

Michael Mahoney Comments on Game Industry

Zombies in Play as Zynga Deal Sparks Glu Mobile Talk: Real M&A

2012-03-28 14:05:08.635 GMT

By Katia Porzecanski and Olga Kharif

March 28 (Bloomberg) -- Glu Mobile Inc., the maker of "Contract Killer: Zombies" and "Gun Bros" games for smartphones, is offering potential buyers the fastest sales growth among U.S. mobile gaming competitors.

Shares of Glu Mobile rose 21 percent last week on speculation it's a takeover candidate after Zynga Inc. paid \$180 million for OMGPOP Inc., which produces the "Draw Something" application. With analysts estimating revenue will climb 86 percent in the next two years, San Francisco-based Glu Mobile traded yesterday at 2.3 times 2013 sales, cheaper than the average for mobile gaming competitors globally and a 58 percent discount to Zynga, according to data compiled by Bloomberg.

Glu Mobile could be the next target in the \$7 billion mobile gaming industry after deals for OMGPOP, Playdom Inc., PopCap Games and Playfish Inc. in the last three years, said Canaccord Financial Inc. While Glu Mobile has slumped 61 percent since its 2007 initial public offering, the company is projected to post its first profit by 2014 as it transitions to so-called freemium games that are downloaded at no cost and then charge for extra features. The company may lure interest from Zynga, Electronic Arts Inc. or DeNA Co. and fetch more than \$6 a share, said Roth Capital Partners LLC, a 34 percent premium.

"They happen to be in the right space at the right time," Daniel Niles, senior portfolio manager at AlphaOne Capital Partners LLC, which owns shares of Glu Mobile and Zynga, said in an interview from San Francisco. "If you're looking at this and saying 'I know I need to get into the freemium business, and I'd like exposure to the fastest growing pieces of that -- which are the guys that produce stuff for cell phones and tablets,' this is a logical candidate that's also not that expensive."

'The Right Premium'

"As a public company, Glu's policy is to not comment on takeover speculation," Chief Executive Officer Niccolo de Masi said in an e-mailed statement. "Our management team and board are fully aligned with our shareholders and would recommend an offer for the company at the right premium."

Adam Isserlis, a spokesman for San Francisco-based Zynga, and John Reseburg, a spokesman for Redwood City, California-based Electronic Arts, declined to comment on whether the

companies are considering bids for Glu Mobile. Sibel Sunar, a spokeswoman for Tokyo-based DeNA in Los Angeles, didn't return phone calls or e-mails requesting comment.

Today, Glu Mobile advanced 12 percent to \$5.02 at 9:57 a.m. in New York, the highest intraday price since August. The stock posted the second-biggest advance in the Russell 2000 Index.

'Family Guy: Uncensored'

Founded in 2001, Glu Mobile began generating the majority of revenue from smartphone games last year and forecasts that the category will make up as much as 88 percent of 2012 sales.

In 2010 the company shifted to the freemium model, which allows users to download games for free and then makes money from micro-transactions for virtual goods and in-game advertising.

Glu Mobile, which bought developers Griptonite Inc. and Blammo Games Inc. last year, offers social mobile games from "Deer Hunter Challenge" to "Stardom: The A-List" and also partners with Activision Blizzard Inc. and News Corp.'s Fox on games such as "Guitar Hero: Warriors of Rock Mobile" and "Family Guy: Uncensored."

The global mobile game market reached about \$7 billion in revenue in 2010, according to Technavio, a market research firm in Elmhurst, Illinois. The U.S. portion of the mobile gaming industry expanded 29 percent in the fourth quarter of 2011 from a year earlier, becoming the fastest-growing category of gaming purchases, based on data from NPD Group Inc., a Port Washington, New York-based market research firm. In the same period, 81 percent of mobile game applications were downloaded at no charge, according to NPD.

Freemium Games

"Mobile has become larger, so the market potential has expanded dramatically," Michael Mahoney, senior managing director at Falcon Point Capital LLC in San Francisco, said in a phone interview. "Fundamentally, two things are very valuable: a distribution platform and some ability to produce hits. Not many companies have that."

Glu Mobile said its freemium games for smartphones and tablet computers are up against offerings from public companies such as Zynga, DeNA, Gree Inc. and Tencent Holdings Ltd. Glu Mobile said it also competes for consumer spending with premium mobile games from Activision, Electronic Arts, Gameloft SA and Take-Two Interactive Software Inc., according to its annual regulatory filing.

Glu Mobile's revenue is projected to reach \$123 million in 2013, based on analysts' estimates compiled by Bloomberg, 86 percent higher than in 2011. That's a steeper increase than every company Glu Mobile lists as a competitor except for Tokyo-based Gree, the data show.

'Not That Expensive'

While Glu Mobile is the second-most expensive among its global competitors at 3.9 times sales in the last 12 months, its price-to-sales multiple drops to 2.3 relative to 2013 revenue, based on yesterday's closing price, data compiled by Bloomberg show. That's less than the group average of 2.9 times 2013 sales and Zynga's ratio of 5.6.

