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The rise of esports investments

A deep dive with Deloitte Corporate Finance LLC and The Esports Observer

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Esports investment has made significant strides in recent years as traditional investors join venture capital in exploring many of the diverse investment opportunities across the industry's diverse ecosystem.

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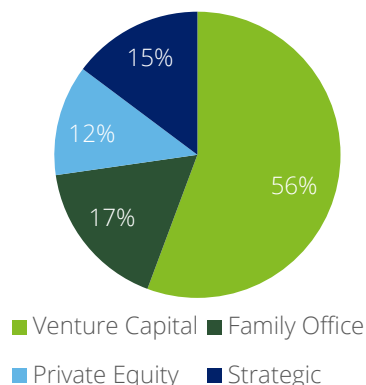
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Dynamics of esports Investments

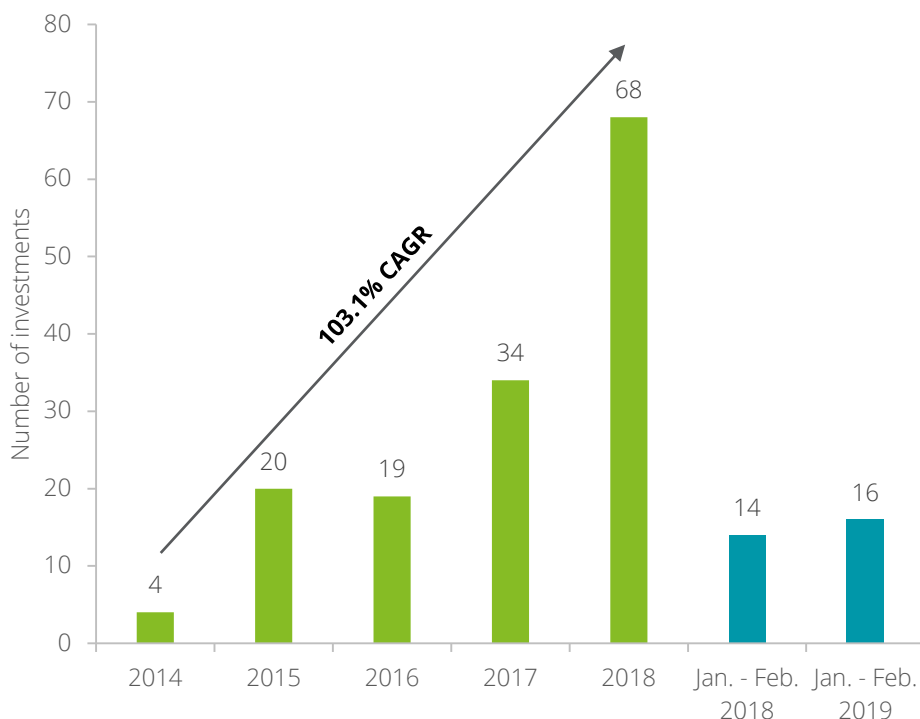
In order to best position themselves to maximize potential investment dollars, esports companies should understand the different investors in the industry and the key questions they will ask.

Executive summary

\$4.5B
 USD invested
 in 2018



Breakdown of esports investments in 2018 by investor type.⁽¹⁾



Number of investments in esports, 2014 – February 2019.⁽²⁾

While popular streamers such as Tyler “Ninja” Blevins have dominated the public discourse on esports and gaming over the past year, an indication of the staying power of the industry and its future potential is the underlying story of investment dollars into the space.

For esports, 2018 was a record year in both number of investments and investment dollars. Over \$4.5B USD was invested into the industry in 2018 alone.⁽³⁾ While this headline number is certainly significant, it is the composition of these investors that also offers interesting insights.

For the first time, traditional private equity investors have gotten involved in a meaningful way. From 2014 to 2017 there were only nine

disclosed investments into esports businesses from private equity firms, relative to the eleven that took place in 2018.⁽⁴⁾

Interest among traditional investors to explore different ways to gain exposure to the industry is indicative of the maturation of the industry and its growing mainstream appeal from an investor perspective.

The esports ecosystem offers a variety of different investment opportunities across a range of subsectors. Some are unique to the industry, such as team organizations, while others hold similarities to other traditional industries, such as consumer products and event planning, which could be more palatable to investors entering the space for the first time. y

A key merit of the industry is the core demographics. In 2018 the esports industry had a global fan base of 380M with 37% representing males aged 21 to 35, and 16% representing females ages 21 to 35.⁽⁵⁾ In addition, in the U.S., 61% of esports viewers earn more than \$50,000 per year.⁽⁶⁾ Investment offers exposure to this demographic that is increasingly averting its attention away from traditional media.

With increasing focus by investors and an attractive industry profile, this thought leadership seeks to explore the current state of the industry from an investor perspective.

In doing so, this paper is divided into three parts: the rise of esports investment, the potential rewards (and risks) of investment, and the dynamics of an esports investment.

The rise of esports investment

The first section examines the history of investment into the industry up to today. More specifically it explores how different investor types have engaged with the industry, such as venture capital and private equity, before ultimately analyzing the current state of the industry through five major subcategories.

These subcategories (team organizations, developers, event coordinators, media platforms & advertising, and consumer products) are examined through an investor lens with a focus on several key

specific valuation considerations.

The potential rewards (and risks) of an investment

After establishing the investment landscape in the prior section, this section explores the potential benefits and hazards of partnerships for both investors and companies alike.

Through a series of articles written by The Esports Observer contributors, this section presents examples of some of the nuanced issues to consider as one explores esports for investment potential.

Dynamics of esports investment

Finally, the publication offers companies in the space an overview of the positives and negatives of partnering with different investor types and a breakdown of key questions and diligence areas they should consider exploring before agreeing to a deal.

Overall, as the industry continues to grow and mature, investment interest from outside players is expected to be in lockstep. The goal of this thought leadership is to provide a starting point for the discussion; offering both traditional investors exploring the space for the first time, and esports companies that are considering raising capital or exploring a sale, some factors to consider when contemplating an investment in this dynamic, fast-growing industry.

Leveling up: the rise of esports investment

Esports investment has made significant strides in recent years as traditional investors join venture capital in exploring the diverse investment opportunities across the industry's ecosystem.

The esports industry attracted over \$4.5B USD in disclosed investment in 2018, up from \$490M from the previous year.⁽⁷⁾ Interest is likely to increase with the introduction of more franchise-style leagues, the centralization of esports teams (including management and support staff), and continued growth in the esports audience—the latter in particular driven by a greater awareness of esports and other forms of live videogame entertainment, within the popular

culture.

Right now, there are uncertainties over the long-term viability of certain esports competition series, and the revenue potential of lower valued teams could stifle future investment into the space. That said, by far the most capital intensive entities are those building the infrastructure behind the industry: game developers, live streaming services, and ancillary services (for in-game communication, player data, etc.).



The esports gold rush years

Competitive show matches have been part of gaming since its early days, but the onset of online and local area network (LAN) support began with packet-based computer networking in the 1970s. Once further developed, this allowed for higher simultaneous player counts and team play, dedicated servers, and persistent user information (i.e. win/loss records, rankings). Esports through the 2000s remained a high-cost consumer hobby, with the global financial crisis, in particular, limiting spending on PC gaming hardware.⁽⁸⁾ At this time, options for broadcasting competitions were also extremely limited, and monetization was restricted to small batches of ticket and merchandise sales at live events, which were held infrequently.

The 2010s saw a growth in both online viewership and prize money for esports.⁽⁹⁾ If one imagines all the stakeholders in the industry as “planets,” then this was a period of near perfect alignment. Game publishers began to transition from cyclical game releases to the “games as a service” (GaaS) model, where revenue is generated continuously from microtransactions, rather than one-time physical and digital sales.

This greatly incentivized publishers to support a competitive scene, and to develop professional esports competitions as marketing extensions of their products. “Free-to-play” games, which originated in Asia and were popularized in the west by *League of Legends*, largely replaced the subscription model (used in games like *World of Warcraft*), and allowed developers to justify the need to keep a game running for years, potentially decades—provided revenue remains consistent.

The simultaneous emergence of dedicated online streaming services allowed esports to expand its audience and support regularly scheduled broadcasts. The resulting consumer brand interest in pro gaming competitions allowed a number of tournament operators to scale into sustainable enterprises. This spawned a number of tournament brands, many of which were financially backed by global “tech giants.” Examples included Samsung’s World Cyber Games, the Boost Mobile-sponsored Major League Gaming circuit, and the Intel Extreme Masters.

Early team organizations, competition organizers, and software developers were, and still largely are, backed by

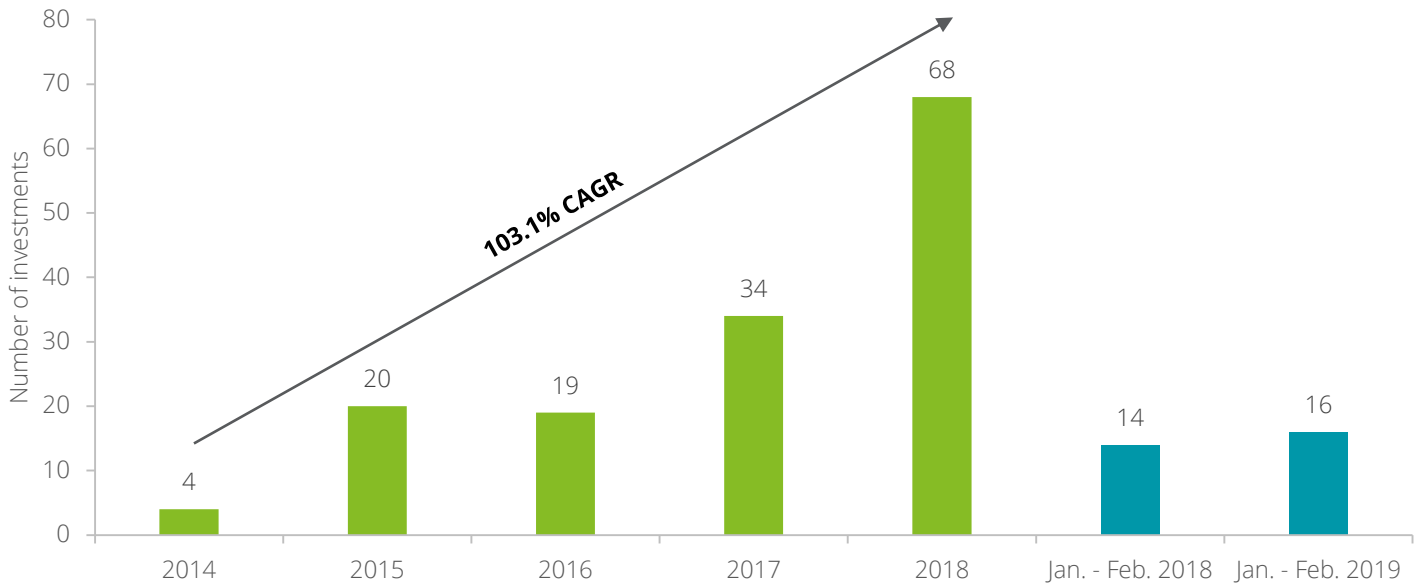
venture capital firms. The high-growth potential, limited operating history, and early instability of the industry led to cautioned interest from larger conglomerates.

There are a few key examples of mergers and acquisitions within the last decade that have had a measured impact on esports’ acceleration:

- In February 2011, Chinese tech conglomerate Tencent Holdings Limited (Tencent) paid \$232M USD for a 93% stake in *League of Legends* developer and publisher Riot Games, Inc. (Riot) —later acquiring the totality of the company for an undisclosed amount.⁽¹⁰⁾ The game’s professional competition in China is run as a joint venture between Tencent and Riot. Tencent is also an owner or investor in multiple esports game publishers, including Supercell, Activision Blizzard, Inc. (Activision Blizzard), and Epic Games, Inc (Epic).
- Amazon.com, Inc. (Amazon) acquired Twitch Interactive, Inc. (Twitch) on Aug. 25, 2014, for \$970M.⁽¹¹⁾ This followed months of reporting that Google LLC (Google) had reached a preliminary deal to acquire Twitch through its YouTube subsidiary, for \$1B.⁽¹²⁾ In subsequent years, Amazon’s subscriptions services and payment methods have been integrated into Twitch. The latter is used in microtransactions, allowing esports operators as well as individual streamers to monetize their content.
- In July 2015, Swedish media firm Modern Times Group (MTG) acquired a majority stake in esports competition organizer, content producer, and services provider Turtle Entertainment (ESL) for \$87M (it currently owns 82.48%).⁽¹³⁾ In November of that same year, MTG fully acquired gaming festival company

Target	Investor/Acquiror	Year	Amount (USD)	Category
Riot Games ⁽¹⁰⁾	Tencent Holdings	2011	\$93	Developer
Twitch ⁽¹¹⁾	Amazon	2014	\$970	Streaming
ESL ⁽¹²⁾⁽¹³⁾	MTG	2015	\$78	Events
MLG ⁽¹⁹⁾	Blizzard Entertainment	2015	\$46	Events
Astro ⁽¹⁴⁾	Logitech	2017	\$85	Consumer Products
Cloud9 ⁽¹⁵⁾	Valor Equity	2018	\$50	Teams
Discord ⁽¹⁶⁾	Tencent Holdings	2018	\$150	Streaming
Roccat ⁽¹⁷⁾	Turtle Beach	2019	\$19	Consumer Products

Notable transactions in the esports industry over the last decade (\$ in millions)



Number of investments in the esports industry, 2014 - Feb. 2019.⁽²¹⁾

DreamHack AB (DreamHack), which also runs a series of esports competitions.⁽¹⁸⁾ At the time these were among the largest investments by a traditional media company into esports and signified the firm’s commitment to gaming as a staple online video category.

- In December 2015, game publisher Activision Blizzard acquired “substantially all” assets of esports competition organizer and broadcasting network Major League Gaming (MLG), for \$46M.⁽¹⁹⁾ MLG continues to organize and broadcast competitions for Activision Blizzard game titles. In 2018, the company created its own Activision Blizzard Esports Leagues division to commercialize its esports properties, such as the *Overwatch* League and *Call of Duty* World League.⁽²⁰⁾

With maturation comes expanded interest

In the period following these high-value acquisitions, many investors from industries adjacent to esports/gaming (i.e. sports teams and entertainment companies) have

recognized the maturation of the esports industry and its potential for growth. While the highest individual investments in 2018 were raised by private game publishers, streaming platforms, and software developers, individual team organizations (which typically recruit player rosters across multiple games) also raised significantly higher capital than in previous years, with the top five highest valued teams collectively raising over \$150M in disclosed funding rounds.⁽²³⁾

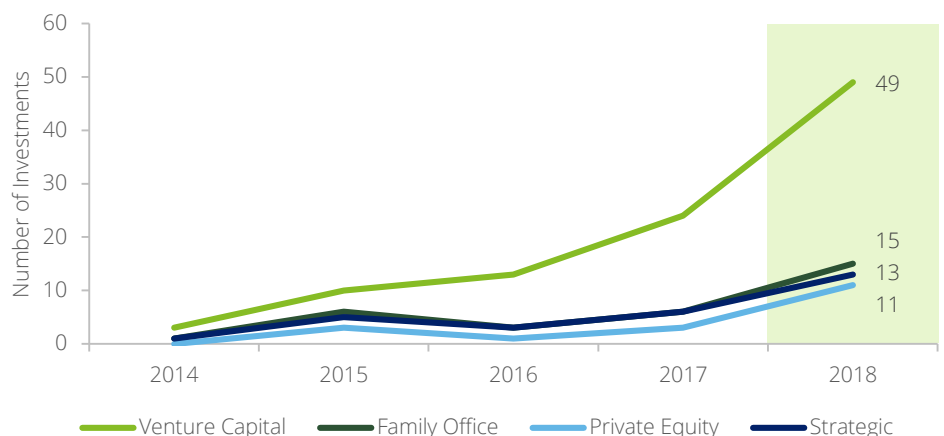
Venture capital

As expected in any nascent industry, venture capital has been the

predominate driver of investment within the esports industry over the last several years.

2018 was a record year for venture capital investment, with 49 investments, double the number of investments in 2017.⁽²⁰⁾ In terms of subindustries, venture capital was largely focused among media platforms & advertising (45%), developers (31%), and team organizations (18%).⁽²⁴⁾

This is likely due to the pre-revenue nature of many types of investments. These are largely tech focused investments with unique concepts, such as BITKRAFT Esports Venture’s



Esports investment breakdown by investor type, 2014-2018.⁽²²⁾

investment into Epics.gg, a digital trading card platform for esports.⁽²⁵⁾

Among developers, analytics has been a key focus area among venture capital investors with over 40% of investments within this subcategory.⁽²⁶⁾ A unique component of esports is the inherent ability to track a variety of data from games played.

