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, 2004

OR

o **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 o

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

The number of shares of the registrant's Common Stock outstanding as of July 26, 2004 was 138,392,458.

ACTIVISION, INC. AND SUBSIDIARIES

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Part I. Financial Information.
Item 1. Financial Statements.

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

	June 30, 2004 (Unaudited)	March 31, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 339,735	$ 466,552
Short-term investments	199,411	121,097
Accounts receivable, net of allowances of $48,279 and $47,028 at June 30, 2004 and March 31, 2004, respectively	123,048	62,577
Inventories	39,635	26,427
Software development	75,696	58,320
Intellectual property licenses	15,159	32,115
Deferred income taxes	23,497	26,127
Other current assets	21,184	18,660
Total current assets	837,365	811,875
Software development	21,660	28,386
Intellectual property licenses	17,630	16,380
Property and equipment, net	24,841	25,539
Deferred income taxes	6,666	9,064
Other assets	1,243	1,080
Goodwill	76,436	76,493
Total assets	$ 985,841	$ 968,817
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 75,558	$ 72,874
Accrued expenses	56,534	63,205
Total current liabilities	132,092	136,079
Commitments and contingencies (Note 14)		
Shareholders' equity:		
Preferred stock, $.000001 par value, 3,750,000 shares authorized, no shares issued at June 30, 2004 and March 31, 2004	—	—
Series A Junior Preferred stock, $.000001 par value, 1,250,000 shares authorized, no shares issued at June 30, 2004 and March 31, 2004	—	—
Common stock, $.000001 par value, 225,000,000 shares authorized, 167,809,185 and 166,876,567 shares issued and 138,263,860 and 137,331,242 shares outstanding at June 30, 2004 and March 31, 2004, respectively	—	—
Additional paid-in capital	770,257	758,626
Retained earnings	220,236	208,279
Less: Treasury stock, at cost, 29,545,325 shares at June 30, 2004 and March 31, 2004	(144,128)	(144,128)
Accumulated other comprehensive income	7,384	9,961
Total shareholders' equity	853,749	832,738
Total liabilities and shareholders' equity	$ 985,841	$ 968,817

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

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

	For the three months ended June 30, 2004	For the three months ended June 30, 2003
Net revenues	$ 211,276	$ 158,725
Costs and expenses:		
Cost of sales – product costs	89,088	76,610
Cost of sales – software royalties and amortization	12,283	15,498
Cost of sales – intellectual property licenses	17,648	10,143
Product development	21,105	13,580
Sales and marketing	41,734	26,285
General and administrative	13,685	11,463
Total costs and expenses	195,543	153,579
Operating income	15,733	5,146
Investment income, net	2,112	1,257
Income before income tax provision	17,845	6,403
Income tax provision	5,888	2,240
Net income	$ 11,957	$ 4,163
Basic earnings per share	$ 0.09	$ 0.03
Weighted average common shares outstanding	137,765	132,069
Diluted earnings per share	$ 0.08	$ 0.03
Weighted average common shares outstanding assuming dilution	153,407	140,655

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

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

	For the three months ended June 30, 2004	For the three months ended June 30, 2003
Cash flows from operating activities:		
Net income	$ 11,957	$ 4,163
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Deferred income taxes	5,028	1,441
Depreciation and amortization	2,579	2,251
Amortization of capitalized software development costs and intellectual property licenses	31,750	19,045
Tax benefit of stock options	3,597	512
Changes in operating assets and liabilities (net of effects of acquisitions):		
Accounts receivable	(60,471)	(17,406)
Inventories	(13,208)	(5,530)
Software development and intellectual property licenses	(26,694)	(28,244)
Other assets	(2,687)	(3,102)
Accounts payable	2,684	5,738
Accrued expenses and other liabilities	(6,671)	(2,566)
Net cash (used in) operating activities	(52,136)	(23,698)
Cash flows from investing activities:		
Capital expenditures	(1,881)	(5,671)
Purchases of short-term investments	(95,493)	(24,500)
Proceeds from sales and maturities of short-term investments	15,962	46,930
Net cash provided by (used in) investing activities	(81,412)	16,759

Cash flows from financing activities:		
Proceeds from issuance of common stock to employees	8,034	1,423
Other borrowings, net	—	(2,818)
Purchase of structured stock repurchase transactions	—	(36,420)
Settlement of structured stock repurchase transactions	—	65,903
Purchase of treasury stock	—	(18,814)
Net cash provided by financing activities	8,034	9,274
Effect of exchange rate changes on cash	(1,303)	2,944
Net increase (decrease) in cash and cash equivalents	(126,817)	5,279
Cash and cash equivalents at beginning of period	466,552	285,554
Cash and cash equivalents at end of period	$ 339,735	$ 290,833

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

ACTIVISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
For the three months ended June 30, 2004
(Unaudited)
(In thousands)

	Common Stock		Additional Paid-In	Retained	Treasury Stock		Accumulated Other Comprehensive	Shareholders'
	Shares	Amounts	Capital	Earnings	Shares	Amounts	Income (Loss)	Equity
Balance, March 31, 2004	**166,877**	**$ —**	**$ 758,626**	**$ 208,279**	**(29,546)**	**$ (144,128)**	**$ 9,961**	**$ 832,738**
Components of comprehensive income:								
Net income	—	—	—	11,957	—	—	—	11,957
Unrealized depreciation on short-term investments	—	—	—	—	—	—	(1,217)	(1,217)
Foreign currency translation adjustment	—	—	—	—	—	—	(1,360)	(1,360)
Total comprehensive income								9,380
Issuance of common stock pursuant to employee stock option and stock purchase plans	933	—	8,034	—	—	—	—	8,034
Tax benefit attributable to employee stock options	—	—	3,597	—	—	—	—	3,597
Balance, June 30, 2004	**167,810**	**$ —**	**$ 770,257**	**$ 220,236**	**(29,546)**	**$ (144,128)**	**$ 7,384**	**$ 853,749**

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

ACTIVISION, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)
For the three months ended June 30, 2004

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, 2004 as filed with the Securities and Exchange Commission ("SEC").

Software Development Costs and Intellectual Property Licenses

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

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

Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks, copyrights, software, technology or other intellectual property or proprietary rights in the development of our products. Depending upon the agreement with the rights holder, we may obtain the rights to use acquired intellectual property in multiple products over multiple years, or alternatively, for a single product.

We evaluate the future recoverability of capitalized intellectual property licenses on a quarterly basis. The recoverability of capitalized intellectual property license costs is evaluated based on the expected performance of the specific products in which the licensed trademark or copyright is to be used. As many of our intellectual property licenses extend for multiple products over multiple years, we also assess the recoverability of capitalized intellectual property license costs based on certain qualitative factors such as the success of other products and/or entertainment vehicles utilizing the intellectual property, whether there are any future planned theatrical releases or television series based on the intellectual property and the rights holder’s continued promotion and exploitation of the intellectual property. Prior to the related product’s release, we expense, as part of cost of sales – intellectual property licenses, capitalized intellectual property costs when we believe such amounts are not recoverable. Capitalized intellectual property costs for those products that are cancelled or abandoned are charged to product development expense in the period of cancellation. Criteria used to evaluate expected product performance include: historical performance of comparable products using comparable technology; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based.

Commencing upon the related product’s release, capitalized intellectual property license costs are amortized to cost of sales – intellectual property licenses based on the ratio of current revenues for the specific product to total projected revenues for all products in which the licensed property will be utilized. As intellectual property license contracts may extend for multiple years, the amortization of capitalized intellectual property license costs relating to such contracts may extend beyond one year. For intellectual property included in products that have been released, 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 development 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 actual impairment charge may be larger than originally estimated in any given quarter. Additionally, as noted above, as many of our intellectual property licenses extend for multiple products over multiple years, we also assess the recoverability of capitalized intellectual property license costs based on certain qualitative factors such as the success of other products and/or entertainment vehicles utilizing the intellectual property, whether there are any future planned theatrical releases or television series based on the intellectual property and the rights holder’s continued promotion and exploitation of the intellectual property. Material differences may result in the amount and timing of charges for any period if management makes different judgments or utilizes different estimates in evaluating these qualitative factors.

Revenue Recognition

We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers. Certain products are sold to customers with a street date (the date that products are made widely available by retailers). For these products we recognize revenue on 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, 2004, we had several stock-based employee compensation plans, which are described more fully in Note 15 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, 2004 filed with the SEC. We account for those plans under the recognition and measurement principles of APB Opinion No. 25 and related Interpretations. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation (amounts in thousands, except per share data):

	Three months ended June 30, 2004	Three months ended June 30, 2003
Net income, as reported	$ 11,957	$ 4,163
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(4,866)	(5,535)
Pro forma net income (loss)	$ 7,091	$ (1,372)
Earnings (loss) per share		
Basic - as reported	$ 0.09	$ 0.03
Basic - pro forma	$ 0.05	$ (0.01)
Diluted - as reported	$ 0.08	$ 0.03
Diluted - pro forma	$ 0.05	$ (0.01)

The fair value of options granted is estimated at the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model requires the input of highly subjective assumptions, including the expected stock price volatility. We use the historical stock price volatility of our common stock over the most recent period that is generally commensurate with the expected option life as the basis for estimating expected stock price volatility. For options granted during the three months ended June 30, 2004 and 2003, the historical stock price volatility used was based on a weekly stock price observation, using an average of the high and low stock prices of our common stock, which resulted in an expected stock price volatility of 48%. For purposes of the above pro forma disclosure, the fair value of options granted is amortized to stock-based employee compensation cost over the period(s) in which the related

employee services are rendered. Accordingly, the pro forma stock-based compensation cost for any period will typically relate to options granted in both the current period and prior periods.

