

University of Wales Trinity Saint David – London Campus

School of Business

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ASSESSMENT 1

SoftBank Group and The Acquisition Strategy of Arm Holdings

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Introduction

Technology is one of the most important factors in the modern society. Lots of organisation are trying to be the market leader in latest technology innovation for their long-term success. Softbank Group is one of them. In order to do that, Softbank decided to acquire Arm Holdings – A British technology firm in 2016. This essay will demonstrate the acquisition strategy of Softbank in both parties views, as well as the performance of two companies after the acquisition deal. Company background will also be examined in this essay.

1. Company Background

1.1. SoftBank Group

SoftBank Group Corp. is a multinational holding company, that was founded by Masayoshi Son in 1981 and was first operated in Japan. The SoftBank Group Corp. engages in the management of various companies. According to Investopedia, Softbank is ranked as the 72th largest company in the world by Fortune magazine, and 7th largest in Japan. Softbank currently operates in various segments in the information industry, as seen in Figure.1 next page . Moreover, they acquire numerous companies and have 161 companies in their portfolio. Lastly, the company generates around \$82billion revenue each year (Investopedia, 2018).

Figure 1: SoftBank distribution segments



Source: S.Simon (2016)

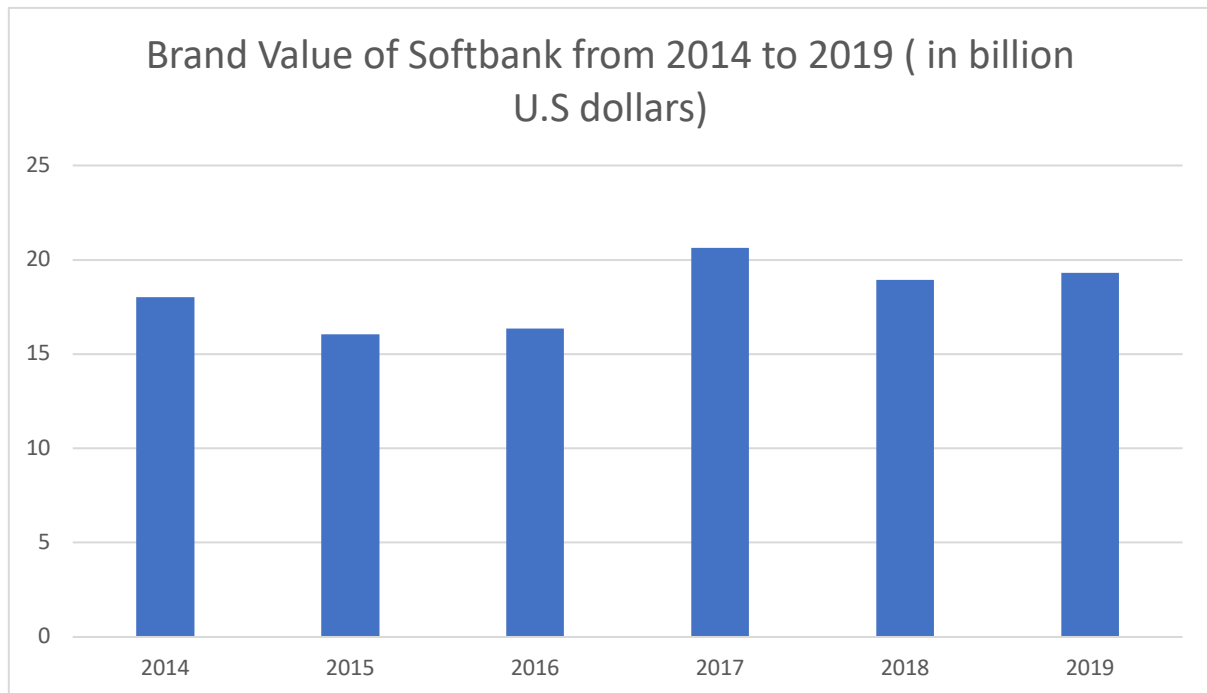
Domestic Telecommunication is the second biggest segment of Softbank, wireless broadband and telephone services for Japanese customers, as well as selling different mobile and broadband devices are provided. This segment was created when 4 smaller companies merged, these consisted of SoftBank Mobile Corp., SoftBank BB Corp., SoftBank Telecom Corp. and the Ymobile Corporation (Investopedia, 2018). Softbank Corp and Wireless City Planning are the companies utilised. Furthermore, they have a partnership with Yahoo Japan for online shopping services. This segment contributed to Softbank's net sale of \$22 billion in 2018 (Investopedia, 2018).

