

ACTIVISION INC /NY
Form 10-K
June 14, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark one)

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

For the fiscal year ended March 31, 2007

OR

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

For the transition period from _____ **to** _____

Commission File Number 0-12699

ACTIVISION, INC.

(Exact name of registrant as specified in its charter)

Delaware

95-4803544

Edgar Filing: ACTIVISION INC /NY - Form 10-K

(State or other jurisdiction of
incorporation or organization)

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

3100 Ocean Park Blvd., Santa Monica, CA
(Address of principal executive offices)

90405
(Zip Code)

Registrant's telephone number, including area code: **(310) 255-2000**

Securities registered pursuant to Section 12(b) of the Act:

| Title of Class | Name of Each Exchange on Which Registered |
|---------------------------------------------|-------------------------------------------|
| Preferred Stock Purchase Rights | The NASDAQ Global Select Market |
| Common Stock, par value \$.000001 per share | |

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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. (Check one):

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 Act). Yes ☐ No ☒

Edgar Filing: ACTIVISION INC /NY - Form 10-K

The aggregate market value of the Common Stock of the registrant held by non-affiliates of the registrant on September 30, 2006 was \$3,404,053,450.

The number of shares of the registrant's Common Stock outstanding as of June 7, 2007 was 283,310,734.

Documents Incorporated by Reference

Portions of the registrant's definitive Proxy Statement, to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K, with respect to the 2007 Annual Meeting of Shareholders, are incorporated by reference into Part III of this Annual Report.

INDEX

| | | Page No. |
|------------------|----------------------------------------------------------------------------------------------------------------------|----------|
| <u>PART I.</u> | | |
| <u>Item 1.</u> | <u>Business</u> | 3 |
| <u>Item 1A.</u> | <u>Risk Factors</u> | 10 |
| <u>Item 1B.</u> | <u>Unresolved Staff Comments</u> | 23 |
| <u>Item 2.</u> | <u>Properties</u> | 24 |
| <u>Item 3.</u> | <u>Legal Proceedings</u> | 24 |
| <u>Item 4.</u> | <u>Submission of Matters to a Vote of Security Holders</u> | 25 |
| <u>PART II.</u> | | |
| <u>Item 5.</u> | <u>Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities</u> | 26 |
| <u>Item 6.</u> | <u>Selected Consolidated Financial Data</u> | 31 |
| <u>Item 7.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 32 |
| <u>Item 7A.</u> | <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 68 |
| <u>Item 8.</u> | <u>Consolidated Financial Statements and Supplementary Data</u> | 69 |
| <u>Item 9.</u> | <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> | 69 |
| <u>Item 9A.</u> | <u>Controls and Procedures</u> | 69 |
| <u>Item 9B.</u> | <u>Other Information</u> | 71 |
| <u>PART III.</u> | | |
| <u>Item 10.</u> | <u>Directors, Executive Officers, and Corporate Governance</u> | 72 |
| <u>Item 11.</u> | <u>Executive Compensation</u> | 72 |
| <u>Item 12.</u> | <u>Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u> | 72 |
| <u>Item 13.</u> | <u>Certain Relationships and Related Transactions, and Director Independence</u> | 72 |
| <u>Item 14.</u> | <u>Principal Accountant Fees and Services</u> | 72 |
| <u>PART IV.</u> | | |
| <u>Item 15.</u> | <u>Exhibits and Financial Statement Schedule</u> | 73 |

SIGNATURES

82

CERTIFICATION

2

PART I

This Annual Report on Form 10-K contains, or incorporates by reference, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements include, but are not limited to, (1) projections of revenues, expenses, income or loss, earnings or loss per share, cash flow projections or other financial items; (2) statements of our plans and objectives, including those relating to product releases; (3) statements of future economic performance; and (4) statements of assumptions underlying such statements. We generally use words such as anticipate, believe, could, estimate, expect, forecast, future, intend, may, plan, positioned, potential, subject to, upcoming and other similar expressions to help identify forward-looking statements. These forward-looking statements are subject to business and economic risk, reflect management's current expectations, estimates and projections about our business, and are inherently uncertain and difficult to predict. Our actual results could differ materially. The forward-looking statements contained herein speak only as of the date on which they were made, and we disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of this Annual Report. Risks and uncertainties that may affect our future results include, but are not limited to, those discussed under the heading Risk Factors, included in Part I, Item 1A. All references to we, us, our, Activision or the Company in the following discussion and analysis are intended to refer to Activision, Inc. and its subsidiaries.

Item 1. BUSINESS

(a) General

Activision, Inc. (Activision, the Company, or we) is a leading international publisher of interactive entertainment software and peripheral products. We have built a company with a diverse portfolio of products that spans a wide range of categories and target markets and that is used on a variety of game hardware platforms and operating systems. We have created, licensed, and acquired a group of highly recognizable brands, which we market to a variety of consumer demographics. Our fiscal 2007 product portfolio included such best-selling products as *Call of Duty 3*, *Guitar Hero II*, *Tony Hawk's Project 8*, *Tony Hawk's Downhill Jam*, *Marvel: Ultimate Alliance*, *Over the Hedge*, and *X-Men: The Official Game*.

Our products cover diverse game categories including action/adventure, action sports, racing, role-playing, simulation, first-person action, music-based gaming, and strategy. Our target customer base ranges from casual players to game enthusiasts, children to adults, and mass-market consumers to value buyers. We currently offer our products primarily in versions that operate on the Sony PlayStation 2 (PS2), Sony PlayStation 3 (PS3), Nintendo Wii (Wii), and Microsoft Xbox 360 (Xbox360) console systems, Nintendo Game Boy Advance (GBA), Sony PlayStation Portable (PSP), and Nintendo Dual Screen (NDS) hand-held devices, and the personal computer (PC). The installed base for the current generation of hardware platforms is significant and the fiscal 2006 release of the Xbox360 and the fiscal 2007 releases of the PS3 and the Wii will further expand the software market. We had a successful and significant presence at the launches of the PS3 and the Wii with three launch titles for the PS3, *Call of Duty 3*, *Marvel: Ultimate Alliance*, and *Tony Hawk's Project 8*, and five launch titles for the Wii, *Call of Duty 3*, *Marvel: Ultimate Alliance*, *World Series of Poker: Tournament of Champions*, *Rapala Tournament Fishing*, and *Tony Hawk's Downhill Jam*. Our plan is to continue to build on our significant launch presence on the PS3, Wii, and Xbox360 (the next-generation platforms) by continuing to expand the number of titles released on the next generation platforms while continuing to market to current-generation platforms as long as economically attractive given their large 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. Our distribution business consists of operations in Europe that provide logistical and sales services to third-party publishers of interactive entertainment software, our own publishing operations, and manufacturers of interactive entertainment hardware.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

We were originally incorporated in California in 1979. In December 1992, we reincorporated in Delaware. In June 2000, we reorganized into the current holding company organizational structure.

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 three-for-two split of our outstanding common shares effected in the form of a 50% stock dividend. The split was paid on March 15, 2004 to shareholders of record as of February 23, 2004. In February 2005, the Board of Directors approved a four-for-three split of our outstanding common shares effected in the form of a 33-1/3% stock dividend. The split was paid March 22, 2005 to shareholders

of record as of March 7, 2005. In September 2005, the Board of Directors approved a four-for-three split of our outstanding common shares effected in the form of a 33-1/3% stock dividend. The split was paid October 24, 2005 to shareholders of record as of October 10, 2005. The par value of our common stock was maintained at the pre-split amount of \$.000001. All share and per share data have been restated as if the stock splits had occurred as of the earliest period presented.

(b) **Business Combinations**

We have completed a number of acquisitions of both software development companies and interactive entertainment product distribution companies. In fiscal 2007, we acquired video game publisher RedOctane Inc., the publisher of the popular Guitar Hero franchise. See Note 3 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K for additional information regarding the accounting treatment of these and prior acquisitions.

(c) **Financial Information About Industry Segments**

We have two reportable segments: publishing and distribution. Publishing relates to the development (both internally and externally), marketing and sale of DVD, CD, UMD, online, and cartridge-based interactive entertainment software and peripheral products owned or controlled by us directly, by license, or through our affiliate label program with certain third-party publishers. Distribution primarily refers to logistical and sales services provided by our European distribution subsidiaries to third-party publishers of interactive entertainment software, our own publishing operations and manufacturers of interactive entertainment hardware. See Note 10 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K for certain financial information regarding reporting segment and geographic areas required by Item 1.

(d) **Narrative Description of Business**

Our objective is to be a worldwide leader in the development, publishing, and distribution of quality interactive entertainment software and peripheral products that deliver a highly satisfying consumer entertainment experience. Our business strategy, the key components of our business operations, and the risk factors that could impact our business are detailed below.

Strategy

Create, Acquire, and Maintain Strong Brands. We focus development and publishing activities principally on products that are, or have the potential to become, franchise properties with sustainable consumer appeal and brand recognition. It is our experience that these products can then serve as the basis for sequels, prequels, and related new products that can be released over an extended period of time. We believe that the publishing and distribution of products based in large part on franchise properties enhances predictability of revenues and the probability of high unit volume sales and operating profits. We have entered into a series of strategic relationships with the owners of intellectual property pursuant to which we have acquired the rights to publish products based on franchises such as Marvel Characters, Inc.

properties, including Spider-Man and X-Men. We have a multi-year, multi-property, publishing agreement with DreamWorks Animation LLC that grants us the exclusive rights to publish video games based on DreamWorks Animation SKG's theatrical release Shrek 2, which was released in the first quarter of fiscal 2005, Shark Tale, which was released in the second quarter of fiscal 2005, Madagascar, which was released in the first quarter of fiscal 2006,

Over the Hedge, which was released in the first quarter of fiscal 2007, and all of their respective forthcoming sequels, including Shrek the Third, which was released in May 2007, and Madagascar 2. As part of our agreement with DreamWorks Animation, we have the exclusive video game rights to potential future films in the Shrek franchise beyond Shrek the Third, upcoming movies, including Bee Movie and Kung Fu Panda, as well as other films currently in development, including Creature Feature and How to Train Your Dragon. We have a strategic alliance with Harrah's Entertainment, Inc. that grants us the exclusive, worldwide interactive rights to develop and publish World Series of Poker video games based on the popular World Series of Poker Tournament. We also have a strategic relationship with professional skateboarder Tony Hawk through an exclusive multi-year agreement to develop video games using his name and likeness. Through fiscal 2007, we have released eight successful titles in the Tony Hawk franchise. We also have created a number of successful internally developed intellectual properties such as the True Crime and Call of Duty franchise properties, and GUN. We also have agreements with MGM Interactive and EON Productions Ltd. to develop and publish video games based on the James Bond license and with Hasbro Properties Group (Hasbro) to develop and publish video games based on the Transformers brand. We plan on releasing our first title under the Hasbro license, *Transformers the Game*,

concurrently with the DreamWorks Pictures and Paramount Pictures Corporation motion picture release, *Transformers*, in July 2007.

Execute Disciplined Product Selection and Development Processes. The success of our publishing business depends, in significant part, on our ability to develop high quality games that will generate high unit volume sales. Our publishing units have implemented a formal control process for the selection, development, production, and quality assurance of our products. We apply this process, which we refer to as the *Greenlight Process*, to all of our products, whether externally or internally developed. The *Greenlight Process* includes in-depth reviews of each project at four important stages of development by a team that includes many of our highest-ranking operating managers and coordination between our sales and marketing personnel and development staff at each step in the process.

We develop our products using a combination of our internal development resources and external development resources acting under contract with us. We typically select our external developers based on their track record and expertise in producing products in the same category. One developer will often produce the same game for multiple platforms and will produce sequels to the original game. We believe that selecting and using development resources in this manner allows us to leverage the particular expertise of our internal and external development resources, which we believe adds to the quality of our products.

Create and Maintain Diversity in Product Mix, Platforms, and Markets. We believe that maintaining a diversified mix of products can reduce our operating risks and enhance profitability. Therefore, we develop and publish products spanning a wide range of product categories, including action/adventure, action sports, racing, role-playing, simulation, first-person action, music-based gaming, and strategy. We also develop products designed for target audiences ranging from casual players to game enthusiasts, children to adults, and mass-market consumers to value buyers. Presently, we concentrate on developing, publishing, and distributing products that operate on PS2, PS3, Xbox360, and Wii console systems, GBA, PSP, and NDS hand-held devices, and the PC. We typically offer our products for use on multiple platforms in order to reduce the risks associated with any single platform, leverage our costs over a larger installed hardware base, and increase unit sales.

Continue to Improve Profitability. We continually strive to manage risk and increase our operating leverage and efficiency with the goal of increased profitability. We believe the key factor affecting our future profitability will be the success rate of our product releases. Therefore, our product selection and development process includes, as a significant component, periodic evaluations of the expected commercial success of products under development. Through this process, for titles that we determine to be less promising, corrections are made in the development process or, if necessary, they are discontinued before we incur additional development costs. In addition, we believe our focus on cross platform releases and branded products will contribute to improved profitability.

We continue to focus on increasing our margins. We have, for example, acquired certain experienced and specialized developers in instances where we can enhance profitability through the elimination of royalty obligations. Additionally, we often rely on independent third-party interactive entertainment software developers to develop some of our software products, thereby taking advantage of specialized independent developers without incurring the fixed overhead obligations associated with increased internally employed staff.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Our sales and marketing staff work with our studio resources to increase the visibility of new product launches and to coordinate the timing and promotion of product releases. Our finance and sales and marketing personnel work together to improve inventory management and receivables collections. We have instituted broad, objective-based reward programs that provide incentives to management and staff throughout the organization to produce results that meet our financial objectives.

Grow Through Continued Strategic Acquisitions and Alliances. The interactive entertainment industry has been consolidating, and we believe that success in this industry will be driven in part by the ability to take advantage of scale. Specifically, smaller companies are more capital constrained, enjoy less predictability of revenues and cash flow, lack product diversity and must spread fixed costs over a smaller revenue base. Several industry leaders are emerging that combine the entrepreneurial and creative spirit of the industry with professional management, the ability to access the capital markets, and the ability to maintain favorable relationships with developers, intellectual property owners, and retailers. Through numerous completed acquisitions since 1997, we believe that we have successfully diversified our operations, our channels of distribution, our development talent pool, and our library of titles, and have emerged as one of the industry's leaders. We intend to continue to evaluate the expansion of our resources through acquisitions, strategic relationships, and key license transactions. We intend to continue expanding

our intellectual property library through key license transactions and strategic relationships with intellectual property owners and to continue to evaluate opportunities to increase our development capacity through the acquisition of or investment in selected experienced software development firms.

Products

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Historically, we have been best known for our action/adventure, strategy, and simulation products. We have been successful in the superheroes and skateboarding categories with our release of titles based on the Spider-Man and X-Men properties, as well as the Tony Hawk franchise. We have also been successful in the first person action categories through the Call of Duty original intellectual property, which we plan on continuing as a successful long-term franchise. In fiscal 2007 we successfully entered the music-based gaming genre with the acquisition of the Guitar Hero franchise. This franchise combines interactive software with a hardware peripheral in the form of a guitar and provides us with an early leadership position and long-term growth opportunity. We have established ourselves as a leader in the value software publishing business with products under our Cabela's, Rapala, World Series of Poker, and Greg Hastings's Paintball licenses, as well as with products distributed on behalf of our value affiliate label partners. Products published by us in this category are generally developed by third parties, often under contract with us, and are marketed under the Activision Value Publishing name. Value software is typically less sophisticated and less complex, both in terms of the development process and consumer gameplay.

Hardware Licenses. Our products currently are being developed or published primarily for PS2, PS3, Wii, and Xbox360 console systems; PSP and NDS hand-held devices; and PCs. In order to maintain general access to the console systems and hand-held devices marketplace, we have maintained licenses for PS2, PS3, Wii, and Xbox360 console systems and GBA, PSP, and NDS hand-held devices with the owners of each such platform. Each license allows us to create multiple products for the applicable platform, subject to certain approval rights which are reserved by each licensor. Each license also requires that we pay the licensor a per unit royalty for each unit manufactured. In contrast, we are not required to obtain any license for the development and production of products for PCs.

Intellectual Property Rights. Many of our current and planned releases are based on intellectual property, other character or story rights, and music rights licensed from third parties, as well as a combination of characters, worlds, and concepts derived from our extensive library of titles, and original characters and concepts owned and created by us. When publishing products based on licensed intellectual property rights, we generally seek to capitalize on the name recognition, marketing efforts, and goodwill associated with the underlying property. For intellectual property owned by Activision, we generally attempt to establish such properties as sustainable, long-term game franchises.

In acquiring intellectual property rights from third parties, we seek to obtain rights to publish titles across a variety of platforms, to include the ability to produce multiple titles and to retain rights over an extended period of time. In past years, we have been able to enter into a series of long-term or multi-product agreements with owners of various intellectual properties that are well known throughout the world and to create products based on these recognizable characters, story lines, or concepts. These agreements typically provide us with exclusive publishing rights for a specific period of time and, in some cases, for specified platforms and, in other cases, with renewal rights upon the satisfaction of certain conditions. The scope of our licensing activities includes theatrical motion pictures, television shows, animated films and series, comic books, literary works, music, sports personalities and events, and celebrities. We intend to continue expanding relationships with our existing intellectual property partners and to enter into agreements with other intellectual property owners for additional recognizable properties, characters, story lines and concepts. However, we may not be able to maintain or expand our existing relationships or to seek out and sustain new long-term relationships of similar caliber in the future.

Product Development and Support

We develop and produce titles using a model in which a core group of creative, production, and technical professionals, in coordination with our marketing and finance departments, have responsibility for the entire development and production process including the supervision and coordination of internal and external resources. This team assembles the necessary creative elements to complete a title using, where appropriate, outside programmers, artists, animators, scriptwriters, musicians and songwriters, sound effects and special effects experts, and sound and video studios. We believe that this model allows us to supplement internal expertise with top quality external resources on an as-needed basis.

In addition, we often seek out and engage independent third-party developers to create products on our behalf. Such products are sometimes owned by us, and usually we have unlimited rights to commercially exploit these products. In other circumstances, the third-party developer may retain ownership of the intellectual property and/or technology included in the product and reserve certain exploitation rights. We typically select these independent third-party developers based on their expertise in developing products in a specific category and use the same developer to produce the same game for multiple platforms. Each of our third-party developers is under contract with us for specific or multiple titles. From time to time, we also acquire the license rights to publish and/or distribute software products that are or will be independently created by third-party developers. In such cases, the agreements with such developers provide us with exclusive publishing and/or distribution rights for a specific period of time, often for specified platforms and territories. In either case, we often have the ability to publish and/or distribute sequels, conversions, enhancements, and add-ons to the product initially being produced by the independent developer and frequently have the right to engage the services of the original developer with regard to the development of such products.

In consideration for the services that the independent third-party developer provides, it receives a royalty generally based on net sales of the product that it has developed. Typically, the developer also receives an advance, which we recoup from the royalties otherwise payable to the developer. The advance generally is paid in milestone stages. The payment at each stage is tied to the completion and delivery of a detailed performance milestone. Some contracts include minimum guaranteed royalty payments which are recorded as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract. Working with an independent developer allows us to reduce our fixed development costs, share development risks with the third-party developer, take advantage of the third-party developer's expertise in connection with certain categories of products or certain platforms, and gain access to proprietary development technologies.

From time to time, we may make a capital investment and hold a minority interest in a third-party developer in connection with interactive entertainment software products to be developed by such developer for us, which we believe helps to create a closer relationship between us and the developer. We account for those capital investments over which we have the ability to exercise significant influence using the equity method. For those investments over which we do not have the ability to exercise significant influence, we account for our investment using the cost method. There can be no assurance that we will realize long-term benefits from such investments or that we will continue to carry such investments at their current value.

Greenlight Process

Edgar Filing: ACTIVISION INC /NY - Form 10-K

We have adopted and implemented a rigorous procedure for the selection, development, production, and quality assurance of our internally and externally produced interactive entertainment software titles. The process, known internally as the Greenlight Process, involves four phases throughout the development and production phases of a title, each of which includes a number of specific performance milestones. The four phases of the Greenlight Process are the concept, prototype, first playable, and alpha. This procedure is designed to enable us to manage and control production and development budgets and timetables, to identify and address production and technical issues at the earliest opportunity, and to coordinate marketing and quality control strategies throughout the production and development phases, all in an environment that fosters creativity. Checks and balances are intended to be provided through the structured interaction of the project team with our creative, technical, marketing, and quality assurance/customer support personnel, as well as our legal, accounting, and finance departments. In order to maintain the competitiveness of our products and to take advantage of increasingly sophisticated technology associated with hardware platforms, our development process includes a significant amount of time for play-testing new products, and extensive product quality evaluations.

Product Support

We provide various forms of product support to both our internally and externally developed titles. Our quality assurance personnel are involved throughout the development and production of each title published by us. We subject all such products to extensive testing before release to ensure compatibility with all appropriate hardware systems and configurations and to minimize the number of bugs and other defects found in the products. To support our products after release, we provide online access to our customers on a 24-hour basis as well as telephone operator help lines during regular business hours. The customer support group tracks customer inquiries and we use this data to help improve the development and production processes.

Publishing Activities

Marketing

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Our marketing efforts include online activities (such as the creation of World Wide Web pages to promote specific titles), public relations, print and broadcast advertising, coordinated in-store and industry promotions (including merchandising and point of purchase displays), participation in cooperative advertising programs, direct response vehicles, and product sampling through demonstration software distributed through the Internet or on compact discs. From time to time, we also receive marketing support from hardware manufacturers and retailers in connection with their own promotional efforts. In addition, certain of our products contain software that enables customers to electronically register their purchases with us online.

We believe that certain of our franchise properties have loyal and devoted audiences who purchase our sequels as a result of dedication to the property and satisfaction from previous product purchases. We therefore market these sequels both toward the established market as well as broader audiences. In addition, in marketing titles based on licensed properties, we believe that we derive benefits from the continued exploitation of these licensed properties and the marketing and promotional activities of the property owners.

Sales and Distribution

Edgar Filing: ACTIVISION INC /NY - Form 10-K

North America. Our products are available for sale or rental in thousands of retail outlets domestically. Our North American customers include Best Buy, Blockbuster, Circuit City, GameStop, Target, Toys R Us, and Wal-Mart. Our largest customers, Wal-Mart and GameStop, accounted for approximately 22% and 8%, respectively, of consolidated net revenues for the fiscal year ended March 31, 2007. For the fiscal year ended March 31, 2006, our largest customers, Wal-Mart and GameStop, accounted for 22% and 10%, respectively, of consolidated net revenues.

