



GAME CHANGER

**Red-hot gaming industry
offers new opportunities
for investors**

MAY 2022



EXECUTIVE SUMMARY

Over the past decade, the gaming industry has made huge strides in innovation, popularity, and revenue generation. In the process, it has garnered much more interest from venture capital (VC) firms, private equity (PE) shops, and strategic buyers. According to PitchBook data, 2021 was a record year for gaming companies across several investment metrics, but the industry itself deserves the most credit for reaching this point.

Even before the pandemic, the gaming industry was supplanting other forms of entertainment, such as going to the movies or the bowling alley, as the preferred downtime for millions of U.S. customers. But its accelerant growth is due to more than its entertainment factor; games are now a social outlet for many, and brands including Epic Games, Sony, and Microsoft have established loyal customer bases that could rival any other industry. As it has matured, the gaming industry has also proved continuously innovative. The underlying technologies behind the user experience, the hardware itself, and advances in cloud computing provide a strong foundation for the industry going forward. Even as COVID-19 restrictions continue to ease, the gaming industry's customer base will likely increase.

Gaming companies are faced with how best to monetize the industry's massive audience and continue to grow it. Working in its favor, the gaming industry's audience is increasingly older, more mature, and has more money to spend on its products. 20 or 30 years ago, video games were mostly consumed by younger players. Today, adults make up a significant percentage of the gaming industry's base, and they potentially have more disposable income to spend on new games and in-game experiences.

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Most promising, however, is the gaming industry's focus on innovation and its potential applications beyond the gaming world. For decades, NASA technologies have found profitable uses outside of space exploration. In the same vein, gaming technologies such as virtual reality can be repurposed for other uses, such as pilot or surgical training. Consoles such as the PlayStation5 or the Oculus headset have more potential than their current, limited applications. For now, though, investors are focused on the games and associated user communities. Gaming platforms are trying to keep up with consumer demand by developing new game titles and creating stimulating user experiences.



PRIVATE MARKET GAMING AT A GLANCE

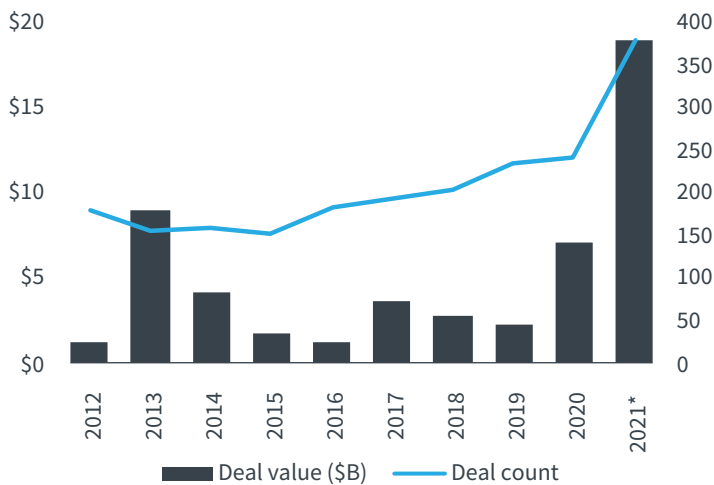
In 2021, almost \$19 billion was invested or spent on U.S. gaming companies. The old record was in 2013, but almost all of the \$9 billion invested that year was due to the \$8.2 billion acquisition of Activision Blizzard (Leonard Green & Partners). Otherwise, much of the past decade has been relatively quiet compared with 2021.

The overriding goal of most gaming investments revolves around establishing new products and user followings before expanding and monetizing them. Popular titles are key: In the eyes of investors, the difference between games such as Fortnite and Call of Duty and up-and-coming titles is vast. For owners of popular titles, the business model pivots to omnichannel growth, with significant attention paid to mobile, device, PC usage, and even merchandise. Up-and-coming titles, on the other hand, often have a difficult time getting noticed. Gaming’s market size is closer to the \$1 trillion range than the \$1 billion range. At a certain stage, growth boils down to growing a user base and effectively monetizing it going forward.

The VC industry is now investing billions of dollars across early- and late-stage opportunities, though the recipes differ. Early-stage companies need to focus on building strong teams that are building potentially popular products with potentially large, cult-like followings. Late-stage companies must focus on growing their user bases and breaching the mainstream market. At the tail end of the spectrum, strategic buyers, including Microsoft and Electronic Arts, have strong balance sheets and the capital to buy new titles to add to their catalogs. Rather than developing new titles in-house, the M&A market allows them to shortcut that process and gain new user bases in a single transaction.