The investment through Softbank Vision Fund is also growing strong. With their high value and reputation, Softbank acquired total of \$100 billion funding in 2017 (Owler, 2019). Notable investors include Apple, Saudi Arabian Government; Sharp, Foxcorn, the funding will be invested in latest technology, such as Artificial Intelligence. Investments in smaller technology companies are planned. For example, Softbank plans to invest in \$4billion into WeWork as well as other companies such as Uber, Vantio.

Softbank's vision is to promote the Information Revolution for society and people wellbeing and happiness with numerous technology innovations in the future (Softbank, 2018). They

want to connect the whole world with their technology service. The company revenue increased by 6.4% to \$1,794.4 billion in 2018 from last year, while the operating income increased by 16.5% from 2017 (Softbank, 2018).

Figure 2: Brand Value of Softbank



Source: Statista, 2019

According to Figure 2, the brand value of Softbank reached 19 billion USD in 2019. The reason behind the success of Softbank is the technology trend and the steady increase of million users, who are using the technology services provided. Softbank's investment activities also generate extremely high return and revenue. The main competitors include NTT Group, KDDI, NTT Domoco, TESSCO Technologies and others (Owler, 2019). Other competitors are companies which involved in telecommunication, technology and investment areas.

2. The acquisition of Arm Holdings

One of the biggest acquisitions of Softbank is ARM Holdings in 2016, which bring benefits to the company in many ways. In July 2016, Softbank reached an agreement to acquire ARM Holdings company, for \$31.4 billion (Tom, 2016). This was one of the biggest deals in European technology. ARM Holdings is a British chip designer company, well known for

designing and licensing chips to larger technology companies. Softbank announced that the acquisitions would help them to become market leader in technology and connect several devices. Softbank wanted to create a new paradigm shift in the technology and network called ‘the Internet of Things’ and was supported by the British Government (Financial Times, 2016).

2.1. Background of Arm Holdings

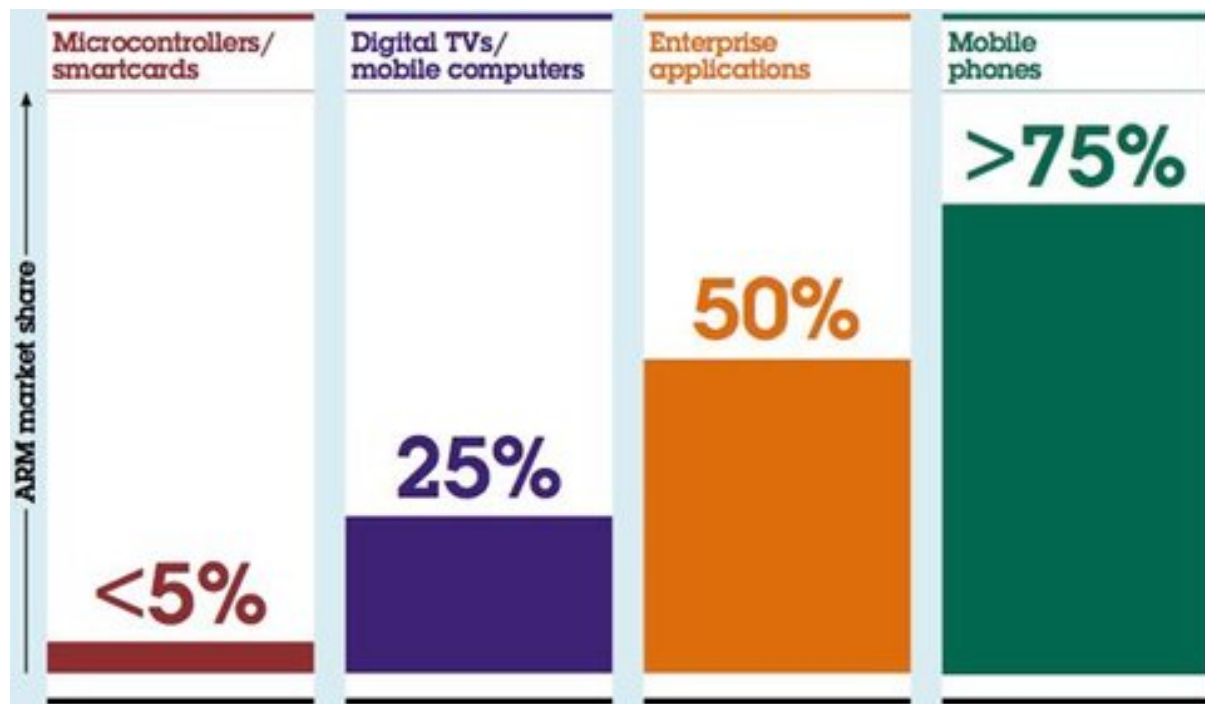
Arm Holdings was an attractive deal for Softbank because of the falling currency value on the Pound in 2016. Arm Holdings is a semiconductor and software design firm that was founded in 1990 and operates in UK. They specialise in designing intellectual property (IP), microprocessors, hardware, software, graphic cores etc (Forbes, 2016). The company design and license their own design and products, for example, microchips to other technology devices companies. The company does not manufacture any chips, they only design and license them. Their microchips are created with low-power processing and highly efficient ecosystem that operate in smartphones and harddrives etc. The strategy of Arm is to focus on applications which has ultra-low power consumptions, high performance and low cost are critical. Arm has been successful over two decades because of its business model and their long term strategies.

