An Analysis on Tencent's Acquisition of Supercell

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Abstract. This paper delves into the intricacies of Tencent's acquisition of Supercell, shedding light on the underlying rationale and objectives that motivated Tencent's strategic move. By examining the synergy between the two entities, it explores the potential benefits envisioned by Tencent through this acquisition, emphasizing the mutual advantages anticipated by both parties. Furthermore, a comprehensive analysis is conducted to scrutinize the financial standing and prevailing market conditions of Tencent and Supercell pre-acquisition. This critical examination serves as a basis for evaluating the extent to which the acquisition has yielded substantial benefits for the involved entities. Through a meticulous assessment, this article endeavours to ascertain the prosperity of the acquisition, gauging its impact on both Tencent and Supercell. By considering various factors such as financial performance, market positioning, and strategic alignment, this analysis aims to provide insights into the efficacy and success of Tencent's acquisition strategy in bolstering its market presence and enhancing its competitive edge in the gaming industry.

1 Introduction

This incident was an acquisition initiated by Tencent by purchasing equity in Supercell. Li et al. stated that, Tencent, one of China's most prosperous gaming firms, has kept up its growth and development through a series of successful foreign mergers and acquisitions [1].

This article discusses Tencent's acquisition of Supercell, exploring the reasons behind it and the benefits it can bring to both companies. The article also investigates whether the acquisition was successful by analysing the two companies' financial situation and other conditions before and after the acquisition. It aims to determine whether the two companies obtained substantial benefits through this acquisition. The article briefly introduces Tencent and Supercell, highlighting their history, services, and achievements. Finally, the article discusses the challenges both companies faced and how the acquisition was supposed to address those challenges. This is crucial for Tencent. In order to get such remarkable outcomes in mobile games, Tencent invested US$8.6 billion in 2016 to purchase 84.3% of a Finnish game developer's shares. Tencent purchases the most popular smartphone game globally developer. Tencent bought Supercell with the intention of combining the two businesses' capabilities to increase its competitiveness in the mobile gaming market. Supercell is a well-known mobile game development business that has created several popular games, including "Clash of Clans," "Cartoon Hay Day," "Boom Island," and "Clash Royale." Despite the fact that Tencent has had considerable success with computer platform games. As an illustration, Tencent created "League of Legends" after acquiring Riot Games in 2015. Tencent has profited greatly from it. But Tencent’s main clientele consists of a sizable population of mobile phone users in the Chinese market. Kenney et al. stated that this deal goes some way toward demonstrating the continued importance of gaming to Tencent’s strategy, given Tencent’s long-standing reliance on gaming revenue in the PC era, as most analysts believe [2]. But this misses the important point that Tencent’s actual client acquisition strategy in the Chinese market is concentrated on the PC and smartphone chat platforms QQ and WeChat, as well as their increasingly important electronic payment systems. This indicates that Tencent's
approach at the time was more focused on immediately acquiring already-successful businesses and games than it was on spending a lot of money on game development. The goal is to implement Tencent's gaming ecosystem and boost global and Chinese market competitiveness. With this deal, Supercell will be able to grow its market share in China and raise a sizable sum of money. Still, is it really that smooth? Through this acquisition, did both parties meet their objectives or see a rise in profits? Through a pre- and post-acquisition analysis of the two firms' profitability and other relevant data, this article seeks to ascertain if the purchase was successful.

2 Case description

Founded in 1998, Tencent is a global leader in Internet technology, with its headquarters located in Shenzhen. Coo and Yang stated that the Chinese market may be regarded to be driving the change of mobile platform games, even if the literature currently available on mobile platforms tends to concentrate on popular distribution channels in Europe and the US (such the Apple App Store and Google Play Store). China has a large number of local third-party app marketplaces. Tencent, the biggest gaming firm in the world, is also based in China [3]. Tencent received approval in 2004 to list on the Hong Kong Stock Exchange. Nearly a billion individuals are connected by the company's messaging and social services, which make it easier to communicate with friends and family throughout the globe. Furthermore, Tencent is well-known for releasing a large number of video games, like the well-liked Honor of Kings, which provide people all over the world excellent interactive entertainment experiences. To support the integrated growth of Internet platforms and content ecology, the firm also handles Tencent news, tenant meetings, sports, live broadcasts, Tencent video, animation, and other content platforms. Tencent has shown an amazing growth strategy during the last ten years, averaging an annual expansion rate of almost 30%. Tencent is aggressively looking for new development prospects, such as investing in cloud computing and artificial intelligence, in response to the increasingly intense market rivalry. The game business Supercell has offices in Shanghai, Seoul, San Francisco, and Helsinki, Finland.

