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**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 June 30, 2003

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

The number of shares of the registrant's Common Stock outstanding as of July 25, 2003 was 88,102,997.

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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)

	<u>June 30, 2003</u>	<u>March 31, 2003</u>
	<u>(Unaudited)</u>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 290,833	\$ 285,554
Short-term investments	98,942	121,400
Accounts receivable, net of allowances of \$56,819 and \$57,356 at June 30, 2003 and March 31, 2003, respectively	33,328	15,822
Inventories	25,107	19,577
Software development	25,768	26,791
Intellectual property licenses	19,229	8,906
Deferred income taxes	33,475	38,290
Other current assets	22,324	10,565
<b>Total current assets</b>	<b>549,006</b>	<b>526,905</b>
Software development	45,667	35,281
Intellectual property licenses	26,456	36,943
Property and equipment, net	26,358	22,265
Deferred income taxes	13,696	10,322
Other assets	1,902	5,081
Goodwill	67,672	68,019
<b>Total assets</b>	<b>\$ 730,757</b>	<b>\$ 704,816</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Current portion of long-term debt	\$ —	\$ 147
Accounts payable	51,340	45,602
Accrued expenses	48,062	58,656
<b>Total current liabilities</b>	<b>99,402</b>	<b>104,405</b>
Long-term debt, less current portion	—	2,671
<b>Total liabilities</b>	<b>99,402</b>	<b>107,076</b>
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, \$.000001 par value, 3,750,000 shares authorized, no shares issued at June 30, 2003 and March 31, 2003	—	—
Series A Junior Preferred stock, \$.000001 par value, 1,250,000 shares authorized, no shares issued at June 30, 2003 and March 31, 2003	—	—
Common stock, \$.000001 par value, 125,000,000 shares authorized, 107,613,658 and 107,372,727 shares issued and 88,016,775 and 90,084,245 shares outstanding at June 30, 2003 and March 31, 2003, respectively	—	—
Additional paid-in capital	639,307	592,295
Retained earnings	134,727	130,564
Less: Treasury stock, at cost, 19,596,883 and 17,288,482 shares at June 30, 2003 and March 31, 2003, respectively	(142,946)	(121,685)
Accumulated other comprehensive income (loss)	267	(3,434)
<b>Total shareholders' equity</b>	<b>631,355</b>	<b>597,740</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 730,757</b>	<b>\$ 704,816</b>

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)

	<u>For the three months ended June 30,</u>	
	<u>2003</u>	<u>2002</u>
Net revenues	\$ 158,725	\$ 191,258
Costs and expenses:		
Cost of sales – product costs	76,610	83,344
Cost of sales – software royalties and amortization	15,498	15,838
Cost of sales – intellectual property licenses	10,143	12,643
Product development	13,580	11,751
Sales and marketing	26,285	21,993
General and administrative	11,463	14,493
Total costs and expenses	<u>153,579</u>	<u>160,062</u>
Operating income	5,146	31,196
Investment income, net	<u>1,257</u>	<u>1,156</u>
Income before income tax provision	6,403	32,352
Income tax provision	<u>2,240</u>	<u>11,648</u>
Net income	<u>\$ 4,163</u>	<u>\$ 20,704</u>
Basic earnings per share	<u>\$ 0.05</u>	<u>\$ 0.23</u>
Weighted average common shares outstanding	<u>88,046</u>	<u>90,059</u>
Diluted earnings per share	<u>\$ 0.04</u>	<u>\$ 0.21</u>
Weighted average common shares outstanding assuming dilution	<u>93,770</u>	<u>100,125</u>

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

**ACTIVISION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(In thousands)

	<b>For the three months ended June 30,</b>	
	<b>2003</b>	<b>2002</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 4,163	\$ 20,704
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Deferred income taxes	1,441	(1,566)
Depreciation and amortization	2,251	2,168
Amortization of capitalized software development costs and intellectual property licenses	19,045	18,527
Tax benefit of stock options and warrants exercised	512	12,753
Changes in operating assets and liabilities (net of effects of acquisitions):		
Accounts receivable	(17,406)	12,946
Inventories	(5,530)	(4,703)
Software development and intellectual property licenses	(28,244)	(33,187)
Other assets	(3,102)	6,061
Accounts payable	5,738	(18,649)
Accrued expenses and other liabilities	(2,566)	2,994
Net cash provided by (used in) operating activities	<u>(23,698)</u>	<u>18,048</u>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(5,671)	(1,860)
Proceeds from disposal of property and equipment	—	408
Purchases of short-term investments	(24,500)	—
Proceeds from sales and maturities of short-term investments	46,930	—
Cash payment to effect business combinations, net of cash acquired	—	(12,091)
Minority capital investment	—	(1,500)
Net cash provided by (used in) investing activities	<u>16,759</u>	<u>(15,043)</u>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common stock to employees	1,423	15,059
Other borrowings, net	(2,818)	1,184
Proceeds from issuance of common stock pursuant to underwritten public offering, net of offering costs	—	248,102
Purchase of structured stock repurchase transactions	(36,420)	—
Settlement of structured stock repurchase transactions	65,903	—
Purchase of treasury stock	(18,814)	—
Net cash provided by financing activities	<u>9,274</u>	<u>264,345</u>
Effect of exchange rate changes on cash	<u>2,944</u>	<u>3,973</u>
Net increase in cash and cash equivalents	5,279	271,323
Cash and cash equivalents at beginning of period	<u>285,554</u>	<u>279,007</u>
Cash and cash equivalents at end of period	<u>\$ 290,833</u>	<u>\$ 550,330</u>

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

**ACTIVISION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**  
For the three months ended June 30, 2003  
(Unaudited)  
(In thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Shareholders' Equity
	Shares	Amounts			Shares	Amounts		
<b>Balance, March 31, 2003</b>	<b>107,373</b>	<b>\$ —</b>	<b>\$ 592,295</b>	<b>\$ 130,564</b>	<b>(17,288)</b>	<b>\$ (121,685)</b>	<b>\$ (3,434)</b>	<b>\$ 597,740</b>
Components of comprehensive income:								
Net income	—	—	—	4,163	—	—	—	4,163
Unrealized depreciation on short-term investments	—	—	—	—	—	—	(24)	(24)
Foreign currency translation adjustment	—	—	—	—	—	—	3,725	3,725
Total comprehensive income								7,864
Issuance of common stock pursuant to employee stock option and stock purchase plans and common stock warrants	241	—	1,423	—	—	—	—	1,423
Tax benefit attributable to employee stock options and common stock warrants	—	—	512	—	—	—	—	512
Structured stock repurchase transactions	—	—	(36,420)	—	—	—	—	(36,420)
Settlement of structured stock repurchase transactions	—	—	81,497	—	(1,144)	(10,000)	—	71,497
Purchase of treasury stock	—	—	—	—	(1,165)	(11,261)	—	(11,261)
<b>Balance, June 30, 2003</b>	<b>107,614</b>	<b>\$ —</b>	<b>\$ 639,307</b>	<b>\$ 134,727</b>	<b>(19,597)</b>	<b>\$ (142,946)</b>	<b>\$ 267</b>	<b>\$ 631,355</b>

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

**ACTIVISION, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**  
**For the three months ended June 30, 2003**

**1. Summary of Significant Accounting Policies**

*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, 2003 as filed with the Securities and Exchange Commission (“SEC”).

*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. Technological feasibility of a product encompasses both technical design documentation and game design documentation. For products where proven 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 cost of sales – software royalties and amortization, capitalized costs when we believe such amounts are not recoverable. Capitalized costs for those products that are cancelled or abandoned are charged to product development expense in the period of cancellation. 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 recoverability of capitalized software development costs is evaluated based on the expected performance of the specific products for which the costs relate. Criteria used to evaluate expected product performance include historical performance of comparable products using comparable technology; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based.

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. Depending upon the agreement with the rights holder, we may obtain the rights to use acquired intellectual property in multiple products over multiple years, or alternatively, for a single product.

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 to be used. As many of our intellectual property licenses extend for multiple products over multiple years, we also assess the recoverability of capitalized intellectual property license costs based on certain qualitative factors such as the success of other products and/or entertainment vehicles utilizing the intellectual property, whether there are any future planned theatrical releases or television series based on the intellectual property and the rights holder’s continued promotion and exploitation of the intellectual property. Prior to the related product’s release, we expense, as part of cost of sales – intellectual property licenses, capitalized intellectual property costs when we believe such amounts are not recoverable. Capitalized intellectual

property costs for those products that are cancelled or abandoned are charged to product development expense in the period of cancellation. Criteria used to evaluate expected product performance include historical performance of comparable products using comparable technology; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based.

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 intellectual property included in 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.

#### *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, when granted and applicable, allows 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.

Sales incentives or other consideration given by us to our customers is accounted for in accordance with Emerging Issues Task Force (“EITF”) Issue 01-9, “Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor’s Products).” In accordance with EITF Issue 01-9, sales incentives and other consideration that are considered adjustments of the selling price of our products, such as rebates and product placement fees, are reflected as reductions of revenue. Sales incentives and other consideration that represent costs incurred by us for assets or services received, such as the appearance of our products in a customer’s national circular ad, are reflected as sales and marketing expenses.

#### *Stock-Based Compensation and Pro Forma Information*

Under SFAS No. 123, “Accounting for Stock-Based Compensation,” compensation expense is recorded for the issuance of stock options and other stock-based compensation based on the fair value of the stock options and other stock-based compensation on the date of grant or measurement date. Alternatively, SFAS No. 123 allows companies to continue to account for the issuance of stock options and other stock-based compensation in accordance with Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees.” Under APB No. 25, compensation expense is recorded for the issuance of stock options and other stock-based compensation based on the intrinsic value of the stock options and other stock-based compensation on the date of grant or measurement date. Under the intrinsic value method, compensation expense is recorded on the date of grant or measurement date only if the current market price of the underlying stock exceeds the stock option or other stock-based compensation exercise price. At June 30, 2003, we had several stock-based employee compensation plans, which are described more fully in Note 14 to the Notes to Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K for the year ended March 31, 2003 filed with the SEC. We account for those



plans under the recognition and measurement principles of APB Opinion No. 25 and related Interpretations. No stock-based employee compensation cost is reflected in net income for any periods presented, as all options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation (amounts in thousands, except per share data):

	<u>Three months ended June 30,</u>	
	<u>2003</u>	<u>2002</u>
Net income, as reported	\$ 4,163	\$ 20,704
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(5,535)	(4,769)
Pro forma net income (loss)	<u>\$ (1,372)</u>	<u>\$ 15,935</u>
<b>Earnings (loss) per share</b>		
Basic - as reported	\$ 0.05	\$ 0.23
Basic - pro forma	<u>\$ (0.02)</u>	<u>\$ 0.18</u>
Diluted - as reported	\$ 0.04	\$ 0.21
Diluted - pro forma	<u>\$ (0.02)</u>	<u>\$ 0.16</u>

The fair value of options granted in the three months ended June 30, 2003 and 2002 has been estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model requires the input of highly subjective assumptions, including the expected stock price volatility. We use the historical stock price volatility of our common stock over the most recent period that is generally commensurate with the expected option life as the basis for estimating expected stock price volatility. In prior fiscal years, the historical stock price volatility used was based on the daily, low stock price of our common stock, which, in recent years, resulted in an expected volatility ranging from approximately 65% to 70%. For options granted during the three months ended June 30, 2003, the historical stock price volatility used was based on a weekly stock price observation, using an average of the high and low stock prices of our common stock, which resulted in an expected stock price volatility of approximately 47%. Management believes such amount is more representative of prospective trends.

## **2. Stock Split**

In April 2003, the Board of Directors approved a three-for-two split of our outstanding common shares effected in the form of a 50% stock dividend. The split was paid on June 6, 2003 to shareholders of record as of May 16, 2003. The par value of our common stock was maintained at the pre-split amount of \$.000001. The consolidated financial statements and Notes thereto, including all share and per share data, have been restated as if the stock split had occurred as of the earliest period presented.

## **3. Cash, Cash Equivalents and 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 income (loss) in

shareholders' equity. The specific identification method is used to determine the cost of securities disposed with realized gains and losses reflected in investment income, net.

The following table summarizes our investments in securities as of June 30, 2003 (amounts in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Cash and cash equivalents:</b>				
Cash and time deposits	\$ 98,024	\$ —	\$ —	\$ 98,024
Money market funds	39,206	—	—	39,206
Auction rate notes	153,603	—	—	153,603
<b>Cash and cash equivalents</b>	<b>290,833</b>	<b>—</b>	<b>—</b>	<b>290,833</b>
<b>Short-term investments:</b>				
Corporate bonds	16,647	17	—	16,664
Taxable senior debt	2,253	—	—	2,253
U.S. agency issues	42,847	80	(132)	42,795
Asset-backed securities	24,574	160	(15)	24,719
Municipal bonds	12,511	—	—	12,511
<b>Short-term investments</b>	<b>98,832</b>	<b>257</b>	<b>(147)</b>	<b>98,942</b>
<b>Cash, cash equivalents and short-term investments</b>	<b>\$ 389,665</b>	<b>\$ 257</b>	<b>\$ (147)</b>	<b>\$ 389,775</b>

The following table summarizes the maturities of our investments in debt securities as of June 30, 2003 (amounts in thousands):

	Amortized Cost	Fair Value
Due in one year or less	\$ 199,301	\$ 199,268
Due after one year through two years	28,560	28,558
	227,861	227,826
Asset-backed securities	24,574	24,719
<b>Total</b>	<b>\$ 252,435</b>	<b>\$ 252,545</b>

For the three months ended June 30, 2003, net realized gains on short-term investments consisted of no gross realized gains and \$4,000 of gross realized losses. There was no net realized gain (loss) for the three months ended June 30, 2002.

#### 4. **Inventories**

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

	June 30, 2003	March 31, 2003
Purchased parts and components	\$ 1,105	\$ 1,129
Finished goods	24,002	18,448
	<b>\$ 25,107</b>	<b>\$ 19,577</b>

## 5. Goodwill

The changes in the carrying amount of goodwill for the three months ended June 30, 2003 are as follows (amounts in thousands):

	<u>Publishing</u>	<u>Distribution</u>	<u>Total</u>
Balance as of March 31, 2003	\$ 63,194	\$ 4,825	\$ 68,019
Adjustment to original purchase allocation	(575)	—	(575)
Effect of foreign currency exchange rates	—	228	228
Balance as of June 30, 2003	<u>\$ 62,619</u>	<u>\$ 5,053</u>	<u>\$ 67,672</u>

## 6. Income Taxes

The income tax provision of \$2.2 million for the three months ended June 30, 2003 reflects our effective income tax rate of approximately 35%. State taxes, partially offset by research and development tax credits and the impact of foreign tax rate differentials, resulted in an effective income tax rate equal to our statutory rate of 35%. The income tax provision of \$11.6 million for the three months ended June 30, 2002 reflects our effective income tax rate of approximately 36%. The significant item that generated the variance between our effective rate as of June 30, 2002 and our statutory rate of 35% was state taxes, partially offset by research and development tax credits.

## 7. Software Development Costs and Intellectual Property Licenses

As of June 30, 2003, capitalized software development costs included \$32.7 million of internally developed software costs and \$38.7 million of payments made to third-party software developers. As of March 31, 2003, capitalized software development costs included \$26.0 million of internally developed software costs and \$36.1 million of payments made to third-party software developers. Capitalized intellectual property licenses were \$45.7 million and \$45.8 million as of June 30, 2003 and March 31, 2003, respectively. Amortization and write-offs of capitalized software development costs and intellectual property licenses were \$19.0 million and \$18.5 million for the three months ended June 30, 2003 and 2002, respectively.

## 8. Comprehensive Income (Loss) and Accumulated Other Comprehensive Income (Loss)

### *Comprehensive Income*

The components of comprehensive income for the three months ended June 30, 2003 and 2002 were as follows (amounts in thousands):

	<u>Three months ended June 30,</u>	
	<u>2003</u>	<u>2002</u>
Net income	\$ 4,163	\$ 20,704
Other comprehensive income (loss)		
Foreign currency translation adjustment	3,725	5,380
Unrealized depreciation on short-term investments	(24)	—
Other comprehensive income	<u>3,701</u>	<u>5,380</u>
Comprehensive income	<u>\$ 7,864</u>	<u>\$ 26,084</u>

*Accumulated Other Comprehensive Income (Loss)*

For the three months ended June 30, 2002, accumulated other comprehensive loss primarily consisted of foreign currency translation adjustments.

For the three months ended June 30, 2003, the components of accumulated other comprehensive income were as follows (amounts in thousands):

	Foreign Currency	Unrealized Appreciation (Depreciation) on Investments	Accumulated Other Comprehensive Income (Loss)
Balance, March 31, 2003	\$ (3,568)	\$ 134	\$ (3,434)
Other comprehensive income (loss)	3,725	(24)	3,701
Balance, June 30, 2003	<u>\$ 157</u>	<u>\$ 110</u>	<u>\$ 267</u>

The amounts above are shown net of taxes. The income taxes related to other comprehensive income were not significant, as income taxes were not provided for foreign currency translation items as these are considered indefinite investments in non-U.S. subsidiaries.

**9. Investment Income, Net**

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

	<u>Three months ended June 30,</u>	
	<u>2003</u>	<u>2002</u>
Interest expense	\$ (195)	\$ (536)
Interest income	1,456	1,692
Net realized loss on investments	<u>(4)</u>	<u>—</u>
Investment income, net	<u>\$ 1,257</u>	<u>\$ 1,156</u>

**10. Supplemental Cash Flow Information**

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

	<u>Three months ended June 30,</u>	
	<u>2003</u>	<u>2002</u>
<b>Non-cash investing and financing activities:</b>		
Subsidiaries acquired with common stock	\$ —	\$ 8,193
Issuance of options and common stock warrants in exchange for licensing rights and other services	—	2,184
Stock offering costs	—	781
Change in unrealized appreciation on short-term investments	24	—
<b>Supplemental cash flow information:</b>		
Cash paid for income taxes	\$ 3,349	\$ 1,314
Cash paid (received) for interest, net	(1,743)	(1,546)

## 11. 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 distribution subsidiaries located in the United Kingdom, the Netherlands and Germany.

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 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 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, 2003. Revenue derived from sales between segments is eliminated in consolidation.

Information on the reportable segments for the three months ended June 30, 2003 and 2002 is as follows (amounts in thousands):

	Three months ended June 30, 2003		
	Publishing	Distribution	Total
Total segment revenues	\$ 114,405	\$ 44,320	\$ 158,725
Revenues from sales between segments	(9,670)	9,670	—
Revenues from external customers	\$ 104,735	\$ 53,990	\$ 158,725
Operating income (loss)	\$ 5,170	\$ (24)	\$ 5,146
Total assets	\$ 643,200	\$ 87,557	\$ 730,757

  

	Three months ended June 30, 2002		
	Publishing	Distribution	Total
Total segment revenues	\$ 153,145	\$ 38,113	\$ 191,258
Revenues from sales between segments	(15,651)	15,651	—
Revenues from external customers	\$ 137,494	\$ 53,764	\$ 191,258
Operating income (loss)	\$ 32,461	\$ (1,265)	\$ 31,196
Total assets	\$ 770,187	\$ 84,566	\$ 854,753

Geographic information for the three months ended June 30, 2003 and 2002 is based on the location of the selling entity. Revenues from external customers by geographic region were as follows (amounts in thousands):

	<b>Three months ended June 30,</b>	
	<b>2003</b>	<b>2002</b>
United States	\$ 82,739	\$ 107,104
Europe	72,740	79,992
Other	3,246	4,162
<b>Total</b>	<b>\$ 158,725</b>	<b>\$ 191,258</b>

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

	<b>Three months ended June 30,</b>	
	<b>2003</b>	<b>2002</b>
Console	\$ 123,826	\$ 144,266
Hand-held	7,508	13,289
PC	27,391	33,703
<b>Total</b>	<b>\$ 158,725</b>	<b>\$ 191,258</b>

As of and for the three months ended June 30, 2003, we had one customer that accounted for 16% of consolidated net revenues and 29% of consolidated accounts receivable, net. As of and for the three months ended June 30, 2002 we had one customer that accounted for 17% of consolidated net revenues and 27% of consolidated accounts receivable, net. This customer was the same customer in both periods and was a customer of both our publishing and distribution businesses.

