



Customer Report for 2012

April 2013

By

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President & CEO

20th Anniversary

20 years ago I incorporated Stardock. I was in college living in a dorm room working 3 jobs. Stardock was just something I was doing until I could get a real job.

I never did find a real job.

Why this report?

Stardock is a privately-held company; so we're not beholden to the disclosures to stockholders that publicly traded companies do. But we've always felt that corporations need to treat their customers as if they were part of the team. I think CEOs should be accessible to the public and I try to adhere to that by posting on various forums as myself. This can have mixed results in an age of page-view hungry media sites, but it is what it is.

Stardock is made up of two internal businesses:

1. **Stardock Software**, which makes consumer software and enterprise software.
2. **Stardock Entertainment**, which develops and publishes its own and third-party games.

We used to have a third called Impulse but we sold that to GameStop in 2011. We also have a number of external companies and studios that we either own the majority of or a significant minority in. Those entities will become more relevant next year.

This report also includes our 2012 Customer Survey.

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

Stardock: Post Impulse

Impulse was a digital distribution service that allowed people to purchase and download games and software. By 2010, it had about 8% of the market (Steam had around 70% back then). In 2011, we sold Impulse to GameStop.

When Stardock divested itself of Impulse, it presented the company with some unprecedented opportunities. We suddenly had enough capital to do essentially anything we wanted. We took 2011 to consider how we should use this capital. Ultimately, it was decided that we would keep Stardock itself relatively small and create an investment fund (this will be discussed more later this year).

This new fund we're creating will follow the following four principles.

1. We should use this capital to help the next generation of software and game developers.
2. We should use this capital to help found new game studios and new software ventures.
3. We will strive to have a *minority* share in these entities in the long-run.
4. These entities should produce things that will help future start-ups in the technology industry.

As a business, our objective is to make a profit. However, there are many ways to make a profit and we believed the best use of our investment capital wasn't to try to turn Stardock into some 1,000+ person company but rather to keep

Stardock small and invest in start-ups who look to create things that will in turn, play it forward. If we are successful, the profit will follow. Even if we are not successful, some benefit will come from it.

Over the next couple of years, some of these new ventures will start to become known. Hopefully, their success will help spawn new opportunities for the next generation software and game developers out there.

Stardock Software

Most of Stardock's income comes from its software. The people who play our games often have no idea that we make software... and vice versa. Then again, most people who use our software don't know we make it. It came with their computer, motherboard, hard drive, video card, etc.

Stardock Software specializes on a type of software called "desktop enhancements". These are programs designed to customize your Windows experience.

In 2012, Microsoft gave us the gift of Windows 8. Contrary to what you might hear, Windows 8 is a very good operating system. However, Microsoft made some... choices that have resulted in a new generation of desktop enhancements being demanded that improve the Windows 8 experience. We deliver these enhancements in a product called Object Desktop (www.objectdesktop.com).

However, we would not have been able to take advantage of these opportunities to the level we did without Jamie McGuffie who joined us as Vice President of Business Development. He was previously a SVP with Compuware and he has transformed Stardock's software development and publishing process completely. Not surprisingly, 2012 was the best year for the software unit in some years.

Object Desktop

Object Desktop (www.objectdesktop.com) is our suite of desktop enhancements. It is targeted at power users. We define power users as being people who focus on maximizing what they can do with a PC.

Start8

Windows 8's desktop has no Start button. I'm serious. The user is expected to either move their mouse to the bottom left, wait for the Start screen tile to display and click on it, or hit the Windows key. This takes you to the Start screen which is a pretty jarring (and if you're someone focused on productivity a terrible) environment to manage and get to your "stuff". There are plenty of debates on how bad the Start screen is, but suffice to say, lots of people find it a big step back.

Start8 does one thing but it does it extremely well: It brings back the Start button and Start menu and then enhances it to fit into the Windows 8 environment. The millions of downloads it has received is a testament to its popularity. The ever growing legions of Start8 clones speaks to its commercial success. Of course, it's not that hard to make something *look* good in a screenshot. It's another thing for something to work exactly how users want. Which is why, despite the clones, Start8 is the go-to solution for this. It was the first and remains the best, by far, solution for getting your Start button/menu experience back on Windows 8.

