TAKE TWO INTERACTIVE SOFTWARE INC
Form 10-Q
June 09, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF l934.

For the quarterly period ended April 30, 2006

OR

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

For the transition period from __________ to __________

Commission file number 0-29230

TAKE-TWO INTERACTIVE SOFTWARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**51-0350842**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

622 Broadway, New York, New York 10012
(Address of principal executive offices including zip code)

Registrant s Telephone Number, Including Area Code (646) 536-2842

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act). Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

As of June 2, 2006, there were 72,548,823 shares of the Registrant s Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES

Condensed Consolidated Balance Sheets (Unaudited)

As of April 30, 2006 and October 31, 2005

(In thousands, except share and per share data)

	April 30, 2006	October 31, 2005
ASSETS		
Current assets		
Cash and cash equivalents	**$ 141,068**	$ 107,195
Accounts receivable, net of allowances of $87,820 and $69,904 at April 30, 2006 and October 31, 2005, respectively	**130,328**	198,068
Inventories	**91,820**	136,227
Software development costs	**69,431**	88,826
Licenses	**4,253**	7,651
Prepaid taxes and taxes receivable	**69,854**	40,307
Prepaid expenses and other current assets	**27,772**	24,025
Deferred tax assets	**38,319**	10,943
Total current assets	**572,845**	613,242
Fixed assets, net	**49,796**	48,617
Software development costs, net of current portion	**27,183**	19,602
Licenses, net of current portion	**4,984**	2,330
Goodwill	**190,491**	179,893
Intangibles, net	**48,916**	58,666
Deferred tax assets	**7,784**	5,506
Other assets	**4,018**	5,020
Total assets	**$ 906,017**	$ 932,876
LIABILITIES and STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	**$ 108,216**	$ 133,353
Accrued expenses and other current liabilities	**135,508**	90,702
Income taxes payable	**14,361**	10,220
Total current liabilities	**258,085**	234,275
Other long-term liabilities	**403**	2,467

Total liabilities	**258,488**	236,742
Stockholders equity		
Common stock, par value $.01 per share; 100,000,000 shares authorized; 72,515,165 and 70,667,421 shares issued and outstanding at April 30, 2006 and October 31, 2005, respectively	**725**	707
Additional paid-in capital	**433,381**	418,053
Deferred compensation		(11,189)
Retained earnings	**208,382**	287,877
Accumulated other comprehensive income	**5,041**	686
Total stockholders equity	**647,529**	696,134
Total liabilities and stockholders equity	**$906,017**	$932,876

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES

Condensed Consolidated Statements of Operations (Unaudited)

For the three and six months ended April 30, 2006 and 2005

(In thousands, except per share data)

	Three months ended April 30,		Six months ended April 30,	
	2006	**2005**	**2006**	**2005**
Net revenues	**$265,122**	$222,068	**$530,103**	$724,542
Cost of goods sold				
Product costs	**130,940**	123,504	**291,793**	360,989
Royalties	**82,282**	21,938	**115,149**	102,147
Software development costs	**34,128**	4,780	**49,722**	8,985
Total cost of goods sold	**247,350**	150,222	**456,664**	472,121
Gross profit	**17,772**	71,846	**73,439**	252,421
Operating expenses				
Selling and marketing	**32,194**	36,275	**73,838**	87,206
General and administrative	**33,705**	28,705	**72,158**	57,392
Research and development	**16,097**	13,785	**33,806**	37,202
Depreciation and amortization	**12,944**	5,102	**19,595**	9,888
Total operating expenses	**94,940**	83,867	**199,397**	191,688
Income (loss) from operations	**(77,168)**	(12,021)	**(125,958)**	60,733
Interest income, net	**4**	1,164	**257**	1,704
Income (loss) before income taxes	**(77,164)**	(10,857)	**(125,701)**	62,437
Provision (benefit) for income taxes	**(26,791)**	(2,671)	**(46,206)**	15,374
Net income (loss)	**$(50,373)**	$(8,186)	**$(79,495)**	$47,063
Per share data:				
Basic:				
Weighted average common shares outstanding	**70,979**	70,112	**70,890**	69,365
Net income (loss) per share	**$(0.71)**	$(0.12)	**$(1.12)**	$0.68

Diluted:				
Weighted average common shares outstanding	**70,979**	70,112	**70,890**	70,678
Net income (loss) per share	**$(0.71)**	$(0.12)	**$(1.12)**	$0.67

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

For the six months ended April 30, 2006 and 2005

(In thousands)