## 12. 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):

	<u>Three months ended June 30,</u>	
	<u>2003</u>	<u>2002</u>
<b>Numerator:</b>		
Numerator for basic and diluted earnings per share - income available to common shareholders	\$ 4,163	\$ 20,704
<b>Denominator:</b>		
Denominator for basic earnings per share weighted average common shares outstanding	88,046	90,059
<b>Effect of dilutive securities:</b>		
Employee stock options and stock purchase plan	5,426	9,645
Warrants to purchase common stock	298	421
Potential dilutive common shares	5,724	10,066
Denominator for diluted earnings per share - weighted average common shares outstanding plus assumed conversions	93,770	100,125
Basic earnings per share	\$ 0.05	\$ 0.23
Diluted earnings per share	\$ 0.04	\$ 0.21

Options to purchase 8,642,016 shares of common stock at exercise prices ranging from \$10.85 to \$22.16 and options to purchase 23,030 shares of common stock at exercise prices ranging from \$18.89 to \$22.16 were outstanding for the three months ended June 30, 2003 and 2002, respectively, but were not included in the calculation of diluted earnings per share because their effect would be antidilutive.

## 13. Commitments

### *Credit Facilities*

We 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 June 30, 2003, the UK Facility provided Centresoft with the ability to borrow up to Great British Pounds ("GBP") 8.6 million (\$14.2 million), including issuing letters of credit, on a revolving basis. Furthermore, as of June 30, 2003, under the UK Facility, Centresoft provided a GBP 0.6 million (\$1.0 million) guarantee for the benefit of our CD Contact subsidiary. The UK Facility bears interest at LIBOR plus 1.5%, 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 June 30, 2003, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of June 30, 2003. The German Facility provided for revolving loans up to EUR 0.8 million (\$0.9 million) as of June 30, 2003, bears interest at a Eurocurrency rate plus 2.5%, is collateralized by the subsidiary's accounts receivable, inventory and certain property and equipment and

has no expiration date. No borrowings were outstanding against the German Facility as of June 30, 2003. Effective July 1, 2003, the German Facility was reduced to EUR 0.5 million (\$0.6 million).

#### *Developer and Intellectual Property 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. Under these agreements, we commit to provide specified payments to a developer or intellectual property holder, based upon contractual arrangements. Assuming all contractual provisions are met, the total future minimum contract commitment for contracts in place as of June 30, 2003 is approximately \$121.9 million and is scheduled to be paid as follows (amounts in thousands):

<u>Fiscal year ending March 31,</u>	
2004	\$ 68,046
2005	34,522
2006	11,050
2007	3,950
2008 and thereafter	<u>4,376</u>
Total	<u>\$ 121,944</u>

The commitment schedule above excludes approximately \$9.3 million of commitments originally scheduled to be paid between fiscal 2004 through fiscal 2007 relating to an intellectual property rights agreement with a third party. Effective June 30, 2003, we terminated the agreement and filed a breach of contract suit against the third party.

#### *Legal and Regulatory 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.

On July 11, 2003, we were informed by the staff of the SEC that the SEC has commenced a non-public formal investigation captioned "In the Matter of Certain Video Game Manufacturers and Distributors." The investigation appears to be focused on certain accounting practices common to the interactive entertainment industry, with specific emphasis on revenue recognition. In connection with this inquiry, the SEC submitted to us a request for information. The SEC staff also informed us that other companies in the video game industry received similar requests for information. The SEC has advised us that this request for information should not be construed as an indication from the SEC or its staff that any violation of the law has occurred, nor should it reflect negatively on any person, entity or security. We intend to cooperate fully with the SEC in the conduct of this inquiry.

#### **14. Capital Transactions**

During fiscal 2003, our Board of Directors authorized a buyback program under which we can repurchase up to \$350.0 million of our common stock. Under the program, shares may be purchased as determined by management and within certain guidelines, 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.

During the three months ended June 30, 2003, we repurchased approximately 1.2 million shares of our common stock for \$11.3 million. In addition, approximately 1.1 million shares of common stock were



acquired in the three months ended June 30, 2003 as a result of the settlement of a structured stock repurchase transaction entered into in fiscal 2003. As of June 30, 2003, we had outstanding structured stock repurchase transactions in the aggregate amount of approximately \$71.4 million. These transactions may be settled in cash or stock based on the market price of our common stock on the date of the settlement. Upon settlement, we will either have our capital investment returned with a premium or receive up to approximately 7.9 million shares of our common stock, depending, respectively, on whether the market price of our common stock is above or below a pre-determined price agreed in connection with each such transaction. These transactions are recorded in shareholders' equity in the accompanying consolidated balance sheet as of June 30, 2003. In any period, cash used in financing activities related to common stock repurchased may differ from the comparable change in shareholders' equity, reflecting timing differences between the recognition of share repurchase transactions and their settlement for cash.

#### **15. 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. For the three months ended June 30, 2003 and 2002, the fees we paid to the law firm account for less than 1% of the firm's total revenues. The rates charged to us were at arm's length, and we believe that the fees are competitive with the fees charged by other law firms.

#### **16. Recently Issued Accounting Standards**

In April 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies the accounting guidance on derivative instruments (including certain derivative instruments embedded in other contracts) and hedging activities that fall within the scope of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is effective for all contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. The guidance is to be applied prospectively. We are currently assessing the impact SFAS No. 149 will have upon our financial position and results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 changes the accounting guidance for certain financial instruments that, under previous guidance, could be classified as equity or "mezzanine" equity by now requiring those instruments to be classified as liabilities (or assets in some circumstances) in the statement of financial position. Further, SFAS No. 150 requires disclosure regarding the terms of those instruments and settlement alternatives. SFAS No. 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 will not have a material impact on our financial position or results of operations.

## 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 game categories such as action/adventure, action sports, racing, role-playing, simulation, first-person action and strategy. We currently offer our products in versions that operate on the Sony PlayStation 2 ("PS2"), Sony PlayStation ("PS1"), Nintendo GameCube ("GameCube") and Microsoft Xbox ("Xbox") console systems, Nintendo Game Boy Advance ("GBA") hand-held device and the personal computer ("PC"). In prior years, we have also offered our products on the Nintendo 64 ("N64") and Sega Dreamcast ("Dreamcast") console systems and Nintendo Game Boy Color ("GBC") hand-held device. Sony recently announced that it would be re-entering the hand-held hardware market with the introduction of its hand-held gaming device, PlayStation Portable ("PSP"). PSP is currently expected to be released in the fourth quarter of calendar 2004. We expect that we will develop titles for this new platform.

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, we primarily sell our products 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 ("UK"), 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. Our distribution business consists of 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 businesses. Operating margins realized from our publishing business are substantially higher than margins realized from our distribution business. Operating margins in our publishing business are affected by our ability to release highly successful or "hit" titles. Though many of these titles have substantial production or acquisition costs and marketing budgets, once a title recoups these costs, incremental net revenues directly and positively impact our operating margin. Operating margins in our distribution business are affected by the mix of hardware and software sales, with software producing higher margins than hardware.

Our focus with respect to future game development will be on big, well-established brands that we believe we can build into successful game franchises such as our superheroes and action sports brands. With regard to our superheroes brands, in August 2002, we exercised an option to develop and publish the video game based on the sequel to the "Spider-Man" movie, which is expected to be theatrically released in the summer of 2004. *Spider-Man: The Movie* was a key release for the first quarter of fiscal 2003 and performed strongly throughout fiscal 2003. In December 2002, we expanded our long-term alliance with Marvel Enterprises through an exclusive, multi-year, licensing agreement that expires in 2009. The agreement extends our exclusive rights to develop and publish video games based on Marvel's comic book franchises Spider-Man, X-MEN, Fantastic Four and Iron Man. The agreement additionally provides us the rights to develop video games in conjunction with motion pictures and television series involving X-MEN, Fantastic Four and Iron Man. Further, another of our key strategies is to continue to be a leader in the action sports category. We will continue to promote our action sports franchises with the release of titles for existing franchises such as *Tony Hawk's Underground*, as well as new action sports titles related to motor cross and snowboarding. We will also continue to develop new intellectual properties, such as the upcoming titles *True Crime: Streets of L.A.* and *Call of Duty*, which we hope to establish as franchise properties.

We will also continue to evaluate emerging brands that we believe have potential to become successful game franchises. For example, in August 2002, we entered into an exclusive licensing agreement to develop and publish video games for the best-selling children's book series, Lemony Snicket's "A Series of Unfortunate Events" which is being developed for a feature film by Paramount Pictures and Nickelodeon Movies. In

December 2002, we entered into a multi-year, multi-property, publishing agreement with DreamWorks SKG that grants us the exclusive rights to publish video games based on DreamWorks SKG's upcoming computer-animated films, "Sharkslayer," "Madagascar" and "Over the Hedge," as well as their sequels. In fiscal 2003, we additionally entered into an agreement to license the rights to publish video games based on the upcoming movie, "Shrek 2."

In addition to acquiring or creating high profile intellectual property, we will also continue our focus on establishing and maintaining relationships with talented and experienced software development teams. During fiscal 2003, we bolstered our internal development capabilities with the acquisitions of two privately-held interactive software development companies, Z-Axis and Luxoflux, as well as a 30% capital investment in a third, Infinity Ward. We have also recently entered into development agreements with other top-level, third-party developers such as id Software, Valve L.L.C., Stainless Steel Studios, Inc., Spark Unlimited and Lionhead Studios.

We are utilizing these developer relationships, new intellectual property acquisitions, and our existing library of intellectual property to further focus our game development on big, well-established brands that we believe have the potential to become franchise properties with sustainable consumer appeal and brand recognition. We are also creating a number of new intellectual properties that we believe have the potential to join this list of franchise properties. Additionally, to maintain the competitiveness of our products and to take advantage of increasingly sophisticated technology associated with new hardware platforms, we are increasing the amount of time spent play-testing new products, conducting more extensive product quality evaluations and lengthening product development schedules to allow time to make the improvements indicated by our testing and evaluations. We are focusing on improved game quality, and in many cases, this will result in an increase in future product development costs.

### **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 included in Item 8 of our Annual Report on Form 10-K for the year ended March 31, 2003 as filed with the SEC. 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, when granted and applicable, allows 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 makes different judgments or utilizes different estimates.

Similarly, management must make estimates of the uncollectibility of our accounts receivable. In estimating the allowance for doubtful accounts, we analyze the age of current outstanding account balances, 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 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. Technological feasibility of a product encompasses both technical design documentation and game design documentation. For products where proven 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 cost of sales – software royalties and amortization, capitalized costs when we believe such amounts are not recoverable. Capitalized costs for those products that are cancelled or abandoned are charged to product development expense in the period of cancellation. 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 recoverability of capitalized software development costs is evaluated based on the expected performance of the specific products for which the costs relate. Criteria used to evaluate expected product performance included historical performance of comparable products using comparable technology; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based.

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 judgments 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. Depending upon the agreement with the rights holder, we may obtain the rights to use acquired intellectual property in multiple products over multiple years, or alternatively, for a single product.

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 to be used. As many of our intellectual property licenses extend for multiple products over multiple years, we also assess the recoverability of capitalized intellectual property license costs based on certain qualitative factors such as the success of other products and/or entertainment vehicles utilizing the intellectual property, whether there are any future planned

theatrical releases or television series based on the intellectual property and the rights holder's continued promotion and exploitation of the intellectual property. Prior to the related product's release, we expense, as part of cost of sales – intellectual property licenses, capitalized intellectual property costs when we believe such amounts are not recoverable. Capitalized intellectual property costs for those products that are cancelled or abandoned are charged to product development expense in the period of cancellation. Criteria used to evaluate expected product performance include historical performance of comparable products using comparable technology; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based.

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 intellectual property included in 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 judgments and estimates are utilized in the assessment of the recoverability of capitalized costs.

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, business segment and platform, as well as operating income (loss) by business segment (amounts in thousands):

	Three months ended June 30,			
	2003		2002	
Net revenues	\$ 158,725	100%	\$ 191,258	100%
<b>Costs and expenses:</b>				
Cost of sales – product costs	76,610	48	83,344	44
Cost of sales – software royalties and amortization	15,498	10	15,838	8
Cost of sales – intellectual property licenses	10,143	6	12,643	7
Product development	13,580	9	11,751	6
Sales and marketing	26,285	17	21,993	11
General and administrative	11,463	7	14,493	8
Total costs and expenses	153,579	97	160,062	84
Operating income	5,146	3	31,196	16
Investment income, net	1,257	1	1,156	1
Income before income tax provision	6,403	4	32,352	17
Income tax provision	2,240	1	11,648	6
Net income	\$ 4,163	3%	\$ 20,704	11%
<b>Net Revenues by Territory:</b>				
United States	\$ 82,739	52%	\$ 107,104	56%
Europe	72,740	46	79,992	42
Other	3,246	2	4,162	2
Total net revenues	\$ 158,725	100%	\$ 191,258	100%
<b>Net Revenues by Segment/Platform Mix:</b>				
<b>Publishing:</b>				
Console	\$ 88,484	77%	\$ 114,160	75%
Hand-held	4,596	4	10,690	7
PC	21,325	19	28,295	18
Total publishing net revenues	114,405	72	153,145	80
<b>Distribution:</b>				
Console	35,342	80	30,106	79
Hand-held	2,912	6	2,599	7
PC	6,066	14	5,408	14
Total distribution net revenues	44,320	28	38,113	20
Total net revenues	\$ 158,725	100%	\$ 191,258	100%
<b>Operating Income (Loss) by Segment:</b>				
Publishing	\$ 5,170	3%	\$ 32,461	17%
Distribution	(24)	—	(1,265)	(1)
Total operating income	\$ 5,146	3%	\$ 31,196	16%

## Results of Operations – Three Months Ended June 30, 2003 and 2002

### Net Revenues

Net revenues for the three months ended June 30, 2003 decreased 17% from the same period last year, from \$191.3 million to \$158.7 million. This decrease was incurred in our publishing business.

The following table details our publishing net revenues by platform as a percentage of total publishing net revenues for the three months ended June 30, 2003 and 2002:

Publishing Net Revenues	Three months ended June 30,	
	2003	2002
<b>PC</b>	<b>19%</b>	<b>18%</b>
<b>Console</b>	<b>77%</b>	<b>75%</b>
PlayStation 2	37	35
Microsoft Xbox	31	12
Nintendo GameCube	5	23
PlayStation	4	5
<b>Hand-held</b>	<b>4%</b>	<b>7%</b>
Game Boy Advance	4	6
Game Boy Color	—	1
<b>Total publishing net revenues</b>	<b>100%</b>	<b>100%</b>

Publishing net revenues for the three months ended June 30, 2003 decreased 25% from the same period last year, from \$153.1 million to \$114.4 million. This decline was experienced in both our domestic and international publishing businesses and is due to the fact that publishing net revenues for the three months ended June 30, 2002, reflect the simultaneous cross-platform, multi-national release of *Spider-Man: The Movie* which was one of our top performing titles of fiscal 2003. Though there were no individual titles that performed comparably to *Spider-Man: The Movie*, publishing net revenues for the three months ended June 30, 2003 reflect solid sales of releases such as *X2 Wolverine's Revenge* for PS2, Xbox, GameCube, GBA and PC, *Return to Castle Wolfenstein* and *Wakeboarding Unleashed* for PS2 and Xbox, *Soldier of Fortune II: Double Helix* for Xbox and *Medieval Total War: Viking Invasion* for PC.

Platform mix of publishing net revenues between PC, console and hand-held for the three months ended June 30, 2003 remained relatively consistent with the same period last year. Platform mix of our future publishing net revenues will likely be impacted by a number of factors, including the ability of hardware manufacturers to continue to increase their installed hardware bases, the introduction of new hardware platforms, as well as the timing of key product releases from our own product release schedule. We expect that net revenues from console titles will continue to represent the largest component of our publishing net revenues with PS2 having the largest percentage of that business due to its larger installed hardware base. We expect net revenues from hand-held titles to remain the smallest component of our publishing net revenues. However, if PSP is introduced in fiscal 2005, we may see an increase in our hand-held business in comparison to prior periods. Our net revenues from PC titles will be primarily driven by our product release schedule.

A significant portion of our revenues and profits are derived from a relatively small number of popular titles and brands each year as revenues and profits are significantly affected by our ability to release highly successful or "hit" titles. For example, for the three months ended June 30, 2003, 21% of our consolidated net revenues and 29% of worldwide publishing net revenues were derived from net revenues from *X2 Wolverine's Revenge*. Though many of these titles have substantial production or acquisition costs and marketing budgets, once a title recoups these costs, incremental net revenues directly and positively impact our operating profits resulting in a disproportionate amount of operating income being derived from these select titles. We expect that a limited

number of titles and brands will continue to produce a disproportionately large amount of our net revenues and profits.

As discussed in the "Overview" section of Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations," in connection with our focus of future game development on big, well-established brands that we believe have the potential to become game franchise properties with sustainable consumer appeal, we have chosen to eliminate certain smaller and non-core projects from our development plan, reducing the number of titles to be released in fiscal 2004. Further, as a result of the increase in the length of product development schedules, the release dates of certain fiscal 2004 titles have shifted to fiscal 2005. Because of these and other factors, we currently expect fiscal 2004 net revenues to be less than those of fiscal 2003, but we currently expect that we will resume net revenue growth in fiscal 2005.

Another factor that could affect fiscal 2004 net revenue performance is software pricing. While we expect console launch pricing for most genres to hold at \$49.99 through the holidays, we believe that we could see additional price declines thereafter.

Distribution net revenues for the three months ended June 30, 2003 increased 16% from the same period last year, from \$38.1 million to \$44.3 million. The increase reflects the distribution of two very successful third-party publishers' titles, as well as the positive impact of the year-over-year strengthening of the Euro and the GBP in relation to the U.S. dollar. For the three months ended June 30, 2003, hardware sales represented approximately 12% of total distribution sales, compared to approximately 28% for the same period last year. The decrease in hardware sales as a percentage of total distribution net revenues reflects the benefit received during the three months ended June 30, 2002 from the hardware launch of the GameCube during that quarter. The decrease also reflects the impact on sales during the three months ended June 30, 2003 of the lower price points of the PS2, GameCube and Xbox hardware in calendar 2003 versus the prior year. For the three months ended June 30, 2003, software sales as a percentage of total distribution net revenues increased over the same period last year. This increase reflects the distribution of two very successful third-party publishers' titles, an increase in the hardware installed base and the acquisition by our UK distribution subsidiary of the distribution rights of a significant new customer. The mix of future distribution net revenues between hardware and software will be driven by a number of factors including hardware price reductions instituted by hardware manufacturers, the introduction of new hardware platforms and our ability to establish and maintain distribution agreements with hardware manufacturers and third-party software publishers. We continue to expect software sales as a percentage of total distribution net revenues in fiscal 2004 to increase slightly from fiscal 2003.

Geographically, our domestic operations include our North American publishing business and our international operations include our European and Asian/Australian publishing businesses and our European distribution business. Domestic net revenues decreased 23% from \$107.1 million for the three months ended June 30, 2002, to \$82.7 million for the three months ended June 30, 2003 for the reason detailed above in the discussion of our publishing business net revenues. International net revenues decreased by 10% from \$84.2 million for the three months ended June 30, 2002, to \$76.0 million for the three months ended June 30, 2003 primarily for the reason detailed above in the discussion of our publishing business.

#### *Costs and Expenses*

Cost of sales – product costs represented 48% and 44% of consolidated net revenues for the three months ended June 30, 2003 and 2002, respectively. The primary factor that affected cost of sales – product costs as a percentage of consolidated net revenues was that distribution net revenues as a percentage of consolidated net revenues increased from 20% for the three months ended June 30, 2002 to 28% for the three months ended June 30, 2003. Distribution net revenues have a higher per unit cost as compared to publishing net revenues.

