

Video Game Industry



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1. Market Size

The worldwide market for video games, computer games and interactive entertainment hardware and software would grow from \$20.7 billion in 2002 to \$30 billion in 2007.

Total U.S. retail sales of video game hardware, software and accessories grew 10 percent in 2002 over 2001. The video game industry generated \$10.3 billion in record-breaking sales, surpassing the previous record high of \$9.4 billion in 2001.

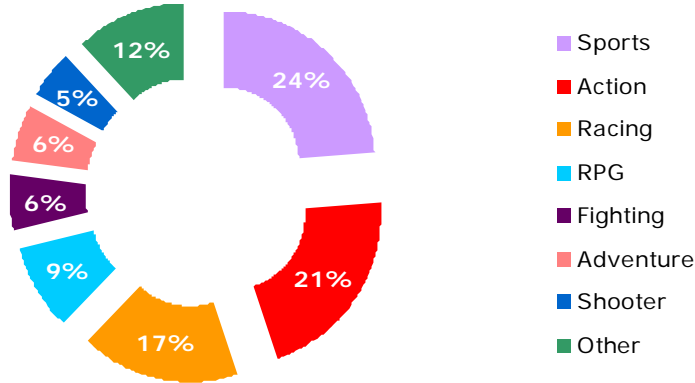
The category of video game software, consisting of both console and portable software, experienced sales gains of 21 percent in dollar volume and sold 15 percent more units in 2002 than in 2001.

The healthy increase in sales was driven by the success of key franchises such as: Grand Theft Auto: Vice City, Madden NFL 2003, Super Mario Sunshine, Spider-Man: The Movie, Halo and Tom Clancy's Splinter Cell.

In 2003, the video game industry should expect unit volume growth to outpace dollar volume growth in the hardware category. The majority of the growth will come primarily from software sales, capitalizing on the hardware sold to date. There is a barrage of new game software launches that will appeal widely to new video gamers, both old and young, expanding the software-to-hardware tie ratios of the previous generation.

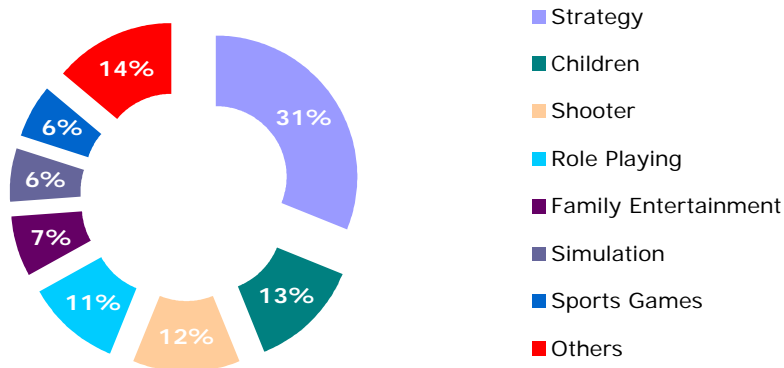
2. Market Statistics

Video Game Software Market Share by Genre - Consoles & Handhelds (US Retail Sales 2001 - April 2002)



Source: NPD

Video Game Software Market Share by Genre - PC (US Retail Sales 2001 - April 2002)



Source: NPD

Top 10 best selling video game titles, ranked by total U.S. units annual - 2002

Rank	Platform / Title	Publisher	Release Date	ARP
1	PS2: Grand Theft Auto: Vice City	Rockstar Games	Oct. '02	\$49
2	PS2: Grand Theft Auto 3	Rockstar Games	Oct. '01	\$50
3	PS2: Madden NFL 2003	Electronic Arts	Aug. '02	\$49
4	GBA: Super Mario Advance 2	Nintendo of America	Feb '02	\$29
5	PS2: Gran Turismo 3: A-Spec	Sony Computer Ent.	July '01	\$24

Rank	Platform / Title	Publisher	Release Date	ARP
6	PS2: Medal Honor Frontline	Electronic Arts	May '02	\$50
7	PS2: Spider-Man: The Movie	Activision	Apr. '02	\$45
8	PS2: Kingdom Hearts	Square EA	Sept. '02	\$49
9	XBX: Halo	Microsoft	Nov. '01	\$48
10	GCN: Super Mario Sunshine	Nintendo of America	Aug. '02	\$49

Source: NPD

The percentage of games rated "M" for Mature is on the rise, games rated "E" for Everyone or "T" for Teen still represent the overwhelming majority of games. Of games released in 2002, 55.7% of games were rated "E", 27.6% were rated "T", and 13.2% were rated "M" 80% of the 20 best-selling console games and 90% of the 20 hottest computer games were rated "E" or "T".

Over a quarter of console game players (25.1%) purchased action games, followed by sports (19.5%), racing (16.6%), "edutainment" (7.6%), role-playing (7.4%), fighting (6.4%), first-person shooters (5.5%) and adventure games (5.1%).

On the other hand, computer gamers displayed somewhat different tastes, as they most often purchased strategy games (27.4%), followed by children's games (15.9%), shooters (11.5%), family entertainment (9.6%) role-playing (8%), sports (6.3%), racing (4.4%), simulation (4.1%) and fighting games (.1%).

3. Competition

There are four categories of companies in this industry.

