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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 December 31, 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 February 6, 2004 was 90,026,834.

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ACTIVISION, INC. AND SUBSIDIARIES

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**Item 1. Financial Statements.**

**ACTIVISION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share data)

	<u>December 31,</u> <u>2003</u>	<u>March 31,</u> <u>2003</u>
	<u>(Unaudited)</u>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 425,424	\$ 285,554
Short-term investments	126,253	121,400
Accounts receivable, net of allowances of \$68,944 and \$57,356 at December 31, 2003 and March 31, 2003, respectively	241,929	15,822
Inventories	35,506	19,577
Software development	43,469	26,791
Intellectual property licenses	26,614	8,906
Deferred income taxes	36,170	38,290
Other current assets	14,217	10,565
<b>Total current assets</b>	<b>949,582</b>	<b>526,905</b>
Software development	27,394	35,281
Intellectual property licenses	22,882	36,943
Property and equipment, net	26,375	22,265
Deferred income taxes	—	10,322
Other assets	844	5,081
Goodwill	74,214	68,019
<b>Total assets</b>	<b>\$ 1,101,291</b>	<b>\$ 704,816</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Current portion of long-term debt	\$ —	\$ 147
Accounts payable	170,936	45,602
Accrued expenses	128,687	58,656
<b>Total current liabilities</b>	<b>299,623</b>	<b>104,405</b>
Long-term debt, less current portion	—	2,671
Deferred income taxes	5,381	—
<b>Total liabilities</b>	<b>305,004</b>	<b>107,076</b>
Commitments and contingencies (Note 14)		
Shareholders' equity:		
Preferred stock, \$.000001 par value, 3,750,000 shares authorized, no shares issued at December 31, 2003 and March 31, 2003	—	—
Series A Junior Preferred stock, \$.000001 par value, 1,250,000 shares authorized, no shares issued at December 31, 2003 and March 31, 2003	—	—
Common stock, \$.000001 par value, 225,000,000 and 125,000,000 shares authorized, 108,950,649 and 107,372,727 shares issued and 89,253,766 and 90,084,245 shares outstanding at December 31, 2003 and March 31, 2003, respectively	—	—
Additional paid-in capital	731,345	592,295
Retained earnings	201,615	130,564
Less: Treasury stock, at cost, 19,696,883 and 17,288,482 shares at December 31, 2003 and March 31, 2003, respectively	(144,128)	(121,685)
Accumulated other comprehensive income (loss)	7,455	(3,434)
<b>Total shareholders' equity</b>	<b>796,287</b>	<b>597,740</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,101,291</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)

	For the three months ended December 31,		For the nine months ended December 31,	
	2003	2002	2003	2002
Net revenues	\$ 508,511	\$ 378,685	\$ 784,759	\$ 739,115
Costs and expenses:				
Cost of sales – product costs	235,301	204,881	384,302	369,004
Cost of sales – software royalties and amortization	23,680	33,503	50,575	67,396
Cost of sales – intellectual property licenses	9,464	14,918	27,008	32,704
Product development	50,354	13,758	79,828	38,768
Sales and marketing	58,503	33,875	102,025	84,644
General and administrative	14,248	10,989	35,847	37,308
Total costs and expenses	391,550	311,924	679,585	629,824
Operating income	116,961	66,761	105,174	109,291
Investment income, net	1,464	2,533	4,125	6,554
Income before income tax provision	118,425	69,294	109,299	115,845
Income tax provision	41,444	24,947	38,248	41,708
Net income	\$ 76,981	\$ 44,347	\$ 71,051	\$ 74,137
Basic earnings per share	\$ 0.87	\$ 0.44	\$ 0.80	\$ 0.77
Weighted average common shares outstanding	88,763	100,209	88,325	96,839
Diluted earnings per share	\$ 0.79	\$ 0.42	\$ 0.74	\$ 0.71
Weighted average common shares outstanding assuming dilution	97,351	106,223	95,786	104,822

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

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

	For the nine months ended December 31,	
	2003	2002
<b>Cash flows from operating activities:</b>		
Net income	\$ 71,051	\$ 74,137
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	18,626	12,817
Depreciation and amortization	7,711	7,050
Amortization and write-offs of capitalized software development costs and intellectual property licenses	76,276	75,800
Tax benefit of stock options and warrants exercised	3,567	24,053
Changes in operating assets and liabilities (net of effects of acquisitions):		
Accounts receivable	(226,007)	(80,649)
Inventories	(15,929)	(16,548)
Software development and intellectual property licenses	(88,714)	(123,366)
Other assets	(968)	4,970
Accounts payable	125,225	41,984
Accrued expenses and other liabilities	75,496	28,802
Net cash provided by operating activities	<u>46,334</u>	<u>49,050</u>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(9,455)	(6,941)
Proceeds from disposal of property and equipment	—	505
Purchases of short-term investments	(131,058)	(384,117)
Proceeds from sales and maturities of short-term investments	126,136	214,817
Cash payment to effect business combinations, net of cash acquired	(3,480)	(21,199)
Minority capital investment	—	(1,500)
Net cash used in investing activities	<u>(17,857)</u>	<u>(198,435)</u>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common stock and common stock options to employees	11,389	18,862
Other borrowings, net	(2,818)	(717)
Proceeds from issuance of common stock pursuant to underwritten public offering, net of offering costs	—	248,072
Purchase of structured stock repurchase transactions	(52,621)	(25,000)
Settlement of structured stock repurchase transactions	166,521	—
Purchase of treasury stock	(19,996)	(18,929)
Net cash provided by financing activities	<u>102,475</u>	<u>222,288</u>
Effect of exchange rate changes on cash	<u>8,918</u>	<u>7,074</u>
Net increase in cash and cash equivalents	139,870	79,977
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>\$ 425,424</u>	<u>\$ 358,984</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 nine months ended December 31, 2003**  
**(Unaudited)**  
**(In thousands)**

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Accumulated Other Comprehensive Income (Loss)	Shareholders' Equity
	Shares	Amount			Shares	Amount		
<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	—	—	—	71,051	—	—	—	71,051
Unrealized depreciation on short-term investments	—	—	—	—	—	—	(52)	(52)
Foreign currency forward contracts	—	—	—	—	—	—	(458)	(458)
Foreign currency translation adjustment	—	—	—	—	—	—	11,399	11,399
Total comprehensive income								81,940
Issuance of common stock and common stock options to employees	1,578	—	11,583	—	—	—	—	11,583
Tax benefit attributable to employee stock options	—	—	3,567	—	—	—	—	3,567
Purchase of structured stock repurchase transactions	—	—	(52,621)	—	—	—	—	(52,621)
Settlement of structured stock repurchase transactions	—	—	176,521	—	(1,144)	(10,000)	—	166,521
Purchase of treasury stock	—	—	—	—	(1,265)	(12,443)	—	(12,443)
<b>Balance, December 31, 2003</b>	<b>108,951</b>	<b>\$ —</b>	<b>\$ 731,345</b>	<b>\$ 201,615</b>	<b>(19,697)</b>	<b>\$ (144,128)</b>	<b>\$ 7,455</b>	<b>\$ 796,287</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 and nine months ended December 31, 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. Typically, these credits are applied against future invoices. 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 December 31, 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. 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 December 31,</u>		<u>Nine months ended December 31,</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Net income, as reported	\$ 76,981	\$ 44,347	\$ 71,051	\$ 74,137
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	126	—	126	—
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(3,693)	(5,011)	(13,432)	(15,225)
Pro forma net income	<u>\$ 73,414</u>	<u>\$ 39,336</u>	<u>\$ 57,745</u>	<u>\$ 58,912</u>
Earnings per share:				
Basic – as reported	<u>\$ 0.87</u>	<u>\$ 0.44</u>	<u>\$ 0.80</u>	<u>\$ 0.77</u>
Basic – pro forma	<u>\$ 0.83</u>	<u>\$ 0.39</u>	<u>\$ 0.65</u>	<u>\$ 0.61</u>
Diluted – as reported	<u>\$ 0.79</u>	<u>\$ 0.42</u>	<u>\$ 0.74</u>	<u>\$ 0.71</u>
Diluted – pro forma	<u>\$ 0.75</u>	<u>\$ 0.37</u>	<u>\$ 0.60</u>	<u>\$ 0.56</u>

The fair value of options granted is 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 each of the quarters in the nine months ended December 31, 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 ranging from 47% to 52%. Management believes such amounts are more representative of prospective trends. For purposes of the above pro forma disclosure, the fair value of options granted is amortized to stock-based employee compensation cost over the period(s) in which the related employee services are rendered. Accordingly, the pro forma stock-based compensation cost for any period will typically relate to options granted in both the current period and prior periods.

## 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. Acquisitions

In May 2002, we acquired a 30% interest in the outstanding capital stock of Infinity Ward, Inc. (“Infinity Ward”), a privately-held interactive software development company, as well as an option to purchase the remaining 70% of outstanding capital stock. In October 2003, we exercised our option to acquire the remaining 70% of the outstanding capital stock of Infinity Ward for cash of approximately \$3.5 million. This acquisition

further enables us to implement our multi-platform development strategy by augmenting our internal product development capabilities for the PC.

A significant portion of the purchase price for this acquisition was assigned to goodwill as the primary asset we acquired in the transaction was an assembled workforce with proven technical and design talent with a history of high quality product creation. Goodwill has been included in the publishing segment of our business and is non-deductible for tax purposes. The results of operations of Infinity Ward are included in our consolidated statement of operations beginning October 24, 2003. Pro forma consolidated statements of operations are not shown, as they would not differ materially from reported results.

#### 4. **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 December 31, 2003 (amounts in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Cash and cash equivalents:</b>				
Cash and time deposits	\$ 201,944	\$ —	\$ —	\$ 201,944
Money market instruments	33,915	—	—	33,915
Auction rate notes	189,565	—	—	189,565
<b>Cash and cash equivalents</b>	<b>425,424</b>	<b>—</b>	<b>—</b>	<b>425,424</b>
<b>Short-term investments:</b>				
Corporate bonds	16,781	4	(33)	16,752
Taxable municipal bonds	5,004	—	—	5,004
Taxable preferred bonds	3,779	—	—	3,779
U.S. agency issues	84,512	63	(32)	84,543
Asset-backed securities	16,095	90	(10)	16,175
<b>Short-term investments</b>	<b>126,171</b>	<b>157</b>	<b>(75)</b>	<b>126,253</b>
<b>Cash, cash equivalents and short-term investments</b>	<b>\$ 551,595</b>	<b>\$ 157</b>	<b>\$ (75)</b>	<b>\$ 551,677</b>

The following table summarizes the maturities of our investments in debt securities as of December 31, 2003 (amounts in thousands):

	Amortized Cost	Fair Value
Due in one year or less	\$ 221,616	\$ 221,613
Due after one year through two years	78,025	78,030
	299,641	299,643
Asset-backed securities	16,095	16,175
Total	<u>\$ 315,736</u>	<u>\$ 315,818</u>

For the three months ended December 31, 2003, net realized gains on short-term investments consisted of \$1,000 of gross realized gains and no gross realized losses. For the nine months ended December 31, 2003, net realized gains on short-term investments consisted of \$21,000 of gross realized gains and \$4,000 of gross realized losses.

