

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark one)

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

For the Quarterly Period Ended June 30, 2005

OR

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

For the transition period from            to

Commission File Number 0-12699

**ACTIVISION, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**95-4803544**

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

**3100 Ocean Park Boulevard, Santa Monica, CA**

(Address of principal executive offices)

**90405**

(Zip Code)

**(310) 255-2000**

(Registrant's telephone number, including area code)

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

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

The number of shares of the registrant's Common Stock outstanding as of July 29, 2005 was 203,622,364.

**ACTIVISION, INC. AND SUBSIDIARIES**

**INDEX**

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

Consolidated Balance Sheets as of June 30, 2005 (Unaudited) and March 31, 2005

Consolidated Statements of Operations for the three months ended June 30, 2005 and 2004 (Unaudited)

Consolidated Statements of Cash Flows for the three months ended June 30, 2005 and 2004 (Unaudited)

Consolidated Statement of Changes in Shareholders' Equity for the three months ended June 30, 2005 (Unaudited)

Notes to Consolidated Financial Statements for the three months ended June 30, 2005 (Unaudited)

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

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

**Item 4. Controls and Procedures**

[PART II.](#)      [OTHER INFORMATION](#)

[Item 1.](#)      [Legal Proceedings](#)

[Item 5.](#)      [Other Information](#)

[Item 6.](#)      [Exhibits](#)

[SIGNATURES](#)

[CERTIFICATIONS](#)

**Part I. Financial Information.**

**Item 1. Financial Statements.**

**ACTIVISION, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

(In thousands, except share data)

	<u>June 30, 2005</u> (Unaudited)	<u>March 31, 2005</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 242,341	\$ 313,608
Short-term investments	543,558	527,256
Accounts receivable, net of allowances of \$76,842 and \$69,191 at June 30, 2005 and March 31, 2005, respectively	94,804	109,144
Inventories	45,136	48,018
Software development	97,825	73,096
Intellectual property licenses	14,336	21,572
Deferred income taxes	8,568	6,760
Other current assets	23,237	23,010
Total current assets	1,069,805	1,122,464
Software development	9,764	18,518
Intellectual property licenses	20,605	14,154
Property and equipment, net	31,911	30,490
Deferred income taxes	35,536	28,041
Other assets	1,299	1,635
Goodwill	98,527	91,661
Total assets	<u>\$ 1,267,447</u>	<u>\$ 1,306,963</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 65,447	\$ 108,984
Accrued expenses	88,558	98,067
Total current liabilities	154,005	207,051
Other liabilities	93	—
Total liabilities	154,098	207,051
Commitments and contingencies (Note 14)		
Shareholders' equity:		
Preferred stock, \$.000001 par value, 3,750,000 shares authorized, no shares issued at June 30, 2005 and March 31, 2005	—	—
Series A Junior Preferred stock, \$.000001 par value, 1,250,000 shares authorized, no shares issued at June 30, 2005 and March 31, 2005	—	—
Common stock, \$.000001 par value, 450,000,000 and 225,000,000 shares authorized, 203,042,745 and 201,030,623 shares issued and outstanding at June 30, 2005 and March 31, 2005, respectively	—	—
Additional paid-in capital	764,560	741,680
Retained earnings	343,029	346,614
Accumulated other comprehensive income	7,743	11,618
Unearned compensation	(1,983)	—
Total shareholders' equity	1,113,349	1,099,912
Total liabilities and shareholders' equity	<u>\$ 1,267,447</u>	<u>\$ 1,306,963</u>

**ACTIVISION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)  
(In thousands, except per share data)

	<u>For the three months ended June 30,</u>	
	<u>2005</u>	<u>2004</u>
Net revenues	\$ 241,093	\$ 211,276
Costs and expenses:		
Cost of sales – product costs	136,754	89,088
Cost of sales – software royalties and amortization	14,576	12,283
Cost of sales – intellectual property licenses	20,940	17,648
Product development	17,802	21,105
Sales and marketing	46,318	41,734
General and administrative	18,151	13,685
Total costs and expenses	<u>254,541</u>	<u>195,543</u>
Operating income (loss)	(13,448)	15,733
Investment income, net	7,348	2,112
Income (loss) before income tax provision (benefit)	(6,100)	17,845
Income tax provision (benefit)	(2,515)	5,888
Net income (loss)	<u>\$ (3,585)</u>	<u>\$ 11,957</u>
Basic earnings (loss) per share	<u>\$ (0.02)</u>	<u>\$ 0.07</u>
Weighted average common shares outstanding	<u>201,856</u>	<u>183,686</u>
Diluted earnings (loss) per share	<u>\$ (0.02)</u>	<u>\$ 0.06</u>
Weighted average common shares outstanding assuming dilution	<u>201,856</u>	<u>204,539</u>

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

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

	<u>For the three months ended June 30,</u>	
	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Net income (loss)	\$ (3,585)	\$ 11,957
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Deferred income taxes	(9,304)	5,028
Realized gain on sale of short term investments	(1,343)	—
Depreciation and amortization	3,161	2,579
Amortization of capitalized software development costs and intellectual property licenses	21,815	31,750
Amortization of stock compensation expenses	17	—
Tax benefit of stock options	6,769	3,597
Changes in operating assets and liabilities (net of effects of acquisitions):		
Accounts receivable	14,383	(60,471)
Inventories	2,882	(13,208)
Software development and intellectual property licenses	(37,005)	(26,694)
Other assets	943	(2,687)
Accounts payable	(43,532)	2,684
Accrued expenses and other liabilities	(9,676)	(6,671)
Net cash used in operating activities	<u>(54,475)</u>	<u>(52,136)</u>
Cash flows from investing activities:		
Capital expenditures	(5,231)	(1,881)

Cash payments to effect business combinations, net of cash acquired	(6,925)	—
Increase in restricted cash	(7,500)	—
Purchases of short-term investments	(73,756)	(186,167)
Proceeds from sales and maturities of short-term investments	66,892	211,657
Net cash provided by (used in) investing activities	(26,520)	23,609
Cash flows from financing activities:		
Proceeds from issuance of common stock to employees	13,169	8,034
Net cash provided by financing activities	13,169	8,034
Effect of exchange rate changes on cash	(3,441)	(1,303)
Net decrease in cash and cash equivalents	(71,267)	(21,796)
Cash and cash equivalents at beginning of period	313,608	165,120
Cash and cash equivalents at end of period	\$ 242,341	\$ 143,324

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

5

**ACTIVISION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**  
For the three months ended June 30, 2005  
(Unaudited)  
(In thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned Compensation	Shareholders' Equity
	Shares	Amounts					
<b>Balance, March 31, 2005</b>	<b>201,031</b>	<b>\$ —</b>	<b>\$ 741,680</b>	<b>\$ 346,614</b>	<b>\$ 11,618</b>	<b>\$ —</b>	<b>\$ 1,099,912</b>
Components of comprehensive income:							
Net loss	—	—	—	(3,585)	—	—	(3,585)
Unrealized appreciation on short-term investments	—	—	—	—	595	—	595
Foreign currency translation adjustment	—	—	—	—	(4,470)	—	(4,470)
Total comprehensive loss							(7,460)
Issuance of common stock pursuant to employee stock option and stock purchase plans	1,952	—	13,169	—	—	—	13,169
Tax benefit attributable to employee stock options	—	—	6,769	—	—	—	6,769
Issuance of stock to effect business combination	60	—	942	—	—	—	942
Restricted stock grant	—	—	2,000	—	—	(2,000)	—
Amortization of unearned compensation	—	—	—	—	—	17	17
<b>Balance, June 30, 2005</b>	<b>203,043</b>	<b>\$ —</b>	<b>\$ 764,560</b>	<b>\$ 343,029</b>	<b>\$ 7,743</b>	<b>\$ (1,983)</b>	<b>\$ 1,113,349</b>

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

6

**ACTIVISION, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**  
**For the three months ended June 30, 2005**

**1. Summary of Significant Accounting Policies**

*Basis of Presentation*

The accompanying consolidated financial statements include the accounts of Activision, Inc. and its subsidiaries ("Activision" or "we"). The information furnished is unaudited and consists of only normal recurring adjustments that, in the opinion of management, are necessary to provide a fair statement of

the results for the interim periods presented. The Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended March 31, 2005 as filed with the Securities and Exchange Commission (“SEC”).

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

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

We account for software development costs in accordance with 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 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.

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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. Material differences may result in the amount and timing of charges for any period if management makes different judgments or utilizes different estimates in evaluating these qualitative factors.

#### *Revenue Recognition*

We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers. Certain products are sold to customers with a street date (the date that products are made widely available 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.

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

Under SFAS No. 123 "Accounting for Stock-Based Compensation," compensation expense is recorded for the issuance of stock options and other stock-based compensation based on the fair value of the stock options and other stock-based compensation on the date of grant or measurement date. Alternatively, SFAS No. 123 allows companies to continue to account for the issuance of stock options and other stock-based compensation in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Under APB No. 25, compensation expense is recorded for the issuance of stock options and other stock-based compensation based on the intrinsic value of the stock options and other stock-based compensation on the date of grant or measurement date. Under the intrinsic value method, compensation expense is recorded on the date of grant or measurement date only if the current market price of the underlying stock exceeds the stock option or other stock-based compensation exercise price. At June 30, 2005, we had several stock-based employee compensation plans, which are described more fully in Note 14 to the Notes to Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K for the year ended March 31, 2005 filed with the SEC. We account for those plans under the recognition and measurement principles of APB Opinion No. 25 and related Interpretations. The following table illustrates the effect on net income (loss) and earnings (loss) per share if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

	Three months ended June 30,	
	2005	2004
Net income (loss), as reported	\$ (3,585)	\$ 11,957
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(2,971)	(4,866)
Pro forma net income (loss)	<u>\$ (6,556)</u>	<u>\$ 7,091</u>
Earnings (loss) per share		
Basic - as reported	\$ (0.02)	\$ 0.07
Basic - pro forma	<u>\$ (0.03)</u>	<u>\$ 0.04</u>
Diluted - as reported	\$ (0.02)	\$ 0.06
Diluted - pro forma	<u>\$ (0.03)</u>	<u>\$ 0.03</u>

Prior to April 1, 2005, the fair value of options granted was estimated at the date of grant using the Black-Scholes option pricing model. As of April 1, 2005, we switched to a Binomial-Lattice model to estimate the fair value of options granted after that date. Both models require 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. For options granted during the three months ended June 30, 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 of 46% and 48%, respectively. For purposes of the above pro forma disclosure, the fair value of options granted is amortized to stock-based employee compensation cost over the period(s) in which the related employee services are rendered. Accordingly, the pro forma stock-based compensation cost for any period will typically relate to options granted in both the current period and prior periods.

#### *Restricted Stock*

In June 2005, we issued the rights to 116,822 shares of restricted stock to an employee. These shares vest over a five-year period and remain subject to forfeiture if vesting conditions are not met. In accordance with APB Opinion No. 25, we recognize unearned compensation in connection with the grant of restricted shares equal to the fair value of our common stock on the date of grant. The fair value of these shares when issued was approximately \$17.12 per share and resulted in an increase in "Additional paid-in capital" and "Unearned compensation" on the accompanying balance sheet of \$2.0 million. Over the vesting period, we reduce unearned compensation and recognize compensation expense. For the first quarter of fiscal 2006, we recorded expense related to these shares of approximately \$17,000 in "General and administrative" on the accompanying statements of operations.

#### *Reclassifications*

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

We have reclassified certain auction rate securities from cash and cash equivalents to short-term investments. Auction rate securities are variable rate bonds tied to short-term interest rates with maturities on the face of the underlying security in excess of 90 days. Auction rate securities have interest rate

resets through a modified Dutch auction at predetermined short-term intervals, typically every 7, 28 or 35 days. Interest paid during a given period is based upon the interest rate determined during the prior auction.

Although these securities are issued and rated as long-term bonds, they are priced and traded as short-term instruments because of the liquidity provided through the interest rate reset. We had historically classified these instruments as cash and cash equivalents if the reset period between interest rate resets was 90 days or less, which was based on our ability to liquidate our holdings or roll our investment over to the next reset period. Our re-evaluation of the maturity dates and other provisions associated with the underlying bonds resulted in a reclassification from cash and cash equivalents to short-term investments of approximately \$196.4 million on the June 30, 2004 balance sheet. As a result of this balance sheet reclassification, certain amounts were reclassified in the accompanying consolidated statement of cash flows for the quarter ended June 30, 2004 to reflect the gross purchases and sales of these securities as investing activities rather than as a component of cash and cash equivalents. This change in classification does not affect previously reported cash flows from operating or from financing activities in the previously reported consolidated statements of cash flows or the previously reported consolidated statements of operations. For the quarter ended June 30, 2004, as a result of these revisions in classification, net cash provided by investing activities related to these current investments increased \$105.0 million.

## 2. Stock Split

In February 2004, the Board of Directors approved a three-for-two split of our outstanding common shares effected in the form of a 50% stock dividend. The split 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 33-1/3% 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.

10

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 quarter ended June 30, 2005, we completed the acquisitions of two 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 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. During the quarter ended June 30, 2004, we did not complete any acquisitions.

## 4. Cash, Cash Equivalents and Short-Term Investments

Short-term investments generally mature between three and thirty months. Investments with maturities beyond one year may be classified as short-term based on their liquid nature and because such securities represent the investment of cash that is available for current operations. All of our short-term investments are classified as available-for-sale and are carried at fair market value with unrealized appreciation (depreciation) reported as a separate component of accumulated other comprehensive income (loss) in shareholders' equity. The specific identification method is used to determine the cost of securities disposed with realized gains and losses reflected in investment income, net.

### *Restricted Cash – Compensating Balances*

As of June 30, 2005, we maintained a \$7.5 million irrevocable standby letter of credit. Under the terms of this arrangement, we are required to maintain on deposit with the bank a compensating balance, restricted as to use, not less than the sum of the available amount of the letter of credit plus the aggregate amount of any drawings under the letter of credit that have been honored thereunder but not reimbursed. At June 30, 2005, the \$7.5 million deposit is included in short-term investments as restricted cash.

11

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Cash and cash equivalents:</b>				
Cash and time deposits	\$ 122,974	\$ —	\$ —	\$ 122,974
Commercial paper	2,493	—	(1)	2,492
U.S. agency issues	4,983	—	(1)	4,982
Money market funds	111,893	—	—	111,893
<b>Cash and cash equivalents</b>	<b>242,343</b>	<b>—</b>	<b>(2)</b>	<b>242,341</b>
<b>Short-term investments:</b>				
Commercial paper	9,290	—	(3)	9,287
Restricted cash	7,500	—	—	7,500

Corporate bonds	169,348	12	(1,144)	168,216
U.S. agency issues	276,784	41	(1,027)	275,798
Mortgage-backed securities	75,161	—	(498)	74,663
Asset-backed securities	7,251	—	(7)	7,244
Common stock	31	3	—	34
Municipal bonds	816	—	—	816
	<u>546,181</u>	<u>56</u>	<u>(2,679)</u>	<u>543,558</u>
Cash, cash equivalents, restricted cash and short-term investments	\$ 788,524	\$ 56	\$ (2,681)	\$ 785,899

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 June 30, 2005 (amounts in thousands):

	Amortized Cost	Fair Value
Due in one year or less	\$ 151,377	\$ 150,658
Due after one year through two years	192,682	191,470
Due after two years through three years	99,586	99,495
Due in three years or more	95,230	94,631
	<u>538,875</u>	<u>536,254</u>
Asset-backed securities	7,251	7,244
Total	\$ 546,126	\$ 543,498

12

For the three months ended June 30, 2005, there were \$1.3 million of gross realized gains and no gross realized losses. For the three months ended June 30, 2004, there were no gross realized gains and no gross realized losses.

In accordance with EITF 03-1, “*The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*,” the fair value of investments in an unrealized loss position for which an other-than-temporary impairment has not been recognized was \$478.4 million at June 30, 2005 with related gross unrealized losses of \$2.7 million. At June 30, 2005, the gross unrealized losses were comprised mostly of unrealized losses on corporate bonds, U.S. agency issues, and mortgage-backed securities with \$0.4 million of unrealized loss being in a continuous unrealized loss position for twelve months or greater.

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

## 5. Inventories

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

	June 30, 2005	March 31, 2005
Finished goods	\$ 41,419	\$ 45,926
Purchased parts and components	3,717	2,092
	<u>\$ 45,136</u>	<u>\$ 48,018</u>

## 6. Goodwill

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

	Publishing	Distribution	Total
Balance as of March 31, 2005	\$ 85,899	\$ 5,762	\$ 91,661
Goodwill acquired during the period	6,260	—	6,260
Issuance of contingent consideration	942	—	942
Adjustment-prior period purchase allocation	(155)	—	(155)
Effect of foreign currency exchange rates	52	(233)	(181)
Balance as of June 30, 2005	\$ 92,998	\$ 5,529	\$ 98,527

## 7. Income Taxes

The income tax benefit of \$2.5 million for the three months ended June 30, 2005 reflects our effective income tax rate for the quarter of 41.2% which differs from our anticipated effective tax rate for the year of 34.5% due to a one-time international tax benefit for the release of certain tax reserves due to the expiration of a tax statute of limitations. The significant items that generated the variance between our effective rate and our statutory rate of 35% were research and development tax credits and the impact of foreign tax rate

differentials, partially offset by state taxes. The income tax provision of \$5.9 million for the three months ended June 30, 2004 reflects our effective income tax rate of approximately 33%. The significant items that generated variances between our effective rate and our statutory rate of 35% were research and development tax credits and the impact of foreign tax rate differentials, partially offset by state taxes.

