
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the Quarterly Period Ended September 30, 2005

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 for 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 Exchange Act). Yes No

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes No

The number of shares of the registrant's Common Stock outstanding as of October 28, 2005 was 273,692,839.

ACTIVISION, INC. AND SUBSIDIARIES

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Part I. Financial Information.

Item 1. Financial Statements.

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

	<u>September 30,</u> 2005 (Unaudited)	<u>March 31,</u> 2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 203,085	\$ 313,608
Short-term investments	547,174	527,256
Accounts receivable, net of allowances of \$78,722 and \$69,191 at September 30, 2005 and March 31, 2005, respectively	116,879	109,144
Inventories	52,035	48,018
Software development	110,248	73,096
Intellectual property licenses	10,513	21,572
Deferred income taxes	11,616	6,760
Other current assets	30,712	23,010
Total current assets	1,082,262	1,122,464
Software development	12,643	18,518
Intellectual property licenses	18,825	14,154
Property and equipment, net	35,668	30,490
Deferred income taxes	48,181	28,041
Other assets	1,239	1,635
Goodwill	98,683	91,661
Total assets	<u>\$ 1,297,501</u>	<u>\$ 1,306,963</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 90,838	\$ 108,984
Accrued expenses	85,759	98,067
Total current liabilities	176,597	207,051
Other liabilities	656	—
Total liabilities	177,253	207,051
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, \$.000001 par value, 3,750,000 shares authorized, no shares issued at September 30, 2005 and March 31, 2005	—	—
Series A Junior Preferred stock, \$.000001 par value, 1,250,000 shares authorized, no shares issued at September 30, 2005 and March 31, 2005	—	—
Common stock, \$.000001 par value, 450,000,000 and 225,000,000 shares authorized, 273,426,871 and 268,040,831 shares issued and outstanding at September 30, 2005 and March 31, 2005, respectively	—	—
Additional paid-in capital	787,454	741,680
Retained earnings	329,787	346,614
Accumulated other comprehensive income	4,890	11,618
Unearned compensation	(1,883)	—
Total shareholders' equity	<u>1,120,248</u>	<u>1,099,912</u>

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

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ACTIVISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	For the three months ended September 30,		For the six months ended September 30,	
	2005	2004	2005	2004
Net revenues	\$ 222,540	\$ 310,626	\$ 463,633	\$ 521,902
Costs and expenses:				
Cost of sales – product costs	112,582	123,177	249,336	212,265
Cost of sales – software royalties and amortization	20,427	46,363	35,003	58,646
Cost of sales – intellectual property licenses	8,449	17,551	29,389	35,199
Product development	28,072	19,881	45,874	40,986
Sales and marketing	56,640	53,234	102,958	94,968
General and administrative	22,917	15,762	41,068	29,447
Total costs and expenses	249,087	275,968	503,628	471,511
Operating income (loss)	(26,547)	34,658	(39,995)	50,391
Investment income, net	6,330	2,645	13,678	4,757
Income (loss) before income tax provision (benefit)	(20,217)	37,303	(26,317)	55,148
Income tax provision (benefit)	(6,975)	11,760	(9,490)	17,648
Net income (loss)	\$ (13,242)	\$ 25,543	\$ (16,827)	\$ 37,500
Basic earnings (loss) per share	\$ (0.05)	\$ 0.10	\$ (0.06)	\$ 0.15
Weighted average common shares outstanding	272,129	246,231	270,643	245,576
Diluted earnings (loss) per share	\$ (0.05)	\$ 0.09	\$ (0.06)	\$ 0.14
Weighted average common shares outstanding assuming dilution	272,129	271,439	270,643	272,227

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

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ACTIVISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	For the six months ended September 30,	
	2005	2004
Cash flows from operating activities:		
Net income (loss)	\$ (16,827)	\$ 37,500
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Deferred income taxes	(24,997)	8,932
Realized gain on short term investments	(1,347)	(471)
Depreciation and amortization	6,593	5,132
Amortization and write-offs of capitalized software development costs and intellectual property licenses	43,827	65,246
Amortization of stock compensation expense	117	—
Tax benefit of stock options and warrants exercised	15,468	4,918
Changes in operating assets and liabilities:		
Accounts receivable	(7,692)	(76,009)
Inventories	(4,017)	(37,263)
Software development and intellectual property licenses	(68,716)	(66,330)
Other assets	(6,624)	(11,208)
Accounts payable	(18,141)	30,127

Accrued expenses and other liabilities	(11,912)	50,136
Net cash provided by (used in) operating activities	(94,268)	10,710
Cash flows from investing activities:		
Capital expenditures	(12,723)	(4,443)
Cash payment to effect business combinations, net of cash acquired	(6,933)	—
Increase in restricted cash	(20,000)	—
Purchases of short-term investments	(132,662)	(242,546)
Proceeds from sales and maturities of short-term investments	132,856	326,480
Net cash provided by (used in) investing activities	(39,462)	79,491
Cash flows from financing activities:		
Proceeds from issuance of common stock to employees	27,364	12,602
Net cash provided by financing activities	27,364	12,602
Effect of exchange rate changes on cash	(4,157)	(1,232)
Net increase (decrease) in cash and cash equivalents	(110,523)	101,571
Cash and cash equivalents at beginning of period	313,608	165,120
Cash and cash equivalents at end of period	\$ 203,085	\$ 266,691

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

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ACTIVISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the Six Months ended September 30, 2005
(Unaudited)
(In thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned Compensation	Shareholders' Equity
	Shares	Amount					
Balance, March 31, 2005	268,041	\$ —	\$ 741,680	\$ 346,614	\$ 11,618	\$ —	\$ 1,099,912
Components of comprehensive income:							
Net loss	—	—	—	(16,827)	—	—	(16,827)
Unrealized loss on short-term investments	—	—	—	—	(1,235)	—	(1,235)
Foreign currency translation adjustment	—	—	—	—	(5,493)	—	(5,493)
Total comprehensive income (loss)	—	—	—	—	—	—	(23,555)
Issuance of common stock pursuant to employee stock option and stock purchase plans	5,306	—	27,364	—	—	—	27,364
Tax benefit attributable to employee stock options	—	—	15,468	—	—	—	15,468
Issuance of stock to effect business combination	80	—	942	—	—	—	942
Restricted stock grant	—	—	2,000	—	—	(2,000)	—
Amortization of unearned compensation	—	—	—	—	—	117	117
Balance, September 30, 2005	273,427	\$ —	\$ 787,454	\$ 329,787	\$ 4,890	\$ (1,883)	\$ 1,120,248

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

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ACTIVISION, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)
For the Three and Six Months ended September 30, 2005

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 consists of only normal recurring 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, 2005 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 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 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. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional costs to be incurred. If revised forecasted or actual product sales are less than, and/or revised forecasted or actual costs are greater than, the original forecasted amounts utilized in the initial recoverability analysis, the net realizable value may be lower than originally estimated in any given quarter, which could result in an impairment charge.

Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks, copyrights, software, technology, or other intellectual property or proprietary rights 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 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 property 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. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional costs to be incurred. If revised forecasted or actual product sales are less than, and/or revised forecasted or actual costs are greater than, the original forecasted amounts utilized in the initial recoverability analysis, the net realizable value may be lower than originally estimated in any given quarter, which could result in an impairment charge. Additionally, as noted above, 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. Material differences may result in the amount and timing of charges for any period if management makes different judgments or utilizes different estimates in evaluating these qualitative factors.

Revenue Recognition

We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers. Certain products are sold to customers with a street date (the date that products are made widely available by retailers). For these products we recognize revenue no earlier than the street date. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection. 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.

Sales incentives or other consideration given by us to our customers is accounted for in accordance with the Financial Accounting Standards Board's 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 September 30, 2005, 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, 2005 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 (loss) and earnings (loss) 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 September 30,</u>		<u>Six months ended September 30,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Net income (loss), as reported	\$ (13,242)	\$ 25,543	\$ (16,827)	\$ 37,500
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(3,705)	(3,559)	(6,676)	(8,498)
Pro forma net income (loss)	<u>\$ (16,947)</u>	<u>\$ 21,984</u>	<u>\$ (23,503)</u>	<u>\$ 29,002</u>
Earnings (loss) per share:				
Basic – as reported	\$ (0.05)	\$ 0.10	\$ (0.06)	\$ 0.15
Basic – pro forma	<u>\$ (0.06)</u>	<u>\$ 0.09</u>	<u>\$ (0.09)</u>	<u>\$ 0.12</u>
Diluted – as reported	\$ (0.05)	\$ 0.09	\$ (0.06)	\$ 0.14
Diluted – pro forma	<u>\$ (0.06)</u>	<u>\$ 0.08</u>	<u>\$ (0.09)</u>	<u>\$ 0.11</u>

Prior to April 1, 2005, the fair value of options granted was estimated at the date of grant using the Black-Scholes option pricing model. As of April 1, 2005, we switched to a binomial-lattice model to estimate the fair value of options granted after that date. We believe that the binomial-lattice model more accurately estimates the fair value of options granted as it is capable of more fully reflecting certain characteristics of employee share options. Both models require the input of highly subjective assumptions, including the expected stock price volatility. To estimate volatility for the binomial-lattice model, we use the implied volatility method based upon the volatilities for exchange-traded options on our stock to estimate short-term volatility, the historical method (annualized standard deviation of the instantaneous returns on Activision's stock) to estimate long-term volatility and a statistical model to estimate the transition or "mean reversion" from short-term volatility to long-term volatility. Based on these methods, for options granted during the three months ended September 30, 2005, the expected stock price volatility ranged from 36% to 53%, with a weighted average volatility of 50%. For the Black-Scholes option pricing model, we used 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. For

options granted during the three months ended September 30, 2004, the historical stock price volatility used was based on a weekly stock price observation, using an average of the high and low stock prices of our common stock, which resulted in an expected stock price volatility of 45%. 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.

Restricted Stock

In June 2005, we issued the rights to 155,763 shares of restricted stock to an employee. These shares vest over a five-year period and remain subject to forfeiture if vesting conditions are not met. In accordance with APB Opinion No. 25, we recognize unearned compensation in connection with the grant of restricted shares equal to the fair value of our common stock on the date of grant. The fair value of these shares when issued was approximately \$12.84 per share and resulted in an increase in "Additional paid-in capital" and "Unearned compensation" on the accompanying balance sheet of \$2.0 million. Over the vesting period, we reduce unearned compensation and recognize compensation expense. For the second quarter of fiscal 2006, we recorded expense related to these shares of approximately \$100,000 in "General and administrative" on the accompanying statements of operations.

Reclassifications

Certain amounts in the consolidated financial statements have been reclassified to conform with the current year's presentation.

We have reclassified certain auction rate securities from cash and cash equivalents to short-term investments. Auction rate securities are variable rate bonds tied to short-term interest rates with maturities on the face of the underlying security in excess of 90 days. Auction rate securities have interest rate resets through a modified Dutch auction at predetermined short-term intervals, typically every 7, 28, or 35 days. Interest paid during a given period is based upon the interest rate determined during the prior auction.

Although these securities are issued and rated as long-term bonds, they are priced and traded as short-term instruments because of the liquidity provided through the interest rate reset. We had historically classified these instruments as cash and cash equivalents if the reset period between interest rate resets was 90 days or less, which was based on our ability to liquidate our holdings or roll our investment over to the next reset period. Our re-evaluation of the maturity dates and other provisions associated with the underlying bonds resulted in a reclassification from cash and cash equivalents to short-term investments of approximately \$123.1 million on the September 30, 2004 balance sheet. As a result of this balance sheet reclassification, certain amounts were reclassified in the accompanying consolidated statement of cash flows for the six months ended September 30, 2004 to reflect the gross purchases and sales of these securities as investing activities rather than as a component of cash and cash equivalents. This change in classification does not affect previously reported cash flows from operating or from financing activities in the previously reported consolidated statements of cash flows or the previously reported consolidated statements of operations. For the six months ended September 30, 2004, as a result of these revisions in classification, net cash provided by investing activities related to these current investments increased \$178.3 million.

2. Stock Split

In February 2005, the Board of Directors approved a four-for-three split of our outstanding common shares effected in the form of a 33-1/3% stock dividend. The split was paid March 22, 2005 to shareholders of record as of March 7, 2005. In September 2005, the Board of Directors approved a four-for-three split of our outstanding common shares effected in the form of a 33-1/3% stock dividend. The split was paid October 24, 2005 to shareholders of record as of October 10, 2005. 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 splits had occurred as of the earliest period presented.

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On March 7, 2005, in connection with our stock split, all shares of common stock held as treasury stock were formally cancelled and restored to the status of authorized but unissued shares of common stock.

3. Cash, Cash Equivalents, and Short-term Investments

Short-term investments generally mature between three and thirty months. 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.

Restricted Cash – Compensating Balances

As of September 30, 2005, we maintained a \$20.0 million irrevocable standby letter of credit. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. Under the terms of this arrangement, we are required to maintain on deposit with the bank a compensating balance, restricted as to use, not less than the sum of the available amount of the letter of credit plus the aggregate amount of any drawings under the letter of credit that have been honored thereunder but not reimbursed. At September 30, 2005, the \$20.0 million deposit is included in short-term investments as restricted cash.

The following table summarizes our investments in securities as of September 30, 2005 (amounts in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash and time deposits	\$ 102,299	\$ —	\$ —	\$ 102,299
Commercial paper	36,140	—	(7)	36,133
US agency issues	2,987	—	—	2,987
Money market instruments	61,666	—	—	61,666
	<u>203,092</u>	<u>—</u>	<u>(7)</u>	<u>203,085</u>
Short-term investments:				
Restricted cash	20,000	—	—	20,000
Corporate bonds	175,263	2	(1,696)	173,569
Certificate of deposit	3,934	—	(12)	3,922
U.S. agency issues	271,998	—	(2,122)	269,876
Asset-backed securities	8,590	—	(29)	8,561
Commercial paper	3,668	—	(2)	3,666
Mortgage-backed securities	68,169	—	(589)	67,580
	<u>551,622</u>	<u>2</u>	<u>(4,450)</u>	<u>547,174</u>
Cash, cash equivalents, and short-term investments	<u>\$ 754,714</u>	<u>\$ 2</u>	<u>\$ (4,457)</u>	<u>\$ 750,259</u>

Auction rate securities are structured with short-term reset dates of generally less than 90 days but with maturities in excess of 90 days. At the end of the reset period, investors can sell or continue to hold the securities at par. These securities are classified in the table below based on their legal stated maturity dates.

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The following table summarizes the maturities of our investments in debt securities as of September 30, 2005 (amounts in thousands):

	Amortized Cost	Fair Value
Due in one year or less	\$ 194,340	\$ 193,202
Due after one year through two years	256,771	254,440
Due after two years through three years	22,811	22,668
Due in three years or more	20,068	19,843
	<u>493,990</u>	<u>490,153</u>
Asset-backed securities	76,759	76,141
Total	<u>\$ 570,749</u>	<u>\$ 566,294</u>

For the three and six months ended September 30, 2005, there were \$4,000 and \$1.3 million of gross realized gains, respectively, and no gross realized losses. For the three and six months ended September 30, 2004, net realized gains on short-term investments consisted of \$471,000 of gross realized gains and no gross realized losses.

In accordance with EITF 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," the fair value of investments in an unrealized loss position for which an other-than-temporary impairment has not been recognized was \$557.4 million at September 30, 2005 with related gross unrealized losses of \$4.5 million. At September 30, 2005, the gross unrealized losses were comprised mostly of unrealized losses on corporate bonds, U.S. agency issues, and mortgage-backed securities with \$0.2 million of unrealized loss being in a continuous unrealized loss position for twelve months or greater.

Our investment portfolio consists of government and corporate securities with effective maturities less than 30 months. The longer the term of the securities, the more susceptible they are to changes in market rates of interest and yields on bonds. Investments are reviewed periodically to identify possible impairment. When evaluating the investments, we review factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the issuer, and our ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery in market value. We have the intent and ability to hold these securities for a reasonable period of time sufficient for a forecasted recovery of fair value up to (or beyond) the initial cost of the investment. We expect to realize the full value of all of these investments upon maturity or sale.

4. Inventories

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

	September 30, 2005	March 31, 2005
Finished goods	\$ 40,606	\$ 45,926
Purchased parts and components	11,429	2,092
	<u>\$ 52,035</u>	<u>\$ 48,018</u>

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5. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the six months ended September 30, 2005 are as follows (amounts in thousands):

	Publishing	Distribution	Total
Balance as of March 31, 2005	\$ 85,899	\$ 5,762	\$ 91,661
Goodwill acquired during the period	6,260	—	6,260
Issuance of contingent consideration	942	—	942
Adjustment to prior period purchase allocation	5	—	5
Effect of foreign currency exchange rates	176	(361)	(185)
Balance as of September 30, 2005	<u>\$ 93,282</u>	<u>\$ 5,401</u>	<u>\$ 98,683</u>

6. Income Taxes

The income tax benefit of \$7.0 million for the three months ended September 30, 2005 reflects our effective income tax rate for the quarter of 34.5%. The significant items that generated the variance between our effective rate and our statutory rate of 35% were research and development tax credits and the impact of foreign tax rate differentials, partially offset by state taxes. The income tax benefit of \$9.5 million for the six months ended September 30, 2005 reflects our effective income tax rate of approximately 36%. The significant items that generated variances between our effective rate and our statutory rate of 35% were a one-time international tax benefit for the release of certain reserves due to the expiration of a tax statute of limitations, research and development tax credits and the impact of foreign tax rate differentials, partially offset by state taxes.

7. Software Development Costs and Intellectual Property Licenses

As of September 30, 2005, capitalized software development costs included \$98.7 million of internally developed software costs and \$24.2 million of payments made to third-party software developers. As of March 31, 2005, capitalized software development costs included \$61.3 million of internally developed software costs and \$30.3 million of payments made to third-party software developers. Capitalized intellectual property licenses were \$29.3 million and \$35.7 million as of September 30, 2005 and March 31, 2005, respectively. Amortization and write-offs of capitalized software development costs and intellectual property licenses were \$43.8 million and \$65.2 million for the six months ended September 30, 2005 and 2004, respectively.

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

Comprehensive Income (Loss)

The components of comprehensive income (loss) for the three and six months ended September 30, 2005 and 2004 were as follows (amounts in thousands):

	<u>Three months ended September 30,</u>		<u>Six months ended September 30,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Net income (loss)	\$ (13,242)	\$ 25,543	\$ (16,827)	\$ 37,500
Other comprehensive income (loss):				
Foreign currency translation adjustment	(1,830)	(92)	(5,493)	(1,452)
Unrealized appreciation (depreciation) on short-term investments	(1,023)	1,547	(1,235)	330
Other comprehensive income (loss)	(2,853)	1,455	(6,728)	(1,122)
Comprehensive income (loss)	\$ (16,095)	\$ 26,998	\$ (23,555)	\$ 36,378

Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) at September 30, 2005 were as follows (amounts in thousands):

	<u>Foreign Currency Translation Adjustment</u>	<u>Unrealized Appreciation (Depreciation) On Investments</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>
Balance, March 31, 2005	\$ 14,838	\$ (3,220)	\$ 11,618
Other comprehensive income (loss)	(5,493)	(1,235)	(6,728)
Balance, September 30, 2005	\$ 9,345	\$ (4,455)	\$ 4,890

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

9. Investment Income, Net

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

	<u>Three months ended September 30,</u>		<u>Six months ended September 30,</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Interest expense	\$ (51)	\$ (58)	\$ (113)	\$ (146)
Interest income	6,377	2,232	12,444	4,432
Net realized gain on investments	4	471	1,347	471
Investment income, net	\$ 6,330	\$ 2,645	\$ 13,678	\$ 4,757

10. Supplemental Cash Flow Information

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

	<u>Six months ended September 30,</u>	
	<u>2005</u>	<u>2004</u>
Non-cash investing and financing activities:		
Subsidiaries acquired with common stock	\$ 942	\$ 1,191
Change in unrealized depreciation (appreciation) on short-term investments	1,235	(330)
Supplemental cash flow information:		
Cash paid for income taxes	\$ 1,511	\$ 5,018
Cash received for interest, net	(12,040)	(4,231)

11. Operations by Reportable Segments and Geographic Area

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

Publishing refers to the development, marketing and sale of products, either directly, by license or through our affiliate label program with certain third-party publishers. In the United States and Canada, 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, Germany, France, Italy, Spain, Australia, Sweden, Canada, and Japan. Our products are sold internationally on a direct-to-retail basis and through third-party distribution and licensing arrangements and through our wholly-owned distribution subsidiaries.

Distribution refers to our operations 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, 2005. Revenue derived from sales between segments is eliminated in consolidation.

