

Netflix's Acquisition of Next Games for €65mn

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Source: The Hans India



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DEAL INTRODUCTION

DETAILS ABOUT THE DEAL

In March 2022, Netflix, entered a combination agreement to acquire Next Games, the Finnish game developer. Paying €2.10 a share, the deal totalled €65mn in cash, costing Netflix double the closing price on the day of announcement. Netflix appointed Goldman Sachs as their financial adviser, Danske Bank A/S, Finland Branch as arranger and Borenius Attorneys Ltd as legal adviser in connection with the **tender offer**. Next Games appointed LionTree Advisors LLC and Alexander Corporate Finance Ltd as the financial advisers and Castrén & Snellman Attorneys Ltd as the legal adviser.



Source: Netflix



INDUSTRY OVERVIEW - ELECTRONIC GAMING

The Electronic Gaming & Multimedia industry includes companies that develop and publish video games, as well as those that create other forms of digital entertainment such as animation, music, and videos. This industry also includes the hardware and technology used to play these games and multimedia, such as consoles, personal computers, and mobile devices. In simple terms, it is an industry that creates and sells interactive digital entertainment and the equipment to play it.

There are several major players in the electronic gaming & multimedia industry. Some of the biggest companies include:

- Sony Interactive Entertainment (PlayStation)
- Microsoft (Xbox)
- Nintendo (Nintendo Switch)
- Tencent (publisher and owns stakes in many game studios)
- Electronic Arts (EA) (publisher of games such as FIFA, Madden, and The Sims)
- Activision Blizzard (publisher of games such as Call of Duty and World of Warcraft)
- Ubisoft (publisher of games such as Assassin's Creed and Far Cry)
- Take-Two Interactive (publisher of games such as Grand Theft Auto and Red Dead Redemption)
- NetEase (publisher and developer)
- Epic Games (developer and publisher of Fortnite)



Source: LinkedIn



INDUSTRY OVERVIEW

2022 TRENDS

The year 2022 was a significant one for the gaming industry, marked by several key developments that shaped its future.

The first of these developments is Microsoft's acquisition of Activision Blizzard (see our report on this deal [here](#)). After a difficult 2021, the industry was closely watching Activision Blizzard and the reports of its toxic work environment. In response, Microsoft made a bold move in January 2022 by announcing its plans to acquire the publisher of the popular game Call of Duty for a sum of \$68.7 billion. The announcement of Microsoft's acquisition of Activision Blizzard was met with mixed reactions. Some believed it was a necessary move to address the company's toxic work culture, while others expressed concern that it could lead to a monopoly, as Microsoft would have control over some of the most profitable games in the industry. Despite personal opinions on the matter, the acquisition of Activision Blizzard by Microsoft raised concerns of antitrust among the Federal Trade Commission. Recently, FTC announced its decision to block the deal, citing antitrust concerns as the reason.

One of the most significant events of the year was the announcement from Google that it would be discontinuing its cloud gaming service, Stadia. This news came as a surprise and had a significant impact on the industry, as Stadia was considered a pioneer in the field of cloud technology for gaming. The closure of Stadia was not seen as the end of cloud gaming, but as a shift towards new ways of incorporating the technology into everyday life. Companies like Samsung made their mark by introducing new features such as Gaming Hub on select smart TVs, which enables access to gaming services like Xbox Game Pass without the need for a separate console or PC. This was a noteworthy move that made gaming more accessible to a wider audience. In 2022, cloud gaming technology was in a state of experimentation and uncertainty, but the future is becoming more apparent. Instead of relying solely on subscription-based models, it is expected that cloud gaming will become integrated into a wide range of devices, both new and existing, in the future.



INDUSTRY OVERVIEW

2023 OUTLOOK

In general, the electronic gaming and multimedia industry has been known to perform well during recessionary periods. The reason for this is multifaceted, with the main reasons being:

1. **Affordability:** Video games and other forms of digital entertainment are relatively inexpensive compared to other forms of entertainment, such as movies and vacations.
2. **Escapism:** During difficult economic times, people often look for ways to escape reality and relieve stress, and gaming provides a form of escapism for many.
3. **Increased leisure time:** Unemployment rates typically rise during a recession, giving people more free time to spend on gaming and other forms of digital entertainment.