For the three months ended December 31, 2002, net realized gains on short-term investments consisted of \$188,000 of gross realized gains and \$56,000 of gross realized losses. For the nine months ended December 31, 2002, net realized gains on short-term investments consisted of \$191,000 of gross realized gains and \$116,000 of gross realized losses.

#### 5. Inventories

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

	December 31, 2003	March 31, 2003
Purchased parts and components	\$ 825	\$ 1,129
Finished goods	34,681	18,448
	<u>\$ 35,506</u>	<u>\$ 19,577</u>

#### 6. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended December 31, 2003 are as follows (amounts in thousands):

	Publishing	Distribution	Total
Balance as of March 31, 2003	\$ 63,194	\$ 4,825	\$ 68,019
Goodwill acquired	3,763	—	3,763
Adjustment to original purchase allocation	1,808	—	1,808
Effect of foreign currency exchange rates	—	624	624
Balance as of December 31, 2003	<u>\$ 68,765</u>	<u>\$ 5,449</u>	<u>\$ 74,214</u>

#### 7. Income Taxes

The income tax provision of \$41.4 million and \$38.2 million for the three and nine months ended December 31, 2003, respectively, reflect our effective income tax rate of approximately 35%. The income tax provision of \$24.9 million and \$41.7 million for the three and nine months ended December 31, 2002, respectively, reflect

our effective income tax rate of approximately 36%. For both periods, the significant items that generated variances between our effective rate and our statutory rate of 35% were state taxes, offset by research and development tax credits.

#### 8. **Software Development Costs and Intellectual Property Licenses**

As of December 31, 2003, capitalized software development costs included \$26.7 million of internally developed software costs and \$44.2 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 \$49.5 million and \$45.8 million as of December 31, 2003 and March 31, 2003, respectively. Amortization and write-offs of capitalized software development costs and intellectual property licenses were \$76.3 million and \$75.8 million for the nine months ended December 31, 2003 and 2002, respectively.

During the three months ended December 31, 2003, we executed a realignment of our product portfolio driven by the evolution of the video game market, which is increasingly dominated by high quality products that are based on recognizable franchises and supported with big marketing programs. We completed a comprehensive review of our product portfolio in which we evaluated each product based on a number of criteria, including: the strength of the franchise, the projected product quality, the potential responsiveness of the product to aggressive marketing support and the financial risk in the event of product failure. As a result of this review, we found that we have an extensive slate of high-potential properties in development. However, we also found that certain projects had a lower likelihood of achieving acceptable levels of operating performance and that continued pursuit of these projects would create a substantial opportunity cost as it related to our slate of high-potential projects. Accordingly, in the three months ended December 31, 2003, we canceled the development of ten products which we believed were unlikely to produce an acceptable level of return on our investment. In connection with the cancellation of these products, we recorded a pre-tax charge of approximately \$21 million in the quarter ended December 31, 2003.

#### 9. **Comprehensive Income and Accumulated Other Comprehensive Income (Loss)**

##### *Comprehensive Income*

The components of comprehensive income for the three and nine months ended December 31, 2003 and 2002 were as follows (amounts in thousands):

	<u>Three months ended December 31,</u>		<u>Nine months ended December 31,</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Net income	\$ 76,981	\$ 44,347	\$ 71,051	\$ 74,137
Other comprehensive income (loss):				
Foreign currency forward contracts	(458)	—	(458)	—
Foreign currency translation adjustment	6,778	2,529	11,399	8,705
Unrealized appreciation (depreciation) on short-term investments	(38)	624	(52)	498
Other comprehensive income	6,282	3,153	10,889	9,203
Comprehensive income	\$ 83,263	\$ 47,500	\$ 81,940	\$ 83,340

*Accumulated Other Comprehensive Income (Loss)*

The components of accumulated other comprehensive income (loss) were as follows (amounts in thousands):

	Foreign Currency Forward Contracts	Foreign Currency Translation Adjustment	Unrealized Appreciation (Depreciation) on Investments	Accumulated Other Comprehensive Income (Loss)
Balance, March 31, 2003	\$ —	\$ (3,568)	\$ 134	\$ (3,434)
Other comprehensive income (loss)	(458)	11,399	(52)	10,889
Balance, December 31, 2003	<u>\$ (458)</u>	<u>\$ 7,831</u>	<u>\$ 82</u>	<u>\$ 7,455</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.

**10. Investment Income, Net**

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

	Three months ended December 31,		Nine months ended December 31,	
	2003	2002	2003	2002
Interest expense	\$ (43)	\$ (138)	\$ (285)	\$ (810)
Interest income	1,506	2,539	4,393	7,289
Net realized gain on investments	1	132	17	75
Investment income, net	<u>\$ 1,464</u>	<u>\$ 2,533</u>	<u>\$ 4,125</u>	<u>\$ 6,554</u>

**11. Supplemental Cash Flow Information**

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

	Nine months ended December 31,	
	2003	2002
Non-cash investing and financing activities:		
Subsidiaries acquired with common stock	\$ —	\$ 10,861
Issuance of options and common stock warrants	377	2,184
Stock offering costs	—	781
Change in unrealized depreciation on short-term investments	52	498
Supplemental cash flow information:		
Cash paid for income taxes	\$ 7,156	\$ 3,847
Cash paid (received) for interest, net	(4,276)	(5,933)

## 12. 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 game specialty stores. We conduct our international publishing activities through offices in the United Kingdom, Germany, France, Italy, 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 and nine months ended December 31, 2003 and 2002 is as follows (amounts in thousands):

	Three months ended December 31, 2003		
	Publishing	Distribution	Total
Total segment revenues	\$ 382,921	\$ 125,590	\$ 508,511
Revenues from sales between segments	(48,801)	48,801	—
Revenues from external customers	\$ 334,120	\$ 174,391	\$ 508,511
Operating income	\$ 104,964	\$ 11,997	\$ 116,961
Total assets	\$ 883,298	\$ 217,993	\$ 1,101,291
	Three months ended December 31, 2002		
	Publishing	Distribution	Total
Total segment revenues	\$ 256,729	\$ 121,956	\$ 378,685
Revenues from sales between segments	(26,345)	26,345	—
Revenues from external customers	\$ 230,384	\$ 148,301	\$ 378,685
Operating income	\$ 54,926	\$ 11,835	\$ 66,761
Total assets	\$ 818,659	\$ 152,458	\$ 971,117

	<b>Nine months ended December 31, 2003</b>		
	<b>Publishing</b>	<b>Distribution</b>	<b>Total</b>
Total segment revenues	\$ 569,122	\$ 215,637	\$ 784,759
Revenues from sales between segments	(63,005)	63,005	—
Revenues from external customers	<u>\$ 506,117</u>	<u>\$ 278,642</u>	<u>\$ 784,759</u>
Operating income	<u>\$ 93,240</u>	<u>\$ 11,934</u>	<u>\$ 105,174</u>
Total assets	<u>\$ 883,298</u>	<u>\$ 217,993</u>	<u>\$ 1,101,291</u>

	<b>Nine months ended December 31, 2002</b>		
	<b>Publishing</b>	<b>Distribution</b>	<b>Total</b>
Total segment revenues	\$ 536,972	\$ 202,143	\$ 739,115
Revenues from sales between segments	(51,535)	51,535	—
Revenues from external customers	<u>\$ 485,437</u>	<u>\$ 253,678</u>	<u>\$ 739,115</u>
Operating income	<u>\$ 96,659</u>	<u>\$ 12,632</u>	<u>\$ 109,291</u>
Total assets	<u>\$ 818,659</u>	<u>\$ 152,458</u>	<u>\$ 971,117</u>

Geographic information for the three and nine months ended December 31, 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 December 31,</b>		<b>Nine months ended December 31,</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
North America	\$ 252,114	\$ 179,643	\$ 381,303	\$ 380,045
Europe	246,919	190,030	385,952	342,561
Other	9,478	9,012	17,504	16,509
Total	<u>\$ 508,511</u>	<u>\$ 378,685</u>	<u>\$ 784,759</u>	<u>\$ 739,115</u>

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

	<b>Three months ended December 31,</b>		<b>Nine months ended December 31,</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
Console	\$ 407,975	\$ 320,528	\$ 611,008	\$ 582,160
Hand-held	20,284	25,632	36,709	56,859
PC	80,252	32,525	137,042	100,096
Total	<u>\$ 508,511</u>	<u>\$ 378,685</u>	<u>\$ 784,759</u>	<u>\$ 739,115</u>

As of and for the three and nine months ended December 31, 2003, we had one customer that accounted for 19% and 18% of consolidated net revenues, respectively, and 32% of consolidated accounts receivable, net. As of and for the three and nine months ended December 31, 2002, we had one customer that accounted for

17% of consolidated net revenues and 29% of consolidated accounts receivable, net. This customer was the same customer in all periods and was a customer of both our publishing and distribution businesses.

### 13. Computation of Earnings Per Share

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

	Three months ended December 31,		Nine months ended December 31,	
	2003	2002	2003	2002
<b>Numerator:</b>				
Numerator for basic and diluted earnings per share – income available to common shareholders	\$ 76,981	\$ 44,347	\$ 71,051	\$ 74,137
<b>Denominator:</b>				
Denominator for basic earnings per share-weighted average common shares outstanding	88,763	100,209	88,325	96,839
<b>Effect of dilutive securities:</b>				
Employee stock options and stock purchase plan	8,230	5,642	7,132	7,422
Warrants to purchase common stock	358	372	329	561
Potential dilutive common shares	8,588	6,014	7,461	7,983
Denominator for diluted earnings per share - weighted average common shares outstanding plus assumed conversions	97,351	106,223	95,786	104,822
Basic earnings per share	\$ 0.87	\$ 0.44	\$ 0.80	\$ 0.77
Diluted earnings per share	\$ 0.79	\$ 0.42	\$ 0.74	\$ 0.71

Options to purchase 5,912,586 shares of common stock at exercise prices ranging from \$18.21 to \$22.16 and options to purchase 6,949,225 shares of common stock at exercise prices ranging from \$18.21 to \$22.16 were outstanding for the three and nine months ended December 31, 2003, respectively, but were not included in the calculation of diluted earnings per share because their effect would be antidilutive.

