Online Game Business in Russia

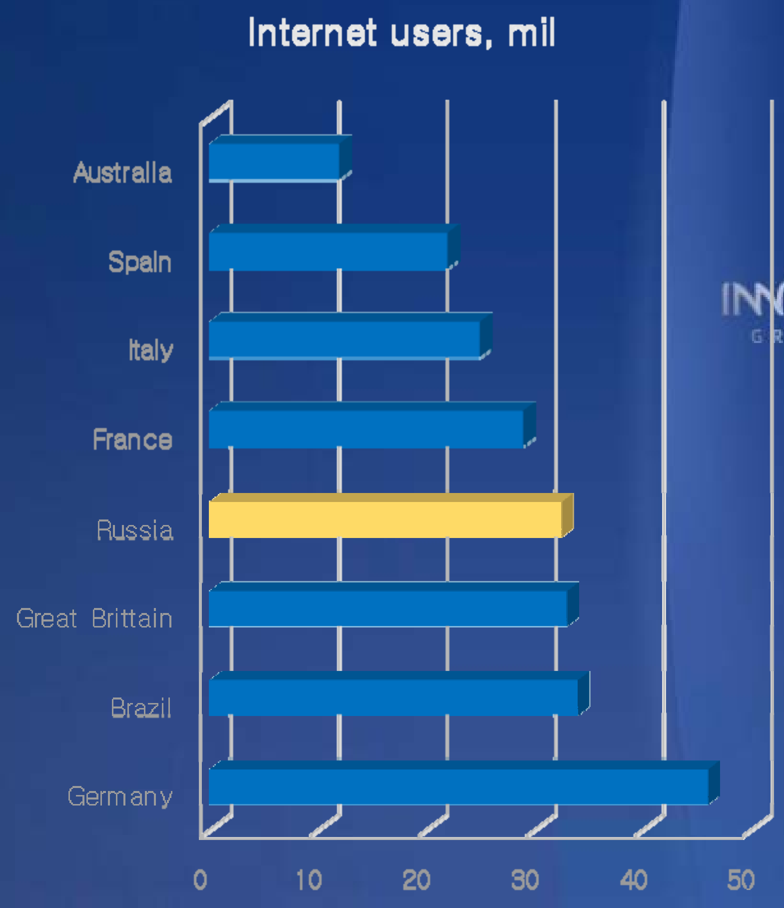
Are Bears a Threat to the Fiber-Optic Backbone?

Sep 10, 2008

Ilya Verigin
Innova Systems, biz dev VP
verigin@innovasystems.ru
http://en.innovasystems.ru

Outline

general words and basic figures on why russian market is so hyped



Market Size: Monetary

- Nearly 100% growth for past several years
- 75-85% growth prognosis for 2009 and 2010

•Bigger part of the market is still with flash and browser games

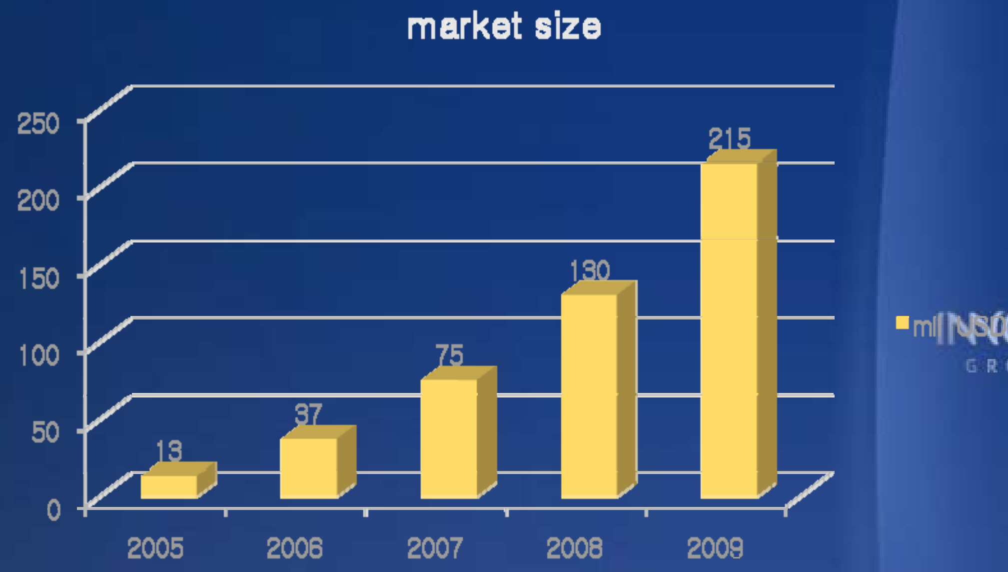
•Relatively high ARPU

  - •$20-70 client based hardcore MMO
  - •$10-50 casual MMO and flash
  - •$3-20 browser-based MMO