In the United States and Canada, our products are sold primarily on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses, and game specialty stores. We believe that a direct relationship with retail accounts results in more effective inventory management, merchandising, and communications than would be possible through indirect relationships. We have implemented electronic data interchange linkages with many of our retailers to facilitate the placing and shipping of orders. We sell our products to a limited number of distributors.

International. 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. We conduct our international publishing activities through offices in the United Kingdom, Germany, France, Italy, Spain, the Netherlands, Canada, Sweden, Australia, South Korea, and Japan. Whenever practicable, we seek to maximize our worldwide revenues and profits by releasing high quality foreign language releases concurrently with English language releases and by continuing to expand the number of direct selling relationships we maintain with key retailers in major territories.

Affiliate Labels. In addition to our own products, we distribute a select number of interactive entertainment products that are developed and marketed by other third-party publishers through our affiliate label programs in North America, Europe, and the Asia Pacific region. The distribution of other publishers' products allows us to increase the efficiencies of our sales force and provides us with the ability to better ensure adequate shelf presence at retail stores for all of the products that we distribute. Distributing other publishers' titles mitigates the risk associated with a particular title or titles published by us failing to achieve expectations. Services provided by us under our affiliate label program include order solicitation, in-store marketing, logistics and order fulfillment, sales channel management, as well as other accounting and general administrative functions. Our current affiliate label partners include LucasArts, as well as several affiliate label partners in our value business. Each affiliate label relationship is unique and may pertain only to distribution in certain geographic territories such as the North America, Europe, or the Asia Pacific region and may be further limited only to specific titles or titles for specific platforms.

See Note 10 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K for certain financial information regarding reporting segments and geographic areas required by Item 1.

Distribution

Edgar Filing: ACTIVISION INC /NY - Form 10-K

We distribute interactive entertainment hardware and software products in Europe through our European distribution subsidiaries: Centresoft in the United Kingdom; NBG in Germany; and CD Contact in the Benelux

countries. These subsidiaries act as wholesalers in the distribution of products and also provide packaging and logistical and sales services. They provide services to our publishing operations and to various third-party publishers, including Sony Computer Entertainment (Sony), Nintendo Co. Ltd. (Nintendo), and Microsoft Corporation (Microsoft). Centresoft is Sony 's exclusive distributor of PlayStation products to the independent channel in the United Kingdom. In the fiscal year ended March 31, 2007, sales for Sony, Nintendo, and Microsoft accounted for approximately 22%, 6%, and 2%, respectively, of our worldwide distribution net revenues.

We entered into the distribution business to obtain distribution capacity in Europe for our own products, while supporting the distribution infrastructure with third-party sales, and to diversify our operations into the European market. Centresoft and our other distribution subsidiaries operate in accordance with strict confidentiality procedures in order to provide independent services to various third-party publishers.

Emerging Technologies

Edgar Filing: ACTIVISION INC /NY - Form 10-K

We are actively supporting emerging platforms (wireless devices, digital downloads, closed and open online networks, and interactive television) by publishing and licensing key brands for these emerging platforms. We have published and licensed rights to various brands, such as *Tony Hawk's Project 8*, *Tony Hawk's Downhill Jam*, *GUN*, *Activision Anthology*, and *Call of Duty 3* for various hand-held wireless devices. We also develop and optimize many of our titles for consoles that support online play, such as PS2, Xbox Live on the Xbox360, and the Sony PS3 and Nintendo Wii consoles. We believe that more of our brands can be successfully published for wireless and online platforms, as well as exploited through other emerging technologies, as they continue to evolve.

In addition, we derive revenue from in-game advertising consisting primarily of fixed product placement. We are developing and expanding on dynamic ad serving technology and will continue to focus on attracting third parties to advertise in our video games.

Manufacturing

Edgar Filing: ACTIVISION INC /NY - Form 10-K

We prepare a set of master program copies, documentation, and packaging materials for our products for each hardware platform on which the product will be released. Except with respect to products for use on the Sony, Nintendo, and Microsoft systems, our disk duplication, packaging, printing, manufacturing, warehousing, assembly, and shipping are performed by third-party subcontractors.

To maintain protection over their hardware technologies, Sony, Nintendo, and Microsoft generally specify or control the manufacturing and assembly of finished products. We deliver the master materials to the licensor or its approved replicator, which then manufactures finished goods and delivers them to us for distribution under our label. At the time our product unit orders are filled by the manufacturer, we become responsible for the costs of manufacturing and the applicable per unit royalty on such units, even if the units do not ultimately sell.

To date, we have not experienced any material difficulties or delays in the manufacture and assembly of our products or material returns due to product defects.

Competition

Edgar Filing: ACTIVISION INC /NY - Form 10-K

The interactive entertainment software industry is intensely competitive and new interactive entertainment software products and platforms are regularly introduced. Our competitors vary in size from small companies with limited resources to very large corporations with significantly greater financial, marketing, and product development resources than we have. Due to their greater resources, certain of our competitors can spend more money and time on developing and testing products, undertake more extensive marketing campaigns, adopt more aggressive pricing policies, pay higher fees to licensors for desirable motion picture, television, sports and character properties, and pay more to third-party software developers than we can. In addition, competitors with larger product lines and popular titles typically have greater leverage with retailers, distributors, and other customers who may be willing to promote titles with less consumer appeal in return for access to such competitor's most popular titles. We believe that the main competitive factors in the interactive entertainment software industry include: product features and playability; brand name recognition; compatibility of products with popular platforms; access to distribution channels; quality of products; ease of use; price; marketing support; and quality of customer service.

We compete primarily with other publishers of personal computer and video game console interactive entertainment software. Significant third-party software competitors currently include, among others: Atari, Inc.;

Capcom Co. Ltd.; Eidos PLC; Electronic Arts Inc.; Konami Company Ltd.; Midway Games Inc.; Namco Bandai Games Ltd.; Sega Enterprises, Ltd.; Take-Two Interactive Software, Inc.; THQ Inc.; Ubisoft Entertainment; Vivendi Games Publishing; and the Walt Disney Company. In addition, integrated video game console hardware and software companies such as Sony, Nintendo, and Microsoft compete directly with us in the development of software titles for their respective platforms.

Employees

Edgar Filing: ACTIVISION INC /NY - Form 10-K

As of March 31, 2007, we had approximately 2,125 employees, including approximately 1,300 in product development, 200 in North American publishing, 175 in international publishing, 150 in operations, corporate finance and administration, and 300 in European distribution activities.

As of March 31, 2007, approximately 340 of our full-time employees were subject to term employment agreements with us. These agreements generally commit such employees to employment terms of between one and five years from the commencement of their respective agreements. Most of the employees subject to such agreements are executive officers or key members of the product development, sales, or marketing divisions. These individuals perform services for us as executives, directors, producers, associate producers, computer programmers, game designers, sales directors, and marketing product managers. The execution by us of employment agreements with such employees, in our experience, reduces our turnover during the development, production, and distribution phases of our entertainment software products and allows us to plan more effectively for future development and marketing activities.

None of our employees are subject to a collective bargaining agreement except for the employees of our German distribution subsidiary who are allowed by German law to belong to an organized labor council. To date, we have not experienced any labor-related work stoppages.

Financial Information about Foreign Geographic Areas

Edgar Filing: ACTIVISION INC /NY - Form 10-K

See Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 10 of Notes to Consolidated Financial Statements included in Item 8.

Available Information

Our website is located at <http://www.activision.com>. Furthermore, our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are available free of charge through our website. The information found on our website is not a part of, and is not incorporated by reference into, this or any other report that we file with or furnish to the SEC.

Item 1A. RISK FACTORS

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Our business is subject to many risks and uncertainties, which may affect our future financial performance. If any of the events or circumstances described below occurs, our business and financial performance could be harmed, our actual results could differ materially from our expectations, and the market value of our securities could decline. The risks discussed below are not the only ones we face. Additional risks exist that we do not currently believe to be material, and there may also be other risks that are not currently known to us, that may also harm our business and adversely affect our future financial performance and the market value of our stock.

Risks Factors Relating to the Interactive Entertainment Software Industry and Our Business

We depend on a relatively small number of brands for a significant portion of our revenues and profits.

A significant portion of our revenues is derived from products based on a relatively small number of popular brands each year, and these products are responsible for a disproportionate amount of our profits. In addition, many of these products have substantial production or acquisition costs and marketing budgets. In fiscal 2007, 39% of our consolidated net revenues (and 52% of our worldwide publishing net revenues) was derived from three brands, which

accounted for 17%, 13%, and 9% of consolidated net revenues, respectively (and 23%, 18%, and 11% of worldwide publishing net revenues, respectively). In fiscal 2006, 30% of our consolidated net revenues (and 38% of our worldwide publishing net revenues) was derived from three brands, which accounted for 14%, 8%, and 8% of consolidated net revenues, respectively (and 18%, 10%, and 10% of our worldwide publishing net revenues, respectively). In fiscal 2005, 37% of our consolidated net revenues (and 48% of our worldwide publishing net revenues) was derived from three brands, which accounted for 16%, 11%, and 10% of consolidated net revenues, respectively (and 21%, 14%, and 13% of our worldwide publishing net revenues, respectively). We expect that a limited number of popular brands will continue to produce a disproportionately large amount of our revenues and profits. Due to this dependence on a limited number of brands, the failure to achieve anticipated results by one or more products based on these brands may significantly harm our business and financial results.

Our future success depends on our ability to release popular products.

The life of any one game product is relatively short and generally involves a relatively high level of sales during the first few months after introduction followed by a rapid decline in sales. Because revenues associated with an initial product launch generally constitute a high percentage of the total revenues associated with the life of a product, delays in product releases or disruptions following the commercial release of one or more new products could have a material adverse effect on our operating results and cause our operating results to be materially different from expectations. It is therefore important for us to be able to continue to develop many high quality new products that are popularly received. We focus our development and publishing activities principally on products that are, or have the potential to become, franchise brand properties. If we are unable to do this, our business and financial results may be negatively affected.

Our business is hit driven. If we do not deliver hit titles, or if consumers prefer competing products, our sales could suffer.

While many new products are regularly introduced, only a relatively small number of hit titles account for a significant portion of net revenue. Competitors may develop titles that imitate or compete with our hit titles, and take sales away from us or reduce our ability to command premium prices for those titles. Hit products published by our competitors may take a larger share of consumer spending than we anticipate, which could cause our product sales to fall below our expectations. If our competitors develop more successful products or offer competitive products at lower price, or if we do not continue to develop consistently high-quality and well received products, our revenue, margins, and profitability will decline.

If we are unable to maintain or acquire licenses to intellectual property, we may publish fewer hit titles and our revenue may decline.

Many of our products are based on intellectual property and other character or story rights acquired or licensed from third parties. These license and distribution agreements are limited in scope and time, and we may not be able to renew key licenses when they expire or to include new products in existing licenses. The loss of a significant number of our intellectual property licenses or of our relationships with licensors, or inability to obtain additional licenses of significant commercial value could have a material adverse effect on our ability to develop new products and therefore on our business and financial results. Additionally, the failure of intellectual property acquired by us to be popularly received could impact the market acceptance of our products in which the intellectual property is included. Such lack of market acceptance could result in the write-off of the unrecovered portion of acquired intellectual property assets, which could cause material harm to our business and financial results. Furthermore, the competition for these licenses and distribution agreements is often intense. Competition for these licenses may also drive up the advances, guarantees, and royalties that we must pay to the licensor, which could increase our costs.

Our business is highly dependent on the success, timely release and availability of new video game platforms, on the continued availability of existing video game platforms, as well as our ability to develop commercially successful products for these platforms.

We derive most of our revenue from the sale of products for play on video game platforms manufactured by third parties, such as Sony's PlayStation 2 and PlayStation 3, Microsoft's Xbox 360 and Nintendo's Wii and DS. The success of our business is driven in large part by the availability of an adequate supply of these video game platforms, our ability to accurately predict which platforms will be successful in the marketplace, and our ability to develop commercially successful products for these platforms. We must make product development decisions and commit significant resources well in advance of the anticipated introduction of a new platform. A new platform for which we

are developing products may be delayed, may not succeed or may have a shorter life cycle than anticipated. Alternatively, a platform for which we have not devoted significant resources could be more successful than we had initially anticipated, causing us to miss out on a meaningful revenue opportunity. If the platforms for which we are developing products are not released when anticipated, are not available in adequate quantities to meet consumer demand, or do not attain wide market acceptance, our revenue will suffer, we may be unable to fully recover the investments we have made in developing our products, and our financial performance will be harmed.

Transitions in console platforms could have a material impact on the market for interactive entertainment software.

In fiscal 2006, Microsoft released Xbox and in fiscal 2007, Sony and Nintendo introduced their respective next-generation hardware platforms, the PlayStation 3 and Wii. When new console platforms are announced or introduced into the market, consumers typically reduce their purchases of game console entertainment software products for current console platforms in anticipation of new platforms becoming available. During these periods, sales of our game console entertainment software products may be expected to slow or even decline until new platforms are introduced and achieve wide consumer acceptance. This decline may not be offset by increased sales of products for the new console platforms. As console hardware moves through its life cycle, hardware manufacturers typically enact price reductions and decreasing prices may put downward pressure on our software prices. During platform transitions, we may simultaneously incur costs both in continuing to develop and market new titles for prior-generation video game platforms, which may not sell at premium prices, and also in developing products for next-generation platforms, which will not generate immediate or near-term revenue. As a result, our operating results during platform transitions may be more volatile and more difficult to predict than during other times, which may cause greater fluctuations in our stock price.

We must make significant expenditures to develop products for new platforms which may not be successful or released when anticipated.

We must make substantial product development and other investments in a particular platform well in advance of introduction of the platform and we may be required to realign our product portfolio and development efforts in response to market changes. Furthermore, development costs for new console platforms are greater than such costs for current console platforms. If increased costs are not offset by higher revenues and other cost efficiencies, our operating results will suffer and our financial position will be harmed. If the platforms for which we develop new software products or modify existing products are not released on a timely basis or do not attain significant market penetration, or if we develop products for a delayed or unsuccessful platform or cancel development of products in response to market changes, we may not be able to recover in revenues our development costs, which could be significant, and our business and financial results could be significantly harmed.

In addition, we seek to release many of our products in conjunction with specific events, such as the release of a related movie. If we miss these key selling periods due to product delays or delayed introduction of a new platform for which we have developed products, our sales will suffer disproportionately.

If the average price of prior-generation titles continues to decline or if we are unable to sustain launch pricing on next-generation titles, our operating results will suffer.

We have experienced a decrease in the average price of our titles for prior-generation platforms. As the interactive entertainment industry transitions to next-generation video game platforms, we expect there to be fewer prior-generation titles able to command premium prices, and we expect that even these titles will be subject to price reductions at an earlier point in their sales cycle than we have seen in prior years. We expect the average price of prior-generation titles to continue to decline, which may have a negative effect on our margins and operating results.

Our next-generation titles for the Xbox360, Sony's PlayStation 3 and the Nintendo Wii have been offered at premium retail prices since the launch of such consoles. We expect to continue to price next-generation titles at a premium level, but if we are unable to sustain launch pricing on these next-generation titles we may experience a negative effect on our margins and operating results.

Our industry is highly competitive and our competition may succeed in narrowing our market share and reducing our sales.

We compete primarily with other publishers of personal computer and video game console interactive entertainment software and peripherals. Our competitors vary in size from small companies with limited resources to very large corporations with significantly greater financial, marketing, and product development resources than we have. In addition, integrated video game console hardware and software companies such as Sony, Nintendo, and Microsoft compete directly with us in the development of software titles for their respective platforms. Certain of these competitors can spend more money and time on developing and testing products, undertake more extensive marketing campaigns, adopt more aggressive pricing policies, pay higher fees to licensors for desirable motion picture, television, sports, music and character properties, and pay more to third-party software developers than we can.

We also compete with other forms of entertainment and leisure activities. For example, we believe that the overall growth in the use of the Internet and online services by consumers may pose a competitive threat if customers and potential customers spend less of their available time using interactive entertainment software and more using the Internet and online services. A number of software publishers who compete with us have developed and commercialized or are currently developing online games for use by consumers over the Internet. Future increased consumer acceptance and increases in the availability of online games or technological advances in online game software or the Internet could result in a decline in platform-based software and negatively impact sales of our products. Direct sales of software over the Internet by competitors could materially adversely affect our distribution business.

Competition in our industry is intense and we expect new competitors to continue to emerge.

Our platform licensors are our chief competitors and frequently control the manufacturing of and have broad approval rights over our video game products.

Generally, when we develop interactive entertainment software products for hardware platforms offered by Sony, Nintendo, or Microsoft, the products are manufactured exclusively by that hardware manufacturer or their approved replicator.

Our agreements with these manufacturers include certain provisions, such as approval rights over all software products and related hardware peripherals and promotional materials and the ability to change the fee they charge for the manufacturing of products, which allow them substantial influence over our costs and the release schedule of our products. In addition, since each of the manufacturers is also a publisher of games for its own hardware platforms and manufactures products for all of its other licensees, a manufacturer may give priority to its own products or those of our competitors in the event of insufficient manufacturing capacity. Accordingly, Sony, Nintendo, or Microsoft could cause unanticipated delays in the release of our products as well as increases to our development, manufacturing, marketing, or distribution costs, which could materially harm our business and financial results.

In addition, our platform licensors control our ability to provide online game capabilities for our console platform products and in large part establish the financial terms on which these services are offered to consumers. Currently, Microsoft provides online capabilities for the Xbox360 and Sony provides online capabilities for PS2 and PS3 products. In each case, compatibility code and/or the consent of the licensor are required for us to include online capabilities in our products. As these capabilities become more significant, the failure or refusal of our licensors to approve our products may harm our business.

Our platform licensors set the royalty rates and other fees that we must pay to publish games for their platforms, and therefore have significant influence on our costs.

We pay a licensing fee to the hardware manufacturer for each copy of a product manufactured for that manufacturer's game platform. In order to publish products for new hardware platforms, we must take a license from the platform licensor which gives the platform licensor the opportunity to set the fee structure that we must pay in order to publish games for that platform. Similarly, the platform licensors have retained the flexibility to change their fee structures for online gameplay and features for their consoles and the manufacturing of products. The control that platform licensors have over the fee structures for their platforms and online access makes it difficult for us to predict our costs and profitability in the medium to long term. It is also possible that platform licensors will not renew our licenses. Because publishing products for console systems is the largest portion of our business, any increase in fee structures or nonrenewal of licenses would have a significant negative impact on our business model and profitability.

We rely on independent third parties to develop some of our software products.

We rely on independent third-party interactive entertainment software developers to develop some of our software products. Since we depend on these developers, in the aggregate, we remain subject to the following risks:

Continuing strong demand for developers' resources, combined with the recognition they receive in connection with their work, may cause developers who worked for us in the past either to work for our competitors in the future or to renegotiate our agreements with them on terms less favorable for us;

Limited financial resources and business expertise and inability to retain skilled personnel may force developers out of business prior to completing our products or require us to fund additional costs; and

Our competitors may acquire the businesses of key developers or sign them to exclusive development arrangements. In either case, we would not be able to continue to engage such developers' services for our products, except for those that they are contractually obligated to complete for us.

Increased competition for skilled third-party software developers also has compelled us to agree to make significant advance payments on royalties to game developers. If the products subject to these arrangements do not generate sufficient revenues to recover these royalty advances, we would have to write-off unrecovered portions of these payments, which could cause material harm to our business and financial results. Typically, we pay developers a royalty based on a percentage of net revenues, less agreed upon deductions, but from time to time, we have agreed to pay developers fixed per unit product royalties after royalty advances are fully recouped. To the extent that sales prices of products on which we have agreed to pay a fixed per unit royalty are marked down, our profitability could be adversely affected.

If our products contain defects, our business could be harmed significantly.

Software products and peripherals as complex as the ones we publish may contain undetected errors when first introduced or when new versions are released. Despite extensive testing prior to release, we cannot be certain that errors will not be found in new products or releases after shipment, that could result in loss of or delay in market acceptance. This loss or delay could significantly harm our business, financial results, and reputation.

We may permit our customers to return our products and to receive pricing concessions which could reduce our net revenues and results of operations.

We are exposed to the risk of product returns and price protection with respect to our distributors and retailers. Return policies allow distributors and retailers to return defective, shelf-worn, and damaged products in accordance with terms granted. Price protection, when granted and

applicable, allows customers a credit against amounts they owe us with respect to merchandise unsold by them. We may permit product returns from, or grant price protection to, our customers under certain conditions. 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. When we offer price protection, we offer it with respect to a particular product to all of our retail customers; however, only those customers who meet the conditions detailed above can avail themselves of such price protection. We also offer a 90-day limited warranty to our end users that our products will be free from manufacturing defects. Although we maintain a reserve for returns and price protection, and although we may place limits on product returns and price protection, we could be forced to accept substantial product returns and provide substantial price protection to maintain our relationships with retailers and our access to distribution channels. Product returns and price protection that exceed our reserves could significantly harm our business and financial results.

Sales of certain titles such as Guitar Hero™ are affected by hardware peripheral availability.

Some of our titles involve a separate hardware peripheral, such as the guitar in Guitar Hero™. Typically, we sell such software both in bundles with the hardware peripheral and on a stand-alone basis. Consumer may not want to buy such game software if they cannot also buy the hardware peripheral. If we underestimate demand or otherwise are unable to produce sufficient quantities of the hardware peripheral or allocate too few peripherals to geographic markets and hardware platforms where demand exceeds supply, we will forego revenue. This may also create greater opportunities for competitors to develop or gain market share with competitive product offerings. If we overestimate demand and make too many peripherals, or allocate too many peripherals to geographic markets and

hardware platforms where there is insufficient demand, we will incur unrecoverable manufacturing costs for unsold units as well as for unsold game software. In either case, hardware peripheral manufacturing and allocation decisions may negatively affect our financial performance.

There are a limited number of manufacturers who are authorized by Sony, Nintendo or Microsoft to make the hardware peripherals for Guitar HeroTM, and the majority of those manufacturers are located in China. Anything that adversely impacts the ability of those manufacturers to produce the hardware peripheral for us, including without limitation the revocation of the first party license to produce the hardware, the utilization of such manufacturer's capacity by one or our competitors, or issues generally negatively impacting international companies operating in China, will adversely impact our ability to supply those peripherals to the market.

We may face difficulty obtaining access to retail shelf space necessary to market and sell our products effectively.