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

As of June 30, 2005, capitalized software development costs included \$84.0 million of internally developed software costs and \$23.6 million of payments made to third-party software developers. As of March 31, 2005, capitalized software development costs included \$61.3 million of internally developed software costs and \$30.3 million of payments made to third-party software developers. Capitalized intellectual property licenses were \$34.9 million and \$35.7 million as of June 30, 2005 and March 31, 2005, respectively. Amortization and write-offs of capitalized software development costs and intellectual property licenses were \$21.8 million and \$31.8 million for the three months ended June 30, 2005 and 2004, respectively.

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

*Comprehensive Income (Loss)*

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

	<u>Three months ended June 30,</u>	
	<u>2005</u>	<u>2004</u>
Net income (loss)	\$ (3,585)	\$ 11,957
Other comprehensive income (loss)		
Foreign currency translation adjustment	(4,470)	(1,360)
Unrealized appreciation (depreciation) on short-term investments	595	(1,217)
Other comprehensive income (loss)	(3,875)	(2,577)
Comprehensive income (loss)	<u>\$ (7,460)</u>	<u>\$ 9,380</u>

*Accumulated Other Comprehensive Income (Loss)*

For the three months ended June 30, 2005, the components of accumulated other comprehensive income (loss) were as follows (amounts in thousands):

	<u>Foreign Currency</u>	<u>Unrealized Appreciation (Depreciation) on Investments</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>
Balance, March 31, 2005	\$ 14,838	\$ (3,220)	\$ 11,618
Other comprehensive income (loss)	(4,470)	595	(3,875)
Balance, June 30, 2005	<u>\$ 10,368</u>	<u>\$ (2,625)</u>	<u>\$ 7,743</u>

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

**10. Investment Income, Net**

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

	<u>Three months ended June 30,</u>	
	<u>2005</u>	<u>2004</u>
Interest income	\$ 6,067	\$ 2,200
Interest expense	(62)	(88)
Net realized gain on investments	1,343	—
Investment income, net	<u>\$ 7,348</u>	<u>\$ 2,112</u>

**11. Supplemental Cash Flow Information**

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

	Three months ended June 30,	
	2005	2004
<b>Non-cash investing and financing activities:</b>		
Change in unrealized appreciation (depreciation) on short-term investments	\$ 595	\$ (1,217)
Subsidiaries acquired with common stock	942	—
Adjustment-prior period purchase allocation	155	—
<b>Supplemental cash flow information:</b>		
Cash paid for income taxes	\$ 382	\$ 2,621
Cash received for interest, net	4,877	2,015

## 12. Operations by Reportable Segments and Geographic Area

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

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

Distribution refers to our operations in the United Kingdom, the Netherlands and Germany that provide logistical and sales services to third-party publishers of interactive entertainment software, our own publishing operations and manufacturers of interactive entertainment hardware.

Resources are allocated to each of these segments using information on their respective net revenues and operating profits before interest and taxes.

15

The accounting policies of these segments are the same as those described in the Summary of Significant Accounting Policies in our Annual Report on Form 10-K for the year ended March 31, 2005. Revenue derived from sales between segments is eliminated in consolidation.

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

	Three months ended June 30, 2005		
	Publishing	Distribution	Total
Total segment revenues	\$ 193,551	\$ 47,542	\$ 241,093
Revenues from sales between segments	(22,451)	22,451	—
Revenues from external customers	\$ 171,100	\$ 69,993	\$ 241,093
Operating income (loss)	\$ (13,909)	\$ 461	\$ (13,448)
Total assets	\$ 1,164,521	\$ 102,926	\$ 1,267,447
	Three months ended June 30, 2004		
	Publishing	Distribution	Total
Total segment revenues	\$ 161,652	\$ 49,624	\$ 211,276
Revenues from sales between segments	(8,324)	8,324	—
Revenues from external customers	\$ 153,328	\$ 57,948	\$ 211,276
Operating income (loss)	\$ 15,894	\$ (161)	\$ 15,733
Total assets	\$ 880,041	\$ 105,800	\$ 985,841

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

	Three months ended June 30,	
	2005	2004
North America	\$ 112,320	\$ 125,191
Europe	119,981	78,101
Other	8,792	7,984
Total	\$ 241,093	\$ 211,276

16

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

	Three months ended June 30,	
	2005	2004
Console	\$ 180,450	\$ 158,321
Hand-held	29,239	22,085
PC	31,404	30,870
<b>Total</b>	<b>\$ 241,093</b>	<b>\$ 211,276</b>

As of and for the three months ended June 30, 2005, we had one customer that accounted for 19% of consolidated net revenues and 32% of consolidated accounts receivable, net. As of and for the three months ended June 30, 2004 we had one customer that accounted for 26% of consolidated net revenues and 33% of consolidated accounts receivable, net. This customer was the same customer in both periods and was a customer of both our publishing and distribution businesses.

### 13. Computation of Earnings (Loss) Per Share

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

	Three months ended June 30,	
	2005	2004
<b>Numerator:</b>		
Numerator for basic and diluted earnings per share - income available to common shareholders	\$ (3,585)	\$ 11,957
<b>Denominator:</b>		
Denominator for basic earnings per share - weighted average common shares outstanding	201,856	183,686
<b>Effect of dilutive securities:</b>		
Employee stock options and stock purchase plan	—	19,915
Warrants to purchase common stock	—	938
Potential dilutive common shares	—	20,853
Denominator for diluted earnings per share - weighted average common shares outstanding plus assumed conversions	201,856	204,539
Basic earnings (loss) per share	\$ (0.02)	\$ 0.07
Diluted earnings (loss) per share	\$ (0.02)	\$ 0.06

Options to purchase 16,234,195 shares of common stock at exercise prices ranging from \$1.33 to \$17.85 and options to purchase 84,933 shares of common stock at exercise prices ranging from \$11.65 to \$12.50 were outstanding for the three months ended June 30, 2005 and 2004, respectively, but were not included in the calculation of diluted earnings (loss) per share because their effect would be antidilutive.

### 14. Commitments and Contingencies

#### *Credit Facilities*

We have revolving credit facilities with our Centresoft subsidiary located in the UK (the "UK Facility") and our NBG subsidiary located in Germany (the "German Facility"). The UK Facility provided Centresoft with the ability to borrow up to Great British Pounds ("GBP") 8.0 million (\$14.4 million), including issuing letters of credit, on a revolving basis as of June 30, 2005. Furthermore, under the UK Facility, Centresoft provided a GBP 0.6 million (\$1.1 million) guarantee for the benefit of our CD Contact subsidiary as of June 30, 2005. The UK Facility bore interest at LIBOR plus 2.0% as of June 30, 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 June 30, 2005, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of June 30, 2005. The German Facility provided for revolving loans up to EUR 0.5 million (\$0.6 million) as of June 30, 2005, bore interest at a Eurocurrency rate plus 2.5%, is collateralized by certain of the subsidiary's property and equipment and has no expiration date. No borrowings were outstanding against the German Facility as of June 30, 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. Additionally, we lease certain of our facilities under non-cancelable operating lease agreements. Assuming all contractual provisions are

met, the total future minimum commitments for these and other contractual arrangements in place as of June 30, 2005, are scheduled to be paid as follows (amounts in thousands):

	Contractual Obligations			
	Facility Leases	Developer and IP	Marketing	Total
Fiscal year ending March 31,				
2006	\$ 8,466	\$ 29,674	\$ 10,780	\$ 48,920
2007	11,190	8,875	3,535	23,600
2008	7,775	6,275	8,375	22,425
2009	6,622	2,900	—	9,522
2010	5,820	—	—	5,820
Thereafter	23,957	—	—	23,957
Total	\$ 63,830	\$ 47,724	\$ 22,690	\$ 134,244

18

#### Compensation Guarantee

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

#### Legal and Regulatory Proceedings

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

In addition, on March 12, 2004, a shareholder derivative lawsuit captioned *Frank Capovilla, Derivatively on Behalf of Activision, Inc. v. Robert Kotick, et al.* was filed, purportedly on behalf of Activision, which in large measure asserts the identical claims set forth in the federal class action lawsuit. That complaint was filed in California Superior Court for the County of Los Angeles. Also, on March 22, 2005, a new derivative lawsuit captioned *Ramalingham Balamohan, Derivatively on Behalf of Nominal Defendant Activision, Inc. v. Robert Kotick, et al.* was filed in the Federal Court in Los Angeles. This complaint makes the same allegations as the previous complaints, but it names all the current directors as defendants. In the California state derivative case, in light of the ruling dismissing the complaint in the federal class action, plaintiff's counsel has requested additional time to consider whether to dismiss the case or file an amended complaint that attempts to distinguish this derivative action from the now dismissed federal class action. Currently, all proceedings in the California state derivative case are stayed pending plaintiff's decision. In the federal derivative case, plaintiff voluntarily filed a notice of dismissal of the action, without prejudice, pending resolution of the federal class action and an order dismissing this action was entered on June 3, 2005. Given the result in the federal class action, we do not anticipate that plaintiff's counsel will attempt to file a new complaint in the federal derivative case.

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 appeared 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. 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 advised us

19

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 cooperated fully with the Securities and Exchange Commission in the conduct of this inquiry. In July 2005, Activision was advised by the staff of the Securities and Exchange Commission that Activision is no longer the subject of this investigation and the matter is closed with regard to Activision.

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.

## 15. Capital Transactions

During fiscal 2003, our Board of Directors authorized a buyback program under which we can repurchase up to \$350.0 million of our common stock of which we had approximately \$226.2 million available for utilization at June 30, 2005. Under the program, shares may be purchased as determined by management and within certain guidelines, from time to time, in the open market or in privately negotiated transactions, including privately negotiated structured option transactions, and through transactions in the options markets. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time or from time to time without prior notice.

During the three months ended June 30, 2005 and June 30, 2004, we did not repurchase any of our common stock or enter into any structured stock repurchase transactions. As of June 30, 2005 and 2004, we had no outstanding structured stock repurchase transactions.

## 16. Recently Issued Accounting Standards and Laws

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

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

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

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

20

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As permitted by SFAS 123, we currently account for share-based payments to employees using Opinion 25’s intrinsic value method and, as such, generally recognize no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123R’s fair value method will have a significant impact on our results of operations, although it will have no impact on our overall financial position. 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. We expect the adoption of SFAS No. 151 will not have a material impact on our financial position or results of operations.

On December 15, 2004 the FASB issued Statement No. 153 (“SFAS No. 153”), *Exchanges of Nonmonetary Assets — an Amendment of Accounting Principles Board Opinion No. 29*. This standard requires exchanges of productive assets to be accounted for at fair value, rather than at carryover basis, unless (1) neither the asset received nor the asset surrendered has a fair value that is determinable within reasonable limits or (2) the transactions lack commercial substance. The new standard is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. We expect 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 2006 and 2007 will be limited to 75% and 45% of the otherwise allowable exclusion and no exclusion will be available in fiscal 2008 and thereafter. The Act also creates a temporary incentive for U.S. multinationals to repatriate accumulated income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations. The deduction is subject to a number of limitations. The Act also provides for other changes in tax law that will affect a variety of taxpayers. On December 21, 2004, the Financial Accounting Standards Board (“FASB”) issued two FASB Staff Positions (“FSP”) regarding the accounting implications of the Act related to (1) the deduction for qualified domestic production activities and (2) the one-time tax benefit for the repatriation of foreign earnings. The FASB determined that the deduction for qualified domestic production activities should be accounted for as a special deduction under FASB Statement No. 109, *Accounting for Income Taxes*. The FASB also confirmed, that upon deciding that some amount of earnings will be repatriated, a company must record in that period the associated tax liability. The guidance in the FSPs applies to financial statements for periods ending after the date the Act was enacted. We are evaluating the Act at this time and have not yet determined whether we will avail ourselves of the opportunity of the one-time tax benefit for the repatriation of foreign earnings. We plan to complete our assessment before the end of fiscal 2006 and are not currently in a position to estimate a range of possible repatriation amounts.

21

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

### Overview

We are a leading international publisher of interactive entertainment software products. We have built a company with a diverse portfolio of products that spans a wide range of categories and target markets and that is used on a variety of game hardware platforms and operating systems. We have created, licensed and acquired a group of highly recognizable brands, which we market to a variety of consumer demographics. Our product portfolio includes such best-selling franchises as Spider-Man, Tony Hawk, Call of Duty, True Crime, X-Men and Shrek.

Our products cover diverse game categories including action/adventure, action sports, racing, role-playing, simulation, first-person action and strategy. Our target customer base ranges from casual players to game enthusiasts, children to adults and mass-market consumers to “value” buyers. We currently offer our products primarily in versions that operate on the Sony PlayStation 2 (“PS2”), Nintendo GameCube (“GameCube”) and Microsoft Xbox (“Xbox”) console systems, Nintendo Game Boy Advance (“GBA”), Sony PlayStation Portable (“PSP”) and Nintendo Dual Screen (“NDS”) hand-held devices and the personal computer (“PC”). The installed base for 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 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.

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Our fiscal 2006 “big propositions” include well-established brands, which are backed by high-profile intellectual property and/or highly anticipated motion picture releases. We have a long-term relationship with Marvel Enterprises through an exclusive licensing agreement. This agreement grants us the exclusive rights to develop and publish video games based on Marvel’s comic book franchises Spider-Man, X-Men, Fantastic 4 and Iron Man. Through our long-term relationship with Marvel Enterprises, our fiscal 2006 releases include titles based on Marvel’s Spider-Man, Fantastic 4 and X-Men. In the first quarter of fiscal 2006 we released the video game, *Fantastic 4*, just prior to the theatrical release of “*Fantastic 4*.” We will also be developing and publishing video games based on New Line Cinema’s future feature film “*Iron Man*.” In addition, through our licensing agreement with Spider-Man Merchandising, LLP, we will be developing and publishing video games based on Columbia Pictures/Marvel Enterprises, Inc.’s upcoming feature film “*Spider-Man 3*,” which is expected to be released in May 2007. We also have an exclusive licensing agreement with professional skateboarder Tony Hawk. The agreement grants us exclusive rights to develop and publish video games using Tony Hawk’s name and likeness. Through the first quarter of fiscal 2006, we have released six successful titles in the Tony Hawk franchise with cumulative net revenues of \$960.8 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 *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 title *True Crime: Streets of L.A.*, released in the third quarter of fiscal 2004, is another title based upon original intellectual property. We expect to develop a variety of games on multiple platforms based on these two original properties including the upcoming fiscal 2006 releases of *Call of Duty 2*, *Call of Duty 2: Big Red One*, and *True Crime: New York City*. 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, “*Shrek Tale*,” which was released in the second quarter of fiscal 2005, “*Madagascar*,” which was released in the first quarter of fiscal 2006, as well as upcoming computer-animated films “*Over the Hedge*,” and all of their respective sequels, including “*Shrek 3*.” Additionally we have a strategic alliance with Harrah’s Entertainment, Inc. that grants us the exclusive, worldwide interactive rights to develop and publish “*World Series of Poker*” video games based on the widely popular World Series of Poker Tournament.

In addition to acquiring or creating high profile intellectual property, we have also continued our focus on establishing and maintaining relationships with talented and experienced software development teams. We have strengthened our internal development capabilities through the acquisition of several

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

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

### Critical Accounting Policies

We have identified the policies below as critical to our business operations and the understanding of our financial results. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see Note 1 to the Notes to Consolidated Financial Statements included in Item 1. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets

23

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and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Revenue Recognition.* We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers. Certain products are sold to customers with a street date (the date that products are made widely available for sale by retailers). For these products we recognize revenue no earlier than the street date. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection. With respect to license agreements that provide customers the right to make multiple copies in exchange for guaranteed amounts, revenue is recognized upon delivery of such copies. Per copy royalties on sales that exceed the guarantee are recognized as earned. In addition, in order to recognize revenue for both product sales and licensing transactions, persuasive evidence of an arrangement must exist and collection of the related receivable must be probable. Revenue recognition also determines the timing of certain expenses, including cost of sales — intellectual property licenses and cost of sales — software royalties and amortization.

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

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

We may permit product returns from, or grant price protection to, our customers under certain conditions. In general, price protection refers to the circumstances when we elect to decrease the wholesale price of a product by a certain amount and, when granted and applicable, allows customers a credit against amounts owed by such customers to us with respect to open and/or future invoices. The conditions our customers must meet to be granted the right to return products or price protection are, among other things, compliance with applicable payment terms, delivery to us of weekly inventory and sell-through reports, and consistent participation in the launches of our premium title releases. We may also consider other factors, including the facilitation of slow-moving inventory and other market factors. Management must make estimates of potential future product returns and price protection related to current period product revenue. We estimate the amount of future returns and price protection for current period product revenue utilizing historical experience and information regarding inventory levels and the demand and acceptance of our products by the end consumer. The following factors are used to estimate the amount of future returns and price protection for a particular title: 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, our 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

24

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our revenue for any period if management makes different judgments or utilizes different estimates in determining the allowances for returns and price protection.

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

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

management's estimates in establishing our inventory provision.