2. Stock Split

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

3. Acquisitions

In May 2002, we acquired a 30% interest in the outstanding capital stock of Infinity Ward, Inc. ("Infinity Ward"), a privately held interactive software development company, as well as an option to purchase the remaining 70% of outstanding capital stock. In October 2003, we exercised our option to acquire the remaining 70% of the outstanding capital stock of Infinity Ward for cash of approximately $3.5 million. This acquisition further enables us to implement our multi-platform development strategy by augmenting our internal product development capabilities for the PC.

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

4. Cash, Cash Equivalents and Short-Term Investments

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

The following table summarizes our investments in securities as of June 30, 2004 (amounts in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash and time deposits	$ 93,570	$ —	$ —	$ 93,570
Money market funds	49,754	—	—	49,754
Auction rate notes	196,411	—	—	196,411
Cash and cash equivalents	339,735	—	—	339,735
Short-term investments:				
Corporate bonds	21,147	—	(108)	21,039
Taxable senior debt	17,019	2	—	17,021
U.S. agency issues	141,652	1	(996)	140,657
Asset-backed securities	17,712	30	(49)	17,693
Municipal bonds	3,001	—	—	3,001
Short-term investments	200,531	33	(1,153)	199,411
Cash, cash equivalents and short-term investments	$ 540,266	$ 33	$ (1,153)	$ 539,146

The following table summarizes the maturities of our investments in debt securities as of June 30, 2004 (amounts in thousands):

	Amortized Cost	Fair Value
Due in one year or less	$ 292,277	$ 291,933
Due after one year through two years	86,953	86,196
	379,230	378,129
Asset-backed securities	17,712	17,693
Total	$ 396,942	$ 395,822

For the three months ended June 30, 2004, there were no gross realized gains and no gross realized losses. For the three months ended June 30, 2003, net realized gains on short-term investments consisted of no gross realized gains and $4,000 of gross realized losses.

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, 2004	March 31, 2004
Purchased parts and components	$ 4,073	$ 392
Finished goods	35,562	26,035
	$ 39,635	$ 26,427

6. Goodwill

The changes in the carrying amount of goodwill for the three months ended June 30, 2004 are as follows (amounts in thousands):

	Publishing	Distribution	Total
Balance as of March 31, 2004	$ 70,898	$ 5,595	$ 76,493
Effect of foreign currency exchange rates	—	(57)	(57)
Balance as of June 30, 2004	$ 70,898	$ 5,538	$ 76,436

7. Income Taxes

The income tax provision of $5.9 million for the three months ended June 30, 2004 reflects our effective income tax rate of 33%. The significant items that generated the variance between our effective rate and our statutory rate of 35% were research and development tax credits and the impact of foreign tax rate differentials, partially offset by state taxes. The income tax provision of $2.2 million for the three months ended June 30, 2003 reflects our effective income tax rate of approximately 35%. State taxes, offset by research and development tax credits and the impact of foreign tax rate differentials, resulted in an effective income tax rate equal to our statutory rate of 35% for the three months ended June 30, 2003.

8. Software Development Costs and Intellectual Property Licenses

As of June 30, 2004, capitalized software development costs included $37.2 million of internally developed software costs and $60.2 million of payments made to third-party software developers. As of March 31, 2004, capitalized software development costs included $35.3 million of internally developed software costs and $51.5 million of payments made to third-party software developers. Capitalized intellectual property licenses were $32.8 million and

$48.5 million as of June 30, 2004 and March 31, 2004, respectively. Amortization and write-offs of capitalized software development costs and intellectual property licenses were $31.8 million and $19.0 million for the three months ended June 30, 2004 and 2003, respectively.

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

Comprehensive Income

The components of comprehensive income for the three months ended June 30, 2004 and 2003 were as follows (amounts in thousands):

	Three months ended June 30, 2004	2003
Net income	$ 11,957	$ 4,163
Other comprehensive income (loss)		
Foreign currency translation adjustment	(1,360)	3,725
Unrealized depreciation on short-term investments	(1,217)	(24)
Other comprehensive income (loss)	(2,577)	3,701
Comprehensive income	$ 9,380	$ 7,864

Accumulated Other Comprehensive Income (Loss)

For the three months ended June 30, 2004, the components of accumulated other comprehensive income were as follows (amounts in thousands):

	Foreign Currency	Unrealized Appreciation (Depreciation) on Investments	Accumulated Other Comprehensive Income (Loss)
Balance, March 31, 2004	$ 9,864	$ 97	$ 9,961
Other comprehensive loss	(1,360)	(1,217)	(2,577)
Balance, June 30, 2004	$ 8,504	$ (1,120)	$ 7,384

The income tax benefit related to other comprehensive loss was not significant.

10. Investment Income, Net

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

	Three months ended June 30, 2004	2003
Interest expense	$ (88)	$ (195)
Interest income	2,200	1,456
Net realized loss on investments	—	(4)
Investment income, net	$ 2,112	$ 1,257

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, 2004	2003
Non-cash investing and financing activities:		
Change in unrealized depreciation on short-term investments	$ 1,217	$ 24
Supplemental cash flow information:		
Cash paid for income taxes	$ 2,621	$ 3,349
Cash paid (received) for interest, net	(2,015)	(1,743)

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, 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, Australia, Sweden, Canada and Japan. Our products are sold internationally on a direct-to-retail basis and through third-party distribution and licensing arrangements and through our wholly-owned distribution subsidiaries.

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

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

The accounting policies of these segments are the same as those described in the Summary of Significant Accounting Policies in our Annual Report on Form 10-K for the year ended March 31, 2004. Revenue derived from sales between segments is eliminated in consolidation.

Information on the reportable segments for the three months ended June 30, 2004 and 2003 is as follows (amounts in thousands):

	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

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

Geographic information for the three months ended June 30, 2004 and 2003 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,	
	2004	2003
United States	$ 125,191	$ 82,739
Europe	78,101	72,740
Other	7,984	3,246
Total	$ 211,276	$ 158,725

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

	Three months ended June 30,	
	2004	2003
Console	$ 158,321	$ 123,826
Hand-held	22,085	7,508
PC	30,870	27,391
Total	$ 211,276	$ 158,725

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

13. Computation of Earnings Per Share

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

	Three months ended June 30, 2004	Three months ended June 30, 2003
Numerator:		
Numerator for basic and diluted earnings per share - income available to common shareholders	$ 11,957	$ 4,163
Denominator:		
Denominator for basic earnings per share-weighted average common shares outstanding	137,765	132,069
Effect of dilutive securities:		
Employee stock options and stock purchase plan	14,939	8,139
Warrants to purchase common stock	703	447
Potential dilutive common shares	15,642	8,586
Denominator for diluted earnings per share - weighted average common shares outstanding plus assumed conversions	153,407	140,655
Basic earnings per share	$ 0.09	$ 0.03
Diluted earnings per share	$ 0.08	$ 0.03

Options to purchase 63,700 shares of common stock at exercise prices ranging from $15.53 to $16.66 and options to purchase 12,963,024 shares of common stock at exercise prices ranging from $7.23 to $14.77 were outstanding for the three months ended June 30, 2004 and 2003, respectively, but were not included in the calculation of diluted earnings per share because their effect would be antidilutive.

14. Commitments and Contingencies

Credit Facilities

We have revolving credit facilities with our Centresoft subsidiary located in the United Kingdom (the "UK Facility") and our NBG subsidiary located in Germany (the "German Facility"). The UK Facility provides Centresoft with the ability to borrow up to Great Britain Pounds ("GBP") 8.0 million ($14.5 million), including issuing letters of credit, on a revolving basis as of June 30, 2004. 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, 2004. The UK Facility bore interest at LIBOR plus 2.0% as of June 30, 2004, is collateralized by substantially all of the assets of the subsidiary and expires in November 2005. 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, 2004, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of June 30, 2004. The German Facility provided for revolving loans up to EUR 0.5 million ($0.6 million) as of June 30, 2004, bore interest at a

Eurocurrency rate plus 2.5%, is collateralized by certain of the subsidiary's property and equipment and has no expiration date. No borrowings were outstanding under the German Facility as of June 30, 2004.

