The End Game
How Top Developers Sold Their Studios

In November 2002 Angel Studios was purchased by Take Two for $28 million dollars in cash and 235,000 shares of stock. A month earlier Activision purchased Luxoflux for $9 million dollars and 110,000 shares of stock. That same year Infogrames (now Atari) purchased Shiny for a surprising $47 million dollars, and who can forget Microsoft's purchase of Rare for a whopping $375 million? And the list goes on: Massive Entertainement, Rainbow Studios, Barking Dog, Black Box, Shaba Games, Gray Matter, Treyarch, Outrage, Volition, Digital Anvil, Westwood Studios, and more. All have been purchased by a major publisher and experienced the thrill of the end game.

For many developers, selling their studio is the final prize for a race well run. But what do you really know about how a deal goes down and whether or not you are a good prospect? What is it that will make your studio attractive? How will your company be valued? And perhaps most importantly, what can you do to prepare?

The information presented in this lecture is based on interviews with key executives from both sides of an acquisition transaction: independent game studios who have been purchased and the publishers who purchased them. Interviews were also conducted with attorneys and investment firms that deal in mergers and acquisitions within the video game and software industries. And finally, research was conducted to quantify specific transactions and acquisition details.

DISCLAIMER

Mergers and acquisitions are complex business relationships that require the help of legal and accounting professionals. The information contained in this lecture is intended to give the reader a basic overview of this process as it relates specifically to the interactive video game business.

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WHO WE INTERVIEWED

BizDev would like to especially thank the following individuals for their help:

Jerry Bowerman. Mr. Bowerman began his career as an investment banker in Seattle and San Francisco. Prior to his current position as chief operating officer for Electronic Arts Canada, Mr. Bowerman served as a vice president of Sierra On-Line, where he participated in the acquisitions of Impressions, Papyrus, Headgate Studios, Greenthumb, Pixellite, and others.

Vance Cook. Mr. Cook's background as a lead programmer for Access Software (Links Golf) eventually led him to start his own company, Headgate Studios, which develops some of the best golf games in the world, including Tiger Woods Golf for Electronic Arts. In April 1996 Headgate was purchased by Sierra On-line, and a few years later, Mr. Cook repurchased his technology and company and began developing games as an independent.

Bernard J. Fischbach, Esq. Mr. Fischbach is a member of the board of directors at Acclaim Entertainment. He is a practicing attorney with Fischbach, Perlstein & Lieberman LLP, a law firm specializing in interactive entertainment and the music industries.

Mark DeSimone. Dr. DeSimone is the former president of Rainbow Studios, the creator of several hit games for the PC, PS2, and Xbox, including Motocross Madness, Splashdown, and ATV Off Road Fury. In December 2001 Rainbow was acquired by THQ.

Brian Fargo. As an industry pioneer, Brian Fargo founded Interplay in 1983. In 1995 Interplay acquired Shiny Studios, which was ultimately sold to Atari in 2002. In 2002 Mr. Fargo left Interplay and formed InXile Entertainment in Newport Beach, California.

Vincent Scheure. Mr. Scheure is an associate with Osborne Clarke in London, England. Osborne Clarke is a full-service commercial law firm with over 100 partners and 800+ people based in the City of London, Bristol, Reading, Cologne, Frankfurt and San Jose, California.

David Lee. Mr. Lee is a partner with the law firm White & Lee in Menlo Park, California, and has participated in over 200 mergers and acquisitions, including the initial public offerings for QUALCOMM, Wind River Systems and Documentum. He was the lead attorney representing Palm Computing, makers of the successful Palm Pilot family of products, in their merger with U.S. Robotics.

Jamie Leece. Mr. Leece is the former president Gotham Games (a division of Take Two Interactive). Mr. Leece participated in the acquisition of Barking Dog Studios by Take Two, along with various other intellectual property acquisitions made by Take Two during his tenure there.

George Metos. As founder of Sculptured Software and Kodiak Interactive, Mr. Metos' studios have developed some of the best selling games in the world, including Mortal Kombat II and III, Star Wars, Jack Nicklaus Golf, and more. Sculptured Software was acquired by Acclaim in 1995.

Stuart Moulder. As general manager of Microsoft Games Studios, Mr. Moulder participated in the acquisitions of FASA, Digital Anvil, Bungie, and Ensemble Studios. Prior to Microsoft, Mr. Moulder spent four years with Sierra On-Line and seven years prior to that at EDS.

Dave Perry. Mr. Perry is a well known developer and founder Shiny Studios (now part of Atari), creator of Earthworm Jim, MDK, and most recently, The Matrix. His company was originally sold to Interplay in 1995, and then re-sold to Atari in April 2002.

Jason Rubin. Crash Bandicoot and Jak and Daxter creator Jason Rubin has been developing video games since Junior High School, and his company, Naughty Dog is one of the top developers for the Sony PlayStation platform. In 2000 Naughty Dog was purchased by Sony Computer Entertainment of America.

Brett Sperry. Westwood Studios co-founder Brett Sperry sold his company twice, first to Virgin Interactive in 1992, and then to Electronic Arts in 1998. Westwood's title Command and Conquer has been one of the best selling PC games of all time.

Paul Tremblay. Mr. Tremblay is one of the founders of Black Box Games, the creator of several hit games, including Need For Speed Hot Pursuit, NHL Hitz, NHL 2K, and Sega Soccer Slam. Black Box Games was purchased by Electronic Arts in June 2002.

Ken Williams. As founder and former CEO of Sierra On-Line, Mr. Williams has an extensive background in the acquisition of game development studios. During his tenure as CEO, Sierra acquired Dynamix, Impressions, Coktel, Papyrus, Headgate Studios, and many others.

Michael Wallace. Mr. Wallace is a managing director in the technology group of UBS Investment Research and he has covered the multimedia consumer software industry since 1992. In 2002, he was ranked second in stock picking in the leisure category by The Wall Street Journal "Best On The Street" Survey.

ACQUISITION HISTORY IN THE VIDEO GAME INDUSTRY

Much of the information included in the table below was collected from financial data released by publishers as required by the Security and Exchange Commission (SEC). Notwithstanding this, I am thankful for the input provided by numerous individuals as well. Please note that information from non-public sources is speculative and presented only in an atmosphere of more fully understanding the dynamics of the industry.

By overlaying the acquisitions in this table with major industry events (such as the introduction of the PlayStation 2) you can envision how environmental factors could have affected each transaction. Microsoft's purchase of Rare in September 2002 could be an example of this.