There are numerous companies using ARM chips recently such as Apple, Samsung, Huawei, Qualcomm and so on (Financial Times, 2016). Finally, ARM Holdings were considered as a strategic fit for the company’s long term goals. The company vision for the future is to create new revenue streams and gain more market share in the technology industry. Arm plans to create a software ecosystem operators to develop future services and innovation. The market opportunity is growing as more chips become smart and require processors. Royalty and license revenue are expected to grow stronger in the future.

According to Business Insider (2010), there are about 1.4 billion microchips designed by ARM Holdings, with 14.8 billion chips shipped and currently being used in different devices. ARM chips are in 90% of smartphones worldwide and 70% of the global population. It is estimated that Arm has sold 90 billion chips in 25 years (Craft,2017). As can be seen in Figure 3 next page, the largest market share of ARM is mobile phones. ARMs has annual revenue of around £1.3 billion. In 2017, ARMs revenue reached £1.37 billion, which is a 7% increase from 2016 (Craft, 2017). The royalty revenue was up by 31% from 2015. They have 6250 employees and

the company is based in Cambridge. Their competitor includes AMD, Microsoft, Intel and so on. From 1999 to 2015, Arm already acquired 21 smaller companies as it grew its global footprint.

Figure 3: ARM's Market Share



Source: Business Insider (2010)

3. The acquisition strategy

3.1. Softbank View

In terms of Softbank, the acquisition would support the company long-term strategy to become the market leader in the industry, connecting and bringing data as well as internet to all other areas such as healthcare and transportation. Softbank also would help ARM Holdings to invest and research further into Artificial Intelligent (AI) and robots, which are the latest innovation in technology. In addition, ARM profit is being decreased with lower market share, therefore it is difficult for Arm to invest in different areas such as AI, 5G, microchips as they want to on their own. Arm needs large investment for that. It is one of the reason why Simon Segars-CEO of ARM Holdings accept the acquisition offer.

