

Elon Musk to acquire social media platform Twitter Inc. for \$43 billion

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“Free speech is the bedrock of a functioning democracy, and Twitter is the digital town square where matters vital to the future of humanity are debated.”

- Elon Musk, CEO of Tesla and SpaceX

Deal Overview

- **Acquirer:** X Holdings (Elon Musk)
- **Target:** Twitter Inc.
- **Industry:** Social Media Platforms
- **Transaction Amount:** \$43 billion
- **Date:** April 14, 2022
- **Target Advisor:** Goldman Sachs Group Inc.
- **Acquirer Advisor:** Morgan Stanley

Elon Musk, CEO of Tesla and SpaceX, announced his intentions of acquiring Twitter (NYSE: TWTR) for approximately \$43 billion; a transaction which

would mark the largest take-private deal since 2016. The tender offer values Twitter at \$54.20 per share, representing a 38% premium above its closing price on April 1st, 2022.

Musk’s takeover attempt dates back to March 14th, 2022, when he acquired a 9.2% stake in Twitter, making him its largest shareholder. In response, Twitter’s board offered him a seat, which would have capped his ownership of Twitter at 14.9%. When Musk refused, the board adopted a ‘poison pill’ strategy whereby existing shareholders could buy more shares at a discount, if Musk were to acquire more than 15% of Twitter. This would dilute Musk’s ownership and make a takeover more expensive. On April 14th, 2022, Musk initiated his hostile bid by making a tender offer directly to Twitter’s shareholders. Contrary to its previous stance, the board unanimously accepted Musk’s offer on April 24, 2022. If regulators and existing shareholders approve, the all-cash transaction is expected to close in the latter half of 2022. By taking Twitter private post-acquisition, Musk hopes to make his envisaged changes regarding Twitter’s product offerings and work on promoting free speech on the platform.

Companies Overview – Twitter

Twitter, the San Francisco-based social networking platform, was co-founded by Jack Dorsey in 2006. Initially serving as a microblogging medium for friend groups, it developed into a large-scale information outlet used by news agencies, companies and political figures alike to share stories, products and ideas with the public. In addition to ‘tweets’, users can interact on the platform through images, videos, audio recordings, and GIFs. Jack Dorsey describes Twitter as “the closest thing we have to a

global consciousness”. Despite rapid early growth, the number of monthly active users stagnated at slightly above 300 million in the years 2015-2018. Investors believe that this was mainly due to a lack of product improvements and a high executive turnover. In recent years, however, Twitter has seen a reinvigorating growth in its monetizable daily active users (mDAUs). Whilst the COVID-19 pandemic and the widespread political activism in 2020 contributed to this user-growth, Twitter’s notable progress in its product offering was also of key importance. Pressured by the activist-investor hedge fund, Elliott Management and global private equity firm Silver Lake, Twitter introduced progressive product features, such as Super Follows, Twitter Spaces, and Twitter Blue—a subscription model that gives users a customizable experience. Due to the platform’s recent scrutiny regarding misinformation and hate-speech, Twitter also introduced a pilot program of a community-based approach to content moderation, called Birdwatch. Through these improvements, Twitter aimed to double its user-base and revenues by the end of 2023 from 2019 and 2020 levels, respectively. Twitter’s revenues have been steadily growing over the years, achieving a 37.8% year-on-year increase to \$5.1 billion in 2021. 89% of Twitter’s revenue comes from advertising services, whilst the other 11% are mainly attributed to data licensing. Despite this revenue-growth, Twitter has only managed to achieve profits in two consecutive years since its IPO; \$1.2 billion in 2018 and \$1.4 billion in 2019. The net loss that Twitter experienced recently is partially attributed to the pandemic; although it fueled growth in Twitter’s user base, many corporations cut back on ad-spending. Twitter was also subject to a large-scale hack of 130 high-profile

accounts, which led to fines and added costs of improving the internal security system. In 2021, Twitter faced a lawsuit for hiding data on Twitter’s user growth, costing it another \$809.5 million. On November 29th, 2021, Jack Dorsey stepped down from his 6-year tenure as the CEO of Twitter, being succeeded by Parag Agrawal. Dorsey justified his leaving by claiming that Twitter was “ready to move on from its founders”.

