

**INFOGRAMES**

*Entertainment*

# **HALF-YEAR REPORT**

**December 31, 2001**

**(FY 2002/2003)**

## **SIX-MONTH INTERIM REPORT**

### **1. BUSINESS ENVIRONMENT AND HIGHLIGHTS FOR THE PERIOD**

The world interactive videogame market continued to grow over the past six months with the introduction of the next generations of consoles and the expansion of the number of consoles in operation.

#### **CONFIRMATION OF HIGH GROWTH PROJECTIONS IN THE US MARKET**

The market is growing at an average annual rate of 6.5% (source: NPD). The positive turn that the market took in mid-2001 was confirmed and strengthened over the second half of the year, despite drops in September and October 2001 in the wake of the events of September 11.

This dynamic was driven by:

- the introduction of Microsoft's X-BOX and Nintendo's Game Cube in November 2001, which were very successful: annual sales at the end of December 2001 were 1.4 and 1.2 million consoles, respectively (source: NPD).
- the continued rapid growth in the number of Sony's PlayStation 2 and Nintendo's Game Boy Advance consoles in operation, whose sales reached 2.0 and 1.6 million units for December 2001 alone, bringing annual sales of these consoles to 6.2 and 4.7 million units, respectively, at the end of December 2001 (source: NPD).

#### **RECOVERY OF THE EUROPEAN MARKET**

After an extensive transition period, the market is emitting signs of recovery in the UK, although the situation in other countries, especially Germany, has not improved. With the holiday period, the market grew in November and December 2001. Nevertheless, a recovery of the European market as a whole cannot be expected before the introduction of the latest two consoles, X-BOX (March 2002) and Game Cube (May 2002), with a 6-9 month lag compared to the United States.

#### **INFOGRAMES GAINING STRENGTH ON THE US MARKET**

Owing to the consolidation of the business of GT INTERACTIVE, INFOGRAMES NORTH AMERICA and HASBRO INTERACTIVE during the previous fiscal year, the position of INFOGRAMES grew considerably stronger especially on the market of PC games, with major titles like Roller Coaster Tycoon, Backyard Basketball, Backyard Football, Survivor and Civilization III, along with nearly 200 catalog titles that sold more than 25,000 copies each in 2001. In 2001, Infogrames held an overall market share of 6.3% (source: NPD), and a PC market share of 14.9% (source: NPD).

#### **STRENGTHENING THE GROUP'S FINANCIAL STRUCTURE**

The Group's financial structure was considerably strengthened during the six-month period by the following operations:

- the acquisition of Interactive Partners through a merger, approved by the Special Shareholders' Meeting of December 17, 2001, which made it possible to simplify the Group's management structure and which brought the treasury stock on that date to 16,067,996 INFOGRAMES ENTERTAINMENT shares,
- the buy-back of 2,179,139 OCEANE 2000-2005 bonds, for € 54.4 million, reducing outstanding bond debt by € 100.5 million,
- the disposal of 8,000,000 INFOGRAMES ENTERTAINMENT shares to the General

Atlantic Partners (GAP) funds in exchange for 50.0 million dollars (€ 56.7 million) in cash and INFOGRAMES INC. convertible bonds for 50.0 million dollars face value (€ 56.7 million) held by GAP.

The combination of these three operations reduced net debt by € 160 million (exclusive of operational financing during the period), strengthened equity by € 100 million (exclusive of income and other movements during the period).

#### **FINAL ACQUISITION PRICE FOR HASBRO INTERACTIVE**

The Group entered into an agreement with Hasbro Inc, effective December 20, 2001, regarding the price adjustment provided in the acquisition agreement. This price adjustment involves:

- the payment by Hasbro Inc. to the Group of 4.0 million dollars in cash (€ 4.5 million),
- the return of 1,685,265 INFOGRAMES ENTERTAINMENT shares by Hasbro Inc. to the Group, which is the equivalent of € 25.0 million based on the share price on January 31, 2002 (share delivery date).

The accounting consequences of this agreement were reported in the consolidated financial statements on December 31, 2001. In accordance with the current accounting regulations, the returned treasury shares are treated as a reduction in equity.