$375 million dollars in cash (the purchase price of Rare) is the most paid for any developer to date. Although Rare was a proven developer of hit games, it appears to be an unusually large sum for a development studio. However, when you consider environmental factors, such as Microsoft's goal to establish itself as a premium console manufacturer (Xbox), it is more easily understood. Rare not only added positive net income to Microsoft Game Studios, but it helps secure their position in the console market. And if indeed this goal is met, then not only will the acquisition have a positive effect on Microsoft/Rare's future product sales, but on the sales of all Microsoft Xbox products.

DATE	COMPANY	PRODUCTS	ACQUIRING COMPANY	TERMS
1991	Distinctive	4D Boxing, Hardball, Test Drive	Electronic Arts	$11 million ($785K in cash)*
1992	Origin	Wing Commander, Ultima	Electronic Arts	$35 million stock (estimate)*
1992	Westwood	Kyrandia	Virgin	$5 milllion value (estimate)*
1994	**SONY PLAYSTATION LAUNCHES**			
1995	Iguana	Turok	Acclaim	$5 million cash + undisclosed stock
Oct-95	Sculptured Software	Star Wars, Mortal Kombat, Jack Nicklaus Golf	Acclaim	$30 million in stock
Oct-95	Probe	Die Hard, Back to the Future, X Men	Acclaim	$30 million in stock (estimate)*
1995	Papyrus	NASCAR	Sierra	$40 million stock (approx.)*
1995	Impressions	Ceasar II, Lords of the Realm	Sierra	$8 million stock (approx.)*
1995	Bullfrog	Populous, Syndicate, Magic Carpet	Electronic Arts	$25 million (estimate)*
1996	**NINTENDO N64 LAUNCHES**			
Apr-96	Headgate	PGA Championship Golf	Sierra	$8-10 million stock*
Sep-96	Mission Studios	Jet Fighter	Take Two	$1,674,478 cash, 182,923 stock (value $440,000). Promissory note value
Jun-96	Formgen	Duke Nukem	GT Interactive	1,030,000 shares GT stock
Jul-96	Humongous	Freddie Fish, Putt Putt	GT Interactive	3,458,000 shares GT stock
Dec-96	DMA	Lemmings	Gremlin	£4.2 million
Apr-97	Berkley Systems	You Don't Know Jack	Sierra	$25 million stock (approx.)
Jul-97	Maxis	Sim City	Electronic Arts	$125 million value stock
Sep-97	Raven	Solidier of Fortune	Activision	Value 13 million, 1,040,000 shares
Sep-97	Odd World	Abe's Oddysee	GT Interactive	$7 million (TCI portion) (estimate)
Oct-97	SingleTrac	JetMoto, Twisted Metal, Twisted Metal II and WarHawk	GT Interactive	$5.4 million in cash and 700,000 shares of stock valued at $7.2 million, (total value of $12.6M)
Aug-98	Westwood	Command and Conquer, Lands of Lore	Electronic Arts	$122.6 million (majority to Westwood)
Sep-98	Crystal Dynamics	Gex, Soul Reaver	Eidos	$47.5 million US (£28.4)
Dec-98	Talonsoft	Battleground, Art of War	Take Two	1,033,336 shares (accounted as a pooling of interest
Dec-98	Reflections	Driver, Distruction Derby	GT Interactive	2.28 million shares of common stock

* Information speculative

DATE	COMPANY	PRODUCTS	ACQUIRING COMPANY	TERMS
Dec-98	FASA	MechWarrior	Microsoft	Undisclosed
1999	**SEGA DREAMCAST LAUNCHES**			
Jan-99	Legend	Mission Critical, Death Gate	GT Interactive	$13.5 million stock
Mar-99	Gremlin	Grand Theft Auto, Realms of the Haunting, Loaded	Infogrames	$36.8 million cash
Sep-99	DMA (Owned by Infogrames)	Grand Theft Auto, Realms of the Haunting, Loaded	Take Two	$11 million cash (assumed DMA debt)
Apr-99	Access Software	Links	Microsoft	Undisclosed
May-99	Pacific Coast and Power	Activision	THQ	$10M in stock (estimate)
Oct-99	Neversoft	AMDK, Tony Hawk Pro Skater	Activision	700,000 shares stock (est. value 10M)
Nov-99	Bungie	Myth	Take Two	$5 million cash for 19%
2000	**SONY PS2 LAUNCHES**			
Jun-00	Bungie	Oni, Myth, Halo	Microsoft	Est. value $20-$40 million (based on Take Two sale of 19% @ 5M cash, 5.8 sale of Bungie assets)*
Jul-00	Pop Top	Railroad Tycoon II, Tropico	Take Two	559,100 shares (est. value $5.8M)
Jul-00	LTStudios	Startup with multiplayer concepts	Argonaut	£300K for 30%, 9.5% bond, remaining 70% purchased 9-2001 for a nominal sum
Aug-00	Volition	Freespace, Red Faction	THQ	890,100 shares common stock + 109,900 shares common (options)+ 500K debt assumed (est value $21.25M)
Oct-00	Just Add Monsters	Kung Fu Chaos	Argonaut	£200,000 cash and 400,000 stock plus a deferred £210,000 in Loan Notes
Dec-00	Digital Anvil	Freelancer	Microsoft	Undisclosed
2001	**MICROSOFT XBOX LAUNCHES**			
Jan-01	Red Zone	NFL Gameday	Sony	Undisclosed
Jan-01	Naughty Dog	Crash Bandicoot, Jak and Daxter	Sony	Undisclosed
Feb-01	Blue Byte	The Settlers	Ubi Soft	Value 13 million Euros ($8.2 M US)
May-01	Ensemble Studios	Age of Empires	Microsoft	926,077 shares common stock (est. value $83M)
Jul-01	Red Storm	Rainbow Six	Ubi Soft	$43 million value
Jan-02	Particle Systems	Powerdrome, SubWar 2050	Argonaut	£2.4 million in total plus 3.5M in Argonaut shares
Jan-02	Gray Matter	Return to Castle Wofenstein	Activision	$3.2 million in stock
Jan-02	Rainbow Studios	Motocross Madness, Splashdown	THQ	Total value est. $44.6M (1,287,000 shares of stock plus performance incentives)
Apr-02	42-Bit	Rally Championship 7	Warthog	Value £400,000 (in Warthog shares), futher 700K shares based on performance
Mar-02	Shaba Games	Wipeout, Big Hurt Baseball, Magic: The Gathering	Activision	387,932 shares of common stock. Value $7.4 million
Apr-02	Shiny	MDK, Matrix	Infogrames	$47 million (31M cash, 16.2 promissory notes)
May-02	Outrage	Decent PC	THQ	Undisclosed
May-02	Z-Axis	Dave Mirra Freestyle BMX	Activision	$12.5 million in cash and 373,385 shares of stock. Total value $20.9 million
Jun-02	Black Box	NHL Hits, Need for Speed, Sega Soccer	Electronic Arts	14M rumored value*
Aug-02	Barking Dog	Global Operations, Homeworld: Cataclysm, Treasure Planet	Take Two	$3 million cash, 242,450 shares restricted stock (total est. value $9M)
Sep-02	Rare	StarFox, Donkey Kong	Microsoft	Total $375 million cash, $100m of which to Nintendo
Oct-02	Luxoflux	True Crime, Vigillante, Streets of LA	Activision	$9 million cash
Oct-02	Treyarch Invention	Tony Hawk, Spider-Man	Activision	1,228,442 shares common stock. Total value $18.2 million
Oct-02	Massive Entertainment	Ground Control	Vivendi Universal	Undisclosed
Jan-03	Infinity Ward	Call of Duty	Activision	Undisclosed
Nov-02	Angel Studios	Smuggler's Run, Midnight Club, Red Dead Revolver, Transworld Surf	Take Two	$28 million cash, 235,679 shares restricted stock (total est. value $38M)
Dec-02	Zed Two	Pillage	Warthog	£1.5 Million over 3 years, contingent on performance*
2003	Fever Pitch	Starlancer (former Digital Avil developers)	Warthog	Value $300,000 Warthog shares
Sep-03	Pivotal Games	Conflict Desert Storm	SCi	Value £2.4 million (Sci already owned 10%)*