The business has released five games into international markets since its founding in 2010: Hay Day, Clash of Clans, Boom Beach, Clash Royale, and Brawl Stars. They wanted to make fantastic games that people would play for years on end and would live on in memory. Sebastian stated, with Supercell, a mobile game developer valued at over $10 billion, and several other internationally acclaimed game developers, Finland stands out in the global gaming business. Still, Supercell is a modest business with only 180 workers. It is significant to the Finnish economy [4]. Supercell's games are all available for free download, and the company's main source of revenue is the in-game virtual currency it sells. Tencent's acquisition of Supercell occurred in June 2016. Tencent purchased 84.3% of the Finnish developer's shares for US$8.6 billion. The charge was paid in part by the Tencent consortium and other investors. Investment organizations like Hillhouse Capital Group are among the investors that are taking part. Tencent is one of the buyers in this group that is making the investment. Tencent invests via the consortium, and the buyer covers the acquisition cost. According to the acquisition arrangement, the seller would receive $4.1 billion at closing and $200 million within three years of delivery. Bank borrowings and syndicate investments from possible co-investors pay the remaining purchase price balance. Tencent completed the transaction by paying the seller the remaining US$4.3 billion in June 2016.

3 Tencent's objective

The first is to generate bigger financial gains. Tencent's prospective income capabilities were improved and significant strategic difficulties were resolved with the acquisition of Supercell. Surpassing Tencent's US$1.3 billion in 2015 sales outside of Asia, Supercell's US$2 billion in revenue outside of Asia in 2016 was largely due to its "League of Legends" platform. Tencent is now more profitable outside. Extending into international markets is the second. Tencent will profit right away from its acquisition of Supercell. The benefits of worldwide development and brand strategy, however, would surely outweigh the possible drawbacks of depending just on the Chinese market. However, Tencent's brand strength in the game industry is also significantly increased by Supercell's superior gaming team and merchandise. Thirdly, it is to compensate for mobile games' flaws. Tencent's overall income for 2015 was 102.863 billion yuan (US$15.841 billion), of which the revenue from online games was 56.587 billion yuan (RMB) and the revenue from smartphone games was around 21.3 billion yuan. Tencent will be assisted by Supercell in expanding its mobile gaming business. Mobile games require more frequent product upgrades and reserve capacities than PC games because of their shorter lifespan. Users want better game quality in the increasingly chilly mobile game industry so that premium games may get more resources. As a result, hiring the best mobile game developers globally has taken precedence. And lastly, this purchase is seen as a protective purchase as well. According to some sources, Tencent's investment is more of a defensive purchase of rival companies; the acquisition cost and potential price are compared to what would have been paid in the event that the purchase had not been completed. NetEase was Tencent's most significant rival in 2016. Despite Tencent's superior gaming income, NetEase continues to rule the App Store's top five. Tencent purchased Supercell in order to keep rivals from doing the same.

4 Advantages and disadvantages

The following two points can be used to sum up the benefits of this acquisition. First, the advantages on both sides are complimentary. The benefit of Supercell is seen
in its iterative innovations and constant innovation in mobile game offerings. Tencent is the exact reverse. Tencent, a massive Chinese Internet company, has a significant platform advantage since, when it initially joined the gaming industry, it concentrated on creating a distribution network. According to Che’s paper, Tencent, as one of the largest IT companies in China, has great development potential with its achievements in the game industry [5]. Teams connected to Tencent and Supercell were able to get complementary advantages through this transaction.