Options to purchase 7,054,122 shares of common stock at exercise prices ranging from \$12.41 to \$22.16 and options to purchase 3,381,950 shares of common stock at exercise prices ranging from \$16.65 to \$22.16 were outstanding for the three and nine months ended December 31, 2002, respectively, but were not included in the calculation of diluted earnings per share because their effect would be antidilutive.

### 14. Commitments and Contingencies

#### *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 December 31, 2003, the UK Facility provided Centresoft with the ability to borrow up to Great British Pounds ("GBP") 8.0 million (\$14.2 million), including issuing letters of credit, on a revolving basis. Furthermore, as of December 31, 2003, under the UK Facility, Centresoft provided a GBP 0.6 million (\$1.1 million) guarantee for the benefit of our CD Contact subsidiary. The UK Facility bears interest at LIBOR plus 2.0%, is collateralized by substantially all of the assets of the subsidiary and expires in November 2004. The UK Facility also contains various covenants



that require the subsidiary to maintain specified financial ratios related to, among others, fixed charges. As of December 31, 2003, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of December 31, 2003. The German Facility provided for revolving loans up to EUR 0.5 million (\$0.6 million) as of December 31, 2003, bears interest at a Eurocurrency rate plus 2.5%, is collateralized by certain of the subsidiary's property and equipment and has no expiration date. No borrowings were outstanding against the German Facility as of December 31, 2003.

*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 December 31, 2003 is approximately \$99.1 million and is scheduled to be paid as follows (amounts in thousands):

<b>Fiscal year ending March 31,</b>	
2004	\$ 29,827
2005	41,350
2006	18,048
2007	5,560
2008 and thereafter	4,325
<b>Total</b>	<b>\$ 99,110</b>

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, after consultation with legal counsel, the outcome of such routine claims will not have a material adverse effect on our business, financial condition, results of operations or liquidity.

On June 30, 2003, we terminated our Star Trek Merchandising License Agreement with Viacom Consumer Products, Inc. and filed a complaint in the Superior Court of the State of California for breach of contract and constructive trust against Viacom Consumer Products and Viacom International, Inc. ("Viacom"). On August 15, 2003, Viacom filed its response to our complaint as well as a cross-complaint alleging, among other matters, a breach of contract by Activision and seeking claimed damages in excess of \$50 million. We strongly dispute the claims by Viacom, consider the damages alleged by Viacom to be speculative and without merit, and intend to defend vigorously and aggressively against the cross-complaint.

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. We responded to this inquiry on September 2, 2003. To date, we have not received a request from the SEC for additional 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 have cooperated and intend to continue to cooperate fully with the SEC in the conduct of this inquiry.

## **15. 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 nine months ended December 31, 2003, we repurchased approximately 1.3 million shares of our common stock for \$12.4 million. In addition, approximately 1.1 million shares of common stock were acquired in the nine months ended December 31, 2003 as a result of the settlement of a structured stock repurchase transaction entered into in fiscal 2003. As of December 31, 2003, we had no outstanding structured stock repurchase transactions. 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 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 sheets. In any period, cash provided by or used in financing activities related to common stock repurchase transactions may differ from the comparable change in shareholders' equity, reflecting timing differences between the recognition of share repurchase transactions and their settlement for cash.

## **16. Related Parties**

In August 2001, we elected to our Board of Directors an individual who is a partner in a law firm that has provided legal services to Activision for more than ten years. For the three and nine months ended December 31, 2003 and 2002, the fees we paid to the law firm account for less than 1% of the firm's total revenues. We believe that the fees charged to us by the law firm are competitive with the fees charged by other law firms.

## **17. Subsequent Events**

On February 11, 2004, 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 is payable on March 15, 2004 to shareholders of record as of February 23, 2004. The par value of our common stock will be maintained at the pre-split amount of \$.000001.

## 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") console system and Nintendo Game Boy Color ("GBC") hand-held device. In calendar 2003, Sony announced that it would be 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. Recently, Nintendo also announced that it plans to launch a new, dual-screened, portable game system before the end of calendar 2004. We are currently in development of titles for the PSP and are awaiting more information from Nintendo regarding their new hand-held platform. Although no specific information regarding such matters is available, we also evaluate potential technology for the next generation console systems expected to be developed by Sony, Microsoft and Nintendo for release in the next two to three calendar years.

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 game specialty stores. We conduct our international publishing activities through offices in the United Kingdom ("UK"), Germany, France, Italy, 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 UK, 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. Examples of these brands are our superheroes and skateboarding brands. We have a long-term alliance with Marvel Enterprises through an exclusive, multi-year, licensing agreement that expires in 2009. The agreement grants us the exclusive rights to develop and publish video games based on Marvel's comic book franchises Spider-Man, X-MEN, Fantastic Four and Iron Man. We currently are in development on the video game *Spider-Man: The Movie 2*, the sequel to the highly successful *Spider-Man: The Movie*, a key fiscal 2003 title release that has continued to perform strongly into fiscal 2004. The video game release of *Spider-Man: The Movie 2* is scheduled to coincide with the "Spider-Man 2" theatrical release in the summer of 2004. Further, another of our key strategies is to continue to be a leader in the skateboarding category. We have an exclusive, multi-year, licensing agreement with professional skateboarder Tony Hawk that expires in 2015. The agreement grants us exclusive rights to develop and publish video games using Tony Hawk's name and his likeness. We have already released in prior periods five successful titles in the Tony Hawk franchise with cumulative net revenues of \$793.9 million, including the most recent, *Tony Hawk's Underground*, which was released in the third quarter of fiscal 2004. We will continue to promote our skateboarding franchise with the release in fiscal 2005 of the sequel to the very successful *Tony Hawk's Underground*.

We will also continue to develop new intellectual properties such as *True Crime: Streets of L.A.* and *Call of Duty*, which were released in the third quarter of fiscal 2004. These highly successful titles were ranked by third-party sales tracking agencies as among the top-five selling games for the holiday season. We expect to

develop a variety of games on multiple platforms based on these two new original properties and hope to establish them as a source of recurring revenues.

We will also continue to evaluate emerging brands that we believe have potential to become successful game franchises. For example, we expect to release titles in fiscal 2005 for “Lemony Snicket’s A Series of Unfortunate Events,” “Shark Tale” and “Shrek 2.” We have 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, Nickelodeon Movies and DreamWorks SKG. We also have 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, “Shark Tale,” “Madagascar” and “Over the Hedge,” as well as their sequels. We additionally have an agreement to develop and publish video games based on the upcoming movie “Shrek 2” which is expected to be theatrically released in May 2004.

In addition to acquiring or creating high profile intellectual property, we have also continued our focus on establishing and maintaining relationships with talented and experienced software development teams. We have strengthened our internal development capabilities through the acquisition in prior fiscal years of a number of talented and experienced development companies. Most recently, in October 2003, we exercised our option to acquire the remaining 70% of the outstanding capital of Infinity Ward, the developer of our newly released PC title, *Call of Duty*. We had acquired the initial 30% of Infinity Ward’s outstanding capital stock in May 2002. We also have development agreements with other top-level, third-party developers such as id Software, Valve L.L.C., Spark Unlimited, Lionhead Studios and The Creative Assembly.

We are utilizing these developer relationships, new intellectual property acquisitions, new original intellectual property creations and our existing library of intellectual property to further focus our game development on product lines that will deliver large, lasting and recurring revenues and operating profit.

### **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. Typically, these credits are applied against future invoices. 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 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.

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 by business segment (amounts in thousands):

	Three months ended December 31,				Nine months ended December 31,			
	2003		2002		2003		2002	
Net revenues	\$ 508,511	100%	\$ 378,685	100%	\$ 784,759	100%	\$ 739,115	100%
Costs and expenses:								
Cost of sales – product costs	235,301	46	204,881	54	384,302	49	369,004	50
Cost of sales – software royalties and amortization	23,680	5	33,503	9	50,575	7	67,396	9
Cost of sales – intellectual property licenses	9,464	2	14,918	4	27,008	3	32,704	4
Product development	50,354	10	13,758	3	79,828	10	38,768	5
Sales and marketing	58,503	11	33,875	9	102,025	13	84,644	12
General and administrative	14,248	3	10,989	3	35,847	5	37,308	5
Total costs and expenses	391,550	77	311,924	82	679,585	87	629,824	85
Operating income	116,961	23	66,761	18	105,174	13	109,291	15
Investment income, net	1,464	-	2,533	1	4,125	1	6,554	1
Income before income tax provision	118,425	23	69,294	19	109,299	14	115,845	16
Income tax provision	41,444	8	24,947	7	38,248	5	41,708	6
Net income	\$ 76,981	15%	\$ 44,347	12%	\$ 71,051	9%	\$ 74,137	10%
Net Revenues by Territory:								
North America	\$ 252,114	50%	\$ 179,643	47%	\$ 381,303	49%	\$ 380,045	51%
Europe	246,919	48	190,030	50	385,952	49	342,561	47
Other	9,478	2	9,012	3	17,504	2	16,509	2
Total net revenues	\$ 508,511	100%	\$ 378,685	100%	\$ 784,759	100%	\$ 739,115	100%
Segment/Platform Mix:								
Publishing:								
Console	\$ 304,996	80%	\$ 211,993	83%	\$ 439,499	77%	\$ 409,919	77%
Hand-held	13,367	3	19,574	7	22,150	4	45,061	8
PC	64,558	17	25,162	10	107,473	19	81,992	15
Total publishing net revenues	382,921	75	256,729	68	569,122	73	536,972	73
Distribution:								
Console	102,979	82	108,535	89	171,509	79	172,241	85
Hand-held	6,917	6	6,058	5	14,559	7	11,798	6
PC	15,694	12	7,363	6	29,569	14	18,104	9
Total distribution net revenues	125,590	25	121,956	32	215,637	27	202,143	27
Total net revenues	\$ 508,511	100%	\$ 378,685	100%	\$ 784,759	100%	\$ 739,115	100%
Operating Income by Segment:								
Publishing	\$ 104,964	21%	\$ 54,926	15%	\$ 93,240	12%	\$ 96,659	13%
Distribution	11,997	2	11,835	3	11,934	1	12,632	2
Total operating income	\$ 116,961	23%	\$ 66,761	18%	\$ 105,174	13%	\$ 109,291	15%

## Results of Operations – Three and Nine Months Ended December 31, 2003 and 2002

### Net Revenues For The Three Months Ended December 31, 2003 and 2002

Net revenues for the three months ended December 31, 2003 increased 34% from the same period last year, from \$378.7 million to \$508.5 million. The increase was generated by our publishing business and, to a lesser degree, our distribution business.

