Customer Report 2010

February 18, 2011

By

Brad Wardell, President & CEO

Why this report?

Stardock is a privately-held company. It does not release financials to the general public. Nonetheless, the company has a reputation for being transparent to its customers. I founded Stardock back when I was a college student nearly 20 years ago, and one of the principles I've held to since that time was the importance of sharing with others what was involved in running your own company – the triumphs and the failures.

Stardock (Stardock Corporation) consists of three businesses:

1. Stardock Software, Inc., which makes consumer software and enterprise software.
2. Stardock Entertainment, Inc., which develops and publishes its own and third-party games.
3. Impulse, Inc., a digital distribution platform that enables developers to sell and manage their software to users around the world. The platform also allows users to update and manage their software purchases as conveniently as possible.

This report summarizes Stardock's performance in 2010. It also includes our 2010 customer survey.

To learn more about Stardock, visit www.stardock.com.

Stardock Software

Historically, the majority of the company's revenue has come from this business unit. And while 2010 was a good year for Stardock Software, it was eclipsed by the growing success of the Impulse digital distribution platform.

Stardock Software currently focuses on desktop enhancement utilities for Windows. These utilities are licensed and enhanced for various enterprise customers such as Dell, HP, Parallels (MacOS) and other key partners. The software is also sold directly to consumers via Impulse.

Below is a sampling of some of our products in this area as well as a review of their respective performances in 2010.

Object Desktop

Object Desktop (www.objectdesktop.com) is our suite of desktop enhancements. It includes the majority of our desktop enhancements and is priced aggressively to attract the top 1% of PC power users. It is explicitly not designed for "casual users". It is priced for users who appreciate its capabilities but don't want to pay a premium.

The programs that make up Object Desktop include:

WindowBlinds

WindowBlinds is the world's only program that allows users to completely change the Windows graphical user interface. A user loads up a "skin" and applies it to their Windows XP, Windows Vista, or Windows 7 desktop and most of the visual elements of Windows change.
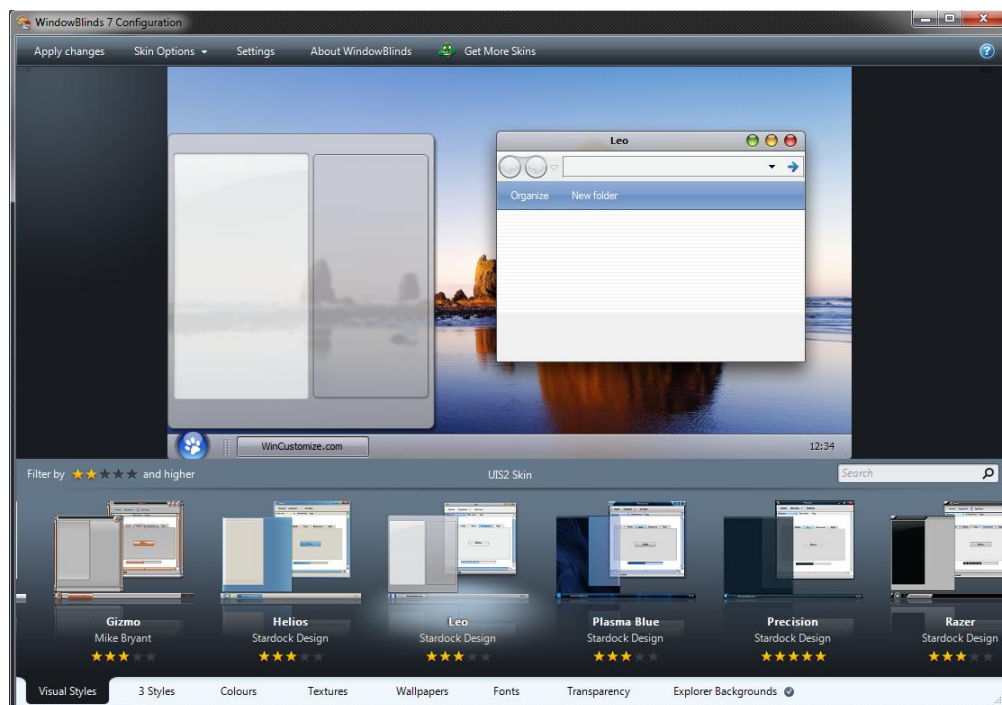

Figure 1: WindowBlinds can change the Windows user interface completely.

WindowBlinds has been licensed under many names over the years to companies ranging from Dell, HP, Alienware, Parallels, AMD, nVidia, Blizzard, and many more. If the program you're using is "skinned" there's a good chance that somewhere under the covers a form of WindowBlinds is in use.

Fences

Fences is a program that enables users to organize their desktop icons into groups called "fences." Users can double-click on the desktop to show and hide their icons, and create filters to automatically organize new icons as they show up. It has become one of our most popular programs in recent years and is currently being licensed to enterprises and OEMs as well as to consumers.

DeskScapes

DeskScapes is a program that lets users have animated wallpaper without measurably impacting system performance. Stardock created the .dream format, a left-over from our work with Microsoft on Windows DreamScenes, as a standard format for animated wallpapers. It can support both MPEG/WMV based video animations as well as dynamic (DirectX based) animated wallpapers.
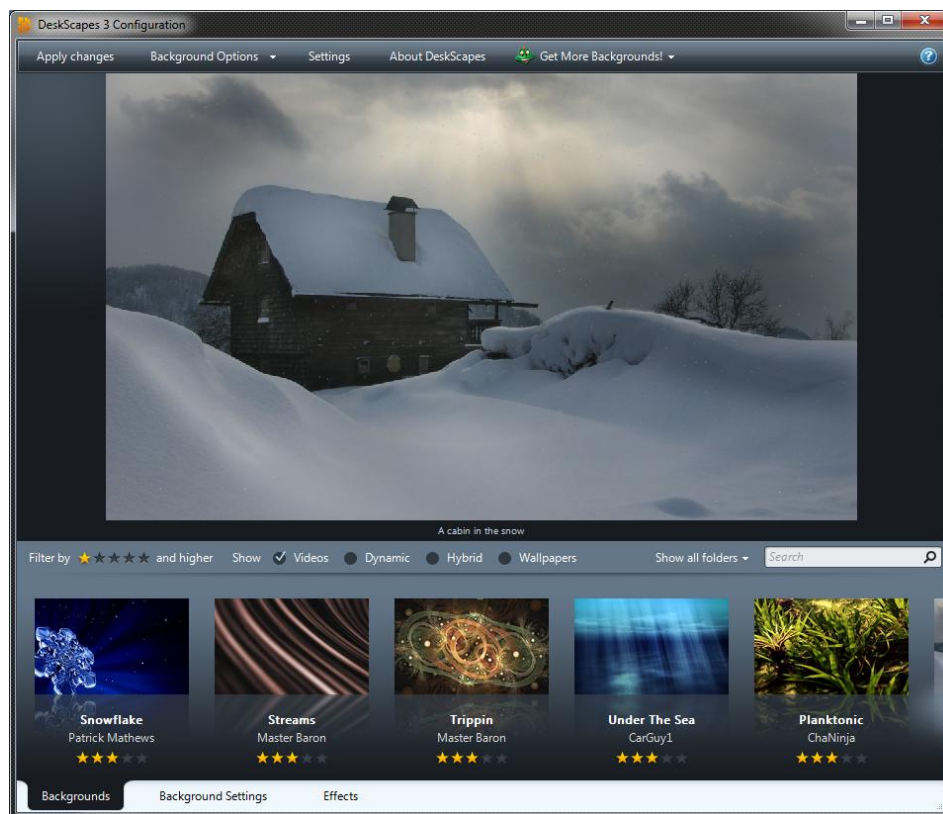

