

## Recent Deal Notables

**Redstone announces plans to acquire Midway:** Viacom chairman, Sumner Redstone has announced intentions to gain a controlling interest in the company. Redstone currently holds 70% of the shares. In April 2004, Midway raised close to \$80m in a secondary public offering.

**THQ agreed to acquire Relic Entertainment for an undisclosed cash amount:** This acquisition of the Vancouver-based PC developer will build upon the existing two property, multi-year and platform publishing agreement that includes Relic's upcoming RTS title *Warhammer 40,000: Dawn of War*.

**Take-Two acquired British developer Mobius Entertainment for an undisclosed amount:** This acquisition will help develop Take-Two's handheld development capabilities by leveraging Mobius' success from their work on the handheld version of *Max Payne*. The developer has previously specialized in Game Boy titles, and will continue to focus on Game Boy Advance and PlayStation Portable titles in the future under the name Rockstar Leeds.

**Midway acquired Surreal Software in an all stock deal (worth approximately \$4.4m):** Midway acquired the developer of Surreal Software, the developer behind Midway's *The Suffering* for an all-stock transaction for 540,317 Midway common shares. A further 137,199 restricted shares have also been issued to key Surreal employees as retention incentives.

**Eidos acquired Danish developer IO Interactive for approximately \$50.1m in cash and stock:** This acquisition (£23m cash and stock plus £5m based on future four year performance) will enhance Eidos' development capabilities while securing the developer of the *Hitman* and *Freedom Fighters* titles.

**Turbine acquires rights to Asheron's Call franchise from Microsoft Game Studios for an undisclosed amount:** Turbine announced that it has acquired the rights to Asheron's Call 1 and 2 from Microsoft Game Studios, its partner in the development of the original version of the leading MMORPG.

**Activision acquired Infinity Ward for \$3.5m in cash:** Activision has exercised its option to buy the remaining 70% of the developers of *Call of Duty*, many of whom also worked on *Medal of Honor*. Activision already owned 30% of Infinity Ward.

## Sector Snapshot

**Acquisitions continue to be key competitive strategy:** Difficult growth conditions and lack of quality IP have sustained buyer appetite and interest for leading development houses and premier IP. Publishers and well-capitalized developers are cash abundant and aggressively seeking to acquire established development teams, preferably with proven IP's.

**Licensing in gaming: innovation or stifling?:** The influx of cross-media licenses projects, continue to saturate the market as publishers hope to capitalize on existing media content from movies, books, television and comics. Expensive licensing fees have highlighted the economic and market benefits of owning successful original IP.

**Waning current hardware product cycles:** Software sales have recently slowed correlating with the waning current hardware product cycle. Developers and publishers are preparing for next generation platforms expected in 2005-2006 and positioning for "first-mover" advantage.

**Development costs will continue to rise:** The anticipated increased costs associated with development for next-generation platforms will create a hurdle for many developers seeking to develop original titles and independently owned IP. Capital constraints could potentially make developers more dependent on publishers and other capital sources and force publishers to seek less-expensive alternatives, including offshore development.

## Public Equities

| Company Name                       | Ticker  | Enterprise Value/LTM |              |              |
|------------------------------------|---------|----------------------|--------------|--------------|
|                                    |         | Revenue              | EBITDA       | EBIT         |
| Acclaim Entertainment Inc.         | AKLM    | 0.4x                 | NM           | NM           |
| Activision Inc.                    | ATVI    | 1.7x                 | 7.7x         | 14.6x        |
| Atari Inc.                         | ATAR    | 0.6x                 | 21.3x        | * 68.5x      |
| Eidos plc                          | EIDSY   | 1.1x                 | 10.2x        | 11.9x        |
| Electronic Arts Inc.               | ERTS    | 4.8x                 | 16.0x        | 17.6x        |
| Konami Corp.                       | KNM     | 1.2x                 | 6.6x         | 8.0x         |
| Midway Games Inc.                  | MWY     | * 11.81              | NM           | NM           |
| Sega Corp.                         | SEGN.YK | 1.2x                 | 10.2x        | 29.4x        |
| Take Two Interactive Software Inc. | TTWO    | 1.2x                 | 10.8x        | 13.8x        |
| THQ Inc.                           | THQI    | 1.0x                 | 3.5x         | 13.0x        |
| <b>Average</b>                     |         | <b>1.5x</b>          | <b>10.8x</b> | <b>15.5x</b> |
| <b>Median</b>                      |         | <b>1.2x</b>          | <b>10.2x</b> | <b>13.8x</b> |

\* Not included in Average or Median calculations  
Enterprise Value = Market Capitalization + Debt - Cash.  
Source: MarketGuide, Multex, and company reports.

## Positioning for Success and Liquidity

The increasingly competitive environment, rising development costs and ongoing market consolidation continue to make it more challenging for smaller, independent developers to create multiple hit titles and original IP or realize liquidity for their efforts. Achieving liquidity necessitates forethought and planning with respect to product development, market timing and strategic positioning. Developers should keep the following considerations in mind:

**Timing the market:** Companies typically wait too long before exploring liquidity options. Optimal timing could take up to 6-9 months to plan depending on market conditions and current stage of product development. The dependence on advanced royalties as cash flow creates a harsh business cycle for developers, sometimes forcing them to accept sub-optimal development contracts and acquisition offers.

**Solidify company identity and development reputation:** Publishers are even more focused on developing reputable and recognizable IP and are seeking developers with innovation, reputation and experience in a genre, and proprietary IP.

**Don't leave money on the table:** Developers often fail to maximize value by not properly valuing their business and failing to properly value acquisition offers from buyers or capitalizing on capital markets opportunities.

**Focus on your strengths:** The day-to-day financial grind takes away from the joys of game development and IP innovation and creation. Developers often get bogged down by business matters and are ill-equipped to maximize shareholder value when liquidity opportunities arise.

## Capstone Partners Advantage

Capstone Partners is a national investment bank focused on executing middle market liquidity and growth transactions. We are dedicated to partnering with developer/publishers to identify and execute growth and liquidity opportunities. Our dedicated relationships and deep knowledge of the industry minimize business exposure for our clients and maximize value realization. We partner with everyone of our clients and are success fee based, which means that there is no financial outlay until a transaction is consummated.

Contact us to learn more about our unique approach and service model.

