



**GAME DEVELOPERS[®]
ASSOCIATION OF
AUSTRALIA**

SUBMISSION TO COMMONWEALTH GOVERNMENT

**REVIEW OF AUSTRALIAN GOVERNMENT FILM
FUNDING SUPPORT**

GAME DEVELOPERS' ASSOCIATION OF AUSTRALIA

August 2006

TABLE OF CONTENTS

BROADER CONTEXT: WHY THE GDAA IS SUBMITTING TO THIS REVIEW.....	3
BACKGROUND AND OVERVIEW OF SUBMISSION.....	5
1. THE AUSTRALIAN GAME INDUSTRY IN A GLOBAL CONTEXT.	8
1.1 Impediments to Industry Growth	
1.2 Industry Vision	
2. ATTRACTING INVESTMENT: GAME INDUSTRY INVESTMENT STRATEGY- PROPOSAL FOR GOVERNMENT ACTION	13
2.1 Establishment of a Games Investment Fund	
2.2 Extension of 10BA	
2.3 Extension of Refundable Tax Offset	
3. PAY-OFFS FROM GOVERNMENT ACTION.....	26
4.CONTACT PERSON.....	26
ATTACHMENTS.....	27
1) Background: GDAA	
2) GDAA Achievements Over Past Three Years	
3) Electronic Games Investment Fund (EGIF)	
4) Industry Context: Summary Data	
5) Australian Game Industry Profile	
6) Incentives Offered by Other Territories	

BROADER CONTEXT: WHY THE GDAA IS SUBMITTING TO THIS REVIEW

The Government has invited submissions to a Review of Australian Film Funding Support. An Issues Paper and Terms of Reference have been made publicly available. The Terms of Reference indicate that:

- i) the scope of the enquiry is broad ranging and all Australian government programs for film funding are within its scope, and
- ii) there is a recognition that 'there is no single definition of 'film' and that it can be interpreted in many different ways.' (p4 Terms of Reference.)

In previous submissions to Government, the GDAA has argued that the current policy framework and incentive structure for film and television has skewed investment into particular areas of the entertainment industry ie film and television while sectors such as games and audio-visual/post production are not afforded the same treatment. The end result is that the current environment does not provide a level playing field. Policy frameworks and funding/incentive structures have created a series of individual silos ie film, television, games, post production/audio-visual, new media etc with no overarching framework..

The recent Digital Content Industry Action Agenda report to the Australian Government, *Unlocking the Potential: Summary* (Strategic Industry Leaders Group, April 2006) identified six key areas for strategic action. These included:

1. Stimulating market interest in investment
2. Confronting international competition
3. Rectifying disadvantage created by the historically-based analogue/digital distinction
4. Recognising digital content as a general purpose technology for the twenty-first century
5. Filling skills gaps in a leading edge industry, and
6. Building a total industry from a fragmented base.

The GDAA supports focused action in each of these areas as they all impact on the future growth of the local games industry. Recognising that future policy frameworks should reflect a 'total industry' in the context of a technology neutral content delivery environment is a significant outcome of the SILG process and the GDAA considers that this needs to be the starting point for any current and future reviews relating to the digital content industry, of which film is clearly a part.

The GDAA has consistently argued for the need for a broader view of the digital content space. However, having said that our specific focus is on what we would term the 'entertainment' component of that space. That is, those sectors producing entertainment product such as games, film, television, new media/online, audio-visual, post production. Moving forward, there is an urgent

need for a significant paradigm shift in the way in which future production of entertainment content is supported.

It is not the business of the GDAA to comment on current barriers to future growth experienced by the film industry nor would we comment on the appropriateness and effectiveness of current film funding mechanisms and activities, except where they directly disadvantage the local games industry, through exclusion. Our focus in submitting this proposal is two fold. That is to:

- i) identify a fundamental weakness of current government policy which currently treats various parts of the digital content sector as separate silos with no overarching framework, and
- ii) present a case for government mechanisms to support the growth of the Australian games industry. While the proposed initiatives outlined here are games specific, they were developed through examination of existing mechanisms available to both the film industry but also more broadly in the ICT sector (ie the proposed model for the Games Investment Fund).

It's Time for a Paradigm Shift

The GDAA believes that the Australian game industry's future growth and ability to compete globally is currently constrained by two key areas of market failure and distortion. These are firstly, imperfect capital markets, including information asymmetries and a lack of mechanisms allowing for risk diversification, and secondly market distortions created by Government policies that skew investment towards alternative sectors within the digital content sector.

The Australian 'entertainment industry' ought to be presented and marketed offshore as a 'one stop shop' for entertainment product. We have the current skills, capability and reputation for producing internationally competitive product across the board. There is absolutely no reason for Australia not to attract large scale franchise properties so that when we're pursuing a film property, we pursue the game license or vice versa. As an example, The Matrix film trilogy was shot in Australia. The game was produced in California but the QA was done by Atari Melbourne House. Australia could have produced that game. We need to have a more coherent strategy for attracting these increasingly inter-related products. On the other side, there may be license owners looking at placing a game in Australia where the film industry would look to secure the film. While the GDAA has established relationships with the film industry locally and AusFilm in Los Angeles, the two sectors operate largely as separate industries. While there are skills and networks specific to both, with rapid convergence across the entertainment sector, especially in the US, these boundaries are increasingly becoming blurred.

The games industry in Australia was born global, is totally export focused and produces commercial product. Unlike the film industry, the games sector does not apply a cultural content argument as a rationale for government support of game product locally. Game products produced in Australia are produced for a global market. However, it can be argued that there are significant social and economic benefits for Australia with local studios employing large numbers of staff with demand for local graduates at an all time high. For example, in the past twelve months we have seen the top five independent game studios in Australia grow by fifty percent. Growth in exports and local employment would be much greater and faster if there were sufficient investment attraction and skills development incentives in place.

The balance between commercial and cultural objectives is a delicate one. Going forward, the GDAA would argue that it is both timely and of paramount importance for government to put in place a consistent framework that underpins the broader digital content/entertainment policy context. Any future content policy framework, including government support mechanisms, need to be delivery channel neutral.

Urgent action is required to reposition the entertainment sector as we face increasing competition from a range of highly aggressive territories offshore. Rapidly emerging game development markets such as China, India, Russia and the Eastern Europe 'hot spots' (Prague and Zagreb) provide on average forty percent cheaper production compared with Australia. At the same time, countries such as Singapore, China and Korea offer significant incentives to attract game production and establishment of studios in their territories. Singapore is right now trying to attract many of our major studios away from Australia and actively pursuing international publishers and developers. The global entertainment industry is changing rapidly and Australia needs to move quickly to ensure it is well positioned going forward to capture its potential share of the global market pie.

BACKGROUND AND OVERVIEW OF SUBMISSION

In its submission to the House of Representatives *Inquiry into the Future Opportunities for Australia's Film, Animation, Special Effects and Electronic Games Industries*, the GDAA made a number of initial recommendations as to how the Commonwealth Government would be able to assist the Australian game industry.

Matters raised by the GDAA in its submission included action to assist the industry in raising its domestic and international profile, encourage skills development, support industry R&D and assist international marketing and promotion activity. The game industry, in conjunction with governments, has action in hand to address these essential elements of an industry development strategy.

While action in each of these areas is of considerable importance to the game industry, unless the crucial issue of access to investment capital is addressed, the ongoing efforts of the industry, State Governments and the Commonwealth Government in these areas will be insufficient for the industry to reach the critical mass required for sustained long-term growth. The GDAA actively participated in the Minister's Strategic Leaders' Industry Group (SLIG) with our Vice-President representing our industry on both the SLIG and Investment Working Group and the CEO sitting on the Skills and Training Working Group. Summary information on the GDAA and Recent Achievements are provided at Attachment 1 and 2 respectively.

In November 2003, the GDAA presented its *Game Industry Development Strategy* which proposed two key actions for Government: establishment of a Games Investment Fund and extension of Division 10BA. Since presentation of that report, the GDAA has continued to look for ways to drive investment into the local game industry. Specifically, this has involved educating the investment community and support for the establishment of an Electronic Games Investment Fund (EGIF) via a PDF license, The EGIF was launched in late October 2005. Summary information on the EGIF is provided at Attachment 3.