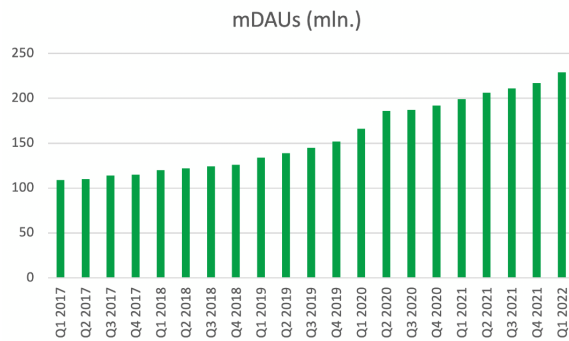


Figure 1: Source: businessofapps.com (Own Illustration)

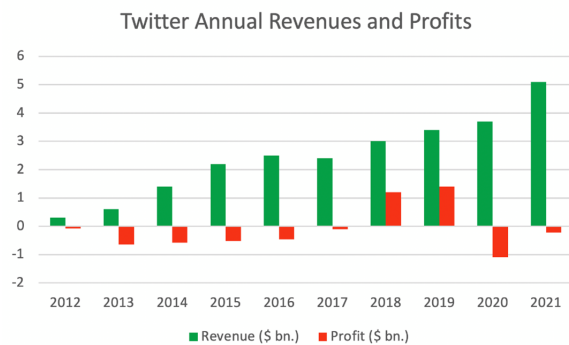


Figure 2: Source: businessofapps.com (Own Illustration)

Companies Overview – X Holdings

Elon Musk formed a triplet of companies, called “X holdings”, which will serve to purchase Twitter. According to an SEC filing, one of the entities will be used to fund the purchase of Twitter shares, while a subsidiary would merge with the social-media firm. According to Musk Twitter has “tremendous potential” which he wants to unlock. More specifically, he wants to make the tweet ranking algorithms and others open source by putting them on GitHub, which would increase trust in Twitter. On the product level, Musk wants to enable long-form tweets and introduce an edit option. Other major goals Musk has for Twitter include relaxing its content restrictions and eradicating fake accounts and spam bots by requiring all humans to authenticate themselves. Musk believes that “if in doubt, let the tweet exist”. Twitter’s business model is mainly ad-based – and Musk wants to change that. He claims to be more interested in subscriptions, which could prove a hard sell since all the main social media networks are freemiums. Musk fears that an over-reliance on ad revenue will give corporations the leverage to pressure Twitter into more stringent content regulation. Therefore, he’ll cut the advertising business down to 45% of revenue. In turn, the recently introduced “Twitter Blue” is forecasted to have 69 million users by 2025. Additionally, a yet undisclosed product, called “X Subscribers”, is expected to have 9 million users by 2023.

Production and organizational costs will be reduced massively. Musk plans to do this, for instance, by firing up to 1000 Twitter employees. Employees had great freedom in the past thanks to the relatively flat hierarchy. Musk also intends to change Twitter’s flexible and laissez-faire work ethic to an

Musk’s planned Revenue of FY 2028 in bn USD

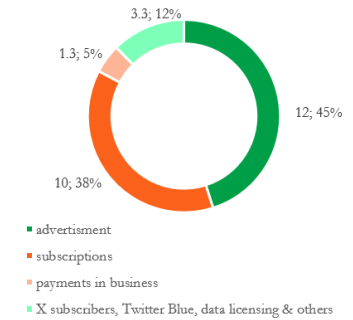


Figure 3: Original source: Musk’s pitch deck for Investors [as cited on Yahoo Finance] (Own Illustration)

“extreme” and engineering-focused culture. He also questioned whether the San Francisco office should be sold “since no one shows up anyway”, as many employees work remotely. Musk wants to have managers in charge, who are willing to take a pay cut and understand the technology in depth. Board member’s pay might even be slashed down to \$0. Having voiced that he does not “have confidence in management”, Musk is expected to become the interim CEO.

According to his recent pitch deck, Musk intends to quintuple revenue from \$5 billion last year to \$26 billion in 2028 and increase the average revenue per user (ARPU) from \$24.83 to \$30.22 respectively. Despite the financial plan, Musk, a self-proclaimed “free speech absolutist”, originally said it’s “not about the economics”, instead he said that he wants to create “a public platform that is maximally trusted and broadly inclusive”, which is “extremely important to the future of civilization”.