Cost of sales – software royalties and amortization for the three months ended June 30, 2003 increased as a percentage of publishing net revenues from the same period last year, from 10% to 14%. In absolute dollars, cost of sales – software royalties and amortization for the three months ended June 30, 2003 was consistent with the same period last year at approximately \$15.5 million. Though there was a higher volume of new title releases during the three months ended June 30, 2003, resulting in a comparable absolute dollar amount, those titles did not achieve the same success as our top selling title in the first quarter of fiscal 2003, *Spider-Man: The Movie*. The strong net revenue performance of *Spider-Man: The Movie* resulted in a lower percentage for the



three months ended June 30, 2002 of cost of sales – software royalties and amortization as a percentage of publishing net revenues as compared to the percentage for the three months ended June 30, 2003.

Cost of sales – intellectual property licenses for the three months ended June 30, 2003 increased slightly as a percentage of publishing net revenues from the same period last year, from 8% to 9%. In absolute dollars, cost of sales – intellectual property licenses for the three months ended June 30, 2003 decreased from the same period last year, from \$12.6 million to \$10.1 million. The increase in the percentage reflects that one of our top performing titles released in the first quarter of fiscal 2004 had a higher intellectual property royalty rate structure than the majority of the top performing titles released in the first quarter of fiscal 2003. The decrease in cost of sales – intellectual property licenses in absolute dollars reflects the decrease in net revenues.

Product development expenses for the three months ended June 30, 2003 increased as a percentage of publishing net revenues from the same period last year, from 8% to 12%. In absolute dollars, product development expense for the three months ended June 30, 2003 also increased from the same period last year, from \$11.8 million to \$13.6 million. The increase in the percentage and in absolute dollars reflects, as previously discussed, our increasing emphasis on product quality and the lengthening of product development schedules.

Sales and marketing expenses of \$26.3 million and \$22.0 million represented 17% and 11% of consolidated net revenues for the three months ended June 30, 2003 and 2002, respectively. The increase in absolute dollars for the three months ended June 30, 2003 from the same period last year primarily was the result of increased costs in our publishing business. The increase in sales and marketing expense dollars in our publishing business was due to the fact that in the first quarter of fiscal 2004, we had a higher number of new title releases, including *X2 Wolverine's Revenge*, *Wakeboarding Unleashed*, and *Return to Castle Wolfenstein* for the PS2 and Xbox, for which we had significant promotional programs. In the first quarter of fiscal 2003, we had one new title release, *Spider-Man: The Movie*, for which we had significant promotional programs. The success of this title contributed to the decrease in sales and marketing expenses as a percentage of consolidated net revenues for the three months ended June 30, 2002 as compared to the three months ended June 30, 2003. The increase in the percentage and absolute dollars also reflects approximately \$2.7 million of costs recorded during the three months ended June 30, 2003 relating to the domestic industry tradeshow that occurs annually in May. Prior to fiscal 2004, costs relating to our annual domestic tradeshow were amortized over the entire fiscal year.

General and administrative expenses for the three months ended June 30, 2003 decreased \$3.0 million from the same period last year, from \$14.5 million to \$11.5 million. As a percentage of consolidated net revenues, general and administrative expenses remained relatively constant year-over-year at approximately 7% to 8%. The decrease in absolute dollars was primarily 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 June 30, 2003 was \$5.1 million, compared to \$31.2 million in the same period last year. The decrease was incurred in our publishing business, reflecting the effects of the first quarter fiscal 2003 release of *Spider-Man: The Movie*, which was one of our top performing titles of fiscal 2003. Distribution operating loss for the three months ended June 30, 2003 decreased as compared to the same period last year, from \$1.3 million to \$24,000. This change includes the incurrence in the first quarter of fiscal 2003 of an approximate \$2.0 million charge for the relocation of our UK distribution facility.

#### *Investment Income, Net*

Investment income, net for the three months ended June 30, 2003 of \$1.3 million was consistent with the same period last year.

#### *Provision for Income Taxes*

The income tax provision of \$2.2 million for the three months ended June 30, 2003, reflects our effective income tax rate of approximately 35%. State taxes, partially offset by research and development tax credits and

the impact of foreign tax rate differentials, resulted in an effective income tax rate equal to our statutory rate of 35%. The realization of deferred tax assets is dependent on the generation of future taxable income. We believe that it is more likely than not that we will generate sufficient taxable income to realize the benefit of net deferred tax assets recognized.

### **Liquidity and Capital Resources**

As of June 30, 2003, our primary source of liquidity was comprised of \$290.8 million of cash and cash equivalents and \$98.9 million of short-term investments. We believe that we have sufficient working capital (\$449.6 million at June 30, 2003), 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 actively manage our capital structure and balance sheet as a component of our overall business strategy. When we determine that market conditions are appropriate, we may seek to achieve long-term value for the shareholders through, among other things, new debt or equity financings or refinancings, share repurchases and other transactions involving our equity or debt securities.

#### *Cash Flows*

Our cash and cash equivalents were \$290.8 million at June 30, 2003 compared to \$285.6 million at March 31, 2003. Activity in cash and cash equivalents for the three months ended June 30, 2003, included \$23.7 million used in operating activities, offset by \$16.8 million and \$9.3 million provided by investing and financing activities, respectively. The principal components comprising cash flows used in operating activities included an increase in accounts receivable and our continued investment in software development and intellectual property licenses. Accounts receivable increased as a result of an increase in the number of first quarter title releases and the timing of their release dates. In the three months ended June 30, 2003, we spent approximately \$28.2 million in connection with the acquisition of publishing or distribution rights for 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. We expect that we will continue to make significant expenditures relating to our investment in software development and intellectual property licenses.

The cash provided by investing activities primarily was the result of the maturity or sale of short-term investment vehicles. The goal of our short-term investments is to maximize return while minimizing risk, maintaining liquidity, coordinating with anticipated working capital needs and providing for prudent investment diversification.

The cash provided by financing activities primarily is the result of the maturity of structured stock repurchase transactions, partially offset by cash used to purchase treasury stock and enter into additional structured stock repurchase transactions. During fiscal 2003, our Board of Directors authorized a buyback program under which we can repurchase up to \$350.0 million of our common stock. Under the program, shares may be purchased as determined by management and within certain guidelines, 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. As of June 30, 2003, we had outstanding structured stock repurchase transactions in the aggregate amount of approximately \$71.4 million. These transactions may be settled in cash or stock based on the market price of our common stock on the date of the settlement. Upon settlement, we will either have our capital investment returned with a premium or receive up to approximately 7.9 million shares of our common stock, depending, respectively, on whether the market price of our common stock is above or below a pre-determined price agreed in connection with each such transaction.

### Credit Facilities

We 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 June 30, 2003, the UK Facility provided Centresoft with the ability to borrow up to Great British Pounds (“GBP”) 8.6 million (\$14.2 million), including issuing letters of credit, on a revolving basis. Furthermore, as of June 30, 2003, under the UK Facility, Centresoft provided a GBP 0.6 million (\$1.0 million) guarantee for the benefit of our CD Contact subsidiary. The UK Facility bears interest at LIBOR plus 1.5%, 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 June 30, 2003, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of June 30, 2003. The German Facility provided for revolving loans up to EUR 0.8 million (\$0.9 million) as of June 30, 2003, bears interest at a Eurocurrency rate plus 2.5%, is collateralized by the subsidiary’s accounts receivable, inventory and certain property and equipment and has no expiration date. No borrowings were outstanding against the German Facility as of June 30, 2003. Effective July 1, 2003, the German Facility was reduced to EUR 0.5 million (\$0.6 million).

### Commitments

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. Under these agreements, we commit to provide specified payments to a developer or intellectual property holder, based upon contractual arrangements. Assuming all contractual provisions are met, the total future minimum contract commitment for contracts in place as of June 30, 2003 is approximately \$121.9 million and is scheduled to be paid as follows (amounts in thousands):

<u>Fiscal year ending March 31,</u>	
2004	\$ 68,046
2005	34,522
2006	11,050
2007	3,950
2008 and thereafter	4,376
Total	<u>\$ 121,944</u>

The commitment schedule above excludes approximately \$9.3 million of commitments originally scheduled to be paid between fiscal 2004 through fiscal 2007 relating to an intellectual property rights agreement with a third party. Effective June 30, 2003, we terminated the agreement and filed a breach of contract suit against the third party.

### Recently Issued Accounting Standards

In April 2003, the FASB issued SFAS No. 149, “Amendment of Statement 133 on Derivative Instruments and Hedging Activities.” SFAS No. 149 amends and clarifies the accounting guidance on derivative instruments (including certain derivative instruments embedded in other contracts) and hedging activities that fall within the scope of SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities.” SFAS No. 149 is effective for all contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. The guidance is to be applied prospectively. We are currently assessing the impact SFAS No. 149 will have upon our financial position and results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 changes the accounting guidance for certain financial instruments that, under previous guidance, could be classified as equity or "mezzanine" equity by now requiring those instruments to be classified as liabilities (or assets in some circumstances) in the statement of financial position. Further, SFAS No. 150 requires disclosure regarding the terms of those instruments and settlement alternatives. SFAS No. 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 will not have a material impact on our financial position or results of operations.

### **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, 2003 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 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 June 30, 2003, our cash equivalents and short-term investments included debt securities of \$252.5 million.

The following table presents the amounts and related weighted average interest rates of our investment portfolio as of June 30, 2003 (amounts in thousands):

	Average Interest Rate		Amortized Cost		Fair Value
<b>Cash equivalents:</b>					
Fixed rate	1.23%	\$	153,603	\$	153,603
Variable rate	1.12		39,206		39,206
<b>Short-term investments:</b>					
Fixed rate	1.97%	\$	98,832	\$	98,942

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 June 30, 2003, assuming a change in currency rates of 10% of period end rates, the potential gain or loss on outstanding hedging contracts would be approximately \$207,400. However any such gain or loss would in turn be offset by the potential gain or loss on the hedged receivable and/or payable.

#### **Market Price Risk**

With regard to the structured stock repurchase transactions described in Note 14 in the Notes to the Consolidated Financial Statements, it is possible that at settlement we could take delivery of shares at an effective repurchase price higher than the then market price.

#### **Item 4. Controls and Procedures**

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer 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 officer and principal financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be 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, results of operations or liquidity.

On July 11, 2003, we were informed by the staff of the SEC that the SEC has commenced a non-public formal investigation captioned "In the Matter of Certain Video Game Manufacturers and Distributors." The investigation appears to be focused on certain accounting practices common to the interactive entertainment industry, with specific emphasis on revenue recognition. In connection with this inquiry, the SEC submitted to us a request for information. The SEC staff also informed us that other companies in the video game industry received similar requests for information. The SEC has advised us that this request for information should not be construed as an indication from the SEC or its staff that any violation of the law has occurred, nor should it

reflect negatively on any person, entity or security. We intend to cooperate fully with the SEC in the conduct of this inquiry.

**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 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 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 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 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 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 Activision, Inc. 2002 Incentive Plan, as amended.
- 10.2 Activision, Inc. 2003 Incentive Plan.
- 31.1 Certification of Robert A. Kotick pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Ronald Doomink pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.3 Certification of William J. Chardavoyne pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 32.1 Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Ronald Doomink pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.3 Certification of William J. Chardavoine pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

- 1.1 We filed a Form 8-K on April 22, 2003, reporting under “Item 7. Financial Statements, Pro Forma Financial Statements and Exhibits” and “Item 9. Regulation FD Disclosure” issuing a press release announcing revised revenues and earnings guidance for the fourth quarter of fiscal 2003 and for the full 2003 fiscal year, and reiterated our fiscal year 2004 outlook.
- 1.2 We filed a Form 8-K on May 5, 2003, reporting under “Item 5. Other Events and Regulation FD Disclosure,” “Item 7. Financial Statements, Pro Forma Financial Statements and Exhibits” and “Item 9. Regulation FD Disclosure” issuing press releases announcing that our Board of Directors increased the number of directors from six to seven members and appointed Ron Doomink to fill the newly-created vacancy, and announcing a three-for-two split of our outstanding common shares.
- 1.3 We filed a Form 8-K on May 8, 2003, reporting under “Item 7. Financial Statements, Pro Forma Financial Statements and Exhibits” and “Item 9. Regulation FD Disclosure” issuing a press release announcing our fourth quarter and fiscal 2003 year end results.

**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: August 4, 2003

ACTIVISION, INC.

*/s/ William J. Chardavoyne*

William J. Chardavoyne

Executive Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)



As Adopted by the Board of Directors  
on April 4, 2002, and amended on  
July 22, 2002 and amended on  
April 10, 2003

**ACTIVISION, INC.**

**2002 INCENTIVE PLAN**

ACTIVISION, INC., a corporation formed under the laws of the State of Delaware (the "Company"), hereby establishes and adopts the following 2002 Incentive Plan (the "Plan").

**RECITALS**

WHEREAS, the Company desires to encourage high levels of performance by those individuals who are key to the success of the Company, to attract new individuals who are highly motivated and who will contribute to the success of the Company and to encourage such individuals to remain as employees of the Company and its subsidiaries by increasing their proprietary interest in the Company's growth and success.

WHEREAS, to attain these ends, the Company has formulated the Plan embodied herein to authorize the granting of incentive awards through grants of share options ("Options"), grants of share appreciation rights, grants of Share Purchase Awards (hereafter defined), grants of Restricted Share Awards (hereafter defined), grants of Performance-Based Awards (hereafter defined), or any other award made under the Plan to those persons (each such person, a "Participant") whose judgment, initiative and efforts are or have been or will be responsible for the success of the Company.

NOW, THEREFORE, the Company hereby constitutes, establishes and adopts the following Plan and agrees to the following provisions:

**ARTICLE 1.**

**PURPOSE OF THE PLAN**

**1.1. Purpose.** The purpose of the Plan is to assist the Company and its subsidiaries in attracting and retaining selected individuals to serve as officers (other than executive officers), consultants, advisors and other key employees of the Company and its subsidiaries who will contribute to the Company's success and to achieve long-term objectives which will inure to the benefit of all shareholders of the Company through the additional incentive inherent in the ownership or increased ownership of the Company's shares of common stock ("Shares"). Options granted under the Plan will be either "incentive share options," intended to qualify as such under the provisions of Section 422 of the Internal Revenue Code of 1986, as amended from time to time (the "Code"), or "nonqualified share options." For purposes of the Plan, the term "subsidiary" shall mean "subsidiary corporation," as such term is defined in Section 424(f) of the Code, and "affiliate" shall have the meaning set forth in Rule 12b-2 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). For purposes of the Plan, the term "Award" shall mean a grant of an Option, a grant of a share appreciation right, a grant of a Share Purchase Award, a grant of a Restricted Share Award, or any other award made under the terms of the Plan.

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## ARTICLE 2.

### SHARES SUBJECT TO AWARDS

**2.1. Number of Shares.** Subject to the adjustment provisions of Section 10.9 hereof, the aggregate number of Shares which may be issued under Awards under the Plan, whether pursuant to Options, share appreciation rights, Share Purchase Awards, Restricted Share Awards or Performance-Based Awards shall not exceed 4,350,000. No Options to purchase fractional Shares shall be granted or issued under the Plan. For purposes of this Section 2.1, the Shares that shall be counted toward such limitation shall include all Shares:

- (1) issued or issuable pursuant to Options that have been or may be exercised;
- (2) issued or issuable pursuant to Share Purchase Awards;
- (3) issued as, or subject to issuance as a Restricted Share Award; and
- (4) issued or issuable under any other Award granted under the terms of the Plan.

**2.2. Shares Subject to Terminated Awards.** The Shares covered by any unexercised portions of terminated Options granted under Articles 4 and 6, Shares forfeited as provided in Section 8.2(a) and Shares subject to any Awards which are otherwise surrendered by the Participant without receiving any payment or other benefit with respect thereto may again be subject to new Awards under the Plan, other than grants of Options intended to qualify as incentive share options. In the event the purchase price of an Option is paid in whole or in part through the delivery of Shares, the number of Shares issuable in connection with the exercise of the Option shall not again be available for the grant of Awards under the Plan. Shares subject to Options, or portions thereof, which have been surrendered in connection with the exercise of share appreciation rights shall not again be available for the grant of Awards under the Plan.

**2.3. Character of Shares.** Shares delivered under the Plan may be authorized and unissued Shares or Shares acquired by the Company, or both.

**2.4. Limitations on Grants to Individual Participant.** Subject to adjustments pursuant to the provisions of Section 10.9 hereof, the maximum number of Shares with respect to which Options or stock appreciation rights may be granted hereunder to any employee during any fiscal year of the Company shall be 500,000 Shares (the "Limitation"). If an Option is cancelled, the cancelled Option shall continue to be counted toward the Limitation for the year granted. An Option (or a stock appreciation right) that is repriced during any fiscal year is treated as the cancellation of the Option (or stock appreciation right) and a grant of a new Option (or stock appreciation right) for purposes of the Limitation for that fiscal year.

## ARTICLE 3.

### ELIGIBILITY AND ADMINISTRATION

**3.1. Awards to Employees and Others.** (a) Participants who receive (i) Options under Articles 4 and 6 hereof or share appreciation rights under Article 5 ("Optionees"), and (ii) Share Purchase Awards under Article 7, Restricted Share Awards under Article 8, Deferred Share Awards (as defined herein) under Article 9, Performance-Based Awards under Article 11, or any other Award granted under the Plan shall consist of such officers (other than executive officers), key employees, consultants and

advisors of the Company or any of its subsidiaries or affiliates as the Committee (as defined in Section 3.2 below) shall select from time to time. Executive officers and Directors (as defined in Section 3.2 below) of the Company shall not be eligible to receive Awards under the Plan. The Committee's designation of an Optionee or Participant in any year shall not require the Committee to designate such person to receive Awards or grants in any other year. The designation of an Optionee or Participant to receive Awards or grants under one portion of the Plan shall not require the Committee to include such Optionee or Participant under other portions of the Plan.

(b) No Option that is intended to qualify as an "incentive share option" may be granted (x) to any individual that is not an employee of the Company or any subsidiary thereof, or (y) to any employee who, at the time of such grant, owns, directly or indirectly (within the meaning of Sections 422(b)(6) and 424(d) of the Code), shares possessing more than 10% of the total combined voting power of all classes of shares of the Company or any of its subsidiaries or affiliates, unless at the time of such grant, (i) the option price is fixed at not less than 110% of the Fair Market Value (as defined in Section 10.2 below) of the Shares subject to such Option, determined on the date of the grant, and (ii) the exercise of such Option is prohibited by its terms after the expiration of five years from the date such Option is granted.

**3.2. Administration.** (a) The Plan shall be administered by a committee (the "Committee") consisting of not fewer than two Directors of the Company (the directors of the Company being hereinafter referred to as the "Directors"), as designated by the Directors. The Directors may remove from, add members to, or fill vacancies in the Committee. Unless otherwise determined by the Directors, each member of the Committee will be a "non-employee director" within the meaning of Rule 16b-3 (or any successor rule) of the Exchange Act and an "outside director" within the meaning of Section 162(m)(4)(C)(i) of the Code and the regulations thereunder.

(b) The Committee is authorized, subject to the provisions of the Plan, to establish such rules and regulations as it may deem appropriate for the conduct of meetings and proper administration of the Plan. All actions of the Committee shall be taken by majority vote of its members.

(c) Subject to the provisions of the Plan, the Committee shall have authority, in its sole discretion, to grant Awards under the Plan, to interpret the provisions of the Plan and, subject to the requirements of applicable law, including Rule 16b-3 of the Exchange Act, to prescribe, amend, and rescind rules and regulations relating to the Plan or any Award thereunder as it may deem necessary or advisable. The Committee shall have no authority to reduce the exercise price of any Options or share appreciation rights granted under the Plan (except in connection with adjustments pursuant to Section 10.9 below). All decisions made by the Committee pursuant to the provisions of the Plan shall be final, conclusive and binding on all persons, including the Company, its shareholders, Directors and employees, and other Plan participants.