Figure 2: DeskScapes allows for animated wallpaper.

IconPackager

IconPackager can change all the icons on the Windows desktop by applying sets of icons called "icon packages". Over the years, it has become the defacto standard way for individuals and companies to update or enhance their desktop icons and has been licensed in countless forms to provide this functionality to OEMs and companies looking to brand their desktop as well as to individuals looking to change it.

WindowFX

WindowFX adds a series of additional "effects" to the Windows experience. It also fills in missing functionality in the base OS. For instance, with WIndowFX installed, a user can do things like drag a window to the corner of the desktop, and the window will resize automatically to a quarter-window. The program also supports easy auto-sizing on multiple monitors. We've always considered WindowFX to be one of our best programs but its sales have not been nearly as strong as we had hoped. We suspect this is because many users believe that its functionality should be "part of the OS" – and therefore, free. This perception has become a growing problem in this market segment in recent years.

2011 Outlook

Stardock has a major new program in internal beta to add to Object Desktop. We will be announcing this before the end of 1st quarter 2011. We also have new versions of existing programs in the works such as SoundPackager, Tweak, DesktopX and more in development.

ObjectDock

ObjectDock (www.objectdock.com) is one of our most popular programs and is on millions of PCs worldwide in one form or other. Most Dell PCs ship with the "Dell Dock" which is a derivative of ObjectDock designed specifically for the OEM market.

Changes in the market

The desktop enhancement market for Windows-based computers isn't going away, but it is mutating. The release of Windows Vista and Windows 7 has reduced the demand for "eye-candy" centric programs. Customers now seek more functionality-based enhancements.

Selling this type of program is harder to do, however. The traditional shareware or demo model fails because non-free software tends to have a greater barrier of entry. Selling via screenshots fails because functionality-based enhancements do not cause an obvious visual change to the OS. Stardock is currently reevaluating our strategy regarding this type of software.

Free to Play

The growing momentum of the iOS and Android platforms has altered the expectations of PC users as well. The traditional "try before you buy" model with a $19.95 price point is no longer viable. Users now expect to pay $1 to $5 for single purpose programs, rather than $19.95 for a program with hundreds of features and a "one-size-fits-all" philosophy.

At GDC 2011 Stardock will be making several announcements which we hope will be beneficial not just for our software but thousands of other software/game developers who are facing the same challenges.

Stardock Entertainment

Last year was a difficult year for the games unit. The release of Sins of a Solar Empire: Trinity was a high point, but the launch of Elemental: War of Magic created a black eye for the company.

War of Magic was the second Stardock title that had launch troubles, Demigod being the first. Demigod went on to be quite successful, because while it suffered from some initial networking issues, the game itself was excellent. By contrast, though War of Magic was able to resolve its technical problems very quickly, it soon became clear that there were underlying compromises in its basic design, compromises that resulted in a game that fell far short of our expectations.

Put another way, what appears "fun" on paper does not always result in "fun" in reality.

The issues surrounding War of Magic's launch led to a reorganization of the Elemental team at Stardock, and a rethinking of Stardock's development and publishing philosophy. It was determined fairly quickly that Stardock's games unit treated its development process much more casually than the typical rigorous software engineering effort. While such a process can work with very small teams of dedicated personnel who are all comfortable wearing many hats, it falls apart on larger projects.

The following specific problems were identified:

1. Internally developed titles lacked a dedicated project manager.
2. Internally developed titles lacked a dedicated game designer.
3. The studio lacked a dedicated overall lead developer.
4. The studio lacked a formalized QA process (in stark contrast with the Software and Impulse teams which have very formalized processes).

While other issues were identified specific to War of Magic, the above four problems absolutely had to be addressed.

To that end, Stardock brought Derek "Kael" Paxton and Jon Shafer on board. Derek has taken charge of the Elemental project, while Jon has taken charge of design for some of Stardock's forthcoming titles.

A formalized QA process has also been instituted based on the Software unit's model. This process has been customized by Derek Paxton to suit the studio's particulars.

Stardock is still in the process of recruiting a seasoned overall lead developer for the studio.

Elemental

Elemental is a fictional world designed to act as the setting for a series of fantasy strategy and role-playing games. During 2010, Stardock had two games in development based on this world, the first being Elemental: War of Magic and a second one being Elemental: <RPG Title>.

Unfortunately, as discussed above, War of Magic was a disappointment to Stardock and its fans in a number of areas and exposed some deep-seated problems with the games unit.

While War of Magic has subsequently been greatly improved, Stardock is not convinced that this title, with a 55 metacritic average, can redeem itself. Therefore, rather than tie new Designer/Project Manager Derek Paxton to the

previously planned expansions of War of Magic, it was decided to have Derek and his team focus on the creation of Elemental: Fallen Enchantress, a stand alone expansion which will not require users to purchase War of Magic.

(Users who purchased War of Magic this past year will receive Fallen Enchantress for free; Stardock will also provide steep discounts to anyone who purchases War of Magic prior to the release of Fallen Enchantress. We are also committed to enhancing War of Magic on its own path for those users who prefer its game mechanics.)

Figure 3: Fallen Enchantress will take a dramatically different direction from War of Magic in terms of game mechanics.

As a practical matter, Fallen Enchantress is a new game, one that shares some art assets with War of Magic but little else. The scope of the differences between the two will become very apparent in the early months of 2011. Extensive brainstorming sessions between Derek Paxton (Fall from Heaven), Brad Wardell (Galactic Civilizations), and Jon Shafer (Civilization V) resulted in a complete redesign; combat systems, tactical combat systems, character creation, economic system, game mechanics, etc. are all new.

