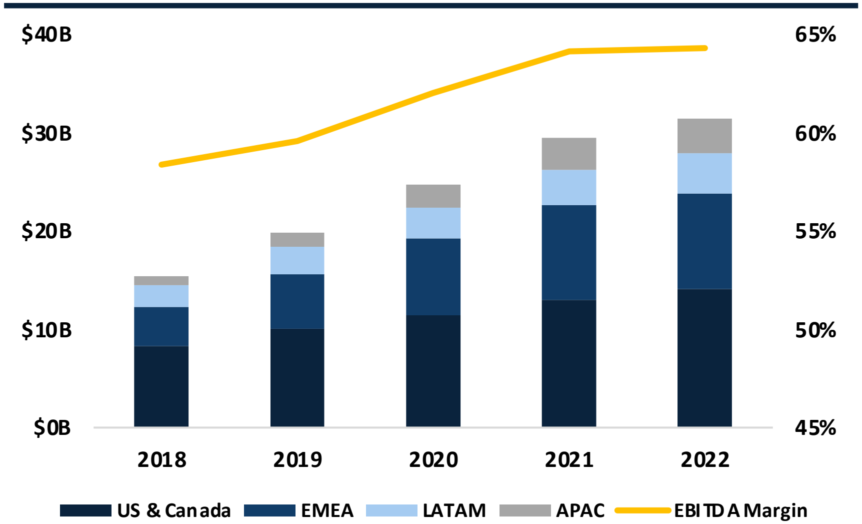
M&A Rationale: Netflix first announced their foray into gaming in 2021 to diversify revenue streams and offset a saturated subscriber environment. They have since made multiple acquisitions in the gaming industry including Night School Studio, Next Games, Boss Fight Entertainment, and Spry Fox. and began rolling out their cloud gaming services across Canada, U.K, and the US.

Current Market Data (mm)

Market Cap	$207,486	Revenue (FY22)	$31,616
Enterprise Value	$216,383	EBITDA (FY22)	$20,333
Share Price	$474.06	EBITDA Margin	64.31%
52 week-high	$500.9	EV/EBITDA	10.41x
52 week-low	$285.33	Forward P/E	29.94x
Cash (3Q23)	$7,353	Debt (3Q23)	$13,901

*Currency in USD

Revenue Breakdown



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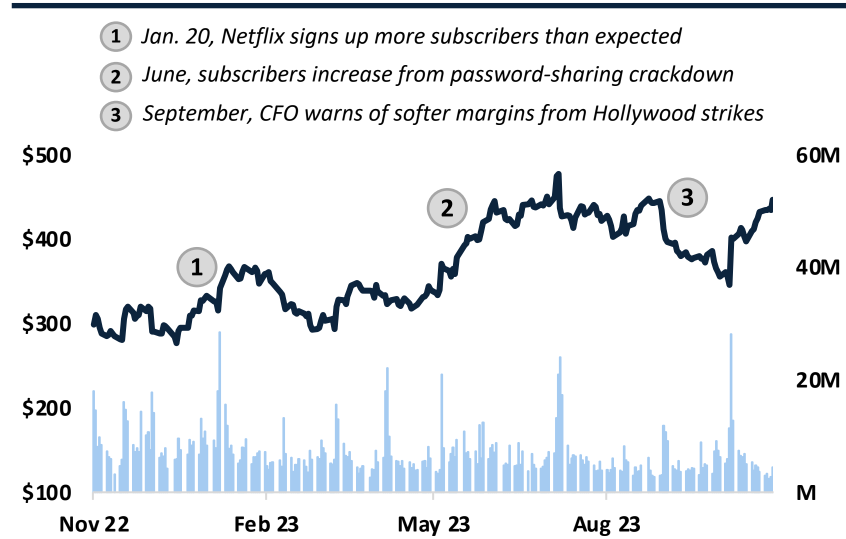

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Sources: S&P Capital IQ, Bloomberg, Company Filings

Key Industry Metrics

Metric	Streaming	Gaming
2023 Revenue	**$171B**	**$406B**
2028E Revenue	**$235B**	**$585B**
Past 5-Year CAGR	**15.46%**	**8.90%**
Next 5-Year CAGR	**6.56%**	**7.55%**
Operating Margin	**6.3%**	**18.1%**

Key Trends

Cloud Gaming: Cloud gaming is technology that allows video games to be streamed directly from the cloud. It has an expected CAGR of 40% from 2020-2030. This eliminates the need for gamers to upgrade hardware.