#### ARTICLE 4.

#### OPTIONS

**4.1. Grant of Options.** The Committee shall determine, within the limitations of the Plan, those officers (other than executive officers), key employees, consultants and advisors of the Company and its subsidiaries and affiliates to whom Options are to be granted under the Plan, the number of Shares that may be purchased under each such Option and the option price, and shall designate such Options at the time of the grant as either "incentive share options" or "nonqualified share options";

*provided, however*, that Options granted to employees of an affiliate (that is not also a subsidiary) or to non-employees of the Company may only be “nonqualified share options.”

**4.2. Share Option Agreements; etc.** All Options granted pursuant to Article 4 and Article 6 herein (a) shall be authorized by the Committee and (b) shall be evidenced in writing by share option agreements (“Share Option Agreements”) in such form and containing such terms and conditions as the Committee shall determine that are not inconsistent with the provisions of the Plan, and, with respect to any Share Option Agreement granting Options that are intended to qualify as “incentive share options,” are not inconsistent with Section 422 of the Code. Granting of an Option pursuant to the Plan shall impose no obligation on the recipient to exercise such Option. Any individual who is granted an Option pursuant to this Article 4 and Article 6 herein may hold more than one Option granted pursuant to such Articles at the same time and may hold both “incentive share options” and “nonqualified share options” at the same time. To the extent that any Option does not qualify as an “incentive share option” (whether because of its provisions, the time or manner of its exercise or otherwise) such Option or the portion thereof which does not so qualify shall constitute a separate “nonqualified share option.”

**4.3. Option Price.** Subject to Section 3.1(b), the option exercise price per each Share purchasable under any “incentive share option” granted pursuant to this Article 4, any “nonqualified share option” granted pursuant to Article 6, and Options intended to be performance-based under Section 162(m) of the Code shall not be less than 100% of the Fair Market Value of such Share on the date of the grant of such Option. The option exercise price per share of each Share purchasable under any “nonqualified share option” that is not intended to be performance-based under Section 162(m) of the Code and is granted pursuant to this Article 4 shall be determined by the Committee at the time of the grant of such Option, but shall not be less than 85% of the Fair Market Value of such Share on the date of the grant of such Option.

**4.4. Other Provisions.** Options granted pursuant to this Article 4 shall be made in accordance with the terms and provisions of Article 10 hereof and any other applicable terms and provisions of the Plan.

## **ARTICLE 5.**

### **SHARE APPRECIATION RIGHTS**

**5.1. Grant and Exercise.** Share appreciation rights may be granted in conjunction with all or part of any Option granted under the Plan, as follows: (i) in the case of a nonqualified share option, such rights may be granted either at the time of the grant of such option or at any subsequent time during the term of the option; and (ii) in the case of an incentive share option, such rights may be granted only at the time of the grant of such option. A “share appreciation right” is a right to receive cash or whole Shares, as provided in this Article 5, in lieu of the purchase of a Share under a related Option. A share appreciation right or applicable portion thereof shall terminate and no longer be exercisable upon the termination or exercise of the related Option, and a share appreciation right granted with respect to less than the full number of Shares covered by a related Option shall not be reduced until, and then only to the extent that, the exercise or termination of the related Option exceeds the number of Shares not covered by the share appreciation right. A share appreciation right may be exercised by the holder thereof (the “Holder”), in accordance with Section 5.2 of this Article 5, by giving written notice thereof to the Company and surrendering the applicable portion of the related Option. Upon giving such notice and surrender, the Holder shall be entitled to receive an amount determined in the manner prescribed in Section 5.2 of this Article 5. Options which have been so surrendered, in whole or in part, shall no longer be exercisable to the extent the related share appreciation rights have been exercised.

**5.2. Terms and Conditions.** Share appreciation rights shall be subject to such terms and conditions, not inconsistent with the provisions of the Plan, as shall be determined from time to time by the Committee, including the following:

(a) Share appreciation rights shall be exercisable only at such time or times and to the extent that the Options to which they relate shall be exercisable in accordance with the provisions of the Plan.

(b) Upon the exercise of a share appreciation right, a Holder shall be entitled to receive up to, but no more than, an amount in cash or whole Shares as determined by the Committee in its sole discretion equal to the excess of the then Fair Market Value of one Share over the option exercise price per Share specified in the related Option multiplied by the number of Shares in respect of which the share appreciation right shall have been exercised. The Holder shall specify in his written notice of exercise, whether payment shall be made in cash or in whole Shares. Each share appreciation right may be exercised only at the time and so long as a related Option, if any, would be exercisable or as otherwise permitted by applicable law.

(c) Upon the exercise of a share appreciation right, the Option or part thereof to which such share appreciation right is related shall be deemed to have been exercised for the purpose of the limitation of the number of Shares to be issued under the Plan, as set forth in Section 2.1 of the Plan.

(d) With respect to share appreciation rights granted in connection with an Option that is intended to be an “incentive share option,” the following shall apply:

(i) No share appreciation right shall be transferable by a Holder otherwise than by will or by the laws of descent and distribution, and share appreciation rights shall be exercisable, during the Holder’s lifetime, only by the Holder.

(ii) Share appreciation rights granted in connection with an Option may be exercised only when the Fair Market Value of the Shares subject to the Option exceeds the option exercise price at which Shares can be acquired pursuant to the Option.

## ARTICLE 6.

### RELOAD OPTIONS

**6.1. Authorization of Reload Options.** Concurrently with the award of any Option (such Option hereinafter referred to as the “Underlying Option”) to any Participant in the Plan, the Committee may grant one or more reload options (each, a “Reload Option”) to such Participant to purchase for cash or Shares (held for at least six months or such other period to avoid accounting charges against the Company’s earnings) a number of Shares as specified below. A Reload Option shall be exercisable for an amount of Shares equal to (i) the number of Shares delivered by the Optionee to the Company to exercise the Underlying Option, and (ii) to the extent authorized by the Committee, the number of Shares used to satisfy any tax withholding requirement incident to the exercise of the Underlying Option, subject to the availability of Shares under the Plan at the time of such exercise. Any Reload Option may provide for the grant, when exercised, of subsequent Reload Options to the extent and upon such terms and conditions consistent with this Article 6, as the Committee in its sole discretion shall specify at or after the time of grant of such Reload Option. Except as otherwise determined by the Committee, a Reload Option will vest and become exercisable six months after the exercise of an Underlying Option or Reload Option by the Participant delivering to the Company Shares owned by the Optionee for at least six months in payment of the exercise price and/or tax withholding obligations. Notwithstanding the fact that the

Underlying Option may be an “incentive share option,” a Reload Option is not intended to qualify as an “incentive share option” under Section 422 of the Code.

**6.2. Reload Option Amendment.** Each Share Option Agreement shall state whether the Committee has authorized Reload Options with respect to the Underlying Option. Upon the exercise of an Underlying Option or other Reload Option, the Reload Option will be evidenced by an amendment to the underlying Share Option Agreement.

**6.3. Reload Option Price.** The option exercise price per Share payable upon the exercise of a Reload Option shall be the Fair Market Value of a Share on the date the corresponding Underlying Option is exercised.

**6.4. Term and Exercise.** Except as otherwise determined by the Committee, each Reload Option vests and is fully exercisable six months after its grant (i.e., six months after the corresponding Underlying Option is exercised). The term of each Reload Option shall be equal to the remaining option term of the Underlying Option.

**6.5. Termination of Employment.** No additional Reload Options shall be granted to Optionees when Options and/or Reload Options are exercised pursuant to the terms of this Plan following termination of the Optionee’s employment unless the Committee, in its sole discretion, shall determine otherwise.

**6.6. Applicability of Other Sections.** Except as otherwise provided in this Article 6, the provisions of Article 10 applicable to Options shall apply equally to Reload Options.

## ARTICLE 7.

### SHARE PURCHASE AWARDS

**7.1. Grant of Share Purchase Award.** The term “Share Purchase Award” means the right to purchase Shares of the Company and to pay for such Shares through a loan made by the Company to the Participant (a “Purchase Loan”) as set forth in this Article 7.

**7.2. Terms of Purchase Loans. (a) *Purchase Loan.*** Each Purchase Loan shall be evidenced by a promissory note. The term of the Purchase Loan shall be for a period of years, as determined by the Committee, and the proceeds of the Purchase Loan shall be used exclusively by the Participant for purchase of Shares from the Company at a purchase price equal to the Fair Market Value on the date of the Share Purchase Award.

**(b) *Interest on Purchase Loan.*** A Purchase Loan shall be non-interest bearing or shall bear interest at whatever rate the Committee shall determine (but not in excess of the maximum rate permissible under applicable law), payable in a manner and at such times as the Committee shall determine. Those terms and provisions as the Committee shall determine shall be incorporated into the promissory note evidencing the Purchase Loan.

**(c) *Forgiveness of Purchase Loan.*** Subject to Section 7.4 hereof, the Company may forgive the repayment of up to 100% of the principal amount of the Purchase Loan, subject to such terms and conditions as the Committee shall determine and set forth in the promissory note evidencing the Purchase Loan. A Participant’s Purchase Loan can be prepaid at any time, and from time to time, without penalty.

**7.3. Security for Loans. (a) Stock Power and Pledge.** Purchase Loans granted to Participants shall be secured by a pledge of the Shares acquired pursuant to the Share Purchase Award. Such pledge shall be evidenced by a pledge agreement (the "Pledge Agreement") containing such terms and conditions as the Committee shall determine. Purchase Loans shall be recourse or non-recourse with respect to a Participant, as determined from time to time by the Committee. The share certificates for the Shares purchased by a Participant pursuant to a Share Purchase Award shall be issued in the Participant's name, but shall be held by the Company as security for repayment of the Participant's Purchase Loan together with a stock power executed in blank by the Participant (the execution and delivery of which by the Participant shall be a condition to the issuance of the Share Purchase Award). Unless otherwise determined by the Committee, the Participant shall be entitled to exercise all rights applicable to such Shares, including, but not limited to, the right to vote such Shares and the right to receive dividends and other distributions made with respect to such Shares. When the Purchase Loan and any accrued but unpaid interest thereon has been repaid or otherwise satisfied in full, the Company shall deliver to the Participant the share certificates for the Shares purchased by a Participant under the Share Purchase Award.

**(b) Release and Delivery of Share Certificates During the Term of the Purchase Loan.** The Company shall release and deliver to each Participant certificates for Shares purchased by a Participant pursuant to a Share Purchase Award, in such amounts and on such terms and conditions as the Committee shall determine, which shall be set forth in the Pledge Agreement.

**(c) Release and Delivery of Share Certificates Upon Repayment of the Purchase Loan.** The Company shall release and deliver to each Participant certificates for the Shares purchased by the Participant under the Share Purchase Award and then held by the Company, provided the Participant has paid or otherwise satisfied in full the balance of the Purchase Loan and any accrued but unpaid interest thereon. In the event the balance of the Purchase Loan is not repaid, forgiven or otherwise satisfied within 90 days after (i) the date repayment of the Purchase Loan is due (whether in accordance with its term, by reason of acceleration or otherwise), or (ii) such longer time as the Committee, in its discretion, shall provide for repayment or satisfaction, the Company shall retain those Shares then held by the Company in accordance with the Pledge Agreement.

**(d) Recourse Purchase Loans.** Notwithstanding Sections 7.3(a), (b) and (c) above, in the case of a recourse Purchase Loan, the Committee may make a Purchase Loan on such terms as it determines, including without limitation, not requiring a pledge of the acquired Shares.

**7.4. Termination of Employment. (a) Termination of Employment by Death, Disability or by the Company Without Cause; Change of Control.** In the event of a Participant's termination of employment or separation from service by reason of death, "disability" or by the Company without "cause," or in the event of a "change of control," the Committee shall have the right (but shall not be required) to forgive the remaining unpaid amount (principal and interest) of the Purchase Loan in whole or in part as of the date of such occurrence. "Change of Control," "disability" and "cause" shall have the respective meanings as set forth in the promissory note evidencing the Purchase Loan.

**(b) Other Termination of Employment.** Subject to Section 7.4(a) above, in the event of a Participant's termination of employment or separation from service for any reason, the Participant shall repay to the Company the entire balance of the Purchase Loan and any accrued but unpaid interest thereon, which amounts shall become immediately due and payable, unless otherwise determined by the Committee.

**7.5. Restrictions on Transfer.** No Share Purchase Award or Shares purchased through such an Award and pledged to the Company as collateral security for the Participant's Purchase Loan

(and accrued and unpaid interest thereon) may be otherwise pledged, sold, assigned or transferred (other than by will or by the laws of descent and distribution).

## ARTICLE 8.

### RESTRICTED SHARE AWARDS

**8.1. Restricted Share Awards.** (a) *Grant.* A grant of Shares made pursuant to this Article 8 is referred to as a “Restricted Share Award.” The Committee may grant to any Participant an amount of Shares in such manner, and subject to such terms and conditions relating to vesting, forfeitability and restrictions on delivery and transfer (whether based on performance standards, periods of service or otherwise) as the Committee shall establish (such Shares, “Restricted Shares”). The terms of any Restricted Share Award granted under this Plan shall be set forth in a written agreement (a “Restricted Share Agreement”) which shall contain provisions determined by the Committee and not inconsistent with this Plan. The provisions of Restricted Share Awards need not be the same for each Participant receiving such Awards.

(b) *Issuance of Restricted Shares.* As soon as practicable after the date of grant of a Restricted Share Award by the Committee, the Company shall cause to be transferred on the books of the Company, Shares registered in the name of the Company, as nominee for the Participant, evidencing the Restricted Shares covered by the Award; provided, however, such Shares shall be subject to forfeiture to the Company retroactive to the date of grant, if a Restricted Share Agreement delivered to the Participant by the Company with respect to the Restricted Shares covered by the Award is not duly executed by the Participant and timely returned to the Company. All Restricted Shares covered by Awards under this Article 8 shall be subject to the restrictions, terms and conditions contained in the Plan and the Restricted Share Agreement entered into by and between the Company and the Participant. Until the lapse or release of all restrictions applicable to an Award of Restricted Shares, the share certificates representing such Restricted Shares shall be held in custody by the Company or its designee.

(c) *Shareholder Rights.* Beginning on the date of grant of the Restricted Share Award and subject to execution of the Restricted Share Agreement as provided in Sections 8.1(a) and (b), the Participant shall become a shareholder of the Company with respect to all Shares subject to the Restricted Share Agreement and shall have all of the rights of a shareholder, including, but not limited to, the right to vote such Shares and the right to receive distributions made with respect to such Shares; *provided, however*, that any Shares or any other property (other than cash) distributed as a dividend or otherwise with respect to any Restricted Shares as to which the restrictions have not yet lapsed shall be subject to the same restrictions as such Restricted Shares and shall be represented by book entry and held as prescribed in Section 8.1(b).

(d) *Restriction on Transferability.* None of the Restricted Shares may be assigned or transferred (other than by will or the laws of descent and distribution), pledged or sold prior to lapse or release of the restrictions applicable thereto.

(e) *Delivery of Shares Upon Release of Restrictions.* Upon expiration or earlier termination of the forfeiture period without a forfeiture and the satisfaction of or release from any other conditions prescribed by the Committee, the restrictions applicable to the Restricted Shares shall lapse. As promptly as administratively feasible thereafter, subject to the requirements of Section 12.1, the Company shall deliver to the Participant or, in case of the Participant’s death, to the Participant’s beneficiary, one or more stock certificates for the appropriate number of Shares, free of all such restrictions, except for any restrictions that may be imposed by law.



**8.2. Terms of Restricted Shares.** (a) *Forfeiture of Restricted Shares.* Subject to Section 8.2(b), all Restricted Shares shall be forfeited and returned to the Company and all rights of the Participant with respect to such Restricted Shares shall terminate unless the Participant continues in the service of the Company as an employee until the expiration of the forfeiture period for such Restricted Shares and satisfies any and all other conditions set forth in the Restricted Share Agreement. The Committee in its sole discretion, shall determine the forfeiture period (which may, but need not, lapse in installments) and any other terms and conditions applicable with respect to any Restricted Share Award and the Committee has the discretion to modify the terms and conditions of a Restricted Share award as long as the rights of the Participant are not impaired.

(b) *Waiver of Forfeiture Period.* Notwithstanding anything contained in this Article 8 to the contrary, the Committee may, in its sole discretion and subject to the limitations imposed under Section 162(m) of the Code and the Treasury Regulations thereunder in the case of a Restricted Share Award intended to comply with the performance-based exception under Code Section 162(m), waive the forfeiture period and any other conditions set forth in any Restricted Share Agreement under appropriate circumstances (including the death, disability or retirement of the Participant or a material change in circumstances arising after the date of an Award) and subject to such terms and conditions (including forfeiture of a proportionate number of the Restricted Shares) as the Committee shall deem appropriate.

## ARTICLE 9.

### DEFERRED SHARE AWARDS

**9.1. Shares and Administration.** Awards of the right to receive Shares that are not to be distributed to the Participant until after a specified deferral period (such Award and the deferred Shares delivered thereunder hereinafter as the context shall require, the “Deferred Shares”) may be made either alone or in addition to share Options, share appreciation rights, or Restricted Share Awards, or Other Share-based Awards (hereafter defined) granted under the Plan. The Committee shall determine the officers (other than executive officers), employees, consultants and advisors of the Company and its subsidiaries to whom and the time or times at which Deferred Shares shall be awarded, the number of Deferred Shares to be awarded to any Participant, the duration of the period (the “Deferral Period”) during which, and the conditions under which, receipt of the Shares will be deferred, and the terms and conditions of the award in addition to those contained in Section 9.2. In its sole discretion, the Committee may provide for a minimum payment at the end of the applicable Deferral Period based on a stated percentage of the Fair Market Value on the date of grant of the number of Shares covered by a Deferred Share award. The Committee may also provide for the grant of Deferred Shares upon the completion of a specified performance period. The provisions of Deferred Share awards need not be the same with respect to each recipient.

**9.2. Terms and Conditions.** Deferred Share awards made pursuant to this Article 9 shall be subject to the following terms and conditions:

(a) Subject to the provisions of the Plan, the Shares to be issued pursuant to a Deferred Share award may not be sold, assigned, transferred, pledged or otherwise encumbered during the Deferral Period or Elective Deferral Period (defined below), where applicable, and may be subject to a risk of forfeiture during all or such portion of the Deferral Period as shall be specified by the Committee. At the expiration of the Deferral Period and Elective Deferral Period, share certificates shall be delivered to the

Participant, or the Participant's legal representative, in a number equal to the number of shares covered by the Deferred Share award.

(b) Amounts equal to any dividends declared during the Deferral Period with respect to the number of Shares covered by a Deferred Share award will be paid to the Participant currently, or deferred and deemed to be reinvested in additional deferred Shares or otherwise reinvested, as determined at the time of the Award by the Committee, in its sole discretion.

(c) Subject to the provisions of paragraph 9.2(d) of this Article 9, upon termination of employment for any reason during the Deferral Period for a given Award, the Deferred Shares in question shall be forfeited by the Participant.

(d) In the event of the Participant's death or permanent disability during the Deferral Period (or Elective Deferral Period, where applicable), or in cases of special circumstances, the Committee may, in its sole discretion, when it finds that a waiver would be in the best interests of the Company, waive in whole or in part any or all of the remaining deferral limitations imposed hereunder with respect to any or all of the Participant's Deferred Shares.

(e) Prior to completion of the Deferral Period, a Participant may elect to further defer receipt of the Award for a specified period or until a specified event (the "Elective Deferral Period"), subject in each case to the approval of the Committee and under such terms as are determined by the Committee, all in its sole discretion.

(f) Each Award shall be confirmed by a Deferred Share agreement or other instrument executed by the Company and the Participant.

