



**Digital Bros S.p.A.**

**Quarterly report as at September 30, 2002**

The Directors' Report on Operations and the related Balance Sheet and Income Statement refer to the period from July 1, 2002 and September 30, 2002.

The Extraordinary General Meeting of Digital Bros S.p.A. held on February 28, 2002 resolved the change the accounting year end from December 31 to June 30 each year. This change became effective as from June 30, 2002. As a result, the period examined here represents the first quarter of the 2002/2003 financial year.

In order to compare financial and economic performance together with the relevant quarter income statements, the following statements have been prepared:

- pro forma consolidated financial statements as at September 30, 2001
- pro forma consolidated income statement as at September 30, 2001 (9 months)
- pro forma Digital Bros S.p.A. income statement as at September 30, 2002 (9 months)

The pro forma consolidated financial statements as at September 30, 2001 were prepared by excluding assets, liabilities, revenues and costs relating to the two companies incorporated under English law Twine Holdings Ltd and Eon Digital Entertainment Ltd which have not been included in the consolidation area since January 1, 2002. Assets and liabilities of Group companies towards the two UK subsidiaries have been shown as amounts receivable from and payable to subsidiary or associated companies. Costs and revenues of Group companies relating to transactions with the UK companies have not been eliminated as part of the consolidation process.

The second and third pro forma statements were prepared by adding the balances for the six month period ended June 30, 2002 to the figures for the three months from July 1, 2002 to September 30, 2002.

## **Board of Directors and Board of Statutory Auditors**

(at the date of approval of this Report)

### *Board of Directors*

#### **Chairman and Managing Director**

Abramo Galante

#### **Managing Director**

Raffaele Galante

#### **Directors**

Lidia Florean, Davide Galante, Sem Bruno Moioli, Bruno Soresina (\*), Dario Treves, Sergio Treves (\*)

(\*) Independent directors

### *Board of Statutory Auditors*

#### **Statutory Auditors**

Franco Gaslini, Chairman of the Board of Statutory Auditors, Statutory Auditor

Giancarlo Giannini, Statutory Auditor

Paolo Villa, Statutory Auditor

#### **Substitute Statutory Auditors**

Giovanni Giovannini

Pietro Ottone

The Board of Directors and the Board of Statutory Auditors were appointed by the General Meeting held in Milan at the Company Head Office on October 29, 2002. The appointments have been made for three financial periods until the approval of the financial statements for the 2004/2005 financial year.

**Comments on the quarterly financial information of Digital Bros S.p.A. as at September 30, 2002**

*Valuation criteria and accounting policies applied.*

The valuation criteria and accounting policies applied in preparing the consolidated quarterly report at September 30, 2002 are consistent with those used by the Company to prepare its consolidated financial statements at June 30, 2002.

The consolidation area changed during the period as a result of the following:

- the merger of Game Channel S.p.A., Evolution Entertainment S.r.l. and Communications & Promotions S.r.l. into Digital Bros S.p.A. on February 26, 2002 with effect for balance sheet and income statement from February 26, 2002. The acquisition of 33% of Game Channel S.p.A. came as an effect of a Euro 52,000 increase in the share capital of Digital Bros S.p.A. with the issue of 400,000 shares with a par value of Euro 0.13 to minority shareholder Sem Moiola.
- the liquidation of the two UK companies Twine Holdings Ltd. and Eon Digital Entertainment Ltd..

As a result, the consolidation area as at September 30, 2002 was as follows:

<b>Company name</b>	<b>Head Office</b>	<b>Currency</b>	<b>Share Capital</b>	<b>% control</b>	<b>Consolidation method</b>
Digital Bros S.p.A.	Milan	Euro	5,160,000	Parent company	Line by line
Game Network On line S.r.l.	Milan	Euro	84,450	100	Line by line
Game Network S.p.A.	Milan	Euro	1,000,000	100	Line by line
Game Network Ltd.	London	GBP	1	100	Line by line
AD1 S.r.l. (1)	Milan	Euro	10,000	100	Line by line

(1) Investment indirectly held through subsidiary Game Network S.p.A.

### *Accounting principles applied*

Some accounting principles unnecessary for the preparation of the annual accounts, had to be made in preparing the quarterly report. In particular, the result for the period is shown before taxation.