In addition, unlike War of Magic, Stardock does not plan to make Fallen Enchantress available at retail in order to keep its schedule as flexible as possible.

Kumquat

One of the major projects at Stardock has been Kumquat, Stardock's underlying game engine. Our long-term goal with Kumquat is to give it out to modders, enabling them to create their own 3D style games with it. Stardock estimates it is still 18 months from achieving this objective.

Sins of a Solar Empire

Sins of a Solar Empire: Trinity (aka Diplomacy) was a major success for Stardock and its development partner, Ironclad Games. A significant new update for Trinity is expected out in early 2011. We will also be making some important announcements regarding Sins of a Solar Empire in 2011.

Figure 4: Sins of a Solar Empire will be entering a new era this year

Free to Play

Stardock's internal lab continues to give input to the Impulse team on how it would like to see Free to Play evolve. Some years ago, Stardock announced it was working on Society (www.societygame.com), an open-ended strategy game. This was before the term "Free to play" was coined but that is the best description for the title. The project has not had full funding yet and the company is considering creating a new business unit dedicated to Society to allow for more partners on this ambitious project.

Figure 5: Stardock's long-term in-house development effort of a large scale free to play real-time strategy game -- Society.

The company does believe that Free to Play / DLC represents the future for gaming (PC and console). As digital distribution overtakes retail, the necessity of having a game be a monolithic, $49.95 purchase will dissipate, allowing for more flexible models for gamers.

Coming Up…

Stardock Entertainment anticipates making 3 big announcements in 2011 concerning its future plans for the PC.

Impulse

Impulse is a digital distribution platform designed to make it easy for consumers to find, purchase, download and update PC games and PC software.
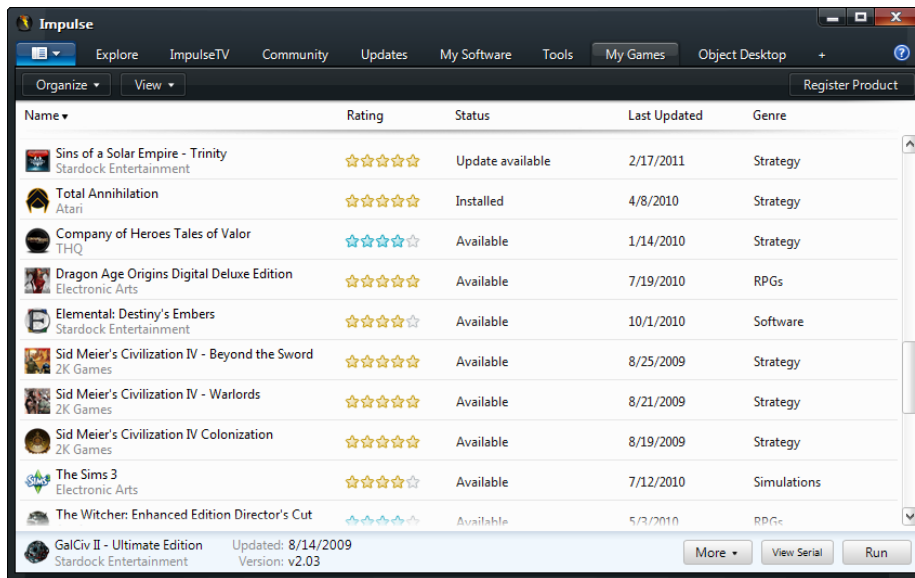

Figure 6: Impulse saw its third party revenue double in 2010

In 2010, Impulse experienced phenomenal growth, becoming Stardock's most profitable business unit. While its trails market leader, Steam, by a large margin, its user base and revenue growth insure that it has a very bright future.
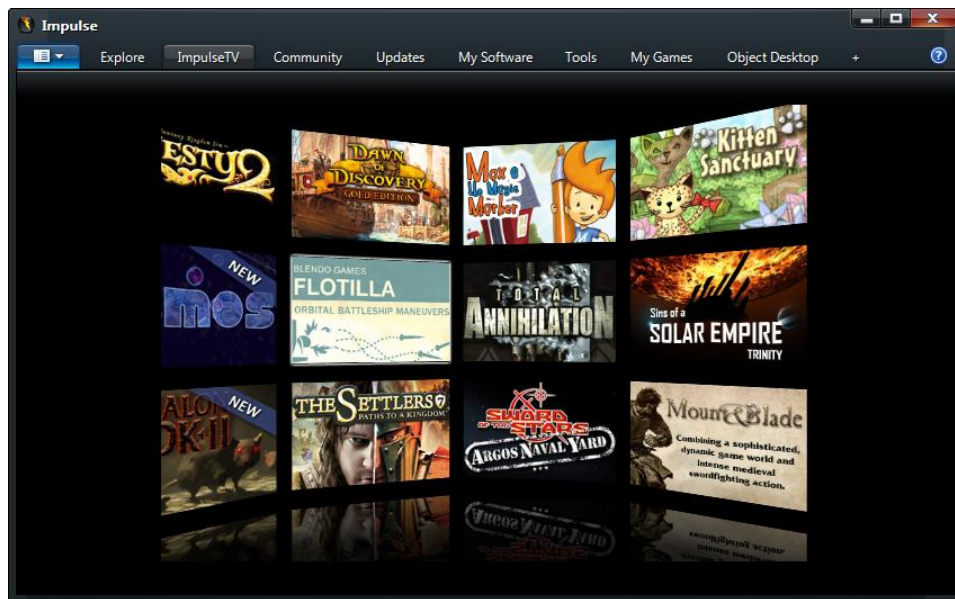

Figure 7: Impulse TV proved very popular with users.

The power of Impulse is that a user who purchases something via their Impulse account is tied to that game or application forever. If that person buys a new computer, they only have to install Impulse, logon and all their purchases are ready to reinstall.

9

Last year, our report gave an estimate of the various market shares of the digital distribution platforms. While subsequent research on the topic caused us to feel more confident in those numbers, we will refrain from giving our estimates on current market share other than to say that Steam has a commanding lead.

Impulse: Phase 5 Preparation

This past year did not see a lot of overt changes to Impulse itself. Rather, because of the increasing acceleration in digital purchasing, much of Impulse's investments were on the back-end. These improvements were designed to speed up our ability to deliver new titles and updates.

In 2009, Impulse was only capable of releasing 3 titles a week. In 2010, that number jumped to 5 titles per day. That number is still increasing. This has allowed Impulse to keep up with the demand on newer titles and give it the ability to have some market differentiation with Steam by typically having "Indie" titles up first.