## ARTICLE 10.

### GENERALLY APPLICABLE PROVISIONS

**10.1. Option Period.** Subject to Section 3.1(b), the period for which an Option is exercisable shall be set by the Committee and shall not exceed ten years from the date such Option is granted, *provided, however*, in the case of an Option that is not intended to be an "incentive share option," the Committee may prescribe a period in excess of ten years. After the Option is granted, the option period may not be reduced, subject to expiration due to termination of employment or otherwise.

**10.2. Fair Market Value.** The "Fair Market Value" of a Share shall be determined in good faith by the Committee in its sole discretion from time to time. In no case shall Fair Market Value be less than the par value of a Share. An Option shall be considered granted on the date the Committee acts to grant the Option or such later date as the Committee shall specify.

**10.3. Exercise of Options.** Vested Options granted under the Plan shall be exercised by the Optionee or by a Permitted Assignee thereof (or by his or her executors, administrators, guardian or legal representative, as provided in Sections 10.6 and 10.7 hereof) as to all or part of the Shares covered thereby, by the giving of written notice of exercise to the Company, specifying the number of Shares to be purchased, accompanied by payment of the full purchase price for the Shares being purchased. Full payment of such purchase price shall be made at the time of exercise and shall be made (i) in cash or by certified check or bank check or wire transfer of immediately available funds, (ii) with the consent of the

Committee, by delivery of a promissory note in favor of the Company upon such terms and conditions as determined by the Committee, (iii) with the consent of Committee, by tendering previously acquired Shares (valued at its Fair Market Value, as determined by the Committee as of the date of tender) that have been owned for a period of at least six months (or such other period to avoid accounting charges against the Company's earnings), (iv) if Shares are traded on a national securities exchange, the Nasdaq Stock Market, Inc. or quoted on a national quotation system sponsored by the National Association of Securities Dealers, Inc. and the Committee authorizes this method of exercise, through the delivery of irrevocable instructions to a broker approved by the Committee to deliver promptly to the Company an amount equal to the purchase price, or (v) with the consent of the Committee, any combination of (i), (ii), (iii) and (iv). In connection with a tender of previously acquired Shares pursuant to clause (iii) above, the Committee, in its sole discretion, may permit the Optionee to constructively exchange Shares already owned by the Optionee in lieu of actually tendering such Shares to the Company, provided that adequate documentation concerning the ownership of the Shares to be constructively tendered is furnished in form satisfactory to the Committee. The notice of exercise, accompanied by such payment, shall be delivered to the Company at its principal business office or such other office as the Committee may from time to time direct, and shall be in such form, containing such further provisions consistent with the provisions of the Plan, as the Committee may from time to time prescribe. In no event may any Option granted hereunder be exercised for a fraction of a Share. The Company shall, subject to Section 10.4 herein, effect the transfer of Shares purchased pursuant to an Option as soon as practicable, and, within a reasonable time thereafter, such transfer shall be evidenced on the books of the Company. No person exercising an Option shall have any of the rights of a holder of Shares subject to an Option until certificates for such Shares shall have been issued following the exercise of such Option. No adjustment shall be made for cash dividends or other rights for which the record date is prior to the date of such issuance.

**10.4. Transferability.** No Option that is intended to qualify as an "incentive stock option" under Section 422 of the Code shall be assignable or transferable by the Optionee, other than by will or the laws of descent and distribution, and such Option may be exercised during the life of the Optionee only by the Optionee or his guardian or legal representative. "Non-qualified share options" and any share appreciation rights granted in tandem therewith are transferable (together and not separately) with the consent of the Committee by the Optionee or Holder, as the case may be, to any one or more of the following persons (each, a "Permitted Assignee"): (i) the spouse, parent, issue, spouse of issue, or issue of spouse ("issue" shall include all descendants whether natural or adopted) of such Optionee or Holder, as the case may be; (ii) a trust for the benefit of one or more of those persons described in clause (i) above or for the benefit of such Optionee or Holder, as the case may be; (iii) an entity in which the Optionee or Holder or any Permitted Assignee thereof is a beneficial owner; or (iv) in the case of a transfer by an Optionee who is a non-employee director, another non-employee director of the Company; provided that such Permitted Assignee shall be bound by and subject to all of the terms and conditions of this Plan and the Share Option Agreement relating to the transferred Option and shall execute an agreement satisfactory to the Company evidencing such obligations; and provided further that such Optionee or Holder shall remain bound by the terms and conditions of this Plan. In the case of a transfer by a non-employee director to another non-employee director, the vesting and exercisability shall after such transfer be determined by reference to the service of the assignee, rather than the assignor. The Company shall cooperate with any Permitted Assignee and the Company's transfer agent in effectuating any transfer permitted under this Section 10.4.

**10.5. Termination of Employment.** Unless the Committee determines otherwise, in the event of the termination of employment of an Optionee or the termination or separation from service of an advisor or consultant for any reason (other than death or disability as provided below), any Option(s) held by such Optionee (or Permitted Assignee) under this Plan and not previously exercised or expired shall be deemed cancelled and terminated on the day of such termination or separation, *provided, however*, that in no instance may the term of the Option, if extended by the Committee, exceed the maximum term

established pursuant to Section 3.1(b)(ii) or 10.1 above. Notwithstanding the foregoing, in the event of the termination or separation from service of an Optionee for any reason other than death or disability, under conditions satisfactory to the Company, the Committee may, in its sole discretion, allow any “nonqualified share options” granted to such Optionee under the Plan and not previously exercised or expired to be exercisable for a period of time to be specified by the Committee, *provided, however*, that in no instance may the term of the Option, as so extended, exceed the maximum term established pursuant to Section 10.1 above.

**10.6. Death.** In the event an Optionee dies while employed by the Company or any of its subsidiaries or affiliates or during his term as an advisor or consultant of the Company or any of its subsidiaries or affiliates, as the case may be, any Option(s) held by such Optionee (or his Permitted Assignee) and not previously expired or exercised shall, to the extent exercisable on the date of death, be exercisable by the estate of such Optionee or by any person who acquired such Option by bequest or inheritance, or by the Permitted Assignee at any time within one year after the death of the Optionee, unless earlier terminated pursuant to its terms, *provided, however*, that if the term of such Option would expire by its terms within six months after the Optionee’s death, the term of such Option shall be extended until six months after the Optionee’s death, *provided further, however*, that in no instance may the term of the Option, as so extended, exceed the maximum term established pursuant to Section 3.1(b)(ii) or 10.1 above.

**10.7. Disability.** In the event of the termination of employment of an Optionee or the separation from service of an advisor or consultant of the Company, due to total disability, the Optionee, or his guardian or legal representative, or a Permitted Assignee shall have the unqualified right to exercise any Option(s) that have not expired or been previously exercised and that the Optionee was eligible to exercise as of the first date of total disability (as determined by the Committee), at any time within one year after such termination or separation, unless earlier terminated pursuant to its terms, *provided, however*, that if the term of such Option would expire by its terms within six months after such termination or separation, the term of such Option shall be extended until six months after such termination or separation, *provided further, however*, that in no instance may the term of the Option, as so extended, exceed the maximum term established pursuant to Section 3.1(b)(ii) or 10.1 above. The term “total disability” shall, for purposes of this Plan, be defined in the same manner as such term is defined in Section 22(e)(3) of the Code.

**10.8. Amendment and Modification of the Plan.** The Committee may, from time to time, alter, amend, suspend or terminate the Plan as it shall deem advisable, subject to any requirement for shareholder approval imposed by applicable law or any rule of any stock exchange or quotation system on which Shares are listed or quoted; provided that no amendments to, or termination of, the Plan shall in any way impair the rights of an Optionee or a Participant (or a Permitted Assignee thereof) under any Award previously granted without such Optionee’s or Participant’s consent.

**10.9. Adjustments.** In the event that the Committee shall determine that any dividend or other distribution (whether in the form of cash, Shares, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase, or exchange of Shares or other securities, the issuance of warrants or other rights to purchase Shares or other securities, or other similar corporate transaction or event affects the Shares with respect to which Awards have been or may be issued under the Plan, such that an adjustment is determined in good faith by the Committee to be appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan, then the Committee shall, in such manner as the Committee may deem equitable, adjust any or all of (i) the number and type of Shares that thereafter may be made the subject of Awards, (ii) the number and type of Shares subject to outstanding Awards and share appreciation rights, and (iii) the grant or exercise price with respect to any

Award, or, if deemed appropriate, make provision for a cash payment to the holder of any outstanding Award; provided, in each case, that with respect to "incentive stock options," no such adjustment shall be authorized to the extent that such adjustment would cause such options to violate Section 422(b) of the Code or any successor provision; and provided further, that the number of Shares subject to any Award denominated in Shares shall always be a whole number. In the event of any reorganization, merger, consolidation, split-up, spin-off, or other business combination involving the Company (collectively, a "Reorganization"), the Committee or the Board of Directors of the Company may cause any Award outstanding as of the effective date of the Reorganization to be cancelled in consideration of a cash payment or alternate Award (whether from the Company or another entity that is a party to the Reorganization) or a combination thereof made to the holder of such cancelled Award substantially equivalent in value to the fair market value of such cancelled Award. The determination of fair market value shall be made by the Committee or the Board of Directors, as the case may be, in their sole discretion.

**10.10. Change of Control.** The terms of any Award may provide in the Share Option Agreement, Restricted Share Agreement, Purchase Loan or other document evidencing the Award, that upon a "Change of Control" of the Company (as that term may be defined therein), (i) Options (and share appreciation rights) immediately vest and become fully exercisable, (ii) restrictions on Restricted Shares lapse and the shares become fully vested, (iii) Purchase Loans are forgiven in whole or in part, and (iv) such other additional benefits as the Committee deems appropriate shall apply, subject in each case to any terms and conditions contained in the applicable document evidencing such Award. For purposes of this Plan, a "Change of Control" shall mean an event described in the applicable document evidencing the Award or such other event as determined in the sole discretion of the Board of Directors of the Company. The Committee, in its discretion, may determine that, upon the occurrence of a Change of Control of the Company, each Option and share appreciation right outstanding hereunder shall terminate within a specified number of days after notice to the Participant or Holder, and such Participant or Holder shall receive, with respect to each Share subject to such Option or share appreciation right, an amount equal to the excess of the Fair Market Value of such Share immediately prior to the occurrence of such Change of Control over the exercise price per share of such Option or share appreciation right; such amount to be payable in cash, in one or more kinds of property (including the property, if any, payable in the transaction) or in a combination thereof, as the Committee, in its discretion, shall determine.

**10.11. Employment Violation.** Each Share Option Agreement evidencing an Option granted hereunder shall include and be subject to the following terms:

- (a) The terms of this Section 10.11 shall apply to the Option if the Optionee is or shall become subject to an employment agreement with the Company.
- (b) If the Optionee materially breaches his or her employment agreement (it being understood that any breach of the post-termination obligations contained therein shall be deemed to be material) for so long as the terms of such employment agreement shall apply to the Optionee (each an "Employment Violation"), the Company shall have the right to require (i) the termination and cancellation of the unexercised portion of the Option, if any, whether vested or unvested, and (ii) payment by the Optionee to the Company of the Recapture Amount (as defined below). Such termination of unexercised Options and payment of the Recapture Amount, as the case may be, shall be in addition to, and not in lieu of, any other right or remedy available to the Company arising out of or in connection with any such Employment Violation including, without limitation, the right to terminate Optionee's employment if not already terminated, seek injunctive relief and additional monetary damages.

(c) “Recapture Amount” shall mean the gross gain realized or unrealized by the Optionee upon each exercise of his Option during the period beginning on the date which is twelve (12) months prior to the date of the Optionee’s Employment Violation and ending on the date of computation (the “Look-back Period”), which gain shall be calculated as the sum of:

(i) if the Optionee has exercised any portion of his Option during the Look-back Period and sold any of the Shares acquired on exercise thereafter, an amount equal to the product of (x) the sales price per Share sold minus the exercise price per Share times (y) the number of Shares as to which the Option was exercised and which were sold at such sales price; plus

(ii) if the Optionee has exercised any portion of his Option during the Look-back Period and not sold any of the Shares acquired on exercise thereafter, with respect to each of such Shares an amount equal to the product of (x) the greatest of the following: (1) the Fair Market Value per Share on the date of exercise, (2) the arithmetic average of the per Share closing sales prices as reported on NASDAQ for the thirty (30) trading day period ending on the trading day immediately preceding the date of the Company’s written notice of its exercise of its rights under this clause (h), or (3) the arithmetic average of the per Share closing sales prices as reported on NASDAQ for the thirty (30) trading day period ending on the trading day immediately preceding the date of computation, minus the exercise price per Share times (y) the number of Shares as to which this Option was exercised and which were not sold;

provided, however, in lieu of payment by the Optionee to the Company of the Recapture Amount determined pursuant to subclause (ii) above, the Optionee, in his or her discretion, may tender to the Company the Shares acquired upon exercise of this Option during the Look-back Period and the Optionee shall not be entitled to receive any consideration from the Company in exchange therefor.

With respect to any other Awards granted hereunder, the terms of any Restricted Share Agreement, share appreciation right, Share Purchase Award or any other document evidencing an Award under the Plan, may include comparable provisions to those set forth in this Section 10.11.

**10.12. Other Provisions.** (a) The Committee may require each Participant purchasing Shares pursuant to an Award under the Plan to represent to and agree with the Company in writing that such Participant is acquiring the Shares without a view to distribution thereof. The certificates for such Shares may include any legend which the Committee deems appropriate to reflect any restrictions on transfer.

(b) All certificates for Shares delivered under the Plan pursuant to any Award shall be subject to such share-transfer orders and other restrictions as the Committee may deem advisable under the rules, regulations, and other restrictions of the Securities and Exchange Commission, any stock exchange upon which the Shares are then listed, and any applicable Federal or state securities law, and the Committee may cause a legend or legends to be put on any such certificates to make appropriate reference to such restrictions.

(c) Awards granted under the Plan may, in the discretion of the Committee, be granted either alone or in addition to, in tandem with, or in substitution for, any other Awards granted under the Plan. If Awards are granted in substitution for other Awards, the Committee shall require the surrender of such other Awards in consideration for the grant of the new Awards. Awards granted in addition to or in tandem with other Awards may be granted either at the same time as or at a different time from the grant of such other Awards.

- (d) Nothing contained in this Plan shall prevent the Board of Directors from adopting other or additional compensation arrangements, subject to shareholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases.
- (e) A Participant shall have no right as a shareholder until he or she becomes the holder of record.
- (f) The Company will provide to its shareholders, at least annually, reports containing financial statements and management's discussion and analysis of financial conditions and results of operations.

**10.13. Terms of Option Grant.** Notwithstanding anything in Section 10.4, 10.5, 10.6, 10.7, 10.10 and 10.11 to the contrary, the Committee may grant an Option under such terms and conditions as may be provided in the Share Option Agreement given to the Optionee and the Committee has the discretion to modify the terms and conditions of an Option after grant as long as the rights of the Optionee are not impaired unless the Optionee otherwise consents, *provided, however*, that in no instance may the term of the Option, as so granted, exceed the maximum term established pursuant to Section 10.1 above, *provided further* that in no instance may the exercise price of the Option be reduced after the date of grant (except in connection with adjustments pursuant to Section 10.9 hereof).

## ARTICLE 11.

### PERFORMANCE-BASED AWARDS.

**11.1. General.** (a) Certain Awards granted under the Plan may be granted in a manner such that the Awards qualify as "performance-based compensation" (as such term is used in Section 162(m) of the Code and the regulations thereunder) and thus be exempt from the deduction limitation imposed by Section 162(m) of the Code ("Performance-Based Awards"). Awards shall only qualify as Performance-Based Awards if, among other things, at the time of grant the Committee is comprised solely of two or more "outside directors" (as such term is used in Section 162(m) of the Code and the regulations thereunder).

(b) Performance-Based Awards may be granted to Participants at any time and from time to time, as shall be determined by the Committee. The Committee shall have complete discretion in determining the number, amount and timing of awards granted to each Participant. Such Performance-Based Awards may take the form of, without limitation, cash, Shares or any combination thereof.

(c) The Committee shall set performance goals at its discretion which, depending on the extent to which they are met, will determine the number and/or value of such Performance-Based Awards that will be paid out to the Participants, and may attach to such Performance-Based Awards one or more restrictions. The maximum amount of Performance-Based Awards to be awarded to any employee during any fiscal year shall be \$1,000,000.

**11.2. Options and Share Appreciation Rights.** Options and share appreciation rights granted under the Plan with an exercise price at or above the Fair Market Value of the Shares on the date of grant should qualify as Performance-Based Awards.

**11.3. Other Awards.** Either the granting or vesting of Performance-Based Awards granted under the Plan shall be subject to the achievement of a performance target or targets, as

determined by the Committee in its sole discretion, based on one or more of the performance measures specified in Section 11.4 below. With respect to such Performance-Based Awards:

- (1) the Committee shall establish in writing (x) the objective performance-based goals applicable to a given period and (y) the individual employees or class of employees to which such performance-based goals apply no later than 90 days after the commencement of such period (but in no event after 25 percent of such period has elapsed);
- (2) no Performance-Based Awards shall be payable to or vest with respect to, as the case may be, any Participant for a given period until the Committee certifies in writing that the objective performance goals (and any other material terms) applicable to such period have been satisfied; and
- (3) after the establishment of a performance goal, the Committee shall not revise such performance goal or increase the amount of compensation payable thereunder (as determined in accordance with Section 162(m) of the Code) upon the attainment of such performance goal.

**11.4. Performance Measures.** The Committee may use the following performance measures (either individually or in any combination) to set performance targets with respect to Awards intended to qualify as Performance-Based Awards: net sales; pretax income before allocation of corporate overhead and bonus; budget; earnings per share; net income; division, group or corporate financial goals; return on stockholders' equity; return on assets; attainment of strategic and operational initiatives; appreciation in and/or maintenance of the price of the common stock or any other publicly-traded securities of the Company; market share; gross profits; earnings before taxes; earnings before interest and taxes; earnings before interest, taxes, depreciation and amortization; economic value-added models; comparisons with various stock market indices; and/or reductions in costs.

## **ARTICLE 12.**

### **MISCELLANEOUS**

**12.1. Tax Withholding.** The Company shall have the right to make all payments or distributions pursuant to the Plan to an Optionee or Participant (or a Permitted Assignee thereof) net of any applicable Federal, State and local taxes required to be paid as a result of the grant of any Award, exercise of an Option or share appreciation rights or any other event occurring pursuant to this Plan. The Company or any subsidiary or affiliate thereof shall have the right to withhold from wages or other amounts otherwise payable to such Optionee or Participant (or a Permitted Assignee thereof) such withholding taxes as may be required by law, or to otherwise require the Optionee or Participant (or a Permitted Assignee thereof) to pay such withholding taxes. If the Optionee or Participant (or a Permitted Assignee thereof) shall fail to make such tax payments as are required, the Company or its subsidiaries or affiliates shall, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to such Optionee or Participant or to take such other action as may be necessary to satisfy such withholding obligations. In satisfaction of the requirement to pay withholding taxes, the Optionee or Participant (or Permitted Assignee) may make a written election, which may be accepted or rejected in the discretion of the Committee, to have withheld a portion of the Shares then issuable to the Optionee (or Permitted Assignee) pursuant to the Plan having an aggregate Fair Market Value equal to the withholding taxes.



**12.2. Right of Discharge Reserved.** Nothing in the Plan nor the grant of an Award hereunder shall confer upon any employee or other individual the right to continue in the employment or service of the Company or any subsidiary or affiliate of the Company or affect any right that the Company or any subsidiary or affiliate of the Company may have to terminate the employment or service of (or to demote or to exclude from future Options under the Plan) any such employee or other individual at any time for any reason. Except as specifically provided by the Committee, the Company shall not be liable for the loss of existing or potential profit with respect to an Award in the event of termination of an employment or other relationship even if the termination is in violation of an obligation of the Company or any subsidiary or affiliate of the Company to the employee, advisor or consultant.