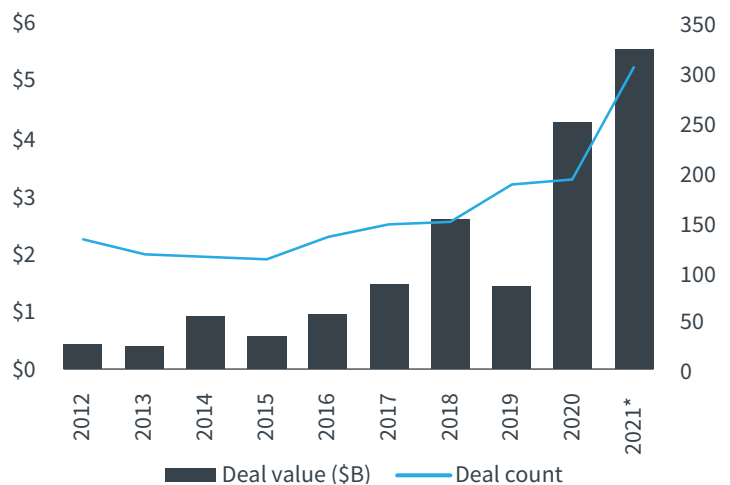
2021 was a massive, promising year for the gaming industry. Success still represents a formidable challenge, however. Startups need to build differentiated, enjoyable games, and platforms such as Meta, Microsoft, and Sony need to fold them into their own ecosystems to continue to grow.

Gaming private market deal activity



Source: PitchBook | Geography: U.S.
*As of December 31, 2021

Gaming VC deal activity



Source: PitchBook | Geography: U.S.
*As of December 31, 2021



“For now, investors are focused on the games and associated user communities. Gaming platforms are trying to keep up with consumer demand by developing new game titles and creating stimulating user experiences.”

— Alex Castelli, Managing Partner of Emerging Markets, CohnReznick



GAMING AND THE VC MARKET

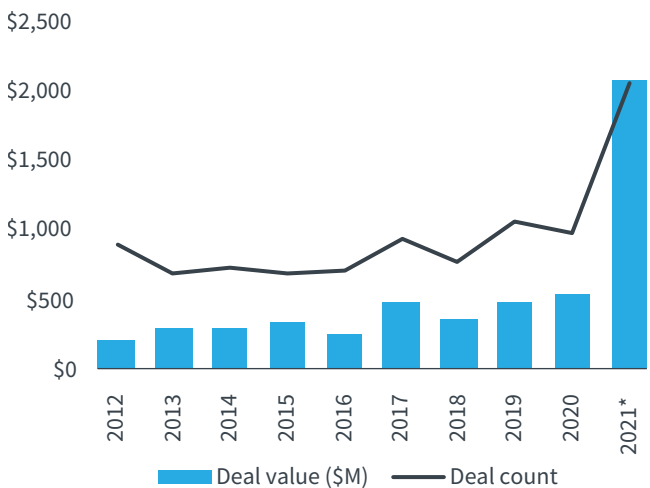
In 2021, for the first time, more than 300 VC investments were made in gaming in a single year. Also for the first time, 2021 saw more than \$5 billion invested. Between 2020 and 2021, the gaming industry attracted almost \$10 billion of venture capital.

Like other investors, venture capital is motivated by game titles and their potential. Some of the biggest VC financings over the past decade have involved household names such as Fortnite (Epic Games), Pokémon Go (Niantic), and Final Fantasy (Machine Zone). But venture's focus tends to come before game titles become successful. At the earliest stages, VC investors pay closer attention to the teams assembled and less to the products themselves. VC firms aim for returns of 10 times or more, and a team's talent and makeup is highly scrutinized. Repeat entrepreneurs are a valuable commodity to VC firms – even more so in gaming. Investors are motivated by founders who have previously developed games and teams and know how to build a following. Smaller startups often struggle to establish and build audiences; inexperienced entrepreneurs lack the promotional network that established

entrepreneurs have built. The early-stage market proved rich in 2021, with more than \$2 billion invested. No other annual total ever eclipsed \$1 billion.

