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COLECO'S NEW VIDEO CHALLENGE

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Attack and defend: In the fantasy world of video games, that is the theme played out daily on millions of American television screens. And much like the characters in those electronic conflicts, Coleco Industries is bent on conquest - the \$5 billion home video game market - at the expense of two well-entrenched rivals, Atari Inc. and Mattel Inc.

To that end, the Hartford-based company recently introduced its Colecovision home video game system, a cartridge-playing console, to face Atari, the industry leader, and Mattel, the marketer of Intellivision, in the marketing arena.

Industry analysts and toy store owners say Colecovision's graphics -especially color quality - are generally superior to those of its competitors, and that in many stores it also enjoys a price advantage. But marketing battles, especially at Christmas, are never easy.

"Graphic superiority, that's the basis of our faith in Colecovision," said Arnold C. Greenberg, Coleco's president. A second, and perhaps more enduring characteristic, is flexibility, he added. "We wanted to design a system that could grow, that would not become obsolete, or frozen at one moment of time."

40-Point Gain in Stock Price

Although Colecovision sales have not yet contributed to Coleco's earnings, other factors have, and Wall Street has taken notice. Coleco's stock has risen more than 40 points from last December, when it traded at 7, and is up 10 points since Oct. 1, despite a 4-point drop yesterday, to \$44.75, on the New York Stock Exchange.

The market has been responding to the company's third-quarter earnings of \$17.6 million, which is more than eight times the profit reported a year ago. Sales, at \$165.6 million, more than tripled last year's third-quarter results.

Coleco attributes the dramatic gains in earnings and stock price to two developments. First, sales of its video game cartridges, which are playable on Atari and Mattel machines, began in the third quarter. Second, sales of its line of table-top arcade games - which includes the hugely successful Pac-Man game -continued strong through the quarter. Coleco said it has sold more than 2.2 million table-top machines since the beginning of the year.

Despite these successes, Colecovision's obstacles are formidable. For one, the player's production run is limited. The company said 500,000, at most, will be produced by the end of the year, compared with nearly 4.5 million Atari units and about 2 million Intellivision units. Some toy store owners are already concerned about pre-Christmas shortages.

Second, Colecovision does not play Atari game cartridges, which account for nearly 80 percent of all cartridges sold. An adapter to correct that shortcoming will be available this month for about \$50, Mr. Greenberg said. But with an additional \$50 tacked on, Colecovision's price advantage disappears. Moreover, Mattel has fought back by offering a \$50 rebate on its own systems sold before Nov. 28.

At most toy stores, Colecovision costs between \$170 and \$190, compared with Intellivision's \$230 to \$250, less the \$50 rebate. Although Atari's suggested retail price is \$199.99 for the 2600 model, and \$269 for the newly introduced 5200, many stores, especially since Colecovision's debut, are discounting the Atari systems.

"When Colecovision was introduced this fall, Atari had a 1977 model product on the market and Mattel had a 1980 product," said Richard Simon, an analyst with Goldman, Sachs. "Atari has since introduced its new model, and Mattel's rebate has made it price competitive. Things are going to get much tougher - I think it will be increasingly difficult for Coleco."

Toy store owners and managers noted, however, that Mattel's new game system is not expected to be widely available before Christmas, and that Atari's new 5200 game system, which features an enlarged memory and a greater selection of games, is not compatible with its old 2600 game system.

Potential Colecovision buyers have also apparently been attracted by Coleco's licensing agreement with Nintendo Inc., the Japanese creator of Donkey Kong, a current arcade hit, and Universal City Studios Inc. One Donkey Kong cartridge comes with each Colecovision unit.

"There's been a lot of interest, because the graphics are wonderful," said Tom Nestor, manager of the electronic games department at F.A.O. Schwartz. "But the Atari is a superior unit. It's better made, and it's more playable."

Mr. Greenberg, whose father founded the company as a leather supply business in 1932, denied that Atari's system is better constructed. Although he conceded that Colecovision's supply will be well under the demand, he said he does not consider that a problem.

"I'm delighted," he said. "That way we'll have continued strong demand in the first quarter of 1983." Supply shortages plagued Coleco in 1977, when the company entered the home video game business with an electronic tennis game. Store buyers liked it and Christmas orders flooded in. But a shortage of computer memory chips and an East Coast dock workers' strike that delayed shipment of circuit boards kept the games off the shelves until after Christmas. Coleco took a loss of \$22 million in 1978 because, by the time the games were delivered, the market shifted toward hand-held games.

To Mr. Greenberg, the key to the game business is the arcade, which will gulp down an estimated \$5 billion in quarters this year, creating, in the process, the hit games that will become the hit cassettes when the licenses are sold.

"Arcade games are the backbone of demand in this business," Mr. Greenberg said. "The key to tapping that demand is licensing, which will continue to be a very important part of our operations."

So is flexibility. A converter will allow Colecovision owners to play Atari cassettes as well as Coleco cassettes. Another accessory will be introduced next year that will, for about \$170, convert Colecovision into what Mr. Greenberg calls a "powerful and utilitarian home computer."

On Tuesday, Mattel announced that it, too, would offer a similar option for Intellivision by the middle of next year.

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GRAPHIC: Illustrations: Table of financial data on Coleco Industries (Page D4) photo of Arnold C. Greenberg (Page D4) Graph of Coleco's stock surge photo of Colecovision