"Considering the growth rates, it's not that expensive," Adam Krejcik, an analyst at Roth Capital in Newport Beach, California, said in a phone interview. "Especially if you compare it to the likes of Zynga."

There's no reason for Glu Mobile to trade at a discount to Zynga and historic takeover multiples in the industry of 6 times to 7 times revenue, Michael Graham, a New York-based analyst at Canaccord, said in a phone interview.

'Plants vs. Zombies'

Zynga, the biggest maker of social games, said last week it acquired New York-based OMGPOP, whose "Draw Something" game has 27.8 million monthly users on Facebook Inc., according to the website AppData. OMGPOP also introduced a mobile version last month that's the most popular program in Cupertino, California-based Apple Inc.'s App Store. Zynga is trying to reduce its reliance on Menlo Park, California-based Facebook, which accounts for more than 90 percent of its sales.

After Zynga disclosed the price of the OMGPOP acquisition in a March 23 regulatory filing, Glu Mobile shares gained 21 percent, the most since November 2010. The stock closed yesterday at \$4.47, giving the game developer a market value of \$286 million. The shares fell as low as 23 cents a share in November 2008.

OMGPOP was the latest in a wave of mobile and social gaming takeovers in the last two years. Electronic Arts in 2009 bought Playfish, with games such as "Pet Society" that are played on Facebook, and last year acquired PopCap, the publisher of "Plants vs. Zombies" and other games for cell phones and social networking websites.

Creating Hits

Walt Disney Co. purchased social-game maker Playdom in 2010 and last year took an accounting charge related to the deal and posted an operating loss in its interactive unit.

Glu Mobile introduced 20 new titles last year, eight of which the company considered “successful,” CEO de Masi said on a Feb. 7 earnings conference call. The company has about 85 iPhone apps and 39 iPad apps available in the App Store.

“If a company has one hit game, it’s not a guarantee it will continue to produce hits,” Justin Smith, founder of social-games researcher Inside Network in Palo Alto, California, said in a phone interview, referring to success broadly in the gaming industry. “There are definitely no guarantees. If you are a large developer able to cross-promote your titles, that gives you a big advantage.”

While Glu Mobile is losing money, the company would still be a good takeover candidate because a buyer could reduce expenses by firing some of its approximately 575 employees, said Tom Taulli, who analyzes acquisitions and public offerings for the Los Angeles-based website IPOPlaybook.com. The games publisher may report its first annual profit of \$7.7 million in 2014, based on analysts’ estimates compiled by Bloomberg.

Zynga’s Acquisitions

“There are not as many companies left,” Taulli said in a phone interview. “The sector has gone through a consolidation over the years.”

Larger gaming companies such as Electronic Arts, valued at \$5.6 billion, and Zynga, which has a \$9.5 billion market capitalization after its December IPO, could be interested in Glu Mobile to further expand in mobile games, according to Taulli, Falcon Point’s Mahoney and Roth Capital’s Krejcik. Zynga, with \$1.9 billion in cash and short-term investments, has made more than 20 acquisitions since 2008. Electronic Arts has holdings of \$1.8 billion in cash and short-term investments.

“The big buyers are going to be EA and Zynga,” Taulli said. “It’s going to be their way to stay at the top of the charts. As you get bigger, it gets harder to innovate.”

Takeover Price

International gaming companies like DeNA, an operator of social gaming and shopping websites worth 333.3 billion yen (\$4 billion), are “looking for a foothold in the U.S. mobile market,” said Graham of Canaccord. “Those are companies that are already slowly getting involved in the U.S. by releasing games here. They could potentially look for an acquisition to accelerate their entry.”

While Taulli estimates Glu Mobile could get as much as a 15 percent premium in a takeover, or about \$5.14 a share based on yesterday’s closing price, Mahoney projects a price tag of \$6 to \$7 a share. Niles of AlphaOne said the company will be able to reach as much as \$8 a share on its own in the next 12 months and may sell for more than \$10 in one to two years as it reaches profitability.

Glu Mobile is “still a relatively smaller company in a very fast-growing segment,” said Roth’s Krejcik. “The acquisition by Zynga, it shows that they’re going to be aggressive in terms of trying to make moves in the space and that there’s still a lot of interest.”

For Related News and Information:

Glu Mobile deal news: [GLUU US <Equity> TCNI MNA <GO>](#) Mergers & acquisitions search: [MA S <GO>](#) Mergers and acquisitions news: [NI MNA <GO>](#) Top deal stories: [TOP DEAL <GO>](#) Real M&A columns: [NI REALMNA <GO>](#)

--With assistance from Cliff Edwards and Douglas MacMillan in San Francisco. Editors: Sarah Rabil, Daniel Hauck.

To contact the reporter on this story:

Katia Porzecanski in New York at +1-212-617-0408 or kporzecansk1@bloomberg.net; Olga Kharif in Portland, Oregon, at +1-503-471-1359 or okharif@bloomberg.net.

To contact the editors responsible for this story:

Daniel Hauck at +1-212-617-1697 or dhauck1@bloomberg.net; Katherine Snyder at +1-212-617-5212 or ksnyder@bloomberg.net; Thomas Giles at +1-415-617-7223 or tgiles5@bloomberg.net.