

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2002

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission File Number 0-12699

ACTIVISION, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

95-4803544

(I.R.S. Employer Identification No.)

3100 Ocean Park Boulevard, Santa Monica, CA

(Address of principal executive offices)

90405

(Zip Code)

(310) 255-2000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

The number of shares of the registrant's Common Stock outstanding as of October 23, 2002 was 67,079,857.

ACTIVISION, INC. AND SUBSIDIARIES

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Part I. Financial Information.

Item 1. Financial Statements.

ACTIVISION, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	September 30, 2002	March 31, 2002
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 339,371	\$ 279,007
Short-term investments	214,328	—
Accounts receivable, net of allowances of \$54,461 and \$42,019 at September 30, 2002 and March 31, 2002, respectively	61,395	76,733
Inventories	25,118	20,736
Software development	44,840	36,263
Intellectual property licenses	8,735	6,326
Deferred income taxes	21,764	22,608
Other current assets	15,324	15,200
Total current assets	730,875	456,873
Software development	11,482	3,254
Intellectual property licenses	35,719	10,899
Property and equipment, net	19,354	17,832
Deferred income taxes	23,894	28,795
Other assets	3,980	3,242
Goodwill	57,810	35,992
Total assets	\$ 883,114	\$ 556,887
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	\$ 189	\$ 168
Accounts payable	57,280	64,410
Accrued expenses	63,080	59,096

Total current liabilities	120,549	123,674
Long-term debt, less current portion	3,222	3,122
Total liabilities	123,771	126,796
Commitments and contingencies (Note 15)		
Shareholders' equity:		
Preferred stock, \$.000001 par value, 3,750,000 shares authorized, no shares issued at September 30, 2002 and March 31, 2002	—	—
Series A Junior Preferred stock, \$.000001 par value, 1,250,000 shares authorized, no shares issued at September 30, 2002 and March 31, 2002	—	—
Common stock, \$.000001 par value, 125,000,000 shares authorized, 71,286,159 and 61,034,263 shares issued and 66,957,400 and 56,705,504 shares outstanding at September 30, 2002 and March 31, 2002, respectively	—	—
Additional paid-in capital	690,940	397,528
Retained earnings	94,174	64,384
Accumulated other comprehensive loss	(5,448)	(11,498)
Less: Treasury stock, at cost, 4,328,759 shares at September 30, 2002 and March 31, 2002	(20,323)	(20,323)
Total shareholders' equity	759,343	430,091
Total liabilities and shareholders' equity	\$ 883,114	\$ 556,887

The accompanying notes are an integral part of these consolidated financial statements.

ACTIVISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	For the three months ended September 30,		For the six months ended September 30,	
	2002	2001	2002	2001
Net revenues	\$ 169,172	\$ 139,604	\$ 360,430	\$ 250,181
Costs and expenses:				
Cost of sales—product costs	80,779	88,157	164,123	152,281
Cost of sales—software royalties and amortization	18,055	7,980	33,893	12,702
Cost of sales—intellectual property licenses	5,143	5,185	17,786	10,459
Product development	13,259	9,020	25,010	18,210
Sales and marketing	28,776	16,425	50,769	35,181
General and administrative	11,826	9,693	26,319	19,439
Total costs and expenses	157,838	136,460	317,900	248,272
Operating income	11,334	3,144	42,530	1,909
Investment income, net	2,865	372	4,021	1,653
Income before income tax provision	14,199	3,516	46,551	3,562
Income tax provision	5,113	1,301	16,761	1,318
Net income	\$ 9,086	\$ 2,215	\$ 29,790	\$ 2,244
Basic earnings per share	\$ 0.14	\$ 0.04	\$ 0.47	\$ 0.05

Weighted average common shares outstanding	66,781	49,862	63,058	47,525
Diluted earnings per share	\$ 0.13	\$ 0.04	\$ 0.43	\$ 0.04
Weighted average common shares outstanding assuming dilution	72,487	57,150	69,277	55,128

The accompanying notes are an integral part of these consolidated financial statements.

ACTIVISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(In thousands)

	For the six months ended September 30,	
	2002	2001
Cash flows from operating activities:		
Net income	\$ 29,790	\$ 2,244
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Deferred income taxes	5,745	(24,199)
Depreciation and amortization	4,545	3,245
Amortization of capitalized software development costs and intellectual property licenses	34,658	17,531
Tax benefit of stock options and warrants exercised	15,479	24,371
Changes in operating assets and liabilities (net of effects of acquisitions):		
Accounts receivable	16,349	(12,589)
Inventories	(4,382)	9,996
Software development and intellectual property licenses	(78,692)	(37,241)
Other assets	2,595	(1,489)
Accounts payable	(7,180)	(563)
Accrued expenses and other liabilities	3,173	2,790
Net cash provided by (used in) operating activities	22,080	(15,904)
Cash flows from investing activities:		
Capital expenditures	(4,775)	(4,652)
Proceeds from disposal of property and equipment	505	391
Purchases of short-term investments	(308,164)	—
Proceeds from sales and maturities of short-term investments	93,652	—
Cash payment to effect business combination, net of cash acquired	(12,091)	—
Minority capital investment	(1,500)	—
Net cash used in investing activities	(232,373)	(4,261)
Cash flows from financing activities:		
Proceeds from issuance of common stock to employees	17,567	23,716
Payment on term loan	—	(8,550)
Other borrowings, net	121	680
Redemption of convertible subordinated notes	—	(62)
Proceeds from issuance of common stock pursuant to underwritten public offering, net of offering costs	248,102	—
Net cash provided by financing activities	265,790	15,784

Effect of exchange rate changes on cash	4,867	983
Net increase (decrease) in cash and cash equivalents	60,364	(3,398)
Cash and cash equivalents at beginning of period	279,007	125,550
Cash and cash equivalents at end of period	\$ 339,371	\$ 122,152

The accompanying notes are an integral part of these consolidated financial statements.

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ACTIVISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the six months ended September 30, 2002

(Unaudited)

(In thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Shareholders' Equity
	Shares	Amount			Shares	Amount		
Balance, March 31, 2002	61,034	\$ —	\$ 397,528	\$ 64,384	(4,329)	\$ (20,323)	(11,498)	\$ 430,091
Components of comprehensive income:								
Net income	—	—	—	29,790	—	—	—	29,790
Unrealized depreciation on short-term investments	—	—	—	—	—	—	(126)	(126)
Foreign currency translation adjustment	—	—	—	—	—	—	6,176	6,176
Total comprehensive income								35,840
Issuance of common stock pursuant to underwritten public offering	7,500	—	247,321	—	—	—	—	247,321
Issuance of common stock pursuant to employee stock option and stock purchase plans and common stock warrants	2,401	—	17,567	—	—	—	—	17,567
Issuance of common stock warrants	—	—	2,184	—	—	—	—	2,184
Tax benefit attributable to employee stock options and common stock warrants	—	—	15,479	—	—	—	—	15,479
Issuance of common stock to effect business combinations	351	—	10,861	—	—	—	—	10,861
Balance, September 30, 2002	71,286	\$ —	\$ 690,940	\$ 94,174	(4,329)	\$ (20,323)	(5,448)	\$ 759,343

The accompanying notes are an integral part of these consolidated financial statements.

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Notes to Consolidated Financial Statements (Unaudited)

For the three and six months ended September 30, 2002

1. Basis of Presentation

The accompanying consolidated financial statements include the accounts of Activision, Inc. and its subsidiaries ("Activision" or "we"). The information furnished is unaudited and reflects all adjustments that, in the opinion of management, are necessary to provide a fair statement of the results for the interim periods presented. The consolidated financial statements should be read in conjunction with the consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2002 as filed with the Securities and Exchange Commission.

Certain amounts in the consolidated financial statements have been reclassified to conform to the current period's presentation. These reclassifications had no impact on previously reported working capital or results of operations.

2. Stock Split

In October 2001, the Board of Directors approved a three-for-two stock split effected in the form of a 50% stock dividend. The stock split was paid at the close of business on November 20, 2001, to shareholders of record as of November 6, 2001. The consolidated financial statements, including all share and per share data, have been restated as if the stock split had occurred as of the earliest period presented.

3. Acquisition

Effective May 20, 2002, we acquired all of the outstanding ownership interests of Z-Axis Ltd. ("Z-Axis"), a privately held interactive software development company, in exchange for \$12.5 million in cash and 249,190 shares of our common stock valued at approximately \$8.2 million. Z-Axis is a console software developer with a focus on action sports video games. This acquisition further enables us to implement our multi-platform development strategy by augmenting our internal product development capabilities for console systems and enhances our position in the action sports genre. The purchase price of the transaction, including acquisition costs, was valued at approximately \$20.9 million and has been allocated to assets acquired and liabilities assumed as follows (amounts in thousands):

Current assets	\$	1,602
Other intangibles		808
Property and equipment		172
Other assets		20
Goodwill		19,202
Current liabilities		(938)
		<hr/>
	\$	20,866
		<hr/>

Goodwill has been included in the publishing segment of our business and is non-deductible for tax purposes. A significant portion of the purchase price for this acquisition was assigned to goodwill as the primary asset we acquired in the transaction was an assembled workforce with proven technical and design talent with a history of high quality product creation. The results of operations of Z-Axis are included in our consolidated statement of operations beginning May 20, 2002. Pro forma consolidated statements of operations are not shown, as they would not differ materially from reported results.

Approximately 93,000 additional shares of our common stock may be issued to Z-Axis' equity holders over the course of several years, depending on the satisfaction of certain product performance requirements and other criteria. This contingent consideration will be recorded as an additional element of the purchase price for Z-Axis when those contingencies are resolved.

4. Short-term Investments

Short-term investments generally mature between three months and two years. Investments with maturities beyond one year may be classified as short-term based on their liquid nature and because such securities represent the investment of cash that is available for current operations. All of our short-term investments are classified as available-for-sale and are carried at fair market value with unrealized appreciation (depreciation) reported as a separate component of accumulated other comprehensive loss in shareholders' equity.