However, Steam's dominance over AAA titles increased in 2010 due to the greater utilization of Steamworks by the major publishers. Most decision makers are not fully aware yet that using Steamworks requires their customer to install the Steam client and create a Steam account in order to play the game. Despite this, Steamworks has become so commonly used that Steam's competitors such as Direct2Drive and GamersGate have begun selling titles that use Steamworks (thus turning their customers into Steam users!).

Impulse's profitability has allowed it to simply not stock titles that use Steamworks. While Impulse has 'only' 3 million users (approximately), that number is more than sufficient to serve as a very effective distribution channel for our partners and for Stardock. Valve CEO Gabe Newell recently stated that Valve is more profitable than Apple or Google per employee. Given the per employee profit of Impulse, we believe that statement. Thus, Impulse has no incentive to force its customers to install a third party client in order to play a game.

Impulse Phase 5 represents the 5th major iteration of the Impulse platform. This will come in the form of the general release of the Impulse::Reactor platform (see below).

Platform Wars

While 2010 saw Impulse's third-party revenue double over the previous year, the consequence was that resources had to be pulled from Impulse::Reactor to put on the store technology in order to handle the growth rate. As a result, Impulse::Reactor was not released for the general developer community in 2010.

The lack of a viable competitor to Steamworks has allowed Steam to cement a dominant position in digital distribution.

For those who are wondering what these platforms provide, here is a brief explanation:

Steamworks/Impulse::Reactor provide:

1. In-game user accounts
2. In-game user achievements
3. An integrated DRM solution
4. A multiplayer matchmaking / connection solution
5. In-game DLC system
6. In-game community system

In "the old days", publishers would license SecuROM for their DRM and GameSpy for most other things. Neither was an inexpensive purchase; taken together, they represented a significant investment. Steamworks changed the model by providing this functionality for "free" with the caveat that the Steam client (and store) would be bundled with the game. Impulse was slow to develop as a competitor because it did not believe that retailers and publishers would accept that trade-off. History has shown that judgment to be wrong.

Though Impulse::Reactor had all 6 items above completed and in use for Elemental: War of Magic, the SDK was not deemed mature enough to release. For 2011, this will be the Impulse business unit's largest single focus.

Figure 8: Impulse::Reactor allows developers to implement DLC in-game seamlessly with very little effort.

Impulse::Reactor's architecture allows it to work without requiring a bundled client. The functionality, instead, is bundled in DLLs and on the server side. Besides giving it an advantage over Steamworks in seamlessness, the biggest reason for this design is sheer practicality – just as Impulse won't stock titles that bundle the Steam client, Impulse wouldn't expect Steam to stock titles that bundled the Steam client. Since Steam has such a large market share, Impulse::Reactor must be designed in such a way to be accepted by the digital retailers.
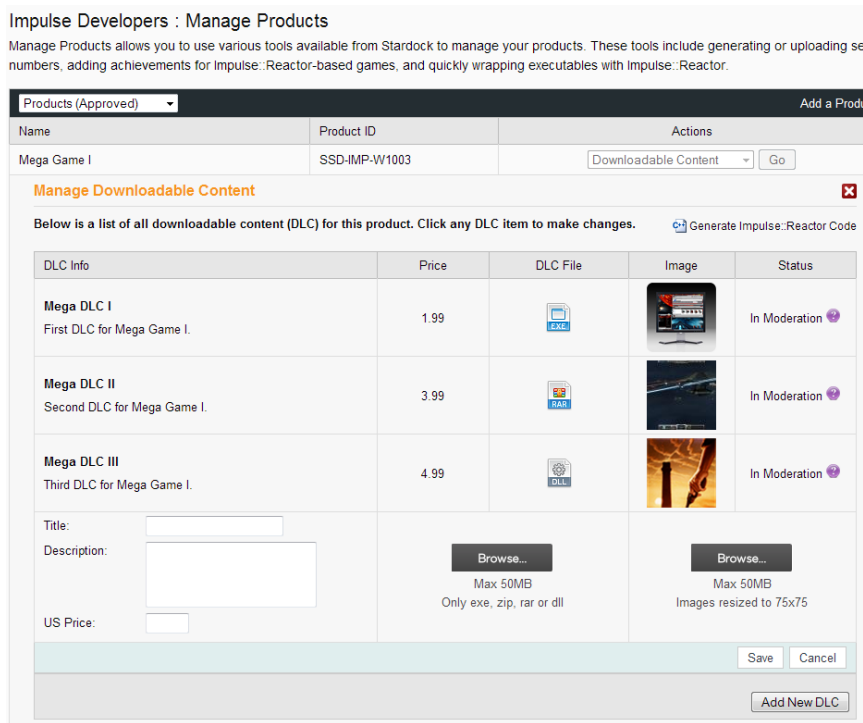
Figure 9: Making it extremely easy for game developers to add new content to their games is a cornerstone of Impulse::Reactor's Free to Play strategy

Gamers Bill of Rights

The Gamers Bill of Rights is a series of principles unveiled by Stardock and Gas Powered Games in 2008, designed to make the PC more competitive with game consoles by providing policies that reduced the risk of purchasing PC games.

At the time it was written (Summer 2008) PC gamers were routinely subjected to very inconvenient copy protection schemes, such as having stealth drivers and/or root kits installed in their systems, and/or being forced to insert physical media (a CD or DVD) into their PC in order for their game to function.

In addition, the return policies on PC titles were relatively draconian, given how inconsistent game performance was from one system to another. Frequently, a user who had problems with their purchase was unable to return their game for a refund. This drove many gamers to buy their games on consoles, due to the more consistently reliable performance of those platforms.

The full list of the Gamers Bill of Rights can be found at www.gamersbillofrights.org. In *casual* terms the principles are:

1. Gamers have the right to return games they have problems with.
2. Gamers have the right to have their games function on their system without problems.
3. Gamers have the right to reasonable post-release support.
4. Gamers have the right to have their games not require a third party program to run in order for their games to function.
5. Gamers have the right to have their games perform well on their systems if it meets the posted specifications.
6. Gamers have the right to demand their games not install hidden drivers.
7. Gamers have the right to re-download any game they have purchased.

8. Gamers have the right to use their games without being inconvenienced by the game's copy protection / DRM.
9. Gamers have the right to play their single player games without requiring an Internet connection.
10. Gamers have the right to sell or transfer physical copies of their games to other people.

This list is the updated list from late 2008. The very first version of the GBOR created objections from developers and publishers for being too vague. This late 2008 edition was considered an improvement.

One of the challenges that came with the GBOR was that gamers have used it as an empty vessel to pour their hopes into. The primary purpose of the GBOR was to set out the conditions under which someone should be able to return their game. This was, back in 2008, something fairly significant.

