million shares even further through a public offering, these big stockholders are letting Eckerd buy them out for the equivalent of around $6 a share. Each AHVC share will convert to 17½% of an Eckerd share, recently selling at 34⅛, or twice book value. The rub is that, while funding AHVC's growth will indeed soak up some of Jack Eckerd's excess cash, the acquisition will dilute Eckerd's earnings. Anxious to avoid paying a big capital gains tax on the transaction, AHVC shareholders understandably won't take cash. So Eckerd must issue 2.2 million new shares, close to a 10% increase in its present float.

According to Walter Loeb, retailing analyst for Morgan Stanley & Co., in fiscal 1981 this dilution should cut earnings by around 9%, to some $3 a share; in 1982 hold them down 5%, to $3.60 or so. Not until 1983 could AHVC add even 10 cents to the $4.45 Eckerd may net by then. As it probably would net that extra dime just by sticking to drugstores, is the entry into home video really worth it?

"Some feel the purer we are the better we'll be," says Turley, "but I want growth, and the home video industry is only emerging—unlike, say, drugstore chains. It's also possible we may diversify again, though I wouldn't anticipate that anytime soon. We're going to proceed conservatively. But when they look at AHVC a lot of people may think I'm saying that tongue-in-cheek." ■

Move over Asteroids and Defenders, the next adversary in the electronic video game wars may be even tougher to beat.

Japanese invaders

By Jonathan Greenberg

A GROUP OF WELL-SUITED corporate executives stands huddled around a video screen in a Times Square arcade. Mesmerized, grown men watch as a dozen red missiles fall from the top of the machine, only to have their progress disrupted by a swift series of colorful explosions. The spectators congratulate their colleague on a good round, secretly wishing that he'd missed and had his bases destroyed in a thermonuclear attack. Lunch hour is almost over, no one has beaten the sinister computer, and addiction to Missile Command makes an afternoon at the office without one last game seem unbearable. The stakes have risen since the pinball days of yesteryear. Electronic video games are serious business.

The lure of the game
Nuclear missiles for lunch.

Electronic video games are also big business. Since 1977 sales of coin-operated games in the U.S. have grown from next to nothing to over $500 million annually. At 25 cents a round, customers feed the machines at least $1 billion at airports, movie lobbies and newsstands nationwide. Revenues of the nine-year-old home game industry, meanwhile, hit $350 million last year.

The leading beneficiary of this addiction is Warner Communications, which owns video game market leader Atari. In the past year, fueled largely by Atari, Warner's stock has shot up by 65% and the company is a Wall Street favorite. Competitors include Gulf & Western (which owns the Japanese company Sega), Bally Manufacturing and Williams Electronics (a spinoff of Xcor) and a small, Florida-based firm called Centuri. Some of these firms have roots in the pinball business—often an unsavory activity—but their current growth excites investors.

Shortly before electronic games took off in the U.S., however, a similar madness struck Japan. Some 40 companies scrambled to build hundreds of thousands of coin-operated video machines to compete with Taito Corp.'s red-hot Space Invaders. Permissive patent laws allowed widespread conceptual theft, and by last year the market was saturated.

Formerly, Japanese companies were content to license their products to U.S. manufacturers. Why export when domestic demand was strong? But now things have changed: Space Invaders' celestial threat is old hat. American game manufacturers must take on the high-tech invaders from Japan.

"I have never taken the Japanese threat lightly," jokes Raymond Kassar, Atari's 53-year-old CEO. Kassar can afford such humor. Warner picked up Atari, the first U.S. coin-op video manufacturer, for $28 million in 1976. At that time Atari had sales of $40 million and an anticipated annual growth rate of 20%. By 1980 Atari emerged as Warner's flagship for the future. On sales of about $435 million, pretax earnings hit $65 million—29% of its parent's operating income. Kassar projects Atari will earn $120 million this year on sales of over $600 million.

Atari is the only U.S. manufacturer in

Games addicts play

You drop a quarter into the slot and instinctively rest one finger on the fire button, another on the thrust activator and two more on the directional controls. The 6-foot machine silently comes to life and you're ready for it. You're in command. The computer in the electronic video game known as Asteroids is going to do everything in its power to destroy your ship, and you're going to use your mortal skills to decimate everything it throws at you.

Four large asteroids, each an inch in diameter, float across the screen. Your ship is tiny but packs a mighty punch. Lining one up, you press the fire button—sending a line of white dots into an oncoming asteroid. It explodes, breaking into two medium-size asteroids. Your follow-up blasts break each of these, which also explode into two smaller fragments. Before you know it there are dozens of asteroids flying in all directions. With the thrust button, you maneuver away from them. But just when you begin to wipe most of the asteroids off the screen, terror strikes: An enemy ship appears. It attacks, with a computerized homing aim. In a scramble to evade, you accidentally run into an asteroid. The game, which takes about five minutes to play, is soon over. You fumble frantically for another quarter.

This scene is repeated millions of times each day in arcades and shops across America. If the game isn't Asteroids, it's Berzerk, or Defender or Pac-Man. If a machine catches on, it spawns addicts. Fans of all ages play regularly, often for months, to master a particular game. Preproduction models go into test markets to gauge popularity. One sure sign of a winner is a game's difficulty. Location owners look for "fast quarter" models that can defeat novices in less than two minutes.

