VENTUREDEAL M&A ANALYSIS

Research and opinion on recent and potential M&A transactions.

Groupon Acquires LivingSocial

DraftKings & FanDuel

Glu Mobile Acquires Crowdstar

November, 2016

VentureDeal

Groupon Acquires LivingSocial For Non Material Sum

Quick Take

Small business marketing company Groupon (NASDAQ:GRPN) announced on October 24, 2016, that it entered into an agreement to acquire all of the outstanding shares of privately-held LivingSocial, an online coupon service.

This tuck-in acquisition will add 1 million LivingSocial users to Groupon's North America customer list of 29.1 million users.

Assuming Groupon didn't overpay for those customers, this deal is a good example of patient management waiting for the right time to increase market share.

Target Company

LivingSocial offers an electronic discount coupon service to help local businesses attract first-time customers.

Service and product categories include:

- Restaurants
- Health & Beauty
- Events & Activities
- Nearby Trips
- Sports & Fitness
- At Home
- Home
- Jewelry
- Services
- Fashion

Below is an video about LivingSocial's 'Experience' service:

(Source: LivingSocial YouTube)

LivingSocial was founded in 2007, had raised $928 million in venture capital and was valued in a 2011 financing round at $6 billion.

Terms

The companies did not announce the terms or amount of the acquisition, which is expected to close by early November 2016, subject to the satisfaction of customary closing conditions.

Groupon said the "acquisition consideration is not material."

As a result, it does not have to disclose the price paid, although it is not uncommon to find that information disclosed in future SEC filings.

Rationale

According to CEO Rich Williams, the acquisition is primarily a customer base expansion.

The deal will add 1 million of LivingSocial's active customers to Groupon's existing US customer base of 29.1 million users, or 3.4%.

Per Groupon's most recent 10-Q, it had 50.7 million active customers in the trailing 12 months ended September 30, 2016.

With an annual gross revenue of $3 billion, that results in an average of $59.17 revenue per customer.

Of course, that is inclusive of their operations worldwide, so the US average is likely to be higher, perhaps an estimated $75 per customer, perhaps discounted to $50.

Since LivingSocial is contributing 1 million customers to Groupon's customer base, the incremental value to Groupon would be an estimated $50 million.

Groupon's annualized sales and marketing expense rate in the US is 38%, so hypothetically it would spend 38% of $50 million, or $19 million to acquire 1 million new US customers.

Therefore, my best guess is that Groupon paid somewhere under $20 million for LivingSocial.

Commentary

Both companies were born out of the "deal of the day" concept which became popular during the aftermath of the financial crisis of 2008.

After the recession ended, cost conscious consumers continued to use the convenient coupon & deal opportunities to save money.

However, small business merchants became less enamored of the service, as they did not see the kind of return business they expected to receive in return for significant discounts.

Also, as the economy improved from the recession lows, there was less demand from the consumer side for discounts. As a result, the marketplace of buyers and sellers of discounts, which is effectively what these two companies operate, slowed.

Concurrent with the acquisition announcement, Groupon also said it plans to reduce the number of countries in which it operates from 27 to 15, in order to focus on the US and Europe.

Groupon also reported quarterly financial results along with the announcement and raised its revenue guidance range to between $3.075 and $3.150 billion for 2016.

It expects its 2016 adjusted EBITDA range to be between $150 million and $165 million.

DraftKings And FanDuel May Need To Combine To Compete

Online fantasy sports industry heavyweights DraftKings (Private: DRAFT) and FanDuel (Private: DUEL) are working on a merger combination, according to a report in the Wall Street Journal.