Apart from the above, the accounting principles are consistent to the principles used in preparing the annual financial statements.

### *Activities undertaken during the quarter*

#### **Video game distribution and co-publishing in Italy**

The Digital Bros Group is the leading video games distributor and co-publisher on the Italian market. These activities are performed directly by Digital Bros S.p.A. The activities involve the localisation, promotion and marketing of video games and their subsequent distribution in Italy. Digital Bros S.p.A. distributes the products of international video game publishers which it represents exclusively on Italy under the Halifax brand name.

Localisation or co-publishing involves making language and cultural changes to video games to adapt them to the Italian market as well as the translation into Italian of the original game manuals, the dubbing of any voices used in the game and, for any licensed products, the physical production of support materials and the development of packaging. The localisation process is carried out by Digital Bros and the video game publishers working closely together.

#### **Video game publishing**

This activity involves the selection and acquisition from developers of rights to exploit video game licences using an international distribution network. The length of the

licence agreements signed with the developers and the geographical areas covered vary from one license agreement to another.

The negative performance of the international market together with the losses made by the UK subsidiaries that undertook this activity in 2001 led to the decision to bring international publishing activities back to Italy, integrating it within the Digital Bros S.p.A. video games distribution organisation which already deals with licences acquired in respect of Italy only. As a result of this decision, during the quarter, the selection of products on the Japanese and Korean markets commenced one more although no products were acquired or launched during the quarter.

### **Digital TV**

The Digital Bros Group subsidiaries Game Network S.p.A. and Game Network Ltd operate the Game Network satellite TV channel which broadcasts programmes produced in-house and dedicated to the video games sector 24 hours a day. The channel is broadcast via the Eutelsat satellite in continental Europe and via the Astra satellite in the United Kingdom. The programmes can be seen unscrambled by anyone with a satellite dish receiver system. In order to improve the sale of advertising on the satellite TV channel, in 2001, the Group set up AD1 S.r.l., a dedicated organisation, which acts as an advertising agency on behalf of Game Network S.p.A., Game Network on line S.r.l. and for several publications outside the Group.

### **On-line gaming**

The on-line gaming business enables PC owning gamers to play on-line via Internet and challenge other players connected to the same server. This is a subscription service and Digital Bros has developed the in house the system which handles payments by players together with billing and the technology used to integrate the data with the gaming servers and enable on-line services to be used. This is a subscription service and Digital Bros has developed the in house the system which handles payments by players together

with billing and the technology used to integrate the data with the gaming servers and enable on-line services to be used.

Current technology - narrow-band internet connection and games consoles with no Internet access – does not exploit the potential of on-line gaming. However, the games the Group has exclusive rights to in Europe - “Legend of Mir” and “Myth of Soma” – can be played using current technology. The Internet access possible using the new generation of games consoles (Playstation2, Nintendo Gamecube and Microsoft Xbox) and the expanding range of broad band Internet connections will offer gamers the chance to use the available services to a greater extent in the near future and will lead to significant growth in the sector.

*Analysis of the results for the quarter and of the outlook for the business*

In the first quarter of the period 2002/2003, the Group recorded revenues from sales and services of Euro 8,122 thousand. This represented a 137% increase on revenues of Euro 3,420 thousand in the corresponding period in 2001.

Revenues may be analysed by business activity during the quarter and for the first nine months of the calendar year, as follows:

**Euro thousands**

<b>3 months</b>	<b>Q1 2002/2003</b>	<b>Q3 2001 pro-forma</b>	<b>Change</b>
Distribution and localisation Italy	7,829	3,318	136%
On-line gaming	189	100	89%
Digital TV and advertising revenues	104	2	n.s.
<b>TOTAL REVENUES</b>	<b>8,122</b>	<b>3,420</b>	<b>137%</b>

**Euro thousands**

<b>9 months</b>	<b>September 30, 2002 pro-forma</b>	<b>September 30, 2001</b>	<b>Change</b>
Distribution and localisation Italy	28,339	16,161	75%
On-line gaming	610	100	n.s.
Digital TV and advertising revenues	638	1,341	-53%
<b>TOTAL REVENUES</b>	<b>29,587</b>	<b>17,602</b>	<b>68%</b>