This data could be leveraged by teams, looking to gain an advantage in competitive play, or among a game's casual player base to beat their friends.

One such example is the artificial intelligence (AI) analytics company, Visor, a support tool for *Overwatch* that can analyze gameplay in real time and provide in-game tips to players. The company raised \$4.7M in

a series A round at the end of 2018.⁽²⁷⁾

Family office

Similar to venture capital, in the early stages of an industry, such as esports, family offices also provided significant investment.

Family offices include high net-worth individuals or investment vehicles that invest on behalf of an individual or family. As they are investing their own money, family offices typically have more flexibility to take greater risk than traditional private equity investors.

Family office investments in esports more than doubled in 2018, from 6 investments in 2017 to 15.⁽²⁸⁾

In 2018, family office investments were mostly made into team

organizations (33%) and developers (27%).⁽²⁹⁾

Private equity

The esports industry experienced a significant increase in private equity investment in 2018.

Private equity groups made 11 investments in 2018, two more investments than made over the last four years combined.⁽³⁰⁾ Unlike venture capital or family offices, private equity will typically require a level of maturation in the underlying business before investing.

This can be seen in the types of investments that private equity made. The major categories of investment were Media Platforms & Advertising (36%), Event Coordinators (27%) and Team Organizations (18%).⁽³¹⁾ Within

Changing esports league structures may entice investors

The adoption of “franchises” and similar league structures may offer esports teams protection from new entrants and investors comfort regarding their potential investment.

By Graham Ashton, The Esports Observer
Consulted by Tobias Seck, The Esports Observer

In the U.S., investors typically make one of three plays: 1) private equity investments in an existing esports team organization and/or ownership group; 2) developing an esports division out of a pre-existing sports franchise; or 3) establishing an entirely new esports team brand, usually as part of a franchise league.

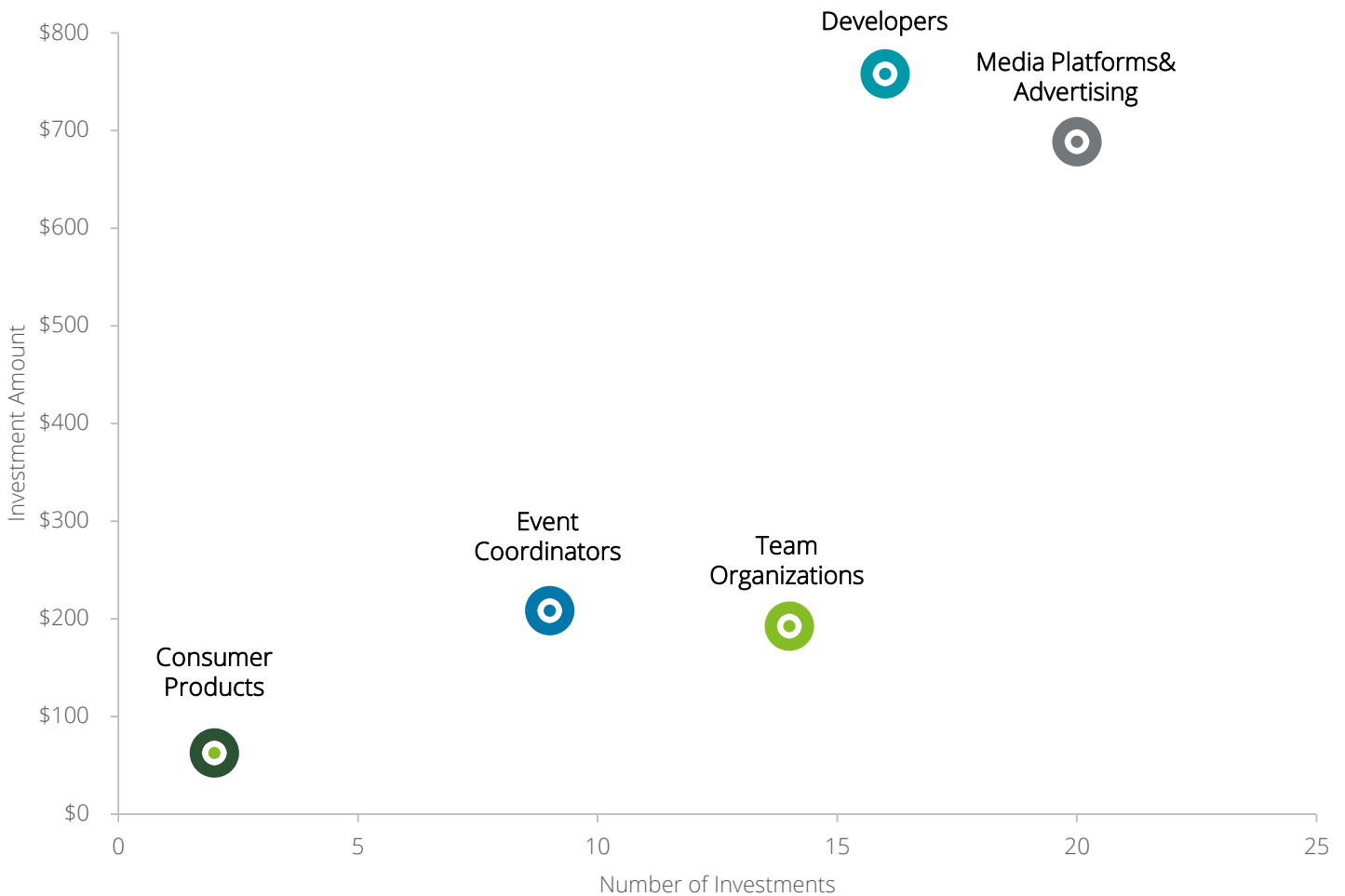
In 2018, multiple esports competition organizers either restructured their existing leagues or built entirely new closed circuit competitions.⁽³⁴⁾ Not all of these competitions are “franchised” in the strict sense of granting partners the right to own/operate teams in a specified location, but all feature buy-in fees, preclude any kind of promotion-relegation system, and introduce revenue sharing and

performance-based financial benefit models for teams.

League of Legends has integrated a partner team model into four professional circuits (China, North America, Europe, and Turkey), with the prices and processes for entry differing between regions. The *Overwatch* League has pulled in franchise fees ranging from a reported \$20M-\$60M for its first two years of operation and intends to expand its team count from the current global 20 to an eventual 28.⁽³⁵⁾ Competitions in lower-tier titles, such as the *Clash Royale* League, *Paladins* Pro League, or national *PLAYERUNKNOWN'S BATTLEGROUNDS* leagues have either offered slots with comparatively lower entry fees,

introduced revenue sharing models, or provided stipends for participants. Growing sports property, and a team brand that is appreciating in value, is one model traditional sports investors are well used to. Cloud9, a multi-game esports organization with teams in both the *Overwatch* League and *League of Legends* Championships series raised \$50M in its Series B funding round.⁽³⁶⁾ For comparison, the average franchise deal for a National Basketball Association (NBA) team during the 1980s was \$58.25M.⁽³⁷⁾

While the viability of esports leagues as 10, or 20-year ventures is untested, the entry cost is so comparatively low, and the target audience value so high, that dozens of traditional investors have taken the bet.



2018 esports investment breakdown by category (\$ in millions).⁽³⁸⁾

Note: In order to avoid skewing the data the chart above does not include the transactions listed below:

- Tencent investment of \$632M into Douyu TV and \$461M into Huya TV.⁽³⁹⁾
- Epic’s capital raise of \$1.3B.⁽⁴⁰⁾

these categories, there was a consistent story of later stage investments into established names, such as Greenoaks Capital investment into Discord Inc., a free voice and text chat app for gamers, and ICONIQ Capital’s participation in Epic’s, the creator of *Fortnite*, \$1.25B capital raise.⁽³²⁾

Strategics

Strategic companies have been consistently involved in esports M&A

over the last five years, with an average 6 investments per year.⁽³³⁾

Strategics have explored investments in the space as a means to expand their presence or capitalize on a growing market.

Today’s esports investment ecosystem

In 2018, the esports industry reached \$4.5B USD in disclosed funding across a broad array of companies.⁽⁴¹⁾ From startups to established companies entering the space, the esports ecosystem is filled with investment opportunities of every shape and size.

With so many different ways to invest in the space, it can be difficult to identify where an investor’s capital may be well placed. To that end, the following is a breakdown of the **five**

primary categories of esports investment opportunity:

-  **Team organizations**
-  **Developers**
-  **Third-party event coordinators**
-  **Media platforms & advertising**
-  **Consumer products**

Team organizations

Just like in traditional team sports, competition within esports takes place between players representing a specific organizational brand. The difference in competitive gaming, however, is that most prominent team brands have diversified across multiple games. Think of it as though the Washington Capitals, Washington Wizards, Washington Mystics, and Baltimore Brigade all wore the same jersey sporting the logo of their ownership group: Monumental Sports Entertainment.

Major esports organizations like Cloud9 or Team Liquid compete across anywhere from five to 12 different games with varying levels of success and scale. This diversification allows a single organization to reach a much broader audience (creating more value for its sponsors) and helps to protect against the risk of any one game losing its value either due to poor performance by the team, or reduced support from the developer.

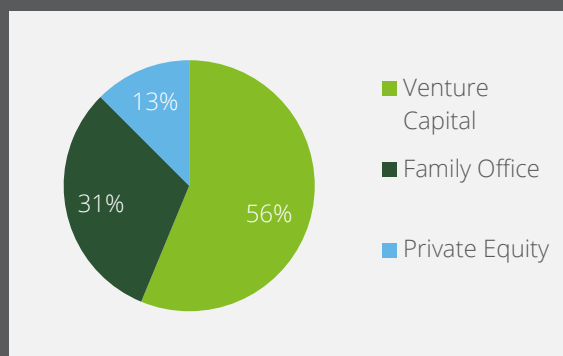
However, casting such a wide net can create substantial added costs for an organization as it must pay salaries for each extra player, coach, and support staff member. The turnover in game popularity outside of the big three (*League of Legends*, *Dota 2*, *Counter-Strike: Global Offensive*) is often so quick that teams should consider broadening their scope to remain relevant, which can also result in a net loss from games which never take off enough to generate revenue for the organization.

When making an investment into a team organization investors should identify a company that has consistently made smart decisions when choosing which games to invest in, and has also shown a willingness to cut its losses in failing titles.

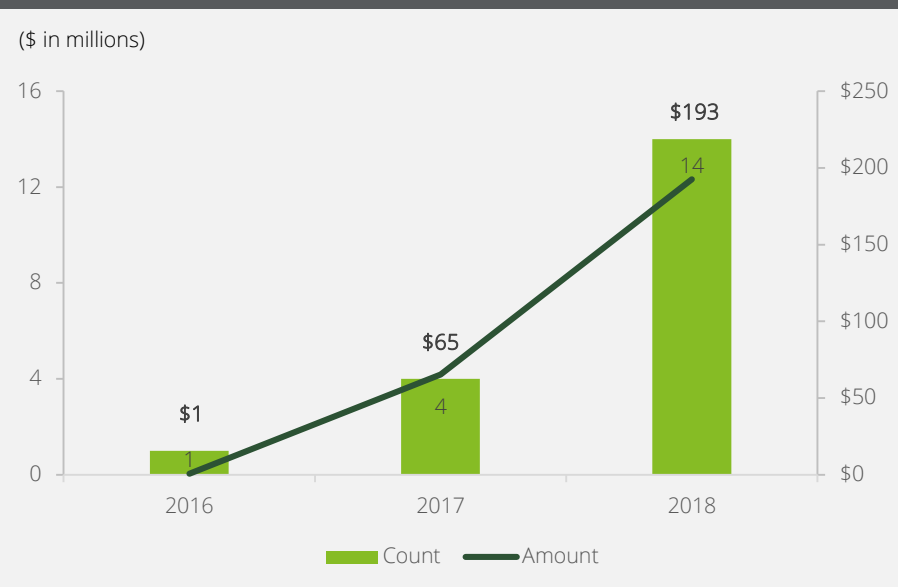
A potential exception comes in the form of single-game organizations which are involved in franchised

Team organizations investment snapshot

Investment in esports teams has increased significantly over the last several years. While this investment has been driven largely by venture capital, it has been largely deployed to the major teams.



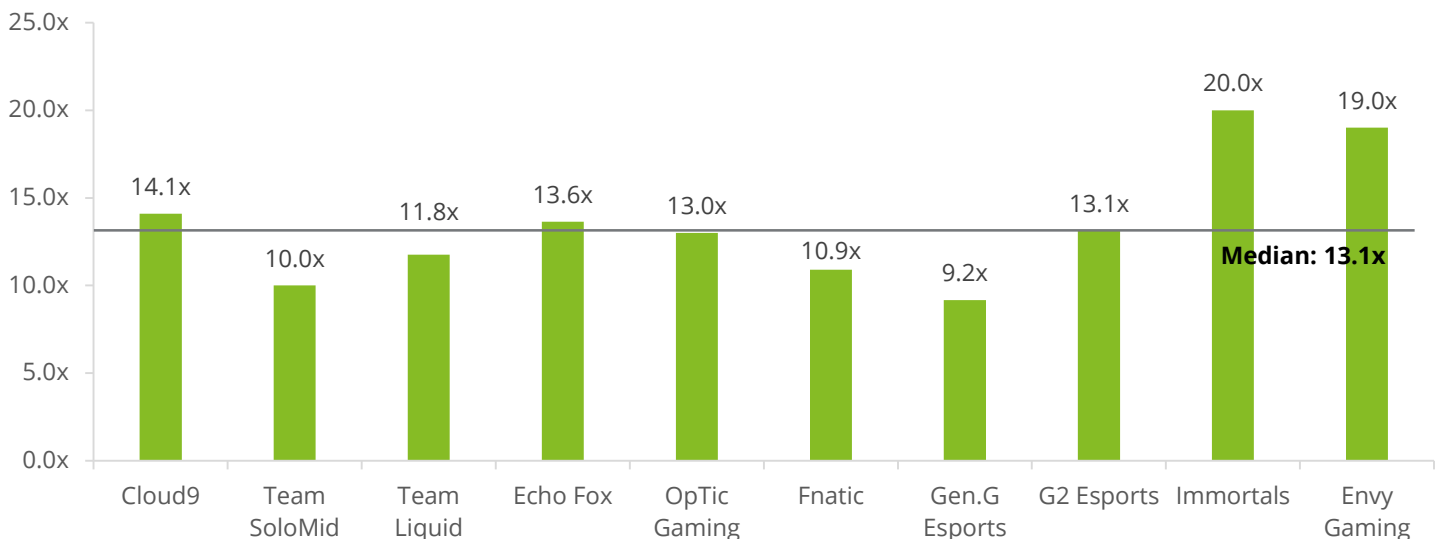
2018 team organization investments by investor type.⁽⁴³⁾



Team organization investments over time, 2016-2018.⁽⁴²⁾

leagues. Teams such as the Overwatch League's Boston Uprising, owned by the Kraft Group, will not be able to diversify into any other games due to league rules.⁽⁴⁴⁾ Similarly, Clutch Gaming was founded by the Houston Rockets ownership group, and controls a franchise spot in the League of Legends Championship Series.⁽⁴⁵⁾ In both cases, the added revenue sharing opportunities for league sponsors and media rights can make investing in these single-game organizations attractive. However, such an investment likely carries substantially more risk, as the brand could lose significant value if that league or game were to collapse.

When making an investment into a team organization investors should identify a company that has consistently made smart decisions when choosing which games to invest in.



2018 estimated revenue multiples for top 10 team organizations. ⁽⁴⁹⁾

With the industry experiencing significant growth over the past few years, esports teams have enjoyed strong growth multiples, as seen above. Growth multiples such as these are largely driven by the expectation of strong future performance. For esports teams, this is the expectation that the industry will continue its strong growth trajectory and the given esports team will remain a major brand in the ecosystem.

However, as the industry matures, investors will likely expect these teams to achieve operational efficiencies as they determine and develop their core competencies. Rather than attempting to be a “one-stop shop” of all things esports (such as teams, media, analytics, consumer products, etc.), many teams are narrowing their focus to the development of winning rosters for the games they are in.