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

We account for software development costs in accordance with Statement of Financial Accounting Standard ("SFAS") No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed." Software development costs are capitalized once technological feasibility of a product is established and such costs are determined to be recoverable. Technological feasibility of a product encompasses both technical design documentation and game design documentation. For products where proven technology exists, this may occur early in the development cycle. Technological feasibility is evaluated on a product-by-product basis. Prior to a product's release, we expense, as part of cost of sales — software royalties and amortization, capitalized costs when we believe such amounts are not recoverable. Capitalized costs for those products that are cancelled or abandoned are charged to product development expense in the period of cancellation. Amounts related to software development which are not capitalized are charged immediately to product development expense. We evaluate the future recoverability of capitalized amounts on a quarterly basis. The recoverability of capitalized software development costs is evaluated based on the expected performance of the specific products for which the costs relate. Criteria used to evaluate expected product performance include: historical performance of comparable products using comparable technology; 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.

25

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. 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.

26

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

	Three months ended June 30,			
	2005		2004	
Net revenues	\$	241,093	100%	\$ 211,276 100%

Costs and expenses:

Cost of sales – product costs	136,754	57	89,088	42
Cost of sales – software royalties and amortization	14,576	6	12,283	6
Cost of sales – intellectual property licenses	20,940	9	17,648	8
Product development	17,802	7	21,105	10
Sales and marketing	46,318	19	41,734	20
General and administrative	18,151	8	13,685	7
<b>Total costs and expenses</b>	<b>254,541</b>	<b>106</b>	<b>195,543</b>	<b>93</b>
<b>Operating income (loss)</b>	<b>(13,448)</b>	<b>(6)</b>	<b>15,733</b>	<b>7</b>
Investment income, net	7,348	3	2,112	1
<b>Income (loss) before income tax provision (benefit)</b>	<b>(6,100)</b>	<b>(3)</b>	<b>17,845</b>	<b>8</b>
Income tax provision (benefit)	(2,515)	(1)	5,888	2
<b>Net income (loss)</b>	<b>\$ (3,585)</b>	<b>(2)%</b>	<b>\$ 11,957</b>	<b>6%</b>
<b>Net Revenues by Territory:</b>				
North America	\$ 112,320	46%	\$ 125,191	59%
Europe	119,981	50	78,101	37
Other	8,792	4	7,984	4
<b>Total net revenues</b>	<b>\$ 241,093</b>	<b>100%</b>	<b>\$ 211,276</b>	<b>100%</b>
<b>Net Revenues by Segment/Platform Mix:</b>				
<b>Publishing:</b>				
Console	\$ 142,362	59%	\$ 119,127	56%
Hand-held	25,331	10	18,430	9
PC	25,858	11	24,095	12
<b>Total publishing net revenues</b>	<b>193,551</b>	<b>80</b>	<b>161,652</b>	<b>77</b>
<b>Distribution:</b>				
Console	38,088	16	39,194	18
Hand-held	3,908	2	3,655	2
PC	5,546	2	6,775	3
<b>Total distribution net revenues</b>	<b>47,542</b>	<b>20</b>	<b>49,624</b>	<b>23</b>
<b>Total net revenues</b>	<b>\$ 241,093</b>	<b>100%</b>	<b>\$ 211,276</b>	<b>100%</b>
<b>Operating Income (Loss) by Segment:</b>				
Publishing	\$ (13,909)	(6)%	\$ 15,894	7%
Distribution	461	—	(161)	—
<b>Total operating income (loss)</b>	<b>\$ (13,448)</b>	<b>(6)%</b>	<b>\$ 15,733</b>	<b>7%</b>

## Results of Operations – Three Months Ended June 30, 2005 and 2004

Net loss for the three months ended June 30, 2005 was \$3.6 million or loss per share of \$0.02, as compared to net income of \$12.0 million or \$0.06 per diluted share for the three months ended June 30, 2004.

### Net Revenues

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

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

	<b>Three Months Ended June 30,</b>		<b>Increase/</b>	<b>Percent</b>
	<b>2005</b>	<b>2004</b>	<b>(Decrease)</b>	<b>Change</b>
<b>Publishing Net Revenues</b>				
North America	\$ 112,320	\$ 125,191	\$ (12,871)	(10)%
Europe	72,439	28,477	43,962	154%
Other	8,792	7,984	808	10%
<b>Total International</b>	<b>81,231</b>	<b>36,461</b>	<b>44,770</b>	<b>123%</b>
<b>Total Publishing Net Revenues</b>	<b>193,551</b>	<b>161,652</b>	<b>31,899</b>	<b>20%</b>

Distribution Net Revenues	47,542	49,624	(2,082)	(4)%
Consolidated Net Revenues	<u>\$ 241,093</u>	<u>\$ 211,276</u>	<u>\$ 29,817</u>	<u>14%</u>

Consolidated net revenues increased 14% from \$211.3 million for the three months ended June 30, 2004 to \$241.1 million for the three months ended June 30, 2005. This increase was generated by our publishing business. Our performance was driven by the following:

- In Europe, our affiliate business exceeded the prior year results due to the launch of LucasArts' *Star Wars: Episode III Revenge of the Sith*. Other drivers of net revenue related to strong performance of our fiscal 2006 first quarter releases of *Madagascar*, *Doom 3* for the Xbox, *Doom 3: Resurrection of Evil* for the PC, and the North American release of *Fantastic Four*. According to NPD, *Doom 3* collector's edition was the #1 best-selling video game in the U.S. on the Xbox platform for the month of April. Additionally, *Madagascar* was the #1 best-selling children's title and the #2 selling game across all platforms for the month of June. This compares to only two releases in the first quarter of fiscal 2005: *Spider-Man 2* and *Shrek 2* for PS2, Xbox, GameCube, GBA and PC. The increase in revenues was partially offset by decreased pricing per unit driven by a lower initial pricing for *Madagascar* versus *Shrek 2* in the prior year and price reductions on catalog titles.
- International net revenues benefited from the year-over-year strengthening of the Euro ("EUR"), Great Britain Pound ("GBP") and Australian Dollar ("AUD") in relation to the U.S. Dollar. We estimate that foreign exchange rates increased reported net revenue by approximately \$4.7 million. Excluding the impact of changing foreign currency rates, our international net revenue increased 110% year-over-year.

28

#### North America Publishing Net Revenue (in thousands)

Three Months Ended June 30, 2005	% of Consolidated Net Revenue	Three Months Ended June 30, 2004	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
\$ 112,320	46%	\$ 125,191	59%	\$ (12,871)	(10)%

Domestic publishing net revenues decreased 10% from \$125.2 million for the three months ended June 30, 2004, to \$112.3 million for the three months ended June 30, 2005. Despite strong North American sales of our fiscal 2006 first quarter releases of *Doom 3* for the Xbox, *Doom 3: Resurrection of Evil* for the PC, *Madagascar* and *Fantastic Four*, the decrease reflects a \$10 lower wholesale pricing difference on *Madagascar* as well as price reductions on catalog titles. This compares with strong North American sales of *Spider-Man 2* and *Shrek 2* for the PS2, Xbox, Gamecube, GBA and PC in the first quarter of fiscal 2005.

#### International Publishing Net Revenue (in thousands)

Three Months Ended June 30, 2005	% of Consolidated Net Revenue	Three Months Ended June 30, 2004	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
\$ 81,231	34%	\$ 36,461	17%	\$ 44,770	123%

International publishing net revenues increased by 123% from \$36.5 million for the three months ended June 30, 2004, to \$81.2 million for the three months ended June 30, 2005. The increase in international publishing revenues was driven largely by the release of LucasArts' *Star Wars: Episode III Revenge of the Sith*, which we shipped exclusively in Europe. This compares to our fiscal 2005 first quarter releases of *Shrek 2* and, on a limited territorial release schedule, *Spider-Man 2* for PS2, Xbox, GameCube, GBA and PC. There also was a positive strengthening of the EUR, GBP and AUD in relation to the U.S. dollar of approximately \$3.2 million. Excluding the impact of changing foreign currency rates, our international publishing net revenue increased 114% year-over-year.

29

#### Publishing Net Revenue by Platform (in thousands)

	Three Months Ended June 30, 2005	% of Publishing Net Revs.	Three Months Ended June 30, 2004	% of Publishing Net Revs.	Increase/ (Decrease)	Percent Change
Publishing Net Revenues						
PC	\$ 25,858	14%	\$ 24,095	15%	\$ 1,763	7%
Console						
PlayStation 2	65,484	34%	68,704	42%	(3,220)	(5)%
Microsoft Xbox	66,607	34%	25,836	16%	40,771	158%
Nintendo GameCube	10,141	5%	23,752	15%	(13,611)	(57)%
Other	130	—%	835	1%	(705)	(84)%
Total Console	142,362	73%	119,127	74%	23,235	20%
Hand-held	25,331	13%	18,430	11%	6,901	37%
Total Publishing Net Revenues	\$ 193,551	100%	\$ 161,652	100%	\$ 31,899	20%

Publishing net revenues increased 20% from \$161.7 million for the three months ended June 30, 2004 to \$193.6 million for the three months ended June 30, 2005.

Personal Computer Net Revenue (in thousands)

Three Months Ended June 30, 2005	% of Publishing Net Revenue	Three Months Ended June 30, 2004	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
\$ 25,858	14%	\$ 24,095	15%	\$ 1,763	7%

Net revenue from sales of titles for the PC increased 7% from \$24.1 million for the three months ended June 30, 2004 to \$25.9 million for the three months ended June 30, 2005. PC revenues were driven by the releases of *Madagascar*, *Fantastic Four*, *Doom 3: Resurrection of Evil* and continued catalog sales of *Rome: Total War* and *Call of Duty*. Net revenues from sales of titles for the PC for the first quarter of fiscal 2005 were driven mainly by *Shrek 2*, *Spider-Man 2* and catalog sales of *Call of Duty*. In addition, the number of premium PC titles released in the first quarter of fiscal 2005 increased to three titles from one PC title released in the first quarter of fiscal 2004. We expect fiscal 2006 PC net revenues as a percentage of total publishing revenues to decrease from the prior fiscal year as there were three strong performing PC exclusive releases in the prior fiscal year, *Call of Duty: United Offensive*, *Doom 3* and *Rome: Total War*.

PlayStation 2 Net Revenue (in thousands)

Three Months Ended June 30, 2005	% of Publishing Net Revenue	Three Months Ended June 30, 2004	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
\$ 65,484	34%	\$ 68,704	42%	\$ (3,220)	(5)%

Net revenue from sales of titles for the PS2 decreased 5% from \$68.7 million for the three months ended June 30, 2004 to \$65.5 million for the three months ended June 30, 2005. In the first quarter of fiscal 2006, PS2 releases consisted of *Madagascar* worldwide, *Fantastic Four* in North America and LucasArts' *Star Wars: Episode III Revenge of the Sith* in European territories. This compares to the releases of *Shrek 2* and *Spider-Man 2* in the first quarter of fiscal 2005. Though the number of titles released increased quarter over quarter, the decrease in net revenues for titles for the PS2 was largely due to a \$10 wholesale pricing difference on *Madagascar* compared to *Shrek 2*, our children's title releases for the three months ended June 30, 2005 and 2004, respectively. We expect our fiscal 2006 revenues from the sales of titles for the PS2 to increase over the previous fiscal year due to a stronger anticipated slate of second and third quarter titles including *GUN*, *Ultimate Spider-Man*, *True Crime New York City*, *Call of Duty 2: Big Red One*, *X-Men Legends 2*, *Shrek Super-Slam* and *Tony Hawk's American Wasteland*.

Microsoft Xbox Net Revenue (in thousands)

Three Months Ended June 30, 2005	% of Publishing Net Revenue	Three Months Ended June 30, 2004	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
\$ 66,607	34%	\$ 25,836	16%	\$ 40,771	158%

Net revenue from sales of titles for the Xbox increased 158% from \$25.8 million for the three months ended June 30, 2004 to \$66.6 million for the three months ended June 30, 2005. The increase was driven mostly by the Xbox exclusive release of *Doom 3* with additional revenues coming from the releases of *Madagascar*, *Fantastic Four* in North America and LucasArts' *Star Wars: Episode III Revenge of the Sith* in our European territories. The increase in net revenues was partially offset by lower initial pricing on *Madagascar*. This compares to only two title releases for the Xbox, *Spider-Man 2* and *Shrek 2*, in the first three months of fiscal 2005 which, although reflecting solid sales both in the domestic and international markets, did not perform as well on the Xbox as they did on other platforms as these titles were not as focused toward the demographic of the Xbox audience. We expect our fiscal 2006 revenues from the sales of titles for the Xbox to increase over the previous fiscal year due to a stronger anticipated slate of second and third quarter titles including *GUN*, *Ultimate Spider-Man*, *True Crime New York City*, *Call of Duty 2: Big Red One*, *X-Men Legends 2*, *Shrek Super-Slam* and *Tony Hawk's American Wasteland*.

Nintendo GameCube Net Revenue (in thousands)

Three Months Ended June 30, 2005	% of Publishing Net Revenue	Three Months Ended June 30, 2004	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
\$ 10,141	5%	\$ 23,752	15%	\$ (13,611)	(57)%

Net revenue from sales of titles for the GameCube decreased 57% from \$23.8 million for the three months ended June 30, 2004 to \$10.1 million for the three months ended June 30, 2005. Though the number of GameCube titles released in the first quarter of fiscal 2006 remained consistent with the first quarter of fiscal 2005, net revenues were impacted by lower initial pricing on *Madagascar*. In addition, our first quarter fiscal 2005 releases of *Spider-Man 2* and *Shrek 2* performed particularly well on this platform as both of these titles were more focused toward the demographic of the GameCube audience. We expect fiscal 2006 net revenues from the sales of titles for the GameCube as a percentage of publishing net revenue to remain relatively consistent with the previous fiscal year.

Hand-held (in thousands)

Three Months Ended June 30, 2005	% of Publishing Net Revenue	Three Months Ended June 30, 2004	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
\$ 25,331	13%	\$ 18,430	11%	\$ 6,901	37%

Net revenue from sales of titles for the hand-held for the three months ended June 30, 2005 increased 37% from the prior fiscal year, from \$18.4 million to \$25.3 million. Although the number of titles released on hand-held platforms remained consistent quarter over quarter at two titles, the increase in net revenues from sales of titles for the hand-held was due mainly to the release of the NDS and PSP leading to sales being made over three hand-held platforms compared to one in the first quarter of fiscal 2005. With the introduction of both the NDS and PSP hand-held platforms we expect that revenues from hand-helds will continue to increase year over year.

*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, introduction of new hardware platforms including the upcoming transition to the next-generation console systems, 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 quarter ended June 30, 2005, 35% of our consolidated net revenues and 44% of worldwide publishing net revenues were derived from net revenues from the *Doom 3* and

LucasArts' *Star Wars: Episode III Revenge of the Sith* 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.

Three factors that could affect future publishing and distribution net revenue performance are console hardware pricing, software pricing and transitions in console platforms. As console hardware moves through its life cycle, hardware manufacturers typically enact price reductions. Reductions in the price of console hardware typically result in an increase in the installed base of hardware owned by consumers. Price cuts on Xbox, PS2 and GBA hardware were announced in March, May and September 2004, respectively. Historically, we have also seen that lower console hardware prices put downward pressure on software pricing. While we expect console software launch pricing for most genres to hold at \$49.99 through the calendar 2005 holidays, we believe we could see additional software price declines thereafter. Additionally, when new console platforms are announced or introduced into the market, consumers typically reduce their purchases of game console entertainment software products for current console platforms in anticipation of new platforms becoming available. During these periods, sales of our game console entertainment software products may be expected to slow or even decline until new platforms are introduced and achieve wide consumer acceptance.

*Distribution Net Revenue (in thousands)*

Three Months Ended June 30, 2005	% of Consolidated Net Revenue	Three Months Ended June 30, 2004	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
\$ 47,542	20%	\$ 49,624	23%	\$ (2,082)	(4)%

Distribution net revenues for the three months ended June 30, 2005 decreased 4% from the prior fiscal year, from \$49.6 million to \$47.5 million. The decrease was primarily due to weaker first quarter business related to third party publishers causing a shift in product mix. This decrease was offset by a 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 revenue decreased \$3.6 million or 7%. The mix of future distribution net revenues will be driven by a number of factors including the occurrence of further hardware price reductions instituted by hardware manufacturers, the introduction of new hardware platforms, our ability to establish and maintain distribution agreements with hardware manufacturers and third-party software publishers and the success of third-party published titles. We are expecting our fiscal 2006 distribution revenues to decrease slightly when compared with fiscal 2005 due mainly to shifting product mix.

*Costs and Expenses**Cost of Sales – Product Costs (in thousands)*

Three Months Ended June 30, 2005	% of Consolidated Net Revenue	Three Months Ended June 30, 2004	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
\$ 136,754	57%	\$ 89,088	42%	\$ 47,666	54%

Cost of sales – product costs represented 57% and 42% of consolidated net revenues for the three months ended June 30, 2005 and 2004, respectively. In absolute dollars, cost of sales – product costs increased due to the mix of affiliate label and mainline business combined with higher sales volume in the first quarter of

fiscal 2006 as compared to the first quarter of fiscal 2005. The primary factors that affected cost of sales – product costs as a percentage of consolidated net revenues were:

- Heavy sales volume in our European territories of LucasArts' *Star Wars: Episode III Revenge of the Sith*. LucasArts' titles are part of our affiliate label program and carry a significantly higher product cost than Activision developed titles.
- Reduced pricing on a number of catalog titles as well as a \$10 pricing difference on *Madagascar* compared to *Shrek 2*.
- An increase in price protection reserves related to channel inventory due to reduced pricing for catalog titles.