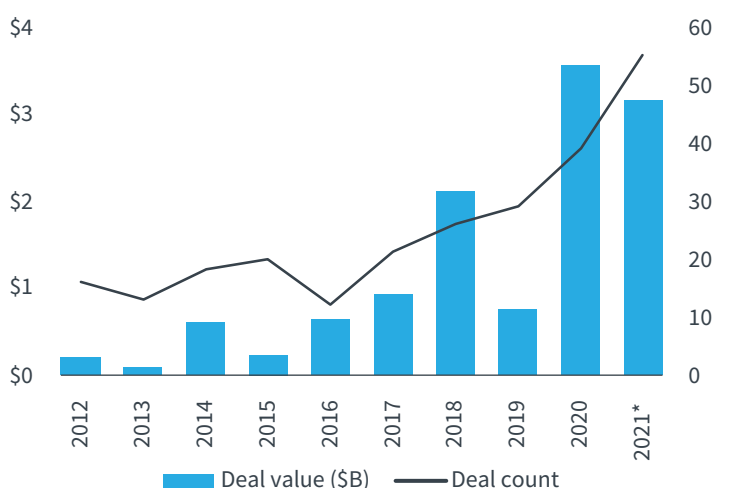
At the later stages, another \$3.1 billion was invested in 2021 across 55 financings, including rounds for Epic Games, Roblox, Niantic, and Mythical Games, among others. The median late-stage valuation popped to \$350.0 million, up from \$218.9 million in 2020. Those higher valuations largely reflect higher consumer demand and a scarcity of companies and titles in which to invest. The single largest late-stage valuation was for Epic Games, which garnered a \$27.7 billion pre-money markup in June 2021 in a round led by Sony, and a November 2021 round at a post-money valuation of \$42.0 billion. Epic Games' catalog includes mature titles, as well as dozens of games for children. Like other late-stage gaming startups, it focuses on monetizing its products instead of developing them. In that sense, the gaming industry is comparable to other emerging technology subsectors, with early dollars dedicated to product development and later dollars dedicated to capitalizing on them.

Gaming early-stage VC deal activity



Source: PitchBook | Geography: U.S.
*As of December 31, 2021

Gaming late-stage VC deal activity



Source: PitchBook | Geography: U.S.
*As of December 31, 2021



PRIVATE EQUITY AND M&A

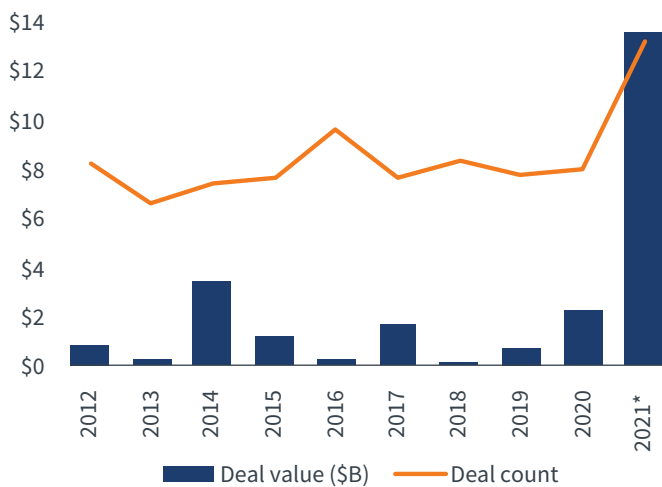
Gaming M&A activity easily broke records in 2021. \$13.3 billion was spent, including an \$8.1 billion purchase of ZeniMax Media by Microsoft and a \$2.1 billion deal for Glu Mobile by Electronic Arts. M&A deal flow also rose – to 66 transactions.

Most gaming M&A involves the largest players in the market, such as Microsoft, Sony, Alphabet, Meta, Electronic Arts, and Ubisoft, among others. In fact, Microsoft has been the most active acquirer of gaming companies over the past decade (see page 8). Gaming giants have dedicated audiences and loyal followings. In lieu of developing new titles from scratch, acquirers can buy them and their development teams. Buyers such as Microsoft and Sony can afford to pay healthy valuations for gaming add-ons and plug them into their robust marketing and distribution channels. Further, those kinds of acquirers can entice sellers with their brands, market position, people, process, and technology. Early-stage gaming startups need to demonstrate successful levels of sustained customer retention and a track record

of sustainable economic growth to attract financial sponsors. Less so if courting strategic buyers who can fold new acquisitions into their existing platforms.