WHY DEVELOPERS SELL THEIR STUDIOS

Without surprise, financial security is the most common reason for independent developers to sell their companies. But this should not be confused with a take-the-money-and-run scheme where one sells his company and retires to a beach in the Bahamas. Occasionally a developer will leave shortly after an acquisition, but in general this is not in line with a publisher's expectation. Publishers expect to see a significant return on their investment, and acquisitions are structured to ensure this through the continued participation of key employees.

> "As we grew, we were constantly under pressure to deliver a big title every Christmas. I can't talk for the others, but my decision to sell was related to the pressure of keeping everyone employed. If our main product missed Christmas one year, we would have to let 1/2 the employees go. So initially, I was relieved to attach our company to a larger and more stable company." **Richard Garcia, formerly of Papyrus Software**

Many of the developers we spoke with sold their companies out of growing concern for growth and the complexities of working with multiple publishing partners. Generally, their collective motives fell into these categories:

- Concern over growth
- Concern over technology changes
- Leverage marketing and distribution
- Benefits for employees
- Personal growth

Concern Over Growth

Many developers who have sold their studios concluded that a single publisher partner was necessary in order to simplify business relationships and provide long-term financial stability. There also was an underlying concern was that their selling-price was at an all-time high.

As one developer explained, "A*s your size grows dramatically, projects can get behind and publishers may refuse to pay, some may cancel projects, and others may go out of business. When you're smaller it may be possible to weather these events with personal cash, loans, etc., but as a larger developer a "Perfect Storm" of these events can deliver a really serious blow"*.

For a developer, sustained growth becomes increasingly complex and risky as the studio grows, since most publishers require non-compete agreements that prevent them from working freely within the industry. To keep teams busy, they often worked with publishers that were less stable financially then themselves. So as their burn rate increased, mistakes and wrong turns were more costly and deadly.

Technology Changes

The transition from one console generation to the next is a powerful catalyst to secure business relationships.

For some, during the transition from PS1 to PS2, their motivation for selling was based on concerns about the implications of technology changes. One developer put it this way: *"The amount of time it took to develop a game was doubling. The amount of people it took was doubling. Hence the cost was going up about five times. And yet the cost of the software was unchanged if not descending. So the risk on each product was going up and the potential profit per person per year was going down. We sold the company partially to mitigate that risk."*

As we move into the next generation of console systems (PS3 and Xbox 2), many developers believe it will be harder and more costly to develop and maintain leading edge technology. This is especially true when you consider that publishers such as EA and others are investing millions of dollars in technology that can be used throughout their company. In the future, the ability for an independent developer to compete primarily on technology may be more difficult, and this could encourage some to look for secure publishing partners.

Leverage Marketing and Distribution

For other developers, especially in the formative years of the industry, distribution and marketing needs played a significant role in their decision to sell. Papyrus, as example, had built strong development and marketing teams, and initially sold their products through Virgin Interactive (via a 3rd party distribution deal). After Sierra acquired them in 1995, sales and profits increased due to Sierra's strong distribution channel and in-house manufacturing.

Employee Benefits

All of the developers we spoke with were concerned about the long-term welfare of their employees. As a small company, it was challenging to provide the level of health insurance, job security, and retirement benefits offered by publishers. Additionally, since many had distributed stock or options to employees, the liquidity of this benefit was ultimately dependent on an acquisition.

Personal Growth and Achievement

A less tangible but equally compelling reason for selling was the realization of a life-long dream. Most of the individuals we talked with had been in business for several years prior to their acquisition. Selling their company was a benchmark both in self-actualization and industry recognition of their achievements.

WHY PUBLISHERS PURCHASE GAME DEVELOPERS

Publicly owned publishing companies have an insatiable appetite for growth and net profits. Each is on a full-time mission to increase their revenue, trim their operational costs, and take the advantage from their competitors. Like a global sports game, they are engaged in a winner take all competition for the hearts and wallets of video game consumers. If your company can assist them in this endeavor then you could be an acquisition candidate.

But until a publisher sees material value, there is little chance that you'll find an interested partner. Publishers generally purchase developers for these reasons:

- Development expertise
- Financial growth
- Competitive advantage
- Proprietary technology
- Intellectual property

Development Expertise

Most publishers are interested in working with teams with proven capabilities, and they tend to acquire developers with whom they have worked with in the past. For most, they purchase studios in order to increase or upgrade their development ability, and all the publishers we spoke with agreed that the talent, the culture, and the experience of the team were among the most valuable assets a studio could offer.

Growth

A driving reason for purchasing an independent developer is to increase the publisher's net income. Since a public company's performance is measured by growth and profitability, if, by acquiring your company, they can increase net profits they are rewarded by their stockholders and the Stock Market. The higher the perceived value, the higher their stock price. The higher the stock price, the more money the stockholders will receive.

This point can be illustrated using our previous example of Rare and Microsoft. Prior to its acquisition, Rare had sales averaging 1.4 million units per title, with more than 90 million units sold since the company was founded.[1] If we assume that Rare is capable of continuing to deliver 8.4 million dollars annually to Microsoft's bottom line in the future, then this would reflect positively on Microsoft's annual net earnings:

1.2 Million Units Annually (slightly lower than their sales average)
*** $35 Wholesale Price per Unit**
*** 20% (An estimate of profitability per unit)**

$8.4 Million Dollars Annually in Net Income

For Microsoft, $8.4 million dollars in additional annual net income is fairly insignificant, but if you consider that their investors value every incremental net income dollar at a multiple of 21.77 times that number[2], it is more meaningful. Loosely defined, this revenue stream is valued by Microsoft shareholders at $182,868,000 (21.77*$8.4M). While this is still far below the $375 million that Microsoft paid for Rare, it does help explain how positive net income is valued.