We expect cost of sales – product costs as a percentage of net revenues to decrease for the remainder of the year as LucasArts' titles will comprise a lower percentage of our overall revenues.

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

Three Months Ended June 30, 2005	% of Publishing Net Revenue	Three Months Ended June 30, 2004	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
\$ 14,576	8%	\$ 12,283	8%	\$ 2,293	19%

Cost of sales – software royalties and amortization for the three months ended June 30, 2005 remained consistent as a percentage of publishing net revenues from the three months ended June 30, 2004 at 8%. Cost of sales – software royalties and amortization for the three months ended June 30, 2005 increased from the prior fiscal year, from \$12.3 million to \$14.6 million. The increase in absolute dollars is due to an increase in the number of platforms with associated software royalties and amortization, combined with external royalty payments for the *Fantastic Four* title.

*Cost of Sales – Intellectual Property Licenses (in thousands)*

Three Months Ended June 30, 2005	% of Publishing Net Revenue	Three Months Ended June 30, 2004	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
\$ 20,940	11%	\$ 17,648	11%	\$ 3,292	19%

Cost of sales – intellectual property licenses for the three months ended June 30, 2005 increased from June 30, 2004 by 19% from \$17.6 million to \$20.9 million. As a percentage of publishing net revenues, cost of sales – intellectual property licenses remained consistent with the three months ended June 30, 2004 at 11%. The increase in absolute dollars reflects the release of more titles with associated intellectual property combined with higher royalty rates on certain titles, such as *Doom 3*. Titles released with associated intellectual property during the first quarter of fiscal 2006 include *Doom 3*, *Madagascar* and *Fantastic Four*. This compares to two titles with associated intellectual property in the first quarter of fiscal 2005, *Spider-Man 2* and *Shrek 2*. We expect cost of sales – intellectual property licenses as a percentage of publishing net revenue to be in line with fiscal 2005.

*Product Development (in thousands)*

Three Months Ended June 30, 2005	% of Publishing Net Revenue	Three Months Ended June 30, 2004	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
\$ 17,802	9%	\$ 21,105	13%	\$ (3,303)	(16)%

Product development expenses for the three months ended June 30, 2005 decreased as a percentage of publishing net revenues as compared to the three months ended June 30, 2004, from 13% to 9%. In absolute dollars, product development expenses for the three months ended June 30, 2005 also decreased compared to the three months ended June 30, 2004, from \$21.1 million to \$17.8 million. The decrease in product development as a percentage of publishing net revenues and in absolute dollars resulted from:

- Higher internal studio bonuses in the first quarter of fiscal 2005 due to the strong performance of the *Shrek 2* and *Spider-Man 2* titles.
- Game cancellation write-offs of \$6.3 million in the first quarter of fiscal 2005 versus no write-offs in the first quarter of fiscal 2006.

Partially offset by:

- Increases in expensed outside developer fees due to an increase in the number of platforms that are in development.

*Sales and Marketing (in thousands)*

Three Months Ended June 30, 2005	% of Consolidated Net Revenue	Three Months Ended June 30, 2004	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
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\$	46,318	19%	\$	41,734	20%	\$	4,584	11%
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Sales and marketing expenses of \$46.3 million and \$41.7 million represented 19% and 20% of consolidated net revenues for the three months ended June 30, 2005 and 2004, respectively. The increase in absolute dollars was a result of continuing significant investment in marketing programs, including television and in-theatre ad campaigns and in-store promotions, run in support of our fiscal 2006 first quarter title releases, *Doom 3*, *Madagascar* and *Fantastic Four*, the last two being previously unproven properties. This compares to only two new releases in fiscal 2005, both of which were previously proven properties. We currently believe that this increased spending will lengthen the product sales life cycle and add to the long term prospects of the respective product lines. We expect to continue to provide significant marketing support for our future "big proposition" titles in launch and subsequent quarters. Accordingly, we expect fiscal 2006 sales and marketing costs to increase slightly in relation to fiscal 2005 spending levels.

35

General and Administrative (in thousands)

Three Months Ended June 30, 2005	% of Consolidated Net Revenue	Three Months Ended June 30, 2004	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
\$ 18,151	8%	\$ 13,685	7%	\$ 4,466	33%

General and administrative expenses for the three months ended June 30, 2005 increased \$4.5 million over the same period last year, from \$13.7 million to \$18.2 million. As a percentage of consolidated net revenues, general and administrative expenses also increased from 7% to 8% from June 30, 2004 to June 30, 2005. The increases were primarily due to an increase in personnel costs related to increased headcount to support expanding operations, annual salary increases and an increase in foreign currency transaction losses incurred by our European publishing business.

Operating Income (Loss) (in thousands)

	Three Months Ended June 30, 2005	% of Segment Net Revs.	Three Months Ended June 30, 2004	% of Segment Net Revs.	Increase/ (Decrease)	Percent Change
Publishing	\$ (13,909)	(7)%	\$ 15,894	10%	\$ (29,803)	(188)%
Distribution	461	1%	(161)	—	622	386%
Consolidated	\$ (13,448)	(6)%	\$ 15,733	7%	\$ (29,181)	(185)%

Publishing operating income (loss) for the three months ended June 30, 2005 decreased \$29.8 million from the same period last year, from \$15.9 million to \$(13.9 million). This decrease was primarily due to:

- Lower profitability on releases in the first quarter of fiscal 2006 versus the same quarter of the previous fiscal year which experienced much higher sales per platform.
- Increases in costs of sales – product costs due to a larger percentage of revenues derived from LucasArts' titles which have a lower associated margin.
- Lower initial pricing of our top selling title this quarter, *Madagascar*, resulting in lower associated margins.
- Lower margins associated with the release of *Doom 3* for the Xbox due to higher rate of costs of sales - intellectual property licenses than the titles released in the first quarter of fiscal 2005.
- Increased general and administrative costs to support increased headcount and costs of expanding operations.
- Increased sales and marketing spending.

Partially offset by:

- Strong performance in our European market of our fiscal 2006 first quarter title releases.

Distribution operating income (loss) for the three months ended June 30, 2005 increased slightly over the same period last year, from \$(161,000) to \$461,000. This increase is primarily due to a shift in the product mix for our distribution business which provided for a higher margin for the three months ended June 30, 2005 versus the three months ended June 30, 2004.

36

Investment Income, Net (in thousands)

Three Months Ended June 30, 2005	% of Consolidated Net Revenue	Three Months Ended June 30, 2004	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
\$ 7,348	3%	\$ 2,112	1%	\$ 5,236	248%

Investment income, net for the three months ended June 30, 2005 was \$7.3 million as compared to \$2.1 million for the three months ended June 30, 2004. The increase was due to a realized gain of \$1.3 million on the sale of common stock and higher invested balances during the three months ended June 30, 2005 as compared to the three months ended June 30, 2004 combined with an increase in yields earned.

*Provision (Benefit) for Income Taxes (in thousands)*

<u>Three Months Ended June 30, 2005</u>	<u>% of Pretax Income</u>	<u>Three Months Ended June 30, 2004</u>	<u>% of Pretax Income</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
\$ (2,515)	41%	\$ 5,888	33%	\$ (8,403)	(143)%

The income tax benefit of \$2.5 million for the three months ended June 30, 2005 reflects our effective income tax rate for the quarter of 41.2% which differs from our expected annual effective tax rate of 34.5% due to a one-time international tax benefit for the release of certain deferred tax liabilities due to the expiration of tax statute of limitations. 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 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.

**Liquidity and Capital Resources**

*Sources of Liquidity*

(in thousands)

	<u>June 30, 2005</u>	<u>March 31, 2005</u>	<u>Increase/ (Decrease)</u>
Cash and cash equivalents	\$ 242,341	\$ 313,608	\$ (71,267)
Short-term investments	543,558	527,256	16,302
	<u>\$ 785,899</u>	<u>\$ 840,864</u>	<u>\$ (54,965)</u>
Percentage of total assets	62%	64%	

  

	<u>For the three months ended June 30, 2005</u>	<u>For the three months ended June 30, 2004</u>	<u>Increase/ (Decrease)</u>
Cash flows used in operating activities	\$ (54,475)	\$ (52,136)	\$ (2,339)
Cash flows provided by (used in) investing activities	(26,520)	23,609	(50,129)
Cash flows provided by financing activities	13,169	8,034	5,135

As of June 30, 2005, our primary source of liquidity is comprised of \$242.3 million of cash and cash equivalents and \$543.6 million of short-term investments. Over the last two years, our primary sources of liquidity have included cash on hand at the beginning of the year and cash flows generated from continuing operations. We have also generated significant cash flows from the issuance of our common stock to employees through the exercise of options which is described in more detail below in "Cash Flows from Financing Activities." We have not utilized debt financing as a significant source of cash flows. However, we do have available at certain of our international locations, credit facilities, which are described below in "Credit Facilities," that can be utilized if needed.

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

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

We believe that we have sufficient working capital (\$915.8 million at June 30, 2005), as well as proceeds available from our international credit facilities, to finance our operational requirements for at least the next twelve months, including purchases of inventory and equipment, the funding of the development, production, marketing and sale of new products and the acquisition of intellectual property rights for future products from third-parties.

*Cash Flows from Operating Activities*

The primary drivers of cash flows from operating activities typically have included the collection of customer receivables generated by the sale of our products, offset by payments to vendors for the manufacture, distribution and marketing of our products, third-party developers and intellectual property holders and our own employees. A significant operating use of our cash relates to our continued investment in software development and intellectual property licenses. We spent approximately \$37.0 million and \$26.7 million in the three months ended June 30, 2005 and 2004, respectively, in connection with the acquisition of publishing or distribution rights for products being developed by third-parties, the execution of new license agreements granting us

long-term rights to intellectual property of third-parties, as well as 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 quarters ended June 30, 2005 and 2004, cash flows used in operating activities were \$54.5 million and \$52.1 million, respectively. The principal components comprising cash flows used in operating activities for the quarter ended June 30, 2005 included operating results and decreases in accounts payable and accrued liabilities, and our continued investment in software development and intellectual property licenses offset by amortization of capitalized software development costs and intellectual property licenses and decreases in accounts receivable. 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 three months ended June 30, 2005 and 2004, cash flows provided by (used in) investing activities were \$(26.5 million) and \$23.6 million, respectively. For the quarter ended June 30, 2005, cash flows used in investing activities were primarily the result of the increase in short-term investments, capital expenditures and cash paid for acquisitions. We have historically financed our acquisitions through the issuance of shares of common stock or a combination of common stock and cash. We will continue to evaluate potential acquisition candidates as to the benefit they bring to us.

#### *Cash Flows from Financing Activities*

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

For the three months ended June 30, 2005 and 2004, cash flows from financing activities were \$13.2 million and \$8.0 million, respectively. The cash provided by financing activities for the quarter ended June 30, 2005 primarily is the result of the issuance of common stock related to employee stock option and stock purchase plans. During fiscal 2003, our Board of Directors authorized a buyback program under which we can repurchase up to \$350.0 million of our common stock. Under the program, shares may be purchased as determined by management and within certain guidelines, from time to time, in the open market or in privately negotiated transactions, including privately negotiated structured stock repurchase transactions and through transactions in the options markets. Depending on market conditions and other factors, these purchases may be

commenced or suspended at any time or from time to time without prior notice. As of June 30, 2005, we had approximately \$226.2 million available for utilization under the buyback program. We actively manage our capital structure as a component of our overall business strategy. Accordingly, in the future, when we determine that market conditions are appropriate, we may seek to achieve long term value for the shareholders through, among other things, new debt or equity financings or refinancings, share repurchases and other transactions involving our equity or debt securities.

#### *Key Balance Sheet Accounts*

##### Accounts Receivable

<u>(amounts in thousands)</u>	<u>June 30, 2005</u>	<u>March 31, 2005</u>	<u>Increase/ (Decrease)</u>
Gross accounts receivable	\$ 171,646	\$ 178,335	\$ (6,689)
Net accounts receivable	94,804	109,144	(14,340)

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

- The timing of our distribution business new releases in first quarter fiscal 2006 versus the prior quarter. In the fourth quarter of fiscal 2005 our distribution business had significant releases late in the quarter resulting in a high accounts receivable balance as compared to the first quarter of fiscal 2006 where most titles were released earlier in the quarter.

Partially offset by:

- Late first quarter North American release of *Fantastic Four* and the late international release of *Madagascar*.

Reserves for returns, price protection and bad debt increased from \$69.2 million at March 31, 2005 to \$76.8 million at June 30, 2005 and reserves as a percentage of gross receivables also increased from 39% to 45%. Reserves for returns and price protection are a function of the number of units and pricing of titles in retail inventory (see description of *Allowances for Returns, Price Protection, Doubtful Accounts and Inventory Obsolescence* in Item 2: Critical Accounting Policies). The change in reserves is primarily due to a large percentage of catalog inventory in the channel. Catalog titles typically have a higher reserve as a percentage of accounts receivable compared to new releases as they are later in their life cycle and at a reduced selling price.

##### Inventories

<u>(amounts in thousands)</u>	<u>June 30, 2005</u>	<u>March 31, 2005</u>	<u>(Decrease)</u>
Inventories	\$ 45,136	\$ 48,018	\$ (2,882)

The decrease in inventories was primarily the result of a decrease in publishing inventories due to:

- A large inventory build at March 31, 2005 in anticipation of the release of *Doom 3* for the Xbox console and *Doom 3: Resurrection of Evil* early in the first quarter of fiscal 2006.

Partially offset by:

- An increase in inventory at our distribution businesses due to the slower moving stock from a variety of publishers.

40

#### Software Development

<u>(amounts in thousands)</u>	<u>June 30, 2005</u>	<u>March 31, 2005</u>	<u>Increase/ (Decrease)</u>
Software development	\$ 107,589	\$ 91,614	\$ 15,975

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

- Continued investment in software development. We incurred approximately \$28.7 million in the quarter ended June 30, 2005 in connection with the acquisition of publishing or distribution rights for products being developed by third parties net of the capitalization of product development costs relating to internally developed products.

Partially offset by:

- \$12.7 million of amortization of capitalized software development cost.

#### Intellectual Property Licenses

<u>(amounts in thousands)</u>	<u>June 30, 2005</u>	<u>March 31, 2005</u>	<u>Increase/ (Decrease)</u>
Intellectual property licenses	\$ 34,941	\$ 35,726	\$ (785)

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

- \$9.1 million of amortization of intellectual property licenses mostly related to new releases in the first quarter of fiscal 2006.

Partially offset by:

- Continued investment in intellectual property licenses. We spent approximately \$8.3 million in the quarter ended June 30, 2005 for license agreements granting us long-term rights to intellectual property of third parties.

#### Accounts Payable

<u>(amounts in thousands)</u>	<u>June 30, 2005</u>	<u>March 31, 2005</u>	<u>Increase/ (Decrease)</u>
Accounts payable	\$ 65,447	\$ 108,984	\$ (43,537)

The decrease in accounts payable was primarily the result of:

- Payments for inventory purchases related to late fourth quarter fiscal 2005 releases of PSP titles, early first quarter fiscal 2006 releases of *Doom 3* and *Doom 3: Resurrection of Evil* and payment for distribution inventory related to significant releases in early first quarter fiscal 2006.

41

#### Accrued Expenses

<u>(amounts in thousands)</u>	<u>June 30, 2005</u>	<u>March 31, 2005</u>	<u>Increase/ (Decrease)</u>
Accrued expenses	\$ 88,558	\$ 98,067	\$ (9,509)

The decrease in accrued expenses was primarily driven by the payment of fiscal 2005 bonuses paid in the first quarter of fiscal 2006 combined with decreases in accrued 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 (\$14.4 million), including issuing letters of credit, on a revolving basis as of June 30, 2005. Furthermore, under the UK Facility, Centresoft provided a GBP 0.6 million (\$1.1 million) guarantee for the benefit of our CD Contact subsidiary as of June 30, 2005. The UK Facility bore interest at LIBOR plus 2.0% as of June 30, 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 June 30, 2005, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of June 30, 2005. The German Facility provided for revolving loans up to EUR 0.5 million (\$0.6 million) as of June 30, 2005, bore interest at a Eurocurrency rate plus 2.5%, is collateralized by certain of the subsidiary's property and equipment and has no expiration date. No borrowings were outstanding against the German Facility as of June 30, 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 June 30, 2005, are scheduled to be paid as follows (amounts in thousands):

Fiscal year ending March 31,	Contractual Obligations			
	Facility Leases	Developer and IP	Marketing	Total
2006	\$ 8,466	\$ 29,674	\$ 10,780	\$ 48,920
2007	11,190	8,875	3,535	23,600
2008	7,775	6,275	8,375	22,425
2009	6,622	2,900	—	9,522
2010	5,820	—	—	5,820
Thereafter	23,957	—	—	23,957
Total	\$ 63,830	\$ 47,724	\$ 22,690	\$ 134,244

### 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 Activision. For the three months ended June 30, 2005 and 2004, 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 Officer, President and the Chief Financial Officer review and make various certifications regarding the accuracy of our periodic public reports filed with the Securities and Exchange Commission, our disclosure controls and procedures, and our internal control over financial reporting. With the assistance of the Disclosure Committee, we will continue to assess and monitor our disclosure controls and procedures, and our internal controls over financial reporting, and will make refinements as necessary.