The following table summarizes our investments in securities as of September 30, 2002 (amounts in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	<hr/>	<hr/>	<hr/>	<hr/>
<i>Cash and cash equivalents</i>				
Cash and time deposits	\$ 121,539	\$ —	\$ —	\$ 121,539
Money market instruments	39,594	—	—	39,594
Auction rate notes	178,238	—	—	178,238
	<hr/>	<hr/>	<hr/>	<hr/>
Cash and cash equivalents	339,371	—	—	339,371
	<hr/>	<hr/>	<hr/>	<hr/>
<i>Short-term investments</i>				
Corporate bonds	61,369	112	(169)	61,312

U.S. agency issues	62,364	76	(21)	62,419
Asset-backed securities	90,721	313	(437)	90,597
Short-term investments	214,454	501	(627)	214,328
Cash, cash equivalents and short-term investments	\$ 553,825	\$ 501	\$ (627)	\$ 553,699

The following table summarizes the maturities of our investments in debt securities as of September 30, 2002 (amounts in thousands):

	Amortized Cost	Fair Value
Due in one year or less	\$ 206,497	\$ 206,434
Due after one year through two years	95,474	95,535
	301,971	301,969
Asset-backed securities	90,721	90,597
Total	\$ 392,692	\$ 392,566

The specific identification method is used to determine the cost of securities disposed with realized gains and losses reflected in investment income, net. For the three and six months ended September 30,

2002, net realized losses on short-term investments consisted of \$2,000 of gross realized gains and \$60,000 of gross realized losses.

5. Inventories

Inventories are valued at the lower of cost (first-in, first-out) or market. Our inventories consist of the following (amounts in thousands):

	September 30, 2002	March 31, 2002
Purchased parts and components	\$ 2,066	\$ 892
Finished goods	23,052	19,844
	\$ 25,118	\$ 20,736

6. Goodwill and Other Intangible Assets

Goodwill

The changes in the carrying amount of goodwill for the six months ended September 30, 2002 are as follows (amounts in thousands):

	Publishing	Distribution	Total
Balance as of March 31, 2002	\$ 31,626	\$ 4,366	\$ 35,992
Goodwill acquired during the period	19,202	—	19,202
Issuance of contingent consideration	2,668	—	2,668
Adjustment to original purchase allocation	(468)	—	(468)
Effect of foreign currency exchange rates	—	416	416
Balance as of September 30, 2002	\$ 53,028	\$ 4,782	\$ 57,810

In July 2002, we issued 101,635 of our common shares with an assigned value of \$2.7 million in conjunction with the resolution of certain contingencies relating to a prior acquisition.

Acquired Intangible Assets

Acquired intangible assets are as follows (amounts in thousands):

September 30, 2002		March 31, 2002	
Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization

Amortized Intangible Assets

Acquired software development and royalty agreements	\$	1,292	\$	(113)	\$	84	\$	—
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Acquired intangible assets are included in the consolidated balance sheets in other current assets. For the three and six months ended September 30, 2002, aggregate amortization expense related to acquired intangible assets was \$113,400. There was no such amortization for the three and six months ended September 30, 2001. All acquired intangible assets as of September 30, 2002 are expected to be expensed during the year ended March 31, 2003.

7. Income Taxes

The income tax provision of \$5.1 million and \$16.8 million for the three and six months ended September 30, 2002, respectively, reflects our effective income tax rate of approximately 36%. The income tax provision of \$1.3 million for the three and six months ended September 30, 2001 reflects our effective income tax rate of approximately 37%. For both periods, the significant item that generated the variance between our effective rate and our statutory rate of 35% was state taxes, partially offset by research and development tax credits.

8. Software Development Costs and Intellectual Property Licenses

Software development costs include payments made to independent software developers under development agreements, as well as direct costs incurred for internally developed products.

We account for software development costs in accordance with Statement of Financial Accounting Standards ("SFAS") No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." Software development costs are capitalized once technological feasibility of a product is established and such costs are determined to be recoverable. For products where proven game engine technology exists, this may occur early in the development cycle. Technological feasibility is evaluated on a product-by-product basis. Prior to a product's release, we expense, as part of product development costs, capitalized costs when we believe such amounts are not recoverable. Amounts related to software development which are not capitalized are charged immediately to product development expense.

We evaluate the future recoverability of capitalized amounts on a quarterly basis. The following criteria are used to evaluate recoverability of software development costs: historical performance of comparable products; the commercial acceptance of prior products released on a given game engine; orders for the product prior to its release; estimated performance of a sequel product based on the performance of the product on which the sequel is based; and actual development costs of a product as compared to our budgeted amount.

Commencing upon product release, capitalized software development costs are amortized to cost of sales—software royalties and amortization based on the ratio of current revenues to total projected revenues, generally resulting in an amortization period of six months or less. For products that have been released in prior periods, we evaluate the future recoverability of capitalized amounts on a quarterly basis. The primary evaluation criterion is actual title performance.

Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks or copyrights in the development of our products.

We evaluate the future recoverability of capitalized intellectual property licenses on a quarterly basis. The recoverability of capitalized intellectual property license costs is evaluated based on the expected performance of the specific products in which the licensed trademark or copyright is used. The following criteria are used to evaluate expected product performance: historical performance of comparable products; the commercial acceptance of prior products released on a given game engine; orders for the product prior to its release; estimated performance of a sequel product based on the performance of the product on which the sequel is based; and actual development costs of a product as compared to our budgeted amount.

Commencing upon the related product's release, capitalized intellectual property license costs are amortized to cost of sales—intellectual property licenses based on the ratio of current revenues for the specific product to total projected revenues for all products in which the licensed trademark or copyright will be utilized. As intellectual property license contracts may extend for multiple years, the amortization of capitalized intellectual property license costs relating to such contracts may extend beyond one year. For products that have been released, we evaluate the future recoverability of capitalized amounts on a quarterly basis. The primary evaluation criterion is actual title performance.

As of September 30, 2002, capitalized software development costs included \$24.2 million of internally developed software costs and \$32.1 million of payments made to independent software developers. As of March 31, 2002, capitalized software development costs included \$16.0 million of internally developed software costs and \$23.5 million of payments made to independent software developers. Capitalized intellectual property licenses were \$44.5 million and \$17.2 million as of September 30, 2002 and March 31, 2002, respectively. In July 2002, we extended our partnership with professional skateboarder, Tony Hawk, through an exclusive multi-year licensing agreement that expires in 2015. Amortization of capitalized software development costs and intellectual property licenses, combined, was \$34.7 million and \$17.5 million for the six months ended September 30, 2002 and 2001, respectively.

9. Accumulated Other Comprehensive Income (Loss)

For the six months ended September 30, 2002, the accumulated other comprehensive loss balance consisted of \$5.3 million of foreign currency adjustments and \$0.1 million of unrealized depreciation on short-term investments.

10. Revenue Recognition

We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers. We may permit product returns from or grant price protection to our customers on unsold merchandise under certain conditions. Price protection policies, when granted and applicable, allow customers a credit against amounts they owe us with respect to merchandise unsold by them. With respect to license agreements that provide customers the right to make multiple copies in exchange for guaranteed amounts, revenue is recognized upon delivery of such copies. Per copy royalties on sales that exceed the guarantee are recognized as earned. In addition, in order to recognize revenue for both product sales and licensing transactions, persuasive evidence of an arrangement must exist and collection of the related receivable must be probable.

Revenue from product sales is reflected after deducting the estimated allowance for returns and price protection. Management must make estimates of potential future product returns and price protection related to current period product revenue. We estimate the amount of future returns and price protection based upon historical experience, customer inventory levels and changes in the demand and acceptance of our products by the end consumer.

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11. Investment Income, Net

Investment income, net is comprised of the following (amounts in thousands):

	Three months ended September 30,		Six months ended September 30,	
	2002	2001	2002	2001
Interest expense	\$ (136)	\$ (662)	\$ (672)	\$ (1,263)
Interest income	3,059	1,034	4,751	2,916
Realized loss on investments	(58)	—	(58)	—
Investment income, net	\$ 2,865	\$ 372	\$ 4,021	\$ 1,653

12. Supplemental Cash Flow Information

Non-cash investing and financing activities and supplemental cash flow information is as follows (amounts in thousands):

	Six months ended September 30,	
	2002	2001
<i>Non-cash investing and financing activities</i>		
Conversion of convertible subordinated notes, net of conversion costs	\$ —	\$ 58,651
Subsidiaries acquired with common stock	10,861	—
Issuance of options and common stock warrants	2,184	3,217
Stock offering costs	781	—
Change in unrealized depreciation on short-term investments	126	—
<i>Supplemental cash flow information</i>		
Cash paid for income taxes	\$ 1,799	\$ 978
Cash paid (received) for interest, net	(2,334)	(1,211)

13. Operations by Reportable Segments and Geographic Area

Based upon our organizational structure, we operate two business segments: (i) publishing of interactive entertainment software and (ii) distribution of interactive entertainment software and hardware products.

Publishing refers to the development, marketing and sale of products, either directly, by license or through our affiliate label program with third party publishers. In the United States, our products are sold primarily on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses and office super-stores. We conduct our international publishing activities through offices in the United Kingdom, Germany, France, Australia, Sweden, Canada and Japan. Our products are sold internationally on a direct to retail basis, through third party distribution and licensing arrangements and through our wholly-owned European distribution subsidiaries.

Distribution refers to our European operations located in the United Kingdom, the Netherlands and Germany that provide logistical and sales services to third party publishers of interactive

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entertainment software, our own publishing operations and manufacturers of interactive entertainment hardware.

Resources are allocated to each of these segments using information on their respective net revenues and operating profits before interest and taxes. The segments are not evaluated based on assets or depreciation.