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Information on the reportable segments for the three and six months ended September 30, 2005 and 2004 is as follows (amounts in thousands):

	Three months ended September 30, 2005		
	Publishing	Distribution	Total
Total segment revenues	\$ 167,407	\$ 55,133	\$ 222,540
Revenues from sales between segments	(14,426)	14,426	—
Revenues from external customers	\$ 152,981	\$ 69,559	\$ 222,540
Operating income (loss)	\$ (27,580)	\$ 1,033	\$ (26,547)
Total assets	\$ 1,203,101	\$ 94,400	\$ 1,297,501
	Three months ended September 30, 2004		
	Publishing	Distribution	Total
Total segment revenues	\$ 266,395	\$ 44,231	\$ 310,626
Revenues from sales between segments	(32,454)	32,454	—
Revenues from external customers	\$ 233,941	\$ 76,685	\$ 310,626
Operating income	\$ 31,609	\$ 3,049	\$ 34,658
Total assets	\$ 986,966	\$ 117,203	\$ 1,104,169
	Six months ended September 30, 2005		
	Publishing	Distribution	Total
Total segment revenues	\$ 360,958	\$ 102,675	\$ 463,633
Revenues from sales between segments	(36,878)	36,878	—
Revenues from external customers	\$ 324,080	\$ 139,553	\$ 463,633
Operating income (loss)	\$ (41,489)	\$ 1,494	\$ (39,995)
Total assets	\$ 1,203,101	\$ 94,400	\$ 1,297,501
	Six months ended September 30, 2004		
	Publishing	Distribution	Total
Total segment revenues	\$ 428,047	\$ 93,855	\$ 521,902
Revenues from sales between segments	(40,778)	40,778	—
Revenues from external customers	\$ 387,269	\$ 134,633	\$ 521,902
Operating income	\$ 47,503	\$ 2,888	\$ 50,391
Total assets	\$ 986,966	\$ 117,203	\$ 1,104,169

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Geographic information for the three and six months ended September 30, 2005 and 2004 is based on the location of the selling entity. Revenues from external customers by geographic region were as follows (amounts in thousands):

	Three months ended September 30,		Six months ended September 30,	
	2005	2004	2005	2004
United States	\$ 111,904	\$ 157,705	\$ 224,224	\$ 282,896

Europe	104,698	141,019	224,679	219,120
Other	5,938	11,902	14,730	19,886
Total	\$ 222,540	\$ 310,626	\$ 463,633	\$ 521,902

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

	Three months ended September 30,		Six months ended September 30,	
	2005	2004	2005	2004
Console	\$ 137,873	\$ 175,471	\$ 318,323	\$ 333,792
Hand-held	63,454	27,225	92,693	49,310
PC	21,213	107,930	52,617	138,800
Total	\$ 222,540	\$ 310,626	\$ 463,633	\$ 521,902

As of and for the three and six months ended September 30, 2005, we had one customer that accounted for 23% of consolidated net revenues in both periods and 32% of consolidated accounts receivable, net at September 30, 2005. As of and for the three and six months ended September 30, 2004, we had one customer that accounted for 19% and 22% of consolidated net revenues, respectively, and 27% 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.

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12. Computation of Earnings (Loss) Per Share

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

	Three months ended September 30,		Six months ended September 30,	
	2005	2004	2005	2004
Numerator:				
Numerator for basic and diluted earnings (loss) per share - income (loss) available to common shareholders	\$ (13,242)	\$ 25,543	\$ (16,827)	\$ 37,500
Denominator:				
Denominator for basic earnings (loss) per share- weighted average common shares outstanding	272,129	246,231	270,643	245,576
Effect of dilutive securities:				
Employee stock options and stock purchase plan	—	24,105	—	25,471
Warrants to purchase common stock	—	1,103	—	1,180
Potential dilutive common shares	—	25,208	—	26,651
Denominator for diluted earnings (loss) per share - weighted average common shares outstanding plus assumed conversions	272,129	271,439	270,643	272,227
Basic earnings (loss) per share	\$ (0.05)	\$ 0.10	\$ (0.06)	\$ 0.15
Diluted earnings (loss) per share	\$ (0.05)	\$ 0.09	\$ (0.06)	\$ 0.14

Options to purchase 22,685,695 shares of common stock at exercise prices ranging from \$1.00 to \$17.04 and options to purchase 21,651,466 shares of common stock at exercise prices ranging from \$1.00 to \$17.04 were outstanding for the three and six months ended September 30, 2005, respectively, but were not included in the calculation of diluted earnings (loss) per share because their effect would be antidilutive.

Options to purchase 3,645,079 shares of common stock at exercise prices ranging from \$7.58 to \$9.38 and options to purchase 2,600,505 shares of common stock at exercise prices ranging from \$7.58 to \$9.38 were outstanding for the three and six months ended September 30, 2004, respectively, but were not included in the calculation of diluted earnings per share because their effect would be antidilutive.

13. Commitments and Contingencies

Credit Facilities

We have revolving credit facilities with our Centresoft subsidiary located in the UK (the "UK Facility") and our NBG subsidiary located in Germany (the "German Facility"). The UK Facility provided Centresoft with the ability to borrow up to Great British Pounds ("GBP") 8.0 million (\$14.1 million),

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including issuing letters of credit, on a revolving basis as of September 30, 2005. Furthermore, under the UK Facility, Centresoft provided a GBP 0.6 million (\$1.1 million) guarantee for the benefit of our CD Contact subsidiary as of September 30, 2005. The UK Facility bore interest at LIBOR plus

2.0% as of September 30, 2005, is collateralized by substantially all of the assets of the subsidiary and expires in May 2006. The UK Facility also contains various covenants that require the subsidiary to maintain specified financial ratios related to, among others, fixed charges. As of September 30, 2005, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of September 30, 2005. The German Facility provided for revolving loans up to EUR 0.5 million (\$0.6 million) as of September 30, 2005, bore 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 September 30, 2005.

As of September 30, 2005, we maintained a \$20.0 million irrevocable standby letter of credit in North America. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. Under the terms of this arrangement, we are required to maintain on deposit with the bank a compensating balance, restricted as to use, not less than the sum of the available amount of the letter of credit plus the aggregate amount of any drawings under the letter of credit that have been honored thereunder but not reimbursed. At September 30, 2005, the \$20.0 million deposit is included in short-term investments as restricted cash.

As of September 30, 2005, our publishing subsidiary located in the UK maintained a GBP 8.0 million (\$14.1 million) irrevocable standby letter of credit. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. The standby letter of credit does not require a compensating balance and is collateralized by substantially all of the assets of the subsidiary and expires on July 31, 2006. As of September 30, 2005, we had EUR 5.9 million (\$7.0 million) outstanding against this letter of credit.

Commitments

In the normal course of business, we enter into contractual arrangements with third parties for non-cancelable operating lease agreements for our offices, 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 lessor, developer or intellectual property holder, based upon contractual arrangements. Typically, the payments to third-party developers are conditioned upon the achievement by the developers of contractually specified development milestones. These payments to third-party developers and intellectual property holders typically are deemed to be advances and are recoupable against future royalties earned by the developer or intellectual property holder based on the sale of the related game. Additionally, in connection with certain intellectual property right acquisitions and development agreements, we will commit to spend specified amounts for marketing support for the related game(s) which is to be developed or in which the intellectual property will be utilized. Additionally, we lease certain of our facilities under non-cancelable operating lease agreements. Assuming all contractual provisions are met, the total future minimum commitments for these and other contractual arrangements in place as of September 30, 2005, are scheduled to be paid as follows (amounts in thousands):

	Contractual Obligations			
	Facility Leases	Developer and IP	Marketing	Total
Fiscal year ending March 31,				
2006	\$ 6,624	\$ 19,579	\$ 8,215	\$ 34,418
2007	11,881	11,880	3,535	27,296
2008	8,494	6,525	8,375	23,394
2009	7,329	2,900	—	10,229
2010	6,521	—	—	6,521
Thereafter	26,975	—	—	26,975
Total	\$ 67,824	\$ 40,884	\$ 20,125	\$ 128,833

Compensation Guarantee

In June 2005, we entered into an employment agreement with the President and Chief Executive Officer of Activision Publishing containing a guarantee related to total compensation. The agreement guarantees that in the event that on May 15, 2010 total compensation has not exceeded \$20.0 million, we will make a payment for the amount of the shortfall. The \$20.0 million guarantee will be recognized as compensation expense evenly over the term of the employment agreement comprising of salary payments, bonus payments, restricted stock expense, stock option expense, and an accrual for any anticipated remaining portion of the guarantee. The remaining portion of the guarantee is accrued over the term of the agreement in "Other liabilities" and will remain accrued until the end of the employment agreement at which point it will be used to make a payment for any shortfall or reclassified into shareholders' equity.

Legal and Regulatory Proceedings

On March 5, 2004, a class action lawsuit was filed against us and certain of our current and former officers and directors. The complaint, which asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 based on allegations that our revenues and assets were overstated during the period between February 1, 2001 and December 17, 2002, was filed in the United States District Court, Central District of California by the Construction Industry and Carpenters Joint Pension Trust for Southern Nevada purporting to represent a class of purchasers of Activision stock. Five additional purported class actions were subsequently filed by Gianni Angeloni, Christopher Hinton, Stephen Anish, the Alaska Electrical Pension Fund, and Joseph A. Romans asserting the same claims. Consistent with the Private Securities Litigation Reform Act ("PSLRA"), the court appointed lead plaintiffs consolidating the six putative

securities class actions into a single case. In an Order dated May 16, 2005, the court dismissed the consolidated complaint because the plaintiffs failed to satisfy the heightened pleading standards of the PSLRA. The court did, however, give the lead plaintiffs leave to file an amended consolidated complaint within 30 days of the order. Rather than file a new complaint, the Plaintiff agreed to dismiss the entire case with prejudice. The Order dismissing the action with prejudice was entered on June 17, 2005.

In addition, on March 12, 2004, a shareholder derivative lawsuit captioned *Frank Capovilla, Derivatively on Behalf of Activision, Inc. v. Robert Kotick, et al.* was filed, purportedly on behalf of Activision, which in large measure asserts the identical claims set forth in the federal class action lawsuit. That complaint was filed in California Superior Court for the County of Los Angeles. Also, on March 22, 2005, a new derivative lawsuit captioned *Ramalingam Balamohan, Derivatively on Behalf of Nominal Defendant Activision, Inc. v. Robert Kotick, et al.* was filed in the Federal Court in Los Angeles. This complaint made the same allegations as the previous complaints, but it named all the then current directors as defendants. In the California state derivative case, in light of the ruling dismissing the complaint in the federal class action, plaintiff's counsel filed an amended complaint which, while still based on the same factual allegations that led to the class action being dismissed in federal court, dropped most of the causes of action and focuses only on the alleged claims of insider trading and breaches of fiduciary duty. Activision intends to contest these allegations as vigorously as the earlier allegations. In the federal derivative case, plaintiff voluntarily filed a notice of dismissal of the action, without prejudice, pending resolution of the federal class action and an order dismissing this action was entered on June 3, 2005.

In addition, we are party to other 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.

14. Recently Issued Accounting Standards and Laws

On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 123 (revised 2004), *Share-Based Payment* ("SFAS No. 123R"), which is a revision of FASB Statement No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"). SFAS No. 123R supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends FASB Statement No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123R is similar to the approach described in SFAS 123. However, SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

SFAS No. 123R must be adopted by us no later than April 1, 2006. Early adoption will be permitted in periods in which financial statements have not yet been issued. We expect to adopt SFAS No. 123R on April 1, 2006.

SFAS No. 123R permits public companies to adopt its requirements using one of two methods:

- A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date.
- A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

As permitted by SFAS 123, we currently account for share-based payments to employees using Opinion 25's intrinsic value method and, as such, generally recognize no compensation cost for employee stock

options. Accordingly, the adoption of SFAS No. 123R's fair value method will have a significant impact on our results of operations, although it will have no impact on our overall financial position. While management continues to evaluate the impact of SFAS No. 123R, we currently believe that the expensing of stock-based compensation will have an impact on our Consolidated Statement of Operations similar to our pro forma disclosure under SFAS 123.

On November 24, 2004, the FASB issued Statement No. 151, *Inventory Costs, an Amendment of ARB No. 43, Chapter 4* ("SFAS No. 151"). The standard requires that abnormal amounts of idle capacity and spoilage costs within inventory should be excluded from the cost of inventory and expensed when incurred. The provisions of SFAS No. 151 are applicable to inventory costs incurred during fiscal years beginning after June 15, 2005. We expect the adoption of SFAS No. 151 will not have a material impact on our financial position or results of operations.

On December 15, 2004 the FASB issued Statement No. 153 ("SFAS No. 153"), *Exchanges of Nonmonetary Assets — an Amendment of Accounting Principles Board Opinion No. 29*. This standard requires exchanges of productive assets to be accounted for at fair value, rather than at carryover basis, unless (1) neither the asset received nor the asset surrendered has a fair value that is determinable within reasonable limits or (2) the transactions lack commercial substance. The new standard was effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS No. 153 did not have a material impact on our financial position or results of operations.

In May 2005, the FASB issued Statement No. 154 ("SFAS No. 154"), *Accounting Changes and Error Corrections — A Replacement of APB Opinion No. 20 and FASB Statement No. 3*. SFAS No. 154 changes the requirements for the accounting and reporting of a change in accounting principle and correction of errors. Under previous guidance, changes in accounting principle were recognized as a cumulative effect in the net income of the period of the change. The new statement requires retrospective application of changes in accounting principle and correction of errors, limited to the direct effects of the change, to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005.

On October 22, 2004, the President of the United States signed the American Jobs Creation Act of 2004 (the "Act"). The Act raises a number of issues with respect to accounting for income taxes. For companies that pay U.S. income taxes on manufacturing activities in the U.S., the Act provides a deduction from taxable income equal to a stipulated percentage of qualified income from domestic production activities. The manufacturing deduction provided by the Act replaces the extraterritorial income ("ETI") deduction currently in place. We currently derive benefits from the ETI exclusion which was repealed by the Act. Our exclusion for fiscal 2006 and 2007 will be limited to 75% and 45% of the otherwise allowable exclusion and no exclusion will be available in fiscal 2008 and thereafter. The Act also creates a temporary incentive for U.S. multinationals to repatriate accumulated income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations. The deduction is subject to a number of limitations. The Act also provides for other changes in tax law that will affect a variety of taxpayers. On December 21, 2004, the Financial Accounting Standards Board ("FASB") issued two FASB Staff Positions ("FSP") regarding the accounting implications of the Act related to (1)

the deduction for qualified domestic production activities and (2) the one-time tax benefit for the repatriation of foreign earnings. The FASB determined that the deduction for qualified domestic production activities should be accounted for as a special deduction under FASB Statement No. 109, *Accounting for Income Taxes*. The FASB also confirmed, that upon deciding that some amount of earnings will be repatriated, a company must record in that period the associated tax liability. The guidance in the FSPs applies to financial statements for periods ending after the date the Act was enacted. We are evaluating the Act at this time and have not yet determined whether we will avail ourselves of the opportunity of the one-time tax benefit for the repatriation of foreign earnings. We plan to complete our assessment before the end of fiscal 2006 and are not currently in a position to estimate a range of possible repatriation amounts.

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

Overview

Our Business

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 variety of consumer demographics. Our product portfolio includes such best-selling franchises as Spider-Man, Tony Hawk, Call of Duty, True Crime, X-Men, and Shrek.

Our products cover diverse game categories including action/adventure, action sports, racing, role-playing, simulation, first-person action, and strategy. Our target customer base ranges from casual players to game enthusiasts, children to adults and mass-market consumers to "value" buyers. We currently offer our products primarily in versions that operate on the Sony PlayStation 2 ("PS2"), Nintendo GameCube ("GameCube"), and Microsoft Xbox ("Xbox") console systems, Nintendo Game Boy Advance ("GBA"), Sony PlayStation Portable ("PSP"), and Nintendo Dual Screen ("NDS") hand-held devices, and the personal computer ("PC"). The installed base for the current generation of hardware platforms is significant and growing and the recent releases of two new handheld devices, NDS and PSP, will also help expand the software market.

We also intend to develop titles for the next-generation console systems which are being developed by Sony, Nintendo and Microsoft. Microsoft recently unveiled their next-generation console, the Xbox 360, which will be released in November 2005. We are currently developing four titles for release concurrently with the release of the Xbox 360, *Tony Hawk's American Wasteland*, *Call of Duty 2*, *Quake IV*, and *GUN*. Sony and Nintendo recently unveiled their next-generation consoles, the PlayStation 3 and Revolution, respectively, and both are expected to be released in calendar 2006. Our plan is to have a significant presence at the launch of each new platform while being careful not to move away too quickly from the current generation platforms given their large and still growing installed base.

Our publishing business involves the development, marketing and sale of products directly, by license or through our affiliate label program with certain third-party publishers. In the United States and Canada, 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, Spain, the Netherlands, 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, we will continue to focus on our "big propositions," products that are backed by strong brands and high quality development, for which we will provide significant marketing support.

Our fiscal 2006 "big propositions" include well-established brands, which are backed by high-profile intellectual property and/or highly anticipated motion picture releases. We have a long-term relationship with Marvel Enterprises through an exclusive licensing agreement. This agreement grants us the exclusive rights to develop and publish video games based on Marvel's comic book franchises Spider-Man, X-Men, Fantastic 4,

and Iron Man. Our fiscal 2006 release schedule includes titles based on Marvel's Spider-Man, Fantastic 4, and X-Men. In the first quarter of fiscal 2006 we released the video game, *Fantastic 4*, just prior to the theatrical release of "Fantastic 4." In the second quarter of fiscal 2006 we released *Ultimate Spider-Man* and *X-Men Legends 2* in North America with a European release following in the third quarter of fiscal 2006. In addition, through our licensing agreement with Spider-Man Merchandising, LLP, we will be developing and publishing video games based on Columbia Pictures/Marvel Enterprises, Inc.'s upcoming feature film "Spider-Man 3," which is expected to be released in May 2007. We also have an exclusive licensing agreement with professional skateboarder Tony Hawk. The agreement grants us exclusive rights to develop and publish video games using Tony Hawk's name and likeness. Through the second quarter of fiscal 2006, we have released six successful titles in the Tony Hawk franchise with cumulative net revenues of \$968.5 million, including *THUG 2*, which was released in the third quarter of fiscal 2005. We continued to promote our skateboarding franchise with the October 2005 release of *Tony Hawk's American Wasteland*.

We also continue to develop a number of original intellectual properties which are developed and owned by Activision. For example, in the third quarter of fiscal 2005 we released *Call of Duty: Finest Hour*, on multiple console platforms. This title followed two other PC titles based upon this original

property, *Call of Duty* and *Call of Duty: United Offensive*, and was ranked by NPD Funworld (“NPD”) as one of the top-five best selling games in December 2004. The title *True Crime: Streets of L.A.*, released in the third quarter of fiscal 2004, is another title based upon original intellectual property. We expect to develop a variety of games on multiple platforms based on these two original properties including the upcoming third quarter fiscal 2006 releases of *Call of Duty 2*, *Call of Duty 2: Big Red One*, and *True Crime: New York City*. Furthermore, we will be releasing another original intellectual property, *GUN*, in the third quarter of fiscal 2006.

We will also continue to evaluate and exploit emerging brands that we believe have potential to become successful game franchises. For example, we have a multi-year, multi-property, publishing agreement with DreamWorks LLC that grants us the exclusive rights to publish video games based on DreamWorks Animation SKG’s theatrical release “Shrek 2,” which was released in the first quarter of fiscal 2005, “Shrek Tale,” which was released in the second quarter of fiscal 2005, “Madagascar,” which was released in the first quarter of fiscal 2006, as well as upcoming computer-animated films “Over the Hedge,” and all of their respective sequels, including “Shrek 3.” Additionally we have a strategic alliance with Harrah’s Entertainment, Inc. that grants us the exclusive, worldwide interactive rights to develop and publish “World Series of Poker” video games based on the widely popular World Series of Poker Tournament. We released our first title under this alliance, *World Series of Poker*, in the second quarter of fiscal 2006.

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 of several development companies with talented and experienced teams including, most recently, the acquisitions of Vicarious Visions Inc. in January 2005, Toys For Bob, Inc. in April 2005, and Beenox, Inc. in May 2005. We have development agreements with other top-level, third-party developers such as id Software and Lionhead Studios.

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 significant, lasting and recurring revenues, and operating profits.

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 Consolidated Financial Statements included in Item 1. 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. Certain products are sold to customers with a street date (the date that

products are made widely available for sale by retailers). For these products we recognize revenue no earlier than the street date. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection. 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.

Sales incentives or other consideration given by us to our customers is accounted for in accordance with the Financial Accounting Standards Board’s 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.

Allowances for Returns, Price Protection, Doubtful Accounts, and Inventory Obsolescence. In determining the appropriate unit shipments to our customers, we benchmark our titles using historical and industry data. We closely monitor and analyze the historical performance of our various titles, the performance of products released by other publishers and the anticipated timing of other releases in order to assess future demands of current and upcoming titles. Initial volumes shipped upon title launch and subsequent reorders are evaluated to ensure that quantities are sufficient to meet the demands from the retail markets but at the same time, are controlled to prevent excess inventory in the channel.