Publishing net revenues for the three months ended December 31, 2003 increased 49% from the same period last year, from \$256.7 million to \$382.9 million. The following tables detail our publishing net revenues by territory and by platform as a percentage of total publishing net revenues for the three months ended December 31, 2003 and 2002:

	Three months ended December 31,		Percent Change
	2003	2002	
<b>Publishing Net Revenues</b>			
North America	\$ 252,114	\$ 179,643	40%
Europe	121,329	68,074	78%
Other	9,478	9,012	5%
<b>Total Publishing Net Revenues</b>	<b>\$ 382,921</b>	<b>\$ 256,729</b>	<b>49%</b>
<b>Distribution Net Revenues</b>	<b>\$ 125,590</b>	<b>\$ 121,956</b>	<b>3%</b>
<b>Consolidated Net Revenues</b>	<b>\$ 508,511</b>	<b>\$ 378,685</b>	<b>34%</b>

	Three months ended December 31,	
	2003	2002
<b>Publishing Net Revenues</b>		
<b>PC</b>	<b>17%</b>	<b>10%</b>
<b>Console</b>	<b>80%</b>	<b>83%</b>
PlayStation 2	48	48
Microsoft Xbox	20	13
Nintendo GameCube	10	12
PlayStation	2	10
<b>Hand-held</b>	<b>3%</b>	<b>7%</b>
Game Boy Advance	3	6
Game Boy Color	—	1
<b>Total Publishing Net Revenues</b>	<b>100%</b>	<b>100%</b>

The increase in publishing net revenues for the three months ended December 31, 2003 occurred in both our domestic and international publishing businesses and in the console and PC platforms. These increases were primarily generated by the strong performance of our new title releases. Publishing console net revenues for the three months ended December 31, 2003 increased 44% from the same period last year, from \$212.0 million to \$305.0 million. This was primarily due to the release in the three months ended December 31, 2003 of several console titles that performed very well in both the domestic and international markets. Our new console releases included *Tony Hawk's Underground* ("THUG") and *True Crime: Streets of L.A.* for PS2, Xbox and GameCube, *Cabela's Dangerous Hunts* for PS2 and Xbox and, in select European markets, *Rouge Squadron III: Rebel Strike* for GameCube. We also continued to see strong catalog sales in our Spider-Man, Star Wars, Tony Hawk and Cabela's franchises. Catalog sales are sales of titles released prior to the current quarter. Publishing PC net revenues for the three months ended December 31, 2003 increased 156% from the same period last year, from \$25.2 million to \$64.6 million. This was primarily due to the release in the three months ended December 31, 2003 of two new premium PC titles, *Call of Duty* and *Empires: Dawn of the Modern World*, that performed very well in both the domestic and international markets. In contrast, during the three months ended December 31, 2002, we released only one smaller PC title. Hand-held net revenues for the three months ended December 31, 2003 decreased 32% from the same period last year, from \$19.6 million to \$13.4 million. This was due to a decrease in the number of GBA games released year-over-year. In the three months



ended December 31, 2002, we released six GBA titles, whereas in the three months ended December 31, 2003, we released only one GBA title, *THUG*.

Geographically, our publishing business includes our North American, European and Asian/Australian publishing businesses. North America publishing net revenues increased 40% from the same period last year, from \$179.6 million for the three months ended December 31, 2002, to \$252.1 million for the three months ended December 31, 2003 for the reasons detailed above in the discussion of our overall publishing business net revenues. International publishing net revenues increased 70% from the same period last year, from \$77.1 million for the three months ended December 31, 2002, to \$130.8 million for the three months ended December 31, 2003 also for the reasons previously discussed above and as a result of the positive impact of the year-over-year strengthening of the Euro and the Great British Pound (“GBP”) in relation to the U.S. dollar. The increase in international publishing net revenues due to the impact of changing foreign currency rates was approximately \$12 million for the three months ended December 31, 2003. Excluding the impact of changing foreign currency rates, our international publishing net revenues increased 54% year-over-year.

Platform mix of publishing net revenues between PC, console and hand-held for the three months ended December 31, 2003 changed somewhat when compared with the same period last year. Publishing PC net revenues increased as a percentage of total publishing net revenues due to the success of our new PC releases as discussed above. Publishing hand-held net revenues as a percentage of total publishing net revenues decreased by more than 50% due to the reduced number of GBA titles released in the fiscal 2004 third quarter compared to the same period last year as discussed above. Publishing console net revenues as a percentage of total publishing net revenues stayed relatively consistent with the same period last year. However, as expected, within the mix of specific consoles, net revenues from the sale of software for the prior generation of console hardware systems, such as PS1, continue to decline as the installed base of the current generation of console hardware systems, PS2, Xbox and GameCube, continues to grow. 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 and/or the new Nintendo dual-screen hand-held device are 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 the three months ended December 31, 2003, 47% of our consolidated net revenues and 62% of worldwide publishing net revenues were derived from two titles. For the nine months ended December 31, 2003, 29% of our consolidated net revenues and 41% of worldwide publishing net revenues were derived from two 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 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.

Two factors that could affect future publishing and distribution net revenue performance are console hardware pricing and software pricing. As console hardware moves through its life cycle, hardware manufacturers typically enact price reductions. Reductions in the price of console hardware typically result in an increase in the installed base of hardware owned by consumers. We believe that there will be price cuts on PS2 and Xbox hardware in mid to late calendar 2004. Historically, we have also seen that lower console hardware prices put downward pressure on software pricing. While we expect console software launch pricing for most genres to hold at \$49.99 through the calendar 2004 holidays, we believe that we could see additional software price declines thereafter.

Distribution net revenues for the three months ended December 31, 2003 increased 3% over the same period last year, from \$122.0 million to \$125.6 million. The increase is primarily due to the positive impact of the year-over-year strengthening of the Euro and the GBP in relation to the U.S. dollar. Excluding the impact of changes in foreign currency rates, distribution net revenues for the three months ended December 31, 2003 were down approximately 8% from the same period last year. This decrease is primarily

due to a change in product mix. For the three months ended December 31, 2003, hardware sales represented approximately 33% of total distribution sales, compared to approximately 41% for the same period last year. The decrease reflects the impact on sales during the fiscal 2004 third quarter of the lower price points of PS2, GameCube and Xbox hardware in the international markets in calendar 2003 versus the prior calendar year. 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 from fiscal 2003.

*Net Revenues For The Nine Months Ended December 31, 2003 and 2002*

Net revenues for the nine months ended December 31, 2003 increased 6% from the same period last year, from \$739.1 million to \$784.8 million. The increase was generated by our publishing business and, to a lesser degree, our distribution business.

Publishing net revenues for the nine months ended December 31, 2003 increased 6% from the same period last year, from \$537.0 million to \$569.1 million. The following tables detail our publishing net revenues by territory and by platform as a percentage of total publishing net revenues for the nine months ended December 31, 2003 and 2002:

	Nine months ended December 31,		Percent Change
	2003	2002	
<b>Publishing Net Revenues</b>			
North America	\$ 381,303	\$ 380,045	—%
Europe	170,315	140,418	21%
Other	17,504	16,509	6%
<b>Total Publishing Net Revenues</b>	<b>\$ 569,122</b>	<b>\$ 536,972</b>	<b>6%</b>
<b>Distribution Net Revenues</b>	<b>\$ 215,637</b>	<b>\$ 202,143</b>	<b>7%</b>
<b>Consolidated Net Revenues</b>	<b>\$ 784,759</b>	<b>\$ 739,115</b>	<b>6%</b>

	Nine months ended December 31,	
	2003	2002
<b>Publishing Net Revenues</b>		
<b>PC</b>	<b>19%</b>	<b>15%</b>
<b>Console</b>		
PlayStation 2	44	42
Microsoft Xbox	22	13
Nintendo GameCube	8	13
PlayStation	3	8
Nintendo 64	—	1
<b>Hand-held</b>		
Game Boy Advance	4	7
Game Boy Color	—	1
<b>Total Publishing Net Revenues</b>	<b>100%</b>	<b>100%</b>

The increase in publishing net revenues for the nine months ended December 31, 2003 is the result of the strong performance of our fiscal 2004 third quarter title releases, as previously detailed, offset by lower publishing net revenue recorded during the first six months of fiscal 2004 due to the lower number of new titles released as compared to the same period last year. Additionally, publishing net revenues in fiscal 2003 benefited from the success of *Spider-Man: The Movie* which was released in the fiscal 2003 first quarter.

North America publishing net revenues for the nine months ended December 31, 2003, were relatively consistent with the same period last year, at \$380.0 million for the nine months ended December 31, 2002, and \$381.3 million for the nine months ended December 31, 2003 for the reasons detailed above in the discussion of our overall publishing business net revenues. International publishing net revenues increased 20% from the same period last year, from \$156.9 million for the nine months ended December 31, 2002, to \$187.8 million for the nine months ended December 31, 2003 for the reasons detailed above and as a result of the positive impact of the year-over-year strengthening of the Euro and the GBP in relation to the U.S. dollar. The increase in international publishing net revenues due to the impact of changing foreign currency rates was approximately \$18 million for the nine months ended December 31, 2003. Excluding the impact of changing foreign currency rates, our international publishing net revenues increased 8% year-over-year.

Distribution net revenues for the nine months ended December 31, 2003 increased 7% from the same period last year, from \$202.1 million to \$215.6 million. The increase is primarily due to the positive impact of the year-over-year strengthening of the Euro and the GBP in relation to the U.S. dollar. Excluding the impact of changes in foreign currency rates, distribution net revenues for the nine months ended December 31, 2003, were down approximately 4% from the same period last year as a result of a change in product mix. For the nine months ended December 31, 2003, hardware sales represented approximately 29% of total distribution sales, compared to approximately 40% for the same period last year. The decrease reflects the impact on sales during the nine months ended December 31, 2003 of the lower price points of PS2, GameCube and Xbox hardware in the international markets in calendar 2003 versus the prior calendar year.