The accounting policies of these segments are the same as those described in the Summary of Significant Accounting Policies in our Annual Report on Form 10-K for the year ended March 31, 2002. Revenue derived from sales between segments is eliminated in consolidation.

Information on the reportable segments for the three and six months ended September 30, 2002 and 2001 is as follows (amounts in thousands):

	Three months ended September 30, 2002		
	Publishing	Distribution	Total
Total segment revenues	\$ 127,098	\$ 42,074	\$ 169,172
Revenues from sales between segments	(9,538)	9,538	—
Revenues from external customers	\$ 117,560	\$ 51,612	\$ 169,172
Operating income	\$ 9,273	\$ 2,061	\$ 11,334
Goodwill	\$ 53,028	\$ 4,782	\$ 57,810
Total assets	\$ 808,243	\$ 74,871	\$ 883,114
	Three months ended September 30, 2001		
	Publishing	Distribution	Total
Total segment revenues	\$ 97,627	\$ 41,977	\$ 139,604
Revenues from sales between segments	(7,481)	7,481	—
Revenues from external customers	\$ 90,146	\$ 49,458	\$ 139,604
Operating income	\$ 2,118	\$ 1,026	\$ 3,144
Goodwill	\$ 5,941	\$ 4,517	\$ 10,458
Total assets	\$ 319,236	\$ 85,575	\$ 404,811
	Six months ended September 30, 2002		
	Publishing	Distribution	Total
Total segment revenues	\$ 280,243	\$ 80,187	\$ 360,430
Revenues from sales between segments	(25,189)	25,189	—
Revenues from external customers	\$ 255,054	\$ 105,376	\$ 360,430
Operating income	\$ 41,733	\$ 797	\$ 42,530
Goodwill	\$ 53,028	\$ 4,782	\$ 57,810
Total assets	\$ 808,243	\$ 74,871	\$ 883,114

	Six months ended September 30, 2001		
	Publishing	Distribution	Total
Total segment revenues	\$ 180,457	\$ 69,724	\$ 250,181
Revenues from sales between segments	(13,481)	13,481	—
Revenues from external customers	\$ 166,976	\$ 83,205	\$ 250,181
Operating income	\$ 812	\$ 1,097	\$ 1,909

Goodwill	\$ 5,941	\$ 4,517	\$ 10,458
Total assets	\$ 319,236	\$ 85,575	\$ 404,811

Geographic information for the three and six months ended September 30, 2002 and 2001 is based on the location of the selling entity. Revenues from external customers by geographic region were as follows (amounts in thousands):

	Three months ended September 30,		Six months ended September 30,	
	2002	2001	2002	2001
United States	\$ 93,298	\$ 71,680	\$ 200,402	\$ 137,944
Europe	72,540	65,537	152,532	107,370
Other	3,334	2,387	7,496	4,867
Total	\$ 169,172	\$ 139,604	\$ 360,430	\$ 250,181

Revenues by platform were as follows (amounts in thousands):

	Three months ended September 30,		Six months ended September 30,	
	2002	2001	2002	2001
Console	\$ 117,366	\$ 72,790	\$ 261,632	\$ 122,552
Hand-held	17,938	42,296	31,227	86,067
PC	33,868	24,518	67,571	41,562
Total	\$ 169,172	\$ 139,604	\$ 360,430	\$ 250,181

As of and for the three and six months ended September 30, 2002, we had one customer that accounted for 15% and 16%, respectively, of consolidated net revenues and 27% of consolidated accounts receivable, net. As of and for the three and six months ended September 30, 2001, we had one customer that accounted for 13% and 14%, respectively, of consolidated net revenues and 18% of consolidated accounts receivable, net. This customer was the same customer in all periods and was a customer of both our publishing and distribution businesses.

14. Computation of Earnings Per Share

The following table sets forth the computations of basic and diluted earnings per share (amounts in thousands, except per share data):

	Three months ended September 30,		Six months ended September 30,	
	2002	2001	2002	2001
<i>Numerator</i>				
Numerator for basic and diluted earnings per share—income available to common shareholders	\$ 9,086	\$ 2,215	\$ 29,790	\$ 2,244
<i>Denominator</i>				
Denominator for basic earnings per share—weighted average common shares outstanding	66,781	49,862	63,058	47,525
Effect of dilutive securities:				
Employee stock options	5,451	6,727	5,941	6,994
Warrants to purchase common stock	255	561	278	609
Potential dilutive common shares	5,706	7,288	6,219	7,603
Denominator for diluted earnings per share—weighted average common shares outstanding plus assumed conversions	72,487	57,150	69,277	55,128
Basic earnings per share	\$ 0.14	\$ 0.04	\$ 0.47	\$ 0.05
Diluted earnings per share	\$ 0.13	\$ 0.04	\$ 0.43	\$ 0.04

Options to purchase 2,155,223 shares of common stock at exercise prices ranging from \$26.34 to \$33.24 and options to purchase 160,588 shares of common stock at exercise prices ranging from \$28.17 to \$33.24 were outstanding for the three and six months ended September 30, 2002, respectively, but were not included in the calculation of diluted earnings per share because their effect would be antidilutive.

Options to purchase 84,075 shares of common stock at exercise prices ranging from \$21.80 to \$25.27 and options to purchase 57,218 shares of common stock at exercise prices ranging from \$20.70 to \$25.27 were outstanding for the three and six months ended September 30, 2001, respectively, but were not included in the calculation of diluted earnings per share because their effect would be antidilutive.

15. Commitments

Credit Facilities and Other

In June 1999, we obtained a \$100.0 million revolving credit facility and a \$25.0 million term loan with a syndicate of banks (the "U.S. Facility"). The revolving portion of the U.S. Facility provided us with the ability to borrow up to \$100.0 million, including issuing letters of credit up to \$80 million, on a revolving basis against eligible accounts receivable and inventory. The term loan had a three-year term with principal amortization on a straight-line quarterly basis beginning December 31, 1999, a borrowing rate based on the banks' base rate (which is generally equivalent to the published prime rate) plus 2% or LIBOR plus 3% and was to expire June 2002. The revolving portion of the U.S. Facility had a borrowing rate based on the banks' base rate plus 1.75% or LIBOR plus 2.75%. In May 2001, we accelerated our repayment of the outstanding balance under the term loan portion of the U.S. Facility. In connection with the accelerated repayment, we amended the U.S. Facility (the "Amended and Restated U.S. Facility"). The Amended and Restated U.S. Facility eliminated the term loan, reduced

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the revolver to \$78.0 million and reduced the interest rate to the banks' base rate plus 1.25% or LIBOR plus 2.25%. The Amended and Restated U.S. Facility was collateralized by substantially all of our assets and expired in August 2002. Due to our improved financial position, including significant cash, cash equivalent and short-term investment balances and minimal debt, we did not seek additional bank financing upon the expiration of the Amended and Restated U.S. Facility.

We have a revolving credit facility through our CD Contact subsidiary in the Netherlands (the "Netherlands Facility"). The Netherlands Facility permitted revolving credit loans and letters of credit up to Euro ("EUR") 2.5 million (\$2.5 million) as of September 30, 2002, based upon eligible accounts receivable balances. The Netherlands Facility is due on demand, bears interest at a Eurocurrency rate plus 1.25%, is collateralized by the subsidiary's accounts receivable and inventory and a EUR 0.5 million (\$0.5 million) guarantee made by our Centresoft subsidiary through its bank facility and expires August 2003. As of September 30, 2002, there were no borrowings or letters of credit outstanding under the Netherlands Facility.

We also have revolving credit facilities with our CentreSoft subsidiary located in the United Kingdom (the "UK Facility") and our NBG subsidiary located in Germany (the "German Facility"). As of September 30, 2002, the UK Facility provided Centresoft with the ability to borrow up to British Pounds ("GBP") 7.0 million (\$10.9 million), including issuing letters of credit, on a revolving basis. Furthermore, as of September 30, 2002, under the UK Facility, Centresoft provided a EUR 0.5 million (\$0.5 million) guarantee which served as collateral for the Netherlands Facility. The UK Facility bears interest at LIBOR plus 2%, is collateralized by substantially all of the assets of the subsidiary and expires in October 2003. The UK Facility also contains various covenants that require the subsidiary to maintain specified financial ratios related to, among others, fixed charges. As of September 30, 2002, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of September 30, 2002. The German Facility provided for revolving loans up to EUR 2.0 million (\$2.0 million) as of September 30, 2002, bears interest at a Eurocurrency rate plus 2.5%, is collateralized by the subsidiary's accounts receivable and inventory and a cash deposit of approximately GBP 0.7 (\$1.1 million) made by our CentreSoft subsidiary and has no expiration date. No borrowings were outstanding against the German Facility as of September 30, 2002.

In connection with our purchases of Nintendo 64, Nintendo GameCube and Game Boy software for distribution in North America and Europe, Nintendo requires us to either provide standby letters of credit or cash prepayment prior to accepting purchase orders.

Private Placement of Convertible Subordinated Notes

In December 1997, we completed the private placement of \$60.0 million principal amount of 6³/₄% convertible subordinated notes due 2005 (the "Notes"). The Notes were convertible, in whole or in part, at the option of the holder at any time after December 22, 1997 (the date of original issuance) and prior to the close of business on the business day immediately preceding the maturity date, unless previously redeemed or repurchased, into our common stock at a conversion price of \$12.583 per share, subject to adjustment in certain circumstances. During the three months ended June 30, 2001, we called for the redemption of the Notes. In connection with that call, holders converted to common stock approximately \$58.7 million aggregate principal amount of their Notes, net of conversion costs. The remaining Notes were redeemed for cash.