New Monetization Models: Free-to-play models have gained popularity with ad-based revenue and in-app purchases driving sales. Subscription models are also emerging bringing companies recurring revenue.

Pivot to Profit: Focus has shifted from subscriber growth to ability to generate profit and free cash flow. This has increased attention toward pricing power with crackdowns on password sharing and ad-tiers being introduced.

Rise of Original Content: To differentiate themselves, services have been investing heavily in original content. Spending is estimated at $72B in 2023, a 14% increase from 2022. However, streaming companies are tightening spending pivoting towards enhanced focus on profitability due to the cooling subscriber growth and content spending wars.

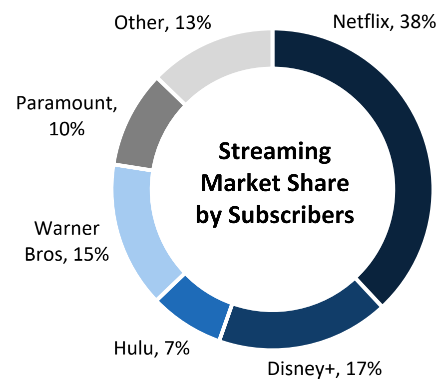
M&A Activity

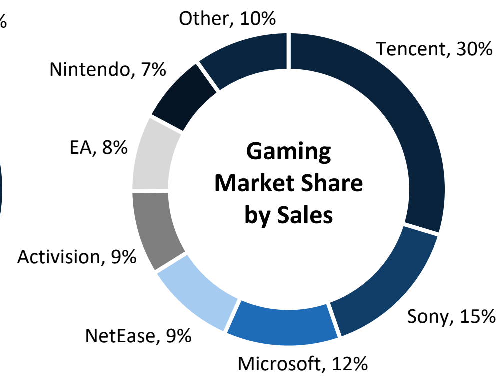
Fragmented Gaming Industry: The gaming industry is currently fragmented, trending toward significant consolidation. In 2022, there were 43 acquisitions made by the 26 largest gaming companies, which was preceded by 60 in the previous year. This has largely been driven by the pandemic, where time spent on gaming increased by 39% during the pandemic. This put increased cash into the hands of gaming companies, which translates into large acquisitions across the industry.

Streaming Consolidation: With the combinations of Disney+ and Hulu, HBO max and Discovery+, and Paramount+ and Showtime, the streaming industry has moved past the consolidation stage and looking toward new growth opportunities.

Redirection of Streaming Spending: Streaming providers have been spending on broadcast rights as opposed to M&A. TV-rights deals will cost ~25 billion in 2023 for sports alone, largely driven by rising broadcast deals where the NFL increased fees by 70% in 2023.

Competitive Landscape





M&A Rationale

M&A Strategic Alternatives and Analysis

Electronic Arts Rationale

Increasingly Attractive Target: Increased acquisitions in the gaming industry, EA has been left as the largest third-party game producer. With a stranglehold on the sports gaming industry and strong re-occurring revenues, EA has become an attractive target.

Strategy Alignment: EA currently derives 74% of revenue from live services and other in-game offerings to customers. With their strategy of growing online communities globally, being acquired by Netflix accelerates this desire, which increases their total addressable market within their largest revenue stream.

Cost Synergies: With cloud technology, there is a reduced need for expensive hardware to play games. This would allow EA to realise significant cost synergies by integrating to Netflix's current digital infrastructure.

Netflix Rationale

End of Subscriber Battles: As streaming matures, the market is diverting focus to profitability. Attention will be looking toward a new growth strategy, which Netflix has identified as gaming.

Gaming Acquisitions: Netflix has made multiple acquisitions in the gaming space largely focusing on mobile gaming. They have identified an interest in eventually moving into the cloud gaming space launching games playable on the TV and PC. EA makes an attractive target with strong IP within their gaming portfolio.

Content Alignment: Netflix's content aligns well with EA's portfolio, promoting cross-selling opportunities. Netflix has recently released popular shows surrounding F1 and the NFL while EA exclusively owns the IP to develop these games. By bundling services together, thus raising prices, Netflix would be able to raise prices while reducing churn.

Cloud gaming is one of the fastest growing segments within gaming, by acquiring EA, Netflix accelerates their ability to build out a cloud gaming platform with their current technology combined with EA's expertise and gaming portfolio, significantly accelerating growth to become a media conglomerate.