The synergy between Supercell and Tencent extends beyond geographical considerations. While Supercell dominates the North American and European gaming scenes, Tencent reigns supreme in the Asian market, particularly in China, where its gaming revenue is unparalleled. Despite China’s gaming market being the largest globally, Supercell's focus has historically been on North America and Europe. However, by joining forces with Tencent, Supercell gains access to invaluable insights and resources tailored for the Asian gaming landscape. Conversely, Tencent stands to benefit greatly from Supercell’s expertise in the Western markets, particularly in the United States, Germany, and the United Kingdom, where there is ample room for growth. This strategic partnership not only bolsters each company's position in their respective strongholds but also presents a significant opportunity for expansion into previously untapped territories. As they pool their resources and knowledge, Supercell and Tencent are poised to establish a formidable presence in both developed and emerging gaming markets worldwide.

Of course, this acquisition's limitations are equally apparent. Supercell's yearly income has decreased since Tencent purchased the company! Revenue for the business dropped to $2 billion in 2017 and then to $1.6 billion in 2018 [6]. The media in America The Information conducted a thorough analysis of Tencent's risk and came to the conclusion that the company's capacity for innovation and revenue generation fell apart following its acquisition by Tencent. Tencent. Due to this disastrous acquisition, Tencent's stellar track record as an investor has been called into question, earning it a "bad review." Furthermore, Supercell's capacity for invention has decreased. Supercell, a once-relentlessly innovative firm that produced popular games, hasn't been able to innovate since 2016. Since the purchase, the business has only released one game. The game Clash of Clans is the most played title the firm has ever produced. According to game analysts cited by "The Information," Supercell is unlikely to duplicate "Clash of Clans'" long-term success given the intense competition in the mobile gaming industry.

5 Analysis of Tencent's stock price after acquisition

The deal gives Tencent more clout in the international gaming market. The Chinese mass market is currently the focus of Tencent's gaming sector, with participation from international firms. Global gaming revenue hit US$99 billion in 2016, with Tencent holding a monopoly on around 13% of that amount [7]. Following the acquisition, Tencent's stock price increased over time. Supercell's games are still quite sustainable even after the acquisition, despite the drop in income. Tencent has acquired 100 million avid mobile gaming players worldwide with the purchase of Supercell. Moreover, the acquisition was risk-averse because it acquired a game studio that threatened Tencent. This avoids the possibility of Supercell being acquired by other competing companies. In recent years, Tencent's stock price has fallen due to the impact of the State Administration of Press and Publication's document prohibiting online games from providing incentive rewards such as daily login, first recharge, and continued recharge. This news triggered a wave of shock in the gaming industry, causing Tencent's stock price to fall by more than 12% [8]. According to the China Times, after China released a draft plan to restrict the online gaming industry, the stock prices of technology giants such as Tencent Holdings plummeted, wiping out tens of billions of dollars in market value. China's State Press and Publication Administration publicly solicits opinions on the "Measures for the Administration of Online Games". It is proposed that online games shall not set inductive rewards such as daily login, first-time recharge, and continuous recharge. The draft stipulates that all online games must set user recharge limits and announce them in their service rules. Pop-up warnings should be issued to users for irrational consumption behaviour.

After the draft was announced, Tencent's share price in Hong Kong fell by more than 15%, while its rival NetEase's share price fell by more than 30%. The Chinese government took action against the gaming industry for the first time in 2021 as part of a massive crackdown on big tech companies, which included placing strict caps on the time children can play online. Tencent is the global leader in the field in terms of revenue, dominating Asian markets and investing in game studios around the world. According to Bloomberg News, Friday's news wiped about $54 billion off the company's stock price. The Hong Kong Hang Seng Index was hit, falling more than 4%. It has been rallying along with global markets on expectations that the Federal Reserve will cut interest rates next year. Gaming company XD fell about 15%, and other technology companies were also hit, with Meituan down more than 2% and Alibaba down 1.8%. In January 2024, after the comment period ended, the document was deleted, causing Tencent's stock price to rise 3.8%. However, the stock price has yet to recover to its previous levels. The collaboration between Tencent and Supercell is expected to increase revenue by jointly developing innovative online games in the future.