Retailers of our products typically have a limited amount of shelf space and promotional resources, and there is intense competition among consumer interactive entertainment software products for high quality retail shelf space and promotional support from retailers. To the extent that the number of products and platforms increases, competition for shelf space may intensify and may require us to increase our marketing expenditures. Retailers with limited shelf space typically devote the most and highest quality shelf space to those products expected to be best sellers. We cannot be certain that our new products will consistently achieve such best seller status. Due to increased competition for limited shelf space, retailers and distributors are in an increasingly better position to negotiate favorable terms of sale, including price discounts, price protection, marketing and display fees, and product return policies. Our products constitute a relatively small percentage of any retailer's sales volume. We cannot be certain that retailers will continue to purchase our products or to provide our products with adequate levels of shelf space and promotional support on acceptable terms. A prolonged failure in this regard may significantly harm our business and financial results.

Our sales may decline substantially without warning and in a brief period of time because a majority of our sales are made to a relatively small number of key customers and because we do not have long-term contracts for the sale of our products.

In the United States and Canada, we primarily sell our products on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses, and game specialty stores. 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 sales are made primarily on a purchase order basis without long-term agreements or other forms of commitments. Our largest customers, Wal-Mart and GameStop, accounted for approximately 22% and 8%, respectively, of our consolidated net revenues for the fiscal year ended March 31, 2007 and approximately 22% and 10% of our consolidated net revenues for the fiscal year ended March 31, 2006. The loss of, or significant reduction in sales to, any of our principal retail customers or distributors could significantly harm our business and financial results. The concentration of sales in a small number of large customers also could make us more vulnerable to collection risk if one or more of these large customers became unable to pay for our products. In addition, having such a large portion of our total net revenue concentrated in a few customers reduces our negotiating leverage with these customers.

We may be burdened with payment defaults and uncollectible accounts if our distributors or retailers cannot honor their credit arrangement with us.

Distributors and retailers in the interactive entertainment software industry have from time to time experienced significant fluctuations in their businesses and a number of them have failed. The insolvency or business failure of any significant retailer or distributor of our products could materially harm our business and financial results. We typically make sales to most of our retailers and some distributors on unsecured credit, with terms that vary depending upon the customer's credit history, solvency, credit limits, and sales history, as well as whether we can obtain

Edgar Filing: ACTIVISION INC /NY - Form 10-K

sufficient credit insurance. Although, as in the case with most of our customers, we have insolvency risk insurance to protect against our customers' bankruptcy, insolvency, or liquidation, this insurance contains a significant deductible and a co-payment obligation, and the policy does not cover all instances of non-payment. In addition, although we maintain a reserve for uncollectible receivables, the reserve may not be sufficient in every circumstance. As a result, a payment default by a significant customer could significantly harm our business and financial results.

We may not be able to maintain our distribution relationships with key vendors and customers.

Our CD Contact, NBG, and Centresoft subsidiaries distribute interactive entertainment software and hardware products and provide related services in the Benelux countries, Germany, and the United Kingdom, respectively, and via export in other European countries for a variety of entertainment software publishers, many of which are our competitors, and hardware manufacturers. From time to time, they also maintain exclusive relationships to serve certain retail customers. These services are generally performed subject to limited-term arrangements. Although we expect to use reasonable efforts to retain these vendors and retail customer relationships, we may not be successful in this regard. The cancellation or non-renewal of one or more of these arrangements could significantly harm our business and financial results.

Our business is subject to risks generally associated with the entertainment industry, any of which could significantly harm our operating results.

Our business is subject to risks that are generally associated with the entertainment industry, including: the popularity, price and timing of our games and the platforms on which they are played; economic conditions that adversely affect discretionary consumer spending; changes in consumer demographics; the availability and popularity of other forms of entertainment; and critical reviews and public tastes and preferences, which may change rapidly and cannot necessarily be predicted. Many of these risks are beyond our control. These risks could negatively impact our business and financial results.

We are exposed to seasonality in the sale of our products.

The interactive entertainment software industry is highly seasonal, with the highest levels of consumer demand occurring during the calendar year end holiday buying season. As a result, our net revenues, gross profits, and operating income have historically been highest during the second half of the calendar year. Our receivables and credit risk are likewise higher during the second half of the calendar year as our customers stock up on our products for the holiday season. Additionally, in a platform transition period, sales of game console software products can be significantly affected by the timeliness of introduction of game console platforms by the manufacturers of those platforms, such as Sony, Nintendo, and Microsoft. The timing of hardware platform introduction is also often tied to holidays and is not within our control. If a hardware platform is released unexpectedly close to the holidays, this would result in a shortened holiday buying season and could negatively impact the sales of our products. Further, delays in development, licensor approvals, or manufacturing can also affect the timing of the release of our products, causing us to miss key selling periods such as the calendar year end holiday buying season.

We may not be able to adequately adjust our cost structure in a timely fashion in response to a sudden decrease in demand.

A significant portion of our selling and general and administrative expense is comprised of personnel and facilities. In the event of a significant decline in revenues, we may not be able to exit facilities, reduce personnel, or make other changes to our cost structure without disruption to our operations or without significant termination and exit costs. Management may not be able to implement such actions in a timely manner, if at all, to offset an immediate shortfall in revenues and profit.

If we do not continue to attract and retain key personnel, we will be unable to effectively conduct our business.

Our success depends to a significant extent on our ability to identify, hire, and retain skilled personnel. The software industry is characterized by a high level of employee mobility and aggressive recruiting among competitors for personnel with technical, marketing, sales, product development, and management skills. We may not be able to attract and retain skilled personnel or may incur significant costs in order to do so. If we are unable to attract additional qualified employees or retain the services of key personnel, our business and financial results could be negatively impacted.

Our products are subject to the threat of piracy and unauthorized copying, and inadequate intellectual property laws and other protections could prevent us from enforcing or defending our proprietary technology.

We regard our software as proprietary and rely on a combination of copyright, patent, trademark and trade secret laws, employee and third-party nondisclosure agreements, and other methods to protect our proprietary rights. We own or license various copyrights, patents, and trademarks. We are aware that some unauthorized copying occurs within the interactive entertainment software industry, and if a significantly greater amount of unauthorized copying of our software products were to occur, it could cause material harm to our business and financial results.

Policing unauthorized use of our products is difficult, and software piracy is a persistent problem, especially in some countries. Further, the laws of some countries where our products are or may be distributed either do not protect our products and intellectual property rights to the same extent as the laws of the United States, or are poorly enforced. Legal protection of our rights may be ineffective in such countries. In addition, though we take steps to make the unauthorized copying and distribution of our products more difficult, as do the manufacturers of consoles on which our games are played, neither our efforts nor those of the console manufacturers may be successful in controlling the piracy of our products. Organized pirate operations have been expanding globally. In addition, the proliferation of technology designed to circumvent the protection measures we use in our products, the availability of broadband access to the Internet, the ability to download pirated copies of our games from various Internet sites and peer-to-peer networks, and the widespread proliferation of Internet cafes using pirated copies of our products, all have contributed to an expansion in piracy. This could have a negative effect on our growth and profitability in the future.

Moreover, as we leverage our software products using emerging technologies such as the Internet and online services, our ability to protect our intellectual property rights and to avoid infringing intellectual property rights of others may diminish. We cannot be certain that existing intellectual property laws will provide adequate protection for our products in connection with these emerging technologies.

Data breaches involving the source code for our products or customer or employee data stored by us could adversely affect our reputation and revenue.

We store the source code for our interactive entertainment software products as it is created on multiple electronic devices. In addition, we store customer account information for, and other confidential information related to, our employees. A breach of the systems on which such source code, account information and other sensitive data is stored could lead to piracy of our software or fraudulent activity and claims and lawsuits against us in connection with data security breaches. If we are subject to data security breaches, we may have a loss in sales or be forced to pay damages or other amounts, which could materially and adversely affect our profitability. In addition, any damage to our reputation resulting from a data breach could have a material adverse impact on our revenue and future growth prospects, or increase our costs by leading to additional security measures being required.

We may be subject to intellectual property claims.

As the number of interactive entertainment software products increases and the features and content of these products continue to overlap, software developers increasingly may become subject to infringement claims. Many of our products are highly realistic and feature materials that are based on real world examples, which may be the subject of intellectual property infringement claims of others. In addition, our products often utilize complex, cutting edge technology that may become subject to emerging intellectual property rights of others. Although we believe that we make reasonable efforts to ensure that our products do not violate the intellectual property rights of others, it is possible that third parties still may claim infringement. From time to time, we receive communications from third parties regarding such claims. Existing or future infringement claims against us, whether valid or not, may be time consuming and expensive to defend.

Intellectual property litigation or claims could force us to do one or more of the following:

Cease selling, incorporating, or using products or services that incorporate the challenged intellectual property;

Obtain a license from the holder of the infringed intellectual property, which if available at all, may not be available on commercially favorable terms; or

Redesign the affected interactive entertainment software products or hardware peripherals, which could cause us to incur additional costs, delay introduction and possibly reduce commercial appeal of our products.

Any of these actions may cause material harm to our business and financial results.

We are subject to the rating of our content by the Entertainment Software Rating Board and similar agencies. Failure to obtain our target ratings for our products could negatively impact our sales.

The Entertainment Software Rating Board (the ESRB) requires game publishers to provide consumers with ratings information, including information relating to violence, nudity, or sexual content contained in software titles,

and imposes significant penalties for noncompliance. Certain countries have also established similar rating systems as prerequisites for product sales in those countries. In some instances, we may be required to modify our products to comply with the requirements of rating systems, which could delay or disrupt the release of our products, or we may be prevented from selling them altogether in certain territories. Our software titles receive a rating from the ESRB of Everyone (age 6 and older), Everyone 10+ (age 10 and older), Teen (age 13 and over), or Mature (age 17 and over). Many of our titles have received an Mature rating. None of our titles have received the Adults Only rating (18 and over). We believe that we comply with rating systems and properly display the ratings and content descriptions received for our titles. If we are unable to obtain the ratings we have targeted for our products as a result of changes in the ESRB's ratings standards or for other reasons, including the adoption of legislation in this area, our business and prospects could be negatively affected.

Our business, products, and distribution are subject to increasing regulation of content in key territories. If we do not successfully respond to these regulations, our business may suffer.

Legislation is continually being introduced that may affect both the content of our products and their distribution. For example, privacy laws in the United States and Europe impose various restrictions on our collection and storage of personal information. Those rules vary by territory although the Internet recognizes no geographical boundaries. In addition, many foreign countries have laws that permit governmental entities to censor the content and/or advertising of interactive entertainment software. Other countries, such as Germany, prohibit certain types of content.

In the United States, numerous laws have been introduced at the federal and state level which attempt to restrict the content of products such as ours or the distribution of such products. For example, recent legislation has been adopted in several states, and proposed at the federal level, that prohibits the sale of certain games (*e.g.*, violent games or those with M (Mature) or AO (Adults Only) ratings) to minors. In addition, a number of state legislative bodies in states such as Illinois, California, Michigan, and Washington have introduced various forms of legislation designed to regulate and control sales of video games deemed inappropriate for sales to minors. New and recent incidents may lead to increased pressure for legislative activity. To date, all the courts have ruled on such legislation in a manner favorable to the interactive entertainment software industry. But in the event such legislation is adopted and enforced, the sales of our products may be harmed because the products we are able to offer to our customers and the size of the potential market for our products may be limited. We may also be required to modify our products or alter our marketing strategies to comply with new and possibly inconsistent regulations, which could be costly or delay the release of our products.

If one or more of our titles were found to contain objectionable undisclosed, pertinent content, our business could suffer.

Throughout the history of our industry, many video games have been designed to include certain hidden content and gameplay features that are accessible through the use of in-game cheat codes or other technological means that are intended to enhance the gameplay experience. However, in some cases, undisclosed, pertinent content or features have been found in other publishers' interactive entertainment software products. In a few cases, the ESRB has reacted to discoveries of undisclosed, pertinent content and features by changing the rating that was originally assigned to the product, requiring the publisher to change the game and/or game packaging and/or fining the publisher. Retailers have on occasion reacted to the discovery of such undisclosed content by removing these games from their shelves, refusing to sell them, and demanding that their publishers accept them as product returns. Likewise, interactive entertainment software consumers have reacted to the revelation of undisclosed content by refusing to purchase such games, demanding refunds for games they have already purchased, refraining from buying other games published by the company whose game contained the objectionable material, and, in at least one occasion, filing a lawsuit against the publisher of the product containing such content.

We have implemented preventative measures designed to reduce the possibility of objectionable undisclosed, pertinent content from appearing in the video games we publish. Nonetheless, these preventative measures are subject to human error, circumvention, overriding, and reasonable resource constraints. If a video game we published were found to contain undisclosed, pertinent content, the ESRB could demand that we recall

Edgar Filing: ACTIVISION INC /NY - Form 10-K

a game and change its packaging to reflect a revised rating, retailers could refuse to sell it and demand we accept the return of any unsold copies or returns from customers, and/or consumers could refuse to buy it, demand that we refund their money or file a lawsuit against us. This could have a material negative impact on our operating results and financial condition. In addition, our reputation could be harmed, which could impact sales of other video games we sell. If any of these consequences were to occur, our business and financial performance could be significantly harmed.

Our products may be subject to legal claims.

In prior fiscal years, at least two lawsuits have been filed against numerous video game companies, including us, by the families of victims who were shot and killed by teenage gunmen in attacks perpetrated at schools. These lawsuits alleged that the video game companies manufactured and/or supplied these teenagers with violent video games, teaching them how to use a gun and causing them to act out in a violent manner. These lawsuits have been dismissed. Similar additional lawsuits may be filed in the future. Although our general liability insurance carrier agreed to defend us in such lawsuits in the past, it is uncertain whether the insurance carrier would do so in the future, or if it would cover all or any amounts which we might be liable for if such future lawsuits are not decided in our favor. If such future lawsuits are filed and ultimately decided against us and our insurance carrier does not cover the amounts we are liable for, it could have a material adverse effect on our business and financial results. Payment of significant claims by insurance carriers may make such insurance coverage materially more expensive or unavailable in the future, thereby exposing our business to additional risk.

Other Risks Relating to Our Business and Ownership of Our Stock

We seek to manage our business with a view to achieving long-term results, and this could have a negative effect on short-term trading.

We focus on creation of shareholder value over time, and we intend to make decisions that will be consistent with this long-term view. As a result, some of our decisions, such as whether to make or discontinue operating investments, manage our balance sheet and capital structure, or pursue or discontinue strategic initiatives, may be in conflict with the objectives of short-term traders. Further, this could adversely affect our quarterly or other short-term results of operations.

We may face limitations on our ability to find suitable acquisition opportunities or to integrate additional acquired businesses.

We intend to pursue additional acquisitions of companies, properties, and other assets that can be purchased or licensed on acceptable terms and which we believe can be operated or exploited profitably. Some of these transactions could be material in size and scope. Although we continue to search for additional acquisition opportunities, we may not be successful in identifying suitable acquisitions. As the interactive entertainment software industry continues to consolidate, we face significant competition in seeking and consummating acquisition opportunities. We may not be able to consummate potential acquisitions or an acquisition may not enhance our business or may decrease rather than increase our earnings. In the future, we may issue additional shares of our common stock in connection with one or more acquisitions, which may dilute our existing shareholders. Future acquisitions could also divert substantial management time and result in short-term reductions in earnings or special transaction or other charges. In addition, we cannot guarantee that we will be able to successfully integrate the businesses that we may acquire into our existing business. Our shareholders may not have the opportunity to review, vote on, or evaluate future acquisitions.

From time to time, we may make a capital investment and hold a minority interest in a third-party developer in connection with interactive entertainment software products to be developed by such developer for us, which we believe helps to create a closer relationship between us and the developer. We account for those capital investments over which we have the ability to exercise significant influence using the equity method. For those investments over which we do not have the ability to exercise significant influence, we account for our investment using the cost method. There can be no assurance that we will realize long-term benefits from such investments or that we will continue to carry such investments at their current value.

Our shareholder rights plan, charter documents, and other agreements may make it more difficult to acquire us without the approval of our Board of Directors.

We have adopted a shareholder rights plan under which one right entitling the holder to purchase one six-hundredths (1/600) of a share, as adjusted on account of stock dividends made since the plan's adoption, of our Series A Junior Preferred Stock price at an exercise price of \$6.67 per share, subject to adjustment and as adjusted on account of stock dividends made since the plan's adoption, is attached to each outstanding share of common stock. Such shareholder rights plan makes an acquisition of control in a transaction not approved by our Board of Directors more difficult. Our Amended and Restated By-laws have advance notice provisions for nominations for election of nominees to the Board of Directors which may make it more difficult to acquire control of us. Our long-term

incentive plans provide, in the discretion of a committee, for acceleration of stock options following a change in control under certain circumstances, which has the effect of making an acquisition of control more expensive. In addition, some of our officers have severance compensation agreements that provide for substantial cash payments and accelerations of other benefits in the event of a change in control. These agreements and arrangements may also inhibit a change in control.

Limitations on our capacity or ability to issue stock and options may require us to use more cash in our employee compensation packages.

Our amended and restated certificate of incorporation and our option plans limit the number of shares of our stock and the number of stock options that we can issue. To increase these limits, we must seek and obtain approval of our stockholders. If our stockholders do not approve increases in our available stock and option pool, our ability to offer stock and stock options to new and existing employees will be limited. This may in turn impair our ability to recruit and retain employees. It may also require us to place greater reliance on cash compensation, which may not be as attractive to existing and prospective employees. Increased use of cash for employee compensation will also reduce the amount of cash available to us for other uses. Each of these consequences could have negative effects on our business and financial results.

Our stock price is highly volatile.

The trading price of our common stock has been and could continue to be subject to wide fluctuations in response to many factors, including:

Quarter to quarter variations in results of operations;

Our announcements of new products;

Our competitors' announcements of new products;

Our product development or release schedule;

General conditions in the computer, software, entertainment, media or electronics industries, and in the economy;

Timing of the introduction of new platforms and delays in the actual release of new platforms;

Hardware manufacturers' announcements of price reductions in hardware platforms;

Consumer spending trends;

Changes in earnings estimates or buy/sell recommendations by analysts; and

Investor perceptions and expectations regarding our products, plans and strategic position, and those of our competitors and customers.

In addition, the public stock markets experience extreme price and trading volume volatility, particularly in high technology sectors of the market. This volatility has significantly affected the market prices of securities of many technology companies for reasons often unrelated to the operating performance of the specific companies. These broad market fluctuations may adversely affect the market price of our common stock.

In our fiscal year 2007, we began recognizing stock-based compensation expense in accordance with Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, related to our employee equity compensation and employee stock purchase programs. The recognition of this expense has a significant impact in lowering our reported net income (or increase our reported net loss).

Beginning in the fiscal year ended March 31, 2007, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004),

Share-Based Payment (SFAS 123R), which requires us to recognize compensation expense for all stock-based awards based on estimated fair values. As a result, beginning with our first quarter

of fiscal 2007, our operating results contain a charge for stock-based compensation related to the equity-based awards we provide to our employees, as well as stock purchases under our employee stock purchase plans. This expense is in addition to the stock-based compensation expense we have recognized in prior periods related to restricted stock unit grants, acquisitions and other grants. The stock-based compensation charges we incur depend on the number of equity-based awards we grant and the number of shares of common stock we sell under our employee stock purchase plans, as well as a number of estimates and variables such as estimated forfeiture rates, the trading price and volatility of our common stock, the expected term of our options, and interest rates. As a result, our stock-based compensation charges can vary significantly from period to period. Going forward, our adoption of SFAS 123R will continue to significantly lower our reported net income (or increase our reported net loss), which could have an adverse impact on the trading price of our common stock.

Changes in our tax rates or exposure to additional tax liabilities could adversely affect our operating results and financial condition.

We are subject to income taxes in the United States and in various foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes and, in the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We are also required to estimate what our taxes will be in the future. Although we believe our tax estimates are reasonable, the estimate process is inherently uncertain, and our estimates are not binding on tax authorities. Our effective tax rate could be adversely affected by changes in our business, including the mix of earnings in countries with differing statutory tax rates, changes in the elections we make, changes in applicable tax laws as well as other factors. Further, our tax determinations are regularly subject to audit by tax authorities and developments in those audits could adversely affect our income tax provision. Should our ultimate tax liability exceed our estimates, our income tax provision and net income could be materially affected.

We are also required to pay taxes other than income taxes, such as payroll, sales, use, value-added, net worth, property, and goods and services taxes, in both the United States and various foreign jurisdictions. We are regularly under examination by tax authorities with respect to these non-income taxes. There can be no assurance that the outcomes from these examinations, changes in our business or changes in applicable tax rules will not have an adverse effect on our operating results and financial condition.

Our international revenues may be affected by regulatory requirements and barriers, cultural differences and currency fluctuations.

Our international revenues have accounted for a significant portion of our total revenues. International sales and licensing accounted for 50%, 52% and 50%, respectively, of our consolidated net revenues in fiscal 2007, 2006 and 2005, respectively. We expect that international revenues will continue to account for a significant portion of our total revenues in the future. International sales may be subject to unexpected regulatory requirements, tariffs, and other barriers. Additionally, foreign sales that are made in local currencies may fluctuate. We have and may continue to engage in limited currency hedging activities. While these hedging activities mitigate some foreign currency risk, our reported results of operations and financial condition would be adversely affected by unfavorable foreign currency fluctuations, particularly the Euro, British pound sterling, Australian dollar and Canadian dollar. Currency exchange rate fluctuations had a positive impact on revenues from internal sales and licensing in the fiscal year ended March 31, 2007. In the future, currency exchange rates may have a negative or materially adverse impact on revenues from international sales and licensing and thus on our business and financial results. In addition, cultural differences may affect consumer preferences and limit the popularity of titles that are hits in the United States. If we do not correctly assess consumer preferences in the countries in our market, our sales and revenue may be lower than expected.

Risk Factors Relating to Results of the Special Subcommittee Review of our Stock Option Granting Practices

SEC investigation and litigation relating to stock options remain pending and may adversely affect our business and results of operations.