Increasing Gaming Consolidation Makes EA an Attractive Target

	King	ZeniMax Media Inc.	Zynga	Bungie	Scopely	Activision
Purchase Year	Nov 2015	Sep 2020	Jan 2022	Jul 2022	Jul 2023	Oct 2023
Acquirer	Activision	Microsoft	Take-Two	Sony	Savvy Games	Microsoft
Purchase Price	$5.9B	$7.5B	$12.7B	$3.7B	$4.9B	$68.7B
Revenue	$2.0B	$0.5B	$2.8B	$0.4B	$0.6B	$7.5B
Location	Sweden/UK	USA	USA	USA	USA	USA

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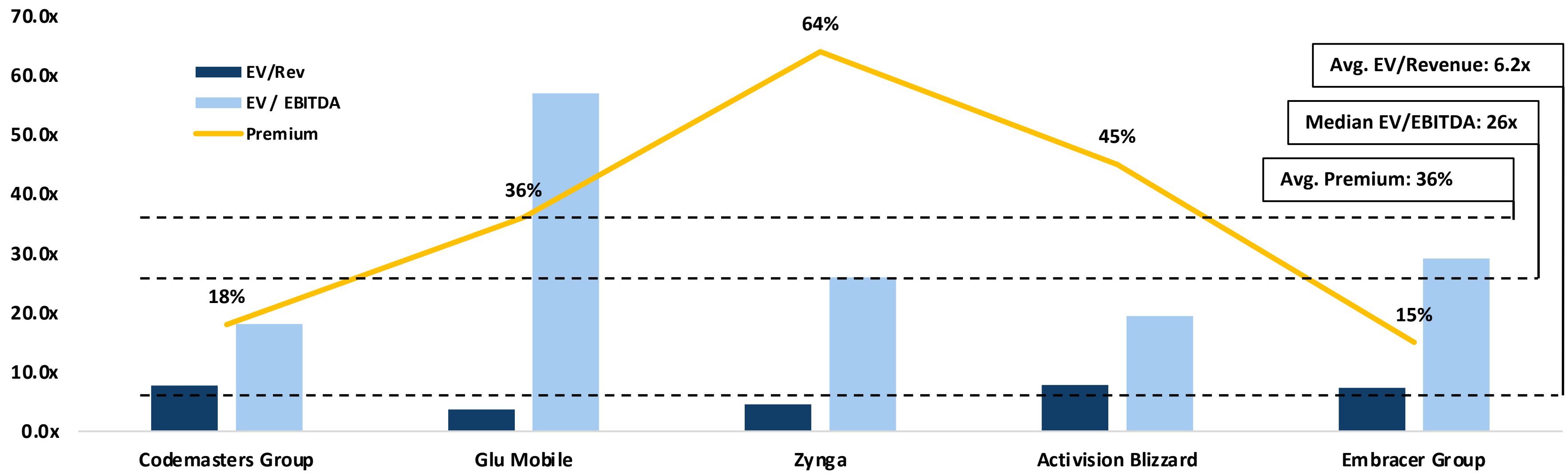
Sources: S&P Capital IQ, Company Filings, Bloomberg

Precedent Transactions Analysis



Codemasters	Glu	Zynga	Activision	Embracer Group
$1.3B acquisition by EA	$2.3B acquisition by EA	$13.9B acquisition by T2	$79.6B acquisition by Microsoft	$1.1B acquisition by Savvy Games Group
Dec 2020	Feb 2021	Jan 2022	Jan 2022	Jun 2022

Precedent transactions median EV / EBITDA of **26x** implies a price of **$183.19** for EA, representing a **35.1%** premium

Sources: S&P Capital IQ, Pitchbook, Bloomberg

Intrinsic Valuation

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Cash Flow Forecast

	Fiscal Year Ending March 31,					
	2023A	2024E	2025E	2026E	2027E	2028E
Revenue	**$7,426**	**$7,797**	**$8,265**	**$8,761**	**$9,287**	**$9,751**
Annual Growth (%)		*5%*	*6%*	*6%*	*6%*	*5%*
EBITDA	**$1,868**	**$2,206**	**$2,405**	**$2,601**	**$2,803**	**$2,943**
Margin (%)	*25%*	*28%*	*29%*	*30%*	*30%*	*30%*
EBIT	**$1,332**	**$2,071**	**$2,256**	**$2,443**	**$2,638**	**$2,774**
Margin (%)	*18%*	*27%*	*27%*	*28%*	*28%*	*28%*
Less: Tax expense	(524)	(518)	(564)	(611)	(659)	(693)
Add: Depreciation and amortization	536	136	148	157	165	170
Less: Capital expenditures	(207)	(187)	(185)	(188)	(183)	(216)
Less: Change in net working capital	169	158	167	179	187	167
Unlevered Free Cash Flow	**$1,306**	**$1,659**	**$1,823**	**$1,981**	**$2,148**	**$2,201**
Annual Growth (%)		*27%*	*10%*	*9%*	*8%*	*2%*

