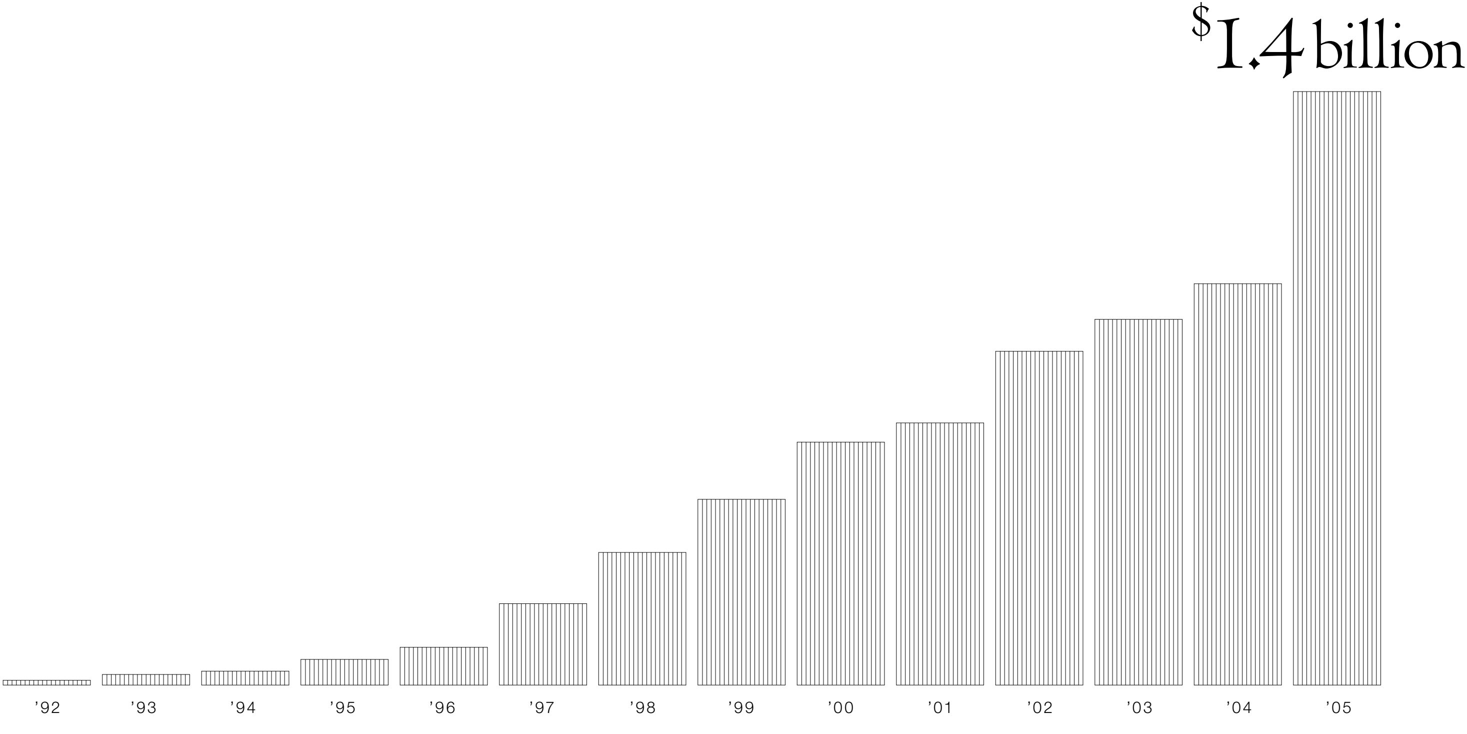
ACTIVISION®
Annual Report 2005

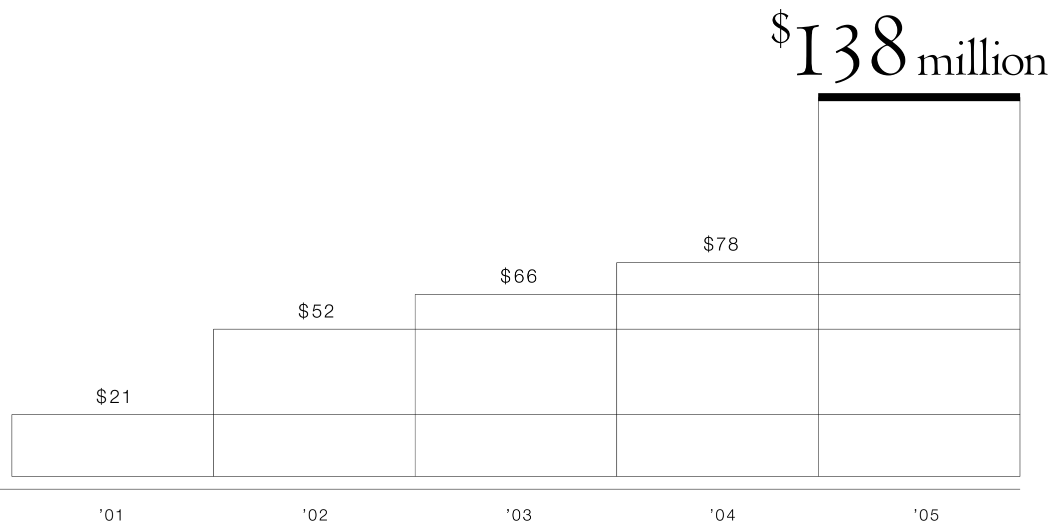
A HISTORY OF GROWTH

RESULTS THROUGH EXECUTION



net revenues

WE ENTERED FISCAL 2006 WITH A STRONG RECORD OF GROWTH, A BROAD PORTFOLIO OF PROVEN PRODUCTS, STRENGTHENED DEVELOPMENT RESOURCES AND A SOLID BALANCE SHEET THAT PROVIDES US WITH THE FINANCIAL FLEXIBILITY TO CAPITALIZE ON FUTURE BUSINESS OPPORTUNITIES.



61% *CAGR from 2001–2005*
net earnings

Financial Highlights	2001	2002	2003	2004	**2005**
In thousands, except per share data					
Net Revenues	$620,183	$786,434	$864,116	$947,656	**$1,405,857**
Operating Income	39,807	80,574	94,847	109,817	**184,571**
Net Earnings	20,507	52,238	66,180	77,715	**138,335**
Diluted Earnings per Share	$ 0.17	$ 0.29	$ 0.32	$ 0.40	**$ 0.66**

To Our Shareholders:

Fiscal 2005 was another outstanding year for Activision, marking our 13th consecutive year of revenue growth.

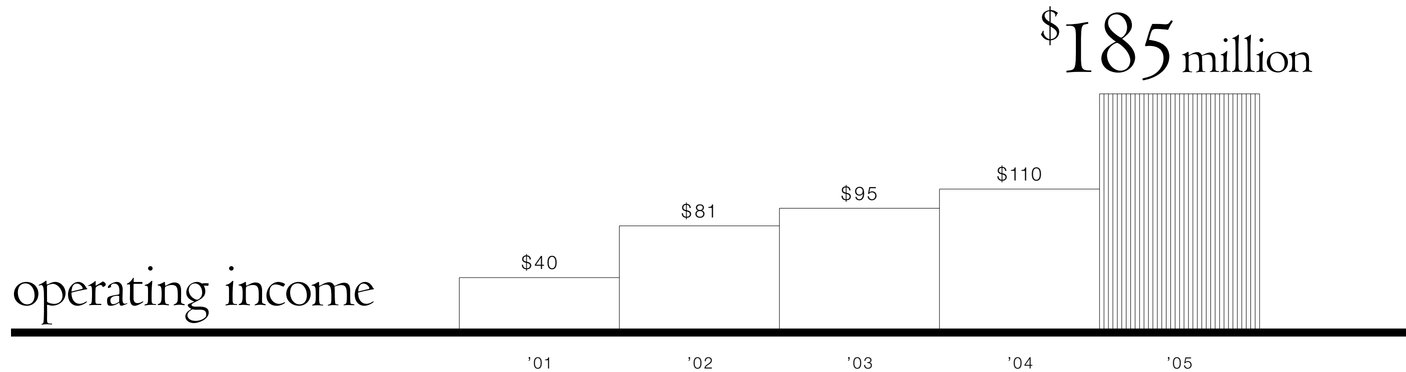
Our net revenues for the fiscal year totaled $1.4 billion, an increase of 48% over the prior fiscal year. We grew our operating margin by 154 basis points, marking our fifth consecutive year of margin expansion. We delivered 78% growth in net income year over year to a record $138 million, or $0.66 per diluted share.

Our financial position has never been stronger. We ended fiscal 2005 with $841 million in cash and short-term investments and $1.1 billion in shareholders' equity, an increase of $267 million over the previous year. Our free cash flow was a record $200 million and our return on invested capital was 45%*.

Over the last five years, the compound annual growth rate of our book value per share has been 37%. If you invested $100 in Activision in March of 2000, your stake would be worth $552 today. This compares favorably to a $100 investment in the Nasdaq Stock Market Index, which would be worth only $37 today.

We believe we can improve our earnings, expand our operating margin and continue to do this at a high rate of return on invested capital.

**Free cash flow and return on invested capital are "non-GAAP financial measures." A reconciliation to the most directly comparable GAAP measures is contained on page 88.*

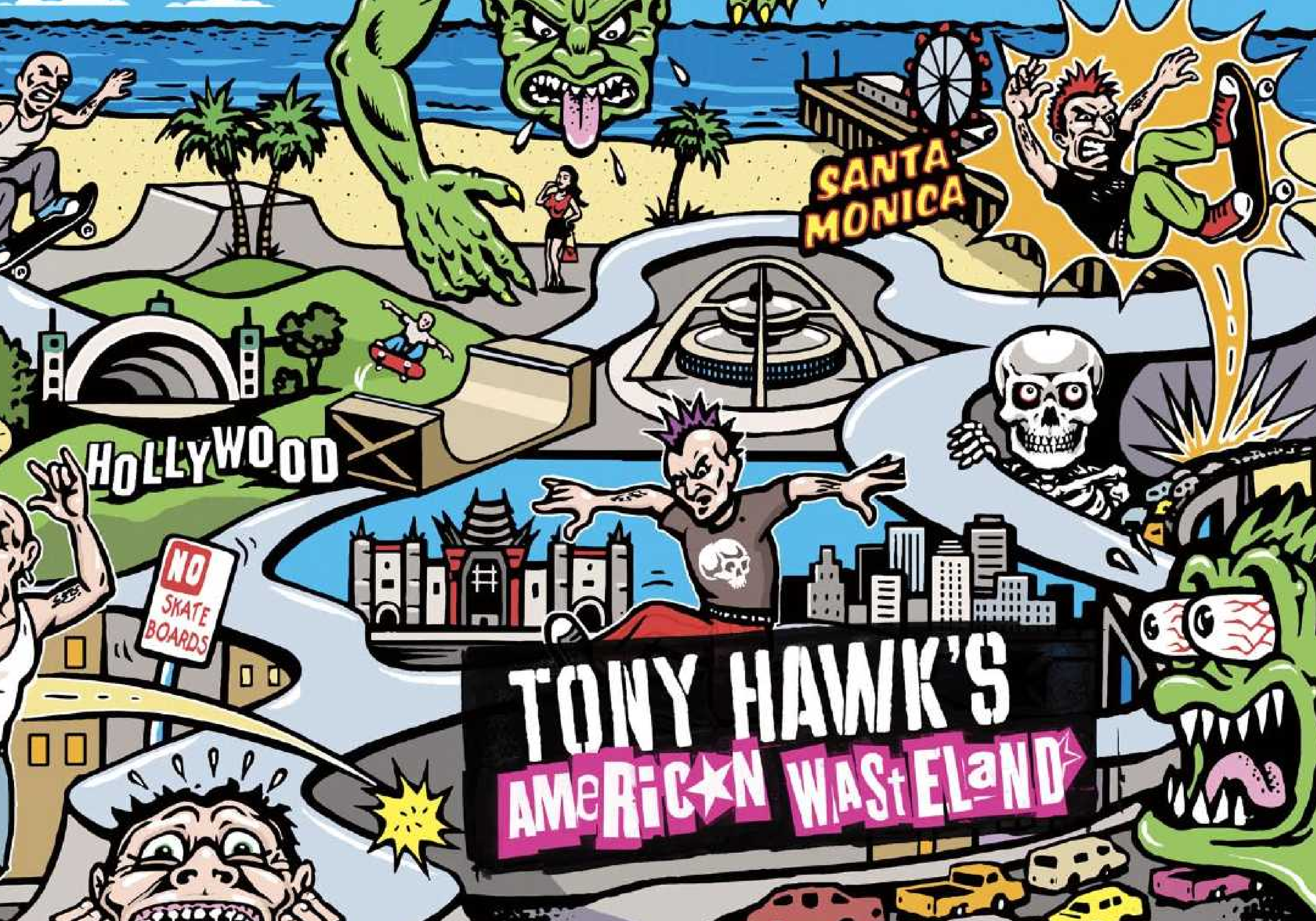


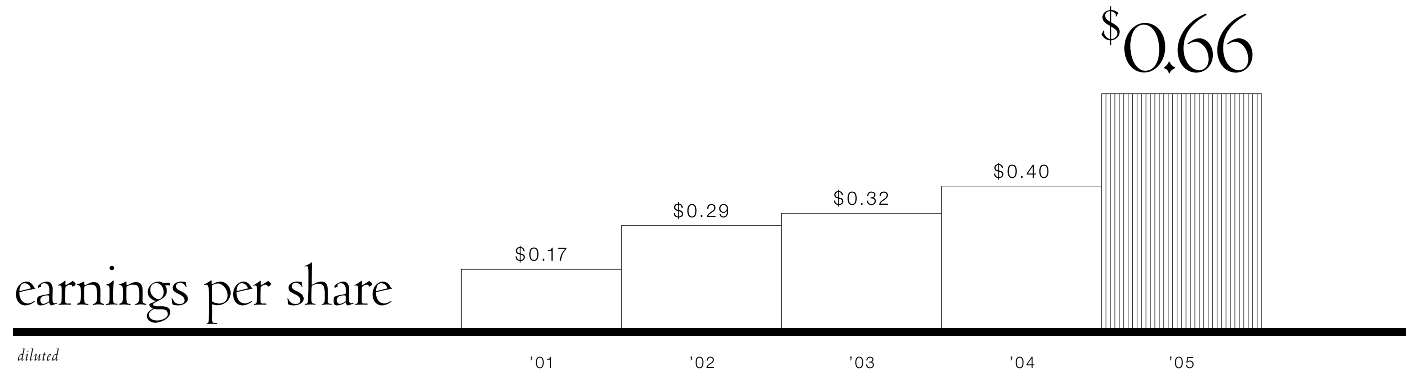
Another Year of Success: During fiscal 2005, Activision remained focused on three key initiatives—building and annualizing our game franchises, strengthening our global market position and increasing the breadth and quality of our development capabilities.

This year, we successfully executed our franchise building strategy, which resulted in the release of more than 10 one-million unit selling titles. Four of these titles sold in excess of two million units. We believe operating margin expansion is best accomplished through increasing the number of multi-million unit titles we release each year and growing the revenues derived from each title. During fiscal year 2006, we will continue our brand building focus by introducing new games based on our top-selling, proven franchises.

In addition to annualizing our proven brands, we will continue to invest carefully in a few new wholly owned intellectual properties. Our track record in this area has been very encouraging. For the past two years, we introduced the most successful new video game brands—*True Crime: Streets of L.A.* and *Call of Duty: Finest Hour.* We will continue to identify and create new potential franchises and plan to introduce new franchises in fiscal 2006.

In fiscal 2005, international publishing revenues increased 72% to a record $376 million. Next fiscal year, we will focus on improving our operating margin, expanding into additional European markets and increasing our direct selling efforts in five new countries—Austria, Denmark, Norway, Portugal and Switzerland.


SANTA
MONICA
HOLLYWOOD
NO
SKATE
BOARDS
TONY HAWK'S
AMERICAN WASTELAND

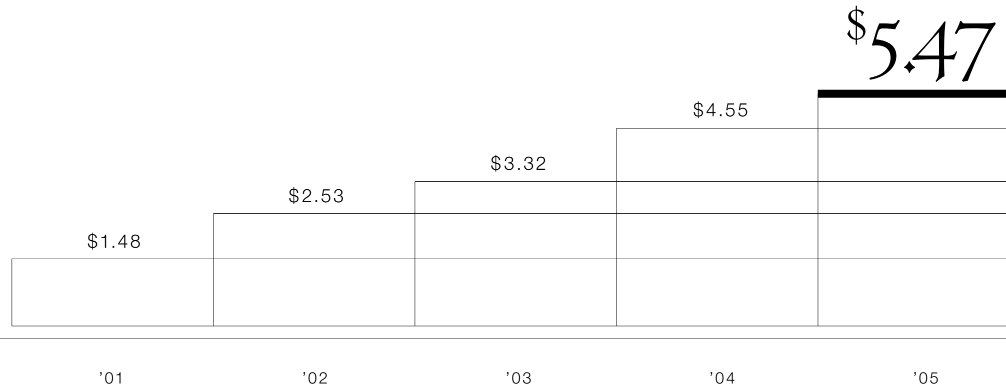


Over the past several months, we also strengthened our development capabilities with the acquisitions of Vicarious Visions, Inc., Toys for Bob, Inc. and Beenox, Inc., and we now have over 1,000 employees in our studio operations. The continued investment in our studios underscores our commitment to product excellence and enhancing our market position. Today, we are recognized as a competitive, consistent leader in product quality and innovation.

We are adept at creating products for all video game platforms—console, handheld and Windows™—and we believe the investments we are making today in next-generation software will provide us with future opportunities to strengthen and leverage our brands.

Poised for the Future: The recent launches of the Nintendo® DS™ and Sony® PSP™ have heralded a new generation of handheld technologies that will continue to broaden the demographic audience for portable gaming. With faster processing power, wireless capabilities and improved screen resolution, these new devices should result in significant handheld software growth.

In fiscal 2005, we grew our publishing net revenues from the handheld platforms by 456% or $114 million. We generated strong sales with our launch titles for the next-generation handheld systems. *Spider-Man 2* for the Nintendo DS was the best-selling U.S. third-party title for the platform during the holiday period.

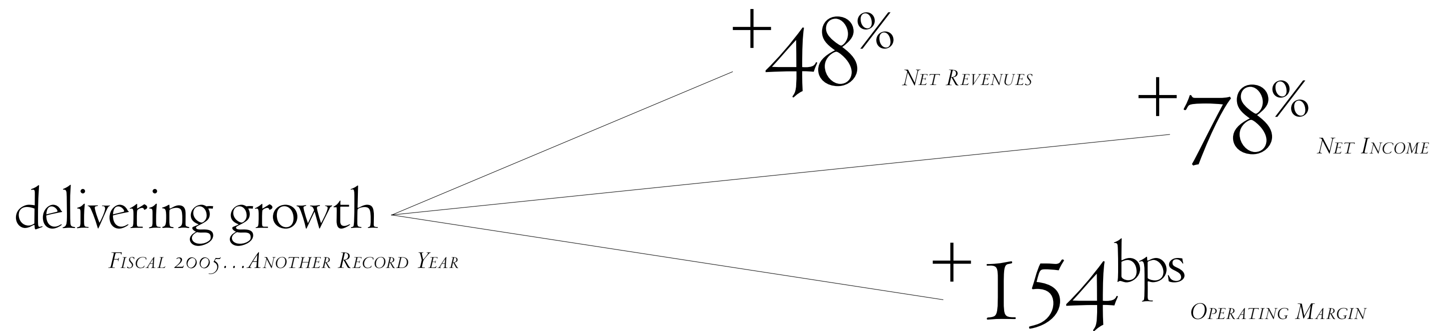


Tony Hawk's Underground 2 Remix ranked as the third best-selling U.S. third-party launch title for the new PSP. These new systems represent an opportunity for revenue growth and margin expansion, and, in fiscal 2006, we plan to leverage our current momentum into a leadership position in the handheld market.