Software Developer and Intellectual Property License Contracts

In the normal course of business, we enter into contractual arrangements with third parties for the development of products, as well as for the rights to intellectual property ("IP"). Under these agreements, we commit to provide specified payments to a developer or IP holder, based upon contractual arrangements. Assuming all contractual provisions are met, the total future minimum

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contract commitment for contracts in place as of September 30, 2002 is approximately \$99.4 million and is scheduled to be paid as follows (amounts in thousands):

Fiscal year ending March 31,

2003	\$ 37,397
2004	47,363
2005	9,488
2006	2,300
2007	2,875
	<hr/>
Total	\$ 99,423
	<hr/>

Legal Proceedings

We are party to routine claims and suits brought by us and against us in the ordinary course of business, including disputes arising over the ownership of intellectual property rights, contractual claims and collection matters. In the opinion of management, the outcome of such routine claims will not have a material adverse effect on our business, financial condition, results of operations or liquidity.

16. Related Parties

In August 2001, we elected to our Board of Directors an individual who is a partner in a law firm that has provided legal services to Activision for more than ten years. We paid approximately \$140,000 and \$643,000 during the three and six months ended September 30, 2002, respectively, for legal services rendered by the law firm.

17. Recently Issued Accounting Standards

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be initially measured at fair value and recognized when the liability is incurred. The provisions of SFAS No. 146 are required to be applied prospectively to exit or disposal activities initiated after December 31, 2002.

18. Subsequent Events

Further enhancing our internal console development capabilities, effective October 4, 2002, we acquired all of the outstanding ownership interests of Luxoflux Corporation ("Luxoflux"), a privately held interactive software development company, in exchange for \$9.0 million in cash and 110,391 shares of our common stock. The common stock is deliverable upon the satisfaction of certain future product performance requirements and other criteria.

On October 4, 2002, our Board of Directors authorized a buyback program under which we can repurchase up to \$150 million of our common stock. Under the program, shares may be purchased as determined by management from time to time in the open market or in privately negotiated transactions, including privately negotiated structured option transactions, and through transactions in the options markets. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time or from time-to-time without prior notice.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

We are a leading international publisher of interactive entertainment software products. We have built a company with a diverse portfolio of products that spans a wide range of categories and target markets and that is used on a variety of game hardware platforms and operating systems. We have created, licensed and acquired a group of highly recognizable brands which we market to a growing variety of consumer demographics.

Our products cover the action/adventure, action sports, racing, role-playing, simulation, first-person action and strategy game categories. We offer our products in versions that operate on the Sony PlayStation ("PS1"), Sony PlayStation 2 ("PS2"), Nintendo 64 ("N64"), Nintendo GameCube ("GameCube") and Microsoft Xbox ("Xbox") console systems, Nintendo Game Boy Advance ("GBA") hand-held device, as well as on personal computers ("PC").

Our publishing business involves the development, marketing and sale of products, either directly, by license or through our affiliate label program with third party publishers. In the United States, our products are sold primarily on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses and office super-stores. We conduct our international publishing activities through offices in the United Kingdom, Germany, France, Australia, Sweden, Canada and Japan. Our products are sold internationally on a direct to retail basis, through third party distribution and licensing arrangements and through our wholly-owned European distribution subsidiaries. In addition to publishing, we maintain distribution operations located in the United Kingdom, the Netherlands and Germany that provide logistical and sales services to third party publishers of interactive entertainment software, our own publishing operations and manufacturers of interactive entertainment hardware.

Our profitability is directly affected by the mix of revenues from our publishing and distribution segments. Publishing operating margins are substantially higher than margins realized from our distribution segment. Operating margins in our distribution segment are also affected by the mix of hardware and software sales, with software producing higher margins than hardware.

In July 2002, we extended our partnership with professional skateboarder, Tony Hawk, through an exclusive multi-year licensing agreement that expires in 2015. The continuation of our long-term relationship with Tony Hawk is part of our strategy to continue to be a leader in the action sports category. Activision O₂, our action sports umbrella brand, has featured such franchises as *Tony Hawk's Pro Skater*, *Mat Hoffman's Pro BMX* and *Shaun Palmer's Pro Snowboarder*. This quarter, in the action sports category, we released *Street Hoops*, *Mat Hoffman's Pro BMX 2* and *Kelly Slater's Pro Surfer*. We will continue to promote our action sports franchises with the release of titles for existing franchises, including *Tony Hawk's Pro Skater 4*, which was released across multiple platforms on October 23, 2002, as well as new action sports titles, including *Shaun*

Murray's Pro Wakeboarder which is expected to be released in the fourth quarter of fiscal 2003. We also plan to continue to focus on our super hero brands. *Spider-Man: The Movie* was a key release for the first quarter of fiscal 2003. This quarter, under our super hero brands, we released *Blade 2*. More recently, on October 22, 2002, we released *X-Men: Next Dimension*. We have also recently exercised an option to develop and publish the game based on the movie sequel to the successful feature film, "Spider-Man" which is expected to be released in the spring of 2004. Additionally, we will continue to focus on our other key brands. We will also continue to evaluate emerging brands that we believe have potential for growth. A significant number of our fiscal 2003 releases will be cross-platform releases, as we believe this provides us with many benefits with regards to sales and consumer awareness, as well as cost structure savings. We believe fiscal 2003 will be a strong growth year for our industry as the installed hardware bases for PS2, GameCube and Xbox continue to increase, enabling the interactive entertainment industry to continue to reach a broader audience.

Critical Accounting Policies

We have identified the policies below as critical to our business operations and the understanding of our financial results. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see Note 1 to the Notes to the Consolidated Financial Statements in Item 8 of our Annual Report on Form 10-K for the year ended March 31, 2002 as filed with the Securities and Exchange Commission. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition. We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection. We may permit product returns from or grant price protection to our customers on unsold merchandise under certain conditions. Price protection policies, when granted and applicable, allow customers a credit against amounts they owe us with respect to merchandise unsold by them. With respect to license agreements that provide customers the right to make multiple copies in exchange for guaranteed amounts, revenue is recognized upon delivery of such copies. Per copy royalties on sales that exceed the guarantee are recognized as earned. In addition, in order to recognize revenue for both product sales and licensing transactions, persuasive evidence of an arrangement must exist and collection of the related receivable must be probable. Revenue recognition also determines the timing of certain expenses, including cost of sales—intellectual property licenses and cost of sales—software royalties and amortization.

Allowances for Returns, Price Protection, Doubtful Accounts and Inventory Obsolescence. We may permit product returns from or grant price protection to our customers under certain conditions. The conditions our customers must meet to be granted the right to return products or price protection are, among other things, compliance with applicable payment terms, delivery to us of weekly inventory and sell-through reports, and consistent participation in the launches of our premium title releases. We may also consider other factors, including the facilitation of slow moving inventory and other market factors. Management must make estimates of potential future product returns and price protection related to current period product revenue. We estimate the amount of future returns and price protection based upon historical experience, customer inventory levels and changes in the demand and acceptance of our products by the end consumer. Significant management judgments and estimates must be made and used in connection with establishing the allowance for returns and price protection in any accounting period. Material differences may result in the amount and timing of our revenue for any period if management made different judgments or utilized different estimates.

Similarly, management must make estimates of the uncollectibility of our accounts receivable. In estimating allowance for doubtful accounts, we analyze historical bad debts, customer concentrations, customer credit worthiness, current economic trends and changes in our customers' payment terms and their economic condition, as well as whether we can obtain sufficient credit insurance. Any significant changes in any of these criteria would impact management's estimates in establishing our allowance for doubtful accounts.

We value inventory at the lower of cost or market. We regularly review inventory quantities on hand and in the retail channel and record a provision for excess or obsolete inventory based on the future expected demand for our products. Significant changes in demand for our products would impact management's estimates in establishing our inventory provision.

Software Development Costs. Software development costs include payments made to independent software developers under development agreements, as well as direct costs incurred for internally developed products.

We account for software development costs in accordance with Statement of Financial Accounting Standards ("SFAS") No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." Software development costs are capitalized once technological feasibility of a product is established and such costs are determined to be recoverable. For products where proven game engine technology exists, this may occur early in the development cycle. Technological feasibility is evaluated on a product-by-product basis. Prior to a product's release, we expense, as part of product development costs, capitalized costs when we believe such amounts are not recoverable. Amounts related to software development which are not capitalized are charged immediately to product development expense.

We evaluate the future recoverability of capitalized amounts on a quarterly basis. The following criteria are used to evaluate recoverability of software development costs: historical performance of comparable products; the commercial acceptance of prior products released on a given game engine; orders for the product prior to its release; estimated performance of a sequel product based on the performance of the product on which the sequel is based; and actual development costs of a product as compared to our budgeted amount.

Commencing upon product release, capitalized software development costs are amortized to cost of sales—software royalties and amortization based on the ratio of current revenues to total projected revenues, generally resulting in an amortization period of six months or less.

For products that have been released in prior periods, we evaluate the future recoverability of capitalized amounts on a quarterly basis. The primary evaluation criterion is actual title performance.

Significant management judgment and estimates are utilized in the assessment of when technological feasibility is established, as well as in the ongoing assessment of the recoverability of capitalized costs.

Intellectual Property Licenses. Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks or copyrights in the development of our products.

We evaluate the future recoverability of capitalized amounts on a quarterly basis. The recoverability of capitalized intellectual property license costs is evaluated based on the expected performance of the specific products in which the licensed trademark or copyright is used. The following criteria are used to evaluate expected product performance: historical performance of comparable products; the commercial acceptance of prior products released on a given game engine; orders for the product prior to its release; estimated performance of a sequel product based on the performance of the product on which the sequel is based; and actual development costs of a product as compared to our budgeted amount.

Commencing upon the related product's release, capitalized intellectual property license costs are amortized to cost of sales—intellectual property licenses based on the ratio of current revenues for the specific product to total projected revenues for all products in which the licensed trademark or copyright will be utilized. As intellectual property license contracts may extend for multiple years, the amortization of capitalized intellectual property license costs relating to such contracts may extend beyond one year. For products that have been released, we evaluate the future recoverability of capitalized amounts on a quarterly basis. The primary evaluation criterion is actual title performance.

