



GAME ON!

Online gaming comes of age

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The online gaming industry is undergoing a period of rapid investment, expansion and innovation. In the last few years, investment and usage has shifted to new forms of gaming (particularly around social networks), 'freemium' and microtransaction business models have been proven, and 'games as a service' has emerged as a viable model. As online gaming reaches the mainstream, traditional media companies and investors are entering the fray, seeking growth and outlets for their IP. Online gaming is coming of age; here are the league tables and key trends as we see them.



GETTING INTO THE GAME

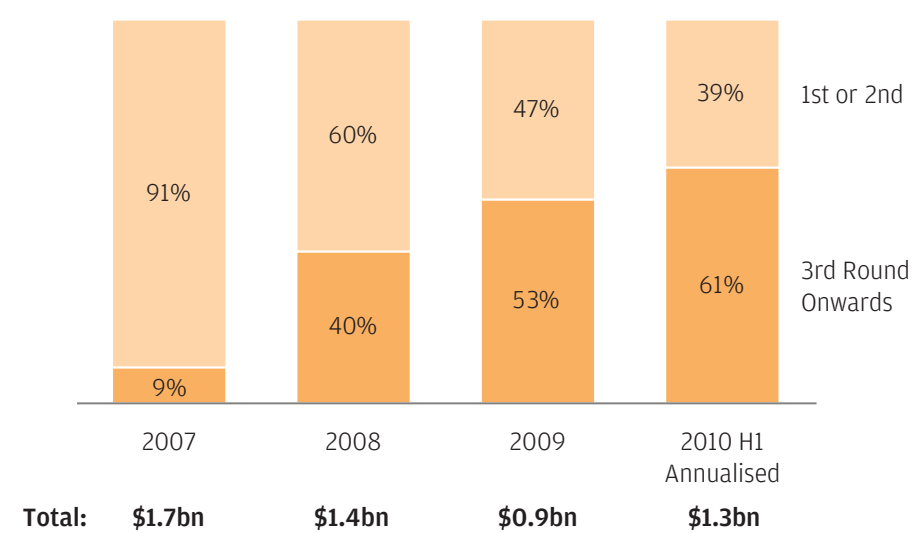
Trends in gaming investment

Gaming investment is heating up - the period 2006 to H1 2010 saw over 700 deals. We estimate that over \$1bn has flown into gaming companies in 2010, over double that which was invested in 2006, despite the more challenging economic environment. Gaming consistently accounts for \$1 in every \$20 invested into online media and tech.

Over this period the leading online games players have substantially increased their revenues (we estimate that the ten largest players all have revenues in excess of £50m) and many have diversified from being single game franchises.

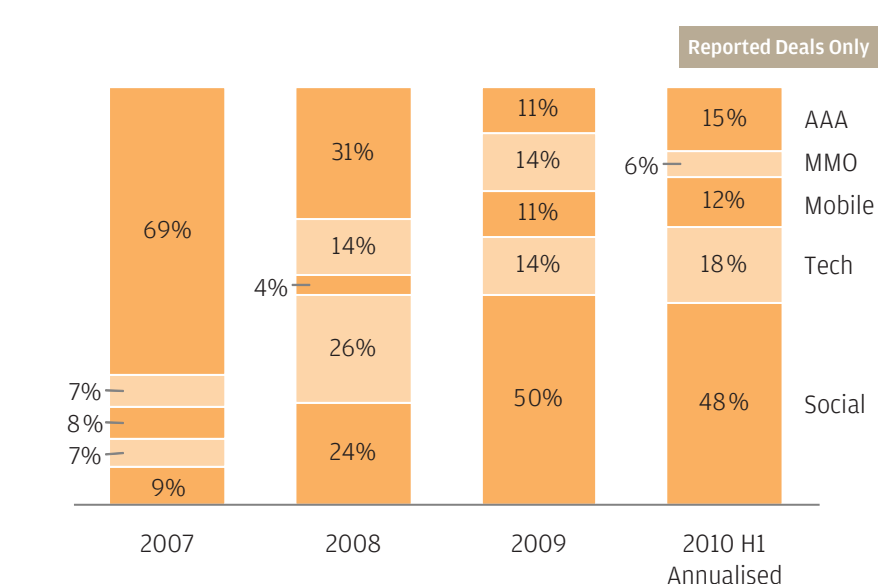
This has enabled a rapid shift in investment from early to later stage funding, and an influx of cash from private equity rather than pure play venture capital funds. 3rd round and beyond funding accounted for over 60% of 2010 H1 investment vs 9% in 2007².