We may permit product returns from, or grant price protection to, our customers under certain conditions. In general, price protection refers to the circumstances when we elect to decrease the wholesale price of a product by a certain amount and, when granted and applicable, allows customers a credit against amounts owed by such customers to us with respect to open and/or future invoices. 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 for current period product revenue utilizing historical experience and information regarding inventory levels and the demand and acceptance of our products by the end consumer. The following factors are used to estimate the amount of future returns and price protection for a particular title: performance of titles, performance of titles in similar genre, performance of hardware platform, performance of brand, marketing trade programs, console hardware life cycle, weeks of on-hand retail channel inventory, including seasonality, quantity of inventory on-hand in the channel, the title’s recent sell-through history, theatrical movie release (if applicable), game ranking, Activision sales force and retail customer feedback, market research conducted by Activision, seasonality, competing titles, and industry pricing. The relative importance of these factors varies among titles depending upon, among other items, genre, platform, seasonality, and sales strategy. 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. Based upon historical experience we believe our estimates are reasonable. However, actual returns and price protection could vary materially from our allowance estimates due to a number of reasons including, among others, a lack of consumer acceptance of a title, the release in the same period of a similarly themed

title by a competitor, or technological obsolescence due to the emergence of new hardware platforms. Material differences may result in the amount and timing of our revenue for any period if management makes different judgments or utilizes different estimates in determining the allowances for returns and price protection.

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 creditworthiness, 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 affect management's estimates in establishing our allowance for doubtful accounts.

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

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

We account for software development costs in accordance with Statement of Financial Accounting Standard ("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 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. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional costs to be incurred. If revised forecasted or actual product sales are less than, and/or revised forecasted or actual costs are greater than, the original forecasted amounts utilized in the initial recoverability analysis, the net realizable value may be lower than originally estimated in any given quarter, which could result in an impairment charge.

Intellectual Property Licenses. Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks, copyrights, software, technology, or other intellectual property or proprietary rights 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 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 property 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 and unreleased products, 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. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional costs to be incurred. If revised forecasted or actual product sales are less than, and/or revised forecasted or actual costs are greater than, the original forecasted amounts utilized in the initial recoverability analysis, the net realizable value may be lower than originally estimated in any given quarter, which could result in an

impairment charge. Additionally, as noted above, 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. Material differences may result in the amount and timing of charges for any period if management makes different judgments or utilizes different estimates in evaluating these qualitative factors.

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

	Three months ended September 30,				Six months ended September 30,			
	2005		2004		2005		2004	
Net revenues	\$ 222,540	100%	\$ 310,626	100%	\$ 463,633	100%	\$ 521,902	100%
Costs and expenses:								
Cost of sales – product costs	112,582	51	123,177	40	249,336	54	212,265	41
Cost of sales – software royalties and amortization	20,427	9	46,363	15	35,003	8	58,646	11
Cost of sales – intellectual property licenses	8,449	4	17,551	6	29,389	6	35,199	7
Product development	28,072	13	19,881	6	45,874	10	40,986	8
Sales and marketing	56,640	25	53,234	17	102,958	22	94,968	18
General and administrative	22,917	10	15,762	5	41,068	9	29,447	5
Total costs and expenses	249,087	112	275,968	89	503,628	109	471,511	90
Operating income (loss)	(26,547)	(12)	34,658	11	(39,995)	(9)	50,391	10
Investment income, net	6,330	3	2,645	1	13,678	3	4,757	1
Income before income tax provision (benefit)	(20,217)	(9)	37,303	12	(26,317)	(6)	55,148	11
Income tax provision (benefit)	(6,975)	(3)	11,760	4	(9,490)	(2)	17,648	4
Net income (loss)	\$ (13,242)	(6)%	\$ 25,543	8%	\$ (16,827)	(4)%	\$ 37,500	7%
Net Revenues by Territory:								
North America	\$ 111,904	50%	\$ 157,705	51%	\$ 224,224	48%	\$ 282,896	54%
Europe	104,698	47	141,019	45	224,679	49	219,120	42
Other	5,938	3	11,902	4	14,730	3	19,886	4
Total net revenues	\$ 222,540	100%	\$ 310,626	100%	\$ 463,633	100%	\$ 521,902	100%
Net Revenues by Segment/Platform Mix Publishing:								
Console	\$ 108,025	48%	\$ 145,542	47%	\$ 250,387	54%	\$ 264,669	51%
Hand-held	44,287	20	23,669	8	69,618	15	42,099	8
PC	15,095	7	97,184	31	40,953	9	121,279	23
Total publishing net revenues	167,407	75	266,395	86	360,958	78	428,047	82
Distribution:								
Console	29,848	13	29,929	10	67,936	15	69,123	13
Hand-held	19,167	9	3,556	1	23,075	5	7,211	1
PC	6,118	3	10,746	3	11,664	2	17,521	4
Total distribution net revenues	55,133	25	44,231	14	102,675	22	93,855	18
Total net revenues	\$ 222,540	100%	\$ 310,626	100%	\$ 463,633	100%	\$ 521,902	100%
Operating Income (loss) by Segment:								
Publishing	\$ (27,580)	(12)%	\$ 31,609	10%	\$ (41,489)	(9)%	\$ 47,503	9%
Distribution	1,033	—	3,049	1	1,494	—	2,888	1
Total operating income (loss)	\$ (26,547)	(12)%	\$ 34,658	11%	\$ (39,995)	(9)%	\$ 50,391	10%

Results of Operations – Three and Six Months Ended September 30, 2005 and 2004

Net Revenues

We primarily derive revenue from sales of packaged interactive software games designed for play on video game consoles (such as the PS2, Xbox, and GameCube), PCs, and hand-held game devices (such as the GBA, NDS, and PSP). We also derive revenue from our distribution business in Europe that provides logistical and sales services to third-party publishers of interactive entertainment software, our own publishing operations, and third-party manufacturers of interactive entertainment hardware.

The following table details our consolidated net revenues by business segment and our publishing net revenues by territory for the three months ended September 30, 2005 and 2004 (in thousands):

	Three Months ended September 30,		Increase/ (Decrease)	Percent Change
	2005	2004		
Publishing Net Revenues				
North America	\$ 111,904	\$ 157,705	\$ (45,801)	(29)%
Europe	49,565	96,788	(47,223)	(49)%
Other	5,938	11,902	(5,964)	(50)%
Total International	55,503	108,690	(53,187)	(49)%
Total Publishing Net Revenues	167,407	266,395	(98,988)	(37)%

Distribution Net Revenues	55,133	44,231	10,902	25%
Consolidated Net Revenues	<u>\$ 222,540</u>	<u>\$ 310,626</u>	<u>\$ (88,086)</u>	<u>(28)%</u>

Consolidated net revenues decreased 28% from \$310.6 million for the three months ended September 30, 2004 to \$222.5 million for the three months ended September 30, 2005. This decrease was incurred in our publishing business and was due to the following:

- More and larger franchise titles were released in the second quarter of fiscal 2005 including *Doom 3*, *Dreamworks' Shark Tale*, the North American release of *X-Men Legends*, and the International release of *Spider-Man 2*. This compares to the second quarter of fiscal 2006 where major releases were *X-Men Legends 2* and *Ultimate Spider-Man*, both of which released in late September in North America. In September 2005, we also launched *World Series of Poker* and in Europe we released *Fantastic 4*, as well as PSP versions of *Tony Hawk's Underground 2 Remix* and *Spider-Man 2* coinciding with the launch of the PSP hardware.
- Catalog sales for the three months ended September 30, 2005 decreased \$27.2 million over the same period last year due to particularly strong performance of our catalog titles in the second quarter of fiscal 2005. Our catalog titles in the second quarter of fiscal 2005 included *Shrek 2* and, in North America, *Spider-Man 2*, which was the number one selling game in the U.S. and U.K. for the month of July 2005. This compares to catalog sales from our first quarter fiscal 2006 movie supported releases of *Fantastic 4*, in North America, and *Madagascar*, which continues to sell well.

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The following table details our consolidated net revenues by business segment and our publishing net revenues by territory for the six months ended September 30, 2005 and 2004 (in thousands):

	Six Months ended September 30,		Increase/ (Decrease)	Percent Change
	2005	2004		
Publishing Net Revenues				
North America	\$ 224,224	\$ 282,896	\$ (58,672)	(21)%
Europe	122,004	125,265	(3,261)	(3)%
Other	14,730	19,886	(5,156)	(26)%
Total International	136,734	145,151	(8,417)	(6)%
Total Publishing Net Revenues	360,958	428,047	(67,089)	(16)%
Distribution Net Revenues	102,675	93,855	8,820	9%
Consolidated Net Revenues	<u>\$ 463,633</u>	<u>\$ 521,902</u>	<u>\$ (58,269)</u>	<u>(11)%</u>

Consolidated net revenues decreased 11% from \$521.9 million for the six months ended September 30, 2004 to \$463.6 million for the six months ended September 30, 2005. This decrease occurred in our publishing business. The decrease in consolidated net revenues was due to the following:

- For the six months ended September 30, 2004, we had a more robust lineup of new releases compared to the six months ended September 30, 2005. Our fiscal 2006 title release slate is more heavily weighted to our fiscal third quarter. In the six months ended September 30, 2004 we released eight major titles including *Spider-Man 2*, *Shrek 2*, *Doom 3*, *Call of Duty: United Offensive*, *Rome: Total War*, *X-Men Legends*, *Dreamworks' Shark Tale*, and *Cabela's Deer Hunt 2005 Season*. Sales of these titles outperformed the five major titles released in the first six months of fiscal 2006, *Doom 3* for the Xbox, *Fantastic 4*, *Madagascar*, and, in North America, *Ultimate Spider-Man* and *X-Men Legends 2*.
- International publishing and distribution net revenues benefited from the strong year over year strengthening of the EUR, GBP, and AUD in relation to the U.S. Dollar. Foreign exchange rates increased reported net revenues by approximately \$3.5 million for the six-months ended September 30, 2005. Excluding the impact of changing foreign currency rates, our international net revenues decreased 1% year over year.

Offset by:

- An increase of 9% in distribution net revenues for the six months ended September 30, 2005 from the prior fiscal year, from \$93.9 million to \$102.7 million. The increase was primarily due to the European release of the PSP resulting in a significant upswing in hardware and software sales.

North America Publishing Net Revenues (in thousands)

	September 30, 2005	% of Consolidated Net Revenues	September 30, 2004	% of Consolidated Net Revenues	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ 111,904	50%	\$ 157,705	51%	\$ (45,801)	(29)%
Six Months Ended	224,224	48%	282,896	54%	(58,672)	(21)%

Domestic publishing net revenues decreased 29% from \$157.7 million for the three months ended September 30, 2004, to \$111.9 million for the three months ended September 30, 2005. The decrease primarily reflects our strong fiscal 2005 second quarter lineup which compares to the limited number of releases in the second quarter of fiscal 2006. In addition, although our catalog titles for the quarter ended September 30, 2005, which included *Madagascar* and *Fantastic 4*, performed well, revenues were lower when compared to our

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catalog titles in the quarter ended September 30, 2004, which included two of our top-selling titles, *Spider-Man 2* and *Shrek 2*.

For the six months ended September 30, 2005, domestic publishing net revenues decreased 21% from \$282.9 million at September 30, 2004 to \$224.2 million. The decrease reflects an overall decrease in the number of mainline releases from eight to five in the first six months of fiscal 2005 compared to the first six months of 2006 combined with the particularly strong performance of our second quarter fiscal 2005 titles.

International Publishing Net Revenues (in thousands)

	September 30, 2005	% of Consolidated Net Revenues	September 30, 2004	% of Consolidated Net Revenues	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ 55,503	25%	\$ 108,690	35%	\$ (53,187)	(49)%
Six Months Ended	136,734	29%	145,151	28%	(8,417)	(6)%

International publishing net revenues decreased by 49% from \$108.7 million for the three months ended September 30, 2004, to \$55.5 million for the three months ended September 30, 2005. In the second quarter of fiscal 2005, international publishing saw particularly strong results from our releases of *Spider-Man 2* and *Doom 3*, which compares to the release of *Fantastic 4* in the second quarter of fiscal 2006 which had limited success in our European territories. The decrease was partially offset by the introduction of the PSP in Europe and the corresponding releases of *Tony Hawk's Underground 2 Remix*, *Spider-Man 2*, and an affiliate title for the PSP.

International publishing net revenues decreased by 6% from \$145.2 million for the six months ended September 30, 2004, to \$136.7 million for the six months ended September 30, 2005. In the first six months of fiscal 2005, international publishing saw particularly strong results from the releases of *Shrek 2*, *Spider-Man 2*, and *Doom 3* in comparison to the fiscal 2006 releases of *Madagascar* and *Fantastic 4* and the PSP releases of *Tony Hawk's Underground 2 Remix*, *Spider-Man 2*, and an affiliate title. The year over year decrease seen in the second quarter of fiscal 2006 discussed above was partially offset by an increase year over year in the first quarter of fiscal 2006 led by the strong performance of our affiliate title, LucasArts' *Star Wars: Episode III Revenge of the Sith*. In addition, there was a positive strengthening of the EUR, GBP, and AUD in relation to the U.S. Dollar of approximately \$2.7 million for the six months ended September 30, 2005 compared to the six months ended September 30, 2004. Excluding the impact of changing foreign currency rates, our international publishing net revenues decreased 8% year over year.

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Publishing Net Revenues by Platform (in thousands)

The following table details our publishing net revenues by platform and as a percentage of total publishing net revenues for the three months ended September 30, 2005 and 2004 (in thousands):

	Quarter Ended September 30, 2005	% of Publishing Net Revs.	Quarter Ended September 30, 2004	% of Publishing Net Revs.	Increase/ (Decrease)	Percent Change
Publishing Net Revenues						
PC	\$ 15,095	9%	\$ 97,184	36%	\$ (82,089)	(84)%
Console						
PlayStation 2	64,658	39%	87,762	33%	(23,104)	(26)%
Microsoft Xbox	25,353	15%	36,763	14%	(11,410)	(31)%
Nintendo GameCube	17,904	11%	20,717	8%	(2,813)	(14)%
Other	110	—%	300	—%	(190)	(63)%
Total Console	108,025	65%	145,542	55%	(37,517)	(26)%
Hand-held	44,287	26%	23,669	9%	20,618	87%
Total Publishing Net Revenues	\$ 167,407	100%	\$ 266,395	100%	\$ (98,988)	(37)%

The following table details our publishing net revenues by platform and as a percentage of total publishing net revenues for the six months ended September 30, 2005 and 2004 (in thousands):

	Six Months Ended September 30, 2005	% of Publishing Net Revs.	Six Months Ended September 30, 2004	% of Publishing Net Revs.	Increase/ (Decrease)	Percent Change
Publishing Net Revenues						
PC	\$ 40,953	11%	\$ 121,279	28%	\$ (80,326)	(66)%
Console						
PlayStation 2	130,142	36%	156,466	37%	(26,324)	(17)%
Microsoft Xbox	91,960	26%	62,599	15%	29,361	47%
Nintendo GameCube	28,045	8%	44,469	10%	(16,424)	(37)%
Other	240	—%	1,135	—%	(895)	(79)%
Total Console	250,387	70%	264,669	62%	(14,282)	(5)%
Hand-held	69,618	19%	42,099	10%	27,519	65%
Total Publishing Net Revenues	\$ 360,958	100%	\$ 428,047	100%	\$ (67,089)	(16)%

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Personal Computer Net Revenues (in thousands)

	September 30, 2005	% of Publishing Net Revenues	September 30, 2004	% of Publishing Net Revenues	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ 15,095	9%	\$ 97,184	36%	\$ (82,089)	(84)%
Six Months Ended	40,953	11%	121,279	28%	(80,326)	(66)%

Net revenues from sales of titles for the PC decreased 84% from \$97.2 million for the three months ended September 30, 2004 to \$15.1 million for the three months ended September 30, 2005. The decrease was attributed entirely to the release of two highly successful PC exclusive titles, *Doom 3* and *Rome: Total War* in the second quarter of fiscal 2005 compared to no PC exclusive titles released in the second quarter of fiscal 2006.

Net revenues from sales of titles for the PC decreased 66% from \$121.3 million for the six months ended September 30, 2004 to \$41.0 million for the six months ended September 30, 2005. As described above, the decrease was primarily related to the releases of *Doom 3* and *Rome: Total War* in the second quarter of fiscal 2005. The decrease was partially offset by continued strong sales in the first half of fiscal 2006 of catalog titles *Rome: Total War* and the Call of Duty brand as well the fiscal 2006 releases of *Doom 3: Resurrection of Evil* and *Madagascar*.

We expect fiscal 2006 PC publishing net revenues as a percentage of total publishing revenues to decrease from the prior fiscal year as there were three strong performing PC exclusive releases in the prior fiscal year, *Call of Duty: United Offensive*, *Doom 3*, and *Rome: Total War* compared to the planned releases of two major PC titles, *The Movies* and *Quake IV* in fiscal 2006.

PlayStation 2 Net Revenues (in thousands)

	September 30, 2005	% of Publishing Net Revenues	September 30, 2004	% of Publishing Net Revenues	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ 64,658	39%	\$ 87,762	33%	\$ (23,104)	(26)%
Six Months Ended	130,142	36%	156,466	37%	(26,324)	(17)%

Net revenues from sales of titles for the PS2 decreased 26% from \$87.8 million for the three months ended September 30, 2004 to \$64.7 million for the three months ended September 30, 2005. The decrease was attributed to the timing of our fiscal 2006 slate of titles in comparison to our fiscal 2005 slate of titles. In the second quarter of fiscal 2005 we experienced a significant portion of our revenues from our top selling PS2 title for the quarter, *Spider-Man 2*, which was released at the end of the first quarter in North America and early in the second quarter internationally. This compares to the timing of our two top selling PS2 titles for the second quarter of fiscal 2006, *Ultimate Spider-Man* and *X-Men Legends 2*, which were both released toward the end of the quarter in North America only and therefore accounted for significantly less revenues than *Spider-Man 2* did in the second quarter of fiscal 2005.

Net revenues from sales of titles for the PS2 decreased 17% from \$156.5 million for the six months ended September 30, 2004 to \$130.1 million for the six months ended September 30, 2005. The decrease was driven mainly by the second quarter releases discussed above combined with an \$8 wholesale pricing difference on *Madagascar* compared to *Shrek 2*, our children's title releases for the first quarter of fiscal 2006 and 2005, respectively.

We expect our fiscal 2006 revenues from the sales of titles for the PS2 to increase over the previous fiscal year due to a stronger slate of third quarter titles including *GUN*, *True Crime: New York City*, *Call of Duty 2: Big Red One*, *Shrek Super-Slam*, and *Tony Hawk's American Wasteland*.

Microsoft Xbox Net Revenues (in thousands)

	September 30, 2005	% of Publishing Net Revenues	September 30, 2004	% of Publishing Net Revenues	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ 25,353	15%	\$ 36,763	14%	\$ (11,410)	(31)%
Six Months Ended	91,960	26%	62,599	15%	29,361	47%

Net revenues from sales of titles for the Xbox decreased 31% from \$36.8 million for the three months ended September 30, 2004 to \$25.4 million for the three months ended September 30, 2005. The decrease is due to the timing of our slate of new releases quarter over quarter. In the second quarter of fiscal 2006, our top two Xbox titles in terms of net revenues, *Ultimate Spider-Man* and *X-Men Legends 2*, were released in the last week of the quarter. This compares to our top revenue title for the second quarter of fiscal 2005, *Spider-Man 2*, which was released late in the first quarter in North America and early in the second quarter internationally.

Net revenues from sales of titles for the Xbox increased 47% from \$62.6 million for the six months ended September 30, 2004 to \$92.0 million for the six months ended September 30, 2005. The increase was driven by the strong first quarter performance of our Xbox exclusive release of *Doom 3* with additional revenues coming from the releases of *Fantastic 4*, LucasArts' *Star Wars: Episode III Revenge of the Sith*, *Madagascar*, and the North American releases of *X-Men Legend 2* and *Ultimate Spider-Man*. This compares to the releases of *Spider-Man 2*, *Shrek 2*, *X-Men Legends*, and *Dreamworks' Shark Tale* in the first six months of fiscal 2005. Although *Spider-Man 2*, *Shrek 2*, and *Dreamworks' Shark Tale* reflected solid sales in both the domestic and international markets, they compare to *Doom 3* for the Xbox which was more focused toward the demographic of the Xbox. The increase was partially offset by lower initial pricing on *Madagascar* and the timing of our second quarter fiscal 2006 releases in comparison to our second quarter fiscal 2005 releases as discussed above.