Developer and Intellectual Property Contracts

In the normal course of business, we enter into contractual arrangements with third parties for the development of products, as well as for the rights to intellectual property. Under these agreements, we commit to provide specified payments to a developer or intellectual property holder based upon contractual arrangements. Assuming all contractual provisions are met, the total future minimum contract commitment for contracts in place as of June 30, 2004 is approximately $85.9 million and is scheduled to be paid as follows (amounts in thousands):

Fiscal year ending March 31,	
2005	$ 54,652
2006	17,752
2007	8,595
2008	1,895
2009 and thereafter	3,020
Total	$ 85,914

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

Marketing Commitments

In connection with certain intellectual property right acquisitions and development agreements, we will commit to spend specified amounts for marketing support for the related game(s) which is to be developed or in which the intellectual property will be utilized. Assuming all contractual provisions are met, the total future minimum marketing commitment for contracts in place as of June 30, 2004 is approximately $49.9 million, which is scheduled to be paid as follows (amounts in thousands):

Fiscal Year ending March 31,		
2005	$	23,350
2006		11,500
2007		10,000
2008		5,000
Total	$	49,850

Lease Obligations

We lease certain of our facilities under non-cancelable operating lease agreements. Total future minimum lease commitments as of June 30, 2004 are as follows (amounts in thousands):

Fiscal Year ending March 31,		
2005	$	7,353
2006		8,561
2007		8,013
2008		4,748
2009		3,701
Thereafter		16,547
Total	$	48,923

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 have subsequently been filed by Gianni Angeloni, Christopher Hinton, Stephen Anish, the Alaska Electrical Pension Fund, and Joseph A. Romans asserting similar claims. Five of the six actions have been transferred to the same court where the first-filed complaint was pending. In addition, on March 12, 2004, a shareholder derivative lawsuit 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 Superior Court for the County of Los Angeles. We strongly deny these allegations and will vigorously defend these cases.

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

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

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. 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, 2004, we did not repurchase any of our common stock or enter into any structured stock repurchase transactions. As of June 30, 2004, we had no outstanding structured stock repurchase transactions.

16. Related Parties

In August 2001, we elected to our Board of Directors an individual who is a partner in a law firm that has provided legal services to Activision for more than ten years. For the three months ended June 30, 2004 and 2003, the fees we paid to the law firm were an insignificant portion of the firm's total revenues. We believe that the fees charged to us by the law firm are competitive with the fees charged by other law firms.

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

Overview

Our Business

We are a leading international publisher of interactive entertainment software products. We have built a company with a diverse portfolio of products that spans a wide range of categories and target markets and that is used on a variety of game hardware platforms and operating systems. We have created, licensed and acquired a group of highly recognizable brands, which we market to a variety of consumer demographics.

Our products cover game categories such as action/adventure, action sports, racing, role-playing, simulation, first-person action and strategy. Our target customer base ranges from game enthusiasts and children to mass-market consumers and "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") hand-held device and the personal computer ("PC"). The installed base for this current-generation of hardware platforms is significant and growing. We believe recent price cuts in calendar 2004 on the Xbox and PS2 hardware should continue to drive the growth of the installed base of these two platforms. We also expect the installed base of the other current-generation platforms to continue to grow. In addition, Sony announced that it would be entering the hand-held hardware market with the introduction of its hand-held gaming device, PlayStation Portable ("PSP"). PSP is currently expected to be released in the United States toward the end of the first quarter of calendar 2005. Nintendo has also announced that it plans to launch a new dual-screened, portable game system, Nintendo Dual Screen ("NDS"), before the end of calendar 2004. We are currently developing titles for the PSP and the NDS with the objective of having one or more titles at launch for each of these platforms. We are also planning to develop titles for the next-generation console systems expected to be developed by Sony, Microsoft and Nintendo for release within the next one to three years. 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 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, we primarily sell our products on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses and game specialty stores. We conduct our international publishing activities through offices in the United Kingdom ("UK"), Germany, France, Italy, Australia, Sweden, Canada and Japan. Our products are sold internationally on a direct-to-retail basis, through third-party distribution and licensing arrangements and through our wholly-owned European distribution subsidiaries. Our distribution business consists of operations located in the UK, the Netherlands and Germany that provide logistical and sales services to third-party publishers of interactive entertainment software, our own publishing operations and manufacturers of interactive entertainment hardware.

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

Our Focus

With respect to future game development, 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.

A number of our fiscal 2005 "big propositions" will include well-established brands, which are backed by high profile intellectual property and/or highly anticipated motion picture releases. Examples of these brands are our superheroes and skateboarding brands. We have a long-term relationship with Marvel Enterprises through an exclusive licensing agreement that expires in 2009. 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 Four and Iron Man. Through our long-term relationship with Spider-Man Merchandising, LLP, in the first quarter of fiscal 2005 we released the video game *Spider-Man 2*, the sequel to the highly successful *Spider-Man: The Movie.* The video game release of *Spider-Man 2* coincided with the "Spider-Man 2" theatrical release in June 2004. Also, under our licensing agreement with Spider-Man Merchandising, LLP, we will be developing and publishing video games based on Columbia Pictures/Marvel Enterprises, Inc.'s upcoming feature film "Spider-Man 3," which is expected to be released in May 2007. In addition, we have an exclusive licensing agreement with professional skateboarder Tony Hawk that continues until 2015. The agreement grants us exclusive rights to develop and publish video games using Tony Hawk's name and his likeness. Through fiscal 2004, we released five successful titles in the Tony Hawk franchise with cumulative net revenues of over $800 million, including the most recent, *Tony Hawk's Underground*, which was released in the third quarter of fiscal 2004. We will continue to promote our skateboarding franchise with the release in fiscal 2005 of the sequel to the very successful *Tony Hawk's Underground*.

We also continue to develop new intellectual properties such as *True Crime: Streets of L.A.* and *Call of Duty*, which were originally released in the third quarter of fiscal 2004. These highly successful titles were both ranked by third-party sales tracking agencies as among the top-five selling games for the holiday season. We expect to develop a variety of games on multiple platforms based on these two new original properties and hope to establish them as a source of recurring revenues. For example, in fiscal 2005, we are scheduled to release *Call of Duty: Finest Hour* which will be released on multiple console platforms.

We will also continue to evaluate 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 SKG that grants us the exclusive rights to publish video games based on DreamWorks SKG's theatrical release "Shrek 2," which was released in the first quarter of fiscal 2005, as well as upcoming computer-animated films, "Shark Tale," which is scheduled to be released in the second quarter of fiscal 2005, "Madagascar" and "Over the Hedge," and their sequels. We also have an exclusive licensing agreement to develop and publish video games for the best-selling children's book series, "Lemony Snicket's A Series of Unfortunate Events" which is being developed as a feature film by Paramount Pictures, Nickelodeon Movies and DreamWorks SKG.

In addition to acquiring or creating high profile intellectual property, we have also continued our focus on establishing and maintaining relationships with talented and experienced software development teams. We have strengthened our internal development capabilities through the acquisition in prior fiscal years of a number of development companies with talented and experienced teams. We have development agreements with other top-level, third-party developers such as id Software, Valve Corporation, Spark Unlimited, Lionhead Studios and The Creative Assembly.

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

Critical Accounting Policies

We have identified the policies below as critical to our business operations and the understanding of our financial results. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see Note 1 to the Notes to the Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K for the year ended March 31, 2004 filed with the SEC. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition. We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers. 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 on 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.

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

We may permit product returns from, or grant price protection to, our customers under certain conditions. In general, price protection refers to the circumstances when we elect to decrease the wholesale price of a product by a certain amount and, when granted and applicable, allows customers a credit against amounts owed by such customers to Activision with respect to open and/or future invoices. The conditions our customers must meet to be granted the right to return products or price protection are, among other things, compliance with applicable payment terms, delivery to us of weekly inventory and sell-through reports, and consistent participation in the launches of our premium title releases. We may also consider other factors, including the facilitation of slow-moving inventory and other market factors. Management must make estimates of potential future product returns and price protection related to current period product revenue. We estimate the amount of future returns and price protection for current period product revenue utilizing historical experience and information regarding inventory levels and the demand and acceptance of our products by the end consumer. The following factors are used to estimate the amount of future returns and price protection for a particular title: historical performance of titles in similar genres, historical performance of the hardware platform, historical performance of the brand, console hardware life cycle, Activision sales force and retail customer feedback, industry pricing, weeks of on-hand retail channel inventory, absolute quantity of on-hand retail channel inventory, Activision warehouse on-hand inventory levels, the title's recent sell-through history (if available), marketing trade programs and competing titles. The relative importance of these factors varies among titles depending upon, among other items, genre, platform, seasonality and sales strategy. Significant management judgments and estimates must be made and used in connection with establishing the allowance for returns and price protection in any accounting period. Historically, total actual returns and price protection have not exceeded our allowance estimates. However, actual returns and price protection could vary materially from our allowance estimates due to a number of reasons including, among others, a lack of consumer acceptance of a title, the release in the same period of a similarly themed title by a competitor, or technological obsolescence due to the emergence of new hardware platforms. Material differences may result in the amount and timing of our revenue for any period if management makes different judgments or utilizes different estimates in determining the allowances for returns and price protection.