	Six months ended April 30,	
	2006	**2005**
Cash flows from operating activities:		
Net income (loss)	**$(79,495)**	$47,063
Adjustment to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	**19,595**	9,888
Loss on disposal of fixed assets		15
Amortization of intellectual property and other	**6,563**	6,642
Amortization of compensatory restricted stock	**2,032**	9,266
Stock-based compensation related to compensatory stock options	**6,662**	
Amortization of software development costs and licenses	**68,982**	28,327
Provision for doubtful accounts and other allowances	**15,712**	14,634
Write-off of software development costs and licenses	**18,462**	3,397
Tax benefit from exercise of compensatory stock and stock options		9,941
Foreign currency transaction (gain) loss	**(1,252)**	247
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	**54,270**	162,459
Inventories	**45,348**	37,847
Software development costs	**(67,504)**	(70,866)
Licenses	**(7,218)**	(5,556)
Prepaid taxes and taxes receivable	**(29,547)**	(8,900)
Prepaid expenses and other current assets	**(1,199)**	373
Non-current assets	**893**	(347)
Accounts payable	**(26,029)**	(76,474)
Accrued expenses and other liabilities	**11,162**	(66,589)
Income taxes payable	**5,206**	(2,748)
Net cash provided by operating activities	**42,643**	98,619
Cash flows from investing activities:		
Purchase of fixed assets	**(13,009)**	(14,610)
Acquisition of intangible assets		(20,000)
Acquisitions, net of cash acquired	**1,143**	(23,244)
Escrow payment for settlement		(7,500)
Payments for prior acquisitions	**(1,334)**	(965)
Proceeds from sale of fixed assets and investments		73

Net cash used in investing activities	**(13,200)**	(66,246)
Cash flows from financing activities:		
Proceeds from exercise of stock options	**1,944**	24,445
Excess tax benefit from exercise of compensatory stock and stock options	**124**	
Other financing		(52)
Net cash provided by financing activities	**2,068**	24,393
Effect of foreign exchange rates	**2,362**	(1,620)
Net increase in cash for the period	**33,873**	55,146
Cash and cash equivalents, beginning of the period	**107,195**	155,095
Cash and cash equivalents, end of the period	**$141,068**	$210,241

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited) (continued)

For the six months ended April 30, 2006 and 2005

(In thousands)

	Six months ended April,	
	2006	**2005**
Supplemental information on businesses acquired:		
Fair value of assets acquired:		
Current assets	**$112**	$111
Non-current assets	**421**	1,196
Intangible assets	**5,644**	7,980
Goodwill	**11,085**	29,433
Less: liabilities assumed		
Current liabilities	**(200)**	(3,275)
Deferred income taxes	**(1,620)**	(3,192)
Net assets of businesses acquired, excluding cash acquired	**$15,442**	$32,253
Cash paid for businesses acquired	**$857**	$24,000
Less: cash acquired	**(2,000)**	(756)
Net cash paid (acquired) for businesses	**(1,143)**	23,244
Additional consideration in connection with acquisitions	**4,085**	6,416
Contingent and deferred consideration		2,593
Issuance of unregistered common stock in connection with acquisitions	**12,500**	
Total consideration, net of cash acquired	**$15,442**	$32,253
Supplemental cash flow information:		
Issuance of warrants to licensor	**$**	$1,183
Cash paid for taxes	**9,724**	26,809
Cash paid for interest	**575**	131

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES

Condensed Consolidated Statements of Stockholders Equity (Unaudited)

For the year ended October 31, 2005 and the six months ended April 30, 2006

(In thousands)

	Common Stock						
	Shares	**Amount**	**Additional Paid-in Capital**	**Deferred Compensation**	**Retained Earnings**	**Accumulated Other Comprehensive Income (loss)**	**Total**
Balance, October 31, 2004	68,159	$ 682	$ 381,928	$ (3,896)	$ 250,402	$ 6,354	$ 635,470
Foreign currency translation adjustment						(5,668)	(5,668)
Net income					37,475		37,475
Comprehensive income							31,807
Purchase of treasury shares, retired	(925)	(9)	(24,920)				(24,929)
Exchange of treasury shares, retired	(367)	(4)	(8,307)				(8,311)
Proceeds from exercise of stock options and warrants	2,753	27	31,196				31,223
Amortization of deferred compensation				14,860			14,860
Issuance of common stock in connection with acquisition	82	1	1,999				2,000
Issuance of compensatory stock and stock options	965	10	22,688	(22,153)			545
Tax benefit in connection with the exercise of compensatory stock and stock options			12,286				12,286
Issuance of warrants to licensor			1,183				1,183
Balance, October 31, 2005	70,667	$ 707	$ 418,053	$ (11,189)	$ 287,877	$ 686	$ 696,134
Foreign currency translation adjustment						4,355	4,355
Net loss					(79,495)		(79,495)
Comprehensive loss							(75,140)
Deferred compensation			(11,189)	11,189			
Proceeds from exercise of stock options and warrants	174	1	1,944				1,945
Stock-based compensation related to compensatory stock options			9,069				9,069
Amortization of restricted stock			2,836				2,836
Issuance of common stock in connection with acquisition	679	7	12,493				12,500
Issuance of compensatory restricted stock, net of forfeitures and cancellations	995	10	51				61
Tax benefit in connection with the exercise of compensatory stock and stock options			124				124
Balance, April 30, 2006	72,515	$ 725	$ 433,381	$	$ 208,382	$ 5,041	$ 647,529