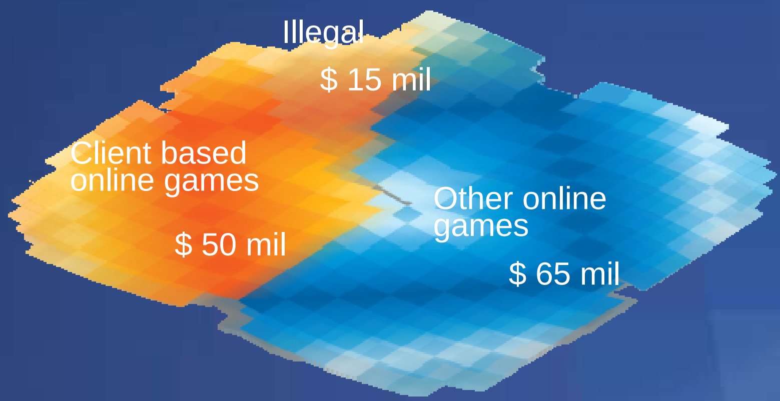
•Relatively high percentage of paying users in case of client-based games

  - •10-25% client based hardcore MMO

•“Wild spender” phenomenon



2008 market breakdown



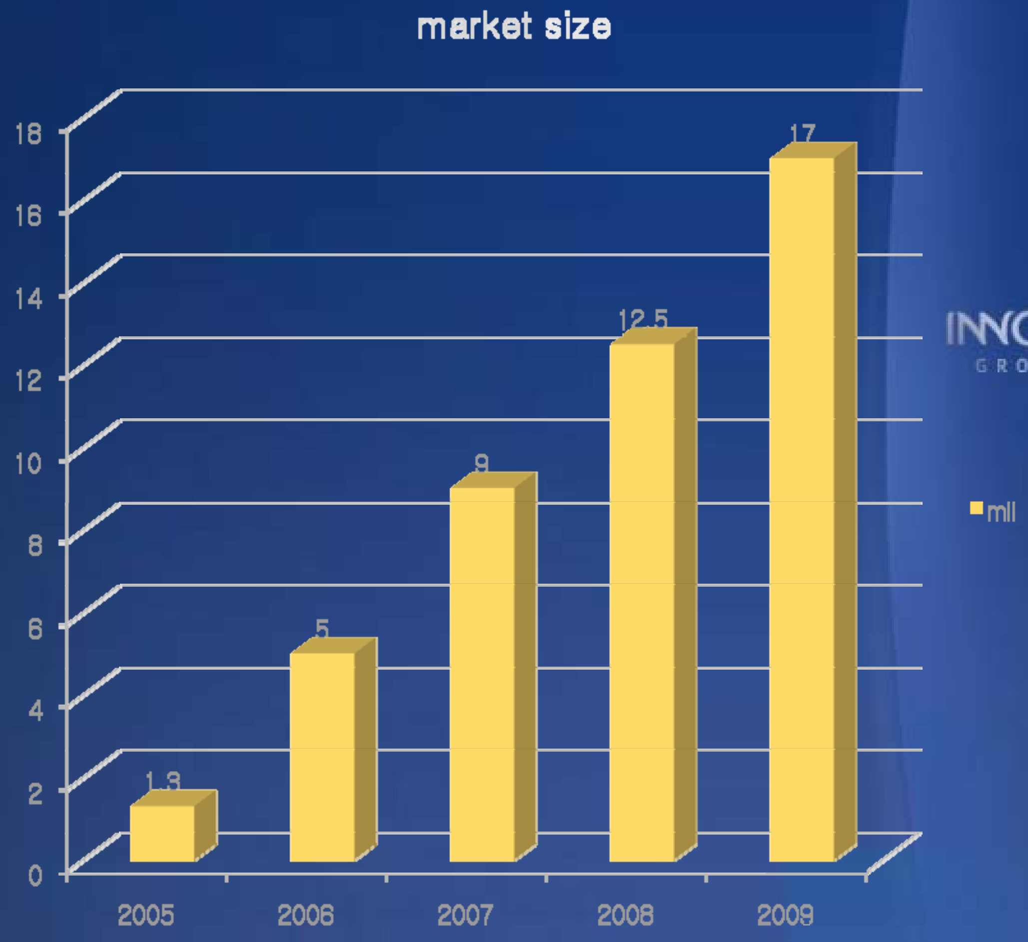
Market Size: Customers

- Slightly lower growth rate (30-40% for 2008, 2009) compared to the monetary value of the market indicates increase in customers' spending
- Online game players constitute up to 40% of the overall Russian Internet population – 32 mil in 2008