#### *Costs and Expenses*

Cost of sales – product costs represented 46% and 54% of consolidated net revenues for the three months ended December 31, 2003 and 2002, respectively. The primary factor impacting cost of sales – product costs as a percentage of consolidated net revenues is the decrease in distribution net revenues as a percentage of total consolidated net revenues, from 32% for the three months ended December 31, 2002 to 25% for the three months ended December 31, 2003. Distribution net revenues have a higher per unit cost as compared to publishing net revenues. Additionally, as previously discussed, in our publishing business, PC net revenues increased year-over-year as a percentage of total publishing net revenues, from 10% for the three months ended December 31, 2002 to 17% for the three months ended December 31, 2003. PC sales have the lowest manufacturing cost per unit of all of the platforms. For the nine months ended December 31, 2003, cost of sales – product costs as a percentage of consolidated net revenues was relatively consistent with the same period last year at 49% and 50% for the nine months ended December 31, 2003 and 2002, respectively. The slight decrease was due to the increase in publishing PC net revenues as a percentage of total publishing revenues, from 15% for the nine months ended December 31, 2002 to 19% for the nine months ended December 31, 2003. Distribution net revenues as a percentage of total consolidated net revenues was flat at 27% for the nine months ended December 31, 2003 and 2002.

Cost of sales – software royalties and amortization for the three months ended December 31, 2003 decreased as a percentage of publishing net revenues over the same period last year, from 13% to 6%. In absolute dollars, cost of sales – software royalties and amortization for the three months ended December 31, 2003 also decreased from the same period last year, from \$33.5 million to \$23.7 million. The decrease in absolute dollars reflects that there were five major titles released in the fiscal 2004 third quarter as compared to eight titles in the fiscal 2003 third quarter. The decrease in the percentage reflects the strong performance of those fiscal 2004 third quarter releases. Cost of sales – software royalties and amortization for the nine months ended December 31, 2003 decreased as a percentage of publishing net revenues over the same period last year, from 13% to 9%. In absolute dollars, cost of sales – software royalties and amortization for the nine months ended December 31, 2003 also decreased from the same period last year, from \$67.4 million to \$50.6 million. The decrease in absolute dollars reflects that there were only 11 major titles released in fiscal 2004 as compared to over 20 in fiscal 2003. The decrease in the percentage reflects the strong performance of the fiscal 2004 third quarter releases.

Cost of sales – intellectual property licenses for the three months ended December 31, 2003 decreased as a percentage of publishing net revenues over the same period last year, from 6% to 2%. This decrease reflects the fact that two of our top performing titles in the three months ending December 31, 2003, *True Crime: Streets of L.A.* and *Call of Duty*, were based on our wholly-owned original intellectual property. Cost of sales – intellectual property licenses for the nine months ended December 31, 2003 decreased slightly as a percentage of publishing net revenues over the same period last year, from 6% to 5%. This slight decrease reflects the benefits received in the fiscal 2004 third quarter from titles released utilizing our own original intellectual

property, offset by the effect of certain of our top performing titles released in the first six months of fiscal 2004 having higher intellectual property royalty rate structures than the top performing titles released in the first six months of fiscal 2003.

Product development expenses for the three months ended December 31, 2003 increased as a percentage of publishing net revenues from the same period last year, from 5% to 13%. In absolute dollars, product development expense for the three months ended December 31, 2003 also increased from the same period last year, from \$13.8 million to \$50.4 million. Product development expenses for the nine months ended December 31, 2003 increased as a percentage of publishing net revenues from the same period last year, from 7% to 14%. In absolute dollars, product development expense for the nine months ended December 31, 2003 also increased from the same period last year, from \$38.8 million to \$79.8 million.

In the third quarter of fiscal 2004, we executed a realignment of our product portfolio driven by the evolution of the video game market, which is increasingly dominated by high quality products that are based on recognizable franchises and supported with big marketing programs. We completed a comprehensive review of our product portfolio in which we evaluated each product based on a number of criteria, including: the strength of the franchise, the projected product quality, the potential responsiveness of the product to aggressive marketing support and the financial risk in the event of product failure. As a result of this review, we found that we have an extensive slate of high-potential properties in development. However, we also found that certain projects had a lower likelihood of achieving acceptable levels of operating performance and that continued pursuit of these projects would create a substantial opportunity cost as it related to our slate of high-potential projects. Accordingly, in the three months ended December 31, 2003, we canceled the development of ten products which we believed were unlikely to produce an acceptable level of return on our investment. In connection with the cancellation of these products, we recorded a pre-tax charge of approximately \$21 million in the quarter ended December 31, 2003.

Additionally, to maintain the competitiveness of our products and to take advantage of increasingly sophisticated technology associated with new hardware platforms, we have increased the amount of time spent play-testing new products, conducted more extensive product quality evaluations and lengthened product development schedules to allow time to make the improvements indicated by our testing and evaluations. We are focused on improved game quality, and in many cases, this has resulted in an increase in product development costs.

The increases in product development as a percentage of publishing net revenues and in absolute dollars reflect the \$21 million charge and our increased emphasis on product quality and the lengthening of product development schedules. In addition, the increases in absolute dollars reflect an increase in studio employee incentive compensation as a result of the strong performance of key fiscal 2004 title releases.

Sales and marketing expenses of \$58.5 million and \$33.9 million represented 11% and 9% of consolidated net revenues for the three months ended December 31, 2003 and 2002, respectively. Sales and marketing expenses of \$102.0 million and \$84.6 million represented 13% and 12% of consolidated net revenues for the nine months ended December 31, 2003 and 2002, respectively. These increases were primarily generated by our publishing business as a result of significant marketing programs, including television and in-theatre ad campaigns and in-store promotions, run in support of three key fiscal 2004 third quarter title releases, *THUG*, and our two new original properties, *True Crime: Streets of L.A.* and *Call of Duty*. We expect to continue to provide significant marketing support for our future "big proposition" titles.

General and administrative expenses for the three months ended December 31, 2003 increased \$3.2 million over the same period last year, from \$11.0 million to \$14.2 million. As a percentage of consolidated net revenues, general and administrative expenses remained constant year-over-year at 3%. The increase in absolute dollars is the result of an increase in general and administrative headcount and in employee related costs. General and administrative expenses for the nine months ended December 31, 2003 decreased \$1.5 million over the same period last year, from \$37.3 million to \$35.8 million. As a percentage of consolidated net revenues, general and administrative expenses remained constant at 5%. The decrease in absolute dollars was primarily due to lower bad debt expense and the incurrence in the first quarter of fiscal 2003 of merger related expenses by our publishing business and an approximate \$2.0 million charge by our distribution business for the relocation of our UK distribution facility, partially offset by a year-over-year increase in general and administrative headcount and in employee related costs in both our publishing and distribution businesses.

### *Operating Income*

Publishing operating income for the three months ended December 31, 2003 increased \$50.1 million from the same period last year, from \$54.9 million to \$105.0 million. This increase is primarily due to the strong performance in both the domestic and international markets of our fiscal 2004 third quarter title releases, partially offset by the product development charge recorded in the fiscal 2004 third quarter in connection with the cancellation of ten products.

Publishing operating income for the nine months ended December 31, 2003 decreased \$3.5 million from the same period last year, from \$96.7 million to \$93.2 million. This is primarily due to a publishing operating loss incurred in the first six months of fiscal 2004 due to lower publishing net revenues as a result of a fewer number of new titles released and the product development charge recorded in the fiscal 2004 third quarter in connection with the cancellation of ten products. The effect of these items were partially offset by the strong performance of our fiscal 2004 third quarter title releases. Additionally, publishing operating income in fiscal 2003 benefited from the success of *Spider-Man: The Movie* which was released in the fiscal 2003 first quarter.

Distribution operating income for the three months ended December 31, 2003 remained relatively flat with the same period last year, at \$12.0 million and \$11.8 million for the three months ended December 31, 2003 and 2002, respectively. Distribution operating income for the three months ended December 31, 2003 benefited from the positive impact of the year-over-year strengthening of the Euro and the GBP in relation to the U.S. dollar. Excluding the impact of changes in foreign currency rates, distribution operating income for the three months ended December 31, 2003 was down approximately \$1.1 million from the same period last year. This decrease is primarily due to an increase in general and administrative headcount and in employee related costs.

Distribution operating income for the nine months ended December 31, 2003 decreased \$0.7 million, compared to the same period last year, from \$12.6 million to \$11.9 million. Excluding the positive impact of the year-over-year strengthening of the Euro and the GBP in relation to the U.S. dollar, distribution operating income for the nine months ended December 31, 2003 decreased \$1.9 million from the same period last year. This decrease is primarily due to an increase in general and administrative headcount and in employee related costs.

### *Investment Income, Net*

Investment income, net for the three months ended December 31, 2003 was \$1.5 million as compared to \$2.5 million for the three months ended December 31, 2002. Investment income, net for the nine months ended December 31, 2003 was \$4.1 million as compared to \$6.6 million for the nine months ended December 31, 2002. These decreases were primarily due to interest rate reductions and the utilization of excess cash to enter into structured stock repurchase transactions and to purchase treasury stock during the three and nine months ended December 31, 2003. Premiums earned on structured stock repurchase transactions are recorded in additional paid-in-capital.

### *Provision for Income Taxes*

The income tax provision of \$41.4 million and \$38.2 million for the three and nine months ended December 31, 2003, respectively, reflect our effective income tax rate of approximately 35%. The income tax provision of \$24.9 million and \$41.7 million for the three and nine months ended December 31, 2002, respectively, reflect our effective income tax rate of approximately 36%. For both periods, the significant items that generated variances between our effective rate and our statutory rate of 35% were state taxes, offset by research and development tax credits.

### *Liquidity and Capital Resources*

As of December 31, 2003, our primary source of liquidity was comprised of \$425.4 million of cash and cash equivalents and \$126.3 million of short-term investments. We believe that we have sufficient working capital (\$650.0 million at December 31, 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 \$425.4 million at December 31, 2003 compared to \$285.6 million at March 31, 2003. Activity in cash and cash equivalents for the nine months ended December 31, 2003, included \$46.3 million and \$102.5 million provided by operating and financing activities, respectively, offset by \$17.9 million used in investing activities. The principal components comprising cash flows provided by operating activities included favorable operating results, partially offset by our continued investment in software development and intellectual property licenses. In the nine months ended December 31, 2003, we spent approximately \$88.7 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 used in investing activities primarily was the result of capital expenditures, the acquisition of a privately-held interactive software development company and the purchase 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 December 31, 2003, we had no outstanding structured stock repurchase transactions. 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 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 December 31, 2003, the UK Facility provided Centresoft with the ability to borrow up to GBP 8.0 million (\$14.2 million), including issuing letters of credit, on a revolving basis. Furthermore, as of December 31, 2003, under the UK Facility, Centresoft provided a GBP 0.6 million (\$1.1 million) guarantee for the benefit of our CD Contact subsidiary. The UK Facility bears interest at LIBOR plus 2.0%, is collateralized by substantially all of the assets of the subsidiary and expires in November 2004. The UK Facility also contains various covenants that require the subsidiary to maintain specified financial ratios related to, among others, fixed charges. As of December 31, 2003, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of December 31, 2003. The German Facility provided for revolving loans up to EUR 0.5 million (\$0.6 million) as of December 31, 2003, bears interest at a Eurocurrency rate plus 2.5%, is collateralized by certain of the subsidiary's property and equipment and has no expiration date. No borrowings were outstanding against the German Facility as of December 31, 2003.