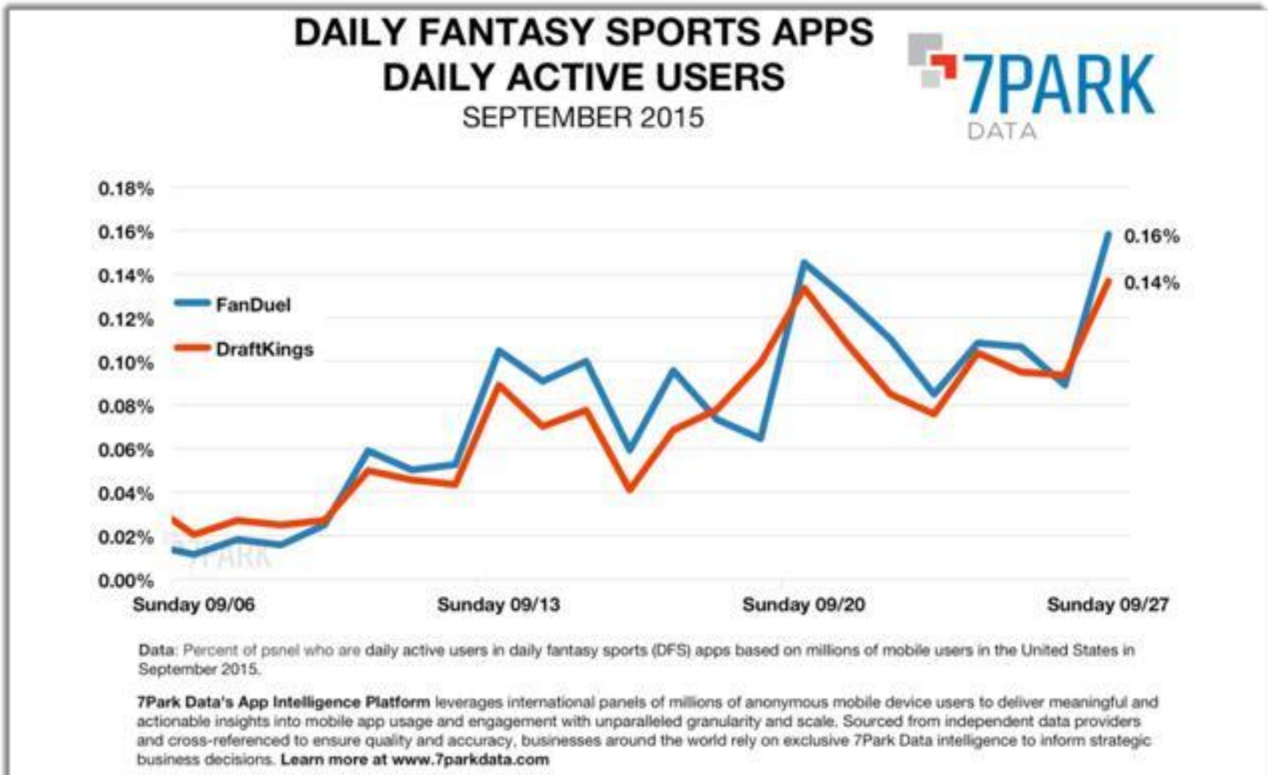
In June, Bloomberg reported that the companies had launched talks to merge in the wake of several states successfully shutting the services down by claiming they facilitated illegal gambling.