Source: Advanced Television



ACQUIRER OVERVIEW

NETFLIX

Ticker: NFLX

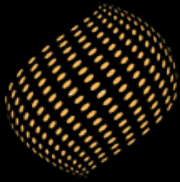
NETFLIX

Netflix is an American multinational subscription on-demand streaming company, where customers can watch TV and Movies from a variety of devices. Customers have a variety of payment plans, where some may watch advertisements and others pay more for greater content options. Since the company's establishment, it has evolved from DVD distribution to a online streaming model, and is one of the biggest competitors in the industry.

The company is headquartered in Los Gatos, California, United States, with over 11,000 employees. Having founded the company in 1997, it was recently announced that Reed Hastings stepped down as CEO, replaced by Greg Peters and Ted Sarandos as co-CEOs.

BUSINESS MODEL

Netflix generates its revenue, primarily through its subscription-based service. The more subscribers it has, the more revenue it generates. The focus of Netflix is therefore how they advertise their products, rather than what they sell. The DVD distribution business, despite previously a key revenue generator, has almost entirely been phased out. While the company is acquiring several game developers, their offerings will be incorporated into existing subscription packages – so will not necessarily be an independent stream of income.



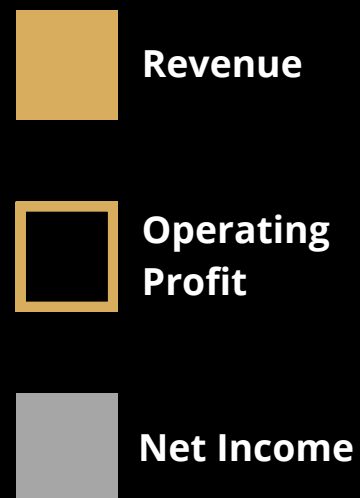
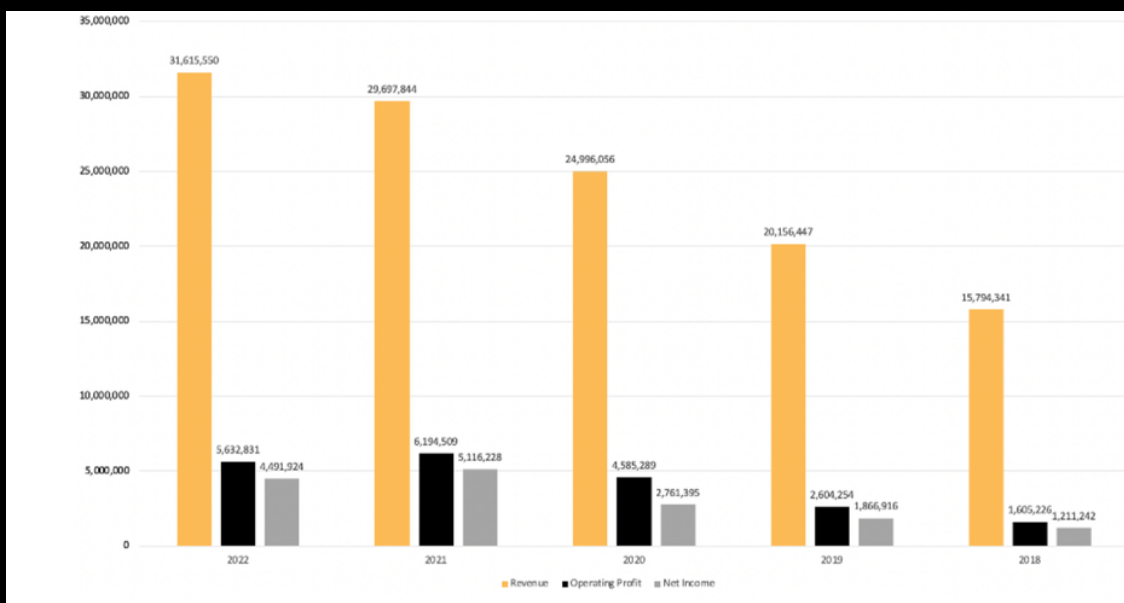
ESG PRACTICES

Netflix has not produced an ESG report since 2021, although did produce a brief update in 2022. There were some key points to take away from their 2021 performance:

- They reduced or avoided more than 14,000 metric tons of emissions, on track to cut 45% of our Scope 1 and 2 emissions by 2030. (from 1.05 million metric tons of carbon dioxide equivalent (MTCO₂e) to 1.54 million in 2021)
- Overall carbon footprint increased by 47%, across all three scopes, largely because of the increase in post-pandemic content production.