Although the special subcommittee of independent members of our Board of Directors established in July 2006 to review our historical stock option granting practices (the Special Subcommittee) has completed its review of those practices and our stock option grants made in the period between 1992 and 2006, a formal investigation by

the SEC relating to our stock option granting practices remains pending, as does derivative litigation against us and certain of our current and former directors and officers. Although we believe that we have taken appropriate action by restating our financial statements for the fiscal year ended March 31, 2006, as filed in our Amended Annual Report on Form 10-K/A on May 25, 2007, and made appropriate disclosures for matters relating to stock options, the SEC (or the court in the derivative actions) may disagree with the findings of the Special Subcommittee or with the manner in which we have accounted for and reported, or not reported, the financial impact of past option grant measurement date errors. If so, we may need to further restate our prior financial statements, further amend our filings with the SEC, or take other actions not currently contemplated. In addition, these proceedings are likely to result in additional legal expense that may affect our results in future periods, and may also result in diversion of management attention and other resources, as well as fines, penalties, damages and other sanctions. These eventualities could materially and adversely affect our business and results of operations. We cannot currently predict the ultimate outcome of these proceedings.

We had a material weakness in internal control over financial reporting and cannot assure you that additional material weaknesses will not be identified in the future. If our internal control over financial reporting or disclosure controls and procedures are not effective, there may be errors in our financial statements that could require a restatement or our filings may not be timely and investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal control over financial reporting as of the end of each year, and to include a management report assessing the effectiveness of our internal control over financial reporting in each Annual Report on Form 10-K. Section 404 also requires our independent registered public accounting firm to attest to, and report on, management's assessment of our internal control over financial reporting. In assessing the findings of the Special Subcommittee's review and the restatement set forth in our Amended Annual Report on Form 10-K/A for the fiscal year ended March 31, 2006, our management concluded that there was a material weakness, as defined in the Public Company Accounting Oversight Board's Auditing Standard No. 2, in our internal control over financial reporting as of March 31, 2006. Our management concluded that this weakness was remedied as of March 31, 2007 with the adoption of new equity compensation policies and procedures by the Compensation Committee and Nominating/Corporate Governance Committees of our Board of Directors and, accordingly, no longer exists as of the date of this filing. See the discussion included in Part II, Item 9A of this Annual Report on Form 10-K for the fiscal year ended March 31, 2007 for additional information regarding our internal control over financial reporting.

Our management does not expect that our internal control over financial reporting will prevent all error or all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. Over time, controls may become inadequate because changes in conditions or deterioration in the degree of compliance with policies or procedures may occur. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

As a result, we cannot assure you that significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in significant deficiencies or material weaknesses, cause us to fail to timely meet our periodic reporting obligations, or result in material misstatements in our financial statements. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules promulgated thereunder. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to timely meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in our stock price.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

As a result of the delayed filing of certain of our periodic reports, we will be ineligible to use Form S-3 or Form S-4 for a period of time. This may adversely affect our ability to engage in certain types of corporate acquisition and capital-raising transactions.

As a result of our delayed filing of certain of our periodic reports, we will be ineligible to register our securities on Form S-3 or Form S-4 for sale by us or resale by other security holders until we have timely filed all periodic reports under the Securities Exchange Act of 1934 for a period of time. In the meantime, we have the ability

to use Form S-1 to raise capital or complete acquisitions. The need to use Form S-1, and the inability to use Form S-3 or Form S-4, could increase our transaction costs and adversely affect our ability to engage in certain types of corporate acquisition and capital-raising transactions until we regain our S-3/S-4 eligibility.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

Our principal corporate and administrative offices are located in approximately 122,200 square feet of leased space in a building located at 3100 Ocean Park Boulevard, Santa Monica, California 90405. The following is a listing of the principal offices maintained by us on May 31, 2007:

| PROPERTY | LOCATION | SQ FT | OWNERSHIP | LEASE EXPIRATION |
|---------------------------------------|-----------------------------|---------|-----------|-------------------------------|
| Corporate Offices | Santa Monica, CA, USA | 122,200 | Lease | December 2010 |
| Product Development Facilities | | | | |
| Activision Canada | Barrie, Ontario | 1,900 | Lease | July 2007 |
| Beenox, Inc. | Quebec City, Quebec, Canada | 11,110 | Lease | September 2007 + January 2010 |
| China | Shanghai & Taipei, China | 1,500 | Lease | Month to Month |
| Infinity Ward, Inc. | Encino, CA, USA | 35,300 | Lease | October 2012 |
| Luxoflux, Inc. | Santa Monica, CA, USA | 14,800 | Lease | January 2009 |
| Motion Capture Studio | Los Angeles, CA, USA | 11,500 | Lease | March 2009 |
| Neversoft Entertainment, Inc. | Woodland Hills, CA, USA | 53,300 | Lease | September 2014 |
| Raven Studios | Middleton, WI, USA | 35,300 | Lease | June 2015 |
| RedOctane | Chennai, India | 6,500 | Lease | July 2008 + May 2009 |
| Shaba Games, Inc. | San Francisco, CA, USA | 23,300 | Lease | February 2013 |
| Toys For Bob, Inc. | Novato, CA, USA | 9,500 | Lease | July 2007 |
| Treyarch Corporation | Santa Monica, CA, USA | 56,200 | Lease | November 2009 |
| Vicarious Visions, Inc. | Menands, NY, USA | 37,100 | Lease | May 2016 |
| Vicarious Visions, Inc. | Mountain View, CA, USA | 3,100 | Lease | June 2007 |
| Z-Axis, Ltd. | Foster City, CA, USA | 24,000 | Lease | February 2009 |
| Publishing Facilities | | | | |
| Australia Publishing | Sydney, Australia | 7,300 | Lease | July 2007 |
| France Publishing | Bezons, France | 3,500 | Lease | October 2007 |
| German Publishing | Burglengenfeld, Germany | 2,200 | Own | N/A |
| Italy Publishing | Legnano, Italy | 2,700 | Lease | September 2009 |
| Japan Publishing | Tokyo, Japan | 2,200 | Lease | March 2008 |
| Korea Publishing | Seoul, South Korea | 1,700 | Lease | August 2007 |
| Nordic Publishing | Stockholm, Sweden | 1,000 | Lease | July 2010 |
| RedOctane | Sunnyvale, CA, USA | 11,800 | Lease | March 2008 |
| Spain Publishing | Madrid, Spain | 1,000 | Lease | April 2009 |
| United Kingdom Publishing | Stockley Park, UK | 15,000 | Lease | September 2015 |
| Value Publishing | Eden Prairie, MN, USA | 14,000 | Lease | May 2008 |
| Distribution Facilities | | | | |
| German Distribution | Burglengenfeld, Germany | 40,900 | Own | N/A |
| Netherlands Distribution-offices | Breda, the Netherlands | 1,000 | Lease | Month to Month |
| Netherlands Distribution-warehouse | Venlo, the Netherlands | 44,600 | Own | N/A |
| United Kingdom Distribution | Birmingham, UK | 182,100 | Lease | May 2011-2018 |

Our publishing operations additionally lease facilities in Arkansas, Canada, Minnesota, New York, and Texas for purposes of sales and branch offices.

Item 3. LEGAL PROCEEDINGS

In July 2006, individuals and/or entities claiming to be stockholders of the Company have filed derivative lawsuits, purportedly on behalf of the Company, against certain current and former members of the Company's Board of Directors as well as several current and former officers of the Company. Three derivative actions have been filed in Los Angeles Superior Court: Vazquez v. Kotick, et al., L.A.S.C. Case No. BC355327 (filed July 12, 2006); Greuer v. Kotick, et al., L.A.S.C. Case No. SC090343 (filed July 12, 2006); and Amalgamated Bank v. Baker, et al., L.A.S.C.

Case No. BC356454 (filed August 3, 2006). These actions have been consolidated by the court under the caption In re Activision Shareholder Derivative Litigation, L.A.S.C. Master File No. SC090343 (West, J.). Two derivative actions have been filed in the United States District Court for the Central District of California: Pfeiffer v. Kotick, et al., C.D. Cal. Case No. CV06-4771 MRP (JTLx) (filed July 31, 2006); and Hamian v. Kotick, et al., C.D. Cal. Case No. CV06-5375 MRP (JLTx) (filed August 25, 2006). These actions have also been consolidated, under the caption In re Activision, Inc. Shareholder Derivative Litigation, C.D. Cal. Case No. CV06-4771 MRP (JTLx) (Pfaelzer, J.). The consolidated complaints allege, among other things, purported improprieties in the Company's issuance of stock options. Plaintiffs seek various relief on behalf of the Company, including damages, restitution of benefits obtained from the alleged misconduct, equitable relief, including an accounting and rescission of option contracts; and various corporate governance reforms. The Company expects that defense expenses associated with the matters will be covered by its directors and officers insurance, subject to the terms and conditions of the applicable policies. On May 24, 2007, the Superior Court granted the Company's motion to stay the state action. The court's order stays the action pending the resolution of motions to dismiss in the federal action, but is without prejudice to any party's right to seek modification of the stay upon a showing of good cause, including a showing that matters may be addressed in the Superior Court without the potential for conflict with or duplication of the federal court proceedings. The Company filed motions to dismiss in the federal action on June 1, 2007, which will be fully briefed by August 15, 2007. The Company was also informed that, on June 1, 2007, a derivative case, Abdelnur vs. Kotick et al., was filed in the United States District Court for the Central District of California, C.D. Case No. CV07-3575 AHM (PJWx), by the same law firm that previously filed the Hamian case, alleging substantially the same claims.

On July 27, 2006, the Company received a letter of informal inquiry from the SEC requesting certain documents and information relating to the Company's historical stock option grant practices. In early June 2007, the SEC informed the Company that the SEC has issued a formal order of non-public investigation, which allows the SEC, among other things, to subpoena witnesses and to require the production of documents. The Company is cooperating with the SEC's investigation, and representatives of the special subcommittee of independent members of our Board of Directors established in July 2006 to review our historical stock option granting practices (the Special Subcommittee) and its legal counsel have met with members of the staff of the SEC on several occasions, in person and by telephone (as has the Company's outside legal counsel), to discuss the progress of the Special Subcommittee's investigation and on February 28, 2007 to brief the SEC staff on the Special Subcommittee's findings and recommendations following the substantial completion of the Special Subcommittee's investigation. A representative of the U.S. Department of Justice has attended certain of these meetings and requested copies of certain documents that we have provided to the staff of the SEC. At this time, the Company has not received any grand jury subpoenas or written requests from the Department of Justice.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

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, employment relationships, and collection matters. In the opinion of management, after consultation with legal counsel, the outcome of such routine claims and lawsuits will not have a material adverse effect on our business, financial condition, results of operations, or liquidity.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II**Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES**

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

The following table sets forth for the periods indicated the high and low reported sale prices for our common stock. As of June 7, 2007, there were approximately 2,417 holders of record of our common stock.

| | High | Low |
|-----------------------------------------|----------|----------|
| <u>Fiscal 2006</u> | | |
| First Quarter ended June 30, 2005 | \$ 13.88 | \$ 10.64 |
| Second Quarter ended September 30, 2005 | 17.30 | 12.07 |
| Third Quarter ended December 31, 2005 | 18.03 | 12.94 |
| Fourth Quarter ended March 31, 2006 | 15.93 | 11.81 |
| <u>Fiscal 2007</u> | | |
| First Quarter ended June 30, 2006 | \$ 15.11 | \$ 10.71 |
| Second Quarter ended September 30, 2006 | 16.00 | 10.47 |
| Third Quarter ended December 31, 2006 | 18.19 | 14.22 |
| Fourth Quarter ended March 31, 2007 | 19.20 | 16.05 |

On June 7, 2007, the last reported sales price of our common stock was \$18.46.

Stock Performance Graph

This performance graph shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of Activision, Inc. under the Securities Act of 1933, as amended or the Exchange Act.

The graph below compares the cumulative 5-year total return of holders of Activision, Inc.'s common stock with the cumulative total returns of the NASDAQ Composite index and the RDG Technology Composite index. The graph tracks the performance of a \$100 investment in our common stock and in each of the indexes (with the reinvestment of all dividends) from March 31, 2002 to March 31, 2007. We have never paid cash dividends on our common stock and have no present plans to do so.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Activision, Inc., The NASDAQ Composite Index
And The RDG Technology Composite Index

* \$100 invested on 3/31/02 in stock or index-including reinvestment of dividends.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Fiscal year ending March 31.

| | 3/02 | 3/03 | 3/04 | 3/05 | 3/06 | 3/07 |
|---------------------------------|---------------|--------------|---------------|---------------|---------------|---------------|
| Activision, Inc. | 100.00 | 48.44 | 119.33 | 148.84 | 184.91 | 253.97 |
| NASDAQ Composite | 100.00 | 72.11 | 109.76 | 111.26 | 132.74 | 139.65 |
| RDG Technology Composite | 100.00 | 66.96 | 99.40 | 95.82 | 112.91 | 117.27 |

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

Cash Dividends

We paid no cash dividends in our fiscal years 2007 or 2006 nor do we anticipate paying any cash dividends at any time in the foreseeable future. We expect that earnings will be retained for the continued growth and development of the business. Future dividends, if any, will depend upon our earnings, financial condition, cash requirements, future prospects, and other factors deemed relevant by our Board of Directors.

Stock Splits

Edgar Filing: ACTIVISION INC /NY - Form 10-K

In April 2003, the Board of Directors approved a three-for-two split of our outstanding common shares effected in the form of a 50% stock dividend. The split was paid on June 6, 2003 to shareholders of record as of May 16, 2003. In February 2004, the Board of Directors approved a second three-for-two split of our outstanding common shares effected in the form of a 50% stock dividend. The split was paid on March 15, 2004 to shareholders of record as of February 23, 2004. In February 2005, the Board of Directors approved a four-for-three split of our outstanding common shares effected in the form of a 33-1/3% stock dividend. The split was paid on March 22, 2005 to shareholders of record as of March 7, 2005. In September 2005, the Board of Directors approved a four-for-three split of our outstanding common shares effected in the form of a 33-1/3% stock dividend. The split was paid October 24, 2005 to shareholders of record as of October 10, 2005. The par value of our common stock was maintained at the pre-split amount of \$.000001. All share and per share data have been restated as if the stock splits had occurred as of the earliest period presented.

On March 7, 2005, in connection with our March 22, 2005 stock split, all shares of common stock held as treasury stock were formally cancelled and restored to the status of authorized but unissued shares of common stock.

Buyback Program

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

Under the buyback program, we did not repurchase any shares of our common stock in the fiscal years ended March 31, 2007, 2006, or 2005. We repurchased approximately 3.4 million shares of our common stock for \$12.4 million in the fiscal year ended March 31, 2004. In addition, approximately 3.1 million shares of common stock were acquired in the fiscal year ended March 31, 2004 as a result of the settlement of \$10.0 million of structured stock repurchase transactions entered into in fiscal 2003. As of March 31, 2007, we had no outstanding structured stock repurchase transactions. Structured stock repurchase transactions are settled in cash or stock based on the market price of our common stock on the date of the settlement. Upon settlement, we either have our capital investment returned with a premium or receive shares of our common stock, depending, respectively, on whether the market price of our common stock is above or below a pre-determined price agreed in connection with each such transaction.

Shareholders' Rights Plan

On April 18, 2000, our Board of Directors approved a shareholders rights plan (the "Rights Plan"). Under the Rights Plan, each common shareholder at the close of business on April 19, 2000 received a dividend of one right for each share of common stock held. Each right represents the right to purchase one six-hundredths (1/600) of a share, as adjusted on account of stock dividends made since the plan's adoption, of our Series A Junior Preferred Stock at an exercise price of \$6.67, as adjusted on account of stock dividends made since the plan's adoption. Initially, the rights are represented by our common stock certificates and are neither exercisable nor traded separately from our common stock. The rights will only become exercisable if a person or group acquires 15% or more of the common stock of Activision, or announces or commences a tender or exchange offer which would result in the bidder's beneficial ownership of 15% or more of our common stock.

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

We may redeem the rights for \$0.01 per right at any time until the first public announcement of the acquisition of beneficial ownership of 15% of our common stock. At any time after a person has acquired 15% or more (but before any person has acquired more than 50%) of our common stock, we may exchange all or part of the rights for shares of common stock at an exchange ratio of one share of common stock per right. The rights expire on April 18, 2010.

Securities Authorized for Issuance Under Equity Compensation Plans

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Information for our equity compensation plans in effect as of March 31, 2007 is as follows (amounts in thousands, except per share amounts):

| Plan Category | (a) Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b) Weighted-average exercise price of outstanding options, warrants and rights | (c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by security holders | 27,060 | \$ 9.36 | 9,619 |
| Equity compensation plans not approved by security holders | 23,304 | \$ 4.53 | 256 |
| Total | 50,364 | | 9,875 |

See Note 14 of the Notes to Consolidated Financial Statements included in Item 8 for the material features of each equity compensation plan that was adopted without security holder approval.

Item 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following table summarizes certain selected consolidated financial data, which should be read in conjunction with our Consolidated Financial Statements and Notes thereto and with Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere herein. The selected consolidated financial data presented below as of and for each of the fiscal years in the five-year period ended March 31, 2007 are derived from our consolidated financial statements except basic and diluted earnings per share and basic and diluted weighted average shares outstanding which have been restated for the effect of our stock splits. The Consolidated Balance Sheets as of March 31, 2007 and 2006 and the Consolidated Statements of Operations and Consolidated Statements of Cash Flows for each of the fiscal years in the three-year period ended March 31, 2007, and the report thereon, are included elsewhere in this Form 10-K (in thousands, except per share data).

| | For the fiscal years ended March 31, | | | | |
|--------------------------------------------------------------------------------------|--------------------------------------|--------------|--------------|------------|------------|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| Statement of Operations Data: | | | | | |
| Net revenues | \$ 1,513,012 | \$ 1,468,000 | \$ 1,405,857 | \$ 947,656 | \$ 864,116 |
| Cost of sales product costs | 799,587 | 734,874 | 658,949 | 475,541 | 440,977 |
| Cost of sales intellectual property licenses and software royalties and amortization | 178,478 | 205,488 | 185,997 | 91,606 | 124,196 |
| Income from operations | 73,147 | 15,226 | 179,608 | 104,537 | 84,691 |
| Income before income tax provision | 109,825 | 45,856 | 192,700 | 110,712 | 93,251 |
| Net income | 85,787 | 40,251 | 135,057 | 74,098 | 59,003 |
| Basic earnings per share (1) | 0.31 | 0.15 | 0.54 | 0.31 | 0.23 |
| Diluted earnings per share (1) | 0.28 | 0.14 | 0.49 | 0.29 | 0.21 |
| Basic weighted average common shares outstanding (1) | 281,114 | 273,177 | 250,023 | 236,887 | 256,639 |
| Diluted weighted average common shares outstanding (1) | 305,339 | 294,002 | 277,712 | 258,350 | 277,620 |
| Net Cash Provided By (Used In): | | | | | |
| Operating activities | 27,162 | 86,007 | 215,309 | 67,403 | 90,975 |
| Investing activities | (35,242) | (85,796) | (143,896) | (170,155) | (301,547) |
| Financing activities | 27,968 | 45,088 | 72,654 | 117,569 | 64,090 |

| | As of March 31, | | | | |
|---------------------------------------------------------------------|-----------------|------------|------------|------------|------------|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| Balance Sheet Data: | | | | | |
| Working capital | \$ 1,060,064 | \$ 922,199 | \$ 913,819 | \$ 675,796 | \$ 422,500 |
| Cash, cash equivalents and short-term investments | 954,849 | 944,960 | 840,864 | 587,649 | 406,954 |
| Capitalized software development and intellectual property licenses | 231,196 | 147,665 | 127,340 | 135,201 | 107,921 |
| Goodwill | 195,374 | 100,446 | 91,661 | 76,493 | 68,019 |
| Total assets | 1,793,947 | 1,418,255 | 1,305,919 | 966,220 | 703,070 |
| Long-term debt | | | | | 2,671 |
| Shareholders' equity | 1,411,532 | 1,222,623 | 1,097,274 | 830,141 | 595,994 |

(1) Consolidated financial information for fiscal years 2005-2002 has been restated for the effect of our four-for-three stock split effected in the form of a 33-1/3% stock dividend to shareholders of record as of October 10, 2005, paid October 24, 2005.

Item 7. 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 are used on a variety of game hardware platforms and operating systems. We have created, licensed, and acquired a group of highly recognizable brands, which we market to a variety of consumer demographics. Our fiscal 2007 product portfolio includes titles such as *Over the Hedge*, *X-Men: The Official Game*, *Marvel: Ultimate Alliance*, *Tony Hawk's Project 8*, *Tony Hawk's Downhill Jam*, *Call of Duty 3*, and *Guitar Hero 2*.

Our products cover diverse game categories including action/adventure, action sports, racing, role-playing, simulation, first-person action, music-based gaming, and strategy. Our target customer base ranges from casual players to game enthusiasts, children to adults, and mass-market consumers to value buyers. We currently offer our products primarily in versions that operate on the Sony PlayStation 2 (PS2), the Sony PlayStation 3 (PS3), the Nintendo Wii (Wii), and the Microsoft Xbox360 (Xbox360) console systems, the Nintendo Game Boy Advance (GBA), the Nintendo Dual Screen (NDS), and the Sony PlayStation Portable (PSP) hand-held devices, and the personal computer (PC). The installed base for the previous generation of hardware platforms (e.g., PS2, Xbox) is significant and the fiscal 2006 release of the Xbox360 and the fiscal 2007 releases of the PS3 and the Wii will further expand the software market. During the third quarter of fiscal 2007, we had a successful and significant presence at the launches of the PS3 and the Wii with three launch titles for the PS3, *Call of Duty 3*, *Marvel: Ultimate Alliance*, and *Tony Hawk's Project 8*, and five launch titles for the Wii, *Call of Duty 3*, *Marvel: Ultimate Alliance*, *World Series of Poker: Tournament of Champions*, *Rapala Tournament Fishing*, and *Tony Hawk's Downhill Jam*. Our plan is to continue to build on our significant launch presence on the PS3, Wii, and Xbox360 (the next-generation platforms) by continuing to expand the number of titles released on the next generation platforms while continuing to market to current-generation platforms as long as economically attractive given their large 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 North America, we primarily sell our products on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses, and game specialty stores. We conduct our international publishing activities through offices in the United Kingdom (UK), Germany, France, Italy, Spain, the Netherlands, Australia, Scandinavia, Canada, South Korea, 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 typically 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 typically producing higher margins than hardware.

Our Focus

With respect to future game development, we will continue to focus on our big propositions, products that are backed by strong brands and high quality development, for which we will provide significant marketing support.