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

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

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

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

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

Significant management judgments and estimates are utilized in the assessment of when technological feasibility is established, as well as in the ongoing assessment of the recoverability of capitalized costs. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional development 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 actual impairment charge may be larger than originally estimated in any given quarter.

Intellectual Property Licenses. Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks, copyrights, software, technology or other intellectual property or proprietary rights in the development of our products. Depending upon the agreement with the rights holder, we may obtain the rights to use acquired intellectual property in multiple products over multiple years, or alternatively, for a single product.

We evaluate the future recoverability of capitalized intellectual property licenses on a quarterly basis. The recoverability of capitalized intellectual property license costs is evaluated based on the expected performance of the specific products in which the licensed trademark or copyright is to be used. As many of our intellectual property licenses extend for multiple products over multiple years, we also assess the recoverability of capitalized intellectual property license costs based on certain qualitative factors such as the success of other products and/or entertainment vehicles utilizing the intellectual property, whether there are any future planned theatrical releases or television series based on the intellectual property and the rights holder's continued promotion and exploitation of the intellectual property. Prior to the related product's release, we expense, as part of cost of sales – intellectual property licenses, capitalized intellectual property costs when we believe such amounts are not recoverable. Capitalized intellectual property costs for those products that are cancelled or abandoned are charged to product development expense in the period of cancellation. Criteria used to evaluate expected product performance include: historical performance of comparable products using comparable technology; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based.

Commencing upon the related product's release, capitalized intellectual property license costs are amortized to cost of sales – intellectual property licenses based on the ratio of current revenues for the specific product to total projected revenues for all products in which the licensed property will be utilized. As intellectual property license contracts may extend for multiple years, the amortization of capitalized intellectual

property license costs relating to such contracts may extend beyond one year. For intellectual property 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 development 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 actual impairment charge may be larger than originally estimated in any given quarter. Additionally, as noted above, as many of our intellectual property licenses extend for multiple products over multiple years, we also assess the recoverability of capitalized intellectual property license costs based on certain qualitative factors such as the success of other products and/or entertainment vehicles utilizing the intellectual property, whether there are any future planned theatrical releases or television series based on the intellectual property and the rights holder's continued promotion and exploitation of the intellectual property. Material differences may result in the amount and timing of charges for any period if management makes different judgments or utilizes different estimates in evaluating these qualitative factors.

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

	Three months ended June 30,	
	2004	2003

Net revenues	$ 211,276	100%	$ 158,725	100%
Costs and expenses:				
Cost of sales – product costs	89,088	42	76,610	48
Cost of sales – software royalties and amortization	12,283	6	15,498	10
Cost of sales – intellectual property licenses	17,648	8	10,143	6
Product development	21,105	10	13,580	9
Sales and marketing	41,734	20	26,285	17
General and administrative	13,685	7	11,463	7
Total costs and expenses	195,543	93	153,579	97
Operating income	15,733	7	5,146	3
Investment income, net	2,112	1	1,257	1
Income before income tax provision	17,845	8	6,403	4
Income tax provision	5,888	2	2,240	1
Net income	$ 11,957	6%	$ 4,163	3%
Net Revenues by Territory:				
United States	$ 125,191	59%	$ 82,739	52%
Europe	78,101	37	72,740	46
Other	7,984	4	3,246	2
Total net revenues	$ 211,276	100%	$ 158,725	100%
Net Revenues by Segment/Platform Mix:				
Publishing:				
Console	$ 119,127	56%	$ 88,484	56%
Hand-held	18,430	9	4,596	3
PC	24,095	12	21,325	13
Total publishing net revenues	161,652	77	114,405	72
Distribution:				
Console	39,194	18	35,342	22
Hand-held	3,655	2	2,912	2
PC	6,775	3	6,066	4
Total distribution net revenues	49,624	23	44,320	28
Total net revenues	$ 211,276	100%	$ 158,725	100%
Operating Income (Loss) by Segment:				
Publishing	$ 15,894	7%	$ 5,170	3%
Distribution	(161)	—	(24)	—
Total operating income	$ 15,733	7%	$ 5,146	3%

Results of Operations – Three Months Ended June 30, 2004 and 2003

Net income for the three months ended June 30, 2004 was $12.0 million or $0.08 per diluted share, as compared to $4.2 million or $0.03 per diluted share for the three months ended June 30, 2003.

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). 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, 2004 and 2003 (in thousands):

	Three Months ended June 30, 2004	Three Months ended June 30, 2003	Increase/ (Decrease)	Percent Change
Publishing Net Revenues				
North America	$ 125,191	$ 82,739	$ 42,452	51%
Europe	28,477	28,420	57	—%

Other	7,984	3,246	4,738	146%
Total International	36,461	31,666	4,795	15%
Total Publishing Net Revenues	161,652	114,405	47,247	41%
Distribution Net Revenues	49,624	44,320	5,304	12%
Consolidated Net Revenues	$ 211,276	$ 158,725	$ 52,551	33%

Consolidated net revenues increased 33% from $158.7 million for the three months ended June 30, 2003 to $211.3 million for the three months ended June 30, 2004. This increase was generated by both our publishing and distribution businesses. The increase in consolidated net revenue was driven by the following:

- Strong performance of our fiscal 2005 first quarter releases of *Spider-Man 2* and *Shrek 2* for PS2, Xbox, GameCube, GBA and PC. In June 2004, according to the NPD Group, a third-party sales tracking agency, *Spider-Man 2* and *Shrek 2* were the number one and two best selling titles in North America across all platforms.

- Publishing console net revenues increased by 35% from $88.5 million for the three months ended June 30, 2003 to $119.1 million for the three months ended June 30, 2004. The increase was driven by our top two releases published on four console platforms.

- International net revenues benefited from the strong year-over-year strengthening of the Euro ("EUR") and Great Britain Pound ("GBP") in relation to the U.S. dollar. We estimate that foreign exchange rates increased reported net revenue by approximately $7.2 million. Excluding the impact of changing foreign currency rates, our international net revenue increased 4% year-over-year.

North America Publishing Net Revenue (in thousands)

June 30, 2004	% of Consolidated Net Revenue	June 30, 2003	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
$ 125,191	59%	$ 82,739	52%	$ 42,452	51%

Domestic publishing net revenues increased 51% from $82.7 million for the three months ended June 30, 2003, to $125.2 million for the three months ended June 30, 2004. The increase reflects the strong performance of our fiscal 2005 first quarter releases of *Spider-Man 2* and *Shrek 2 for* the PS2, Xbox, Gamecube, GBA and PC. We also had solid catalog sales from a number of our franchises, including Spider-Man and Call of Duty.

International Publishing Net Revenue (in thousands)

June 30, 2004	% of Consolidated Net Revenue	June 30, 2003	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
$ 36,461	17%	$ 31,666	20%	$ 4,795	15%

International publishing net revenues increased by 15% from $31.7 million for the three months ended June 30, 2003, to $36.5 million for the three months ended June 30, 2004. International publishing also saw strong results from 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 and the GBP in relation to the U.S. dollar of approximately $2.4 million. Excluding the impact of changing foreign currency rates, our international publishing net revenue increased 8% year-over-year.

Publishing Net Revenue by Platform

Publishing net revenues increased 41% from $114.4 million for the three months ended June 30, 2003 to $161.7 million for the three months ended June 30, 2004. The following table details our publishing net revenues by platform and as a percentage of total publishing net revenues for the three months ended June 30, 2004 and 2003 (in thousands):

	Quarter Ended June 30, 2004	% of Publishing Net Revs.	Quarter Ended June 30, 2003	% of Publishing Net Revs.	Increase/ (Decrease)	Percent Change
Publishing Net Revenues						
PC	$ 24,095	15%	$ 21,325	19%	$ 2,770	13%
Console						
PlayStation 2	68,704	42%	42,453	37%	26,251	62%
Microsoft Xbox	25,836	16%	35,148	31%	(9,312)	(26)%
Nintendo GameCube	23,752	15%	6,226	5%	17,526	281%
Other	835	1%	4,657	4%	(3,822)	(82)%
Total Console	119,127	74%	88,484	77%	30,643	35%
Hand-held						

Game Boy Advance	18,430	11%	4,596	4%	13,834	301%
Total Publishing Net Revenues	$ 161,652	100%	$ 114,405	100%	$ 47,247	41%

Personal Computer Net Revenue (in thousands)

June 30, 2004	% of Publishing Net Revenue	June 30, 2003	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
$ 24,095	15%	$ 21,325	19%	$ 2,770	13%

Net revenue from sales of titles for the PC increased 13% from $21.3 million for the three months ended June 30, 2003 to $24.1 million for the three months ended June 30, 2004. Our new release titles performed very well in both the domestic and international markets. In addition, the number of premium PC titles released in the first quarter of fiscal 2005 increased to 3 titles from 1 PC title released in the first quarter of fiscal 2004. We expect fiscal 2005 PC publishing net revenues to continue to increase as a percentage of total publishing net revenues over fiscal 2004 reflecting the release of more PC titles in fiscal 2005, including the highly anticipated *Doom 3* and *Rome: Total War*.