Stage of Funding, Gaming Investment Worldwide^{1,2}, 2007-10 H1



Investors are betting on continued rapid growth in social gaming over other types of gaming, particularly AAA gaming, which accounted for less than 15% of investment into gaming in 2009 and H1 2010, while social gaming companies accounted for nearly half of all investment, up from less than 10% in 2007.

Investment¹ in Gaming, Worldwide by Type, 2007-10 H1



1. Includes debt & equity injections. Does not include acquisitions. Coverage in Asia may be incomplete
 2. Excludes funding where stage not known
 Source: Crunchbase, OC&C analysis

Our investment league tables suggest that this is not 'dumb money', as they feature many leading venture capital (VC) and private equity (PE) firms. A portfolio approach is in evidence for both types of investor, reflecting the sector's risk and maturity (the vast majority have invested in more than two gaming companies). Deal

values among PE firms are reaching mid-cap levels, opening the door to new tranches of investors.

The nascent nature of the sector is illustrated by the fragmented base of investors - the top 20 investors did 100 deals between them, less than 15% of the total.

Reported VC Investments¹, 2006-2010 H1

Rank	Company	Count	Total (\$m)	Average Deal Value (\$m)
1	Benchmark Capital	13	106	8
2	New Enterprise Associates	4	104	26
3	Peacock Equity	3	103	34
4	Balderton Capital	3	96	32
5	Accel Partners	7	71	10
6	Sequoia Capital	9	57	6
7	Index Ventures	5	57	11
8	Charles River Ventures	6	50	8
9	Norwest Venture Partners	3	46	15
10	Alsop-Louie Partners	3	42	14
11	Jerusalem Venture Partners	4	33	8
12	Mohr Davidow Ventures	4	30	7
13	Greylock Partners	3	28	9
14	Menlo Ventures	3	24	8
15	Intel Capital	4	24	6

Reported PE Investments¹, 2006-10 H1

Rank	Company	Count	Total (\$m)	Average Deal Value (\$m)
1	ABRY Partners	1	400	400
2	Providence Equity Partners	2	310	155
3	Advanced Equities	3	257	86
4	SoftBank	3	214	71
5	Adnreessen Horowitz	2	200	100
6	Temasek Holdings	1	100	100
7	Goldman Sachs	1	99	100
8	GMT Capital	1	87	87
9	Maverick Capital	2	67	33
10	IAC	1	50	50

1. Includes debt & equity injections. Does not include acquisitions. Coverage in Asia may be incomplete
Source: Crunchbase, OC&C analysis

WINNING AND LOSING ONLINE

The companies and business models of the (near) future

The online browser based gaming market remains highly fragmented by company type and size. The top 30 online games companies includes 12 social network game developers, 8 portals, 8 browser based

massively multi-player online games (MMOGs) companies, and 2 skill-based gaming companies¹. We estimate that fifteen companies have revenues in excess of £25m.