- Demographics similar to overall worldwide
- Age span widening
- Female players number grows

- Online games is #2 most popular reason for Internet use

- 95% of customers play from home
    - Negligible PC Café share



INNOVA GROUP

Market: Overall Situation

- Shifting focus from browser- to client-based games
  Top 5 browser games:
    - Carnage (Carnage.ru)
    - Legend: Legacy of the Dragons (IT Territory)
    - Territory (IT Territory)
    - Ganja Wars
    - Fight Club

- Growing number of client-based MMO games in the market:
  – Ragnarok (Gravity Russia)
  – Everquest II (Akella)
  – Tales of Pirates (Nival)
  – R2 (Innova)
  – RF Online (Innova)
  – Lineage 2 (Innova)*
  – Ace Online (Innova)
  – Fortress 2 (Innova)
  – World of Warcraft (Blizzard)
  – Voyage Century Online (Netville)
  – Pirates of the Burning Sea (Akella)
  – Perfect World (Nival)
  – Requiem (Gravity Russia)
  – Granada Espada (Nival)
  – 9 Dragons (PlayTen, Gfi)*
  – Allods Online (Nival)*
  – Age of Conan (1C)*

* - not yet available to public

- Business model:
  – Predominantly F2P
  – Small chance for higher quality titles to go for P2P
    - More risky
    - No significant ARPU gain / may be loss
    - Fewer taxation , business definition issues
  – Ad based biz model games are few and have not proved well
    - Fight Club (Finam IC)
  – Proliferation of partnership programs in case of browser-based MMO / flash games
    - Numerous merits
    - Distribution / marketing mechanism
    - Hard to maintain quality and brand consistency

Market: Overall Situation

- Growing interest and attention to the industry
- Major international publishers entering the market
  - EA Russia
- Extensive attention from non-related major businesses
  - Mr. A. Mamut (Troika Dialog IC)
  - Finam IC
  - Gazprom Media
  - RBK
- Corporate mergers / acquisitions
  - Astrum Online holding
  - Mr. A. Mamut (Troika Dialog IC)
- High profile / value deals in related business areas
- Number of newcomers and startups
  - Often, sadly, quite hopeless

Market Size: Growth Perspectives

- 2009, 2010
  - 75-85% market capitalization growth
  - 30-40% customer base growth

•Growth sources

Organic growth:

•PC penetration (10-15% growth)

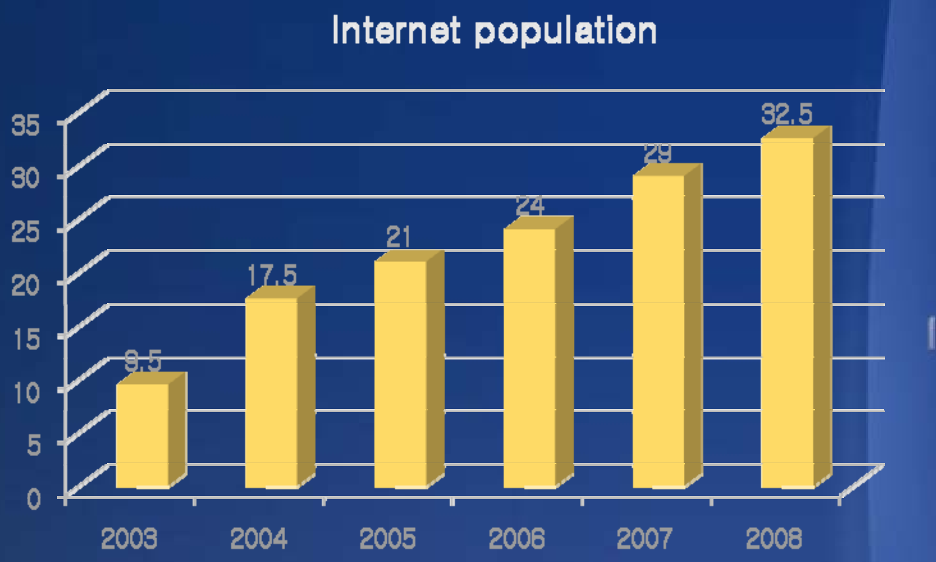
•Internet penetration (15-20% growth)