The largest source of Netflix's emissions are from TV and Film production, from diesel powered generators, to petrol vehicles. Decarbonising this industry is essential to meeting their 2030 target of cutting 45% of Scope 1 and 2 emissions by 2030.

KEY FINANCIALS





TARGET OVERVIEW



Ticker: OYJ

NEXT GAMES

Next Games is a video game studio that creates games based on popular movies and TV shows. Some of its biggest titles include the likes of 'Stranger Things: Puzzle Tales,' 'The Walking Dead: Our World,' and 'The Walking Dead: No Man's Land.'

The business was founded in Finland in 2013. As of the end of 2021, it had 120 employees, led by CEO Teemu Huuhtanen.

In 2017, Next Games went public on the NASDAQ First North Finland at €7.90 a share, before being acquired by Netflix in 2022.

BUSINESS MODEL

Next Games business model is moulded to allow users to play Next Games' games free of charge. Companies such as Netflix or AMC transfer the IP rights of popular movies and TV shows, in turn receiving a portion of royalties. Next Games then develop and publish games based on these shows. The games are then sold via platforms such as the Apple and Google app stores, with these platforms taking a 30% fee of all in-app purchases.

With games free to play for users, in 2021 Next Games generated a large proportion (95%) of its revenue via in-game purchases.