## 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 December 31, 2003 is approximately \$99.1 million and is scheduled to be paid as follows (amounts in thousands):

<u>Fiscal year ending March 31,</u>	
2004	\$ 29,827
2005	41,350
2006	18,048
2007	5,560
2008 and thereafter	<u>4,325</u>
Total	<u>\$ 99,110</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.

### 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 reader or listener 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 December 31, 2003, our cash equivalents and short-term investments included debt securities of \$315.8 million.

The following table presents the amounts and related weighted average interest rates of our investment portfolio as of December 31, 2003 (amounts in thousands):

	<u>Average Interest Rate</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
<b>Cash equivalents:</b>			
Fixed rate	1.26%	\$ 189,565	\$ 189,565
Variable rate	0.98	33,915	33,915
<b>Short-term investments:</b>			
Fixed rate	1.85%	\$ 126,171	\$ 126,253

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 December 31, 2003, assuming a change in currency rates of 10% of period end rates, the additional potential gain or loss on outstanding hedging contracts would be approximately \$1.3 million. 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 15 in the Notes to the Consolidated Financial Statements, at those times when we have structured stock repurchase transactions outstanding, it is possible that at settlement we could take delivery of shares at an effective repurchase price higher than the then market price. As of December 31, 2003, we had no structured stock repurchase transactions outstanding.

#### **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, after consultation with legal counsel, the outcome of such routine claims will not have a material adverse effect on our business, financial condition, results of operations or liquidity.



On June 30, 2003, we terminated our Star Trek Merchandising License Agreement with Viacom Consumer Products, Inc. and filed a complaint in the Superior Court of the State of California for breach of contract and constructive trust against Viacom Consumer Products and Viacom International, Inc. (“Viacom”). On August 15, 2003, Viacom filed its response to our complaint as well as a cross-complaint alleging, among other matters, a breach of contract by Activision and seeking claimed damages in excess of \$50 million. We strongly dispute the claims by Viacom, consider the damages alleged by Viacom to be speculative and without merit, and intend to defend vigorously and aggressively against the cross-complaint.

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. We responded to this inquiry on September 2, 2003. To date, we have not received a request from the SEC for additional 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 have cooperated and intend to continue to cooperate fully with the SEC in the conduct of this inquiry.

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

We held a special Meeting of the Stockholders on December 29, 2003 in Santa Monica, California. One item was submitted to a vote of the stockholders: the approval of the amendment of our Amended and Restated Certificate of Incorporation, as amended, to increase the number of authorized shares of common stock from 125,000,000 to 225,000,000.

The amendment to our Amended and Restated Certificate of Incorporation, as amended, was approved. Set forth below are the results of the voting.

For	Against	Abstain
69,575,971	7,883,004	29,043

**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).
- 3.6 Certificate of Amendment of Amended and Restated Certificate of Incorporation, dated December 29, 2003.
- 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 Employment agreement dated November 6, 2003 between Activision and Kathy Vrabeck.
- 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. Chardavoynne 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. Chardavoynne 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 November 6, 2003, reporting under “Item 7. Financial Statements, Pro Forma Financial Statements and Exhibits” and “Item 12. Results of Operations and Financial Condition” issuing a press release announcing our second quarter fiscal 2004 financial results.
- 1.2 We filed a Form 8-K on December 18, 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 revenue and earnings guidance for the third fiscal quarter of fiscal year 2004 and for the full 2004 fiscal year and reiterating our guidance for the fourth fiscal quarter of fiscal 2004.
- 1.3 We filed a Form 8-K on December 23, 2003, reporting under “Item 5. Other Events and Regulation FD Disclosure” and “Item 7. Financial Statements, Pro Forma Financial Statements and Exhibits” issuing a press release announcing the appointment of two new independent directors to our Board of Directors and the resignation of a current independent board member.

**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: February 13, 2004

ACTIVISION, INC.

*/s/ William J. Chardavoyne*

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

**CERTIFICATE OF AMENDMENT  
OF  
AMENDED AND RESTATED CERTIFICATE OF INCORPORATION, AS AMENDED,  
OF  
ACTIVISION, INC.**

ACTIVISION, INC., a corporation duly organized and existing under and by virtue of the General Corporation Law of the State of Delaware, DOES HEREBY CERTIFY as follows:

1. The name of the corporation (hereinafter called the "Corporation") is Activision, Inc.
2. The Amended and Restated Certificate of Incorporation, as amended, of the Corporation is hereby amended by deleting the first paragraph of Article FOURTH and replacing it in its entirety with the following:

"FOURTH: The total number of shares of capital stock which the Corporation shall have authority to issue is two hundred and thirty million (230,000,000) shares, of which five million (5,000,000) shares are designated Preferred Stock, par value \$.000001 per share and aggregate par value of five dollars (\$5.00) ("Preferred Stock"), and of which two hundred twenty-five million (225,000,000) shares are designated Common Stock, par value \$.000001 per share and aggregate par value of two hundred twenty-five dollars (\$225.00) ("Common Stock"). Of the 5,000,000 shares of Preferred Stock, one million one hundred and twenty-five thousand (1,125,000) shares are designated Series A Junior Preferred Stock, par value \$.000001 per share and aggregate par value of one dollar and one hundred twenty-five thousandth cents (\$1.125)."

3. The foregoing amendment of the certificate of incorporation of the corporation was duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, I have subscribed this document on the date set forth below and do hereby affirm, under the penalties of perjury, that this document is the act and deed of the corporation named herein and that the facts stated herein are true.

Dated: December 29, 2003

/s/ George Rose  
George Rose, Secretary

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November 6, 2003

Kathy Vrabeck  
11 Via Emilia  
Newport Coast, CA 92657

Dear Kathy:

This letter (the "Agreement") confirms the terms of your employment by Activision Publishing, Inc. ("Employer"), on the terms and conditions set forth below. This Agreement supercedes the terms of the employment agreement dated April 1, 2001, as amended March 19, 2003 (including all addendums thereto, the "2001 Employment Agreement") previously entered into between you and Employer.

**1. Term**

The term of your employment under this Agreement shall commence on November 1, 2003 (the "Effective Date") and terminate on April 1, 2006 (the "Expiration Date"). For purposes of this Agreement, the period of time from the Effective Date through the Expiration Date shall be defined as the "Employment Period". Notwithstanding anything contained herein to the contrary, your employment pursuant to the terms of this Agreement is subject to termination pursuant to Paragraph 9 below.

**2. Salary**

(a) In full consideration for all rights and services provided by you under this Agreement, you shall receive an annual base salary (the "Base Salary") during the Employment Period. Commencing on the Effective Date, your Base Salary for the fiscal year ending March 31, 2004 shall be \$450,000. Thereafter, on April 1 of each year of the Employment Period, beginning on April 1, 2004, your Base Salary shall be reviewed on an annual basis as described below, to determine if an increase is warranted, subject to the following annual minimum Base Salary:

- i. From April 1, 2004 through March 31, 2005 your Base Salary shall be no less than \$475,000;
- ii. From April 1, 2005 through March 31, 2006 your Base Salary shall be no less than \$515,000.

(b) Each Base Salary referred to in Paragraph 2(a) shall constitute your minimum base salary during the applicable period, and your Base Salary may be increased above the minimum if Employer's Board of Directors (or the Compensation Committee of such Board of Directors), in its sole and absolute discretion, elects to do so. In the event of an increase in your Base Salary beyond the applicable minimum Base Salary for a particular period indicated above, such increased Base Salary shall then constitute your minimum Base Salary for all subsequent periods under this Agreement.

(c) The Base Salary shall be paid in accordance with the then prevailing payroll practices of Employer at regular intervals as Employer may establish from time to time for its senior executive officers. Employer may withhold from any amounts payable under this Agreement all applicable tax, Social Security and other legally required withholding pursuant to any law or regulation (the "Withholding"). Any period of less than a full fiscal year for which the Base Salary is calculated shall be pro rata.

(d) In addition to your Base Salary, you may be eligible to receive an annual discretionary bonus (the “Annual Bonus”). Your target Annual Bonus during the Employment Period shall be 75% of the then applicable Base Salary, provided that the actual amount of the Annual Bonus, if any, is within the sole and absolute discretion of the Employer’s Board of Directors (or the Compensation Committee of the Board of Directors) and is designed to encourage you to remain employed by Employer and to continue any favorable performance during such continued employment. The Annual Bonus shall be based upon (i) the achievement by Employer of its financial and business objectives and goals and your achievement of certain mutually agreed objectives and goals and/or your contribution to the success of Employer’s financial and business objectives and goals, for the fiscal year with respect to which the Annual Bonus is calculated, such determination to be made by Employer’s Board of Directors (or the Compensation Committee of the Board of Directors) in its sole discretion. Employer’s overall financial performance may also be considered by Employer’s Board of Directors (or the Compensation Committee of the Board of Directors) in determining whether any of the Annual Bonus is awarded and, if so, the amount. You acknowledge that Employer retains the right to modify, at any time, any and all of the criteria used to determine whether the Executive is eligible for a bonus and, if so, the amount of any such bonus. The Annual Bonus may take the form of, without limitation, cash, shares of common stock of the Company and/or Options (as defined herein), as the case may be. Any Annual Bonus shall be subject to Withholding

(e) You are also being granted non-qualified stock options (“Options”) under the existing or modified Board-approved stock option plans established by Activision, to purchase shares of common stock of Activision. The Options will have an exercise price that is the market low of such common stock on the date of grant. The Options are being granted to you strictly subject in all respects to the terms and conditions of Activision’s stock option plan pursuant to which the Options are issued and the applicable stock option agreement(s) thereunder, including, generally and without limitation, as follows

- i. Options to purchase 150,000 shares of Activision common stock which will vest and become exercisable ratably over five years so long as you remain employed with Employer at all times on a continuous basis, in increments of options to purchase 30,000 on each of November 1, 2004, November 1, 2005, November 1, 2006, November 1, 2006 and November 1, 2005 respectively;
- ii. Options to purchase 100,000 shares of Activision common stock, with all of such Options vesting and become exercisable, so long as you remain employed with Employer at all times on a continuous basis on November 1, 2008. Notwithstanding the foregoing, the vesting and exercisability of a 50% portion of the Options granted under this Paragraph 2(e)(ii) will accelerate and such accelerated Options will vest in equal increments of 25,000 Options on April 1, 2005, and April 1, 2006, respectively, subject to the achievement of certain acceleration criteria applicable to each specific acceleration even/date and related option increment, as well as to your remaining employed with Employer on a continuous basis. All applicable acceleration criteria must be agreed in good faith by you and Employer.