The planned launch of the Xbox360™ from Microsoft in the fall of 2005 and the Sony PlayStation® 3 and Nintendo® Revolution™ in 2006 will usher in the next generation of console hardware. These sophisticated new systems will feature significant visual and audio enhancements that will make video games accessible to even broader audiences worldwide. Since 1995, new console introductions have helped grow the installed base of consumers by 30%, cycle over cycle.

In 2000, when the PlayStation® 2 computer entertainment system was introduced, Activision grew net revenues. Today, we believe we are well positioned to take advantage of the opportunities presented by the upcoming console systems. Our deep understanding of the hardware and software should enable us to match the right brands with the appropriate hardware platforms to maximize our financial results.

Continuing as a Global Leader: The barriers to enter the video game business are higher than ever, and Activision's leadership position, with the resources, scale, infrastructure and creative talent, will allow the Company to take advantage of the industry's positive business fundamentals. Our portfolio of well-established



brands, strong catalog titles, expanding publishing capabilities and expertise in consistently creating commercially successful games should enable us to capitalize on the largest installed base of current-generation hardware in the industry's history, as well as leverage the many opportunities likely to emerge from the launch of exciting next-generation video game systems.

Our ability to maintain, grow and extend our portfolio of best-selling franchises and create new franchises is an important part of our success. We believe that the strength of our brands coupled with our proven game development capabilities will allow us to maintain our market leadership for years to come.

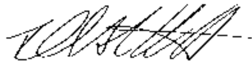
In fiscal 2006, we expect to launch our largest slate of new games across more than eight hardware platforms. The majority of these titles are new innovative versions of our best-selling franchises—*Tony Hawk, Spider-Man, Shrek, Call of Duty, DOOM, X-Men, QUAKE* and *True Crime*. Our product slate also includes two movie-based games, *Madagascar* and *Fantastic 4*, as well as *GUN*, an all-new wholly owned property being developed by our internal studio, Neversoft Entertainment, the team behind the best-selling *Tony Hawk* series.

In fiscal 2006, our catalog lineup will be our strongest ever and includes our top-selling titles launched in prior fiscal years including games based on *Spider-Man, Call of Duty* and *Tony Hawk's Underground*.

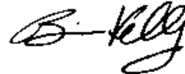
Values and Value Creation: Whether it is the capability to develop great games, or sell and market games globally, Activision continues to excel. Although several factors contributed to our success, none is more important or appreciated than the hard work, dedication and tireless efforts of all of the incredibly talented people in our Company. Our employees around the world continue to be the strength of our organization and the driving force behind our achievements. We thank each of them for their passionate commitment that allows us to enjoy a reputation as a truly great entertainment company and a great place to work.

At Activision, there is an inseparable link between our values and the value creation we offer our shareholders. We have made substantial progress over the past several years in strengthening our business. We are committed to continuing this progress. We appreciate the support of our customers, partners and shareholders and look forward to the future, which we believe will offer even greater opportunities for continued financial success.

Sincerely,

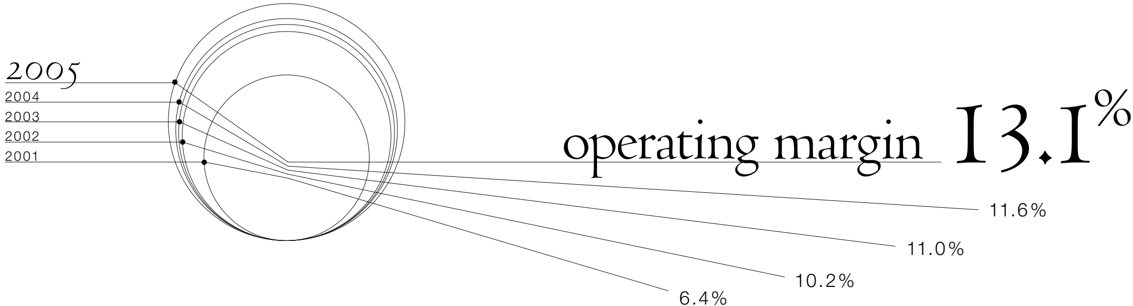


Robert A. Kotick
Chairman and CEO



Brian G. Kelly
Co-Chairman

Ronald Doornink
President



Preparing for new opportunities in video games

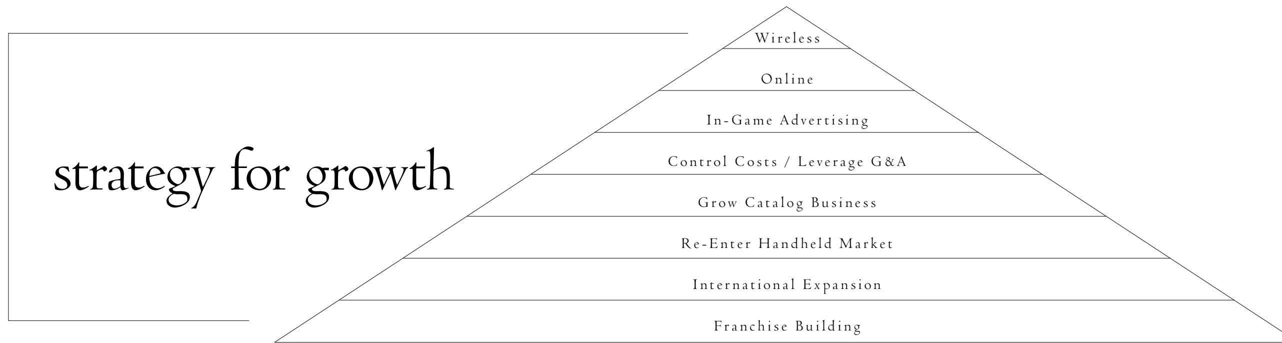
The introduction of the Nintendo DS and Sony PSP marked the beginning of an exciting new era for video games. Microsoft's Xbox360, Sony's PlayStation 3 and Nintendo's Revolution will usher in the next generation of console gaming. Personal computers equipped with Vista™, Microsoft's enhanced operating environment, will offer entirely new opportunities for PC games. These new systems all share a common attribute—they will deliver enhanced production values that are likely to expand the overall market for video games.

For the first time, the Nintendo DS and PSP bring console-like production values to portable gaming which has previously appealed to 6–11 year old consumers. These new devices are attracting both the traditional Game Boy audience, and older gamers ages 12–25, and they offer a more attractive business model than Game Boy, which should contribute to our overall margin expansion efforts.

The new consoles deliver meaningful enhancements over today's generation of hardware. These systems offer super-charged graphics, high-definition resolution, theater-like sound and more memory capacity. Coupled with multiplayer gaming over the Internet and broader geographical hardware penetration, these advances should create the largest audiences for games in our industry's history.

And Activision is ready to leverage these new opportunities! Over the past year, we made a significant commitment to increase and strengthen our game development personnel and resources, and we will support all of the new systems with games based on the popular franchises we control.

strategy for growth



Achieving sustainable growth

Expanding demographics, globalization and new hardware technology introductions are expected to drive Activision's performance in the coming years. While their impetus to future growth can be stunning, it is important to remember that trends don't guarantee results. The impact of these industry fundamentals will be realized by those companies with the talent, imagination and resources necessary to face the changing marketplace and stay ahead of the curve.

Activision's ability to deliver sustainable growth and offer superior returns to our shareholders is built on the competitive leadership of our world-class studios, established brands and well-integrated global publishing operations. Over the last decade, we have demonstrated the discipline to prioritize opportunities and remain focused on improving our financial returns for our owners and stakeholders.

We believe that we will be able to continue to build momentum for our business and deliver operating margin expansion and high levels of return on invested capital through four key initiatives—increasing operating income derived from an annualized game portfolio; investing in select wholly owned intellectual properties; achieving greater international market penetration; and focusing on emerging new opportunities—wireless gaming, in-game advertising and online gaming.

As we look ahead, our commitment to delivering exceptional games, leveraging our marketing and sales expertise and growing our global infrastructure should enable us to propel our market position and financial returns for years to come.

Selected Consolidated Financial Data

The following table summarizes certain selected consolidated financial data, which should be read in conjunction with our Consolidated Financial Statements and Notes thereto and with Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere herein. The selected consolidated financial data presented below as of and for each of the fiscal years in the five-year period ended March 31, 2005 are derived from our audited consolidated financial statements except basic and diluted earnings per share and basic and diluted weighted average shares outstanding which have been restated for the effect of our stock splits. The Consolidated Balance Sheets as of March 31, 2005 and 2004 and the Consolidated Statements of Operations and Consolidated Statements of Cash Flows for each of the fiscal years in the three-year period ended March 31, 2005, and the report thereon, are included elsewhere in this Annual Report.

(In thousands, except per share data)		Restated[1]			
Year ended March 31,	**2005[2]**	2004[2]	2003[2]	2002[2]	2001
Statement of Operations Data:					
Net revenues	**$1,405,857**	$ 947,656	$ 864,116	$786,434	$620,183
Cost of sales—product costs	**658,949**	475,541	440,977	435,725	324,907
Cost of sales—intellectual property licenses and software royalties and amortization	**185,997**	91,606	124,196	99,006	89,702
Income from operations	**184,571**	109,817	94,847	80,574	39,807
Income before income tax provision	**197,663**	115,992	103,407	83,120	32,544
Net income	**138,335**	77,715	66,180	52,238	20,507
Basic earnings per share	**0.74**	0.44	0.34	0.34	0.18
Diluted earnings per share	**0.66**	0.40	0.32	0.29	0.17
Basic weighted average common shares outstanding	**187,517**	177,665	192,479	151,955	111,895
Diluted weighted average common shares outstanding	**209,145**	193,191	207,310	178,366	123,300
Cash Provided by (Used in):					
Operating activities	**215,309**	67,403	90,975	111,792	81,565
Investing activities	**(143,896)**	(170,155)	(301,547)	(8,701)	(8,631)
Financing activities	**72,654**	117,569	64,090	50,402	2,547

As of March 31,	**2005[2]**	2004[2]	2003[2]	2002[2]	2001
Balance Sheet Data:					
Working capital	**$ 915,413**	$ 675,796	$ 422,500	$333,199	$182,980
Cash, cash equivalents and short-term investments	**840,864**	587,649	406,954	279,007	125,550
Capitalized software development and intellectual property licenses	**127,340**	135,201	107,921	56,742	42,205
Goodwill	**91,661**	76,493	68,019	35,992	10,316
Total assets	**1,306,963**	968,817	704,816	556,887	359,957
Long-term debt	**—**	—	2,671	3,122	63,401
Shareholders' equity	**1,099,912**	832,738	597,740	430,091	181,306

(1) Consolidated financial information for fiscal years 2004–2001 has been restated for the effect of our four-for-three stock split effected in the form of a 33⅓% stock dividend to shareholders of record as of March 7, 2005, paid March 22, 2005.

(2) Effective April 1, 2001, we adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangibles." SFAS No. 142 addresses financial accounting and reporting requirements for acquired goodwill and other intangible assets. Under SFAS No. 142, goodwill is deemed to have an indefinite useful life and should not be amortized but rather tested at least annually for impairment. In accordance with SFAS No. 142, we have not amortized goodwill during the years ended March 31, 2005, 2004, 2003 and 2002.

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 fiscal 2005 product portfolio included such best-selling products as *Spider-Man 2: The Movie ("Spider-Man 2"), Shrek 2, Tony Hawk's Underground 2 ("THUG 2"), Call of Duty: Finest Hour, Shark Tale, DOOM 3* and *X-Men Legends*.

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 this current generation of hardware platforms is significant and growing and the fiscal 2005 release of two new handheld devices, NDS, which was released worldwide, and PSP, which was released in North America, will also help expand the software market. We successfully executed our strategy of having a high-quality product presence at the launch of the NDS and PSP with one title based on the Spider-Man franchise at the launch of the NDS and two titles based on the Spider-Man and Tony Hawk franchises for the launch of the PSP. We are currently developing additional titles for the PSP and the NDS while continuing to develop games for the GBA given its large and growing base.

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 is expected to be released in November 2005. We are currently developing four titles for release on 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. Though there are still many unknowns relating to these new platforms, our aim 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" will include well-established brands, which are backed by high-profile intellectual property and/or highly anticipated motion picture releases. Examples of these brands are our superheroes and skateboarding brands. 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. Through our long-term relationship with Marvel Enterprises, we expect our fiscal 2006 releases to include titles based on Marvel's Spider-Man, Fantastic 4 and X-Men. The video game release of *Fantastic 4* is scheduled for June 2005 just prior to the theatrical release of "Fantastic 4." We will also be developing and publishing video games based on New Line Cinema's upcoming feature film "Iron Man," which is expected to be released in calendar 2007. 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. In addition, we 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 fiscal 2005, we have released six successful titles in the Tony Hawk franchise with cumulative net revenues of $958.1 million, including the most recent, *THUG 2*, which was released in the third quarter of fiscal 2005. We will continue to promote our skateboarding franchise with the release in fiscal 2006 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 the highly successful *Call of Duty: Finest Hour*, on multiple console platforms. This title was ranked by NPD Funworld ("NPD") as one of the top-five best selling games in December 2004 and was the third game based upon this original property following the *Call of Duty* and *Call of Duty: United Offensive* titles for the PC. The highly successful 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. We also expect to establish our fiscal 2006 release, *GUN*, as a source of recurring revenues.

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, "Shark 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."

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 the Consolidated Financial Statements included in this Annual Report. The preparation of financial statements in conformity with generally accepted accounting principles

Management's Discussion and Analysis of Financial Condition and Results of Operations

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 Activision 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: historical performance of titles in similar genres, historical performance of the hardware platform, historical performance of the brand, console hardware life cycle, Activision sales force and retail customer feedback, industry pricing, weeks of on-hand retail channel inventory, absolute quantity of on-hand retail channel inventory, Activision warehouse on-hand inventory levels, the title's recent sell-through history (if available), marketing trade programs and competing titles. 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 impact management's estimates in establishing our allowance for doubtful accounts.

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

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

We account for software development costs in accordance with Statement of Financial Accounting 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; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based.

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

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

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

Commencing upon the related product's release, capitalized intellectual property license costs are amortized to cost of sales—intellectual property licenses based on the ratio of current revenues for the specific product to total projected revenues for all products in which the licensed 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.

Selected Consolidated Statements of Operations Data

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

(In thousands) Year ended March 31,	**2005**		2004		2003	
Net revenues	**$1,405,857**	**100%**	$947,656	100%	$864,116	100%
Costs and expenses:						
Cost of sales—product costs	**658,949**	**47**	475,541	50	440,977	51
Cost of sales—software royalties and amortization	**123,800**	**9**	59,744	6	79,194	9
Cost of sales—intellectual property licenses	**62,197**	**5**	31,862	3	45,002	5
Product development	**86,543**	**6**	97,859	10	56,971	7
Sales and marketing	**230,058**	**16**	128,221	14	100,646	12
General and administrative	**59,739**	**4**	44,612	5	46,479	5
Total costs and expenses	**1,221,286**	**87**	837,839	88	769,269	89
Income from operations	**184,571**	**13**	109,817	12	94,847	11
Investment income, net	**13,092**	**1**	6,175	—	8,560	1
Income before income tax provision	**197,663**	**14**	115,992	12	103,407	12
Income tax provision	**59,328**	**4**	38,277	4	37,227	4
Net income	**$ 138,335**	**10%**	$ 77,715	8%	$ 66,180	8%
Net Revenues by Territory:						
North America	**$ 696,325**	**50%**	$446,812	47%	$432,261	50%
Europe	**675,074**	**48**	479,224	51	413,125	48
Other	**34,458**	**2**	21,620	2	18,730	2
Total net revenues	**$1,405,857**	**100%**	$947,656	100%	$864,116	100%
Net Revenues by Segment/Platform Mix:						
Publishing:						
Console	**$ 713,947**	**51%**	$508,418	54%	$466,116	54%
Hand-held	**138,695**	**10**	24,945	2	49,966	6
PC	**220,087**	**15**	132,369	14	99,893	11
Total publishing net revenues	**1,072,729**	**76**	665,732	70	615,975	71
Distribution:						
Console	**$ 256,452**	**18%**	$223,802	24%	$208,505	24%
Hand-held	**23,282**	**2**	18,361	2	14,103	2
PC	**53,394**	**4**	39,761	4	25,533	3
Total distribution net revenues	**333,128**	**24**	281,924	30	248,141	29
Total net revenues	**$1,405,857**	**100%**	$947,656	100%	$864,116	100%
Operating Income by Segment:						
Publishing	**$ 160,826**	**11%**	$ 93,223	10%	$ 79,139	9%
Distribution	**23,745**	**2**	16,594	2	15,708	2
Total operating income	**$ 184,571**	**13%**	$109,817	12%	$ 94,847	11%

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Results of Operations—Fiscal Years Ended March 31, 2005 and 2004

Net income for the year ended March 31, 2005 was $138.3 million or $0.66 per diluted share, as compared to $77.7 million or $0.40 per diluted share for the year ended March 31, 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 years ended March 31, 2005 and 2004 (in thousands):

Year ended March 31,	**2005**	2004	Increase/ (Decrease)	Percent Change
Publishing net revenues				
North America	**$ 696,325**	$446,812	$249,513	56%
Europe	**341,946**	197,300	144,646	73%
Other	**34,458**	21,620	12,838	59%
Total international	**376,404**	218,920	157,484	72%
Total publishing net revenues	**1,072,729**	665,732	406,997	61%
Distribution net revenues	**333,128**	281,924	51,204	18%
Consolidated net revenues	**$1,405,857**	$947,656	$458,201	48%

Consolidated net revenues increased 48% from $947.7 million for the year ended March 31, 2004 to $1,405.9 million for the year ended March 31, 2005. This increase was principally generated by our publishing business. The increase in consolidated net revenues was driven by the following:

- Strong performances from our publishing business on the releases of our largest ever lineup of titles including: *Spider-Man 2, Call of Duty: Finest Hour, THUG 2, Shrek 2, X-Men Legends, Doom 3, Lemony Snicket's A Series of Unfortunate Events, Shark Tale, Cabela's Big Game Hunter 2005* and *Rome: Total War*. The strength of these titles combined with the significant sales and marketing investment led to over ten million-unit selling titles and achievement of our goal of having four multi-million-unit selling titles. We also had strong catalog sales from a number of our franchises including Tony Hawk, True Crime, Spider-Man and Call of Duty. As a result of the strong performance of our key fiscal 2005 releases, we were able to maintain the original price points for those titles for an extended period of time.
- Continued focus on international publishing expansion with the opening of offices in Spain and Italy and an increased focus on other territories contributing to an increase in International Publishing revenues of 72% over fiscal 2004.
- An increase in our hand-held platform presence growing consolidated hand-held revenues by $118.7 million or 274% from $43.3 million for the year ended March 31, 2004 to $162.0 million for the year ended March 31, 2005. This was driven by a significant increase in the number of GBA titles released from four titles in fiscal 2004 to eleven titles in fiscal 2005, and by the introduction of the PSP and NDS platforms, for which we released a combined total of three titles.
- International net revenues benefited from the strong year-over-year strengthening of the Euro ("EUR") and Great British Pound ("GBP") in relation to the U.S. dollar. We estimate that foreign exchange rates increased reported net revenues by approximately $55.3 million. Excluding the impact of changing foreign currency rates, our international net revenues increased 31% year-over-year.