Significant management judgment and estimates are utilized in the assessment of the recoverability of capitalized costs.

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The following table sets forth certain consolidated statements of operations data for the periods indicated as a percentage of total net revenues and also breaks down net revenues by territory and platform, as well as operating income by business segment (amounts in thousands):

	Three months ended September 30,				Six months ended September 30,			
	2002		2001		2002		2001	
Net revenues	\$ 169,172	100%	\$ 139,604	100%	\$ 360,430	100%	\$ 250,181	100%
Costs and expenses:								
Cost of sales—product costs	80,779	48	88,157	63	164,123	46	152,281	61
Cost of sales—software royalties and amortization	18,055	10	7,980	6	33,893	9	12,702	5
Cost of sales—intellectual property licenses	5,143	3	5,185	3	17,786	5	10,459	4
Product development	13,259	8	9,020	7	25,010	7	18,210	7
Sales and marketing	28,776	17	16,425	12	50,769	14	35,181	14
General and administrative	11,826	7	9,693	7	26,319	7	19,439	8
Total costs and expenses	157,838	93	136,460	98	317,900	88	248,272	99
Operating income	11,334	7	3,144	2	42,530	12	1,909	1
Investment income, net	2,865	1	372	1	4,021	1	1,653	1
Income before income tax provision	14,199	8	3,516	3	46,551	13	3,562	2
Income tax provision	5,113	3	1,301	1	16,761	5	1,318	1
Net income	\$ 9,086	5%	\$ 2,215	2%	\$ 29,790	8%	\$ 2,244	1%
NET REVENUES BY TERRITORY:								
United States	\$ 93,298	55%	\$ 71,680	51%	\$ 200,402	56%	\$ 137,944	55%
Europe	72,540	43	65,537	47	152,532	42	107,370	43
Other	3,334	2	2,387	2	7,496	2	4,867	2
Total net revenues	\$ 169,172	100%	\$ 139,604	100%	\$ 360,430	100%	\$ 250,181	100%
ACTIVITY/PLATFORM MIX:								
Publishing:								
Console	\$ 83,766	66%	\$ 46,755	48%	\$ 197,926	71%	\$ 79,099	44%
Hand-held	14,797	12	32,735	33	25,487	9	69,600	38
PC	28,535	22	18,137	19	56,830	20	31,758	18
Total publishing net revenues	127,098	75	97,627	70	280,243	78	180,457	72

Distribution:									
Console	33,600	80	26,035	62	63,706	80	43,453	62	
Hand-held	3,141	7	9,561	23	5,740	7	16,467	24	
PC	5,333	13	6,381	15	10,741	13	9,804	14	
<hr/>									
Total distribution net revenues	42,074	25	41,977	30	80,187	22	69,724	28	
<hr/>									
Total net revenues	\$ 169,172	100%	\$ 139,604	100%	\$ 360,430	100%	\$ 250,181	100%	
<hr/>									
OPERATING INCOME BY SEGMENT:									
Publishing	\$ 9,273	6%	\$ 2,118	2%	\$ 41,733	12%	\$ 812	—%	
Distribution	2,061	1	1,026	—	797	—	1,097	1	
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Total operating income	\$ 11,334	7%	\$ 3,144	2%	\$ 42,530	12%	\$ 1,909	1%	
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Results of Operations—Three and Six Months Ended September 30, 2002 and 2001

Net Revenues

Net revenues for the three months ended September 30, 2002 increased 21% over the same period last year, from \$139.6 million to \$169.2 million. Net revenues for the six months ended September 30, 2002 increased 44% over the same period last year, from \$250.2 million to \$360.4 million. The increase in the three month period was primarily generated by our publishing business. The increase in the six month period was generated by both our publishing and distribution businesses.

Publishing net revenues for the three months ended September 30, 2002 increased 30% from \$97.6 million to \$127.1 million. The following table details our publishing net revenues by platform as a percentage of total publishing net revenues for the three months ended September 30, 2002 and 2001:

	Three months ended September 30,	
	2002	2001
Publishing Net Revenues		
PC	22%	19%
Console	66%	48%
PlayStation 2	37	2
Microsoft Xbox	12	—
PlayStation	9	23
Nintendo GameCube	5	—
Nintendo 64	3	21
Sega Dreamcast	—	2
Hand-held	12%	33%
Game Boy Advance	11	21
Game Boy Color	1	12
Total publishing net revenues	100%	100%

The increase in publishing net revenues was primarily attributable to net revenues from a higher number of console titles versus hand-held titles in the three months ended September 30, 2002 as compared to the same period last year. Console titles have a higher price point than that of hand-held titles. For the three months ended September 30, 2002, console publishing net revenues were 66% of publishing net revenues, and hand-held publishing net revenues were 12% of publishing net revenues. For the three months ended September 30, 2001, console publishing net revenues were 48% of publishing net revenues, and hand-held publishing net revenues were 33% of publishing net revenues. Performance in the hand-held sector in the three months ended September 30, 2001 reflects the launch of the Nintendo Game Boy Advance hardware in June 2001. Our GBA sales for the three months ended September 30, 2001 benefited from the related hardware launch, which drove GBA software sales. Console publishing net revenues in the three months ended September 30, 2002 included the simultaneous cross-platform releases of titles such as *Mat Hoffman's Pro BMX 2*, *Street Hoops* and *Blade 2*, as well as *Kelly Slater's Pro Surfer*. We also continued to see strong console sales from prior quarter releases for our *Spider-Man* and *Tony Hawk* brands. Publishing PC net revenues for the three months ended September 30, 2002 also increased when compared to the same period last year, increasing 57% from \$18.1 million to \$28.5 million. The increase in publishing PC net

revenues reflects the release during the three months ended September 30, 2002 of *Medieval: Total War* which performed very well in both the domestic and international marketplaces.

As demonstrated above and as further noted in our subsequent discussion of net revenues for the six months ended September 30, 2002 and 2001, a significant portion of our publishing net revenues is derived from products based on a relatively small number of popular brands each year. We expect that a limited number of popular brands will continue to produce a disproportionately large amount of our net revenues.

Distribution net revenues for the three months ended September 30, 2002 remained relatively consistent with the same period last year at approximately \$42 million. Distribution console net revenues for the three months ended September 30, 2002 increased 29% over the same period last year, from \$26.0 million to \$33.6 million. Distribution console net revenues for the three months ended September 30, 2002 benefited from the international hardware launches of Xbox and GameCube in March 2002 and May 2002, respectively. The increase in distribution console net revenues was offset primarily by a decline in distribution hand-held net revenues from \$9.6 million for the three months ended September 30, 2001, to \$3.1 million for the three months ended September 30, 2002, for the reasons detailed above.

Domestic net revenues grew 30% from \$71.7 million for the three months ended September 30, 2001 to \$93.3 million for the three months ended September 30, 2002. International net revenues increased by 12% from \$67.9 million for the three months ended September 30, 2001 to \$75.9 million for the three months ended September 30, 2002. The increase in both domestic and international net revenues is reflective of the improvements in our publishing segment as described above.

Publishing net revenues for the six months ended September 30, 2002 increased 55% from \$180.5 million to \$280.2 million. The following table details our publishing net revenues by platform as a percentage of total publishing net revenues for the six months ended September 30, 2002 and 2001:

	Six months ended September 30,	
	2002	2001
Publishing Net Revenues		
PC	20%	18%
Console	71%	44%
PlayStation 2	36	6
Microsoft Xbox	12	—
PlayStation	7	24
Nintendo GameCube	15	—
Nintendo 64	1	12
Sega Dreamcast	—	2
Hand-held	9%	38%
Game Boy Advance	8	25
Game Boy Color	1	13
Total publishing net revenues	100%	100%

The increase in publishing net revenues was primarily attributable to the simultaneous cross-platform, multi-national release in the first quarter of fiscal 2003 of *Spider-Man: The Movie* and the benefit from a price reduction in console hardware prices resulting in an increased hardware base. In the six months ended September 30, 2002, 42% of our worldwide publishing net revenues were derived from *Spider-Man: The Movie*. Publishing console net revenues increased 150% from \$79.1 million to \$197.9 million due to the release of *Spider-Man: The Movie* as previously noted. Publishing PC net revenues for the six months ended September 30, 2002 also increased when compared to the same period last year, increasing 79% from \$31.8 million to \$56.8 million. The increase in publishing PC net

revenues reflects the PC release during the six months ended September 30, 2002 of *Medieval: Total War*, *Soldier of Fortune II: Double Helix*, as well as *Spider-Man: The Movie*, all of which performed very well in both the domestic and international marketplaces. Publishing hand-held net revenues decreased 63% from \$69.6 million to \$25.5 million. As previously described, this decrease reflects the fact that the Nintendo Game Boy Advance hardware was launched in June 2001. Our GBA sales for the six months ended September 30, 2001 benefited from the related hardware launch, which drove GBA software sales.

Distribution net revenues for the six months ended September 30, 2002 increased 15% from the same period last year, from \$69.7 million to \$80.2 million, primarily driven by an increase in our distribution console net revenues. Distribution console net revenues for the six months ended September 30, 2002 increased 47% over the same period last year, from \$43.5 million to \$63.7 million. Distribution console net revenues for the

six months ended September 30, 2002 benefited from the international hardware launches of Xbox and GameCube in March 2002 and May 2002, respectively. Additionally, we benefited from the price reduction on PS2 hardware that was effective September 2001, as this resulted in both an increase in sales of PS2 hardware, as well as an increase in sales of PS2 software due to the corresponding larger installed hardware base.

Domestic net revenues grew 45% from \$137.9 million for the six months ended September 30, 2001 to \$200.4 million for the six months ended September 30, 2002. International net revenues increased by 43% from \$112.2 million for the six months ended September 30, 2001 to \$160.0 million for the six months ended September 30, 2002. The increase in domestic net revenues is reflective of the improvements in our publishing segment as described above, and the increase in international net revenues is reflective of the improvements in both our publishing and distribution segments as described above.