PlayStation 2 Net Revenue (in thousands)

June 30, 2004	% of Publishing Net Revenue	June 30, 2003	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
$ 68,704	42%	$ 42,453	37%	$ 26,251	62%

Net revenue from sales of titles for the PS2 increased 62% from $42.5 million for the three months ended June 30, 2003 to $68.7 million for the three months ended June 30, 2004. Though the number of new PS2 titles decreased in the first quarter of fiscal 2005 to 2 from 4 in fiscal 2004, we were able to increase our PS2 sales in both the domestic and international markets. The increase is primarily due to strong, worldwide sales of our PS2 titles including *Spider-Man 2* and *Shrek 2*.

Microsoft Xbox Net Revenue (in thousands)

June 30, 2004	% of Publishing Net Revenue	June 30, 2003	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
$ 25,836	16%	$ 35,148	31%	$ (9,312)	(26)%

Net revenue from sales of titles for the Xbox decreased 26% from $35.1 million for the three months ended June 30, 2003 to $25.8 million for the three months ended June 30, 2004. The decrease is due to a reduction in the number of Xbox titles released in the first quarter of fiscal 2005 to 2 from 5 in the first quarter of fiscal 2004. Though the titles released on the Xbox, *Spider-Man 2* and *Shrek 2*, reflect solid sales both in the domestic and international markets, these titles 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 as compared to the titles released in the three months ended June 30, 2003, *X2: Wolverine's Revenge, Return to Castle Wolfenstein, Wakeboarding Unleashed* and *Soldier of Fortune II: Double Helix*.

Nintendo GameCube Net Revenue (in thousands)

June 30, 2004	% of Publishing Net Revenue	June 30, 2003	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
$ 23,752	15%	$ 6,226	5%	$ 17,526	281%

Net revenue from sales of titles for the Nintendo GameCube increased 281% from $6.2 million for the three months ended June 30, 2003 to $23.8 million for the three months ended June 30, 2004. Though the number of GameCube titles released in the first quarter of fiscal 2005 remained relatively consistent with the first quarter of fiscal 2004, our first quarter fiscal 2005 releases of *Spider-Man 2* and *Shrek 2* performed very well in both the domestic and international markets as these titles were more focused toward the demographic of the GameCube audience.

Game Boy Advance Net Revenue (in thousands)

June 30, 2004	% of Publishing Net Revenue	June 30, 2003	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
$ 18,430	11%	$ 4,596	4%	$ 13,834	301%

Net revenue from sales of titles for the GBA for the three months ended June 30, 2004 increased 301% from the prior fiscal year, from $4.6 million to $18.4 million. The 2 titles released in the three months ended June 30, 2004, *Spider-Man 2* and *Shrek 2*, performed very well in both the domestic and international markets as these titles were more focused toward the demographic of the GBA audience. We expect the hand-held installed base to grow with the release of the NDS and PSP which are expected to launch in late calendar year 2004 and early calendar year 2005, respectively. In addition, in fiscal 2005, as the GBA hardware approaches the peak of its life cycle, we expect to increase our focus on developing GBA games for mass-market consumers.

The platform mix of our future publishing net revenues will likely be impacted by a number of factors, including the ability of hardware manufacturers to continue to increase their installed hardware base and the introduction of new hardware platforms, as well as the 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, if the PSP and/or the NDS hand-held devices are introduced in fiscal 2005, we may see an increase in our hand-held business in comparison to prior periods. Our net revenues from PC titles will be primarily driven by our product release schedule.

A significant portion of our revenues and profits are derived from a relatively small number of popular titles and brands each year as revenues and profits are significantly affected by our ability to release highly successful or "hit" titles. For example, for the three months ended June 30, 2004, 62% of our consolidated net revenues and 81% of worldwide publishing net revenues were derived from net revenues from our *Spider-Man 2* and *Shrek 2* titles. Though many of these titles have substantial production or acquisition costs and marketing budgets, once a title recoups these costs, incremental net revenues directly and positively impact operating profits resulting in a disproportionate amount of operating income being derived from these select titles. We expect that a limited number of titles and brands will continue to produce a disproportionately large amount of our net revenues and profits.

Two factors that could affect future publishing and distribution net revenue performance are console hardware pricing and software pricing. As console hardware moves through its life cycle, hardware manufacturers typically enact price reductions. Reductions in the price of console hardware typically result in an increase in the installed base of hardware owned by consumers. Price cuts on Xbox and PS2 hardware were announced in March and May 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 at retail for most genres to hold at $49.99 through the calendar 2004 holidays, we believe we could see additional software price declines thereafter.

Distribution Net Revenue (in thousands)

June 30, 2004	% of Consolidated Net Revenue	June 30, 2003	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
$ 49,624	23%	$ 44,320	28%	$ 5,304	12%

Distribution net revenues for the three months ended June 30, 2004 increased 12% from the prior fiscal year, from $44.3 million to $49.6 million. The increase was primarily due to the positive impact of the year-over-year strengthening of the EUR and the GBP in relation to the U.S. dollar. Excluding the impact of the changing foreign currency rates, our distribution net revenue was in line with our prior fiscal year, with a slight increase of 1% year-over-year. The mix of future distribution net revenues will be driven by a number of factors including the occurrence of further hardware price reductions instituted by hardware manufacturers, the introduction of new hardware platforms, our ability to establish and maintain distribution agreements with hardware manufacturers and third-party software publishers and the success of third-party published titles. We are expecting our fiscal 2005 distribution revenues to be in line with fiscal 2004.

Costs and Expenses

Cost of Sales – Product Costs (in thousands)

June 30, 2004	% of Consolidated Net Revenue	June 30, 2003	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
$ 89,088	42%	$ 76,610	48%	$ 12,478	16%

Cost of sales – product costs represented 42% and 48% of consolidated net revenues for the three months ended June 30, 2004 and 2003, respectively. In absolute dollars, cost of sales – product costs increased due to higher sales volume in the first quarter of fiscal 2005 as compared to the first quarter of fiscal 2004. There were two primary factors that affected cost of sales – product costs as a percentage of consolidated net revenues:

- Increased ability to maintain premium pricing on big proposition titles in the three months ended June 30, 2004.

- Product costs as percentage of net revenues decreased due to a lower percentage of revenues generated from our distribution business in the three months ended June 30, 2004.

We expect cost of sales – product costs as a percentage of net revenues to continue to be lower than the comparable period in the prior fiscal year throughout fiscal 2005. This is primarily due to a lower percentage of revenue generated from our distribution business in fiscal 2005, which is a lower margin business. We may also receive a benefit from changes in product mix in fiscal 2005 due to an increase in PC publishing net revenues as a percentage of total publishing net revenues and the focus on "big proposition" titles, for which we could benefit from higher retail pricing and manufacturing volume discounts.

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

June 30, 2004	% of Publishing Net Revenue	June 30, 2003	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
$ 12,283	8%	$ 15,498	14%	$ (3,215)	(21)%

Cost of sales – software royalties and amortization for the three months ended June 30, 2004 decreased as a percentage of publishing net revenues from the prior three months ended June 30, 2003, from 14% to 8%. In absolute dollars, cost of sales – software royalties and amortization for the three months ended June 30, 2004 also decreased from the prior fiscal year, from $15.5 million to $12.3 million. The decrease is due to a reduction in the number of titles released in the three months ended June 30, 2004, to 2 as compared to 5 in the three months ended June 30, 2003. The decrease in the percentage reflects the strong performance and

relatively high expectations for future revenues of our internally developed fiscal 2005 first quarter releases of *Spider-Man 2* and *Shrek 2* as compared to marginally performing externally developed titles in fiscal 2004.

Cost of Sales – Intellectual Property Licenses (in thousands)

June 30, 2004	% of Publishing Net Revenue	June 30, 2003	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
$ 17,648	11%	$ 10,143	9%	$ 7,505	74%

Cost of sales – intellectual property licenses for the three months ended June 30, 2004 increased in absolute dollars and as a percentage of publishing net revenues over the same period last year, from 9% to 11%. The increases reflect the fact that our top performing titles in the three months ended June 30, 2004 had a higher royalty rate than our top titles released in the three months ended June 30, 2003. We expect cost of sales – intellectual property licenses to increase in fiscal 2005 as compared to fiscal 2004, as we expect to have more titles releasing with licensed intellectual property.

Product Development (in thousands)

June 30, 2004	% of Publishing Net Revenue	June 30, 2003	% of Publishing Net Revenue	Increase/ (Decrease)	Percent Change
$ 21,105	13%	$ 13,580	12%	$ 7,525	55%

Product development expenses for the three months ended June 30, 2004 increased as a percentage of publishing net revenues as compared to the three months ended June 30, 2003, from 12% to 13%. In absolute dollars, product development expenses for the three months ended June 30, 2004 also increased compared to the three months ended June 30, 2003, from $13.6 million to $21.1 million. The increase in product development as a percentage of publishing net revenues and in absolute dollars resulted from:

- Higher game development costs as development time and team sizes are increasing due to enhanced production values and to support more complex and robust gaming experiences.