We expect our fiscal 2006 revenues from the sales of titles for the Xbox to increase over the previous fiscal year due to a stronger slate of third quarter titles including *GUN*, *True Crime: New York City*, *Call of Duty 2: Big Red One*, *Shrek Super-Slam*, and *Tony Hawk's American Wasteland*. Given the significant installed base of the current generation Xbox, we anticipate strong Xbox sales in fiscal 2006 despite the release of the next generation Xbox 360. We also expect the introduction of the next generation Xbox 360 in November to provide significant opportunity. We anticipate releasing *Quake IV*, *Tony Hawk's American Wasteland*, *Call of Duty 2*, and *GUN* concurrently with the release of the Xbox 360. We plan on releasing titles for the Xbox 360 at a \$10 retail price increase over current generation titles.

Nintendo GameCube Net Revenues (in thousands)

	September 30, 2005	% of Publishing Net Revenues	September 30, 2004	% of Publishing Net Revenues	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ 17,904	11%	\$ 20,717	8%	\$ (2,813)	(14)%
Six Months Ended	28,045	8%	44,469	10%	(16,424)	(37)%

Net revenues from sales of titles for the Nintendo GameCube decreased 14% from \$20.7 million for the three months ended September 30, 2004 to \$17.9 million for the three months ended September 30, 2005. The decrease is due to our fiscal 2006 North American second quarter releases for the GameCube of *Ultimate Spider-Man*, *X-Men Legends 2*, and, internationally, *Fantastic 4*, as compared to the strong second quarter fiscal 2005 performance of *Spider-Man 2*, *Dreamworks' Shark Tale*, and LucasArts' *Jedi Knight: Jedi Academy*. These titles performed particularly well as they were targeted toward the demographic of the GameCube audience. Further contributing to the decrease was the timing of our fiscal 2006 second quarter releases.

Net revenues from sales of titles for the Nintendo GameCube decreased 37% from \$44.5 million for the six months ended September 30, 2004 to \$28.0 million for the six months ended September 30, 2005. The

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overall decrease is due to lower initial pricing of our childrens' title releases of *Madagascar* in the first quarter of fiscal 2006 as compared to *Shrek 2* in the first quarter of fiscal 2005. In addition, as our first half fiscal 2005 GameCube releases were highly consistent with the demographic of the GameCube audience they performed particularly well on this platform in relation to our first half fiscal 2006 releases of *Ultimate Spider-Man*, *X-Men Legends 2*, *Fantastic 4*, and *Madagascar*.

We expect fiscal 2006 net revenues from the sales of titles for the GameCube as a percentage of publishing net revenues to remain relatively consistent with the previous fiscal year as our slate of third quarter fiscal 2006 releases is less focused toward the demographic of the GameCube audience as compared to other platforms.

Hand-Held (in thousands)

	September 30, 2005	% of Publishing Net Revenues	September 30, 2004	% of Publishing Net Revenues	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ 44,287	26%	\$ 23,669	9%	\$ 20,618	87%
Six Months Ended	69,618	19%	42,099	10%	27,519	65%

Net revenues from sales of titles for hand-held platforms for the three months ended September 30, 2005 increased 87% from the prior fiscal year, from \$23.7 million to \$44.3 million. The increase is primarily due to the release of three PSP titles in Europe, *Spider-Man 2*, *Tony Hawk's Underground 2: Remix*, and an affiliate title concurrent with the European release of the PSP platform. In addition, we saw particularly strong performance of *World Series of Poker* on the PSP, *Ultimate Spider-Man* and *Madagascar* on the NDS and GBA, and the release of four 2-for-1 GBA catalog title combos, which include two games repackaged on a single cartridge.

Net revenues from sales of titles for hand-held platforms for the six months ended September 30, 2005 increased 65% from the prior fiscal year, from \$42.1 million to \$69.6 million. The increase is mainly due to the worldwide introductions of the NDS and PSP hand-held platforms. Although the number of titles released year over year remained relatively consistent, we were able to sell these titles over three hand-held platforms compared to just one in the first half of fiscal 2005. In addition, titles for the PSP have a higher retail pricing point of \$49.99 which compares to no titles released at the \$49.99 pricing point in the first half of fiscal 2005.

With the worldwide introduction of the NDS and PSP hand-held platforms and the expected corresponding increase in the number of titles across gaming platforms released year over year, we expect that revenues from hand-helds will continue to increase versus fiscal 2005.

Overall

The 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 base and the introduction of new hardware platforms, as well as the performance of key product releases from our 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, with the recent release of the NDS and PSP platforms, we expect to see a continued 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 titles. For example, for the three months ended September 30, 2005, 27% of our consolidated net revenues and 35% of worldwide publishing net revenues were derived from our *Ultimate Spider-Man* and *X-Men Legends 2* titles. For the six months ended September 30, 2005, 23% of our consolidated net revenues and 29% of worldwide publishing net revenues were derived from our *Madagascar* and *Fantastic 4* 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 operating profits resulting in a

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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.

Three factors that could affect future publishing and distribution net revenues performance are console hardware pricing, software pricing and transitions in console platforms. 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. Price cuts on Xbox, PS2, and GBA hardware were announced in March, May, and September 2004, respectively. 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 2005 holidays, we believe we could see additional software price declines thereafter. Additionally, when new console platforms are announced or introduced into the market, such as the upcoming November release of the Xbox 360, consumers typically reduce their purchases of game console entertainment software products for current console platforms in anticipation of new platforms becoming available. During these periods, sales of our game console entertainment software products may be expected to slow or even decline until new platforms are introduced and achieve wide consumer acceptance.

Distribution Net Revenues (in thousands)

	September 30, 2005	% of Consolidated Net Revenues	September 30, 2004	% of Consolidated Net Revenues	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ 55,133	25%	\$ 44,231	14%	\$ 10,902	25%
Six Months Ended	102,675	22%	93,855	18%	8,820	9%

Distribution net revenues for the three months ended September 30, 2005 increased 25% from the prior fiscal year, from \$44.2 million to \$55.1 million. The increase was primarily due to the European release of the PSP platform resulting in stronger than anticipated performance of PSP hardware and software sales. This was partially offset by the impact of a weaker EUR and GBP in relation to the U.S. dollar during the quarter of \$0.7 million. Excluding the impact of the changing foreign currency rates, our distribution net revenues increased 26% year over year.

Distribution net revenues for the six months ended September 30, 2005 increased 9% from the prior fiscal year, from \$93.9 million to \$102.7 million. Consistent with above, the increase was primarily due to the European release of the PSP resulting in a significant upswing in hardware and software sales. This was partially offset by a slight decrease in business related to third party publishers. In addition, there was a positive impact from stronger EUR and GBP in relation to the U.S. Dollar for the six months ended September 30, 2005 of \$0.8 million. Excluding the impact of the changing foreign currency rates, our distribution net revenues increased 9% year over year.

The mix of future distribution net revenues will be driven by a number of factors including the occurrence of further hardware price reductions instituted by hardware manufacturers, the introduction of new hardware platforms, our ability to establish and maintain distribution agreements with hardware manufacturers and third-party software publishers and the success of third-party published titles. We are expecting our fiscal 2006 distribution revenues to be in line with fiscal 2005 due mainly to shifting product mix.

Costs and Expenses

Cost of Sales – Product Costs (in thousands)

	September 30, 2005	% of Consolidated Net Revenues	September 30, 2004	% of Consolidated Net Revenues	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ 112,582	51%	\$ 123,177	40%	\$ (10,595)	(9)%
Six Months Ended	249,336	54%	212,265	41%	37,071	17%

Cost of sales – product costs represented 51% and 40% of consolidated net revenues for the three months ended September 30, 2005 and 2004, respectively. In absolute dollars, cost of sales – product costs decreased 9% which is consistent with the decrease in sales volume in the second quarter of fiscal 2006 as compared to the second quarter of fiscal 2005. The primary factors affecting the increase in the cost of sales – product costs as a percentage of consolidated net revenues for the second quarter of fiscal 2006 are:

- A shift in the product mix versus the second quarter of fiscal 2005. PC revenues represented 36% of publishing revenues in the second quarter of fiscal 2005 compared to 9% in second quarter of fiscal 2006. PC titles typically have significantly lower product costs associated with them.
- An increase in the percentage of consolidated net revenues provided by our distribution business from 14% in the second quarter of fiscal 2005 to 25% in the second quarter of fiscal 2006. Our distribution segment is a lower margin business than our publishing segment. In addition, distribution revenues from hardware sales increased from 12% in the second quarter of fiscal 2005 to 20% in the second quarter of fiscal 2006. Hardware sales carry a lower margin than software sales.

Cost of sales – product costs represented 54% and 41% of consolidated net revenues for the six months ended September 30, 2005 and 2004, respectively. In absolute dollars, cost of sales – product costs increased 17% as compared to the first six months of fiscal 2005. The primary factors affecting the increases in the cost of sales – product costs in both absolute dollars and as a percentage of consolidated net revenues are:

- Heavy sales volume in our European territories of LucasArts' *Star Wars: Episode III Revenge of the Sith*. LucasArts' titles are part of our affiliate label program and carry a significantly higher product cost than Activision developed titles.
- Reduced pricing on a number of catalog titles as well as an \$8 wholesale pricing difference on *Madagascar* compared to *Shrek 2*.
- A shift in the product mix versus the first six months of fiscal 2005. PC revenues represented 28% of publishing revenues in the first half of fiscal 2005 compared to 11% in the first half of fiscal 2006. PC titles typically have significantly lower product costs associated with them.

- An increase in the percentage of consolidated net revenues provided by our distribution business from 18% in the first half of fiscal 2005 to 22% in the first half of fiscal 2006. Our distribution segment is a lower margin business than our publishing segment.

We expect cost of sales – product costs as a percentage of net revenues to decrease for the remainder of the year as LucasArts’ titles will comprise a lower percentage of our overall revenues and a lower percentage of revenues will be generated from our distribution business for the rest of fiscal 2006. We also expect to benefit from higher retail pricing on our titles for the upcoming launch of the Xbox 360.

Cost of Sales – Software Royalties and Amortization (in thousands)

	<u>September 30, 2005</u>	<u>% of Publishing Net Revenues</u>	<u>September 30, 2004</u>	<u>% of Publishing Net Revenues</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
Three Months Ended	\$ 20,427	12%	\$ 46,363	17%	\$ (25,936)	(56)%
Six Months Ended	35,003	10%	58,646	14%	(23,643)	(40)%

Cost of sales – software royalties and amortization as a percentage of publishing net revenues decreased from 17% for the three months ended September 30, 2004 to 12% for the three months ended September 30, 2005. In absolute dollars, cost of sales – software royalties and amortization for the three months ended September 30, 2005 decreased from the prior fiscal year, from \$46.4 million to \$20.4 million or 56%. The decreases in both the percentage of publishing net revenues and in absolute dollars is mainly due to the fiscal 2005 second quarter release of *Doom 3*, which was our top selling title that quarter and carried a significantly higher royalty rate than most of our products. Further contributing to the decrease in absolute dollars was the overall decrease in sales quarter over quarter.

Cost of sales – software royalties and amortization as a percentage of publishing net revenues decreased from 14% for the six months ended September 30, 2004 to 10% for the six month ended September 30, 2005. In absolute dollars, cost of sales – software royalties and amortization for the six months ended September 30, 2005 decreased \$23.6 million from the prior fiscal year, from \$58.6 million for the six months ended September 30, 2004 to \$35.0 million. This decrease is due primarily to the fiscal 2005 second quarter release of *Doom 3*, as discussed above.

Cost of Sales – Intellectual Property Licenses (in thousands)

	<u>September 30, 2005</u>	<u>% of Publishing Net Revenues</u>	<u>September 30, 2004</u>	<u>% of Publishing Net Revenues</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
Three Months Ended	\$ 8,449	5%	\$ 17,551	7%	\$ (9,102)	(52)%
Six Months Ended	29,389	8%	35,199	8%	(5,810)	(17)%

Cost of sales – intellectual property licenses for the three months ended September 30, 2005 decreased in absolute dollars by 52% from \$17.6 million for the three months ended September 30, 2004 to \$8.4 million for the three months ended September 30, 2005 while the percentage of cost of sales – intellectual property licenses to publishing net revenues also decreased from 7% to 5%. The decreases are mainly due to the decrease in overall sales volumes quarter over quarter related to the timing of release of titles with associated intellectual property as discussed above. Lastly, in the second quarter of fiscal 2006, we received a one-time benefit due to the settlement of an intellectual property claim.

Cost of sales – intellectual property licenses for the six months ended September 30, 2005 decreased in absolute dollars by 17% from \$35.2 million for the six months ended September 30, 2004 to \$29.4 million for the six months ended September 30, 2005 while the percentage of cost of sales – intellectual property licenses to publishing net revenues remained consistent at 8%. The decrease is consistent with the decrease in the overall sales volume for the first half of fiscal 2006 compared to the first half of fiscal 2005.

We expect cost of sales – intellectual property licenses as a percentage of publishing net revenues to be in line with fiscal 2005.

Product Development (in thousands)

	<u>September 30, 2005</u>	<u>% of Publishing Net Revenues</u>	<u>September 30, 2004</u>	<u>% of Publishing Net Revenues</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
Three Months Ended	\$ 28,072	17%	\$ 19,881	7%	\$ 8,191	41%
Six Months Ended	45,874	13%	40,986	10%	4,888	12%

Product development expenses for the three months ended September 30, 2005 increased as a percentage of publishing net revenues as compared to the three months ended September 30, 2004, from 7% to 17%. In absolute dollars, product development expenses for the three months ended September 30, 2005 increased approximately \$8.2 million compared to the three months ended September 30, 2004, from \$19.9 million to \$28.1 million.

Product development expenses for the six months ended September 30, 2005 increased as a percentage of publishing net revenues as compared to the six months ended September 30, 2004, from 10% to 13%. In absolute dollars, product development expenses for the six months ended September 30, 2005 increased approximately \$4.9 million compared to the six months ended September 30, 2004, from \$41.0 million to \$45.9 million.

The increases for both the three and six month periods ending September 30, 2005 compared to the three and six month periods ending September 30, 2004 are due to:

- An overall increase in the number of titles under development including more technologically advanced titles, which incur more development costs per title, and costs incurred for titles for next generation consoles prior to their meeting capitalization requirements. We plan on releasing titles for the Xbox 360 at a \$10 retail price increase over current generation titles.
- An increase in internal studio capabilities and the corresponding increase in the number of titles being developed internally.
- Increased outside developer fees related to voice-overs, localization, and music for an increased number of titles.
- Increased quality assurance costs to support an increased number of titles in development across more platforms.

Sales and Marketing (in thousands)

	<u>September 30, 2005</u>	<u>% of Consolidated Net Revenues</u>	<u>September 30, 2004</u>	<u>% of Consolidated Net Revenues</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
Three Months Ended	\$ 56,640	25%	\$ 53,234	17%	\$ 3,406	6%
Six Months Ended	102,958	22%	94,968	18%	7,990	8%

Sales and marketing expenses of \$56.6 million and \$53.2 million represented 25% and 17% of consolidated net revenues for the three months ended September 30, 2005 and 2004, respectively. The increases both in absolute dollars and as a percentage of net revenues were primarily generated by our publishing business as a result of increases in sales and marketing headcount to support European expansion and customer growth strategies combined with increased promotional expenses related to our fiscal 2006 product slate.

Sales and marketing expenses increased 8% from \$95.0 million and 18% of consolidated net revenues for the six months ended September 30, 2004 to \$103.0 million and 22% of consolidated net revenues for the six months ended September 30, 2005. The increases both in absolute dollars and as a percentage of net

revenues were primarily generated by our publishing business as a result of continuing significant investment in marketing programs provided in support of our first half fiscal 2006 title releases, *Doom 3* for the Xbox, *Ultimate Spider-Man*, *X-Men Legends 2*, *Madagascar*, and *Fantastic 4*. In addition, we experienced increases in sales and marketing headcount to support European expansion and customer growth strategies combined with increased promotional expenses related to our fiscal 2006 product slate.

We expect to continue to provide significant marketing support for our future “big proposition” titles in launch and subsequent quarters. Accordingly, we expect fiscal 2006 sales and marketing costs to increase in relation to fiscal 2005 spending levels.

General and Administrative (in thousands)

	<u>September 30, 2005</u>	<u>% of Consolidated Net Revenues</u>	<u>September 30, 2004</u>	<u>% of Consolidated Net Revenues</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
Three Months Ended	\$ 22,917	10%	\$ 15,762	5%	\$ 7,155	45%
Six Months Ended	41,068	9%	29,447	5%	11,621	39%

General and administrative expenses for the three months ended September 30, 2005 increased \$7.2 million over the same period last year, from \$15.8 million to \$22.9 million. As a percentage of consolidated net revenues, general and administrative expenses increased from 5% to 10% for the three months ended September 30, 2004 and 2005, respectively. The increase in absolute dollars was primarily due to an increase in personnel costs related to increased headcount to support expanding operations, increased outside professional fees, an increase in bad debt reserves, and foreign currency transaction losses incurred by our European publishing business due to the strengthening of the U.S. Dollar and EUR against the GBP. The increase as a percentage of consolidated net revenues is due to the combination of the increases discussed and the decreased sales volume in the second quarter of fiscal 2006 in comparison to the second quarter of fiscal 2005.

For the six months ended September 30, 2005, general and administrative expenses increased \$11.6 million or 39% over the same period last year, from \$29.4 million to \$41.1 million. As a percentage of consolidated net revenues, general and administrative expenses increased from 5% to 9%. Consistent with the above, the increase is due to higher personnel costs related to increased headcount to support expanding operations, increased outside professional fees, an increase in bad debt reserves, and in foreign currency transaction losses incurred by our European publishing business due to the strengthening of the U.S. Dollar and EUR against the GBP. The increase as a percentage of consolidated net revenues is due mainly to the significant decrease in sales volume.

Operating Income (Loss) (in thousands)

	<u>September 30, 2005</u>	<u>% of Segment Net Revs.</u>	<u>September 30, 2004</u>	<u>% of Segment Net Revs.</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
Three Months Ended						
Publishing	\$ (27,580)	(16)%	\$ 31,609	12%	\$ (59,189)	(187)%
Distribution	1,033	2%	3,049	7%	(2,016)	(66)%
Consolidated	<u>\$ (26,547)</u>	<u>(12)%</u>	<u>\$ 34,658</u>	<u>11%</u>	<u>\$ (61,205)</u>	<u>(177)%</u>

Publishing operating income (loss) for the three months ended September 30, 2005 decreased \$59.2 million or 187% from the same period last year, from income of \$31.6 million to a loss of \$27.6 million while the percentage of operating income to segment revenues decreased from 12% to (16%). The impact of changes in foreign currency rates did not have a material impact on international publishing operating income for the three months ended September 30, 2005. This decrease is primarily due to:

- A shift in the timing of releases quarter over quarter causing a decrease in revenues.
- The decrease in the percentage of operating income to segment revenues is due mainly to increasing costs of sales - product costs due to a smaller percentage of revenues derived from PC titles as well as a larger percentage of revenues derived from LucasArts' titles as discussed above.
- Increased operating expenditures to support title releases, increased headcount to support company growth, and costs of European expansion.

Distribution operating income for the three months ended September 30, 2005 decreased by \$2.0 million over the same period last year, from \$3.0 million to \$1.0 million. This decrease is primarily due to a shift in the mix of hardware versus software sales due to the introduction of the PSP platform in Europe. Hardware tends to be a lower margin business. The impact of changes in foreign currency rates did not have a material impact on distribution operating income for the three months ended September 30, 2005.

	September 30, 2005	% of Segment Net Revs.	September 30, 2004	% of Segment Net Revs.	Increase/ (Decrease)	Percent Change
Six Months Ended						
Publishing	\$ (41,489)	(11)%	\$ 47,503	11%	\$ (88,992)	(187)%
Distribution	1,494	1%	2,888	3%	(1,394)	(48)%
Consolidated	<u>\$ (39,995)</u>	(9)%	<u>\$ 50,391</u>	10%	<u>\$ (90,386)</u>	(179)%

Publishing operating income (loss) for the six months ended September 30, 2005 decreased \$89.0 million from the same period last year, from income of \$47.5 million to a loss of \$41.5 million. Changes in foreign currency rates related to the year over year weakening of the EUR, GBP, and AUD in relation to the U.S. dollar did not have a material impact on publishing operating income. This decrease is primarily due to:

- A shift in the timing of releases quarter over quarter causing a decrease in revenues.
- The decrease in the percentage of operating income to segment revenues is due mainly to increasing costs of sales - product costs due to a smaller percentage of revenues derived from PC titles as well as a larger percentage of revenues derived from LucasArts' titles as discussed above.
- Lower initial pricing of our top selling title for the first half of fiscal 2006, *Madagascar*, resulting in lower associated margins.
- Increased operating expenditures to support title releases, increased headcount to support company growth, and costs of European expansion.

