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Master of the Game

By DYAN MACHAN

With the success of Grand Theft Auto V, CEO Strauss Zelnick has put Take-Two Interactive Software on the path to long-term prosperity.

Strauss Zelnick's early success in the movie industry earned him the epithet media wunderkind. It stuck like Krazy Glue, no matter that the kid is now 56.

A serial hit maker in multiple media, Zelnick has another winner on his hands with the videogame *Grand Theft Auto V*, launched in mid-September by a subsidiary of **Take-Two Interactive Software** (ticker: TTWO), the gaming company he has chaired since 2007 and run as CEO since January 2011. The latest installment in a controversial but hugely popular crime series, *GTA* sold nearly 29 million units in its first six weeks on the market. And the long-awaited kickoff of the first major videogame-console cycle in seven years—**Microsoft** (MSFT) introduced the Xbox One last month, and **Sony** (SNE), the PlayStation 4—can only mean more sales for Take-Two's flagship property.

Yet Zelnick knows too much to be turning handstands in either the midtown Manhattan offices of ZelnickMedia, his private-equity firm, or Take-Two's headquarters farther downtown. "It's wonderful; we are thrilled, full stop," he says. "We are not champagne-poppers around here. The nature of this business is that you have to do it all over again."

Spoken just like a guy who was running a major film studio—in his case, 20th Century Fox—by the time he was 32.

TAKE-TWO WAS FOUNDED in 1993, and its history could inspire one of the dramas it sells. Its founder pleaded guilty in 2007 to falsifying business records, and Zelnick seized the opportunity to organize a group of investors who took control of the company, remade the board, and installed him as chairman. His brief included diversifying Take-Two's revenue base, which was largely dependent on the *Grand Theft* franchise.

Today, Take-Two has nine gaming brands that have sold more than five million units each. The company, which competes primarily against **Electronic Arts** (EA) and **Activision Blizzard** (ATVI), had three of the top 10 best-selling titles in October: *Grand Theft V*, the *NBA 2K14* basketball game, and *WWE 2K14*, a wrestling game, according to market researcher NPD Group.

The videogame industry has been under pressure in recent years as more-casual players have moved to cheap games available on mobile devices and tablets, including a \$3 version of *Angry Birds*, and *Candy Crush Saga*, available for free. The average console or personal-computer game retails for about \$60, and in the case of blockbusters like *Grand Theft Auto*, can cost \$100 million to develop and another \$50 million to market, according to Evan Wilson, an analyst at Pacific Crest Securities. Videogames generated \$7 billion at retail last year, down 39% from the industry's peak in 2008, says NPD.



Brad Trent for Barron's

Zelnick has overseen Take-Two's development of multiple videogame brands, lessening the company's dependence on the Grand Theft Auto franchise.

Zelnick hopes the new hardware will be positive for sales, but notes that near-term success isn't a slam-dunk. "It's a costly and difficult period," he says.

No matter a game's potential, it sells into a small base at first, and publishers must take care not to alienate gamers who have older consoles. Take-Two is hedging its bets, with 10 unique titles in development for use with the new consoles.

In addition to selling games, the company sells add-on content and virtual currency that players can download. James Hardiman, an

analyst at Longbow Research, says downloadable content and micro-transactions associated with *Grand Theft* alone could add a dollar per share to future earnings.

WHEN ZELNICK JOINED Take-Two, the company had about \$980 million in annual sales. In the fiscal year ended on March 31, sales totaled \$1.22 billion. Take-Two earned 36 cents a share in fiscal 2013, but is expected to net more than 10 times that, or about \$3.77 a share, in fiscal 2014, on revenue of \$2.2 billion to \$2.3 billion. In fiscal 2015, earnings could fall back to \$1.06 a share. The balance sheet is healthy, with \$218 million of net cash.

Take-Two's shares have fallen about 20%, to \$17, since Zelnick's team took charge, owing to economic and industry challenges, and several years of losses. The company rejected a \$26 cash bid from Electronic Arts in 2008, stating at the time that the offer failed to recognize the value of Take-Two's turnaround efforts.

The shares have rallied 50% this year, however, mostly in anticipation of the *Grand Theft* launch. Several analysts have 12-month target prices in the low- to mid-\$20s.

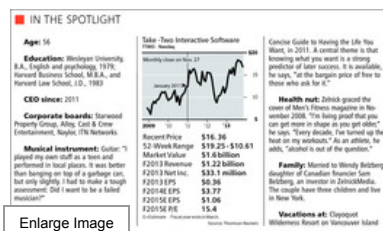
Zelnick believes Take-Two has been victimized by investors because of its feast-or-famine years, even though the company announced in October that it expects to be profitable for the foreseeable future. Hardiman, the Longbow analyst, says the shareholder base has turned over, with short-term traders who bought on the rumor of *Grand Theft V*'s success selling on the news.