Our fiscal 2007 releases have included well-established brands, which are backed by high-profile intellectual property and/or highly anticipated motion picture releases. For example, we have a long-term relationship with Marvel Entertainment, Inc. through an exclusive licensing agreement for the Spider-Man and X-Men franchises through 2017. This agreement grants us the exclusive rights to develop and publish video games based on Marvel's comic book and movie franchises Spider-Man and X-Men. Through March 31, 2007, games based on the Spider-Man and X-Men franchises have generated approximately \$852.7 million in net revenues worldwide. Under this agreement, in the

first quarter of fiscal 2007 we released the video game, *X-Men: The Official Game*, coinciding with the theatrical release of *X-Men: The Last Stand*. In the third quarter of fiscal 2007, we released *Marvel: Ultimate Alliance* across multiple platforms and *Spider-Man: Battle for New York* on the NDS and GBA. In addition, through our licensing agreement with Spider-Man Merchandising, LP, we developed and published video games based on Columbia Pictures/Marvel Entertainment, Inc.'s feature film *Spider-Man 3*, which was released in May 2007. Our agreement with Spider-Man Merchandising, LP grants us exclusive worldwide publishing rights to publish entertainment software products based on subsequent Spider-Man movie sequels or new television series through 2017.

We also have an exclusive licensing agreement with professional skateboarder Tony Hawk. The agreement grants us exclusive rights to develop and publish video games through 2015 using Tony Hawk's name and likeness. Through March 31, 2007, we have released eight successful titles in the Tony Hawk franchise with cumulative net revenues of \$1.2 billion, including the two fiscal 2007 third quarter releases, *Tony Hawk's Project 8*, which was released on the PSP, Xbox360, PS2, and PS3, and *Tony Hawk's Downhill Jam* which was released on the Wii, NDS, and GBA. According to the NPD Group, which is a provider of consumer and retail market research information for a wide range of industries, for the eighth consecutive year the Tony Hawk franchise had a top 10 best-selling game in the U.S. for the month of December. We will continue to build on the highly successful Tony Hawk franchise with future releases currently in development for multiple platforms.

We continue to develop a number of original intellectual properties internally. For example, in the third quarter of fiscal 2007 we released *Call of Duty 3* on the PS2, PS3, Xbox, Xbox360, and the Wii. According to the NPD Group, *Call of Duty 3* was the #3 best-selling console game in the U.S. *Call of Duty 3* was the sixth release based upon this original intellectual property following two PC exclusive titles, *Call of Duty* and *Call of Duty: United Offensive*, as well as multi-platform releases of *Call of Duty: Finest Hour*, *Call of Duty: Big Red One*, and *Call of Duty 2*. We expect to continue to develop a variety of games on multiple platforms based on this original intellectual property as well as continue to invest in developing other original intellectual properties.

We have continued our focus on establishing and maintaining relationships with talented and experienced software development and publishing teams. In June 2006, we acquired RedOctane, Inc. (RedOctane), the publisher of the popular Guitar Hero franchise. In the third quarter of fiscal 2007 we released *Guitar Hero 2* on the PS2, which according to the NPD Group was the #1 game in dollars for the U.S. for the month of December and the #2 game overall for the third quarter of fiscal 2007. We have also developed *Guitar Hero 2* for the Xbox360 and plan on continuing to build on this franchise by investing in future development of Guitar Hero titles across a variety of platforms. We also have development agreements with other top-level, third-party developers such as id Software, Inc., Splash Damage, Ltd., and Traveller's Tales.

We will also continue to evaluate and exploit emerging brands that we believe have potential to become successful game franchises. For example, we have a multi-year, multi-property, publishing agreement with DreamWorks Animation LLC that grants us the exclusive rights to publish video games based on DreamWorks Animation SKG's theatrical release *Shrek 2*, which was released in the first quarter of fiscal 2005, *Shrek the Third*, which was released in the second quarter of fiscal 2005, *Madagascar*, which was released in the first quarter of fiscal 2006, *Over the Hedge*, which was released in the first quarter of fiscal 2007, and all of their respective sequels. In addition, our multi-year agreement with DreamWorks Animation LLC also grants us the exclusive video game rights to four upcoming feature films, as well as potential future films in the *Shrek* franchise beyond the *Shrek the Third*.

Additionally, we have a strategic alliance with Harrah's Entertainment, Inc. that grants us the exclusive, worldwide interactive rights to develop and publish *World Series of Poker* video games based on the popular World Series of Poker Tournament. In the second quarter of fiscal 2006, we released our first title under this alliance, *World Series of Poker*, which became the number one poker title of calendar 2005. Further building on this franchise, in the second quarter of fiscal 2007, we released our second title under this alliance, *World Series of Poker: Tournament of Champions*.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

We also continue to build on our portfolio of licensed intellectual property. In February 2006, we signed an agreement with Hasbro Properties Group granting us the exclusive global rights (excluding Japan) to develop console, hand-held, and PC games based on Hasbro's Transformers brand. We anticipate releasing the first game concurrently with the July 2007 movie release of the live action Transformers film from DreamWorks Pictures and Paramount Pictures. In April 2006, we signed an agreement with MGM Interactive and EON Productions Ltd. granting us the exclusive rights to develop and publish interactive entertainment games based on the James Bond license through 2014. In May 2006, we signed a multi-year agreement with Mattel, Inc. which grants us the exclusive

worldwide distribution rights to new video games on all platforms based on Mattel, Inc.'s *Barbie* brand. In the third quarter of fiscal 2006, we distributed six *Barbie* titles: *Barbie in the 12 Dancing Princesses*, *The Barbie Diaries: High School Mystery*, *Barbie Fashion Show*, *Barbie Horse Adventures: Mystery Ride*, *Barbie and the Magic of Pegasus*, and *Barbie as the Princess and the Pauper*. In September 2006, we entered into a distribution agreement with MTV Networks Kids and Family Group's Nickelodeon, a division of Viacom Inc., to be the exclusive distributor of three new Nick Jr. PC CD-ROM titles, published by Nickelodeon and based on the top preschool series on commercial television, *Dora The Explorer*, *The Backyardigans*, and *Go, Diego, Go!*.

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

Critical Accounting Policies

We have identified the policies below as critical to our business operations and the understanding of our financial results. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. For a detailed discussion on the application of these and other accounting policies, see Note 1 to the Notes to Consolidated Financial Statements included in Item 8. 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 (i.e., a date on which products are made widely available by retailers). For these products we recognize revenue no earlier than the street date. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection. With respect to license agreements that provide customers the right to make multiple copies in exchange for guaranteed amounts, revenue is recognized upon delivery of such copies. Per copy royalties on sales that exceed the guarantee are recognized as earned. With respect to on-line transactions, such as electronic downloads of titles or product add-ons, revenue is recognized when the fee is paid by the on-line customer to purchase online content and we are notified by the online retailer that the product has been downloaded. 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 are accounted for in accordance with the Financial Accounting Standards Board's Emerging Issues Task Force (EITF) Issue 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products). In accordance with EITF Issue 01-9, sales incentives and other consideration that are considered adjustments of the selling price of our products, such as rebates and product placement fees, are reflected as reductions of revenue. Sales incentives and other consideration that represent costs incurred by us for assets or services received, such as the appearance of our products in a customer's national circular ad, are reflected as sales and marketing expenses.

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

We may permit product returns from, or grant price protection to, our customers under certain conditions. In general, price protection refers to the circumstances when we elect to decrease the wholesale price of a product by a certain amount and, when granted and applicable, allows customers a credit against amounts owed by such customers to us with respect to open and/or future invoices. The conditions our customers must meet to be granted the right to return products or price protection are, among other things, compliance with applicable payment terms, and consistent delivery to us of inventory and sell-through reports. We may also consider other factors, including the facilitation of

slow-moving inventory and other market factors. Management must make estimates of potential future product returns and price protection related to current period product revenue. We estimate the amount of future returns and price protection for current period product revenue utilizing historical experience and information regarding inventory levels and the demand and acceptance of our products by the end consumer. The following factors are used to estimate the amount of future returns and price protection for a particular title: historical performance of titles in similar genres, historical performance of the hardware platform, historical performance of the brand, console hardware life cycle, Activision sales force and retail customer feedback, industry pricing, weeks of on-hand retail channel inventory, absolute quantity of on-hand retail channel inventory, our warehouse on-hand inventory levels, the title's recent sell-through history (if available), marketing trade programs, and competing titles. The relative importance of these factors varies among titles depending upon, among other items, genre, platform, seasonality, and sales strategy. Significant management judgments and estimates must be made and used in connection with establishing the allowance for returns and price protection in any accounting period. Based upon historical experience we believe our estimates are reasonable. However, actual returns and price protection could vary materially from our allowance estimates due to a number of reasons including, among others, a lack of consumer acceptance of a title, the release in the same period of a similarly themed title by a competitor, or technological obsolescence due to the emergence of new hardware platforms. Material differences may result in the amount and timing of our revenue for any period if factors or market conditions change or if management makes different judgments or utilizes different estimates in determining the allowances for returns and price protection. For example, a 1% change in our March 31, 2007 allowance for returns and price protection would impact net revenues by \$0.9 million.

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

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

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

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

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

evaluation criterion is actual title performance.

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

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

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

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

Commencing upon the related product's release, capitalized intellectual property license costs are amortized to cost of sales intellectual property licenses based on the ratio of current revenues for the specific product to total projected revenues for all products in which the licensed property will be utilized. As intellectual property license contracts may extend for multiple years, the amortization of capitalized intellectual property license costs relating to such contracts may extend beyond one year. For intellectual property included in products that have been released and unreleased products, we evaluate the future recoverability of capitalized amounts on a quarterly basis. The primary evaluation criterion is actual title performance.

Significant management judgments and estimates are utilized in the assessment of the recoverability of capitalized costs. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional costs to be incurred. If revised forecasted or actual product sales are less than, and/or revised forecasted or actual costs are greater than, the original forecasted amounts utilized in the initial recoverability analysis, the net realizable value may be lower than originally estimated in any given quarter, which could result in an impairment charge. Additionally, as noted above, as many of our intellectual property licenses extend for multiple products over multiple years, we also assess the recoverability of capitalized intellectual property license costs based on certain qualitative factors such as the success of other products and/or entertainment vehicles utilizing the intellectual property, whether there are any future planned theatrical releases or television series based on the intellectual property and the rights holder's continued promotion and exploitation of the intellectual property. 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.

Stock-Based Compensation. On April 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options and employee stock purchases related to the Employee Stock Purchase Plan (employee stock purchases), based on estimated fair values. SFAS 123R supersedes our previous accounting under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123R. We have applied the provisions of SAB 107 in our adoption of SFAS 123R.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

We adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of April 1, 2006, the first day of our fiscal year 2007. The Company's Consolidated Financial Statements as of and for the fiscal year ended March 31, 2007 reflect the impact of SFAS 123R. In

accordance with the modified prospective transition method, the Company's Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R. See Note 14 for additional information.

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 123(R)-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards (FSP 123R-3). We have elected not to adopt the alternative transition method provided in the FSP 123R-3 for calculating the tax effects of stock-based compensation pursuant to SFAS 123R. We followed paragraph 81 of SFAS No. 123R to calculate the initial pool of excess tax benefits and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123R.

SFAS 123R requires companies to estimate the fair value of share-based payment awards on the measurement date using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Consolidated Statement of Operations. Stock-based compensation expense recognized under SFAS 123R for the fiscal year ended March 31, 2007 was \$25.5 million. Prior to the adoption of SFAS 123R, the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123). Under APB 25, compensation expense was 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 was recorded on the measurement date only if the current market price of the underlying stock exceeded the stock option or other stock-based award's exercise price. For the fiscal years ended March 31, 2006 and 2005, we recognized \$3.1 million and \$3.4 million, respectively, in stock-based compensation expense related to employee stock options and restricted stock, under APB 25. See Note 14 to the Consolidated Financial Statements for additional information.

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in our Consolidated Statements of Operations for the fiscal year ended March 31, 2007 includes compensation expense for share-based payment awards granted prior to, but not yet vested as of, April 1, 2006 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123, and compensation expense for the share-based payment awards granted subsequent to April 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. As stock-based compensation expense recognized in the Consolidated Statements of Operations for the fiscal year ended March 31, 2007 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

As of April 1, 2005, we changed our method of valuation for share-based awards to a binomial-lattice model from the Black-Scholes option-pricing model (Black-Scholes model) which was used for options granted prior to April 1, 2005 for FAS 123 fair value disclosures. For additional information, see Note 14 to the Consolidated Financial Statements. Our determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to our expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

Selected Consolidated Statements of Operations Data

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

| | 2007 | | Fiscal Year ended March 31, 2006 | | 2005 | |
|---------------------------------------------------|------|-----------|-------------------------------------|----|-----------|------|
| Net revenues | \$ | 1,513,012 | 100% | \$ | 1,468,000 | 100% |
| Costs and expenses: | | | | | | |
| Cost of sales product costs | | 799,587 | 52 | | 734,874 | 50 |
| Cost of sales software royalties and amortization | | 132,353 | 9 | | 147,822 | 10 |
| Cost of sales intellectual property licenses | | 46,125 | 3 | | 57,666 | 4 |
| Product development | | 133,073 | 9 | | 132,651 | 9 |
| Sales and marketing | | 196,213 | 13 | | 283,395 | 19 |
| General and administrative | | 132,514 | 9 | | 96,366 | 7 |
| Total costs and expenses | | 1,439,865 | 95 | | 1,452,774 | 99 |
| Income from operations | | 73,147 | 5 | | 15,226 | 1 |
| Investment income, net | | 36,678 | 2 | | 30,630 | 2 |
| Income before income tax provision | | 109,825 | 7 | | 45,856 | 3 |
| Income tax provision | | 24,038 | 1 | | 5,605 | |
| Net income | \$ | 85,787 | 6% | \$ | 40,251 | 3% |
| Net Revenues by Territory: | | | | | | |
| North America | \$ | 753,376 | 50% | \$ | 710,040 | 48% |
| Europe | | 718,973 | 47 | | 717,494 | 49 |
| Other | | 40,663 | 3 | | 40,466 | 3 |
| Total net revenues | \$ | 1,513,012 | 100% | \$ | 1,468,000 | 100% |
| Net Revenues by Segment/Platform Mix: | | | | | | |
| Publishing: | | | | | | |
| Console | \$ | 886,795 | 59% | \$ | 812,345 | 55% |
| Hand-held | | 153,357 | 10 | | 158,861 | 11 |
| PC | | 78,886 | 5 | | 183,457 | 13 |
| Total publishing net revenues | | 1,119,038 | 74 | | 1,154,663 | 79 |
| Distribution: | | | | | | |
| Console | | 238,662 | 16 | | 196,413 | 13 |
| Hand-held | | 122,293 | 8 | | 76,973 | 5 |
| PC | | 33,019 | 2 | | 39,951 | 3 |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

| | | | | | | |
|-------------------------------------|--------------|------|--------------|------|--------------|------|
| Total distribution net revenues | 393,974 | 26 | 313,337 | 21 | 333,128 | 24 |
| Total net revenues | \$ 1,513,012 | 100% | \$ 1,468,000 | 100% | \$ 1,405,857 | 100% |
| Operating Income (Loss) by Segment: | | | | | | |
| Publishing | \$ 64,076 | 4% | \$ (6,715) | % | \$ 155,863 | 11% |
| Distribution | 9,071 | 1 | 21,941 | 1 | 23,745 | 2 |
| Total operating income | \$ 73,147 | 5% | \$ 15,226 | 1% | \$ 179,608 | 13% |

Results of Operations Fiscal Years Ended March 31, 2007 and 2006*Net Revenues*

We primarily derive revenue from sales of packaged interactive software games designed for play on video game consoles (such as the PS2, PS3, Xbox360, and Wii), PCs, and hand-held game devices (such as the GBA, NDS, and PSP). We also derive revenue from our distribution business in Europe that provides logistical and sales services to third-party publishers of interactive entertainment software, our own publishing operations and third-party manufacturers of interactive entertainment hardware.

The following table details our consolidated net revenues by business segment and our publishing net revenues by territory for the years ended March 31, 2007 and 2006 (in thousands):

| | For the fiscal years ended March 31, | | | |
|-------------------------------|-----------------------------------------|--------------|-------------------------|-------------------|
| | 2007 | 2006 | Increase/ (Decrease) | Percent Change |
| Publishing net revenues | | | | |
| North America | \$ 753,376 | \$ 710,040 | \$ 43,336 | 6% |
| Europe | 324,999 | 404,157 | (79,158) | (20)% |
| Other | 40,663 | 40,466 | 197 | 0% |
| Total international | 365,662 | 444,623 | (78,961) | (18)% |
| Total publishing net revenues | 1,119,038 | 1,154,663 | (35,625) | (3)% |
| Distribution net revenues | 393,974 | 313,337 | 80,637 | 26% |
| Consolidated net revenues | \$ 1,513,012 | \$ 1,468,000 | \$ 45,012 | 3% |

Consolidated net revenues increased 3% from \$1,468.0 million for the fiscal year ended March 31, 2006 to \$1,513.0 million for the fiscal year ended March 31, 2007. This increase in consolidated net revenues was driven by the following:

Strong performance of our North American publishing unit led to a year over year increase in net revenues of \$43.3 million or 6%. In the third quarter of fiscal 2007, we released a focused but high quality slate of titles, which resulted in strong consumer demand for our new releases in the third quarter, continuing reorders in the fourth quarter and strong price realization. In fiscal 2007, our major releases included *Call of Duty 3*, *Guitar Hero 2*, *Marvel: Ultimate Alliance*, *Tony Hawk's Project 8*, *Over the Hedge*, *X-Men: Official Game*, *Shrek Smash N' Crash*, *Tony Hawk's Downhill Jam*, *Series of Poker Tournament of Champions*, *Pimp My Ride*, and titles for our Cabela's, History Channel and new Barbie franchises. In fiscal 2006, we released the following major releases: *Doom 3* for the Xbox, *Madagascar*, *Fantastic Four*, *Ultimate Spider-Man*, *X-Men Legends II*, *THAW*, *Call of Duty 2*, *Call of Duty 2: Big Red One*, *GUN*, *True Crime: New York City*, *Quake 4*, *Shrek SuperSlam*, *The Movies*, *Cabela's Dangerous Hunts 2*, and *World Series of Poker*.

An increase in net revenues from our distribution business due to a stronger release schedule for certain third-party publishers, higher revenues from hardware sales related to the launch of PS3 and Nintendo Wii, as well as ongoing sales of NDS and PSP, and the addition of a significant new customer in the second quarter of fiscal 2007.

Impact of the year over year strengthening of the Great Britain Pound (GBP), Euro (EUR) and Australian Dollar (AUD) in relation to the United States Dollar (USD). Foreign exchange rates increased reported net revenues by approximately \$51.6 million or 4% for the year ended March 31, 2007. Excluding the impact of changing foreign currency rates, our consolidated net revenues remained about in line with prior year.

Partially offset by:

A decrease in publishing net revenues from our European publishing operations primarily due to a more focused slate in fiscal 2007, and a decrease in our affiliate business as only one title, LucasArts *Star Wars*

Lego 2 was released in 2007, whereas two strong affiliate titles, LucasArts *Star Wars: Episode III Revenge of the Sith* and LucasArts *Star Wars Battlefront II*, were released in fiscal 2006.

In fiscal 2008, we plan to leverage our traditional core franchises, such as Spiderman, Shrek, Call of Duty and Tony Hawk, and extend our market leadership in the music-based gaming genre with Guitar Hero. In addition, we expect strong market growth as the next generation consoles gain critical mass. As a result, we anticipate revenues will increase in fiscal 2008 in comparison to the record net revenues achieved in fiscal 2007.

North America Publishing Net Revenues (in thousands)

| March 31, 2007 | % of Consolidated Net Revenues | March 31, 2006 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|--------------------------------------|-------------------|--------------------------------------|-------------------------|-------------------|
| \$ 753,376 | 50% | \$ 710,040 | 48% | \$ 43,336 | 6% |

North America publishing net revenues increased 6% from \$710.0 million for the year ended March 31, 2006 to \$753.4 million for the year ended March 31, 2007. Although the company released fewer titles in fiscal 2007, the high quality slate drove strong consumer demand and enabled the company to maintain pricing and record lower provisions for returns and price protection than in fiscal 2006. Net revenues were impacted by strong performances from *Guitar Hero 2*, *Call of Duty 3*, *Marvel: Ultimate Alliance* and *Tony Hawk's Project 8*. North America publishing net revenues increased as a percentage of consolidated net revenues from 48% for the year ended March 31, 2006 to 50% for the year ended March 31, 2007. The increase in the percentage of consolidated net revenues is due to a combination of strong performance in North America and a decrease in our international publishing net revenues due to a smaller slate and a decrease in the number of affiliate titles in Europe released in fiscal 2007.

International Publishing Net Revenues (in thousands)

| March 31, 2007 | % of Consolidated Net Revenues | March 31, 2006 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|--------------------------------------|-------------------|--------------------------------------|-------------------------|-------------------|
| \$ 365,662 | 24% | \$ 444,623 | 30% | \$ (78,961) | (18)% |

International publishing net revenues decreased by 18% from \$444.6 million for the year ended March 31, 2006 to \$365.7 million for the year ended March 31, 2007. Additionally, international publishing net revenues as a percentage of consolidated net revenues decreased from 30% for the year ended March 31, 2006 to 24% for the year ended March 31, 2007. The decrease in international publishing net revenues was primarily due to the decrease in the number of titles released internationally in fiscal 2007. Additionally, in Europe, our net revenues were impacted by a decrease in revenues from our affiliate titles. Fiscal 2006 included the successful LucasArts titles, *Star Wars: Revenge of the Sith* and *Star Wars Battlefront II*, while fiscal 2007 included one major affiliate label release, LucasArts *Lego Star Wars II: The Original Trilogy*. The decrease in international publishing net revenues was partially offset by a year over year strengthening of the EUR and the GBP in relation to the USD, which increased reported net revenues for fiscal 2007 by approximately \$24.2 million. Excluding the impact of changing foreign currency rates, our international publishing net revenues decreased 23% year over year.