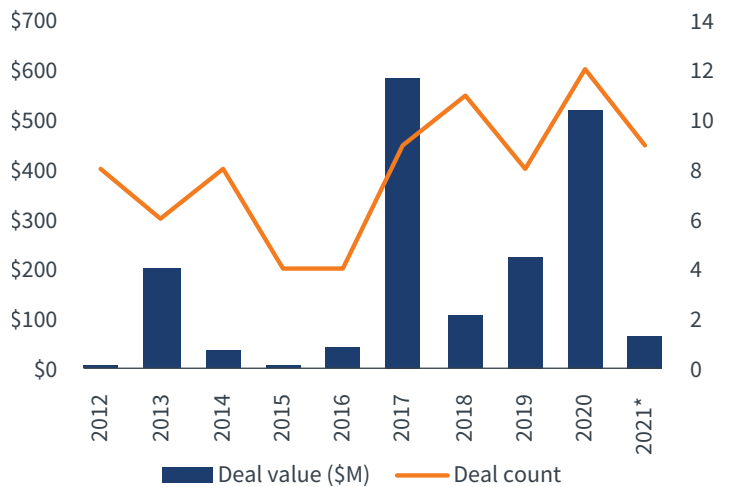
Private equity is also active in gaming, though not to the same degree as strategics or venture capitalists. PE's range is almost exclusively on the mature side: The typical PE fund timeline requires growth initiatives that can be achieved in five years or less, with the opportunity to expand a company's multiples in a short amount of time. The PE model is also much more conducive to proven track records and loyal customer bases. In 2021, for example, The Carlyle Group acquired Jagex, the gaming company behind the RuneScape franchise. After launching 20 years ago, RuneScape has become a \$1.0 billion franchise and has amassed more than 300 million player accounts. Carlyle's vast financial resources and intellectual intelligence should help Jagex improve revenue, optimize costs, bolster human capital, and identify add-on investments.

Gaming M&A activity

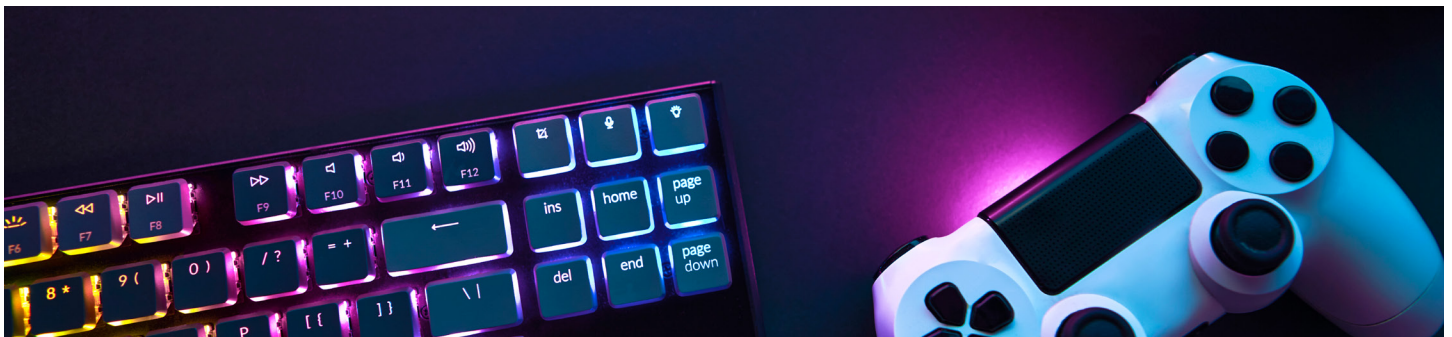


Source: PitchBook | Geography: U.S.
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Gaming PE deal activity