Regarding to the organisational culture after the acquisition, ARM would remain as an independent subsidiary of Softbank, so ARM's organisational structure, culture and activities would not change. Softbank would not take part in the management, managerial decision making or business models of ARM. ARM would not change in terms of organisational value, naturality, independence and the location of its' headquarters. Furthermore, Softbank allows ARM Holdings to reinvest their profit into research and development of latest innovation in technology. ARM Holdings plan to focus on increasing market shares in wireless and network market (Medeiro, 2019) which aligns with Softbank's long term goals. Softbank wants to maintain ARM Holdings own value, while generating more investment and funding for their long-term vision. Besides, Softbank wants to maintain the same culture and long-term division with companies that have the same background as them . Softbank are determined to in invest in talented people which could lead to innovation. Softbank made a requirement to ARM Holdings to double the number of employees in a 5 year period. (Medeiro, 2019)

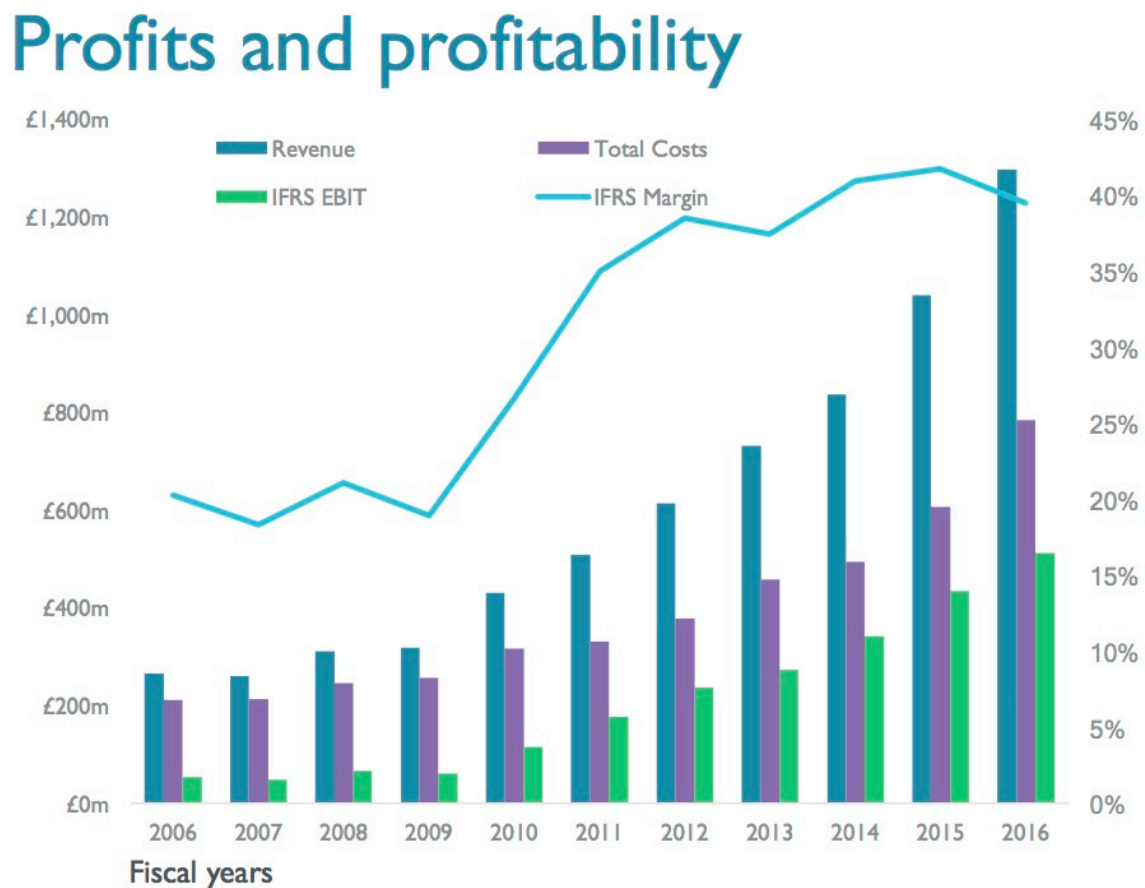
Softbank announced that they would increase the resources and investment towards ARM by double in order to enhance ARM's ecosystem and support their potential (Dugar et al., 2016). The acquisition for Softbank seen as a long term investment to take advantage of ARM's market and development. The investment also benefits ARM Holdings as they need financial resources for the research in IOT (Internet of Things). According to IDC (2016), ARM invested \$150 million in their research and development (R&D) and hire 2000 additional employees. Hiring more engineers will lead to more innovation and enhance product quality and speed delivery. As a small company, the resources and financial ability are limited and Softbank can provide what they are lack of. Specifically, ARMs are planning to seek about \$121 billion funding to invest in different markets in 2020 (IDC, 2016). With the same technology culture, Softbank expected to build a strong foundation for their partnership with ARM Holdings and look for new opportunities. Both parties would gain market leader to a semiconductor ecosystem, which is unrivalled in the technology industry. Softbank strategy is making high risk by investing in new businesses and companies with high payment over assets.