Publishing Net Revenues by Platform

Publishing net revenues decreased 3% from \$1,154.7 million for the year ended March 31, 2006 to \$1,119.0 million for the year ended March 31, 2007. The following table details our publishing net revenues by platform and as a percentage of total publishing net revenues for the years ended March 31, 2007 and 2006 (in thousands):

| | Year Ended March 31, 2007 | % of Publishing Net Revs | Year Ended March 31, 2006 | % of Publishing Net Revs | Increase/ (Decrease) | Percent Change |
|--------------------------------|---------------------------------|--------------------------------|---------------------------------|--------------------------------|-------------------------|-------------------|
| Publishing Net Revenues | | | | | | |
| PC | \$ 78,886 | 7% | \$ 183,457 | 16% | \$ (104,571) | (57)% |
| Console | | | | | | |
| Sony PlayStation 3 | 53,842 | 5% | | % | 53,842 | n/a |
| Sony PlayStation 2 | 500,927 | 45% | 422,239 | 36% | 78,688 | 19% |
| Microsoft Xbox360 | 200,394 | 18% | 102,809 | 9% | 97,585 | 95% |
| Microsoft Xbox | 54,232 | 5% | 205,864 | 18% | (151,632) | (74)% |
| Nintendo Wii | 54,636 | 5% | | % | 54,636 | n/a |
| Nintendo GameCube | 22,761 | 2% | 80,964 | 7% | (58,203) | (72)% |
| Other | 3 | % | 469 | % | (466) | (99)% |
| Total console | 886,795 | 80% | 812,345 | 70% | 74,450 | 9% |
| Hand-held | | | | | | |
| Game Boy Advance | 48,478 | 4% | 79,738 | 7% | (31,260) | (39)% |
| PlayStation Portable | 49,931 | 4% | 52,016 | 5% | (2,085) | (4)% |
| Nintendo Dual Screen | 54,948 | 5% | 27,107 | 2% | 27,841 | 103% |
| Total hand-held | 153,357 | 13% | 158,861 | 14% | (5,504) | (3)% |
| Total publishing net revenues | \$ 1,119,038 | 100% | \$ 1,154,663 | 100% | \$ (35,625) | (3)% |

Personal Computer Net Revenues (in thousands)

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 78,886 | 7% | \$ 183,457 | 16% | \$ (104,571) | (57)% |

Net revenues from sales of titles for the PC decreased 57% from \$183.5 million and 16% of publishing net revenues for the year ended March 31, 2006 to \$78.9 million and 7% of publishing net revenues for the year ended March 31, 2007. The decreases were primarily due to the strong performance of our fiscal 2006 PC releases, as well as a decrease in the number of titles released for the PC during fiscal 2007 as compared to fiscal 2006. In fiscal 2006, we released the highly successful PC title, *Call of Duty 2*, which was ranked by NPD Funworld as the number two best selling PC title in the United States for the third quarter of fiscal 2006, as well as *Quake 4*, *The Movies*, and *Doom 3: Resurrection of Evil*. This compares to fiscal 2007 where net revenues were primarily derived from catalog sales of *Call of Duty 2*, *Quake 4* and *The Movies*, as well as revenues from our European affiliate title LucasArts *Lego Star Wars II: The Original Trilogy*.

We expect fiscal 2008 PC publishing net revenues to increase due to the release of *Enemy Territory: Quake Wars*, and *Call of Duty 4*, as well as PC releases of large scale movie titles (*Spider Man the Movie 3*, *Shrek the Third* and *Transformers*). *Quake* and *Call of Duty* had no PC releases in the fiscal 2007 base period and should attract a significant audience on the PC platform in fiscal 2008.

Sony PlayStation 3 Net Revenues (in thousands)

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 53,842 | 5% | \$ 53,842 | % | \$ 53,842 | n/a |

The PS3 was released in November 2006 in North America and in March 2007 in Europe. Consistent with our goal of having a significant presence at the launch of each new platform, we released three titles concurrently with the hardware releases: *Call of Duty 3*, *Marvel: Ultimate Alliance*, and *Tony Hawk's Project 8*. All of these titles were released at premium retail pricing (i.e. \$59.99 in the United States).

We expect net revenues from sales of titles for the PS3 to increase as the installed base of hardware grows.

Sony PlayStation 2 Net Revenues (in thousands)

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 500,927 | 45% | \$ 422,239 | 36% | \$ 78,688 | 19% |

Net revenues from sales of titles for the PS2 increased 19% from \$422.2 million for the year ended March 31, 2006 to \$500.9 million for the year ended March 31, 2007. Although we released a fewer number of major titles for the PS2 in fiscal 2007, the strong performance of these releases, particularly the PS2 exclusive title *Guitar Hero 2*, resulted in higher net revenues in absolute dollars and as a percentage of publishing net revenues. The key titles impacting the fiscal 2007 results were *Call of Duty 3*, the #3 title overall for the third quarter of fiscal 2007 according to NPD Funworld, and *Guitar Hero 2* (game and accessories), the #1 best selling title on the PS2 platform for the third quarter of fiscal 2007 per NPD Funworld. In addition, we released *Marvel: Ultimate Alliance*, *Over the Hedge*, *Tony Hawk's Project 8*, *X-Men: The Official Game*, *Shrek Smash N' Crash Racing* and our European affiliate title, LucasArts' *Star Wars Lego 2*. This compares to fiscal 2006 where we released the PS2 titles *Call of Duty 2: Big Red One*, *Tony Hawk's American Wasteland*, *Shrek SuperSlam*, *GUN*, *True Crime: New York City*, *Madagascar*, *Fantastic Four*, *X-Men Legends 2*, *Ultimate Spiderman* and two affiliate titles in Europe, LucasArts' *Star Wars: Revenge of the Sith* and *Star Wars Battlefront II*.

Although we expect net revenues from sales of titles for the PS2 to decline over time as consumers transition to next generation platforms, we continue to expect significant net revenues for PS2 for fiscal 2008 as we plan to develop and release many of our key titles on this platform.

Microsoft Xbox360 Net Revenues (in thousands)

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 200,394 | 18% | \$ 102,809 | 9% | \$ 97,585 | 95% |

Net revenues from sales of titles for the Xbox360 increased 95% from \$102.8 million for the year ended March 31, 2006 to \$200.4 million for the year ended March 31, 2007. As a percentage of publishing net revenues, net revenues from sales of titles for the Xbox360 doubled from 9% for the year ended March 31, 2006 to 18% for the year ended March 31, 2007. These increases are due to the growing installed base for the Xbox360, as well as an increase in the number of titles released. In fiscal 2007, we released ten titles for this platform, and according to NPD Funworld, three of our titles, *Call of Duty 3*, *Tony Hawk's Project 8* and *Marvel: Ultimate Alliance* ranked among the top ten Xbox 360 titles during the third quarter of fiscal 2007. In fiscal 2006, we released four titles concurrently with the November 2005 launch of the Xbox360 hardware, *Call of Duty 2*, *THAW*, *Quake 4*, and *GUN*, and we experienced strong sales for these four titles although limited by hardware availability.

We expect net revenues from sales of titles for the Xbox360 to significantly increase in the upcoming fiscal year due to the growing installed base and our strong slate of Xbox360 titles.

Microsoft Xbox Net Revenues (in thousands)

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 54,232 | 5% | \$ 205,864 | 18% | \$ (151,632) | (74)% |

Net revenues from sales of titles for the Xbox decreased 74% from \$205.9 million for the year ended March 31, 2006 to \$54.2 million for the year ended March 31, 2007. As a percentage of publishing net revenues, net revenues from sales of titles for the Xbox decreased from 18% for the year ended March 31, 2006 to 5% for the year ended March 31, 2007. These decreases were primarily attributable to a slowdown in sales for the Xbox as customers upgrade to the Xbox360, and the reduction in the number of titles released by us for this platform. In fiscal 2007 we released five major titles for Xbox: *Call of Duty 3*, *Tony Hawk's Project 8*, *Marvel: Ultimate Alliance*, *Over the Hedge* and *X-Men: The Official Game*. In fiscal 2006, we released our largest slate including *Call of Duty: Big Red One*, *Tony Hawk's American Wasteland*, *GUN*, *Ultimate Spiderman*, *X-Men Legends 2*, *True Crime: New York City*, *Shrek: SuperSlam*, *Madagascar*, *Fantastic Four* and the Xbox exclusive, *Doom 3*.

We expect our fiscal 2008 net revenues from sales of titles for the Xbox to decrease as consumers transition to next generation platforms and as we stop developing new titles for this platform.

Nintendo Wii Net Revenues (in thousands)

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 54,636 | 5% | \$ %\$ 54,636 | | | n/a |

The Nintendo Wii was released in November 2006. Consistent with our goal of having a significant presence at the launch of each next generation platform, we released five titles concurrently with the release of Wii;

Call of Duty 3, Marvel: Ultimate Alliance, World Series of Poker: Tournament of Champions, Rapala Tournament Fishing, and Tony Hawk's Downhill Jam. With the strong consumer demand for the platform, our five releases performed well, three of which were top ten Wii titles in the third quarter of fiscal 2007, according to NPD Funworld: *Call of Duty 3, Marvel Ultimate Alliance and Tony Hawk's Downhill Jam.*

We expect net revenues from sales of titles for the Wii to significantly increase with the growth of the installed base and an increase in the number of titles on our slate for fiscal 2008. Due to its mass market appeal, we believe that the Wii will provide a significant opportunity for us in the upcoming fiscal years.

Nintendo GameCube Net Revenues (in thousands)

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 22,761 | 2% | \$ 80,964 | 7% | \$ (58,203) | (72)% |

Net revenues from sales of titles for the Nintendo GameCube decreased 72% from \$81.0 million for the year ended March 31, 2006 to \$22.8 million for the year ended March 31, 2007. The decrease in absolute dollars and as a percentage of publishing net revenues reflects a decrease in the number of new releases in fiscal 2007 compared to fiscal 2006 and a significant slowdown in sales on the GameCube platform as customers transition to the next generation platforms. In fiscal 2006, we released nine major titles: *Madagascar, Tony Hawk's American Wasteland, Ultimate Spiderman, Fantastic Four, Call of Duty: Big Red One, True Crime: New York City, GUN, Shrek Super Slam* and *X-Men Legends 2*. This compares to fiscal 2007 when we released four titles: *Over the Hedge, X-Men: The Official Game, Shrek Smash N' Crash Racing*, and our European affiliate title, *Star Wars Lego 2*.

We expect net revenues for the GameCube to significantly decrease in fiscal 2008. Net revenues will be generated from catalog sales only, as we will no longer develop titles for this platform.

Hand-held (in thousands)

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 153,357 | 13% | \$ 158,861 | 14% | \$ (5,504) | (3)% |

Net revenues from sales of titles for the hand-held platforms decreased 3% from \$158.9 million for the year ended March 31, 2006 to \$153.4 million for the year ended March 31, 2007. Hand-held net revenues as a percentage of publishing net revenues decreased slightly from 14% to 13%. Within the hand-held platforms, net revenues for the GBA platform decreased 39%, from \$79.7 million for the prior fiscal year, to \$48.5 million for fiscal 2007, PSP decreased by 4%, from \$52.0 million to \$49.9 million, and net revenues for the NDS doubled from \$27.1 million for fiscal 2006 to \$54.9 million for the current year. The decrease in net revenues for GBA is primarily related to slower GBA sales due to wider

Edgar Filing: ACTIVISION INC /NY - Form 10-K

acceptance of the NDS platform. The net revenue increase for NDS reflects the strong performance of our key fiscal 2007 titles which includes *Over the Hedge*, *Tony Hawk's Downhill Jam*, *X-Men: The Official Game*, *Spider-Man: Battle for New York* and LucasArts' *Star Wars Lego 2* in Europe, as the platform continued to gain consumer acceptance and market share. PSP net revenues for fiscal 2007 were slightly lower than the previous year. In fiscal 2006, we released a stronger PSP slate and our titles performed well with the consumer excitement for the March 2005 North America platform launch, and the September 2005 European platform launch. The 2006 slate included *Tony Hawk's Underground 2*, *Spider-Man: The Movie 2*, *X-Men Legends 2*, *World Series of Poker*, and two affiliate titles in Europe. Our key releases in fiscal 2007 were *Marvel: Ultimate Alliance*, *Tony Hawk's Project 8*, *Call of Duty: Roads to Victory*, and one European affiliate title, LucasArts' *Star Wars Lego 2*.

With the installed base of the NDS and PSP continuing to increase, we expect that fiscal 2008 hand-held net revenues to continue to increase year over year.

Overall

The platform mix of our future publishing net revenues will likely be impacted by a number of factors, including the ability of hardware manufacturers to continue to increase their installed hardware base for the next-generation platforms, as well as the performance of key product releases from our product release schedule. We expect that net revenues from console titles will continue to represent the largest component of our publishing net revenues with Xbox 360 having the largest percentage of that business in fiscal 2008 due to its large installed hardware base and our strong slate of titles. We expect significant growth in net revenues from PS3 and Wii next-generation console systems and a decrease in the percentage of PS2 business in fiscal 2008. With the installed base of the NDS and PSP platforms continuing to increase, we also expect to see a continued increase in our hand-held business in line with the growth in the installed base. 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 and revenues and profits are significantly affected by our ability to release highly successful hit titles. For example, for the year ended March 31, 2007, 29% of our consolidated net revenues and 39% of worldwide publishing net revenues were derived from net revenues from our *Call of Duty 3*, *Guitar Hero 2*, and *Marvel: Ultimate Alliance* 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.

Three key factors that could affect future publishing and distribution net revenue performance are console hardware pricing, software pricing, and transitions in console platforms. As console hardware moves through its life cycle, hardware manufacturers typically enact price reductions. Reductions in the price of console hardware typically result in an increase in the installed base of hardware owned by consumers. Historically, we have seen that lower console hardware prices put downward pressure on software pricing. However, we expect console software launch pricing for the Xbox360 and PS3 to hold at current levels as a result of the strong consumer acceptance of these price points that has occurred since the launch of the next generation platforms and the greater product capability and value of next generation titles. We continue to expect software pricing on PS2 to hold at \$39.99 with continued momentum on this platform. We will not be launching any new NGC or Xbox title in fiscal year 2008.

Distribution Net Revenues (in thousands)

| March 31, 2007 | % of Consolidated Net Revenues | March 31, 2006 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|--------------------------------------|-------------------|--------------------------------------|-------------------------|-------------------|
| \$ 393,974 | 26% | \$ 313,337 | 21% | \$ 80,637 | 26% |

Distribution net revenues for the year ended March 31, 2007 increased 26% from the prior fiscal year, from \$313.3 million to \$394.0 million. Foreign exchange rates increased reported distribution net revenues by approximately \$27.3 million for the year ended March 31, 2007.

Excluding the impact of the changing foreign currency rates, our distribution net revenues increased \$53.3 million or 17% year over year. This year over year increase was primarily due to the strong releases for certain third-party publishers, increased hardware sales primarily related to the launch of two new platforms in fiscal 2007, the PS3 and the Nintendo Wii, as well as ongoing sales of NDS and PSP hardware, and the addition of a new customer in the second quarter of fiscal 2007.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

The mix of distribution net revenues between hardware and software sales varied year over year with approximately 17% of distribution net revenues from hardware sales in the year ended March 31, 2007 as compared to 20% in the prior fiscal year. Fiscal 2007 results included the hardware releases of the Nintendo Wii in November 2006 and the PS3 in late March 2007. Fiscal 2006 included the release of the PSP in Europe in the second quarter and the Xbox360 in November 2005. 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, and our ability to establish and maintain distribution agreements with hardware manufacturers, third-party software publishers and retail customers.

We expect our fiscal 2008 distribution net revenues to decrease in absolute dollars and as a percentage of consolidated net revenues when compared with fiscal 2007 primarily due to the loss of a customer at the end of fiscal 2007 and strong growth of our publishing business.

Costs and Expenses

Cost of Sales Product Costs (in thousands)

| March 31, 2007 | % of Consolidated Net Revenues | March 31, 2006 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|---------------------------|-----------------------------------------------|---------------------------|-----------------------------------------------|---------------------------------|---------------------------|
| \$ 799,587 | 52% | \$ 734,874 | 50% | \$ 64,713 | 9% |

Cost of sales product costs represented 52% and 50% of consolidated net revenues for the years ended March 31, 2007 and 2006, respectively. In absolute dollars, cost of sales product costs increased 9% from \$734.9 million for the year ended March 31, 2006 to \$799.6 million for the year ended March 31, 2007. The primary factors affecting the increase in cost of sales product costs in absolute dollars and as a percentage of consolidated net revenues were:

An increase in consolidated net revenues of 3% from \$1,468.0 million for the year ended March 31, 2006 to \$1,513.0 million for the year ended March 31, 2007.

A higher percentage of our business relating to distribution which carries higher product costs than our publishing business.

Higher net revenues from products for console platforms in absolute dollars and as a percentage of publishing net revenues from \$812.3 million and 70% of publishing net revenues in fiscal 2006 to \$886.8 million and 80% of publishing net revenues in fiscal 2007. Console products have higher costs of sales product costs associated with them than PC products, due to the royalty payments to hardware manufacturers.

Partially offset by:

Non-recurring write-downs of inventory costs recorded in fiscal 2006 in the amount of \$14.5 million due to the high level of inventory for certain titles which, due to weaker market conditions and a slow down in re-orders caused by the console transition.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

We expect cost of sales — product costs as a percentage of net revenues to decrease in fiscal 2008 as compared to fiscal 2007 primarily due to a larger proportion of our business being derived from the publishing segment in fiscal 2008.

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

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|---------------------------|---------------------------------------------|---------------------------|---------------------------------------------|---------------------------------|---------------------------|
| \$ 132,353 | 12% | \$ 147,822 | 13% | \$ (15,469) | (10)% |

Cost of sales — software royalties and amortization — for the year ended March 31, 2007 decreased as a percentage of publishing net revenues from the prior fiscal year, from 13% to 12%. In absolute dollars, cost of sales

software royalties and amortization for the year ended March 31, 2007 also decreased from the prior fiscal year, from \$147.8 million to \$132.4 million. The decreases were mainly due to:

A decrease in the number of titles released in fiscal 2007 as compared to the prior year when we had the largest slate of new releases in our history. A decrease in amortization of software development costs from internally developed games, was partially offset by increases in royalties for games developed by third party developers.

Non-recurring costs recorded in fiscal 2006 totaling \$12.6 million, related to impairment charges for a title in development in 2006, and recoverability write-offs related to released titles.

We expect costs of sales software royalties and amortization to increase in fiscal 2008 in proportion to the expected increase in publishing net revenues.

Cost of Sales Intellectual Property Licenses (in thousands)

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 46,125 | 4% | \$ 57,666 | 5% | \$ (11,541) | (20)% |

Cost of sales intellectual property licenses for the year ended March 31, 2007 decreased in absolute dollars and as a percentage of publishing net revenues over the same period last year, from \$57.7 million to \$46.1 million and from 5% to 4%, respectively. The decreases in both absolute dollars and as a percentage of publishing net revenues were due mainly to a decrease in the number of titles with associated intellectual property in fiscal 2007 compared to fiscal 2006. In fiscal 2007, we released the following titles with associated intellectual property: *Marvel: Ultimate Alliance*, *Over the Hedge*, *X-Men: Official Game*, *Guitar Hero 1 and 2*, *Tony Hawk's Project 8* and *Tony Hawk's Downhill Jam*. In fiscal 2006, we released the following titles with associated intellectual property: *Doom 3* for the Xbox, *Madagascar*, *Fantastic Four*, *Ultimate Spider-Man*, *X-Men Legends II*, *THAW*, *Quake IV*, and *Shrek SuperSlam*.

We expect intellectual property licenses to increase in absolute dollars and as a percentage of publishing net revenues in fiscal 2008 as a result of our planned title slate which includes several key releases with licensed intellectual property such as *Spider-Man: The Movie 3*, *Transformers*, *Shrek the Third*, and *Bee Movie*.

Product Development (in thousands)

Edgar Filing: ACTIVISION INC /NY - Form 10-K

| March 31, 2007 | % of Publishing Net Revenues | March 31, 2006 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 133,073 | 12% | \$ 132,651 | 11% | \$ 422 | % |

Product development expenses of \$133.1 million and \$132.7 million represented 12% and 11% of publishing net revenues for the years ended March 31, 2007 and 2006, respectively. The increases in both absolute dollars and as a percentage of net revenues was primarily generated by:

Increased costs incurred to fund more product development capacity at certain studios as well as the addition of Red Octane.

Increases in product development expenses of \$4.8 million in fiscal 2007 related to stock-based compensation expense as a result of the implementation of SFAS 123R.

Compensation provided to employees in fiscal 2007 to cure tax penalties related to previously-exercised stock options.

Partially offset by:

Product cancellation charges of \$11.4 million, including termination fees, incurred during fiscal 2006. Given the market conditions, the lower than expected performance of some of our third quarter fiscal 2006 releases, and risks associated with console transition, we performed a thorough review of the then pending product slate. To better align opportunities associated with the next-generation console platforms with income potential and risks associated with certain titles in development, we canceled development of certain titles and permanently removed them from our future title slate. There were no product cancellation charges during fiscal 2007.

The implementation during fiscal 2007 of certain cost control initiatives including sharing technologies and tools across multiple platforms and studios, increasing our development schedules to facilitate a longer pre-production phase and more predictable workflow times, and outsourcing certain areas of game development to lower cost service providers.

Sales and Marketing (in thousands)

| March 31, 2007 | % of Consolidated Net Revenue | March 31, 2006 | % of Consolidated Net Revenue | Increase/ (Decrease) | Percent Change |
|-------------------|-------------------------------------|-------------------|-------------------------------------|-------------------------|-------------------|
| \$ 196,213 | 13% | \$ 283,395 | 19% | \$ (87,182) | (31)% |

Sales and marketing expenses of \$196.2 million and \$283.4 million represented 13% and 19% of consolidated net revenues for the years ended March 31, 2007 and 2006, respectively. The decrease in both absolute dollars and as a percentage of net revenues was a result of the implementation of a more targeted media program which worked more efficiently helped by the overall strength and high quality of our fiscal 2007 title slate. We also released fewer titles in fiscal 2007 compared to fiscal 2006, where we had the largest slate of new releases in our history. The decreases were partially offset by expenses of \$5.1 million in fiscal 2007 related to stock-based compensation expense as a result of the implementation of SFAS 123R, as well as sales and marketing expenses associated with the acquisition of the Guitar Hero franchise.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

General and Administrative (in thousands)

| March 31, 2007 | % of Consolidated Net Revenues | March 31, 2006 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|---------------------------|-----------------------------------------------|---------------------------|-----------------------------------------------|---------------------------------|---------------------------|
| \$ 132,514 | 9% | \$ 96,366 | 7% | \$ 36,148 | 38% |

General and administrative expenses of \$132.5 million and \$96.4 million represented 9% and 7% of consolidated net revenues for the years ended March 31, 2007 and 2006, respectively. The increases were primarily due to increased legal expenses and professional fees relating primarily to our internal review of historical stock option granting practices, the consolidation of RedOctane into our results of operations, amortization of intangible assets related to the RedOctane acquisition, and stock-based compensation expense of \$10.0 million in fiscal 2007 as a result of the implementation of SFAS 123R. These increases were partially offset by the benefits of our cost optimization program launched in the fourth quarter of fiscal 2006 and gains on foreign currency.