Based on market activity by some of the highest valued esports teams, the following appear to be the most likely sources of expenditure over the next two to three years:

- **Dedicated training facilities are**

Of the \$258M USD in investments made to team organizations in the last two years, over 50% has gone to the top 10.⁽⁴⁶⁾

- **replacing the long-used “gaming house.”**

For organizations, this can offer revenue potential in the form of naming rights, on-site activations, and content creation. In addition, it allows consolidation of staff and players, with management and talent working under the same roof.

- **Recruitment of high-quality management and sales teams,** typically with professional experience wholly outside the esports and gaming industries.
- **Talent development and youth outreach,** including academy or secondary teams for tier-one esports titles, and seasonal competitions for college students.

- **International expansion,** with teams either recruiting game rosters or building subsidiary team brands in Latin America, Southeast Asia, and the Asian Pacific regions.
- **Stronger merchandising arms and retail presence.** In the *League of Legends* Championship Series (LCS), for example, nearly all teams have an ongoing apparel partnership with brands including Puma SE and Champion Athletics.⁽⁴⁷⁾

The result of these trends is that newly formed teams may have difficulty when exploring investment options. They may also have limited ability to achieve the scale required for operational efficiencies.

As a result, while investment for team organizations has increased, the focus of this investment has historically been towards making the strong stronger. Of the \$258M USD in investments made to team organizations in the last two years, over 50% has gone to the top 10.⁽⁴⁸⁾

Developers

Developers are the core difference between esports and traditional sports. If the National Basketball Association (NBA) was to disband, you could still get a group of people together to play basketball whenever you wanted. New groups could form to organize professional play for the sport. The success or failure of that game is not dependent upon the ability of a single governing body to generate revenue.

This is not the case in esports. In order to play *League of Legends*, even at the amateur level, Riot must continually spend resources and capital maintaining the game. If the company shut down its servers, the entire *League of Legends* esports ecosystem would immediately collapse.

With the exception of some fighting games, every single prominent esports played today relies on the active support of the game's developer.⁽⁵³⁾

Not only that but in many cases today the developer is also the primary source of that sport's infrastructure and prize money. The modern esports ecosystem is heavily reliant on the success and sustainability of its most prominent developers.

That said, the industry is constantly evolving. Many of the biggest esports titles today have come from developers who were not players in the space just two years ago. Whether it's a well-established company maintaining its big esports games, or a smaller company developing the next big thing, there are investment opportunities available with developers at every level.

Valuation considerations

Unlike the other subsectors of the esports ecosystem, developers represent a more mature industry with several major developers attaining market capitalizations well into the billions.

These larger developers consistently dominated the market, with the top 25 companies accounting for 77% of the total global game market in 2017.⁽⁵⁴⁾

The dominance of the space by this smaller subset of developers is due in part as a hedge against the inherent risk of video game development.

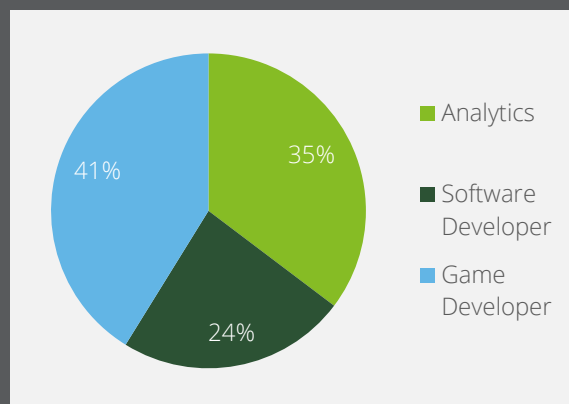
The development of a video game by a developer often takes several years and requires significant capital outlay to complete. Having multiple studios under a developer working on different games all at once allows developers to have a greater opportunity of creating a blockbuster title while also spreading revenue throughout the year.

These developers can also leverage their economies of scale for production and distribution.

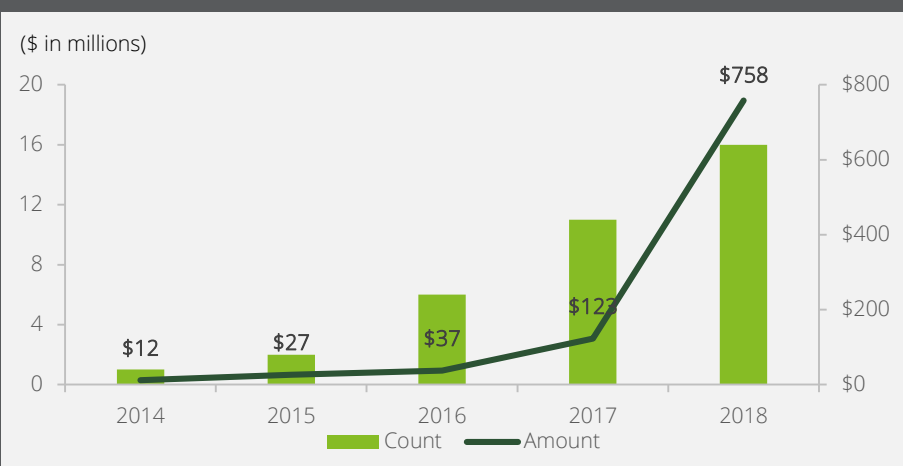
When examining investments over the last several years, one can see how the strong developers have been getting stronger.

Developers investment snapshot

Investment in developers has continued to grow over the past several years. While the space is dominated by the largest developers, there remains opportunities for smaller investments in fledgling subsectors such as analytics or early stage game developers.

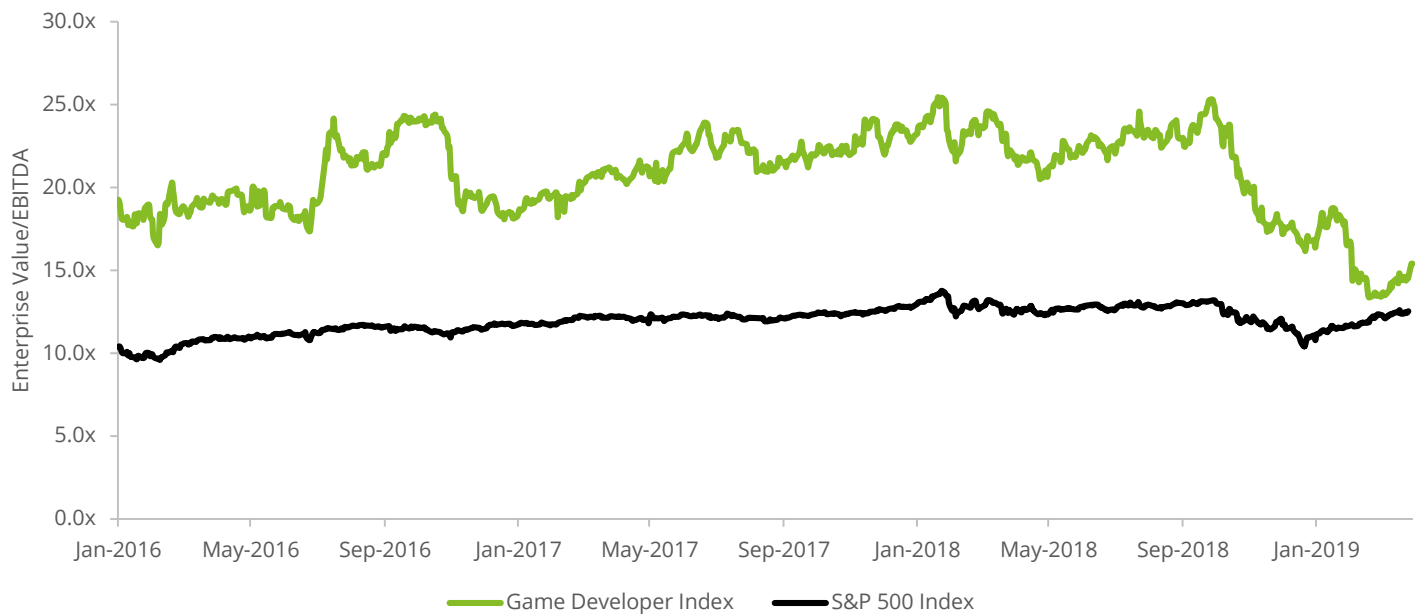


2018 investments in developers by subcategory.⁽⁵²⁾



Developer investments over time, 2014-2018.⁽⁵⁰⁾

For comparison purposes, This table does not include Epic Games \$1.25B capital raise in 2018.⁽⁵¹⁾



Index of game developer EV/EBITDA multiples compared to the S&P 500 from 2016-YTD 2019. (Game Developer Index includes Electronic Arts (EA), Activision Blizzard (ATVI), Take-Two Interactive Software Inc. (TTWO), NetEase, Inc. (NTES), and Nintendo (NTDOY).

Since 2015, the major investments among game developers have been with the larger developers.⁽⁵⁵⁾ This would include major activity such as Activision Blizzard's acquisition of King.com Limited, the creator of the popular *Candy Crush* mobile game, for \$5.9 billion in 2015 and NetEase Inc.'s (NetEase) investment of \$100M into Bungie Inc., the creator of popular titles such as *Halo* and *Destiny*, in 2018.⁽⁵⁶⁾⁽⁵⁷⁾

Compared to the S&P 500, these investments appear to be paying off. Game developers have consistently outperformed the S&P 500 when comparing EV/EBITDA multiples. Multiples for game developers reached a high in January 2018 of 25.5x.⁽⁵⁸⁾

This performance has been largely driven by several positive trends that have been favorable for these developers. These trends include the rise of mobile gaming, particularly in Asia, where demand for mobile games is expected to drive revenue growth by 10-15% per year in the future.⁽⁵⁹⁾ Another trend has been the

emergence of micro-transactions. Micro-transactions consist of smaller in-game items that a player can purchase to enhance their in-game experience.

Micro-transactions have benefited developers as they can have lower development costs and allow them to maintain consistent revenue streams from the same player base.

While this trend has been a boon for many developers, in the past year there has been increasing player pushback on this over monetization. In addition, one particular type of microtransaction, the "loot box", where players pay for a randomized set of in-game items of varying quality, is facing greater scrutiny from governments that consider it a form of gambling. For instance, in 2018 the Netherlands and Belgium determined that some loot boxes violated their gambling laws.⁽⁶⁰⁾

Increasing pressure on micro-transaction revenue could be contributing to the declining developer multiples seen above.

While this subsector is dominated by the major developers, there continues to be investment opportunities among smaller start-up developers with unique concepts or gameplay.

This includes the largest investment of 2018, the \$1.25B capital raise of Epic.⁽⁶¹⁾

In addition to game developers, other developers have also seen significant investment interest. Particularly among venture capital investors and analytics companies. These developers typically seek to harness the underlying data within video games to enhance the player experience whether through improving their gameplay or providing meaningful analysis for competition. Since 2016 there has been over \$35M invested in analytics developers alone.⁽⁶²⁾

Overall, while the space is dominated by major developers, there remains opportunities for investments of all sizes.

Third-party event coordinators

While many of the most prestigious esports tournaments are operated by developers, there is an entire ecosystem of third-party event coordinators operating throughout the world. From international championships to high school leagues, third-party organizers play a critical role in the industry and are often contracted by developers to operate regional leagues and select events within a tournament circuit.

Event coordinators vary greatly in scale from major names like ESL and DreamHack that operate events for thousands of attendees across the world, to regional groups that operate

small weekly tournaments such as the Connecticut-based Great Value Smash.⁽⁶³⁾⁽⁶⁴⁾

In addition to running their own self-branded events, many event coordinators also run white label tournaments for various clients. Some also offer on-demand online tournament services which allow amateur players to experience a tournament environment. Additionally, third-party organizers generate revenue through ticket sales, sponsorships, media rights, and merchandise.

Perhaps the most appealing thing about third-party organizers to a potential investor is their scalability.

Not only can these companies diversify into a wide range of tournament products and organization services, but organizers at every level have the potential to scale almost infinitely. DreamHack has expanded into India, Spanish organizer LVP works with Riot to run a U.K. league, and Chinese company Mars Media will soon operate a *Dota 2* Major in France.⁽⁶⁵⁾⁽⁶⁶⁾⁽⁶⁷⁾ Successful third-party organizers can expand not only the size and scope of an individual tournament, but continually move into new territories to work with new partners.

Valuation considerations

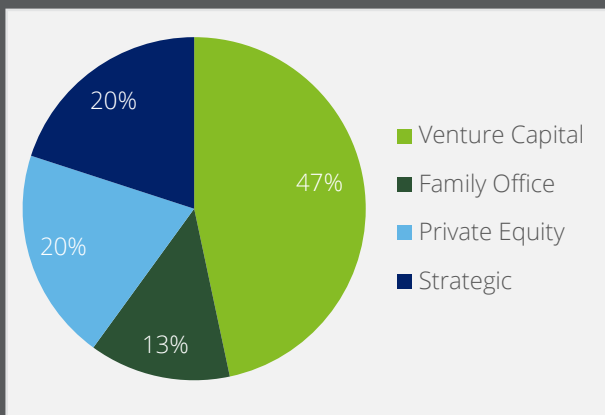
As event coordinators become increasingly important in the esports industry and the landscape grows more competitive, coordinators are looking for ways to differentiate themselves. Without a unique and scalable platform, many coordinators are unlikely to succeed.

One manner in which event coordinators are differentiating themselves is through the development of their own facilities. At the inception of the industry coordinators would utilize existing spaces that could offer reasonable accommodations for tournaments and events. However, as the industry has grown so has the demand for events with hyper-specific offerings.⁽⁶⁸⁾ This had led to the development of dedicated esports arenas, training facilities, and venues across the globe.⁽⁶⁹⁾

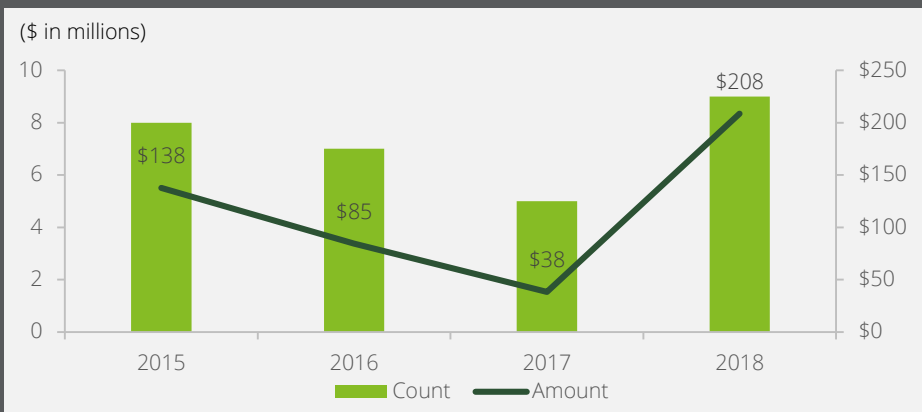
The rationale for the continued investment in the space has varied depending on the stage of the company and type of investor. The recent investment into N3rd Street Gamers by SeventySix Capital and Comcast Sports Ventures (Comcast Spectacor) was meant to help facilitate growth in pursuit of a national expansion strategy.⁽⁷⁰⁾