Costs and Expenses

Cost of sales—product costs represented 48% and 63% of consolidated net revenues for the three months ended September 30, 2002 and 2001, respectively. Cost of sales—product costs represented 46% and 61% of consolidated net revenues for the six months ended September 30, 2002 and 2001, respectively. The decreases were due to several factors. First, there was a change in the product mix of our publishing business. The product mix of our publishing business for the three and six months ended September 30, 2001 reflects a higher number of titles on hand-held devices, four titles, as compared to the three and six months ended September 30, 2002, one title. Hand-held devices generally have the highest manufacturing per unit cost of all platforms. Second, there was a decrease in distribution net revenues as a percentage of total consolidated net revenues. Distribution net revenues have a higher per unit cost as compared to publishing net revenues. Lastly, our console manufacturing costs for the six months ended September 30, 2002 benefited from the economies of scale due to the high volume of *Spider-Man: The Movie* units manufactured.

Cost of sales—software royalties and amortization increased as a percentage of publishing net revenues to 14% for the three months ended September 30, 2002, from 8% for the three months ended September 30, 2001. Cost of sales—software royalties and amortization increased as a percentage of publishing net revenues to 12% for the six months ended September 30, 2002, from 7% for the six months ended September 30, 2001. The increases reflect the change in the product mix of our publishing business. Though GBA titles generally have the highest per unit manufacturing cost of all platforms, they have the lowest product development cost structure. As such, in the three and six months ended September 30, 2001 in which GBA titles accounted for a higher proportion of publishing net revenues, the related cost of sales—software royalties and amortization was correspondingly low. This is in comparison to the three and six months ended September 30, 2002 in which console titles accounted for a higher proportion of publishing net revenues. Console titles such as PS2, Xbox and GameCube have high product development cost structures, and the release of titles on these platforms will result in a correspondingly high cost of sales—software royalties and amortization.

Cost of sales—intellectual property licenses remained relatively flat as a percentage of publishing net revenues for the three months ended September 30, 2002 and 2001 at 4% to 5% and for the six months ended September 30, 2002 and 2001 at 6%. In absolute dollars, for the three months ended September 30, 2002 as compared to the three months ended September 30, 2001, cost of sales—intellectual property licenses remained relatively flat at approximately \$5.1 million. This is due to the fact that both periods' results were driven by a similar mix of branded titles with similar intellectual property royalty rates. For the six months ended September 30, 2002, cost of sales—intellectual property licenses increased 70% over the same period last year, from \$10.5 million to \$17.8 million. This increase was due to the fact that our top performing titles in the first quarter of fiscal 2003 were products with higher intellectual property royalty rates.

Product development expenses as a percentage of publishing net revenues have stayed relatively flat for all periods at 9% to 10%. Product development expense for the three months ended September 30, 2002 increased \$4.3 million from the same period last year, from \$9.0 million to \$13.3 million. Product development expense for the six months ended September 30, 2002 increased \$6.8 million from the same period last year, from \$18.2 million to \$25.0 million. The increases are

reflective of the change in product mix of titles in development, more console and less hand-held, during the respective periods. The cost to develop titles for console systems, including PS2, Xbox and GameCube, is higher than the cost to develop titles for the legacy console systems and, as described above, hand-held devices. Additionally, we had more titles in development during fiscal 2003, approximately 116 titles, compared to titles in development during fiscal 2002, approximately 91 titles.

Sales and marketing expenses of \$28.8 million and \$16.4 million represented 17% and 12% of consolidated net revenues for the three months ended September 30, 2002 and 2001, respectively. The increase in sales and marketing expense was the result of increased TV and print ads in support of new brands such as *Street Hoops*, *Mat Hoffman's Pro BMX 2* and *Kelly Slater's Pro Surfer*. Sales and marketing expenses of \$50.8 million and \$35.2 million for the six months ended September 30, 2002 and 2001, respectively, represented 14% of consolidated net revenues for both periods. The increase in sales and marketing expense dollars was the result of a significant marketing program in support of the simultaneous cross-platform, multi-national release of *Spider-Man: The Movie* during the first quarter of fiscal 2003. Additionally, in the three and six months ended September 30, 2002, we also provided sponsorship for select action sports tours/tournaments in support of our Activision O₂ brand.

General and administrative expense for the three months ended September 30, 2002, increased \$2.1 million over the same period last year, from \$9.7 million to \$11.8 million. General and administrative expense for the six months ended September 30, 2002, increased \$6.9 million over the same period last year, from \$19.4 million to \$26.3 million. For all periods, as a percentage of consolidated net revenues, general and administrative expenses remained relatively constant at approximately 7% to 8%. The increases in the dollar amounts of general and administrative expenses were primarily due to an increase in worldwide administrative support needs and headcount related expenses as a result of acquisitions and our continued growth. The increase in general and administrative expenses for the six months ended September 30, 2002 as compared to the same period last year was additionally due to the incurrence in the first quarter of fiscal 2003 of an approximate \$2.0 million charge for the relocation of our UK distribution facility due to the increased growth of our UK distribution and UK publishing businesses.

Operating Income

Operating income for the three months ended September 30, 2002, was \$11.3 million, compared to \$3.1 million in the same period last year. Operating income for the six months ended September 30, 2002, was \$42.5 million, compared to \$1.9 million in the same period last year. The increase in operating income for the three months ended September 30, 2002 over the same period last year was primarily due to an increase in the success of our publishing business due to the success of new releases such as *Street Hoops* and *Medieval: Total War* and the continued strong performance of our *Spider-Man* and *Tony Hawk* brands. The increase in operating income for the six months ended September 30, 2002 over the same period last year was primarily due to an increase in the success of our publishing business due to the success of *Spider-Man: The Movie*, released in the first quarter of fiscal 2003. Distribution operating income for the three and six months ended September 30, 2002 remained relatively consistent with the same periods last year. Operating income for the three and six months ended September 30, 2002 also reflected the benefits generated by cross-platform releases and our continued focus on building operating efficiencies and controlling costs.

Investment Income, Net

Investment income, net for the three months ended September 30, 2002 was \$2.9 million as compared to \$0.4 million for the three months ended September 30, 2001. Investment income, net for the six months ended September 30, 2002 was \$4.0 million as compared to \$1.7 million for the six months ended September 30, 2001. These increases were primarily due to higher average cash and short-term investment balances partially offset by lower interest rates.

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Provision for Income Taxes

The income tax provision of \$5.1 million and \$16.8 million for the three and six months ended September 30, 2002, respectively, reflects our effective income tax rate of approximately 36%. The significant item that generated the variance between our effective rate and our statutory rate of 35% was state taxes, partially offset by research and development tax credits. The realization of deferred tax assets primarily is dependent on the generation of future taxable income. We believe that it is more likely than not that we will generate taxable income sufficient to realize the benefit of net deferred tax assets recognized.

Liquidity and Capital Resources

As of September 30, 2002, our primary source of liquidity is comprised of \$339.4 million of cash and cash equivalents and \$214.3 million of short-term investments. We believe that we have sufficient working capital (\$610.3 million at September 30, 2002), as well as proceeds available from our international credit facilities (described below), to finance our operational requirements for at least the next twelve months, including purchases of inventory and equipment, the funding of the development, production, marketing and sale of new products and the acquisition of intellectual property rights for future products from third parties. We have historically financed our acquisitions through the issuance of shares of common stock or a combination of common stock and cash. We will continue to evaluate potential acquisition candidates as to the benefit they bring to us and as to our ability to make such acquisitions.

Cash Flows

Our cash and cash equivalents were \$339.4 million at September 30, 2002 compared to \$279.0 million at March 31, 2002. This \$60.4 million increase in cash and cash equivalents for the six months ended September 30, 2002, resulted from \$22.1 million and \$265.8 million provided by operating and financing activities, respectively, offset by \$232.4 million utilized in investing activities. The principal components comprising cash flows from operating activities included favorable operating results, tax benefits from stock option and warrant exercises and reductions in accounts receivable, partially offset by our continued investment in software development and intellectual property licenses and reductions in accounts payable, driven by a seasonal change in working capital needs. Approximately \$78.7 million was expended in the six months ended September 30, 2002 in connection with the acquisition of publishing or distribution rights to products being developed by third parties, the execution of new license agreements granting us long-term rights to intellectual property of third parties, as well as the capitalization of product development costs relating to internally developed products. The cash used in investing activities primarily was the result of the investment of excess cash balances into short-term investment vehicles. The goal of our short-term investments is to maximize return while preserving the value and safety of the principal involved, maintaining liquidity, coordinating with anticipated working capital needs and providing for prudent investment diversification. Cash used in investing activities was also the result of business combinations and equipment purchases. On May 20, 2002, we acquired all of the outstanding ownership interests of Z-Axis Ltd. ("Z-Axis"), a privately held interactive software development company, in exchange for \$12.5 million in cash and 249,190 shares of our common stock valued at approximately \$8.2 million. The cash provided by financing activities primarily was the result of proceeds from the June 7, 2002 issuance of 7,500,000 shares of our common stock for proceeds of approximately \$247.3 million, net of offering costs. The proceeds from this offering are being used for general corporate purposes, including, among other things, additions to working capital and financing of capital expenditures, joint ventures and/or strategic acquisitions.

On October 4, 2002, we utilized a portion of those proceeds and acquired Luxoflux Corporation, a privately held interactive software development company in exchange for \$9.0 million in cash and

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110,391 shares of our common stock. The delivery of the common stock is subject to the satisfaction of certain future product performance requirements and other criteria.

On October 4, 2002, our Board of Directors authorized a buyback program under which we can repurchase up to \$150 million of our common stock. Under the program, shares may be purchased as determined by management from time to time in the open market or in privately negotiated transactions, including privately negotiated structured option transactions, and through transactions in the options markets. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time or from time-to-time without prior notice.