This submission builds on our previous business case and argues that there is now more than ever a very strong case for Commonwealth Government to address market failures within the capital market. Each of the following recommendations for Commonwealth Government action are targeted at addressing failures within the capital market facing electronic game developers. Together, the three policy initiatives proposed would address the current difficulties that the game industry confronts in trying to raise capital from either individual or institutional investors and in attracting production from offshore. Should these initiatives be adopted, the game industry would be well placed for rapid and sustained growth.

It should be noted that the issue of access to capital is not unique to the game industry. Indeed many of the barriers experienced by the film, television, post-production, audio-visual sector are consistent with the problems the game industry faces.

The three key actions recommended are that the Commonwealth Government:

- **Implement a Game Investment Fund (GIF) program** – the objective of the GIF program, consisting of an *institutional fund* program modelled on the highly successful Innovation Investment Fund program and an *individual fund* program somewhat analogous to the Film Licensed Investment Company (FLIC) scheme, would be to encourage the establishment of active capital market for games investment through establishment of pooled funds of institutional and individual capital;

- **Extend the Division 10BA of the Income Tax Assessment Act to the game industry** - the objective of the extension of Division 10BA arrangements to games would be to facilitate improved access for the game industry to directly attract investment by individuals in game content development; and
- **Extend the Refundable Tax Offset to the game industry** – the key objective would be to attract next generation high value game productions to Australia. However, access to the RTO would also provide a significant incentive for local investment in game titles.

The implementation of these initiatives, designed to place the Australian industry on a sustainable high-growth pathway, would require a relatively modest level of government assistance.

Given the high potential economic benefits associated with the game industry, implementation of the proposed policy measures set out in this submission should generate strong net benefits for the wider Australian economy.

Access to an optimally functioning private capital market for game investment is necessary if the Australian game industry is to develop to its full potential.

The following submission provides an overview of the Australian industry in a global context, impediments to future growth are identified and the three recommendations for the Games Investment Strategy are detailed. Examples of incentives for the games sector offered in other international territories are also provided.

1. THE AUSTRALIAN GAME INDUSTRY IN A GLOBAL CONTEXT

The Australian electronic game industry is a significant, but poorly understood, contributor to the Australian economy. It is also part of a larger global entertainment industry (now bigger than film box office) and a major export industry. Our industry's export earnings are already impressive compared with other software and media content sectors and the industry believes there is strong potential for delivering exponential growth in the next 3-5 years.

In its submission to the House of Representatives Inquiry into *Future Opportunities for Australia's Film, Animation, Special Effects and Electronic Games Industries*, the GDAA argued that there is now a window of opportunity to aggressively grow the industry and increase Australia's share of the global pie: more investment, more export dollars, more jobs.

The game industry in Australia is currently a niche player within the rapidly expanding global game industry. It is characterised by its high export orientation, the high-value added nature of employment within the industry and by its synergies with other creative industries such as filmed entertainment and software development. The Australian game industry possesses important strengths, namely the quality and cost effectiveness of Australian programming and creative talent. However, despite these strengths, the industry currently faces an uncertain future as the global industry undergoes significant structural change.

Summary statistics on the global game industry are provided at Attachment 4.

Locally, the Australian game industry has experienced significant growth and attracted overseas investment.

The local electronic game development industry comprises over 40 companies spread throughout Australia, with major clusters in Queensland and Victoria. Around 1 000 people are employed with growth expected to reach 2000 within five years. The industry exports over \$100m worth of exports per annum and future projections are that this will rise to \$500m by the end of the decade, assuming investment growth.

Australian companies have developed over 200 internationally successful games and currently enjoy a reputation for being creative, delivering product on time, with relatively low production costs.

A profile of the industry is provided at Attachment 5.

1.1 Impediments to Industry Growth

The rising complexity and cost associated with game development in general, and console game development in particular, is driving the need for developers to achieve greater scale in their operations. Critical mass is needed in the Australian industry if it is to be able to carve out a sustainable growth position within the global market.

Given the continuing growth and reach of the global market, our local game developers have a window of opportunity to grab a larger slice of the global pie.

However, there are some major impediments to leveraging this opportunity:

- **Transition Phase to Next Generation Consoles**

The games industry globally is currently in a transition period moving to next generation consoles ie we're moving from PlayStation2 and Xbox to PlayStation3 and Xbox360. This transition is far more significant than any previous transition phase in the history of games development. In the new environment we will see project budgets of \$US15 -20m with project teams of 120 people plus full-time for two years plus significant growth in outsourcing as developers look to manage overheads and growth in demands for art production. This compares with the current console environment where budgets are of the order \$US7-10m with project teams of around 40-50. The growth is exponential and unprecedented. It also means we will see less projects overall but larger scale productions particularly of franchise properties.

The impact this transition period to next generation console development will have on the long term viability of our local industry is of major concern.

There are two key issues here:

i)our ability to grow **critical mass** and ensure we have the skills required to produce larger scale projects plus our own IP, and

ii)the urgent need for an **investment** environment and incentives that enable our studios to:

-create and retain more of their own IP (including significant prototype development)

-seek licenses from offshore that can be produced in Australia, and

-access capital that enables them to negotiate better deals.

We are already seeing less fee-for-service projects on the global market and while all of our medium-to-large size studios are recruiting right now to manage production of current projects, we are already seeing an overall decline in the number of fee for service projects available. At the same time, publishers are increasingly looking to mitigate risk which presents a real opportunity in terms of

alternative deal structures but only if the investment environment exists to leverage it.

- **Competition from other territories which offer significant incentives to attract game production** and establishment and growth of game studios. In particular, Canada, Korea, Malaysia, the United Kingdom and France are offering incentives for international production and relocation/establishment of game studios. Attachment 6 provides a summary of these incentives. At the same time, emerging markets such as China, Taiwan, Holland and Eastern Europe are all aggressively pushing for growth in their respective territories. Australia currently has no incentives available to compete at this level and in the next generation environment, this will be critical. As noted in the SILG Report, competition from offshore is a challenge for many parts of the digital content industry but for the entertainment sector, it is a huge issue.

In this context, the Australian game industry has 12 months max to position itself to continue competing in a rapidly growing but increasingly more complex market.

If we are unable to establish an investment structure that supports growth, the industry may not survive. Moreover, we are also losing projects to other territories that offer significant incentives that we can't compete with.

One likely scenario is our major studios become targets for acquisition by multinationals at cheap fire-sale prices as they bleed companies to death through lack of project deals with maybe some smaller developers in the wireless and hand-held space achieving niche market status. This will not be enough to maintain a sustainable industry going forward.

For the Australian game industry right now, it's fly or die!

- **Dominance of overseas based publishers and distributors** who constitute the industry's key investment market. There are currently plans locally to create an indigenous publisher; this is dependent on investment decisions yet to be finalised.
- **Our level of profile with offshore publishers and investors;** while we have put significant effort into this area, now more than ever before it will be critical to remain 'in the face' of our export markets ie publishers, distributors and investors at shows such as GDC (US), Europe and Asia.

1.2 Industry Vision

Given all of the above factors, the GDAA has a very clear vision for the next three years. If this vision is realised, the benefits to the Australian game industry will be significant.

Our Vision

If current market failures are addressed, our vision for the Australian game industry in 2010 would include:

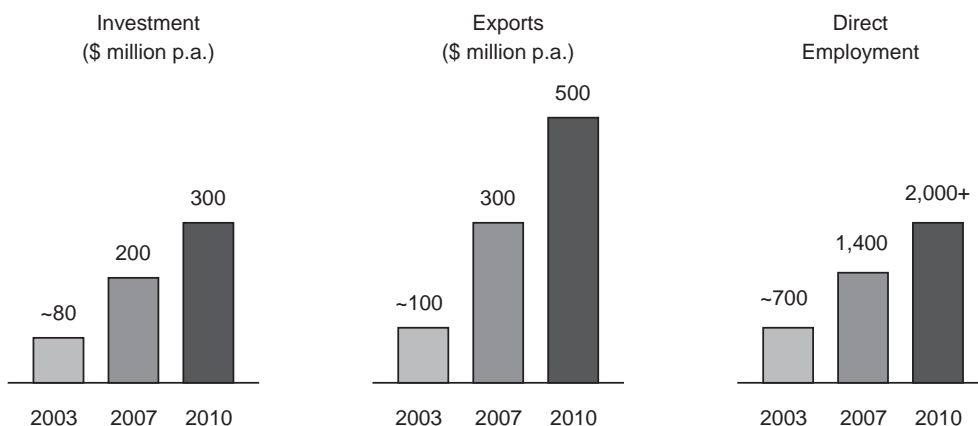
- Industry ownership of a considerable IP portfolio that both generates a strong royalty stream and positions the industry to create and retain ownership of follow-on game titles;
- The industry is able to buy rights to valuable existing content franchise licenses;
- Recognition of Australia as a centre of game development excellence with a sustainable position within the rapidly expanding global industry;
- Australian and international investment into the game industry totalling \$300 million per annum;
- Game exports exceeding \$500 million per annum;
- Direct industry employment exceeding 2,000; and
- Reflecting increasing synergies between different forms of digital content, the game industry being an important part of a vibrant creative content cluster in Australia.