**12.3. Nature of Payments.** All Awards made pursuant to the Plan are in consideration of services performed or to be performed for the Company or any subsidiary or affiliate of the Company. Any income or gain realized pursuant to Awards under the Plan and any share appreciation rights constitutes a special incentive payment to the Optionee, Participant or Holder and shall not be taken into account, to the extent permissible under applicable law, as compensation for purposes of any of the employee benefit plans of the Company or any subsidiary or affiliate of the Company except as may be determined by the Committee or by the Directors or directors of the applicable subsidiary or affiliate of the Company.

**12.4. Unfunded Status of the Plan.** The Plan is intended to constitute an “unfunded” plan for incentive and deferred compensation. With respect to any payments not yet made to a Participant or Optionee by the Company, nothing contained herein shall give any such Participant or Optionee any rights that are greater than those of a general creditor of the Company. In its sole discretion, the Committee may authorize the creation of trusts or other arrangements to meet the obligations created under the Plan to deliver the Shares or payments in lieu of or with respect to Awards hereunder; provided, however, that the existence of such trusts or other arrangements is consistent with the unfunded status of the Plan.

**12.5. Severability.** If any provision of the Plan shall be held unlawful or otherwise invalid or unenforceable in whole or in part, such unlawfulness, invalidity or unenforceability shall not affect any other provision of the Plan or part thereof, each of which remain in full force and effect. If the making of any payment or the provision of any other benefit required under the Plan shall be held unlawful or otherwise invalid or unenforceable, such unlawfulness, invalidity or unenforceability shall not prevent any other payment or benefit from being made or provided under the Plan, and if the making of any payment in full or the provision of any other benefit required under the Plan in full would be unlawful or otherwise invalid or unenforceable, then such unlawfulness, invalidity or unenforceability shall not prevent such payment or benefit from being made or provided in part, to the extent that it would not be unlawful, invalid or unenforceable, and the maximum payment or benefit that would not be unlawful, invalid or unenforceable shall be made or provided under the Plan.

**12.6. Gender and Number.** In order to shorten and to improve the understandability of the Plan document by eliminating the repeated usage of such phrases as “his or her” and any masculine terminology herein shall also include the feminine, and the definition of any term herein in the singular shall also include the plural except when otherwise indicated by the context.

**12.7. Governing Law.** The Plan and all determinations made and actions taken thereunder, to the extent not otherwise governed by the Code or the laws of the United States, shall be governed by the laws of the State of Delaware and construed accordingly.

**12.8. Effective Date of Plan; Termination of Plan.** The Plan shall be effective on the date of the approval of the Plan by the Board of Directors. Notwithstanding the foregoing, no Option intended

to qualify as an incentive share option shall be granted hereunder until the Plan shall be approved by the holders of a majority of the shares entitled to vote thereon, provided such approval is obtained within 12 months after the date of adoption of the Plan by the Board of Directors. Awards may be granted under the Plan at any time and from time to time prior to April 3, 2012, on which date the Plan will expire except as to Awards and related share appreciation rights then outstanding under the Plan. Such outstanding Awards and share appreciation rights shall remain in effect until they have been exercised or terminated, or have expired.

**12.9. Captions.** The captions in this Plan are for convenience of reference only, and are not intended to narrow, limit or affect the substance or interpretation of the provisions contained herein.

**12.10. Dissolution or Liquidation.** In the event of the proposed dissolution or liquidation of the Company, the Committee shall notify each Optionee and Participant as soon as practicable prior to the effective date of such proposed transaction. The Committee in its sole discretion may permit an Optionee to exercise an Option until ten days prior to such transaction with respect to all vested and exercisable Shares covered thereby and with respect to such number of unvested Shares as the Committee shall determine. In addition, the Committee may provide that any forfeiture provision or Company repurchase option applicable to any Restricted Share Award shall lapse as to such number of Shares as the Committee shall determine, contingent upon the occurrence of the proposed dissolution or liquidation at the time and in the manner contemplated. To the extent an Option has not been previously exercised, the Option shall terminate automatically immediately prior to the consummation of the proposed action. To the extent a forfeiture provision applicable to a Restricted Share Award has not been waived by the Committee, the related Restricted Share Award shall be forfeited automatically immediately prior to the consummation of the proposed action.

**12.11. Successors and Assigns.** This Plan shall be binding upon and inure to the benefit of the respective successors and permitted assigns of the Company, Optionees and Participants.

**STOCK OPTION AGREEMENT**  
**(Non-Transferable)**

Stock Option # \_\_\_\_\_

For \_\_\_\_\_ Shares

Issued Pursuant to the  
2002 Incentive Plan of

**ACTIVISION, INC.**

THIS CERTIFIES that on \_\_\_\_\_ (the "Issuance Date") \_\_\_\_\_ (the "Holder") was granted an option (the "Option") to purchase at the option price of \$ \_\_\_\_\_ per share, all or any part of \_\_\_\_\_ fully paid and non-assessable shares ("Shares") of common stock, par value \$.000001 per share, of ACTIVISION, INC., a Delaware corporation (the "Company"), upon and subject to the following terms and conditions:

**a. Terms of the Plan.** The Option is granted pursuant to, and is subject to the terms and conditions of, the Company's 2002 Incentive Plan (the "Plan"), the terms, conditions and definitions of which are hereby incorporated herein as though set forth at length, and the receipt of a copy of which the Holder hereby acknowledges by his signature below. Capitalized terms used herein shall have the meanings set forth in the Plan, unless otherwise defined herein.

[The Company intends that this Option qualify as an "incentive" share option within the meaning of Section 422 of the Internal Revenue Code to the maximum extent permissible under the Internal Revenue Code. To the extent that the Option does not qualify as an incentive share option, the Option or the portion thereof which does not so qualify shall constitute a separate "nonqualified" share option.]

**b. Expiration.** This Option shall expire on [ten (10) years less one day from date of issuance], unless extended or earlier terminated in accordance herewith.

**c. Exercise.** This Option may be exercised or surrendered during the Holder's lifetime only by the Holder or his/her guardian or legal representative. THIS OPTION SHALL NOT BE TRANSFERABLE BY THE HOLDER OTHERWISE THAN BY WILL OR BY THE LAWS OF DESCENT AND DISTRIBUTION, SUBJECT TO THE TERMS AND CONDITIONS OF THE PLAN.

This Option shall vest and be exercisable as follows:

Vesting Date	Shares Vested at Vesting Date	Cumulative Shares Vested at Vesting Date
[vesting schedule]		

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This Option shall be exercised by the Holder (or by her executors, administrators, guardian or legal representative) as to all or part of the Shares, by the giving of written notice of exercise to the Company, specifying the number of Shares to be purchased, accompanied by payment of the full purchase price for the Shares being purchased. Full payment of such purchase price shall be made at the time of exercise and shall be made (i) in cash or by certified check or bank check or wire transfer of immediately available funds, (ii) with the consent of the Company, by tendering previously acquired Shares (valued at its Fair Market Value (as defined in the Plan), as determined by the Company as of the date of tender), or (iii) with the consent of the Company, a combination of (i) and (ii). Such notice of exercise, accompanied by such payment, shall be delivered to the Company at its principal business office or such other office as the Company may from time to time direct, and shall be in such form, containing such further provisions as the Company may from time to time prescribe. In no event may this Option be exercised for a fraction of a Share. The Company shall effect the transfer of Shares purchased pursuant to an Option as soon as practicable, and, within a reasonable time thereafter, such transfer shall be evidenced on the books of the Company. No person exercising this Option shall have any of the rights of a holder of Shares subject to this Option until certificates for such Shares shall have been issued following the exercise of such Option. No adjustment shall be made for cash dividends or other rights for which the record date is prior to the date of such issuance.

(d) Termination of Employment. In the event of the termination of employment or separation from service of the Holder for any reason (other than death or disability as provided below), this Option, to the extent not previously exercised or expired, shall be deemed cancelled and terminated on the day of such termination or separation, unless the Company decides, in its sole discretion, to extend the term of this Option, subject to the terms of the Plan.

(e) Death. In the event the Holder dies while employed by the Company or any of its subsidiaries or affiliates, or during his term as a Director of the Company or any of its subsidiaries or affiliates, as the case may be, this Option, to the extent not previously exercised or expired, shall, to the extent exercisable on the date of death, be exercisable by the estate of the Holder or by any person who acquired this Option by bequest or inheritance, at any time within one year after the death of the Holder, *provided, however*, that if the term of such Option would expire by its terms within six months after the Optionee's death, the term of such Option shall be extended until six months after the Optionee's death, *provided further, however*, that in no instance may the term of the Option, as so extended, exceed the maximum term established pursuant to Sections 3.1(b)(ii) or 10.1 of the Plan.

(f) Disability. In the event of the termination of employment of the Holder or the separation from service of the Holder due to total disability, the Holder, or her guardian or legal representative, shall have the unqualified right to exercise any portion of this Option which has not been previously exercised or expired and which the Holder was eligible to exercise as of the first date of total disability (as determined by the Company), at any time within one year after such termination or separation, *provided, however*, that if the term of such Option would expire by its terms within six months after such termination or separation, the term of such Option shall be extended until six months after such termination or separation, *provided further, however*, that in no instance may the term of the Option, as so extended, exceed the maximum term established pursuant to Section 3.1(b)(ii) or 10.1 of the Plan. The term "total disability" shall, for purposes of this Share Option Agreement, be defined in the same manner as such term is defined in Section 22(e)(3) of the Internal Revenue Code of 1986, as amended.

(g) Change of Control. If the Holder is an active employee of the Company or any of its subsidiaries at the time there occurs a "Change of Control" of the Company (as defined below) and the Holder's employment is terminated by the Company or any of its subsidiaries other than for Cause (as defined below) within twelve (12) months following such Change of Control, or such longer period as the Committee may determine, the portion, if any, of this Option with respect to which the right to exercise

has not yet accrued, shall immediately vest and be exercisable in full, effective upon such termination, for a period of 30 days thereafter, or such longer period as the Committee may determine. For purposes of this Option, a "Change of Control" of the Company shall be deemed to occur if:

(i) there shall have occurred a Change of Control of a nature that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as in effect on the date hereof, whether or not the Company is then subject to such reporting requirement, provided, however, that there shall not be deemed to be a Change of Control of the Company if immediately prior to the occurrence of what would otherwise be a Change of Control of the Company (a) the Holder is the other party to the transaction (a "Control Event") that would otherwise result in a Change of Control of the Company or (b) the Holder is an executive officer, trustee, director or more than 5% equity holder of the other party to the Control Event or of any entity, directly or indirectly, controlling such other party;

(ii) the Company merges or consolidates with, or sells all or substantially all of its assets to, another company (each, a "Transaction"), provided, however, that a Transaction shall not be deemed to result in a Change of Control of the Company if (a) immediately prior thereto the circumstances in (i)(a) or (i)(b) above exist, or (b) (1) the shareholders of the Company, immediately before such Transaction own, directly or indirectly, immediately following such Transaction in excess of fifty percent (50%) of the combined voting power of the outstanding voting securities of the corporation or other entity resulting from such Transaction (the "Surviving Corporation") in substantially the same proportion as their ownership of the voting securities of the Company immediately before such Transaction and (2) the individuals who were members of the Company's Board of Directors immediately prior to the execution of the agreement providing for such Transaction constitute at least a majority of the members of the board of directors or the board of trustees, as the case may be, of the Surviving Corporation, or of a corporation or other entity beneficially directly or indirectly owning a majority of the outstanding voting securities of the Surviving Corporation; or

(iii) the Company acquires assets of another company or a subsidiary of the Company merges or consolidates with another company (each, an "Other Transaction") and (a) the shareholders of the Company, immediately before such Other Transaction own, directly or indirectly, immediately following such Other Transaction 50% or less of the combined voting power of the outstanding voting securities of the corporation or other entity resulting from such Other Transaction (the "Other Surviving Corporation") in substantially the same proportion as their ownership of the voting securities of the Company immediately before such Other Transaction or (b) the individuals who were members of the Company's Board of Directors immediately prior to the execution of the agreement providing for such Other Transaction constitute less than a majority of the members of the board of directors or the board of trustees, as the case may be, of the Other Surviving Corporation, or of a corporation or other entity beneficially directly or indirectly owning a majority of the outstanding voting securities of the Other Surviving Corporation, provided, however, that an Other Transaction shall not be deemed to result in a Change of Control of the Company if immediately prior thereto the circumstances in (i)(a) or (i)(b) above exist.

For purposes of this clause (g), "Cause" shall mean (unless a different definition is used in the Holder's written employment agreement with the Company, if any, in which case such different definition shall apply to the Holder) any of the following:

- (i) material breach by the Holder of his or her employment agreement, if any, or material failure by the Holder to perform his or her duties (other than as a result of incapacity due to physical or mental illness) during his or her employment with the Company after written notice of such breach or failure and the Holder failed to cure such breach or failure to the Company's reasonable satisfaction within five (5) days after receiving such written notice;
- (ii) material breach by the Holder of his or her Employee Proprietary Information Agreement or other similar arrangement entered into by the Holder in connection with his or her employment by the Company; or
- (iii) any act of fraud, misappropriation, misuse, embezzlement or any other material act of dishonesty in respect of the Company or its funds, properties, assets or other employees.

(h) Employment Violation. In consideration of the granting and by acceptance of this Option, the Holder hereby agrees that the terms of this clause (h) shall apply to the Option. The Holder acknowledges and agrees that each exercise of this Option and each written notice of exercise delivered to the Company and executed by the Holder shall serve as a reaffirmation of and continuing agreement by the Holder to comply with the terms contained in this clause (h).

The Company and the Holder acknowledge and agree that if the Holder materially breaches his or her employment agreement (it being understood that any breach of the post-termination obligations contained therein shall be deemed to be material) for so long as the terms of such employment agreement shall apply to the Holder (each an "Employment Violation"), the Company shall have the right to require (i) the termination and cancellation of the unexercised portion of this Option, if any, whether vested or unvested, and (ii) payment by the Holder to the Company of the Recapture Amount (as defined below). The Company and the Holder further agree that such termination of unexercised Options and payment of the Recapture Amount, as the case may be, shall be in addition to, and not in lieu of, any other right or remedy available to the Company arising out of or in connection with any such Employment Violation including, without limitation, the right to terminate the Holder's employment if not already terminated, seek injunctive relief and additional monetary damages.

For purposes of this clause (h), the "Recapture Amount" shall mean the gross gain realized or unrealized by the Holder upon each exercise of this Option during the period beginning on the date which is twelve (12) months prior to the date of the Holder's Employment Violation and ending on the date of computation (the "Look-back Period"), which gain shall be calculated as the sum of:

- (i) if the Holder has exercised any portion of this Option during the Look-back Period and sold any of the Shares acquired on exercise thereafter, an amount equal to the product of (x) the sales price per Share sold minus the exercise price per Share times (y) the number of Shares as to which this Option was exercised and which were sold at such sales price; plus
- (ii) if the Holder has exercised any portion of this Option during the Look-back Period and not sold any of the Shares acquired on exercise thereafter, with respect to each of such Shares an amount equal to the product of (x) the greatest of the following: (1) the Fair Market Value per Share on the date of exercise, (2) the arithmetic average of the per Share closing sales

prices as reported on NASDAQ for the thirty (30) trading day period ending on the trading day immediately preceding the date of the Company's written notice of its exercise of its rights under this clause (h), or (3) the arithmetic average of the per Share closing sales prices as reported on NASDAQ for the thirty (30) trading day period ending on the trading day immediately preceding the date of computation, minus the exercise price per Share times (y) the number of Shares as to which this Option was exercised and which were not sold;

provided, however, in lieu of payment by the Holder to the Company of the Recapture Amount determined pursuant to subclause (ii) above, the Holder, in his or her discretion, may tender to the Company the Shares acquired upon exercise of this Option during the Look-back Period and the Optionee shall not be entitled to receive any consideration from the Company in exchange therefor.

(i) Adjustments. In the event that the Company shall determine that any dividend or other distribution (whether in the form of cash, shares of common stock of the Company, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase, or exchange of shares of common stock of the Company or other securities, the issuance of warrants or other rights to purchase shares of common stock of the Company, or other securities, or other similar corporate transaction or event affects the Shares, such that an adjustment is determined by the Company to be appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available to the Holder, then the Company shall, in such manner as the Company may deem equitable, adjust any or all of (i) the number and type of shares of common stock of the Company subject to this Option, and (ii) the grant or exercise price with respect to this Option, or, if deemed appropriate, make provision for a cash payment to the Holder.

(j) Delivery of Share Certificates. Within a reasonable time after the exercise of this Option, the Company shall cause to be delivered to the person entitled thereto a certificate for the Shares purchased pursuant to the exercise of this Option. If this Option shall have been exercised with respect to less than all of the Shares subject to this Option, the Company shall also cause to be delivered to the person entitled thereto a new Stock Option Agreement in replacement of this Stock Option Agreement if surrendered at the time of the exercise of this Option, indicating the number of Shares with respect to which this Option remains available for exercise, or the Company shall make a notation in its books and records to reflect the partial exercise of this Option.

(k) Withholding. In the event that the Holder elects to exercise this Option or any part thereof, and if the Company or any subsidiary or affiliate of the Company shall be required to withhold any amounts by reasons of any federal, state or local tax laws, rules or regulations in respect of the issuance of Shares to the Holder pursuant to this Option, the Company or such subsidiary or affiliate shall be entitled to deduct and withhold such amounts from any payments to be made to the Holder. In any event, the Holder shall make available to the Company or such subsidiary or affiliate, promptly when requested by the Company or such subsidiary or affiliate, sufficient funds to meet the requirements of such withholding; and the Company or such subsidiary or affiliate shall be entitled to take and authorize such steps as it may deem advisable in order to have such funds available to the Company or such subsidiary or affiliate out of any funds or property due or to become due to the Holder.

(l) Reservation of Shares. The Company hereby agrees that at all times there shall be reserved for issuance and/or delivery upon exercise of this Option such number of Shares as shall be required for issuance or delivery upon exercise hereof.

(m) Rights of Holder. Nothing contained herein shall be construed to confer upon the Holder any right to be continued in the employ of the Company and/or any subsidiary or affiliate of the Company or derogate from any right of the Company and/or any subsidiary or affiliate of the Company to

retire, request the resignation of, or discharge the Holder at any time, with or without cause. The Holder shall not, by virtue hereof, be entitled to any rights of a shareholder in the Company, either at law or in equity, and the rights of the Holder are limited to those expressed herein and are not enforceable against the Company except to the extent set forth herein.

(n) Exclusion from Pension Computations. By acceptance of the grant of this Option, the Holder hereby agrees that any income realized upon the receipt or exercise hereof, or upon the disposition of the Shares received upon its exercise, is special incentive compensations and, to the extent permissible under applicable law, shall not be taken into account as “wages”, “salary” or “compensation” in determining the amount of any payment under any pension, retirement, incentive, profit sharing, bonus or deferred compensation plan of the Company or any of its subsidiaries or affiliates.

(o) Registration; Legend. The Company may postpone the issuance and delivery of Shares upon any exercise of this Option until (a) the admission of such Shares to listing on any stock exchange or exchanges on which Shares of the Company of the same class are then listed and (b) the completion of such registration or other qualification of such Shares under any state or federal law, rule or regulation as the Company shall determine to be necessary or advisable. The Holder shall make such representations and furnish such information as may, in the opinion of counsel for the Company, be appropriate to permit the Company, in light of the then existence or non-existence with respect to such Shares of an effective Registration Statement under the Securities Act of 1933, as amended, to issue the Shares in compliance with the provisions of that or any comparable act.

The Company may cause the following or a similar legend to be set forth on each certificate representing Shares or any other security issued or issuable upon exercise of this Option unless counsel for the Company is of the opinion as to any such certificate that such legend is unnecessary:

THE SECURITIES REPRESENTED BY THIS CERTIFICATE MAY NOT BE OFFERED FOR SALE, SOLD OR OTHERWISE TRANSFERRED EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “ACT”), OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE ACT, THE AVAILABILITY OF WHICH IS ESTABLISHED BY AN OPINION FROM COUNSEL TO THE COMPANY.