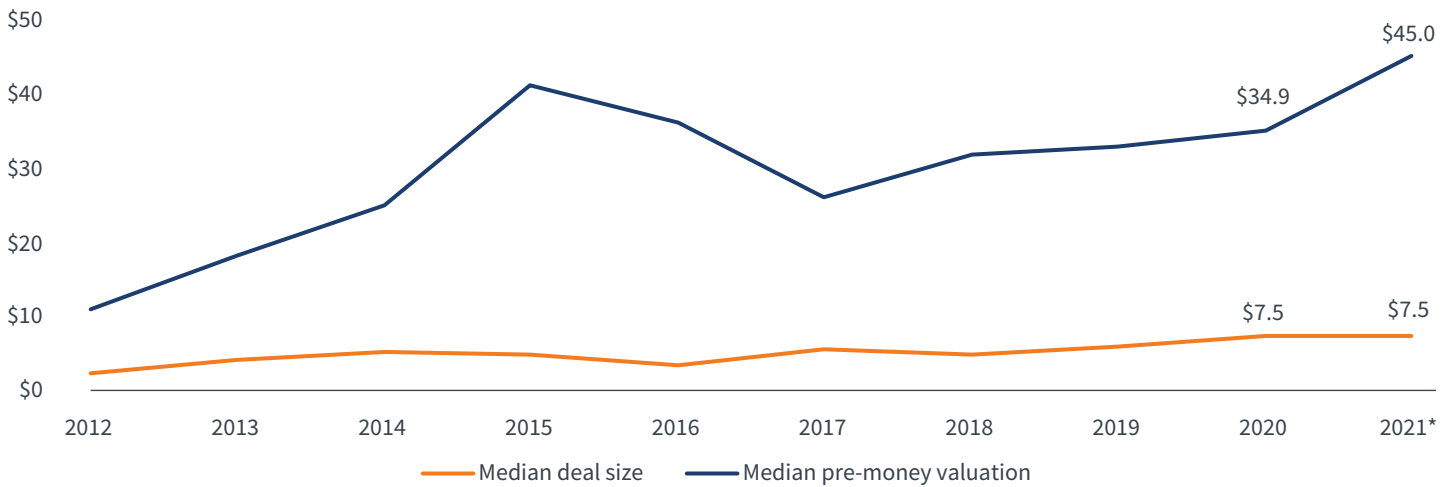
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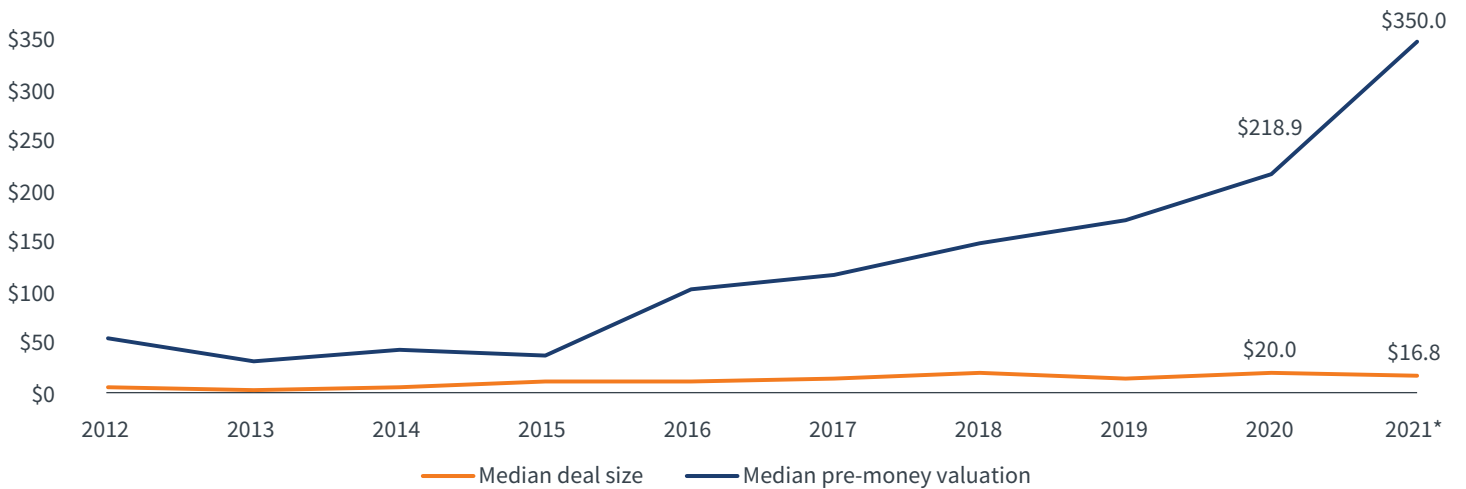
GAMING BY THE NUMBERS

Median gaming early-stage VC deal value and pre-money valuation (\$M)



Source: PitchBook | Geography: U.S.
*As of December 31, 2021

Median gaming late-stage VC deal value and pre-money valuation (\$M)



