

FW: updated draft

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 Attachments: Final Draft Executive Session - 38 Studios.ppt (989.18 kB)

Tony & Maureen,

This is the deck being presented on 38 Studios in Executive Session today. There may be one or two final tweaks...but 99% there. You are both scheduled to participate in a conference call tomorrow at 10:00. We will provide a call in number soon.

Mike

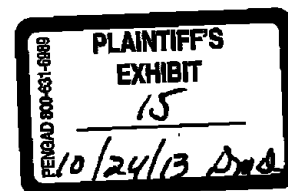
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Rhode Island
 Economic Development Corporation
Building the 21st Century Innovation Economy

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Building the 21st Century International Economy

Executive Session Briefing:

Video Game Industry & 38 Studios Opportunity

RIEDC Board Meeting
6/9/10

J. Michael Saul

Draft: Not for Public Record

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Video Game Industry

◆ Size & Growth...

- \$72 billion global industry including both hardware and software revenues
- Global Revenues projected to reach \$124 billion by 2013.

◆ Market...

- More than 2/3 of American Households play PC or video games.
- Average gamer is 35 years old.
- 42% of American households own a gaming console.
- By 2014 60% of American households forecasted to play an "online" game

◆ Dynamics...

- Online gaming industry has advantage of generations of loyal users
- Increasing market penetration and rising average user age
- Constantly evolving technology ensuring users fresh and exciting product

◆ Clustering...

- Nearly 70% of US video game companies are in one of 7 metro regions
- Boston ranks 6th and NYC ranks 5th in # of US companies

◆ Jobs & Workforce...

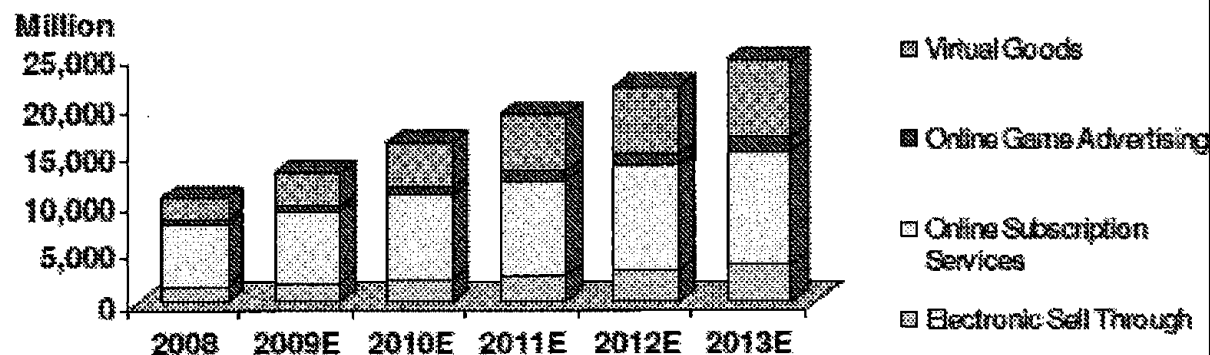
- More than 1,200 jobs in Massachusetts' video game industry
- Types of jobs include: Engineering, Artist, Game Designer, and Quality Assurance

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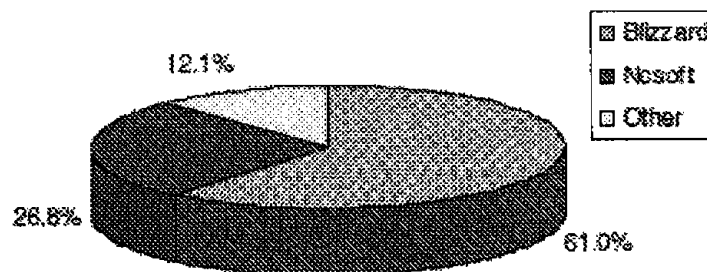
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Video Game Industry

Online Game Revenues by Component



2009 Global MMORPG Share Total Market \$2.05 Billion

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Rhode Island's Video Game Assets

◆ RISD

- Majors: Film Animation Video, Graphic Design, Illustration, & Digital Media
- Curriculum includes culture, story, media, art, design, and technology
- Many RISD grads & interns currently work in the video game industry
- Over 100 RISD graduates stay in RI each year & over 3000 RISD alum in MA and RI

◆ URI

- Computer Science curriculum includes interactive and collaborative gaming track as well as computer programming, software engineering, & interactive 3D graphics research
- Gaming track led by Dr. Jean Yves-Herve

◆ Brown

- Computer Science & Visual Arts curriculum includes software engineering, 3D animation, & innovating game development
- Strengths in machine decision and game theory, interfaces in virtual reality
- Dr. Chad Jenkins author of "Creative Games: Mechanics, Content & Technology"

◆ RI Companies Involved in Video Games, and Digital Animation

- Hasbro
- GTECH

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Rhode Island's Economic Opportunity