Event coordinators investment snapshot

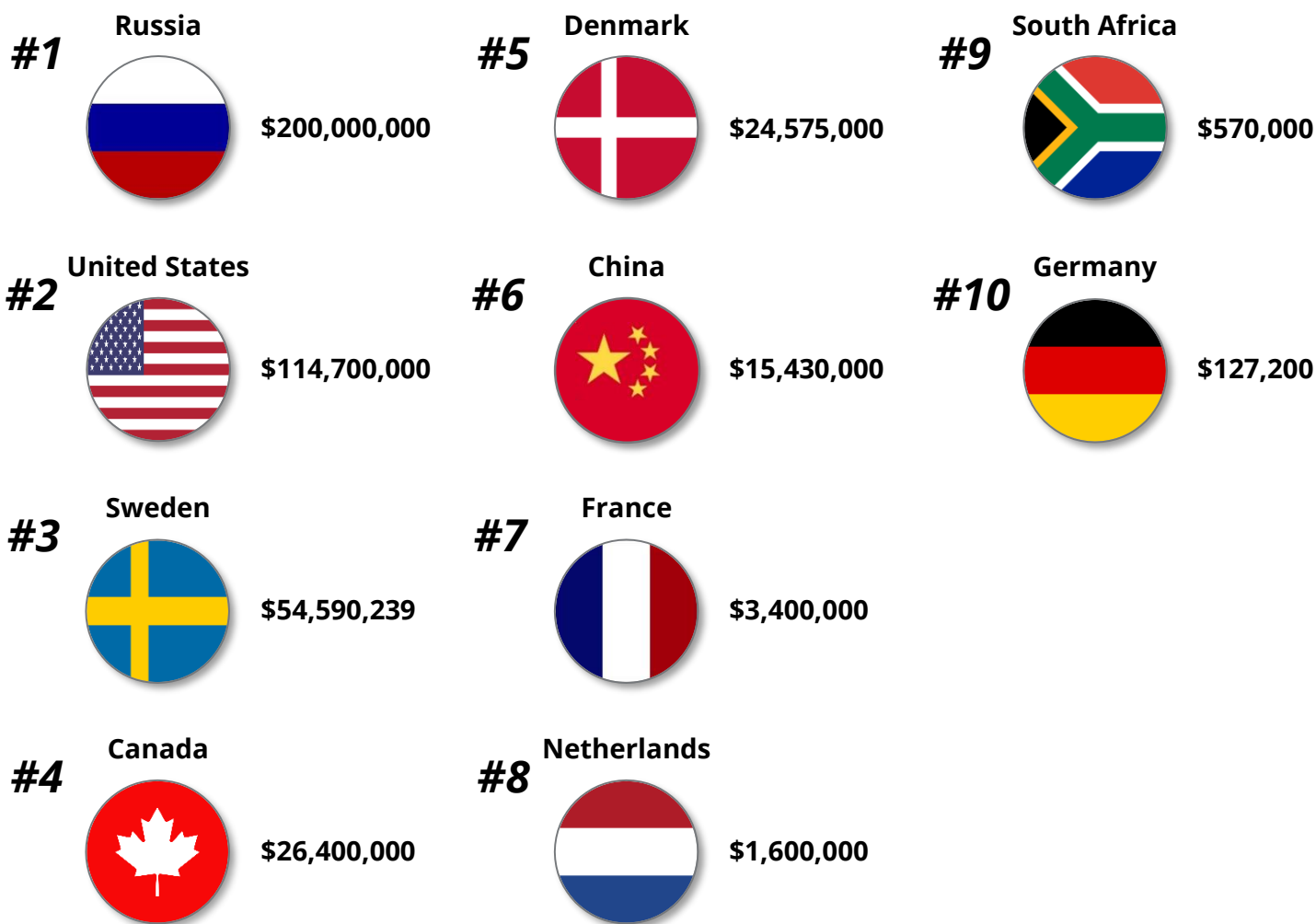
Event coordinator companies experienced a significant increase in both number of investments and dollars invested in 2018. These investments were also well diversified across the range of investor types.



2018 event coordinator investments by investor type.⁽⁷²⁾



Event coordinator investments over time, 2015-2018.⁽⁷¹⁾



Cumulative event coordinators investment by country (2015 – 2019).⁽⁷³⁾

In a similar fashion, the investment by Creandum and Sunstate into RFRSH Entertainment was to expand the brand by bringing competitions to three new locations in 2019: Sao Paulo, Brazil; Miami, United States; and Madrid, Spain.⁽⁷⁴⁾ The investors hope to establish the company on a mainstream level, in leagues with NBA, UFC, football and online entertainment in general.⁽⁷⁵⁾

Notable investments that work to establish brands on a mainstream level help strengthen the industry's credibility. This additional awareness may even serve to direct more capital into the space.

Top investments by country

As the data above suggests, Russian-

based companies have received the largest amount of capital in the event coordinators space.⁽⁷⁶⁾ These investments are directly tied to the funding and subsequent sale of ESforce Holdings.⁽⁷⁷⁾ In 2015, the company held its first funding round, receiving \$100M in its Series A.⁽⁷⁸⁾ Only three years later the company would be acquired for \$100M, the exact amount it had previously raised.⁽⁷⁹⁾

In comparison, the investments within the United States are more diverse with a total of 10 investments, into 5 different companies, since 2015.⁽⁸⁰⁾ One of the most noteworthy investments into a U.S.-based esports event coordinator was Smash.gg's raise of \$11M to help local esports fans create their own tournaments.⁽⁸¹⁾

Smash.gg works to create smaller events from the ground up – enabling fans to take organizing into their own hands.⁽⁸²⁾

Sweden-based event coordinators have received \$54.6M in capital since 2015, with the most recent investment of \$1.3M into Challengermode.⁽⁸³⁾⁽⁸⁴⁾ Similar to the rationale of investment into RFRSH Entertainment, Challengermode sought to achieve their next phase of growth by going mainstream.⁽⁸⁵⁾

This continued alignment in investment thesis supports the notion that as capital flows into event coordinators and demonstrates its viability, incremental funds will follow.

Media platforms & advertising

Media platforms & advertising encompasses a variety of different categories that are focused on fan engagement. This ranges from advertising agencies that support nonendemic brands seeking to gain exposure within the space to companies exploring new ways to get viewers more engaged with the influencers and teams they watch on a regular basis through different streaming services.

From an investment perspective, this category remains in its infancy. Of the 15 investments into media platforms & advertising companies in 2018, all but three had a venture capital

investor.⁽⁸⁶⁾ Excluding significant outlier investments by Tencent into Douyu TV and Huya TV for \$632.0M and \$462.0M respectively, the average investment size was just under \$10.0M.⁽⁸⁷⁾

With an actively engaged and growing demographic, the esports industry will likely see an increasing number of nonendemic brands explore different ways to engage with the space. For many brands, the underlying demographics of esports are appealing. Esports has an estimated global fan base of 380 million and this is largely comprised of millennials between the ages of 21 and 35.⁽⁸⁸⁾ Not only are these viewers young, they also represent expendable

income. In the U.S., 61% of esports fans over the age of 18 are earning more than \$50,000 a year.⁽⁸⁹⁾ Many fans are increasingly shifting away from traditional forms of media and are instead engaging with streaming platforms such as Twitch and YouTube. In 2018 the average concurrent viewer count for Twitch was around 1.1 million.⁽⁹⁰⁾

Both endemic and nonendemic brands will increasingly be drawn to these underlying dynamics, and as a result, the need for advertising support is expected to remain. In fact, according to a SuperData research report, by 2020 advertising and sponsorship will account for 60% of the industry's overall revenue.⁽⁹¹⁾

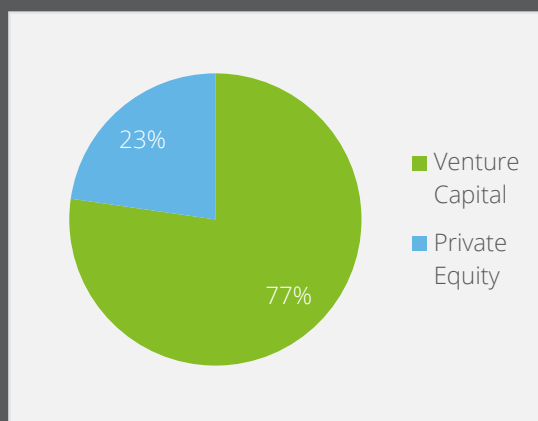
Brand engagement could take a variety of paths. For example, some can take a traditional sponsorship route, such as Audi Denmark's \$750,000 partnership deal with popular Danish esports team Astralis for branding on Astralis jerseys.⁽⁹²⁾ Engagement can also take other forms, such as KFC Corporation's partnership with notable Twitch streamers of the game *PLAYERUNKNOWN'S BATTLEGROUNDS*, such as DrLupo, where if the streamer won a game viewers could post a KFC emoji into the stream's chat for a chance to win a \$5 KFC gift card.⁽⁹³⁾

No matter the form that engagement takes, nonendemic brands will rely on advertisers with an understanding of the underlying demographics of the industry and effective ways of engaging. This creates an opportunity for investors to capitalize on this trend.

An example of this is the September 2018 \$3.6M Series A capital raise for Upfluence, an influencer focused marketing agency with an emphasis on offering brands support in working with Twitch influencers.⁽⁹⁴⁾

Media platforms & advertising investment snapshot

Largely dominated by smaller venture capital investments, the category has experienced steady investment growth over the last few years as investors increasingly recognize the value of the esports fan base demand for greater engagement.

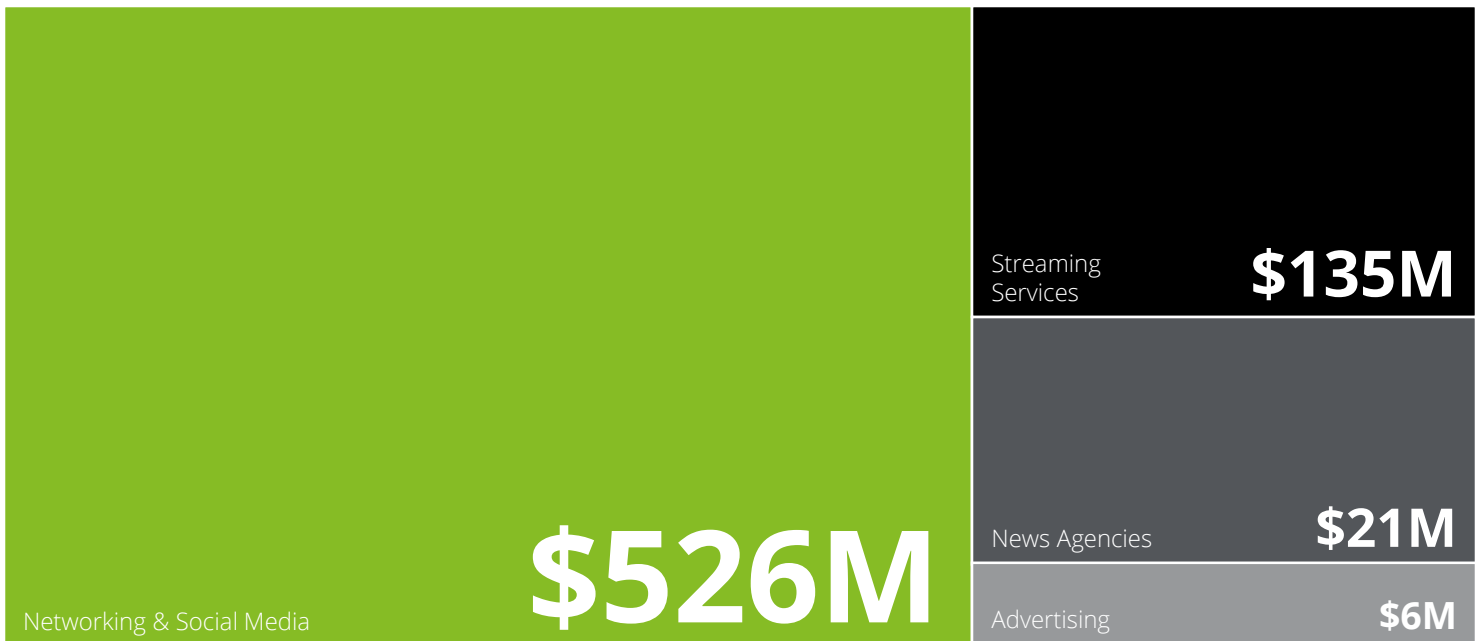


2018 media platforms & advertising investments by investor type.⁽⁹⁷⁾



Media platforms & advertising investments over time, 2015-2018.⁽⁹⁵⁾

For normalization, this table does not include Amazon's \$970M acquisition of Twitch in 2014 or Tencent's investment into two streaming platforms for \$1.0B in 2018.⁽⁹⁶⁾



Networking & Social Media

Breakdown of media platforms & advertising investments in 2018 by subcategory.⁽⁹⁹⁾

Note: this table does not include Tencent's investment into two streaming platforms for \$1.0B in 2018.⁽⁹⁸⁾

As noted above, the use of streaming services has increased rapidly over the last several years. For example, for Twitch, average daily concurrent viewer count has grown from a little over 100,000 in 2012 to 1.1 million viewers in 2018.⁽¹⁰⁰⁾

Viewers are engaging both with presentations of competitive play and popular influencers. As larger streaming services, such as Twitch and YouTube, compete for viewers, an industry has emerged for tools that support and enhance the streaming experience for content creators and fans alike.

Investments into streaming services and social media engagement has increased by over 200% from 2017 to 2018.⁽¹⁰¹⁾ These investments have largely consisted of capital raises by

venture capital firms into early stage startups.

An example would include StreamElements, a “full-stack” platform that supports streamers in broadcasting their gameplay. The company raised \$11.3M in Series A funding in 2018.⁽¹⁰²⁾

In addition to these software tools that assist creators in their production of streaming content, other media platforms & advertising companies have focused on enhancing the viewer experience through various applications that add an additional layer of connectivity with other fans or the creators themselves.

One of the larger investments in 2018 within the media platforms & advertising category relates to this

engagement. Discord, a popular gaming chat application, raised \$150.0M in 2018 at a \$2.05B valuation.⁽¹⁰³⁾ Discord has grown quickly over its three years of existence as users have used its voice and text communication services to talk with teammates and friends during and outside of gameplay.⁽¹⁰⁴⁾ By May 2018, Discord had 130 million registered users, tripling its user base since 2017.⁽¹⁰⁵⁾

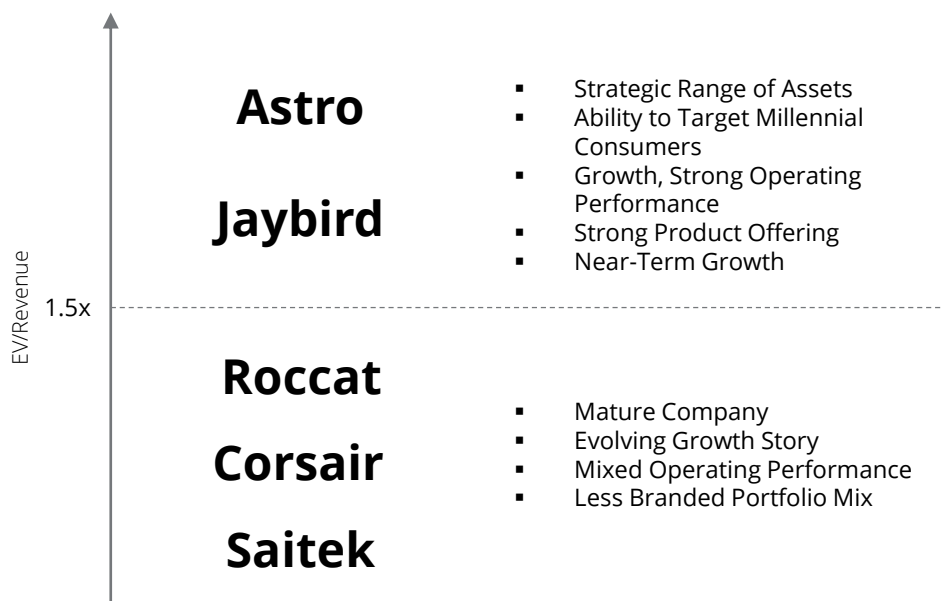
Other examples within this space include Taunt, a social engagement platform for fans that allow viewers to compete against each other by predicting the outcome of games they are viewing. The company raised \$3.0M in 2018 from The Foundry Group.⁽¹⁰⁶⁾

 **Consumer products**

One of the most attractive esports segments for traditional private equity and strategic buyers continues to be consumer products. These companies typically offer consistent revenue streams with a strong runway for growth, which can make for a well-suited partner and investment opportunity. This thesis aligns with the figure presented on page 20, which shows large strategic investors (namely Logitech and Foxconn) directing capital into consumer technology products.

For the apparel segment of consumer products, there has been rapid growth in the west, with dedicated streetwear brands competing with merchandise designed by team organizations.⁽¹⁰⁷⁾

Valuation considerations⁽¹⁰⁸⁾



Case study: Logitech acquires ASTRO Gaming

Tapping into a popular esports headset brand offers significant opportunity to major computer peripherals player.

With esports rising popularity, peripheral brands are seeking ways to resonate within the space. One example of this dynamic is the acquisition of ASTRO Gaming (“ASTRO”) by Logitech International (“Logitech”) for \$85M USD in July 2017.⁽¹⁰⁹⁾ With an expected revenue of \$35M in 2017, this purchase price implies a multiple of 2.4x revenue.⁽¹¹⁰⁾

In the years leading up to the transaction, Logitech was experiencing fairly flat annual revenue growth of (0.15%) from 2014 to 2015 and 0.69% from 2015 to 2016.⁽¹¹¹⁾ By comparison, overall esports revenue grew 67.52% and 51.69%, respectively.⁽¹¹²⁾

Additionally, the acquisition of ASTRO was an opportunity to further diversify in an increasingly competitive hardware market that has faced headwinds in recent years.⁽¹¹³⁾ Worldwide PC shipments have sharply declined, and peripheral hardware has followed a similar trend

due to a combination of factors including market saturation, extended replacement cycles, and competition from other consumer devices.⁽¹¹⁴⁾

By contrast, the esports hardware market, however, has been able to insulate itself from some of these trends, due in part to the promotion of products by influencers and teams. Similar to a basketball fan wanting to get the signature shoe of their favorite player, esports fans are motivated to get the hardware they see their favorite players using.