Deliverables

The key performance targets, in relation to investment, exports and jobs, that the industry would be seeking to achieve over the remainder of the decade are set out in Figure 1.

Figure 1

GAME INDUSTRY DEVELOPMENT: KEY PERFORMANCE INDICATORS



Our proposed Federal Government policy interventions in the game capital market would directly result in over \$225 million in additional Australian investment into the industry over the remainder of the decade.

By 2010, the industry would aim to attract at least \$300 million per annum in total investment, four times current levels. Higher levels of investment into the industry will in turn generate higher employment and export earnings.

The growth rates that the game industry is setting itself to 2010 are both impressive and achievable. For example, investment would grow by over 20 per cent per annum and exports by over 25 per cent per annum. However, achieving exports of \$500 million per annum by 2010 does not represent an upper limit on potential industry performance. Should the industry develop, and fully exploit, just two or three global 'hit' titles, exports could reach even higher levels.

2. GAME INDUSTRY INVESTMENT STRATEGY: PROPOSAL FOR GOVERNMENT ACTION

The Australian game industry to date has largely self funded investment and growth and there are many areas that the industry will continue to accept responsibility for in the future. However, for the industry to grow to the next level and continue to compete globally, the GDAA believes that implementation of a well designed, targeted and integrated set of policy initiatives, as proposed, would address current market failures, facilitating rapid expansion of the local industry over the next decade.

The GDAA proposes three key initiatives that would support rapid growth:

- 1) Implementation of a Games Investment Fund with both institutional and individual components**
- ii) Extension of Division 10BA to the game industry, and**
- iii) Extension of the Refundable Tax Offset (RTO) to the game industry.**

An indicative cost/benefit summary is shown in Table 1:

TABLE 1: INDICATIVE COST/BENEFIT SUMMARY FOR INITIATIVES

Initiative	Costs	Direct Benefits
Game Investment Fund Program: <i>Institutional Funds</i>	Upfront capped investment of \$40 million drawn down over four years plus associated government administrative expenses. However, over a ten year time frame there are strong prospects that the Government would recoup its \$40 million upfront investment.	Additional investment in game production of at least \$60 million (includes a minimum \$20 million of matching private sector funding) over a four year period. This investment would support around 120 full-time jobs in the industry for four years (which would generate PAYE tax revenue totalling over \$12 million over the period) and exports totalling over \$60 million.
Game Investment Fund Program: <i>Individual Funds</i>	Cost in foregone revenue totalling around \$4.5 million over the 2004 to 2008 period plus associated government administrative expenses.	<i>Direct benefits</i> Additional investment in game production of at least \$30 million over the 2004 to 2008 period. This investment would support around 60 full-time jobs in the industry for four years (which would generate PAYE tax revenue totalling over \$6 million over the period) and exports totalling over \$30 million.
Extension of Division 10BA	Net foregone tax revenue rising to \$1.7 million p.a. by the end of the decade plus associated government administrative expenses.	Additional investment in game production rising to \$11 million per annum by the end of the decade. This investment would support around 85 full-time jobs in the industry (which would generate PAYE tax revenue totalling over \$2.1 million per annum) and exports exceeding \$11 million per annum.
Extension of Refundable	\$9.375m in tax credits which Government would	Additional investment in game production of \$75 million over 3 years. This

Tax Offset (RTO)	provide on \$75 million of investment plus associated administrative expenses	investment would support 200 full-time jobs (which would generate PAYE tax revenue totalling over \$15 million over the period) and exports of \$75million as a minimum over the 3 year period.
------------------	---	---

A detailed explanation of these indicative costs/benefits for both the Games Investment Fund and extension of 10BA is provided in the full report previously provided to DCITA¹.

A strategic partnership between the public and private sector can deliver this outcome.

The following outlines the three initiatives in more detail.

2.1 Establishment of a Games Investment Fund

Currently, it is very rare for game developers in Australia to self-fund full game development. As a result, they are forced to enter into agreements with a small number of international publishers whereby the publisher takes ownership of the copyright to the game (and also often the IP rights over any software tools that the developer creates in the course of the games development) as well as retaining the bulk of any profits that the game generates.

The business model of most local game developers is largely one of 'fee-for-service' game development for international publishers. Under this model the local developer not only receives a small share of the game's 'up-side' but also, due to loss of copyright and other IP rights, has no rights in relation to the development of any game sequels. Under this business model local developers are also exposed to the risk of project cancellation at short notice, which causes considerable cash-flow management problems, as the developer may need to cover staff and overhead costs for several months as new project work is sought.

By contrast, if the developer were able to fund the cost of a game they had originated themselves (or developed based on licensed content that they have secured the rights to), in addition to owning the copyright (which would allow them to fully benefit from hits via production of sequels), they may also negotiate rights to 40 to 50 per cent of royalties from game sales.

¹ The Allen Consulting Group, *Game Industry Development Strategy: Proposal for Government Action*, Report prepared on behalf of the Game Developers' Association of Australia, October 2003.

Given that sequels are major revenue generators within the game market, for instance, in the Australian market over 60 per cent of top 20 game titles over the past five years have been sequels², while in the US market in 2001 the ten top selling console game titles were all sequels³, the lack of IP rights associated with the fee-for-service model is a very important issue for the development of the local industry.

An optimally functioning private capital market for game would have the following key features:

- institutional investors would be able to access specialised professionally managed investment funds that allow them to diversify risk by investing in multiple projects and companies;
- private investors would be able to access specialised professionally managed investment funds that allow them to diversify risk by investing in multiple projects and companies;
- private and institutional investors would be able to invest in the game industry under equivalent taxation terms as they are able to access for investment in other creative content sectors; and
- investment in larger scale productions could be secured through both offshore and local investment.

Consideration of developments offshore suggest that a self-sustaining private capital market for game investment is achievable. In offshore centres of game activity that have achieved a critical mass of activity, a mature private sector capital market is now developing.

Achieving the critical mass that is required, if the Australian game industry is to be able to retain ownership and fully benefit from the IP it generates, is currently being constrained by two key areas of market failure and distortion within the Australian game market, namely:

- **imperfect capital markets**, including information asymmetries and a lack of mechanisms allowing for risk diversification; and
- **market distortions created by Government policies** that skew investment towards alternative sectors within the creative content industry.

² Based on analysis of games sales data on the Australian Film Commission website.

³ Department of Trade and Industry, UK, (2002), *Competitive Analysis of the UK Games Software Sector*

Through implementation of a well designed, targeted and integrated set of policy initiatives, which, amongst other things, will create conditions in which specialised expertise can be developed on the game industry among finance and venture capital providers, the Commonwealth Government can cost effectively address these obstacles to growth. The outcome should be a rapid expansion of the game industry in Australia over the next decade which will generate significant net benefits for the Australian community.

Table 2 summarises the forecast *indicative* costs and benefits associated with the establishment of two licensed GIFs focused on attracting institutional pooled capital.

TABLE 2: GIF: INSTITUTIONAL POOLED FUNDS COMPONENT – COST/BENEFIT SUMMARY

Costs	Benefits**
<p>Upfront investment of \$40 million drawn down over five years plus associated government administrative expenses.</p> <p>However, over a ten year time frame there are strong prospects that the Government would recoup its \$40 million upfront investment.</p>	<p><i>Direct benefits</i></p> <p>Additional investment in game production of at least \$60 million over a five year period. This investment would support around 95 full-time jobs in the industry for four years (which would generate PAYE tax revenue totalling over \$12 million over the period) and exports totalling over \$60 million.</p> <p><i>Overall benefit</i></p> <p>Contributing to the creation of vibrant sustainable and high growth Australian game industry generating over \$500 million in exports per annum by the end of the decade.</p>

* assumes that the full \$40 million is drawn down within the specified time period for the program.