In the event of termination of your employment, disposition of the Options will be governed by the provisions of Paragraph 9(e) of this Agreement, the terms and conditions of Activision’s stock option plan pursuant to which the Options are issued and the applicable stock option agreement(s) thereunder. The Options issued pursuant to this paragraph are in addition to the stock options previously granted to you (the “Existing Options”). Except as otherwise set forth in Section 9(e) of this Agreement, the terms of any Existing Options granted to you,

whether pursuant to the 2001 Employment Agreement or otherwise, shall not be affected by the execution of this Agreement and shall remain subject to the terms of stock option plans and agreements pursuant to which such Existing Options were granted.

(f) You will be eligible for such additional grants of stock options commensurate with your position with Employer as the Board of Directors (or Compensation Committee of the Board of Directors), in its sole discretion, may award to you from time to time. Terms of such options when granted, if any, shall be at all times strictly subject to the terms of this Agreement, the terms and conditions of Activision's stock option plan pursuant to which the options are issued and the applicable stock option agreement(s) thereunder.

**3. Title**

You are being employed under this Agreement in the position of President of Activision Publishing, a division of Employer.

**4. Duties**

You shall personally and diligently perform, on a full-time and exclusive basis, such services as Employer or any of its related or affiliated entities or divisions may reasonably require. You are also required to read, review and observe all of Employer's existing policies, procedures, rules and regulations as well as those adopted by Employer during the term of your employment. You will at all times perform all of the duties and obligations required by you under this Agreement in a loyal and conscientious manner and to the best of your ability and experience.

**5. Expenses**

To the extent you incur necessary and reasonable business expenses in the course of your employment, you shall be reimbursed for such expenses, subject to Employer's then current policies regarding reimbursement of such business expenses.

**6. Other Benefits**

You shall be entitled to those benefits, which are standard for persons in similar positions with Employer, including coverage under Employer's health, life insurance and disability plans, and eligibility to participate in Employer's 401(k) plan. In addition, during the Employment Period, Employer will maintain a term insurance policy or policies for a period of ten (10) years, covering your life in an amount of \$2,000,000 and naming your estate or any other person designated by you as beneficiary of such policy or policies. Nothing paid to you under any such plans and arrangements (nor any bonus or stock options which Employer's Board of Directors (or the Compensation Committee of such Board of Directors), in its sole and absolute discretion, shall provide to you)) shall be deemed in lieu, or paid on account, of your Base Salary. Except as otherwise specifically provided in this Agreement, you expressly agree and acknowledge that after the expiration or early termination of the term of your employment under this Agreement for any reason, you are entitled to no additional benefits, except as specifically provided under the benefit plans referred to above and those benefit plans in which you subsequently may become a participant, and subject in each case to the terms and conditions of each such plan. Notwithstanding anything to the contrary set forth above, you shall be entitled to receive those benefits provided by COBRA upon the expiration or earlier termination of this Agreement.

**7. Vacation and Paid Holidays**

- (a) You will be entitled to paid vacation days in accordance with the normal vacation policies of Employer in effect from time to time, provided that in no event shall you be entitled to less than twenty (20) days of paid vacation per year.
- (b) You shall be entitled to all paid holidays given by Employer to its full-time employees.

**8. Protection of Employer's Interests**

(a) **Duty of Loyalty.** During the Employment Period, you will not compete in any manner, whether directly or indirectly, as a principal, employee, agent or owner, with Employer, or any affiliate of Employer, except that the foregoing will not prevent you from holding at any time less than five percent (5%) of the outstanding capital stock of any company whose stock is publicly traded.

(b) **Property of Employer.** All rights worldwide with respect to any and all intellectual or other property of any nature produced, created or suggested by you during the term of your employment or resulting from your services which (i) relate in any manner at the time of conception or reduction to practice to the actual or demonstrably anticipated business of Employer, (ii) result from or are suggested by any task assigned to you or any work performed by you on behalf of Employer, or (iii) are based on any property owned or idea conceived by Employer, shall be deemed to be a work made for hire and shall be the sole and exclusive property of Employer. You agree to execute, acknowledge and deliver to Employer, at Employer's request, such further documents, including copyright and patent assignments, as Employer finds appropriate to evidence Employer's rights in such property.

(c) **Confidentiality.** Any confidential and/or proprietary information of Employer or any affiliate of Employer shall not be used by you or disclosed or made available by you to any person except as required in the course of your employment, and upon expiration or earlier termination of the term of your employment, you shall return to Employer all such information which exists in written or other physical form (and all copies thereof) under your control. Without limiting the generality of the foregoing, you acknowledge signing and delivering to Employer the Activision Employee Proprietary Information Agreement and you agree that all terms and conditions contained in such agreement, and all of your obligations and commitments provided for in such agreement, shall be deemed, and hereby are, incorporated into this Agreement as if set forth in full herein. The provisions of this paragraph shall survive the expiration or earlier termination of this Agreement.

(d) **Covenant Not to Solicit.** After the expiration of the Employment Period of this Agreement or earlier termination of your employment pursuant to Paragraphs 9(a), (b) or (c) of this Agreement for any reason whatsoever, you shall not, either alone or jointly, with or on behalf of others, directly or indirectly, whether as principal, partner, agent, shareholder, director, employee, consultant or otherwise, at any time during a period of two (2) years following such expiration or termination, offer employment to, or directly or indirectly solicit the employment or engagement of, or otherwise entice away from the employment of Employer or any affiliated entity, either for your own account or for any other person firm or company, any person who was employed by Employer or any such affiliated entity during the term of your employment, whether or not such person would commit any breach of his or her contract of employment by reason of his or her leaving the service of Employer or any affiliated entity.



## 9. Termination

(a) **By Employer.** At any time during the Employment Period, Employer may terminate your employment under this Agreement for Cause defined as your (i) willful, reckless or gross misconduct or fraud, (ii) gross negligent performance of job responsibilities, and (iii) conviction of or pleading no contest to a felony or crime involving dishonesty or moral turpitude. In addition, Employer will have the right to terminate your employment without Cause and such termination shall not be deemed to constitute a wrongful discharge of Employee or a wrongful termination of Employee's employment by Employer or a breach by Employer of any term of this Agreement and/or any other duty or obligation, expressed or implied, which Employer may owe to Employee pursuant to any principle or provision of law.

(b) **By Employee.** You may terminate your employment under this Agreement only: (i) upon Employer's material breach of Section 2, or (ii) upon any relocation without your consent of the place at which you primarily are performing your services to Employer to a location which is outside Los Angeles County.

(c) **Death or Disability.** In the event of your death during the term of this Agreement, this Agreement shall terminate and Employer only shall be obligated to pay your estate or legal representative only the amounts set forth in Paragraph 9(d)(i) below. In the event you are unable, with or without reasonable accommodation, to perform the services required of your position as a result of any physical (excluding pregnancy) or mental condition ("disability"), then Employer shall have the right, at its option, to terminate your employment under this Agreement, and Employer shall be obligated to pay you only the amounts set forth in Paragraph 9(d)(ii) below. You acknowledge and agree that your ability to continuously perform your duties for Employer is an essential part of your position and that any inability to perform such duties during the term of this Agreement for a period of 60 or more consecutive days or an aggregate of 90 or more days during any 12-month period would create an undue hardship for Employer and the operation of its business. Unless and until so terminated, during any period of disability during which you are unable, with or without reasonable accommodation, to perform the services required of you under this Agreement, your Base Salary shall be payable to the extent of, and subject to, Employer's policies and practices then in effect with regard to sick leave and disability benefits.

(d) **Termination of Obligations.** In the event of the termination of your employment under this Agreement pursuant to Paragraphs 9(a), 9(b) or 9(c), all obligations of Employer to you under this Agreement shall immediately terminate except as follows:

- i. **Compensation upon Death.** In the event of this Agreement is terminated as a result of your death, your heirs, successors or legal representatives shall receive: (i) the Base Salary through the date of termination of this Agreement; (ii) any unpaid Annual Bonus for any previously completed fiscal year if such Annual Bonus is awarded to you pursuant to the terms of Paragraph 2(d) of this Agreement by the Board of Directors (or the Compensation Committee of such Board of Directors) and remain not paid; (iii) the pro rata portion of the Annual Bonus for the fiscal year in which your termination occurs to the extent such Annual Bonus is awarded to you pursuant to the terms of Paragraph 2(d) of this Agreement by the Board of Directors (or the Compensation Committee of such Board of Directors); (iv) an amount equal to two hundred (200%) percent of the dollar amount of the Base Salary paid or payable to you for Employer's most recent fiscal year immediately prior to your date of death; (v) reimbursement of expenses due to you pursuant to Paragraph 5; (vi) your then current spouse and minor children, if any, shall receive the same level of health/medical insurance or coverage that was provided to you immediately prior to your death for an eighteen month period, with the cost of such continued insurance or coverage

being borne by Employer. All such payments shall be in addition to any payments your widow, beneficiaries or estate may be entitled to receive pursuant to any pension or employee benefit plan or life insurance policy maintained by Employer.