1. The first category includes Sony, Nintendo, Microsoft and Electronic Arts. The market leader is Sony and its PlayStation brand. Microsoft and Nintendo are significantly competitive. Nintendo is being very aggressive with hardware pricing, software bundling and is doing a better job with third-party relationships. This should really benefit them in the long-term. Microsoft is expected to be extremely competitive on all fronts and has now become a battle-tested veteran.

From fiscal 1995 to fiscal 2002, Sony has reported \$36 billion in revenue from video games, compared with \$32 billion for Nintendo. On the other hand, Nintendo has reported significantly higher operating income. Nevertheless, the momentum is clearly on Sony's side. Nintendo has been consistently profitable, but their revenue has not significantly grown in the past ten years.

2. The second category of companies include the Japanese-based companies that have their roots in the arcade business: Capcom, Konami, Namco and Sega. These companies are faced with the problems of a declining arcade business and a slow Japanese economy. Their biggest challenge will be expanding on an international basis
3. The third category of companies includes Activision, Take-Two Interactive and THQ. These are companies that have experienced strong growth on the strength of one or two very successful product lines. The challenge for these companies is taking the earnings from their hit product lines and building a consistent, dependable revenue stream.
4. The final group consists of the European companies that have grown rapidly through expansion: Eidos Interactive, **Infogrames**, Ubi Soft and Vivendi Universal Games.

4. Market Trends

Some of the market trends:

- The industry concentrates on big names and copies of known successes because of an increasing emphasis on generating hits that outsell other games by wide margins.
- Game developers predict more big-budget games based on hot movie properties such as "The Lord of the Rings" and, probably, more imitators of last's year bestseller, "Grand Theft Auto: Vice City".
- So sanguine are some game developers that they already are planning titles for next-generation PlayStation 3 and Xbox 2 consoles that aren't likely to be available for another two years.
- The industry continues to be fuelled by what has always driven it: the enthusiasm of a generation raised on video games. That remains true even though many of those gamers are no longer children.
- As for 2003 and beyond, the industry would move towards connectivity via the Internet and a new level of superior quality games that can harness the power of these technologically advanced machines.
- The video-game industry has repeatedly proven to be recession-proof. It's cost-effective entertainment because the cost per unit of time spent is low compared to movies, for example.
- The focus of the video game industry had shifted to software in 2002. Video game hardware dominated the spotlight in 2001.

5. Driving Forces

There are 5 primary driving forces in the video game industry that have been behind the change and evolution of the industry over time.

- Technological change. Technology in the industry constantly changes, producing successive generations of increasingly powerful hardware systems, typically at lower costs.
- Product innovation. The software development side of the industry is increasingly becoming a business of risky bets on individual software titles that are hoped to be significant hits. The large number of developers has resulted in a continuous production of highly innovative products.
- Changes in the industry growth rate. The industry has been characterized by significant cyclical patterns, although the long-term prospects for the industry are good.
- Changes in the personal computer industry. As a significant substitute for consoles, the lower cost and increasing performance of home computers can eventually threaten the industry.
- Changes in the industry's consumers. Although video game hardware has largely appealed to adolescent males, changes may occur which cause the demographics of the industry's customers to expand to young adults and women in general.

6. Infogrames/Atari

6.1 Overview

Infogrames, founded in France in 1983, acquired the rights to the Atari brand in early 2001 when it bought Hasbro Interactive. In October 2001 the company relaunched the brand and began using it as a games publishing label. The company's U.S. operations are now known as Atari, Inc., and trade on the NASDAQ under the symbol "ATAR." Though its origins are French, 65% of the company's business is done in the United States.

6.2 Position & Prospects

The current hard times are particularly painful for Infogrames because it benefited three years ago from an earlier round of consolidation by amassing a portfolio of game companies. It spent more than \$300 million in three years acquiring companies such as Hasbro Interactive, Shiny Entertainment, GT Interactive Software, Accolade Inc. and Paradigm Entertainment.

The acquisitions turned Infogrames into Europe's largest game company and one of the top five game publishers in the United States. But the properties had little in common, and it did not work out. The most troubled property was GT Interactive, responsible for the bulk of a \$322.6-million net loss at Infogrames' U.S. subsidiary in 2000.

Its licenses have yet to pay off. The company released its "Survivor" game just as the show's popularity fizzled. And its "Men in Black" game failed to wow either critics or consumers. Its "Matrix" games will not be released until next year, but analysts question whether the games will perform well enough to justify the \$47 million Infogrames paid to license and develop the titles.

So far, Infogrames has not been able to consolidate its disparate empire and generate a profit. Its U.S. business has recovered and eked out a \$1-million operating profit and a \$700,000 net loss for the fiscal year that ended in June. The subsidiary completed the year with just \$6 million in cash. Its French parent did worse, posting a net loss of about \$78 million on revenue of about \$750 million, \$419 million from its U.S. arm.

The onetime acquirer may find itself being acquired if it cannot turn a profit this fiscal year to satisfy creditors holding convertible bonds worth \$122.4 million and \$302.5 million due in 2004 and 2005, respectively.

Infogrames has a number of valuable assets it could sell, including its "Backyard Sports" and "Test Drive" franchises, its Hasbro licenses to produce games based on Monopoly and Scrabble, and its publishing contracts with independent game studios for such titles as "Unreal 2003," "Neverwinter Nights" and "Sid Meier's Civilization III."

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