(p) Amendment. The Company may at any time or from time to time amend the terms of the Plan, and may, with the consent of the Holder, at any time or from time to time amend the terms and conditions of this Option, *provided, however*, that in no instance may the exercise price of this Option be reduced after the date of grant (except in connection with adjustments pursuant to Section 10.9 of the Plan).

(q) Notices. Any notice which either party hereto may be required or permitted to give to the other shall be in writing, and may be delivered personally or by mail, postage prepaid, or overnight courier, addressed as follows: if to the Company, at its office at 3100 Ocean Park Boulevard, Santa Monica, California 90405, Attn: General Counsel, or at such other address as the Company by notice to the Holder may designate in writing from time to time; and if to the Holder, at the address shown below her signature on this Stock Option Agreement, or at such other address as the Holder by notice to the Company may designate in writing from time to time. Notices shall be effective upon receipt.



(r) Interpretation. A determination of the Committee as to any questions which may arise with respect to the interpretation of the provisions of this Option and of the Plan shall be final and binding. The Committee may authorize and establish such rules, regulations and revisions thereof as it may deem advisable.

IN WITNESS WHEREOF, the parties have executed this Stock Option Agreement as of the date set forth above.

ACTIVISION, INC.

By: \_\_\_\_\_

Name:

Title:

Date: \_\_\_\_\_

Attest: \_\_\_\_\_

ACCEPTED:

\_\_\_\_\_  
Option Holder

\_\_\_\_\_  
Address

\_\_\_\_\_  
City            State    Zip Code

\_\_\_\_\_  
Social Security Number

**ACTIVISION, INC.**

**2003 INCENTIVE PLAN**

ACTIVISION, INC., a corporation formed under the laws of the State of Delaware (the "Company"), hereby establishes and adopts the following 2003 Incentive Plan (the "Plan").

**RECITALS**

WHEREAS, the Company desires to encourage high levels of performance by those individuals who are key to the success of the Company, to attract new individuals who are highly motivated and who will contribute to the success of the Company and to encourage such individuals to remain as directors, officers and/or employees of the Company and its subsidiaries by increasing their proprietary interest in the Company's growth and success.

WHEREAS, to attain these ends, the Company has formulated the Plan embodied herein to authorize the granting of incentive awards through grants of share options ("Options"), grants of share appreciation rights, grants of Share Purchase Awards (hereafter defined), grants of Restricted Share Awards (hereafter defined), grants of Performance-Based Awards (hereafter defined), or any other award made under the Plan to those persons (each such person, a "Participant") whose judgment, initiative and efforts are or have been or will be responsible for the success of the Company.

NOW, THEREFORE, the Company hereby constitutes, establishes and adopts the following Plan and agrees to the following provisions:

**ARTICLE 1.**

**PURPOSE OF THE PLAN**

**1.1. Purpose.** The Purpose of the Plan is to assist the Company and its subsidiaries in attracting and retaining selected individuals to serve as directors, officers, consultants, advisors and other employees of the Company and its subsidiaries who will contribute to the Company's success and to achieve long-term objectives which will inure to the benefit of all shareholders of the Company through the additional incentive inherent in the ownership or increased ownership of the Company's shares of common stock, par value \$.000001 per share ("Shares"). For purposes of the Plan, the term "subsidiary" shall mean "subsidiary corporation," as such term is defined in Section 424(f) of the Internal Revenue Code of 1986, as amended (the "Code"), and "affiliate" shall have the meaning set forth in Rule 12b-2 of the Securities and Exchange Commission ("SEC"), promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). For purposes of the Plan, the term "Award" shall mean a grant of an Option, a grant of a share appreciation right, a grant of a Share Purchase Award, a grant of a Restricted Share Award, or any other award made under the terms of the Plan.

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## ARTICLE 2.

### SHARES SUBJECT TO AWARDS

**2.1.** *Number of Shares.* Subject to the adjustment provisions of Section 8.6 hereof, the aggregate number of Shares which may be issued under Awards under the Plan shall not exceed [9,000,000]. No Options to purchase fractional Shares shall be granted or issued under the Plan. For purposes of this Section 2.1, the Shares that shall be counted toward such limitation shall include all Shares issued or issuable under any Award granted under the terms of the Plan.

**2.2.** *Shares Subject to Terminated Awards.* The Shares covered by any unexercised portions of terminated Options, Shares forfeited as provided in Section 6.1(a) and Shares subject to any Awards which are otherwise surrendered by the Participant without receiving any payment or other benefit with respect thereto may again be subject to new Awards under the Plan, other than grants of Options intended to qualify as incentive share options. In the event the purchase price of an Option is paid in whole or in part through the delivery of Shares, the number of Shares issuable in connection with the exercise of the Option shall not again be available for the grant of Awards under the Plan. Shares subject to Options, or portions thereof, which have been surrendered in connection with the exercise of a Related SAR (as defined in Article 5, below) shall not again be available for the grant of Awards under the Plan.

**2.3.** *Character of Shares.* Shares delivered under the Plan may be authorized and unissued Shares or Shares acquired by the Company, or both.

**2.4.** *Limitations on Grants to Individual Participant.* Subject to adjustments pursuant to the provisions of Section 8.6 hereof, the maximum number of Shares with respect to which Options or share appreciation rights may be granted hereunder to any employee during any fiscal year of the Company shall be [750,000] Shares (the "Limitation"). If an Option is cancelled, the cancelled Option shall continue to be counted toward the Limitation for the fiscal year in which it was granted. An Option (or a share appreciation right) that is repriced during any fiscal year is treated as the cancellation of the Option (or share appreciation right) and a grant of a new Option (or share appreciation right) for purposes of the Limitation for that fiscal year.

## ARTICLE 3.

### ELIGIBILITY AND ADMINISTRATION

**3.1.** *Awards to Employees, Directors and Others.* Participants who receive (i) Options under Article 4 hereof or share appreciation rights under Article 5 ("Optionees"), and (ii) any other Awards granted under the Plan shall consist of such officers, employees, consultants, advisors, and directors ("Directors") of the Company or any of its subsidiaries or affiliates as the Committee (as defined in Section 3.2 below) shall select from time to time in its sole and absolute discretion.

**3.2.** *Administration.* (a) The Plan shall be administered by a committee or committees (the "Committee") consisting of not fewer than two Directors as designated by the Directors. The Directors may remove from, add members to, or fill vacancies in the Committee. In

determining the composition of any committee or subcommittee, the Directors or the Committee, as the case may be, shall consider the desirability of compliance with the compositional requirements of (i) Rule 16b-3 of the SEC with respect to award holders who are subject to the trading restrictions of Section 16(b) of the Exchange Act with respect to securities of the Company and (ii) Section 162(m) of the Code, but shall not be bound by such compliance.

Notwithstanding any other provision of this Plan, any Award to a member of the Committee must be approved by the Board of Directors of the Company (excluding Directors who are also members of the Committee) to be effective.

(c) The Committee is authorized, subject to the provisions of the Plan, to establish such rules and regulations as it may deem appropriate for the conduct of meetings and proper administration of the Plan. All actions of the Committee shall be taken by majority vote of its members.

(d) Subject to the provisions of the Plan, the Committee shall have authority, in its sole discretion, to grant Awards under the Plan, to determine the amount and/or number of Shares subject to an Award, to determine the terms of such Award (which terms need not be identical), to interpret the provisions of the Plan and, subject to the requirements of applicable law, to prescribe, amend, and rescind rules and regulations relating to the Plan or any Award thereunder as it may deem necessary or advisable. All decisions made by the Committee pursuant to the provisions of the Plan shall be final, conclusive and binding on all persons, including the Company, its shareholders, Directors and employees, and other Plan participants.

#### ARTICLE 4.

##### OPTIONS

4.1. *Grant of Options.* The Committee shall determine, within the limitations of the Plan, those Participants to whom Options are to be granted under the Plan, the number of Shares that may be purchased under each such Option and the option price, the time or times at which Options are exercisable, and all other terms of the Options, and shall designate such Options at the time of the grant as either incentive share options (“ISOs”) that satisfy the requirements of Section 422 of the Code or nonqualified share options (“NQOs”) not intended to satisfy those requirements; *provided, however,* that Options granted to employees of an affiliate (that is not also a subsidiary) or to non-employees of the Company may only be NQOs.

4.2. *Share Option Agreements; etc.* All Options granted pursuant to this Article 4 (a) shall be authorized by the Committee and (b) shall be evidenced in writing by share option agreements (“Share Option Agreements”) in such form and containing such terms and conditions as the Committee shall determine that are not inconsistent with the provisions of the Plan, and, with respect to any Share Option Agreement granting Options that are intended to qualify as ISOs, are not inconsistent with Section 422 of the Code. Granting of an Option pursuant to the Plan shall impose no obligation on the recipient to exercise such Option. To the extent that any Option does not qualify as an ISO (whether because of its provisions, the time or manner of its exercise or otherwise) such Option or the portion thereof which does not so qualify shall constitute a separate NQO.

**4.3. Option Price.** Except as otherwise provided herein, and subject to Section 4.5, the option exercise price per each Share purchasable under any Option for all (i) ISOs, (ii) NQOs that are Performance-Based Awards (as defined in Article 9, below) and (iii) Options granted under Section 4.4, below shall not be less than 100% of the Fair Market Value of such Share on the date of the grant of such Option. Except as otherwise provided herein, the Option exercise price per share of each Share purchasable under any NQO that is not intended to be performance-based under Section 162(m) of the Code shall be determined by the Committee at the time of the grant of such Option.

**4.4. Reload Options.** An Option may provide, subject to such terms as the Committee shall authorize, that upon the exercise of the Option, the holder will automatically be granted a new Option covering that number of Shares equal to (i) the number of Shares delivered to the Company by the holder, or withheld from Shares otherwise issuable to the holder upon exercise, in payment of the exercise price of the Option or the tax withholding obligations attributable thereto and/or (ii) that number of Shares with a then Fair Market Value equal to the amount of the withholding obligations paid in cash by the holder.

**4.5. Incentive Options.** Options granted under the Plan that are intended to be ISOs will be subject to the following additional terms:

(a) **Dollar limit.** To the extent that the aggregate Fair Market Value (determined as of the respective date or dates of grant) of Shares with respect to which Options that would otherwise be ISOs are exercisable for the first time by an individual during any calendar year under the Plan (and any other plan of the Company, a parent or subsidiary corporation or predecessor thereof) exceeds the sum of \$100,000 (or other amount allowed under Section 422 of the Code or the regulations promulgated thereunder), whether by reason of acceleration or otherwise, those Options will not be treated as ISOs. In making this determination, Options will be taken into account in the order in which they were granted.

(b) **10% Shareholder.** If any employee to whom an ISO is to be granted is, on the date of grant, the owner of Shares (determined using the attribution rules of Section 424(d) of the Code) possessing more than 10% of the total combined voting power of all classes of stock of his or her employer corporation or of its parent or subsidiary, then the following special provisions will apply to the option granted to that employee:

(i) The Option price per Share of the stock subject to that ISO will not be less than 110% of the Fair Market Value of the Option Shares on the date of grant; and

(ii) The Option will not have a term in excess of 5 years from the date of grant.

(c) **Term.** In no event will an ISO be exercisable after the expiration of 10 years from the date of grant of such Option.

(d) **Employees.** The class of employees eligible to receive ISOs is all employees of the Company or a parent or subsidiary. ISOs may only be granted to employees of the Company or a parent or subsidiary. For purposes of this Plan, "parent" has the meaning attributed to such term for purposes of Section 422(b) of the Code.

(e) Transferability. An ISO is not transferable by the employee to whom it is granted, other than by will or the laws of descent and distribution, and is exercisable, during his lifetime, only by such employee.

4.6. *Other Provisions*. Options granted pursuant to this Article 4 shall be made in accordance with the terms and provisions of Article 8 hereof and any other applicable terms and provisions of the Plan.

## ARTICLE 5.

### SHARE APPRECIATION RIGHTS

5.1. *Grant and Exercise*. The Committee may provide share appreciation rights (i) in conjunction with all or part of any Option granted under the Plan or at any subsequent time during the term of such Option (a "Related SAR") or (ii) without regard to any Option or other Award (a "Freestanding SAR"; Related SARs and Freestanding SARs are referred to collectively herein as "share appreciation rights"), in each case upon such terms and conditions as the Committee may establish, subject to Section 5.3, below, including the right to receive up to, but no more than, an amount in cash or Shares (or part cash, part Shares) as determined by the Committee in its sole discretion.

5.2. Upon the exercise of a Related SAR, the Option or part thereof to which such Related SAR is related shall be deemed to have been exercised for the purpose of the limitation of the number of Shares to be issued under the Plan, as set forth in Section 2.1 of the Plan.

5.3. With respect to a Related SAR granted in connection with an Option that is intended to be an ISO, the following shall apply:

(a) Such Related SAR shall be granted only at the time of the grant of such ISO.

(b) No Related SAR shall be transferable by a Holder otherwise than by will or by the laws of descent and distribution, and such Related SAR shall be exercisable, during the Holder's lifetime, only by the Holder.

(c) A Related SAR granted in connection with an Option may be exercised only when the Fair Market Value of the Shares subject to the Option exceeds the option exercise price at which Shares can be acquired pursuant to the Option.

(d) The right to receive up to, but no more than, an amount in cash or Shares (or part cash, part Shares) with respect to such Related SAR may not exceed the excess of the then Fair Market Value of one Share over the Option exercise price per Share specified in the related Option multiplied by the number of Shares into which the Related SAR is exercisable.

## ARTICLE 6.

### RESTRICTED SHARES AND RESTRICTED SHARE UNITS

**6.1. Restricted Share Awards. (a) Grant.** The Committee may grant to any Participant (i) Shares (together with cash dividend equivalents if so determined by the Committee) (such Shares, “Restricted Shares”) and/or units which represent a conditional right to receive Shares, cash or a combination of Shares and cash in the future (such units, “Restricted Share Units”) in such amount and manner, and subject to such terms and conditions relating to vesting, forfeitability and restrictions on delivery and transfer (whether based on performance standards, periods of service or otherwise) as the Committee shall establish. A grant of Restricted Shares and/or Restricted Share Units made pursuant to this Article 6 is referred to as a “Restricted Share Award.” The terms of any Restricted Share Award granted under this Plan shall be set forth in a written agreement (a “Restricted Share Agreement”) which shall contain provisions determined by the Committee and not inconsistent with this Plan. The provisions of Restricted Share Awards need not be the same for each Participant receiving such Awards. The Committee has absolute discretion to determine whether any consideration (other than services) is to be received by the Company or its affiliates as a condition precedent to the issuance of restricted stock.

**(b) Rights of Holders of Restricted Shares.** Beginning on the date of grant of the Restricted Shares and subject to execution of the Restricted Share Agreement, the Participant shall become a shareholder of the Company with respect to all Shares subject to the Restricted Share Agreement and shall have all of the rights of a shareholder, including, but not limited to, the right to vote such Shares and the right to receive distributions made with respect to such Shares; *provided, however*, that any Shares or any other property (other than cash) distributed as a dividend or otherwise with respect to any Restricted Shares as to which the restrictions have not yet lapsed shall be subject to the same restrictions as such Restricted Shares.

**(c) Rights of Holders of Restricted Share Units.** Unless the Committee otherwise provides in a Restricted Share Agreement, any Participant holding Restricted Share Units shall have no rights as a shareholder of the Company with respect to such Restricted Share Units. The Committee may provide in the Restricted Share Agreement evidencing a grant of Restricted Share Units that the Participant holding such Restricted Share Units shall be credited with additional Restricted Share Units on account of any dividends paid after the date of the Restricted Share Agreement and prior to delivery of Shares or cash pursuant to such Restricted Share Agreement, in a manner determined by the Committee in its sole discretion.

**(d) Waiver of Forfeiture Period.** Notwithstanding anything contained in this Article 6 to the contrary, the Committee may, in its sole discretion and subject to the limitations imposed under Section 162(m) of the Code and the Treasury Regulations thereunder in the case of a Restricted Share Award intended to comply with the performance-based exception under Code Section 162(m), waive the forfeiture period and any other conditions set forth in any Restricted Share Agreement under appropriate circumstances (including the death, disability or retirement of the Participant or a material change in circumstances arising after the date of an Award) and subject to such terms and conditions (including forfeiture of a proportionate number of the Restricted Share and/or Restricted Share Units) as the Committee shall deem appropriate.



## ARTICLE 7.

### DEFERRED SHARE AWARDS

**7.1. Shares and Administration.** (a) Awards of the right to receive Shares that are not to be distributed to the Participant until after a specified deferral period (such Award and the deferred Shares delivered thereunder hereinafter as the context shall require, the “Deferred Shares”) may be made on such terms, conditions and restrictions as the Committee shall determine, including the time or times at which Deferred Shares shall be awarded, the number of Deferred Shares to be awarded to any Participant, and the duration of the period (the “Deferral Period”) during which, and the conditions under which, receipt of the Shares will be deferred.

(b) Prior to completion of the Deferral Period, a Participant may elect to further defer receipt of the Award for a specified period or until a specified event (the “Elective Deferral Period”), subject in each case to the approval of the Committee and under such terms as are determined by the Committee, all in its sole discretion.

(c) Each Award shall be confirmed by a Deferred Share agreement or other instrument executed by the Company and the Participant.

(d) In the event of the Participant’s death or permanent disability during the Deferral Period (or Elective Deferral Period, where applicable), or in cases of special circumstances, the Committee may, in its sole discretion, when it finds that a waiver would be in the best interests of the Company, waive in whole or in part any or all of the remaining deferral limitations imposed hereunder with respect to any or all of the Participant’s Deferred Shares.

## ARTICLE 8.

### GENERALLY APPLICABLE PROVISIONS

**8.1. Fair Market Value.** The “Fair Market Value” of a Share shall be determined in good faith by the Committee in its sole discretion from time to time. In no case shall Fair Market Value be less than the par value of a Share. An Option shall be considered granted on the date the Committee acts to grant the Option or such later date as the Committee shall specify.

**8.2. Exercise of Options.** Vested Options granted under the Plan shall be exercised by the Optionee or by a Permitted Assignee thereof (or by his or her executors, administrators, guardian or legal representative, as provided in Sections 9.5 and 9.6 hereof) as to all or part of the Shares covered thereby, by the giving of written notice of exercise to the Company, specifying the number of Shares to be purchased, accompanied by payment of the full purchase price for the Shares being purchased. Full payment of such purchase price shall be made at the time of exercise and shall be made (i) in cash or by certified check or bank check or wire transfer of immediately available funds, (ii) with the consent of the Committee, by tendering previously acquired Shares (valued at their then Fair Market Value, as determined by the Committee as of the date of tender) that have been owned for a period of at least six months (or such other period to avoid accounting charges against the Company’s earnings), (iii) if Shares are traded on a national securities exchange, the Nasdaq Stock Market, Inc., or quoted on a national quotation

system sponsored by the National Association of Securities Dealers, Inc., and the Committee authorizes this method of exercise, through the delivery of irrevocable instructions to a broker approved by the Committee to deliver promptly to the Company an amount equal to the purchase price, or (iv) through any other method specified in the Share Option Agreement, or with the consent of the Committee, any combination of (i), (ii), and (iii). In connection with a tender of previously acquired Shares pursuant to clause (ii) above, the Committee, in its sole discretion, may permit the Optionee to constructively exchange Shares already owned by the Optionee in lieu of actually tendering such Shares to the Company, provided that adequate documentation concerning the ownership of the Shares to be constructively tendered is furnished in form satisfactory to the Committee. The notice of exercise, accompanied by such payment, shall be delivered to the Company at its principal business office or such other office as the Committee may from time to time direct, and shall be in such form, containing such further provisions consistent with the provisions of the Plan, as the Committee may from time to time prescribe. In no event may any Option granted hereunder be exercised for a fraction of a Share. No person exercising an Option shall have any of the rights of a holder of Shares subject to an Option until certificates for such Shares shall have been issued following the exercise of such Option. No adjustment shall be made for cash dividends or other rights for which the record date is prior to the date of such issuance.