Online Gaming Company League Table, Ranked by Estimated Revenue

Revenue Bands, 2010E (£m)	Rank	Company Name	Type of Company (Principle Revenue Model)	HQ	Principle Games or Portals	Company MAUs, May-10 (Millions)	YoY Growth (May-09 - May-10)
200+	1	Zynga	Social network Games	USA	Farmville, Mafia Wars	248	500%+
100-200	2	Club Penguin (Disney)	BBMMOG (freemium)	USA	Club Penguin	15	-6%
100-200	3	GameForge	BBMMOGs (microtransactions)	Germany	Metin	26	-14%
50-100	4	Rock You!	Social Network Games	USA	Zoo World	66	58%
50-100	5	Playfish (EA)	Social Network Games	UK (/USA)	Pet Society	59	108%
50-100	6	CrowdStar	Social Network Games	USA / Ireland	Happy Aquarium	46	500%+
50-100	7	Bigpoint	BBMMOGs (microtransactions)	Germany	Bigpoint	10	20%
50-100	8	Playdom (Disney)	Social Network Games	USA	Social City	41	365%
50-100	9	Astrum Online Entertainment	BBMMOGs (microtransactions)	Russia	RZOnline	13	216%
50-100	10	Travian Games	BBMOGs (microtransactions)	Germany	Travian, Wewaii	12	-56%
25-50	11	Sulake	BBMMOG (freemium)	Finland	Habbo Hotel	7	-26%
25-50	12	Midasplayer	Skill Games	UK	King	10	46%
25-50	13	Jagex	BBMMOG (freemium)	UK	Runescape	9	-9%
25-50	14	InnoGames	BBMMOGs (microtransactions)	Germany	Tribal Wars	8	18%
25-50	15	Big Fish	Portal	USA / Ireland / Canada	BigFishGames	11	-30%
10-25	16	GameDuell	Skill Games	Germany	Game Duell	8	66%
10-25	17	MindJolt	Social Network Games	USA	MindJolt Games	13	259%
10-25	18	6waves	Social Network Games	Hong Kong	6waves Poker	12	134%
10-25	19	Spil Games	Portal	Netherlands	Agame, Games.co.uk	53	0%
10-25	20	Miniclip	Portal	UK	Miniclip	29	-15%
10-25	21	Popcap Games	Social Network Games	USA	Bejeweled Blitz	10	380%
10-25	22	Pogo (EA)	Portal	USA	Pogo	32	0%
10-25	23	wooga	Social Network Games	Germany	Bubble Island	9	n/a
10-25	24	Country Life	Social Network Games	Unknown	Country Life	9	n/a
10-25	25	SlashKey	Social Network Games	USA	FarmTown	9	106%
10-25	26	Yahoo! Games	Portal	USA	Yahoo! Games	26	-35%
10-25	27	WildTangent	Portal	USA	WildGames	26	-12%
10-25	28	MSN (Microsoft)	Portal	USA	MSN Games	24	-31%
10-25	29	Meteor Games	Social Network Games	USA	Island Paradise, Ranch Town	7	n/a
10-25	30	MTV Networks / Nickelodeon (Viacom)	Portal	USA	Addicting Games	23	-11%

1. Skill based games are games on which the player places a wager

Note: Revenues estimated based on business model and usage benchmarks

Source: Crunchbase, Comscore, OC&C analysis, Application data provided by Appdata

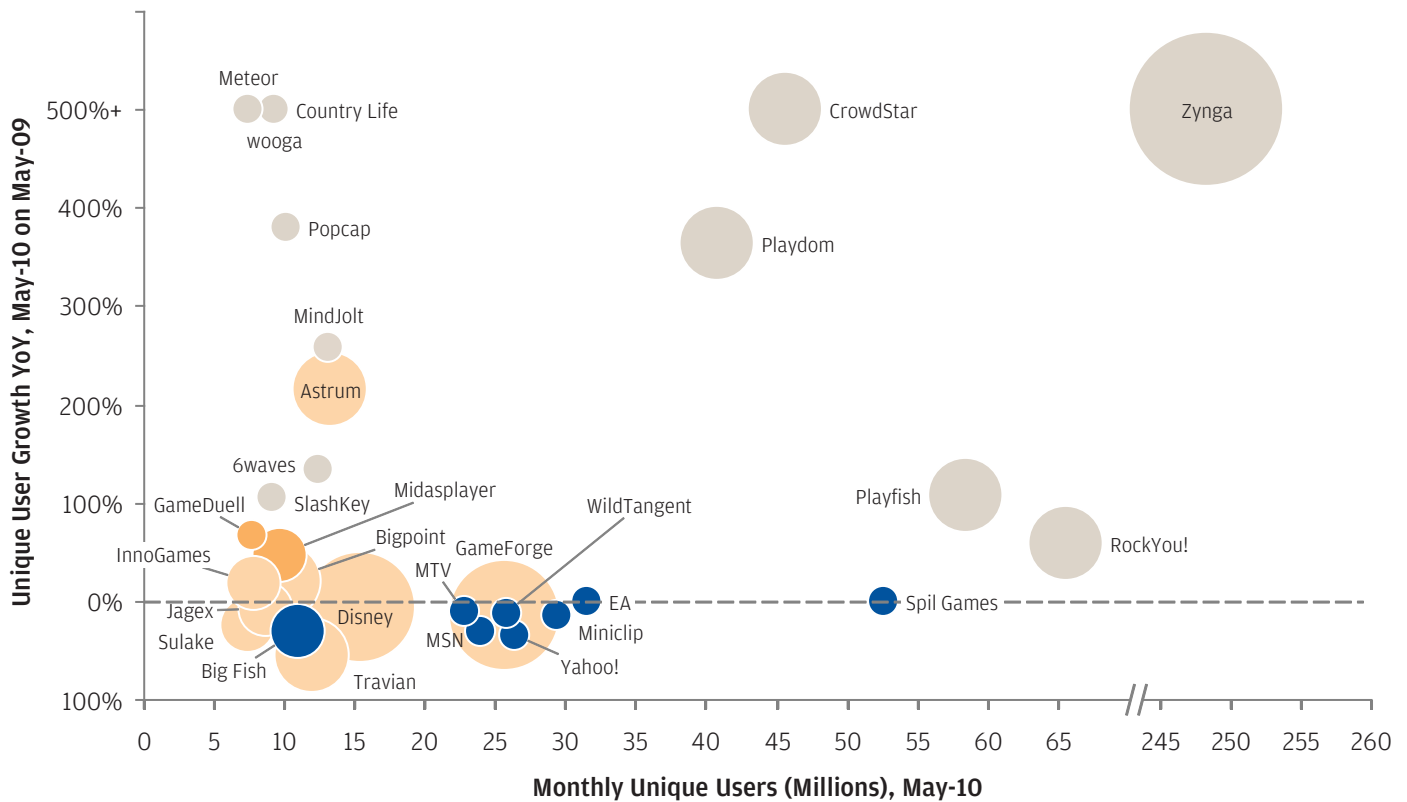
Recent usage data suggests that portals have been in decline, the performance of MMOGs is variable and social network based games players are growing extremely rapidly. Portals have been having trouble competing with Facebook as a platform, where friends explicitly recommend games to one another or do so implicitly by opting to send automatic 'in game' updates, like "Sarah has been making house calls in TirNua". MMOGs meanwhile fail to address the growing