- ii. Compensation upon Disability. In the event this Agreement is terminated as a result of your disability, you shall receive: (i) the Base Salary through the date of your termination; (ii) any unpaid Annual Bonus for any previously completed fiscal year if such Annual Bonus is actually awarded to you pursuant to the terms of Paragraph 2(d) of this Agreement by the Board of Directors (or the Compensation Committee of such Board of Directors) and remain not paid in whole or in part; (iii) the pro rata portion of the Annual Bonus for the fiscal year in which your termination occurs to the extent such Annual Bonus is awarded pursuant to the terms of Paragraph 2(d) of this Agreement by the Board of Directors (or the Compensation Committee of such Board of Directors); (iv) reimbursement of expenses due to you pursuant to Paragraph 5; (v) an amount equal to two hundred (200%) percent of the dollar amount of the Base Salary paid or payable to you for Employer's most recent fiscal year immediately prior to your disability termination, less the amount, if any, of any payments received by you from any Employer-funded disability insurance plan; and (vi) you and your then current spouse and minor children, if any, shall receive the same level of health/medical insurance or coverage provided immediately prior to such disability termination for an eighteen month period, with the cost of such continued insurance or coverage being borne by Employer.
- iii. Compensation upon Termination Without Cause. In the event your employment under this Agreement is terminated by Employer without Cause, then you shall receive: (i) the Base Salary through the date of your termination; (ii) any unpaid Annual Bonus for any previously completed fiscal year if such Annual Bonus is then awarded to you pursuant to the terms of this Agreement; (iii) the pro rata portion of the Annual Bonus for the fiscal year in which your termination occurs to the extent such Annual Bonus is awarded pursuant to the terms of this Agreement ; (iv) payment of 50% of your target Annual Bonus not otherwise covered in sub-paragraphs 9(d)(iii)ii and iii above, calculated using the rate referenced in Paragraph 2(d), for the remaining balance of the term of this agreement; (v) reimbursement of expenses due you pursuant to Paragraph 5; (vi) 100% of the Base Salary payable to you through the Expiration Date had your employment not been terminated, such Base Salary to be determined in accordance with the terms of Paragraph 2(a) of this Agreement; and (vii) you and your then current spouse and minor children, if any, shall receive the same level of health/medical insurance or coverage provided immediately prior to such termination for an eighteen month period, with the cost of such continued insurance or coverage being borne by Employer.

(e) **Disposition of Stock Options Upon Termination.** Upon termination of your employment for any reason, the following terms shall apply to all of the Options and the Existing Options issued to you:

- (i) In the event of termination of your employment for Cause, or by your breach of this Agreement, all such stock options, whether or not vested, shall expire immediately on the date of termination of your employment and all such stock options shall immediately be cancelled and no longer continue vest or be exercisable as of the date of termination of your employment.
- (ii) In the event of your termination of employment by reason of your death or disability, all such stock options shall cease to vest immediately as of the date of such termination of your employment, all unvested stock options shall be cancelled and only vested stock options shall continue to be exercisable until the earlier of (a) the end of the 30th day after the date of such termination of your employment, or (b) the expiration of such stock option pursuant to the terms of the stock option agreement for such stock option; and upon the expiration of such period, all stock options then remaining unexercised shall be cancelled.
- (iii) In the event of termination of your employment by Employer without Cause, all such stock options shall cease to vest immediately as of the date of such termination of your employment, all unvested stock options shall be cancelled and only vested stock options shall continue to be exercisable until the earlier of (a) the end of the 30th day after the date of such termination of your employment, or (b) the expiration of such stock option pursuant to the terms of the stock option agreement for such stock option; and upon the expiration of such period, all stock options then remaining unexercised shall be cancelled.
- (iv) In the event of termination of your employment for any reason not otherwise described in Paragraphs 9(e)(i)-(iii), all such stock options shall cease to vest immediately as of the date of such termination of your employment, all unvested stock options shall be cancelled and only vested stock options shall continue to be exercisable until the earlier of (a) the end of the 30th day after the date of such termination of your employment, or (b) the expiration of such stock option pursuant to the terms of the stock option agreement for such stock option; and upon the expiration of such period, all stock options then remaining unexercised shall be cancelled.

**10. Use of Employee's Name**

Employer shall have the right, but not the obligation, to use your name or likeness for any publicity or advertising purpose.

**11. Assignment**

Employer may assign this agreement or all or any part of its rights under this agreement to any entity which succeeds to all or substantially all of Employer's assets (whether by merger, acquisition, consolidation, reorganization or otherwise) or which Employer may own substantially, and this agreement shall inure to the benefit of such assignee.

**12. No Conflict with Prior Agreements**

You represent to Employer that neither your commencement of employment under this Agreement nor the performance of your duties under this Agreement conflicts or will conflict with any contractual commitment on your part to any third party, nor does it or will it violate or interfere with any rights of any third party.

**13. General Provisions**

(a) **Entire Agreement.** This Agreement, including the Employment Proprietary Information Agreement referred to herein, and, with respect to the Options, together with Activision's stock option plan pursuant to which the Options are granted and the stock option agreement(s) thereunder, supersedes all prior or contemporaneous agreements and statements, whether written or oral, concerning the terms of your employment with Employer, and no amendment or modification of this Agreement shall be binding unless it is set forth in a writing signed by both Employer and Employee. To the extent that this Agreement conflicts with any of Employer's policies, procedures, rules or regulations, this Agreement shall supersede the other policies, procedures, rules or regulations. Without limiting the generality of the foregoing, you acknowledge that this Agreement supercedes the 2001 Employment Agreement and such agreement is hereby declared terminated and of no further force or effect, except that any Existing Options granted pursuant to such agreement shall remain valid in all respects and shall be governed by the terms of stock option plans and agreements pursuant to which such Existing Options were granted.

(b) **No Broker.** You have given no indication, representation or commitment of any nature to any broker, finder, agent or other third party to the effect that any fees or commissions of any nature are, or under any circumstances might be, payable by Employer or any affiliate of Employer in connection with your employment under this Agreement.

(c) **Waiver.** No waiver by either party of any breach by the other party of any provision or condition of this Agreement shall be deemed a waiver of any similar or dissimilar provision or condition at the same or any prior or subsequent time.

(d) **Prevailing Law.** Nothing contained in this Agreement shall be construed so as to require the commission of any act contrary to law and wherever there is any conflict between any provision of this Agreement and any present or future statute, law, ordinance or regulation, the latter shall prevail, but in such event the provision of this Agreement affected shall be curtailed and limited only to the extent necessary to bring it within legal requirements.

(e) **Choice of Law.** This Agreement shall be governed by and construed in accordance with the laws of the State of California without regard to conflict of law principles.

(f) **Immigration.** In accordance with the Immigration Reform and Control Act of 1986, employment under this Agreement is conditioned upon satisfactory proof of your identity and legal ability to work in the United States.

(g) **Venue and Jurisdiction.** The parties agree that all actions or proceedings initiated by either party hereto arising directly or indirectly out of this Agreement shall be litigated in federal or state court in Los Angeles, California. The parties hereto expressly submit and consent in advance to such jurisdiction

and agree that service of summons and complaint or other process or papers may be made by registered or certified mail addressed to the relevant party at the address set forth below. The parties hereto waive any claim that a federal or state court in Los Angeles, California, is an inconvenient or an improper forum.

(h) **Severability.** If any provision of this Agreement is held to be illegal, invalid or unenforceable under existing or future laws effective during the term of this Agreement, such provisions shall be fully severable, the Agreement shall be construed and enforced as if such illegal, invalid or unenforceable provision had never comprised a part of this Agreement, and the remaining provisions of this Agreement shall remain in full force and effect and shall not be affected by the illegal, invalid or unenforceable provision or by its severance from this Agreement. Furthermore, in lieu of such illegal, invalid or unenforceable provision, there shall be added automatically as part of this Agreement a provision as similar in terms to such illegal, invalid or unenforceable provision as may be possible and be legal and enforceable.

(i) **Legal Counsel.** Employee acknowledges that he has been given the opportunity to consult with legal counsel of his own choosing regarding this Agreement. Employee understands and agrees that Activision's General Counsel, or any other attorney or member of management who has discussed any term or condition of this Agreement with him, is only acting on behalf of the company and not on behalf of Employee.

(j) **Right to Negotiate.** Employee hereby acknowledges that he has been given the opportunity to participate in the negotiation of the terms of this Agreement.

(k) **Services Unique.** You recognize that the services being performed by you under this Agreement are of a special, unique, unusual, extraordinary and intellectual character giving them a peculiar value, the loss of which cannot be reasonably or adequately compensated for in damages, and in the event of a breach of this Agreement by you (particularly, but without limitation, with respect to the provisions hereof relating to the exclusivity of your services and the provisions of Paragraph 8 of this Agreement).

(l) **Injunctive Relief.** In the event of a breach or threatened breach of this Agreement, you hereby agree that any remedy at law for any breach or threatened breach of this Agreement will be inadequate and, accordingly, each party hereby stipulates that the other is entitled to obtain injunctive relief for any such breaches or threatened breaches. The injunctive relief provided for in this paragraph is in addition to, and is not in limitation of, any and all other remedies at law or in equity otherwise available to the applicable party. The parties agree to waive the requirement of posting a bond in connection with a court's issuance of an injunction.

(m) **Remedies Cumulative.** The remedies in this paragraph are not exclusive, and the parties shall have the right to pursue any other legal or equitable remedies to enforce the terms of this Agreement.

(n) **Attorneys' Fees And Costs.** If either party brings an action to enforce, interpret or apply the terms of this Agreement or declare its rights under this Agreement, the prevailing party in such action, including all appeals, shall receive all of its or his attorneys' fees, experts' fees, and all of its or his costs, in addition to such other relief as may be granted.

**14. Notices**

All notices which either party is required or may desire to give the other shall be in writing and given either personally or by depositing the same in the United States mail addressed to the party to be given notice as follows:

To Employer: 3100 Ocean Park Boulevard  
Santa Monica, California 90405  
Attention: Senior Vice President,  
Business Affairs and General Counsel

To Employee: 11 Via Emilia  
Newport Coast, CA 92657

Either party may by written notice designate a different address for giving of notices. The date of mailing of any such notices shall be deemed to be the date on which such notice is given.

**15. Headings**

The headings set forth herein are included solely for the purpose of identification and shall not be used for the purpose of construing the meaning of the provisions of this Agreement.

If the foregoing accurately reflects our mutual Agreement, please sign where indicated.

**ACCEPTED AND AGREED TO:**

**Employer**

**Employee**

By: /s/ Ronald Doomink

By: /s/ Kathy Vrabeck

Name: \_\_\_\_\_

Kathy Vrabeck

Title: \_\_\_\_\_

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

Date: 11/9/03

**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: February 13, 2004

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

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**CERTIFICATION**

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

1. I have reviewed this quarterly report on Form 10-Q of Activision, Inc.;
2. Based on my knowledge, this 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: February 13, 2004

*/s/ Ronald Doomink*  
\_\_\_\_\_  
Ronald Doomink  
President, Activision, Inc. and  
Chief Executive Officer,  
Activision Publishing, Inc.



**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: February 13, 2004

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

**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 December 31, 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  
February 13, 2004

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.

**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 December 31, 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.  
February 13, 2004

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.

**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 December 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William J. Chardavoine, 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. Chardavoine  
William J. Chardavoine  
Executive Vice President and  
Chief Financial Officer  
February 13, 2004

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.