**8.3. Transferability.** Except as provided below, and except as otherwise authorized by the Committee in a Share Option Agreement with respect to an Optionee, no Option shall be assignable or transferable by the Optionee, other than by will or the laws of descent and distribution, and such Option may be exercised during the life of the Optionee only by the Optionee or his guardian or legal representative. NQOs and any Related SARs granted in tandem therewith are transferable (together and not separately) with the consent of the Committee by the Optionee or holder of such Related SAR ("Holder"), as the case may be, to any one or more of the following persons (each, a "Permitted Assignee"): (i) the spouse, parent, issue, spouse of issue, or issue of spouse ("issue" shall include all descendants whether natural or adopted) of such Optionee or Holder, as the case may be; (ii) a trust for the benefit of one or more of those persons described in clause (i) above or for the benefit of such Optionee or Holder, as the case may be; (iii) an entity in which the Optionee or Holder or any Permitted Assignee thereof is a beneficial owner; or (iv) in the case of a transfer by an Optionee who is a non-employee director, another non-employee director of the Company; provided that such Permitted Assignee shall be bound by and subject to all of the terms and conditions of this Plan and the Share Option Agreement relating to the transferred Option and shall execute an agreement satisfactory to the Company evidencing such obligations; and provided further that such Optionee or Holder shall remain bound by the terms and conditions of this Plan. In the case of a transfer by a non-employee director to another non-employee director, the vesting and exercisability shall after such transfer be determined by reference to the service of the assignee, rather than the assignor. The Company shall cooperate with any Permitted Assignee and the Company's transfer agent in effectuating any transfer permitted under this Section 8.3.

**8.4. Termination of Employment.** The Committee will determine and set forth in each Share Option Agreement whether the Options granted in such Share Option Agreement will continue to be exercisable, and the terms of such exercise, on and after the date that an Optionee ceases to be employed by or to provide services to the Company or an affiliate, whether by reason of death, disability, voluntary or involuntary termination of employment or services, or

otherwise. The date of termination of an Optionee's employment or services will be determined by the Committee, which determination will be final.

**8.5. *Amendment and Modification of the Plan.*** The Committee may, from time to time, alter, amend, suspend or terminate the Plan as it shall deem advisable, subject to any requirement for shareholder approval imposed by applicable law or any rule of any stock exchange or quotation system on which Shares are listed or quoted; provided that the Committee may not amend the Plan, without the approval of the Company's shareholders, to increase the number of Shares that may be the subject of Options under the Plan (except for adjustments pursuant to Section 8.6 hereof). In addition, no amendments to, or termination of, the Plan shall in any way impair the rights of an Optionee or a Participant (or a Permitted Assignee thereof) under any Award previously granted without such Optionee's or Participant's consent.

**8.6. *Adjustments.*** In the event that the Committee shall determine that any dividend or other distribution (whether in the form of cash, Shares, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase, or exchange of Shares or other securities, the issuance of warrants or other rights to purchase Shares or other securities, or other similar corporate transaction or event affects the Shares with respect to which Awards have been or may be issued under the Plan, such that an adjustment is determined in good faith by the Committee to be appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan, then the Committee shall, in such manner as the Committee may deem equitable, adjust any or all of (i) the number and type of Shares that thereafter may be made the subject of Awards, (ii) the number and type of Shares subject to outstanding Awards, and (iii) the grant or exercise price with respect to any Award, or, if deemed appropriate, make provision for a cash payment to the holder of any outstanding Award; provided, in each case, that with respect to ISOs, no such adjustment shall be authorized to the extent that such adjustment would cause such options to violate Section 422(b) of the Code or any successor provision; and provided further, that the number of Shares subject to any Award denominated in Shares shall always be a whole number. In the event of any reorganization, merger, consolidation, split-up, spin-off, or other business combination involving the Company (collectively, a "Reorganization"), the Committee or the Board of Directors of the Company may cause any Award outstanding as of the effective date of the Reorganization to be cancelled in consideration of a cash payment or alternate Award (whether from the Company or another entity that is a party to the Reorganization) or a combination thereof made to the holder of such cancelled Award substantially equivalent in value to the fair market value of such cancelled Award. The determination of fair market value shall be made by the Committee or the Board of Directors, as the case may be, in their sole discretion.

**8.7. *Change of Control.*** The terms of any Award may provide in the Share Option Agreement, Restricted Share Agreement, or other document evidencing the Award, that upon a "Change of Control" of the Company (as that term may be defined therein), (i) Options (and share appreciation rights) immediately vest and become fully exercisable, (ii) restrictions on Restricted Shares lapse and the shares become fully vested, and (iii) such other additional benefits as the Committee deems appropriate shall apply, subject in each case to any terms and conditions contained in the applicable document evidencing such Award. For purposes of this Plan, a "Change of Control" shall mean an event described in the applicable document

evidencing the Award or such other event as determined in the sole discretion of the Board of Directors of the Company. The Committee, in its discretion, may determine that, upon the occurrence of a Change of Control of the Company, each Option and share appreciation right outstanding hereunder shall terminate within a specified number of days after notice to the Participant or Holder, and such Participant or Holder shall receive, with respect to each Share subject to such Option or share appreciation right, an amount equal to the excess of the Fair Market Value of such Share immediately prior to the occurrence of such Change of Control over the exercise price per share of such Option or share appreciation right; such amount to be payable in cash, in one or more kinds of property (including the property, if any, payable in the transaction) or in a combination thereof, as the Committee, in its discretion, shall determine.

**8.8. Employment Violation.** Each Share Option Agreement evidencing an Option granted hereunder shall include and be subject to the following terms:

(a) The terms of this Section 8.8 shall apply to the Option if the Optionee is or shall become subject to an employment agreement with the Company.

(b) If the Optionee materially breaches his or her employment agreement (it being understood that any breach of the post-termination obligations contained therein shall be deemed to be material) for so long as the terms of such employment agreement shall apply to the Optionee (each an "Employment Violation"), the Company shall have the right to require (i) the termination and cancellation of the unexercised portion of the Option, if any, whether vested or unvested, and (ii) payment by the Optionee to the Company of the Recapture Amount (as defined below). Such termination of unexercised Options and payment of the Recapture Amount, as the case may be, shall be in addition to, and not in lieu of, any other right or remedy available to the Company arising out of or in connection with any such Employment Violation including, without limitation, the right to terminate Optionee's employment if not already terminated, seek injunctive relief and additional monetary damages.

(c) "Recapture Amount" shall mean the gross gain realized or unrealized by the Optionee upon each exercise of his Option during the period beginning on the date which is twelve (12) months prior to the date of the Optionee's Employment Violation and ending on the date of computation (the "Look-back Period"), which gain shall be calculated as the sum of:

(i) if the Optionee has exercised any portion of his Option during the Look-back Period and sold any of the Shares acquired on exercise thereafter, an amount equal to the product of (x) the sales price per Share sold minus the exercise price per Share times (y) the number of Shares as to which the Option was exercised and which were sold at such sales price; plus

(ii) if the Optionee has exercised any portion of his Option during the Look-back Period and not sold any of the Shares acquired on exercise thereafter, with respect to each of such Shares an amount equal to the product of (x) the greatest of the following: (1) the Fair Market Value per Share on the date of exercise, (2) the arithmetic average of the per Share closing sales prices as reported on NASDAQ for the thirty (30) trading day period ending on the trading day immediately preceding the date of the Company's written notice of its exercise of its rights under this Section 8.8, or (3) the

arithmetic average of the per Share closing sales prices as reported on NASDAQ for the thirty (30) trading day period ending on the trading day immediately preceding the date of computation, minus the exercise price per Share times (y) the number of Shares as to which this Option was exercised and which were not sold;

provided, however, in lieu of payment by the Optionee to the Company of the Recapture Amount determined pursuant to subclause (ii) above, the Optionee, in his or her discretion, may tender to the Company the Shares acquired upon exercise of this Option during the Look-back Period and the Optionee shall not be entitled to receive any consideration from the Company in exchange therefor.

With respect to any other Awards granted hereunder, the terms of any Restricted Share Agreement, share appreciation right, Share Purchase Award or any other document evidencing an Award under the Plan, may include comparable provisions to those set forth in this Section 8.8.

**8.9. Other Provisions.** (a) Nothing contained in this Plan shall prevent the Board of Directors from adopting other or additional compensation arrangements, subject to shareholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases.

(b) A Participant shall have no right as a shareholder until he or she becomes the holder of record.

(c) The Committee's designation of an Optionee or Participant in any year shall not require the Committee to designate such person to receive Awards or grants in any other year. The designation of an Optionee or Participant to receive Awards or grants under one portion of the Plan shall not require the Committee to include such Optionee or Participant under other portions of the Plan.

**8.10. Terms of Option Grant.** Notwithstanding anything in this Plan to the contrary, the Committee may grant an Option under such terms and conditions as may be provided in the Share Option Agreement given to the Optionee and the Committee has the discretion to modify the terms and conditions of an Option after grant as long as the rights of the Optionee are not impaired unless the Optionee otherwise consents, *provided, however*, that in no instance may the term of an ISO exceed the maximum term established pursuant to Section 4.5 above.

**8.11. Repricing of Options and Share Appreciation Rights.** Except as provided in Section 8.6 above, the exercise price of an Option or share appreciation right granted hereunder may not be reduced after such Option or share appreciation right has been granted to a Participant.

## ARTICLE 9.

### PERFORMANCE-BASED AWARDS

**9.1. General.** (a) Certain Awards granted under the Plan may be granted in a manner such that the Awards qualify as "performance-based compensation" (as such term is used in

Section 162(m) of the Code and the regulations thereunder) and thus be exempt from the deduction limitation imposed by Section 162(m) of the Code (“Performance-Based Awards”). Awards shall only qualify as Performance-Based Awards if, among other things, at the time of grant the Committee is comprised solely of two or more “outside directors” (as such term is used in Section 162(m) of the Code and the regulations thereunder).

(b) Performance-Based Awards may be granted to Participants who are executive officers or key employees of the Company or a parent or subsidiary (“Key Employees”) at any time and from time to time, as shall be determined by the Committee. The Committee shall have complete discretion in determining the number, amount and timing of awards granted to each Key Employee. Such Performance-Based Awards may take the form of, without limitation, cash, Shares or any combination thereof.

(c) The Committee shall set performance goals at its discretion which, depending on the extent to which they are met, will determine the number and/or value of such Performance-Based Awards that will be paid out to the Key Employees, and may attach to such Performance-Based Awards one or more restrictions. The maximum amount of Performance-Based Awards (other than Options or share appreciation rights) to be awarded to any Key Employee during any fiscal year of the Company shall be \$[1,000,000]. The maximum amount of Performance-Based Awards that are Options or share appreciation rights that may be awarded to any Key Employee during any fiscal year of the Company is Options or share appreciation rights covering up to [750,000] Shares.

9.2. *Other Awards.* Either the granting or vesting of Performance-Based Awards (other than Options or share appreciation rights) granted under the Plan shall be subject to the achievement of a performance target or targets, as determined by the Committee in its sole discretion, based on one or more of the performance measures specified in Section 9.3 below. With respect to such Performance-Based Awards:

(1) the Committee shall establish in writing (x) the objective performance-based goals applicable to a given period and (y) the individual Key Employees or class of Key Employees to which such performance-based goals apply no later than 90 days after the commencement of such period (but in no event after 25 percent of such period has elapsed);

(2) no Performance-Based Awards shall be payable to or vest with respect to, as the case may be, any Key Employee for a given period until the Committee certifies in writing that the objective performance goals (and any other material terms) applicable to such period have been satisfied; and

(3) after the establishment of a performance goal, the Committee shall not revise such performance goal or increase the amount of compensation payable thereunder (as determined in accordance with Section 162(m) of the Code) upon the attainment of such performance goal.

9.3. *Performance Measures.* The Committee may use the following performance measures (either individually or in any combination) to set performance targets with respect to

Awards intended to qualify as Performance-Based Awards: net sales; pretax income before allocation of corporate overhead and bonus; budget; earnings per share; net income; division, group or corporate financial goals; return on stockholders' equity; return on assets; attainment of strategic and operational initiatives; appreciation in and/or maintenance of the price of the common stock or any other publicly-traded securities of the Company; market share; gross profits; earnings before taxes; earnings before interest and taxes; earnings before interest, taxes, depreciation and amortization; economic value-added models; comparisons with various stock market indices; and/or reductions in costs.

## ARTICLE 10.

### MISCELLANEOUS

**10.1. Tax Withholding.** The Company shall have the right to make all payments or distributions pursuant to the Plan to an Optionee or Participant (or a Permitted Assignee thereof) (any such person, a "Payee") net of any applicable Federal, State and local taxes required to be paid as a result of (i) the grant of any Award, (ii) the exercise of an Option or share appreciation rights, (iii) the delivery of shares or cash, or lapse of any restrictions, in connection with Restricted Share Awards or (iv) any other event occurring pursuant to this Plan. The Company or any subsidiary or affiliate thereof shall have the right to withhold from wages or other amounts otherwise payable to such Payee such withholding taxes as may be required by law, or to otherwise require the Payee to pay such withholding taxes. If the Payee shall fail to make such tax payments as are required, the Company or its subsidiaries or affiliates shall, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to such Payee or to take such other action as may be necessary to satisfy such withholding obligations. In satisfaction of the requirement to pay withholding taxes, the Payee may make a written election, which may be accepted or rejected in the discretion of the Committee, to have withheld a portion of the Shares then issuable to the Payee pursuant to the Plan having an aggregate Fair Market Value equal to the withholding taxes.

**10.2. Right of Discharge Reserved.** Nothing in the Plan nor the grant of an Award hereunder shall confer upon any employee, Director or other individual the right to continue in the employment or service of the Company or any subsidiary or affiliate of the Company or affect any right that the Company or any subsidiary or affiliate of the Company may have to terminate the employment or service of (or to demote or to exclude from future Options under the Plan) any such employee, Director or other individual at any time for any reason. Except as specifically provided by the Committee, the Company shall not be liable for the loss of existing or potential profit with respect to an Award in the event of termination of an employment or other relationship even if the termination is in violation of an obligation of the Company or any subsidiary or affiliate of the Company to the employee, Director, advisor or consultant.

**10.3. Nature of Payments.** All Awards made pursuant to the Plan are in consideration of services performed or to be performed for the Company or any subsidiary or affiliate of the Company. Any income or gain realized pursuant to Awards under the Plan and any share appreciation rights constitutes a special incentive payment to the Optionee, Participant or Holder and shall not be taken into account, to the extent permissible under applicable law, as compensation for purposes of any of the employee benefit plans of the Company or any

subsidiary or affiliate of the Company except as may be determined by the Committee or by the Directors or directors of the applicable subsidiary or affiliate of the Company.

**10.4. *Unfunded Status of the Plan.*** The Plan is intended to constitute an “unfunded” plan for incentive and deferred compensation. With respect to any payments not yet made to a Participant or Optionee by the Company, nothing contained herein shall give any such Participant or Optionee any rights that are greater than those of a general creditor of the Company. In its sole discretion, the Committee may authorize the creation of trusts or other arrangements to meet the obligations created under the Plan to deliver the Shares or payments in lieu of or with respect to Awards hereunder; provided, however, that the existence of such trusts or other arrangements is consistent with the unfunded status of the Plan.

**10.5. *Severability.*** If any provision of the Plan shall be held unlawful or otherwise invalid or unenforceable in whole or in part, such unlawfulness, invalidity or unenforceability shall not affect any other provision of the Plan or part thereof, each of which remain in full force and effect. If the making of any payment or the provision of any other benefit required under the Plan shall be held unlawful or otherwise invalid or unenforceable, such unlawfulness, invalidity or unenforceability shall not prevent any other payment or benefit from being made or provided under the Plan, and if the making of any payment in full or the provision of any other benefit required under the Plan in full would be unlawful or otherwise invalid or unenforceable, then such unlawfulness, invalidity or unenforceability shall not prevent such payment or benefit from being made or provided in part, to the extent that it would not be unlawful, invalid or unenforceable, and the maximum payment or benefit that would not be unlawful, invalid or unenforceable shall be made or provided under the Plan.

**10.6. *Gender and Number.*** In order to shorten and to improve the understandability of the Plan document by eliminating the repeated usage of such phrases as “his or her,” any masculine terminology herein shall also include the feminine, and the definition of any term herein in the singular shall also include the plural except when otherwise indicated by the context.

**10.7. *Governing Law.*** The Plan and all determinations made and actions taken thereunder, to the extent not otherwise governed by the Code or the laws of the United States, shall be governed by the laws of the State of Delaware and construed accordingly.

**10.8. *Effective Date of Plan; Termination of Plan.*** The Plan shall be effective on the date of the approval of the Plan by the Board of Directors. Notwithstanding the foregoing, no Option intended to qualify as an ISO shall be granted hereunder until the Plan shall be approved by the holders of a majority of the shares entitled to vote thereon, provided such approval is obtained within 12 months after the date of adoption of the Plan by the Board of Directors. Awards may be granted under the Plan at any time and from time to time prior to April 28, 2013, on which date the Plan will expire except as to Awards then outstanding under the Plan. Such outstanding Awards shall remain in effect until they have been exercised or terminated, or have expired.



**10.9. Captions.** The captions in this Plan are for convenience of reference only, and are not intended to narrow, limit or affect the substance or interpretation of the provisions contained herein.

**10.10. Dissolution or Liquidation.** In the event of the proposed dissolution or liquidation of the Company, the Committee shall notify each Optionee and Participant as soon as practicable prior to the effective date of such proposed transaction. The Committee in its sole discretion may permit an Optionee to exercise an Option until ten days prior to such transaction with respect to all vested and exercisable Shares covered thereby and with respect to such number of unvested Shares as the Committee shall determine. In addition, the Committee may provide that any forfeiture provision or Company repurchase option applicable to any Restricted Share Award shall lapse as to such number of Shares as the Committee shall determine, contingent upon the occurrence of the proposed dissolution or liquidation at the time and in the manner contemplated. To the extent an Option has not been previously exercised, the Option shall terminate automatically immediately prior to the consummation of the proposed action. To the extent a forfeiture provision applicable to a Restricted Share Award has not been waived by the Committee, the related Restricted Share Award shall be forfeited automatically immediately prior to the consummation of the proposed action.

**10.11. Successors and Assigns.** This Plan shall be binding upon and inure to the benefit of the respective successors and permitted assigns of the Company, Optionees and Participants.

**CERTIFICATION**

I, Robert A. Kotick, 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 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 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-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2003

*/s/ Robert A. Kotick*  
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Robert A. Kotick  
Chief Executive Officer

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**CERTIFICATION**

I, Ronald Doornink, 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 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 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-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2003

*/s/ Ronald Doornink*  
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Ronald Doornink  
President, Activision, Inc. and  
Chief Executive Officer,  
Activision Publishing, Inc.

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**CERTIFICATION**

I, William J. Chardavoyne, 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 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 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-15(e) and 15d-15(e)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2003

/s/ William J. Chardavoyne  
William J. Chardavoyne  
Executive Vice President and  
Chief Financial Officer

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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**

In connection with the quarterly report of Activision, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2003 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  
Chief Executive Officer,  
August 4, 2003

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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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**

In connection with the quarterly report of Activision, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2003 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 Doomink  
Ronald Doomink  
President, Activision, Inc.  
Chief Executive Officer,  
Activision Publishing, Inc.  
August 4, 2003

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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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**

In connection with the quarterly report of Activision, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William J. Chardavoyne, Executive Vice President and 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  
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William J. Chardavoyne  
Executive Vice President and  
Chief Financial Officer,  
August 4, 2003

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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