"A hot video game brings in 2 or 3 times what a hot pinball machine makes," says Steven Epstein, owner of New York's Broadway Arcade. His 60 video machines grossed nearly $500,000 last year. "I've got limos in front and neighborhood kids here at the same time."

An expert on coin-op machines, Epstein buys his units outright and judges their popularity according to resale value. "I just sold an Asteroids for $1,600; I paid $2,000 for it a year ago and have made $10,000 with it since then," he explains. "Depreciation is negligible." Epstein currently likes Williams' Defenders and Stern's Berzerk. But he complains that some games, such as Atari's unsuccessful Battlezone, have a life span as short as two months.

Coin-op manufacturers, of course, are all too aware of their tenuous hold on success. "There's nothing consistent about this business," concludes Jim Pierce, president of Cinematronics, which makes a popular game called Star Castle. "If you've got a game that makes good money you're going to sell all you can make. If your games are not in the top ten you're going to eat them."—J.G.

both coin-operated and home video. Thus, it can afford to spend big on product development—an estimated $20 million last year. Unlike Bally's Midway, which has licensed its games from Japan, Atari breeds its own hits, such as Asteroids. At $2,000 a unit, Atari has made about $140 million from that game alone. And a deluxe version is on its way.

Roughly 65% of Atari's revenues comes from home game systems and cartridges. A basic unit retails for about $165 and plugs into any television set; cartridges go for $20 to $30, and there are 43 available. Warner executives boast that they control 80% of the home video market and 50% of the coin-op segment, though rough-and-tumble competition has cut Atari's lead there, and its current share is probably closer to 25%.

The home market will probably fuel the company's growth over the next five years. Only 4% of U.S. households with televisions currently own a video game, so the potential is immense. In 1980 Atari sold about 1.25 million players at $125 each. Its nearest competitor, Mattel's Intellivision, introduced a more expensive home system last year, sold out its 200,000 units and has yet to restock retailers.

Mattel Electronics' President Joshua Denham hopes to increase sales by 150% this year. "Our product has the ability to do things that Atari's does not," says Denham. One major retailer is more explicit: "Atari's not even close to being authentic, especially in the sports games. When you show both machines, it's going to be quite obvious which is better."

Kassar counters that Atari's surpasses Mattel's in "playability." Intellivision's sophistication, he believes, will turn off customers who don't want Mattel's whiz-bang effects. He may be right. Kim Mayo, a 24-year-old nurse, recently opted for Atari instead of Mattel, unimpressed by Mattel's potential as a personal computer. "I don't have a business at home," she explains.

A third contender is N.A. Philips' Magnavox, which introduced Odyssey, the industry's first home system, in 1972. Odyssey II is the industry's least successful unit, although its early entry and strong distribution channels are an asset. Critics complain of Maganavox' sleepy marketing attitude and say the company is too busy promoting videodiscs to give Odyssey II the attention it needs.

Survival in the coin-ops is likely to be much more difficult. There is no follow-up cartridge business, and at the moment competition is stiff. The success of Space Invaders and Asteroids has made the games wildly popular in outlets that traditionally steered clear of pinball machines. What's more, one game can gross $500 a week—a handsome sum even if 60% goes to a distributor. One Manhattan newsstand operator, for example, claims he earns more from his two video games than from the sale of newspapers.

Still, a shakeout among producers is already in the works. Apart from the Japanese, recent new entrants include three major pinball manufacturers—Williams, Stern and Gottlieb. Williams and Stern both blasted into the market last year with major hits, while Gottlieb burned its fingers and may wind up as an early casualty in the game wars.

The Asian invasion, however, could be even more deadly: Nearly all U.S. game companies license some electronics from the Japanese. Although their share of the U.S. market is now less than 10%, it will grow fast. Three big Japanese companies—Taito, Universal and Sega, a subsidiary of Gulf & Western—have recently opened U.S. manufacturing facilities, and each is importing hundreds of machines monthly.

In December, Nintendo, a $100 million-plus Japanese coin-op manufacturer, began exporting to the U.S. and now ships 2,000 games a month. The only major Japanese producer that still limits its U.S. business to licensing is Namco, which has supplied Midway with all of its recent hits. Its 10,000-square-foot Silicon Valley office is, however, vastly oversized for its current two-person staff.

There are indications, too, that the Japanese invaders might not all be playing by the rules. Copies of popular American games are being manufactured in Japan and sold here at cut-rate prices. Only the names of the games and the artwork are changed. "There is a racket in L.A. that imports knockoffs of Williams' Defender and sells them $400 cheaper than the American-made machine," says Ed Adlum, publisher of the trade journal *RePlay*.

"Two years ago," says one industry expert, "we had no Japanese manufacturers in this country. Now they are coming on very strong. Soon they may even outnumber the Americans." If that's correct, Wall Street's fascination with electronic games may end abruptly—just as a session of Space Invaders stops when the tide of aliens destroys the last defender on earth. ■