** Assumes additional \$60 million of investment in games investment (\$40 million government funds plus \$20 million matching private funds) occurs as a result of GIF institutional focused fund and a continuation in the short-to-medium term of current jobs [1 job with average salary of \$75,000 p.a. (which generates PAYE tax revenue of around \$25,000 per annum) per \$125,000 of investment] and exports (>\$1 of exports for each \$1 of investment) outcomes per dollar of investment in the industry.

Table 3 summarises the forecast *indicative* costs and benefits associated with the individual pooled funds elements of the GIF program.

TABLE 3: GIF: INDIVIDUAL POOLED FUNDS COMPONENT – COST/BENEFIT SUMMARY

Costs*	Benefits**
<p>Cost in foregone revenue totalling around \$4.5 million over the 2004 to 2008 period plus associated government administrative expenses.</p>	<p><i>Direct benefits</i></p> <p>Additional investment in game production of at least \$30 million over the 2004 to 2008 period. This investment would support around 60 full-time jobs in the industry for four years (which would generate PAYE tax revenue totalling over \$6 million over the period) and exports totalling over \$30 million.</p> <p><i>Overall benefit</i></p> <p>Contributing to the creation of vibrant sustainable and high growth Australian game industry generating over \$500 million in exports per annum by the end of the decade.</p>

- Assumes that a total of \$30 million in investment is raised by the two Game MIS licence holders over the 2004 to 2008 period and that the ratio of revenue foregone to funds raised is the same as for the 10BA program. As a reference point to likely outcomes, the FLIC scheme saw \$22.5 million raised over the three years of the program.

The Commonwealth Treasury Department, in its 2002 Tax Expenditure Statement, reported that for 2001-02 the Division 10B and 10BA arrangements resulted in net foregone revenue of \$6 million (no breakdown between 10BA and 10B claims was available). This figure is significantly lower than previous figures produced by Treasury to cost 10B and 10BA. This is due to Treasury recently revisiting and subsequently altering their methodology for costing these concessions.

Given that more funding is eligible for 10B than 10BA but that 10BA arrangements are more generous than those for 10B, for the sake of the indicative costing of the GIF MISs we have assumed that half (\$3 million) of the \$6 million net cost to revenue from 10BA and 10B is associated with Division 10BA.

The AFC reports that in 2001-02 the total value of investment eligible for the 10BA concession was \$20.14 million. Therefore, for each million in Australian private investment accessing the 10BA concession, the net cost to revenue is now estimated at around \$150,000. Therefore net revenue foregone associated with \$30 million raised through the GIF MISs is here estimated at \$4.5 million.

** Assumes additional \$30 million of investment in games development occurs as a result of establishing the GIF individual focused funds and a continuation in the short-to-medium term of current jobs [1 job with average salary of \$75,000 p.a. (which generates PAYE tax revenue of around \$25,000 per annum) per \$125,000 of investment] and exports (>\$1 of exports for each \$1 of investment) outcomes per dollar of investment in the industry.

Sources: Treasury Department, Tax Expenditure Statement 2002; Discussions with Treasury Departmental officers; AFC, Key Industry Statistics; AFC, website

Potential Investment Activity Associated with GIF Program

Taken as a whole, the two GIF managers could *each* be expected to invest around \$45 million over four years (\$30 million of GIF institutional funds plus \$15 million of individual 'MIS' funds). A \$45 million investment portfolio would be expected to consist of a diverse range of investments. Across a \$45 million portfolio, a total of perhaps 10 to 15 discrete investments would be expected. It could include equity investments in companies, co-investment in major console game projects, the purchase of exploitation rights for existing creative content property (such as films), and so on.

Likely Spread of Investment into Projects

The proposed GIF has three key areas in which funding might be allocated. Indicative investment amounts per project are as follows:

- 1) **Prototype/Concept Development:** \$A400-500k per prototype. Concept development for handheld and mobile would be less, of the order \$A100-250k although prototypes for next generation handheld are requiring increased investment.
- 2) **License acquisition:** These will range from \$US100k for a small title (eg Ratbag paid \$US100k per annum for three years for 'World of Outlaws') to \$US500k - \$US1m for a mid range title and \$US10m plus for a high value title eg Harry Potter.
- 3) **Game Production:** This could range from anywhere between \$A1m – 15m plus, depending on how the fund is structured and the type of financing deal.

2.2 Extension of 10BA

Significance of Electronic Games to 10BA

An electronic game is a similar medium to a film in that it is a collection of moving images. Section 124ZAA (1) in Division 10BA defines a film to mean "an aggregate of images, or of images and sound, embodied in any material." (A copy of an electronic game is provided at Attachment 1).

Section 3 of the Film Act (Vic) 2001 defines a film to mean: "a recording in or material of any kind (whether invented at the commencement of this Section or not) from which moving images, with or without associated sound, may be produced." A moving image means: "any image created in film, video, digital or other media format, being an image that alters with time and that is able to be displayed upon a screen."

The Federal Court in *SEGA Enterprises Ltd and another v Galaxy Electronics Pty Ltd and another* [1996] 761FCA1 held that a computer game constitutes a "cinematograph film" within the meaning of the Copyright Act.

There is an argument that electronic games possibly come within an Australian film for the purpose of 10BA. But it is by no means conclusive. The problem is that an electronic game would most likely not fall within the definition of a “qualifying Australian film” eligible for receiving the certification by the relevant minister necessary to access the tax deductions in Division 10BA.

It is significant that an electronic game is not contemplated within the list of films excluded from certification as a “qualifying Australian film.”

Rationale for Extension of Division 10BA

As noted above, access to an optimally functioning private capital market for game investment is necessary if the Australian game industry is to develop to its full potential. The Australian game industry is global, commercially focused and growing. Already the Australian games industry generates approximately \$A100m of export earnings which represents over 95 per cent of total earnings for the industry. However, Australia is not capturing its share of macro-economic growth. The gap between the US, UK and key competitors is growing and Australia is at the bottom end. Achieving the critical mass required if the Australian industry is to be able to retain ownership and fully benefit from the Intellectual Property it generates is currently constrained by two key areas of market distortion: i) imperfect capital markets, including information asymmetries and a lack of mechanisms which allow risk diversification, and ii) market distortions created by Government policies that skew investment towards alternative sectors within the creative content industry (refer Attachment 2 for industry background information).

The extension of 10BA would provide a significant incentive for local investors to invest in game products. There is a lot of interest in the local and offshore investment community in game investment. However, there is currently no mechanism in Australia which provides an incentive for individual investors to invest in this industry. In the past 12 months, game companies have had potential investors interested in investing in game products, often linked to film properties, but have not proceeded because of lack of comparable incentives with the film industry.

A specific example is South Australian-based Ratbag Games (bought by Midway Studios in August 2005 and closed in December 2005) which had a producer/financier interested in investing in a game linked to a film product. When the investor realised that 10BA did not apply to the game, they walked away as there was no incentive for them to proceed. Our discussions with merchant banks and other potential investors in Australia all indicate that the lack of an incentive in this area, comparable with the film industry, is a major barrier to local activity.

Another example is Irrational Games based in Canberra, a company that was trying to develop a franchise property from a locally produced game. The

company focused on raising investment locally to keep both the IP and development in Australia. However, a lack of incentive for local investors proved a key barrier and the company was recently acquired by publisher Take 2 Interactive.

In 2003 Macquarie Bank conducted due diligence on the local game industry with a view to establishing a Retail Investment Fund of the order \$A30m in game products. This fund has been put on hold with a key reason being the lack of investor incentive, particularly the fact that 10BA does not currently apply to games.

Access to Division 10BA arrangements would be of far greater use to the game industry than the currently available Division 10B arrangements, which provide little (if any) benefits for investors in games. Under Division 10B, investors must write off the capital costs of their investment over two years, beginning in the financial year in which the project is first exploited or used for income producing purposes. These conditions mean Division 10B is of little use in a game industry context as games typically take between 18 – 24 months to develop with a short, often less than 12 months, marketing opportunity during which almost all economic returns from the game are generated.

Therefore the ability under 10B to write-off investment over two years actually provides less beneficial terms than the use of standard amortization practices (where the capital cost of an asset is depreciated in line with its economic life). Under standard amortization practices, almost 100 per cent of capital costs in game investment would be written off within 12 months of first commercial exploitation of the game.

Division 10BA arrangements by contrast allow access to a full write-off of investment at the time of investment, thereby providing the write-off up to two years earlier than would be the case under standard amortisation of the investment.