Take-Two announced last Tuesday that it bought out one prominent investor, Carl Icahn, and will pay \$203.5 million, or \$16.93 a share, for his 11.3% stake. Icahn accumulated most of his shares toward the end of 2009 at under \$10 apiece. Three directors associated with him, including his son Brett, will leave the board of Take-Two, whose shares fell more than 5% on the day. Icahn didn't return calls for comment.

ZELNICK GREW UP IN South Orange, N.J., the ambitious second-oldest of five children. His father, whom Zelnick recalls as gentle, intellectual, and modest, was a lawyer and accountant with a successful trademark practice. His mother, who did bookkeeping, was the strong-willed disciplinarian in the home. "My father and I were very different characters," he says. "My father came home every night at 6:40 for dinner but stayed inside his head. I was more of a sales guy."

Zelnick learned years later that his siblings called him "the prince" behind his back, but he took no offense. "I was a man with a plan," he says, referring to his childhood dream of heading a movie studio someday.

Given his lack of film-industry connections, Zelnick figured he needed a gold-plated resume. He graduated from Wesleyan University with honors in 1979, and then earned a law degree and an M.B.A. simultaneously from Harvard. His summer internships included stints at **Goldman Sachs** (GS), McKinsey, and **Viacom** (VIA/B), where he exhibited a knack for office politics.



Assigned to review 10,000 movie contracts to determine whether Viacom retained the video rights, Zelnick read through the document stacks. He saw that most contracts were identical, and after speaking to several legal experts, delivered his assessment that Viacom indeed had the video rights to all of the films save for 10 Frank Sinatra movies. He finished the project, which was to have taken all summer, in two weeks. "Because I delivered heroic news, and so quickly, they gave me an office and an assistant," he says. "It's the entertainment business. They do things like that."

Soon, the 21-year-old was invited to board meetings.

SHORTLY BEFORE GRADUATING from Harvard, Zelnick paid a visit to Brian McGrath, head of international TV programming at Columbia Pictures and a contact from his Viacom summer. Columbia had no job available, but Zelnick persisted, and eventually was hired.

While working on international rights, he sought to have Columbia's technology department create a computerized system for rights management, but was told the tech specialists were too busy. As Zelnick relates it, he continued to ask if they were too busy to do the job for his boss, or his boss' boss, or Fay Vincent, then CEO of the company. The invocation of Vincent finally did the trick.

Zelnick says the new system helped his division double revenue in the quarter it was implemented, and the additional funds went straight to the bottom line. Management wanted to know who was responsible. "I wasn't stupid," he says. "I told them it was my boss."

McGrath was promoted, and brought Zelnick up the ladder as his vice president.

Zelnick left Columbia in 1986 for Vestron Pictures, an independent film studio. Luck followed, and one of the first movies he greenlighted—*Dirty Dancing*—won an Academy Award. At Vestron, which no longer is operating, he got to know Joe Roth, the film producer and an executive at 20th Century Fox, who recommended him to Barry Diller, then chairman of Fox Inc.

According to Zelnick, Diller and his boss, Rupert Murdoch (chairman of *Barron's* owner, News Corp), wanted a president who could help make the trains run on time. Thus Zelnick achieved his lifelong goal, becoming president and chief operating officer of the Fox studio.

During his four years at Fox, Zelnick boosted profits by cutting costs but was passed over for the chief executive's job when Roth left. He quit to join Crystal Dynamics, a gaming-software company, and left in 1994 to head Bertelsmann's North American music group. After turning the unit around, he was promoted to chief executive of Bertelsmann's BMG Entertainment, but left in 2000 to start ZelnickMedia and become his own boss.

ZELNICKMEDIA OVERSEES several hundred million dollars; about 70% is from institutions and the rest, from wealthy individuals and families. The firm, which is owned by Zelnick and outside partners, closed one fund in 2008 and is raising money for a second to participate in the digital transformation of media and entertainment. Zelnick says returns have been in the top quartile to date, as measured by Cambridge Associates against other media/communications private-equity funds. ZelnickMedia currently owns or has investments in seven companies, including Airvana, which sells technology to improve broadband on mobile devices, and Alloy, a youth-oriented marketing concern.

Digital technology is driving nearly all media today, enabling individualized consumption. "I am my own network planner and my own news aggregator, and I am better informed, not worse," Zelnick says.

News organizations will survive only if they generate "must have" information, he maintains. Regional and local news don't have much to offer, and paper is a thing of the past, in his view. Big-screen cinema, one of the last pillars of non-individualized entertainment, will survive, but audiences will shrink as the time compresses between theater and ancillary releases. Tablet computers will become ubiquitous, he predicts.

Will Zelnick repeat the triumphs of his earlier years? That remains to be seen. He admits he had envisioned sitting on 10 times as much capital as ZelnickMedia has now, but claims to be "emotionally comfortable with failure."

Only a wunderkind would ever call it that.

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