www.stardock.com/products/start8

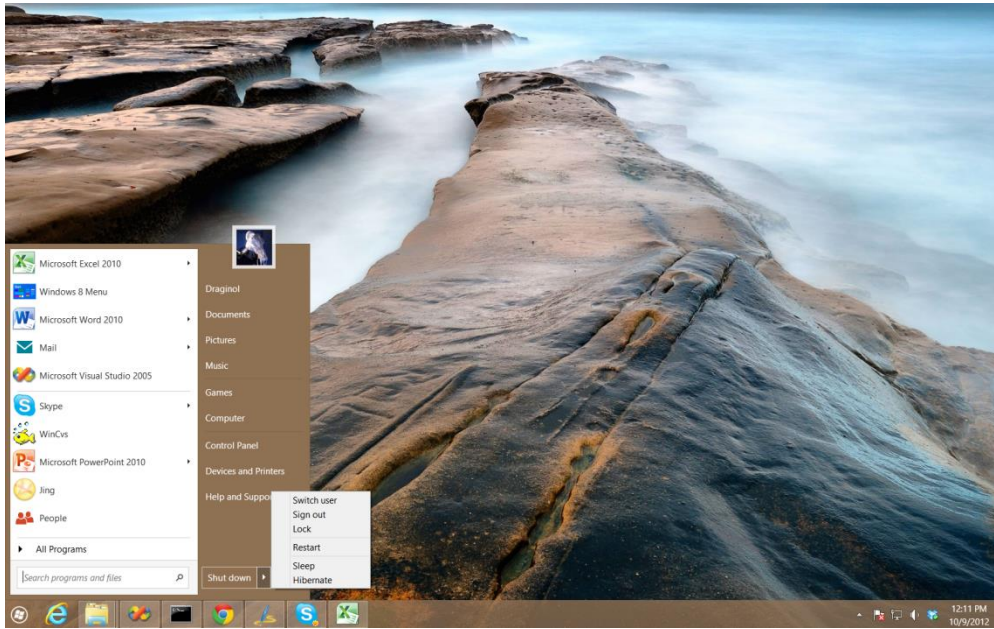


Figure 1: Start8 adds the Start button and menu back to Windows 8

Fences

Fences was already popular before Windows 8 shipped. If you want to know how the Start screen *could* have been done, check out Fences. We released Fences 2 last year. It allows users to create “fences” on the desktop to organize their icons and folders. Users can also instantly have a clean desktop by double-clicking on the desktop to hide the icons.

www.stardock.com/products/fences



Figure 2: Fences makes it easy to organize your desktop

ModernMix

ModernMix lets you run those new "Metro" (ModernUI) apps in a window on the desktop. Windows 8 includes a new development API called WinRT. The apps made with this were called "metro" apps but are now called "modern" apps. The main downside is that they all run full-screen. You haven't lived until you've had a weather "widget" take up a 30 inch display. ModernMix fixes this. It allows users to run Metro (Modern) apps on the desktop in a resizable window like any other app. This makes Modern apps much more practical on the desktop. I don't mind running the new Mail app now because I can run it on my desktop next to my other apps.