The industry has shown to be a revenue generating avenue and as gamers demand more customization the hardware manufacturers are driven to offer these options with the latest high-performance processors and graphics cards.⁽¹¹⁵⁾

As such, the acquisition of ASTRO offered the opportunity to further expand Logitech’s product portfolio

within the esports industry.

ASTRO also gave Logitech access to higher margin products with retail values between \$200 and \$300.⁽¹¹⁶⁾

The result for Logitech was a significantly stronger brand presence in the esports industry commanding the attention of major influencers in the space – specifically with those already gaming with ASTRO headsets, such as Nick “NICKMERCUS” Kolcheff and Brett “Dakotaz” Hoffman.⁽¹¹⁷⁾ As of today, ASTRO and/or Logitech constitute a piece of the gaming setups of more than 60% of the top streamers.⁽¹¹⁸⁾

For Astro, the transaction offered a great opportunity to leverage the capabilities of one of the largest players in the technology hardware industry.

While ASTRO’s operations were previously limited to the United States, the acquisition offered the

(Continued on next page)

ability to expand sales globally.⁽¹¹⁹⁾

In fact, one of Logitech's first steps following the acquisition was to capitalize on the new product line by making them available outside the United States.⁽¹²⁰⁾

This acquisition also provided ASTRO access to a vast network of distributors and suppliers, which could be leveraged to reduce costs and increase efficiencies.⁽¹²¹⁾

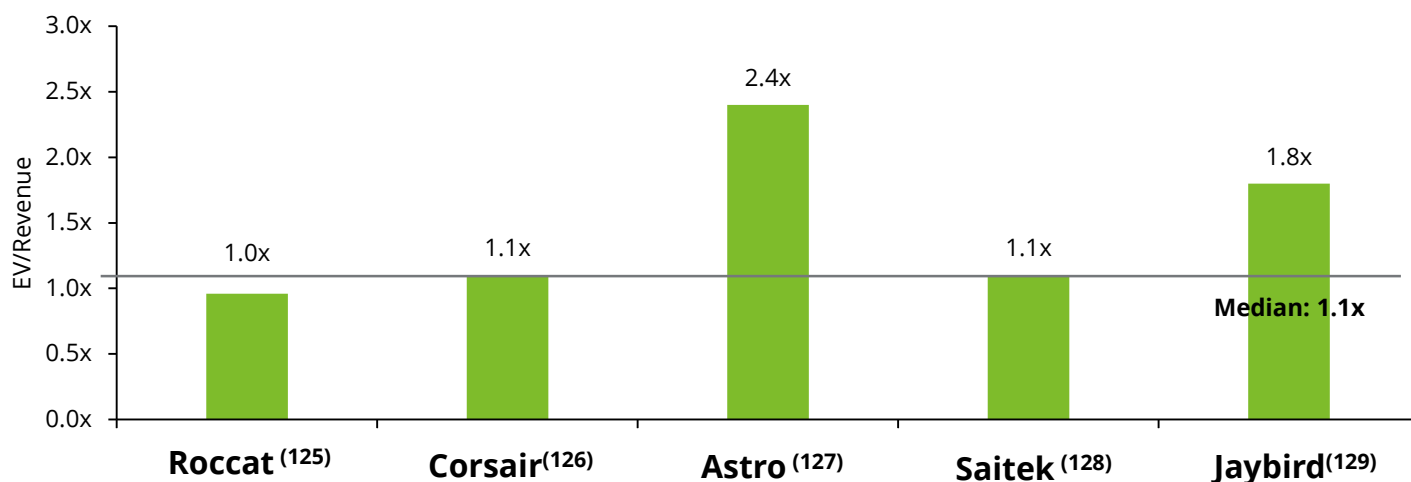
Previously, ASTRO's flagship headset product line was limited to three SKUs due to high R&D costs. Post-acquisition, capital was invested into the development of new high-margin product lines, increasing the total number of SKUs.⁽¹²²⁾

The years following the transaction Logitech experienced revenue growth far in excess of the years preceding, at 10.08% from 2016 to 2017 and 15.55% from 2017 to 2018.⁽¹²³⁾

Although the total revenue of ASTRO only contributed 2% to total net sales growth, the guiding strategy of diversification into esports was likely a significant success factor for the 57% growth experienced in the gaming segment of Logitech.⁽¹²⁴⁾

Following this acquisition Logitech continues to build a diverse business that incorporates esports and gaming peripherals.

Consumer product enterprise value to revenue multiples



	Roccat (125)	Corsair (126)	Astro (127)	Saitek (128)	Jaybird (129)
Close	March 2018	July 2017	July 2017	Sep. 2016	April 2016
Acquiror	Turtle Beach	EagleTree Capital	Logitech	Logitech	Logitech
Size ⁽¹⁾ \$MM:	\$19.2	\$525.0	\$85.0	\$13.0	\$50.0
Target Description	Manufactures computer components and accessories, such as keyboards and mice.	Manufactures and markets high-performance PC peripherals and components, such as cases, keyboards, PCs, and fans.	Designs and manufactures video gaming equipment, such as, wireless and Bluetooth headsets for Xbox, PlayStation, PC, and mobile systems.	Designs and manufactures consumer electronics products, such as computer games accessories, input devices, and audio products.	Designs, develops, and manufactures Bluetooth headphones and activity trackers for sports and active lifestyles.
Target Geography	Germany	Global	United States	Global	Global

Conclusion

Ultimately, the esports ecosystem is vast and growing every day. Making sound investments in the space requires significant research, and likely partnering with a group or advisor who has an intimate knowledge of the industry. However, by understanding the basic structure of esports, you will be better equipped to begin asking the right questions, identifying where your investment can have the most impact, and yield the greatest potential return.

Potential rewards (and risks) in esports investing

As the esports industry becomes increasingly more appealing as an area for investment, investors and companies alike should understand the potential benefits, and risks, of exploring partnerships.

ESL IEM Katowice 2019 (Copyright: ESL | Adela Sznajder).



Introduction

Investment interest in the esports industry is increasing.⁽¹³⁰⁾

Investments, measured by number of deals and amount invested were larger in 2018 than any year prior.⁽¹³¹⁾ In addition to this general increase in deal flow, the types of investors considering investments has also grown.

2018 was a record year for private equity investment into esports, and as the industry continues to grow these traditional investors will continue to look for ways to explore potential opportunities.⁽¹³²⁾ For traditional investor groups, entering a new industry for the first time, understanding the key benefits, and perhaps more importantly, key challenges is critical.

This section seeks to address these considerations for a traditional investor considering esports investments. Through a series of short articles, this section highlights some of the potential advantages and risks of investment for both investors and companies operating within esports looking for investments.

This section begins with two brief primers on the potential benefits of an investment in esports.

For investors, esports offers access to a fast growing industry highlighted by a youthful demographic.

For esports companies, in addition to investment proceeds, investors can offer business expertise and credibility as these esports companies aim to capitalize on near and long term opportunities.

This section then highlights some of the nuanced challenges and considerations an investor should consider when exploring investment options. Through a series of articles written by The Esports Observer, major topics and trends within the industry are presented and discussed from an investor perspective.

Why Modern Times Group made two of esports' best investments to-date

The first article highlights the successes of MTG's two investments into ESL and DreamHack.

Late to the party: learning from the history of Heroes of the Storm's esports initiatives

The second examines some of the potential challenges of developing an esports league and the challenges this can have for not only developers, but also team organizations and other groups that are vested in the leagues success.

The rising power (and risk) of influencers in esports

The final article considers the rise of influencers and the potential challenges their popularity poses to the existing team organization structure.

The core focus of these articles is to demonstrate that while the industry has experienced significant notoriety over the past several years, there are nuanced considerations that will require in-depth diligence.

The value of an esports investment: an investor view

Many investors will find the strong expected growth trajectory of the industry, potential for diversification and hedging, and unique customer base intriguing propositions as they explore new opportunities within the esports ecosystem.

While endemic brands and investors already involved in esports can already see its value, outside investors will likely be drawn by several potential benefits and considerations.

Although each subsector of the esports ecosystem will have nuances that can add further benefits depending on an investor's current portfolio; overall, the strong performance of the industry to-date and its unique customer base are driving factors in its appeal.

Industry with strong growth profile

With \$869M of revenue in 2018 and an expected CAGR of 34.9% over the next four years, the esports industry is an attractive market.⁽¹³³⁾ In addition, the disruptive nature of the space and its impact on traditional media and sports, will likely appeal to investors looking to get in on "the

next big thing."

Diversification opportunity

Due to the uniqueness of the industry, traditional investors may also view esports investments as a means of diversification.

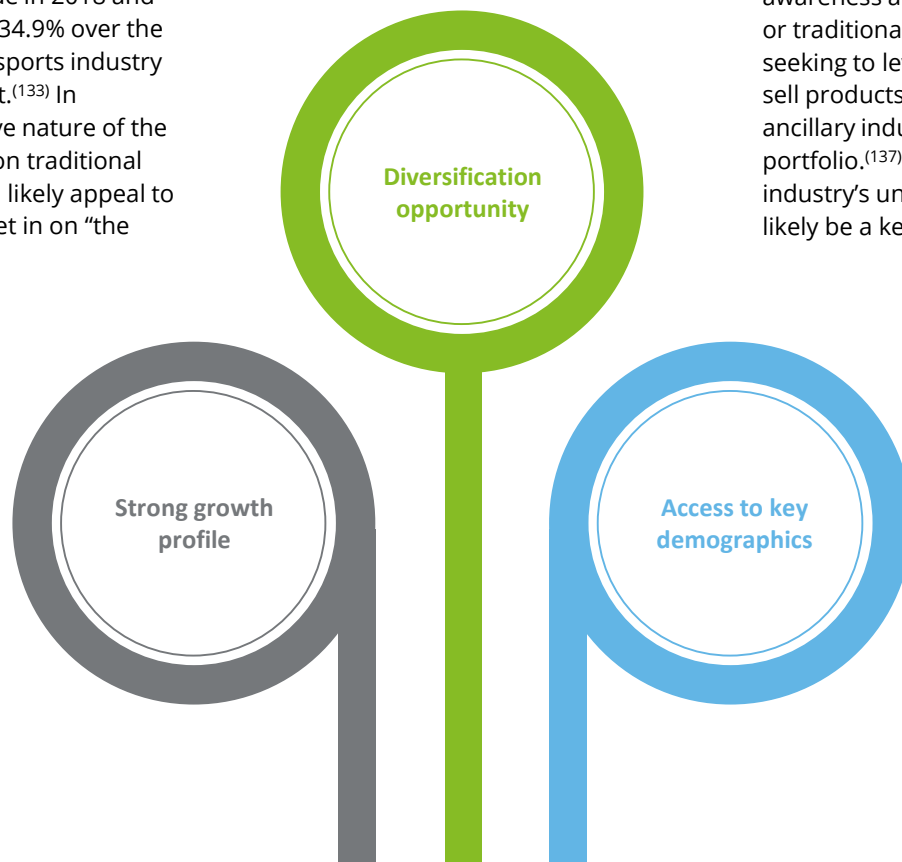
Unlike more mature industries that may have a more limited growth profile, the esports industry is still in its nascent stages and offers exposure to trends that are not wholly reflected in other industries. As such, an investment in esports could offer strong hedging implications.

Access to key demographic

In 2018 the esports industry had a global fan base of 380M with 37% representing males aged 21 to 35, and 16% representing females ages 21 to 35.⁽¹³⁴⁾ In addition, in the U.S., 61% of esports viewers earn more than \$50,000 per year.⁽¹³⁵⁾

The industry offers access to a unique demographic that is increasingly turning away from traditional media.⁽¹³⁶⁾

By investing into this space, investors can gain access to this demographic. Whether this would be nonendemic brands attempting to increase awareness among this demographic, or traditional private equity investors seeking to leverage access to cross-sell products and services from ancillary industries within their portfolio.⁽¹³⁷⁾ No matter intent, the industry's unique fan base would likely be a key investment highlight.



The value of an esports investment: an investee view

As the esports industry grows, companies that invest in strategic partnerships can obtain access to a variety of tangible and intangible benefits that can help to fuel growth, establish operational efficiencies, and drive market positioning.

With so much investment activity occurring throughout the industry, it's important to remember that there is meaningful value being provided to many esports companies through their funding round.

In the last 15 months, over \$4.5B USD in disclosed funding has flowed into the esports industry.⁽¹³⁸⁾ From prominent esports organizations to third-party event coordinators, small startups to major streaming platforms, the pool of investment opportunity within esports is vast.

With so much investment activity occurring throughout the industry, it's important to remember that there is

meaningful value being provided to many esports companies through these funding rounds. A strong understanding of the value these investments provides should not only help companies identify the right investment partners, but can aid investors in determining how they can get involved in the space.

From the perspective of an esports company, the primary investment benefits can be bucketed as



proceeds, knowledge, and credibility.

Proceeds

One of the most obvious and direct benefits of any investment is the infusion of capital into a business. With the esports industry growing so rapidly, many esports companies have become reliant on capital investment in order to seize new opportunities or maintain their current market share.

Franchised league systems such as the *League of Legends* Championship Series and the *Overwatch* League require teams to pay franchise fees ranging anywhere from \$8M to \$20M, respectively.⁽¹³⁹⁾ While these payments can be spread out over time, they represent a significant expense in the budget of any team organization, and many of these teams do not yet generate enough revenue to offset those costs. To that end, many teams have stated that their recent funding rounds will be used in part to cover these franchise fees. For example G2 Esports raised \$17M in funding in February 2019, in part to pay the franchise fee to enter the European *League of Legends* Championship Series.⁽¹⁴⁰⁾

There are many segments of the market which remain open to the first company that is able to establish a firm foothold. A prime example of this is high school esports. While there are several companies attempting to create national systems for high school esports, none has yet risen to become the industry standard.⁽¹⁴¹⁾ This is part of the reason why one of the companies competing in this

space, PlayVS, has already completed multiple funding rounds, injecting millions in new capital in order to move quickly to develop its platform, secure partnerships, and build out its infrastructure.⁽¹⁴²⁾

Knowledge

In many ways, the esports industry is still working to shed its grassroots origins. Some of the most prominent team organizations, event coordinators, and startups began as passion projects started by competitors and fans rather than being established as profit-oriented business ventures. While the leaders of these companies certainly know the esports industry well, they may lack the knowledge, experience, and connections that can help scale their business to the next level.

This is why having investors get involved as board members or strategic advisors is an appealing proposition for a growing esports company. Often, companies in the esports industry are looking for more than just someone to write a check when seeking investment; they are looking for a strategic partner. Someone who can help the company navigate its next expansion effort, offer guidance on new projects, and offer a large network of new contacts in complementing industries.

This type of partnership can be just as valuable as the capital itself. In discussions with esports companies and startups, an investor should consider how active a role that investor wants to take in advising that company, and what additional value

that party can bring to that specific organization.

There are a number of questions a potential investor might consider when exploring an esports investment opportunity. If considering investing in a tournament organizer, investor questions may include: Where is the tournament organizer hoping to expand next? Does the investor have connections in that region that can offer guidance on which cities would make the best tournament hosts? If the team the investors is meeting with plans to build a training facility, can the investor advise them on how to keep construction costs low?

Investors should ask thoughtful questions to ensure that they fully understand the current and future needs of the company, and how a partnership will be most profitable.

Credibility

The esports industry has gained a great deal of credibility over the last 12 months, but still has room for improvement in earning the same level of universal respect as traditional industries.⁽¹⁴³⁾

Most conversations with new partners, investors, sponsors, and government officials still requires a significant amount of education on the basic mechanics of the industry, and many investors still need to be sold on the economic potential and capacity for viable industry business cases.