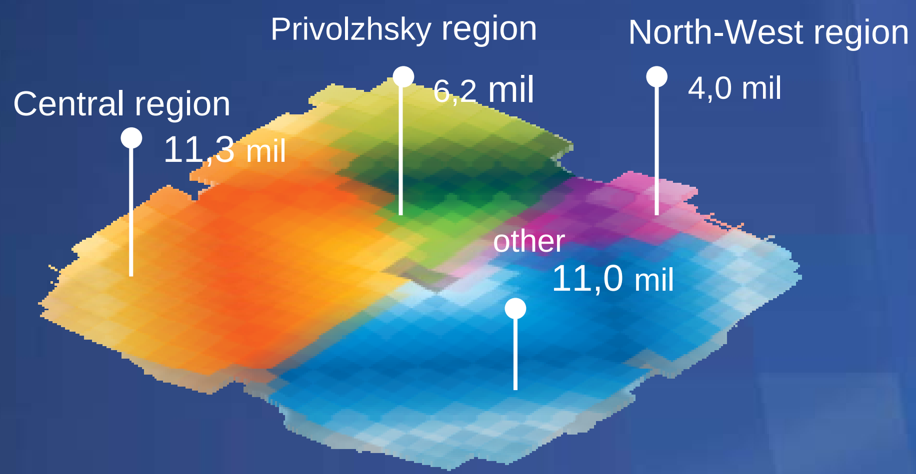
•Broadband penetration (40-50% growth)

Single-player game players migration

•Client-based online game growth (additionally)