State of the Industry – Social Media

The social media market is expected to account for 33% of all digital advertising spending in 2022. It’s projected to grow from \$159.68 billion in 2021 to around \$225 billion in 2022 and will reach \$833.50 billion in 2026 at a cumulative annual growth rate (CAGR) of 39%, with significant adoption by all age groups. North America remains the most lucrative market for social media companies globally as the average revenue per user (ARPU) from this region has been the largest in the last 5 years.

The average use of social media is 2.5 hours per day on smartphones alone. The number of users is expected to grow from 4.6 bn people in 2021 to 5.8 billion by 2026. Many of the new digital behaviors that people adopted during the pandemic have endured, resulting in meaningful increases in various kinds of digital activity.

The exponential rate of data generated from social media has led companies to make decisions on the basis of data analytics of behavior, location, and demographics to improve services, product portfolios, and marketing of companies. 54% of social media users research products via social media. What’s more, 81% of consumers’ purchasing choices are swayed by their friends’ social posts and recommendations, and 78% are influenced by brands’ posts, making social e-commerce the perfect marketing solution. Social commerce sells at a point in the journey where customers are most active and inspired, turning social media engagement into sales due to integrated shopping and payment solutions. This shortens the path to purchase, reducing abandonment and taking advantage of growing rates of impulse purchasing.

Users on Twitter are around three times more likely to follow brands and are also more likely to engage with them than on Facebook. Twitter, however, lacks some properties that its competitors have, like gathering huge amounts of data from their user, that lend themselves to being better monetization platforms. Competitors offer more targeted ads, resulting in employing clients’ resources more effectively than Twitter. Twitter’s competition includes knockoff apps like Parler, Gab, Gettr, MeWe, and Truth Social, but also other big tech platforms like Facebook, Instagram, WhatsApp, Google, YouTube, LinkedIn, Snapchat, TikTok, Pinterest, as well as large regional platforms including WeChat, Kakao, and Line. Comparing the user base of the most popular social media platforms, we found that Twitter’s U.S. user base is most similar to that of Whatsapp, Reddit, and Snapchat in our analysis of demographic factors like gender, age, education, and area of residence.

2021 Data	Twitter	Snapph at	delta	YouTube	delta	Whats App	delta	Reddit	delta
Total	0.23	-0.25	0.02	0.81	0.58	0.23	0.00	0.18	0.05
Men	0.25	0.22	0.03	0.82	0.57	0.26	0.01	0.23	0.02
Women	0.22	0.28	0.06	0.80	0.58	0.21	0.01	0.12	0.10
Ages 18-29	0.42	0.45	0.23	0.85	0.53	0.24	0.18	0.36	0.06
30-49	0.27	0.24	0.03	0.91	0.64	0.30	0.03	0.22	0.05
Ages 50-64	0.18	0.12	0.06	0.83	0.65	0.23	0.05	0.10	0.08
Ages 65+	0.07	0.02	0.05	0.49	0.42	0.10	0.03	0.03	0.04
White	0.22	0.23	0.01	0.79	0.57	0.16	0.06	0.17	0.05
Black	0.29	0.26	0.03	0.84	0.55	0.23	0.06	0.17	0.12
Hispanic	0.23	0.31	0.08	0.85	0.62	0.46	0.23	0.14	0.09
Less than \$30k	0.12	0.25	0.13	0.75	0.63	0.23	0.11	0.10	0.02
\$30k- \$49,999	0.29	0.27	0.02	0.83	0.54	0.20	0.09	0.17	0.12
\$50k- \$74,999	0.22	0.29	0.07	0.79	0.57	0.19	0.03	0.20	0.02
More than \$75K	0.34	0.28	0.06	0.90	0.56	0.29	0.05	0.26	0.08
High school or less	0.14	0.21	0.07	0.70	0.56	0.20	0.06	0.09	0.05
Some college	0.26	0.32	0.06	0.86	0.60	0.16	0.10	0.20	0.06
College graduate	0.33	0.23	0.10	0.89	0.56	0.33	0.00	0.26	0.07
Urban	0.27	0.28	0.01	0.84	0.57	0.28	0.01	0.18	0.09
Suburban	0.23	0.25	0.02	0.81	0.58	0.23	0.00	0.21	0.02
Rural	0.18	0.18	0.00	0.74	0.56	0.09	0.09	0.10	0.08
total delta		1.14		11.44		1.20		1.27	
whighted delta 1		1.00		9.12		0.85		0.96	
whighted delta 2		0.88		6.26		0.73		0.65	