North America Publishing Net Revenues

(In thousands) **March 31, 2005**	**% of Consolidated Net Revenues**	March 31, 2004	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$696,325	**50%**	$446,812	47%	$249,513	56%

North America publishing net revenues increased 56% from $446.8 million for the year ended March 31, 2004, to $696.3 million for the year ended March 31, 2005. The increase reflects the strong performance of our fiscal 2005 slate of titles, strong catalog sales from a number of our franchises and a significant increase in our hand-held platform presence.

International Publishing Net Revenues

(In thousands) **March 31, 2005**	**% of Consolidated Net Revenues**	March 31, 2004	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$376,404	**26%**	$218,920	23%	$157,484	72%

International publishing net revenues increased by 72% from $218.9 million for the year ended March 31, 2004 to $376.4 million for the year ended March 31, 2005. International publishing also saw strong results from our 2005 titles, as well as strong fourth quarter performance in our LucasArts affiliate business. In addition, we had strong catalog sales from a number of our franchises, including Spider-Man, Call of Duty, Tony Hawk, and True Crime. There also was a positive strengthening of the EUR and the GBP in relation to the U.S. dollar of approximately $29.0 million. Excluding the impact of changing foreign currency rates, our international publishing net revenues increased 59% year-over-year. In the coming year, we will continue to focus on expanding our international publishing capabilities. In fiscal 2006, we expect to increase our direct-selling efforts in five countries and materially expand our international marketing efforts.

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Publishing Net Revenues by Platform

Publishing net revenues increased 61% from $665.7 million for the year ended March 31, 2004 to $1,072.7 million for the year ended March 31, 2005. The following table details our publishing net revenues by platform and as a percentage of total publishing net revenues for the years ended March 31, 2005 and 2004 (in thousands):

Publishing Net Revenues	Year Ended March 31, 2005	% of Publishing Net Revs	Year Ended March 31, 2004	% of Publishing Net Revs	Increase/ (Decrease)	Percent Change
PC	$ 220,087	21%	$132,369	20%	$ 87,718	66%
Console						
Sony PlayStation 2	417,310	39%	289,048	43%	128,262	44%
Microsoft Xbox	196,894	18%	145,111	22%	51,783	36%
Nintendo GameCube	96,936	9%	52,909	8%	44,027	83%
Other	2,807	—%	21,350	3%	(18,543)	(87%)
Total console	713,947	66%	508,418	76%	205,529	40%
Hand-held						
Game Boy Advance	101,642	9%	24,621	4%	77,021	313%
PlayStation Portable	19,200	2%	—	—%	19,200	100%
Nintendo Dual Screen	17,699	2%	—	—%	17,699	100%
Other	154	—%	324	—%	(170)	(52%)
Total hand-held	138,695	13%	24,945	4%	113,750	456%
Total publishing net revenues	$1,072,729	100%	$665,732	100%	$406,997	61%

Personal Computer Net Revenues

(In thousands) March 31, 2005	% of Publishing Net Revenues	March 31, 2004	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$220,087	21%	$132,369	20%	$87,718	66%

Net revenues from sales of titles for the PC increased 66% from $132.4 million for the year ended March 31, 2004 to $220.1 million for the year ended March 31, 2005. Driving the increase were the fiscal 2005 releases of *Doom 3* and *Rome: Total War* combined with continued strong sell-through of our catalog title, *Call of Duty*. According to NPD, we were the only publisher to have three top-ten PC titles for calendar year 2004—*Doom 3, Call of Duty* and *Rome: Total War*. Also contributing to the increase in net revenues from sales of titles for the PC was an increase in the total number of titles shipped from eight in fiscal 2004 to fifteen in fiscal 2005. We expect fiscal 2006 PC publishing net revenues as a percentage of total publishing net revenues to remain consistent with fiscal 2005.

Sony PlayStation 2 Net Revenues

(In thousands) **March 31, 2005**	**% of Publishing Net Revenues**	March 31, 2004	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$417,310	**39%**	$289,048	43%	$128,262	44%

Net revenues from sales of titles for the PS2 increased 44% from $289.0 million for the year ended March 31, 2004 to $417.3 million for the year ended March 31, 2005. The increase was primarily due to strong, worldwide sales of several of our fiscal 2005 releases including *THUG 2, Call of Duty: Finest Hour, X-Men Legends, Spider-Man 2, Shrek 2, Shark Tale, Lemony Snicket's A Series of Unfortunate Events* and *Cabela's Big Game Hunter 2005*. In fiscal 2005, we released thirteen titles for PS2 compared to ten in fiscal 2004 which included: *True Crime: Streets of L.A., Tony Hawk's Underground, X2: Wolverine's Revenge, Return to Castle Wolfenstein, Cabela's Dangerous Hunts* and *Cabela's Deer Hunt 2004 Season*. We expect the installed base of PS2 to continue to grow, although at a slower rate than in previous years, due to the anticipated release of the next-generation system in calendar 2006. Given our slate of fiscal 2006 titles, as the installed base increases we expect our overall net revenues from PS2 sales to continue to increase over prior periods. In addition, Sony recently announced that they will be releasing their next-generation console, the PlayStation 3 ("PS3"), in calendar 2006. Given the initially low installed base, we expect the release of the PS3 to have little impact on fiscal 2006 net revenues.

Microsoft Xbox Net Revenues

(In thousands) **March 31, 2005**	**% of Publishing Net Revenues**	March 31, 2004	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$196,894	**18%**	$145,111	22%	$51,783	36%

Net revenues from sales of titles for the Xbox increased 36% from $145.1 million for the year ended March 31, 2004 to $196.9 million for the year ended March 31, 2005. Though the number of new Xbox titles remained relatively consistent from fiscal 2004 to fiscal 2005, we were able to increase our Xbox sales in both the North America and international markets. The increase was primarily due to strong worldwide sales of several of our Xbox titles including *THUG 2, Call of Duty: Finest Hour, X-Men Legends, Spider-Man 2, Shrek 2, Shark Tale, Greg Hastings' Tournament Paintball* and *Cabela's Big Game Hunter 2005*. The increase was also affected by an increased installed base of the Xbox due mainly to the price cuts on the Xbox hardware in calendar 2004. Given our slate of fiscal 2006 titles, as the installed base increases we expect our overall net revenues from Xbox sales to continue to increase over prior periods. We expect the growth of the installed base of Xbox hardware to continue to grow through the remainder of calendar 2005 with growth slowing as the release of Microsoft's next-generation system, the Xbox 360, which is expected to be released in November 2005. Consistent with our strategy of having a high-quality presence at the launch of each new platform, we are currently developing four titles, *Tony Hawk's American Wasteland, Call of Duty 2, Quake IV* and *GUN,* to be released concurrently with the launch of the Xbox 360. We expect that the potential release of the Xbox 360 will not have a material impact on our fiscal 2006 net revenues due to a number of factors, including an initially small installed base.

Nintendo GameCube Net Revenues

(In thousands) **March 31, 2005**	**% of Publishing Net Revenues**	March 31, 2004	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$96,936	**9%**	$52,909	8%	$44,027	83%

Net revenues from sales of titles for the Nintendo GameCube increased 83% from $52.9 million for the year ended March 31, 2004 to $96.9 million for the year ended March 31, 2005. The increase is primarily due to the increase in the number of GameCube new title releases from five in fiscal 2004 to eight in fiscal 2005. Also driving the increase in revenues was that the title slate in fiscal 2005 performed strongly as it was more targeted toward the demographic of the GameCube audience than the fiscal 2004 GameCube title slate. Our fiscal 2005 title slate was driven by new title releases of *Shrek 2, Spider-Man 2, Shark Tale, Lemony Snicket's A Series of Unfortunate Events, THUG 2* and *Call of Duty: Finest Hour*. Fiscal 2004 GameCube revenues were driven mainly by releases of *Tony Hawk's Underground* and *True Crime: Streets of L.A*. We expect the installed base of GameCube

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hardware to continue to grow given its current low price point; however, at a slower pace than previous years given the upcoming next-generation console transition. We also expect fiscal 2006 GameCube net revenues to increase over fiscal 2005 given our planned 2006 product slate. Nintendo recently announced that they will be releasing their next-generation console, the Revolution, in calendar 2006. Given the initially low installed base, we expect the release of the Revolution to have little initial impact on our net revenues.

Hand-held

(In thousands) **March 31, 2005**	**% of Publishing Net Revenues**	March 31, 2004	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$138,695	**13%**	$24,945	4%	$113,750	456%

Net revenues from sales of titles for the hand-held for the year ended March 31, 2005 increased 456% from the prior fiscal year, from $24.9 million to $138.7 million. This was driven mainly by a significant increase in the number of GBA titles released from four titles in fiscal 2004 to eleven titles in fiscal 2005 and the introduction of two new handheld devices, NDS, which was released worldwide, and PSP, which was released in North America. We successfully executed our strategy of having a high-quality presence at the launch of both the NDS and PSP platforms with one title based on the Spider-Man franchise at the launch of the NDS and two titles based on the Spider-Man and Tony Hawk franchises for the launch of the PSP. In addition to the increase in the number of GBA titles released, we implemented a customized marketing plan for the GBA platform and demographic to support a strong slate of new releases including *THUG 2, Shrek 2: Beg for Mercy!, Shark Tale, Lemony Snicket's A Series of Unfortunate Events, Spider-Man 2* and *Shrek 2* which were all targeted toward the demographic of the GBA audience.

We expect the overall hand-held market to grow significantly with the recent releases of the NDS and PSP. However, with the releases of the NDS and PSP we expect that market share for the GBA will eventually begin to decrease while the overall hand-held market will continue to expand with a growing installed base and broader demographic on the newer platforms. We expect to continue our focus on developing hand-held games for mass-market consumers for each of these hand-held platforms. Due to the expected increase in the overall hand-held market and our fiscal 2006 product slate, we expect net revenues from sales of titles for the hand-held to increase over 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, the introduction of new hardware platforms, as well as the timing 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 releases 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 is derived from a relatively small number of popular titles and brands each year as revenues and profits are significantly affected by our ability to release highly successful or "hit" titles. For example, for the year ended March 31, 2005, 31% of our consolidated net revenues and 41% of worldwide publishing net revenues were derived from net revenues from our *Spider-Man 2, THUG 2* and *Call of Duty: Finest Hour* titles. Though many 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 disproportionate amount of operating income being derived from these select titles. We expect that a limited number of titles and brands will continue to produce a disproportionately large amount of our net revenues and profits.

Two factors that could affect future publishing and distribution net revenue performance are console hardware pricing and software pricing. As console hardware moves through its life cycle, hardware manufacturers typically enact price reductions. Reductions in the price of console hardware typically result in an increase in the installed base of hardware owned by consumers. 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.

Distribution Net Revenues

(In thousands) **March 31, 2005**	**% of Consolidated Net Revenues**	March 31, 2004	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$333,128	**24%**	$281,924	30%	$51,204	18%

Distribution net revenues for the year ended March 31, 2005 increased 18% from the prior fiscal year, from $281.9 million to $333.1 million. Excluding the impact of the changing foreign currency rates, our distribution net revenues increased 9% year-over-year. About half of this increase was due to the positive impact of the year-over-year strengthening of the EUR and the GBP in relation to the U.S. dollar. The increase was primarily due to the continued growth in the industry wide software market, an increase in sales to mass merchants, as well as a change in the product mix. The mix of distribution net revenues between hardware and software sales varied year-over-year with approximately 13% of distribution net revenues from hardware sales in the year ended March 31, 2005 as compared to 28% in the prior fiscal year. This was mainly attributed to an increase in business with large, mass-market customers that generate a higher percentage of sales from software. In both fiscal years, hardware sales were principally comprised of sales of console hardware. 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 and our ability to establish and maintain distribution agreements with hardware manufacturers and third-party software publishers. We expect our fiscal 2006 distribution results to be in line with fiscal 2005.

Costs and Expenses

Cost of Sales—Product Costs

(In thousands) **March 31, 2005**	**% of Consolidated Net Revenues**	March 31, 2004	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$658,949	**47%**	$475,541	50%	$183,408	39%

Cost of sales—product costs represented 47% and 50% of consolidated net revenues for the years ended March 31, 2005 and 2004, respectively. In absolute dollars, cost of sales—product costs increased 39% due to significantly higher sales in fiscal 2005 as compared to fiscal 2004. The primary factors affecting the reduction in the cost of sales—product costs as a percentage of consolidated net revenues were:

- Increased ability to maintain premium pricing on “big proposition” titles for the year ended March 31, 2005.
- An increase in publishing net revenues from sales of PC titles by 66% year-over-year. PC publishing revenues as a percent of publishing net revenues for the year also grew from 20% to 21%. PC titles typically have lower product costs associated with them.
- A lower percentage of revenues generated from our distribution business, which is a lower margin business, in fiscal 2005 as compared to fiscal 2004.

We expect cost of sales—product costs as a percentage of net revenues to slightly decrease as a percentage of revenue in fiscal 2006 as compared to fiscal 2005. This is primarily due to a lower percentage of revenue expected to be generated from our distribution business in fiscal 2006, which is a lower margin business. We may also continue to experience a benefit from changes in product mix in fiscal 2006 due to the focus on “big proposition” titles, for which we could benefit from higher retail pricing and manufacturing volume discounts.

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Cost of Sales—Software Royalties and Amortization

(In thousands) **March 31, 2005**	**% of Publishing Net Revenues**	March 31, 2004	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$123,800	**12%**	$59,744	9%	$64,056	107%

Cost of sales—software royalties and amortization for the year ended March 31, 2005 increased as a percentage of publishing net revenues from the prior fiscal year, from 9% to 12%. In absolute dollars, cost of sales—software royalties and amortization for the year ended March 31, 2005 also increased from the prior fiscal year, from $59.7 million to $123.8 million. This increase was due to an increase in the number of titles released as well as an increase in the overall costs to develop games. This compares to fiscal 2004 in which a higher proportion of revenues were derived from internally developed titles with lower associated game development costs. In fiscal 2006, we expect cost of sales—software royalties and amortization to decrease as a percentage of publishing net revenues as compared to fiscal 2005 as our fiscal 2006 titles slate includes a higher percentage of internally developed titles.

Cost of Sales—Intellectual Property Licenses

(In thousands) **March 31, 2005**	**% of Publishing Net Revenues**	March 31, 2004	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$62,197	**6%**	$31,862	5%	$30,335	95%

Cost of sales—intellectual property licenses for the year ended March 31, 2005 increased in absolute dollars and as a percentage of publishing net revenues over the same period last year, from 5% to 6%. The increases in both absolute dollars and as a percentage of publishing net revenues were due to the release of more titles with associated licensed intellectual property as well as continued strong catalog sales of titles with associated licensed intellectual property compared to the titles released in fiscal 2004 for which a higher proportion of revenues was derived from titles that were internally developed with no associated intellectual property. In fiscal 2005 we released the following titles with associated intellectual property: *Spider-Man 2, Shrek 2, Shark Tale, X-Men Legends, THUG 2, Lemony Snicket's A Series of Unfortunate Events* and *Doom 3*. In fiscal 2004, two of our top performing titles, *True Crime: Streets of L.A.* and *Call of Duty,* were based on our wholly-owned original intellectual property. In fiscal 2006, we expect cost of sales—intellectual property licenses to remain relatively flat as a percentage of publishing net revenues as compared to fiscal 2005.

Product Development

(In thousands) **March 31, 2005**	**% of Publishing Net Revenues**	March 31, 2004	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$86,543	**8%**	$97,859	15%	$(11,316)	(12%)

Product development expenses for the year ended March 31, 2005 decreased as a percentage of publishing net revenues from the prior fiscal year, from 15% to 8%. In absolute dollars, product development expenses for the year ended March 31, 2005 also decreased from the prior fiscal year, from $97.9 million to $86.5 million. The decrease in product development as a percentage of publishing net revenues and in absolute dollars primarily resulted from a pre-tax charge of approximately $21 million taken in the third quarter of fiscal 2004 related to the cancellation of products which were believed to be unlikely to produce an acceptable level of return on our investment. Excluding the impact of the pre-tax charge, product development expenses for the year ended March 31, 2005 increased by approximately $9.7 million. This increase was attributable to higher game development costs as development time and team sizes as well as quality assurance time increased due to enhanced production values and to support more complex and robust gaming experiences. We expect product development costs to increase in absolute dollars due to next-generation development costs but stay constant as a percentage of revenues as we leverage the costs against bigger brands, sold in more markets, across more gaming devices.

Sales and Marketing

(In thousands) March 31, 2005	% of Consolidated Net Revenues	March 31, 2004	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$230,058	**16%**	$128,221	14%	$101,837	79%

Sales and marketing expenses of $230.1 million and $128.2 million represented 16% and 14% of consolidated net revenues for the years ended March 31, 2005 and 2004, respectively. The increases in both absolute dollars and as a percentage of net revenues was primarily generated by our publishing business as a result of significant marketing programs, including television and in-theatre ad campaigns and in-store promotions, run in support of our key fiscal 2005 "big proposition" title releases *Spider-Man 2, Shrek 2, Doom 3, Shark Tale, X-Men Legends, THUG 2, Call of Duty: Finest Hour* and *Lemony Snicket's A Series of Unfortunate Events*. Our experience has shown that this increased spending will lengthen the product sales life cycle and add to the long-term prospects of the respective product lines.

General and Administrative

(In thousands) March 31, 2005	% of Consolidated Net Revenues	March 31, 2004	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$59,739	**4%**	$44,612	5%	$15,127	34%

General and administrative expenses of $59.7 million and $44.6 million represented 4% and 5% of consolidated net revenues for the years ended March 31, 2005 and 2004, respectively. The increase in absolute dollars was primarily due to an increase in headcount and related costs to support business growth, as well as an increase in professional services fees to support Sarbanes-Oxley related compliance. The decrease as a percentage of consolidated net revenues was due mainly to the significant increase in sales volume.

Operating Income

(In thousands)	March 31, 2005	% of Segment Net Revs	March 31, 2004	% of Segment Net Revs	Increase/ (Decrease)	Percent Change
Publishing	**$160,826**	**15%**	$ 93,223	14%	$67,603	73%
Distribution	**23,745**	**7**	16,594	6	7,151	43
Consolidated	**$184,571**	**13%**	$109,817	12%	$74,754	68%

Publishing operating income for the year ended March 31, 2005 increased $67.6 million from the same period last year, from $93.2 million to $160.8 million. Excluding the impact of changes in foreign currency rates, publishing operating income for the year ended March 31, 2005 increased approximately $56.7 million from the same period last year. International publishing operating income for the year ended March 31, 2005 benefited from the positive impact of the year-over-year strengthening of the EUR and the GBP in relation to the U.S. dollar. The $56.7 million increase is primarily due to:

- Strong performance in both the North America and international markets of our fiscal 2005 title releases. The strong performance of the fiscal 2005 releases was driven by our largest lineup ever of big propositions, a record number of million-unit and multi-million-unit titles and an increased hand-held presence.

Partially offset by:

- Increased sales and marketing spending.
- Increased cost of sales—product costs, cost of sales—software royalties and amortization, and cost of sales—intellectual property licenses.

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Distribution operating income for the year ended March 31, 2005 increased over the same period last year, from $16.6 million to $23.7 million. Excluding the impact of changes in foreign currency rates, distribution operating income for the year ended March 31, 2005 increased approximately $5.4 million from the same period last year. Distribution operating income for the year ended March 31, 2005 benefited from the positive impact of the year-over-year strengthening of the EUR and the GBP in relation to the U.S. dollar. The $5.4 million increase was primarily due to continued growth industry-wide in the software market combined with a change in the product mix of hardware versus software sales as software tends to be a higher margin business.

Investment Income, Net

(In thousands) **March 31, 2005**	**% of Consolidated Net Revenues**	March 31, 2004	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$13,092	**1%**	$6,175	—%	$6,917	112%

Investment income, net for the year ended March 31, 2005 was $13.1 million as compared to $6.2 million for the year ended March 31, 2004. The increase was primarily due to higher invested balances combined with rising yields during the year ended March 31, 2005 as compared to 2004.