The increase in revenues from video games distribution in Italy is in line with the expansion seen on the market well before the launch to the two new generation gaming consoles - Microsoft Xbox (March 2002) and Nintendo Gamecube (May 2002) – but is especially due to the extension of the user base for the Sony Playstation 2 console. As the following tables show, the growth in turnover is largely due to higher revenues from the distribution of video games for consoles - + 139% for the first quarter of the year ended June 30, 2003 and +87% for the first nine months of the calendar year:

**Euro thousands**

<b>3 months</b>	<b>September 30, 2002</b>	<b>September 30, 2001</b>	<b>Change</b>
Distribution of video games for consoles	6,527	2,728	+139%
Distribution of video games for PC	595	590	+1%
Distribution of Hardware and accessories	707	0	n.s.
<b>Total distribution revenues in Italy</b>	<b>7,829</b>	<b>3,318</b>	<b>+134%</b>

**Euro thousands**

<b>9 months</b>	<b>September 30, 2002 pro-forma</b>	<b>September 30, 2001</b>	<b>Change</b>
Distribution of video games for consoles	23,514	12,607	+87%
Distribution of video games for PC	2,227	3,299	-32%
Distribution of Hardware and accessories	2,598	255	n.s.
<b>Total distribution revenues in Italy</b>	<b>28,339</b>	<b>16,161</b>	<b>+75%</b>

The following two tables contain further analysis of the sector in order to provide a better understanding of the changeover to the 128 bit generation of games consoles that was completed in 2002. The first table compares units sold and sales revenues by type of console in the quarter, the six month period ended June 30, 2002 and in the prior twelve month period. The second table compares the revenues from the distribution of each type of console as a percentage of total revenues from the distribution of software consoles in the first nine months of the 2002 calendar year and the year ended December 31, 2001:

Euro thousands	1 <sup>st</sup> Quarter 2002/2003		June 30, 2002 – 6 months		December 31, 2001 – 12 months	
	Units	Revenues	Units	Revenues	Units	Revenues
Sega Dreamcast	2,216	10	1,146	6	9,145	188
Nintendo Gameboy	15,312	298	29,582	552	146,824	2,584
Nintendo Gameboy Advance	14,571	528	23,687	884	53,781	1,962
Nintendo 64	0	0	0	0	40,045	293
Sony Playstation	63,379	915	122,666	1,783	502,926	9,280
Sony Playstation 2	86,838	3,674	284,655	11,951	346,609	13,294
Microsoft Xbox	15,027	725	15,027	694	0	0
Nintendo GameCube	8,268	377	25,548	1,117	0	0
<b>Total distribution - Consoles</b>	<b>205,611</b>	<b>6,527</b>	<b>502,311</b>	<b>16,987</b>	<b>1,099,330</b>	<b>27,601</b>

Weighted percentage	September 30, 2002 pro-forma	December 31, 2001
Sega Dreamcast	0%	1%
Nintendo Gameboy	4%	9%
Nintendo Gameboy Advance	7%	7%
Nintendo 64	0%	1%
Sony Playstation	11%	34%
Sony Playstation 2	66%	48%
Microsoft Xbox	6%	0%
Nintendo GameCube	6%	0%
<b>Total revenues from distribution - consoles</b>	<b>100%</b>	<b>100%</b>

The figures regarding sales volumes should be read considering the seasonal factors that traditionally represent a dominant factor in the market with sales largely concentrated in the final quarter of the calendar year. This appears to highlight the success of the Sony

Playstation 2 console to an even greater extent. In fact, the Company's revenues from the sale of software for the Sony Playstation 2 have already increased in the first nine months of the calendar year to stand at Euro 15,625 thousand (the sum of Euro 11,951 thousand in the first half of 2002 and Euro 3,674 thousand in the quarter from July to September). This represents an increase of Euro 2,331 thousand compared to the Euro 13,294 thousand recorded in the full year 2001. As a percentage of total sales revenues, sales of software for the Sony Playstation 2 have increased from 48% in 2001 to 66% in the first nine months of the 2002 calendar year.