Distribution operating income for the six months ended September 30, 2005 decreased \$1.4 million over the same period last year, from \$2.9 million to \$1.5 million. This decrease is primarily due to a shift in the mix of hardware versus software sales from 11% in the first half of fiscal 2005 to 17% in the first half of fiscal 2006 due to the introduction of the PSP platform in Europe combined with the reduced volume of first party business. Hardware tends to be a lower margin business. The impact of changes in foreign currency rates did not have a material impact on distribution operating income for the six months ended September 30, 2005.

Investment Income, Net (in thousands)

	September 30, 2005	% of Consolidated Net Revenues	September 30, 2004	% of Consolidated Net Revenues	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ 6,330	3%	\$ 2,645	1%	\$ 3,685	139%
Six Months Ended	13,678	3%	4,757	1%	8,921	188%

Investment income, net for the three months ended September 30, 2005 was \$6.3 million as compared to \$2.6 million for the three months ended September 30, 2004. Investment income, net for the six months ended September 30, 2005 increased \$8.9 million from \$4.8 million for the six months ended September 30, 2004 as compared to \$13.7 million for the six months ended September 30, 2005. The increases in both the three and six months ended September 30, 2005 as compared to the three and six months ended September 30, 2004 was primarily due to higher invested balances combined with rising yields and a realized gain in the first quarter of fiscal 2006 of \$1.3 million on the sale of an investment in common stock.

Provision (Benefit) for Income Taxes (in thousands)

	September 30, 2005	% of Pretax Income	September 30, 2004	% of Pretax Income	Increase/ (Decrease)	Percent Change
Three Months Ended	\$ (6,975)	35%	\$ 11,760	32%	\$ (18,735)	(159)%
Six Months Ended	(9,490)	36%	17,648	32%	(27,138)	(154)%

The income tax benefit of \$7.0 million and \$9.5 million for the three months and six months ended September 30, 2005, respectively, reflects our effective income tax rate of 34.5% and 36%, respectively. The significant items that generated the variance between our effective rate and our statutory rate of 35% were a one-time international tax benefit for the release of certain reserves due to the expiration of a tax statute of limitations, research and development tax credits and the impact of foreign tax rate differentials, offset by an increase in state taxes. The realization of deferred tax assets depends primarily on the generation of future taxable income. We believe that it is more likely than not that we will generate taxable income sufficient to realize the benefit of net deferred tax assets recognized.

Net Income (Loss)

Net loss for the three months ended September 30, 2005 was \$13.2 million or loss per share of \$0.05, as compared to net income of \$25.5 million or \$0.09 per diluted share for the three months ended September 30, 2004.

Net loss for the six months ended September 30, 2005 was \$16.8 million or \$0.06 loss per share, as compared to net income of \$37.5 million or \$0.14 per diluted share for the six months ended September 30, 2004.

Liquidity and Capital Resources

Sources of Liquidity (in thousands)

	September 30, 2005	March 31, 2005	Increase/ (Decrease)
Cash and cash equivalents	\$ 203,085	\$ 313,608	\$ (110,523)
Short-term investments	547,174	527,256	19,918
	<u>\$ 750,259</u>	<u>\$ 840,864</u>	<u>\$ (90,605)</u>
Percentage of total assets	58%	64%	

	For the six months ended September 30, 2005	For the six months ended September 30, 2004	Increase/ (Decrease)
Cash flows provided by (used in) operating activities	\$ (94,268)	\$ 10,710	\$ (104,978)
Cash flows provided by (used in) investing activities	(39,462)	79,491	(118,953)
Cash flows provided by financing activities	27,364	12,602	14,762

As of September 30, 2005, our primary source of liquidity is comprised of \$203.1 million of cash and cash equivalents and \$547.2 million of short-term investments. Over the last two years, our primary sources of liquidity have included cash on hand at the beginning of the year and cash flows generated from continuing operations. We have also generated significant cash flows from the issuance of our common stock to employees through the exercise of options which is described in more detail below in "Cash Flows from Financing Activities." We have not utilized debt financing as a significant source of cash flows. However, we do have available at certain of our international locations credit facilities, which are described below in "Credit Facilities," that can be utilized if needed.

In August 2003, we filed with the Securities and Exchange Commission two amended shelf registration statements, including the base prospectuses therein. The first shelf registration statement, on Form S-3, allows us, at any time, to offer any combination of securities described in the base prospectus in one or more offerings with an aggregate initial offering price of up to \$500,000,000. Unless we state otherwise in the applicable prospectus supplement, we expect to use the net proceeds from the sale of the securities for general corporate purposes, including capital expenditures, working capital, repayment or reduction of long-term and short-term debt, and the financing of acquisitions and other business combinations. We may invest funds that we do not immediately require in marketable securities.

The second shelf registration statement, on Form S-4, allows us, at any time, to offer any combination of securities described in the base prospectus in one or more offerings with an aggregate initial offering price of up to \$250,000,000 in connection with our acquisition of the assets, business, or securities of other companies whether by purchase, merger, or any other form of business combination.

We believe that we have sufficient working capital (\$905.7 million at September 30, 2005), as well as proceeds available from our international credit facilities, 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.

Cash Flows from Operating Activities

The primary drivers of cash flows from operating activities typically have included the collection of customer receivables generated by the sale of our products, offset by payments to vendors for the manufacture, distribution, and marketing of our products, third-party developers and intellectual property holders, and our own employees. A significant operating use of our cash relates to our continued investment in software development and intellectual property licenses. We spent approximately \$68.7 million and \$66.3 million in the six months ended September 30, 2005 and 2004, respectively, 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 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. Our future cash commitments relating to these investments are detailed below in "Commitments." Cash flows from operations 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 typically will directly and positively impact cash flows.

For the six months ended September 30, 2005 and 2004, cash flows provided by (used in) operating activities were \$(94.3) million and \$10.7 million, respectively. The principal components comprising cash flows used in operating activities for the six months ended September 30, 2005 included operating results and cash paid for accounts payable and accrued liabilities, and our continued investment in software development and intellectual property licenses offset by amortization of capitalized software development costs and intellectual property licenses and increases in accounts receivable. An analysis of the change in key balance sheet accounts is below in "Key Balance Sheet Accounts." We expect that a primary source of future liquidity, both short-term and long-term, will be the result of cash flows from continuing operations.

Cash Flows from Investing Activities

The primary drivers of cash from investing activities typically have included capital expenditures, acquisitions of privately held interactive software development companies and the net effect of purchases and sales/maturities 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.

For the six months ended September 30, 2005 and 2004, cash flows provided by (used in) investing activities were \$(39.5) million and \$79.5 million, respectively. For the six months ended September 30, 2005, cash flows used in investing activities were primarily the result of the increase in restricted cash, which is included in short-term investments, capital expenditures, and cash paid for acquisitions. We have historically financed our acquisitions through the issuance of shares of common stock or a combination of common stock and cash. We will continue to evaluate potential acquisition candidates as to the benefit they bring to us.

Cash Flows from Financing Activities

The primary drivers of cash provided by financing activities have historically related to transactions involving our common stock, including the issuance of shares of common stock to employees and the public and the purchase of treasury shares. We have not utilized debt financing as a significant source of cash flows. However, we do have available at certain of our international locations credit facilities, which are described below in "Credit Facilities," that can be utilized if needed.

For the six months ended September 30, 2005 and 2004, cash flows from financing activities were \$27.4 million and \$12.6 million, respectively. The cash provided by financing activities for the six months ended September 30, 2005 primarily is the result of the issuance of common stock related to employee stock option and stock purchase plans. 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 stock repurchase 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 September 30, 2005, we had approximately \$226.2 million available for utilization under the buyback program. We actively manage our capital structure as a component of our overall business strategy. Accordingly, in the future, 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.

Key Balance Sheet Accounts

Accounts Receivable

(amounts in thousands)	September 30, 2005	March 31, 2005	Increase/ (Decrease)
Gross accounts receivable	\$ 195,601	\$ 178,335	\$ 17,266
Net accounts receivable	116,879	109,144	7,735

The increase in gross accounts receivable was primarily the result of the late quarter North America releases of *Ultimate Spider-Man* and *X-Men Legends 2*. Significant shipments were made to customers in September and the related receivables were not due prior to quarter end.

Reserves for returns, price protection, and bad debt as a percentage of gross accounts receivable was 40% as of September 30, 2005 compared to 39% at March 31, 2005. Reserves for returns and price protection are a function of the number of units and pricing of titles in retail inventory (see description of *Allowances for Returns, Price Protection, Doubtful Accounts, and Inventory Obsolescence* in Item 2: Critical Accounting Policies).

Inventories

(amounts in thousands)	September 30, 2005	March 31, 2005	Increase/ (Decrease)
Inventories	\$ 52,035	\$ 48,018	\$ 4,017

The increase in inventories was the result of the build up of publishing inventory balances to support early Q3 title releases.

Software Development

(amounts in thousands)	September 30, 2005	March 31, 2005	Increase/ (Decrease)
Software development	\$ 122,891	\$ 91,614	\$ 31,277

Software development was higher at the end of the second quarter of fiscal 2006 as a result of:

- Continued investment in software development. We incurred approximately \$59.3 million in the quarter ended September 30, 2005 in connection with the capitalization of product development costs relating to internally developed products as well as amounts paid to third parties for product development.

Partially offset by:

- \$28.1 million of amortization of capitalized software development cost related mostly to titles released in the first half of fiscal 2006.

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Intellectual Property Licenses

<u>(amounts in thousands)</u>	<u>September 30, 2005</u>	<u>March 31, 2005</u>	<u>Increase/ (Decrease)</u>
Intellectual property licenses	\$ 29,338	\$ 35,726	\$ (6,388)

Intellectual property licenses were lower at the end of the second quarter of fiscal 2006 as a result of:

- \$ 15.7 million of amortization of intellectual property licenses related to new title releases in the first two quarters of fiscal 2006.

Partially offset by:

- Continued investment in intellectual property licenses. We spent approximately \$ 9.3 million year to date for license agreements granting us long-term rights to intellectual property of third parties.

Accounts Payable

<u>(amounts in thousands)</u>	<u>September 30, 2005</u>	<u>March 31, 2005</u>	<u>Increase/ (Decrease)</u>
Accounts payable	\$ 90,838	\$ 108,984	\$ (18,146)

The decrease in accounts payable was primarily the result of lower payables of our distribution business. As of March 31, 2005, distribution payables were high due to the launch of the NDS in Europe. This was partially offset by an increase in publishing payables due to inventory purchases to support early Q3 title releases.

Accrued Expenses

<u>(amounts in thousands)</u>	<u>September 30, 2005</u>	<u>March 31, 2005</u>	<u>Increase/ (Decrease)</u>
Accrued expenses	\$ 85,759	\$ 98,067	\$ (12,308)

The decrease in accrued expenses was primarily driven by:

- Decrease in liabilities related to affiliate label products in our European territories.
- Decrease in bonus related accruals due to timing of payment of year end bonuses and a lower accrual for fiscal 2006.

Partially offset by:

- Increased income taxes payable as of the end of the second quarter.

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Credit Facilities

We have revolving credit facilities with our Centresoft subsidiary located in the UK (the "UK Facility") and our NBG subsidiary located in Germany (the "German Facility"). The UK Facility provided Centresoft with the ability to borrow up to Great British Pounds ("GBP") 8.0 million (\$14.1 million), including issuing letters of credit, on a revolving basis as of September 30, 2005. Furthermore, under the UK Facility, Centresoft provided a GBP 0.6 million (\$1.1 million) guarantee for the benefit of our CD Contact subsidiary as of September 30, 2005. The UK Facility bore interest at LIBOR plus 2.0% as of September 30, 2005, is collateralized by substantially all of the assets of the subsidiary and expires in May 2006. The UK Facility also contains various covenants that require the subsidiary to maintain specified financial ratios related to, among others, fixed charges. As of September 30, 2005, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of September 30, 2005. The German Facility provided for revolving loans up to EUR 0.5 million (\$0.6 million) as of September 30, 2005, bore 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 September 30, 2005.

As of September 30, 2005, we maintained a \$20.0 million irrevocable standby letter of credit in North America. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. Under the terms of this arrangement, we are required to maintain on deposit with the bank a compensating balance, restricted as to use, not less than the sum of the available amount of the letter of credit plus the aggregate amount of any drawings under the letter of credit that have been honored thereunder but not reimbursed. At September 30, 2005, the \$20.0 million deposit is included in short-term investments as restricted cash.

As of September 30, 2005, our publishing subsidiary located in the UK maintained a GBP 8.0 million (\$14.1 million) irrevocable standby letter of credit. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. The standby letter of credit does not require a compensating balance and is collateralized by substantially all of the assets of the subsidiary and expires on July 31, 2006. As of September 30, 2005, we had EUR 5.9 million (\$7.0 million) outstanding against this letter of credit.

Commitments

In the normal course of business, we enter into contractual arrangements with third-parties for non-cancelable operating lease agreements for our offices, 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 lessor, developer or intellectual property holder, based upon contractual arrangements. Typically, the payments to third-party developers are conditioned upon the achievement by the developers of contractually specified development milestones. These payments to third-party developers and intellectual property holders typically are deemed to be advances and are recoupable against future royalties earned by the developer or intellectual property holder based on the sale of the related game. Additionally, in connection with certain intellectual property right acquisitions and development agreements, we will commit to spend specified amounts for marketing support for the related game(s) which is to be developed or in which the intellectual property will be utilized. Assuming all contractual provisions are met, the total future minimum commitments for these and other contractual arrangements in place as of September 30, 2005, are scheduled to be paid as follows (amounts in thousands):

	Contractual Obligations			
	Facility Leases	Developer and IP	Marketing	Total
Fiscal year ending March 31,				
2006	\$ 6,624	\$ 19,579	\$ 8,215	\$ 34,418
2007	11,881	11,880	3,535	27,296
2008	8,494	6,525	8,375	23,394
2009	7,329	2,900	—	10,229
2010	6,521	—	—	6,521
Thereafter	26,975	—	—	26,975
Total	\$ 67,824	\$ 40,884	\$ 20,125	\$ 128,833

Financial Disclosure

We maintain internal controls over financial reporting, which generally include those controls relating to the preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America. We also are focused on our “disclosure controls and procedures,” which as defined by the Securities and Exchange Commission are generally those controls and procedures designed to ensure that financial and non-financial information required to be disclosed in our reports filed with the Securities and Exchange Commission is reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is communicated to management, including our Chief Executive Officers and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Our Disclosure Committee, which operates under the board approved Disclosure Committee Charter and Disclosure Controls & Procedures Policy, includes senior management representatives and assists executive management in its oversight of the accuracy and timeliness of our disclosures, as well as in implementing and evaluating our overall disclosure process. As part of our disclosure process, senior finance and operational representatives from all of our corporate divisions and business units prepare quarterly reports regarding their current quarter operational performance, future trends, subsequent events, internal controls, changes in internal controls, and other accounting and disclosure-relevant information. These quarterly reports are reviewed by certain key corporate finance representatives. These corporate finance representatives also conduct quarterly interviews on a rotating basis with the preparers of selected quarterly reports. The results of the quarterly reports and related interviews are reviewed by the Disclosure Committee. Finance representatives also conduct reviews with our senior management team, our internal and external counsel and other appropriate personnel involved in the disclosure process, as appropriate. Additionally, senior finance and operational representatives provide internal certifications regarding the accuracy of information they provide that is utilized in the preparation of our periodic public reports filed with the Securities and Exchange Commission. Financial results and other financial information also are reviewed with the Audit Committee of the Board of Directors on a quarterly

basis. As required by applicable regulatory requirements, the Chief Executive Officer, President, and the Chief Financial Officer review and make various certifications regarding the accuracy of our periodic public reports filed with the Securities and Exchange Commission, our disclosure controls and procedures, and our internal control over financial reporting. With the assistance of the Disclosure Committee, we will continue to assess and monitor our disclosure controls and procedures, and our internal controls over financial reporting, and will make refinements as necessary.

Recently Issued Accounting Standards and Laws

On December 16, 2004, the Financial Accounting Standards Board (“FASB”) issued FASB Statement No. 123 (revised 2004), *Share-Based Payment* (“SFAS No. 123R”), which is a revision of FASB Statement No. 123, *Accounting for Stock-Based Compensation* (“SFAS 123”). SFAS No. 123R supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends FASB Statement No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123R is similar to the approach described in SFAS 123. However, SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

SFAS No. 123R must be adopted by us no later than April 1, 2006. Early adoption will be permitted in periods in which financial statements have not yet been issued. We expect to adopt SFAS No. 123R on April 1, 2006.

SFAS No. 123R permits public companies to adopt its requirements using one of two methods:

- A “modified prospective” method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date.
- A “modified retrospective” method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

As permitted by SFAS 123, we currently account for share-based payments to employees using Opinion 25’s intrinsic value method and, as such, generally recognize no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123R’s fair value method will have a significant impact on our results of operations, although it will have no impact on our overall financial position. While management continues to evaluate the impact of SFAS No. 123R, we currently believe that the expensing of stock-based compensation will have an impact on our Consolidated Statement of Operations similar to our pro forma disclosure under SFAS 123.

On November 24, 2004, the FASB issued Statement No. 151, *Inventory Costs, an Amendment of ARB No. 43, Chapter 4* (“SFAS No. 151”). The standard requires that abnormal amounts of idle capacity and spoilage costs within inventory should be excluded from the cost of inventory and expensed when incurred. The provisions of SFAS No. 151 are applicable to inventory costs incurred during fiscal years beginning after June 15, 2005. We expect the adoption of SFAS No. 151 will not have a material impact on our financial position or results of operations.

On December 15, 2004 the FASB issued Statement No. 153 (“SFAS No. 153”), *Exchanges of Nonmonetary Assets — an Amendment of Accounting Principles Board Opinion No. 29*. This standard requires exchanges of productive assets to be accounted for at fair value, rather than at carryover basis, unless (1) neither the asset received nor the asset surrendered has a fair value that is determinable within reasonable limits or (2) the transactions lack commercial substance. The new standard is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS No. 153 did not have a material impact on our financial position or results of operations.

In May 2005, the FASB issued Statement No. 154 (“SFAS No. 154”), *Accounting Changes and Error Corrections – A Replacement of APB Opinion No. 20 and FASB Statement No. 3*. SFAS No. 154 changes the requirements for the accounting and reporting of a change in accounting principle and correction of errors.

Under previous guidance, changes in accounting principle were recognized as a cumulative effect in the net income of the period of the change. The new statement requires retrospective application of changes in accounting principle and correction of errors, limited to the direct effects of the change, to prior periods’ financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005.

On October 22, 2004, the President of the United States signed the American Jobs Creation Act of 2004 (the “Act”). The Act raises a number of issues with respect to accounting for income taxes. For companies that pay U.S. income taxes on manufacturing activities in the U.S., the Act provides a deduction from taxable income equal to a stipulated percentage of qualified income from domestic production activities. The manufacturing deduction provided by the Act replaces the extraterritorial income (“ETI”) deduction currently in place. We currently derive benefits from the ETI exclusion which was repealed by the Act. Our exclusion for fiscal 2006 and 2007 will be limited to 75% and 45% of the otherwise allowable exclusion and no exclusion will be available in fiscal 2008 and thereafter. The Act also creates a temporary incentive for U.S. multinationals to repatriate accumulated income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations. The deduction is subject to a number of limitations. The Act also provides for other changes in tax law that will affect a variety of taxpayers. On December 21, 2004, the Financial Accounting Standards Board (“FASB”) issued two FASB Staff Positions (“FSP”) regarding the accounting implications of the Act related to (1) the deduction for qualified domestic production activities and (2) the one-time tax benefit for the repatriation of foreign earnings. The FASB determined that the deduction for qualified domestic production activities should be accounted for as a special deduction under FASB Statement No. 109, *Accounting for Income Taxes*. The FASB also confirmed, that upon deciding that some amount of earnings will be repatriated, a company must record in that period the associated tax liability. The guidance in the FSPs applies to financial statements for periods ending after the date the Act was enacted. We are evaluating the Act at this time and have not yet determined whether we will avail ourselves of the opportunity of the one-time tax benefit for the repatriation of foreign earnings. We plan to complete our assessment before the end of fiscal 2006 and are not currently in a position to estimate a range of possible repatriation amounts.

Inflation

Our management currently believes that inflation has not had a material impact on continuing operations.

Factors Affecting Future Performance

In connection with the Private Securities Litigation Reform Act of 1995 (the “Litigation Reform Act”), we have disclosed certain cautionary information to be used in connection with written materials (including this Quarterly Report on Form 10-Q) and oral statements made by or on behalf of our employees and representatives that may contain “forward-looking statements” within the meaning of the Litigation Reform Act. Such statements consist of any statement other than a recitation of historical fact and can be identified by the use of forward-looking terminology such as “may,” “expect,” “anticipate,” “estimate,” or “continue” or the negative thereof or other variations thereon or comparable terminology. The reader is cautioned that all forward-looking statements are necessarily speculative and there are numerous risks and uncertainties that could cause actual events or results to differ materially from those referred to in such forward-looking statements. For a discussion that highlights some of the more important risks identified by management, but which should not be assumed to be the only factors that could affect future performance, see our Annual Report on Form 10-K for the fiscal year ended March 31, 2005 which is incorporated herein by reference. The reader 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 instruments entered into for purposes “other than trading.” 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 interest rates, foreign currency exchange rates, and the timing of transactions.