In making Division 10BA arrangements available to game investors, the core benefit and eligibility features of Division 10BA would remain the same as they currently are for film, namely:

- i) investors in eligible projects would be able to deduct at the time of investment 100 per cent of the capital cost of their investment against income; and
- ii) to be eligible for the concession projects must be substantively Australian produced content and must be completed and first used for commercial exploitation within two years of investment.

An indicative Cost/Benefit Summary, prepared for the GDA by The Allen Consulting Group, is presented in Table 4 below:

TABLE 4: DIVISION 10BA EXTENSION – INDICATIVE COST/BENEFIT SUMMARY

Costs*	Benefits**
<p>Net foregone tax revenue rising to around \$1.7 million per annum by the end of the decade plus associated government administrative expenses.</p>	<p><i>Direct benefits</i></p> <p>Additional investment in games production rising to \$11 million per annum by the end of the decade. This investment would support around 85 full-time jobs in the industry (which would generate PAYE tax revenue totalling over \$2.1 million per annum) and exports exceeding \$11 million per annum.</p> <p><i>Overall benefit</i></p> <p>Contributing to the creation of vibrant sustainable and high growth Australian game industry generating over \$500 million in exports per annum by the end of the decade.</p>

* The Commonwealth Treasury Department, in its 2002 Tax Expenditure Statement, reported that for 2001-02 the Division 10B and 10BA arrangements resulted in net foregone revenue of \$6 million (no breakdown between 10BA and 10B claims was available).

Given that more funding is eligible for 10B than 10BA but that 10BA arrangements are more generous than those for 10B, for the sake of the indicative costing of the extension of 10BA to games we have assumed that half (\$3 million) of the \$6 million net cost to revenue from 10BA and 10B is associated with Division 10BA.

The AFC reports that in 2001-02 the total value of investment eligible for the 10BA concession was \$20.14 million. Therefore, for each million in Australian private investment accessing the 10BA concession, the net cost to revenue is now estimated at around \$150,000.

The \$20.14 million in investment accessing 10BA represents only 11 per cent of the \$183.8 million in private Australian investment into film and TV production in 2001-02.

Currently, total private Australian investment in game development is estimated at less than \$10 million per annum as most of the \$100 million in industry production is funded by international game publishers. Even if the Australian game industry generates private investment from Australians at 10 times current levels, i.e. \$100 million, a similar rate of access to 10BA as that experienced in the filmed entertainment industry would suggest that extension of 10BA to games would result in an additional \$11 million of eligible project investment accessing Division 10BA. This would be associated with a rise in net foregone revenue of around \$1.7 million per annum. In the short term, extension of Division 10BA to games would have a much lower foregone revenue figure.

** Assumes additional \$11 million of investment in games development occurs as a result of extension of Division 10BA to games and continuation in the short-to-medium term of current jobs [1 job with average salary of \$75,000 p.a. (which generates PAYE tax revenue of around \$25,000 per annum) per \$125,000 of investment] and exports

(>\$1 of exports for each \$1 of investment) outcomes per dollar of investment in the industry.

Sources: Treasury Department, Tax Expenditure Statement 2002; Discussions with Treasury Departmental officers; AFC, Key Industry Statistics; AFC, website; Discussions with game industry stakeholders.

Our calculations indicate that the projected net foregone revenue is minimal in relation to the direct benefits delivered to both the local industry and Commonwealth Government.

2.3 Extension of Refundable Tax Offset (RTO)

The current Refundable Tax Offset provides an incentive for large budget film production to locate in Australia. The tax offset will provide a benefit worth 12.5 per cent of a film's qualifying Australian production expenditure. This is provided to the film production company through the company's tax return. The offset amount will be applied against Australian Federal tax liabilities accrued in the production of the film, with any excess refunded. Projects that access the benefits of 10BA or Division 10B cannot also access the RTO.

The RTO is a tax credit that could easily be extended and applied to the game industry. The key objective of such an extension would be to attract large scale next generation game productions to Australia. These would be largely 'fee for service' productions. However, the extension of the RTO would also enable developers who are able to raise \$A15m for a project to also access the tax credit, provided the production remained in Australia. This could apply to both current and future generation titles.

A key point to be made here is that if Division 10BA is not extended to the games industry, then there does need to be some other incentive to attract both institutional and private investment locally.

An indicative Cost/Benefit Summary for extension of the RTO to the game sector is presented in Table 5 below:

TABLE 5: INDICATIVE COST/BENEFIT SUMMARY FOR INITIATIVE

Initiative	Costs	Direct Benefits
Extension of Refundable Tax Offset (RTO)	\$9.375m in tax credits which Government would provide on \$75 million of investment	Additional investment in game production of \$75 million over 3 years. This investment would support 200 full-time jobs (which would generate PAYE tax revenue totalling over \$15 million over the period) and exports of \$75million as a minimum over the 3 year period.

*The calculation is based on 5 of our largest studios securing at least one project each over the next three years worth \$A15m per project, with a total of \$A75 million investment over the period.

**The estimate of Costs is based on the tax credit Government would be providing over the period. It could be argued that there is no cost to Government given that if the incentive is not available, then the production/s will not be brought to Australia.

The calculation for employment, tax revenue and exports have applied the same formula as the other initiatives ie 1 job with average salary of \$75,000 p.a. (which generates PAYE tax revenue of around \$25,000 per annum) per \$125,000 of investment] and exports (>\$1 of exports for each \$1 of investment) outcomes per dollar of investment in the industry.

Source: GDAА calculation and The Allen Consulting Report.

Application of RTO Criteria to Game Industry

In terms of the current criteria applied to the RTO, we believe game productions would qualify. The definition in relation to ‘production’ seems applicable. We are currently reviewing the definition of a ‘game’, in terms of an interactive entertainment product for the purposes of this incentive (and others).

We have reviewed the criteria for qualifying for the RTO and would make the following points:

1) The \$A15m Minimum Expenditure Requirement

Specifically, we expect next generation titles to be of the order \$US10-20 million (and some analysts argue they may be higher). However, there will be less of these projects globally so competition for securing them will be fierce. The current minimum of \$A15m per project is consistent with expected next generation project budgets. However, if the minimum was reduced to say \$10m then the scope for Australian game developers would be even greater as they

could access the incentive for both current and next generation projects (which are of the order \$US7-10m). As an example, Transformers, produced by Atari Melbourne House, had a production budget of \$US10m). The TY the Tasmanian Tiger franchise cost approximately \$US14m and current title, Heroes Across Europe (IR Gurus Interactive,) is \$US6m.

As noted earlier, extension of the RTO to game production would also enable companies that were able to raise \$15m plus locally to access the tax credit. Again if the minimum expenditure was reduced this would provide even greater incentive for local investment, but only for large scale titles. There would still be a gap in terms of attracting smaller scale investment in the Australian market. Access to a Games Investment Fund and a 10BA incentive would address this and act as a complementary avenue to FTO.

Production Bundling

The film and television industry has previously argued for bundling of film/television product to meet the \$A15m threshold. Again, for the game industry if such bundling of game projects was possible, then the expected investment and export value would be expected to be much greater. For example, 5 of the larger studios bundling current and next generation titles over a three year period could see \$A150 million of investment for the period, assuming an average of \$A10 million per project.

2) 70% Requirement for Local Production

The current RTO requires that at least 70 per cent of the production is completed locally within Australia. This can be comfortably applied to game productions where most of the project is done locally already. It should also be noted that around 75 per cent of a game project budget is allocated to salaries/staff costs. The current provision of 30 per cent still allows the game developer to outsource some aspects if required.

The visual effects sector is arguing the case for removing the 70 percent requirement in order to allow some producers to access the tax credit for 'fee for service' components of a larger scale production (which may be being produced offshore). If the 70 percent local production requirement was removed, for the game industry this would provide similar scope for future outsourcing opportunities that some developers may want to leverage. **Overall, the GDAA would argue that any changes made to the current RTO should apply to the game sector where it provides additional incentive for investment.**

3) Goods, Services, Technology, Rent and Other Budget Items

The current RTO requires goods, services, technology (including that brought in from offshore for a production), rent, land and other items to be purchased locally. Any expenses for raising funding are excluded. These requirements can be met in terms of game productions.

3. PAY OFFS FROM GOVERNMENT ACTION AND NEXT STEPS

There is no question that Government support to address failures in the capital market for game investment will allow the Australian game industry to dramatically increase its performance and its ability to continue competing globally.

