

Follow The Money: Understanding Console Publishers

Presented By

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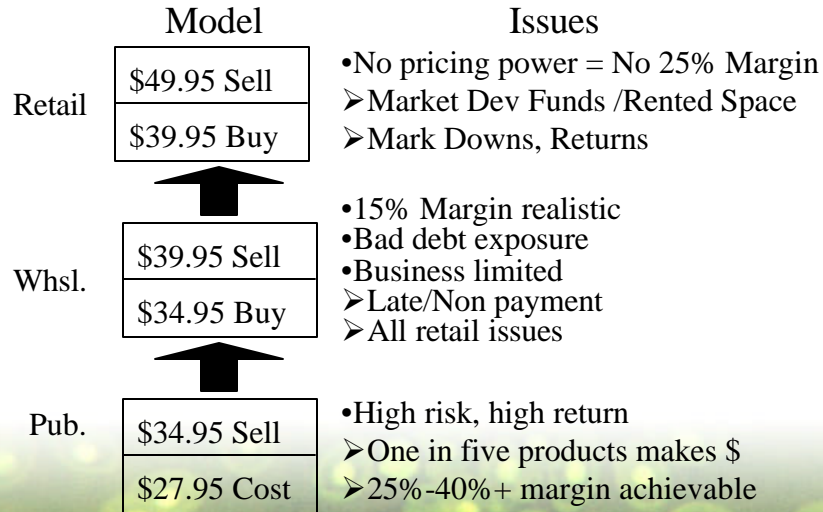


Some Quick Definitions

- **Publisher**
 - In the business of selling games for consumption by the public
 - May develop product internally or from external developers
- **Developer**
 - In the business of creating games, does not sell to the general public
- **Distributor**
 - Essentially a breaker of bulk, buys large wholesale lots and sells in somewhat smaller wholesale lots
- **Video Game**
 - Played on proprietary console



The Value Chain:



A Typical P&L (1/2)

Assume

- DVD or CD
- 35 product a year publisher
- Game is developed outside or licensed
- P&L is simplified,
- royalties are

Gross Revenue			
Gross Units		90,000	
Average Wholesale \$		37.00	
	Gross Revenue	3,330,000	
Net Revenue			
Return Reserve Units @ 6%		5,400	
Net Units		84,600	
	Net Revenue	3,130,200	100%
COGS \$			
Distribution		1.00	
Production		2.00	
HW Royalty and various		8.00	23%
Total/Unit		11.00	
	COGS	990,000	32%
Royalties Including Dev Cost \$			
Intellectual Property		200,000	6%
Developer		600,000	19%
	Royalty	800,000	26%
	Total COGs & Royalties \$	1,790,000	57%

A Typical P&L (2/2)

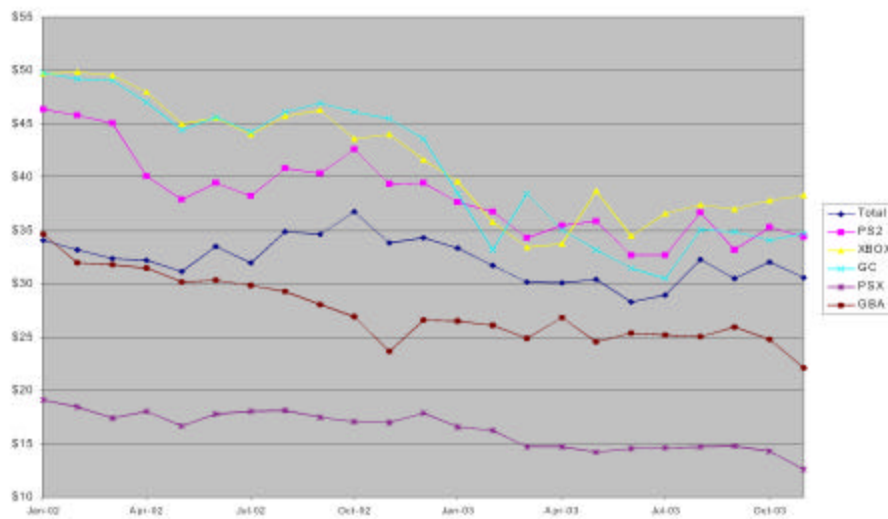
Assume

- DVD or CD
- 35 product a year publisher
- Game is developed outside or licensed
- P&L is simplified
- royalties not actual

	Gross Revenue	3,330,000	
	Net Revenue	3,130,200	100%
	COGS	990,000	32%
	Total COGs & Royalties \$	1,790,000	57%
	Gross Profit \$	1,340,200	43%
	Other Expenses \$		
	Fixed Overhead	275,000	9%
	Vrbl Mktng	300,000	10%
	Variable Dev	25,000	1%
	Total Internal Expense	600,000	19%
	Net Profit \$	740,200	24%

Retail

Video Game Console ASP Trends

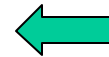


Source: NPD TRSTS represents total estimated US market

Source: Arcadia Investment Corp.