Prominent, respected investors carry

a great deal of weight in the space today as they can greatly increase the level of credibility for a given company. A nonendemic sponsor may not have heard of aXiomatic, or fully understand the value of its organization Team Liquid, but knowing that NBA star Michael Jordan has invested in the team will likely make many executives sit up and take notice.⁽¹⁴⁴⁾ The fashion industry is far more likely to hear what the owners of 100 Thieves have to say about their streetwear line if they know that hip-hop icons Aubrey “Drake” Graham and Scooter Braun are actively involved.⁽¹⁴⁵⁾

Adding a celebrity or prominent business figure to an investment group can go a long way toward opening doors and making an esports company “legitimate” to an outsider’s perception.

In addition, when considering future liquidity events for the business, such

as potential full sales to strategics or majority or minority recapitalizations with private equity investors, having the support and investment backing of traditional investment groups (e.g. venture capital, growth capital, family offices, or private equity) can offer a strong indication to future potential follow-on investors that the business is credible.

Conclusion

The potential benefits of esports investments may seem evident at the surface level, but understanding how proceeds, knowledge, and credibility factors apply specifically to esports companies can serve both sides of the negotiating table. Investors can ask better questions and determine the specific value they bring to an organization to in turn optimize their return on investment, while companies can gain a clearer understanding of their needs and seek out investors that best suit them.

Why Modern Times Group made two of esports' best investments to-date

By recognizing the shifting media environment early and putting its key investments into a position to capitalize on growth, MTG has solidified its position as a major player within the rising esports industry.

By Andrew Hayward, The Esports Observer

Consulted by Tobias Seck, The Esports Observer

Esports is such a young and rapidly evolving industry that with many investments, it's simply too early to decide whether or not they have been economically successful moves. For example, despite all of its potential, it could be years before we know whether *Overwatch* League teams can get a return on investment on the millions of dollars poured into franchising.⁽¹⁴⁶⁾

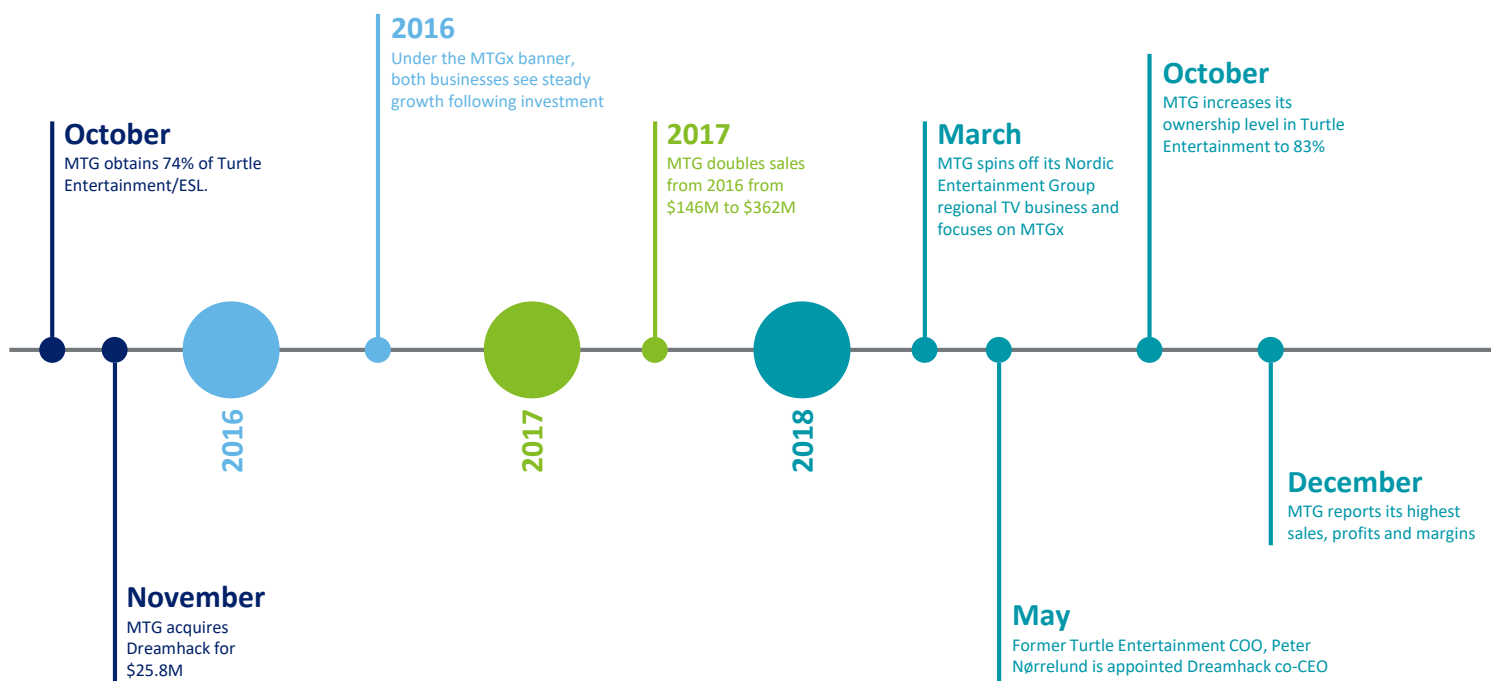
However, there is one straightforward example of a lucrative investment—two, actually. The Modern Times Group (MTG) made a significant move establishing itself in esports in 2015

by acquiring a majority interest in ESL parent company Turtle Entertainment, as well as fully acquiring DreamHack.⁽¹⁴⁷⁾⁽¹⁴⁸⁾ Since then, both tournament operators have continually grown and become even more firmly entrenched as key companies and market leaders in the industry.

MTG has since restructured its organizational structure and split its media business from those key investments and others in the gaming and video space, shedding previous business interests to refocus on its rapidly-growing digital endeavors.⁽¹⁴⁹⁾



DreamHack Masters Stockholm 2018 (Copyright DreamHack | Adela Sznajder).



Timeline of MTG's investments into Turtle Entertainment/ESL and Dreamhack.⁽¹⁶⁰⁾⁽¹⁶¹⁾

Here's a look back at the timeline of MTG's esports investments and decisions, the financial impact to-date, and how it has changed the Swedish firm's focus going forward.

Making moves

MTG first invested in Turtle Entertainment/ESL in July 2015, acquiring 74% of the company from founders and investors for €74M EUR (then \$86.9M USD).⁽¹⁵⁰⁾ Four months later, in November 2015, MTG acquired DreamHack in its entirety for kr244M SEK (then \$25.8M).⁽¹⁵¹⁾ Both companies were placed under the MTGx video games, esports, and video brand, and steadily grew in 2016 and 2017, after which MTG began making further moves.⁽¹⁵²⁾

In March 2018, MTG's board announced that it would instigate a process to split the company into two publicly-traded entities, with its Nordic Entertainment Group regional TV business spun off into a separate company.⁽¹⁵³⁾ Meanwhile, the side of

the business previously under the MTGx umbrella—which also included online competitive league, E-Sports Entertainment Association League (ESEA)—would continue on simply as MTG following the completion of the split.⁽¹⁵⁴⁾

At the time, Tobias Gyhlénus, group head of PR at MTG, told The Esports Observer that the timing was right "in order to maximize the focus and potential of each group for the benefit of owners, customers, and employees."⁽¹⁵⁵⁾ In May 2018, MTG continued its restructuring maneuvers by appointing long-time employee (and previously Turtle Entertainment COO) Peter Nørrelund as DreamHack's co-CEO to help optimize the company's growth and development.⁽¹⁵⁶⁾

In October of 2018, MTG increased its ownership level of Turtle Entertainment/ESL to 82.48%, paying kr152M (then \$17M) for that additional 8.48% control.⁽¹⁵⁷⁾ That's a significant premium over the rate

paid for MTG's original investment in the company.

Financial growth

Each year following 2015, MTG's sales and profits have continued to increase. MTG's 2017 annual report hailed the company's evolution into "a smarter and more relevant MTG," and it showed in the significant growth of the MTGx business.⁽¹⁵⁸⁾ Sales in the division more than doubled over 2016, rising from kr1.33B (\$146M) to kr2.96B (\$361.7M). Esports accounted for the largest share of the division's sales at 46% for 2017.⁽¹⁵⁹⁾

That surge continued into 2018. In Q1, MTG reported 32% year-over-year growth in esports revenues, driven by more than 70% growth in ESL's revenue from owned-and-operated events.⁽¹⁶²⁾

Following the March announcement of the impending split into two companies, the remaining MTGx half reported kr994M (\$112M) in sales, up

4.41% from Q1 2018 and 63% year-over-year.⁽¹⁶³⁾ Esports represented kr411M (\$46.3M) of that, marking a 41% increase over Q1 2018 and representing 41.3% of total revenue for the vertical.⁽¹⁶⁴⁾ This was driven by more than 60% growth year-over-year in revenue for ESL and DreamHack.⁽¹⁶⁵⁾

In Q3 2018, the MTGx division reported kr1.02B (\$111M) in sales, an increase of 28.3% from kr798M (\$86.8M) the same quarter in 2017.⁽¹⁶⁶⁾ Turtle Entertainment/ESL saw a 16% revenue boost over Q3 2017, however, DreamHack saw lower year-over-year revenue due to changes in its Q3/Q4 event schedule.⁽¹⁶⁷⁾ Esports sales were down 13% year-over-year in Q4, as double-digit growth in both ESL and DreamHack's owned and operated business was diminished by weakened work-for-hire revenues.⁽¹⁶⁸⁾

For the full year of 2018, MTG reported its highest-ever sales, profits, and margins, with the MTGx division profitable for the first time on a full-year basis despite ESL's restructuring costs of kr49M (\$5.5M).⁽¹⁶⁹⁾ Overall, the MTGx division's sales were up nearly 36% for 2018 at kr4.03B (\$449.4M) over

kr2.96B (\$361.7M) in 2017.⁽¹⁷⁰⁾ Esports accounted for kr1.52B (\$169.5M) of that in 2018, up 11% over the kr1.37B (\$167.4M) tally in 2017.⁽¹⁷¹⁾

The impact on MTG

MTG's fortunes have risen each year since adding Turtle Entertainment/ESL and DreamHack to its stable, with MTG's digital businesses gradually taking a more prominent role in the company's current and future outlook. That point is driven home with the split between MTG and the new Nordic Entertainment Group (NENT Group), which was finalized when the latter's shares began trading on the Nasdaq Stockholm market in late March 2019.⁽¹⁷²⁾

Even before the split, the shifting interest and momentum within MTG was apparent. In the years leading up to the plan, the company shed various television interests in other European countries, gradually whittling down its focus on traditional terrestrial TV offerings as its digital elements grew and became a much larger part of MTG's identity.⁽¹⁷³⁾⁽¹⁷⁴⁾⁽¹⁷⁵⁾

MTG continues to invest in the esports space, too. The company has

invested in BITKRAFT Esports Ventures—an investment fund specifically for industry companies—as well as nutrition brand Runtime and learning app Blitz.⁽¹⁷⁶⁾ With the NENT Group formally splitting off, MTG can now focus its attention specifically on its complementary digital offerings, including esports.

ESL and DreamHack continue to grow as two of the industry's leading global third-party tournament coordinator. After 19 years in the business, ESL's bold new rebrand is intended to help light its own path ahead and show that the company is still vital in today's esports landscape, while DreamHack's extended events schedule shows its own ongoing expansion.⁽¹⁷⁷⁾ Those investments could pay off even more significantly over time as the esports industry is expected to continue to grow by leaps and bounds.

Investing in Turtle Entertainment/ESL and DreamHack has not only set MTG up as one of the most prominent players in esports, but has also permanently altered the course of the 32-year-old company as it adapts to the changing entertainment landscape.

Late to the party: learning from the history of *Heroes of the Storm's* esports initiatives

Establishing a successful esports league can offer its challenges, and these challenges are not the exclusive issue of the developer. Industry players further downstream who invest time and capital to participate can also face significant risk.

By Trent Murray, The Esports Observer

Consulted by Tobias Seck, The Esports Observer

The factors that led to the cancelation of the league and the decline of *Heroes of the Storm* esports can serve as an important lesson for evaluating the viability of future games and leagues.

Developer Blizzard Entertainment (Blizzard), a subsidiary of Activision Blizzard, has perhaps one of the most important legacies in all of esports. *StarCraft* launched the modern era of professionalized competitive gaming, *Hearthstone* opened the doors for an entire genre of digital card game esports, and the *Overwatch* League kicked off a brand new era of franchised leagues and geolocation.⁽¹⁷⁸⁾⁽¹⁷⁹⁾⁽¹⁸⁰⁾

However, things have not been all landmark decisions and sold out grand finals. In December 2018, Blizzard announced that it was discontinuing all esports support for one of its lesser-known title, *Heroes of the Storm* (HOTS).⁽¹⁸¹⁾

The game had professional leagues in four major regions, commitments from major organizations like Fnatic and Team Liquid, and to-date has awarded the sixth-most total prize money across all events of any esports, according to Esports Earnings (\$17.9M USD).⁽¹⁸²⁾⁽¹⁸³⁾ Despite significant investment on the part of its developer, *Heroes of the Storm* failed to grow an audience on Twitch during the two years its professional league, the Heroes Global Championship (HGC), was in operation.⁽¹⁸⁴⁾

The factors that led to the cancelation of the league and the decline of *Heroes of the Storm* esports can serve as an important lesson for evaluating the viability of future games and leagues.

Late arrival to the genre

The Multiplayer Online Battle Arena (MOBA) genre is one of the biggest in all of esports.⁽¹⁸⁵⁾ Two of the “big three” esports titles (*League of Legends* and *Dota 2*) are MOBAs.⁽¹⁸⁶⁾ By the time Blizzard entered the space, its leaders had already established a firm foothold. *League of Legends* (LoL) launched in 2009.⁽¹⁸⁷⁾ *Dota 2* was released in 2013.⁽¹⁸⁸⁾ *SMITE* was released in 2014.⁽¹⁸⁹⁾ *Heroes of the Storm* did not enter its open beta phase until May of 2015.⁽¹⁹⁰⁾ By that time, not only had these other titles established large, entrenched player bases, but plenty of other studios had tried and failed to compete. The DC Universe-themed *Infinite Crisis* never made it out of beta.⁽¹⁹¹⁾ Electronic Arts abandoned *Dawngate* by the end of 2014.⁽¹⁹²⁾ Major publishers and popular IP came and went. To this day, many MOBAs have had difficulties cracking the market dominance of LoL and *Dota 2*.⁽¹⁹³⁾

Arriving so late to the MOBA party meant that Blizzard's entry would come with extremely high expectations, and would have to find a way to differentiate itself in an already saturated market.

A unique MOBA experience faces growing pains

Blizzard's first attempt to stand out from the MOBA scene was to declare that *Heroes of the Storm* did not belong in that market at all. The developer ignored the MOBA label in all press and marketing, referring to the game instead as a "team brawler."⁽¹⁹⁴⁾

In order to stand out and offer players a unique experience, *Heroes of the Storm* had also tried to improve and differentiate many of the core features and mechanics of other MOBA titles.

These changes created a lower

emphasis on individual player skill in favor of stressing the importance of teamwork for achieving victory.⁽¹⁹⁵⁾

For veteran MOBA players and newcomers alike, this combination of messaging and departure from convention gave many players the impression that *Heroes of the Storm* was the MOBA for people who had not enjoyed the traditional MOBA experience.⁽¹⁹⁶⁾

While enjoyable at a casual level, these unique game mechanics also likely helped to create a disconnect between the game's esports scene and its general player base. One of the primary reasons many players first choose to watch a game's competitive content is to learn how to improve their own skills. However, because professional *Heroes of the Storm* placed so much emphasis on teamwork, there was often little a player could learn that would translate into their solo play

experience.

Additionally, *Heroes of the Storm* drew some criticism for its ranked play experience from some of the game's top players.⁽¹⁹⁷⁾ Due to matchmaking problems, a lack of key drafting features, and various other issues, top competitive players would explore organizing their own ranked mode outside of the *Heroes of the Storm* ranked ladder.⁽¹⁹⁸⁾

Throughout the lifespan of *Heroes of the Storm*, the disparity between the game played by the pros and the experience of the average player would create separation between the game's core community and its professional scene.⁽¹⁹⁹⁾

Between its messaging and core gameplay experience, *Heroes of the Storm* struggled to incentivize players to engage with its competitive scene.⁽²⁰⁰⁾ When looking at successful, long-lasting esports, the opposite is consistently true.⁽²⁰¹⁾ Players can watch top-level professional matches and learn how to improve their own game. Individual skill and playmaking ability are rewarded across the board.

In spite of these hurdles, however, a small, dedicated esports scene began to emerge for *Heroes of the Storm*.

Where's the value?