Operating Income (in thousands)

| | March 31, 2007 | % of Segment Net Revs | March 31, 2006 | % of Segment Net Revs | Increase/ (Decrease) | Percent Change |
|--------------|-------------------|-----------------------------|-------------------|-----------------------------|-------------------------|-------------------|
| Publishing | \$ 64,076 | 6% | \$ (6,715) | (1)% | \$ 70,791 | 1054% |
| Distribution | 9,071 | 2% | 21,941 | 7% | (12,870) | (59)% |
| Consolidated | \$ 73,147 | 5% | \$ 15,226 | 1% | \$ 57,921 | 380% |

Publishing operating income for the year ended March 31, 2007 increased \$70.8 million from the same period last year, from an operating loss of \$6.7 million to operating income of \$64.1 million. The increase is primarily due to:

The strong performance of our fiscal 2007 titles.

A decrease in provision for returns and price protection in fiscal 2007 from 18% of consolidated net revenues in fiscal 2006 compared to 9% of consolidated net revenues in fiscal 2007, primarily due to improved market conditions and stronger sell through of our 2007 title releases.

A significant decrease in sales and marketing spending as a result of improved efficiency in executing our marketing programs.

The implementation of certain cost control initiatives resulting in decreased product development and general and administrative expenses (excluding expenses related to our internal review of historical stock option granting practices and expenses relating to the informal SEC inquiry and derivative litigation).

Fiscal 2006 results included cancellation, impairment, and earn-out recoverability charges totaling \$24.0 million. See additional description of charges incurred in the cost of sales software royalties and amortization and the product development discussions.

Fiscal 2006 results also included write-downs of inventory costs of \$14.5 million. See additional description in the cost of sales product costs discussion.

Partially offset by:

Stock-based compensation expenses of \$22.4 million for the year ended March 31, 2007 as a result of the implementation of SFAS 123R.

Legal and other professional fees of \$26.9 million associated with our internal review of historical stock option granting practices, including expenses relating to the informal SEC inquiry and derivative litigation.

Amortization of intangible assets related to the RedOctane acquisition of \$11.7 million.

Distribution operating income for the year ended March 31, 2007 decreased over the same period last year, from \$21.9 million to \$9.1 million. The decrease in operating income in 2007 was primarily due to increased business from large mass-market customers for which we earn smaller margins, an increase in hardware sales which carries a lower margin than software, and higher reserves for inventory obsolescence.

Investment Income, Net (in thousands)

| March 31, 2007 | % of Consolidated Net Revenues | March 31, 2006 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|--------------------------------------|-------------------|--------------------------------------|-------------------------|-------------------|
| \$ 36,678 | 2% | \$ 30,630 | 2% | \$ 6,048 | 20% |

Investment income, net for the year ended March 31, 2007 was \$36.7 million as compared to \$30.6 million for the year ended March 31, 2006. The increase was primarily due to higher yields earned on our short term investments and cash equivalents, and a realized gain in the third quarter of fiscal 2007 of \$1.8 million on the sale of an investment in common stock.

Provision for Income Taxes (in thousands)

| March 31, 2007 | % of Pre Tax Income | March 31, 2006 | % of Pre Tax Income | Increase/ (Decrease) | Percent Change |
|-------------------|---------------------------|-------------------|---------------------------|-------------------------|-------------------|
| \$ 24,038 | 22% | \$ 5,605 | 12% | \$ 18,433 | 329% |

The income tax provision of \$24.0 million for the year ended March 31, 2007 reflects our effective income tax rate of 22%. This is higher than prior years as a result of an increase in pretax income for the year ended March 31, 2007, versus the amount of pretax income for the year ended March 31, 2006, without a corresponding increase in the benefit of book/tax differences. The significant items that generated the variance between our effective rate and our statutory rate of 35% were research and development tax credits, the impact of foreign tax rate differentials, and the elimination of the valuation allowance for research and development tax credits, partially offset by state taxes and the establishment of tax reserves for these credits and other deferred tax assets. The realization of deferred tax assets depends primarily on the generation of future taxable income. We believe that it is more likely than not that we will generate taxable income sufficient to realize the benefit of net deferred tax assets recognized.

Net Income

Net income for the year ended March 31, 2007 was \$85.8 million or \$0.28 per diluted share, as compared to \$40.3 million or \$0.14 per diluted share for the year ended March 31, 2006.

Results of Operations Fiscal Years Ended March 31, 2006 and 2005
Net Revenues

Edgar Filing: ACTIVISION INC /NY - Form 10-K

We primarily derive revenue from sales of packaged interactive software games designed for play on video game consoles (such as the PS2, Xbox, Xbox360, and GameCube), PCs, and hand-held game devices (such as the GBA, NDS, and PSP). We also derive revenue from our distribution business in Europe that provides logistical and sales services to third-party publishers of interactive entertainment software, our own publishing operations and third-party manufacturers of interactive entertainment hardware.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

The following table details our consolidated net revenues by business segment and our publishing net revenues by territory for the years ended March 31, 2006 and 2005 (in thousands):

| | For the years ended March 31, | | | Increase/ (Decrease) | Percent Change | | |
|-------------------------------|-------------------------------|-----------|----|-------------------------|-------------------|----------|------|
| | 2006 | 2005 | | | | | |
| Publishing net revenues | | | | | | | |
| North America | \$ | 710,040 | \$ | 696,325 | \$ | 13,715 | 2% |
| Europe | | 404,157 | | 341,946 | | 62,211 | 18% |
| Other | | 40,466 | | 34,458 | | 6,008 | 17% |
| Total international | | 444,623 | | 376,404 | | 68,219 | 18% |
| Total publishing net revenues | | 1,154,663 | | 1,072,729 | | 81,934 | 8% |
| Distribution net revenues | | 313,337 | | 333,128 | | (19,791) | (6)% |
| Consolidated net revenues | \$ | 1,468,000 | \$ | 1,405,857 | \$ | 62,143 | 4% |

Consolidated net revenues increased 4% from \$1,405.9 million for the year ended March 31, 2005 to \$1,468.0 million for the year ended March 31, 2006. This increase in consolidated net revenues was solely generated by our publishing business and was driven by the following:

An increase year over year in the number of titles released. Our fiscal 2006 launch schedule included the largest slate of new releases in our history. In fiscal 2006, we released seventeen major titles including the following major releases: *Doom 3* for the Xbox, *Madagascar*, *Fantastic Four*, *Ultimate Spider-Man*, *X-Men Legends II*, *THAW*, *Call of Duty 2*, *Call of Duty 2: Big Red One*, *GUN*, *True Crime: New York City*, *Quake 4*, *Shrek SuperSlam*, *The Movies*, *Cabela's Dangerous Hunts 2*, and *World Series of Poker*. In addition, four of these titles, *Call of Duty 2*, *THAW*, *Quake 4*, and *GUN*, were released concurrently with the release of the Xbox360 platform at a premium retail price of \$59.99. This compares to fourteen titles in fiscal 2005, which included the following major releases: *Spider-Man 2*, *Call of Duty: Finest Hour*, *Tony Hawk's Underground 2* (*THUG 2*), *Shrek 2*, *X-Men Legends*, *Doom 3*, *Lemony Snicket's A Series of Unfortunate Events*, *Shark Tale*, *Cabela's Big Game Hunter 2005*, and *Rome: Total War*. Additionally in fiscal 2006, we achieved our goal of increasing the number of million and multi-million unit selling titles.

An increase in our hand-held platform presence growing publishing hand-held revenues by \$20.2 million or 15% from \$138.7 million for the year ended March 31, 2005 to \$158.9 million for the year ended March 31, 2006. This was driven by an increase in the number of hand-held titles released combined with titles being released across more hand-held platforms with the fiscal 2005 introductions of the PSP and NDS.

Partially offset by:

An increase in provision for return and price protection throughout fiscal 2006 from 12% of net revenues in fiscal 2005 to 18% of net revenues in fiscal 2006, due to challenging market conditions and the ongoing console transition.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

A decrease in net revenues from our distribution business due mostly to the effect of year over year weakening of the Euro (EUR) and Great Britain Pound (GBP) in relation to the United States Dollar (USD). Foreign exchange rates decreased reported distribution net revenues by approximately \$14.9 million for the year ended March 31, 2006. Excluding the impact of changing foreign currency rates, our distribution net revenues decreased 1% year over year.

North America Publishing Net Revenues (in thousands)

| March 31, 2006 | % of Consolidated Net Revenues | March 31, 2005 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|---------------------------|-----------------------------------------------|---------------------------|-----------------------------------------------|---------------------------------|---------------------------|
| \$ 710,040 | 48% | \$ 696,325 | 50% | \$ 13,715 | 2% |

North America publishing net revenues increased 2% from \$696.3 million for the year ended March 31, 2005 to \$710.0 million for the year ended March 31, 2006. The increase reflects our largest slate of releases in company history and expansion of our hand-held presence with products for PSP, NDS, and GBA. This was offset by weaker market conditions resulting in higher provisions for returns and price protection. North America publishing net

Edgar Filing: ACTIVISION INC /NY - Form 10-K

revenues decreased as a percentage of consolidated net revenues from 50% for year ended March 31, 2005 to 48% for the year ended March 31, 2006. The decrease is due to a larger increase in our international publishing net revenues due to successful expansion efforts into new territories and the strong performance of our affiliate titles in Europe.

International Publishing Net Revenues (in thousands)

| March 31, 2006 | % of Consolidated Net Revenues | March 31, 2005 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|--------------------------------------|-------------------|--------------------------------------|-------------------------|-------------------|
| \$ 444,623 | 30% | \$ 376,404 | 27% | \$ 68,219 | 18% |

International publishing net revenues increased by 18% from \$376.4 million for the year ended March 31, 2005 to \$444.6 million for the year ended March 31, 2006. Additionally, international publishing net revenues as a percentage of consolidated net revenues increased from 27% for the year ended March 31, 2005 to 30% for the year ended March 31, 2006. The increases were due mainly to our successful expansion efforts into new territories combined with strong performance from our affiliate label products which included the successful LucasArts titles, *Star Wars: Revenge of the Sith* and *Star Wars Battlefront II*. The increase in international publishing net revenues was partially offset by a weakening of the EUR and the GBP in relation to the USD of approximately \$14.5 million. Excluding the impact of changing foreign currency rates, our international publishing net revenues increased 22% year over year.

Publishing Net Revenues by Platform

Publishing net revenues increased 8% from \$1,072.7 million for the year ended March 31, 2005 to \$1,154.7 million for the year ended March 31, 2006. The following table details our publishing net revenues by platform and as a percentage of total publishing net revenues for the years ended March 31, 2006 and 2005 (in thousands):

| | Year Ended March 31, 2006 | % of Publishing Net Revs | Year Ended March 31, 2005 | % of Publishing Net Revs | Increase/ (Decrease) | Percent Change |
|-------------------------|---------------------------------|--------------------------------|---------------------------------|--------------------------------|-------------------------|-------------------|
| Publishing Net Revenues | | | | | | |
| PC | \$ 183,457 | 16% | \$ 220,087 | 21% | \$ (36,630) | (17)% |
| Console | | | | | | |
| Sony PlayStation 2 | 422,239 | 36% | 417,310 | 39% | 4,929 | 1% |
| Microsoft Xbox | 205,864 | 18% | 196,894 | 18% | 8,970 | 5% |
| Microsoft Xbox360 | 102,809 | 9% | | % | 102,809 | % |
| Nintendo GameCube | 80,964 | 7% | 96,936 | 9% | (15,972) | (16)% |
| Other | 469 | % | 2,807 | % | (2,338) | (83)% |
| Total console | 812,345 | 70% | 713,947 | 66% | 98,398 | 14% |
| Hand-held | | | | | | |
| Game Boy Advance | 79,738 | 7% | 101,796 | 9% | (22,058) | (22)% |
| PlayStation Portable | 52,016 | 5% | 19,200 | 2% | 32,816 | 171% |
| Nintendo Dual Screen | 27,107 | 2% | 17,699 | 2% | 9,408 | 53% |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

| | | | | | | |
|-------------------------------|--------------|------|--------------|------|-----------|-----|
| Total hand-held | 158,861 | 14% | 138,695 | 13% | 20,166 | 15% |
| Total publishing net revenues | \$ 1,154,663 | 100% | \$ 1,072,729 | 100% | \$ 81,934 | 8% |

Personal Computer Net Revenues (in thousands)

| March 31, 2006 | % of Publishing Net Revenues | March 31, 2005 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 183,457 | 16% | \$ 220,087 | 21% | \$ (36,630) | (17)% |

Net revenues from sales of titles for the PC decreased 17% from \$220.1 million and 21% of publishing net revenues for the year ended March 31, 2005 to \$183.5 million and 16% of publishing net revenues for the year ended

March 31, 2006. The decrease in both absolute dollars and as a percentage of publishing revenue was due to the slate of PC titles released in fiscal 2005 in comparison to fiscal 2006. In fiscal 2005, we released the highly successful PC titles *Doom 3* and *Rome: Total War* and also had strong continued sell through of our catalog title, *Call of Duty*. Although we had strong sales from our fiscal 2006 PC titles, *Call of Duty 2*, *The Movies*, and *Quake 4*, in fiscal 2005, according to NPD Funworld, we were the only publisher to have three top-ten PC titles for calendar year 2004.

Sony PlayStation 2 Net Revenues (in thousands)

| March 31, 2006 | % of Publishing Net Revenues | March 31, 2005 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 422,239 | 36% | \$ 417,310 | 39% | \$ 4,929 | 1% |

Net revenues from sales of titles for the PS2 increased 1% from \$417.3 million for the year ended March 31, 2005 to \$422.2 million for the year ended March 31, 2006. The slight increase was primarily due to an increase in the number of major titles released for the PS2 from seven major titles in fiscal 2005 to nine major titles in fiscal 2006. This increase was offset by an increase in the provision for returns and price protection on new releases due to weaker market conditions. In addition, *Madagascar*, which was our fifth best selling PS2 title for fiscal 2006 in terms of units sold, was released at a lower initial retail pricing point of \$39.99 compared to \$49.99 for comparable children's titles in fiscal 2005. As a percentage of publishing net revenues, net revenues from sales of titles for the PS2 decreased from 39% for the year ended March 31, 2005 to 36% for the year ended March 31, 2006. The decrease is due to a change in our platform revenue mix due to the introduction of the Xbox360.

Microsoft Xbox Net Revenues (in thousands)

| March 31, 2006 | % of Publishing Net Revenues | March 31, 2005 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 205,864 | 18% | \$ 196,894 | 18% | \$ 8,970 | 5% |

Net revenues from sales of titles for the Xbox increased 5% from \$196.9 million for the year ended March 31, 2005 to \$205.9 million for the year ended March 31, 2006 and held steady as a percentage of publishing net revenues at 18%. The increase was primarily attributable to the strong performance of our first quarter fiscal 2006 Xbox exclusive release of *Doom 3* which had no comparable Xbox exclusive title released in fiscal 2005. This increase was offset by increased provisions for returns and price protection in anticipation of quicker required pricing actions as a result of the introduction of the Xbox360, which is expected to result in a gradual slowdown in sales for the Xbox as customers upgrade or anticipate upgrading to the next-generation platform.

Microsoft Xbox360 Net Revenues (in thousands)

| March 31, 2006 | % of Publishing Net Revenues | March 31, 2005 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|

Edgar Filing: ACTIVISION INC /NY - Form 10-K

| | | | | | | |
|----|---------|----|----|-----|---------|---|
| \$ | 102,809 | 9% | \$ | %\$ | 102,809 | % |
|----|---------|----|----|-----|---------|---|

The Xbox360 was released in November 2005 and was the first of the next-generation hardware to be released. Consistent with our goal of having a significant presence at the launch of each new platform, we released four titles concurrently with the release of the Xbox360, *Call of Duty 2*, *THAW*, *Quake 4*, and *GUN*. All of these titles were released at premium retail pricing of \$59.99. Although limited by hardware availability in fiscal 2006, we experienced strong sales of these four titles, and, according to NPD Funworld, *Call of Duty 2* was the number one title on the Xbox360 and had the highest attach rate of any console launch in video game history.

Nintendo GameCube Net Revenues (in thousands)

| March 31, 2006 | % of Publishing Net Revenues | March 31, 2005 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 80,964 | 7% | \$ 96,936 | 9% | \$ (15,972) | (16)% |

Net revenues from sales of titles for the Nintendo GameCube decreased 16% from \$96.9 million for the year ended March 31, 2005 to \$81.0 million for the year ended March 31, 2006. Despite an increase in the number of titles released for the GameCube from seven major titles for the year ended March 31, 2005 to nine major titles for the year ended March 31, 2006, the releases in fiscal 2006, which included *GUN*, *Call of Duty 2: Big Red One*, *THAW*, and *True Crime: New York City*, were less geared toward the demographics of the GameCube audience as compared to our fiscal 2005 title releases, which included *Spider-Man 2* and *Shrek 2*. Additionally, *Madagascar*, which was our top selling title on the GameCube in fiscal 2006, was released at a lower initial retail pricing of \$39.99 as compared to *Spider-Man 2* and *Shrek 2*, which were both released at an initial retail price of \$49.99. *Madagascar* was our top selling title on the GameCube for fiscal 2006 and although it performed strongly, it compares to fiscal 2005 where our top two selling titles on the GameCube were *Spider-Man 2* and *Shrek 2*, each of which outperformed *Madagascar*.

Hand-held (in thousands)

| March 31, 2006 | % of Publishing Net Revenues | March 31, 2005 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 158,861 | 14% | \$ 138,695 | 13% | \$ 20,166 | 15% |

Net revenues from sales of titles for the hand-held for the year ended March 31, 2006 increased 15% from the prior fiscal year, from \$138.7 million to \$158.9 million. Additionally, hand-held net revenues as a percentage of publishing net revenues increased from 13% for the year ended March 31, 2005 to 14% for the year ended March 31, 2006. The increases were due to the worldwide introductions of the NDS and PSP hand-held platforms in late fiscal 2005 and the continued growth of their installed base throughout fiscal 2006, which resulted in hand-held titles being sold across more platforms. In addition, compared to the other hand-held platforms, titles for the PSP have a higher retail pricing point of \$49.99. The major titles driving hand-held net revenues in fiscal 2006 were *Madagascar*, *Madagascar: Operation Penguin*, *Fantastic Four*, *Ultimate Spider-Man*, and *Shrek SuperSlam* for the GBA; *Madagascar*, *Ultimate Spider-Man*, *Tony Hawk's American Sk8land*, and *Shrek SuperSlam* for the NDS; and *THUG 2*, *Spider-Man 2*, *X-Men Legends II*, and LucasArts' *Star Wars Battlefront II* for the PSP. This compares to fiscal 2005 where the main titles driving hand-held net revenues were *Shrek 2*, *Spider-Man 2*, and *DreamWorks Shark Tale* for the GBA; *Spider-Man 2* for the NDS; and *THUG 2* and *Spider-Man 2* for the PSP.

Distribution Net Revenues (in thousands)

| March 31, 2006 | % of Consolidated Net Revenues | March 31, 2005 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|--------------------------------------|-------------------|--------------------------------------|-------------------------|-------------------|
| \$ 313,337 | 21% | \$ 333,128 | 24% | \$ (19,791) | (6)% |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Distribution net revenues for the year ended March 31, 2006 decreased 6% from the prior fiscal year, from \$333.1 million to \$313.3 million. Foreign exchange rates decreased reported distribution net revenues by approximately \$14.9 million for the year ended March 31, 2006. Excluding the impact of the changing foreign currency rates, our distribution net revenues decreased \$4.9 million or 1% year over year. The remaining year over year decrease was primarily due to the termination of relationships with unprofitable publishers and stronger third-party releases in fiscal 2005.

The mix of distribution net revenues between hardware and software sales varied year over year with approximately 20% of distribution net revenues from hardware sales in the year ended March 31, 2006 as compared to 13% in the prior fiscal year. This was mainly attributed to the release of the PSP in Europe in the second quarter of

fiscal 2006 and the release of the Xbox360 in November 2005. In both fiscal years, hardware sales were principally comprised of sales of console hardware.

Costs and Expenses

Cost of Sales Product Costs (in thousands)

| March 31, 2006 | % of Consolidated Net Revenues | March 31, 2005 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|--------------------------------------|-------------------|--------------------------------------|-------------------------|-------------------|
| \$ 734,874 | 50% | \$ 658,949 | 47% | \$ 75,925 | 12% |

Cost of sales product costs represented 50% and 47% of consolidated net revenues for the years ended March 31, 2006 and 2005, respectively. In absolute dollars, cost of sales product costs increased 12% from \$658.9 million for the year ended March 31, 2005 to \$734.9 million for the year ended March 31, 2006. The primary factors affecting the increase in cost of sales product costs in absolute dollars and as a percentage of consolidated net revenues were:

Volume growth in our European territories of LucasArts *Star Wars: Episode III Revenge of the Sith*, and *Star Wars Battlefront II*. LucasArts titles are part of our affiliate label program and carry a significantly higher product cost than Activision developed titles.

Write-downs of inventory costs for certain titles in fiscal 2006 in the amount of \$14.5 million due to the high level of inventory for certain titles at the end of our third quarter of fiscal 2006. At the end of the third quarter of fiscal 2006 we reviewed the levels of inventory and determined that, due to lower than expected re-orders caused by weaker market conditions and the ongoing console transition, we anticipated that certain titles in our inventory would likely be sold below its original cost.

A decrease in our PC net revenues as a percentage of publishing net revenues from 21% in fiscal 2005 to 16% in fiscal 2006. Products for PC typically have lower costs of sales product costs associated with them as they do not require royalty payments to hardware manufacturers.

An increase in provision for returns and price protection throughout fiscal 2006 from 12% of net revenues in fiscal 2005 compared to 18% of net revenues in fiscal 2006, due to challenging market conditions and the ongoing console transition.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

An increase in consolidated net revenues of 4% from \$1,405.9 million for the year ended March 31, 2005 to \$1,468.0 million for the year ended March 31, 2006.

Reduced pricing on a number of catalog titles as well as new releases in our kids genre.