Retail (2/2)

Gross Revenue		
	Gross Units	80,000
	Average Wholesale	\$37



- Full price doesn't hold
- Assuming you can price protect Earns/Turn -

Whsl	Retail	Margin	Profit
\$39.95	\$49.95	25%	\$13
\$24.00	\$29.95	25%	\$6
\$16.00	\$19.95	25%	\$4

- = Defensive inventory + Aggressive Returns
- Product that doesn't sell through bites back hard

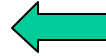
H/W Royalty

- H/W Maker Royalty Buys
 - Access to a system
 - Consumer assurance of quality / Credibility
- H/W Maker Costs
 - \$
 - Autonomy



IP Royalty (1/2)

Royalty/Dev Cost			
	Intellectual Property	200,000	6%
	Developer	600,000	18%
	Royalty	800,000	24%



- IP may be rented or **created**
- What does an IP buy?
 - Advertising
 - Some minimal expectations



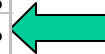
IP Royalty (2/2)

Rank	Original IP	Units	Rented IP	Units
1	GRAND THEFT AUTO:VICE	5,642,669		
2	GRAND THEFT AUTO 3	5,104,192		
3	GRAN TURISMO 3:A-SPEC	3,217,546		
4			MADDEN NFL 2003	2,700,412
5			MADDEN NFL 2004	2,376,998
6			TONY HAWKS PRO SKATR3	2,002,399
7			MADDEN NFL 2002	1,999,271
8	METAL GEAR SOLID 2	1,991,482		
9	FINAL FANTASY X	1,787,947		
10	MEDAL HONOR FRONTLINE	1,767,103		
11			KINGDOM HEARTS	1,617,569
12			SPIDER-MAN: THE MOVIE	1,569,485
13			NBA STREET	1,542,407
14	ATV OFF ROAD FURY	1,532,532		
15	MAX PAYNE	1,461,115		
16	JAK AND DAXTER:LEGACY	1,387,143		
17			DRAGONBALL Z: BUDOKAI	1,358,000
18	MIDNIGHT CLUB:STREET	1,349,384		
19	SOCOM:SEALS W/HEADSET	1,347,508		
20			BOND:AGENT UNDER FIRE	1,306,918
<small>TRST Data</small>	(11 games)	26,588,621	(9 games)	16,473,459



Developer Royalty

Royalty/Dev Cost			
	Intellectual Property	200,000	6%
	Developer	600,000	18%
	Royalty	800,000	24%



Internal Vs. External Development

•Internal

- Cheaper for hit products, close control of technology,
- Not variabilized, high management overhead, unlikely to rule more than one category, more expensive for misses

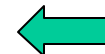
•External

- Much cheaper for misses, access to best technology/skill, highly variabilized
- Much more expenses for hits, loose control of technology, IP control risk



Variable Marketing

Other Expenses			
	Variable Marketing	300,000	9%



• Consumer Advertising

- Magazine, Online, TV, Movie Trailer, Other

• Consumer Promotions

- In-Pack/Cross Promotion, Reservation with gift, Demo

• Trade Marketing

- Box comps, sell-sheet, sales video, CO-OP Advertising and Market Development Funds



Variable Marketing (2)

- What works?

“Which of these items highly influence your game purchase decisions?”

Demos - 78.23%
 Reviews - 46.62%
 Trailer / Video Clips - 37.96%
 TV Commercials - 34.64%
 Magazine Ads - 31.20%

(Gigex 8/02 survey)

- You can only fool some of the people some of the time

- Push to quality
- Gamerankings.com Vs. TRST



Variable Marketing (3)

All time PS2 Gamerankings.com Vs. '03 TRST

	Title	Units	Rank GR	GR %
1	GRAND THEFT AUTO:VICE	5,642,669	1	97
2	GRAND THEFT AUTO 3	5,104,192	1	97
3	GRAN TURISMO 3:A-SPEC	3,217,546	5	94
4	MADDEN NFL 2003	2,700,412	17	91
5	MADDEN NFL 2004	2,376,998	23	90
6	TONY HAWKS PRO SKATR3	2,002,399	7	92
7	MADDEN NFL 2002	1,999,271	18	91
8	METAL GEAR SOLID 2	1,991,482	2	95
9	FINAL FANTASY X	1,787,947	21	91



Followed The \$

Price of admission →

Product →

Shelf rental + communication →

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Royalty	800,000	26%	
Total COGs & Royalties	1,790,000	57%	
Gross Profit	1,340,200	43%	
Other Expenses			
Fixed Overhead	275,000	9%	
Variable Marketing	300,000	10%	
Variable Dev	25,000	1%	
Other	0		
Total Internal Expense	600,000	19%	
Net Profit	740,200	24%	



Game Production: Challenges

- Market Acceptance
 - Typical of entertainment industry
- Software Development
 - Small machines pushed beyond reasonable limits
- Distribution
 - Typical of packaged goods industry



Market Challenge: What to make?

- Packaged Goods Approach
 - Brand/Franchise/System above all
 - Strive for barely noticeable differences
 - Usually heavily research dependent
- Entertainment Approach
 - Throw lots of stuff on the wall, see what sticks
- Software Approach
 - Novel is cool, technology is cool
- Entrepreneurial
 - Opportunistic, focus on value vs. absolute quality
- By gamers for gamers
 - Make the games you want to play



Development Challenge: Issues

- Game creation is doubly iterative
 - Programming, Design, Play balancing
- Most tasks are resistant to brute force fixes
 - Programming, Level Design
- Process not standardized
 - New games → new technology → learning curve
- Keeping it fun
 - Participation in the process warps judgment



Development Challenge: Do

- Focus on the first 10%
 - Mistakes are far, far easier to avoid than to fix
 - Keep expectations clear
- Lots and lots and *lots of* smoke detectors
 - Constant Plan Vs. Progress Monitoring
 - Microsoft Project-Learn it, Love it, Live it
 - Regular, multi-tiered milestone reviews
- Discipline to respond fast & hard to problems
- Keep successful teams together
 - There is no magic dust and you can't sprinkle it



Development Challenge: Don't

- Commit more than one crime
 - New engine/technology
 - New IP
 - New team
- Forget your player
 - Know the audience, then exceed *their* expectations
- Forget a game has to be fun



Distribution Challenge: Thoughts

- Successful products are pulled through, not pushed in
- Hits are unpredictable, plan that way
- Manage returns before they manage you
- Remember: there has to be a relationship between price and value