Figure 4: Original source: Survey of U.S. adults conducted Jan. 25-Feb. 8, 2021.(Own Illustration)

Twitter has been underperforming social media platforms both in the stock market as well as measured in ARPU growth.

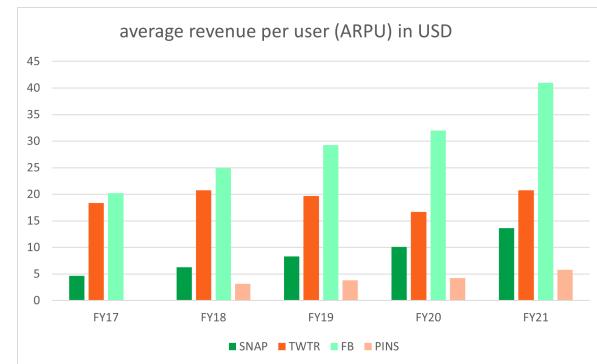


Figure 5: Source: stockdividendscreener.com (Own Illustration)

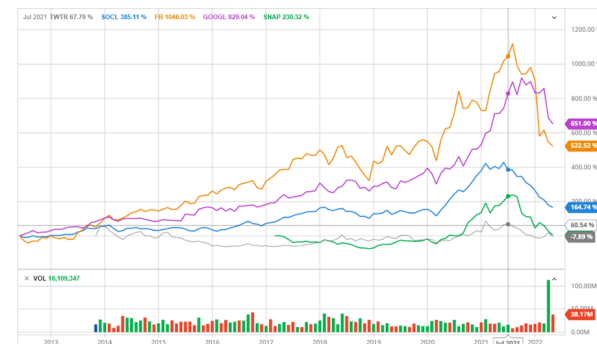


Figure 6: Source: barchart.com

Deal Structure

On April 21st, 2022, Musk announced that he had \$46.5 billion of funding secured for the all-cash transaction. It consisted of \$12.5 billion in margin loans, using Tesla stock as collateral, and \$13 billion in classic debt financing, both issued by a consortium of banks led by Morgan Stanley. The remaining \$21 billion will be financed by his own cash. Since the announcement of his 9.2% stake in Twitter on April 4th, 2022, Tesla shares have tumbled by over 40%. This has reduced the reliability of his margin loans that were issued against Tesla stock.

In an attempt to reduce the reliance of his financing on Tesla's stock performance, Musk announced on May 5th, 2022, that he secured \$7.14 billion in equity funding from 19 investors, decreasing the amount of his margin loans to \$6.25 billion. Equity was bought by private investors, like Lawrence J. Ellison, as well as venture capital firms, the major ones being Sequoia Capital Fund and VyCapital. Within the social media space, we think LinkedIn, Quora, Reddit, and YouTube to be the most relevant competitors that threaten Twitter's core product and use case. However, social media platforms are mostly either private or part of conglomerates, which only publish consolidated financial statements, distorting the multiples analysis. As the competitors in our analysis are larger in size, they are generally expected to have a bigger EBITDA margin due to being more efficient than smaller companies, which in turn makes the comparison to Twitter harder.