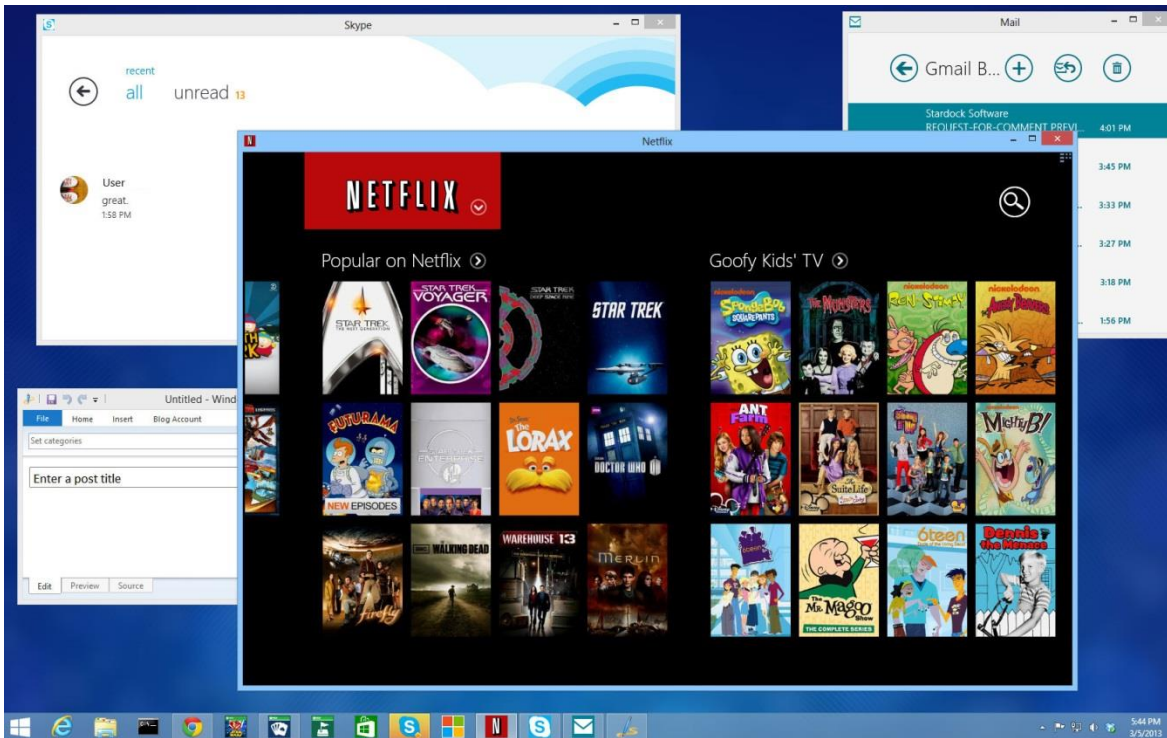


Figure 3: ModernMix -- run Windows 8 Metro apps in a window on the desktop

The Best of the Rest

Those apps are some of our newest and most popular programs. Also popular are:

- Decor8 which allows users to change the Start Screen background.
- DeskScapes which allows users to change the desktop screen background more easily and supports animation
- WindowBlinds, our most popular desktop enhancement of all time. We're working on version 8 to support Windows 8. This program lets you change the look and feel of the Windows GUI.
- ObjectDock. We released version 2 last year and it's been a big hit. Gives Windows a customizable dock.
- WindowFX. This is a fun program for Windows 8/7 users. Adds lot of cool polish tweaks to Windows.

This is an abbreviated version of what Stardock Software makes but these are our most popular consumer products.

The App Store Effect

As users migrate to getting their software off of “app stores” the increasing challenge developers will have is in getting a lot better at promoting their products. Great programs have always languished in obscurity but in the age of App stores, the problem has grown far more dire.

We have had developers express frustration at the way these app stores work. That success or failure can boil down to “knowing” the right people in order to get featured.

The consolidation of user exploration from web resources into these app stores has created a “lottery” effect for apps where some apps make it big and others fail based largely on how discoverable they are on these app stores. This has led to the creation of a cottage industry of companies who are paid to download apps from app stores to artificially inflate the statistical popularity of apps on these stores in order for those apps to become more discoverable.

There are resources online for sophisticated app users to find the “good stuff” but as a percentage, more and more users are simply relying on the manipulated discoverability inherent in app stores. This is a serious problem that we are investing resources into tackling.

Stardock Entertainment

Stardock Entertainment mostly develops and publishes games. The best known is probably *Sins of a Solar Empire* which was developed by Ironclad Games and published by Stardock.

Last year was Stardock Entertainment's best year financially ever. However, take that with a grain of salt – we released three titles last year where we normally only release one. I don't expect that to happen again anytime soon.

Sins of a Solar Empire

Last year, we released [Sins of a Solar Empire: Rebellion](#) (82 Metacritic) which was co-developed by one of Stardock's internal game teams while Ironclad has focused on its much anticipated [Sins of a Dark Age](#) MOBA style game. *Sins: Rebellion* was immensely successful – far more successful than either Stardock or Ironclad had projected. I suspect there will be more news on this front as we go forward.



Figure 4: Sins of a Solar Empire: Rebellion

Elemental

Our fantasy game universe (Elemental) has had a bit of a roller coaster ride. The first title in this world was called *War of Magic* and it bombed (54 Metacritic) back in 2010. However, the second game, *Fallen Enchantress*, has been a hit for us (78 Metacritic). While not as popular as *Sins of a Solar Empire: Rebellion*, *Fallen Enchantress* has successfully redeemed the Elemental game world.

The first *Fallen Enchantress* expansion – *Legendary Heroes*, is due out this year. Unlike *Fallen Enchantress*, where we felt like we were striving for just the right balance, *Legendary Heroes* has the advantage of starting with a solid base.