Source: PitchBook | Geography: U.S.
*As of December 31, 2021



GAMING BY THE NUMBERS

Top gaming VC deals since 2012*

Company	Close date	Deal value (\$M)	Lead investor
Epic Games	Sept. 18, 2020	\$1,780.0	SpaceX
Epic Games	Oct. 26, 2018	\$1,250.0	KKR
Epic Games	June 2, 2021	\$1,000.0	Sony
Forte	Nov. 12, 2021	\$725.0	Kora Management
Roblox	Jan. 6, 2021	\$520.0	Dragoneer
Zwift	Sept. 16, 2020	\$450.0	KKR
Unity	May 23, 2017	\$400.0	Silver Lake
Scopely	March 16, 2020	\$400.0	NewView Capital
Machine Zone	Sept. 5, 2014	\$377.0	JP Morgan
Scopely	Oct. 28, 2020	\$340.0	NewView Capital
Machine Zone	Aug. 1, 2016	\$330.0	Novator Partners
Niantic	Nov. 22, 2021	\$300.0	Peate Ventures
Niantic	Jan. 2, 2019	\$245.0	IVP
Niantic	Nov. 24, 2017	\$200.0	Spark Capital
ProbablyMonsters	Sept. 1, 2021	\$200.0	LKCM Headwater

Source: PitchBook | Geography: U.S.
*As of December 31, 2021

Most active VC firms in gaming since 2012*

Company	Deal count
Galaxy Interactive	44
BITKRAFT Ventures	39
Andreessen Horowitz	37
Makers Fund	27
1Up Ventures	25
Greycroft	22
Spark Capital	20
Sequoia Capital	20
Alumni Ventures	19
CourtsideVC	18
March Capital	17
Gaingels	16
MaC Venture Capital	16
First Round Capital	16

Source: PitchBook | Geography: U.S.
*As of December 31, 2021



GAMING BY THE NUMBERS

Largest gaming acquisitions since 2012*

Company	Close date	Deal value (\$M)	Acquirer
ZeniMax Media	March 9, 2021	\$8,121.0	Microsoft
Glu Mobile	May 3, 2021	\$2,100.0	Electronic Arts
Meta Quest	July 21, 2014	\$2,000.0	Facebook
Gearbox Software	April 7, 2021	\$1,378.0	Embracer Group
Kabam	Feb. 23, 2017	\$1,000.0	Netmarble Games
Twitch Interactive	Sept. 25, 2014	\$970.0	Amazon
Aspyr Media	Feb. 3, 2021	\$450.0	Saber Interactive
Storm8	Feb. 28, 2020	\$400.0	Stillfront Group
Gaikai	Aug. 10, 2012	\$380.0	Sony
Parsec	Sept. 7, 2021	\$333.0	Unity
Daybreak Game Company	Dec. 22, 2020	\$300.0	Enad Global 7
Respawn Entertainment	Dec. 1, 2017	\$273.0	Electronic Arts
FoxNext Games	Jan. 22, 2020	\$250.0	Scopely

Source: PitchBook | Geography: U.S.
*As of December 31, 2021

Most active gaming acquirers since 2012*

Company	Deal count
Microsoft	9
Stillfront Group	6
Kabam	6
Zynga	6
Meta Platforms	5
Social Gaming Network	5
Enthusiast Gaming	5
Animoca Brands	5
TinyBuild	4
Gamigo	4
Keywords Studios	4
Warner Bros. Entertainment	4

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*As of December 31, 2021



Backing the best teams – A Q&A with CohnReznick

What were some of the factors that led to a record year in gaming investments?

Castelli: What we're seeing is an industry that enjoyed accelerated growth over the past two years. Gaming has become more than just entertainment for a lot of people; it is now also a social outlet, and that aspect doesn't seem to be going away. The video game publishers have responded to demand, and new technologies have also helped. As we see more and more technology advancements, this growth will continue, because it's a social outlet and it's still entertainment.

Ultimately, what attracts new users every day depends on the type of entertainment you're generating. Once that is achieved, the challenge becomes monetizing those audiences while continuing to grow them. Some of the video game publishers have been doing some pretty interesting stuff, including in-game monetization such as character upgrades. If a game has a large subscriber base, even low-cost upgrades can have a noticeable impact on the revenue side.

Meir: A lot of the growth we've seen in the last year is due to innovation, which has led to newly created whitespace. I think the user demographic is changing, too. It's certainly different than it was 20 years ago. Over the years, the gaming industry has been able to retain much of its user base, and many of today's users have more disposable income than gaming audiences have in the past.