Commentary

- Revenue growth driven by industry-wide growth while EA's live services are primed to drive outsized returns
- Increasing margins derived from improved efficiency in workforce, property commitments, and SG&A requirements, returning to margins achieved historically
- FCF discounted at a 8.5% WACC
- Capex maintained at historical levels, largely driven by software development and licensing fees

Value Per Share – Terminal Multiple Method

	Low	Base	High
Cost of Capital	**9.0%**	**8.5%**	**8.0%**
Terminal Multiple	**14.0 x**	**15.0 x**	**16.0 x**
Terminal Value	$36,384	$44,150	$51,658
PV of Cash Flows	$7,014	$8,125	$8,818
PV of Terminal Value	$25,226	$31,217	$37,246
Enterprise Value	**$32,240**	**$39,342**	**$46,064**
Less: Net Debt & NCI	$(65)	$(65)	$(65)
Less: OTM Convertible Debt	--	--	--
Implied Equity Value	**$32,305**	**$39,407**	**$46,129**
F.D. Shares Outstanding	269	269	269
Implied Value Per Share	**$120**	**$146**	**$171**
Implied Upside (Downside)	*(11.5%)*	*8.0%*	*26.4%*
TV % of Total	*78.2%*	*79.3%*	*80.9%*

Sensitivity Analysis

Exit Multiple	WACC 7.5%	8.0%	8.5%	9.0%	9.5%
13.0 x	$ 135.64	$ 133.28	$ 130.97	$ 128.72	$ 126.52
14.0 x	$ 143.68	$ 141.16	$ 138.70	$ 136.30	$ 133.95
15.0 x	$ 151.73	$ 149.05	$ 146.44	$ 143.89	$ 141.39
16.0 x	$ 159.77	$ 156.94	$ 154.17	$ 151.47	$ 148.83
17.0 x	$ 167.82	$ 164.82	$ 161.90	$ 159.05	$ 156.27

- Terminal multiple taken based on Analysts' projections and analysis
- Base case based on projected industry growth rates, and expected margin improvement for Electronic Arts
- Best case based on enhanced profit margins and revenue growth
- Worst case based on decreased profit margins and lower expected growth

Sources: S&P Capital IQ, Company Filings

Accretion/ Dilution Analysis

M&A Strategic Alternatives and Analysis

2024E Financial Performance Projections

Metric	100% Debt	50/50	100% Equity
Debt/EBITDA	**2.45**	**1.52**	**0.59**
Incremental FCF	**$(260)**	**$1,046.4**	**$2,352.7**
2024E EPS	**$14.55**	**$15.25**	**$15.82**
2025E EPS	**$16.66**	**$17.15**	**$17.84**
2024E Accretion	**0.15%**	**5.00%**	**8.93%**
2025E Accretion	**8.68%**	**11.84%**	**14.42%**

