

Raising the Stakes: Microsoft Buys Skype

Written by Bob Snyder
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Imagine a poker game where only billionaires can play. The pot they are playing for is worth billions, of course, and each player would risk all their winnings for fear of losing this grand pot...and for fear that missing this one pot could eventually mean losing the entire game.



That's not a bad analogy for the deal where **Microsoft buys Skype**. Others were sitting at the table, but Microsoft bluffed its way through and put in \$8.5 billion to take the hand.

Microsoft's known to only grudging buy up companies, compared to, say, a Cisco that has acquisition in its culture. When Microsoft does buy, the company is so tough and so arrogant on terms that those deals can blow up. Remember the Yahoo fiasco.

Then there was the \$6 billion acquisition of advertising firm **aQuantive** in 2007 where Redmond failed to find a role for the

Razorfish

division before anxiously selling it off. Microsoft still struggles to make a profit from online advertising.

And **Danger**, which lived up to its name, as far as Microsoft was concerned. Purchased for an estimated \$500 million in 2008, Danger was the mobile tech company that produced *Hiptop*

. Instead of a HTC-like success in mobile telephony, Microsoft turned it into the stillborn KIN phone...and now, not even relatives are looking for the Next-of-Kin.

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So while the MicroSkype deal is signed...it still has to be consummated. Meanwhile, this deal is the biggest-ever Microsoft deal and exactly what did the conservative Microsoft buy?...

Skype is popular, admired and used by hundreds of millions of consumers... but with a revenue of \$860 million, a loss (not profit) of \$7 million, and a long-term debt of \$686 million. This is the second time Skype (since it began in 2003) has been bought out: eBay fell for the dream and paid \$3.1 billion for Skype in in 2005. Four years later, eBay had an auction that doesn't rank as one of their best: they ended up selling the majority of their stake to a private investment group for \$1.2 billion less than it paid.

Today Microsoft is paying about \$1000 for each Skype customer whose cash value per customers seems to be only about \$30. Based on Skype's income from subscriptions and call charges, Microsoft will get their \$8.5 billion back in just...35 years?

Skeptics say it's hard to see how the Skype purchase is worthwhile from technology, cost, or user base. Many claim Microsoft could buy a telephony infrastructure for less.

So Why? Why? Why?

First, Windows took Skype off the cardtable where other competitors (think Google, Facebook) might have grabbed the Skype deck and played its cards to their own advantage. From a Microsoft executive point of view, if this investment takes away a lethal gun that could be used one day to mug Redmond-- that's worth \$8.5 billion in the long term. Shareholders might certainly disagree in the short term.

But any practical application is more complex to understand.

Windows Live Messenger offers free instant messaging, and voice and video chat and has 330 million active users each month, with 40 million or so online at any one moment. Skype has 124 million active users each month with 20-30 million on at any one time. (Many of these users probably overlap between the two companies, but no one knows how many overlap.)

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Skype integrates telephone connectivity, outbound and inbound phone calls. While online services are free to use, these phone services cost money. Skype also makes it easy to buy phone numbers to cheaply establish a telephone presence in a foreign country. About 8 million Skype users pay for the phone service (no one pays at Live Messenger).

With Microsoft's corporate Lync, Exchange, and Live Messenger, adding Skype's telephony infrastructure could bring value to the Microsoft UC business platform. (Microsoft also plans to integrate Kinect into Lync.)

Integrating Skype into Windows Phone might work in the cellphone market (although telcos and carriers would not appreciate it, nor adopt free VoIP).

Or maybe by using **aQuantive** know-how, Microsoft has figured out how to integrate online ads into Skype, solving two problems in one deft trick.

Unless Skype is the magic that makes Microsoft jump to the top in mobile phones (a goal that has eluded them) or the ladder to climb to the top in unified communications for business (think videoconferencing for the world's SMBs), then this acquisition is mainly a defensive play to keep the Skype customer base away from the wrong hands.

Microsoft thinks its buying an ace for \$8 billion plus, but aces and eights are **clearly a dead man's hand** in poker.

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