Thirdly, the acquisition helps Softbank to have long term expansion and commitment to global market such as in UK and China. According to Negishi (2018), China accounts for a fifth of ARM Holdings' revenue. China was also the largest market for semiconductors in 2016 with \$132 billion. Softbank saw the potential in the Chinese market when the Government announced they want to develop self-vehicles, smart appliances and latest technology in the

future. Arm Holdings already have large Chinese market share which will allow Softbank to enter the market easier. Additionally, Softbank wants to maintain and grow their leadership and competitive advantage in science and technology in the UK.

3.2. Arm Holdings View

Figure 4: Arm Holdings Cost and Revenue from 2006 to 2016



Source: Softbank (2016)

As can be seen in figure 4, ARM's annual revenue grew faster than their cost over 10 years. The profit increased to over 40% in 2016 and could generate higher profit in the future. According to Softbank report (2016). ARM had over \$1.3 billion of net cash with no debt. Therefore, Softbank saw the potential of ARM in the future to acquire them.

In regard to ARM Holdings, the deal sent out signals that even in times of uncertainty with Brexit, the UK is still an attractive and desirable destination to complete business and is open to international investment which could lead to innovation and create wealth. After the acquisition announcement, ARM's share increased to 44% in the market, (Figure 5) which boosts the company reputation in the UK and prepare for global competition. For a small limited company like ARM, it is difficult to do increase the share price and their company size by itself and Softbank can help them achieve that. ARM Holdings got many benefits over this deal. They got to expand their company size and overhead, focus on investing in R+D but still remain their organisational cultural, business model and headquarter in Cambridge. Softbank will support ARM Holdings only through funding and strategies so that ARM can reach their full potential. (Business Insider, 2016)

Figure 5: ARM Holdings share price in 2016



Source: Business Insider (2016)

Specifically, ARM will focus heavily on automobile and micro- chips, especially for auto vehicles, therefore, a lot of innovation will be needed. They plan to expand globally after the acquisition. Moreover, they are currently planning to a new building, which worth \$61 million in Cambridge with 6000 employees. (King and Kahn, 2019). Arm Holdings can make long-term investments in technology and their projects without demanding investors who want short-term profits. In addition, the organisation also wants to compete with bigger companies such as Intel and other data centre markets.