We owe the success of *Fallen Enchantress* to Derek "Kael" Paxton who joined us in 2011 to take over the franchise. Best known for his work on *Fall From Heaven*, he was able to take the muddle of *War of Magic* and turn it into a very good game. But as good as *Fallen Enchantress* is, the best is yet to come.

www.fallenenchantress.com.



Figure 5: Fallen Enchantress: Legendary Heroes comes out this Spring

What's Next

I suspect we will have *at least*, two new game announcements in 2013.

We have continued to follow-up on bringing in top-tier game designers to evaluate, tweak and enhance future titles. This process started with Derek "Kael" Paxton who developed the popular Civilization IV mod "Fall from Heaven". His work has been transformative both in terms of how games get designed here but in how they get produced. As a result, I'm pleased to announce that Derek Paxton is VP of Stardock Entertainment and in charge of the studio.

After Derek Paxton joined us, Jon Shafer joined us to help on Fallen Enchantress and help design an unannounced game. After Fallen Enchantress was completed, he founded his own company (Conifer) to work on a new strategy game called At the Gates.

This year, with the "next generation" of Stardock games in pre-production, we've brought Soren Johnson (designer of Civilization IV) to work on the designs for our new titles for the next few months. The emphasis on dedicated game design has resulted in greater confidence that new franchises will not have to go through the rocky experience that Elemental: War of Magic went through.

Beating the 64-bit drum

For strategy gamers, the last few years have been a mixed blessing. There have been some great titles released but the innovation in strategy games has been diminishing. This is not the result of a lack of game design or inventive thinking. The problem stems from a catastrophic decision made at Microsoft: not giving DirectX 10 to Windows XP users.

As a corollary, Microsoft continuing to sell 32-bit versions of Windows well after the hardware stopped being natively 32-bit has held back PC game development immensely.

Game developers have been stuck with DirectX 9 and 2GB of memory for the past decade. While this hasn't harmed first person shooters (they only have to manage a handful of objects at once), it has been poisonous to other

genres. Next time you're playing an RPG in first person with no party you can refer to DirectX 9 and 2GB of memory as a big reason for that.

With DirectX 11 we can go to town with shader anti-aliasing and lowering the development capability requirements on having a multi-core based simulation (right now, nearly all of a game's simulation occurs on 1 thread on 1 core). And with 64-bit, we can fit a lot more stuff into memory.

There are whole classes of games waiting to be made that require these kinds of advances. Luckily, after a decade long wait, we are nearing critical mass. The days of games supporting 32-bit OSes is, thankfully, coming to an end. DirectX 10 as a minimum requirement has also arrived.

Team Building

We've been fortunate to bring on board some amazing talent in the past year. Soren Johnson, who designed Civilization IV is now consulting on all our game projects and the results will appear immediately in Legendary Heroes and the subsequent games as well. We also have been fortunate enough to work with Geoff Knorr, who composed the music for Civilization V, who is leading music composition on two of our upcoming games. We have also *long* struggled with our visuals and recently teamed up with Dorian Newcomb who was largely responsible for the beautiful general look of Civilization V (we're not actively recruiting from our friends at Firaxis, Zynga closing its offices on the East coast has been a boon).

Derek Paxton (Kael), best known for Fall from Heaven is now in charge of Stardock Entertainment. While best known in the industry as a modder, his professional experience was as an executive project manager at Novell before joining Stardock.

Actual Building

This year we will build out the last of the space in the Stardock building in Plymouth MI. After this, we will be completely out of space until we construct a second building next door.



Figure 6: Stardock building

Here's what we're doing with the build out:

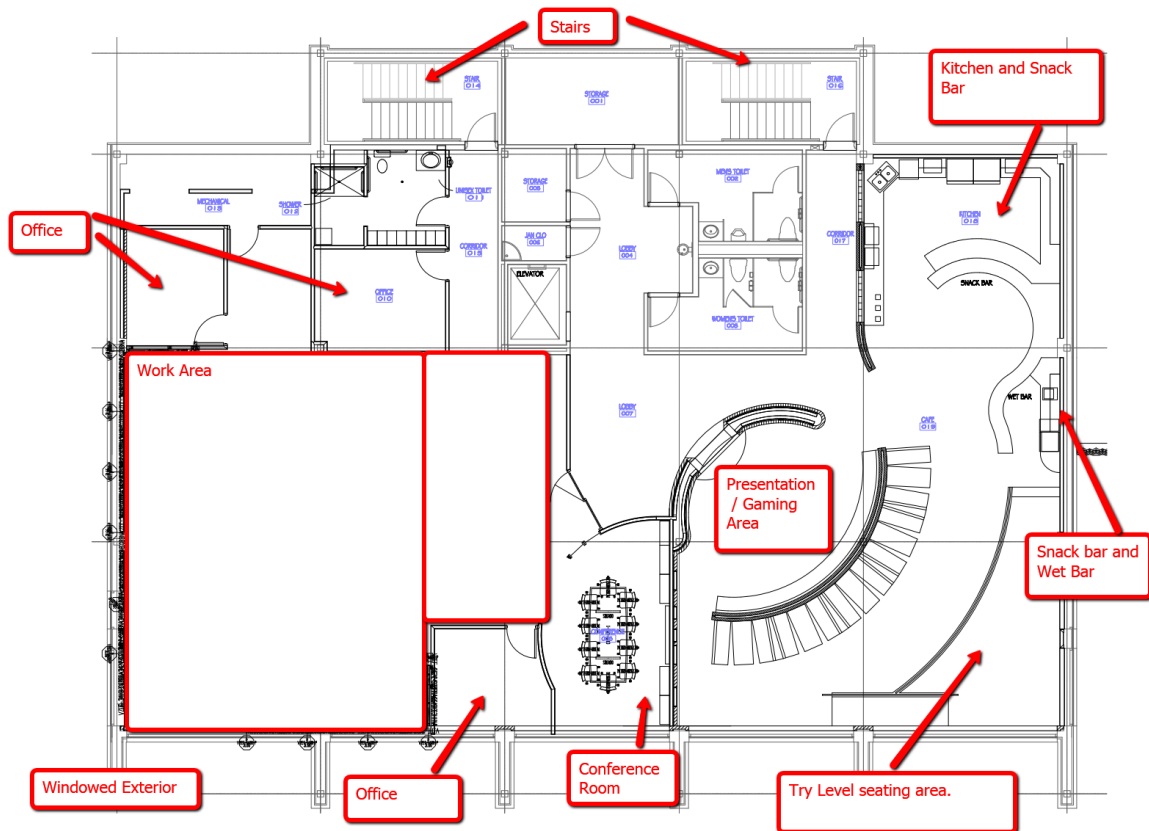


Figure 7: Blue prints for the new build out

Financials of a software company

Every company is different. But there's probably enough in common between them for you to get a rough idea of what goes into having your own software company.

Last year we ran about a 27% profit margin. We typically target a 15% margin but last year was an unusual year due to Windows 8's release and multiple game titles in a single year.

If you run a privately held company, tax planning becomes a pretty strong budgetary force (in case you were wondering why private companies try to keep their margins). Better to hire people and put them on future projects than lose it in taxes.

Our biggest expense, by far, are employees. That's about half our costs. The other half gets spread between marketing, advertising, rent, and general operations.

We have a credit line but with most of our revenue now coming from digital sales, we no longer use it. But if you do start a company and have a credit line, just make sure that your interest payments aren't more than 10% of your monthly expenses or you are getting into a hole.

The worst thing companies can do (and I have done this) is allow themselves to get into a financial hole rather than laying people off. Back when the OS/2 market died in the late 90s, I waited too long to lay people off and we ended up losing a lot more people as a result when we finally had no other choice. It's one of the crummy things about running a business (I generally don't recommend it to others).

Another key thing to emphasize is taxes. I mentioned it earlier but when I see people celebrate big Kickstarter projects, I am almost certain they're not aware that a third of that (or more) is going to go away in taxes. I think Kickstarter is a game changer for our industry (in a good way) but there is a definite downside to get a big check in the mail. If you're going to use Kickstarter, use it as it was intended – seed money. Don't use it to fund a significant portion of your effort if you can avoid it.

Financial management is an absolutely critical part of running your up and coming software business. So make sure you set up cash flow projections for a year out. Create financial models. If you're doing Kickstarter, take the first 2-days of revenue, you should be able to generate 3 to 4 times that total -- with media coverage being the wild card.