Company Name	Price (\$/share)	Market Data		Financial Data (FY11)		Valuation	
		Market Cap (\$bn)	EV (\$bn)	Sales (\$bn)	EBITDA (\$bn)	EV/EBITDA	EV/Sales
Meta	181.54	327.5	499.4	148.3	89.2	7.1x	3.3x
Google	2719.81	1418.0	1238.0	348.2	112.2	11.7x	3.9x
Tencent	44.25	428.9	427.6	180.0	36.0	11.9x	4.1x
Average subset						10.2x	3.8x
Median subset						11.7x	3.9x
Snap	23.26	36.3	37.2	7.7	3.1	12.3x	4.9x
Microsoft	332.56	1946.0	1900.0	337.9	107.1	12.7x	6.1x
Average of entire set						7.2x	4.0x
Median of entire set						11.7x	4.1x
Twitter (March 9th)	33.55	26.9	26.9	7.2	1.00	16.1x	4.5x
Twitter (May 24th)	33.26	26.9	26.9	7.2	1.00	16.2x	4.5x
Twitter (Musk's offer)	142	43.4	46.5	7.2	1.00	28.6x	6.3x

Figure 7: “Comparable Company Analysis”, Source: Yahoo Finance (Own Illustration)

Although the subset of selected public competitors is limited, we think it gives us a better comparison than looking at the entire set of selected competitors. Twitter's EV/Sales market ratios trade in line with the market. EV/Sales multiples are usually found to be between 1x and 3x. In our case, investors might believe that future sales will greatly

increase across the entire industry, hence the higher multiple. This belief is also backed up by the industry's CAGR estimates mentioned before.

With Twitter being on the lower end of both revenue growth and gross margins relative to the market we would expect a lower EV/EBITDA multiple for Twitter, which is not what we observe in reality. In Twitter's case, it should not be dismissed that in addition to revenues, costs have also been significantly on the rise, which leads to a very unsteady operating profit development and results in a much lower EBITDA growth. This should result in an even lower EV/EBITDA multiple with which investors seem to disagree. It, therefore, seems that investors shared Musk's perspective of Twitter being an essential service for society with extreme potential but not to the extent Elon did even before the deal announcement. In our view, Twitter is certainly one of the social media platforms which can change a lot, both on the product side, as well as on the cost side of the business, as well as the number of active users. Seeing the growth story, we think an above-average valuation of between 11x to 18x EV/EBITDA is justified from a more long-term perspective.

Potential Risks & Potential Upsides

Although the board has already approved the acquisition, there are still numerous hurdles to overcome for its completion. Firstly, a majority vote of Twitter's shareholders in favor of the acquisition will be required on May 25th, 2022. Furthermore, key regulators, including the SEC, must approve the deal. The fact that Musk failed to comply with SEC's laws earlier this year, by not disclosing his 5% stake in Twitter in a timely manner, will not help

the situation. Whilst this might imply penalties, it is unlikely to put a stop to the deal altogether. Approval by the FTC regarding antitrust laws can also be expected, as the acquirer is not a social media competitor of Twitter.

Arguably, it is Musk himself who poses the biggest risk to the deal. On May 13th, 2022, Musk announced that the deal is “temporarily on hold” due to his suspicions that spam accounts on Twitter comprise more than 5% of users, contrary to Twitter's statements. Although he did clarify that he was “still committed to (the) acquisition”, investors' sentiment on the completion of the deal has grown in pessimism—Twitter traded at \$38.29 per share on May 21st, 2022, representing only 70.6% of the tender offer's valuation. After all, the breakup fee is a mere \$1 billion dollars, which could hardly prevent Musk from leaving the deal.

Assuming that the deal goes through, Twitter's change in strategy and leadership would bring about new risks and opportunities for the company. Whilst Musk's intention to decrease content regulation might attract supporters of free speech, numerous users are expected to leave the platform. This is especially true for advertisers, which are concerned with their reputation and brand safety. Musk's plans for free speech may also collide with the Digital Services Act passed by the EU on April 23, 2022, requiring social media platforms to increase their screening and content moderation. Although Musk clarified that he would promote free speech only to the extent permitted by the law, this could still pose a restriction to his vision of Twitter as a free speech platform. Furthermore, the shift from Twitter's flexible and people-oriented culture to the hard-working and engineering-focused ethic envis-

aged by Musk might reduce employees' motivation. Nonetheless, Glassdoor revealed that interest in Twitter's job openings rose by 263% after the deal was announced.

By alienating advertisers and Musk having stated that economic considerations are not the motive of this acquisition, Twitter's financial situation might worsen—note that it is already making losses. Musk's plans to expand Twitter's product offerings and its subscription-based revenue stream will entail costs in the short term but might prove profitable over time.