The GBOR is not a list of promises from a developer or a publisher. It is (as the name implies) a list of rights held by gamers. Publishers and developers are not granting these rights. These are rights Stardock (and GPG) believed were inherent and necessary for the PC to remain competitive to consoles.

The problem with those who are vigorously "anti-DRM" is that they tend to make no distinction between the various kinds of DRM. If the vast majority of users "don't care" about DRM and the militant anti-DRM segment sees it as an "all or nothing" proposition then the market will ultimately choose more stringent forms of DRM.

Stardock's principle objection to obnoxious DRM solutions is that they aren't effective at increasing overall revenue. Piracy is a significant issue for PC titles but it is too often blamed for the poor performance of titles when in fact the title failed on its own merits. In our opinion, DRM that is seamless to reasonable users is perfectly acceptable. DRM that requires the user to jump through hoops is not.

Updating The Gamers Bill of Rights

We are currently talking to developers and publishers regarding a 2011 edition of the GBOR. As digital distribution takes over, some of the concepts in it have become irrelevant (rootkits, CD's in the drive, etc.) or problematic. Some open-ended games will require Internet connections even if they are single player games. Item #10 is becoming increasingly quaint.

The most important principles of the Gamers Bill of Rights, in our view, are these 3 core ideals:

1. Gamers have the right to return a game if it doesn't work as designed on their computer for a full refund.
2. Gamers have the right to play their game without being inconvenienced by copy protection or DRM.
3. Gamers have the right to their privacy and anonymity in a game.

Item #1 is much broader than the current GBOR. But it gets around a lot of subjectivity. If a user buys a game and it doesn't work, they should be able to return it. Whether it's because it's buggy, doesn't run well on their computer, etc. It eliminates the debate as to why it's not working. It's not about placing blame, it's about reducing the purchasing risk.

Item #2 is subjective but it can be recognized by having PC publishers clearly state what they are doing and allowing gamers to decide whether it is acceptable to them or not. One person might believe having to have an Internet connection at install is unacceptable. Another user might think it's perfectly okay to be required to be constantly on. The key here is for this information to be clearly communicated so that users can opt out (return the title) if the terms are unacceptable to them.
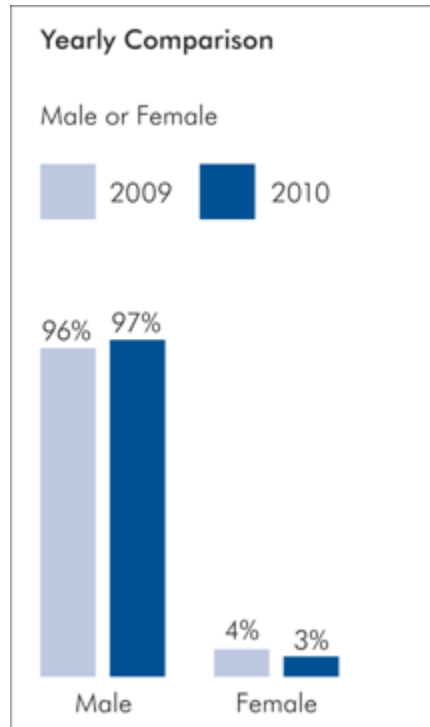
Item #3 is new but likely to become an increasingly serious issue. While anonymous gaming encourages deplorable behavior at times, it is important to remember, these are games. Privacy matters because in an age of AI driven data mining, the business models of gaming would likely go down a dark path if the software *knows* who you are in "real life".

How these updates will go will depend on the feedback of developers and publishers and will likely be part of the 2011 customer report.
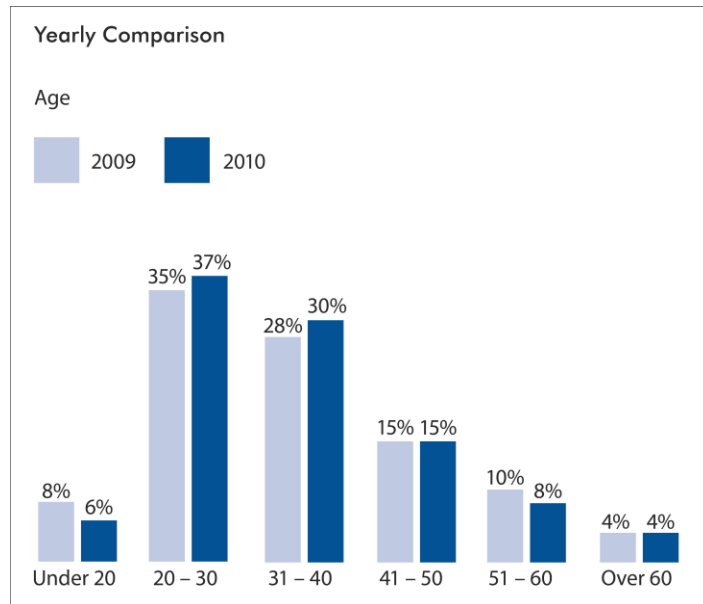
Stardock 2010 Customer Survey