◆ Job Creation

- 450 direct jobs & 3.4 employment multiplier 1,100 total jobs
- Estimated income tax revenue in excess of \$5M per year
- Spawning potential = 200 direct & 686 with multiplier – within ~ 5 years
- Leverage video game industry growth and growth of industry jobs in Boston market

◆ Build Creative and Knowledge Industry

- Develop a vertical market that intersects some of Rhode Islands best growth assets
- Commercialization of ideas is faster and requires less capital than other knowledge economy industries

◆ Foster Entrepreneurial Activity

- Spark starts within RI's most active entrepreneurial communities
- Wide range of industry entry points given the breadth of platform opportunities
- Talent, dynamic anchor, assets like RISD etc are key components

◆ Retain Talent

- Provide compelling job opportunities for local college graduates
- Develop feeder programs at RI universities

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Company Background

- ◆ Two studios
 - 38 Studios in Maynard, Ma (86 employees)
 - Big Huge Games (BHG) in Baltimore, Maryland (79 employees)
- ◆ Project Mercury
 - Single player multi platform game for release in fall 2011.
 - Publishing and Retail Distribution Agreement between EA & 38 Studios.
 - Ownership and IP on Mercury remains with 38 Studios. EA responsible for all development and marketing costs. 38 Studios responsible for game completion. Revenue sharing and royalty arrangement once EA recoups investment. EA investment north of \$50.0 million. Year 1 revenues projected at \$20.0 million +.
- ◆ Project Copernicus
 - 38 Studios Games developing a Multi-player Online Game (MOG)
 - Targeted for release in 2nd half of 2012
 - Year one subscription revenue projected at \$46.0 million.

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Management & Visionary Team

Management team includes 100+ years of industry specific executive and development experience with top tier companies such as EA, Sony Online, Comcast, Nintendo, etc.

- **Jennifer MacLean, CEO**
 - Comcast, VP of Games - products, strategy, and business development.
 - Chair Emeritus of the Board of Directors of the Int'l Games Developer Association
- **R.A. Salvatore, Executive Creator of Worlds**
 - Author on NY Times and WSJ best selling lists
 - Lucasfilm, New Jedi Order series of novels and Attack of the Clones.
 - Wrote 40 novels which have sold over 15 million copies worldwide
- **Todd McFarlane, Executive Art Director**
 - Creator of "Spawn" comic book and Emmy Award winning HBO series
 - Owner McFarlane Toys
 - Artist of Spider Man comic books for Marvel/Epic comics
- **Curt Schilling, Founder**

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Design & Production Team

Extensive Expertise in RPG Genre, MMOG Design and Development:
over \$11B in Shipped Product Sales

- Lead Designers from:
 - Morrowind, Oblivion, Fallout 3
 - World of Warcraft
 - EverQuest and EverQuest II
 - Rise of Nations, Rise of Legends, Catan, Civilization II
- Selected Titles from other Team Members:
 - Star Wars: The Force Unleashed
 - Fable
 - Half-Life

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38 Studios Project Details

- ✦ Relocation & Expansion - 450 jobs to RI by 12/31/12
- ✦ Average wage ~ \$70k/yr
 - Programming, engineering, artist, designer, production, quality assurance
- ✦ Proposed transaction
 - \$75.0 million credit enhanced bond issue pending passage of Job Creation Guaranty Program
 - ~ Likely 20 year issue with 10 year call
 - ~ 1/2 of 1% fee upfront
 - ~ 1.5% annual fee on outstanding bond amount
 - ~ Earnings recapture to create an additional funding source for entrepreneurial ventures
 - ~ Total state return > 10% = fees + income tax + fund for investment
- ✦ Minimum equity covenant
- ✦ Collateral includes lien on all company IP
- ✦ No tax credits until loan is repaid
- ✦ Job Shortfall Penalty fee of
 - \$7,500 per job...over 300% of income tax benefit per job

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Project Risks and Rewards

- ◆ **Pre-revenue company**

- Top tier management team to complete both Mercury and Copernicus
- Publishing and Distribution Agreement (PDA) between EA & 38 Studios on Mercury
- \$11.1M invested by EA to date out of commitment of \$19.7M for production costs
- EA recently committed to additional investment of \$2M for marketing expenses
- EA reviews 500+ proposals per year and selects less than 10%
- EA assumes 4 to 5 million unit sales of Copernicus, 38 Studios conservatively estimates 3 million unit sales
- All milestones met to date on PDA, reviewed by EA & First City National

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Project Risks and Rewards

- **Product not yet branded**

- Original IP makes up majority of top games historically
- EA contributing to Mercury marketing efforts
- Pre-release of Mercury as chapter in Copernicus
- 38 Studios will brand Copernicus using downloadable content packs and “beta keys” with Mercury customers
- Buzz around people – McFarlane and Salvatore are followed like rock stars
- Toy line by McFarlane Toys
- Comic Books drawn by Todd McFarlane
- Prequel book to the Copernicus story written by R.A. Salvatore