4. Post-Acquisition Performance

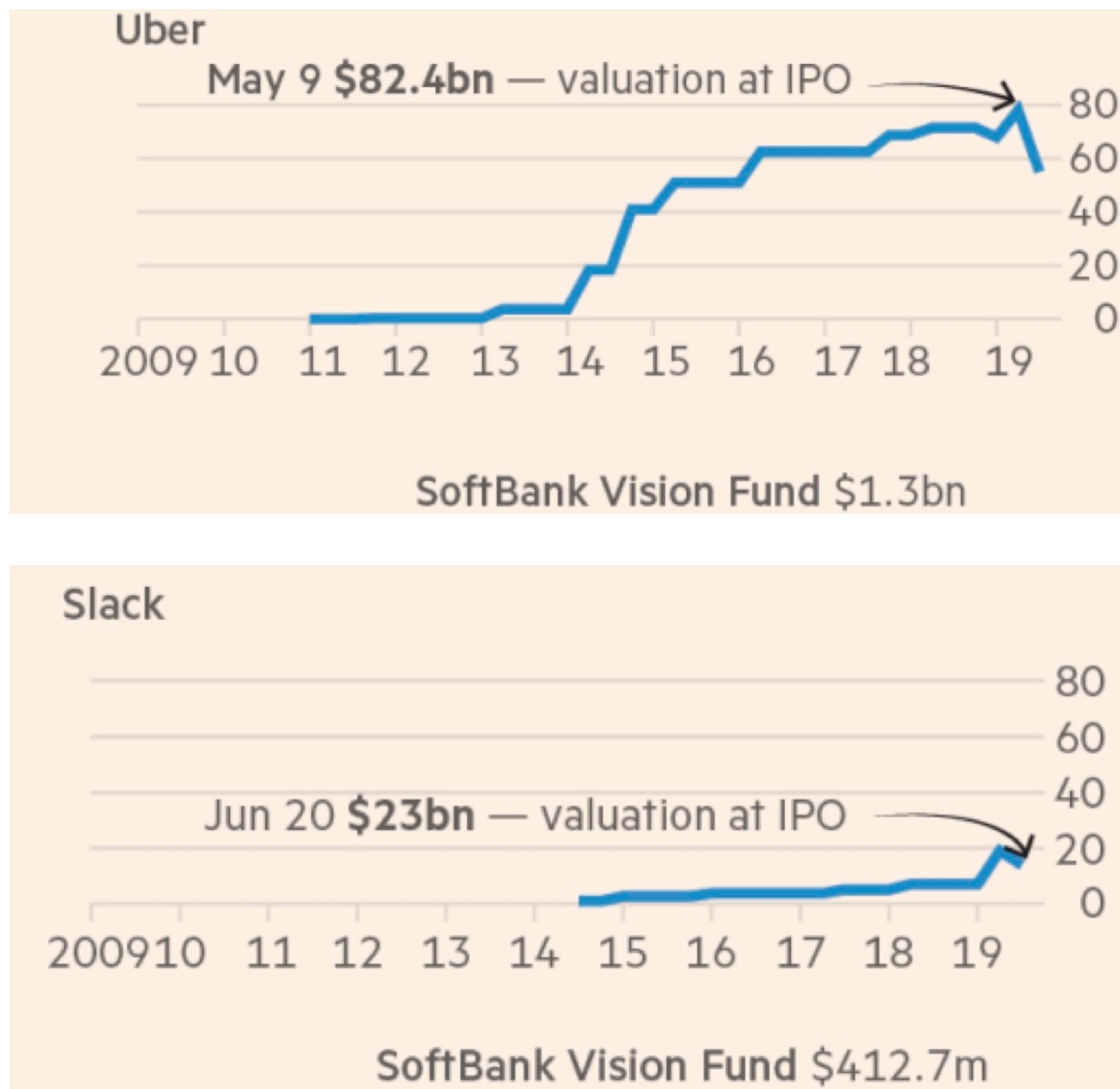
According to Softbank financial year report in 2016, the ARM segment after the acquisition recorded net total sales of \$112,902 million and the income was \$12,919 million . Softbank is still growing strong after the acquisition. According to Reuters (2019), Softbank operating profit for 2019 is 890 billion yen, 9% up from last year.

In addition, Softbank launched Vision Fund in 2017 with \$100 billion funding with other major investors. Apple is one of the main investors because of the close relationship with Softbank , which the company invested in Vision Fund for \$1 billion. Apple believed that the funding would speed up the development of technology, which was vital for them. With ARM's partnership and Vision Fund, they announced that the company will invest heavily in Artificial Intelligence and related companies. Softbank has been investing in 24 companies so far (Softbank, 2019) and the company's goal is to have the highest technology fund in the world.

The biggest investor was Saudi Aribia sovereign, with \$45 billion (Forbes, 2017). With the success of investing in ARM Holdings, Softbank will use these funding to invest in other small but promising technology companies such as Uber, WeWork, DoorDash. The Vision Fund already had a net return of 29%. (Financial Times, 2019). It will help numerous private technology companies enhance the value and delay the public offering to the stock market. However, the investment from Vision Fund does not guarantee for the success of those companies after getting the funding, therefore the return success rate of Vision Fund is questionable. For example, as can be seen from Figure 6, shares of Uber and Slack are 36% and 25% lower than their IPO last time in 2019. Softbank already facing difficult time to raise funding for their next Vision Fund because of the low unexpected return from those companies

they invested in. Previous large investors announced they would make less contribution or stop investing for the next Vision Fund 2.0.