## Recently Issued Accounting Standards and Laws

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

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

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

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

As permitted by SFAS 123, we currently account for share-based payments to employees using Opinion 25’s intrinsic value method and, as such, generally recognize no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123R’s fair value method will have a significant impact on our results of operations, although it will have no impact on our overall financial position. 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

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June 15, 2005. We expect the adoption of SFAS No. 151 will not have a material impact on our financial position or results of operations.

On December 15, 2004 the FASB issued Statement No. 153 (“SFAS No. 153”), *Exchanges of Nonmonetary Assets — an Amendment of Accounting Principles Board Opinion No. 29*. This standard requires exchanges of productive assets to be accounted for at fair value, rather than at carryover basis, unless (1) neither the asset received nor the asset surrendered has a fair value that is determinable within reasonable limits or (2) the transactions lack commercial substance. The new standard is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. We expect 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 2006 and 2007 will be limited to 75% and 45% of the otherwise allowable exclusion and no exclusion will be available in fiscal 2008 and thereafter. The Act also creates a temporary incentive for U.S. multinationals to repatriate accumulated income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations. The deduction is subject to a number of limitations. The Act also provides for other changes in tax law that will affect a variety of taxpayers. On December 21, 2004, the Financial Accounting Standards Board (“FASB”) issued two FASB Staff Positions (“FSP”) regarding the accounting implications of the Act related to (1) the deduction for qualified domestic production activities and (2) the one-time tax benefit for the repatriation of foreign earnings. The FASB determined that the deduction for qualified domestic production activities should be accounted for as a special deduction under FASB Statement No. 109, *Accounting for Income Taxes*. The FASB also confirmed, that upon deciding that some amount of earnings will be repatriated, a company must record in that period the associated tax liability. The guidance in the FSPs applies to financial statements for periods ending after the date the Act was enacted. We are evaluating the Act at this time and have not yet determined whether we will avail ourselves of the opportunity of the one-time tax benefit for the repatriation of foreign earnings. We plan to complete our assessment before the end of fiscal 2006 and are not currently in a position to estimate a range of possible repatriation amounts.

## Inflation

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

## Factors Affecting Future Performance

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

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the potential loss arising from fluctuations in market rates and prices. Our market risk exposures primarily include fluctuations in interest rates, 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 June 30, 2005, our cash equivalents and short-term investments included debt securities of \$543.5 million.

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

	Average Interest Rate	Amortized Cost	Fair Value
<b>Cash equivalents:</b>			
Fixed rate	3.28%	\$ 7,476	\$ 7,474
Variable rate	3.18	111,893	111,893
<b>Short-term investments:</b>			
Fixed rate	3.23%	\$ 546,150	\$ 543,524

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

#### Foreign Currency Exchange Rate Risk

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

### Item 4. Controls and Procedures

#### **Evaluation of Disclosure Controls and Procedures**

The Company’s management, with the participation of the Company’s Chief Executive Officer, President and Chief Financial Officer, has evaluated the effectiveness of the Company’s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. 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 Officer, President and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures. Based on this evaluation, the Chief Executive Officer, President and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective 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.

#### **Changes in Internal Control Over Financial Reporting**

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

### Part II. OTHER INFORMATION

## Item 1. Legal Proceedings

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

In addition, on March 12, 2004, a shareholder derivative lawsuit captioned *Frank Capovilla, Derivatively on Behalf of Activision, Inc. v. Robert Kotick, et al.* was filed, purportedly on behalf of Activision, which in large measure asserts the identical claims set forth in the federal class action lawsuit. That complaint was filed in California Superior Court for the County of Los Angeles. Also, on March 22, 2005, a new derivative lawsuit captioned *Ramalingham Balamohan, Derivatively on Behalf of Nominal Defendant Activision, Inc. v. Robert Kotick, et al.* was filed in the Federal Court in Los Angeles. This complaint makes the same allegations as the previous complaints, but it names all the current directors as defendants. In the California state derivative case, in light of the ruling dismissing the complaint in the federal class action, plaintiff's counsel has requested additional time to consider whether to dismiss the case or file an amended complaint that attempts to distinguish this derivative action from the now dismissed federal class action. Currently, all proceedings in the California state derivative case are stayed pending plaintiff's decision. In the

47

federal derivative case, plaintiff voluntarily filed a notice of dismissal of the action, without prejudice, pending resolution of the federal class action and an order dismissing this action was entered on June 3, 2005. Given the result in the federal class action, we do not anticipate that plaintiff's counsel will attempt to file a new complaint in the federal derivative case.

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 appeared 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. 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 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 cooperated fully with the Securities and Exchange Commission in the conduct of this inquiry. In July 2005, Activision was advised by the staff of the Securities and Exchange Commission that Activision is no longer the subject of this investigation and the matter is closed with regard to Activision.

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

## Item 5. Other Information

### Non-Employee Director Compensation

On July 26, 2005, as part of its annual review of directors' compensation, our Board unanimously approved the recommendations jointly made by our Nominating and Corporate Governance Committee and our Compensation Committee to adjust the compensation paid to our non-employee directors. These modifications take effect at the conclusion of the 2005 Annual Stockholders Meeting, to be held on September 15, 2005. Non-employee directors elected at the meeting will receive the compensation listed in the table below. In addition to the compensation listed in the table, non-employee directors are reimbursed for expenses incurred in attending Board, committee and stockholder meetings.

48

Set forth below is a table summarizing cash and equity compensation that we pay to our non-employee directors.

	Current	Effective September, 2005
<b>Cash Compensation for Directors</b>		
Annual Retainer	\$ 30,000	\$ 45,000
For Each Board Meeting	1,200	1,500
For Each Telephone Board Meeting	950	1,000
For Each Committee Meeting	1,000	1,000
For Each Telephone Committee Meeting	750	750
For Serving as Chairman of the Audit Committee	10,000	20,000
For Serving as Chairman of the Compensation Committee	5,000	20,000
For Serving as Chairman of the Nominating and Corporate Governance Committee	5,000	10,000
Per Day for Special Assignments	1,000	1,000
For Serving as an Audit Committee Member	5,000	5,000

Upon the earlier of a non-employee director's initial appointment or election to the Board, such director receives a grant of options to purchase 30,000 shares of our common stock; at each subsequent re-election, a non-employee director receives options to purchase 12,500 shares of our common stock for service to us. These options vest ratably every six months over a two-year period.

In addition to the option programs, each non-employee director is required, within four years of such non-employee director's first election to the Board, to own shares of our common stock having a value of at least three years' annual retainer for service on the Board. Non-employee directors are subject to these guidelines for as long as they continue to serve on our Board. In the event that any director is not re-elected to our Board or voluntarily retires from our Board, such director would continue to be governed by the guidelines for a period of six months after he or she leaves our Board.

#### **Amendment to 2003 Incentive Plan**

On July 26, 2005, upon the recommendation of our management and the Compensation Committee, our Board approved amendments to our 2003 Incentive Plan (the "2003 Plan") to conform the provisions of the 2003 Plan to Section 409A of the Internal Revenue Code of 1986 (the "Code"), added by the American Jobs Creation Act of 2004, which imposes additional taxes and interest charges on certain deferred compensation unless the compensation meets stringent new requirements. The amendments to the 2003 Plan include the following:

- Elimination of the ability to issue reload options and deferred share awards;
- Revision of the definition of "fair market value" for purposes of determining the exercise price of options and the grant price of share appreciation rights;
- Additional limitations to the terms and conditions under which share appreciation rights may be issued, including adding a requirement that share appreciation rights may only be payable in shares of stock;
- Additional limitations on delivery time for restricted shares once they have fully vested; and
- Increased flexibility to amend the 2003 Plan to make further changes to conform it to future interpretations of Section 409A of the Code.

49

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Our Board has determined, on advice of counsel, that none of the proposed amendments would constitute a "material amendment" requiring stockholder approval under the NASDAQ listing rules.

50

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#### **Item 6. Exhibits**

##### **(a) Exhibits**

3.1	Amended and Restated Certificate of Incorporation of Activision Holdings, dated June 1, 2000 (incorporated by reference to Exhibit 2.5 of our Current Report on Form 8-K, filed on June 16, 2000).
3.2	Amended and Restated Bylaws dated August 1, 2000 (incorporated by reference to Exhibit 3.2 of our Current Report on Form 8-K, filed July 11, 2001).
3.3	Certificate of Amendment of Amended and Restated Certificate of Incorporation of Activision Holdings, dated June 9, 2000 (incorporated by reference to Exhibit 2.7 of our Current Report on Form 8-K, filed on June 16, 2000).
3.4	Certificate of Designation of Series A Junior Preferred Stock of Activision, Inc., dated December 27, 2001 (incorporated by reference to Exhibit 3.4 of our Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2001).
3.5	Certificate of Amendment of Amended and Restated Certificate of Incorporation, as amended, of Activision, Inc., dated as of April 4, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed April 5, 2005).
4.1	Rights Agreement dated as of April 18, 2000, between us and Continental Stock Transfer & Trust Company, which includes as exhibits the form of Right Certificates as Exhibit A, the Summary of Rights to Purchase Series A Junior Preferred Stock as Exhibit B and the form of Certificate of Designation of Series A Junior Preferred Stock of Activision as Exhibit C (incorporated by reference to our Registration Statement on Form 8-A, Registration No. 001-15839, filed April 19, 2000).
10.1	Activision, Inc. Amended and Restated 2003 Incentive Plan, effective as of July 26, 2005.
10.2	Employment Agreement dated June 15, 2005 between Michael Griffith and Activision Publishing, Inc.
10.3	Stock Option Agreement dated June 15, 2005 between Michael Griffith and Activision, Inc.

- 10.4 Restricted Stock Agreement dated June 15, 2005 between Michael Griffith and Activision, Inc.
- 10.5 Amendment dated June 15, 2005 to employment agreement dated July 22, 2002, as previously amended by that certain letter agreement dated June 1, 2004 between Activision and Ronald Doornink.
- 31.1 Certification of Robert A. Kotick pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

51

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- 31.2 Certification of Ronald Doornink pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.3 Certification of William J. Chardavoine pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Ronald Doornink pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.3 Certification of William J. Chardavoine pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

52

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#### SIGNATURES

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

Date: August 4, 2005

ACTIVISION, INC.

*/s/ William J. Chardavoine*

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

53

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## ACTIVISION, INC.

**AMENDED AND RESTATED 2003 INCENTIVE PLAN**  
**(Effective as of July 26, 2005)**

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

**RECITALS**

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

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

WHEREAS, the Activision, Inc. 2003 Incentive Plan (the "Original Plan") was initially adopted by the Board of Directors on, and was effective on, April 29, 2003, but was not approved by the Company's stockholders. Although the Plan contemplates the issuance of "incentive stock options" as described below, because the Original Plan was not timely approved by the Company's stockholders no such options will be issued under this Plan, and any purported grant of incentive stock options under this Plan will instead constitute a grant of nonqualified stock options (hereafter defined).

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

**ARTICLE 1.**

**PURPOSE OF THE PLAN**

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

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Exchange Act of 1934, as amended (the "Exchange Act"). For purposes of the Plan, the term "Award" shall mean a grant of an Option, a grant of a share appreciation right, a grant of a Restricted Share Award, or any other award made under the terms of the Plan.

**ARTICLE 2.**

**SHARES SUBJECT TO AWARDS**

**2.1. Number of Shares.** Subject to the adjustment provisions of Section 8.6 hereof, the aggregate number of Shares which may be issued under Awards under the Plan shall not exceed 18,000,000. No Options to purchase fractional Shares shall be granted or issued under the Plan. For purposes of this Section 2.1, the Shares that shall be counted toward such limitation shall include all Shares issued or issuable under any Award granted under the terms of the Plan.

**2.2. Shares Subject to Terminated Awards.** Shares covered by an Award shall only be counted as used to the extent they are actually issued. Any Shares related to Awards which terminate by expiration, forfeiture, cancellation, or otherwise without the issuance of such Shares, are settled in cash in lieu of Shares, or are exchanged with the Committee's permission, prior to the issuance of Shares, for Awards not involving Shares, shall be available again for grant under the Plan. In the event the purchase price of an Option is paid in whole or in part through the delivery of Shares, the number of Shares issuable in connection with the exercise of the Option shall not again be available for the grant of Awards under the Plan. Shares subject to Options, or portions thereof, which have been surrendered in connection with the exercise of a Related SAR (as defined in Article 5, below) shall not again be available for the grant of Awards under the Plan.

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

**2.4. Limitations on Grants to Individual Participant.** Subject to adjustments pursuant to the provisions of Section 7.6 hereof, and unless and until the Committee determines that an Award to a Covered Employee shall not be designed to qualify as a Performance-Based Award (as defined in Article 8, below), the following limits (each an "Annual Award Limit" and, collectively, "Annual Award Limits") shall apply to grants of such Awards under the Plan:

(a) Options: The maximum aggregate number of Shares subject to Options granted in any one fiscal year of the Company (a "Fiscal Year") to any one Participant shall be 1,500,000 Shares.

(b) SARs: The maximum number of Shares subject to share appreciation rights granted in any one Fiscal Year to any one Participant shall be 1,500,000 Shares.

(c) Restricted Shares or Restricted Share Units: The maximum aggregate grant with respect to Awards of Restricted Shares or Restricted Share Units in any one Fiscal Year to any one Participant shall be 1,500,000.

(d) Performance-Based Awards: The maximum aggregate Award of Performance-Based Awards (other than Options or share appreciation rights) that any one

2

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Participant may receive in any one Fiscal Year shall be 1,500,000 Shares (if such Award is payable in Shares), or equal to the value of 1,500,000 Shares. For this purpose, to the extent an Award is payable in cash or property other than Shares, then such Award shall be treated as payable in such number of Shares having a value equal to the value of the cash or property (other than Shares) payable under such Award, determined as of the earlier of the date of vesting or payout.

The above Annual Award Limits are intended to comply with Code Section 162(m) and the Treasury Regulations thereunder, and shall be applied and/or construed in such a way to ensure compliance with Code Section 162(m) and the Treasury Regulations thereunder.

### ARTICLE 3.

#### ELIGIBILITY AND ADMINISTRATION

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

**3.2. Administration.** (a) The Plan shall be administered by a committee or committees (the “Committee”) consisting of not fewer than two Directors as designated by the Directors. The Directors may remove from, add members to, or fill vacancies in the Committee. In determining the composition of any committee or subcommittee, the Directors or the Committee, as the case may be, shall consider the desirability of compliance with the compositional requirements of (i) Rule 16b-3 of the SEC with respect to award holders who are subject to the trading restrictions of Section 16(b) of the Exchange Act with respect to securities of the Company, (ii) Section 162(m) of the Code and (iii) the rules and regulations of the NASDAQ Stock Market (“NASDAQ”), but shall not be bound by such compliance.

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

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

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

3

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pursuant to the provisions of the Plan shall be final, conclusive and binding on all persons, including the Company, its shareholders, Directors and employees, and other Plan participants.

### ARTICLE 4.

#### OPTIONS

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

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

**4.3. Option Price.** Except as otherwise provided herein, and subject to Section 4.4, the option exercise price per each Share purchasable under any Option shall not be less than 100% of the Fair Market Value of such Share on the date of the grant of such Option.

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

(a) **Dollar limit.** To the extent that the aggregate Fair Market Value (determined as of the respective date or dates of grant) of Shares with respect to which Options that would otherwise be ISOs are exercisable for the first time by an individual during any calendar year under the Plan (and

any other plan of the Company, a parent or subsidiary corporation or predecessor thereof) exceeds the sum of \$100,000 (or other amount allowed under Section 422 of the Code or the regulations promulgated thereunder), whether by reason of acceleration or otherwise, those Options will not be treated as ISOs. In making this determination, Options will be taken into account in the order in which they were granted.

(b) 10% Shareholder. If any employee to whom an ISO is to be granted is, on the date of grant, the owner of Shares (determined using the attribution rules of Section 424(d) of the Code) possessing more than 10% of the total combined voting power of all classes of stock

4

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of his or her employer corporation or of its parent or subsidiary, then the following special provisions will apply to the option granted to that employee:

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

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

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

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

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

4.5. *Other Provisions*. Options granted pursuant to this Article 4 shall be made in accordance with the terms and provisions of Article 7 hereof and any other applicable terms and provisions of the Plan.

## ARTICLE 5.

### SHARE APPRECIATION RIGHTS

5.1. *Grant and Exercise*. The Committee may provide share appreciation rights (i) in conjunction with all or part of any Option granted under the Plan or at any subsequent time during the term of such Option (a "Related SAR") or (ii) without regard to any Option or other Award (a "Freestanding SAR"; Related SARs and Freestanding SARs are referred to collectively herein as "share appreciation rights"), in each case upon such terms and conditions as the Committee may establish, subject to Section 5.3, below, including the right to receive Shares as determined by the Committee in its sole discretion. Subject to Section 9.13 below, (i) share appreciation rights may be granted only if Shares are traded on an established securities market at the date of grant, and (ii) share appreciation rights granted under this Plan shall be payable only in Shares.