Publishers also grow by opening new markets and genres. For example, although Electronic Arts dominates the sports genre they have little penetration in the 3rd person action genre (Crash Bandicoot, Spyro, Ratchet and Clank). If EA believed that they could earn significantly more revenue by competing in this market, it could be motivation to purchase an independent developer that specializes in this genre. The more profitable the developer, the more attractive they would be.

Finally, financial growth can also be obtained by acquiring a team to which a publisher has major financial commitments, most often in the form of on-going royalty payments. Electronic Arts' acquisition of Black Box may fall partially into this category. Black Box was the independent developer responsible for EA's hit series Need For Speed, and no doubt, EA was paying Black Box significant royalties as a result.[3] By purchasing Black Box, EA recaptured these royalty payments and acquired a proven development team.

[1] Rare, founded in 1985, grabbed the attention of the video game world in 1994 with its creation of 'Donkey Kong Country'. The game became the biggest- selling 16-bit title in history. Rare has since become one of the premiere developers in the world, with sales averaging 1.4 million units per title and nearly 90 million games sold since the company was founded. Five of its top 20 all-time-best-selling N64 titles include 'GoldenEye 007', the second-best-selling game in North America, with worldwide sales topping eight million. Junipermedia, 2004.

[2] 21.77 was Microsoft's forward P/E ratio in early February 2004. It is used here as an example only.

[3] On January 27, 2004 Reuters reported that Need for Speed Underground had already sold 5.5 million units, and was the top selling EA product during the holiday 2003 season. While NFS Underground was developed by Black Box as a wholly owned EA company, one can assume that had the acquisition not occurred, EA would have paid Black Box sizable royalties for this product.

Competitive Advantage

It is often advantageous to purchase a developer that has been successfully operating in a space where a publisher is having difficulty. It is even more attractive if by doing so they can take market share from their competitors or make it more difficult for them to compete. Activision's acquisition of Infinity Ward in January 2003 accomplished just this. A significant number of Infinity Ward's staff came from Electronic Arts where they were key developers on the hit product Medal of Honor. By acquiring Infinity Ward, Activision not only secured a proven team of specialized developers for their own World War II series, Call of Duty, but they also struck a blow to EA.

> "Infinity Ward has a very talented team of programmers, designers and artists, many of whom were members of the team that developed *Medal of Honor Allied Assault*, one of the most acclaimed PC games of last year. We are confident that this studio's development strengths will further establish Activision as a leader in the PC action genre." **Activision Annual Report 2003**

Proprietary Technology

Developers who own technology that publishers perceive as superior are often candidates for acquisition. Such was the case with Luxoflux. Activision was attracted to Luxoflux based appreciably on their cross-platform technology and their ability to bolster Activision's internal development capability.[4]

Proprietary technology is attractive to publishers, but it is often weighed against a make-or-buy decision. Electronic Arts, more than any other publisher, is capable of developing highly advanced technology in-house. But if a developer can help them enter a market more quickly, then it can be a catalyst for purchase. Jerry Bowerman, chief operating officer of EA Vancouver, felt strongly that even in light of EA's capabilities, technology was still the key, *"If they don't have a non-compete, and they own the technology, and they shipped a hit, then they are going to get acquired."*

Sierra's purchase of Headgate Studios is an example of this. In 1996, when Headgate was purchased, Sierra was expanding its Front Page Sports line of products. Although Headgate had not yet shipped a game, Sierra believed that Headgate's golf technology would allow them to enter this segment of the sports market more quickly and with less risk. For them, the purchase was justified based on future sales in a genre where they had no prior presence.

> "A previous deal, to acquire Treyarch, was done for different reasons. Treyarch had developed a popular game based on the Spider-man movie. By acquiring Treyarch, Activision instantly secured the rights to what was to become one of its top-selling games." **Robert Kotick, CEO Activision**

Intellectual Property

When Electronic Arts purchased assets from Virgin Interactive in 1998 for $122.6 million dollars, they were interested in the properties created by Westwood Studios, and in particular, the Command and Conquer franchise. Command and Conquer has been one of the best selling real-time-strategy games of all time, and by adding it to their portfolio, Electronic Arts immediately became a leader in this category.[5] While $122.6 million dollars was sizable, EA could justify it based on forecasted sales of it and other Westwood properties. Ownership of Westwood's IP was a key to the acquisition.

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[4] Activision's Quarterly Report, November, 2003: "… we have also continued our focus on establishing and maintaining relationships with talented and experienced software development teams. During fiscal 2003, we bolstered our internal development capabilities with the acquisitions of two privately-held interactive software development companies, Z-Axis and Luxoflux."

[5] February, 11 2003 Electronic Arts Press Release: "The Command & Conquer line of games is one of the most popular franchises in gaming history. To date, the franchise has sold more than 21 million units worldwide on multiple platforms, and the series has landed in several editions of the Guinness Book of World Records as the best-selling computer strategy game series of all time."

The acquisition of DMA gave Take Two ownership of Grand Theft Auto franchise, which proved later to be an incredibly profitable purchase. Sierra's acquisition of Papyrus was based substantially on the license that Papyrus had negotiated with NASCAR. And perhaps the most recent example of an acquisition motivated by a license is that of Shiny by Atari for $47 million dollars. Atari was keenly interested in acquiring the rights to The Matrix, so much so that they took out a loan in order to finance the purchase.[6]

DATING AND MARRIAGE

> "I consider a publishing contract with a developer like dating. If things don't go well, either party can break up and walk away. Selling a company is like a marriage. If things don't go well it's very messy when it breaks apart." **Jason Rubin, Naughty Dog**

Developers often refer to their publisher relationships using the analogy of dating and marriage. One developer told us that when a publisher and developer sign a development agreement for a single product, it is very much like a first date. At this point neither party knows too much about the other. Their attraction is based on what they perceive the other can do for them, and the date can either go well or terribly wrong. If it goes well, then there is likely to be a second date, a third, and perhaps, if the two continue to find each other attractive, marriage (or acquisition). Our developers cautioned young developers to consider every project and relationship a potential marriage. They advised others to "end well" on every project, since one never knows if the relationships forged on one of these "dates" might turn out to be something more permanent.

One of the most significant aspects of an acquisition is the permanence of the relationship. Once an acquisition is competed, it is nearly impossible to unwind the relationship. Borrowing from a well known expression affords us the ability to pass on a bit of wisdom: *What two companies join together is nearly impossible to pull apart*.