Each year we send a survey out to roughly 3 million of our customers to gauge changing views on Stardock, our products, and the technology industry as a whole. Here are this year's results.
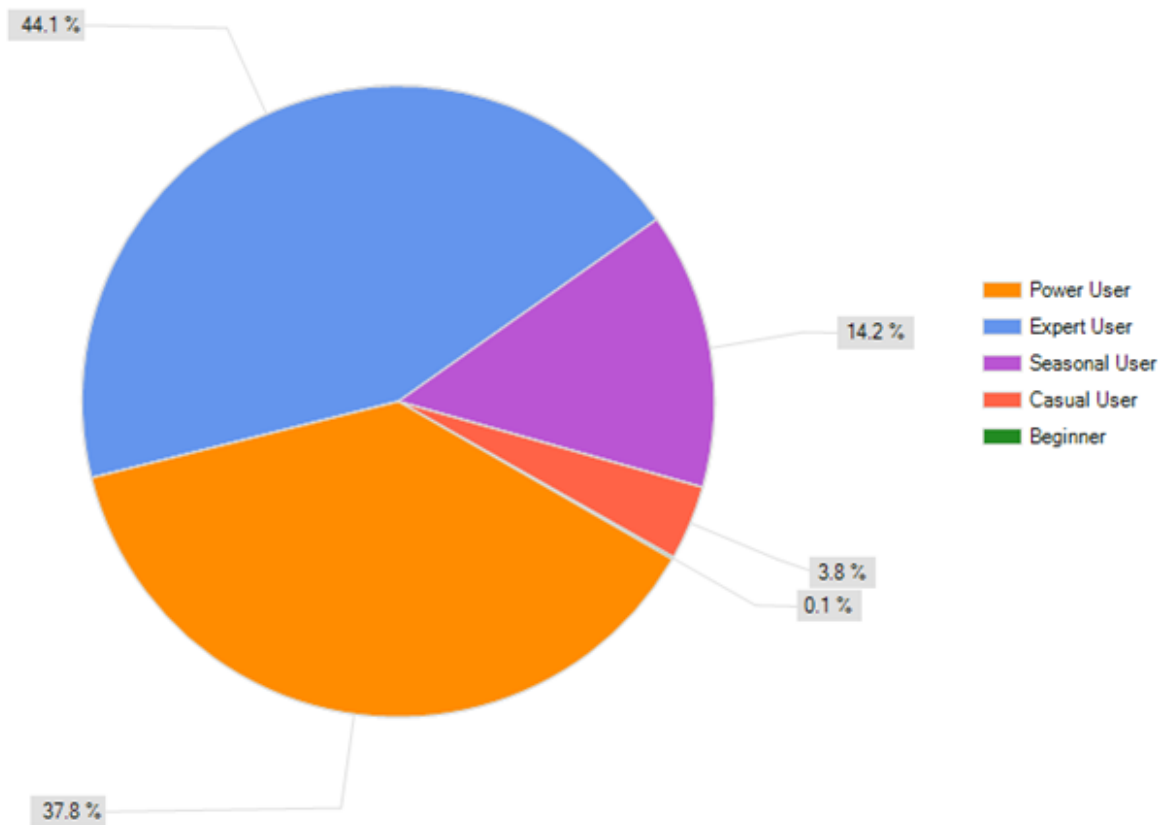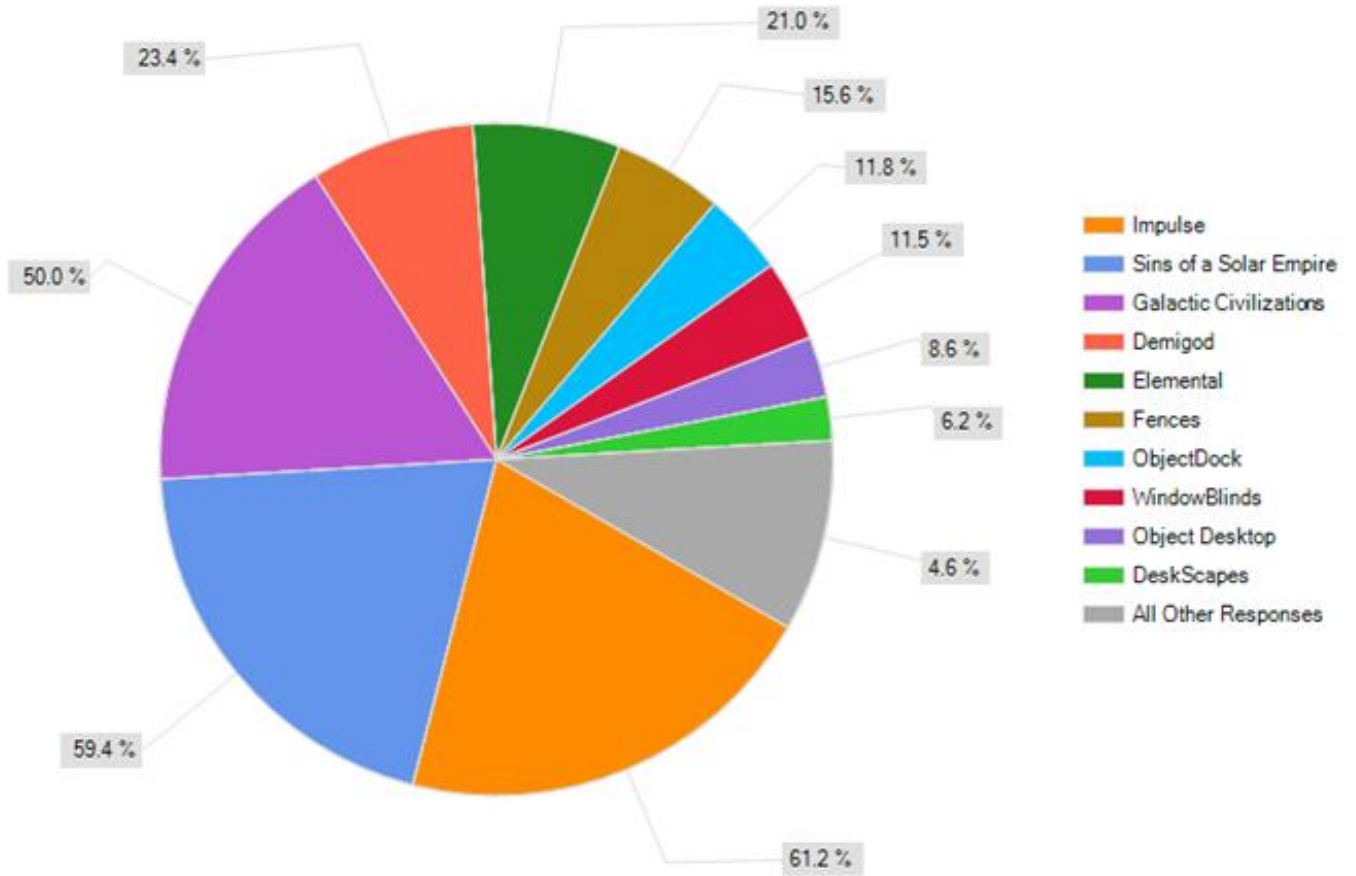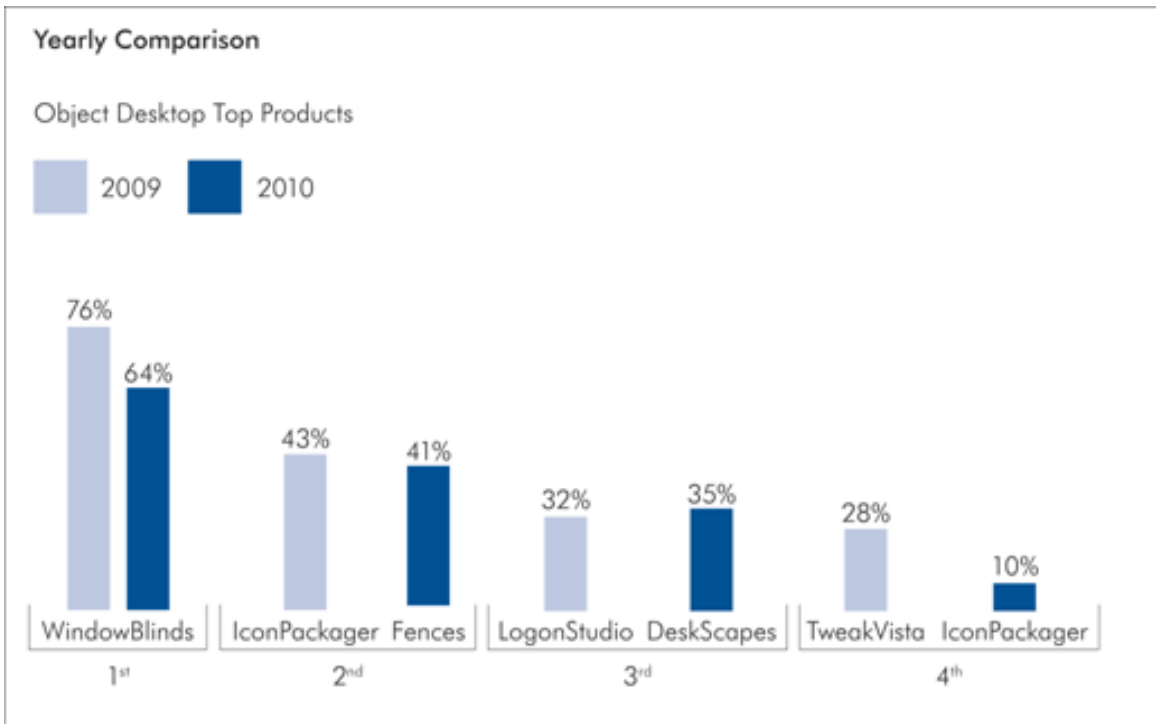
Are you male or female?