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

5.3. Notwithstanding any other provision of this Plan to the contrary, with respect to a Related SAR granted in connection with an ISO: (a) the Related SAR will expire no later than the expiration of the underlying ISO; (b) the exercise of the Related SAR may not have economic and tax consequences more favorable than the exercise of the ISO followed by an

5

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immediate sale of the underlying Shares, and the value of the payout with respect to the Related SAR may be for no more than 100% of the excess of the Fair Market Value of the Shares subject to the underlying ISO at the time the Related SAR is exercised over the Option Price of the underlying ISO; (c) the Related SAR may be exercised only when the Fair Market Value of the Shares subject to the ISO exceeds the Option exercise price of the ISO; (d) the Related SAR may be exercised only when the underlying ISO is eligible to be exercised; and (e) the Related SAR is transferable only when the underlying ISO is transferable, and under the same conditions.

## ARTICLE 6.

### RESTRICTED SHARES AND RESTRICTED SHARE UNITS

6.1. *Restricted Share Awards*. (a) *Grant*. The Committee may grant to any Participant (i) Shares (together with cash dividend equivalents if so determined by the Committee, subject to the provisions of Section 409A of the Code, if applicable) (such Shares, "Restricted Shares") and/or units which represent a conditional right to receive Shares, cash or a combination of Shares and cash in the future (such units, "Restricted Share Units") in such amount and manner, and subject to such terms and conditions relating to vesting, forfeitability and restrictions on delivery and transfer (whether based on performance standards, periods of service or otherwise) as the Committee shall establish. A grant of Restricted Shares and/or Restricted Share Units made pursuant to this Article 6 is referred to as a "Restricted Share Award." The terms of any Restricted Share Award granted under this Plan shall be set forth in a written agreement (a "Restricted Share Agreement") which shall contain provisions determined by the Committee and not inconsistent with this Plan. The provisions of Restricted Share Awards need not be the same for each Participant receiving such Awards. The Committee has absolute discretion to determine whether any consideration (other than services) is to be received by the Company or its affiliates as a condition precedent to the issuance of restricted stock. Subject to Section 9.13 below, delivery of Shares pursuant to an Award of Restricted Share Units (or an Award of Restricted Shares) shall be made no later than 2-1/2 months after the close of the Company's first taxable year in which such Shares are no longer subject to a risk of forfeiture (within the meaning of Section 409A of the Code).

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

(c) *Rights of Holders of Restricted Share Units.* Unless the Committee otherwise provides in a Restricted Share Agreement, any Participant holding Restricted Share Units shall have no rights as a shareholder of the Company with respect to such Restricted Share Units. The Committee may provide in the Restricted Share Agreement evidencing a grant of Restricted Share Units that the Participant holding such Restricted Share Units shall be credited with additional Restricted Share Units on account of any dividends paid after the date of the

6

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Restricted Share Agreement and prior to delivery of Shares or cash pursuant to such Restricted Share Agreement, in a manner determined by the Committee in its sole discretion.

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

## ARTICLE 7.

### GENERALLY APPLICABLE PROVISIONS

7.1. *Fair Market Value.* The “Fair Market Value” of a Share shall mean a price that is based on the opening, closing, actual, high, low, or average selling prices of a Share reported on the NASDAQ or other established stock exchange (or exchanges) on the applicable date, the preceding trading day, the next succeeding trading day, or an average of trading days, as determined by the Committee in its discretion. Unless the Committee determines otherwise, if the Shares are traded over the counter at the time a determination of its Fair Market Value is required to be made hereunder, its Fair Market Value shall be deemed to be equal to the average between the reported high and low or closing bid and asked prices of a Share on the most recent date on which Shares were publicly traded. In the event Shares are not publicly traded at the time a determination of their Fair Market Value is required to be made hereunder, the determination of their Fair Market Value shall be made by the Committee in such manner as it deems appropriate.

7.2. *Exercise of Options.* Vested Options granted under the Plan shall be exercised by the Optionee or by a Permitted Assignee thereof (or by his or her executors, administrators, guardian or legal representative, as provided in Sections 8.5 and 8.6 hereof) as to all or part of the Shares covered thereby, by the giving of written notice of exercise to the Company, specifying the number of Shares to be purchased, accompanied by payment of the full purchase price for the Shares being purchased. Full payment of such purchase price shall be made at the time of exercise and shall be made (i) in cash or by certified check or bank check or wire transfer of immediately available funds, (ii) with the consent of the Committee, by tendering previously acquired Shares (valued at their then Fair Market Value, as determined by the Committee as of the date of tender) that have been owned for a period of at least six months (or such other period to avoid accounting charges against the Company’s earnings), (iii) if Shares are traded on a national securities exchange, the NASDAQ, or quoted on a national quotation system sponsored by the National Association of Securities Dealers, Inc., and the Committee authorizes this method of exercise, through the delivery of irrevocable instructions to a broker approved by the Committee to deliver promptly to the Company an amount equal to the purchase price, or (iv)

7

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

7.3. *Transferability.* Except as provided below, and except as otherwise authorized by the Committee in a Share Option Agreement with respect to an Optionee, no Option shall be assignable or transferable by the Optionee, other than by will or the laws of descent and distribution, and such Option may be exercised during the life of the Optionee only by the Optionee or his guardian or legal representative. NQOs and any Related SARs granted in tandem therewith are transferable (together and not separately) with the consent of the Committee by the Optionee or holder of such Related SAR (“Holder”), as the case may be, to any one or more of the following persons (each, a “Permitted Assignee”): (i) the spouse, parent, issue, spouse of issue, or issue of spouse (“issue” shall include all descendants whether natural or adopted) of such Optionee or Holder, as the case may be; (ii) a trust for the benefit of one or more of those persons described in clause (i) above or for the benefit of such Optionee or Holder, as the case may be; (iii) an entity in which the Optionee or Holder or any Permitted Assignee thereof is a beneficial owner; or (iv) in the case of a transfer by an Optionee who is a non-employee director, another non-employee director of the Company; provided that such Permitted Assignee shall be bound by and subject to all of the terms and conditions of this Plan and the Share Option Agreement relating to the transferred Option and shall execute an agreement satisfactory to the Company evidencing such obligations; and provided further that such Optionee or Holder shall remain bound by the terms and conditions of this Plan. In the case of a transfer by a non-employee director to another non-employee director, the vesting and exercisability shall after such transfer be determined by reference to the service of the assignee, rather than the assignor. The Company shall cooperate with any Permitted Assignee and the Company’s transfer agent in effectuating any transfer permitted under this Section 7.3.

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

8

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**7.5. Amendment and Modification of the Plan.** The Committee may, from time to time, alter, amend, suspend or terminate the Plan as it shall deem advisable, subject to any requirement for shareholder approval imposed by applicable law or any rule of any stock exchange or quotation system on which Shares are listed or quoted; provided that the Committee may not amend the Plan, without the approval of the Company's shareholders, to increase the number of Shares that may be the subject of Options under the Plan (except for adjustments pursuant to Section 7.6 hereof). In addition, no amendments to, or termination of, the Plan shall in any way impair the rights of an Optionee or a Participant (or a Permitted Assignee thereof) under any Award previously granted without such Optionee's or Participant's consent, except to the extent necessary to avoid the imposition of additional tax and/or interest under Section 409A of the Code with respect to Awards that are treated as nonqualified deferred compensation.

**7.6. Adjustments.** In the event that the Committee shall determine that any dividend or other distribution (whether in the form of cash, Shares, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase, or exchange of Shares or other securities, the issuance of warrants or other rights to purchase Shares or other securities, or other similar corporate transaction or event affects the Shares with respect to which Awards have been or may be issued under the Plan, such that an adjustment is determined in good faith by the Committee to be appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan, then the Committee shall, in such manner as the Committee may deem equitable, adjust any or all of (i) the number and type of Shares that thereafter may be made the subject of Awards, (ii) the number and type of Shares subject to outstanding Awards, and (iii) the grant or exercise price with respect to any Award, or, if deemed appropriate, make provision for a cash payment to the holder of any outstanding Award; provided, in each case, that with respect to ISOs, no such adjustment shall be authorized to the extent that such adjustment would cause such options to violate Section 422(b) of the Code or any successor provision; provided further, with respect to all Options, no such adjustment shall be authorized to the extent that such adjustment would cause such Options to violate the provisions of Section 409A of the Code; and provided further, that the number of Shares subject to any Award denominated in Shares shall always be a whole number. In the event of any reorganization, merger, consolidation, split-up, spin-off, or other business combination involving the Company (collectively, a "Reorganization"), the Committee or the Board of Directors of the Company may cause any Award outstanding as of the effective date of the Reorganization to be cancelled in consideration of a cash payment or alternate Award (whether from the Company or another entity that is a party to the Reorganization) or a combination thereof made to the holder of such cancelled Award substantially equivalent in value to the fair market value of such cancelled Award. The determination of fair market value shall be made by the Committee or the Board of Directors, as the case may be, in their sole discretion.

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

9

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

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

(a) The terms of this Section 7.8 shall apply to the Option if the Optionee is or shall become subject to an employment agreement with the Company.

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

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

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

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

Company's written notice of its exercise of its rights under this Section 7.8, or (3) the arithmetic average of the per Share closing sales prices as reported on NASDAQ for the thirty (30) trading day period ending on the trading day immediately preceding the date of computation, minus the exercise price per Share times (y) the number of Shares as to which this Option was exercised and which were not sold;

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

With respect to any other Awards granted hereunder, the terms of any Restricted Share Agreement, share appreciation right or any other document evidencing an Award under the Plan, may include comparable provisions to those set forth in this Section 7.8.

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

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

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

**7.10. Terms of Option Grant.** Notwithstanding anything in this Plan to the contrary, the Committee may grant an Option under such terms and conditions as may be provided in the Share Option Agreement given to the Optionee and the Committee has the discretion to modify the terms and conditions of an Option after grant as long as the rights of the Optionee are not impaired unless the Optionee otherwise consents, *provided, however*, that in no instance may the term of an ISO exceed the maximum term established pursuant to Section 4.4 above and provided, further, that no such modification may cause the Option to violate the provisions of Section 409A of the Code without the consent of the Optionee.

**7.11. Repricing of Options and Share Appreciation Rights.** Except as provided in Section 7.6 above, the exercise price of an Option or share appreciation right granted hereunder may not be reduced after such Option or share appreciation right has been granted to a Participant.

## ARTICLE 8.

### PERFORMANCE-BASED AWARDS

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

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

(c) The Committee shall set performance goals at its discretion which, depending on the extent to which they are met, will determine the number and/or value of such Performance-Based Awards that will be paid out to the Key Employees, and may attach to such Performance-Based Awards one or more restrictions.

**8.2. Other Awards.** Either the granting or vesting of Performance-Based Awards (other than Options or share appreciation rights) granted under the Plan shall be subject to the achievement of a performance target or targets, as determined by the Committee in its sole discretion, based on one or more of the performance measures specified in Section 8.3 below. With respect to such Performance-Based Awards:

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

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

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

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

## ARTICLE 9.

### MISCELLANEOUS

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

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

**9.3. Nature of Payments.** All Awards made pursuant to the Plan are in consideration of services performed or to be performed for the Company or any subsidiary or affiliate of the Company. Any income or gain realized pursuant to Awards under the Plan and any share appreciation rights constitutes a special incentive payment to the Optionee, Participant or Holder

and shall not be taken into account, to the extent permissible under applicable law, as compensation for purposes of any of the employee benefit plans of the Company or any subsidiary or affiliate of the Company except as may be determined by the Committee or by the Directors or directors of the applicable subsidiary or affiliate of the Company.

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

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

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

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

**9.8. Effective Date of Plan; Termination of Plan.** The Original Plan was originally adopted by the Board of Directors on, and was effective on, April 29, 2003. This Plan (as amended and restated) was adopted by the Board of Directors on July 26, 2005. Awards may be granted under the Plan at any time and from time to time prior to April 28, 2013, on which date the Plan will expire except as to Awards then outstanding under the Plan. Such outstanding Awards shall remain in effect until they have been exercised or terminated, or have expired.

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

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

**9.12. Indemnification.** Each individual who is or shall have been a member of the Board, or a committee appointed by the Board, shall be indemnified and held harmless by the Company against and from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by him in connection with or resulting from any claim, action, suit, or proceeding to which he may be a party or in which he may be involved by reason of any action taken or failure to act under the Plan and against and from any and all amounts paid by him in settlement thereof, with the Company's approval, or paid by him in satisfaction of any judgment in any such action, suit, or proceeding against him, provided he shall give the Company an opportunity, at its own expense, to handle and defend the same before he undertakes to handle and defend it on his own behalf, unless such loss, cost, liability, or expense is a result of his own willful misconduct or except as expressly provided by statute.

The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such individuals may be entitled under the Company's Certificate of Incorporation or Bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

**9.13. Amendment to Comply with Applicable Law; Waiver of Code Section 409A Provisions.** It is intended that no Award granted under this Plan shall be subject to any interest or additional tax under Section 409A of the Code. In the event Code Section 409A is amended after the date hereof, or regulations or other guidance is promulgated after the date hereof that would make an Award under the Plan subject to the provisions of Code Section 409A, then the terms and conditions of this Plan shall be interpreted and applied, to the extent possible, in a manner to avoid the imposition of the provisions of Code Section 409A. Notwithstanding the foregoing and notwithstanding anything in this Plan to the contrary, with respect to any Award to any Participant, the Committee may specifically waive any provision of this Plan that is intended to comply with Code Section 409A, including without limitation certain restrictions set forth in Sections 4.3, 5.1, 6.1, 7.6 and 7.10 hereof, and may grant Awards hereunder to such Participant that do not comply with Code Section 409A.

June 15, 2004



Mr. Michael Griffith  
11061 Toddtree Lane  
Cincinnati, Ohio 45242

Dear Mr. Griffith:

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

**1. Term**

(a) The initial term of your employment under this Agreement shall commence on June 15, 2005 (the "Effective Date") and expire on June 30, 2010 (the "Expiration Date") unless earlier terminated as provided in Paragraph 9 below or as may be extended as provided in Paragraph 1(b) below (the "Employment Period").

(b) If, at any time during the Employment Period, your Total Compensation exceeds \$40,000,000, Employer shall have the option to extend the Employment Period for up to an additional three year period, commencing on July 1, 2010 and expiring no later than June 30, 2013; provided, however, that Employer's exercise of this option shall in no way impact your entitlement to the payment described in Paragraph 2(i) on May 15, 2010. For purposes of this Agreement, "Total Compensation" shall mean the total of (i) your cumulative Base Salary through the date of determination, (ii) your cumulative Annual Bonuses through such date, (iii) the realized and unrealized gains (based upon the closing price of the common stock of Activision, Inc. ("Activision") as reported on The NASDAQ Stock Market on the applicable date) from any and all vested stock options issued to you, (iv) the market value of all vested restricted, stock grants issued to you plus the amounts you realized from the sale of any shares sold by you which were the subject of such restricted stock grants.

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

**2. Salary**

(a) In full consideration for all rights and services provided by you under this Agreement, you shall receive the compensation set forth in this Paragraph 2. Commencing on the Effective Date, you shall receive an annual base salary ("Base Salary") of \$600,000 for the period of time from the Effective Date until June 30, 2006. Thereafter, on July 1 of each year of the Employment Period, beginning on July 1, 2006, your Base Salary shall automatically increase to an amount equal to one hundred eight (108%) percent of the Base Salary for the prior year.

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(b) Base Salary payments shall be made in accordance with Employer's then prevailing payroll policy. The Base Salary referred to in Paragraph 2(a) shall constitute your minimum Base Salary during the applicable period, and your Base Salary may be increased above the minimum at any time if Activision's Board of Directors (or the Compensation Committee of such Board of Directors), in its sole and absolute discretion, elects to do so. In the event of an increase in your Base Salary beyond the applicable minimum Base Salary for a particular period, such increased Base Salary shall then constitute your minimum Base Salary for each subsequent year under this Agreement.

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

(d) In addition to your Base Salary, you may be eligible to receive an annual discretionary bonus (the "Annual Bonus"). Your target Annual Bonus during the term of this Agreement shall be 100% of the then applicable Base Salary, provided that the actual amount of the Annual Bonus, if any, is within the sole and absolute discretion of the Activision's Board of Directors (or the Compensation Committee of the Board of Directors) and shall be based upon your achievement of certain mutually agreed objectives and goals and/or your contribution to the success of Employer's financial and business objectives and goals for the fiscal year with respect to which the Annual Bonus is calculated, such determination made by Activision's Board of Directors (or the Compensation Committee of the Board of Directors) in its sole discretion. The Annual Bonus shall take the form of, without limitation, cash, shares of common stock of Activision and/or options to purchase such shares, as determined by the Compensation Committee in its sole discretion. Employer's overall financial performance will also be considered in determining whether any of the Annual Bonus is awarded and, if so, the amount. The Annual Bonus, if granted, is generally paid to employees in May. Except as otherwise set forth in this Agreement, you must remain continuously employed by Employer through the date on which the Annual Bonus is paid to be eligible to receive such Annual Bonus. Any Annual Bonus shall be subject to withholding.