It should be highlighted that the year 2002 was the final swan song of the Sega Dreamcast and Nintendo 64 consoles while historic consoles Sony Playstation and Nintendo Gameboy Color saw their sales decrease as a percentage of the total from 43% in 2001 (34% Sony Playstation and 9% Nintendo Gameboy Color) to 15% in the first nine months of 2002 (11% Sony Playstation and 4% Gameboy Color).

The performance achieved by the distribution of software for recently introduced consoles, Microsoft Xbox and Nintendo Gamecube, was satisfactory with revenues representing 6% of total revenues for the first nine months of the year. The successful introduction was undoubtedly assisted by the price cuts seen in recent months and expected to continue next spring. The success of the Nintendo Gamecube outside the Christmas period had a particularly great impact. This console is aimed at a younger target market and is often considered more of a toy than a games console. As a result, it might have been expected to have a more difficult launch before expanding its market share in the Christmas period 2002.

Revenues from on-line gaming activities are generated by subscriptions to the first on-line game launched by the Digital Bros in Europe, "Legend of Mir", and a second game, "Myth of Soma". A further boost to revenues will be provided by the physical distribution of the product – in particular Myth of Soma – with a prepaid subscription included. The Group believes that it will be able to increase awareness and visibility of the game without entering into expensive marketing campaigns. It also believes it can penetrate the markets most receptive to the new gaming format where there has been

limited success to date in terms of the number of paying players (e.g. the German market).

The analysis of revenues from digital TV activities provides a better explanation of the Euro 703 thousand decrease in the first nine months of 2002 compared to the same period in 2001:

**Euro thousands**

<b>9 months</b>	<b>September 30, 2002 pro-forma</b>	<b>September 30, 2001</b>
Barter	13	1,215
Advertising revenues	227	126
Revenues from prize competitions	306	0
Revenues from Interactive TV	92	0
<b>Total Digital TV and advertising revenues</b>	<b>638</b>	<b>1,341</b>

Until such time as the advertising market recovers and digital TV establishes itself as an entertainment medium, the Group has been looking for different revenue streams such as prize competitions, exclusively run in the United Kingdom.

The second half of the 2002 calendar year saw the introduction of “Premium SMS”, only in the United Kingdom at the moment. This service allows Game Network viewers to send SMS messages live on screen and take part in surveys and games. The messages are sent from cellular phones using a premium telephone number.

Another source of revenue, telesales, is expected to be increased in the second quarter of the year ended June 30, 2003. The telesales would promote not only products related to the video games sector but also products regarding the average target viewer of the TV channel.

The size of margins is directly related to the revenue trend. The positive revenue trend, together with the cost containment policies implemented with effect from the last quarter of 2001, has led to a significant improvement in the main income statement indicators at consolidated level and for the parent company, as follows:

**Euro thousands**

<b>3 months</b>	<b>Group</b>			<b>Digital Bros S.p.A.</b>		
	<b>30/09/2002</b>	<b>30/09/2001</b>	<b>Diff</b>	<b>30/09/2002</b>	<b>30/09/2001</b>	<b>Diff</b>
EBITDA	(643)	(1,461)	818	(231)	(392)	161
EBIT	(1,135)	(1,802)	667	(642)	(711)	69
EBT	(1,855)	(10,776)	8,921	(1,367)	(1,339)	(28)

**Euro thousands**

<b>9 months pro-forma</b>	<b>Group</b>			<b>Digital Bros S.p.A.</b>		
	<b>30/09/2002</b>	<b>30/09/2001</b>	<b>Diff</b>	<b>30/09/2002</b>	<b>30/09/2001</b>	<b>Diff</b>
EBITDA	(1,121)	(3,908)	2,787	489	(763)	1,252
EBIT	(2,460)	(4,987)	2,527	(644)	(1,769)	1,125
EBT	(4,581)	(14,864)	10,283	(2,766)	(3,322)	556

Historically, a loss has always been recorded in the first quarter of the accounting period, especially in the distribution of video games in Italy. The reasons for this lie in the seasonal nature of sales which are concentrated in the Christmas period – the second quarter of the financial year – and are extremely low over the summer period which has traditionally represented between 10% and 15% of total annual revenues. Given the excellent trend of revenue growth, we believe that the objective of a breakeven position at consolidated EBIT level for the 2002 calendar year remains valid.