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Project Risks and Rewards

- ◆ Changing industry dynamics due to technology
 - Flexibility to adopt new technologies in pre-production phases of future releases
 - Example: Option to incorporate motion sensing technology via downloadable content
 - Ability to adjust from subscription to “Freemium” pricing model using “free to start” and “chapter based billing”
- ◆ Product Revenue Shortfall/Repayment
 - Company’s “worst case” (> 70% reduction in EBITDA) financial projections reflects full repayment
 - Loan repayment break-even is 25% reduction in company’s “worst case” scenario
 - Expertise to create new single player games to supplement earnings as needed
- ◆ Upside
 - Tax revenues, repayment of principal + interest & fees
 - Utilize moderate financial ROI to seed an industry focused investment fund

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Company "Most Likely" Projections

In 000's	2010	2011	2012	2013	2014
Revenues	\$0	\$20,748	\$65,455	\$195,423	\$218,333
Operating Expenses	\$34,931	\$47,683	\$75,193	\$114,112	\$120,475
Net Profit	(\$39,537)	(\$34,913)	(\$17,743)	\$74,657	\$56,390
EBITDA	(\$34,931)	(\$26,935)	(\$9,738)	\$81,811	\$97,858
Debt Service	\$4,606	\$7,977	\$8,005	\$17,868	\$15,021
Debt Service Coverage	-7.58	-3.38	-1.22	4.58	6.51

Assumptions

- Mercury release 09/2011, sell 1.7 million units 2011, 1.4 million units 2012
- Copernicus release 09/2012, 2.0 million box sales 2012, 600k subscriptions 2012, 1.0 million subscriptions 2013, 1.2 million subscriptions 2014 & forward.
- New Role Playing Game every 2 Years, each 30% more successful than prior
- New Online Game every 4 years
- Debt Service: 10 year term, 3 year interest only, 7 year level principal

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Company "Worst Case" Projections

In 000's	2010	2011	2012	2013	2014
Revenues	\$0	\$20,748	\$65,455	\$90,923	\$77,933
Operating Expenses	\$34,931	\$47,683	\$75,193	\$61,000	\$60,437
Net Profit	(\$39,537)	(\$34,913)	(\$17,743)	\$21,970	\$11,191
EBITDA	(\$34,931)	(\$26,935)	(\$9,738)	\$29,923	\$17,496
Debt Service	\$4,606	\$7,977	\$8,005	\$17,868	\$15,021
Debt Service Coverage	-7.58	-3.38	-1.22	1.67	1.16

Changes in Assumptions from "Most Likely"

- Copernicus subscriptions drop from 600k at outset (2012) to 300k annually 2013 & forward

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RIEDC Break Even Projection

In 000's	2010	2011	2012	2013	2014
Revenues	\$0	\$20,748	\$65,455	\$83,039	\$75,314
Operating Expenses	\$34,931	\$47,683	\$75,193	\$61,000	\$60,175
Net Profit	(\$39,537)	(\$34,913)	(\$17,743)	\$14,874	\$8,833
EBITDA	(\$34,931)	(\$26,935)	(\$9,738)	\$22,039	\$15,139
Debt Service	\$4,606	\$7,977	\$8,005	\$17,868	\$15,021
Debt Service Coverage	-7.58	-3.38	-1.22	1.23	1.01

Changes in Assumptions from Company "Worst Case"

- New Role Playing Game every two years; Game 2 (2013) initial sales equal to Mercury initial sales, second year sales increase by 20% over Mercury second year sales levels
- Follow on Games must perform equal to or better than Game 2

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Due Diligence Process

- ◆ **Wells Fargo**
 - Reviewed Private Placement Memorandum for Equity Offering
 - Discussed with Wells' Capital Market team their due diligence process and conclusions
- ◆ **Strategy Analytics & Perimeter Partners**
 - Identified potential economic and employment benefits of project
 - Confirmed that RI has the necessary components for cluster development
 - Confirmed that 38 Studios opportunity would accelerate cluster development
 - Provided insight to the critical success factors necessary for 38 Studios and Cluster Development
- ◆ **RIEDC**
 - Completed normal credit due diligence
 - Independent conversations with industry players (e.g. Providence Equity, Hasbro and others)
 - Research on industry

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Next Steps

- ◆ Strategy Analytics (SA) & Perimeter Partners (PP) final report
- ◆ Finalize Total RI Return of 10+% based on the sum of (1) guaranty fees plus (2) direct state income tax benefit of new jobs plus (3) profit sharing recapture to establish an equity fund.
- ◆ Negotiate term sheet
- ◆ Board approval
- ◆ Confirm with EA all company representations

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