Because of this permanence, certain aspects of the relationship should be carefully considered:

- Culture
- Management
- Employees and redundancies
- Location
- Price
- Deal structure and performance incentives

Culture

For both publishers and developers, culture is an important component of the purchase decision. EA's Jerry Bowerman explained it this way, *"…we look at culture very carefully. What would happen if we purchased a company that had been in business for years and during that time they never worked on the weekends? Here at EA we do whatever it takes to get a product out on time. So that would cause a lot of problems for both of us."*

Not only is the work schedule an important aspect of culture, but issues can include whether employees have private offices or cubicles, whether snacks are free or paid for by the company, whether the Christmas party is small or elaborate, and literally hundreds of other subtle procedures and policies. No matter how insignificant these may be, all contribute to the heart and soul of the developer's culture.

Both parties want to make the transition as easy and painless as possible, since distractions are costly, translating into poorer product and late deliveries. The two must carefully consider the

[6] Atari's 2003 annual report notes in connection with the Shiny Acquisition, the Company obtained a $50.0 million medium-term loan from Infogrames SA.

operational procedures of the other and whether their marriage will work. If in the process of an acquisition a publisher destroys a developer's culture, then they end up killing the very thing that they worked so hard to get.

Stuart Moulder, Microsoft's GM agreed. *"Assume that most publishers are purchasing a developer to gain the benefits of the developer's creative talent (rather than just for IP or some other reason). Then a publisher needs to understand the developer's culture, respect it (it's that culture that is at the heart of the developer's success) and its people."*

Management

Independent developers are used to calling their own shots, making decisions quickly, and taking risks in order to grow their companies. For many, the idea of having to report to a "manager" is foreign and troublesome. But, once a developer is acquired they are likely to loose a significant amount of the freedom that they enjoyed as an independent.

> "After the sale, I was really surprised that Sierra wanted to make changes with our company. As the former management of the company, we felt we already knew how to run the company and only wanted to be held accountable for results, not process. Our main fight was over the control of marketing, but the whole ordeal turned off management. So we slowly gave up, stopped caring and stopped fighting change. After that, it is only a matter of time before we left." **Richard Garcia, former Papyrus Software**

For Rainbow Studios, one of the prime attractions to THQ was that Rainbow would be allowed to work autonomously. At the same time, Mark DeSimone (Rainbow President) also knew that Rainbow would be giving up ultimate control, especially in terms of the products they would be allowed to build. But they were reminded that in the process of working as an independent studio, they were dependent on their ability to convince someone other than themselves that their ideas were sound. So things didn't change that much.

Naughty Dog's Jason Rubin has been pleased with the level autonomy that Sony has allowed them continue to enjoy. He believes that this has a lot to do with the healthy relationship that Sony and Naughty Dog had established prior the acquisition. This is what he had to say about life post-acquisition: *"I don't look at my job at Naughty Dog as being any less important. I still try to make the best games possible and I still work just as long and hard at it."*

Once a developer is acquired there are significant changes to policy and procedures that restrict a founder's ability to react to market conditions. And this can be an issue that is surprisingly tough to swallow. One of the worse things an independent developer can do is to give up control of their company on paper but not emotionally.

Employees and Redundancies

An independent developer's employees are its most valuable assets. How they are treated, how their stock options are dealt with, how their health and retirement benefits are considered are sensitive issues to be discussed during the negotiation.

Because retention is an important issue for both the buyer and seller, key employees are often offered performance and retention incentives as part of the purchase. Who pays for these programs is decided in the negotiation, but clearly both parties know that retaining know-how is critically important.

While retention is critical to the success of a merger, it makes little sense for a publisher to retain a developer's employees in areas where the publisher has established leadership. A developer's sales, marketing, accounting and finance, and IT employees are often made redundant soon after an acquisition.

Location

Publishers know that creativity is closely tied to the developer's work environment. As a result, many developers continue operating from their same office after the acquisition, their lease or property being transferred to the publisher. However, it is important to understand that once an acquisition is complete a publisher has the authority to move or shut down any facility they own (unless there is a contractual obligation in place to prevent it).

EA's move of Westwood Studios in early 2003 is an example of this. Prior to the acquisition, Westwood (Virgin) had invested in a new, 50,000 square foot building in Las Vegas. The building included motion capture facilities, comfortable offices, and was a showcase not only for the video game industry but for Las Vegas as well.

"Microsoft Corp. has agreed to acquire Ensemble Studios Inc., the Dallas-based games developer responsible for the top-selling Age of Empires game franchise. Microsoft said Ensemble will continue to create titles from its Dallas headquarters. Other terms were not disclosed." **Puget Sound Business Journal 2001**

After the acquisition Westwood continued to operate from this facility, but in 2003, EA closed it and relocated key employees to Los Angeles, where they were consolidating operations with other west-coast studios. While this has surely been an adjustment for Westwood's employees, they along with other LA-based EA teams will enjoy a new 250,000 foot campus in Playa Vista.

Employees at Bungie may have faced a similar experience. After their acquisition by Microsoft in 1999, Microsoft opened Bungie West in Seattle, relocating many long-time Chicago natives there.

Price

Surprisingly, price is one of the easier issues for the parties to agree on. It is made easier primarily because both parties employ attorneys and accounting professionals who have standardized methods for assigning value to a developer's assets.

David Lee, a partner at the law firm White & Lee in Silicon Valley explained. *"One of the things we do is to help sellers determine a valuation that is justifiable. Obviously we want them to get the highest price possible. We also want to make sure that they have a clear understanding and expectation of what life will be like in the new company."*

In order to define a fair price it is important to understand the basic concepts of valuation, which are detailed in the next section.

Deal Structure and Performance Incentives

The implications of mergers and acquisitions are highly complex. Seasoned tax attorneys and accountants expend significant amounts of energy and expertise to understand the financial impact that an acquisition will have on the parties. The information included below is a generalization intended only to help you understand the basic concepts and structures.

How a deal is structured, and in particular, the tax implications for both the buyer and seller, are key issues. As with all acquisitions, the parties must decide whether to structure their deal as an asset sale, stock sale, whether it will be a tax-free or taxable transaction. Whenever possible, the parties try to maximize the overall benefits and minimize the tax implications. Generally, buyers prefer to purchase assets and to leave the developer's liabilities behind. But what developers need to keep in mind is that as a seller of assets, they are taxed on the gain. As a result, sellers (developers) prefer to sell their stock (rather than assets) and rid themselves of their liabilities.

