



Funcom Risk Factors

Investment in Funcom involves a degree of risk. Several factors should be carefully considered before making any investment decision. The risks described below do not constitute a full list of the risks the Company is exposed to. Additional risk factors may also impair the Company's operations.

Shareholders should rely upon their own examination of all communications from Funcom and should study this carefully and also consult information and knowledge about the gaming space and the Massively Multiplayer Online Game segment. Shareholders should not construe the contents of this Report as legal, accounting or tax advice, or as information necessarily applicable to each potential investor's particular situation. Each potential investor should consult its own advisers for independent advice so that a balanced judgment can be made of a potential investment decision and all that is discussed and described in this report. The Company urges investors to track the industry and gaming media to gain a thorough and independent understanding of Funcom and the potential of its games.

This report and other communication from Funcom may also contain various "forward-looking statements" that involve inherent risks and uncertainties, including statements regarding the intent, opinion, belief or current expectations of Funcom or its management with respect to, among other things but not limited to, (i) goals and strategies, (ii) plans for new product development, (iii) marketing plans for Funcom's target markets, (iv) evaluation of Funcom's markets, competition and competitive position, (v) trends which may be expressed or implied by financial or other information or statements contained herein, and (vi) outcomes of disputes. Such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance and outcomes to be materially different from any future results, performance or outcomes expressed or implied by such forward-looking statements.

Macroeconomic fluctuations

Funcom is exposed to the economic cycle, since changes in the general economic situation could affect demand for Funcom's products. Computer games are used for entertainment and therefore the demand may decline during recession when disposable income decreases.

Currency fluctuations

Because a considerable share of Funcom's business is conducted in currencies other than its functional currency, Funcom will be exposed to volatility associated with foreign currency exchange rates. Funcom invoices all non-EU customers in USD, while EU customers are invoiced in EUR. The operational costs of Funcom are to a large extent in NOK. The operational costs of Funcom are to a large extent in NOK. Funcom has only implemented an operational hedge by maintaining its cash and cash equivalents in NOK."

Share price volatility

The Funcom share price could experience substantial fluctuations caused by a number of factors. Many of these will be outside Funcom's control and may be independent of its operational and financial development. Factors which may affect the share price include the following (the list is not exhaustive):

- Reactions to quarterly and annual financial reports published by Funcom
- Changes in analysts' estimates
- Changes in the gaming industry in general
- Changes in market and financial prospects
- Rumors and speculation in the market

Variability of operating results etc.

Funcom's operating results may vary from month to month. Funcom's operating result may be hard to forecast due to unpredictable demand for its products, the competitive environment, other general economic and market conditions and unanticipated difficulties in pursuing Funcom's business strategy.

External parties

Funcom's success depends also partly on the ability of the Company's partners to effectively fulfill their commitments. Funcom has partners in the areas of hosting and server administration, billing, publishing, sales and distribution, hardware as well as other areas.

Contracts

Non-Swiss and non-Norwegian law governs several of Funcom's agreements. In addition, dispute resolution is set to venues in different places in Europe and the US. This may increase the legal risk and increase the costs in connection with the enforcement of any specific agreement.

Changes in the gaming industry in general

The market for Funcom's products and services is competitive and trend oriented. Failure of Funcom to maintain competitive products and services offering could have a material adverse effect on Funcom. If the generally expected market growth fails to materialize, the profitability of MMOs is likely to suffer.

Delay of product releases

For the current development projects, Funcom has a strong focus on making plans, analyzing risks, estimating time needed in each project phase and measuring progress. There is, however, an inherent development timeline risk in all software development, including in MMO game software development, and there is no assurance that development schedules will be held. If Funcom does not manage to release their games at the planned dates, the development budgets of the games may increase. There is also a risk that competitors will gain a foothold in the market at the expense of Funcom or that the games will be less competitive when launched due to advances of competitors, making users less willing to spend additional time and money on new games from Funcom.

Unsuccessful projects under development

Currently, there is a number of MMOs in development worldwide. Hence, consumers will have a number of options to choose between. Through the history of MMOs, the market has never accommodated many top-selling products at any one time. Even though the number of serious competitors to Funcom in the large scale MMO-space, developers with the necessary skills, experience, and technological and financial resources in place, is limited, there is a risk that one or more of Funcom's games could be unsuccessful.

Dependence on success of *Age of Conan*

Funcom's future income is highly dependent on the success of the *Age of Conan* MMO. In itself, *Age of Conan* is expected to contribute with significant revenues and earnings, and if *Age of Conan* attains low subscriber numbers there will be a negative impact on future cash flows and the valuation of Funcom. Furthermore, the game is intended to be one of the funding sources for the development of other titles, and lower cash inflows than expected could also have an indirect effect in terms of reduced revenues, earnings and cash flows from other games and the future funding requirements of the Company.

Dependence on the attractiveness of the Conan brand

The success of the *Age of Conan* game is dependent on the attractiveness of the Conan brand. The Conan brand is owned by CPI and the overall brand development is therefore not in the control of Funcom, although Funcom contributes to brand development through its *Age of Conan* game.

Dependence on consumer satisfaction

The commercial success of Funcom's games is to a high degree dependent on consumer satisfaction. Consumer satisfaction is dependent on the perceived fun factor, quality of service of the support and error correction services. Even though the Company strives to ensure high consumer satisfaction there is a risk that the consumers will be unsatisfied with Funcom products, the support and the number of bugs and errors in the products. Consumer satisfaction may also be affected by the gaming community related to the game.

