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Pac-Man Finally Meets His Match Feverish competition takes its toll on video-game stocks

Over the past several years, almost no business has grown faster than video games, but last week stocks of most of the industry's highflying participants came crashing down with a thud. Warner Communications, owner of Atari, the king of video games, unexpectedly forecast a slump in fourth-quarter earnings. The news reverberated through Wall Street. Analysts began recalculating profit estimates of the best-known games manufacturers, trying to divine whether the Atari setback had more cosmic implications. By week's end no one was quite ready to declare that the stock market was flashing a bleak "Game Over" for the popular amusements. But it seemed clear that video-game makers would no longer be able to rack up record profits with the ease of a twelve-year-old joystick junkie who stars at Pac-Man.

When investors finished adding up the losses after the stock market closed on Friday, the extent of the devastation was electrifying. The most money was lost on Warner. The company's stock sank during the week like a runaway elevator—from \$54 to \$35, a loss in market valuation of an astounding \$1.3 billion. Shares of the other market leader, Mattel Inc., which makes Intellivision, lost \$192 million, fully 40% of their earlier value.

Until last week, the only question most people asked about home video games was how fast they would spread. It seemed as if every child in America, and many adults, was interested in buying plastic game cartridges and playing them on consoles (which typically cost \$200 or more) hooked up to a television set.

No one sold the cartridges and the consoles better than Warner's ten-year-old Atari. By acquiring the rights to popular arcade games like Space Invaders and Pac-Man, and designing them to fit players of its own manufacture, Atari saw its sales leap from \$30 million in 1976 to \$1.1 billion last year. As late as last

summer it still held about 80% of the world market, and in doing so had got a lock on an enormously profitable business in which cartridges that cost only about \$6 to manufacture can usually be sold for a retail price of \$25 to \$50.

Atari's success quickly lured other competitors. A year ago, Mattel was still the major one, but at least 20 companies have products on store shelves this Christmas. In order to hold on to its market share, Atari spent heavily to promote its new E.T. and Raiders of the Lost Ark games. But sales failed to reach expected levels.

Suddenly last week, Consumer Products Division President Perry Odak, 37, who had been with Atari for only eight months, was ousted. Although his removal was attributed to personality differences, the announcement came the same day as the revised fourth-quarter forecast. Warner now predicts that it will earn only about \$4.05 or \$4.10 a share this year. While that is an increase of 10% to 15% over 1981, it is well below analysts' earlier estimates of as much as \$6.63.

The bad news about Atari arrived with other grim tidings for the industry. Mattel said that it expected to lose money during the fourth quarter, even though it was shipping more of its heavily advertised Intellivision games than it did a year ago. The company blamed a softening retail market and higher marketing costs that resulted from increased competition. After Mattel's shares began dropping, trading was suspended for more than 1½ days.

Even the up-and-comers among video games were not spared. The stock of Coleco Industries Inc., which has a hit cartridge called Donkey Kong and a new console, ColecoVision, fell almost nine points in two days. Declared President Arnold Greenberg: "This is an inevitable initial reaction when the largest company in the industry says it has had disappointments. Some of the newer companies like us have really taken a large share away from Atari and Mattel." Coleco, based in Hartford, Conn., expects its sales to jump 180% this year, to \$500 million.

Another fast-growing youngster that has stolen business from the leaders is Imagic, which was incorporated just 18 months ago. Its popular cartridge, Demon Attack, was chosen the "game of the year" by an industry magazine, and the company's revenues are expected to reach \$50 million this year. The firm had planned to cash in on its popularity and go public this month, but when the other shares got zapped, Imagic's stock offering was postponed.

Such small companies need fresh capital if they are going to keep up in a business where supply has finally caught up with demand. For instance, Imagic has budgeted \$10 million—about 20% of its estimated 1982 sales—for six months of television commercials. That is still only a fraction of the \$100 million that Atari spent on advertising in 1982. Money alone, however, is not enough; in the latest ranking of the bestselling video games, Atari's top entry, Berzerk, ranks only fourth.

Despite the financial community's reaction to individual stocks, sales for the industry are still robust. Video games have been among the bestselling items this season in the face of generally flabby retail

sales. Says Leisure Industries Analyst David Londoner of Wall Street's Wertheim & Co.: "We don't think the market for cartridges will peak until 1984 or 1985." But Londoner adds, "I don't think the stock market will continue to be enraptured by video games." While millions of Americans will still be looking for a Donkey Kong or Frogger game under their trees this Christmas, investors have already started the search for other hot stocks.

—By Alexander L. Taylor III. Reported by Dick Thompson/San Francisco and Susanne Washburn/New York

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By Alexander L. Taylor, III; Dick Thompson and Susanne Washburn

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