Stardock Expenses

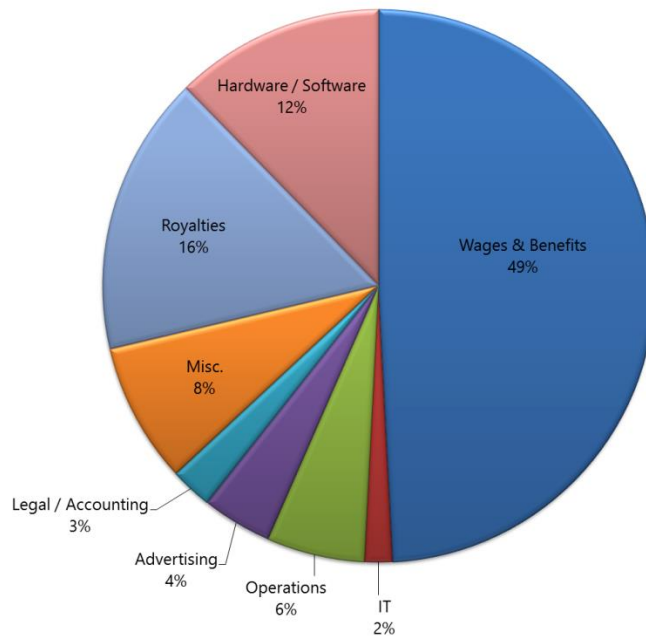


Figure 8: Where our money goes

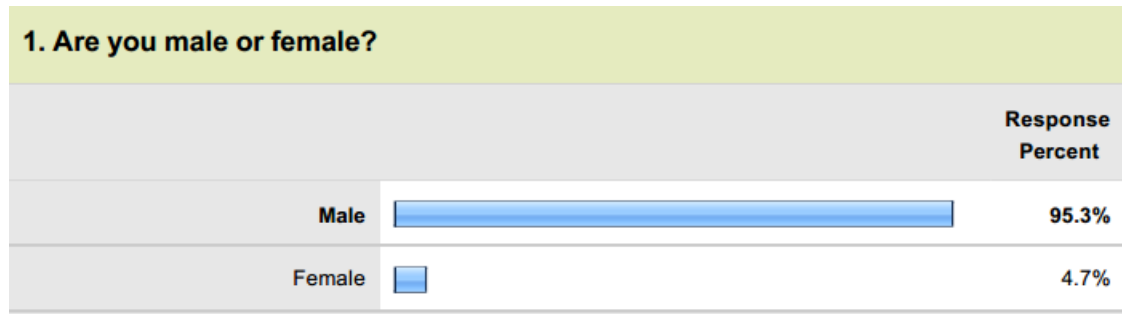
Conclusions

While 2012 was our best year to date, there are some very exciting things coming up. 2013 is going to be a tougher year (relatively speaking) since it's going to be hard to top 2012. The software group is on its way to having a great year but it'll be tougher going for the games group since its new stuff won't start to show up until 2014.

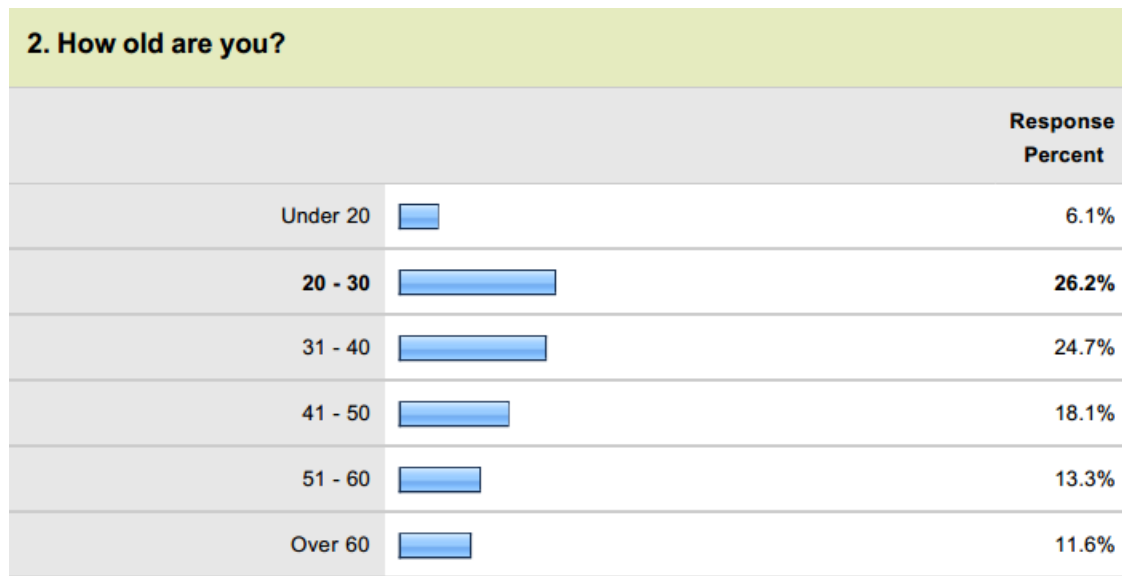
In the meantime, have a great year and see you next year! Thanks for being our customer!