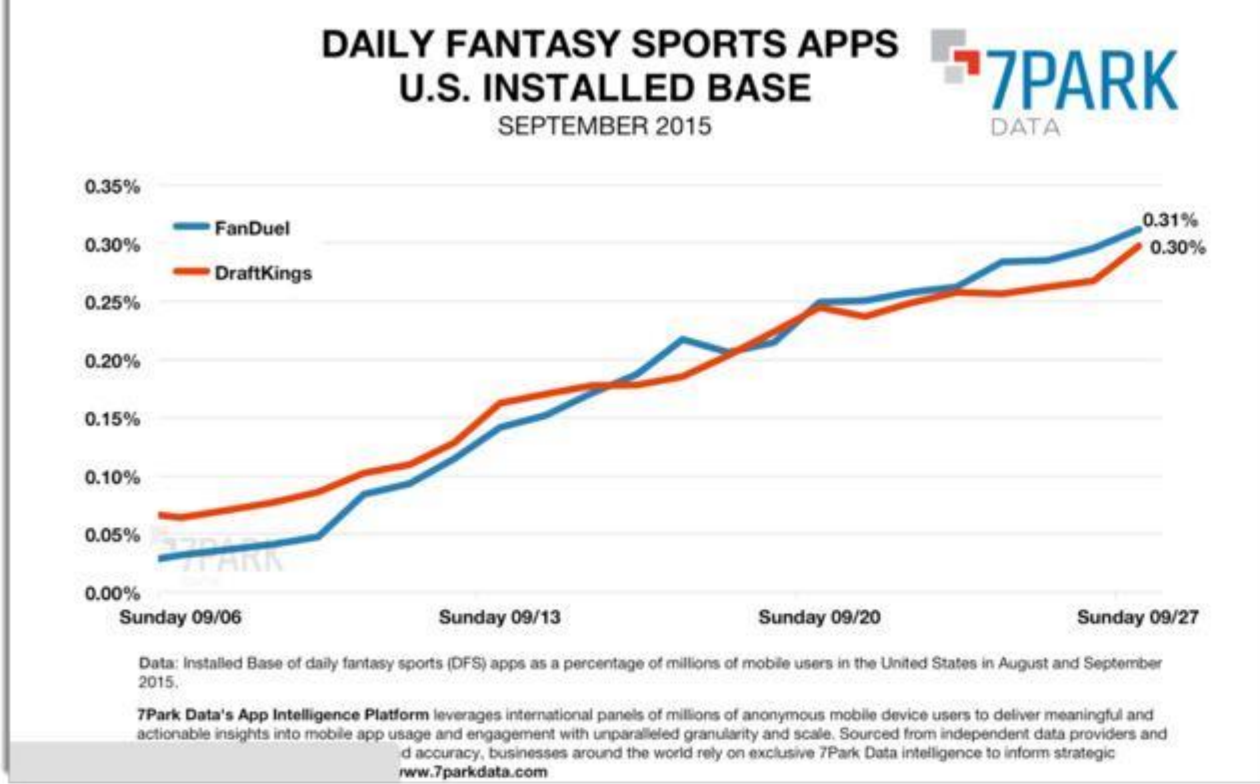
Since then, the state of New York, the most prominent state to take action, has passed legislation granting the services legal status as "games of skill".

After that legislation was passed, both companies raised large funding rounds; DraftKings received $154 million from investors and FanDuel netted $55 million in debt funding.

Then, in October, the two companies settled their controversy with New York by agreeing to pay $6 million each.

A 2015 comparison of the two firms' market share revealed they were largely even:



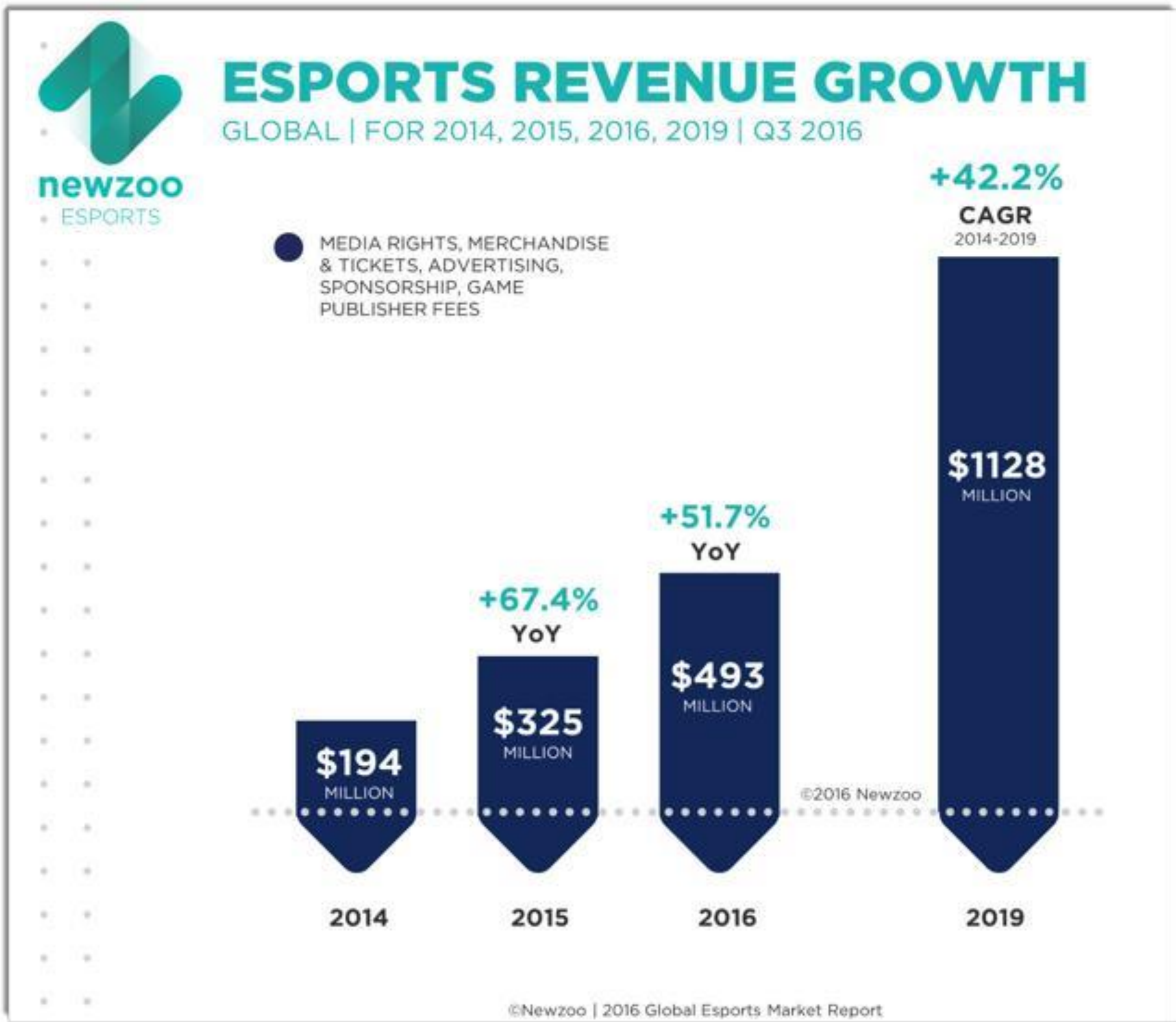


(Source: Fortune & 7ParkData)

In my previous article on FanDuel, I emphasized the potential for the firm with the legal woes behind it:

FanDuel Is A Unicorn Back On The Fast Track

In that article, I showed the tremendous growth estimates for eSports over the next few years:



(Source: Newzoo)

So, the market, inclusive of merchandise, advertising, tickets, sponsorship, and game publisher fees, is expected to grow to $1.1 billion by 2019, representing a CAGR of 42.2%.

That high growth rate will attract competitors.

Video game makers such as Activision Blizzard (NASDAQ:ATVI) and Electronic Arts (NASDAQ:EA) have apparently created new divisions devoted to eSports initiatives.

Media firm ESPN, a unit of Walt Disney Company (NYSE:DIS) has also been reported to have created a unit to develop a potentially competitive service to expand on its fantasy football site. It's not hard to see the potential value of tie-ins between an eSports site and the heavyweight sports media presence of ESPN, backed by the deep financial pockets of Disney.

Yahoo (NASDAQ:YHOO) also is a player in fantasy sports.

The report goes on to say that DraftKings CEO Jason Robins would likely be the combined group's CEO, with FanDuel's CEO Nigel Eccles as Chairman.

No terms of a proposed transaction have been discovered, nor do we have any idea whether both brands would continue to operate or one would fold into the other.

Rationale

Both companies are privately-held, so no confirmed financials are available. They have both been valued by private investors at more than $1 billion.

DraftKings has focused its efforts on far fewer sports, while FanDuel has a broader offering spread among many more sports.

Rationalizing their approach to the market opportunities will be one challenge for the combined entity.

Commentary

The WSJ report says that "neither company has figured out how to be profitable, with heavy spending on marketing eating up revenue." I don't believe the WSJ has access to confirmed financials, so I'm doubtful that it can confidently express such an opinion.

I suspect that the real reason the two companies are considering a merger is to be able to more effectively compete with booming new competitors coming into the market, as I previously detailed.

Major video game makers are getting interested, and although they would be new to the business, they have tremendous capabilities at user experience.

ESPN may be expanding their foray into eSports beyond just football, completely removing a potential marketing channel for the upstarts.