Provision for Income Taxes

(In thousands) **March 31, 2005**	**% of Pre-Tax Income**	March 31, 2004	% of Pre-Tax Income	Increase/(Decrease)	Percent Change
$59,328	**30%**	$38,277	33%	$21,051	55%

The income tax provision of $59.3 million for the year ended March 31, 2005 reflects our effective income tax rate of 30%. 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 an increase in our deferred tax asset valuation allowance and 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.

Results of Operations—Fiscal Years Ended March 31, 2004 and 2003

Net income for the year ended March 31, 2004 was $77.7 million or $0.40 per diluted share, as compared to $66.2 million or $0.32 per diluted share for the year ended March 31, 2003.

Net Revenues

The following table details our consolidated net revenues by business segment and our publishing net revenues by territory for the years ended March 31, 2004 and 2003 (in thousands):

Year ended March 31,	2004	2003	Increase/(Decrease)	Percent Change
Publishing net revenues				
North America	$446,812	$432,261	$14,551	3%
Europe	197,300	164,984	32,316	20%
Other	21,620	18,730	2,890	15%
Total international	218,920	183,714	35,206	19%
Total publishing net revenues	665,732	615,975	49,757	8%
Distribution net revenues	281,924	248,141	33,783	14%
Consolidated net revenues	$947,656	$864,116	$83,540	10%

Consolidated net revenues increased 10% from $864.1 million for the year ended March 31, 2003 to $947.7 million for the year ended March 31, 2004. This increase was generated by both our publishing and distribution businesses. The increase in consolidated net revenues was driven by the following:

- Strong performance of our fiscal 2004 third quarter releases of *True Crime: Streets of L.A.* and *Tony Hawk's Underground* for the PS2, Xbox and GameCube and *Call of Duty* for the PC. We continued to see strong sales of these titles through March 2004. In addition, we had strong results from several other titles released during fiscal 2004 including, *Return to Castle Wolfenstein, X2: Wolverine's Revenge, Cabela's Dangerous Hunts, Cabela's Deer Hunt 2004 Season,* and in select European markets, *Jedi Knight: Jedi Academy*. We also had strong catalog sales from a number of our franchises, including Spider-Man. Catalog sales are sales of titles released prior to the current fiscal year.
- Publishing console net revenues increased by 9% from $466.1 million for the year ended March 31, 2003 to $508.4 million for the year ended March 31, 2004. As expected, within the mix of specific consoles, net revenues from the sale of software for the prior generation console hardware systems, such as PS1, continued to decline while the net revenues from the sale of software for the current generation of console hardware systems continued to grow.
- Net revenues were positively impacted from titles selling at higher average retail prices throughout fiscal 2004 as compared to fiscal 2003. As a result of the strong performance of our key fiscal 2004 releases, we were able to maintain the original price points for those titles for an extended period of time.
- International net revenues benefited from the strong year-over-year strengthening of the Euro ("EUR") and Great British Pound ("GBP") in relation to the U.S. dollar. We estimate that foreign exchange rates increased reported net revenues by approximately $52.1 million. Excluding the impact of changing foreign currency rates, our international net revenues increased 4% year-over-year.
- The increase in publishing net revenues was offset by fewer titles released in fiscal 2004 as compared to fiscal 2003.

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North America Publishing Net Revenues

(In thousands) March 31, 2004	% of Consolidated Net Revenues	March 31, 2003	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$446,812	47%	$432,261	50%	$14,551	3%

North America publishing net revenues increased 3% from $432.3 million for the year ended March 31, 2003, to $446.8 million for the year ended March 31, 2004. The increase reflects the strong performance of our fiscal 2004 third quarter releases of *True Crime: Streets of L.A.* and *Tony Hawk's Underground* for the PS2, Xbox and GameCube and *Call of Duty* for the PC. We continued to see strong sales of these titles through March 2004. The increase in net revenues was offset by fewer titles released in fiscal 2004 as compared to fiscal 2003.

International Publishing Net Revenues

(In thousands) March 31, 2004	% of Consolidated Net Revenues	March 31, 2003	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$218,920	23%	$183,714	21%	$35,206	19%

International publishing net revenues increased by 19% from $183.7 million for the year ended March 31, 2003 to $218.9 million for the year ended March 31, 2004. International publishing also saw strong results from our 2004 releases of *True Crime: Streets of L.A.* and *Tony Hawk's Underground* for the PS2, Xbox and GameCube and *Call of Duty* for the PC. We also had strong results from several other titles released during fiscal 2004 including, *Return to Castle Wolfenstein, X2: Wolverine's Revenge* and *Jedi Knight: Jedi Academy*. In addition, we had strong catalog sales from a number of our franchises, including Spider-Man. There also was a positive strengthening of the EUR and the GBP in relation to the U.S. dollar of approximately $22.2 million. Excluding the impact of changing foreign currency rates, our international publishing net revenues increased 7% year-over-year. The increase in net revenues was offset by fewer titles released in fiscal 2004 as compared to fiscal 2003.

Publishing Net Revenues by Product Line

Publishing net revenues increased 8% from $616.0 million for the year ended March 31, 2003 to $665.7 million for the year ended March 31, 2004. The following table details our publishing net revenues by platform and as a percentage of total publishing net revenues for the years ended March 31, 2004 and 2003 (in thousands):

Publishing Net Revenues	Year Ended March 31, 2004	% of Publishing Net Revs	Year Ended March 31, 2003	% of Publishing Net Revs	Increase/ (Decrease)	Percent Change
PC	$132,369	20%	$ 99,893	16%	$ 32,476	33%
Console						
Sony PlayStation 2	289,048	43%	260,307	42%	28,741	11%
Microsoft Xbox	145,111	22%	75,329	12%	69,782	93%
Nintendo GameCube	52,909	8%	74,694	12%	(21,785)	(29%)
PlayStation	20,843	3%	52,722	9%	(31,879)	(60%)
Other	507	—%	3,064	1%	(2,557)	(83%)
Total console	508,418	76%	466,116	76%	42,302	9%
Hand-held						
Game Boy Advance	24,621	4%	44,060	7%	(19,439)	(44%)
Game Boy Color	324	—%	5,906	1%	(5,582)	(95%)
Total hand-held	24,945	4%	49,966	8%	(25,021)	(50%)
Total publishing net revenues	$665,732	100%	$615,975	100%	$ 49,757	8%

Personal Computer Net Revenues

(In thousands) March 31, 2004	% of Publishing Net Revenues	March 31, 2003	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$132,369	20%	$99,893	16%	$32,476	33%

Net revenues from sales of titles for the PC increased 33% from $99.9 million for the year ended March 31, 2003 to $132.4 million for the year ended March 31, 2004. Though the number of premium PC titles released in fiscal 2004 remained relatively consistent with fiscal 2003, certain of our fiscal 2004 releases, *Call of Duty, Empires: Dawn of the Modern World* and, in select European markets, *Jedi Knight: Jedi Academy,* performed very well in both the North America and international markets. According to NPD Group, a third-party sales tracking agency, *Call of Duty* was the number one selling PC title in North America during the quarter of its release, our third quarter of fiscal 2004.

Sony PlayStation 2 Net Revenues

(In thousands) March 31, 2004	% of Publishing Net Revenues	March 31, 2003	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$289,048	43%	$260,307	42%	$28,741	11%

Net revenues from sales of titles for the PS2 increased 11% from $260.3 million for the year ended March 31, 2003 to $289.0 million for the year ended March 31, 2004. Though the number of new PS2 titles reduced in fiscal 2004 to 10 from 13 in fiscal 2003, we were able to increase our PS2 sales in both the North America and international

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markets. The increase is primarily due to strong, worldwide sales of several of our PS2 titles including *True Crime: Streets of L.A., Tony Hawk's Underground, X2: Wolverine's Revenge, Return to Castle Wolfenstein, Cabela's Dangerous Hunts* and *Cabela's Deer Hunt 2004 Season*.

Microsoft Xbox Net Revenues

(In thousands) March 31, 2004	% of Publishing Net Revenues	March 31, 2003	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$145,111	22%	$75,329	12%	$69,782	93%

Net revenues from sales of titles for the Xbox increased 93% from $75.3 million for the year ended March 31, 2003 to $145.1 million for the year ended March 31, 2004. Though the number of new Xbox titles remained relatively consistent from fiscal 2003 to fiscal 2004, we were able to increase our Xbox sales in both the North America and international markets. The increase is primarily due to strong worldwide sales of several of our Xbox titles including *True Crime: Streets of L.A., Tony Hawk's Underground, Return to Castle Wolfenstein, Soldier of Fortune 2, X2: Wolverine's Revenge, Tenchu: Return from Darkness* and, in select European markets, *Jedi Knight: Jedi Academy*. The increase was also due to an increased installed base of the Xbox.

Nintendo GameCube Net Revenues

(In thousands) March 31, 2004	% of Publishing Net Revenues	March 31, 2003	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$52,909	8%	$74,694	12%	$(21,785)	(29%)

Net revenues from sales of titles for the Nintendo GameCube decreased 29% from $74.7 million for the year ended March 31, 2003 to $52.9 million for the year ended March 31, 2004. The decrease is primarily due to a reduction in the number of GameCube new title releases from nine in fiscal 2003 to five in fiscal 2004. The titles that were released for GameCube performed strongly, including *Tony Hawk's Underground* and *True Crime: Streets of L.A.*

Sony PlayStation Net Revenues

(In thousands) March 31, 2004	% of Publishing Net Revenues	March 31, 2003	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$20,843	3%	$52,722	9%	$(31,879)	(60%)

Net revenues from sales of titles for the Sony PlayStation console system ("PS1") for the year ended March 31, 2004 decreased 60% from the prior fiscal year, from $52.7 million to $20.8 million. The decrease was expected due to the market transition away from the prior generation of hardware platforms, such as PS1, to the current generation console systems.

Game Boy Advance Net Revenues

(In thousands) March 31, 2004	% of Publishing Net Revenues	March 31, 2003	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$24,621	4%	$44,060	7%	$(19,439)	(44%)

Net revenues from sales of titles for the GBA for the year ended March 31, 2004 decreased 44% from the prior fiscal year, from $44.1 million to $24.6 million. This is due to a decrease in the number of GBA games released year-over-year. In fiscal 2003, we released 11 GBA titles, whereas in fiscal 2004 we released 4 GBA titles. We expect the hand-held installed base to grow with the release of the NDS and PSP which are expected to launch in late calendar year 2004 and early calendar year 2005, respectively.

A significant portion of our revenues and profits are derived from a relatively small number of popular titles and brands each year as revenues and profits are significantly affected by our ability to release highly successful or "hit" titles. For example, for the year ended March 31, 2004, 28% of our consolidated net revenues and 40% of worldwide publishing net revenues were derived from net revenues from our *Tony Hawk's Underground* and *True Crime: Streets of L.A.* 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 disproportionate amount of operating income being derived from these select titles.

Distribution Net Revenues

(In thousands) March 31, 2004	% of Consolidated Net Revenues	March 31, 2003	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$281,924	30%	$248,141	29%	$33,783	14%

Distribution net revenues for the year ended March 31, 2004 increased 14% from the prior fiscal year, from $248.1 million to $281.9 million. The increase was primarily due to the positive impact of the year-over-year strengthening of the EUR and the GBP in relation to the U.S. dollar. Excluding the impact of the changing foreign currency rates, our distribution net revenues was in line with our prior fiscal year, with a slight increase of 2% year-over-year. The mix of distribution net revenues between hardware and software sales varied year-over-year with approximately 28% hardware in the year ended March 31, 2004 as compared to 38% hardware in the prior fiscal year. This is mainly attributed to an increase in business with large, mass-market customers that generate a higher percentage of sales from software. In both fiscal years, hardware sales were principally comprised of sales of console hardware.

Costs and Expenses

Cost of Sales—Product Costs

(In thousands) March 31, 2004	% of Consolidated Net Revenues	March 31, 2003	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$475,541	50%	$440,977	51%	$34,564	8%

Cost of sales—product costs represented 50% and 51% of consolidated net revenues for the years ended March 31, 2004 and 2003, respectively. In absolute dollars, cost of sales—product costs increased due to higher sales volume in fiscal 2004 as compared to fiscal 2003. There were two primary factors that affected cost of sales—product costs as a percentage of consolidated net revenues:

- The product mix of our publishing business for the year ended March 31, 2004 reflects a lower proportion of net revenues from titles for hand-held devices, as compared to the year ended March 31, 2003. Titles for hand-held devices generally have the highest manufacturing per unit cost of all platforms.
- Due to the lower manufacturing costs for PC titles, we were able to benefit from the strong sales of *Call of Duty* for the year ended March 31, 2004.

Cost of Sales—Software Royalties and Amortization

(In thousands) March 31, 2004	% of Publishing Net Revenues	March 31, 2003	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$59,744	9%	$79,194	13%	$(19,450)	(25%)

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Cost of sales—software royalties and amortization for the year ended March 31, 2004 decreased as a percentage of publishing net revenues from the prior fiscal year, from 13% to 9%. In absolute dollars, cost of sales—software royalties and amortization for the year ended March 31, 2004 also decreased from the prior fiscal year, from $79.2 million to $59.7 million. The decrease in absolute dollars reflects that there were approximately fifteen major titles released in fiscal 2004 as compared to over twenty in fiscal 2003. The decrease in the percentage reflects the strong performance of our internally developed key fiscal 2004 third quarter releases.

Cost of Sales—Intellectual Property Licenses

(In thousands) March 31, 2004	% of Publishing Net Revenues	March 31, 2003	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$31,862	5%	$45,002	7%	$(13,140)	(29%)

Cost of sales—intellectual property licenses for the year ended March 31, 2004 decreased in absolute dollars and as a percentage of publishing net revenues over the same period last year, from 7% to 5%. The decreases reflect the fact that two of our top performing titles in fiscal 2004, *True Crime: Streets of L.A.* and *Call of Duty,* were based on our wholly-owned original intellectual property. Additionally, during fiscal 2003, we recorded an approximate $7.0 million charge related to an assessment of the recoverability of certain of our investments in long-term licensing agreements.

Product Development

(In thousands) March 31, 2004	% of Publishing Net Revenues	March 31, 2003	% of Publishing Net Revenues	Increase/(Decrease)	Percent Change
$97,859	15%	$56,971	9%	$40,888	72%

Product development expenses for the year ended March 31, 2004 increased as a percentage of publishing net revenues from the prior fiscal year, from 9% to 15%. In absolute dollars, product development expenses for the year ended March 31, 2004 also increased from the prior fiscal year, from $57.0 million to $97.9 million. The increase in product development as a percentage of publishing net revenues and in absolute dollars resulted from:

- A $21 million game cancellation charge recorded in the fiscal 2004 third quarter. We executed a realignment of our product portfolio driven by the evolution of the video game market, which is increasingly dominated by high-quality products that are based on recognizable franchises and supported with big marketing programs. We completed a comprehensive review of our product portfolio in which we evaluated each product based on a number of criteria, including: the strength of the franchise, the projected product quality, the potential responsiveness of the product to aggressive marketing support and the financial risk in the event of product failure. As a result of this review, we believed that we had an extensive slate of high-potential properties in development. However, we found that certain projects had a lower likelihood of achieving acceptable levels of operating performance and that continued pursuit of these projects would create a substantial opportunity cost as it related to our slate of high-potential projects. Accordingly, in the three months ended December 31, 2003, we cancelled the development of ten products that we believed were unlikely to produce an acceptable level of return on our investment. In connection with the cancellation of these products, we recorded a pre-tax charge of approximately $21 million.
- Our increased emphasis on product quality and the lengthening of product development schedules. To maintain the competitiveness of our products and to take advantage of increasingly sophisticated technology associated with new hardware platforms, we have increased the amount of time spent play-testing new products, conducted more extensive product quality evaluations and lengthened product development schedules to allow time to make the improvements indicated by our testing and evaluations. We are focused on improved game quality, and in many cases, this has resulted in an increase in product development costs.
- The increase in absolute dollars is also due to an increase in studio employee incentive compensation as a result of the strong performances of key fiscal 2004 title releases.

Sales and Marketing

(In thousands) March 31, 2004	% of Consolidated Net Revenues	March 31, 2003	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$128,221	14%	$100,646	12%	$27,575	27%

Sales and marketing expenses of $128.2 million and $100.6 million represented 14% and 12% of consolidated net revenues for the years ended March 31, 2004 and 2003, respectively. The increase in sales and marketing expense dollars and as a percentage of net revenues for the year ended March 31, 2004 from the prior fiscal year was primarily generated by our publishing business as a result of significant marketing programs, including television and in-theatre ad campaigns and in-store promotions, run in support of our three key fiscal 2004 third quarter title releases, *Tony Hawk's Underground,* and our two new original properties, *True Crime: Streets of L.A.* and *Call of Duty*.

General and Administrative

(In thousands) March 31, 2004	% of Consolidated Net Revenues	March 31, 2003	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$44,612	5%	$46,479	5%	$(1,867)	(4%)

General and administrative expenses for the year ended March 31, 2004 decreased $1.9 million over the same period last year, from $46.5 million to $44.6 million. As a percentage of consolidated net revenues, general and administrative expenses remained constant at 5%. The decrease in absolute dollars was primarily due to:

- Lower bad debt expense of approximately $3.9 million.
- The incurrence in the first quarter of fiscal 2003 of $1.0 million of merger related expenses by our publishing business.
- An approximate $2.0 million charge incurred in fiscal 2003 by our distribution business for the relocation of our UK distribution facility.
- Partially offset by a $5.2 million year-over-year increase in general and administrative employee related costs in both our publishing and distribution businesses.

Operating Income

(In thousands)	March 31, 2004	% of Segment Net Revs	March 31, 2003	% of Segment Net Revs	Increase/ (Decrease)	Percent Change
Publishing	$ 93,223	14%	$79,139	13%	$14,084	18%
Distribution	16,594	6	15,708	6	886	6
Consolidated	$109,817	12%	$94,847	11%	$14,970	16%

Publishing operating income for the year ended March 31, 2004 increased $14.1 million from the same period last year, from $79.1 million to $93.2 million. International publishing operating income for the year ended March 31, 2004 benefited from the positive impact of the year-over-year strengthening of the EUR and the GBP in relation to the U.S. dollar. Excluding the impact of changes in foreign currency rates, publishing operating income for the year ended March 31, 2004 increased approximately $7.8 million from the same period last year. This increase is primarily due to:

- Strong performance in both the North America and international markets of our fiscal 2004 third quarter title releases.

Partially offset by:

- Increased sales and marketing spending.
- The product development charge recorded in the fiscal 2004 third quarter in connection with the cancellation of ten products.

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Distribution operating income for the year ended March 31, 2004 increased slightly over the same period last year, from $15.7 million to $16.6 million. Distribution operating income for the year ended March 31, 2004 benefited from the positive impact of the year-over-year strengthening of the EUR and the GBP in relation to the U.S. dollar. Excluding the impact of changes in foreign currency rates, distribution operating income for the year ended March 31, 2004 was down slightly by approximately $0.9 million from the same period last year. This decrease is primarily due to an increase in general and administrative employee related costs.

Investment Income, Net

(In thousands) March 31, 2004	% of Consolidated Net Revenues	March 31, 2003	% of Consolidated Net Revenues	Increase/(Decrease)	Percent Change
$6,175	—%	$8,560	1%	$(2,385)	(28%)

Investment income, net for the year ended March 31, 2004 was $6.2 million as compared to $8.6 million for the year ended March 31, 2003. The decrease was primarily due to interest rate reductions and the utilization of excess cash to enter into structured stock repurchase transactions and to purchase treasury stock during the year ended March 31, 2004. Premiums earned on structured stock repurchase transactions are recorded in additional paid-in-capital.