The proposed Government policy interventions in the game capital market would directly result in over \$A225 million in additional investment into the industry over the remainder of the decade. However, these initiatives will also lead to the establishment of a vibrant private capital market for game investment in Australia, which will in turn allow for further investment from within Australia and offshore. Also, the increased scale of the Australian game industry would better place it to secure increased levels of international production investment.

In order to carry forward the development of the three policy initiatives proposed here, and/or to develop any other incentives that may be considered following this review, the GDAА will make resources available to work with the Commonwealth Government, through its representatives, to work through the issues as quickly as possible.

In closing, it needs to be restated that for the Australian game industry, there is a serious timing issue. Our developers have 12 months max to position themselves to continue to compete and grow in the global market. It is imperative that we progress these now and work to early implementation. When the first business case was presented, the industry had a window of three years. That window has significantly reduced to 12-18 months maximum. **If we are unable to grow critical mass and establish an investment structure that supports growth, the industry may not survive.**

The GDAА is keen to work in partnership with the Commonwealth (and State Governments) to ensure that the best case scenario presented here is delivered.

4. CONTACT PERSON

The key contact person for this submission is:

Evelyn Richardson
President and CEO
Game Developers' Association of Australia

Ph: 03 9866 6322 Mob: 0407 303 646
Evelynrichardson@gdaa.com.au
www.gdaa.com.au

ATTACHMENT 1

BACKGROUND: Game Developers' Association of Australia (GDAA)

The GDAA was established in December 1999 and comprises Corporate Members from game development companies and educational institutions, Associate Corporate Members (in service sectors that support the industry), Individuals and Students.

Current membership includes companies from all over Australia: ACT, NSW, Qld, SA, Tas, Vic and WA and the US. The GDAA represents over 85 percent of the local industry.

GDAA Objectives

The main purpose of the GDAA is to promote the growth of the Australian electronic game industry both domestically and internationally in order to:

- Attract capital and publishers from offshore
- Retain and attract new talent into our local industry
- Represent the interests of GDAA members, and
- Promote a sense of community within the Australian electronic game development industry.

The GDAA's national headquarters were established in Melbourne and an Executive Director was appointed by the Board for a three year period in November 2002. In May 2005, a President and CEO role was created.

The GDAA has the following Board structure:

President and CEO	Evelyn Richardson (Vic)
Vice President	Tom Crago (CEO, Tantalus, Vic)
Secretary	Graham Edelsten (Director, Auran, Qld))
Treasurer	Ross Symons (CEO Big Ant Studios, Vic)
Member	Luke Carruthers (CEO Imaginary Numbers, NSW)
Member	Shainiel Deo (CEO, Halfbrick Studios, Qld)
Member	Steve Woodgate (CEO, KaWoW, Qld)
Member	John Moss (QANTM College, Qld)
Member	Mike Fegan (CEO, IR Gurus, Vic)
Member	Neil Boyd (AIE, ACT)

ATTACHMENT 2

ACHIEVEMENTS OVER THE PAST THREE YEARS

The GDAA's President and CEO, former President (Adam Lancman) and Board have worked hard over the past three years to achieve outcomes in the three strategic priority areas identified in the Business Plan.

Achievements include:

- **Attracted over \$1.8m of direct Government support** for industry activities
- **Membership growth of 60 percent in the last 12 months** with over 60 members nationally, reflecting rapid industry growth and relevance of the GDAA's action agenda. In addition, growth in corporate membership has also grown by 60 percent. The GDAA has also seen significant growth in Corporate Associate membership (70 per cent), a trend we expect to continue during the transition phase to next generation console development

Profile Raising

- **Hosted the first (in 2003) and largest ever Australian presence at the Electronic Entertainment Expo (E3) in Los Angeles in 2003, 2004, 2005 and 2006;** 39 companies attended in 2004 (up from 24 in 2003). In 2004, over \$A 30m worth of deals were signed at E3 up from \$A 17m in 2003. In 2005, over 40 companies attended the largest scale show ever presented in the US. 16 companies showcased product on 28 screens on 2 000 sq ft of showspace in West Hall. Projected deals over the next two years as a result of E3 attendance is \$A92m; in 2006, 45 companies attended, projected deals are worth \$A95m over the next two years and \$A7.2 worth of deals have been signed post E3 2006
- **The GDAA secured sponsorship from 9 Government sponsors for E3 in 2004 and in 2005, cross-Government support grew to 12 Government agencies,** the largest ever cross-Government support of an international trade show. **Moreover, industry matched funding has grown significantly each year** (from 10 percent to 35 percent of total budget) with a long term plan of reducing Government support and increasing industry sponsorship dollar for dollar
- **Hosted a major private networking event in the US in March 2004 and March 2005** with over 150 publishers, investors and industry players attending. In 2005, we secured media coverage in both the US and Australia. The Great Aussie BBQ: III is scheduled for March 2007 in San Francisco
- **Launched the Australian Games Innovation Centre (AGIC)** in April 2005, highlighting the 20 year history of our industry and profiling our best product. The AGIC comprises the GDAA, AIE and a national games showcase and is co-located with Atari Melbourne House. The AGIC has already hosted a growing number of publishers, Government delegations and international visitors (ie investors, journalists) plus GDAA business development and other activities

- **Hosted a national stand at the European Game Network in the UK in September 2004.**
- **Hosted five highly successful Industry-Government Roundtables** resulting in financial support for E3, our investment business case and recent skills initiatives
- **Hosting inaugural industry conference, Game Connect: Asia Pacific**, Brisbane 30 November-2 December 2006
- **Major supporter of the Australian Game Developers' Conference (AGDC)** which attracted over 1000 delegates; the GDAA sponsored the Executive VIP Party which hosts 100 guests from across the industry at a high level networking event
- **Founding sponsor of the first Women in Games luncheon** (co-hosted with Krome Studios) which became a regular AGDC event. In 2003, over 45 women attended, up on 8 in 2002. In 2004, this grew to 51
- **Brought US journalists to AGDC to profile our industry in the US**, sponsored by Invest Australia and Invest Victoria
- **The success of our profiling activities continues to grow and is evidenced by significant media coverage offshore and nationally** (press, trade publications, television, radio and Government publications) and recent features article in BRW weekly magazine
- **Recent articles on the Australian games industry (BRW, Play Magazine, Edge Magazine, GameBiz Daily).**

Investment

- **Commissioned and presented to Federal Government, Game Industry Development Strategy: Proposal for Government Action**, proposing establishment of a Game Investment Fund and extension of both Division 10BA to games and the Refundable Tax Offset
- **Vice-President of the GDAA was a member of the Federal Minister for Communications, IT and the Arts, Strategic Industry Leaders Group and member of the Investment Working Committee**
- **Establishment of a Pooled Development Fund (national), located in Queensland. The Fund will look to raise \$3m in round one for games projects.** GDAA President and CEO is a member of Advisory Committee and support was provided to identify an appropriate Chairperson
- **Working with private sector to develop private funding models for game investment.** Some companies have already benefited and the GDAA is already pursuing a range of options in this area
- **GDAA President and CEO is a committee member of Film Victoria's Digital Media EAC Committee**

- **Lobbying Federal and State Government for initiatives to support greater investment in game development.**

Skills and Training

- **Provision of Sony PlayStation2 development kits to Victorian developers.** This program is unique in the world
- **Sony PlayStation2 Program was rolled out in Queensland** in early 2005 and like the Queensland Program is managed by the GDAA
- **First game title signed within 12 months of being part of Sony PlayStation2 Program (Victoria): *Heroes of the Pacific*** developed by That Game and IR Gurus Interactive
- **Provision of Sony performance analyser** located at AGIC for local industry use
- **Provision of Microsoft Xbox Development Kit to Victorian developers.** Like the Sony Program, this is unique in the world
- **Secured AusIndustry grant to deliver a *Project and Business Management Program for the Game Industry*** run in Brisbane and Melbourne with support from both the Queensland and Victorian Governments. The GDAA is currently in discussions with The Australian Film, Television and Radio School (AFTRS) to roll out a national Enterprise Development Program for the Games sector
- **A highly successful Professional Development Model for teachers in the game sector** was trialed in Victoria in October 2004. An ongoing Industry-Education Forum has been established and expansion of a national program is planned
- **The GDAA has worked with both the tertiary and higher education sectors to develop game specific courses relevant to the local industry**
- **Establishment of sustainable strategic relationships with publishers, hardware manufacturers and tool providers with direct flow on effects for members** including introductions and free software
- **Hosted a delegation of developers to China** to review outsourcing opportunities and assessment of online space.