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We manage our interest rate risk by maintaining an investment portfolio consisting primarily of debt instruments with high credit quality and relatively short average maturities. We also manage our interest rate risk by maintaining sufficient cash and cash equivalent balances such that we are typically able to hold our investments to maturity. As of September 30, 2005, our cash equivalents and short-term investments included debt securities of \$566.3 million.

The following table presents the amounts and related weighted average interest rates of our investment portfolio as of September 30, 2005 (amounts in thousands):

	Average Interest Rate	Amortized Cost	Fair Value
Cash equivalents:			
Fixed rate	3.78%	\$ 39,127	\$ 39,120
Variable rate	3.64%	61,666	61,666
Short-term investments:			
Fixed rate	3.54%	\$ 551,622	\$ 547,174

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

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 EUR, GBP, and AUD. The volatility of EUR, GBP, and AUD (and all other applicable currencies) will be monitored frequently throughout the coming year. When appropriate, we enter into hedging transactions in order to mitigate our risk from foreign currency fluctuations. We will continue to use hedging programs in the future and may use currency forward contracts, currency options, and/or other derivative financial instruments commonly utilized to reduce financial market risks if it is determined that such hedging activities are appropriate to reduce risk. We do not hold or purchase any foreign currency contracts for trading purposes. As of September 30, 2005, we had no outstanding hedging contracts.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company’s disclosure controls and procedures are designed to reasonably assure that (i) information required to be disclosed in the company’s reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and (ii) information is accumulated and communicated to management, including the Chief Executive Officer, President, and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in our periodic reports. Inherent limitations to any system of disclosure controls and procedures include, but are not limited to, the possibility of human error and the circumvention or overriding of such controls by one or more person. In addition, we have designed our system of controls based on certain assumptions, which

we believe are reasonable, about the likelihood of future events, and our system of controls may therefore not achieve its desired purposes under all possible future events.

The Company’s management, with the participation of the Company’s Chief Executive Officer, President, and Chief Financial Officer, has evaluated the effectiveness of the Company’s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on this controls evaluation, and subject to the limitations described above, the Chief Executive Officer, President, and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective to provide reasonable, but not absolute, assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported on a timely basis.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On March 5, 2004, a class action lawsuit was filed against us and certain of our current and former officers and directors. The complaint, which asserts claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 based on allegations that our revenues and assets were overstated during the period between February 1, 2001 and December 17, 2002, was filed in the United States District Court, Central District of California by the Construction Industry and Carpenters Joint Pension Trust for Southern Nevada purporting to represent a class of purchasers of Activision stock. Five additional purported class actions were subsequently filed by Gianni Angeloni, Christopher Hinton, Stephen Anish, the Alaska Electrical Pension Fund, and Joseph A. Romans asserting the same claims. Consistent with the Private Securities Litigation Reform Act (“PSLRA”), the court appointed lead plaintiffs consolidating the six putative securities class actions into a single case. In an Order dated May 16, 2005, the court dismissed the consolidated complaint because the plaintiffs failed to satisfy the heightened pleading standards of the PSLRA. The court did, however, give the lead plaintiffs leave to file an amended consolidated complaint within 30 days of the order. Rather than file a new complaint, the Plaintiff agreed to dismiss the entire case with prejudice. The Order dismissing the action with prejudice was entered on June 17, 2005.

In addition, on March 12, 2004, a shareholder derivative lawsuit captioned *Frank Capovilla, Derivatively on Behalf of Activision, Inc. v. Robert Kotick, et al.* was filed, purportedly on behalf of Activision, which in large measure asserts the identical claims set forth in the federal class action lawsuit. That complaint was filed in California Superior Court for the County of Los Angeles. Also, on March 22, 2005, a new derivative lawsuit captioned *Ramalingham Balamohan, Derivatively on Behalf of Nominal Defendant Activision, Inc. v. Robert Kotick, et al.* was filed in the Federal Court in Los Angeles. This complaint made the same allegations as the previous complaints, but it named all the then current directors as defendants. In the California state derivative case, in light of the ruling dismissing the complaint in the federal class action, plaintiff’s counsel filed an amended complaint which, while still based on the same factual allegations that led to the class action being dismissed in federal court, dropped most of the causes of action and focuses only on the alleged claims of insider trading and breaches of fiduciary duty. Activision intends to contest these allegations as vigorously as the earlier allegations. In the federal derivative case, plaintiff voluntarily filed a notice of dismissal of the action, without prejudice, pending resolution of the federal class action and an order dismissing this action was entered on June 3, 2005.

In addition, we are party to other 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.

Item 4. Other Information

We held our 2005 Annual Meeting of the Stockholders on September 15, 2005 in Santa Monica, California. Three items were submitted to a vote of the stockholders: (1) the election of eight directors to hold office for one year terms and until their respective successors are duly elected and qualified; (2) to approve the Company’s 2003 Incentive Plan; and (3) to approve amendments to the Company’s Second Amended and Restated 2002 Employee Stock Purchase Plan and Restated 2002 Employee Stock Purchase Plan for International Employees (collectively, the “Employee Purchase Plans”) to increase by 1,500,000 the total number of shares of Company common stock reserved for issuance under the Employee Purchase Plans.

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

	<u>For</u>	<u>Withheld</u>
Robert J. Corti	181,856,156	7,655,386
Ronald Doornink	180,606,849	8,904,693
Barbara S. Isgur	180,511,913	8,999,629
Brian G. Kelly	184,039,617	5,471,925
Robert A. Kotick	185,017,303	4,494,239
Robert J. Morgado	180,462,747	9,048,795
Peter J. Nolan	183,055,849	6,455,693
Richard Sarnoff	189,089,590	421,952

The Company’s 2003 Incentive Plan was approved. Set forth below are the results of the voting.

<u>For</u>	<u>Against</u>	<u>Abstain</u>	<u>Not Voted</u>
135,103,989	20,953,272	143,505	33,310,776

Amendments to the Company’s Second Amended and Restated 2002 Employee Stock Purchase Plan and Restated 2002 Employee Stock Purchase Plan for International Employees (collectively, the “Employee Purchase Plans”) to increase by 1,500,000 the total number of shares of Company common stock reserved for issuance under the Employee Purchase Plans were approved. Set forth below are the results of the voting.

<u>For</u>	<u>Against</u>	<u>Abstain</u>	<u>Not Voted</u>
128,718,248	27,309,079	173,439	33,310,776

Item 6. Exhibits

(a) Exhibits

3.1

Amended and Restated Certificate of Incorporation of Activision Holdings, 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 Amended and Restated Bylaws dated August 1, 2000 (incorporated by reference to Exhibit 3.2 of our Current Report on Form 8-K, filed July 11, 2001).
- 3.3 Certificate of Amendment of Amended and Restated Certificate of Incorporation of Activision Holdings, dated June 9, 2000 (incorporated by reference to Exhibit 2.7 of our Current Report on Form 8-K, filed on June 16, 2000).
- 3.4 Certificate of Designation of Series A Junior Preferred Stock of Activision, Inc., 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).

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- 3.5 Certificate of Amendment of Amended and Restated Certificate of Incorporation, as amended, of Activision, Inc., dated as of April 4, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed April 5, 2005).
- 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 September 9, 2005 between Thomas Tippl and Activision Publishing, Inc.
- 10.2 Stock Option Agreement dated October 3, 2005 between Thomas Tippl and Activision, Inc.
- 10.3 Restricted Stock Agreement dated October 3, 2005 between Thomas Tippl and Activision, Inc.
- 31.1 Certification of Robert A. Kotick pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Ronald Doornink pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.3 Certification of William J. Chardavoyne pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Ronald Doornink pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.3 Certification of William J. Chardavoyne pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

Date: November 3, 2005

ACTIVISION, INC.

/s/ William J. Chardavoyne

William J. Chardavoyne

Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

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September 9, 2005

Thomas Tippl
3033 Burning Tree Lane
Cincinnati, OH 45237

Dear Mr. Tippl:

This letter ("Agreement") confirms the terms of your employment by Activision Publishing, Inc. ("Employer"), on the terms and conditions set forth below.

1. Term

(a) The initial term of your employment under this Agreement shall commence on October 1, 2005 or such other date as the parties may mutually agree (the "Effective Date") and expire on September 30, 2010 (the "Expiration Date") unless earlier terminated as provided in Paragraph 9 below or as may be extended as provided in Paragraph 1(b) below (the "Employment Period").

(b) If, at any time during the Employment Period, your Total Compensation exceeds \$15,000,000, Employer shall have the option to extend the Employment Period for up to an additional three-year period, commencing on October 1, 2010 and expiring no later than September 30, 2013. For purposes of this Agreement, "Total Compensation" shall mean the total of (i) your cumulative Base Salary through the date of determination, (ii) your cumulative Annual Bonuses through such date, (iii) the realized and unrealized gains (based upon the closing price of the common stock of Activision, Inc. ("Activision") as reported on The NASDAQ Stock Market on the applicable date) from any and all vested stock options issued to you, (iv) the market value of all vested restricted stock grants issued to you plus the amounts you realized from the sale of any shares sold by you which were the subject of such restricted stock grants.

(c) Employer may exercise the option granted to it under Paragraph 1(b) by giving written notice to you no later than June 30, 2010, which notice shall state the exact length of the Employment Period as so extended.

2. Salary

(a) In full consideration for all rights and services provided by you under this Agreement, you shall receive the compensation set forth in this Paragraph 2. Commencing on your payroll start date, you shall receive an annual base salary of \$450,000 for the period until October 1, 2006; provided that the aggregate of base salary payments through the period ending September 30, 2006 will not be less than \$350,000. Thereafter, on October 1 of each year of the Employment Period, beginning on October 1, 2006, your Base Salary shall automatically increase to an amount equal to one hundred four (104%) percent of the Base Salary for the prior year.

(b) Base Salary payments shall be made in accordance with Employer's then prevailing payroll policy. The 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 at any time if Activision'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, such increased Base Salary shall then constitute your minimum Base Salary for each subsequent year under this Agreement.

(c) Employer shall not be required to actually use your services during the term of this Agreement. You will not be permitted or authorized to act on behalf of Employer if Employer is not utilizing your services unless specifically authorized in writing to the contrary by Employer. All of your obligations to Employer under this Agreement generally, and specifically with regard to Paragraph 8, shall continue throughout the term of this Agreement and shall remain in full force and effect. Moreover, you have an obligation to abide by the terms of the Employee Proprietary Information Agreement executed by you and Employer's corporate governance policies.

(d) You will receive a signing bonus of \$100,000 payable on Effective Date.

(e) 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 term of this Agreement will 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 Activision's Board of Directors (or the Compensation Committee of the Board of Directors) and will be based upon 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 made by Activision's Board of Directors (or the Compensation Committee of the Board of Directors) in its sole discretion. The Annual Bonus may take the form of, without limitation, cash, shares of common stock of Activision and/or options to purchase such shares, as determined by the Compensation Committee in its sole discretion. Employer's overall financial performance will also be considered in determining whether any of the Annual Bonus is awarded and, if so, the amount. The Annual Bonus, if granted, is generally paid to employees in May. Except as otherwise set forth in this Agreement, you must remain continuously employed by Employer through the date on which the Annual Bonus is paid to be eligible to receive such Annual Bonus. Any Annual Bonus shall be subject to withholding.

(f) Pursuant to the Activision 2003 Incentive Plan ("Plan"), you will, on or before the Effective Date, be granted a non-qualified stock option (the "Option") to purchase an aggregate of 600,000 shares of the Activision's common stock in three tranches of 200,000 shares each. As to the First Tranche of 200,000 shares covered by the Option, such option will vest ratably over the five years following the Effective Date, with 20% of the amount vesting at the end of each year. As to the Second Tranche of 200,000 shares covered by the Option, such option will not vest until the end of the fifth year following the

Effective Date (subject to possible earlier vesting in three equal annual installments if Employee shall achieve certain performance objectives to be mutually determined by you and Employer for the fiscal years 2007, 2008 and 2009) and will thereupon fully vest in its entirety (on a "cliff-vesting" basis). As to the Third Tranche of 200,000 shares covered by the Option, such option will not vest until the end of the fifth year following the Effective Date and will thereupon fully vest in its entirety (on a "cliff-vesting" basis). The Option

will have an exercise price per share that will be the fair market value on the grant date and will be governed in all other respects by (and you agree to enter into) Activision's standard form of stock option agreement for similar grants of "inducement" options.

(f) You may be eligible for such additional stock option grants 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 in connection with any extensions of this Agreement's contract term.

(g) In consideration for abandoning certain benefits with your prior employer and forgoing certain other executive opportunities and related equity participations, pursuant to the Plan, you also will receive, on or before the Effective Date, a restricted stock grant (the "Grant") of the number of shares of Activision's common stock (the "Restricted Shares") (any fractional shares resulting from this computation shall be rounded up to the next whole number) equal to \$1,500,000 divided by the fair market value on the grant date ("Market Price"), which Restricted Shares will vest ratably over the third, fourth and fifth years following the Effective Date, with one third of the amount granted vesting at the end of each of the third, fourth and fifth years following the Effective Date.

(h) Within six months of the Effective Date, you shall relocate your principal residence to within a 60-minute vehicle commute of Employer's headquarters (Santa Monica, California). At the time of relocation, Employer shall pay for the following costs: (i) all closing costs associated with buying and selling a home, including real estate commissions for the sale of your existing principal residence; (ii) all moving costs for household goods; and (iii) \$420,000 mortgage assistance ("Mortgage Assistance"), payable \$7,000.00 each month for 60 months. In addition, Employer will reimburse you for the actual incremental income taxes paid by you by reason of the inclusion in your income of the payments to you of the amounts set forth in clauses (i) and (ii), as well as for the first 36 months of the payments of the amounts set forth in clause (iii), of the immediately preceding sentence Prior to your relocation, Employer will reimburse you for your reasonable commuting costs between your current residence and Los Angeles.

(i) Employer will reimburse you for reasonable, one time legal, accounting and tax costs relating to the adjustments in your expatriate status resulting from your transfer to Southern California, such reimbursement not to exceed \$25,000 in the aggregate. These reimbursements will be grossed up to account for any income taxes due. Employer reserves the right in its discretion to pay these amounts directly to the service providers.

3. Appointment; Title; Reporting

You are being employed under this Agreement in the position of Chief Financial Officer of Employer. You shall report to the President and Chief Executive Officer of Employer.

You will also be appointed to the Board of Directors of Employer, your appointment to become effective as of the Effective Date.

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. You will not engage in any outside business activities nor serve on the board of directors or trustees of any entity without the prior approval of the Co-Chairmen of Activision.

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 Activision's Employee Stock Purchase Plan and Employer's 401(k) plan (with Employer matching your contributions to such 401K plan in accordance with Employer's matching policy). In addition to the foregoing benefits, Employer will provide you during the Employment Period, at Employer's expense, with a supplemental term life insurance policy with a benefit amount of \$2,000,000 through a carrier of Employer's choice. Nothing paid to you under any such plans and arrangements (nor any bonus or stock options which Activision'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. You expressly agree and acknowledge that after the expiration or early termination of the term of your employment under this Agreement, you are entitled to no additional benefits, except as specifically provided in this Agreement and 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 or CAL-COBRA on 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) paid vacation days per year.

(b) You shall be entitled to all paid holidays given by Employer to its full-time employees.

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8. Protection of Employer's Interests

(a) **Duty of Loyalty.** During the term of your employment, you will owe a duty of loyalty to Employer, which includes, but is not limited to, your not competing 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) **Policy Compliance.** You confirm that you have read, understand and will comply with the terms of Employer Corporate Governance Policies, including but not limited to Code of Business Conduct and Ethics and Code of Ethics for Senior Executive and Senior Financial Officers, and any reasonable amendments thereto which you receive.

(c) **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.

(d) **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 as of the Effective Date 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. You also acknowledge that upon termination of your employment for any reason whatsoever, you will promptly deliver to Employer or surrender to Employer's representative all Employer property, including without limitation, all documents and other materials (and all copies thereof) relating to Employer's business, all identification and access cards, all contact lists and third party business cards however and wherever preserved, and any equipment provided by Employer, including computers, telephones, personal digital assistants, memory cards and similar devices which you possess or have in your custody or under your control. The provisions of this paragraph shall survive the expiration or earlier termination of this Agreement.

(e) **Non-Competition.** During your Employment Period and for a period of one year following the expiration of the Employment Period, you shall not engage (including, without limitation, as an officer, director, shareholder, owner, partner, joint venturer, member or in a managerial capacity, or as an employee, independent contractor, consultant, advisor or sales

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representative) in any Competitive Business (as hereinafter defined) in the Territory (as hereinafter defined). For purposes of determining whether you are permitted to be a shareholder of a corporation engaged in a Competitive Business, the Executive's direct or indirect ownership (alone or together with a group) of less than 5% of the issued and outstanding securities of a company whose securities are publicly-traded in any U.S. or non-U.S. securities exchanges or quotation system shall be permitted. As used herein, the term "Competitive Business" shall mean any business engaged in publishing and distributing video games and entertainment software for personal computers. As used herein, the term "Territory" shall mean:

(1) The following counties in the State of California: Alameda, Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Fresno, Glenn, Humboldt, Imperial, Inyo, Kern, Kings, Lake, Lassen, Los Angeles, Madera, Marin, Mariposa, Mendocino, Merced, Modoc, Mono, Monterey, Napa, Nevada, Orange, Placer, Plumas, Riverside, Sacramento, San Benito, San Bernardino, San Diego, San Francisco, San Joaquin, San Luis Obispo, San Mateo, Santa Barbara, Santa Cruz, Shasta, Sierra, Siskiyou, Solano, Sonoma, Stanislaus, Sutter, Tehama, Trinity, Tulare, Tuolumne, Ventura, Yolo, and Yuba;

(2) Each and every county or other political or geographical subdivision in the balance of the United States of America and the dependent territories of the United States of America; and

(3) Each and every county or other political or subdivision in the world.

(f) **Covenant Not to Solicit.** During the Employment Period and for a period of two years following the expiration of the Employment Period 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: (a) 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; or (b) directly or indirectly solicit, induce or entice any client, customer, contractor, licensor, agent, partner or other business relationship of Employer to terminate, discontinue, renegotiate or otherwise cease or modify their relationship with Employer. You expressly acknowledge and agree that the restrictions contained in this paragraph are reasonably tailored to protect Employer's confidential information and trade secrets, and are reasonable in all circumstances in scope, duration and all other respects. It is expressly agreed by the parties that if for any reason whatsoever any one or more of such restrictions shall (either taken by itself or themselves together) be adjudged to go beyond what is reasonable in all circumstances for the protection of the legitimate interests of Employer, the parties agree that the prohibitions shall be in effect and upheld to the fullest extent permissible under applicable laws.

9. Termination

(a) **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, (ii) material breach by you of the Agreement, which shall continue uncured for a period of 45 days after written notice to you of such material breach consistent with the cure provisions described later in this Paragraph, (iii) conviction of or plea of no contest to a felony or crime involving dishonesty or moral turpitude, (iv) breach of duty of loyalty, or (v) violation of Employer's corporate governance policies. In addition, but subject to the provisions of Paragraphs 9(e)(iii) and 9(f)(ii) below, Employer may terminate your employment under this Agreement at any time 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. In the case of any termination for Cause pursuant to clause (ii), Employer shall give written notice of termination to you ("Notice of Cause Termination"), and shall specify the date of such termination, which shall not be earlier than 45 days after the date on which notice is given to you. Such notice shall specify the particular acts or circumstances that purport to constitute Cause for such termination. You shall be given the opportunity within 30 days after receiving such notice to explain why Cause for such termination does not exist or to cure any such basis for Cause. Within 15 days after any such explanation, you will be given the final decision regarding whether Cause exists. If the final decision is that Cause exists, your employment with Employer shall be terminated under Paragraph 9(a)(ii) pursuant to the Notice of Cause Termination as of the date of termination specified in the notice. If the final decision is that Cause does not exist, your employment with Employer shall not be terminated under Paragraph 9(a)(ii) pursuant to such Notice of Cause Termination.

(b) **Employee.** You may terminate your employment under this Agreement in the event of Employer's relocation to a location more than 25 miles from 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 shall be obligated to pay only your estate or legal representative the amounts set forth in Paragraph 9(e)(i) below and further comply with provisions of Paragraph 9(f)(iii). In the event that you have or develop a Disability, then Employer shall have the right, at its option, to terminate your employment under this Agreement, subject to the provisions of Paragraphs 9(e)(ii) and 9(f)(iii) below. Unless and until so terminated, during any period of Disability during which you are unable 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. "Disability" shall be determined in accordance with the definitions set forth in the Employer's disability insurance policies and shall be determined by a physician mutually agreed upon by you and Employer. If you and Employer are unable to agree on such a physician, you and Employer shall each appoint one physician and those two physicians shall appoint a third physician who shall make such a determination. You shall cooperate and make yourself available for any medical examination reasonably required by Employer with respect to any determination of your Disability.