Provision for Income Taxes

(In thousands) March 31, 2004	% of Pre-Tax Income	March 31, 2003	% of Pre-Tax Income	Increase/(Decrease)	Percent Change
$38,277	33%	$37,227	36%	$1,050	3%

The income tax provision of $38.3 million for the year ended March 31, 2004 reflects our effective income tax rate of 33%. 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 an increase in our deferred tax asset valuation allowance and state taxes. The realization of deferred tax assets depends primarily on the generation of future taxable income.

Selected Quarterly Operating Results

Our quarterly operating results have in the past varied significantly and will likely vary significantly in the future, depending on numerous factors, several of which are not under our control. See Item 1 "Business—Factors Affecting Future Performance" of our Annual Report on Form 10-K, which has been previously filed with the Securities and Exchange Commission. Our business also has experienced and is expected to continue to experience significant seasonality, largely due to consumer buying patterns and our product release schedule focusing on those patterns. Net revenues typically are significantly higher during the fourth calendar quarter, primarily due to the increased demand for consumer software during the year-end holiday buying season. Accordingly, we believe that period-to-period comparisons of our operating results are not necessarily meaningful and should not be relied upon as indications of future performance.

The following table is a comparative breakdown of our quarterly results for the immediately preceding eight quarters (amounts in thousands, except per share data):

		Restated[1]						
Quarter ended	**March 31, 2005**	**Dec. 31, 2004**	**Sept. 30, 2004**	**June 30, 2004**	March 31, 2004	Dec. 31, 2003	Sept. 30, 2003	June 30, 2003
Net revenues	**$203,861**	**$680,094**	**$310,626**	**$211,276**	$162,897	$508,511	$117,523	$158,725
Operating income (loss)	**(2,899)**	**137,079**	**34,658**	**15,733**	4,643	116,961	(16,933)	5,146
Net income (loss)	**3,573**	**97,262**	**25,543**	**11,957**	6,664	76,981	(10,093)	4,163
Basic earnings (loss) per share	**0.02**	**0.52**	**0.14**	**0.07**	0.04	0.43	(0.06)	0.02
Diluted earnings (loss) per share	**0.02**	**0.47**	**0.13**	**0.06**	0.03	0.40	(0.06)	0.02

(1) Consolidated financial information has been restated for the effect of our four-for-three stock split effected in the form of a 33 1/3% stock dividend to shareholders of record as of March 7, 2005, paid March 22, 2005.

Liquidity and Capital Resources

Sources of Liquidity

(In thousands) As of and for the year ended March 31,	**2005**	2004	Increase/ (Decrease)
Cash and cash equivalents	**$ 313,608**	$ 165,120	$148,488
Short-term investments	**527,256**	422,529	104,727
	$ 840,864	$ 587,649	$253,215
Percentage of total assets	**64%**	61%	
Cash flows provided by operating activities	**$ 215,309**	$ 67,403	$147,906
Cash flows used in investing activities	**(143,896)**	(170,155)	(26,259)
Cash flows provided by financing activities	**72,654**	117,569	(44,915)

Management's Discussion and Analysis of Financial Condition and Results of Operations

As of March 31, 2005, our primary source of liquidity is comprised of $313.6 million of cash and cash equivalents and $527.3 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, as well as from the utilization of structured stock repurchase transactions, which are 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 ($915.4 million at March 31, 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 $126.9 million and $115.2 million in the years ended March 31, 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 the capitalization of product development costs relating to internally developed products. We expect that we will continue to make significant expenditures relating to our investment in software development and intellectual property licenses. 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 year ended March 31, 2005 and 2004, cash flows from operating activities were $215.3 million and $67.4 million, respectively. The principal components comprising cash flows from operating activities for the year ended March 31, 2005 included favorable operating results and increases in accounts payable and accrued liabilities, partially offset by increases in accounts receivable and our continued investment in software development and intellectual property licenses. See an analysis of the change in key balance sheet accounts 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 used in 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 year ended March 31, 2005 and 2004, cash flows used in investing activities were $143.9 million and $170.2 million, respectively. For the year ended March 31, 2005, cash flows used in investing activities were primarily the result of capital expenditures, cash paid for an acquisition, and the increase in short-term investments. 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 related to transactions involving our common stock, including the issuance of shares of common stock to employees and the public, the purchase of treasury shares, as well as the use of structured stock repurchase transactions. 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 year ended March 31, 2005 and 2004, cash flows from financing activities were $72.7 million and $117.6 million, respectively. The cash provided by financing activities for the year ended March 31, 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. In the past, we have entered into structured stock repurchase transactions that were settled in cash or stock based on the market price of our common stock on the date of the settlement. Upon settlement, we either had our capital investment returned with a premium or received shares of our common stock, depending, respectively, on whether the market price of our common stock was above or below a pre-determined price agreed in connection with each such transaction. As of March 31, 2005, we had approximately $226.2 million available for utilization under the buyback program and no outstanding structured stock repurchase transactions. 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)	**March 31, 2005**	March 31, 2004	Increase/ (Decrease)
Gross accounts receivable	**$178,335**	$109,605	$68,730
Net accounts receivable	**109,144**	62,577	46,567

The increase in gross accounts receivable was primarily the result of:

- Late fourth quarter North American releases of *THUG 2 Remix* and *Spider-Man 2* for the PSP. Both titles were released concurrently with the release of the PSP platform in late March 2005.
- The fourth quarter releases of three affiliate titles, *Mercenaries, Star Wars: Knights of the Old Republic II* and *Star Wars: Republic Commando,* in our European territories.
- A continued increase in business of our UK distribution facility with large, mass-market customers. Large, mass-market customers typically have longer trading terms than smaller, independent accounts.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Reserves for returns, price protection and bad debt increased from $47.0 million at March 31, 2004 to $69.2 million at March 31, 2005 while reserves as a percentage of gross receivables declined from 43% to 39%. The change in reserves is primarily due to the strong sell-through to end consumers of our key third quarter fiscal 2005 releases.

Inventories

(Amounts in thousands)	**March 31, 2005**	March 31, 2004	Increase/ (Decrease)
Inventories	**$48,018**	$26,427	$21,591

The increase in inventories was driven by our publishing business, primarily the result of:

- Inventory buildup for our highly anticipated early April 2005 release of *Doom 3* for the Xbox console.

Software Development and Intellectual Property Licenses

(Amounts in thousands)	**March 31, 2005**	March 31, 2004	Increase/ (Decrease)
Software development and intellectual property licenses	**$127,340**	$135,201	$(7,861)

The decrease in software development and intellectual property licenses was primarily the result of:

- Releases of titles in fiscal 2005 with large intellectual property licenses or developer advances as of March 31, 2004. These titles included *Spider-Man 2, Shrek 2, THUG 2, Call of Duty, Doom 3, Lemony Snicket's A Series of Unfortunate Events, Shark Tale* and *Rome: Total War.*

Partially offset by:

- Continued investment in software development and intellectual property licenses. We spent approximately $126.9 million in the year ended March 31, 2005 in connection with the acquisition of publishing or distribution rights for products being developed by third parties, payments on license agreements granting us long-term rights to intellectual property of third parties, as well as the capitalization of product development costs relating to internally developed products.

Accounts Payable

(Amounts in thousands)	**March 31, 2005**	March 31, 2004	Increase/ (Decrease)
Accounts payable	**$108,984**	$72,874	$36,110

The increase in accounts payable was primarily the result of:

- Increased inventory purchases by our publishing business as a result of highly anticipated release of *Doom 3* for the Xbox in early April 2005.
- Increases in our fourth quarter European sales volume and inventory purchases related to our focus on international expansion, including our addition of offices in Spain and Italy and the release of three hit affiliate titles in the fourth quarter of fiscal 2005.

Accrued Expenses

(Amounts in thousands)	**March 31, 2005**	March 31, 2004	Increase/ (Decrease)
Accrued expenses	**$98,067**	$63,205	$34,862

The increase in accrued expenses was primarily driven by:

- Continued focus on marketing and co-op support for our key titles. It has been our experience that this increased spending will lengthen the product sales life cycle and add to the long-term prospects of the respective product lines.
- Increased foreign income taxes payable.
- Expenses related to the fourth quarter releases of three affiliate label products in our European territories.

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 GBP 8.0 million ($15.0 million), including issuing letters of credit, on a revolving basis as of March 31, 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 March 31, 2005. The UK Facility bore interest at LIBOR plus 2.0% as of March 31, 2005, is collateralized by substantially all of the assets of the subsidiary and expires in January 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 March 31, 2005, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of March 31, 2005. The German Facility provided for revolving loans up to EUR 0.5 million ($0.6 million) as of March 31, 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 March 31, 2005.

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 March 31, 2005, are scheduled to be paid as follows (amounts in thousands):

	Contractual Obligations			
Fiscal year ending March 31,	Facility Leases	Developer and IP	Marketing	Total
2006	$11,990	$45,557	$18,759	$ 76,306
2007	11,440	7,975	2,500	21,915
2008	7,906	5,775	7,500	21,181
2009	6,620	2,900	—	9,520
2010	5,783	—	—	5,783
Thereafter	19,626	—	—	19,626
Total	$63,365	$62,207	$28,759	$154,331

As of March 31, 2005 and 2004, we did not have any relationships with unconsolidated entities or financial parties, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market, or credit risk that could arise if we had engaged in such relationships.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Related Parties

In August 2001, we elected to our Board of Directors an individual who is a partner in a law firm that has provided legal services to Activision for more than ten years and who remains a director of the Company. For the years ended March 31, 2005, 2004 and 2003, the fees we paid to the law firm were an insignificant portion of the law firm's total revenues. We believe that the fees charged to us by the law firm are competitive with the fees charged by other law firms.

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 Officers 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 the Company no later than April 1, 2006. Early adoption will be permitted in periods in which financial statements have not yet been issued. The Company expects 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.

The Company has not yet determined which method it will use.

As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using Opinion 25's intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123R's fair value method will have a significant impact on the Company's results of operations, although it will have no impact on its overall financial position. The impact of adoption of SFAS No. 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future.

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. The Company expects 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 Company expects the adoption of SFAS No. 153 will not have a material impact on our financial position or results of operations.

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 2005, 2006, and 2007 will be limited to 95%, 75%, and 45%, respectively, 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.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Inflation

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

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, foreign currency exchange rates and market prices. 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 market prices 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 March 31, 2005, our cash equivalents and short-term investments included debt securities of $551.4 million.

The following table presents the amounts and related weighted average interest rates of our investment portfolio as of March 31, 2005 (amounts in thousands):

	Average Interest Rate	Amortized Cost	Fair Value
Cash equivalents:			
Fixed rate	2.82%	$ 25,227	$ 25,218
Variable rate	2.71	107,519	107,519
Short-term investments:			
Fixed rate	2.96%	$530,302	$526,194

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 GBP and EUR. The volatility of GBP and EUR (and all other applicable currencies) will be monitored frequently throughout the coming year. When appropriate, we enter into hedging transactions in order to mitigate our risk from foreign currency fluctuations. We will continue to use hedging programs in the future and may use currency forward contracts, currency options and/or other derivative financial instruments commonly utilized to reduce financial market risks if it is determined that such hedging activities are appropriate to reduce risk. We do not hold or purchase any foreign currency contracts for trading purposes. As of March 31, 2005, we had no outstanding hedging contracts.

Market Price Risk

With regard to the structured stock repurchase transactions described in Note 15 in the Notes to the Consolidated Financial Statements, at those times when we have structured stock repurchase transactions outstanding, it is possible that at settlement we could take delivery of shares at an effective repurchase price higher than the then market price. As of March 31, 2005, we had no structured stock repurchase transactions outstanding.

Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officers 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. Disclosure controls and procedures are designed with the objective of ensuring 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 Officers and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures. Based on this evaluation, the Chief Executive Officers and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective in recording, processing, summarizing, and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act. Notwithstanding the foregoing, 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.

Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of the Company's management, including our Chief Executive Officers and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on criteria established in the framework in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, the Company's management concluded that its internal control over financial reporting was effective as of March 31, 2005.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm has audited management's assessment of the effectiveness of the Company's internal control over financial reporting as of March 31, 2005 as stated in their report included with the accompanying consolidated financial statements.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Activision, Inc.:

We have completed an integrated audit of Activision, Inc.'s 2005 consolidated financial statements and of its internal control over financial reporting as of March 31, 2005 and audits of its 2004 and 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated Financial Statements

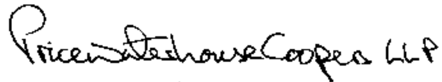
In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of changes in shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Activision, Inc. and its subsidiaries (the "Company") at March 31, 2005 and 2004 and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal Control Over Financial Reporting

Also, in our opinion, management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that the Company maintained effective internal control over financial reporting as of March 31, 2005 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



PricewaterhouseCoopers LLP
Los Angeles, California
June 7, 2005

Consolidated Balance Sheets

(In thousands, except share data) March 31,	**2005**	2004
Assets		
Current assets:		
Cash and cash equivalents	**$ 313,608**	$ 165,120
Short-term investments	**527,256**	422,529
Accounts receivable, net of allowances of $69,191 and $47,028 at March 31, 2005 and 2004, respectively	**109,144**	62,577
Inventories	**48,018**	26,427
Software development	**73,096**	58,320
Intellectual property licenses	**21,572**	32,115
Deferred income taxes	**6,760**	26,127
Other current assets	**23,010**	18,660
Total current assets	**1,122,464**	811,875
Software development	**18,518**	28,386
Intellectual property licenses	**14,154**	16,380
Property and equipment, net	**30,490**	25,539
Deferred income taxes	**28,041**	9,064
Other assets	**1,635**	1,080
Goodwill	**91,661**	76,493
Total assets	**$1,306,963**	$ 968,817
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	**$ 108,984**	$ 72,874
Accrued expenses	**98,067**	63,205
Total liabilities	**207,051**	136,079
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, $.000001 par value, 3,750,000 shares authorized, no shares issued at March 31, 2005 and 2004	**—**	—
Series A Junior Preferred stock, $.000001 par value, 1,250,000 shares authorized, no shares issued at March 31, 2005 and 2004	**—**	—
Common stock, $.000001 par value, 225,000,000 shares authorized, 201,030,623 and 222,502,089 shares issued and 201,030,623 and 183,108,323 shares outstanding at March 31, 2005 and 2004, respectively	**—**	—
Additional paid-in capital	**741,680**	758,626
Retained earnings	**346,614**	208,279
Less: Treasury stock, at cost, no shares and 39,393,765 shares as of March 31, 2005 and 2004, respectively	**—**	(144,128)
Accumulated other comprehensive income	**11,618**	9,961
Total shareholders' equity	**1,099,912**	832,738
Total liabilities and shareholders' equity	**$1,306,963**	$ 968,817

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

Consolidated Statements of Operations

(In thousands, except per share data)

For the years ended March 31,	**2005**	2004	2003
Net revenues	**$1,405,857**	$947,656	$864,116
Costs and expenses:			
Cost of sales—product costs	**658,949**	475,541	440,977
Cost of sales—software royalties and amortization	**123,800**	59,744	79,194
Cost of sales—intellectual property licenses	**62,197**	31,862	45,002
Product development	**86,543**	97,859	56,971
Sales and marketing	**230,058**	128,221	100,646
General and administrative	**59,739**	44,612	46,479
Total costs and expenses	**1,221,286**	837,839	769,269
Income from operations	**184,571**	109,817	94,847
Investment income, net	**13,092**	6,175	8,560
Income before income tax provision	**197,663**	115,992	103,407
Income tax provision	**59,328**	38,277	37,227
Net income	**$ 138,335**	$ 77,715	$ 66,180
Basic earnings per share	**$ 0.74**	$ 0.44	$ 0.34
Weighted average common shares outstanding	**187,517**	177,665	192,479
Diluted earnings per share	**$ 0.66**	$ 0.40	$ 0.32
Weighted average common shares outstanding—assuming dilution	**209,145**	193,191	207,310

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

Consolidated Statements of Changes in Shareholders' Equity

(In thousands) For the years ended March 31, 2005, 2004 and 2003	Common Stock				Treasury Stock			
	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Shares	Amount	Accumulated Other Comprehensive Income (Loss)	Shareholders' Equity
Balance, March 31, 2002	183,103	$—	$ 397,528	$ 64,384	(12,987)	$ (20,323)	$(11,498)	$ 430,091
Components of comprehensive income:								
Net income for the year	—	—	—	66,180	—	—	—	66,180
Unrealized appreciation on short-term investments	—	—	—	—	—	—	134	134
Foreign currency translation adjustment	—	—	—	—	—	—	7,930	7,930
Total comprehensive income								74,244
Issuance of common stock pursuant to underwritten public offering	22,500	—	247,291	—	—	—	—	247,291
Issuance of common stock to employees	7,999	—	20,547	—	—	—	—	20,547
Issuance of common stock pursuant to warrants and common stock warrants	92	—	2,184	—	—	—	—	2,184
Tax benefit attributable to employee stock options and common stock warrants	—	—	23,884	—	—	—	—	23,884
Purchase of structured stock repurchase transactions	—	—	(110,000)	—	—	—	—	(110,000)
Issuance of common stock to effect business combinations	1,053	—	10,861	—	—	—	—	10,861
Purchase of treasury shares	—	—	—	—	(21,589)	(101,362)	—	(101,362)
Balance, March 31, 2003	214,747	—	592,295	130,564	(34,576)	(121,685)	(3,434)	597,740
Components of comprehensive income:								
Net income for the year	—	—	—	77,715	—	—	—	77,715
Unrealized depreciation on short-term investments	—	—	—	—	—	—	(37)	(37)
Foreign currency translation adjustment	—	—	—	—	—	—	13,432	13,432
Total comprehensive income								91,110
Issuance of common stock to employees	6,853	—	25,730	—	—	—	—	25,730
Issuance of common stock pursuant to warrants and common stock warrants	558	—	1,038	—	—	—	—	1,038
Tax benefit attributable to employee stock options and common stock warrants	—	—	12,417	—	—	—	—	12,417
Structured stock repurchase transactions	—	—	(52,621)	—	—	—	—	(52,621)
Settlement of structured stock repurchase transactions	—	—	176,521	—	(2,288)	(10,000)	—	166,521
Issuance of common stock to effect business combinations	344	—	3,246	—	—	—	—	3,246
Purchase of treasury shares	—	—	—	—	(2,530)	(12,443)	—	(12,443)
Balance, March 31, 2004	222,502	—	758,626	208,279	(39,394)	(144,128)	9,961	832,738
Components of comprehensive income:								
Net income for the year	**—**	**—**	**—**	**138,335**	**—**	**—**	**—**	**138,335**
Unrealized depreciation on short-term investments	**—**	**—**	**—**	**—**	**—**	**—**	**(3,317)**	**(3,317)**
Foreign currency translation adjustment	**—**	**—**	**—**	**—**	**—**	**—**	**4,974**	**4,974**
Total comprehensive income								**139,992**
Issuance of common stock to employees	**16,691**	**—**	**68,192**	**—**	**—**	**—**	**—**	**68,192**
Issuance of common stock pursuant to warrants and common stock warrants	**1,123**	**—**	**4,462**	**—**	**—**	**—**	**—**	**4,462**
Tax benefit attributable to employee stock options and common stock warrants	**—**	**—**	**53,337**	**—**	**—**	**—**	**—**	**53,337**
Issuance of common stock to effect business combinations	**109**	**—**	**1,191**	**—**	**—**	**—**	**—**	**1,191**
Retirement of treasury shares	**(39,394)**	**—**	**(144,128)**	**—**	**39,394**	**144,128**	**—**	**—**
Balance, March 31, 2005	**201,031**	**$—**	**$ 741,680**	**$346,614**	**—**	**$ —**	**$ 11,618**	**$1,099,912**

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

Consolidated Statements of Cash Flows

(In thousands) For the years ended March 31,	**2005**	2004	2003
Cash Flows from Operating Activities:			
Net income	**$ 138,335**	$ 77,715	$ 66,180
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income taxes	**878**	15,147	3,355
Depreciation and amortization	**10,702**	10,795	12,114
Realized gain on sale of short-term investments	**(471)**	(21)	(234)
Amortization and write-offs of capitalized software development costs and intellectual property licenses	**134,799**	87,922	100,415
Tax benefit of stock options and warrants exercised	**53,337**	12,417	23,884
Change in operating assets and liabilities (net of effects of acquisitions):			
Accounts receivable, net	**(46,527)**	(42,497)	61,922
Inventories	**(21,591)**	(6,850)	1,159
Software development and intellectual property licenses	**(126,938)**	(115,202)	(151,594)
Other assets	**1,543**	(5,232)	1,836
Accounts payable	**35,413**	23,005	(19,072)
Accrued expenses and other liabilities	**35,829**	10,204	(8,990)
Net cash provided by operating activities	**215,309**	67,403	90,975
Cash Flows from Investing Activities:			
Cash used in business acquisitions (net of cash acquired)	**(21,382)**	(3,480)	(21,199)
Capital expenditures	**(14,941)**	(11,976)	(11,877)
Purchase of short-term investments	**(868,723)**	(703,400)	(822,114)
Proceeds from sales and maturities of short-term investments	**761,150**	548,701	554,638
Other	**—**	—	(995)
Net cash used in investing activities	**(143,896)**	(170,155)	(301,547)
Cash Flows from Financing Activities:			
Proceeds from issuance of common stock to employees and common stock pursuant to warrants	**72,654**	26,483	20,547
Notes payable, net	**—**	(2,818)	(720)
Proceeds from issuance of common stock pursuant to underwritten public offering, net of offering costs	**—**	—	248,072
Purchase of structured stock repurchase transactions	**—**	(52,621)	(110,000)
Settlement of structured stock repurchase transactions	**—**	166,521	—
Purchase of treasury stock	**—**	(19,996)	(93,809)
Net cash provided by financing activities	**72,654**	117,569	64,090
Effect of exchange rate changes on cash	**4,421**	11,195	6,583
Net increase (decrease) in cash and cash equivalents	**148,488**	26,012	(139,899)
Cash and cash equivalents at beginning of period	**165,120**	139,108	279,007
Cash and cash equivalents at end of period	**$ 313,608**	$ 165,120	$ 139,108

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

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Business

Activision, Inc. ("Activision" or "we") is 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 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"). In prior years, we have also offered our products on the Sony PlayStation ("PS1") and Nintendo 64 ("N64") console systems and Nintendo Game Boy Color ("GBC") hand-held device. We also intend on developing titles for the next-generation console systems being developed by Sony, Nintendo, and Microsoft.