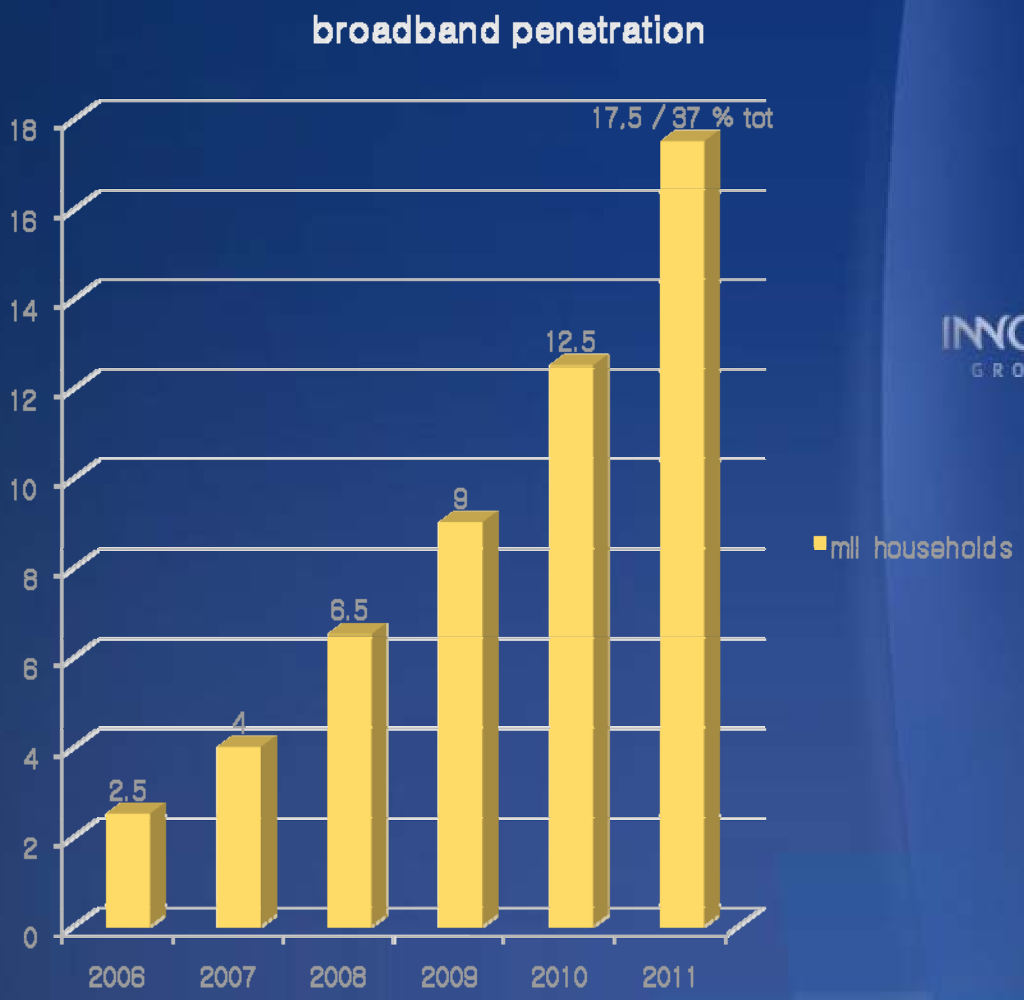
Browser -based game players migration





Online Game Biz Environment: Internet and Infrastructure

- High performance fiber-optical backbone network
  - Rostelecom
  - Transtelecom
  - Sinterra
  - Vympelcom (Golden Telecom)
- Quickly developing last-mile
  - Comstar Direct
  - Corbina Telecom
  - AKADO
  - NetByNet
  - QWERTY
  - North-West Telecom
  - R-Telecom
  - Svyaz'invest regional daughter companies
- Backbone ISPs going into end-user market
- Broadband penetration: 6,5 mil households, 40-50% growth
- Predominance of flat-rate plans in Moscow, but expensive traffic in regions
- Lack of high standard IDCs, especially in regions
- Need to develop a lot of infrastructure internally / lack of relevant services (CDN, etc)



INNOVA GROUP

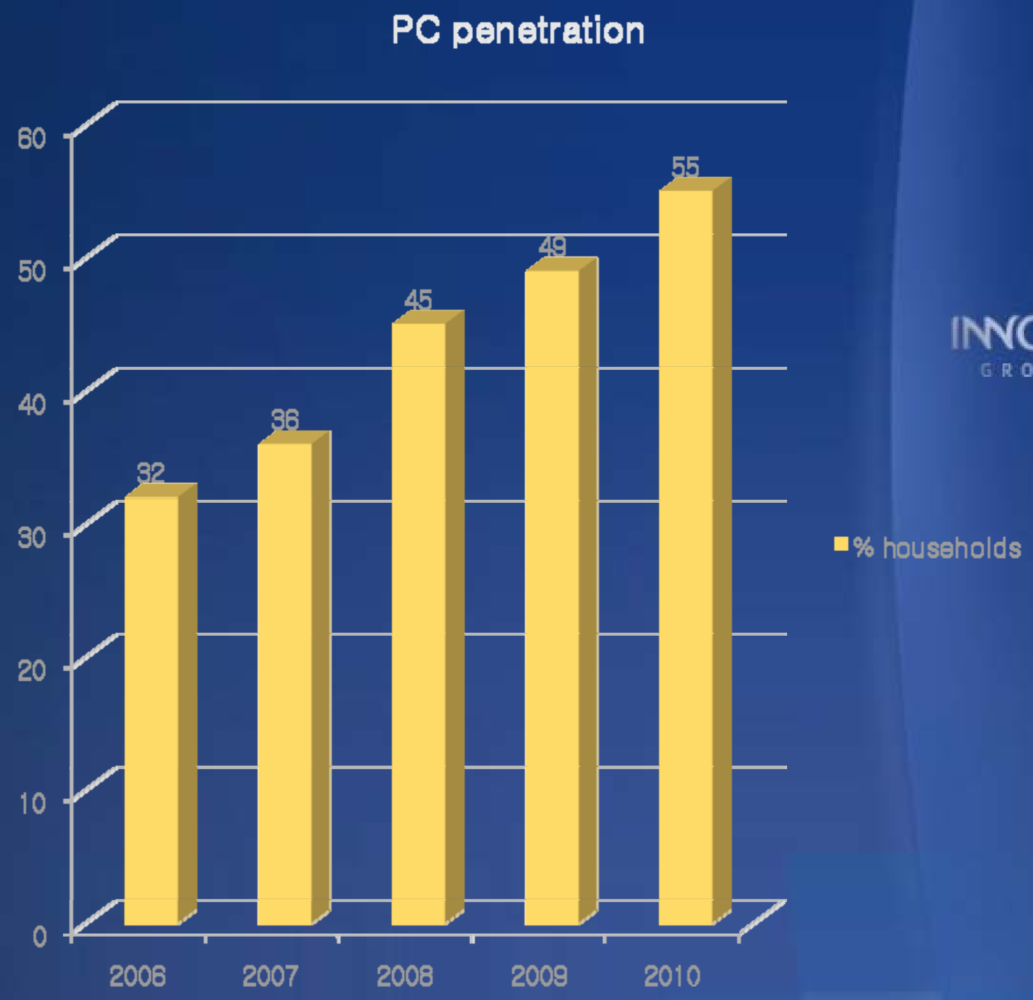
Online Game Biz Environment: PC

- PC penetration: 45% of total households, 10-15% growth

- Relatively high average PC specs:
  - P4 1500 GHz CPU
  - 1GB RAM
  - NVIDIA 5600 video
  - >60 GB HDD