## **2. ANALYSIS OF THE ACTIVITY AND SIX-MONTH CONSOLIDATED INCOME STATEMENT**

<b>€ millions</b>	<b>December 31, 2001 (6-month)</b>	<b>December 31, 2000 (6-month)</b>	<b>June 30, 2001 (12-month)</b>
Revenue	422.1 100.0%	349.7 100.0%	674.3 100%
Gross margin	231.0 54.7%	179.5 51.3%	339.7 50.4%
<b>Operating income (loss)</b>	<b>20.8</b> <b>4.9%</b>	<b>(12.4)</b> <b>-3.5%</b>	<b>(55.8)</b> <b>-8.3%</b>
Interest and investment income (loss)	(11.2) -2.7%	2.0 0.6%	(9.0) -1.3%
Extraordinary items	20.9 5.0%	(4.4) -1.3%	(25.9) -3.8%
Corporate income tax	(2.2) -0.5%	(0.5) -0.1%	(12.9) -1.9%
<b>Net income (loss) before amortization of goodwill</b>	<b>28.3</b> <b>6.7%</b>	<b>(15.3)</b> <b>-4.4%</b>	<b>(103.6)</b> <b>-15.4%</b>
Companies consolidated by the equity method	0.0 0.0%	0.7 0.2%	0.7 0.1%
Amortization of goodwill	(11.4) -2.7%	(9.2) -2.6%	(20.6) -3.1%
<b>Consolidated net income (loss)</b>	<b>16.9</b> <b>4.0%</b>	<b>(23.8)</b> <b>-6.8%</b>	<b>(123.5)</b> <b>-18.3%</b>
<b>Net income (loss) Group share</b>	<b>15.8</b> <b>3.7%</b>	<b>(22.2)</b> <b>-6.3%</b>	<b>(121.3)</b> <b>-18.0%</b>

#### **INCOME STATEMENTS**

The income statements on December 31, 2001 (6-month), December 31, 2000 (6-month) and June 30, 2001 (12-month) break down as follows:

<b>€ millions</b>	<b>December 31, 2001 (6-month)</b>	<b>December 31, 2000 (6-month)</b>	<b>June 30, 2001 (12-month)</b>
Revenue	422.1 100.0%	349.7 100.0%	674.3 100.0%
<b>Gross margin</b>	<b>231.0</b> <b>54.7%</b>	<b>179.5</b> <b>51.3%</b>	<b>339.7</b> <b>50.4%</b>
Research and development	(58.2) -13.8%	(54.7) -15.6%	(101.4) -15.0%
Marketing and sales	(104.8) -24.8%	(91.2) -26.1%	(193.5) -28.7%
General and administrative	(47.2) -11.2%	(46.0) -13.2%	(100.6) -14.9%
<b>Operating income (loss)</b>	<b>20.8</b> <b>4.9%</b>	<b>(12.4)</b> <b>-3.5%</b>	<b>(55.8)</b> <b>-8.3%</b>

The Group's consolidated **revenue** rose by 20.7% compared to the same period last year. This growth was largely driven by:

- the excellent performance of products resulting from the acquisition of Hasbro Interactive in January 2001,
- very satisfactory results of the Group's US sales, showing spectacular gains of 48% over the same period last year,
- the growth of sales for next-generation consoles (PS2, Game Boy Advance and X-BOX), which already represent 30% of the 6-month consolidated revenue.

The **consolidated gross margin** was € 231.0 million, 28.7% higher than the same period last year, posting a relative improvement of 3.4 points. This increase, proportionally stronger than the increase in revenue, is the result of contrasting effects:

- a product-mix effect, especially in the US,
- the improvement of margins in Europe, representing the first concrete sign of the market's revival during the period.

**Research and development costs** amounted to € 58.2 million, 6.4% higher than the same period last year. Accounting for the effects of the acquisition of Hasbro Interactive, this shows that the R&D effort has stabilized due to the increased experience on the new consoles and to the rationalization of the Group's software development capabilities.

**Marketing and selling costs** were € 104.8 million, as opposed to € 91.2 million for the same period last year, which is a clear improvement in relative value (24.8% of revenue versus 26.1% for the previous period). This growth is the result of the continuing "branding" efforts begun in past years, as well as of the rationalization of operations by the application of synergies and factors of scale. In addition, the reorganization of marketing structures, both in the US and Europe, improved the targeting of advertising campaigns and increased the flexibility of marketing costs per product. The combined effect of these factors led to a nearly 1.3-point reduction in the "marketing and selling costs/revenue" ratio compared to the same period last year.