The industry is maturing through a natural evolution process, and you can see that most clearly in the industry's focus on omnichannel. In the past, traditional gaming revenue streams were centered on title sales – names such as Call of Duty and Grand Theft Auto. The industry has pivoted to complementary revenue streams, including in-game purchases such as seasonal character customization, NFTs, or more traditional merchandise. Shirts and hats for big titles can capture millions of dollars in new revenue.

Beyond merchandise, these gaming companies are asking themselves how they can increase their reach across platforms, whether it's a mobile device, personal computer, PlayStation or Xbox. There have been so many technological advancements just over the past few years. That's attractive to investors who are looking for revenue streams beyond subscriber bases and traditional sales.



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Backing the best teams – A Q&A with CohnReznick

What kinds of qualities or attributes are venture capitalists looking for?

Castelli: Over the last couple of years, VCs have been writing bigger checks compared to five years ago. Early-stage investing is about the entrepreneurs. With gaming in particular, VCs value the serial entrepreneur – somebody who has put together a team before and had successful outcomes. Then they look at the team behind the company and whether they can hit a home run on content. They're looking at the pipeline of potential games that the company is working on. VCs aren't looking for 4x returns; they're looking for 10x or more. Otherwise, they haven't really achieved their goals.

Meir: In the early stage, it's very much betting on the team and less on the product. As you move up into maturity and the lifecycle of a company, I think there are other elements that go into it. The prospect of selling to a strategic acquirer comes into play, especially if you strike gold with a piece of viral content that becomes very appealing to a buyer.

What are your thoughts on the current gaming M&A market?

Tronkina: There has definitely been a huge pickup over the last couple of years. We've seen more people sitting in front of their TVs and on their phones. Gaming has helped people feel less secluded and more socially connected. Beyond that, some of the new technologies coming on the market, such as new consoles, are driving deals. Over the last couple of years, hardware manufacturers have come up with new products. When considering an acquisition or investment, commonly asked questions are: How do we utilize this hardware? How do we utilize the social interaction aspect of gaming? How do we monetize the content and distribution of a particular game?

The M&A market is fueled by consolidation efforts and coming up with multiple ways to create and distribute content. I don't see the M&A market slowing anytime soon, especially as platforms continue to add new users and people spend more time playing these games. I saw a recent estimate that the gaming sector expects tremendous growth over the next decade.

What type of gaming companies are PE firms attracted to? Do they prefer outright acquisitions, or are they more inclined to do growth investments?

Tronkina: Private equity is focused on exits. To get there, they have to figure out a way to increase the company's multiples within a five-to-seven-year horizon. The more IPOs and strategic acquisitions there are, the more ravenous private equity's appetite. The question is how much value a PE firm can generate in a short amount of time, and that depends on the PE firm's experience in the industry.

It also depends on whether the company has other suitors – especially strategic buyers, which would drive up the price. A company such as Microsoft can integrate an acquired title into its existing game infrastructure, create new revenue streams, and bid higher for the asset. But there is a lane for PE, as seen with Carlyle's acquisition of Jagex in 2021. Jagex is behind the RuneScape franchise, which has been around for 20 years. It has a loyal following and still has lots of growth potential, but it also reached the point where it needed somebody to come in to help accelerate those growth efforts.

Whether a PE firm takes a controlling position or not is a big question and is part of an investor's game plan before investing. A controlling position would come down to creating an additional revenue stream or tweaking a company's revenue subscription model by boosting its subscriber base or introducing a new distribution platform.

Above everything else, though, it would have to be with a company that has a proven track record and a loyal customer base. Some firms would rather take a noncontrolling position with a company that has a proven track record or experienced team and keep some money for another investment – while still hitting a home run with the growth investment. That would reduce their risk, and in the case of really attractive companies, the management team may not be willing to sell the company anyway.



About CohnReznick

As a leading advisory, assurance, and tax firm, CohnReznick helps forward-thinking organizations achieve their vision by optimizing performance, maximizing value, and managing risk. Clients benefit from the right team with the right capabilities; proven processes customized to their individual needs; and leaders with vital industry knowledge and relationships. Headquartered in New York, NY, with offices nationwide, the firm serves organizations around the world through its global subsidiaries and membership in Nexia International. For more information, visit

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