How old are you?

Yearly Comparison

Age

2009 | 2010

Under 20	20 – 30	31 – 40	41 – 50	51 – 60	Over 60
8% / 6%	35% / 37%	28% / 30%	15% / 15%	10% / 8%	4% / 4%

What is your level of computer expertise?

44.1 %

14.2 %

3.8 %

0.1 %

37.8 %

- Power User
- Expert User
- Seasonal User
- Casual User
- Beginner

Which, if any Stardock programs do you use? (check all that apply)

Legend:
- Impulse
- Sins of a Solar Empire
- Galactic Civilizations
- Demigod
- Elemental
- Fences
- ObjectDock
- WindowBlinds
- Object Desktop
- DeskScapes
- All Other Responses

Values shown: 21.0 %, 23.4 %, 15.6 %, 11.8 %, 11.5 %, 8.6 %, 50.0 %, 6.2 %, 4.6 %, 59.4 %, 61.2 %
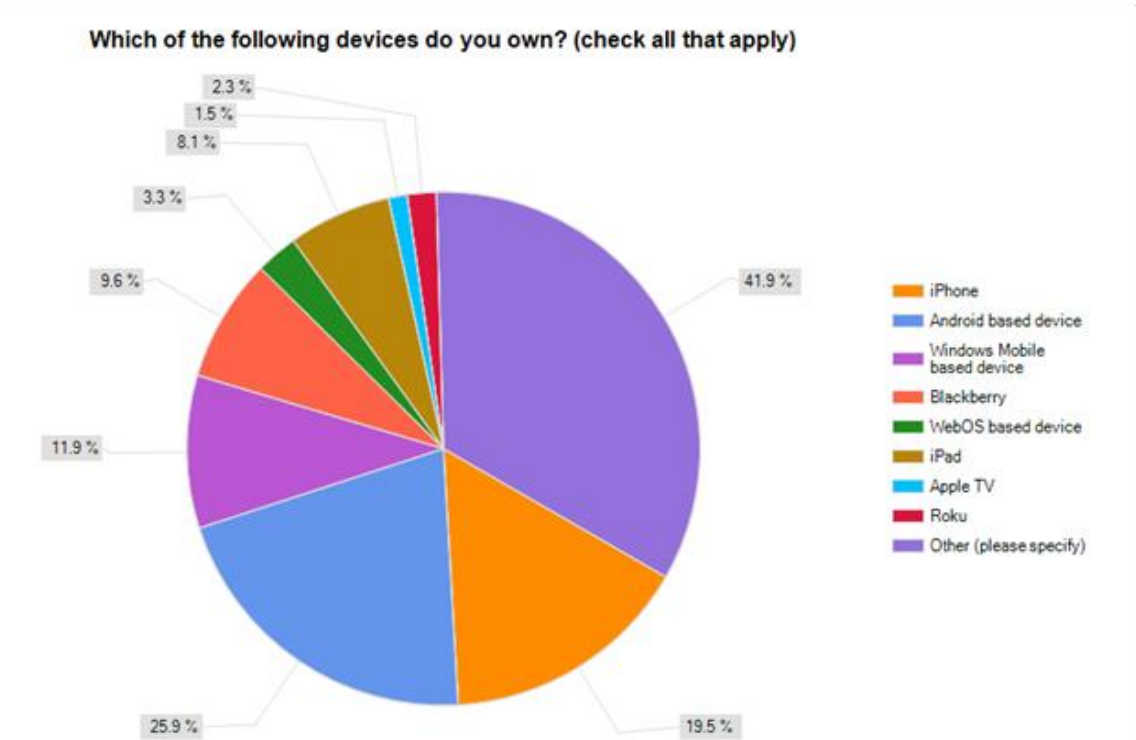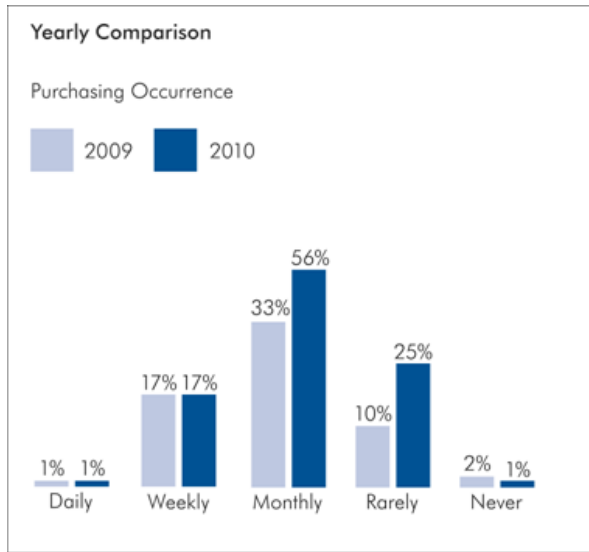
Stardock Customer Report 2010

Which Object Desktop programs do you use (if applicable)