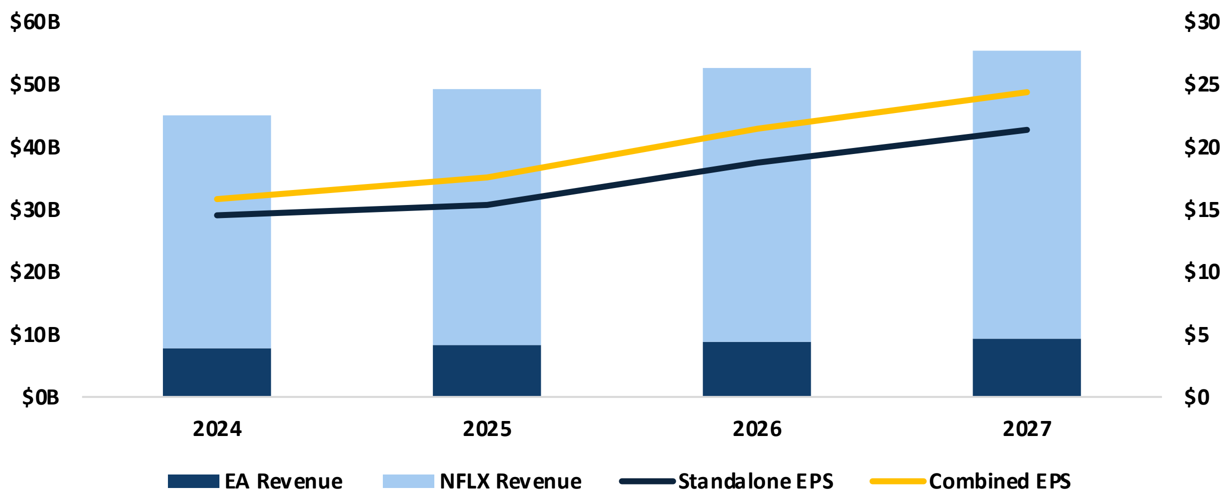
Transaction Structuring

Purchase Premium: Assumed 35.1% purchase premium based on precedent transactions analysis. This comes in below the 45% premium Activision recently received which is justified as they were a larger company with stronger EBITDA margins and more popular titles.

Recommended Financing: It is recommended Netflix complete an all-stock transaction. This is justified as in the current environment, debt is not as an attractive option and it is advised they do not become too levered as they are still in a relatively high growth phase. They would be better off using their excess cash and debt capacity to re-invest in their business. Lastly, an all-stock transaction shifts part of the risk onto EA shareholders while allowing them to realize the upside in becoming a media conglomerate.

Financing Justification: Today's media giants, such as Disney, were built on acquisitions, namely Disney acquiring Pixar. The deal was an all-stock transaction, where re-investing in growth was vital to Disney's success today and why it is advised Netflix finance the acquisition with stock.

Standalone vs. Combined Entity Performance



Commentary

- Assumed cost synergies begin in 2025 as a percentage of SG&A based on economies of scale by combining companies and decreased required spend on SG&A.
- Assumed revenue synergies, beginning in 2025, as an uptick in subscribers based on bundling opportunities or a combined platform.
- Calculated revenue synergies by combining subscriber growth rate with Netflix's ARPU.

Sources: S&P Capital IQ, Bloomberg, Company Filings

Horizontal Integration

Alternative Target Companies: An alternative option to acquire is Roblox, which allows users to create and play games, however they have negative profits. Take-Two Interactive is another option with best-selling games GTA, Borderlands, and NBA 2K. The final option is Nintendo who develops both games and hardware, such as the Nintendo Switch.

Recommendation: Acquire Take-Two Interactive

Rationale: By acquiring Take-Two, Netflix would gain access to GTA, one of the best-selling titles of all time along with other best sellers such as Red-Dead Redemption, Borderlands, and NBA 2K. This would bring a loyal following and large fan base to Netflix services.

Vertical Integration

Alternative Target Companies: Vertical integration opportunities would include acquiring an international studio such as Lions Gate Entertainment, acquiring a sports broadcasting company such as DAZN, or GeoComply, a geolocation, cybersecurity company to protect user data and enhance their password sharing crackdown.

Recommendation: Acquire DAZN

Rationale: Netflix's competitors are increasingly investing in sports streaming, a gigantic market. Apple has acquired MLS and is discussing rights to broadcast F1. Amazon has NFL Thursday Night Football and Disney has ESPN. Acquiring DAZN allows Netflix to instantly compete in sports streaming and access DAZN's 15M+ subscriber base.

Spin-Off

Potential Spin-Off: With Netflix's subscription model and goal of developing a library of games, it is unlikely they would be interested in one of EA's titles. Additionally, with EA Game Pass and the growth in subscription models, spinning off specific titles decreases the value-add for customers purchasing subscription services.

Spin-Off from EA's Perspective: With EA having exclusive rights to sports titles such as NFL, UEFA Champions League, NHL, and F1, it is unlikely they would be willing to spin-off any of the franchises as they are often repurchased by players each new league year. For example, with Madden bringing in ~$600M per year, it is unlikely they would part with any of these franchises.

Likelihood: Media companies will likely target EA for their whole gaming portfolio, decreasing the likelihood of acquiring an individual franchise. EA would also unlikely be willing to part with any of its cash-cow franchises alone.