The early days of *Heroes of the Storm* was a veritable who's who of top esports teams. Cloud9, Evil Geniuses, Virtus.pro, and Natus Vincere all signed teams before Blizzard held the game's first World Championship at BlizzCon 2015.⁽²⁰²⁾⁽²⁰³⁾⁽²⁰⁴⁾

However, by the time the *Heroes of the Storm Global Championship* ("HGC") launched in 2017, all four organizations had left the game.⁽²⁰⁵⁾⁽²⁰⁶⁾⁽²⁰⁷⁾ A few prominent organizations such as Fnatic and Dignitas remained, but many of the teams that qualified for the HGC remained unsigned by any significant



Competitive *Heroes of the Storm* gameplay at the 2017 DreamHack Mid-Season Brawl. (Copyright DreamHack | Abraham Engelmark)

esports brand throughout the league's existence.⁽²⁰⁸⁾

One significant barrier for both team organizations and viewers was the lack of in-person tournaments. While viewership for *Heroes of the Storm* was never especially high, it was always substantially higher during live tournaments when compared to online events.⁽²⁰⁹⁾

With low viewership, online events provide limited value to esports teams, and although Blizzard provided large prize pools for each year of *Heroes of the Storm* esports, that money was limited to the major offline tournaments.⁽²¹⁰⁾ Online competitions also meant that the players could not be shown on camera, which meant that the sponsor logos on team jerseys were rarely visible.

From 2016-2018, Blizzard held three international offline tournaments a year.⁽²¹¹⁾ There were occasionally other small live events during the year, but the overwhelming majority of *Heroes of the Storm*'s highest level of competition took place online. As a result, teams outside of the top two in a region had difficulties generating value from their investment in *Heroes of the Storm*.

By the end of 2018, only six prominent esports organizations (Tempo Storm, Dignitas, Fnatic, Team Liquid, Method, and Gen.G) had *Heroes of the Storm* rosters out of 32 HGC teams.⁽²¹²⁾

What can we learn

While Blizzard was most adversely impacted when *Heroes of the Storm* was unable to gain wider acceptance, it also affected many of the organizations who chose to invest.

When a professional organization invests in a new game, there are substantial upfront costs including player and support staff salaries, allocating resources to provide jerseys, graphic assets, and social media coverage for the new team.

As player salaries continue to rise and franchise fees become more common, effectively identifying sustainable games will become more and more important for both team owners and their potential investors. The story of *Heroes of the Storm* provides a few key points by which investors can examine a game to help evaluate the potential risk/reward of investing at an early stage.

Is this game relevant?

For a game to build up enough momentum to become sustainable as an esports, it needs to be embraced by a large player base. Is the game in question at the forefront of a relevant genre, or is it chasing a trend that has already passed?

While not a perfect indicator of long term esports health, a large player base can make it more economically viable for a developer to continue investing in both the esports scene and ongoing development. The majority of a game's viewing audience will likely come from its active player base as well, so the size of that player base can provide an indicator of expected viewership.

Is this game competitive?

Successful esports games are designed to reward individual skill and playmaking ability and have an actively supported, popular competitive mode. Ideally, the game's ranked mode also provides an experience that closely resembles the

game mode played by professionals.

The competitive depth of a game can be a strong indicator of sustainability. *StarCraft: Brood War* and *Super Smash Bros. Melee* are widely considered to be two of the deepest competitive games ever made, and both have sustained active, professional esports scenes more than 15 years after their release.⁽²¹³⁾

Are there enough offline events?

Online leagues can drastically reduce operating costs for developers, but they often provide little value to esports organizations if they don't directly feed into a wide array of offline tournaments. Sponsorships are typically a key revenue stream for team organizations, so they need to be able to generate value for brands with every game.

Any game that over-emphasizes online events without some clear way to generate visibility for sponsors will likely struggle to generate that value.

A healthy esports ecosystem should have multiple opportunities for all professional esports teams to compete offline, with the best teams earning extra value by qualifying for international championships.

While there are plenty of additional factors professional teams must weigh before choosing to invest in any game, answering these questions can provide investors with a useful baseline by which to measure the health of each game professional teams participate in, and to evaluate the potential risk/reward of buying into a high-ticket franchise system. Several active esports titles today show warning signs in at least a few of these categories, and so investing requires careful consideration.

The rising power (and risk) of influencers in esports

As esports influencers continue to gain larger followings built on the social aspects of their entertainment value, the recognition of their brands in their own right may lead them away from the structure of traditional esports team organizations.

Despite its common usage in marketing, the term “influencer” carries somewhat of a negative connotation within the gaming community. Professional esports teams will often identify their line-up of influencer talent simply as “streamers” or “content creators.” The esports industry relies on authenticity, which conflicts with the idea of pro-gamers known more for marketing value than dexterity with keyboard and mouse.

Nevertheless, certain gaming influencers are rapidly outpacing the value of the professional esports teams they are contracted to, and the ethical concerns with influencer marketing—highlighted by controversies such as the Fyre Festival campaign or YouTube personalities such as Laura Lee and Felix “Pewdiepie” Kjellberg—are just as likely to cripple a team.⁽²¹⁴⁾⁽²¹⁵⁾⁽²¹⁶⁾⁽²¹⁷⁾

This was exemplified by the CSGOLotto scandal, in which two popular YouTubers promoted a so-called “skin gambling website” without properly disclosing their ownership in the business.⁽²¹⁸⁾ This was the first Federal Trade Commission (FTC) case levied against influencers.⁽²¹⁹⁾

For the esports industry, influencers may pose a secondary problem; loss of leverage. While esports tournaments and competition brands are able to garner millions of views in a single event, team organizations are discovering that the brand equity of their professional players in some instances is quickly being outpaced by influencers.

Traditional media agencies, such as Creative Artists Agency (CAA) and United Talent Agency (UTA) have set up gaming-focused divisions, and in some cases, drawn talent away from endemic esports organizations.⁽²²⁰⁾⁽²²¹⁾



Michael “Shroud” Grzesiek, a notable influencer, competing at the DreamHack ASTRO Open in 2017. (Copyright DreamHack | Adela Sznajder)

By Graham Ashton, The Esports Observer

Consulted by Tobias Seck, The Esports Observer

Esports ambassadors driving value

Esports has entered the mainstream consciousness, with dedicated episodes in TV shows such as *The Simpsons*, to public—and capital—endorsement by hip-hop stars including Aubrey “Drake” Graham, Jacques Bermon “Travis Scott” Webster II, and DeAndre Cortez “Soulja Boy” Way.⁽²²²⁾⁽²²³⁾

In tandem, certain gaming personalities have slowly become household names among their target age group. The most notable of these is Tyler “Ninja” Blevins, a former *Halo* professional who quickly became Twitch’s most subscribed personality after a set of star-studded *Fortnite* streams, and high profile media appearances.⁽²²⁴⁾ These include a multi-commercial campaign with Samsung to promote its Galaxy phone series, a live-stream in Times Square on New Year’s Eve, and a cameo appearance at the NFL’s own Super Bowl commercial.⁽²²⁵⁾⁽²²⁶⁾⁽²²⁷⁾

It should be noted that while Ninja occasionally competes in tournaments, he is more often recognized as one of the most popular gaming influencers.⁽²²⁸⁾ This represents a schism within the gaming entertainment space; the purely-competitive scene, and players (or in some cases, entire teams) that are personality-driven.

This factors into the diversification opportunity for esports investors.

(Continued on next page)

While media rights are one of the fastest growing revenue streams in the industry, predicted to account for \$251.3M of the projected \$1.1B total revenues in 2019, the reliance on sponsorships has prompted certain professional esports teams to run influencer-driven campaigns for sponsors.⁽²²⁹⁾

Examples include G2 Esports' "Making the Squad," a talent-contest for *Fortnite* streamers, and Team SoloMid establishing a "Fortnite house" to create content for the game before an official tournament was even announced.⁽²³⁰⁾⁽²³¹⁾

All said, there are some instances of competitive players taking the typical role of a brand ambassador.

Last year, two Russian *Dota 2* players from the organization Virtus.pro were featured in advertisements for The Procter & Gamble Company brands Head & Shoulders, and Gillette.⁽²³²⁾ Most notably, the Chinese *League of Legends* player Jian "Uzi" Zi-Hao was featured in a promo campaign for a major athletic footwear and apparel company.⁽²³³⁾

Characteristics of the gaming influencer

Marketing influencers typically accumulate their audience and reach by building credibility within a given industry. Gaming influencers carry many of the traits seen in any other type of social media personalities: they start conversations, drive engagement, and set trends among their audience. While some gaming influencers may occupy their own niche (e.g. gameplay tutorials and tips, unboxing videos, product/game reviews), the most followed personalities typically bear the following characteristics:

Competence of play: Whether male or female, the most popular gaming streamers usually have a high win-rate when playing. Their ability at a given game is rarely at the level of a purely competitive gamer, but they are able to maintain a respectable

in-game rank. Since they are in many ways the protagonist of their stream, audiences tend to favor a player that can triumph consistently.

Regular scheduling: While the specific times of play are subject to change, an influencer will typically broadcast on a daily basis. The earliest start and latest end time are pre-provided, with an announcement posted on all social media channels once the broadcast has begun. In many cases, highlights of these streams, which can last up to 10 hours, are posted on various video on demand services.

Associated game: A successful influencer will be able to transition between multiple game titles, particularly when a new release or content update arrives. However, the most popular gaming influencers predominantly play one specific game.



Key characteristics of a major gaming influencer.

Which major influencers got their start in esports?

Many of the most popular influencers initially started as competitive esports players and eventually shifted their focus towards entertainment.⁽²⁴¹⁾

Tyler “Ninja” Blevins

Became a professional streamer for Luminosity Gaming in 2011. Began streaming *Fortnite* in 2017, follower count grew by 250% from 500K in six months .

Followers: 31.1M

Game: *Halo 3*

Teams: Cloud9, Renegades, Team Liquid

Michael “Shroud” Grzesiek

Stepped down from Cloud9’s *CS:GO* team in 2017, and left the organization and game entirely in 2018. Has competed in some *PLAYERUNKNOWN’S BATTLEGROUNDS* tournaments since.

Followers: 8.2M

Game: *Counter-Strike: Global Offensive*

Teams: compLexity gaming, Cloud9

Matthew “Nadeshot” Haag

A former player and captain for OpTic Gaming, Haag became a full-time content creator in 2015. He set up 100 Thieves as a lifestyle brand in 2017, before building out the company into an esports organization in 2018.

Followers: 6.7M

Game: *Call of Duty*

Team: OpTic Gaming

Jaryd “summit1G” Russel Lazar

While Lazar is a full-time streamer, he still competes as a semi-professional player. His last recorded competition was in August 2018.

Followers: 4.5M

Game: *Counter-Strike: Global Offensive*

Teams: A51, Team Mythic, subLe

Michael “Imagtpie” Santana

Retired from professional *League of Legends* play in 2014, briefly returned to competitive play in 2017 in “Delta Fox,” a team made of retired players—known also as the “Meme Team.”

Followers: 1.0M

Game: *League of Legends*

Team: Dignitas

Influencers vs. professional esports teams

As mentioned, influencers have been a staple of esports team organizations for some time already. The organizations that are largely cash-flow positive generate a significant source of income by retaining highly followed professional players and influencers, using them to promote sponsor products through video content, and splitting the revenue share.

A clear example is Team SoloMid (TSM), which has ten *Fortnite* influencers signed to its roster, all of whom have a combined 11.5M followers on Twitch.⁽²³⁴⁾ The combined Twitch followers of TSM’s *League of Legends* professional team, its flagship

...Certain gaming influencers are rapidly outpacing the value of the teams they are contracted to...

competitive roster, is only 2.8M.⁽²³⁵⁾

TSM promotes its sponsors, including Dr. Pepper, Geico, and Grubhub, through all its professional players, but in May 2018 the organization signed a partnership deal with Chipotle Mexican Grill, Inc. that focused exclusively on the team’s “*Fortnite* house,” with product promotion via content on social

media, YouTube, and Twitch.⁽²³⁶⁾⁽²³⁷⁾

While *Fortnite* developer Epic Games is attempting to build a competitive scene around the game, complete with a \$30M prize pool World Cup in 2019—the largest prize pool in esports to-date—the current value for professional teams lies in its streaming potential.⁽²³⁸⁾ The game is less about competing, and instead functions as a video-game social media platform, complete with in-game live events (including music concerts).⁽²³⁹⁾ The game has celebrity players including Joel Thomas “Deadmau5” Zimmerman, Chancelor “Chance the Rapper” Bennett, and various professional sports athletes and personalities, who are not known for playing competitive videogame titles.⁽²⁴⁰⁾

While this is a positive development in driving audience and brand interest in live gaming events, it poses several potential risks for esports organizations that have traditionally focused on competition prowess:

- **Can an esports organization with limited experience in brand development and management guarantee the success of its influencers?**
How do these organizations recruit influencers, and ensure long term audience growth?
- **If investors and brands entering the live gaming space can attain a greater reach and ROI through individual investors, how will this affect the resources for competitive esports players?**
What will be the effect on esports tournament operators if more teams siphon their resources to content creation and marketing, instead of

player development and recruitment?

- **Will esports organizations need to change their business models to accommodate the rise of both influencers and gaming-centric marketing agencies?**
For example, Tyler “Ninja” Blevins and Jack “CouRage” Dunlop were previously signed to Luminosity Gaming and OpTic Gaming, respectively. The two later signed exclusive influencer management deals with Loaded, an agency created by esports technology and services company Popdog.⁽²⁴²⁾
- **What happens if an influencer’s brand value (i.e. follower count, value of sponsorships) exceeds that of their team?** How can investors be assured that the company will not lose that relationship?

The phenomenon of gaming influencers within esports can be compared to the boom of professional wrestling in the 1980s.

While the outcome of *Fortnite* matches and popular streaming titles are not fixed, they are more for “entertainment purposes” rather than legitimate contests. Whereas the success of professional wrestling entertainment and its contemporaries did not steal the audience of professional sports, the relatively short history and market instability may put professional esports teams in an awkward position.

Until recently, influencers have been a profitable side-arm of the esports industry; a way to generate greater ROI for sponsors. Soon, they could become the dominant face of live videogaming, and a more valuable prospect for stakeholders.



Dynamics of esports investments

In order to effectively position themselves to maximize potential investment dollars, esports companies should understand the different investors in the industry and the key questions they will likely ask.

As the esports industry continues to rise in popularity, new investors will explore the space in order to capitalize on its strong expected growth profile over the next several years. With an influx of new investors, it is important for esports companies to understand what each investor type is able to offer. While the dollar size of an investment is certainly the headline item, different investors can offer other intangible benefits and possible risks.

In addition to understanding the value proposition of different investors, it is also important to understand the questions they will likely ask, and which areas will be important areas of focus as they go through a diligence process.

An esports company that understands the investor's concerns will be better positioned to maximize the benefit of a partnership and reduce potential risks.

Investor landscape

Investor type and subsequent investment structure can vary significantly on any given deal by industry, sector, and may even be situation/circumstance specific. The main investor types can be bucketed into: family offices, venture capital, traditional private equity, and strategic. Each segment operates and invests in a unique manner, but are all typically variations on stage of company, amount of capital invested, investment structure, and risk tolerance.

In the esports industry, the number of investments has significantly increased with only four investments in 2014 to a record 68 investments in 2018, representing a 103.1% CAGR.⁽²⁴³⁾ The majority of these investments are classified as venture capital, which is often defined by investments in early-stage companies.

These ventures are considered to be riskier due to the unsecured nature of the investment and lack of historical performance/financials. To adapt to this increased risk, venture capital firms seek greater than normal returns on their investments.

The esports industry's rapid growth in number of investments and mean size of investment carries the implication that traditional private equity firms will likely begin to enter the space in a much more regular fashion. Private equity firms typically aim to invest with a five-year hold period with either a minority (less than 50% of the business is acquired) or majority investment (greater than 50% of the business is acquired). A full purchase (100% of the business is acquired) is much less common as private equity firms want to encourage management to remain on the platform with a direct incentive to grow the business. Private equity firms are also more risk averse relative to venture capital and will want to see strong historical financials in their target investment.

Family office investments can follow any model depending on the size of the firm and can take part in venture-like opportunities or those with more established companies. A family office is run as a private wealth advisory firm that typically seeks to preserve capital as opposed to generate significant, above-market returns for shareholders. For this reason, family offices are not tied to any specific

time horizon and may invest in companies for periods in excess of five years without hesitation.