Cash Only

Regardless of how the deal is structured, a buyer may want to fund the acquisition with cash, their own stock, or a combination of both. In the case of Rare, public records show that the acquisition was a cash sale whereupon Rare received $275 million dollars from Microsoft (Nintendo was paid another $100 million dollars).

Stock Only

In other deals, a developer may not get any cash up front. Such was the case with Headgate Studios, which was purchased by Sierra in 1996. In this deal, Headgate was given an undisclosed amount of restricted stock, which prevented Headgate from selling for a certain period of time. Obviously, there was less liquidity with restricted stock, but Headgate evaluated the risk and determined that market conditions were favorable for this type of a transaction. And it paid off. Shortly after the acquisition, Sierra was sold to CUC and Headgate's restrictions were lifted.

For George Metos of Sculptured Software, in a similarly structured acquisition by Acclaim, things seemed to go in the opposite direction. Sculptured was purchased by Acclaim in October 1995, and shortly after the acquisition Acclaim restated their income. Naturally, the stock price dropped significantly. Sculptured was able to re-negotiate and came out okay in the end—but there were scary moments in between.

Cash and Stock

Many deals are a combination of cash and unrestricted or restricted stock. The acquisition of Angel Studios by Take Two in November 2002 is a good example. In this deal, Take Two gave Angel Studios $28 million dollars in cash and 235,679 shares of restricted stock. The total value of the deal was $38 million.

The acquisition of Barking Dog by Take Two in August 2002 was similar. In this deal, Take Two paid Barking Dog $3 million in cash and 242,450 shares of restricted stock.

Debt Assumption

A publisher may also assume the debts of a developer, as was the case with Volition when they were purchased by THQ in August 2000. In this deal, Volition was given 890,100 shares common stock, 109,900 shares common stock (in the form of options), and THQ assumed $500,000 in debt incurred by the company.[7]

Incentives

Publishers often build incentives into deals that translate into additional income based on future performance by the studio. This mechanism is especially useful when the price difference between what a publisher is willing to pay is a significantly less than what the developer is asking.

> "As part of the original acquisition agreement, approximately 360,000 additional shares of our common stock could also be issued to Treyarch's equity holders and employees over the course of several years, depending on the satisfaction of certain product performance requirements and other criteria." **Activision 2003 Annual Report**

As an example, if our fictitious developer, PlayWare, Inc. has an asking price of $20 million dollars and a significant amount of this is based on anticipated net sales, then a publisher may respond with a counter-offer, saying, *"We'll give you ten million dollars now, and if you hit that sales number, we'll give you the other $10 million that you are asking for."*

Performance incentives were used in Activision's acquisition of Luxoflux in October 2002. In this deal, Luxoflux was purchased for $9.0 million dollars in cash, but the terms also specified that an

[7] 05.09.2000 THQ Inc. (NASDAQ NMS: THQI) announced that it had acquired revolutionary game developer Volition, Inc. As consideration for the transaction THQ issued approximately 890,100 shares of common stock, assumed existing Volition stock options providing for the future issuance of approximately 109,900 shares of THQ common stock, and assumed approximately $500,000 in net liabilities. The acquisition was consummated on August 31, 2000 and will be accounted for as a pooling of interests.

additional 165,000 shares of Activision stock could be issued to Luxoflux equity holders and employees over several years, depending on the "satisfaction of certain product performance requirements and other criteria." [8]

VALUATION

A key component of an acquisition is the selling price. While both the buyer and seller use the same variables, their interpretation of the values may be vastly different. Then, once a price is established, the parties must agree on how the deal will be structured, whether as an asset or stock sale, whether it will be taxable or a tax-free transaction. Because of the implications, both parties employ experienced legal and accounting advisors who evaluate each structure and determine the effect it will have on their client. For both, a major concern is the tax liability.

When determining value, the variables most commonly discussed are as follows:

- Developer's profit contribution
- Value of the development team
- Value of tangible assets (building, computers, IP)
- Value of the technology
- Strategic value

A Brief Explanation of P/E Ratio and Developer Acquisitions

From a publisher's perspective, an acquisition is often motivated by a belief that it will have an accretive effect on the publisher's stock price. While a complete explanation of this is beyond the scope of this lecture, it is useful to understand the basic dynamic of a publisher's P/E ratio and how an acquisition might affect it. As one publisher said, "*if you don't understand how the P/E ratio works, then you need to stop and learn it. It is absolutely essential to how we would look at acquiring a company*."

This greatly simplified example provides some insight:

Electronic Giant (a fictitious publisher) has a Forward P/E ratio of $24.33, meaning that for every one dollar that EG earns in net income, the stock market values their company at $24.33 times that number. Theoretically, for every additional dollar that EG earns, the value of their company should increase by $24.33.

If EG acquires an independent developer that is earning $1 million dollars a year in net income, then the value of their company could potentially increase by $24 million dollars, which is a substantial. Therefore, it is logical that EG could pay up to $24 million dollars for the developer before it would hav e an adverse affect on their stock price.

It is that it is unlikely that EG would pay twenty-four times the earning of a developer, unless there were other highly strategic reasons for the acquisition. Additionally, many of the acquisitions that were s tructured to maximize a publishers P/E ratio are no longer attractive given new accounting rules that eliminates pooling-of-interests acquisitions. Nevertheless, this exercise helps to establish a ceiling price for both parties.

Developer's Profit Contribution

A developer's income (net profit) is a tangible asset that is attractive to publishers, first because it demonstrates the health of the developer; and second because that profit, when acquired, directly affects the publisher's bottom line. Through the process of negotiation, a value is assigned to this future cash stream.

Multiple of Earnings

A simple way to determine a developer's income value is by applying a reasonable multiple to their income potential. In other words, if PlayWare, Inc. is earning Y million dollars per year in gross income, then one could argue that given today's standards, they could reasonably ask for Y times X, X being a multiplier that both parties agree is fair. What is fair? According to one source, a 1X multiplier would be the lowest a developer should consider today. But keep in mind that most developers have received many more times than this.

[8] Activision 2003 Annual Report .

P/E Ratio
If a developer is profitable (and to be a desirable acquisition candidate most are), a value can be determined based on the positive impact the developer's net income will have on the publisher's bottom line. Often this value is determined by using the publisher's P/E ratio as a basis (see insert on previous page). Since the P/E ratio reflects the value stockholders place on the publisher's net income, a percentage of this maximum value can be used to justify the purchase price of a development studio. While this method is used today, it was more popular before pooling-of-interest acquisitions were eliminated.[9]

Value of the Development Team

Another way to determine a developer's value is by assigning a minimum value to their employees. Using current industry multipliers, a developer's employees are often valued at $100,000-$150,000 each (although one developer told us that $200,000 was a fair price). The reasoning behind this is fairly straightforward: If a publisher were to hire, train, and retain an equally effective employee, how much money would they have to spend to do so? $100-$150K per employee is a fair assessment.