Mega Media Merger

Potential Merger Candidates: With both big tech companies and media conglomerates highly valuing subscription-based business models, Netflix could be a potential target at some point as they mature. Big tech companies that could realise strong synergies by acquiring Netflix would be Apple, Microsoft, Disney, and Amazon. Any of these companies could significantly grow their product offerings by merging with Netflix at a time big tech is looking to diversify their revenue streams.

Netflix's Attractive IP and Platform: Netflix has extraordinarily valuable IP in their streaming platform. By merging with one of the companies mentioned above, they could leverage Netflix's IP base to drive revenue across other business lines.

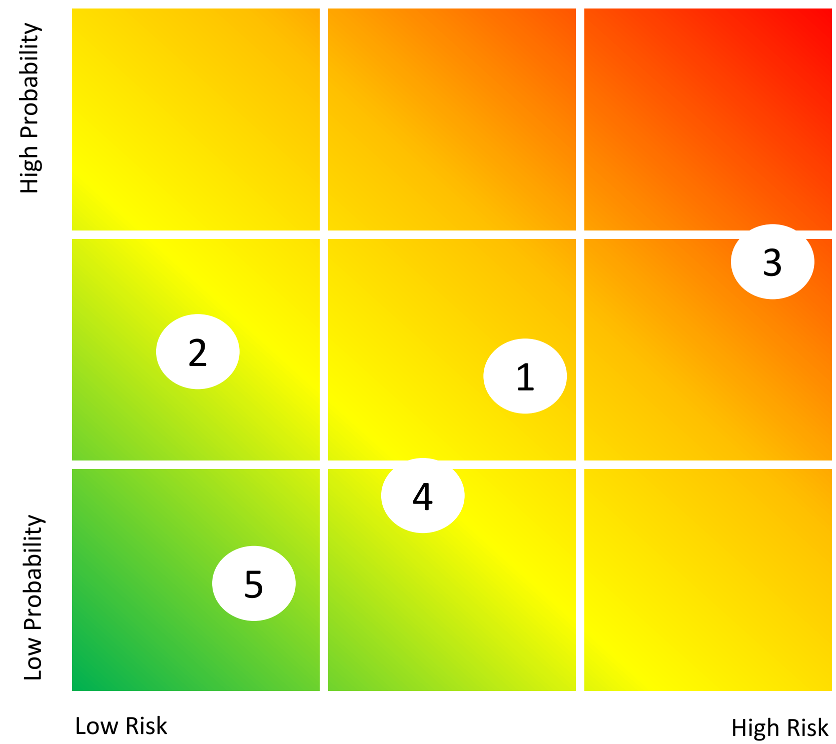
Likelihood: With Netflix's current market cap of ~$214B, a merger would become quite expensive, reducing the likelihood. However, with their highly attractive recurring revenue streams, they would be highly coveted on the market if a deal were to become possible as they mature.

Risks and Mitigants

M&A Strategic Alternatives and Analysis

Risks	Mitigation Strategies
1 **Synergies Not Realized**	Given the popularity of Netflix's shows and large subscriber base, this is mitigated by tailoring content and games to successful series. For example, F1 Drive to Survive had ~7M viewers. Netflix could leverage this popularity into sales of the corresponding game. Further, they could develop games for titles such as Squid Game with EA's strong developer talent.
2 **Failed Cultural Integration**	Netflix has made multiple gaming acquisitions in the past, successfully operating the studios globally. Acknowledging EA is a much larger developer, Netflix has experience integrating gaming companies.
3 **Technological Integration**	Netflix has a proven ability to develop and maintain infrastructure to service the largest subscriber base within streaming. Although investment would be required, Netflix has a proven ability to develop and successfully manage large data infrastructure.
4 **Dilutive Transaction**	Since Netflix's stock is highly valued at a Forward P/E ratio of 29.59x, their cost of stock is cheap at 3.37%. Conversely, EA's stock is yielding 5.6%, increasing the likelihood that the transaction is accretive to all investors, even if synergies are not fully realized immediately.
5 **Loss of Key Licences**	It would take massive investment from another company and years of development, decreasing profits, deterring competition. Additionally, sports leagues have a relationship with EA who has already developed the games and returns a strong revenue stream to the sports leagues.

Risk Matrix



The biggest risk for Netflix will be technological integration which will be key to them becoming a media conglomerate. Having scaled to ~250M subscribers, they should be able to successfully develop and maintain the technology to build out an industry leading cloud gaming platform.