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. Our distribution business consists of operations in Europe that provide logistical and sales services to third-party publishers of interactive entertainment software, our own publishing operations and manufacturers of interactive entertainment hardware.

We maintain operations in the United States, Canada, the United Kingdom ("UK"), Germany, France, Italy, Spain, Japan, Australia, Sweden and the Netherlands. In fiscal year 2005, international operations contributed approximately 50% of consolidated net revenues.

Principles of Consolidation

The consolidated financial statements include the accounts of Activision, Inc., a Delaware corporation, and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Cash, Cash Equivalents and Short-term Investments

Cash and cash equivalents include cash, money markets and short-term investments with original maturities of not more than 90 days.

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 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.

Concentration of Credit Risk

Financial instruments which potentially subject us to concentration of credit risk consist principally of temporary cash investments and accounts receivable. We place our temporary cash investments with financial institutions. At various times during the fiscal years ended March 31, 2005 and 2004, we had deposits in excess of the Federal Deposit Insurance Corporation ("FDIC") limit at these financial institutions.

Our customer base includes retail outlets and distributors, including mass-market retailers, consumer electronics stores, discount warehouses and game specialty stores in the United States and countries worldwide. We perform ongoing credit evaluations of our customers and maintain allowances for potential credit losses. We generally do not require collateral or other security from our customers. As of and for the years ended March 31, 2005, 2004 and 2003, we had one customer that accounted for

Notes to Consolidated Financial Statements

23%, 20% and 16%, respectively, of consolidated net revenues and 41%, 39% and 46%, respectively, 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.

Financial Instruments

The estimated fair values of financial instruments have been determined using available market information and valuation methodologies described below. However, considerable judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented herein may not be indicative of the amounts that we could realize in a current market exchange. The use of different market assumptions or valuation methodologies may have a material effect on the estimated fair value amounts.

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate fair value due to their short-term nature. Short-term investments are carried at fair value with fair values being estimated based on quoted market prices.

We account for derivative instruments in accordance with Statement of Financial Accounting Standard ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of SFAS 133" and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 133, 138 and 149 require that all derivatives, including foreign exchange contracts, be recognized in the balance sheet in other current assets or accrued expenses at their fair value.

We utilize forward contracts in order to reduce financial market risks. These instruments are used to hedge foreign currency exposures of underlying assets, liabilities, or certain forecasted foreign currency denominated transactions. Our accounting policies for these instruments are based on whether they meet the criteria for designation as hedging transactions. Changes in fair value of derivatives that are designated as cash flow hedges, are highly effective, and qualify as hedging instruments, are recorded in other comprehensive income until the underlying hedged item is recognized in earnings within the financial statement line item consistent with the hedged item. Any ineffective portion of a derivative change in fair value is immediately recognized in earnings. Changes in fair value of derivatives that do not qualify as hedging instruments are recorded in earnings. The fair value of foreign currency contracts is estimated based on the spot rate of the various hedged currencies as of the end of the period. As of March 31, 2005 and 2004, we had no outstanding foreign exchange forward contracts.

Equity Investments

From time to time, we may make a capital investment and hold a minority interest in a third-party developer in connection with entertainment software products to be developed by such developer for us. We account for those capital investments over which we have the ability to exercise significant influence using the equity method. For those investments over which we do not have the ability to exercise significant influence, we account for our investment using the cost method.

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; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based.

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

Significant management judgments and estimates are utilized in the assessment of when technological feasibility is established, as well as in the ongoing assessment of the recoverability of capitalized costs. 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; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based.

Commencing upon the related product's release, capitalized intellectual property license costs are amortized to cost of sales—intellectual property licenses based on the ratio of current revenues for the specific product to total projected revenues for all products in which the licensed 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.

Notes to Consolidated Financial Statements

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.

Inventories
Inventories are valued at the lower of cost (first-in, first-out) or market.

Property and Equipment
Property and equipment are recorded at cost. Depreciation and amortization are provided using the straight-line method over the shorter of the estimated useful lives or the lease term: buildings, 25 to 33 years; computer equipment, office furniture and other equipment, 2 to 5 years; leasehold improvements, through the life of the lease. When assets are retired or disposed of, the cost and accumulated depreciation thereon are removed and any resultant gains or losses are recognized in current operations.

Goodwill
We account for goodwill using the provisions of SFAS No. 142, "Goodwill and Other Intangibles." SFAS No. 142 addresses financial accounting and reporting requirements for acquired goodwill and other intangible assets. Under SFAS No. 142, goodwill is deemed to have an indefinite useful life and should not be amortized but rather tested at least annually for impairment. An impairment loss should be recognized if the carrying amount of goodwill is not recoverable and its carrying amount exceeds its fair value. In accordance with SFAS No. 142, we have not amortized goodwill during the years ended March 31, 2005, 2004 and 2003.

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.

Allowance for Returns and Price Protection
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 Activision 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: historical performance of titles in similar genres, historical performance of the hardware platform, historical performance of the brand, console hardware life cycle, Activision sales force and retail customer feedback, industry pricing, weeks of on-hand retail channel inventory, absolute quantity of on-hand retail channel inventory, Activision warehouse on-hand inventory levels, the title's recent sell-through history (if available), marketing trade programs and competing titles. 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.

Shipping and Handling

Shipping and handling costs, which consist primarily of packaging and transportation charges incurred to move finished goods to customers, are included in cost of sales—product costs.

Advertising Expenses

We expense advertising as incurred, except for production costs associated with media advertising which are deferred and charged to expense the first time the related ad is run. Advertising expenses for the years ended March 31, 2005, 2004 and 2003 were approximately $150.7 million, $76.6 million and $60.0 million, respectively, and are included in sales and marketing expense in the consolidated statements of operations.

Investment Income, Net

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

Year ended March 31,	**2005**	2004	2003
Interest income	**$12,898**	$6,502	$9,259
Interest expense	**(277)**	(348)	(933)
Net realized gain on short-term investments	**471**	21	234
Investment income, net	**$13,092**	$6,175	$8,560

Income Taxes

We account for income taxes using SFAS No. 109, "Accounting for Income Taxes." Under SFAS No. 109, income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Notes to Consolidated Financial Statements

Foreign Currency Translation

The functional currencies of our foreign subsidiaries are their local currencies. All assets and liabilities of our foreign subsidiaries are translated into U.S. dollars at the exchange rate in effect at the end of the period, and revenue and expenses are translated at weighted average exchange rates during the period. The resulting translation adjustments are reflected as a component of accumulated other comprehensive income (loss) in shareholders' equity.

Comprehensive Income

Comprehensive income includes net income, unrealized appreciation (depreciation) on short-term investments, foreign currency translation adjustments, and the effective portion of gains or losses on cash flow hedges that are presented as a component of accumulated other comprehensive income (loss) in shareholders' equity.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities or the disclosure of gain or loss contingencies 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.

Earnings Per Common Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for all periods. Diluted earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding, increased by common stock equivalents. Common stock equivalents are calculated using the treasury stock method and represent incremental shares issuable upon exercise of our outstanding options and warrants and, if applicable in the period, conversion of our convertible debt. However, potential common shares are not included in the denominator of the diluted earnings per share calculation when inclusion of such shares would be anti-dilutive, such as in a period in which a net loss is recorded.

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 March 31, 2005, we had several stock-based employee compensation plans, which are described more fully in Note 14. We

account for those plans under the recognition and measurement principles of APB Opinion No. 25 and related Interpretations. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

Year ended March 31,	**2005**	2004	2003
Net income, as reported	**$138,335**	$ 77,715	$ 66,180
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	**64**	192	—
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	**(15,435)**	(18,303)	(21,004)
Pro forma net income	**$122,964**	$ 59,604	$ 45,176
Earnings per share			
Basic—as reported	**$ 0.74**	$ 0.44	$ 0.34
Basic—pro forma	**$ 0.66**	$ 0.34	$ 0.23
Diluted—as reported	**$ 0.66**	$ 0.40	$ 0.32
Diluted—pro forma	**$ 0.59**	$ 0.31	$ 0.22

The fair value of options granted in the years ended March 31, 2005, 2004 and 2003 has been estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

	Employee and Director Options and Warrants			Employee Stock Purchase Plan		
	2005	2004	2003	**2005**	2004	2003
Expected life (in years)	**3**	4	3	**0.5**	0.5	0.5
Risk free interest rate	**3.25%**	2.01%	1.51%	**2.66%**	1.75%	1.13%
Volatility	**48%**	49%	69%	**46%**	51%	69%
Dividend yield	**—**	—	—	**—**	—	—

The Black-Scholes option pricing model requires the input of highly subjective assumptions, including the expected stock price volatility. We use the historical stock price volatility of our common stock over the most recent period that is generally commensurate with the expected option life as the basis for estimating expected stock price volatility. In fiscal 2003, the historical stock price volatility used was based on the daily, low stock price of our common stock, which, in recent years, resulted in an expected volatility ranging from approximately 65% to 70%. For options granted during each of the quarters in the years ended March 31, 2005 and 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 ranging from 45% to 48%. Management believes such amounts are more representative of prospective trends. For purposes of the above pro forma disclosure, the fair value of options granted is amortized to stock-based employee compensation cost over the period(s) in which the related employee services are rendered. Accordingly, the pro forma stock-based compensation cost for any period will typically relate to options granted in both the current period and prior periods.

Notes to Consolidated Financial Statements

For options granted during fiscal 2005, 2004 and 2003, the per share weighted average fair value of options with exercise prices equal to market value on the date of grant was $4.11, $2.08 and $3.28, respectively. The per share weighted average estimated fair value of Employee Stock Purchase Plan shares granted during the years ended March 31, 2005, 2004 and 2003 was $2.12, $1.13 and $1.63, respectively.

The effects on pro forma disclosures of applying SFAS No. 123 are not likely to be representative of the effects on pro forma disclosures of future years.

Common stock warrants are granted to non-employees in connection with the development of software and acquisition of licensing rights for intellectual property. In accordance with EITF No. 96-18, "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring or in Conjunction with Selling Goods or Services," the fair value of common stock warrants granted is determined as of the measurement date and is capitalized, expensed and amortized consistent with our policies relating to software development and intellectual property license costs.

Reclassifications

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

The Company has 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. The Company 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. The Company's 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 $301.4 million on the March 31, 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 years ended March 31, 2004 and 2003 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. As of March 31, 2004, before these revisions in classification, $301.4 million of these current investments were classified as cash and cash equivalents on the consolidated balance sheet. For the years ended March 31, 2004 and 2003, as a result of these revisions in classification, net cash used in investing activities related to these current investments increased $155.0 million and $146.4 million, respectively.

2. Stock Splits

In April 2003, the Board of Directors approved a three-for-two split of our outstanding common shares effected in the form of a 50% stock dividend. The split was paid on June 6, 2003 to shareholders of record as of May 16, 2003. In February 2004, the Board of Directors approved a second three-for-two split of our outstanding common shares effected in the form of a 50% stock dividend. The split was paid on March 15, 2004 to shareholders of record as of February 23, 2004. In February 2005, the Board of Directors approved a four-for-three split of our outstanding common shares effected in the form of a 33⅓% stock dividend. The split was paid March 22, 2005 to shareholders of record as of March 7, 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.

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. Acquisitions

During the three years ended March 31, 2005, we separately completed the acquisition of four privately held interactive software development companies. We accounted for these acquisitions in accordance with SFAS No. 141, "Business Combinations." SFAS No. 141 addresses financial accounting and reporting for business combinations, requiring that the purchase method be used to account and report for all business combinations. These acquisitions have further enabled us to implement our multi-platform development strategy by bolstering our internal product development capabilities for console systems and personal computers and strengthening our position in the first-person action, action and action sports game categories. A significant portion of the purchase price for all of these acquisitions was assigned to goodwill as the primary asset we acquired in each of the transactions was an assembled workforce with proven technical and design talent with a history of high quality product creation. Pro forma consolidated statements of operations for these acquisitions are not shown, as they would not differ materially from reported results.

4. Cash, Cash Equivalents and Short-term Investments

The following table summarizes our cash, cash equivalents and short-term investments as of March 31, 2005 (amounts in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash and time deposits	$180,871	$ —	$ —	$180,871
Money market instruments	107,519	—	—	107,519
Commercial paper	21,589	—	(7)	21,582
Corporate bonds	3,638	—	(2)	3,636
Cash and cash equivalents	313,617	—	(9)	313,608
Short-term investments:				
Auction rate notes	15,020	—	—	15,020
Corporate bonds	160,907	6	(1,602)	159,311
U.S. agency issues	266,837	—	(2,037)	264,800
Asset-backed securities	83,517	23	(496)	83,044
Municipal bonds	4,019	—	—	4,019
Common stock	167	895	—	1,062
Short-term investments	530,467	924	(4,135)	527,256
Cash, cash equivalents and short-term investments	$844,084	$924	$(4,144)	$840,864

Notes to Consolidated Financial Statements

The following table summarizes our cash, cash equivalents and short-term investments as of March 31, 2004 (amounts in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash and time deposits	$101,414	$ —	$ —	$101,414
Money market funds	60,006	—	—	60,006
Commercial paper	3,700	—	—	3,700
Cash and cash equivalents	165,120	—	—	165,120
Short-term investments:				
Auction rate notes	301,432	—	—	301,432
Corporate bonds	21,047	13	(24)	21,036
U.S. agency issues	71,817	76	(4)	71,889
Asset-backed securities	23,113	74	(38)	23,149
Municipal bonds	5,023	—	—	5,023
Short-term investments	422,432	163	(66)	422,529
Cash, cash equivalents and short-term investments	$587,552	$163	$ (66)	$587,649

Auction rate securities are securities that 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.

The following table summarizes the maturities of our investments in debt securities as of March 31, 2005 (amounts in thousands):

	Amortized Cost	Fair Value
Due in one year or less	$169,738	$169,028
Due after one year through two years	203,741	201,530
Due after two years through three years	75,256	74,762
Due in three years or more	23,275	23,048
	472,010	468,368
Asset-backed securities	83,517	83,044
Total	$555,527	$551,412

For the year ended March 31, 2005, net realized gains on short-term investments consisted of $471,000 of gross realized gains and no gross realized losses. For the year ended March 31, 2004, net realized gains on short-term investments consisted of $25,000 of gross realized gains and $4,000 of gross realized losses. For the year ended March 31, 2003, net realized gains on short-term investments consisted of $350,000 of gross realized gains and $116,000 of 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 $508,224,000 and $28,583,000 at March 31, 2005 and 2004, respectively, with related gross unrealized losses of $4,144,000 and $66,000, respectively. At March 31, 2005, the gross unrealized losses were comprised mostly of unrealized losses on corporate bonds, U.S. agency issues, and asset-back securities with $464,000 of unrealized loss being in a continuous unrealized loss position for twelve months or greater. At March 31, 2004, the gross unrealized losses were comprised mostly of unrealized losses on corporate bonds, U.S. agency issues, and asset-back securities with $21,000 of unrealized loss being in a continuous unrealized loss position for twelve months or greater.

The Company's 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, the Company reviews 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 the Company's ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery in market value. The Company has 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. The Company expects to realize the full value of all of these investments upon maturity or sale.

5. Software Development Costs and Intellectual Property Licenses

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. As of March 31, 2004, capitalized software development costs included $35.3 million of internally developed software costs and $51.5 million of payments made to third-party software developers. Capitalized intellectual property licenses were $35.7 million and $48.5 million as of March 31, 2005 and 2004, respectively. Amortization and write-offs of capitalized software development costs and intellectual property licenses, combined, was $134.8 million, $87.9 million and $100.4 million for the years ended March 31, 2005, 2004 and 2003, respectively.

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

Notes to Consolidated Financial Statements

6. Inventories

Our inventories consist of the following (amounts in thousands):

March 31,	2005	2004
Purchased parts and components	$ 2,092	$ 392
Finished goods	45,926	26,035
	$ 48,018	$ 26,427

7. Property and Equipment, Net

Property and equipment, net was comprised of the following (amounts in thousands):

March 31,	2005	2004
Land	$ 592	$ 557
Buildings	4,684	4,379
Computer equipment	39,696	34,076
Office furniture and other equipment	14,560	13,687
Leasehold improvements	9,391	5,540
Total cost of property and equipment	68,923	58,239
Less accumulated depreciation	(38,433)	(32,700)
Property and equipment, net	$ 30,490	$ 25,539

Depreciation expense for the years ended March 31, 2005, 2004 and 2003 was $10.6 million, $10.0 million and $8.1 million, respectively.