(e) As an inducement to enter into this Agreement, pursuant to the Activision 2003 Incentive Plan ("Plan"), you will, on or before the Effective Date, be granted a non-qualified stock option (the "Option") to purchase an aggregate of 1,000,000 shares of the Activision's common stock in two tranches of 350,000 shares each and one tranche of 300,000 shares. As to the first tranche of 350,000 shares covered by the Option, such option will vest ratably over the five years following the Effective Date, with 20% of the amount vesting at the end of each year. As to the second tranche of 350,000 shares covered by the Option, such option will not vest until the end of the fifth year following the Effective Date (subject to possible earlier vesting in three equal annual installments if Employee shall achieve certain performance objectives to be mutually determined by you and Employer for the fiscal years 2007, 2008 and 2009) and will thereupon fully vest in its entirety (on a "cliff-vesting" basis). As to the third tranche of 300,000 shares covered by the Option, such option will not vest until the end of the fifth year following the Effective Date and

will thereupon fully vest in its entirety (on a "cliff-vesting" basis). The Option will have an exercise price per share that will be the fair market value on the grant date and will be governed in all other respects by (and you agree to enter into) Activision's standard form of stock option agreement for similar grants of "inducement" options.

(f) You may be eligible for such additional stock option grants commensurate with your position with Employer as the Board of Directors (or Compensation Committee of the Board of Directors), in its sole discretion, may award to you from time to time in connection with any extensions of this Agreement's contract term.

(g) In consideration for abandoning certain benefits with your prior employer and forgoing certain other executive opportunities and related equity participations, pursuant to the Plan, you also will receive, on or before the Effective Date, a restricted stock grant (the "Grant") of the number of shares of Activision's common stock (any fractional shares resulting from this computation shall be rounded up to the next whole number) equal to \$2,000,000 divided by the fair market value on the grant date ("Market Price"), which restricted stock grant will vest ratably over the third, fourth and fifth years following the Effective Date, with one third of the amount granted vesting at the end of each of the third, fourth and fifth years following the Effective Date.

(h) Within three months of the Effective Date, you shall relocate your principal residence to within a 30- to 60-minute vehicle commute of Employer's headquarters (Santa Monica, California). At the time of relocation, Employer shall pay for the following costs: (i) all closing costs associated with buying and selling a home, including real estate commissions for the sale of your existing principal residence; (ii) all moving costs for household goods; and (iii) \$300,000 mortgage assistance, payable \$8,333.33 each month for 36 months. In addition, Employer will reimburse you for the actual incremental income taxes paid by you by reason of the inclusion in your income of the payments to you of the amounts set forth in clauses (i) and (ii) of the immediately preceding sentence. Prior to your relocation, Employer will reimburse you for your reasonable commuting costs between your current residence and Los Angeles.

(i) In the event that on May 15, 2010 your Total Compensation plus any severance payments that you have received, has not exceeded \$20,000,000 ("Guarantee Amount"), Employer will make a payment to you for the amount of any shortfall. This payment is required to be made by Employer whether or not you are employed by Employer on May 15, 2010, unless your employment has been terminated by Employer pursuant to Paragraphs 9(a), 9(c) or 9(e) or by you other than by reason of Paragraph 9(b), in which case no payment shall be required under this Paragraph 2(i).

### **3. Title; Reporting**

You are being employed under this Agreement in the position of President and Chief Executive Officer of Employer. You shall report to the Co-Chairmen of Activision and, through January 2006, the Chairman of Employer.

3

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### **4. Duties**

You shall personally and diligently perform, on a full-time and exclusive basis, such services as Employer or any of its related or affiliated entities or divisions may reasonably require. You are also required to read, review and observe all of Employer's existing policies, procedures, rules and regulations as well as those adopted by Employer during the term of your employment. You will at all times perform all of the duties and obligations required by you under this Agreement in a loyal and conscientious manner and to the best of your ability and experience. You will not engage in any outside business activities nor serve on the board of directors or trustees of any entity without the prior approval of the Co-Chairmen of Activision.

### **5. Expenses**

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

### **6. Other Benefits**

You shall be entitled to those benefits which are standard for persons in similar positions with Employer, including coverage under Employer's health, life insurance and disability plans, and eligibility to participate in Activision's Employee Stock Purchase Plan and Employer's 401(k) plan (with Employer matching your contributions to such 401K plan in accordance with Employer's matching policy). Nothing paid to you under any such plans and arrangements (nor any bonus or stock options which Activision's Board of Directors (or the Compensation Committee of such Board of Directors), in its sole and absolute discretion, shall provide to you) shall be deemed in lieu, or paid on account, of your Base Salary. You expressly agree and acknowledge that after the expiration or early termination of the term of your employment under this Agreement, you are entitled to no additional benefits, except as specifically provided in this Agreement and except as specifically provided under the benefit plans referred to above and those benefit plans in which you subsequently may become a participant, and subject in each case to the terms and conditions of each such plan. Notwithstanding anything to the contrary set forth above, you shall be entitled to receive those benefits provided by COBRA or CAL-COBRA upon the expiration or earlier termination of this Agreement.

### **7. Vacation and Paid Holidays**

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

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

4

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

(a) **Duty of Loyalty.** During the term of your employment, you will owe a duty of loyalty to Employer, which includes, but is not limited to, your not competing in any manner, whether directly or indirectly, as a principal, employee, agent or owner, with Employer, or any affiliate of Employer, except that the foregoing will not prevent you from holding at any time less than five percent (5%) of the outstanding capital stock of any company whose stock is publicly traded.

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

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

(d) **Non-Competition.** During your Employment Period, the Consulting Term and for a period of one year following the later of (i) the expiration of the Employment Period and (ii) the expiration of the Consulting Term, you shall not engage (including, without limitation, as an officer, director, shareholder, owner, partner, joint venturer, member or in a managerial capacity, or as an employee, independent contractor, consultant, advisor or sales representative) in any Competitive Business (as hereinafter defined) in the Territory (as hereinafter defined). For purposes of determining whether you are permitted to be a shareholder of a corporation engaged in a Competitive Business, the Executive's direct or indirect ownership (alone or together with a group) of less than 5% of the issued and outstanding securities of a company whose securities are publicly-traded in any U.S. or non-U.S. securities exchanges or quotation system shall be permitted. As used herein, the term "Competitive Business" shall mean any business engaged in publishing and distributing video games and entertainment software for personal computers. As used herein, the term "Territory" shall mean:

5

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

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

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

(e) **Covenant Not to Solicit.** During the Employment Period, the Consulting Term and for a period of two years following the later of (i) the expiration of the Employment Period for any reason whatsoever or (ii) the expiration of the Consulting Term, you shall not, either alone or jointly, with or on behalf of others, directly or indirectly, whether as principal, partner, agent, shareholder, director, employee, consultant or otherwise, offer employment to, or directly or indirectly solicit the employment or engagement of, or otherwise entice away from the employment of Employer or any affiliated entity, either for your own account or for any other person, firm or company, any person who was employed by Employer or any such affiliated entity during the term of your employment, whether or not such person would commit any breach of his or her contract of employment by reason of his or her leaving the service of Employer or any affiliated entity.

## 9. Termination

(a) **Employer.** At any time during the Employment Period, Employer may terminate your employment under this Agreement for Cause, defined as your (i) willful, reckless or gross misconduct, (ii) material breach by you of the Agreement, which shall continue uncured for a period of 45 days after written notice to you of such material breach, or (iii) conviction of a felony involving dishonesty or moral turpitude. In addition, but subject to the provisions of Paragraph 9(d)(iii) below, Employer may terminate your employment under this Agreement at any time without Cause. In the case of any termination for Cause pursuant to clause (ii), Employer shall give written notice of termination to you ("Notice of Cause Termination"), and shall specify the date of such termination, which shall not be earlier than 45 days after the date on which notice is given to you. Such notice shall specify the particular acts or circumstances that purport to constitute Cause for such termination. You shall be given the opportunity within 30 days after receiving such notice to explain why Cause for such termination does not exist or to cure any such basis for Cause. Within 15 days after any such explanation, you will be given the final decision regarding whether Cause exists. If the final decision is that Cause exists, your employment with Employer shall be terminated under Paragraph 9(a) (ii) pursuant to the Notice of Cause Termination as of the date of termination specified in the notice. If the final decision is that Cause does not exist, your employment with Employer shall not be terminated under Paragraph 9(a)(ii) pursuant to such Notice of Cause Termination.

6

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(b) **Employee.** You may terminate your employment under this Agreement upon the continuing occurrence of the following, which shall remain uncured for a period of 45 days following notice to Employer of such occurrence: (i) the material diminution of your duties and responsibilities hereunder in violation of the Agreement, provided that neither your ceasing to have investor relations, financial reporting or similar responsibilities, nor the addition of one or more operating units or subsidiaries by reason of acquisitions or similar transactions that are not incorporated into Employer, nor the addition of new management and reporting responsibilities at Employer or Activision by reason of significant increase in the size and scope of Employer's core business due to acquisitions or similar events shall be considered a diminution in your duties or responsibilities in violation of the Agreement; (ii) a

reduction in your Base Salary; (iii) the elimination or reduction of your participation in any incentive or benefit plan, or reduction of participation in any such plan, other than, in any such case, as a result of the modification, reduction or elimination of such plan with regard to all senior executives of Employer or as a result of regulatory, tax or accounting requirements; or (iv) your relocation without your consent to a location more than 25 miles from Los Angeles County; provided, that you shall not have the right to terminate your employment pursuant to clauses (i), (ii) or (iii) of this Paragraph 9(b) after such date as your Total Compensation shall equal or exceed the Guarantee Amount so long as, in the case of (i) above, your position remains as a senior executive position with the equivalent of divisional leadership responsibilities.

(c) **Death or Disability.** In the event of your death during the term of this Agreement, this Agreement shall terminate and Employer shall be obligated to pay only your estate or legal representative the amounts set forth in Paragraph 9(d)(i) below. In the event that you have or develop a Disability, then Employer shall have the right, at its option, to terminate your employment under this Agreement, subject to the provisions of Paragraph 9(d)(ii) below. Unless and until so terminated, during any period of Disability during which you are unable to perform the services required of you under this Agreement, your Base Salary shall be payable to the extent of, and subject to, Employer's policies and practices then in effect with regard to sick leave and disability benefits. "Disability" shall be determined in accordance with the definitions set forth in the Employer's disability insurance policies and shall be determined by a physician mutually agreed upon by you and Employer. If you and Employer are unable to agree on such a physician, you and Employer shall each appoint one physician and those two physicians shall appoint a third physician who shall make such a determination. You shall cooperate and make yourself available for any medical examination reasonably required by Employer with respect to any determination of your Disability.

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

- (i) **Compensation upon Death.** In the event of this Agreement is terminated as a result of your death, your heirs, successors or legal representatives shall receive: (i) the Base Salary through the date of termination of this Agreement; (ii) any unpaid Annual Bonus for any prior fiscal year; (iii) the pro rata portion of the Annual Bonus for the fiscal year in which your termination occurs to the extent such Annual Bonus is earned; (iv) an amount

7

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equal to 300% of the dollar amount of the Base Salary paid or payable to you for Employer's most recent fiscal year immediately prior to your date of death; (v) reimbursement of expenses due to you pursuant to Paragraphs 2(h) and 5; (vi) immediate vesting of a pro rata (based upon the amount of time between the Effective Date and the date of your death) portion of the unvested portion of the second and third tranches of the Option issued to you pursuant to Paragraph 2(e); and (vii) your then current spouse and minor children, if any, shall receive the same level of health/medical insurance or coverage that was provided to you immediately prior to your death for a two year period, with the cost of such continued insurance or coverage being borne by Employer. All such payments shall be in addition to any payments your widow, beneficiaries or estate may be entitled to receive pursuant to any pension or employee benefit plan or life insurance policy maintained by Employer.

- (ii) **Compensation upon Disability.** In the event this Agreement is terminated as a result of your Disability, you shall receive: (i) the Base Salary through the date of your termination; (ii) any unpaid Annual Bonus for any prior fiscal year; (iii) the pro rata portion of the Annual Bonus for the fiscal year in which your termination occurs to the extent such Annual Bonus is earned; (iv) reimbursement of expenses due to you pursuant to Paragraphs 2(h) and 5; (v) an amount equal to three hundred (300%) percent of the dollar amount of the Base Salary paid or payable to you for Employer's most recent fiscal year immediately prior to your Disability termination, less the amount, if any, of any payments received by you from any Employer-funded disability insurance plan; and (vi) you and your then current spouse and minor children, if any, shall receive the same level of health/medical insurance or coverage provided immediately prior to such Disability termination for a two year period, with the cost of such continued insurance or coverage being born by Employer.
- (iii) **Compensation upon Termination Without Cause.** In the event your employment under this Agreement is terminated by Employer without Cause, or by you pursuant to Paragraph 9(b), then you shall receive: (i) the Base Salary through the date of your termination; (ii) any unpaid Annual Bonus for any prior fiscal year; (iii) the pro rata portion of the Annual Bonus for the fiscal year in which your termination occurs to the extent such Annual Bonus is earned; (iv) reimbursement of expenses due you pursuant to Paragraphs 2(h) and 5; and (v) 50% of the Base Salary payable to you from the date of termination through the Expiration Date had your employment not been terminated, such Base Salary to be determined in accordance with the terms of Paragraph 2(a) of this Agreement and to be paid on a salary continuation basis as and when normally paid by Employer; and (vi) 100% of the Annual Bonus amount payable to you during the period following the date of termination through the Expiration Date had your employment not been terminated, which Annual Bonus shall be equal to the product of your Base Salary that would have been in effect for such fiscal year and a fraction, the

8

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numerator of which is the total of the Annual Bonus paid to you in the two fiscal years prior to termination, and the denominator of which is the Base Salary that was paid to you in the two fiscal years prior to termination, such Annual Bonus to be paid as and when normally paid by Employer. Upon such termination, you will also enter into a consulting relationship with Employer on the terms set forth in Paragraph 10.

(e) **Performance Termination.** At any time during the Employment Period, Employer may terminate your employment under this Agreement by reason of your failure to perform the functions of your position at the level appropriate for Employer, provided that you shall have been given written notice of such performance deficiencies and shall have failed to cure such performance deficiencies within 12 months following such notice. In the event your employment under this Agreement is terminated by Employer pursuant to this Paragraph 9(e), then you shall receive: (i) Base Salary through date of termination; (ii) any unpaid Annual Bonus for any prior fiscal year, (iii) the pro rata portion of the Annual Bonus for the fiscal year in which your termination occurs to the extent such Annual Bonus is earned; (iv) reimbursement of expenses due you pursuant to Paragraphs 2(h) and 5; and (v) 50% of the Base Salary payable to you from the date of termination through the Expiration Date had your employment not been terminated, such Base Salary to be determined in accordance with the terms of Paragraph 2(a) of this Agreement and to be paid on a salary continuation basis as and when normally paid by Employer; and

(vi) 100% of the Annual Bonus amount payable to you during the period following the date of termination through the Expiration Date had your employment not been terminated, which Annual Bonus shall be equal to the product of your Base Salary that would have been in effect for such fiscal year and a fraction, the numerator of which is the total of the Annual Bonus paid to you in the two fiscal years prior to termination, and the denominator of which is the Base Salary that was paid to you in the two fiscal years prior to termination, such Annual Bonus to be paid as and when normally paid by Employer; provided that the total of severance payments following a termination pursuant to this Paragraph 9(e) shall not be more than the Pro-Rata Guarantee Amount. The Pro Rata Guarantee Amount shall be (i) \$4,000,000 if your employment is terminated before the second anniversary of the effective Date, (ii) \$8,000,000 if your employment is terminated after the second anniversary of the Effective date and before the third anniversary of the Effective Date, (iii) \$12,000,000 if your employment is terminated after the third anniversary of the Effective Date and before the fourth anniversary of the Effective Date, (iv) \$16,000,000 if your employment is terminated after the fourth anniversary of the Effective Date and before the fifth anniversary of the Effective Date, and (v) \$20,000,000 if your employment is terminated after the fifth anniversary of the Effective Date.

#### **10. Consulting Agreement.**

In the event Employer elects to terminate your employment under this Agreement without cause, or you terminate your employment pursuant to Paragraph 9(b), you agree that upon the effective date of such termination, you and Employer shall then enter into a consulting agreement (the "Consulting Agreement") pursuant to which Employer will retain your services as a consultant of Employer for a period of equal to the remaining Employment Period (as such Employment Period may have been extended pursuant to Paragraph 1(b)), following such termination and for a period of additional two years (the "Consulting Term"). The Consulting Agreement shall provide for, among other things:

9

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(a) payment of consulting fees to you in the following amounts: (i) until the Expiration Date, the amount equal to 50% of the Base Salary that would have been payable to you had your employment not been terminated, such Base Salary to be determined in accordance with the terms of Paragraph 2(a) of this Agreement, and (ii) following the Expiration Date, \$250,000 per annum. Payment of consulting fees shall be made in accordance with Employer's standard payroll practices and will be subject to Withholding;

(b) that you shall continue to receive those benefits described in Paragraph 6 above;

(c) that you shall not be restricted from engaging (including, without limitation, as an officer, director, shareholder, owner, partner, joint venturer, member or in a managerial capacity, or as an employee, independent contractor, consultant, advisor or sales representative) in such activities as you deem appropriate to engage in during the Consulting Term, provided that such activities or activities of any entity to which you are providing services shall not be directly competitive with the activities of Employer or any of its affiliates (regardless of whether Employer engaged in such activities prior to the commencement of the Consulting Agreement or may commence engaging in such activities at any time during the Consulting Term);

(d) that you will continue to abide by all of Employer's internal rules, policies and procedures. Without limiting the generality of the foregoing, you will remain subject to the provisions of Paragraph 8 of this Agreement, including without limitation, your agreement not to engage in solicitations of any employees of Employer and its affiliates for a period of (2) years following the termination of the Consulting Agreement;

(e) that you shall also remain subject to the provisions of the Employee Proprietary Information Agreement previously executed by you; and

(f) such other terms and provisions as Employer deems appropriate

In the event Employer and you fail to execute the Consulting Agreement, then provisions of this Paragraph 10 shall govern the relationship between you and Employer until the expiration of the Consulting Term.

