

Recent Deal Notables

Take-Two Interactive Software acquired Angel Studios for \$28 million in cash, plus stock. Take-Two, which owns the Rockstar Games label, said that Angel Studios will be renamed Rockstar San Diego. Previously, Angel Studios developed Rockstar Games' *Midnight Club* and *Smuggler's Run* titles. Angel Studios is currently developing *Midnight Club II*. Angel Studios has 125 developers.

Activision acquired developer Luxoflux for an undisclosed amount. Luxoflux has collaborated with Activision since 1997 and is presently developing two games for Activision. Luxoflux brings a strong development team, a proven track record and proprietary technology used to create compelling interactive entertainment experiences across multiple console platforms.

Microsoft Corp acquired Rare Ltd. for \$375 million in cash. The acquisition will help Rare Ltd. to extend its international market reach and more rapidly deliver enhanced product offerings. Under terms of the agreement, Rare will begin creating exclusive content for Xbox. Rare has produced such recent hits as "GoldenEye 007," "Perfect Dark," and "Donkey Kong 64."

Electronic Arts, Inc. acquired Black Box Games for an undisclosed amount. This acquisition brings a proven developer of top sports and racing titles to Electronic Arts, Inc. to work on future titles for the Sony PS2, Nintendo GameCube and Microsoft Xbox.

THQ acquired the assets of ValuSoft for \$9.7 million in cash, plus stock. ValuSoft publishes and distributes productivity and interactive entertainment software. THQ stated that ValuSoft's range of "reasonably priced software targeting the casual computer user" would allow the firm to branch out into a new market segment.

Sector Snapshot

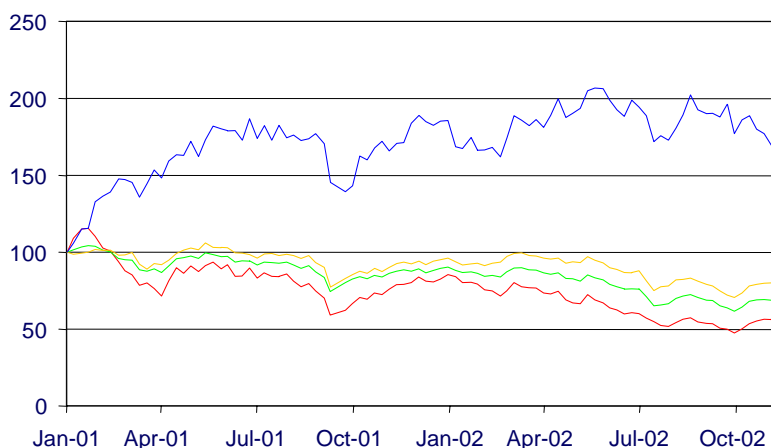
It's all about the franchise: Publishers continue to vie for top hits to create a franchise with repeatable sales. EA has "Madden" and "Sims," Take-Two has "Grand Theft Auto," and THQ has "WWE." Developers and publishers are also reviving past hits from the 16-bit and 32-bit era.

Cost of game development continues to rise: Game development costs have increased from \$3.0 million in the 32/64-bit cycle to \$4.0 million in 128-bit cycle for a given title, with development costs reaching as much as \$8-10 million. The rising cost of development represents increased risk for smaller gaming companies which rely more heavily on individual titles for future viability. Larger companies, with diversified portfolios and stronger balance sheets, can better weather industry volatility.

Consolidation on the horizon: In order to bolster their market share and gain a competitive edge, many leading game publishers are actively pursuing acquisitions of niche development houses. Of particular interest are groups that have: (1) a track record of producing "AAA" quality titles for console or PC platforms; (2) strong technical skills; and (3) proprietary technology and intellectual property.

Alternative gaming platforms represent a key long-term growth opportunity: With the widespread adoption of online gaming and the emergence of viable mobile gaming platforms, subscription-based gaming has emerged as a unique growth opportunity for the gaming industry. Alternative platforms will be used to drive growth, diversify revenue streams and extend brands into new mediums. Subscription-based gaming services offer opportunities not only for development companies but also for providers of delivery platform technology and related support services. While opportunities for niche players abound, we anticipate aggressive strategic consolidation in the next 4 to 6 quarters.

Capstone Index



The Capstone Gaming Index is a market capitalization weighted index that includes the following companies: AKLM, ATVI, BFUN, EIDSY, ERTS, IFGM, MWY, SEGN, THQI and TTWO (January 1 2001 to November 15 2002).

Public Equities

Company	Ticker	*Enterprise Value/LTM		
		Revenues	EBIT	EBITDA
Acclaim Entertainment	AKLM	0.4x	20.8x	5.5x
Activision, Inc.	ATVI	0.8x	6.2x	3.9x
Eidos plc	EIDSY	1.2x	4.7x	4.7x
Electronic Arts, Inc.	ERTS	4.2x	26.4x	23.0x
Infogrames, Inc.	IFGM	1.0x	NM	NM
Midway Games, Inc.	MWY	1.2x	NM	NM
Sega Enterprises	SEGN	1.0x	NM	NM
THQ Inc.	THQI	0.9x	11.6x	8.6x
Take-Two Interactive Sft	TTWO	1.5x	14.1x	12.1x
Average		1.4x	14.0x	9.6x
Median		1.0x	12.8x	7.1x

Enterprise Value = Market Capitalization + Debt - Cash.

Source: MarketGuide, Multex, and company reports.

Acquirers on the Hunt

Mid-sized game developer seeking to acquire developers with AAA game development experience or publisher with quality portfolio of titles.

Foreign game publisher/developer seeking to acquire development teams with between 30-40 developers who have developed proprietary IP and experience in one of three genres: Action, Sports, or Role Playing Games.

Large developer seeking to acquire development house with 100+ developers, with portfolio of AAA quality games on core platforms. Team must have successfully brought a product to finish and have industry expertise, interesting technology, and intellectual property.

Large developer seeking to acquire development houses with one to three development teams that have created proven hit titles for a single platform.