*or similar

- 95% of customers play from home
  - Negligible PC Café share



Online Game Biz Environment: Payment Gateways and Infrastructure

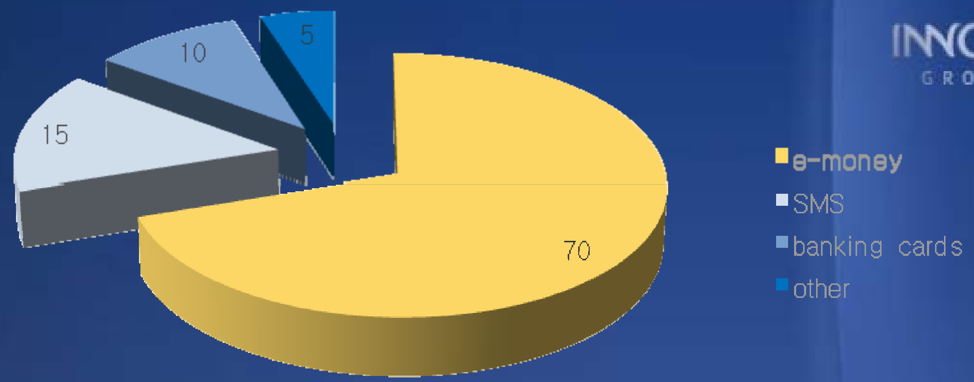
- Highly developed payment infrastructure
  - E-money
    - Yandex Money
    - Web Money
    - Mail.ru Money
  - Prepaid (scratch) cards
  - SMS payments, subscriptions
  - Banking cards
  - Payment terminals
    - OSMP
    - E-port
    - Cyberplat

  Over 30 000 terminals in Russia

- Available globally, despite low banking card penetration level

- Legal and tax issues with certain PG types, specifically e-money

MMOG payments breakdown ,%



INNOVA GROUP

Online Game Biz Environment: Market and Customer Specifics

•Relatively high loyalty
•Tendency to self-organize
•Not "spoiled" yet
•Competitive (psychographics)

•Relatively high ARPU and paying customer percentage
•"Wild spenders"

•Currently hardcore-centered
•Developing actively in casual direction

•"Wild spenders" are:
- •Hardcore and/or
- •Achievers / dominators and/or
- •Philanthropist

•Demographic focus: 18-27 male; higher education, earner
•Age span is widening in both directions
•Historically very low percentage of female customers; grows considerably as of late

Online Game Biz Environment: Law and Regulations

- Virtually no governmental regulations / relevant laws
  - Creates immense difficulties in defining online game business for authority relations purposes
  - Creates immense difficulties in defining business models other than subscription or one-time sales
  - Benefits fair business (as any government non-involvement)
    - But leaves it exposed to unfair accusations
  - Does not protect the customers from unfair business
- No rating systems
- Risk of censorship / enforceable web resource registration requirement introduction
- Sporadic legislative initiatives; no clear perspective
- Serious corruption issue
- Various challenges associated with taxation
  - Due to difficulties in defining the business within Russian law
  - Due to corruption problems

INNOVA GROUP

Online Game Biz Environment: General Overview

- Biz environment – specific and challenging
  - Cultural challenges
  - Historically high probability of fraud / swindle deals
    - Has been decreasing along with overall business culture improvement
  - High percentage of fraud from customers
  - Corruption
  - Bureaucracy
  - Numerous difficulties and complications in dealing with authorities / complying with regulations
  - Taxes
    - Up to 70% of the gross revenue
  - Widespread dilettantism; lack of competent managers
  - Lack of qualified staff on all levels of game publishing / development business
  - High and rising operational cost of business
    - Human resources
    - Capital resources
    - Monetary resources

Online Game Biz Environment: General Overview

- Russian business practice negative specifics:
  - Tendency for short-sightedness, immediate benefit / gratification as the priority
  - Low value of partnership. Can often be traded for more immediate – even if much less significant – benefits
  - Very high "human factor" and "ambitions factor"
  - Usually overall hostile competitive attitude
  - Planning and commitment are not of the highest value; widespread entrepreneur-style approach
  - Often negligible value of moral and ethical aspects of business