What is your preferred way of purchasing software?
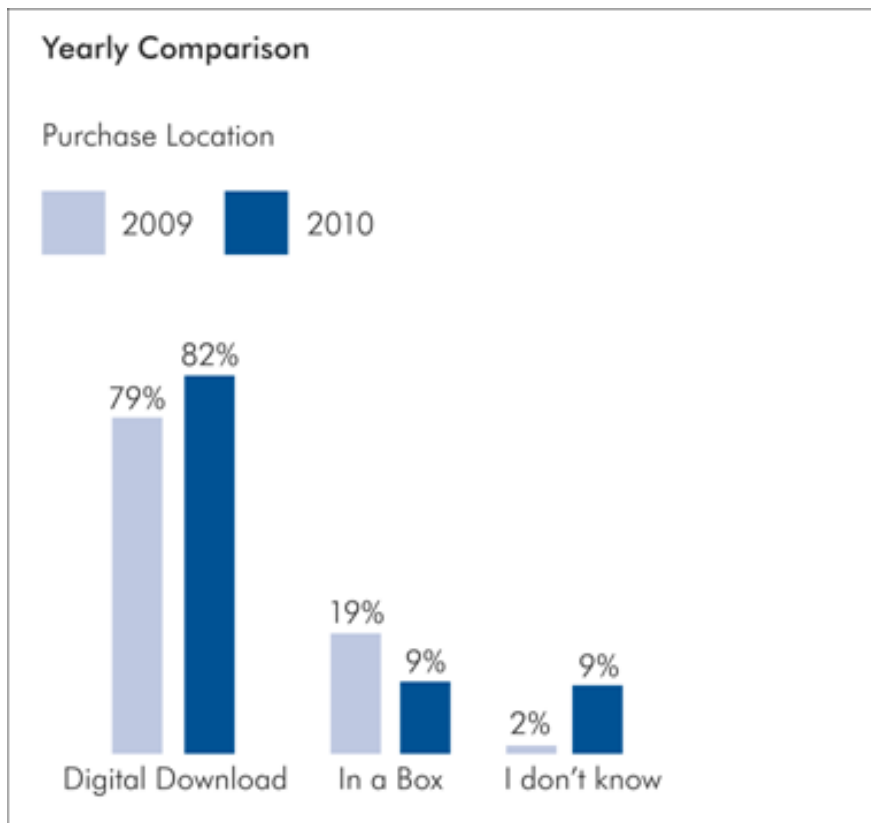
How often do you purchase software or games?

Stardock Customer Report 2010

Yearly Comparison

Purchasing Occurrence

2009   2010

Which of the following devices do you own? (check all that apply)

- iPhone
- Android based device
- Windows Mobile based device
- Blackberry
- WebOS based device
- iPad
- Apple TV
- Roku
- Other (please specify)

Stardock Customer Report 2010

Which affects your purchase more? DRM or Price?
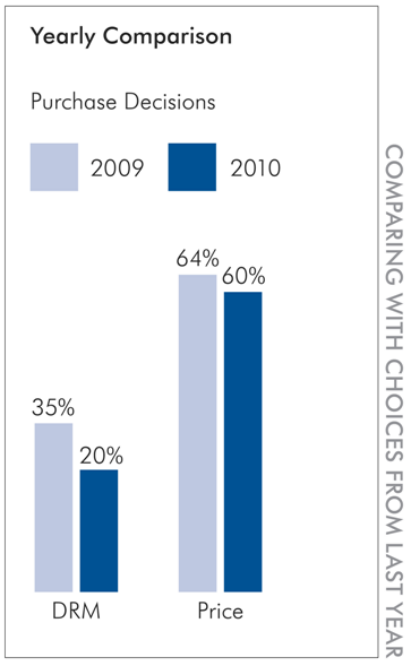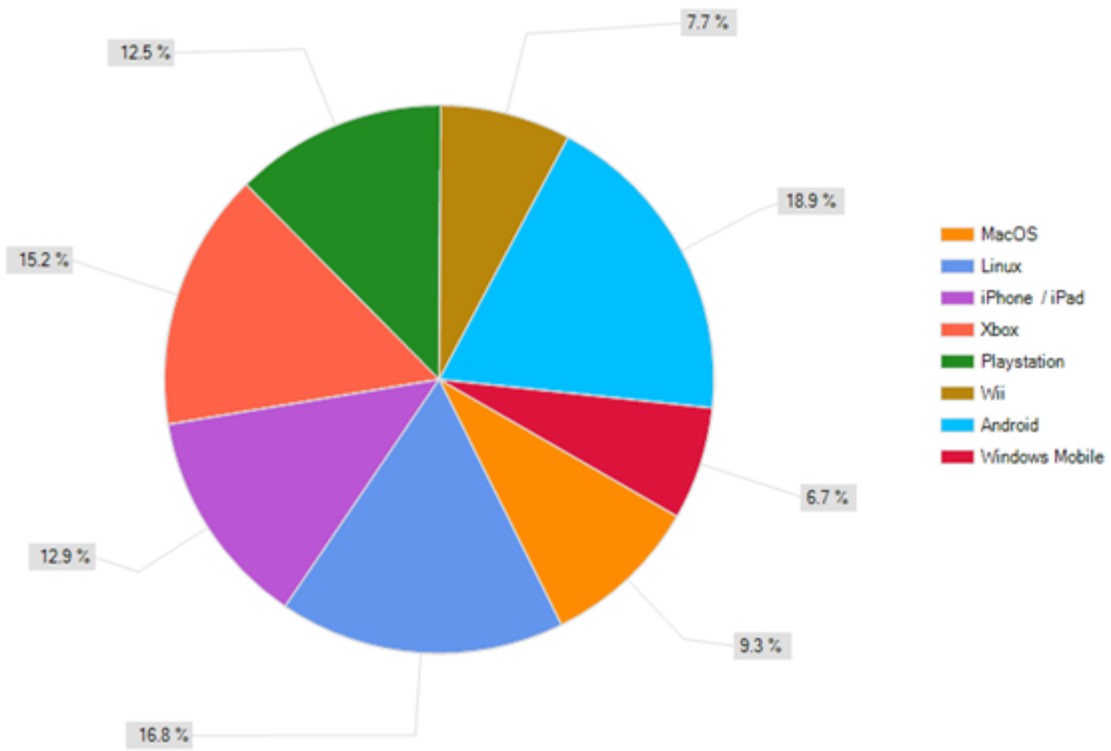
What is your overall opinion of Stardock?

Yearly Comparison

Customer Opinion

■ 2009 ■ 2010

	Very Positive	Somewhat Positive	Neutral	Somewhat Negative	Very Negative
2009	59%	31%	8%	2%	1%
2010	51%	38%	9%	2%	.3%