**General and administrative costs** were € 47.2 million (+2.6%), after taking into account the integration of Hasbro Interactive in January 2001. Drastic restructuring measures for the acquired entities, along with the program to cut fixed costs begun in summer 2001, reduced the "General and administrative costs/revenue" ratio by 2 points over the same period last year, which demonstrates the Group's ability to post strong growth while controlling structural costs.

The consolidated **operating income** is positive at € 20.8 million, or 4.9% of revenues, versus a loss of € 12.4 million, or 3.5% of revenue, for the same period last year. This growth can be broken down as follows:

- a 3.4-point improvement in the gross margin,
- a 1.8-point improvement in R&D costs,
- a 1.3-point improvement in marketing and selling costs,
- a 2.0-point improvement in general and administrative costs.

#### **REVIEW OF THE INCOME STATEMENT**

Consolidated **interest and investment income** went from a gain of € 2.0 million to a loss of € 11.2 million, primarily due to the decrease in foreign exchange gains and the increase in interest expenses on bonds because of a larger average debt compared to the same period last year.

There was a **net gain from current business of € 9.6 million**, or 2.3% of total revenue, as compared with a loss of € 10.4 million, or 3.0% of revenue, the previous year.

The **tax expense** for the period amounted to € 2.2 million, versus € 0.5 million the previous year. This charge is made up mostly of changes in deferred tax assets, with no effect on cash and cash equivalents.

**Exceptional items** amounted to a net profit € 20.9 million, compared with a loss of € 4.4 million for the same period last year, and consisted of the following items:

€ millions	December 31, 2001 ( 6-month)	December 31, 2000 ( 6-month)
Capital gains (losses) on the sale of assets	(0.4)	1.6
Repositioning of games portfolio	(4.8)	(2.2)
Closing and restructuring charges	(6.5)	(2.8)
Depreciation of prepaid royalties	(6.5)	-
Gain (loss) on bond buy-back	46.4	-
Other non-recurring expenses	(7.3)	(1.0)
<b>Total</b>	<b>20.9</b>	<b>(4.4)</b>

After taking into account the income of companies consolidated by the equity method and the amortization of goodwill, the **consolidated net income** amounted to € 16.9 million, as opposed to a loss of € 23.8 million for the same period last year.

**Net income**, Group share, is positive at € 15.8 million as compared with a loss of € 22.2 million for the same period last year.

### 3. ANALYSIS OF THE CONSOLIDATED BALANCE SHEET AS OF DECEMBER 31, 2001

Balance-sheet items as of December 31, 2001

(€ millions)	December 31, 2001	June 30, 2001
Shareholders' equity group share	352.8	253.9
Minority interests	11.8	12.0
Contingency and loss provisions	10.9	21.3
Debt (exclusive of convertible bond premiums)	492.7	569.3
Cash and cash equivalents	89.0	99.0
Working capital	155.4	101.0
Goodwill	247.5	293.6
Intangible assets	299.8	305.5
Other assets	76.5	57.4

**Consolidated shareholders' equity**, group share, amounted to € 352.8 million on December 31, 2001, compared with € 253.9 million on June 30, 2001.

This increase in shareholders' equity was the result of the following:

<b>Shareholders' equity, net of minority interests, on June 30, 2001</b>	<b>253.9</b>
Net income	15.8
Merger with Interactive Partners, net of cancellation of treasury shares	(10.8)
Purchase/ Disposal of Treasury shares, net of tax	123.2
Exercise of stock options	0.4
Employee Savings Plan	1.3
Cancellation of treasury shares returned by Hasbro Inc.	(25.0)
Unrealized foreign-exchange gain (loss)	(6.0)
<b>Shareholders' equity, net of minority interests, on December 31, 2001</b>	<b>352.8</b>

**Debt**, (exclusive of redemption premiums) amounted to € 492.7 million on December 31, 2001 (€ 569.3 million on June 30, 2001), consisting of € 378.5 million in convertible bonds (€ 463.8 million on June 30, 2001) maturing in 2004 and 2005. **Cash and cash equivalents** on December 31, 2001 amounted to € 89.0 million, compared with € 99.0 million on June 30, 2001. Net debt (exclusive of redemption premiums) amounted to € 403.7 million on December 31, 2001, compared with € 470.3 million on June 30, 2001. The "total debt/total shareholders' equity" ratio was 1.27 on December 31, 2001, compared with 2.05 on June 30, 2001. The Group also holds 7 million treasury shares, which are treated as a reduction in shareholders' equity on December 31, 2001.