- Russian business practice positive specifics:
  - High value of oral agreements
  - Creativeness in problem solving
  - Openness to new things, adaptability
  - Importance of personal relations

Online Game Biz in Russia: Good and Bad Parts

Good

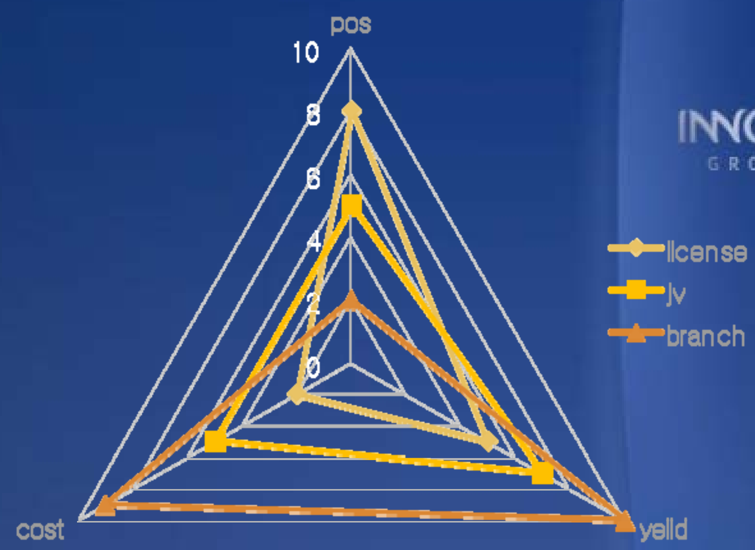
- High growth potential
  - Internet penetration within target population (113 mil): 28%
  - Online games is #2 most popular reason for Internet use
  - 40-50% broadband Internet penetration growth
- Well developed Internet infrastructure (particularly, backbone)
- Top notch payment infrastructure
- Favorable market specifics, such as user behavior, ARPU etc, and tendencies

Bad

- Very challenging business environment
  - Corruption
  - Fraud / swindle
  - Lack of “service” attitude
  - Business cost
  - Staff
- Taxes: big (up to 70%) and difficult
- Oligarchic intervention into the industry
- Growing competition
  - Lowering margins
  - Growing customer power

Online Game Biz in Russia: Prospects and Opportunities

- Licensing
  - Good partner is of paramount importance
    - Technically
    - Marketing-vise
    - CS / GM / etc operations
    - Overall management culture
    - “Administrative resource”
- Joint enterprises
  - Local management is the key
  - Look for a partner with the “administrative resource”
  - Prepare for high costs
- Branch office
  - Local management
  - Even higher costs
  - No “administrative resource” means a very serious handicap