8. Goodwill

The changes in the carrying amount of goodwill were as follows (amounts in thousands):

	Publishing	Distribution	Total
Balance as of March 31, 2003	$63,194	$4,825	$68,019
Goodwill acquired during the year	3,763	—	3,763
Issuance of contingent consideration	3,246	—	3,246
Adjustment—prior period purchase allocation	695	—	695
Effect of foreign currency exchange rates	—	770	770
Balance as of March 31, 2004	70,898	5,595	76,493
Goodwill acquired during the year	16,194	—	16,194
Issuance of contingent consideration	1,191	—	1,191
Adjustment—prior period purchase allocation	(2,384)	—	(2,384)
Effect of foreign currency exchange rates	—	167	167
Balance as of March 31, 2005	**$85,899**	**$5,762**	**$91,661**

9. Accrued Expenses

Accrued expenses were comprised of the following (amounts in thousands):

March 31,	**2005**	2004
Accrued royalties payable	**$11,851**	$ 7,218
Accrued selling and marketing costs	**17,521**	11,456
Affiliate label program payable	**20,605**	162
Income tax payable	**3,977**	9,897
Accrued bonus and vacation pay	**18,423**	20,042
Other	**25,690**	14,430
Total	**$98,067**	$63,205

10. Operations by Reportable Segments and Geographic Area

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 directly, by license or through our affiliate label program with certain third-party publishers. In the United States, we primarily sell our products on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses and game specialty stores. We conduct our international publishing activities through offices in the UK, Germany, France, Italy, Spain, the Netherlands, 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 located in the UK, the Netherlands and Germany.

Notes to Consolidated Financial Statements

Distribution refers to our operations 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.

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. Transactions between segments are eliminated in consolidation.

Information on the reportable segments for the three years ended March 31, 2005 is as follows (amounts in thousands):

Year ended March 31, 2005	**Publishing**	**Distribution**	**Total**
Total segment revenues	**$1,072,729**	**$333,128**	**$1,405,857**
Revenue from sales between segments	**(111,676)**	**111,676**	**—**
Revenues from external customers	**$ 961,053**	**$444,804**	**$1,405,857**
Operating income	**$ 160,826**	**$ 23,745**	**$ 184,571**
Total assets	**$1,174,910**	**$132,053**	**$1,306,963**

Year ended March 31, 2004	Publishing	Distribution	Total
Total segment revenues	$ 665,732	$281,924	$ 947,656
Revenue from sales between segments	(67,859)	67,859	—
Revenues from external customers	$ 597,873	$349,783	$ 947,656
Operating income	$ 93,223	$ 16,594	$ 109,817
Total assets	$ 859,874	$108,943	$ 968,817

Year ended March 31, 2003	Publishing	Distribution	Total
Total segment revenues	$ 615,975	$248,141	$ 864,116
Revenue from sales between segments	(57,462)	57,462	—
Revenues from external customers	$ 558,513	$305,603	$ 864,116
Operating income	$ 79,139	$ 15,708	$ 94,847
Total assets	$ 619,132	$ 85,684	$ 704,816

Geographic information is based on the location of the selling entity. Revenues from external customers by geographic region were as follows (amounts in thousands):

Year ended March 31,	**2005**	2004	2003
North America	**$ 696,325**	$446,812	$432,261
Europe	**675,074**	479,224	413,125
Other	**34,458**	21,620	18,730
Total	**$ 1,405,857**	$947,656	$864,116

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

Year ended March 31,	**2005**	2004	2003
Console	**$ 970,399**	$732,220	$674,621
Hand-held	**161,977**	43,306	64,069
PC	**273,481**	172,130	125,426
Total	**$ 1,405,857**	$947,656	$864,116

A significant portion of our revenues is derived from products based on a relatively small number of popular brands each year. In fiscal 2005, 37% of our consolidated net revenues (48% of worldwide publishing net revenues) was derived from three brands, which accounted for 16%, 11% and 10%, respectively, of consolidated net revenues (21%, 14% and 13%, respectively, of worldwide publishing net revenues). In fiscal 2004, 35% of our consolidated net revenues (49% of worldwide publishing net revenues) was derived from three brands, which accounted for 17%, 14% and 4%, respectively, of consolidated net revenues (24%, 20% and 5%, respectively, of worldwide publishing net revenues). In fiscal 2003, 38% of our consolidated net revenues (52% of worldwide publishing net revenues) was derived from two brands, one of which accounted for 20% and the other of which accounted for 18% of consolidated net revenues (27% and 25%, respectively, of worldwide publishing net revenues).

Notes to Consolidated Financial Statements

11. Computation of Earnings Per Share

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

Year ended March 31,	**2005**	2004	2003
Numerator:			
Numerator for basic and diluted earnings per share—income available to common shareholders	**$138,335**	$ 77,715	$ 66,180
Denominator:			
Denominator for basic earnings per share—weighted average common shares outstanding	**187,517**	177,665	192,479
Effect of dilutive securities:			
Employee stock options and stock purchase plan	**20,660**	14,723	13,704
Warrants to purchase common stock	**968**	803	1,127
Potential dilutive common shares	**21,628**	15,526	14,831
Denominator for diluted earnings per share—weighted average common shares outstanding plus assumed conversions	**209,145**	193,191	207,310
Basic earnings per share	**$ 0.74**	$ 0.44	$ 0.34
Diluted earnings per share	**$ 0.66**	$ 0.40	$ 0.32

Options to purchase approximately 182,000, 12,628,000 and 10,399,000 shares of common stock for the years ended March 31, 2005, 2004 and 2003, respectively, were not included in the calculation of diluted earnings per share because their effect would be antidilutive.

12. Income Taxes

Domestic and foreign income before income taxes and details of the income tax provision are as follows (amounts in thousands):

Year ended March 31,	**2005**	2004	2003
Income before income taxes:			
Domestic	**$174,535**	$ 84,339	$ 78,761
Foreign	**23,128**	31,653	24,646
Total	**$197,663**	$115,992	$103,407
Income tax expense (benefit):			
Current:			
Federal	**$ (355)**	$ 502	$ 1,703
State	**342**	311	413
Foreign	**5,126**	9,899	7,872
Total current	**5,113**	10,712	9,988
Deferred:			
Federal	**5,744**	14,113	1,794
State	**(2,707)**	(871)	3,065
Foreign	**(2,159)**	1,906	(1,504)
Total deferred	**878**	15,148	3,355
Add back benefit credited to additional paid-in capital:			
Tax benefit related to stock option and warrant exercises	**53,337**	12,417	23,884
Income tax provision	**$ 59,328**	$ 38,277	$ 37,227

Notes to Consolidated Financial Statements

The items accounting for the difference between income taxes computed at the U.S. federal statutory income tax rate and the income tax provision for each of the years are as follows:

Year ended March 31,	**2005**	2004	2003
Federal income tax provision at statutory rate	**35.0%**	35.0%	35.0%
State taxes, net of federal benefit	**2.8**	2.3	2.4
Research and development credits	**(6.4)**	(8.0)	(6.0)
Incremental (decremental) effect of foreign tax rates	**(2.3)**	(2.3)	(0.2)
Increase of valuation allowance	**2.3**	5.8	2.1
Rate changes	**—**	—	0.8
Other	**(1.4)**	0.2	1.9
	30.0%	33.0%	36.0%

Deferred income taxes reflect the net tax effects of temporary differences between the amounts of assets and liabilities for accounting purposes and the amounts used for income tax purposes. The components of the net deferred tax asset and liability are as follows (amounts in thousands):

March 31,	**2005**	2004
Deferred asset:		
Allowance for doubtful accounts	**$ 205**	$ 634
Allowance for sales returns	**8,580**	8,334
Inventory reserve	**391**	385
Vacation and bonus reserve	**2,961**	2,771
Amortization and depreciation	**4,306**	5,036
Tax credit carryforwards	**53,130**	36,599
Net operating loss carryforwards	**31,885**	25,851
Other	**3,899**	2,248
Deferred asset	**105,357**	81,858
Valuation allowance	**(25,666)**	(18,857)
Net deferred asset	**79,691**	63,001
Deferred liability:		
Capitalized research expenses	**41,208**	25,252
State taxes	**3,682**	2,558
Deferred liability	**44,890**	27,810
Net deferred asset	**$ 34,801**	$ 35,191

The tax benefits associated with certain net operating loss carryovers relate to employee stock options. Pursuant to SFAS No. 109, net operating losses have been reduced by $30.9 million relating to these items which will be credited to additional paid-in capital when realized.

As of March 31, 2005, our available federal net operating loss carryforward of approximately $153.5 million is subject to certain limitations as defined under Section 382 of the Internal Revenue Code. The net operating loss carryforwards expire between 2020 and 2024. We have various state net operating loss carryforwards totaling $102.5 million which are not subject to limitations under Section 382 of the Internal Revenue Code. We have tax credit carryforwards of $31.4 million and $22.3 million for federal and state purposes, respectively, which begin to expire in 2006.

At March 31, 2005, our deferred income tax asset for tax credit carryforwards and net operating loss carryforwards was reduced by a valuation allowance of $25.7 million as compared to $18.9 million in the prior fiscal year. Realization of the deferred tax assets is dependent upon the continued generation of sufficient taxable income prior to expiration of tax credits and loss carryforwards. Although realization is not assured, management believes it is more likely than not that the net carrying value of the deferred tax asset will be realized.

Cumulative undistributed earnings of foreign subsidiaries for which no deferred taxes have been provided approximated $59.9 million at March 31, 2005. Deferred income taxes on these earnings have not been provided as these amounts are considered to be permanent in duration.

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 2005, 2006, and 2007 will be limited to 95%, 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.

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 ($15.0 million) and GBP 8.0 million ($14.6 million), including issuing letters of credit, on a revolving basis as of March 31, 2005 and 2004, respectively. Furthermore, under the UK Facility, Centresoft provided a GBP 0.6 million ($1.1 million) and a GBP 0.3 million ($0.5 million) guarantee for the benefit of our CD Contact subsidiary as of March 31, 2005 and 2004, respectively. The UK Facility bore interest at LIBOR plus 2.0% as of March 31, 2005 and 2004, is collateralized by substantially all of the assets of the subsidiary and expires in January 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 March 31, 2005 and 2004, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of March 31, 2005 or 2004. The German Facility provided

Notes to Consolidated Financial Statements

for revolving loans up to EUR 0.5 million ($0.6 million) as of both March 31, 2005 and 2004, 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 March 31, 2005 or 2004.

Developer and Intellectual Property Contracts

In the normal course of business we enter into contractual arrangements with third-parties for the development of products, as well as for the rights to intellectual property. Under these agreements, we commit to provide specified payments to a developer, or intellectual property holder, based upon contractual arrangements. 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. Assuming all contractual provisions are met, the total future minimum contract commitment for contracts in place as of March 31, 2005 is approximately $62.2 million, which is scheduled to be paid as follows (amounts in thousands):

Year ended March 31,	
2006	$45,557
2007	7,975
2008	5,775
2009	2,900
Total	$62,207

Marketing Commitments

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 marketing commitment for contracts in place as of March 31, 2005 is approximately $28.8 million, which is scheduled to be paid as follows (amounts in thousands):

Year ended March 31,	
2006	$18,759
2007	2,500
2008	7,500
Total	$28,759

Lease Obligations

We lease certain of our facilities under non-cancelable operating lease agreements. Total future minimum lease commitments as of March 31, 2005 is approximately $63.4 million, which is scheduled to be paid as follows (amounts in thousands):

Year ended March 31,	
2006	$ 11,990
2007	11,440
2008	7,906
2009	6,620
2010	5,783
Thereafter	19,626
Total	$ 63,365

Facilities rent expense for the years ended March 31, 2005, 2004 and 2003 was approximately $10.6 million, $8.7 million and $7.6 million, respectively.

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 have subsequently been 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. We do not know whether the lead plaintiffs will file an amended consolidated complaint, but in the event that one is filed, we intend to vigorously defend the case at such time.

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 of Los Angeles. This complaint makes the same allegations as the previous complaints, but it names all the current directors as defendants. We strongly deny allegations in both derivative cases and will vigorously defend these cases. In the California derivative case, Activision, as nominal defendant, filed a motion to stay all proceedings. The case, and all motion practice and responsive pleadings, has been held in abeyance pending a status conference with the court. In the Federal derivative case, plaintiff filed a notice of dismissal of the action, without prejudice on or about June 3, 2005.

On July 11, 2003, we were informed by the staff of the Securities and Exchange Commission that the Securities and Exchange Commission has commenced a non-public formal investigation captioned “In the Matter of Certain Video Game Manufacturers and Distributors.” The investigation appears to be focused on certain accounting practices common to the interactive entertainment industry, with specific emphasis on revenue recognition. In connection with this inquiry, the Securities and Exchange Commission submitted to us a request for information. We responded to this inquiry on September 2, 2003. To date, we have not received a request from the Securities and Exchange Commission for any additional information. The Securities and Exchange Commission staff also informed us that other companies in the video game industry received similar requests for information. The Securities and Exchange Commission has advised us that this request for information should not be construed as an indication from the Securities and Exchange Commission or its staff that any violation of the law has occurred, nor should it reflect negatively on any person, entity or security. We have cooperated and intend to continue to cooperate fully with the Securities and Exchange Commission in the conduct of this inquiry.

Notes to Consolidated Financial Statements

On June 30, 2003, we terminated our Star Trek Merchandising License Agreement with Viacom Consumer Products, Inc. and filed a complaint in the Superior Court of the State of California for breach of contract and constructive trust against Viacom Consumer Products and Viacom International, Inc. ("Viacom"). On August 15, 2003, Viacom filed its response to our complaint as well as a cross-complaint alleging, among other matters, a breach of contract by Activision and seeking claimed damages in excess of $50 million. On February 23, 2005, we reached an agreement with Viacom that settled the legal disputes. As a result of the settlement, all pending lawsuits filed by each party in the Superior Court in Los Angeles regarding this matter have been dismissed by court order dated March 18, 2005. The settlement had no material impact on the financial results of Activision's operations.

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. Stock Compensation and Employee Benefit Plans

Stock Option Plans

We sponsor several stock option plans for the benefit of officers, employees, consultants and others.

On February 28, 1992, the shareholders of Activision approved the Activision 1991 Stock Option and Stock Award Plan, as amended, (the "1991 Plan") which permits the granting of "Awards" in the form of non-qualified stock options, incentive stock options ("ISOs"), stock appreciation rights ("SARs"), restricted stock awards, deferred stock awards and other common stock-based awards to directors, officers, employees, consultants and others. The total number of shares of common stock available for distribution under the 1991 Plan is 34,050,000. The 1991 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were no shares remaining available for grant under the 1991 Plan as of March 31, 2005.

On September 23, 1998, the shareholders of Activision approved the Activision 1998 Incentive Plan, as amended (the "1998 Plan"). The 1998 Plan permits the granting of "Awards" in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred stock awards and other common stock-based awards to directors, officers, employees, consultants and others. The total number of shares of common stock available for distribution under the 1998 Plan is 13,500,000. The 1998 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 21,200 shares remaining available for grant under the 1998 Plan as of March 31, 2005.

On April 26, 1999, the Board of Directors approved the Activision 1999 Incentive Plan, as amended (the "1999 Plan"). The 1999 Plan permits the granting of "Awards" in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred share awards and other common stock-based awards to directors, officers, employees, consultants and others. The total number of shares of common stock available for distribution under the 1999 Plan is 22,500,000. The 1999 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 17,900 shares remaining available for grant under the 1999 Plan as of March 31, 2005.

On August 23, 2001, the shareholders of Activision approved the Activision 2001 Incentive Plan, as amended (the "2001 Plan"). The 2001 Plan permits the granting of "Awards" in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred stock awards and other common stock-based awards to directors, officers, employees, consultants and others. The total number of shares of common stock available for distribution under the 2001 Plan is 6,750,000. The 2001 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 284,500 shares remaining available for grant under the 2001 Plan as of March 31, 2005.

On April 4, 2002, the Board of Directors approved the Activision 2002 Incentive Plan (the "2002 Plan"). The 2002 Plan permits the granting of "Awards" in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred share awards and other common stock-based awards to officers (other than executive officers), employees, consultants, advisors and others. The 2002 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. The total number of shares of common stock available for distribution under the 2002 Plan is 13,050,000. There were approximately 21,200 shares remaining available for grant under the 2002 Plan as of March 31, 2005.

On September 19, 2002, the shareholders of Activision approved the Activision 2002 Executive Incentive Plan (the "2002 Executive Plan"). The 2002 Executive Plan permits the granting of "Awards" in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred share awards and other common stock-based awards to officers, employees, directors, consultants and advisors. The total number of shares of common stock available for distribution under the 2002 Executive Plan is 7,500,000. The 2002 Executive Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 6,500 shares remaining available for grant under the 2002 Executive Plan as of March 31, 2005.

On December 16, 2002, the Board of Directors approved the Activision 2002 Studio Employee Retention Incentive Plan, as amended (the "2002 Studio Plan"). The 2002 Studio Plan permits the granting of "Awards" in the form of non-qualified stock options and restricted stock awards to key studio employees (other than executive officers) of Activision, our subsidiaries and affiliates and to contractors and others. The 2002 Studio Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. The total number of shares of common stock available for distribution under the 2002 Studio Plan is 4,500,000. There were approximately 3,100 shares remaining available for grant under the 2002 Studio Plan as of March 31, 2005.

On April 29, 2003, our Board of Directors approved the Activision 2003 Incentive Plan (the "2003 Plan"). The 2003 Plan permits the granting of "Awards" in the form of non-qualified stock options, SARs, restricted stock awards, deferred stock awards and other common stock-based awards to directors, officers, employees, consultants and others. The 2003 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. The total number of shares of common stock available for distribution under the 2003 Plan is 18,000,000. There were approximately 16,394,600 shares remaining available for grant under the 2003 Plan as of March 31, 2005.

The exercise price for Awards issued under the 1991 Plan, 1998 Plan, 1999 Plan, 2001 Plan, 2002 Plan, 2002 Executive Plan, 2002 Studio Plan and 2003 Plan (collectively, the "Plans") is determined at the discretion of the Board of Directors (or the Compensation Committee of the Board of Directors, which administers the Plans), and for ISOs, is not to be less than the fair market value of our common stock at the date of grant, or in the case of non-qualified options, must exceed or be equal to 85% of the fair market value of our common stock at the date of grant. Options typically become exercisable in installments over a period not to exceed seven years and must be exercised within 10 years of the date of grant. However, certain options granted to executives vest immediately. Historically, stock options have been granted with exercise prices equal to or greater than the fair market value at the date of grant.

Other Employee Stock Options

In connection with prior employment agreements between Activision and Robert A. Kotick, Activision's Chairman and Chief Executive Officer, and Brian G. Kelly, Activision's Co-Chairman, Mr. Kotick and Mr. Kelly were granted options to purchase common stock. The Board of Directors approved the granting of these options. Relating to such grants, as of March 31, 2005, approximately 6,228,600 shares were outstanding with a weighted average exercise price of $2.32.

We additionally have approximately 70,900 options outstanding to employees as of March 31, 2005, with a weighted average exercise price of $4.64. The Board of Directors approved the granting of these options. Such options have terms similar to those options granted under the Plans.

Director Warrants

During the fiscal year ended March 31, 1997, we issued warrants to purchase 180,000 shares of our common stock, at exercise prices ranging from $2.63 to $3.08 to two of our outside directors in connection with their election to the Board. Such warrants vested 25% on the first anniversary of the date of grant, and 12.5% each six months thereafter and expire within 10 years from the date of grant. Relating to such warrants, as of March 31, 2005, no shares were outstanding.