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
(Dollars in thousands, except per share amounts)

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1. ORGANIZATION AND DESCRIPTION OF BUSINESS

Take-Two Interactive Software, Inc. (the Company) was incorporated in the State of Delaware in September 1993. The Company develops, publishes and distributes interactive software games designed for personal computers, video game consoles and handheld platforms.

2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

Basis of Presentation

The unaudited condensed consolidated financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the financial statements do not include all information and disclosures necessary for a presentation of the Company s financial position, results of operations and cash flows in conformity with generally accepted accounting principles in the United States of America. In the opinion of management, the financial statements reflect all adjustments (consisting only of normal recurring accruals) necessary for a fair statement of the Company s financial position, results of operations and cash flows. The results of operations for an interim period are not necessarily indicative of the results for the full year. The financial statements should be read in conjunction with the audited financial statements and notes thereto contained in the Company s Annual Report on Form 10-K for the fiscal year ended October 31, 2005.

Estimates

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 and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reported periods. The most significant estimates and assumptions relate to the adequacy of allowances for returns, price concessions and doubtful accounts; the amortization and recoverability of software development costs, licenses and other intangibles; valuation of inventories, fair value of stock compensation and realization of deferred income taxes. Actual amounts could differ significantly from these estimates.

Stock Split

In April 2005, the Company effected a three-for-two stock split in the form of a stock dividend. Accordingly, all share and per share data in the accompanying unaudited condensed consolidated financial statements and notes thereto give retroactive effect to the stock split.

Financial Instruments

The carrying amounts of the Company s financial instruments, including cash and cash equivalents, accounts receivable, income tax receivable and payable, accounts payable and accrued liabilities, approximate fair value because of their short maturities. The Company considers all highly liquid instruments purchased with original maturities of three months or less to be cash equivalents.

The Company transacts business in various foreign currencies and has significant sales and purchase transactions denominated in foreign currencies. The Company uses forward exchange contracts to seek to mitigate foreign currency risk associated with foreign currency assets and liabilities, primarily certain intercompany receivables and payables. The Company does not designate foreign currency forward contracts as hedging instruments under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. As a result, the Company marks to market its foreign currency forward contracts each period and any gains and losses are recognized in net income. At April 30, 2006, the Company had no outstanding foreign currency forward contracts.

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

Recently Issued Accounting Pronouncements

Effective November 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) (SFAS 123(R)), Share-Based Payment, which revised Statement of Financial Accounting Standards 123 (SFAS 123), Accounting for Stock-Based Compensation. Refer to Note 3 to the unaudited condensed consolidated financial statements for further information. There were no other accounting policies adopted during the six months ended April 30, 2006 that had a material effect on the Company s financial condition and results of operations.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
(Dollars in thousands, except per share amounts)

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154, Accounting Changes and Error Corrections (SFAS 154), which replaces APB Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements An Amendment of APB Opinion No. 28. SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management does not believe the adoption of SFAS 154 will have a material impact on the Company s condensed consolidated financial statements.

3. STOCK-BASED COMPENSATION

Effective November 1, 2005, the Company adopted SFAS 123(R), which revised Statement of Financial Accounting Standard 123. SFAS 123(R) requires all share-based payment transactions with employees, including grants of employee stock options, to be recognized as compensation expense over the requisite service period based on their relative fair values. Prior to the adoption of SFAS 123(R), stock-based compensation expense related to employee stock options was not recognized in the statement of operations if the exercise price was at least equal to the market value of the common stock on the grant date, in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. Prior to November 1, 2005, the Company had adopted the disclosure-only provisions under SFAS 123.

The Company elected to use the Modified Prospective Application (MPA) method for implementing SFAS 123(R). Under the MPA method, prior periods are not restated and new awards are valued and accounted for prospectively upon adoption. Outstanding prior stock option awards that are non-vested as of October 31, 2005 are recognized as compensation expense in the statement of operations over the remaining requisite service period.