#### **11. Use of Employee's Name**

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

#### **12. Assignment**

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

10

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#### **13. No Conflict with Prior Agreements**

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

#### **14. Successors**

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

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

#### **15. Minimum Ownership Position**

At all times during the term on or after the second anniversary of the Effective date, you shall own a number of shares of Activision's common stock that have an "aggregate market value" which is at least equal to the greater of (a) 1.50 times your annual Base Salary set forth in Paragraph 2(a) or (b) ten percent (10%) of the total amount realized by you from all option exercises within two years of the Effective Date, determined for each option so exercised to be an amount equal to the Market Price (as defined in Paragraph 2(g)) of Activision's shares on the applicable exercise date over the exercise price per share of such options. For purposes of this Agreement, "aggregate market value" shall be the product of the Market Price and the total number of Activision's shares owned by you as of the applicable date. All Activision restricted stock grants to you shall be included for these purposes in the foregoing calculation. Employer shall in good faith monitor such ownership position. You also agree to comply with any additional stock ownership guidelines that may be adopted by the Board of Directors and apply to Employer's senior executives.

## 16. General Provisions

(a) **Entire Agreement.** This Agreement, together with the Employee Proprietary Information Agreement, and stock option agreement, supersedes all prior or contemporaneous agreements and statements, whether written or oral, concerning the terms of your employment with Employer, and no amendment or modification of these agreements shall be binding unless it is set forth in a writing signed by both Employer and you. To the extent that this Agreement conflicts with any of Employer's policies, procedures, rules or regulations, this Agreement shall supersede the other policies, procedures, rules or regulations.

(b) **No Broker.** You have given no indication, representation or commitment of any nature to any broker, finder, agent or other third party to the effect that any fees or commissions of

11

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any nature are, or under any circumstances might be, payable by Employer or any affiliate of Employer in connection with your employment under this Agreement.

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

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

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

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

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

(h) **Venue and Jurisdiction.** The parties agree that all actions or proceedings initiated by either party hereto arising directly or indirectly out of this Agreement shall be litigated in federal or state court in Los Angeles, California. The parties hereto expressly submit and consent in advance to such jurisdiction and agree that service of summons and complaint or other process or papers may be made by registered or certified mail addressed to the relevant party at the address set forth below. The parties hereto waive any claim that a federal or state court in Los Angeles, California, is an inconvenient or an improper forum.

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

12

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(j) **Legal Counsel.** You acknowledge that you have been given the opportunity to consult with legal counsel of your own choosing regarding this Agreement. You understand and agree that Employer's General Counsel, or any other attorney or member of management who has discussed any term or condition of this Agreement with him, is only acting on behalf of the Employer and not on your behalf.

(k) **Right to Negotiate.** You hereby acknowledge that you have been given the opportunity to participate in the negotiation of the terms of this Agreement.

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

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

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

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

(p) **Amendment.** This Agreement may not be amended or modified otherwise than by a written agreement executed by the parties hereto or their respective successors and legal representatives. The parties shall cooperate in good faith in making any amendments to this Agreement that may be necessary to avoid imposition of any penalty tax imposed under Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), or the regulations thereunder.

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

13

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

## 17. **Notices**

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

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

To You: Michael Griffith  
11061 Toddree Lane  
Cincinnati, Ohio 45242

14

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

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

### ACCEPTED AND AGREED TO:

**Employer**

**Employee**

ACTIVISION PUBLISHING, INC.

By: /s/ George Rose  
Its: Sr. Vice President &  
General Counsel

/s/ Michael Griffith  
Michael Griffith

15

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## STOCK OPTION AGREEMENT

Stock Option #03000705/  
03000706/03000707

For 1,000,000 Shares

## ACTIVISION, INC.

THIS STOCK OPTION AGREEMENT (THIS "OPTION AGREEMENT") CERTIFIES that on June 15, 2005 (the "Issuance Date"), Michael Griffith (the "Holder") was granted an option (the "Option") to purchase at the option price of \$17.12 per share, all or any part of 1,000,000 fully paid and non-assessable shares ("Shares") of common stock, par value \$.000001 per share, of ACTIVISION, INC., a Delaware corporation (the "Company"), upon and subject to the following terms and conditions:

- General Terms of the Option.** The Option is granted as a material inducement to the Holder's entering into employment with the Company pursuant to an employment agreement dated June 15, 2005 (the "Employment Agreement"). In addition, this Option has been granted pursuant to and is subject to the terms and conditions of the Company's 2003 Incentive Plan (the "Plan"), and the terms and conditions of the Plan shall be deemed to be incorporated herein by reference and made a part of this Option. Holder hereby acknowledges by his signature below that he has received a copy of the Plan. Capitalized terms used herein shall have the meanings set forth in the Plan, unless otherwise defined herein.
- Expiration.** This Option shall expire on June 30, 2015, unless extended or earlier terminated in accordance herewith.
- Exercise.** Except as otherwise permitted under the Plan, this Option may be exercised or surrendered during the Holder's lifetime only by the Holder or his/her guardian or legal representative. EXCEPT AS OTHERWISE PERMITTED UNDER THE PLAN, THIS OPTION SHALL NOT BE TRANSFERABLE BY THE HOLDER OTHERWISE THAN BY WILL OR BY THE LAWS OF DESCENT AND DISTRIBUTION. With the Company's consent which may be granted or withheld in its sole discretion, Options may be transferred to certain permitted assignees, such as certain relatives of, or entities controlled by, the Participant, as more fully set forth in Section 8.3 of the Plan.

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

Vesting Date	Shares Vested at Vesting Date	Cumulative Shares
June 30, 2006	70,000	70,000
June 30, 2007	70,000	140,000
June 30, 2008	70,000	210,000
June 30, 2009	70,000	280,000
June 30, 2010	720,000	1,000,000

This Option shall be exercised by the Holder (or by his executors, administrators, guardian or legal representative) as to all or part of the Shares, by the giving of written notice of

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

4. **Tranches Subject to Acceleration.** Pursuant to Paragraph 2(e) of the Employment Agreement, of the 720,000 Shares scheduled to vest on June 30, 2010, 350,000 Shares may be subject to accelerated vesting if Holder shall achieve certain performance objectives to be mutually determined by Holder and the Company at the rate of 116,666 Shares to vest on June 30, 2007 for achievement of such performance objectives during the Company's fiscal year 2007, 116,666 Shares to vest on June 30, 2008 for achievement of such performance objectives during the Company's fiscal year 2008, and 116,667 Shares to vest on June 30, 2009 for achievement of such performance objectives during the Company's fiscal year 2009. In addition, pursuant to Paragraph 9(d) (i) of the Employment Agreement, of the 720,000 Shares scheduled to vest on June 30, 2010, a pro rata (based upon the amount of time between the Issuance Date and the date of the death of the Holder) portion of 650,000 Shares may be subject to immediate vesting upon the death of the Holder.

5. **Termination of Employment.** In the event of the termination of employment or separation from service of the Holder for any reason (other than death or disability as provided below), this Option, to the extent not previously exercised or expired, shall be deemed cancelled and terminated on the day of such termination or separation, unless the Company decides, in its sole discretion, to extend the term of this Option, subject to the terms of the Plan, except that if your employment is terminated by the Company other than for Cause (as defined in the Employment Agreement), the term of this Option shall be extended and shall be exercisable for a period of thirty (30) days following the date of termination.

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

within six months after the Optionee's death, the term of such Option shall be extended until six months after the Optionee's death.

7. *Disability.* In the event of the termination of employment of the Holder or the separation from service of the Holder due to the Disability (as defined in Paragraph 9(c) of the Employment Agreement) of the Holder, the Holder, or his guardian or legal representative, shall have the unqualified right to exercise any portion of this Option which has not been previously exercised or expired and which the Holder was eligible to exercise as of the first date of Disability, at any time within one year after such termination or separation, *provided, however*, that if the term of such Option would expire by its terms within six months after such termination or separation, the term of such Option shall be extended until six months after such termination or separation.

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

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

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

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

(b) as to any Shares acquired by the Holder upon exercise and not thereafter sold, with respect to each of such Shares an amount equal to the product of (x) the greatest of the following: (1) the Fair Market Value per Share on the date of exercise,

3

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

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

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

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

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

4

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or the Company shall make a notation in its books and records to reflect the partial exercise of this Option.

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

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

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

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

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

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

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WHICH IS ESTABLISHED BY AN OPINION FROM COUNSEL TO THE COMPANY.

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

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

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

**[Remainder of page intentionally blank.]**

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

ACTIVISION, INC.

By: /s/ George Rose

Name: George Rose

Title: Sr. Vice President & General Counsel

Date: June 15, 2005

Attest:

/s/ Danielle Kim

Accepted and Confirmed:

/s/ Michael Griffith

MICHAEL GRIFFITH

Address

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City                      State                      Zip Code

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Social Security Number

## ACTIVISION, INC.

## RESTRICTED STOCK AWARD AGREEMENT

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

- Name of Grantee: Michael Griffith
- Total Number of Shares of Restricted Stock Awarded: 116,822(1)
- Date of Grant: June 15, 2005
- This award of Restricted Stock is being made pursuant to and as a material inducement for the Grantee to enter into an employment agreement dated June 15, 2005 (the "Employment Agreement") and is governed by the terms of the Employment Agreement and the terms of the Restricted Stock Award Terms attached hereto as Exhibit A. In addition, this award of Restricted Stock is granted under and subject to the terms and conditions of the Company's 2003 Incentive Plan (the "Plan"), the terms, conditions and definitions of which are hereby incorporated herein as though set forth at length, and the receipt of a copy of which the Grantee hereby acknowledges by his signature on the irrevocable stock attached hereto as Exhibit B. Capitalized terms used herein shall have the meanings set forth in the Plan, unless otherwise defined herein.
- **This award of Restricted Stock is conditioned upon your endorsement in blank of the irrevocable stock power attached hereto as Exhibit B. If you do not return the attached irrevocable stock power within sixty (60) days from the Date of Grant, this award shall be deemed forfeited. As such, promptly endorse and return the attached irrevocable stock power to the General Counsel at the following address:**

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

Dated: June 15, 2005

ACTIVISION, INC.

By: /s/ George Rose

Title: Sr. Vice President  
General Counsel

/s/ Michael Griffith

(1) Amount equal to \$2,000,000 divided by the closing price of ATVI stock as reported on closing on NASDAQ on July 1, 2005.

EXHIBIT A

ACTIVISION, INC.

RESTRICTED STOCK AWARD TERMS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A-1

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

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

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

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

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

4. **Vesting.** Except as otherwise provided in Section 5 or 10, on each Anniversary Date beginning with the third Anniversary Date through and including the fifth Anniversary Date that Grantee remains in continuous employment with the Company or any of its subsidiaries or affiliates, the Restrictions shall lapse with respect to one-third of the original number of Restricted Shares set forth on the Grant Notice, as adjusted to account for additional shares of Common Stock resulting from dividend reinvestment pursuant to Section 6 hereof or any adjustment pursuant to Section 9 hereof. Fractional shares shall be rounded up to the nearest whole share of Common Stock (for which purpose one-half share shall be rounded up to the nearest whole share of Common Stock). Upon termination of Grantee’s employment with the Company and its subsidiaries and affiliates for any reason other than death or Disability, whether by action of Grantee or the Company, any remaining Restricted Shares which have not become vested in accordance with this Section 4 shall immediately be forfeited to the Company without payment of consideration by the Company.

5. **Tax Withholding.** Upon the lapse of the Restrictions (or any such earlier time, if any, that an election is made under Section 83(b) of the Code, or any successor provision thereto, to include the value of such shares in taxable income), the Company shall be entitled to withhold from Grantee’s compensation any required taxes, including, but not limited to, Grantee’s social security and Medicare taxes and federal, state and local income tax with respect to the income arising from the lapse of the Restrictions. The Company shall have the right to require the payment of any such

A-2

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taxes before delivering the stock certificate with respect to the Vested Shares and the related stock power held by the Company in accordance with Section 6 hereof. Alternatively, in lieu of such withholding, Grantee shall be entitled to cover all or any part of the taxes arising from the lapse of the Restrictions through a reduction of the number of Vested Shares delivered to Grantee or a delivery, or tender, to the Company of shares of Common Stock already held by Grantee, in each case valued in the same manner as used in computing withholding taxes under the applicable laws. Additionally, to the extent it is determined by a regulatory agency or a court of competent jurisdiction that shares of Common Stock which would otherwise be considered Restricted Shares pursuant to the terms of the Award nevertheless result in current federal or state taxation, (i) all Restrictions as to such shares shall immediately lapse, (ii) such shares shall immediately become Vested Shares and (iii) Grantee shall be entitled to cover all or any part of the taxes through a reduction of such Restricted Shares resulting in the taxable event.

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

all other record holders of Common Stock. To the extent the Restricted Shares have not been forfeited, Grantee shall be entitled to voting privileges associated with the Restricted Shares.

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

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

9. Adjustments. Notwithstanding anything to the contrary herein, in the event that the Committee shall determine that any dividend or other distribution (whether in the form of cash, shares or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, spin-off, combination, repurchase, or share exchange, or other similar corporate transaction or event, affects the Restricted Shares such that an adjustment is determined by the

A-3

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Committee to be appropriate in order to prevent dilution or enlargement of the rights of Grantee under this Award, then the Committee shall, in such manner as it may deem equitable, make any adjustments to the Award it deems appropriate. In addition, the Committee is authorized to make such adjustments as it deems appropriate in the terms and conditions of, and the criteria included in, the Award in recognition of unusual or nonrecurring events (including, without limitation, events described in the preceding sentence) affecting the Company or any subsidiary or affiliate or the financial statements of the Company or any subsidiary or affiliate, or in response to changes in applicable laws, regulations or accounting principles.

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

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

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

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

A-4

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

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

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

A-5

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**IRREVOCABLE STOCK POWER**

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

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

\_\_\_\_\_  
First Name Middle Name Last Name Date

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

B-1

**EXHIBIT C**

**ACTIVISION, INC.**

**Restricted Stock Award dated as of \_\_\_\_\_, 20**

**Designation of Beneficiary**

I, \_\_\_\_\_ ("Grantee"), hereby designate

PRIMARY  
(Print Beneficiary's Name) Last First Middle Initial  
Print Beneficiary's Address Relationship

PRIMARY  
(Print Beneficiary's Name) Last First Middle Initial  
Print Beneficiary's Address Relationship

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

SECONDARY  
(Print Beneficiary's Name) Last First Middle Initial  
Print Beneficiary's Address Relationship

SECONDARY  
(Print Beneficiary's Name) Last First Middle Initial  
Print Beneficiary's Address Relationship

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

\_\_\_\_\_  
Date Grantee

**ACKNOWLEDGED AND ACCEPTED BY THE COMPANY:**

\_\_\_\_\_  
Date Signature of Company Representative

C-1



Activision Publishing, Inc.  
3100 Ocean Park Boulevard  
Santa Monica, California 90405

June 15, 2005

Ron Doornink  
872 9th Street  
Manhattan Beach, CA 90266

Dear Ron,

Reference is made to your employment agreement dated as of July 22, 2002, as previously amended by that Amendment No. 1 to employment agreement, effective as of February 27, 2003 and by that certain letter dated June 1, 2004 (collectively "Agreement") with Activision Publishing, Inc. ("Employer"). This is to confirm our mutual agreement that, with the commencement of Michael Griffith's employment with Employer, your title at Employer will be Chairman and that you will no longer have the titles of President or Chief Executive Officer of Employer. Except as so amended by this letter, the Agreement remains in full force and effect.

If the forgoing correctly sets forth our mutual understanding, please so indicate by signing below.

Sincerely

ACTIVISION PUBLISHING, INC.

By: /s/ George Rose  
Sr. Vice President  
General Counsel

ACCEPTED AND AGREED TO:

/s/ Ron Doornink  
Ron Doornink

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**CERTIFICATION**

I, Robert A. Kotick, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Activision, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2005

*/s/ Robert A. Kotick*

Robert A. Kotick  
Chief Executive Officer

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**CERTIFICATION**

I, Ronald Doornink, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Activision, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2005

*/s/ Ronald Doornink*

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

CERTIFICATION

I, William J. Chardavoyne, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Activision, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2005

*/s/ William J. Chardavoyne*

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William J. Chardavoyne  
Executive Vice President and  
Chief Financial Officer

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

In connection with the quarterly report of Activision, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert A. Kotick, Chief Executive Officer of the Company, certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ Robert A. Kotick  
\_\_\_\_\_  
Robert A. Kotick  
Chief Executive Officer  
August 4, 2005

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

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

In connection with the quarterly report of Activision, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ronald Doornink, President of the Company and Chairman of Activision Publishing, Inc., certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ Ronald Doornink

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Ronald Doornink  
President, Activision, Inc.  
and Chairman,  
Activision Publishing, Inc.  
August 4, 2005

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

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

In connection with the quarterly report of Activision, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William J. Chardavoyne, Executive Vice President and Chief Financial Officer of the Company, certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ William J. Chardavoyne

\_\_\_\_\_  
William J. Chardavoyne

Executive Vice President and

Chief Financial Officer

August 4, 2005

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

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