(d) **Performance Termination.** At any time during the Employment Period, Employer may terminate your employment under this Agreement by reason of your failure to perform the

functions of your position at the level appropriate for Employer, provided that you shall have been given written notice of such performance deficiencies and shall have failed to cure such performance deficiencies within 18 months following such notice if the notice occurs during the first year of Employment Period and 12 months following such notice at any time thereafter. For purposes of this Agreement, Performance Termination shall not be deemed termination without cause.

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

(i) Compensation upon Death. In the event 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 prior fiscal year; (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 earned; (iv) an amount equal to 300% 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 approved expenses due to you pursuant to Paragraphs 2(h) and 5; (vi) immediate vesting of a pro rata (based upon the amount of time between the Effective Date and the date of your death) portion of the unvested portion of the second and third tranches of the Option issued to you pursuant to Paragraph 2(e); and (vii) 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 a two (2) year 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 prior fiscal year; (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 earned; (iv) reimbursement of approved expenses due to you pursuant to Paragraphs 2(h) and 5; (v) an amount equal to three hundred (300%) 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, (vi) the long-term monthly disability payments according to Employer's benefit plan for Executives 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 Disability termination for a two year

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, or by you pursuant to Paragraph 9(b), then you shall receive: (i) the Base Salary through the date of your termination; (ii) any unpaid Annual Bonus for any prior fiscal year; (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 earned; (iv) reimbursement of approved expenses due you pursuant to Paragraphs 2(h) and 5; (v) 100% of the Base Salary payable to you from the date of termination 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 to be paid on a salary continuation basis as and when normally paid by Employer; and (vi) continued monthly payments of the remaining balance of Mortgage Assistance pursuant to Paragraph 2(h).
- (iv) Compensation upon Termination For Cause. In the event your employment under this Agreement is terminated by Employer for Cause, then you shall receive: (i) the Base Salary through the date of your termination; and (ii) reimbursement of approved expenses due you pursuant to Paragraphs 2(h) and 5.
- (v) Compensation upon Termination For Performance Deficiency. In the event your employment under this Agreement is terminated by Employer pursuant to Paragraph 9(d), then you shall receive: (i) Base Salary through date of termination; (ii) any unpaid Annual Bonus for any prior fiscal year; (iii) reimbursement of approved expenses due you pursuant to Paragraphs 2(h) and 5; and (iv) continued monthly payments of the remaining balance of Mortgage Assistance pursuant to Paragraph 2(h).
- (vi) Payment Limitations. Notwithstanding the foregoing, to the extent any of the provisions of this Paragraph 9(e) allow for payments of Base Salary, Annual Bonus or Mortgage Assistance subsequent to your termination, such payments will occur and continue only for so long as you do not become employed at any time subsequent to your termination by a corporation or other entity engaged in a Competitive Business or otherwise become engaged in directly or indirectly in a Competitive Business.

(f) **Disposition of Stock Options and Restricted Shares Upon Termination.** Upon termination of your employment for any reason, the following terms shall apply to the stock options issued to you pursuant to this Agreement under Paragraphs 2(e) and (f) and Restricted Shares issued to you pursuant to Paragraph 2(g), respectively:

- (i) In the event of termination of your employment for Cause, or as a result of Performance Termination:

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- (1) All stock options granted to you under this Agreement, 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;
 - (2) You will be allowed to vest such number of Restricted Shares then unvested, so that the aggregate number of Restricted Shares already vested as of the termination date but not yet sold, if any, and such newly-vested Restricted Shares is equal to: \$1,500,000, less net, after tax proceeds of any Restricted Shares vested and sold by you as of the date of termination, and the resulting remainder divided by the Market Price of the Restricted Shares on the date of termination. All other Restricted Shares then remaining unvested shall be cancelled. Nothing set forth in this Paragraph 9(f)(i) shall be deemed to require Employer to issue any Restricted Shares in addition to the Restricted Shares then vested or unvested, already granted to you as of the date of termination pursuant to the terms of this Agreement.
- (ii) In the event of termination of your employment by Employer without Cause or by you pursuant to Paragraph 9(b):
 - (1) All stock options granted to you under this Agreement shall continue to vest and be exercisable through the Expiration Date in accordance with same respective vesting schedules and under same terms had your employment not be terminated, but subject to the Valuation Limit determination as described in more detail in Exhibit A to this Agreement;
 - (2) You will be allowed to vest Restricted Shares in accordance with same respective vesting schedule and under same terms had your employment not be terminated, but subject to the Valuation Limit determination described in more detail in Exhibit A to this Agreement;
 - (3) To the extent any of the provisions of this Paragraph 9(f)(ii) allow vesting of Restricted Shares and vesting and exercise of stock options subsequent to your termination, such vesting and/or will occur and/or continue only for so long as you do not become employed at any time subsequent to your termination by a corporation or other entity engaged in a Competitive Business. Should you become employed at any time subsequent to your termination without cause by a

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corporation or other entity engaged in a Competitive Business or otherwise become engaged directly or indirectly in a Competitive Business, (a) all stock options and Restricted Shares granted to you under this Agreement shall cease to vest immediately as of the date of such employment, (b) all then unvested stock options and Restricted Shares shall be cancelled, and only vested stock options shall continue to be exercisable until the earlier of (i) the end of the 30th day after you commence engaging in a Competitive Business, or (ii) 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. Notwithstanding the foregoing, in the event such employment or engagement in a Competitive Business is in breach of Paragraph 8(d) of this Agreement, then all Restricted Shares and stock options

granted to you under this Agreement, whether or not vested, shall expire immediately on the date you commence engaging in a Competitive Business and all such Restricted Shares and stock options shall immediately be cancelled and no longer continue vest or be exercisable as of the date of your employment or engagement in a Competing Business.

- (4) Nothing set forth in this Paragraph 9(f)(ii) shall be deemed to require Employer to issue any Restricted Shares or grant to you any stock options in addition to the Restricted Shares and stock options, then vested or unvested, already issued to you as of the date of termination pursuant to the terms of this Agreement.
- (iii) In the event of your termination of employment by reason of your death or disability:
- (1) All stock options granted to you under this Agreement shall cease to vest immediately as of the date of such termination of your employment, all unvested stock options shall be cancelled (except in the event of death, with regard to Second Tranche and Third Tranche only, the stock options in such tranches will vest as of the date of termination in the amount determined pro-rata based on the length of your employment), 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;

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- (2) You will be allowed to vest such number of Restricted Shares then unvested, so that the aggregate number of Restricted Shares already vested as of the termination date but not yet sold, if any, and such newly-vested Restricted Shares is equal to: \$1,500,000, less net, after tax proceeds of any Restricted Shares vested and sold by you as of the date of termination, and the resulting remainder divided by the Market Price of the Restricted Shares on the date of termination. All other Restricted Shares then remaining unvested shall be cancelled. Nothing set forth in this Paragraph 9(f)(iii) shall be deemed to require Employer to issue any Restricted Shares in addition to the Restricted Shares then vested or unvested, already granted to you as of the date of termination pursuant to the terms of this Agreement.
- (iv) In the event of termination of your employment for any reason not otherwise described in Paragraphs 9(f)(i)-(iii), including without limitation, by reason of your breach of this Agreement, all stock options granted to you under this Agreement, 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 to vest or be exercisable as of the date of termination of your employment. All Restricted Shares then remaining unvested also shall be cancelled.

10. No Shop Clause

During the Employment Period, you shall not seek or negotiate for employment other than with Employer, its subsidiary or affiliate, with the exception of (i) the final 120 days of the Employment Period, or (ii) any time after the delivery by the Employer of written notice of performance deficiencies in accordance with Paragraph 9(d), provided that you first provide Employer with written notice of your intent to seek external employment and such interviews may occur strictly subject to your continuing obligations under this Agreement, including, without limitation, your duty of loyalty, compliance with Employer's corporate governance policies and confidentiality obligations.

11. Use of Employee's Name

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

12. 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.

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13. 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.

14. Successors

(a) This Agreement is personal to you and without the prior written consent of Employer shall not be assignable by you otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by your legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon Employer and its successors and assigns, including any successor by reason of merger, sale of all or substantially all of the assets of Employer or by operation of law.

15. Minimum Ownership Position

At all times during the term on or after the second anniversary of the Effective date, you shall own a number of shares of Activision's common stock that have an "aggregate market value" which is at least equal to the greater of (a) 1.50 times your annual Base Salary set forth in Paragraph 2(a) or (b) ten

percent (10%) of the total amount realized by you from all option exercises within two years of the Effective Date, determined for each option so exercised to be an amount equal to the Market Price (as defined in Paragraph 2(g)) of Activision's shares on the applicable exercise date over the exercise price per share of such options. For purposes of this Agreement, "aggregate market value" shall be the product of the Market Price and the total number of Activision's shares owned by you as of the applicable date. All Activision restricted stock grants to you shall be included for these purposes in the foregoing calculation. Employer shall in good faith monitor such ownership position. You also agree to comply with any additional reasonable stock ownership guidelines that may be adopted by the Board of Directors and apply to Employer's senior executives.

16. General Provisions

(a) **Entire Agreement.** This Agreement, together with the Employee Proprietary Information Agreement, and stock option agreement, supersede 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 these agreements shall be binding unless it is set forth in a writing signed by both Employer and you. 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.

(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

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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) **Expiration.** This Agreement does not constitute a commitment of Employer with regard to your employment, express or implied, other than to the extent expressly provided for herein. Upon expiration of the term of this Agreement, it is the contemplation of both parties that your employment with Employer shall cease, and that neither Employer nor you shall have any obligation to the other with respect to your continued employment. In the event that your employment continues for a period of time following the term unless and until agreed to in a new subscribed written document, such continuation of your employment shall be "at will," and may be terminated without obligation at any time by either party giving notice to the other.

(f) **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.

(g) **Immigration.** The parties acknowledge and agree that you are not a citizen of the United States of America and your expatriate status will require adjustment in connection with your acceptance of this position. The effectiveness of this Agreement is expressly not conditioned upon successful adjustment of your immigration status and receipt of documents from Immigration and Naturalization Service. Loss of your immigration status in the United States during the Employment Period will result in Employer providing compensation of no less than undertaken in the provisions of paragraphs 9 (e) (iii) and 9 (f) (ii), provided such loss is not as a result of your direct action, inaction or omission in the visa or work permit process..

(h) **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.

(i) **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

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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.

(j) **Legal Counsel.** You acknowledge that you have been given the opportunity to consult with legal counsel or any other advisor of your own choosing regarding this Agreement. You understand and agree that Employer'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 Employer and not on your behalf.

(k) **Right to Negotiate.** You hereby acknowledge that you have been given the opportunity to participate in the negotiation of the terms of this Agreement. You acknowledge and confirm that you have read this Agreement, fully understand its terms and contents and have had the opportunity to ask Employer about any questions, concerns or issues you may have on connection with this Agreement or its terms.

(l) **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 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 Paragraphs 8 and 10 of this Agreement).

(m) **Injunctive Relief.** In the event of a breach of or threatened breach of the provisions of this Agreement regarding the exclusivity of your services and the provisions of Paragraphs 8 and 10 of this Agreement you agree that any remedy of law would be inadequate. Accordingly you agree that Employer is entitled to obtain injunctive relief for 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.

(n) **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.

(o) **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 your attorneys' fees, experts' fees, and all of its or your costs, in addition to such other relief as may be granted.

(p) **Amendment.** This Agreement may not be amended or modified otherwise than by a written agreement executed by the parties hereto or their respective successors and legal representatives. The parties shall cooperate in good faith in making any amendments to this Agreement that may be necessary to avoid imposition of any penalty tax imposed under Section

409A of the Internal Revenue Code of 1986, as amended (the "Code"), or the regulations thereunder.

(q) **Deferred Compensation.** Notwithstanding anything to the contrary in this Agreement, in the event that it is determined that any payment to be made under this Agreement is considered "nonqualified deferred compensation" subject to Section 409A of the Code or the regulations thereunder, payment under this Agreement shall be delayed for six months following the termination of employment of Employee. Any such deferred amount shall be included in Total Compensation notwithstanding any such deferral.

(p) **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.

17. 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 You: 3033 Burning Tree Lane
Cincinnati, OH 45237

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.

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

ACCEPTED AND AGREED TO:

Employer

Employee

ACTIVISION PUBLISHING, INC.

By: _____

Its: _____

**in the Event of Termination Without Cause
pursuant to Paragraph 9(f)(ii)**

Section 1

(a) The term “**Valuation Limit**” shall mean the number obtained by multiplying (a) 2.5 by (b) the number that is equal to the sum of your initial Base Salary and targeted Annual Bonus during the first year of the Employment Period, times the number of full and partial years worked as of the date of termination. For purposes of this definition, any partial year of employment will be pro-rated based on the number of whole months actually worked through the year of termination.

(b) The term “**Aggregate Earned Value**” shall mean the aggregate of the value of Restricted Shares vested by you prior to termination and the value of the stock options you may have exercised, if any, prior to termination. Accordingly, Aggregate Earned Value shall be determined by adding two components:

(i) The value of Restricted Shares obtained by multiplying the number of Restricted Shares you may have vested as of the termination date, whether then sold or unsold, by the Market Price of Restricted Shares on the date of their respective vesting; and

(ii) The value of exercised stock options, which shall be equal to the net, pre tax proceeds actually realized by you from the exercise of any stock options prior to termination and sale of shares issued upon such exercise. In the event you exercise a stock option but do not sell and still hold the shares issued upon such exercise as of the termination date, the proceeds realized by you with respect to those shares shall be deemed to be the remainder obtained by subtracting (i) the total price paid upon exercise of the option for such shares from (ii) the Market Price.

(c) The term “**Future Shares Value**” shall mean the number of Restricted Shares that have vested after the termination date, multiplied by the Market Price of such Restricted Shares on the date of their respective vesting.

(d) The term “**Future Options Value**” shall mean the number equal to the net, pretax proceeds realized by you from the exercise of any stock options after the termination date and the sale of stock issued pursuant to those stock options, regardless of whether such options may have vested before or after your termination. In the event you exercise a stock option but do not sell the shares issued upon such exercise at the time the Future Options Value is calculated, the proceeds realized by you with respect to those

shares shall be deemed to be the remainder obtained by subtracting (i) the total price paid upon exercise of the option for such shares from (ii) the Market Price.

Section 2.

(a) You and Employer acknowledge and agree that in the event of your termination without cause or by you pursuant to Paragraph 9(b) or as a result of your loss of immigration status and legal ability to work for Employer in the United States as referenced in Paragraph 16(g) of the Employment Agreement, you will be allowed to continue to vest Restricted Shares and stock options issued to you pursuant to this Agreement prior to termination until such time as the sum of the Aggregate Earned Value, the Future Shares Value and the Future Options Value exceeds the Valuation Limit.

- i. If on the date of your termination, the Aggregate Earned Value equals to or exceeds the Valuation Limit, then you will not be entitled to vest any additional Restricted Shares or stock options and any then remaining unvested Restricted Shares and stock options shall be cancelled. You may then sell any vested Restricted Shares or exercise any then vested stock options in accordance with their terms;
- ii. If on the date of your termination, the Aggregate Earned Value is less than the Valuation Limit, you will be allowed to continue to vest Restricted Shares and stock options subsequent to your termination until such time as the aggregate of the Future Shares Value and the Future Options Value is equal to or exceeds the amount by which the Valuation Limit exceeds the Aggregate Earned Value on the termination date. When the Valuation Limit is so reached, you will not be entitled to vest any additional Restricted Shares or stock options and any then remaining unvested Restricted Shares and stock options shall be cancelled. You may sell any vested Restricted Shares or exercise any then vested stock options in accordance with their terms.

STOCK OPTION AGREEMENT

**Issued Pursuant to the
2003 Incentive Plan of
ACTIVISION, INC.**

Stock Option #03000934

For 600,000 Shares

THIS STOCK OPTION AGREEMENT (THIS "OPTION AGREEMENT") CERTIFIES that on October 3, 2005 (the "Issuance Date"), Thomas Tippl (the "Holder") was granted an option (the "Option") to purchase at the option price of \$20.28 per share, all or any part of 600,000 fully paid and non-assessable shares ("Shares") of common stock, par value \$.000001 per share, of ACTIVISION, INC., a Delaware corporation (the "Company"), upon and subject to the following terms and conditions:

- General Terms of the Option.** The Option is granted as a material inducement to the Holder's entering into employment with the Company pursuant to an employment agreement dated September 9, 2005 (the "Employment Agreement"). In addition, this Option has been granted pursuant to and is subject to the terms and conditions of the Company's 2003 Incentive Plan (the "Plan"), and the terms and conditions of the Plan shall be deemed to be incorporated herein by reference and made a part of this Option. Holder hereby acknowledges by his signature below that he has received a copy of the Plan. Capitalized terms used herein shall have the meanings set forth in the Plan, unless otherwise defined herein.
- Expiration.** This Option shall expire on October 3, 2015, unless extended or earlier terminated in accordance herewith.
- Exercise.** Except as otherwise permitted under the Plan, this Option may be exercised or surrendered during the Holder's lifetime only by the Holder or his/her guardian or legal representative. EXCEPT AS OTHERWISE PERMITTED UNDER THE PLAN, THIS OPTION SHALL NOT BE TRANSFERABLE BY THE HOLDER OTHERWISE THAN BY WILL OR BY THE LAWS OF DESCENT AND DISTRIBUTION. With the Company's consent which may granted or withheld in its sole discretion, Options may be transferred to certain permitted assignees, such as certain relatives of, or entities controlled by, the Participant, as more fully set forth in Section 8.3 of the Plan.

This Option shall vest and be exercisable as follows (except as otherwise provided in this Option Agreement or the Employment Agreement):

Vesting Date	Shares Vested at Vesting Date	Cumulative Shares
October 3, 2006	40,000	40,000
October 3, 2007	40,000	80,000
October 3, 2008	40,000	120,000
October 3, 2009	40,000	160,000
October 3, 2010	440,000	600,000

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

4. **Tranches Subject to Acceleration.** Pursuant to Paragraph 2(e) of the Employment Agreement, of the 440,000 Shares scheduled to vest on October 3, 2010, 200,000 Shares may be subject to accelerated vesting if Holder shall achieve certain performance objectives to be mutually determined by Holder and the Company at the rate of 66,666 Shares to vest on May 3, 2007 for achievement of such performance objectives during the Company's fiscal year 2007, 66,666 Shares to vest on May 3, 2008 for achievement of such performance objectives during the Company's fiscal year 2008, and 66,667 Shares to vest on May 3, 2009 for achievement of such performance objectives during the Company's fiscal year 2009. In addition, pursuant to Paragraph 9(f)(iii) (1) of the Employment Agreement, of the 440,000 Shares scheduled to vest on June 30, 2010, a pro rata (based upon the amount of time between the Issuance Date and the date of the death of the Holder) portion of 400,000 Shares may be subject to immediate vesting upon the death of the Holder.

5. **Termination of Employment.** Please refer to Employment Agreement Paragraph 9 for treatment of stock options in the case of termination.

6. **Death.** In the event the Holder dies while employed by the Company or any of its subsidiaries or affiliates, this Option, to the extent not previously expired or exercised, shall, to the extent exercisable on the date of death, be exercisable by the estate of the Holder or by any person who acquired this Option by bequest or inheritance, at any time within one year after the death of the Holder, *provided, however*, that if the term of such Option would expire by its terms within six months after the Optionee's death, the term of such Option shall be extended until six months after the Optionee's death.

7. **Disability.** In the event of the termination of employment of the Holder or the separation from service of the Holder due to the Disability (as defined in Paragraph 9(c) of the Employment Agreement) of the Holder, the Holder, or his guardian or legal representative, shall have the unqualified

right to exercise any portion of this Option which has not been previously exercised or expired and which the Holder was eligible to exercise as of the first date of Disability, at any time within one year after such termination or separation, *provided, however*, that if the term of such Option would expire by its terms within six months after such termination or separation, the term of such Option shall be extended until six months after such termination or separation.

8. *Employment Violation.* In consideration of the granting and by acceptance of this Option, the Holder hereby agrees that the terms of this Section 8 shall apply to the Option. The Holder acknowledges and agrees that each exercise of this Option and each written notice of exercise delivered to the Company and executed by the Holder shall serve as a reaffirmation of and continuing agreement by the Holder to comply with the terms contained in this Section 8.