ATTACHMENT 3

Electronic Games Investment Fund (EGIF)

The Electronic Games Investment Fund (EGIF) has been established to attract investment into the electronic games industry in Australia. The EGIF is a registered Pooled Development Fund (PDF) which offers tax concessions on realised returns from investment in the fund.

Risk is substantially minimised through contractual publisher commitments for sale of the completed game and completion guarantees to ensure production as per specification of the distributor.

The objectives of the EGIF are to:

- Offer an alternative model to the traditional games development/publisher model currently in place by developing a pool of capital to invest in special purpose Investee Companies (developers) in the early stages of development of new game titles
- Invest in companies and new game titles that satisfy EGIF's investment criteria
- Generate a high yielding medium to long term investment returns for Investors, while reducing risk through prudential management.

Investment Criteria

- Investment in emerging/established electronic game software development companies predominantly based in Australia. Investment will be via a special purpose company formed specifically to develop the game concept.
- The developer must have advanced the game concept sufficiently that graphics and a working demonstration can be displayed.
- The Investee Company must have publisher support demonstrated by a contractual agreement to pay the cost of production no more than 90 days after delivery of the completed game. The Developer must also have a Completion Guarantee that guarantees delivery within the budget to the specifications of the Publisher Agreement.
- Only Investments, based on their feasibility, a Due Diligence report and publisher proposals that meet the Company's desired investment hurdle rate of 30% IRR before tax will be funded. Though this is the desired investment hurdle rate, this rate should not be assumed to be certain in any way.
- EGIF will only invest in companies displaying sound management, corporate governance and reporting capabilities.
- Investment terms will be short to medium-term (between 1 to 3 years) based on production timeframes and publisher indications.

- Investments monitored monthly by EGIF's fund manager and completion guarantors.

Directors

- Tom Parkinson - Chairman
- Stephen Copplin
- Peter Dowling
- Jeff Jones

Directors are supported by an industry advisory panel, and EGIF's funds manager – Ashley & Munro Corporate Services Pty Ltd.

Offer Highlights

- Offer Price per Share **\$1.00**
- Target Subscription **\$5,000,000**
- Total number of Shares on Issue following closure of the Issue (assuming Target Subscription is achieved) **5,000,006**
- Minimum Subscription Amount **\$2,000,000**
- Minimum Investment **\$100,000** and thereafter in lots of **\$10,000**

Source: EGIF Chairman, September 2005.

ATTACHMENT 4

INDUSTRY CONTEXT

The following provides a summary overview of the current global and local market.

- The global game market is worth around \$A40 billion and growing at 16.8% per annum; revenue is expected to reach \$A74.3 billion in 2009 (PwC, 2005)
- The 2005 market for interactive games software is estimated at \$A37.4 Billion (34.5 billion in 2004) (Ibid)
- The game industry is now larger than film box office; 2004 global market for games worth \$A34.5 billion (up 11.1%) compared to global film box office takings of \$A33.2 billion (up 5.3%) (Ibid)
- Globally the industry is experiencing double digit growth (Ibid)
- Future growth over the medium term is high with PwC projecting a compound annual growth rate of 15.7% (2005-09) in software sales to reach \$A1.2 billion in 2009, and rapid growth in Asia Pacific area. PwC projects global market to reach \$A74.2 billion by 2009 with emerging software segments such as online and mobile to account for a significant portion (Ibid)
- PwC projects Asia Pacific will continue to be the fastest growing; going from \$13.7 billion in 2004 to \$31.4 billion by 2009, with a compound annual rate of 18 %
- The US, the second largest market in 2004, had \$11.1 billion in revenues and is projected to grow 12.9% compounded annually to reach \$20.5 billion in 2009 (Ibid)
- 70% of game players are over 18 years, with 20% aged 39 years plus (Ibid)
- 32% of people paying games in Australia are women (Roy Morgan Research). Electronic Arts reports that 85% of subscribers to its fee based, online games site are female and that the average age is 45
- Spending on interactive games software in Australia grew 22.1% in 2004 fuelled by blockbuster titles such as Grand Theft Auto: San Andreas and Halo 2. With next generation static games and handhelds being released in Australia over the next 18 months, growth will remain strong over the next five years. Between 2005-09, sales will grow by 15.7% CAGR reaching \$A1.2 billion (Ibid)
- Overall, sales of consoles, handhelds and peripherals have dropped from 34 to 20%, reflecting end of life cycle current generation technology. The introduction of the Sony PSP, Nintendo DS, Xbox260, PS3 and Revolution will see increased growth in the console space

- Increased convergence occurring between the game industry and other content industries continues to grow as a key trend
- It is becoming common now in the US for games to be developed in conjunction with film properties. Local Australian examples include:
 - Krome Studios: *King Arthur*
 - Atari Melbourne House completed all the QA for *The Matrix*
 - Ratbag: *Dukes of Hazzard: Return of the General Lee*
 - Blue Tongue: *Polar Express* (with Tantalus Interactive producing the hand-held version)
 - Tantalus Interactive: *Jimmy Neutron-Attack of the Twonkies*
 - Perception: working on the *Stargate SG-1* title (they purchased the license through MGM)
- By the end of 2004, 43% of all gamers had played online, up 37% on 2003. While PCS are still dominant, real growth is occurring in the online console market (PwC Ibid)
- With more than 17.4 million mobile phone subscribers in Australia at the end of 2004, mobile gaming holds significant potential. Most current handsets come bundled with at least one game offering users a trial before they buy. Many devices are also internet-enabled, providing access to download content and titles (Ibid)
- Other ancillary revenue streams such as 'in game advertising' are emerging in the market. Global estimates value in game advertising at \$A270 million at end 2004 (Ibid). In Australia, Massive Incorporated, one of the largest players in this area has recently established their Asia Pacific Headquarters here.

The global industry is in a significant transition phase characterised by:

- **Rising complexity and cost associated with game development**, and consoles in particular, requires the Australian industry to achieve greater scale in operations; there will be further growth in service and sub-contracting
- **Critical mass is required** if the Australian industry is to achieve a sustainable growth position within the global market – it must be large enough to develop and retain its own IP; our vision is 6-8 companies with 150-200 staff each
- **Access to an optimally functioning private capital market** for game investment is critical if the industry is to develop its full potential; this will require private/public funding models; extension of Division10BA; extension of the Refundable Tax Offset, and other concessions
- **Developing and retaining skilled talent:** currently the industry meets its requirements via a mix of offshore and local talent; we need to ensure we can meet future demands for new talent.

ATTACHMENT 5

AUSTRALIAN GAME INDUSTRY PROFILE

[REFER INSERT: Games Australia 2006]

ATTACHMENT 6

INCENTIVES OFFERED BY OTHER TERRITORIES

Policies in place overseas that target support towards the game industry may also act to skew investment away from the Australian game industry.

Recognising the pressures created by structural change currently occurring within the game industry, policy makers in a number of countries have recently introduced programs designed to assist local developers succeed in this challenging environment. Such international policy decisions also place pressure on the Australian industry as they increase the relative attractiveness of the game investment environment in these competing international locations. Some recent policy developments in Canada, the UK, France and Korea are briefly considered below. Other relevant developments are also provided.

Canada – Quebec Province

Game companies that operate in Montreal's Cite du Multimedia or in one of Quebec's Information Technology Development Centres (CDTI) are eligible for a range of tax incentives.

Companies can access tax credits equivalent to 40 per cent of the salaries of full-time equivalent employees up to a maximum of C\$15,000 per employee per annum. This assistance is renewable on a yearly basis for a maximum of ten years until December 2013.

Companies located in a CDTI may also be eligible for a five year tax holiday for themselves and the foreign nationals they employ as well as tax credits on equipment purchases. Other Government programs open to game developers include refundable tax credits on production costs and tax incentives for R&D.

United Kingdom

Two schemes in the United Kingdom, the Enterprise Investment Scheme and the Small Business Tax Credits scheme, while not exclusively targeted at games, do in fact, given the nature of company activity of the game industry, provide considerable incentives for investment in the UK game industry.

Under the Enterprise Investment Scheme, for unquoted (unlisted) companies whose gross assets do not exceed 15 million pounds, investors can get tax relief up to the value they invest, benefits/dividends are tax free and there is no Corporate Gains Tax to pay on shares.

The Small Business Tax Credits scheme provides for capital expenditure on computer equipment to be 100 per cent deductible in its first year and provides smaller starting rates on Corporate Gains Tax (10 per cent starting rate up to 50,000 pounds profit, 20 per cent up to 1.5 million pounds profit versus the standard CGT rate of 30 per cent).