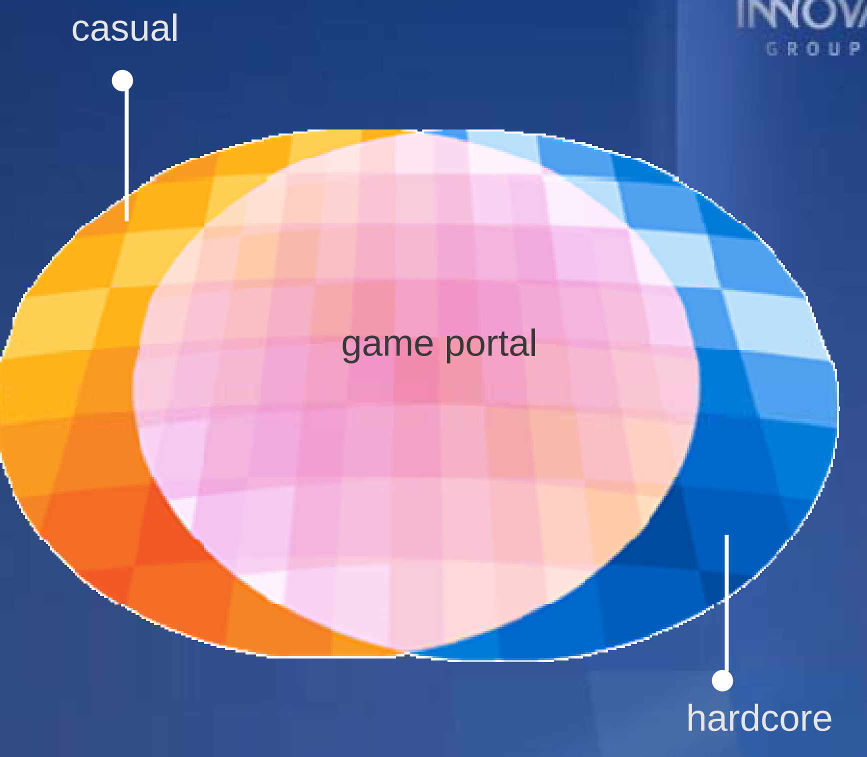
*pos – probability of success

Online Game Biz in Russia: Prospects and Opportunities

- Casual
  - The new king of the hill
  - Russia combine Asian and European ways well accepting both casual games as time passers and “party fun” – socializing experience
  - Tendency to show good ARPU, considerably higher than browser-based MMO games
    - $10-50 casual MMO and flash
    - $3-20 browser-based MMO
  - Expecting ARPU to increase further
  - Access to wide audience (massive traffic) is a certain prerequisite

- Classic (hardcore) MMOG
  - Will look more like niche, but only in comparison with the emerging casual segment
  - Overall will remain solid, but will suffer from user “spoiling”
  - Best ARPU: $20-70
  - Highest paying user percentage
  - Most “wild spenders”

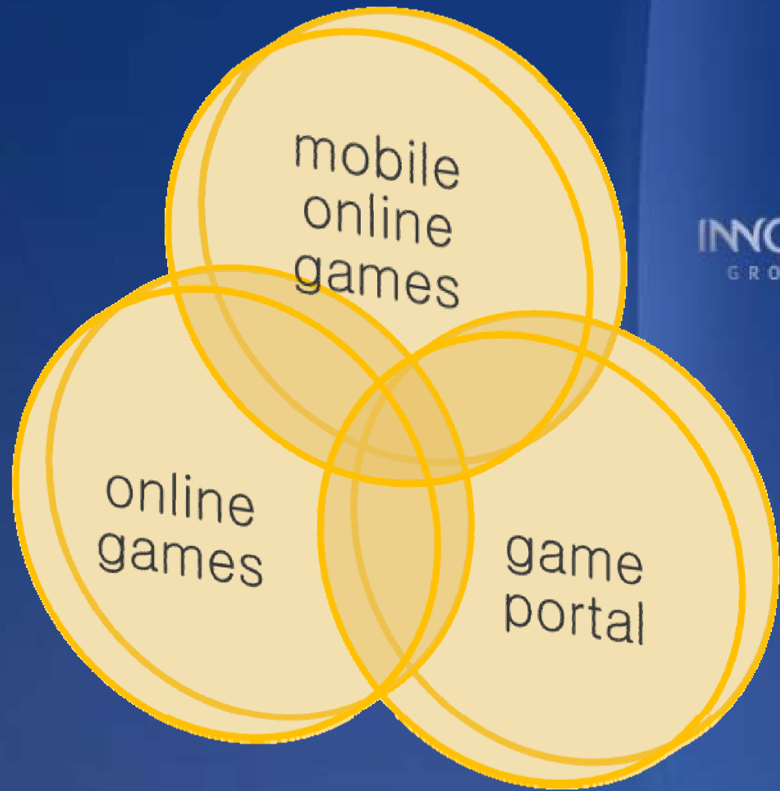
- Game portal
  - New (no full-scale precedent exist)
    - Unknown customer response
    - High potential
    - First mover advantage
    - games.mail.ru
    - ag.ru
  - Synergetic with casual games
  - Will benefit from partnering / channeling with a major traffic source
  - Can develop into a more diverse entertainment / content portal



INNOVA GROUP

Online Game Biz in Russia: Prospects and Opportunities

- Mobile MMO
  - Mobile Internet market #3 in Europe
  - Mobile game and content market in Russia: over $100 mil in 2007
  - Single player games are yesterday
    - High competition
    - Loosing in face of mobile SNS and online games
  - MTS online mobile game *test* launch in Q3 2008: $0.5 mil / 3 month
  - Growing number of 3G phones



Summary

- Russian market is the place to be; very appealing
  - Good stats
  - Even better perspectives
    - If you're up to the challenges
- Russian market holds a lot of serious challenges
  - It's extremely difficult for a foreign company to work on it directly
  - Professional, reliable partner is the key
- Russian market is growing in size and consumption level. The customer wants high quality up to date contents
  - Casual
  - Hardcore
- Growing opportunity for mobile online games and SNS

INNOVA GROUP

So, Are Bears a threat to the Fiber-Optic Backbone?

Your questions, please

NO

Ilya Verigin
Innova Systems, biz dev VP
verigin@innovasystems.ru
http://en.innovasystems.ru