The merger, if it happens, may save the two companies some on operating costs, so that cost savings may be relevant here, too. If they can show a better path to profitability as a combined entity, that may be enough to support an IPO to tap public markets for more capital to compete effectively.

For DraftKings and FanDuel, it may be a case of "Go big or go home."

Glu Mobile Acquires Crowdstar To Diversify Portfolio

Quick Take

Mobile game publisher Glu Mobile (NASDAQ:GLUU) has acquired fashion game developer Crowdstar at an approximate value of $45.5 million in an all-cash transaction.

The acquisition represents a strategic buy for GLUU, with Crowdstar's focus on female users.

Crowdstar is readying its home-focused app for commercial launch soon.

With the acquisition, GLUU may be developing opportunities for transactional tie-ins with brands through Crowdstar's apps, potentially adding a new and attractive revenue stream.

Target

Burlingame, California-based Crowdstar was a venture capital-backed startup founded in 2008 by Suren Markosian, Peter Relan, and Jeffrey Tang.

The company developed a flagship mobile-based social fashion game, *Covet Fashion*, that enables women to style looks with actual brand clothing and accessory items.

Covet Fashion is available on Apple iOS, Google Play, Amazon and Microsoft platforms.

Major brand partners included BCBGMAXAZRIA, Rebecca Minkoff, and Rachel Zoe. Other strategic partners are Tencent, NHN, and Facebook.

Notable investors were Time Warner Investments (Rachel Lam) and Intel Capital and the company received $49 million in total investment.

Rationale

Glu is a well-known publisher of free-to-play mobile games but has acquired Crowdstar to expand and diversify its offerings.

In addition to being focused on women's fashion through its *Covet Fashion* app, Crowdstar is also readying for launch a second major title, *Design Home*.

Still in beta testing stage in Canada, the app has recently reached #54 in the Canada App Store Top Grossing chart spot for all iPhone apps.

According to Glu Mobile's new Executive Chairman Niccolo de Masi, *Design Home* "is exhibiting promising potential in early beta results as a platform, and we are optimistic that it can be a significant growth driver for the company in 2017."

Terms

Glu acquired 80.6% of Crowdstar for $40.8 million and will pay an additional $4.5 million in cash to the drag-along holders of company stock. It expects to own 98.5% of company shares after the drag-along is completed and intends to acquire 100% of voting power soon.

With a purchase price enterprise value of $45.5 million in cash, the investors didn't make any money on the deal, but probably got most of their invested capital back, so the investment wasn't a total loss to them.

Commentary

Looking at Glu's stable of titles, only seven out of 68 games are for women or girls, or roughly 10%.

It seems clear that Glu wants to adjust that product mix by acquiring a female-focused game developer in Crowdstar.

Furthermore, Crowdstar's game focus on fashion and home design appeals to an older demographic, the 18 - 34-year-old female user rather than Glu's more typical 8 - 18 focus.

Glu is paying a healthy price for Crowdstar, so my guess is that this is a signal that it intends to focus on an older, female user that may be a casual user or may want a more substantial app, such as Design Home.

Concurrent with the acquisition announcement, Glu announced the appointment of president Nick Earl as CEO. Earl was previously a senior executive at Electronic Arts and is considered a "product-centric" executive.

Previous CEO Niccolo de Masi moved up to Executive Chairman and will focus on more strategic acquisitions such as Crowdstar and cultivating connections between Glu and third party celebrity tie-ins like its *Kim Kardashian: Hollywood*.

So, does this acquisition signal a strategic shift for GLUU? The company's new CEO Nick Earl referred to the Crowdstar transaction as "strategic and complementary", so my belief is that it represents a strategic adjustment to focus more on 'highly social and interactive mobile community platforms' (CEO Earl's words).

If Glu can capitalize on the increased social aspects with potential direct brand tie-ins, that could presage a more transactional, "ecommerce" approach.

Glu could begin to generate revenues by facilitating users buying brand items direct from the app, with Glu effectively acting as the distribution partner for brands.

Women's fashion, home design products and related brand tie-ins represent large, multi-billion dollar transactional opportunities.

We'll see how GLUU monetizes this new strategic acquisition. If it can succeed in getting a piece of the transactional pie with brands, the marginal revenue could be significant.