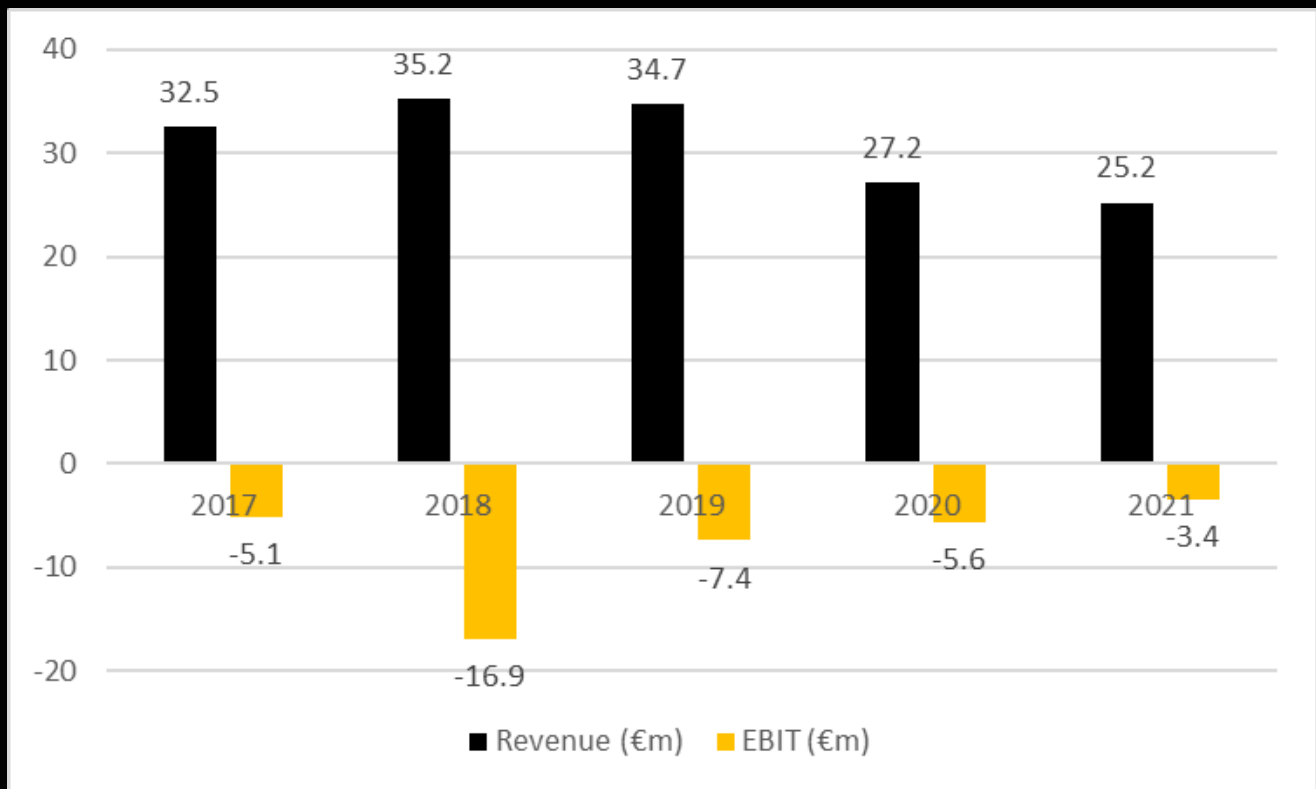
ESG PRACTICES

Next Games is a member of the Fair Play Alliance and part of the 140 company-strong group committed to developing and sharing information to create safer and fairer game experiences for all users. The company also drives responsible gaming via diversity and inclusion through its events and games, such as allowing players to choose their own pronouns on servers.

Next Games is also an associate member of Planet Alliance, a cohort of gaming-companies who have set ambitious commitments to people and the planet.

Internally, Next Games has made the commitment to reach 50% of non-male identifying employees in its staff by 2030.

KEY FINANCIALS





DEAL ANALYSIS

STRENGTHS

- The key strength of the deal is the complementation it provides to Netflix's wider strategy of building out its gaming and video catalogue, following on from its acquisition of Night School Studios towards the end of 2021.
- Furthermore, with a strong relationship already formed between Netflix and Next Games given the latter's previous development of Netflix titles, the acquisition provides a strong foundation for Netflix's growth in the sector.
- Speaking on the matter, Michael Verdu, VP of games at Netflix, stated: "While we're just getting started in games, I am confident that together with Next Games we will be able to build a portfolio of world class games that will delight our members around the world."

WEAKNESSES

- Revenue generated by Next Games is highly reliant on in-game purchases. Therefore, should Netflix be unable to maintain this level, it could see its **return on investment** in Next Games wither.



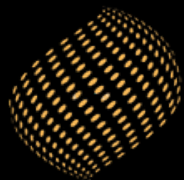
DEAL ANALYSIS

OPPORTUNITIES

- **The move provides Netflix access to Finland, one of the most successful countries when it comes to mobile game development. With over 260 game development studios in Finland alongside rapid growth of the gaming market in the last decade, it is clear why Netflix has established its European gaming hub in Helsinki.**
- **Recent surveys, including one published by Deloitte, have highlighted that Gen Z users increasingly prefer video games as their top choice of entertainment, highlighting the acquisition's ability to allow Netflix to unearth a new market of potential customers.**

THREATS

- **The main threat to Netflix is the high level of competition. With the gaming market becoming more lucrative, the likes of Google, Apple, and Facebook have all ramped up their interest and investment in the industry over the previous few years. For Netflix to become a leader in the industry, it will continue to have to make smart acquisitions that place it ahead of its peers.**
- **A report published by Morgan Stanley highlighted the slowing mobile games market in countries such as the US, Japan and China. Therefore, Netflix will have to originate innovative content to keep users engaged.**



VALUATION ANALYSIS

DISCOUNTED CASH FLOW ANALYSIS (DCF)

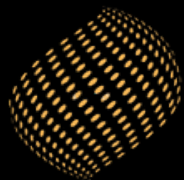
Enterprise Value	63
(+) Cash	2
(-) Debt	(3)
Equity Value	62
# of Millions of Shares	31
Share Price	2.00

[Please click on the table to access full model.](#)

As calculated by the Discounted Cash Flow (DCF) Analysis, Next Games's share price, was found to be between €2.00 and €3.23. This calculation was obtained through the use of **sensitivity analysis**, in which three scenarios were calculated in the DCF, a conservative, base and an optimistic one.

To build the model, various assumptions were taken into consideration, two crucial ones being the **Terminal Growth Rate** (2.5%), and the **Weighted Average Cost of Capital** (WACC) (7.9%) for the base cases. Therefore, it must be noted that the valuation obtained from the model was affected by these assumptions.

Based on the share price calculated, it appears that Netflix paid a reasonable price, or if not acquired Next Games at a **discount**. Although, the size of the deal may seem low, the opportunities that the deal presents is invaluable for Netflix. Therefore, the strategic and well-evaluated price of the deal could benefit Netflix massively in the upcoming years.