- Costs associated with product cancellations.

- The increase in absolute dollars is also due to an increase in studio employee incentive compensation as a result of the strong performances of key fiscal 2005 title releases.

Sales and Marketing (in thousands)

June 30, 2004	% of Consolidated Net Revenue	June 30, 2003	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
$ 41,734	20%	$ 26,285	17%	$ 15,449	59%

Sales and marketing expenses of $41.7 million and $26.3 million represented 20% and 17% of consolidated net revenues for the three months ended June 30, 2004 and 2003, respectively. The increase as a percentage of net revenues was primarily generated by our publishing business as a result of significant marketing programs, including television and in-theatre ad campaigns and in-store promotions, run in support of our two key fiscal 2005 first quarter title releases, *Spider-Man 2* and *Shrek 2*. 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 2005 sales and marketing costs to exceed fiscal 2004 spending levels.

General and Administrative (in thousands)

June 30, 2004	% of Consolidated Net Revenue	June 30, 2003	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
$ 13,685	7%	$ 11,463	7%	$ 2,222	19%

General and administrative expenses for the three months ended June 30, 2004 increased $2.2 million over the same period last year, from $11.5 million to $13.7 million. As a percentage of consolidated net revenues, general and administrative expenses remained constant at 7%. The increase in absolute dollars was primarily due to an increase in personnel costs to support operations partially offset by lower bad debt expense.

Operating Income (Loss) (in thousands)

	June 30, 2004	% of Segment Net Revs.	June 30, 2003	% of Segment Net Revs.	Increase/ (Decrease)	Percent Change
Publishing	$ 15,894	10%	$ 5,170	5%	$ 10,724	207%
Distribution	(161)	—	(24)	—	(137)	571%
Consolidated	$ 15,733	7%	$ 5,146	3%	$ 10,587	206%

Publishing operating income for the three months ended June 30, 2004 increased $10.7 million from the same period last year, from $5.2 million to $15.9 million. International publishing operating income for the three months ended June 30, 2004 benefited from the positive impact of the year-over-year strengthening of the EUR and the GBP in relation to the U.S. dollar. Excluding the impact of changes in foreign currency rates, publishing operating income for the three months ended June 30, 2004 increased approximately $9.9 million from the same period last year. This increase is primarily due to:

- Strong performance in both the domestic and international markets of our fiscal 2005 first quarter title releases.

Partially offset by:

- Increased sales and marketing spending.
- Increased product development costs.

Distribution operating loss for the three months ended June 30, 2004 increased slightly over the same period last year, from ($24,000) to ($161,000). Excluding the impact of changes in foreign currency rates, distribution operating income for the three months ended June 30, 2004 was down by approximately $0.1 million from the same period last year. This decrease is primarily due to an increase in general and administrative employee related costs.

Investment Income, Net (in thousands)

June 30, 2004	% of Consolidated Net Revenue	June 30, 2003	% of Consolidated Net Revenue	Increase/ (Decrease)	Percent Change
$ 2,112	1%	$ 1,257	1%	$ 855	68%

Investment income, net for the three months ended June 30, 2004 was $2.1 million as compared to $1.3 million for the three months ended June 30, 2003. The increase was primarily due to higher invested balances during the three months ended June 30, 2004 as compared to the three months ended June 30, 2003.

Provision for Income Taxes (in thousands)

June 30, 2004	% of Pretax Income	June 30, 2003	% of Pretax Income	Increase/ (Decrease)	Percent Change
$ 5,888	33%	$ 2,240	35%	$ 3,648	163%

The income tax provision of $5.9 million for the three months ended June 30, 2004 reflects our effective income tax rate of 33%. The significant items that generated the variance between our effective rate and our statutory rate of 35% were research and development tax credits and the impact of foreign tax rate differentials, 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)

	June 30, 2004	March 31, 2004	Increase/ (Decrease)
Cash and cash equivalents	$ 339,735	$ 466,552	$ (126,817)
Short-term investments	199,411	121,097	78,314
	$ 539,146	$ 587,649	$ (48,503)
Percentage of total assets	55%	61%	

	For the three months ended June 30, 2004	For the three months ended March 31, 2004	Increase/ (Decrease)
Cash flows provided by (used in) operating activities	$ (52,136)	$ 21,069	$ (73,205)
Cash flows provided by (used in) investing activities	(81,412)	2,688	(84,100)
Cash flows provided by financing activities	8,034	15,094	(7,060)

As of June 30, 2004, our primary source of liquidity is comprised of $339.7 million of cash and cash equivalents and $199.4 million of short-term investments. We believe that we have sufficient working capital ($705.3 million at June 30, 2004), as well as funds 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.

We actively manage our capital structure and balance sheet as a component of our overall business strategy. When we determine that market conditions are appropriate, we may seek to achieve long-term value for the shareholders through, among other things, new debt or equity financings or refinancings, share repurchases and other transactions involving our equity or debt securities.

Cash Flows

Cash and cash equivalents were $339.7 million at June 30, 2004 compared to $466.6 million at March 31, 2004. Activity in cash and cash equivalents for the three months ended June 30, 2004 included $52.1 million used in operating activities and $81.4 million used in investing activities, offset by $8.0 million provided by financing activities. Primary drivers of operating cash flows were increased accounts receivable and inventories at the end of the quarter, continued investment in software development and intellectual property rights and amortization of capitalized software development costs and intellectual property licenses for titles released in the first quarter. The increase in accounts receivable and inventories was due to the late first quarter release in the US and early second quarter release in most of Europe of *Spider-Man 2*. In the three months ended June 30, 2004, we spent approximately $31.8 million in connection with the acquisition of publishing or distribution rights for products being developed by third parties and the execution of new license agreements granting us long-term rights to intellectual property of third parties, as well as 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. We currently expect that a primary source of future liquidity, both short-term and long-term, will be the result of cash flows from continuing operations.

For the quarter ended June 30, 2004, cash flows used in investing activities were principally due to the purchase of short-term investments. Cash provided by financing activities for the same period is the result of issuance of common stock related to employee stock option and stock purchase plans.

Key Balance Sheet Accounts

Accounts Receivable

(amounts in thousands)	**June 30, 2004**	**March 31, 2004**	**Increase/ (Decrease)**
Gross accounts receivable	$ 171,327	$ 109,605	$ 61,722
Net accounts receivable	123,048	62,577	60,471

The increase in gross accounts receivable was primarily the result of the release of *Spider-Man 2* domestically late in first quarter of fiscal 2005. Significant shipments were made to customers at the end of the quarter and the related receivables were not due prior to quarter end.

Reserves for returns and price protection as a percentage of gross accounts receivable declined from 41% as of March 31, 2004 to 26% as of June 30, 2004. The decline was due to the launch of two successful big proposition titles at the end of the quarter which required lower reserves.

Inventories

(amounts in thousands)	**June 30, 2004**	**March 31, 2004**	**Increase/ (Decrease)**
Inventories	$ 39,635	$ 26,427	$ 13,208

The increase in inventories was primarily the result of:

- Higher inventory in our European territories in anticipation of the release of *Spider-Man 2* after June 30, 2004 in those territories.

- Higher hardware inventory on hand at our UK distribution business.

Software Development and Intellectual Property Licenses

(amounts in thousands)	**June 30, 2004**	**March 31, 2004**	**Increase/ (Decrease)**
Software development and intellectual property licenses	$ 130,145	$ 135,201	$ (5,056)

Software development and intellectual property licenses was slightly lower at the end of the first quarter of fiscal 2005 as a result of:

- $31.8 million of amortization and write-offs of capitalized software development costs and intellectual property licenses.

Offset by:

- Continued investment in software development and intellectual property licenses. We spent approximately $26.7 million in the quarter ended June 30, 2004 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.

Accounts Payable

(amounts in thousands)	June 30, 2004	March 31, 2004	Increase/ (Decrease)
Accounts payable	$ 75,558	$ 72,874	$ 2,684

The increase in accounts payable was primarily the result of:

- Increased inventory purchases by our publishing business to support the launch of *Spider-Man 2*.

Accrued Expenses

(amounts in thousands)	June 30, 2004	March 31, 2004	Increase/ (Decrease)
Accrued expenses	$ 56,534	$ 63,205	$ (6,671)

The decrease in accrued expenses was primarily driven by the payment of fiscal 2004 bonuses paid in the first quarter of fiscal 2005.

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 provides Centresoft with the ability to borrow up to GBP 8.0 million ($14.5 million), including issuing letters of credit, on a revolving basis as of June 30, 2004. 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, 2004. The UK Facility bore interest at LIBOR plus 2.0% as of June 30, 2004, is collateralized by substantially all of the assets of the subsidiary and expires in November 2005. 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, 2004, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of June 30, 2004. The German Facility provided for revolving loans up to EUR 0.5 million ($0.6 million) as of June 30, 2004, bore interest at a Eurocurrency rate plus 2.5%, is collateralized by certain of the subsidiary’s property and equipment and has no expiration date. No borrowings were outstanding under the German Facility as of June 30, 2004.