Credit Facilities

In June 1999, we obtained a \$100.0 million revolving credit facility and a \$25.0 million term loan with a syndicate of banks (the "U.S. Facility"). The revolving portion of the U.S. Facility provided us with the ability to borrow up to \$100.0 million, including issuing letters of credit up to \$80 million, on a revolving basis against eligible accounts receivable and inventory. The term loan had a three-year term with principal amortization on a straight-line quarterly basis beginning December 31, 1999, a borrowing rate based on the banks' base rate (which is generally equivalent to the published prime rate) plus 2% or LIBOR plus 3% and was to expire June 2002. The revolving portion of the U.S. Facility had a borrowing rate based on the banks' base rate plus 1.75% or LIBOR plus 2.75%. In May 2001, we accelerated our repayment of the outstanding balance under the term loan portion of the U.S. Facility. In connection with the accelerated repayment, we amended the U.S. Facility (the "Amended and Restated U.S. Facility"). The Amended and Restated U.S. Facility eliminated the term loan, reduced the revolver to \$78.0 million and reduced the interest rate to the banks' base rate plus 1.25% or LIBOR plus 2.25%. The Amended and Restated U.S. Facility was collateralized by substantially all of our assets and expired in August 2002. Due to our improved financial position, including significant cash, cash equivalent and short-term investment balances and minimal debt, we did not seek additional bank financing upon the expiration of the Amended and Restated U.S. Facility.

We have a revolving credit facility through our CD Contact subsidiary in the Netherlands (the "Netherlands Facility"). The Netherlands Facility permitted revolving credit loans and letters of credit up to Euro ("EUR") 2.5 million (\$2.5 million) as of September 30, 2002, based upon eligible accounts receivable balances. The Netherlands Facility is due on demand, bears interest at a Eurocurrency rate plus 1.25%, is collateralized by the subsidiary's accounts receivable and inventory and a EUR 0.5 million (\$0.5 million) guarantee made by our Centresoft subsidiary through its bank facility and expires August 2003. As of September 30, 2002, there were no borrowings or letters of credit outstanding under the Netherlands Facility.

We also have revolving credit facilities with our CentreSoft subsidiary located in the United Kingdom (the "UK Facility") and our NBG subsidiary located in Germany (the "German Facility"). As of September 30, 2002, the UK Facility provided Centresoft with the ability to borrow up to British Pounds ("GBP") 7.0 million (\$10.9 million), including issuing letters of credit, on a revolving basis. Furthermore, as of September 30, 2002, under the UK Facility, Centresoft provided a EUR 0.5 million (\$0.5 million) guarantee which served as collateral for the Netherlands Facility. The UK Facility bears interest at LIBOR plus 2%, is collateralized by substantially all of the assets of the subsidiary and expires in October 2003. The UK Facility also contains various covenants that require the subsidiary to maintain specified financial ratios related to, among others, fixed charges. As of September 30, 2002, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility at September 30, 2002. The German Facility provided for revolving loans up to EUR 2.0 million (\$2.0 million) as of September 30, 2002, bears interest at a Eurocurrency rate plus 2.5%, is collateralized by the subsidiary's accounts receivable and inventory and a cash deposit of approximately GBP 0.7 (\$1.1 million) made by our CentreSoft subsidiary and has no expiration date. No borrowings were outstanding against the German Facility as of September 30, 2002.

Commitments

In connection with our purchases of Nintendo 64, Nintendo GameCube and Game Boy software for distribution in North America and Europe, Nintendo requires us to either provide standby letters of credit or cash prepayment prior to accepting purchase orders.

In the normal course of business, we enter into contractual arrangements with third parties for the development of products, as well as for the rights to intellectual property ("IP"). Under these agreements, we commit to provide specified payments to a developer or IP holder, based upon contractual arrangements. Assuming all contractual provisions are met, the total future minimum contract commitment for contracts in place as of September 30, 2002 is approximately \$99.4 million and is scheduled to be paid as follows (amounts in thousands):

Fiscal year ending March 31,	
2003	\$ 37,397
2004	47,363
2005	9,488
2006	2,300
2007	2,875
Total	\$ 99,423

Recently Issued Accounting Standards

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be initially measured at fair value and recognized when the liability is incurred. The provisions of SFAS No. 146 are required to be applied prospectively to exit or disposal activities initiated after December 31, 2002.

Factors Affecting Future Performance

In connection with the Private Securities Litigation Reform Act of 1995 (the "Litigation Reform Act"), we have disclosed certain cautionary information to be used in connection with written materials (including this Quarterly Report on Form 10-Q) and oral statements made by or on behalf of our employees and representatives that may contain "forward-looking statements" within the meaning of the Litigation Reform Act. Such statements consist of any statement other than a recitation of historical fact and can be identified by the use of forward-looking terminology such as "may," "expect," "anticipate," "estimate" or "continue" or the negative thereof or other variations thereon or comparable terminology. The listener or reader is cautioned that all forward-looking statements are necessarily speculative and there are numerous risks and uncertainties that could cause actual events or results to differ materially from those referred to in such forward-looking statements. For a discussion that highlights some of the more important risks identified by management, but which should not be assumed to be the only factors that could affect future

performance, see our Annual Report on Form 10-K for the fiscal year ended March 31, 2002 which is incorporated herein by reference. The reader or listener is cautioned that we do not have a policy of updating or revising forward-looking statements and thus he or she should not assume that silence by management over time means that actual events are bearing out as estimated in such forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the potential loss arising from fluctuations in market rates and prices. Our market risk exposures primarily include fluctuations in interest rates and foreign currency exchange rates. Our

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market risk sensitive instruments are classified as "other than trading." Our exposure to market risk as discussed below includes "forward-looking statements" and represents an estimate of possible changes in fair value or future earnings that would occur assuming hypothetical future movements in interest rates or foreign currency exchange rates. Our views on market risk are not necessarily indicative of actual results that may occur and do not represent the maximum possible gains and losses that may occur, since actual gains and losses will differ from those estimated, based upon actual fluctuations in foreign currency exchange rates, interest rates and the timing of transactions.

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We manage our interest rate risk by maintaining an investment portfolio consisting primarily of debt instruments with high credit quality and relatively short average maturities. We also manage our interest rate risk by maintaining sufficient cash and cash equivalent balances such that we are typically able to hold our investments to maturity. As of September 30, 2002, our cash equivalents and short-term investments included debt securities of \$392.6 million.

The following table presents the amounts and related weighted average interest rates of our investment portfolio as of September 30, 2002 (amounts in thousands):

	Average Interest Rate	Amortized Cost	Fair Value
<i>Cash equivalents</i>			
Fixed rate	1.92%	\$ 178,238	\$ 178,238
Variable rate	1.77	39,594	39,594
<i>Short-term investments</i>			
Fixed rate	2.55%	\$ 214,454	\$ 214,328

Our short-term investments generally mature between three months and two years.

Foreign Currency Exchange Rate Risk

We transact business in many different foreign currencies and may be exposed to financial market risk resulting from fluctuations in foreign currency exchange rates, particularly GBP and EUR. The volatility of GBP and EUR (and all other applicable currencies) will be monitored frequently throughout the coming year. When appropriate, we enter into hedging transactions in order to mitigate our risk from foreign currency fluctuations. We will continue to use hedging programs in the future and may use currency forward contracts, currency options and/or other derivative financial instruments commonly utilized to reduce financial market risks if it is determined that such hedging activities are appropriate to reduce risk. We do not hold or purchase any foreign currency contracts for trading purposes. As of September 30, 2002, assuming a change in currency rates of 10% of period end rates, the potential gain or loss on outstanding hedging contracts would be approximately \$100,000. However any such gain or loss would in turn be offset by the potential gain or loss on the hedged receivable and/or payable.

Item 4. Controls and Procedures

Within 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officers and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officers and principal financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be

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included in our periodic reports filed with the Securities and Exchange Commission. In addition, we reviewed our internal controls, and there have been no significant changes in our internal controls or in other factors that could significantly affect those internal controls subsequent to the date we carried out our last evaluation.

Part II.—OTHER INFORMATION

Item 1. Legal Proceedings

We are party to routine claims and suits brought by us and against us in the ordinary course of business including disputes arising over the ownership of intellectual property rights, contractual claims and collection matters. In the opinion of management, the outcome of such routine

claims will not have a material adverse effect on our business, financial condition or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

We held our 2002 Annual Meeting of the Stockholders on September 19, 2002 in Beverly Hills, California. Four items were submitted to a vote of the stockholders: (1) the election of six directors to hold office for one year terms and until their respective successors are duly elected and qualified; (2) the approval of the adoption of our 2002 Executive Incentive Plan; (3) the approval of the adoption of our 2002 Employee Stock Purchase Plan; and (4) the approval of the selection of PricewaterhouseCoopers LLP as our independent auditors for the fiscal year ending March 31, 2003.

All six directors were recommended by the Board of Directors and all were elected. Set forth below are the results of the voting for each director.

	For	Withheld
Kenneth L. Henderson	52,435,799	3,904,019
Barbara S. Isgur	53,519,796	2,820,022
Brian G. Kelly	54,266,599	2,073,219
Robert A. Kotick	54,266,922	2,072,896
Steven T. Mayer	53,520,703	2,819,115
Robert J. Morgado	54,147,805	2,192,013

The adoption of our 2002 Executive Incentive Plan was approved. Set forth below are the results of the voting.

For	Against	Abstain
28,792,957	27,494,725	52,136

The adoption of our 2002 Employee Stock Purchase Plan was approved. Set forth below are the results of the voting.

For	Against	Abstain
54,399,591	1,857,748	82,479

The selection of PricewaterhouseCoopers LLP as our independent auditors for the fiscal year ending March 31, 2003 was approved. Set forth below are the results of the voting.