The Company has stock-based compensation plans under which directors, officers and other employees are eligible to receive stock options and restricted stock awards. Generally, stock options are granted with an exercise price equal to the market value of a share of common stock on the date of grant, expire within five years and vest over three years. As of April 30, 2006, the Company s 2002 stock option plan provides for a total of 11.0 million shares of common stock to be issued of which approximately 1.1 million shares were available for grant. As of April 30, 2006, the Company s Incentive Stock Plan (restricted stock awards) provides for a total of 2.5 million shares of common stock to be issued of which approximately 0.25 million shares were available for grant.

The following table summarizes the activity in options under the Company s stock based compensation plans:

	Shares (in thousands)	Weighted Average Exercise Price
Options outstanding at October 31, 2005	7,495	$20.47
Granted-exercise price equal to fair value	65	18.13
Exercised	(86)	12.87
Forfeited	(65)	19.56
Options outstanding at January 31, 2006	7,409	$20.55
Granted-exercise price equal to fair value	116	16.77
Exercised	(98)	10.37
Forfeited	(296)	20.87
Options outstanding at April 30, 2006	7,131	$20.61
Options exercisable at April 30, 2006	4,341	$19.12

As of April 30, 2006, the weighted average remaining contractual term of the Company s options outstanding and exercisable is 3.0 years and 2.5 years, respectively. As of April 30, 2006, due to the Company s stock price, there is no aggregate intrinsic value related to options outstanding or exercisable. As of April 30, 2006, the total future unrecognized compensation cost related to outstanding unvested options is $29.4 million which will be recognized as compensation expense over the remaining vesting period.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
(Dollars in thousands, except per share amounts)

The weighted average per share fair values of options granted were $7.43 and $14.85 for the three months ended April 30, 2006 and 2005, respectively, and $7.86 and $13.81 for the six months ended April 30, 2006 and 2005, respectively. The fair value of the Company s options was estimated using the Black-Scholes option-pricing model. This model requires the input of assumptions regarding a number of complex and subjective variables that will usually have a significant impact on the fair value estimate. These variables include, but are not limited to, the volatility of the Company s stock price and employee stock option exercise behaviors. The assumptions and variables used for the current period grants were developed based on SFAS 123(R) and SEC guidance contained in Staff Accounting Bulletin (SAB) No. 107, Share-Based Payment. The following table summarizes the assumptions and variables used by the Company to compute the weighted average fair value of stock option grants:

	Three months ended April 30,				Six months ended April 30,			
	2006		**2005**		**2006**		**2005**	
Risk free interest rate	**4.7**	**%**	4.0	%	**4.6**	**%**	3.8	%
Expected stock price volatility	**55.0**	**%**	66.1	%	**55.0**	**%**	66.8	%
Expected term until exercise (years)	**3.5**		5.0		**3.7**		4.8	
Dividends	**None**		None		**None**		None	

For the three and six months ended April 30, 2006, the Company used a combination of historical volatility and the implied volatility for publicly traded options on the Company s stock as the expected volatility assumption required in the Black-Scholes option-pricing model consistent with SFAS 123(R) and SAB 107. Prior to fiscal 2006, the Company had used its historical stock price volatility in accordance with SFAS 123 for purposes of its pro forma information. The selection of the implied volatility approach was based upon the availability of actively traded options on the Company s stock and the Company s assessment that implied volatility is more representative of future stock price trends than historical volatility.

SFAS 123(R) requires the recognition of stock-based compensation for the number of awards that are ultimately expected to vest. As a result, for most awards, recognized stock compensation was reduced for estimated forfeitures prior to vesting primarily based on a historical annual forfeiture rate of approximately 7%. Estimated forfeitures will be reassessed at each balance sheet date and may change based on new facts and circumstances. Prior to October 31, 2005, actual forfeitures were accounted for as they occurred for purposes of required pro forma stock compensation disclosures.

Restricted stock awards are expensed on a straight-line basis over the vesting period, which typically ranges from one to four years. The following table summarizes the activity in non-vested restricted stock under the Company s stock based compensation plans:

	Shares (in thousands)	Weighted Average Grant Date Fair Value
Non-vested restricted stock at October 31, 2005	600	$ 23.03
Granted	45	19.24
Vested	(52)	22.35
Forfeited	(6)	19.00
Non-vested restricted stock at January 31, 2006	587	$ 22.84

Granted	962	15.59
Vested	(57)	22.25
Forfeited	(5)	22.78
Non-vested restricted stock at April 30, 2006	1,487	$ 18.17

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
(Dollars in thousands, except per share amounts)

The following table summarizes the components and classification of stock-based compensation expense in the Company s condensed consolidated statements of operations:

	Three months ended April 30,		**Six months ended April 30,**	
	2006	**2005**	**2006**	**2005**
Stock options	**$2,134**	$	**$6,662**	$
Restricted stock	**1,727**	4,464		