Commitments

In the normal course of business, we enter into contractual arrangements with third parties for the development of products, as well as for the rights to intellectual property. Under these agreements, we commit to provide specified payments to a developer or intellectual property holder, based upon contractual arrangements. 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 rights 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, 2004, are scheduled to be paid as follows (amounts in thousands):

	Contractual Obligations			
	Facility Leases	Developer and IP	Marketing	Total
Fiscal year ending March 31,				
2005	$ 7,353	$ 54,652	$ 23,350	$ 85,355
2006	8,561	17,752	11,500	37,813
2007	8,013	8,595	10,000	26,608
2008	4,748	1,895	5,000	11,643
2009	3,701	3,020	—	6,721
Thereafter	16,547	—	—	16,547
Total	$ 48,923	$ 85,914	$ 49,850	$ 184,687

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

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 officer 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 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 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 controls 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.

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 listener or reader is cautioned that all forward-looking statements are necessarily speculative and there are numerous risks and uncertainties that could cause actual events or results to differ materially from those referred to in such forward-looking statements. For a discussion that highlights some of the more important risks identified by management, but which should not be assumed to be the only factors that could affect future performance, see our Annual Report on Form 10-K for the fiscal year ended March 31, 2004 which is incorporated herein by reference. The reader or listener is cautioned that we do not have a policy of updating or revising forward-looking statements and thus he or she should not assume that silence by management over time means that actual events are bearing out as estimated in such forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the potential loss arising from fluctuations in market rates and prices. Our market risk exposures primarily include fluctuations in interest rates, foreign currency exchange rates and market prices. Our market risk sensitive instruments are classified as "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, 2004, our cash equivalents and short-term investments included debt securities of $395.8 million.

The following table presents the amounts and related weighted average interest rates of our investment portfolio as of June 30, 2004 (amounts in thousands):

	Average Interest Rate	Amortized Cost	Fair Value
Cash equivalents:			
Fixed rate	1.44%	$ 196,411	$ 196,411
Variable rate	1.07	49,754	49,754

Short-term investments:			
Fixed rate	1.74%	$ 200,531	$ 199,411

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

Foreign Currency Exchange Rate Risk

We transact business in many different foreign currencies and may be exposed to financial market risk resulting from fluctuations in foreign currency exchange rates, particularly GBP and EUR. The volatility of GBP and EUR (and all other applicable currencies) will be monitored frequently throughout the coming year. When appropriate, we enter into hedging transactions in order to mitigate our risk from foreign currency fluctuations. We will continue to use hedging programs in the future and may use currency forward contracts, currency options and/or other derivative financial instruments commonly utilized to reduce financial market risks if it is determined that such hedging activities are appropriate to reduce risk. We do not hold or purchase any foreign currency contracts for trading purposes. As of June 30, 2004, there were no hedging contracts outstanding.

Item 4. Controls and Procedures

As of the end of the period covered by this report, our management conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on this evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective. 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 Activision to disclose material information otherwise required to be set forth in our periodic reports.

Changes in Internal Controls

There was no change in our internal controls 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 have subsequently been filed by Gianni Angeloni, Christopher Hinton, Stephen Anish, the Alaska Electrical Pension Fund, and Joseph A. Romans asserting similar claims. Five of the six actions have been transferred to the same court where the first-filed complaint was pending. In addition, on March 12, 2004, a shareholder derivative lawsuit 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 Superior Court for the County of Los Angeles. We strongly deny these allegations and will vigorously defend these cases.

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

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

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 6. Exhibits and Reports on Form 8-K

(a) Exhibits

1.1	Underwriting agreement between Activision and Goldman, Sachs & Co. dated June 4, 2002 (incorporated by reference to Exhibit 1.1 of Activision’s 8-K, filed June 6, 2002).
3.1	Amended and Restated Certificate of Incorporation, dated June 1, 2000 (incorporated by reference to Exhibit 2.5 of our Current Report on Form 8-K, filed on June 16, 2000).

3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation, dated June 9, 2000 (incorporated by reference to Exhibit 2.7 of our Current Report on Form 8-K, filed on June 16, 2000).
3.3	Certificate of Amendment of Amended and Restated Certificate of Incorporation, dated August 23, 2001 (incorporated by reference to Exhibit 3.3 of Amendment No. 1 to our Registration Statement on Form S-3, Registration No. 333-66280, filed on August 31, 2001).

3.4	Certificate of Designation of Series A Junior Preferred Stock, dated December 27, 2001 (incorporated by reference to Exhibit 3.4 of our Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2001).
3.5	Amended and Restated By-laws dated August 1, 2000 (incorporated by reference to Exhibit 3.2 of our Current Report on Form 8-K, filed July 11, 2001).
4.1	Rights Agreement dated as of April 18, 2000, between us and Continental Stock Transfer & Trust Company, which includes as exhibits the form of Right Certificates as Exhibit A, the Summary of Rights to Purchase Series A Junior Preferred Stock as Exhibit B and the form of Certificate of Designation of Series A Junior Preferred Stock of Activision as Exhibit C (incorporated by reference to our Registration Statement on Form 8-A, Registration No. 001-15839, filed April 19, 2000).
10.1	Activision, Inc. 2002 Incentive Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2003).
10.2	Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended June 30, 2003).
10.3	Amendment I dated April 1, 2004 to employment agreement dated March 1, 2002, between Combined Distribution (Holdings) Limited and Richard Steele.
10.4	Amendment I dated April 29, 2004 to employment agreement dated April 1, 2002, between Activision and Michael Rowe.
10.5	Amendment II dated June 1, 2004 to employment agreement dated July 22, 2002, between Activision and Ron Doornink.
31.1	Certification of Robert A. Kotick pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Ronald Doornink pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3	Certification of William J. Chardavoyne pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Ronald Doornink pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.3	Certification of William J. Chardavoyne pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

1.1	We furnished a Form 8-K on May 6, 2004, reporting under "Item 7. Financial Statements, Pro Forma Financial Statements and Exhibits" and "Item 12. Results of Operations and Financial Condition" issuing a press release announcing our fourth quarter and fiscal 2004 year end results.

SIGNATURES

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

Date: August 3, 2004

ACTIVISION, INC.

/s/ William J. Chardavoyne

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

Exhibit 10.3

April 1, 2004

Mr Richard Steele
213 Station Road
Knowle
SOLIHULL B93 0PU

Dear Richard

Variation to Service Agreement

This letter confirms a variation to your terms and conditions of employment. The letter is intended to supplement and not replace the Service Agreement between Combined Distribution (Holdings) Limited and you, dated 1 March 2002 (the "Service Agreement"), which will continue to apply to you. Changes/amendments to the Service Agreement are set out below. Where no changes/amendments are noted, the provisions of the Service Agreement remain in force.

The following clauses will replace those of the same number in the Service Agreement:

3.1 The Employment shall commence on 1 March 2002 and, unless terminated in accordance with clause 12 (Termination of and suspension from Employment), shall continue for a fixed period, to terminate on 31 March 2006. The parties will negotiate a mutually agreeable transition plan in the event that they are unable to agree to a further extension to the Service Agreement. Nothing in this agreement precludes the Executive from pursuing statutory termination or redundancy benefits, if available, in the event that the Company does not exercise the option to extend the fixed term or otherwise terminates the Executive without cause as defined in clause 12.

7.1 During his employment the Company shall pay to the Executive:

(a) a basic salary at the rate of **£216,000** per annum. This salary shall accrue from day to day, be payable by equal monthly instalments in arrears on or about the last Friday of each month and shall include any fees to which the Executive is entitled as a director of any Group Company;

Stock Options

You will be granted further stock options under the terms of Activision Inc.'s existing or modified stock option plan as follows:

A grant of 200,000 stock options effective as of 29 April 2004. Such options will have an exercise price of US$13.75 and will vest per the terms of the specific Stock Option Agreement on 1 April 2005, 1 April 2006 and 1 April 2007. These stock options are in addition to the existing stock options granted under the terms of the Service Agreement at clause 9.4 and are granted under and governed by the terms and conditions of the Company's Stock Option Plan and the Option Agreement.

The terms of this letter come into force with immediate effect.

Please sign and date below where indicated to acknowledge your acceptance of the variation of the terms of your Service Agreement and return the signed copy to me at your earliest convenience.

Yours sincerely

/s/ Ronald Doornink

Signed for and on behalf of **COMBINED DISTRIBUTION (HOLDINGS) LIMITED**

/s/ Ronald Doornink	4/1/04
Director	Date

Signed by **RICHARD STEELE**

/s/ Richard Steele	30/7/04
RICHARD STEELE	Date

Exhibit 10.4

April 29, 2004

Mr. Michael Rowe
3100 Walnut Street
Manhattan Beach, California 90266

Re: Your Employment Agreement with Activision, Inc.
dated April 1, 2002 (the "Employment Agreement")

Dear Mike:

This letter confirms our agreement to amend the terms of the Employment Agreement in accordance with the provisions set forth below. Capitalized terms not defined in this letter shall have the meanings ascribed to them in the Employment Agreement.