*Investments made during the quarter*

During the quarter the Company issued a convertible bond into Digital Bros ordinary shares with a value of Euro 4 million. Incidental charges totalling Euro 231 thousand

were capitalised under intangible assets. These costs are amortised on a straight-line basis over the period of the convertible bond.

In July, Digital Bros S.p.A. acquired international rights of two video game titles at a cost of Euro 250 thousand.

#### *Net financial position*

The Group's net financial position went from net indebtedness of Euro 8,720 thousand at June 30, 2002 to net indebtedness of Euro 10,444 thousand at September 30, 2002, a deterioration of Euro 1,724 thousand. The Euro 783 thousand decrease in short-term financial assets was countered by a Euro 3,007 thousand decrease in amounts due to banks and by an increase in medium/long term debt as a result of the issue of a convertible bond of Euro 4,000 thousand. No conversion requests were made during the quarter with the result that the bond loan continued to be reported at its original value at September 30, 2002.

The level of gearing – the ratio of net financial indebtedness to shareholders' equity – remained fairly low at the end of the period standing at 0.58 compared to 0.44 at June 30, 2002.

#### **Significant events after the end of the quarter**

The General Meeting held on October 30, 2002 reappointed the Board of Directors that was in office in the last three years (see in this report).

The General Meeting also appointed the Board of Statutory Auditors and external auditors, Grant Thornton, for the next three years.

## Quarterly report as at September 30, 2002

### Consolidated Balance Sheet at September 30, 2002

(amounts in thousands of Euro)

	30/09/2001 Pro forma	30/06/02	30/09/02
Non-current assets	8,227	7,608	7,611
Current assets	45,829	41,550	38,258
<i>including cash at bank and on hand and short-term financial assets</i>	9,596	9,351	8,568
Prepaid expenses and accrued income	494	231	256
<b>Total assets</b>	<b>54,550</b>	<b>49,389</b>	<b>46,125</b>
<i>Liabilities and shareholders' equity</i>			
Share capital and reserves	40,638	22,553	19,724
Loss for the period	(14,864)	(2,825)	(1,855)
<b>Total shareholders' equity</b>	<b>25,774</b>	<b>19,728</b>	<b>17,869</b>
Provisions for risks	0	175	175
Employee severance indemnity reserve	301	392	404
Payables	28,184	28,909	27,494
<i>due after less than a year</i>	28,077	28,817	23,454
<i>due after more than a year</i>	107	92	4,040
Accrued expenses and deferred income	291	185	183
<b>Total liabilities</b>	<b>28,776</b>	<b>29,661</b>	<b>28,256</b>
<b>Total liabilities and shareholders' equity</b>	<b>54,550</b>	<b>49,389</b>	<b>46,125</b>
Cash at bank and on hand	9,596	9,351	8,568
Short-term financial assets			
Short term financial liabilities	17,454	17,979	14,972
Financial liabilities due after more than a year	107	92	4,040
<b>Net financial position</b>	<b>(7,965)</b>	<b>(8,720)</b>	<b>(10,444)</b>

## Quarterly report as at September 30, 2002

### Consolidated Income Statement – 1<sup>st</sup> quarter of year ended June 30, 2003

(amounts in thousands of Euro)

	Third quarter 2001 - Pro forma	First quarter 2002/2003
Sales revenues	3,420	8,122
Change in inventory	(205)	204
Other revenues	1,068	125
<b>Value of production</b>	<b>4,283</b>	<b>8,451</b>
Production costs	(5,744)	(9,094)
<b>Gross margin</b>	<b>(1,461)</b>	<b>(643)</b>
Amortisation and depreciation	(341)	(492)
Provisions	0	0
<b>Operating loss</b>	<b>(1,802)</b>	<b>(1,135)</b>
Net financial income (charges)	(662)	(468)
Extraordinary charges	(8,312)	(252)
<b>Loss before taxation</b>	<b>(10,776)</b>	<b>(1,855)</b>

## Quarterly report as at September 30, 2002

### Consolidated Income Statement at September 30, 2002

(amounts in thousands of Euro)