Figure 6: Uber and Slack valuation at IPO from 2009 to 2019



Source : *Financial Times* (2019)

Secondly, Softbank announced in 2017 that they would sell 51% of ARM Chinese subsidiary to Chinese group investors for \$775.2m (The Register, 2018). The deal is expected to be happen in June 2018. ARM China accounts for about 20% of ARM's annual revenue. The deal happens when the trade regulations between US and China is tensed, leading to difficulties for both parties' manufacturers. Therefore, the deal will make it easier for ARM to develop their

technology products and expand opportunities without worrying about regulations. The sales are intended to allow Softbank to expand further in China without worrying about regulations through the joint venture. Arm Holdings still get most of licenses, royalty and software revenue by ARM China. In addition, ARM China also plans to expand their services into Chinese Government and security purposes. The deal will help to reduce the sensitiveness for those purposes and pressure from U.S. Furthermore, Chinese Government are encouraging Chinese technology companies to develop and create their own products and core technologies in order to reduce the dependence on foreign chips and hardware in China (Made in 2025 directive project). 90% of semiconductors in China are imported from foreign countries (The Register, 2018). However, joint venture partnership can lead to pressure that Arm need to share their intellectual property with their Chinese partnership, which might end of in the hand of the competitors.

Third, Softbank founder – Masayoshi Son said that he plans to relist and make public offerings of Arm Holdings to stock markets after 5 years from 2019, only 3 years after he bought the company (Forbes, 2019). Masayoshi Son further plans to transfer 25% of ARM stakes to the Vision Fund. The listing will help Softbank to raise more funds, use Arm share as collateral for more debt. As an acquisitive company, Softbank needs to seek to different financing options. From different acquisition, Softbank turns from a telecommunication carrier company to a strategic holding company.

One of the biggest problems Softbank currently facing is debt, although they have high operating profit and return. Softbank announced that they currently have \$160 billions of current and non-current interest debt in 2018, which accounts for 6 times the profit company earns (Techcrunch, 2018). The share price is down at the latest offering, raising doubts for investors. Softbank is already looking to take some cash out from their investment to Arm Holdings.

Conversely, because of the commitment to expand the company headcount, ARM spent \$200 million from their profit in 2017 (Techcrunch, 2018). Softbank's expenses doubled after the acquisition to expand their business and recruit more employees. The investment in AI and other IOT devices (Internet of Things) have not earned any return yet as expected. Furthermore, Arm also facing fierce competition from other well-established companies , including Amazon and Siemens AG. The mobile phone market is currently growing saturated. Therefore, Arm

will face slow growth of their biggest market share. The revenue from royalties and license of Arm in 2017 decreased to \$1.6 billion (Techcrunch, 2018). In addition, Arm made two big software-related acquisitions on Treasure Data and Stream Technologies.

The success of the acquisition deal will be considered to which degree Softbank's investment into Arm can encourage Arm's growth beyond what it could have done on its own, as well as what income and profit Softbank could generate, regarding's to financial term . In strategic term, the success is considered how Softbank technology and portfolio being connected and reach worldwide. Even with the acquisition deal, ARM as a small company, have limited resources to invest in R+D, compared to the size and fragmentation of the Internet of Things (IoT). In addition, Arm's uniqueness is their small size and no competition with their customers with a diligent business model. Therefore, it is important for Softbank to fit Arm under their portfolios and asset , without losing their uniqueness.

In my opinion, Softbank made the right move to acquire Arm Holdings. The company saw the full potential in the future of Arm Holdings, to become the market leader in semi-conductor chips industry. Arm Holding also need further funding and investment for their project, and Softbank can help them. Both companies might even make great return in the future because of the fast development of technology and information system.

Conclusion

The essay analysed in details about the acquisition strategy of Softbank and Arm Holdings, with benefits and challenges. Two companies' performance were also be mentioned.

Softbank considers Arm Holdings as a tool to advance in the semi-conductor chips market and to invest in the next generation technology innovation such as Artificial Intelligence. In the contrary, Arm Holdings decided to be a part of Softbank because the long-term need of investment to the research and development of IoT (Internet of Things). It is vital to consider both parties' strategy to compete and advance in the technology industry , as well as the performance after the acquisition deal.

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