Rating risks

Funcom is, as a developer of mature games, exposed to the risk that rating agencies in the various markets will set the allowed age level to play the Funcom games too high or too low and thereby potentially limiting the addressable market. Rating agencies may also change their rating policies, or fine Funcom for rating breaches, although Funcom always strives to adhere to rating regulations. Funcom may also receive the attention of special interest organizations focusing on the gaming industry, both through PR campaigns and through legal procedures. Actions of disloyal employees or outside parties by introducing unknown and controversial material into the games of the Company may constitute a risk for penalties or other actions from rating agencies.

Reviews

The commercial success of Funcom's MMOs may be, to a high degree, dependent on favorable reviews by the major gaming publications and sites. There are already very high expectations to Funcom's *Age of Conan* MMO, and should Funcom fail to meet the expectations this may have a negative effect in the review scores of the game and thereby potentially on the sales potential of the game.

Technological risks

The successful operation of an MMO depends on a large number of complicated hardware and software components that need to work successfully together. Any errors, bugs or viruses in any software may harm the operation of the MMOs and thus have an adverse effect on Funcom's ability to gain revenues. Similarly any errors, power failures, shortcuts etc. in any hardware component may harm the operation of the MMOs and thus have an adverse effect on Funcom's ability to gain revenues. Further, the games Funcom develop may not perform equally well on all PC configurations – impacting sales negatively. Although Funcom endeavors to reduce the technological risks before a game launch and during the operations of a game, these risks will always be present to some degree at launch

Hacking

Funcom's MMOs may be subject to hacking activities. Any hacking activity may affect Funcom's ability to operate its MMOs, which will affect Funcom's ability to gain revenues.

Risks related to the Internet

Funcom's MMOs are operated on the Internet. Funcom's revenues are therefore dependent on the continued and uninterrupted operation of the Internet. Any adverse incident, hereunder but not limited to bugs, viruses, worms, etc. affecting the Internet may affect Funcom's ability to gain revenues.

Theft or loss of source code

Funcom's source code is stored in a fireproof safe, but is also available to employees working on the Company's games. Should all or parts of the source code be stolen or lost, this may affect Funcom's ability to gain revenues or reduce its technological edge in the market.

Difficulties in recruiting and loss of key employees

Funcom is dependent on the ability to recruit, motivate and retain highly skilled technical, managerial and marketing personnel. Funcom may experience difficulties in recruiting, motivating and retaining the necessary expertise and key employees, or may need to pay higher compensation, which could adversely affect operating results. Further, it should be taken into consideration that work permits in the countries where Funcom has subsidiaries may be difficult to obtain. The documentation and formalization of internal information, routines and processes have not always been of today's standard. Therefore, there is a risk of losing vital information if key employees, for various reasons, leave Funcom.

International operations

Operations in international markets are subject to risks inherent in international business activities, including in particular general economic conditions in each such country, overlapping differing tax structures, managing an organization spread over various jurisdictions, currency fluctuations, and unexpected changes in regulatory requirements and complying with a variety of foreign laws and regulations.

Tax exposure

The Company is incorporated in the Netherlands with subsidiaries in Norway, Switzerland, Luxembourg and the USA. The overall tax charge will depend on where profits are accumulated and taxed since these countries have different tax systems and tax rates. The Funcom Group is today taxed under a number of different legal systems with different laws for tax residency, tax credits and tax exemption rules. Consequently, the Funcom Group is exposed to changes of tax policies and changes of tax legislations, proactively and/or retroactively. The Company is of the view that it reports profits and losses in accordance with tax rules applicable to the Funcom Group. The tax authorities in the jurisdictions where the Funcom Group operates are not bound by the judgment of the Company, and there can be no assurance that they will agree with it. If one or more of the relevant tax authorities challenges the Company's view, this may result in an increased overall tax charge.

Difficulties in enforcing the Company's intellectual property and proprietary rights

Funcom's success depends on its proprietary game technology. Funcom relies on a combination of trade secret, copyright and trademark laws, non-disclosure agreements and contractual provisions to protect its proprietary rights. International copyright and trademark laws protect Funcom's technology. Existing trade secrets and copyright laws afford only limited protection, and unauthorized parties may attempt to copy aspects of Funcom's proprietary rights or to obtain and use information and technology that Funcom regards as proprietary. In addition, the laws of some foreign jurisdictions do not protect Funcom's proprietary rights in the same manner and to the same extent as the laws of the US, Switzerland and Norway do. There can be no assurance that the steps taken by the Funcom to protect its proprietary rights will be adequate.

Intellectual Property Rights of others

Funcom operates in a competitive industry. Technology is evolving at a fast pace and innovating companies develop solutions in relatively close technological proximity.

This poses the risk that the Company could inadvertently encroach upon the protected rights of others, including rights protected by patents. This is the nature of the industry in which Funcom operates. Funcom is aware of the fact that there may be patents potentially forming basis of infringement claims. US patents and/or litigation in the US are particularly worrisome because there are a large number of US software patents in existence. There is also to a greater extent a culture for opportunistic patent litigation in the US. Infringement on copyrights, design rights and trademark law could surface as well. There is always an inherent risk of substantial claims related to infringement of intellectual property rights. Such claims could also have a negative impact on the various contracts of the company because infringement of intellectual property rights is likely to be construed as a material breach of contract.

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