For	Against	Abstain
53,148,956	3,171,833	19,029

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 1.1 Underwriting agreement between Activision and Goldman, Sachs & Co. dated June 4, 2002 (incorporated by reference to Exhibit 1.1 of Activision's 8-K, filed June 6, 2002).
- 3.1 Our Amended and Restated Certificate of Incorporation, dated June 1, 2000 (incorporated by reference to Exhibit 2.5 of our Current Report on Form 8-K, filed on June 16, 2000).
- 3.2 Our Certificate of Amendment of Amended and Restated Certificate of Incorporation, dated June 9, 2000 (incorporated by reference to Exhibit 2.7 of our Current Report on Form 8-K, filed on June 16, 2000).
- 3.3 Our Certificate of Amendment of Amended and Restated Certificate of Incorporation, dated August 23, 2001 (incorporated by reference to Exhibit 3.3 of Amendment No. 1 to our Registration Statement on Form S-3, Registration No. 333-66280, filed on August 31, 2001).
- 3.4 Our Certificate of Designation of Series A Junior Preferred Stock, dated December 27, 2001 (incorporated by reference to Exhibit 3.4 of our Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2001).
- 3.5 Our Amended and Restated By-laws dated August 1, 2000 (incorporated by reference to Exhibit 3.2 of our Current Report on Form 8-K, filed July 11, 2001).
- 4.1 Rights Agreement dated as of April 18, 2000, between us and Continental Stock Transfer & Trust Company, which includes as exhibits the form of Right Certificates as Exhibit A, the Summary of Rights to Purchase Series A Junior Preferred Stock as Exhibit B and the form of Certificate of Designation of Series A Junior Preferred Stock of Activision as Exhibit C (incorporated by reference to our Registration Statement on Form 8-A, Registration No. 001-15839, filed April 19, 2000).
- 10.1 Amendment I dated July 22, 2002 to employment agreement dated May 22, 2000, between Activision Publishing, Inc. and Robert A.

Kotick.

- 10.2 Amendment I dated July 22, 2002 to employment agreement dated May 22, 2000, between Activision Publishing, Inc. and Brian G. Kelly.
- 99.1 Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.2 Certification of Ronald Doomink pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.3 Certification of William J. Chardavoynne pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

- 1.1 We have filed a Form 8-K on August 14, 2002, reporting under "Item 7. Financial Statements, Pro Forma Financial Statements and Exhibits" and "Item 9. Regulation FD Disclosure" the certification of our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2002 by our CEO(s) and CFO.
- 1.2 We have filed a Form 8-K on October 11, 2002, reporting under "Item 7. Financial Statements, Pro Forma Financial Statements and Exhibits" and "Item 9. Regulation FD Disclosure" issuing a press release announcing a buyback program under which we can repurchase up to \$150 million of our common stock and issuing a press release announcing our acquisition of Luxoflux Corporation.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 1, 2002

ACTIVISION, INC.

/s/ WILLIAM J. CHARDAVOYNE

William J. Chardavoynne
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

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CERTIFICATIONS

CERTIFICATION

I, Robert A. Kotick, Chairman and Chief Executive Officer of Activision, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Activision, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 1, 2002

/s/ ROBERT A. KOTICK

Robert A. Kotick
Chairman and Chief Executive Officer

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CERTIFICATION

I, Ronald Doomink, President of Activision Inc., and Chief Executive Officer of Activision Publishing, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Activision, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 1, 2002

/s/ RONALD DOORNINK

Ronald Doomink
*President, Activision, Inc. and Chief Executive
Officer, Activision Publishing, Inc.*

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CERTIFICATION

I, William J. Chardavoine, Executive Vice President and Chief Financial Officer of Activision, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Activision, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
- a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 1, 2002

/s/ WILLIAM J. CHARDAVOYNE

William J. Chardavoyne
Executive Vice President and Chief Financial Officer

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**AMENDMENT NO. 1
TO
AMENDED AND RESTATED EMPLOYMENT AGREEMENT**

This Amendment No. 1, dated as of July 22, 2002, to the Amended and Restated Employment Agreement, dated as of May 22, 2000 (the "Agreement"), by and between Activision, Inc., a Delaware corporation with its principal offices at 3100 Ocean Park Boulevard, Santa Monica, CA 90405 (the "Company"), and ROBERT A. KOTICK (the "Executive").

WHEREAS, the Company and the Executive are parties to the Agreement, providing for the employment by the Company of the Executive and for compensation and benefits to be provided to the Executive;

WHEREAS, the parties hereto desire to extend the term of the Agreement as provided herein; and

WHEREAS, in consideration for the Executive entering into this Amendment No. 1 to the Agreement, on July 22, 2002 the Company granted to the Executive options to purchase up to 350,000 shares of common stock of the Company under the Activision, Inc. 2002 Executive Incentive Plan at \$22.94 per share, the low bid price on such date. Options to purchase 250,000 of the shares will vest in four equal amounts on July 22 of 2003, 2004, 2005 and 2006. Options to purchase the remaining 100,000 shares will vest in two equal amounts on July 22 of 2005 and 2006, subject to accelerated vesting if certain earnings targets are met. Regardless of vesting, the 100,00 options do not become exercisable until July 22, 2005. All of the options shall expire on the tenth anniversary of the grant date. In the event of a termination of employment (other than a termination by the Company for cause or a voluntary termination by Executive), the options must be exercised within the twelve month period following the termination of employment or the date first exercisable, whichever is later.

NOW, THEREFORE, the parties hereto agree that the Agreement is amended as follows:

1. Section 2 of the Agreement is hereby amended in its entirety to read as follows:

Employment Period. The employment of the Executive under the terms of this Agreement shall become effective on April 1, 2000 and terminate on March 31, 2008 (the "Employment Period"). Notwithstanding anything herein to the contrary, the Executive's employment pursuant to the terms of this Agreement is subject to termination pursuant to Section 5 below.

2. Except as specifically amended hereby, the Agreement shall remain in full force and effect and is hereby ratified and confirmed in all respects.

3. This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original and all of which, taken together, shall constitute a single agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment No. 1 to the Agreement as of the date first written above.

ACTIVISION, INC.

By: /s/ GEORGE ROSE

Name: George Rose
Title: Sr. Vice President and General Counsel

ACCEPTED AND AGREED TO:

/s/ ROBERT A. KOTICK

Robert A. Kotick

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[AMENDMENT NO. 1 TO AMENDED AND RESTATED EMPLOYMENT AGREEMENT](#)

**AMENDMENT NO. 1
TO
AMENDED AND RESTATED EMPLOYMENT AGREEMENT**

This Amendment No. 1, dated as of July 22, 2002, to the Amended and Restated Employment Agreement, dated as of May 22, 2000 (the "Agreement"), by and between Activision, Inc., a Delaware corporation with its principal offices at 3100 Ocean Park Boulevard, Santa Monica, CA 90405 (the "Company"), and BRIAN G. KELLY (the "Executive").

WHEREAS, the Company and the Executive are parties to the Agreement, providing for the employment by the Company of the Executive and for compensation and benefits to be provided to the Executive;

WHEREAS, the parties hereto desire to extend the term of the Agreement as provided herein; and

WHEREAS, in consideration for the Executive entering into this Amendment No. 1 to the Agreement, on July 22, 2002 the Company granted to the Executive options to purchase up to 350,000 shares of common stock of the Company under the Activision, Inc. 2002 Executive Incentive Plan at \$22.94 per share, the low bid price on such date. Options to purchase 250,000 of the shares will vest in four equal amounts on July 22 of 2003, 2004, 2005 and 2006. Options to purchase the remaining 100,000 shares will vest in two equal amounts on July 22 of 2005 and 2006, subject to accelerated vesting if certain earnings targets are met. Regardless of vesting, the 100,000 options do not become exercisable until July 22, 2005. All of the options shall expire on the tenth anniversary of the grant date. In the event of a termination of employment (other than a termination by the Company for cause or a voluntary termination by Executive), the options must be exercised within the twelve month period following the termination of employment or the date first exercisable, whichever is later.

NOW, THEREFORE, the parties hereto agree that the Agreement is amended as follows:

1. Section 2 of the Agreement is hereby amended in its entirety to read as follows:

Employment Period. The employment of the Executive under the terms of this Agreement shall become effective on April 1, 2000 and terminate on March 31, 2008 (the "Employment Period"). Notwithstanding anything herein to the contrary, the Executive's employment pursuant to the terms of this Agreement is subject to termination pursuant to Section 5 below.

2. Except as specifically amended hereby, the Agreement shall remain in full force and effect and is hereby ratified and confirmed in all respects.

3. This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original and all of which, taken together, shall constitute a single agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Amendment No. 1 to the Agreement as of the date first written above.

ACTIVISION, INC.

By: /s/ GEORGE ROSE

Name: George Rose
Title: Sr. Vice President and General Counsel

ACCEPTED AND AGREED TO:

/s/ BRIAN G. KELLY

Brian G. Kelly

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[AMENDMENT NO. 1 TO AMENDED AND RESTATED EMPLOYMENT AGREEMENT](#)

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Exhibit 99.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of Activision, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert A. Kotick, Chief Executive Officer of the Company, certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ROBERT A. KOTICK

Robert A. Kotick
Chairman and Chief Executive Officer
Activision, Inc.
November 1, 2002

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[CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002](#)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of Activision, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ronald Doomink, President of the Company and Chief Executive Officer of Activision Publishing, Inc., certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ RONALD DOORNINK

Ronald Doomink
President,
Activision, Inc.
Chief Executive Officer,
Activision Publishing, Inc.
November 1, 2002

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[CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002](#)

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Exhibit 99.3

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of Activision, Inc. (the "Company") on Form 10-Q for the period ending September 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William J. Chardavoyne, Chief Financial Officer of the Company, certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ WILLIAM J. CHARDAVOYNE

William J. Chardavoyne
Chief Financial Officer
Activision, Inc.
November 1, 2002

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[CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002](#)