**Goodwill** was € 247.5 million on December 31, 2001, down from € 293.6 million on June 30, 2001. This decrease came in particular from the € 29.4-million downward revision of the acquisition price of INFOGRAMES INTERACTIVE INC.

**Intangible assets** amounted to € 299.8 million on December 31, 2001, down from € 305.5 million on June 30, 2001. This decrease over the period is due essentially to foreign-exchange differences and acquisitions of game software.

**Net working capital** grew by € 44.4 million, chiefly owing to the effect of the Christmas holiday season on sales.

#### **4. SIGNIFICANT EVENTS SINCE DECEMBER 31, 2001**

At the end of January 2002, Hasbro Inc. executed the agreement with the Group concerning the revision of the acquisition price of Hasbro Interactive. As indicated in paragraph 1 above and in note 2.B of the schedule to the six-month consolidated financial statements, all of the effects of this agreement were taken into account in the six-month financial statements as of December 31, 2001.

In accordance with the decision of the Shareholders' Meeting of December 15, 2000, the Group freely allocated, on January 15, 2002, one INFOGRAMES ENTERTAINMENT share for every 20 shares held. This free allocation is not accounted for in the consolidated financial statements as of December 31, 2001, with the exception of the calculation of the net earnings per share and the net diluted earnings per share.

#### **5. PROSPECTS**

The continued strength of the US market, boosted by renewed growth in the European market expected with the introduction of the X-BOX in March 2002 and the Game Cube in May 2002, is setting the stage for expanding sales in the second half, despite seasonal differences that are normally less favorable, especially in the third quarter.

The INFOGRAMES worldwide catalog will be further strengthened in the second half with several major releases:

- Stuntman (developed by the creator of Driver) and V-Rally 3 for PS2,
- Jet Set Radio and Grand Prix 4, released alongside the X-BOX introduction in Europe,
- Sonic Adventures for Game Cube (with the introduction of the machine in Europe), the first product after the agreement with SEGA,
- Unreal 2 and Neverwinternights for PC, much anticipated by gamers.

The level of activity during the second half of the fiscal year will depend, on the one hand, on the continued growth of the US market and, on the other hand, on the success of the releases of X-Box and Game Cube in Europe in March and May 2002 respectively and the continued growth of PS2 sales, in an environment usually less favorable due to seasonality effects.

#### **6. TRADING BY THE CORPORATION IN ITS OWN STOCK**

##### **SHARE PRICE**

Under the authority granted to it by the Annual Shareholders' Meetings of December 15, 2000 and December 17, 2001, the Corporation purchased 418,690 and sold 567,916 INFOGRAMES ENTERTAINMENT shares during the six-month period ended December 31, 2001, for the purpose of maintaining an orderly market in its stock. As of December 31, 2001, the Group no longer holds any of its own stock acquired pursuant to these authorizations.

## **TREASURY STOCK**

Following the acquisition of INTERACTIVE PARTNERS SA by INFOGRAMES ENTERTAINMENT SA through a merger on December 17, 2001, the Group held 16,067,996 INFOGRAMES ENTERTAINMENT shares. The Group disposed of 10,700,000 of these shares between December 17 and 31, 2001 in refinancing operations.

As of today, the Group also holds 1,685,265 INFOGRAMES ENTERTAINMENT shares, which were returned to it by Hasbro Inc. pursuant to the revision of the acquisition price of Hasbro Interactive, bringing the total number of treasury shares to more than 7 million.

## **7. EMPLOYEES STOCK PURCHASE PLAN**

An Employee Savings Plan (ESP) was set up in 1999-2000 for all of the Corporation's employees in France. After an initial subscription in May 2000 for € 0.9 million, a second subscription was carried out in December 2001 for € 1.3 million. As of December 31, 2001, employees held approximately 0.02% of the capital through the Employee Savings Plan.