'casual gamer' segment, which skews more to women and individuals who prefer to 'dip in and out' of games, playing for short periods of time.

The declining usage challenge for portals has been exacerbated recently by a weak online advertising market. Social network games and MMOGs have benefited from their consumer-funded freemium (payment for premium features) / virtual goods microtransaction business models.

Online Gaming Estimated Companies' Scale and Growth in Usage

	Average User Growth
Social Network Games	+326%
BBMMOG	+18%
Skill Games	+56%
Portal	-17%
All Companies	+134%
○ Bubble size equivalent to estimated revenue band	



Source: Comscore, OC&C analysis; Application data provided by AppData

Looking forwards, the continued success of social network based games publishers will depend on their ability to keep their costs of user acquisition low and to develop popular, new games in an increasingly crowded marketplace. We expect that these challenges will result in the increased use of established brands, characters and other intellectual property from sports, movies and television, for example EA Sports FIFA Superstars, a football game released by Playfish post acquisition by EA.

Facebook is likely to be both friend and foe for these players, with Facebook credits facilitating in-game transactions but currently taking a 30% cut for the privilege.

PLAYING TO WIN

Strategies for media players

Non-gaming media companies of all sorts are getting in on the online action, principally through acquisitions. Besides putting capital to work in a growing segment of media, IP owners of all flavours are looking to online games as a new outlet for their brands and as a means to engage with their audiences online.

Following Disney's acquisition of Playdom in July, the company is reported to be at work on games which leverage Marvel characters. As an investor in Bigpoint, NBC agreed to the exclusive distribution for a number of games based on Universal Pictures IP, including the Terminator. MTV networks, which attracts 22 million users

to its gaming sites each month, is expected to release social games based on Nickelodeon characters, following its acquisition of a small start-up.

Given this, media players should be asking themselves:

- What is my online gaming strategy and what role should I be playing (eg developer, publisher, IP licensor, investor)?
- What lessons can be learnt from a 'patchy' history of investment - how do I support innovation without stifling creativity?
- Who are the top acquisition candidates?

Acquisitions, Ranked by Total Value of Deals¹, 2006-2010 H1

Rank	Company	Count	Total (\$m)	Average Deal Value (\$m)
1	Electronic Arts	3	445	148
2	The Walt Disney Company	2	368	184
3	Real Networks	1	260	260
4	Warner Bros	2	209	105
5	MTV Networks	1	200	200
6	Microsoft	1	200	200
7	Oberon Media	1	114	114
8	Viacom	1	102	102
9	KT	1	85	85
10	Square Enix	1	83	83

1. Coverage in Asia may be incomplete
Source: Crunchbase, OC&C analysis

Strategies for online gaming companies

With the market rapidly growing up and credible business models now in place, online gaming companies could become more valuable than ever. However, differentiation will become increasingly challenging. To maximise your chance of success, consider the following key questions:

- How can I develop an umbrella brand that will draw players to my games over my competitors?
- Customer acquisition is going to become increasingly costly - how do I retain my audience and stop burning cash on acquisition?
- What is my strategy to differentiate, in the face of copycat games being continually released?
- What are investors looking for and how can I dress myself up for future funding rounds?

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