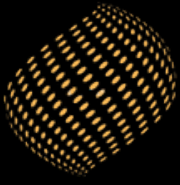
VALUATION ANALYSIS

MERGER MODEL ACCRETION/DILUTION ANALYSIS

PBT	5,104.42
Less:Income Tax	750.35
Net income	4,354.07
Outstanding Diluted shares of combined company	455
EPS of combined company	9.5694
EPS of acquirer standalone	11.2445
Accretive/Dilutive	Dilutive
Accretive/Dilutive	-1.6751
Accretive/Dilutive (%)	-15%

[Please click on the table to access full model.](#)

Based on the merger model and the accretion/dilution analysis shown above, the deal between Netflix and Next Games can be expected it to be **dilutive**, having the possibility of decreasing sing the **EPS** of the acquirer by 15%. This outcomes is logical given the very small market size as well as incredible smaller income statement of Next Games compared to Netflix. Therefore, when taking into account merging the two financial statements of the companies, Netflix appears to be worsening their position. It is important to note that the merger model was based on the 2021 annual reports of the companies, due to the deal closing in March 2022. In hindsight, the 2022 figures showed that Netflix's EPS decreased by 11.2%, which follows our dilution analysis. Although one specific acquisition cannot explain the full reason behind the EPS decline, it surely makes it evident that Netflix was not able to benefit from this acquisition by the end of 2022 in terms of EPS accretion.



CONCLUSION

IMPACT ON NEXT GAMES

Access to additional resources: As part of Netflix, Next Games will have access to additional resources, such as capital and technology, that can be used to further develop and improve their mobile games.

Integration with a larger platform: Next Games will have the opportunity to integrate their mobile games into the Netflix platform, which has a vast user base and can provide greater exposure for their titles.

Expansion of creative opportunities: With the backing of Netflix, Next Games may have greater freedom to develop new and innovative games, as well as explore new genres and themes.

Potential challenges with integration: As with any acquisition, there may be challenges with integrating Next Games into the Netflix platform, such as maintaining company culture and retaining key personnel.

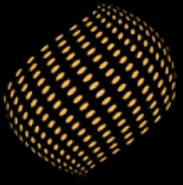
IMPACT ON NETFLIX

Netflix's acquisition of Next Games could have several potential impacts on the streaming giant.

The primary of these is the ability to diversify their revenue streams; Netflix has been heavily reliant on its subscription-based revenue model, and this acquisition allows it to expand into the gaming market and generate additional revenue from in-app purchases.

Increased engagement and retention: Gaming is a highly engaging and addictive form of entertainment, and integrating games into the Netflix platform could increase user engagement and retention, as well as attract new users.

Expansion of content library: By acquiring Next Games, Netflix gains access to a library of existing mobile games and potential future titles, which can be integrated into the Netflix platform and offered to users.



CONCLUSION

IMPACT ON INDUSTRY COMPETITORS

Increased competition: The acquisition puts Netflix in direct competition with other streaming and gaming companies, such as Amazon, Apple, and Google, who have already made significant investments in the gaming industry. This could lead to increased competition in the market.

Potential consolidation: The acquisition could lead to further consolidation in the gaming industry, with larger companies acquiring smaller studios to compete with Netflix and other streaming and gaming giants.

Impact on independent developers: The acquisition by Netflix could make it more difficult for independent game developers to compete in the market, as larger companies have more resources and a larger user base to draw from.



Source: The New York Times



GLOSSARY

Dilutive: Dilutive in finance refers to the negative change in value after a transaction.

Discount: Decreased amount paid per share in comparison to the share price at the time of the M&A transaction, often presented as a per amount

EPS: Earnings per share is a measure of a company's profitability, calculated by dividing quarterly or annual income by the number of outstanding stock shares.

ROI: Return on investment represents the monetary value of an investment after subtracting the costs associated with an investment

Sensitivity Analysis: The analysis of how a change in assumptions (inputs) can impact the output of a financial model.

Tender Offer: A public offer to buy most or all of a company's shares.

Terminal Growth Rate: A growth rate that a company is expected to grow at forever based on the market and industry conditions.

WACC: Cost of capital used to represent a firm's after-tax costs from all resources.



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