EA's Jerry Bowerman provided a simple explanation, "*What does it cost you to recruit, train, and make productive an employee? It's not hard to get a floor value of $100,000 per employee*."

While the "average" employee may be valued using this method, certain individuals possess knowledge and know-how that is valued significantly higher, especially if their skills are in demand by the publisher. As an example, an average employee at id Software (makers of Doom and Quake) might be valued at one rate, but cofounder and lead programmer John Carmack's personal value and contribution to the company would certainly be measured altogether differently.

Value of the Technology

Perhaps the most valuable asset (other than people) that a developer brings to the negotiation table is its proprietary technology. When it comes to technology, EA enjoys a position few can duplicate.

> "An October 11 acquisition of 30-person Luxoflux is typical. That company has proprietary technology that allows video game coding to be easily replicated to run on alternative gaming platforms. That process has often been quite time-consuming, costly, and bug-ridden." **Robert Kotick, CEO Activision**

Whether EA buys or builds technology is mostly dependent on timing and cost. If an independent developer can deliver technology that allows EA to take market share from their competitors or to open new markets quicker and safer, then there is a basis for a relationship. EA's acquisition of Black Box is a good example. In just 3 ½ years, Black Box was able to start their company, develop core technology, and ship thirteen games (two PSX, four PS2, three Xbox, three Gamecube, and one Dreamcast)—all of which were top sellers. Clearly, EA could see that technologically something very good was happening at Black Box.

But as we look to the future, some believe that the window of opportunity for technology-based acquisitions is closing, especially given that the technology advances made recently are less obvious to consumers. The message Grand Theft Auto's success sent throughout the industry was that video game sales are not necessarily driven by technology. Accentuating this perception are the advances and stability of middleware such as Renderware. Publishers and a few independent ventures are continuing to invest millions of dollars in engine technology that

[9] The Financial Accounting Standards Board (FAS 141) eliminates the pooling-of-interests method for mergers, and also specifies the criteria for the separate recognition of intangible assets and goodwill. For more information on pooling of interest, see http://www.kirchman.com/comply/alerts/ea1299-3.html

can be amortized across a broad number of products. If this trend continues, generalized developer software could ultimately loose value.

THE DEAL

Once the parties have determined that there is mutual interest in an acquisition, a tremendous amount of work must be completed in order to finalize the sale.

Whether it was brought forward by an agent, investment banker, or the publisher themselves; at some point the publisher will present the developer with an offer, which is often done verbally at the conclusion of a series of meetings.

If the developer is interested in moving forward, the publisher creates a letter of intent (LOI). This document, which can be as few as three or as many as fifteen pages, spells out in broad terms what the publisher is prepared to offer. Often, the LOI has been preceded by broad verbal agreements on both sides. Nevertheless, rarely is it signed without changes. The LOI summarizes the general terms of the agreement:

- Structure of the deal (whether purchase of assets, stock exchange, or other)
- Structure and nature of the compensation (cash, common and restricted stock)
- Timing
- Incentives and performance milestones

Once the LOI is signed it sets in motion a number of activities. On the developer side, a team of attorneys and accounting professionals begin assembling volumes of information requested by the publisher:

- Verification of asset ownership (property, IP, technology)
- Verification of employee compensation and employee contracts (non-competes, IP transfer)
- Verification of income and expenses
- Verification of debt and liabilities
- Verification of non-compete agreements and other encumbrances

The developers we spoke with advised others to be prepared in advance for these requests. Attorney David Lee agreed, saying that an important task his firm undertakes is to prepare clients legally and financially for the acquisition process. In the end, everything of substance is contained in the acquisition transaction documents. Lee recommends that as early as possible a developer should seek counsel, since a tremendous amount of work is required to help a developer determine a fair valuation for their company and to ensure that documents, licenses, and other diligence issues are in order.

Two of the biggest mistakes a developer can make are to overstate the value of assets or fail to secure ownership of their IP. If either occurs there is bound to be a price adjustment, since publishers almost always make their offers contingent on clear ownership of property and realistic values.

Simultaneously, the developer's accountants and attorneys are engaged in other equally time consuming tasks:

- Assessment of a publisher's solvency and projected value of stock
- Collecting and presenting accounting information
- Collecting and presenting IP ownership documents
- Assessing tax implications

- Developing and presenting counter-proposals based on their findings

Despite the consuming nature of these tasks, a deal can move rather quickly. It is not unusual to have an entire law firm devoted to a purchase, with attorneys specialized in tax, contracts, acquisitions and other areas moving in and out of the deal as necessary.

"The smart publishers know who the good developers are and so there is always that possibility of being in competition. Usually publishers will not want to get into that situation though, for obvious reasons. So there is always sniffing going on, but a publisher will usually try to restrict discussions to just them at some point early on to keep the conversations two-way. "**Stuart Moulder, General Manager, Microsoft**

Time

How long does it can take to complete a deal? Most acquisitions are concluded in as few as two or as many as nine months. Most of the deals we studied took two to three months on average to complete.

Ken Williams, former CEO of Sierra, cautioned that acquisitions that take too long to finalize are less likely to go through. Once a publisher makes a decision to purchase a developer, they want to proceed quickly.

Competition

When asked whether offers from a publisher's competitors made a difference in the ultimate price, the answer from most all was "yes". At the same time, both parties cautioned not to over-use this leverage. Most felt that an overly aggressive negotiation could leave bitter feelings, which would be a poor start to a permanent relationship.

In a "humility is strength" posture, developers also advised to avoid situations where it would be perceived that they were "approaching a publisher" about their interest in being acquired. Like a teenager waiting to be asked to the prom, eagerness ultimately weakens a developer's leverage. David Lee summarized this principle nicely, *"Your leverage goes completely the opposite way when you're looking for someone to buy you as opposed to someone knocking on your door."*

"Honestly, that would put me off. It says that the developer's focus and energies are being diluted by issues outside of the creative and technical realms where their true value lies. If the company is perpetually in "please buy us mode", they are probably making some decisions about their time and money that run in conflict with making an awesome game." **Stuart Moulder, General Manager, Microsoft (Regarding developers who groom for acquisition)**

Publishers agreed. And to the opposite extreme, most avoid entering a bidding war for developers. While there was some flexibility in their price, prior to an acquisition most had already determined what they were willing to pay. Ken Williams looked at it this way, "*I preferred to deal without the bankers – primarily because this meant the deal wasn't being shopped to the high bidder. I had a policy of never being the high bidder."*

Publishers are also not attracted to developers who groomed themselves for acquisition. They made it clear that they are only interested in purchasing developers who have made and shipped hit games. Their advice to those wanting to be purchased: *Make great games*.