The specific amendments to the Employment Agreement are as follows:

1. Paragraph 1 of the Employment Agreement is deleted in its entirety and is replaced with the following:

"1. Term

The term of your employment under this agreement shall commence on April 1, 2002 and expire on March 31, 2007, unless earlier terminated as provided below."

2. Paragraph 2(a) of the Employment Agreement is supplemented with the following sentence:

"Notwithstanding anything to the contrary set forth in this agreement, commencing effective as of April 1, 2004, your base salary shall be $350,000.

3. Paragraph 2(d) of the Employment Agreement is deleted in its entirety and is replaced with the following:

"In addition to your base salary, you may be eligible to receive an annual discretionary bonus targeted at sixty percent (60%) of your annual base salary (pro-rated for the amount of time that you actually perform services for Employer during a particular fiscal year). The amount of this bonus, if any, is within the sole and absolute discretion of the Employer's Board of Directors (or the Compensation Committee of the Board of Directors). Certain of the criteria that will be considered to evaluate your eligibility for a bonus is your achievement of specific objectives and/or your contribution to the success of the corporate goals and objectives. Employer's overall financial performance will also be considered in determining whether any bonus is awarded and, if so, the amount. Discretionary bonuses, if granted, are generally paid to employees in May. You must remain continuously employed by Employer through the date on which the discretionary bonus is paid to be eligible to receive a bonus. Employer retains the right to modify, at any time, any

and all of the criteria used to determine whether Employee is eligible for a bonus and, if so, the amount of any such bonus."

Employer and you do hereby agree that the terms of that certain Memorandum dated July 23, 2002 as specifically relating to the reduction of your bonus level to 55% are hereby deemed no longer in effect.

4. Paragraph 2(e) of the Employment Agreement is amended by adding the following provisions to the end of the sentence currently constituting such Paragraph:

"Without limiting the generality of the foregoing, in consideration for your execution of this letter, you were also granted, under Employer's 2002 Executive Incentive Plan, options to purchase 135,000 shares of Employer's common stock. The options were issued on April 29, 2004 at an exercise price of $13.75 per share. The options will vest as follows: 27,000 of such options will vest on April 1, 2005; 27,000 of such options will vest on April 1, 2006; and 81,000 of such options will vest on March 31, 2007. The foregoing options will be governed in all other respects by Employer's 2002 Executive Incentive Plan."

Except as specifically set forth above, the Employment Agreement shall remain unmodified and in full force and effect.

If the foregoing accurately reflects your understanding of the provisions of your Employment Agreement that are being amended pursuant to this letter, please so indicate by signing in the space provided below.

Very truly yours,

/s/ Ronald Doornink
Ron Doornink
Chief Executive Officer

ACCEPTED AND AGREED TO:

/s/ Michael Rowe

Michael Rowe

June 1, 2004

Mr. Ron Doornink
872 9th Street
Manhattan Beach, CA 90266

Re: Employment Agreement Amendment

Dear Ron:

The purpose of this letter is to confirm certain agreements we have reached with regard to your title and responsibilities with the company. We refer to your Employment Agreement dated as of July 22, 2002, as amended as of February 27, 2003 and as supplemented by letter dated July 23, 2002 (collectively, the "Employment Agreement"). Capitalized terms used in this letter have the meanings set forth in the Employment Agreement. This letter supplements and amends the Employment Agreement. To the extent any provisions of this letter conflict with or differ from the provisions of the Employment Agreement, this letter will be controlling.

1. The Employment Agreement provides that we will mutually agree on or before October 31, 2004 what your title and responsibilities will be commencing April 1, 2005 through March 31, 2006. Notwithstanding anything to the contrary contained in Paragraph 3 of the Employment Agreement, this is to confirm that we have agreed that you will continue in your current positions as President of Activision, Inc. ("Activision") and as Chief Executive Officer of Activision Publishing, Inc. ("Activision Publishing") through December 31, 2005. Thereafter, even though we agree that effective as of December 31, 2005, you will no longer serve as President of Activision and Chief Executive Officer of Activision Publishing, the Employment Period (as defined in the Employment Agreement) shall nevertheless continue through June 30, 2007 and you will continue to perform your duties and responsibilities as an employee of Employer, serving at the direction and subject to the management of Employer and Activision, performing such executive advisory and other related services as Employer, Activision or any of their related or affiliated entities or divisions may reasonably request ("transitional employment services"). The period from January 1, 2006 to June 30, 2007 shall be referred to as "transitional employment period" and the definition of the term "Expiration Date" shall be amended to mean June 30, 2007.

2. Paragraph 11 of the Employment Agreement is deleted and the phrase "11. Intentionally omitted." is substituted in its stead. The last two sentences of Paragraph 3 (which were added by amendment) and the last sentence of Paragraph 9(d)(iii) of the Employment Agreement are deleted.

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3. You and we have agreed to the following further modifications of the terms and conditions of the employment arrangement, as follows:

(a) During the transitional employment period, you shall be required to provide no less than 20 hours per month in services in accordance with directions received from the management and Board of Directors of Employer, Activision or any of their related or affiliated entities or divisions. You have offered, and we have agreed, that at the reasonable request of Employer you will devote more than the 20 hours per month currently contemplated to support the internal succession and transition plan currently being contemplated by Employer and Activision. We have discussed, for example, your willingness to assist beyond the 20 hours per month if there were a major business/organizational issue, a large acquisition or another significant event where management could use your experience and knowledge.

(b) If the internal succession and transition plan currently being contemplated by Employer and Activision is ultimately not adopted and implemented by Employer and Activision and as a result a new CEO/President is appointed prior to December 31, 2005, you and Employer/Activision will work together in good faith to develop and implement a transition plan which may provide for you to begin the transitional employment services before January 1, 2006. If your reduced role begins early for this reason, you would commit to provide the 20 hours per month as set forth in the Employment Agreement with no change in compensation for the applicable period from what is set forth in the Employment Agreement as amended by this letter agreement - specifically, you would receive your full time equivalent compensation through March 31, 2006 and compensation at the reduced level provided with regard to the transitional employment period thereafter through the Expiration Date.

(c) If the internal succession and transition plan currently being contemplated by Employer and Activision changes and Employer/Activision does not appoint a new CEO/President prior to December 31, 2005, you have agreed to consider in good faith during the balance of the Employment Period (including during the transitional employment period) assisting in transition and similar matters that may require more than 20 hours per month depending on the circumstances at the time, if reasonably requested by Employer. We would expect that this could arise in circumstances similar to those described in paragraph (a), above.

3. During the transitional employment period, you will continue to be an employee of Employer, you will maintain an office at Employer's principal business location and you will be subject to Employer's internal rules, policies and procedures applicable to employees of Employer, including without limitation, payroll payment schedule, withholding, employment benefits, code of conduct and confidentiality. All your stock option awards will continue to vest in accordance with their existing terms.

4. In connection with the extension of your existing positions with Employer and Activision, Employer has increased your base salary for the current fiscal year to $550,000, has increased certain bonus caps and has increased your target bonus potential

to 100% of your base salary for fiscal 2005. This also is to confirm that your base salary next fiscal year - beginning April 1, 2005 - will be fixed at 110% of current base salary. Your base salary during the transitional employment period shall be $250,000 per annum. In addition, Employer has agreed to award you a special option grant to purchase 50,000 shares at an exercise price of $14.75. The option will vest and become exercisable in one-third increments, with the first one third vesting and becoming exercisable on April 1, 2005, the second one third on April 1, 2006 and the final one third on April 1, 2007.

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5. Except as modified or supplemented by this letter, your Employment Agreement remains in full force and effect.

Please sign the enclosed copies of this letter and return one of them to us to confirm your acceptance and agreement to the foregoing.

ACTIVISION PUBLISHING, INC.

By: */s/ Brian G. Kelly*
Brian G. Kelly

Accepted and Agreed:

/s/ Ronald Doornink
Ron Doornink

Exhibit 31.1

CERTIFICATION

I, Robert A. Kotick, Chief Executive Officer of Activision, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Activision, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2004

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

CERTIFICATION

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

1. I have reviewed this quarterly report on Form 10-Q of Activision, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2004

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

Exhibit 31.3

CERTIFICATION

I, William J. Chardavoyne, Executive Vice President and Chief Financial Officer of Activision, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Activision, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2004

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

Exhibit 32.1

**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, 2004 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 3, 2004

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

Exhibit 32.2

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, 2004 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Ronald Doornink, President of the Company and Chief Executive Officer of Activision Publishing, Inc., certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Ronald Doornink
Ronald Doornink
President, Activision, Inc.
Chief Executive Officer,
Activision Publishing, Inc.
August 3, 2004

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

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

In connection with the quarterly report of Activision, Inc. (the “Company”) on Form 10-Q for the period ending June 30, 2004 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 3, 2004

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