The Company and the Holder acknowledge and agree that if the Holder materially breaches the Employment Agreement (it being understood that any breach of the post-termination obligations contained therein shall be deemed to be material) for so long as the terms of the Employment Agreement shall apply to the Holder (each an "Employment Violation"), subject to the cure provision outlined in Paragraph 9(a) of the Employment Agreement, the Company shall have the right to require (i) the termination and cancellation of the unexercised portion of this Option, if any, whether vested or unvested, and (ii) payment by the Holder to the Company of the Recapture Amount (as defined below). The Company and the Holder further agree that such termination of unexercised Options and payment of the Recapture Amount, as the case may be, shall be in addition to, and not in lieu of, any other right or remedy available to the Company arising out of or in connection with any such Employment Violation including, without limitation, the right to terminate the Holder's employment if not already terminated, seek injunctive relief and additional monetary damages.

For purposes of this Section 8, the "Recapture Amount" shall mean the gross gain realized or unrealized by the Holder upon each exercise of this Option during the period beginning on the date which is twelve (12) months prior to the date of the Holder's Employment Violation and ending on the date of computation (the "Look-back Period"), which gain shall be calculated as the sum of:

(a) as to any Shares acquired by the Holder upon exercise of any portion of this Option during the Look-back Period and thereafter sold, an amount equal to the product of (x) the sales price per Share sold minus the exercise price per Share times (y) the number of Shares as to which this Option was exercised and which were sold at such sales price; plus

(b) as to any Shares acquired by the Holder upon exercise and not thereafter sold, with respect to each of such Shares an amount equal to the product of (x) the greatest of the following: (1) the Fair Market Value per Share on the date of exercise, (2) the arithmetic average of the per Share closing sales prices as reported on NASDAQ for the thirty (30) trading day period ending on the trading day immediately preceding the

date of the Company's written notice of its exercise of its rights under this Section 8, or (3) the arithmetic average of the per Share closing sales prices as reported on NASDAQ for the thirty (30) trading day period ending on the trading day immediately preceding the date of computation, minus the exercise price per Share times (y) the number of Shares as to which this Option was exercised and which were not sold;

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

9. *Registration; Postponement.* The Company may postpone the issuance and delivery of Shares upon any exercise of this Option until (a) the admission of such Shares to listing on any stock exchange or exchanges on which Shares of the Company of the same class are then listed and (b) the completion of such registration or other qualification of such Shares under any state or federal law, rule or regulation as the Company shall determine to be necessary or advisable. The Holder shall make such representations and furnish such information as may, in the opinion of counsel for the Company, be appropriate to permit the Company, in light of the then existence or non-existence with respect to such Shares of an effective Registration Statement under the Securities Act of 1933, as amended, to issue the Shares in compliance with the provisions of that or any comparable act. The Company shall have the right to register the Shares underlying this Option on a Form S-8 or S-3 to facilitate their resale by the Holder.

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

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

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

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

14. *Rights of Holder.* Nothing contained herein shall be construed to confer upon the Holder any right to be continued in the employ of the Company and/or any subsidiary or affiliate of the Company or derogate from any right of the Company and/or any subsidiary or affiliate of the Company to retire, request the resignation of, or discharge the Holder at any time, with or without cause. The Holder shall not, by virtue hereof, be entitled to any rights of a shareholder in the Company, either at law or in equity, and the rights of the Holder are limited to those expressed herein and are not enforceable against the Company except to the extent set forth herein.

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

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

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

17. *Amendment.* The Company may, with the consent of the Holder, at any time or from time to time amend the terms and conditions of this Option, and may at any time or from time to time amend the terms of the Plan.

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

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

[Remainder of page intentionally blank.]

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

ACTIVISION, INC.

By: _____
Name:
Title:

Date: _____

Attest: _____

Accepted and Confirmed:

THOMAS TIPPL

Address

City State Zip Code

Social Security Number

ACTIVISION, INC.

RESTRICTED STOCK AWARD AGREEMENT

You have been awarded restricted shares of the Company's common stock, \$0.000001 par value per share ("Restricted Stock"), subject to the following terms and conditions:

- Name of Grantee: Thomas Tippl
- Total Number of Shares of Restricted Stock Awarded: 72,534(1)
- Date of Grant: October 3, 2005
- This award of Restricted Stock is being made pursuant to and as a material inducement for the Grantee to enter into an employment agreement dated September 9, 2005 (the "Employment Agreement") and is governed by the terms of the Employment Agreement and the terms of the Restricted Stock Award Terms attached hereto as Exhibit A. In addition, this award of Restricted Stock is granted under and subject to the terms and conditions of the Company's 2003 Incentive Plan (the "Plan"), the terms, conditions and definitions of which are hereby incorporated herein as though set forth at length, and the receipt of a copy of which the Grantee hereby acknowledges by his signature on the irrevocable stock attached hereto as Exhibit B. Capitalized terms used herein shall have the meanings set forth in the Plan, unless otherwise defined herein.
- **This award of Restricted Stock is conditioned upon your endorsement in blank of the irrevocable stock power attached hereto as Exhibit B. If you do not return the attached irrevocable stock power within sixty (60) days from the Date of Grant, this award shall be deemed forfeited. As such, promptly endorse and return the attached irrevocable stock power to the General Counsel at the following address:**

Activision, Inc.
3100 Ocean Park Boulevard
Santa Monica, CA 90405
Attn: General Counsel
- If you wish to elect a designated beneficiary to whom shares of common stock otherwise due to you pursuant to the terms of this award shall be distributed in the event of your death prior to distribution, please complete and return to the General Counsel along with your irrevocable stock power the beneficiary designation form attached hereto as **Exhibit C**.

Dated: October 3, 2005

ACTIVISION, INC.

Accepted and Agreed:

By: _____
Title: Sr. Vice President, General Counsel

THOMAS TIPPL

(1) Amount equal to \$1,500,000 divided by the closing price of ATVI stock as reported on closing on NASDAQ on October 3, 2005.

EXHIBIT A

ACTIVISION, INC.

RESTRICTED STOCK AWARD TERMS

Activision, Inc., a Delaware corporation ("Company"), has granted you ("Grantee") an award of restricted stock pursuant to the terms and conditions set forth in your Notice of Restricted Stock Award ("Grant Notice"), these Restricted Stock Award Terms ("Award Terms") and your Employment Agreement (defined in the Grant Notice). In addition, this award of Restricted Stock is subject to the terms and conditions of the Company's 2003 Incentive Plan (the "Plan"), the terms, conditions and definitions of which are hereby incorporated herein as though set forth at length, and the receipt of a copy of which the Grantee hereby acknowledges by his signature on the irrevocable stock power attached to the Grant Notice as Exhibit B. Capitalized terms used herein shall have the meanings set forth in the Plan, unless otherwise defined herein. The text of the Plan and the Grant Notice are incorporated herein by reference and made a part of these Award Terms.

1. Definitions. For purposes of this Award, the following terms shall have the meanings set forth below:

"**Anniversary Date**" means the annual anniversary of the Date of Grant.

"**Award**" means this Restricted Stock Award.

"**Board**" means the Board of Directors of the Company.

"**Code**" means the Internal Revenue Code of 1986, as amended, and regulations thereunder.

"**Committee**" means the Compensation Committee of the Board or such other Board committee designated by the Board in accordance with the Plan.

“**Common Stock**” means the Company’s common stock, \$0.000001 par value per share.

“**Company**” means Activision, Inc. and any successor thereto.

“**Date of Grant**” means the Date of Grant set forth on the Grant Notice.

“**Disability**” shall have the meaning set forth in the Employment Agreement.

“**Grant Notice**” means the Notice of Restricted Stock Award accompanying these Award Terms.

“**Plan**” means the Activision, Inc. 2003 Incentive Plan, as amended from time to time.

“**Restricted Shares**” means shares of Common Stock subject to the Award which are subject to the Restrictions. This amount shall include any additional shares of Common Stock

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resulting from the investment of dividends declared on existing Restricted Shares pursuant to Section 6 hereof and additional or different securities issued as a result of any adjustment pursuant to Section 10 hereof.

“**Restrictions**” means the restrictions set forth in Section 3 hereof which are imposed on shares of Common Stock subject to this Agreement prior to vesting.

“**Vested Shares**” means the shares of Common Stock subject to this Agreement which have become vested pursuant to Section 4 or 5 hereof and are, therefore, no longer subject to the Restrictions.

2. **Grant of Restricted Stock.** Pursuant to action of the Board and in accordance with the Employment Agreement, the Company hereby awards to Grantee the number of shares of Common Stock as set forth on the Grant Notice.

3. **Restrictions.** From the Date of Grant until the date Grantee obtains a vested right to shares of Common Stock subject to this Award pursuant to Section 4, 5 or 10 hereof, neither the shares of Common Stock subject to this Award (including any additional shares resulting from the reinvestment of dividends declared on the original shares awarded or an adjustment of the original shares pursuant to Section 10 hereof) nor any right or privilege pertaining thereto may be sold, assigned, transferred, pledged, hypothecated or otherwise disposed or encumbered in any way, otherwise than by transfer to a trust in accordance with Section 15 hereof, and shall not be subject to execution, attachment or similar process (collectively, the “Restrictions”). Any attempt to sell, transfer, assign, pledge, hypothecate or otherwise dispose of or encumber the Restricted Shares or any right or privilege pertaining thereto, otherwise than by transfer to a trust pursuant to Section 16 hereof, shall be null and void and of no force and effect. Upon the lapse of the Restrictions with respect to any shares of Common Stock subject to this Award, Grantee shall obtain a vested right to such shares of Common Stock.

4. **Vesting.** Except as otherwise provided in Section 5 or 10, on each Anniversary Date beginning with the third Anniversary Date through and including the fifth Anniversary Date that Grantee remains in continuous employment with the Company or any of its subsidiaries or affiliates, the Restrictions shall lapse with respect to one-third of the original number of Restricted Shares set forth on the Grant Notice, as adjusted to account for additional shares of Common Stock resulting from dividend reinvestment pursuant to Section 6 hereof or any adjustment pursuant to Section 9 hereof. Fractional shares shall be rounded up to the nearest whole share of Common Stock (for which purpose one-half share shall be rounded up to the nearest whole share of Common Stock). Upon termination of Grantee’s employment with the Company and its subsidiaries and affiliates **THE FOLLOWING PROVISIONS WILL APPLY:**

Restricted Shares will vest ratably over the third, fourth and fifth years following the Effective Date, with one third of the amount granted vesting at the end of each of the third, fourth and fifth years following the Effective Date. In the event of Grantee’s termination, the provisions of Paragraph 9 of the Employment Agreement will govern vesting.

5. **Tax Withholding.** Upon the lapse of the Restrictions (or any such earlier time, if any, that an election is made under Section 83(b) of the Code, or any successor provision thereto, to include the value of such shares in taxable income), the Company shall be entitled to withhold from

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Grantee’s compensation any required taxes, including, but not limited to, Grantee’s social security and Medicare taxes and federal, state and local income tax with respect to the income arising from the lapse of the Restrictions. The Company shall have the right to require the payment of any such taxes before delivering the stock certificate with respect to the Vested Shares and the related stock power held by the Company in accordance with Section 6 hereof. Alternatively, in lieu of such withholding, Grantee shall be entitled to cover all or any part of the taxes arising from the lapse of the Restrictions through a reduction of the number of Vested Shares delivered to Grantee or a delivery, or tender, to the Company of shares of Common Stock already held by Grantee, in each case valued in the same manner as used in computing withholding taxes under the applicable laws. Additionally, to the extent it is determined by a regulatory agency or a court of competent jurisdiction that shares of Common Stock which would otherwise be considered Restricted Shares pursuant to the terms of the Award nevertheless result in current federal or state taxation, (i) all Restrictions as to such shares shall immediately lapse, (ii) such shares shall immediately become Vested Shares and (iii) Grantee shall be entitled to cover all or any part of the taxes through a reduction of such Restricted Shares resulting in the taxable event.

6. **Custody, Voting and Dividends.** Restricted Shares shall be held in certificated form by the Company or its agent for Grantee’s account, with appropriate notation of the Restrictions made in the Company’s records and on the certificate for the Restricted Shares. Additionally, the grant of Restricted Shares is conditioned upon Grantee’s endorsement in blank of the irrevocable stock power attached to the Grant Notice as Exhibit B. The irrevocable stock power must be endorsed and returned to the General Counsel within sixty (60) days from the Date of Grant. Failure to do so within the prescribed time period will result in an immediate forfeiture of the Restricted Shares. At the option of the Grantee, any dividends declared on Restricted

Shares shall be reinvested in additional shares of Common Stock (in accordance with such methods or procedures as shall be established from time to time by the Committee), which shall vest concurrently with the Restricted Shares, or shall be paid to the Grantee concurrently with the payment of such dividends to all other record holders of Common Stock. To the extent the Restricted Shares have not been forfeited, Grantee shall be entitled to voting privileges associated with the Restricted Shares.

7. Lapse of Restrictions. If, and when, the Restrictions lapse, the Company shall distribute certificates for such Vested Shares to the Grantee, which will not bear any restrictive legend other than such legends as may be required pursuant to applicable securities or blue sky laws. Additionally, the Company will deliver to Grantee no later than thirty (30) days following the lapse of such Restrictions the related irrevocable stock power held by the Company pursuant to Section 6 hereof.

8. Committee Discretion. The Committee shall have plenary authority to (a) interpret any provision of these Award Terms, (b) make any determinations necessary or advisable for the administration of the Award, and (c) waive any conditions or rights under the Award, or amend, alter, accelerate, suspend, discontinue or terminate the Award; provided, however, that, except as provided in Section 9 hereof, without the consent of Grantee, no such amendment, alteration, suspension, discontinuation or termination of this Award may impair the rights of Grantee with the Award or modify the Award in any way materially inconsistent with the terms of Employment Agreement.

9. Adjustments. Notwithstanding anything to the contrary herein, in the event that the Committee shall determine that any dividend or other distribution (whether in the form of cash,

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shares or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, spin-off, combination, repurchase, or share exchange, or other similar corporate transaction or event, affects the Restricted Shares such that an adjustment is determined by the Committee to be appropriate in order to prevent dilution or enlargement of the rights of Grantee under this Award, then the Committee shall, in such manner as it may deem equitable, make any adjustments to the Award it deems appropriate. In addition, the Committee is authorized to make such adjustments as it deems appropriate in the terms and conditions of, and the criteria included in, the Award in recognition of unusual or nonrecurring events (including, without limitation, events described in the preceding sentence) affecting the Company or any subsidiary or affiliate or the financial statements of the Company or any subsidiary or affiliate, or in response to changes in applicable laws, regulations or accounting principles.

10. Postponement; Registration. The Company may postpone the issuance and delivery of Restricted Shares until (a) the admission of such Restricted Shares to listing on any stock exchange or exchanges on which Common Stock of the Company are then listed and (b) the completion of such registration or other qualification of such Restricted Shares under any state or federal law, rule or regulation as the Company shall determine to be necessary or advisable. The Grantee shall make such representations and furnish such information as may, in the opinion of counsel for the Company, be appropriate to permit the Company, in light of the then existence or non-existence with respect to such Restricted Shares of an effective Registration Statement under the Securities Act of 1933, as amended, to issue the Restricted Shares in compliance with the provisions of that or any comparable act. The Company shall have the right to register the Restricted Shares on a Form S-8 or S-3 to facilitate their resale by the Grantee. The Company may not postpone the issuance and delivery of Restricted Shares up to an amount equal to the taxes payable as a result of the vesting of Restricted Shares.

11. Beneficiary Designations. Grantee shall file with the Executive Vice President of Human Resources on the form attached to the Grant Notice as **Exhibit C**, or such other form as may be prescribed by the Company, a designation of a primary beneficiary(ies) and a contingent beneficiary(ies) to whom shares of Common Stock otherwise due to Grantee pursuant to the terms hereof shall be distributed in the event of the death of Grantee prior to distribution. Grantee shall have the right to change the beneficiary from time to time; provided, however, that any change shall not become effective until received in writing by the secretary of the Company or its designee. If any designated beneficiary survives Grantee but dies before receiving all of Grantee's benefits hereunder to which he or she is entitled, any remaining benefits due Grantee to which the deceased beneficiary is entitled shall be distributed to the deceased beneficiary's estate. If there is no effective beneficiary designation on file at the time of Grantee's death, or if the designated primary beneficiary(ies) and contingent beneficiary(ies) predecease Grantee, the payment of benefits shall be made to Grantee's estate.

12. Legend. The Company may cause the following or a similar legend to be set forth on each certificate representing Restricted Shares or any other security issued unless counsel for the Company is of the opinion as to any such certificate that such legend is unnecessary:

THE SECURITIES REPRESENTED BY THIS CERTIFICATE MAY NOT BE OFFERED FOR SALE, SOLD OR OTHERWISE TRANSFERRED EXCEPT PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE

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ACT, THE AVAILABILITY OF WHICH IS ESTABLISHED BY AN OPINION FROM COUNSEL TO THE COMPANY.

13. No Right to Continued Employment. Nothing in these Award Terms shall be deemed to create any limitation or restriction on such rights as the Company otherwise would have to terminate the employment of Grantee at any time for any reason.

14. Governing Law. To the extent federal law does not otherwise control, the validity, interpretation, performance and enforcement of this Award shall be governed by the laws of the State of California, without giving effect to principles of conflicts of laws thereof.

15. Successors and Assigns. The provisions of this Award shall be binding upon and inure to the benefit of the Company, its successors and assigns, and Grantee and, to the extent applicable, Grantee's legal representative. Grantee may transfer Restricted Shares to the trustee of a trust only to the extent approved in advance by the Committee (or its designee), in its sole discretion, and the Restricted Shares are held by such trustee subject to all the terms and conditions set forth in this Award. Furthermore, as a condition to transfer, the Committee (or its designee) shall have the authority to require the trustee to execute any documentation deemed appropriate by the Committee (or its designee) to ensure the Restricted Shares will continue to be subject to the terms and conditions set forth in this Award.

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EXHIBIT B

IRREVOCABLE STOCK POWER

FOR VALUE RECEIVED, and pursuant to the Restricted Stock Award dated as of _____ (the "Award"), the undersigned does hereby sell, assign, transfer and convey to

Activision, Inc. (the "Company") _____ shares of Activision, Inc. common stock, \$0.000001 par value, represented by Certificate(s) No. _____, and hereby irrevocably constitutes and appoints _____ to transfer said stock on the books of the Company, with full power of substitution in the premises.

First Name Middle Name Last Name Date

Instructions: Please do not fill in any blanks other than the signature line. The purpose of this irrevocable stock power is to enable the Company to exercise full ownership and control over the restricted stock subject to the Award in the event of forfeiture.

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EXHIBIT C

ACTIVISION, INC.

Restricted Stock Award dated as of _____, 20

Designation of Beneficiary

I, _____ ("Grantee"), hereby designate

PRIMARY

(Print Beneficiary's Name) Last First Middle Initial

Print Beneficiary's Address Relationship

PRIMARY

(Print Beneficiary's Name) Last First Middle Initial

Print Beneficiary's Address Relationship

as my primary beneficiary(ies) for purposes of the above-referenced award ("Award"). In the event of my death prior to the distribution of all shares of Common Stock otherwise due to me pursuant to the Award, such primary beneficiary(ies) shall receive the remaining amount in equal shares. If none of the above-named primary beneficiary(ies) survive me, the remaining amount of shares of Common Stock shall be distributed in equal shares to those then living of the following person(s):

SECONDARY

(Print Beneficiary's Name) Last First Middle Initial

Print Beneficiary's Address Relationship

SECONDARY

(Print Beneficiary's Name) Last First Middle Initial

Print Beneficiary's Address Relationship

It is understood that this Designation of Beneficiary is made pursuant to the Award and is subject to the conditions stated therein. It is further understood that all prior designations of beneficiary under the Award are hereby revoked and that this Designation of Beneficiary may only be revoked in writing, signed by Grantee and filed with the Company prior to Grantee's death.

Date Grantee

ACKNOWLEDGED AND ACCEPTED BY THE COMPANY:

Date Signature of Company Representative

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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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) 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
 - d) 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: November 3, 2005

/s/ Robert A. Kotick

Robert A. Kotick
Chief Executive Officer

CERTIFICATION

I, Ronald Doornink, President of Activision Inc., and Chairman 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) 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
 - d) 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: November 3, 2005

/s/ Ronald Doornink

Ronald Doornink
President, Activision, Inc. and
Chairman,
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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) 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
 - d) 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: November 3, 2005

/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 September 30, 2005 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,
November 3, 2005

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 September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ronald Doornink, President of the Company and Chairman of Activision Publishing, Inc., certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ Ronald Doornink

Ronald Doornink
President, Activision, Inc.
Chairman,
Activision Publishing, Inc.
November 3, 2005

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 September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William J. Chardavoyne, Executive Vice President and Chief Financial Officer of the Company, certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ William J. Chardavoyne

William J. Chardavoyne
Executive Vice President and
Chief Financial Officer,
November 3, 2005

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.