The Negotiation

Most of the developers we spoke with spent nearly fifty-percent of their time throughout the process in acquisition related activities. Decisions regarding management structure, employee benefits, incentives, and countless other decisions could only be made by them. At the same time, all were represented by experienced attorneys and accounting professionals.

Publishers often have an acquisition team in place or the ability to assemble one quickly. When Sierra was actively involved in acquisitions, their core team consisted of a lead counsel, business development VP (also an attorney), and a VP of business development (whose job it was to provide an integration and transition plan). So busy where they that they had a room at their corporate headquarters in Seattle converted into an “acquisition room” where developer documents were collected and studied.

As information is being collected, the parties engage in a series of negotiation meetings, each designed to find agreement on countless issues. At some point, they find agreement and a final set of documents is prepared.

Final Purchase Document

At the conclusion of a negotiation a final purchase agreement is compiled. This agreement, whether an asset purchase or a stock exchange, is a collection of documents that detail the understanding:

- Purchase agreement and exhibits:
  - List of assets (mortgages, equipment, etc.)
  - Lease details (office, equipment)
  - Bills of sale
  - IP agreements and ownership
  - Employee agreements and non-compete agreements
  - Transition agreements, including incentive and bonus plans

WHAT CAN GO WRONG?

Not all developer acquisitions have happy endings. Deals based primarily on a publisher’s stock can sour if the stock takes a nose dive. Developers we spoke with advised that the stock you receive is only as good as the company behind it.

On a related note, most developers understand the implications of restricted stock but may neglect to consider that once their company is purchased they become employees of the publisher. As such, they are subject to the same insider trading regulations as other officers in the publishing company. As with all public companies, there are notifications, waiting and black-out periods that can restrict company insiders from selling their stock.

“Compatibility between cultures and respect for the workings of our culture were very important factors, particularly THQ’s desire to leave us to what we do best.”
Mark DeSimone, Rainbow Studios

Beyond the financial implications, the parties should carefully consider the other’s culture. An acquisition is a permanent deal, and neither party is keen to give up how they conduct business. What is clear, however, is that a continued clash of cultures is a loosing proposition for both parties.

For publishers, the value of an acquisition is almost always dependent on the continued involvement of key-employees. If key individuals leave prematurely it causes irreparable harm to both parties. Many of the publishers we talked with could recall developers who had lost interest soon after their acquisition, and their disappointment in these developers was obvious. Microsoft’s Stuart Moulder told us that because they know just how important this issue can be, Microsoft invests a considerable amount of time in evaluating the motives of developers before they acquire them.

It is also not uncommon for employees to be resentful when a few individuals reap huge benefits from the sale of the company. This too can cause harm.

On a completely different but important note, it is hard to predict how success may affect someone who has sacrificed and risked much to obtain it. Vance Cook, co-founder of Headgate Studios, talked about this in relation to his partner, who was killed last year in a flying accident. "*I've heard several stories of people selling their company, going out and buying sports cars and airplanes, and very quickly meeting their death in them. This wasn't exactly the case with Mark (Mr. Cook's partner), but it is a phenomenon that individuals selling their companies might want to consider."* This is a sobering reminder that business success should always be kept in perspective.

THE FUTURE

> "I don't believe graphics are going to sell games in the future. A lot of the most popular games these days are not the most impressive (graphically), whereas that used to be the case."
> **Jason Rubin, Naughty Dog**

With the consolidation that has recently occurred in the industry, one wonders how long the window of opportunity for developer acquisitions will remain open. In some respects, with the stabilization of technology, it is becoming more difficult for independent developers to compete on this feature alone. At the same time, it is a mistake to underestimate the creativity and ingeniousness that has propelled this industry from infancy into a multi-billion dollar a year industry.

Publishers made it clear that when they are acquiring a company, they are buying talented people. And we know that creativity, ingenuity, and invention will always be in demand. And as such, there is no end to what independent developers will be able to offer publishers.

FINAL NOTES

We have learned that developers are purchased because they have something tangible to offer: technology and know-how that is superior to the competition and companies that are healthy and driven by a love of the game. When they began, some of the developers we spoke with may have had wild dreams of becoming wealthy, but few started their companies solely to get rich. They just wanted to make cool games.

In the long run, what happens after the sale? For Don Mattrick, who sold his company, Distinctive Software, to Electronic Arts in 1991, life is pretty comfortable. Mr. Mattrick is president of Electronic Arts Worldwide Studios and over the course of EA's climb to the top he has enjoyed wealth and success beyond imagination. Few have experienced this level of financial success, but most of the developers we spoke with have benefited greatly from the sale of their company.

Surprisingly, though, what impressed me most was the genuine enthusiasm and love of games and technology that embodied the interviews I conducted. No doubt it was this love that propelled these developers to the top of their field. And no doubt it was because of this that their companies were purchased.

REMAINING QUESTIONS

The subject matter presented is incredibly broad and complex, and no doubt there are lingering questions, especially as they relate to developers who are interested in being purchased. The questions and answers below may be helpful:

Q. How do you find publishers interested in purchasing development studios?
A. Most often publishers approach developers. Some believe that when a developer approaches a publisher it weakens their negotiation leverage.

Q. Who exactly sells your company?
A. Acquisitions are a team effort, usually lead by an attorney experienced in mergers and acquisitions. It is not uncommon to have a team of a dozen or more highly qualified attorneys and accountants working on your acquisition.

Q What do publishers look for and how do they justify a purchase price?
A. Publishers look for developers who have proven track records making hit games and innovative products. They justify the purchase price based on a fair multiple of the developer's revenue (or revenue potential), assets, technology, intellectual property, and employees.

Q. What is the single most important thing I can do in order to be acquired?
A. Unanimously, the publishers we spoke with agreed that in order to be considered for acquisition you must develop a creative, innovative, hit title.

Q. How important is proprietary technology and IP?
A. It depends on the publisher. In general, proprietary technology is very important, since it usually will allow the publisher to improve the creation of other games as well. Intellectual property can be equally compelling, provided it has broad appeal.

ABOUT DAN ROGERS

Dan Lee Rogers, the president and CEO of BizDev, Inc., has been at the forefront of consumer technology pioneering development and marketing strategies for the world's most successful software and technology publishers, including Sierra On-Line, Virgin Interactive, and IBM. Over his career, he has been associated with some of the biggest hits in the consumer interactive market.

Mr. Rogers is a dynamic speaker, published author, and noted authority on interactive software development. He contributes to Game Developers Magazine, Gamasutra On-Line, Game Developers Conference, and other prestigious interactive game publications and forums. He lives with his family outside of Yosemite National Park.

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