	September 30, 2001 Pro forma	September 30, 2002 Pro forma
Sales revenues	17,602	29,587
Change in inventory	4,117	1,065
Other revenues	1,296	442
<b>Value of production</b>	<b>23,015</b>	<b>31,094</b>
Production costs	(26,923)	(32,215)
<b>Gross margin</b>	<b>(3,908)</b>	<b>(1,121)</b>
Amortisation and depreciation	(1,079)	(1,339)
Provisions	0	0
<b>Operating loss</b>	<b>(4,987)</b>	<b>(2,460)</b>
Net financial (charges)	(1,068)	(1,243)
Extraordinary (charges)	(8,809)	(878)
<b>Loss before taxation</b>	<b>(14,864)</b>	<b>(4,581)</b>

**Quarterly report as at September 30, 2002**

**Digital Bros S.p.A. balance sheet as at September 30, 2002**

(amounts in thousands of Euro)

	<b>30/09/01</b>	<b>30/06/02</b>	<b>30/09/02</b>
Non-current assets	8,352	9,134	9,200
Current assets	52,786	43,150	40,710
<i>including cash at bank and on hand and short-term financial assets</i>	20,387	12,608	12,533
Prepaid expenses and accrued income	405	114	87
<b>Total assets</b>	<b>61,543</b>	<b>52,398</b>	<b>49,997</b>
<b><i>Liabilities and shareholders' equity</i></b>			
Share capital and reserves	40,516	26,936	25,451
Loss for the period	(3,322)	(1,486)	(1,367)
<b>Total shareholders' equity</b>	<b>37,194</b>	<b>25,450</b>	<b>24,084</b>
Provisions for risks	0	175	175
Employee severance indemnity reserve	218	336	351
Payables	23,840	26,264	25,230
<i>due after less than a year</i>	23,733	26,172	21,190
<i>due after more than a year</i>	107	92	4,040
Accrued expenses and deferred income	291	173	157
<b>Total liabilities</b>	<b>24,131</b>	<b>26,612</b>	<b>25,562</b>
<b>Total liabilities and shareholders' equity</b>	<b>61,543</b>	<b>52,398</b>	<b>49,997</b>
Cash and cash equivalents and short-term financial assets	20,387	12,608	12,533
Short-term financial payables	17,037	17,955	14,970
Financial payables due after more than a year	107	92	4,040
<b>Net financial position</b>	<b>3,242</b>	<b>(5,439)</b>	<b>(6,477)</b>

## Quarterly report as at September 30, 2002

### Digital Bros S.p.A. Income Statement for the 1<sup>st</sup> quarter of the year ended June 30, 2003

(amounts in thousands of Euro)

	<b>Third quarter of 2001</b>	<b>First quarter of 2002/2003</b>
Sales revenues	3,308	7,829
Change in inventory	(205)	205
Other revenues	1,079	256
<b>Value of production</b>	<b>4,182</b>	<b>8,290</b>
Production costs	(4,574)	(8,521)
<b>Gross margin</b>	<b>(392)</b>	<b>(231)</b>
Amortisation and depreciation	(319)	(411)
Provisions	0	0
<b>Operating loss</b>	<b>(711)</b>	<b>(642)</b>
Net financial (charges)	(614)	(468)
Extraordinary (charges)	(14)	(257)
<b>Loss before taxation</b>	<b>(1,339)</b>	<b>(1,367)</b>

## Quarterly report as at September 30, 2002

### Digital Bros S.p.A. Income Statement as at September 30, 2002

(amounts in thousands of Euro)

	30/09/01	30/09/02 Pro forma
Sales revenues	16,046	28,358
Change in inventory	4,108	1,044
Other revenues	1,724	904
<b>Value of production</b>	<b>21,878</b>	<b>30,306</b>
Production costs	(22,641)	(29,817)
<b>Gross margin</b>	<b>(763)</b>	<b>489</b>
Amortisation and depreciation	(1,006)	(1,133)
Provisions	0	0
<b>Operating loss</b>	<b>(1,769)</b>	<b>(644)</b>
Net financial (charges)	(1,019)	(1,241)
Extraordinary (charges)	(534)	(881)
<b>Loss before taxation</b>	<b>(3,322)</b>	<b>(2,766)</b>