Notes to Consolidated Financial Statements

Employee Stock Purchase Plans

On July 22, 2002, the Board of Directors approved the 2002 Employee Stock Purchase Plan for eligible domestic employees. The shareholders of Activision subsequently approved the 2002 Employee Stock Purchase Plan on September 19, 2002. Then, on February 11, 2003, the Board of Directors approved the 2002 Employee Stock Purchase Plan For International Employees. The primary terms of the 2002 Employee Stock Purchase Plan and the 2002 Employee Stock Purchase Plan For International Employees (collectively the “2002 Purchase Plans”) are the same. Under the 2002 Purchase Plans, up to 1,125,000 shares of our common stock may be purchased by eligible employees during two overlapping, twelve-month offering periods that commence each April 1 and October 1 (the “Offering Period”). At any point in time, employees may participate in only one Offering Period. The first day of each Offering Period is referred to as the “Offering Date.” Common stock is purchased by 2002 Purchase Plans participants at 85% of the lesser of fair market value on the Offering Date for the Offering Period that includes the common stock purchase date or the fair market value on the common stock purchase date. Employees may purchase shares having a value not exceeding 15% of their gross compensation during an Offering Period, limited to a maximum of 15,000 common shares per common stock purchase date. During the year ended March 31, 2005, employees purchased approximately 147,800, 50,500 and 262,300 shares at a price of $8.84, $5.29 and $8.61 per share, respectively, within the 2002 Purchase Plans’ Offering Periods. During the year ended March 31, 2004, employees purchased approximately 323,100, 80,000 and 340,400 shares at a price of $4.11, $5.30 and $4.11 per share, respectively, within the 2002 Purchase Plans’ Offering Periods.

Activity of Employee and Director Options and Warrants

Activity of all employee and director options and warrants during the last three fiscal years was as follows (amounts in thousands, except weighted average exercise price amounts):

	2005		2004		2003	
	Shares	**Wtd. Avg. Ex. Price**	Shares	Wtd. Avg. Ex. Price	Shares	Wtd. Avg. Ex. Price
Outstanding at beginning of year	**48,851**	**$ 4.94**	48,947	$4.76	38,591	$3.13
Granted	**5,626**	**11.76**	9,060	5.42	19,231	7.11
Exercised	**(16,625)**	**3.87**	(6,113)	3.65	(7,567)	2.42
Forfeited	**(1,273)**	**3.79**	(3,043)	6.05	(1,308)	4.33
Outstanding at end of year	**36,579**	**$ 6.45**	48,851	$4.94	48,947	$4.76
Exercisable at end of year	**18,885**	**$ 5.22**	26,133	$3.95	22,992	$3.22

For the years ended March 31, 2005, 2004 and 2003, all options were granted at an exercise price equal to the fair market value on the date of grant.

The following tables summarize information about all employee and director stock options and warrants outstanding as of March 31, 2005 (share amounts in thousands):

	Outstanding Options			Exercisable Options	
	Shares	Remaining Wtd. Avg. Contractual Life (in years)	Wtd. Avg. Exercise Price	Shares	Wtd. Avg. Exercise Price
Range of exercise prices:					
$ 1.33 to $ 2.29	758	5.11	$ 1.49	755	$ 1.48
$ 2.31 to $ 2.33	6,142	3.98	2.33	6,142	2.33
$ 2.35 to $ 4.51	3,891	7.31	4.14	1,097	3.42
$ 4.56 to $ 4.72	4,834	7.37	4.69	2,904	4.68
$ 4.72 to $ 6.25	3,887	7.53	5.47	1,366	5.54
$ 6.25 to $ 7.45	1,696	7.96	7.06	300	6.96
$ 7.54 to $ 7.65	4,324	7.32	7.65	1,822	7.65
$ 7.73 to $ 9.20	4,814	7.12	8.98	3,215	9.02
$ 9.22 to $11.44	4,896	8.93	10.69	1,284	10.23
$11.45 to $17.85	1,337	9.74	14.76	—	—
	36,579	7.05	$ 6.45	18,885	$ 5.22

Non-Employee Warrants

In prior years, we have granted stock warrants to third-parties in connection with the development of software and the acquisition of licensing rights for intellectual property. The warrants generally vest upon grant and are exercisable over the term of the warrant. The exercise price of third-party warrants is generally greater than or equal to their fair market value of our common stock at the date of grant. No third-party warrants were granted during the year ended March 31, 2005. As of March 31, 2005, 702,000 third-party warrants to purchase common stock were outstanding with a weighted average exercise price of $6.04 per share. No third-party warrants were granted during the year ended March 31, 2004. As of March 31, 2004, 2,052,000 third-party warrants to purchase common stock were outstanding with a weighted average exercise price of $7.13 per share. During the year ended March 31, 2003, we granted warrants to a third-party to purchase 450,000 shares of our common stock at an exercise price of $9.92 per share in connection with, and as partial consideration for, a license agreement that allows us to utilize intellectual property owned by the third-party in conjunction with an Activision product. The warrants vested upon grant and have a three-year term. The fair value of the warrants was determined using the Black-Scholes pricing model, assuming a risk-free rate of 4.18%, a volatility factor of 70% and expected term as noted above. The per share weighted average estimated fair value of the third-party warrants granted during the year ended March 31, 2003 was $4.85 per share. As of March 31, 2003, 2,646,000 third-party warrants to purchase common stock were outstanding with a weighted average exercise price of $4.69 per share.

In accordance with EITF 96-18, we measure the fair value of the securities on the measurement date. The fair value of each warrant is capitalized and amortized to expense when the related product is released and the related revenue is recognized. Additionally, as more fully described in Note 1, the recoverability of capitalized software development costs and intellectual property licenses is evaluated on a quarterly basis with amounts determined as not recoverable being charged to expense. In connection with the evaluation of capitalized software development costs and intellectual property licenses, any capitalized amounts for related third-party warrants are additionally reviewed for recoverability with amounts determined as not recoverable being amortized to expense. For the years ended March 31, 2005, 2004 and 2003, $1.6 million, $0.2 million and $3.6 million, respectively, was amortized and included in cost of sales—software royalties and amortization and/or cost of sales—intellectual property licenses.

Notes to Consolidated Financial Statements

Employee Retirement Plan

We have a retirement plan covering substantially all of our eligible employees. The retirement plan is qualified in accordance with Section 401(k) of the Internal Revenue Code. Under the plan, employees may defer up to 92% of their pre-tax salary, but not more than statutory limits. Effective January 1, 2003, we contribute 20% of each dollar contributed by a participant. Prior to January 1, 2003, we contributed 5% of each dollar contributed by a participant. Our matching contributions to the plan were approximately $905,000, $700,000, and $320,000 during the years ended March 31, 2005, 2004 and 2003, respectively.

15. Capital Transactions

Buyback Program

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, from time to time and within certain guidelines, 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.

Under the buyback program, we did not repurchase any shares of our common stock in the year ended March 31, 2005. We repurchased approximately 2.5 million shares of our common stock for $12.4 million and 21.6 million shares of our common stock for $101.4 million, in the years ended March 31, 2004 and 2003, respectively. In addition, approximately 2.3 million shares of common stock were acquired in the year ended March 31, 2004 as a result of the settlement of $10.0 million of structured stock repurchase transactions entered into in fiscal 2003. As of March 31, 2005, we had no outstanding structured stock repurchase transactions. Structured stock repurchase transactions are settled in cash or stock based on the market price of our common stock on the date of the settlement. Upon settlement, we either have our capital investment returned with a premium or receive shares of our common stock, depending, respectively, on whether the market price of our common stock is above or below a pre-determined price agreed in connection with each such transaction. These transactions are recorded in shareholders' equity in the accompanying consolidated balance sheets. As of March 31, 2005, we had approximately $226.2 million available for utilization under the buyback program and no outstanding stock repurchase transactions.

Shelf Registrations

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.

Shareholders' Rights Plan

On April 18, 2000, our Board of Directors approved a shareholders rights plan (the "Rights Plan"). Under the Rights Plan, each common shareholder at the close of business on April 19, 2000, received a dividend of one right for each share of common stock held. Each right represents the right to purchase two nine-hundredths (2/900) of a share, as adjusted on account of stock dividends made since the plan's adoption, of our Series A Junior Preferred Stock at an exercise price of $8.89, as adjusted on account of stock dividends made since the plan's adoption. Initially, the rights are represented by our common stock certificates and are neither exercisable nor traded separately from our common stock. The rights will only become exercisable if a person or group acquires 15% or more of the common stock of Activision, or announces or commences a tender or exchange offer which would result in the bidder's beneficial ownership of 15% or more of our common stock.

In the event that any person or group acquires 15% or more of our outstanding common stock each holder of a right (other than such person or members of such group) will thereafter have the right to receive upon exercise of such right, in lieu of shares of Series A Junior Preferred Stock, the number of shares of common stock of Activision having a value equal to two times the then current exercise price of the right. If we are acquired in a merger or other business combination transaction after a person has acquired 15% or more of our common stock, each holder of a right will thereafter have the right to receive upon exercise of such right a number of the acquiring company's common shares having a market value equal to two times the then current exercise price of the right. For persons who, as of the close of business on April 18, 2000, beneficially own 15% or more of the common stock of Activision, the Rights Plan "grandfathers" their current level of ownership, so long as they do not purchase additional shares in excess of certain limitations.

We may redeem the rights for $.01 per right at any time until the first public announcement of the acquisition of beneficial ownership of 15% of our common stock. At any time after a person has acquired 15% or more (but before any person has acquired more than 50%) of our common stock, we may exchange all or part of the rights for shares of common stock at an exchange ratio of one share of common stock per right. The rights expire on April 18, 2010.

16. Accumulated Other Comprehensive Income (Loss)

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

	Foreign Currency	Unrealized Appreciation (Depreciation) on Investments	Accumulated Other Comprehensive Income (Loss)
Balance, March 31, 2004	$ 9,864	$ 97	$ 9,961
Comprehensive income (loss)	4,974	(3,317)	1,657
Balance, March 31, 2005	**$14,838**	**$(3,220)**	**$11,618**

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

17. Supplemental Cash Flow Information

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

Year ended March 31,	**2005**	2004	2003
Non-cash investing and financing activities:			
Subsidiaries acquired with common stock	**$ 1,191**	$ 3,246	$10,861
Adjustment—prior period purchase allocation	**(2,384)**	—	—
Issuance of options and common stock warrants	**—**	—	2,184
Stock offering costs	**—**	—	781
Change in unrealized appreciation (depreciation) on short-term investments	**(3,317)**	(37)	134
Supplemental cash flow information:			
Cash paid for income taxes	**$12,178**	$10,463	$ 5,491
Cash received for interest, net	**10,543**	6,213	7,804

Notes to Consolidated Financial Statements

18. Quarterly Financial and Market Information (Unaudited)

(Amounts in thousands, except per share data)	Quarter ended June 30	Sept. 30	Dec. 31	Mar. 31	Year ended
Fiscal 2005:					
Net revenues	**$211,276**	**$310,626**	**$680,094**	**$203,861**	**$1,405,857**
Operating income (loss)	**15,733**	**34,658**	**137,079**	**(2,899)**	**184,571**
Net income	**11,957**	**25,543**	**97,262**	**3,573**	**138,335**
Basic earnings per share	**0.07**	**0.14**	**0.52**	**0.02**	**0.74**
Diluted earnings per share	**0.06**	**0.13**	**0.47**	**0.02**	**0.66**
Common stock price per share:					
High	**12.82**	**12.30**	**15.38**	**18.71**	**18.71**
Low	**10.31**	**9.12**	**9.36**	**13.59**	**9.12**
Fiscal 2004:					
Net revenues	$158,725	$117,523	$508,511	$162,897	$ 947,656
Operating income (loss)	5,146	(16,933)	116,961	4,643	109,817
Net income (loss)	4,163	(10,093)	76,981	6,664	77,715
Basic earnings (loss) per share	0.02	(0.06)	0.43	0.04	0.44
Diluted earnings (loss) per share	0.02	(0.06)	0.40	0.03	0.40
Common stock price per share:					
High	6.75	7.19	9.55	12.13	12.13
Low	4.51	5.43	5.79	8.54	4.51

19. 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 No. 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 No. 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 the Company no later than April 1, 2006. Early adoption will be permitted in periods in which financial statements have not yet been issued. The Company expects 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 No. 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 No. 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company has not yet determined which method it will use.

As permitted by SFAS No. 123, the Company currently accounts for share-based payments to employees using Opinion 25's intrinsic value method and, as such, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123R's fair value method will have a significant impact on the Company's results of operations, although it will have no impact on its overall financial position. The impact of adoption of SFAS No. 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future.

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. The Company expects 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 Company expects the adoption of SFAS No. 153 will not have a material impact on our financial position or results of operations.

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 2005, 2006, and 2007 will be limited to 95%, 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.

20. Subsequent Events

On April 4, 2005, we held a Special Meeting of Stockholders in Santa Monica, California. One item was submitted to a vote of the stockholders: To approve an amendment to the Company's Amended and Restated Certificate of Incorporation, as amended, to increase the number of authorized shares of common stock from 225,000,000 to 450,000,000. The amendment to the Company's Amended and Restated Certificate of Incorporation, as amended, to increase the number of authorized shares of common stock from 225,000,000 to 450,000,000 was approved.

Non-GAAP Disclosures

Free Cash Flow

(In thousands)	Three Months Ended 3/31/05	12/31/04	9/30/04	6/30/04	3/31/04
Net Cash Provided by (Used In) Operating Activities	$ 118,931	$ 85,668	$ 62,846	$ (52,136)	$ 21,069
Less: Capital Expenditures	$ (6,911)	$ (3,587)	$ (2,562)	$ (1,881)	$ (2,521)
Free Cash Flow	$ 112,020	$ 82,081	$ 60,284	$ (54,017)	$ 18,548
Trailing Twelve Month Free Cash Flow	$ 200,368	$ 106,896	$ 121,998	$ 30,779	$ 55,427

Return on Invested Capital

(In thousands)	Three Months Ended 3/31/05	12/31/04	9/30/04	6/30/04	3/31/04
NET OPERATING PROFIT AFTER TAXES					
Net income	$ 3,573	$ 97,262	$ 25,543	$ 11,957	$ 6,664
Less:					
Investment income	(5,138)	(3,197)	(2,645)	(2,112)	(2,051)
Tax effect on Investment income[(B)]	1,394	991	846	697	677
Net Operating Profit After Taxes	$ (171)	$ 95,056	$ 23,744	$ 10,542	$ 5,290
Trailing Twelve Month Net Operating Profit After Taxes	$ 129,171	$ 134,632	$ 115,576	$ 80,826	$ 73,630
INVESTED CAPITAL					
Total assets	$1,306,963	$1,344,629	$1,104,169	$985,841	$968,817
Less:					
Cash and short-term investments	840,864	713,180	606,087	539,146	587,649
Current liabilities (non-interest bearing)	207,051	311,433	216,342	132,092	136,079
Invested capital	$ 259,048	$ 320,016	$ 281,740	$314,603	$245,089
Trailing Twelve Month Invested capital[(A)]	284,100	282,288	268,816	260,784	236,584
Return on Invested Capital[(C)]	0%	30%	8%	3%	2%
Trailing Twelve Month Return on Invested Capital[(C)]	45%	48%	43%	31%	31%

(A) Amounts for the trailing twelve months represent averages of the previous four fiscal quarters.
(B) Tax effect represents investment income multiplied by our effective tax rate.
(C) Return on Invested Capital and Trailing Twelve Month Return on Invested Capital is the percentage of Net Operating Profit After Taxes to Invested Capital, and the percentage of Trailing Twelve Month Net Operating Profit After Taxes to Trailing Twelve Month Invested Capital, respectively.

Market for Registrant's Common Equity and Related Stockholder Matters

Our common stock is quoted on the Nasdaq National Market under the symbol "ATVI."

The following table sets forth for the periods indicated the high and low reported sale prices for our common stock. As of May 31, 2005, there were approximately 2,808 holders of record of our common stock.

	High	Low
Fiscal 2004		
First Quarter ended June 30, 2003	$ 6.75	$ 4.51
Second Quarter ended September 30, 2003	7.19	5.43
Third Quarter ended December 31, 2003	9.55	5.79
Fourth Quarter ended March 31, 2004	12.13	8.54
Fiscal 2005		
First Quarter ended June 30, 2004	**$12.82**	**$10.31**
Second Quarter ended September 30, 2004	**12.30**	**9.12**
Third Quarter ended December 31, 2004	**15.38**	**9.36**
Fourth Quarter ended March 31, 2005	**18.71**	**13.59**

On May 31, 2005, the last reported sales price of our common stock was $15.80.

Cash Dividends

We paid no cash dividends in our fiscal years 2005 or 2004 nor do we anticipate paying any cash dividends at any time in the foreseeable future. We expect that earnings will be retained for the continued growth and development of the business. Future dividends, if any, will depend upon our earnings, financial condition, cash requirements, future prospects and other factors deemed relevant by our Board of Directors.

Stock Splits

In April 2003, the Board of Directors approved a three-for-two split of our outstanding common shares effected in the form of a 50% stock dividend. The split was paid on June 6, 2003 to shareholders of record as of May 16, 2003. In February 2004, the Board of Directors approved a second three-for-two split of our outstanding common shares effected in the form of a 50% stock dividend. The split was paid on March 15, 2004 to shareholders of record as of February 23, 2004. In February 2005, the Board of Directors approved a four-for-three split of our outstanding common shares effected in the form of a 33⅓% stock dividend. The split was paid on March 22, 2005 to shareholders of record as of March 7, 2005. The par value of our common stock was maintained at the pre-split amount of $.000001. All share and per share data have been restated as if the stock splits had occurred as of the earliest period presented.

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.

Corporate Information

Officers

Robert A. Kotick
Chairman and Chief Executive Officer

Brian G. Kelly
Co-Chairman

Ronald Doornink
President, Activision, Inc. and Chairman, Activision Publishing, Inc.

Michael Griffith
President and Chief Executive Officer, Activision Publishing, Inc.

Kathy P. Vrabeck
President, Activision Publishing

William J. Chardavoyne
Chief Financial Officer and Executive Vice President

Michael J. Rowe
Executive Vice President, Human Resources

Richard Steele
President, Activision Distribution and Executive Vice President, International Distribution

George L. Rose
Senior Vice President, Business and Legal Affairs, General Counsel and Secretary

Board of Directors

Robert A. Kotick
Chairman and Chief Executive Officer

Brian G. Kelly
Co-Chairman

Ronald Doornink
President, Activision, Inc. and Chairman, Activision Publishing, Inc.

Robert J. Corti
Chief Financial Officer, Avon Products, Inc.

Kenneth L. Henderson
Partner, Bryan Cave LLP

Barbara S. Isgur
Former Senior Vice President, Stratagem

Robert J. Morgado
Chairman, Maroley Media Group

Peter J. Nolan
Managing Partner, Leonard Green & Partners L.P.

Transfer Agent

Continental Stock Transfer & Trust Company
17 Battery Place
New York, New York 10004
(212) 509-4000

Auditor

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Los Angeles, California

Bank

US Bank
Los Angeles, California

Corporate Counsel

Bryan Cave LLP
New York, New York

Corporate Headquarters

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Foster City, California
Los Angeles, California
Madison, Wisconsin
New York, New York
Novato, California
San Francisco, California
Troy, New York
Woodland Hills, California

International Offices

Bezons, France
Birmingham, United Kingdom
Breda, The Netherlands
Burglengenfeld, Germany
Legnano, Italy
Madrid, Spain
Ontario, Canada
Quebec City, Canada
Slough, United Kingdom
Stockholm, Sweden
Sydney, Australia
Tokyo, Japan
Venlo, The Netherlands

Forward-Looking Statement

The statements contained in this report that are not historical facts are "forward-looking statements." The Company cautions readers of this report that a number of important factors could cause Activision's actual future results to differ materially from those expressed in any such forward-looking statements. These important factors, and other factors that could affect Activision, are described in Activision's Annual Report on Form 10-K for the fiscal year ended March 31, 2005, which was filed with the United States Securities and Exchange Commission. Readers of this Annual Report are referred to this filing.

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Annual Meeting

September 15, 2005
Bryan Cave LLP
120 Broadway, Suite 300
Santa Monica, California 90401

Annual Report on Form 10-K

Activision's Annual Report on Form 10-K for the year ended March 31, 2005 is available to shareholders without charge upon request from our corporate offices.

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