Stardock Survey Results 2012

Each year we send out a survey to millions of Stardock customers. It's amazing how consistent many of the results are year after year. Below are some of the results in the survey. For those of you who participated, thank you for taking the time!









Believe it or not, this is actually less imbalanced than last year.




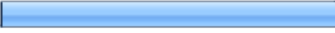







Our key demographic is 20 to 30 year olds.

4. How long have you been a Stardock customer?

		Response Percent
6 months or less		26.0%
1 year or less		11.5%
1-3 years		20.9%
3-5 years		16.1%
5 years or more		18.2%
I don't know		7.3%







This wasn't a surprise since last year was our best year on record -- most of our respondents were new customers. In previous years, 3-5 years was the biggest chunk.

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

		Response Percent
Apple TV		6.6%
Android based device		57.1%
iPad		25.3%
iPhone		26.3%
Windows Phone		8.3%
Xbox		31.4%
Wii		29.5%
Playstation		31.3%
None of these		12.1%



This surprised us. However, both Android and Apple devices grew as a % over last year. So did Windows Phone. The rest lost ground.

7. Where do you learn about new products, games, etc?

		Response Percent
YouTube		30.6%
Game/Tech Sites		71.0%
Email Notices		43.5%
Facebook		16.3%
Twitter		8.3%
Forums		41.8%

This is pretty normal. Good news for the Tech sites. However, one startling change has been the growth of YouTube as a source of information.

8. What do you use most from Stardock?

		Response Percent
Our Software		56.7%
Our Games		43.3%

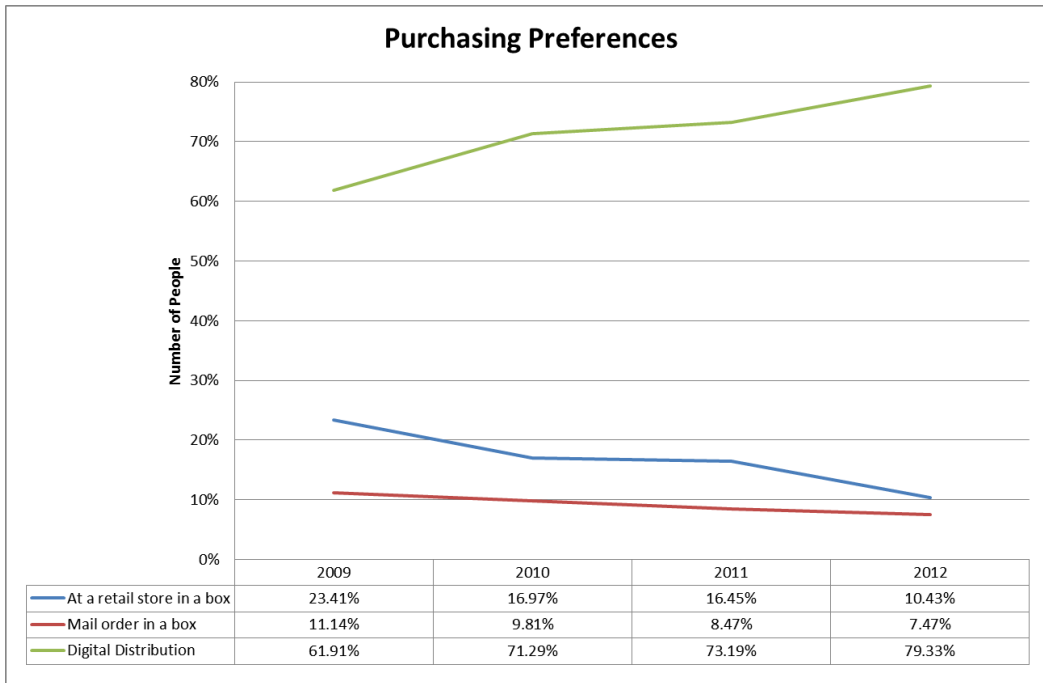
The games had an unusually good year last year since we released Fallen Enchantress, Sins of a Solar Empire: Rebellion and The Political Machine 2012. First time we've ever released 3 games in 1 year and it showed in the results with the gamers getting over 40% for the first time.