As a result of close interaction between the Scottish Games Alliance and Scottish Enterprise (the governments key economic development agency), Scottish Enterprise's Creative Industries Cluster Initiative now provides support for the game industry including management training, support for trade missions and providing product development support for the development of game prototypes. Also, Scottish Enterprise administers a £33 million proof of concept fund that supports development of leading edge technology with potential for licensing or new business creation. The game industry has been successful in accessing support through this fund.

France

In 2003, the French Government set aside €4 million to fund the development of video games. The initiative is being co-funded by France's National Centre Cinematography and the Ministry of Industry.

French companies are able to submit proposals to receive funding for games already under development. The proposals will be assessed against criteria reflecting innovation, commercial viability and other factors. Successful applicants will receive up to 40 per cent of the cost of developing their games and bringing them to market. Grants received must be repaid within one year of when a company signs a publishing contract for its game. Recipients whose games are not published can apply to have the repayment condition waived.

The French Ministry of Culture said the goal of the initiative is to support the industry while it is struggling under tough economic conditions. France is home to several gaming enterprises, including Ubi Soft Entertainment S.A., and Atari Entertainment S.A., the largest interactive game publisher in Europe and the parent company of Atari.

South Korea

In 1999, the Korean Government founded the non-profit Korea Game Development and Production Institute (KGDI), to foster the growth of the Korean game industry. The KGDI provides the industry with technical support, overseas business support, joint research and development and professional training. It also provides Korean game developers with pre-production grants and industrial incubating funding.

The GDAA CEO recently visited the Institute located in Seoul. It was confirmed that the Korean Government invests \$US10 million per annum in the Institute's operations, including support for the incubator and resource facilities.

This excludes investment in E3 and other targeted export marketing activities. Over 236 companies have been assisted in entering offshore markets.

This funding has seen over 100 new companies established up to late 2003. An academy was also established (funded separately) in 2000 which has produced 250 game specialists per annually having completed two year formal education programs.

The KGDI recently brokered a partnership with Nokia for the development of games for the Nokia wireless gaming platform.

The Korean Government's goal is for the industry to achieve US\$300 million in annual game exports and US\$800 million in overall game production by the end of 2003. Significant growth in the online space is predicted and the Government is investing heavily in assisting companies to compete and enter offshore markets. Of the local studios that the GDAA met with, most were preparing for expansion/relocation to China.

Malaysia

Malaysia, through its Multimedia Super Corridor program, offers significant incentives for multimedia, including games, activities. These include:

- Five year exemption from Malaysian income tax, renewable to 10 years, or a 100% Investment Tax Allowance (ITA) which enables a company to deduct 100% of qualifying expenditure from its statutory income for 5 years
- Duty-free importation of technology
- R&D grants, with seed capital for SMEs at least 51% Malaysian owned
- Unrestricted employment of foreign knowledge workers
- Freedom to source capital globally for infrastructure projects.

Singapore, Hong Kong and Taiwan all have similar support schemes, all of which offer tax incentives, subsidies and project funding (mostly on a dollar-for-dollar basis). These programs are open to local companies and foreign investors. In each instance the benefits are determined on a case-by-case basis.

China

On a recent trip to China by the GDAA CEO and member companies, it was clear that the Chinese Government is ramping up to grow investment in the games area, particularly in terms of online games. Each of the five major provinces with game clusters all provide incentives for studios to establish in the province. This includes attracting foreign owned studios in. The incentive is on a case by case basis and it was not possible to obtain dollar amounts.

The GDAA believes that China is emerging as a strong competitor and potential partner in the games area. With large numbers of game graduates being produced and focused attention by Government at both the national and provincial level, the potential for growth in China is significant. While Australian studios are actively looking to partner with local Chinese studios, this may not provide a long term solution to meeting our requirements for future outsourcing. At the same time, large publishers may over time out-price our studios in relation to accessing talent. This remains to be seen and will be largely dependent on the kinds of relationships within China that our studios can establish and build over time.

There have also been recent reports that the Chinese Government may invest up to \$US1 billion in game development. These have yet to be substantiated but all the indicators are that China is looking to ramp up investment quickly in the sector.

Isle of Man, United Kingdom

The Government of the Isle of Man is targeting the videogames industry as part of new plans designed to encourage more businesses to set up shop on the island.

A Government representative attended the September 2005 Game Developers Conference in a bid to meet with games professionals and inform them about the initiatives.

The Isle of Man recently announced plans to abolish its general corporate tax rate with effect from April 2006. In addition, the Government is offering grant packages of up to 40 per cent to help offset the cost of moving, setting up operations and acquiring new office equipment.

More than USD 90 million has been invested in the Island's telecommunications infrastructure over the past five years. Part of this funding went towards setting up Europe's first Super Fast (HSPDA) 3Gnetwork, two self-healing fiber rings connecting the island to the UK and Ireland, 100 per cent broadband coverage and free ADSL and ISDN connections available for both businesses and individuals.

Other Initiatives

US: Venture Capital Investment in Massive Multiplayer Games (MMGs)

With the proliferation of Internet broadband access connecting online gamers around the world, startups that specialize in massively multiplayer games, or MMGs, would seem just the right growth area for venture firms.

That was certainly the case last year when venture firms looked to cut themselves a slice of the \$14 billion to \$15 billion video game industry, investing in startups like Perpetual Entertainment, WildTangent Inc., Tao Group Ltd., Xfire Inc., Fathammer Ltd., Funcom NV and Game Trust Inc. In total, venture capitalists invested over \$51 million into MMG startups in 2004.

Yet until this summer, venture capitalists had mostly reined in their enthusiasm for the sector in spite of the industry's increasingly bright prospects. **Since May, however, the industry is once again drawing the interest of venture firms as four startups have received new venture fundings totalling over \$40 million in just the past several months.**

MMGs are online multiplayer role-playing games that allow thousands of participants to dwell in an evolving virtual world at the same time over the Internet, according to Wikipedia.

In the game's virtual world, each player is usually represented by an avatar — a graphical representation of the character he or she plays. The game's publisher designs and hosts the persistent, always available virtual world these players inhabit, where they can engage in a variety of activities with other players from all over the world. The game developers also supervise each virtual world, usually offering the users evermore updated sets of new activities and enhancements to secure their interest.

One of the key draws for venture capitalists to MMG sites was their subscription-based revenue model. These gaming companies had dumped the much-maligned Internet advertising model for online gaming to reap millions in subscription fees from MMG role-playing games.

The industry is seeing 50% growth in the market on an annual basis thanks primarily to the growth of broadband in the U.S, according to Jeff Anderson, the president and CEO of Turbine Inc., a producer and publisher of online subscription entertainment. Nevertheless, the hit-and-miss nature of the video game business, coupled with stiff competition from consoles made by Sony Corp. and Microsoft Corp., left many venture firms wary.

In the past few months, venture money has returned to MMG startups in healthy numbers. Hoping that an early entry into the developing online gaming market will reap big rewards, venture firms have recently funded startups like Turbine, Boonty Inc., Revolver Ltd. and Funcom.

The largest deals went to Turbine and Boonty, who raised \$30 million and \$10 million, respectively.

Turbine played its way into a \$30 million Series B round of funding in May, tapping new investors Tudor Ventures of Boston and Columbia Capital of Waltham, Mass., to lead the round. Earlier investors Highland Capital Partners Inc. of Lexington, Mass., and Polaris Venture Partners, also of Waltham, participated. Founded in 1994, the Westwood, Mass.-based company received an \$18 million Series A round of funding from Highland and Polaris in December 2003.

And in July, digital game distributor Boonty of New York concluded its \$10 million second-round financing. The round included new investors Rothschild & Cie. Gestion and Spéf Venture, as well as return investors OTC Asset Management and Entrepreneur Venture, all of Paris.

Revolver, a Beer Sheba, Israel-based animation platform startup, raised \$500,000 from incubator Maayan Technology Ventures Ltd. for the initial stages of developing comprehensive platforms for animation and two- and three-dimensional online games.

Oslo-based online gaming company Funcom finished the summer by adding another €500,000 (\$627,131) to its third round to close with €5 million. The additional funds came from Nordic Venture Partners, which joined existing investors Northzone Ventures, Teknoinvest Management A/S and Stelt Holding NV, all of Oslo, who had invested the initial €4.5 million in April 2004.