The investments into esports teams have been led primarily by wealthy individuals, family offices, and venture capital firms.⁽²⁴⁴⁾

Investment into esports teams has yet to become commonplace for traditional private equity likely due to the risk and unpredictable cash flows of the organizations. Private equity firms typically seek to minimize risk and esports teams have yet to enact a model that enables consistent, reliable cash flows as winning tournaments and sponsorships tend to vary greatly over any given period of time. For this reason, it is difficult to estimate or verify future growth and creates a misalignment with private equity objectives. As professional esports teams grow and establish additional avenues of consistent revenue-generating products/services, it is likely that private equity firms will begin to partake in these types of investments.

Private equity firms have been willing to enter the esports industry with investments into peripheral esports

Several pros and cons of different investment types.



Venture Capital

Pros

- Credibility
- Active support for growth
- Retain ownership

Cons

- Focus on early stage and pre-revenue investments



Private Equity

- Credibility
- Larger investment sizes
- Can offer strategic assistance for growth

- Five year investment horizon before exit
- Debt financing component
- Potential loss of control



Family Office

- Longer term investment horizon

- Informal investing process
- Strategic assistance typically limited

companies, such as consumer or related software products. EagleTree Capital's acquisition of Corsair Components, Inc. in July 2017 is one example that may serve as a strong indication that private equity firms are seeking exposure to the esports industry, but have focused on familiar segments, such as consumer electronics.⁽²⁴⁵⁾ These peripheral esports companies are becoming increasingly attractive to private equity firms as they not only provide exposure into one of the fastest-growing industries, but also offer an attractive demographic of millennials between the ages of 21 to 35 with significant disposable income.⁽²⁴⁶⁾ As the industry continues to grow in size and esports companies continue to show consistent revenue growth, the number of investments in the space by traditional private equity firms is expected to significantly increase.

Further, as private equity firms demonstrate that their investments are viable and successful, others will likely follow – helping push significant capital into the growing industry. In fact, from 2014 to 2017 there were only three disclosed investments into esports businesses from private equity firms, relative to the nine that

took place in 2018.⁽²⁴⁷⁾

In a similar fashion, many strategic players that were initially hesitant to invest in the space have become much more active in the past year as the industry holds greater potential to be a profitable venture. One reason for this initial caution is due to their typical investment model, which calls for acquiring 100% of the target business. Given the early stage of the esports space it's likely that few owners were willing to part with their entire business. As the space has grown and given rise to profitable enterprises – opportunities for both strategic investors and business owners arose.

The importance of strategic investors in the space should not be overlooked as nonendemic brands raise awareness and interest. Endemic strategics also have a lot to offer with deep industry connectivity and knowledge that can be leveraged in a variety of ways. Relationships with suppliers can help improve margin through cost reduction and connections to distributors can offer a target company international reach. Given the global nature of the esports industry a global component of any

given company can be of extreme value.

What are investors looking for?

When considering an investment into esports each investor is looking for distinctive qualities in a target company. More specifically, in valuing a business to determine the suitability of an investment, investors will look to confirm consistent future revenue streams and cash flow. If there is significant revenue generated on a consistent basis, the valuation metrics are typically straight-forward.

However, with revenue models that incorporate inconsistent cash inflows or potential future brand value, which are indicative of professional esports teams and prize pools, it's difficult to verify or project future revenue. This unpredictability alone can push away the majority of investor types.

Therefore, esports companies that are well positioned for an investment are typically those that can show consistent revenue generation. To combat the negative element of unpredictable cash flows there are a few ways that target companies can adjust their approach to potential investors. For example, the company can show that there are future plans to develop consistent revenue streams – the introduction of merchandise is one avenue that is often explored in esports.

Additionally, if the target company has had a consistent sponsor throughout its operations, regardless if the dollar contribution is low, that verifies standardization in cash flow it could help in building a strong case for an investment. If the target company does not have plans to build out an avenue of consistent revenue generation, a large following on gaming and/or social media platforms can also serve to validate growth prospects. This is because the investor may have the ability to

From 2014 to 2017 there were only nine disclosed investments into esports businesses from private equity firms, relative to the eleven that took place in 2018.⁽²⁴⁷⁾

leverage and mobilize this base in times where the unpredictable cash flows are not realized.

Several key questions from investors

After evaluating the alternatives and preparing for a potential investment there are a number of factors that play into selecting the appropriate partner.

Ownership

How much equity is the owner looking to sell? Does the owner want to retain full control of the business?

If the goal is to retain ownership of the business the ideal partners are venture capital or private equity firms – both of which may be willing to make minority investments. In the event the owner is looking for a full sale, then a strategic investor is most likely the ideal partner.

Experience and industry connectivity

Is the owner looking for a partner with deep and leverageable connections? Is this an important factor in the overall consideration?

If the owner hopes to leverage the

partner to take advantage of worldwide distribution or lower cost producers, then this is an important consideration.

Generally speaking, all investor types can offer partnerships – the key here is determining which partnerships are the most valuable for the current stage of the business.

Willingness to remain on the platform

Is the owner looking to stay with the business and help the investor grow?

In nearly all cases, with the exception of strategics, the investor will want management to remain on the platform. In the event the owner is looking for a full exit, then a strategic investor is better suited as they typically have the infrastructure in place to continue operations without management.

Alignment

Is the owner looking for a passive partner or one that plans to significantly alter operations? Do the owner and the potential investor have a similar plan for the company's next steps?

This is an extremely important factor

for esports businesses as management may want to explore untested areas of the industry, while the investor hopes to only explore existing profitable ventures.

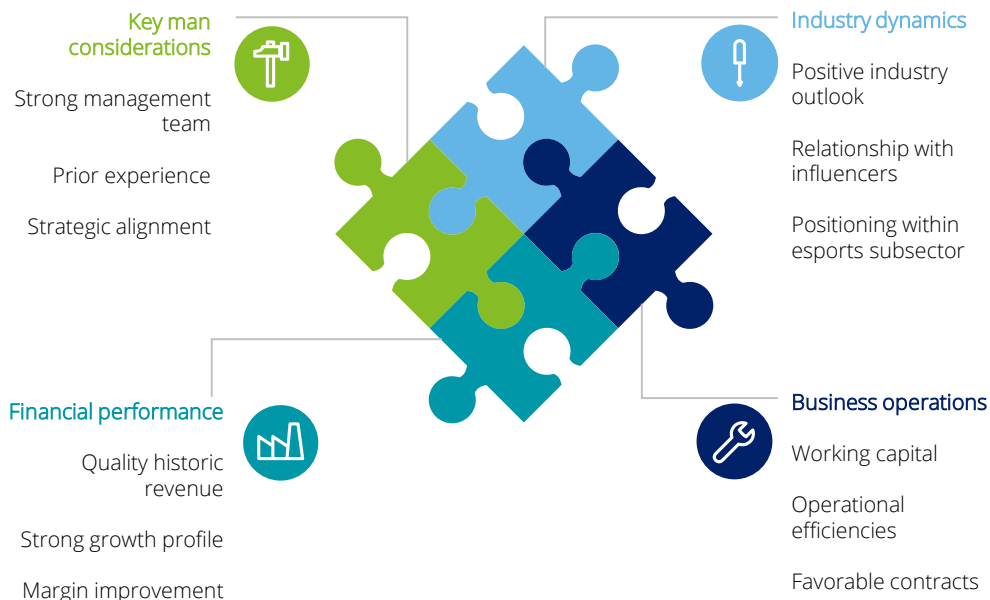
For the most part, minority investments (venture capital and private capital) come with the flexibility of choice between passive and active investors, while majority (private equity) and strategic investors don't always offer a choice.

To understand the various factors and their corresponding implications can be extremely valuable in the context of esports. As data suggests, the current investment partner of choice is venture capital with roughly 100 investments in the space since 2014.⁽²⁴⁸⁾ Family offices are the second choice with 43 investments, followed by strategic investors with 27.⁽²⁴⁹⁾ As expected, due to the age of the industry, private equity lags behind with only 12 investments.⁽²⁵⁰⁾ Every business is going to require a tailored approach, even more so in a young industry, which makes the choice of a partner an extremely important process. As the industry grows the number of investor alternatives is expected to increase accordingly and each factor should be considered carefully.

Due diligence considerations

One of the most crucial aspects of any investment process is the due diligence that is performed on the target company. In short, due diligence is the process by which a potential investor confirms that the information received from the company is accurate and complete. This process is inclusive of an in-depth review of the company's financials, the competitive landscape, the addressable market, and a variety of other factors.

In the esports space there are a variety of industry-specific aspects that investors typically look for when conducting due diligence on a potential investment.



Several key diligence areas to consider for esports companies.

Strong management team

A common and fundamental diligence item arising from venture capital and traditional private equity firms continues to be the management team. In a young industry (from an investment viability standpoint) experiencing rapid growth, traditional private equity firms will look for a strong management team to navigate the landscape. Although venture capital has successfully entered the esports industry and will have a greater understanding of the space, management will be able to provide key insights on any major shifts that may arise. As suggested previously, all these factors are amplified by the nascent aspect of the esports industry, which further stresses the importance of a strong management team. For traditional private equity firms, having confidence in the decision-making capabilities and vision of a management team can offer confidence as the firm explore investments. This holds true across the entire esports industry – team organizations, developers, event coordinators, consumer products, and media and advertising all require

strong management teams.

The components of a strong management team, in the eyes of a potential investor, include (but are not limited to) the following: prior experience, industry connectivity, willingness to remain on the platform, and future growth plans.

Prior experience

Prior experience is a strong factor, as a majority of the potential investors will not have deep experience in esports. Industry experience not only allows management to adeptly react to changes in the market, but it also helps when planning future growth alternatives. For example, two ways that private equity firms may attempt to increase revenue in portfolio companies are through new product lines or further penetration of existing markets. The individuals most suited to decide which avenue to explore is management, as they have been operating in the industry and will understand the needs of their customer base, further

demonstrating the value of an experienced management team.

This experience cumulated over years of operating in the space comes with deep industry connectivity, which refers to the connections, partners, and networks that senior management have developed over their tenure in the industry. These ties become invaluable in the daily operations of the business as they help to maintain consistent suppliers, rates, and other factors that would be subject to variation to new market entrants. These networks are often even more difficult to develop and maintain in a young, dynamic industry, which suggests that a connected management team in the esports space can provide significant value.

These factors reinforce a desire for a strong management team and as such, in determining the viability of an investment, venture capital and private equity firms should ensure that management is willing to remain on the platform for the investment

period. Management's willingness to remain on the platform allows for a continuity in culture, vision, and relationships that helps minimize any potential disruptions in the business' daily operations. Therefore, if management is unwilling to remain on the platform the likelihood of continued interest in the target company from venture capital and traditional private equity firms is likely low.

Industry dynamics

The historical and future growth of the target company's industry is also a key component of the diligence process.

An investor should seek to ensure that the macroeconomic trends of the industry are favorable as a downturn in the sector can have significant adverse effects on the performance of the business. Through market research and management discussions, venture capital and private equity firms can develop an informed opinion on the future of the industry in question.

This component of diligence continues to favor the esports industry as current market research suggests strong and continued growth. In a similar manner, the potential investor aims to diligence the size of the addressable market. If the target company has already addressed or served a majority of the existing market, then the room for additional market penetration may become a concern. Venture capital and private equity firms are looking to create additional value through their investments and a target company that doesn't offer a strong runway for growth is likely not an ideal candidate. In relation to the esports industry, the addressable market has proven to be sizable and growing.⁽²⁵¹⁾

Quality of financials

Another key piece of the diligence process comes into play with respect to the company's historical financials. The potential investor will work to verify and confirm the accuracy of the financials provided to-date and aim to ensure that all items are accounted for. This process is important, as the final financial figures delivered to the investor will inform the valuation of the company. This process may be less relevant for venture capital investors, relative to private equity, as venture capital firms seek to invest in early-stage companies that often lack significant historical data. For this reason, those firms initially directing capital into the esports industries, beginning around 2014, were venture capital.⁽²⁵²⁾ As private equity firms increasingly begin to enter the space financial due diligence will be of growing importance. Private equity firms will track and verify historical figures with an ideal target company typically offering consistent, year-over-year revenue growth. In addition to top-line growth, private equity firms typically look for margin improvement – as growing revenue while simultaneously reducing operating costs signals that the target company is achieving operational efficiencies. This diligence stream is most relevant to product-based esports companies as a majority of the professional esports teams have yet to demonstrate profitability on a consistent basis.

Working capital

Working capital, defined as current operating assets less current operating liabilities, is a critical portion of the financial due diligence. The target working capital, which is agreed upon by both parties, is a figure that represents the normal level of working capital in a business

Valor Equity invests in Cloud9

The largest investment into an esports team organization

The \$50M USD Series B investment round, led by Valor Equity Partners (Valor), into Cloud9 Esports, Inc. (Cloud9) was the largest investment into an esports team to-date and included two other investment firms, Reimagined Ventures and TrueBridge Capital Partners.⁽²⁵⁴⁾

Founded in 2013 by Jack and Paullie Etienne, Cloud9 generated revenue on its first day of operations through immediately securing sponsorship agreements.⁽²⁵⁵⁾ This success has continued, and under Etienne's management, Cloud9 expanded to multiple games. As the team grew in both size and revenue it developed a strong, loyal fan base that helped lock down sponsorships and drive merchandise sales. Only two years after inception, Cloud9 was valued at \$30.2M – the second most valuable esports team, behind Fnatic at \$42.6M.⁽²⁵⁶⁾

With this investment Valor, TrueBridge Capital Partners, and Reimagined Ventures were able to break into one of the fastest growing industries with an iconic and respected brands. Valor's entrenched position in the consumer and technology sector offers a unique perspective that Cloud9 is positioned to leverage.

Furthermore, this investment helped establish Cloud9 as the most valuable esports team in the world, at an estimated \$310M.⁽²⁵⁷⁾ In this case, the alignment of incentives and opportunity forged a partnership that benefited all parties involved.

and will ultimately adjust the final purchase price. If at close the working capital delivered is less than the target, the seller will pay the buyer, and if it's greater than the target then the buyer will pay the seller.⁽²⁵³⁾ Due to the fact that the esports space has only recently become viable from a traditional investment standpoint, most of the target companies will have not had the time or capital to generate significant operating assets

or liabilities, which can reduce the overall importance of this metric. As the target working capital figure grows, assuming all else constant, the larger the purchase price adjustment. Therefore, this diligence stream may not presently be a key consideration for many esports companies, but will likely become more relevant as the industry grows.

Influencer relationships

A diligence stream specific to the esports space relates to the contracts and agreements in place between sponsors and partners. Although nearly every major industry enlists the

use of both sponsors and partners, it is evident that they play an extraordinarily important role in esports. Major influencers can help propel a partnered brand forward based on their reach and audience alone. Therefore, the potential investor will want to diligence these contracts in-depth.

Partnerships are important for product-based esports organizations as they can offer significant brand exposure on a global scale.

Furthermore, when discussing product partnerships, investors will look to see if the related contracts offer reasonable terms to the target company. For example, a contract that dictates significant revenue share over a long period of time may raise concerns, while a short-term contract with an up-front fee or small revenue share will likely be viewed favorably. For professional esports teams, sponsorships are a key component to the diligence process as they may offer the only consistent revenue stream outside of merchandise sales. Thus, it's in the investors interest to

verify and determine the future sustainability of these contracts. In this case, a favorable contract is typically longer-term and offers the target company the ability to renew the contract.

Across both sponsorship and partnership contracts is the need to determine the value they offer the target company – if the overall exposure or revenue offered by any given contract is not offset by the relevant costs, then a potential investor may signal the contract as problematic and seek to have it renegotiated or terminated in the consideration of an investment.

The due diligence process serves to confirm the initial investment thesis of the venture capital or private equity firm. There is continuous and open dialogue between parties throughout each diligence stream and as problems arise, solutions can also be reached. At the close of all diligence items the investor and target company can move forward and close the deal, forming a new partnership.

Several key takeaways for esports investments

As esports companies consider the pursuit of additional capital the following takeaways are important to consider in order to achieve a successful investment process.



- When investing in the esports industry, investors will look for strong management teams that have a good understanding of the space and the vision and capabilities to further expand the business.



- To entice traditional private equity partners, esports companies should demonstrate several years of performance to demonstrate the business concept and operational viability.



- Sponsorship and influencer contracts remain an important diligence item across investor type and the demonstrated stickiness of these relationships will likely be an important topic during the investment process.

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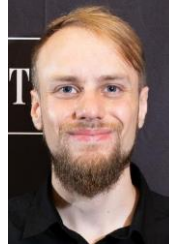


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