10. What is your preferred method of purchasing software?		Response Percent
At a retail store in a box		10.0%
Mail order in a box		7.5%
At a retail store via a kiosk		0.4%
Digital Distribution through Amazon		7.3%
Digital Distribution through GameStop Impulse		2.1%
Digital Distribution through Steam		37.2%
Digital Distribution through Direct2Drive		0.2%
Digital Distribution through GOG		2.9%
Digital Distribution through GamersGate		0.5%
Digital Distribution through Metaboli		0.1%
Digital Distribution through the publisher directly		20.8%
Digital Distribution from some other source		4.5%
None of the above		2.8%
Digital Distribution from some other source (please specify)		3.7%

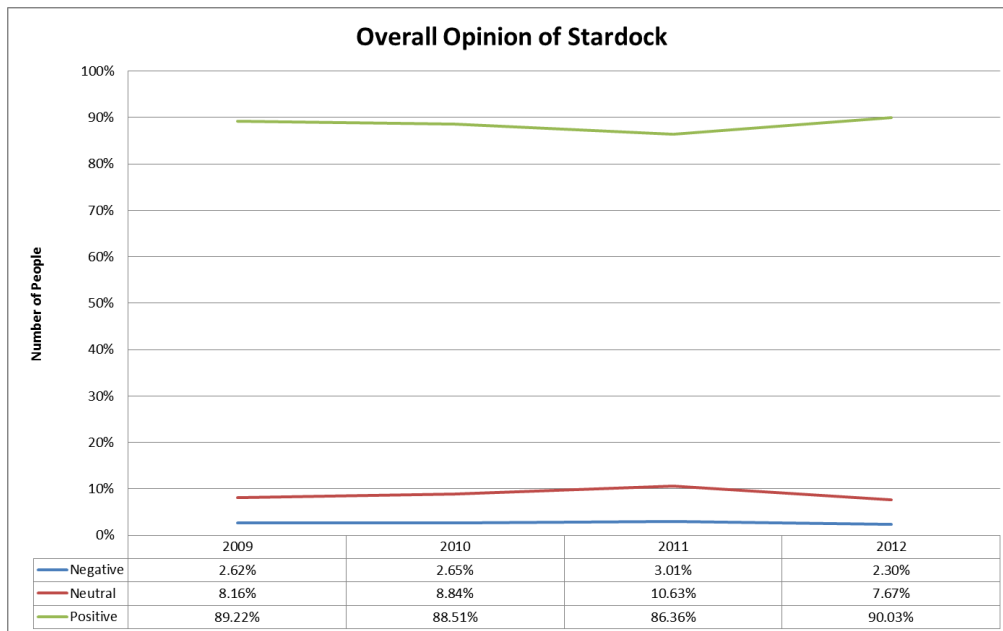
This is a pretty startling how fast this has changed. In the 2008 customer report, 58% said in a box, 42% digitally. This year it was about 18% in a box, 82% digitally. That's a massive change in just 4 years.

Interesting trends

We've been conducting these surveys for the past few years. They're available online but we've taken the time to compare the results from year to year. Here are some of the findings we thought were interesting:



This is no surprise really. Even in 2009, 3 out of 5 of our customers preferred digital. But now, it's 4 out of 5 in only 4 years and if anything, the trend seems to be accelerating. Less than 1 out of 5 people want to buy their software in a box. **Steam alone accounts for 90% of our non-direct game revenue.**



This was an interesting stat in that it showed that there was a dip in 2011. When we looked at the particulars, we found that there were quite a few people upset regarding the sale of Impulse. It's more significant than it might seem when you consider that the vast majority of respondents aren't game buyers. That means a significant % of our gaming buyers had a negative reaction to the sale of Impulse. I know how they feel. Sometimes running a company is about choosing the least bad of the choices available.

The results showed a recover from the previous year. A big part of that was Start8 which is very popular. Another significant element (based on feedback) was the support given to War of Magic with free copies of Fallen Enchantress.

Mind you, these statistics should only be used as a comparison to previous years since there is a self-selecting aspect for people who would answer these surveys.