6 Supercell revenue analysis after acquisition

After being acquired by Tencent in 2016, Supercell's revenue and EBITDA showed an overall downward trend. Since 2016, Supercell had not posted revenue
growth until 2021, when the entire gaming market reaped the dividends as lockdowns caused people to spend more time and money on games. The reasons for the company's revenue decline are as follows. First, the company has only released one game since the acquisition. After being acquired, Supercell's innovation capabilities have declined [9]. The latest game is "Brawl Stars", released in 2018 and will enter the Chinese market in 2022. Six years have passed since the company's last game was released, resulting in declining revenue [10].

Additionally, the company's vision is to create great games that can be remembered forever, so managers are in no rush to increase revenue. CEO Ilkka Paananen revealed, in the short term, if it wants to achieve financial numbers quickly and maintain sustained revenue growth, it just needs to launch a new game, but no one on our team is willing to sacrifice our game for revenue [11]. Secondly, the company's games are friendly to players who do not recharge. Supercell insists that not charging will not affect the gaming experience. As a result, although Tencent helped the company acquire more than 20 million Chinese players, revenue remained relatively high. Third, there are some macroeconomic factors. The global economic recession and inflation have limited consumers' disposable income, resulting in less game spending.

Moreover, the company withdrew from the Russian market after the 2022 war sanctions, losing 12 million Russian players. Additionally, as a European company, Supercell bills its bills in euros. The euro's depreciation exacerbated the decline in revenue and EBITDA.

7 Conclusion

This case is a friendly acquisition, and the two companies aim to achieve a win-win situation. However, the acquisition could have been more successful than expected. For Tencent, this acquisition is profitable. Judging from the valuation of Supercell, when Tencent acquired Supercell in 2016, the company was valued at US$10.2 billion, with an acquisition multiple of 11 times, which is indeed very low. Tencent acquired the company from SoftBank at a reasonable price as SoftBank was in crisis in 2016. Referring to the P/E ratio of game companies such as Nintendo, the current P/E ratio is about 18 times, so Supercell is now worth US$12.2 billion. However, the acquisition could have been more successful for Supercell because it did not help the company increase revenue. However, it is undeniable that it is still one of the best gaming companies in the world, and its per capita revenue is still far ahead. Supercell is no longer in its prime, but the company is trying to do some amazing things, as it has killed over 30 games to date. The company may release a fantastic game shortly and turn things around.

Although the acquisition of Tencent achieved its strategic purpose this time, it increased its competitiveness in the Chinese mobile game market by acquiring Supercell. It combines Tencent's massive number of mobile software users and Supercell's innovative games. However, this is not accepted by players. It can be seen from the article that Supercell's turnover continued to decrease in the years after the acquisition. Moreover, Tencent's strategy favours spending large amounts of money on purchasing already-developed games rather than developing its original games. It is undoubtedly a waste for a team full of talents like Supercell. As mentioned in the article, Supercell has yet to launch any new excellent games for several consecutive years. The large sums of money from acquisitions have made them conservative and less innovative. Although acquisitions can generate large profits in the short term, the cost is the company's unique innovation and development capabilities.

Therefore, the suggestions for this acquisition include the following points: First, Tencent should respect and maintain the style and characteristics of the acquired company in future acquisitions. The originality of the acquired company should be respected. Second, Tencent should develop its original games after absorbing innovative talents and teams. This can make Tencent more competitive in the gaming and software fields. Finally, Tencent should set goals for the companies it acquires to give them a sense of crisis. A comfortable environment can easily cause acquired companies to lose innovation capabilities and motivation, and they can regain their fighting spirit through new goals. It is crucial for Tencent to establish robust communication channels and foster a culture of collaboration between the acquired companies and its existing teams. By promoting open dialogue and exchange of ideas, Tencent can leverage the diverse expertise and perspectives of both sides to drive innovation and creativity.

References