



Preparing For Funding

Gamer Technology Law Conference
March 17, 2006

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So you want to make a videogame? ...and you need money!?

- The big picture – the importance of understanding the industry and the marketplace
- The publishing model – issues and economics
- Alternative game development structures and third party financing



Understanding the Industry and the Marketplace

- What is the game industry?
 - Console games
 - PC games
 - Online games
 - MMOs
 - Casual games
 - Mobile/wireless games

Understanding the Industry and the Marketplace

- Industry growth and size
 - Video gaming is a mainstream entertainment business
 - But it's different from other entertainment businesses and does require special skills and expertise
- Game development becoming more complex
 - Development budgets are increasing
 - Development cycle is longer
 - Marketing costs are increasing

Understanding the Industry and the Marketplace

- Console/PC gaming is a hits driven business
 - Hits generate a disproportionate amount of publisher revenues, earnings and cash flow
- Increased use of established and licensed content
 - Publishers desire to create brands and franchises that:
 - Leverage investment in prior games
 - Capitalize on built-in consumer awareness
 - Can be exploited in multiple media
 - Sports games and movie licenses

Understanding the Industry and the Marketplace

- Platform shift every 5-6 years
 - Increases uncertainty as to development costs and schedules
 - Developers and publishers must deal with new platform specifications
- 2005-2006(-2007?) - changeover from the PS2/Xbox/GameCube to the PS3/Xbox 360/Revolution consoles
 - Transition thus far has been characterized by delays and hardware shortages

Understanding the Industry and the Marketplace

- Growth in online game play
 - Significant departure from the established packaged goods model
 - Subscription based revenues
 - New consoles have advanced networking and online gaming capabilities
 - Facilitates online distribution
- Growth in international markets
- In-game revenue sources

Understanding the Industry and the Marketplace

- Publishing business – growth and consolidation have created publishing tiers
 - The top tier publishers continue to gain both financial strength and bargaining power in the marketplace
 - Top tier publishers can afford to take risks, can afford expensive licenses of intellectual property and are able to wield considerable marketing power
 - Publishers grow by acquiring other publishers and top developers - in-house development is less expensive and easier to control

Understanding the Industry and the Marketplace

- Game development from the developer's perspective
 - "Business" or "project"
 - Developer size and small number of projects (often one at a time) limits ability to spread title risk
- Developer options
 - Status quo – title by title existence
 - Be acquired
 - Grow
 - Consider other platforms and industry sectors

Game Development Business Models

- Publishing model
 - Publisher finances the development of a game on an ongoing basis; development advances are recoupable out of royalties
 - Royalties tend to be paid on only the most successful games and many developers never see royalties
 - Publishers at risk for development costs of games that are not successful economically

Game Development Business Models

- Publishing economics – where the dollars go
 - Consumer \$50 Price of game
 - Retailer – \$10 Retail profit
 - Publisher \$40 Wholesale price of the game
 - \$ 4 Markdown/return allowance
 - Publisher \$36 Publisher net revenues
 - Console
 - Manufacturer \$ 8 Platform fee
 - \$ 3 Physical distribution and COGS
 - \$25 Available for marketing, license fees and publisher and developer

Game Development Business Models

- Publishing economics – where the dollars go
 - Assumptions
 - 10% license royalty
 - \$2M marketing budget
 - 20% developer royalty
 - Budget – breakeven – developer share at 1M units
 - \$7M - 400K units - \$2.7M
 - \$10M - 533K units - \$2.1M
 - \$15M - 755K units - \$1.1M
 - \$20M - 978K units - \$50K

Game Development Business Models

- How does a publisher reduce title risk?
 - Use licensed or branded intellectual properties
 - Use proven technology (license game engines)
 - Less reliance on external development
 - Add online/multiplayer component
- Publisher can do some distribution deals for independently developed properties
 - Publisher/distributor does not take the development risk for a game title but earns only a distribution fee

Game Development Business Models

- Variations on the publishing model and the "Desirable Developer"
 - A developer with a proven track record of success (success = hit games), technology (game engine) or content (brand IP) may be desirable since those could reduce costs and risk to a publisher
 - Publisher may give something to have priority access to the developer's games or IP – either dollars or a commitment to publish more than one game

Game Development Business Models

- Examples of variations on the publishing deal
 - Multi-title publishing deal (publisher locks in a developer for several titles)
 - A “first look” or “output” deal for the developer’s product
 - (Multi-title) publishing deal PLUS equity investment
 - (Multi-title) publishing deal PLUS equity investment PLUS option to buy 100% of developer
- Increasingly rare – and in the end it's a publishing deal

Game Development Business Models

- Publisher could share the financial risk
 - Co-production funds - provides partial financing in conjunction with publisher financing
- Reality Check
 - Financially sound publishers aren't really interested in this due to enormous cash reserves and less financially sound publishers are not ideal co-production partners
 - May have more viability in situations involving third party with valuable license (e.g., studio with interest in exploitation of rights in multiple media)

Game Development Business Models

- What's a developer to do?
 - Unable to get a publishing deal for the titles it wants to make
 - Does not have the resources to self-finance prototype development and/or production
- Developer alternatives
 - Prototype financing
 - Production financing
 - Grow/consolidate/get a non-financial partner
 - Obtain investment

Game Development Business Models

- Developer alternatives – prototype development
 - Use of third part development funds
 - Act as middlemen between publishers and distributors
 - Fund prototype development to prove concept and then strike a deal with publisher or distributor
 - Reality Check
 - Limited viability
 - Fund has to get paid for its risk but what if publishing deal is not attainable or only on customary terms
 - Fund may gain rights in developer IP

Game Development Business Models

- Developer alternatives – production financing - the “film model”
 - Production advances secured by distributor agreement to pay \$X (film budget) for completed film
 - Completion guarantor provides production oversight and guarantee of film completion on budget and on time for delivery to distributor
 - When film is completed, distributor accepts delivery and pays for film

Game Development Business Models

- Developer alternatives – production financing for games
 - Production funds
 - Funds all or a significant portion of development and then strikes a distribution deal
 - Reality Check
 - Game development different from film production
 - Completion guarantors not as experienced in the game business
 - Publishers as distributors not likely to provide distribution commitment in advance of completion of the title.

Game Development Business Models

- Developer alternatives – growth and consolidation
 - Internal growth
 - Internal growth must be managed and is not incremental
 - Consolidation and partnerships with other developers
 - Pooling of resources
 - Ability to further develop prototypes and properties
 - Pursue exploitation in other media
- Reality check
 - Choose your partners wisely

Game Development Business Models

- Developer alternatives – investment
 - Difficult for smaller developers – investors tend to invest in businesses
 - Growth and consolidation should improve chances for investment
 - More like in some game sectors than others – mobile and MMOs – business model/payment mechanisms
- Reality check
 - Savvy investors will make meaningful investments only in the very best developers and in certain industry sectors

Game Development Business Models

- Developer alternatives – changing or focusing on particular industry sectors
 - Handhelds
 - PC coupled with online distribution
 - Casual games
- Reality check
 - Adjustment to different types of game development may be difficult – employee morale and interest
 - Online distribution does open up opportunities

Game Development Business Models

Conclusions

Thank you

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