Cost of Sales Software Royalties and Amortization (in thousands)

| March 31, 2006 | % of Publishing Net Revenues | March 31, 2005 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 147,822 | 13% | \$ 123,800 | 12% | \$ 24,022 | 19% |

Cost of sales software royalties and amortization for the year ended March 31, 2006 increased as a percentage of publishing net revenues from the prior fiscal year, from 12% to 13%. In absolute dollars, cost of sales software royalties and amortization for the year ended March 31, 2006 also increased from the prior fiscal year, from \$123.8 million to \$147.8 million. The increases in cost of sales software royalties and amortization in both absolute dollars and as a percentage of publishing net revenues were mainly due to:

Impairment charges and recoverability write-offs of \$12.6 million in fiscal 2006. We performed a detailed review of capitalized costs for released titles and determined that expected future revenues, given the change

in market conditions, on certain titles would not support the remaining capitalized software balance on these titles. As a result, we incurred a \$3.8 million recoverability charge on these titles in fiscal 2006. In addition, we reviewed future recoverability of capitalized amounts on titles in development and determined that one of our titles, to be released in fiscal 2007, was unlikely to fully recover capitalized costs given the change in expectations as a result of weaker market conditions and uncertainty involved in the console transition and, as a result, took an impairment charge of \$8.8 million on this title.

Overall continued increases in costs to develop titles for additional platforms, particularly those titles released for the more technologically advanced next-generation console platforms.

Cost of Sales Intellectual Property Licenses (in thousands)

| March 31, 2006 | % of Publishing Net Revenues | March 31, 2005 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 57,666 | 5% | \$ 62,197 | 6% | \$ (4,531) | (7)% |

Cost of sales intellectual property licenses for the year ended March 31, 2006 decreased in absolute dollars and as a percentage of publishing net revenues over the same period last year, from \$62.2 million to \$57.7 and from 6% to 5%, respectively. The decreases in both absolute dollars and as a percentage of publishing net revenues were due mainly to a one-time benefit related to the settlement of an intellectual property claim in the second quarter of fiscal 2006. The number of titles with associated intellectual property remained relatively flat year over year. In fiscal 2006, we released the following titles with associated intellectual property: *Doom 3* for the Xbox, *Madagascar*, *Fantastic Four*, *Ultimate Spider-Man*, *X-Men Legends II*, *THAW*, *Quake IV*, and *Shrek SuperSlam*. In fiscal 2005 we released the following titles with associated intellectual property: *Spider-Man 2*, *Shrek 2*, *Shark Tale*, *X-Men Legends*, *THUG 2*, *Lemony Snicket's A Series of Unfortunate Events*, and *Doom 3*.

Product Development (in thousands)

| March 31, 2006 | % of Publishing Net Revenues | March 31, 2005 | % of Publishing Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|------------------------------------|-------------------|------------------------------------|-------------------------|-------------------|
| \$ 132,651 | 11% | \$ 87,776 | 8% | \$ 44,875 | 51% |

Product development expenses for the year ended March 31, 2006 increased as a percentage of publishing net revenues from the prior fiscal year, from 8% to 11%. In absolute dollars, product development expenses for the year ended March 31, 2006 also increased from the prior fiscal year, from \$87.8 million to \$132.7 million. The increase in product development expenses both in absolute dollars and as a percentage of publishing net revenues was due to:

Increased development, quality assurance, and outside developer costs as a result of the development of more technologically advanced titles across more platforms.

Product cancellation charges of \$11.4 million, including termination fees, incurred during fiscal 2006. Given the market conditions, the lower than expected performance of some of our third quarter fiscal 2006 releases, and risks associated with console transition, we performed a thorough review of our upcoming product slate. To better align opportunities associated with the next-generation console platforms with income potential and risks associated with certain titles in development, we canceled development of certain titles and permanently removed them from our future title slate.

Increased costs in fiscal 2006 related to the full year operation of three recently acquired studios, Vicarious Visions, Inc., Toys for Bob, Inc., and Beenox, Inc., as well as costs incurred to fund more product development capacity at certain studios.

Sales and Marketing (in thousands)

| March 31, 2006 | % of Consolidated Net Revenue | March 31, 2005 | % of Consolidated Net Revenue | Increase/ (Decrease) | Percent Change |
|-------------------|-------------------------------------|-------------------|-------------------------------------|-------------------------|-------------------|
| \$ 283,395 | 19% | \$ 230,299 | 16% | 53,096 | 23% |

Sales and marketing expenses of \$283.4 million and \$230.3 million represented 19% and 16% of consolidated net revenues for the years ended March 31, 2006 and 2005, respectively. The increases in both absolute dollars and as a percentage of net revenues was primarily generated by our publishing business as a result of significant marketing programs including television and in-theatre ad campaigns and in-store promotions to support our biggest product release slate in company history. The increase in sales and marketing investment as a percentage of net revenues was a result of additional sales and marketing investment during the key holiday season which did not provide the revenue increase that was anticipated at the time that the marketing costs were incurred.

General and Administrative (in thousands)

| March 31, 2006 | % of Consolidated Net Revenues | March 31, 2005 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|--------------------------------------|-------------------|--------------------------------------|-------------------------|-------------------|
| \$ 96,366 | 7% | \$ 63,228 | 4% | 33,138 | 52% |

General and administrative expenses for the year ended March 31, 2006 increased \$33.1 million over the same period last year, from \$63.2 million to \$96.4 million. As a percentage of consolidated net revenues, general and administrative expenses increased from 4% to 7%. The increases were primarily due to an increase in personnel costs including costs related to European territory expansion, separation and severance costs associated with a less than 7% reduction in workforce in the fourth quarter of fiscal 2006, increased bad debt write-offs, an increase in foreign currency transaction losses, and increased legal costs.

Operating Income (in thousands)

| | March 31, 2006 | % of Segment Net Revs | March 31, 2005 | % of Segment Net Revs | Increase/ (Decrease) | Percent Change |
|--------------|-------------------|-----------------------------|-------------------|-----------------------------|-------------------------|-------------------|
| Publishing | \$ (6,715) | (1)% | \$ 155,863 | 15% | (162,578) | (104)% |
| Distribution | 21,941 | 7% | 23,745 | 7% | (1,804) | (8)% |
| Consolidated | \$ 15,226 | 1% | \$ 179,608 | 13% | (164,382) | (92)% |

Publishing operating income for the year ended March 31, 2006 decreased \$162.6 million from the same period last year, from \$155.9 million to an operating loss of \$6.7 million. The decrease is primarily due to:

Hand-held (in thousands)

Increased sales and marketing spending to support our large title release slate.

An increase in provision for returns and price protection throughout fiscal 2006 from 12% of net revenues in fiscal 2005 compared to 18% of net revenues in fiscal 2006, due to challenging market conditions and the ongoing console transition.

Cancellation, impairment, and earn-out recoverability charges totaling \$24.0 million taken in fiscal 2006. See additional description of charges incurred in the cost of sales – software royalties and amortization and the product development discussions.

Write-downs of inventory costs of \$14.5 million taken during fiscal 2006. See additional description in the cost of sales product costs discussion.

Distribution operating income for the year ended March 31, 2006 decreased over the same period last year, from \$23.7 million to \$21.9 million. The decrease was primarily due to the impact of changes in foreign currency rates on distribution operating income of approximately \$1.4 million. Excluding the impact of changes in foreign currency rates, distribution operating income for the year ended March 31, 2006 decreased approximately \$0.4 million or 2% from the same period last year.

Investment Income, Net (in thousands)

| March 31, 2006 | % of Consolidated Net Revenues | March 31, 2005 | % of Consolidated Net Revenues | Increase/ (Decrease) | Percent Change |
|-------------------|--------------------------------------|-------------------|--------------------------------------|-------------------------|-------------------|
| \$ 30,630 | 2% | \$ 13,092 | 1% | \$ 17,538 | 134% |

Investment income, net for the year ended March 31, 2006 was \$30.6 million as compared to \$13.1 million for the year ended March 31, 2005. The increase was primarily due to higher invested balances combined with rising yields, a realized gain in the first quarter of fiscal 2006 of \$1.3 million on the sale of an investment in common stock, and a realized gain of \$2.9 million on the sale of a cost basis investment during the year ended March 31, 2006 as compared to 2005.

Provision for Income Taxes (in thousands)

| March 31, 2006 | % of Pre Tax Income | March 31, 2005 | % of Pre Tax Income | Increase/ (Decrease) | Percent Change |
|-------------------|---------------------------|-------------------|---------------------------|-------------------------|-------------------|
| \$ 5,605 | 12% | \$ 57,643 | 30% | \$ (52,038) | (90)% |

The income tax provision of \$5.6 million for the year ended March 31, 2006 reflects our effective income tax rate of 12%, which differs from our effective rate of 30% for the year ended March 31, 2005, due to an increase in federal research and development credit for the year ended March 31, 2006, over the amount generated for the year ended March 31, 2005, and a decrease in pretax income for the year ended March 31, 2006, versus the amount of pretax income for the year ended March 31, 2005, without a corresponding decrease in the benefit of book/tax. The significant items that generated the variance between our effective rate and our statutory rate of 35% were research and development tax credits and the impact of foreign tax rate differentials, partially offset by an increase in our deferred tax asset valuation allowance and state taxes. The realization of deferred tax assets depends primarily on the generation of future taxable income. We believe that it is more likely than not that we will generate taxable income sufficient to realize the benefit of net deferred tax assets recognized.

Net Income

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Net income for the year ended March 31, 2006 was \$40.3 million or \$0.14 per diluted share, as compared to \$135.1 million or \$0.49 per diluted share for the year ended March 31, 2005.

Selected Quarterly Operating Results

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

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

| | March 31, 2007 | Dec. 31, 2006 | Sept. 30, 2006 | For the quarters ended | | Dec. 31, 2005 | Sept. 30, 2005 | June 30, 2005 |
|---------------------------------------|-------------------|------------------|-------------------|------------------------|-------------------|------------------|-------------------|------------------|
| | | | | June 30, 2006 | March 31, 2006 | | | |
| Net revenues | \$ 312,512 | \$ 824,259 | \$ 188,172 | \$ 188,069 | \$ 188,125 | \$ 816,242 | \$ 222,540 | \$ 241,093 |
| Cost of sales | 216,007 | 483,180 | 141,078 | 137,800 | 128,309 | 498,325 | 141,458 | 172,270 |
| Operating income (loss) | (29,114) | 173,120 | (37,410) | (33,449) | (26,560) | 83,893 | (27,788) | (14,319) |
| Net income (loss) | (14,422) | 142,820 | (24,302) | (18,309) | (9,128) | 67,856 | (14,230) | (4,247) |
| Basic earnings (loss) per share (1) | (0.05) | 0.51 | (0.09) | (0.07) | (0.03) | 0.25 | (0.05) | (0.02) |
| Diluted earnings (loss) per share (1) | (0.05) | 0.46 | (0.09) | (0.07) | (0.03) | 0.23 | (0.05) | (0.02) |

(1) Consolidated financial information has been restated for the effect of our four-for-three stock split effected in the form of a 33-1/3% stock dividend to shareholders of record as of October 10, 2005, paid October 24, 2005.

Liquidity and Capital Resources*Sources of Liquidity*

| (in thousands) | As of and for the year ended March 31, | | Increase/ (Decrease) | |
|---------------------------------------------|-------------------------------------------|------------|-------------------------|----------|
| | 2007 | 2006 | | |
| Cash and cash equivalents | \$ 384,409 | \$ 354,331 | \$ | 30,078 |
| Short-term investments | 570,440 | 590,629 | | (20,189) |
| | \$ 954,849 | \$ 944,960 | \$ | 9,889 |
| Percentage of total assets | 53% | 67% | | |
| Cash flows provided by operating activities | \$ 27,162 | \$ 86,007 | \$ | (58,845) |
| Cash flows used in investing activities | (35,242) | (85,796) | | 50,554 |
| Cash flows provided by financing activities | 27,968 | 45,088 | | (17,120) |

As of March 31, 2007, our primary source of liquidity is comprised of \$384.4 million of cash and cash equivalents and \$570.4 million of short-term investments. Over the last two years, our primary sources of liquidity have included cash on hand at the beginning of the year and cash flows generated from continuing operations. We have also generated cash flows from the issuance of our common stock to employees through the exercise of options, which is described in more detail below in *Cash Flows from Financing Activities*. We have not utilized debt financing as a significant source of cash flows. However, we do have available at certain of our international locations, credit facilities, which are described below in *Credit Facilities*, that can be utilized if needed.

We believe that we have sufficient working capital (\$1,060.1 million at March 31, 2007), as well as proceeds available from our international credit facilities, to finance our operational requirements for at least the next twelve months, including purchases of inventory and equipment, the funding of the development, production, marketing and sale of new products, and the acquisition of intellectual property rights for future products from third parties.

Cash Flows from Operating Activities

The primary source of cash flows from operating activities typically have included the collection of customer receivables generated by the sale of our products, offset by payments to vendors for the manufacture, distribution, and marketing of our products, third-party developers and intellectual property holders, and our own employees. A significant operating use of our cash relates to our continued investment in software development and intellectual property licenses. We spent approximately \$166.1 million and \$193.9 million in the years ended March 31, 2007 and 2006, respectively, in connection with the acquisition of publishing or distribution rights for products being developed by third parties, the execution of new license agreements granting us long-term rights to intellectual property of third parties, as well as the capitalization of product development costs relating to internally developed products. The decrease period over period is primarily due to new agreements with DreamWorks Animation LLC, Marvel Characters which were signed in fiscal 2006, partially offset by increased product development costs related to titles in development and additional intellectual property licenses in fiscal 2007. 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 expenditures, once a title recoups these costs,

Edgar Filing: ACTIVISION INC /NY - Form 10-K

incremental net revenues typically will directly and positively impact cash flows.

For the years ended March 31, 2007 and 2006, cash flows from operating activities were \$27.2 million and \$86.0 million, respectively. The principal components comprising cash flows from operating activities for the year ended March 31, 2007, included favorable operating results, amortization of capitalized software development costs and intellectual property licenses, increases in payables and accrued liabilities, partially offset by investments in software development and intellectual property licenses and increases in accounts receivables. See an analysis of the

change in key balance sheet accounts below in *Key Balance Sheet Accounts*. We expect that a primary source of future liquidity, both short-term and long-term, will be the result of cash flows from continuing operations.

Cash Flows from Investing Activities

The primary source of cash used in investing activities typically have included capital expenditures, acquisitions of privately held interactive software development companies and publishing companies, and the net effect of purchases and sales/maturities of short-term investment vehicles. The goal of our short-term investments is to maximize return while minimizing risk, maintaining liquidity, coordinating with anticipated working capital needs, and providing for prudent investment diversification.

For the years ended March 31, 2007 and 2006, cash flows used in investing activities were \$35.2 million and \$85.8 million, respectively. For the year ended March 31, 2007, cash flows used in investing activities were primarily the result of cash paid for business acquisitions and capital expenditures, purchases of short-term investments, partially offset by proceeds from sales and maturities of short-term investments. The decrease in cash flows used in investing activities versus the prior year was primarily related to our short term investment activity as we had net proceeds from maturities in fiscal 2007 versus net purchases of short term investments in fiscal 2006. We have historically financed our acquisitions through the issuance of shares of common stock or a combination of common stock and cash. We will continue to evaluate potential acquisition candidates as to the benefit they bring to us.

Cash Flows from Financing Activities

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

For the years ended March 31, 2007 and 2006, cash flows from financing activities were \$28.0 million and \$45.1 million, respectively. The cash provided by financing activities for the year ended March 31, 2007 was the result of the issuance of common stock related to employee stock option and stock purchase plans. The decrease in cash provided by financing activities from the prior year is due to the suspension of stock option exercises as of November 9, 2006 due to our internal review of historical stock option granting practices.

During fiscal 2003, our Board of Directors authorized a buyback program under which we can repurchase up to \$350.0 million of our common stock. Under the program, shares may be purchased as determined by management and within certain guidelines, from time to time, in the open market or in privately negotiated transactions, including privately negotiated structured stock repurchase transactions and through transactions in the options markets. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time or from time to time without prior notice. As of March 31, 2007, we had approximately \$226.2 million available for utilization under the buyback program. We actively manage our capital structure as a component of our overall business strategy. Accordingly, in the future, when we determine that market conditions are appropriate, we may seek to achieve long term value for the shareholders through, among other things, new debt or equity financings or refinancings, share repurchases, and other transactions involving our equity or debt securities.

*Key Balance Sheet Accounts*Accounts Receivable

| (amounts in thousands) | March 31, 2007 | March 31, 2006 | Increase/ (Decrease) |
|---------------------------|----------------|----------------|-------------------------|
| Gross accounts receivable | \$ 240,112 | \$ 127,035 | \$ 113,077 |
| Net accounts receivable | 148,694 | 28,782 | 119,912 |

The increase in gross accounts receivable was primarily the result of higher fourth quarter revenues due to:

The fourth quarter fiscal 2007 European release of the PS3 hardware.

Late fourth quarter fiscal 2007 European releases of *Call of Duty 3*, *Tony Hawk's Project 8*, and *Marvel: Ultimate Alliance* for the PS3. There were no corresponding new releases in the fourth quarter of fiscal 2006.

Continued strong catalogue performance of our 2006 holiday slate.

Reserves for returns, price protection and bad debt decreased from \$98.3 million at March 31, 2006 to \$91.4 million at March 31, 2007 while reserves as a percentage of gross receivables decreased from 77% to 38%. This decrease was largely due to significant reserves for returns and price protection required at March 31, 2006 related to weak market conditions and the uncertainty involved in the ongoing console transition. Reserves for returns and price protection are a function of the number of units and pricing of titles in retail inventory (see description of Allowances for Returns, Price Protection, Doubtful Accounts, and Inventory Obsolescence in Item 7: Critical Accounting Policies).

Inventories

| (amounts in thousands) | March 31, 2007 | March 31, 2006 | Increase/ (Decrease) |
|------------------------|----------------|----------------|-------------------------|
| Inventories | \$ 91,231 | \$ 61,483 | \$ 29,748 |

The increase in inventories at March 31, 2007 compared to March 31, 2006 is the result of additional inventories associated with RedOctane and the Guitar Hero products, which was acquired in the first quarter of fiscal 2007, additional PS3 inventory due to the European release of the console late in the fourth quarter of fiscal 2007, and an increase in inventories at our distribution business related to the addition of a significant new customer in the second quarter of fiscal 2007.

Software Development

| (amounts in thousands) | March 31, 2007 | March 31, 2006 | Increase/ (Decrease) |
|------------------------|----------------|----------------|-------------------------|
| Software development | \$ 130,922 | \$ 60,619 | \$ 70,303 |

Software development increased from \$60.6 million at March 31, 2006 to \$130.9 million at March 31, 2007 due to continued investment in software development for titles being developed for release in fiscal 2008, particularly for three significant new games slated for release in the first quarter of fiscal 2008, offset by amortization of software development costs for titles launched in fiscal 2007.

Intellectual Property Licenses

| (amounts in thousands) | March 31, 2007 | March 31, 2006 | Increase/ (Decrease) |
|--------------------------------|----------------|----------------|-------------------------|
| Intellectual Property Licenses | \$ 100,274 | \$ 87,046 | \$ 13,228 |

Intellectual property licenses increased from \$87.0 million at March 31, 2006 to \$100.3 million at March 31, 2007. The increase in intellectual property licenses was primarily the result of:

Continued investment in intellectual property licenses totaling \$23.2 million in fiscal 2007 for license agreements granting us long-term rights to intellectual property of third parties, such as our agreement with MGM Interactive and EON Productions Ltd. to develop and publish interactive entertainment games based on the James Bond license.

Partially offset by:

\$10.0 million of amortization of intellectual property licenses mostly related to releases in the first quarter of fiscal 2007.

Accounts Payable

| (amounts in thousands) | March 31, 2007 | March 31, 2006 | Increase/ (Decrease) |
|------------------------|----------------|----------------|-------------------------|
| Accounts payable | \$ 136,517 | \$ 88,994 | \$ 47,523 |

The increase in accounts payable of \$47.5 million from March 31, 2006 to March 31, 2007 primarily reflects amounts due to support the significant launch slate in the first quarter of fiscal 2008 versus no similar launches in the same quarter of fiscal 2007.

Accrued Expenses

| (amounts in thousands) | March 31, 2007 | March 31, 2006 | Increase/ (Decrease) |
|------------------------|----------------|----------------|-------------------------|
| Accrued expenses | \$ 204,652 | \$ 104,862 | \$ 99,790 |

Hand-held (in thousands)

The increase in accrued expenses was primarily driven by:

Tax reserves recorded in fiscal 2007 as a result of improved profitability leading to utilization of net operating loss carryforwards.

Increased annual bonuses as a result of company performance.

Increased royalties payable due to higher percentage of products being developed externally.

Credit Facilities

We have revolving credit facilities with our Centresoft subsidiary located in the UK (the UK Facility) and our NBG subsidiary located in Germany (the German Facility). The UK Facility provided Centresoft with the ability to borrow up to GBP 12.0 million (\$23.6 million), including issuing letters of credit, on a revolving basis as of March 31, 2007. Furthermore, under the UK Facility, Centresoft provided a GBP 0.6 million (\$1.2 million) guarantee for the benefit of our CD Contact subsidiary as of March 31, 2006. The UK Facility bore interest at LIBOR plus 2.0% as of March 31, 2007, is collateralized by substantially all of the assets of the subsidiary and expires in January 2008.

The UK Facility also contains various covenants that require the subsidiary to maintain specified financial ratios related to, among others, fixed charges. As of March 31, 2006, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of March 31, 2006. The German Facility provided for revolving loans up to EUR 0.5 million (\$0.7 million) as of March 31, 2007, bore interest at a Eurocurrency rate plus 2.5%, is collateralized by certain of the subsidiary's property and equipment and has no expiration date. No borrowings were outstanding against the German Facility as of March 31, 2007.

As of March 31, 2007, we maintained a \$7.5 million irrevocable standby letter of credit. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. Under the terms of this arrangement, we are required to maintain on deposit with the bank a compensating balance, restricted as to use, of not less than the sum of the available amount of the letter of credit plus the aggregate amount of any drawings under the letter of credit that have been honored thereunder but not reimbursed. At March 31, 2007, the \$7.5 million deposit is included in short-term investments as restricted cash. No borrowings were outstanding as of March 31, 2007 or 2006.

As of March 31, 2007, our publishing subsidiary located in the UK maintained a EUR 4.0 million (\$5.3 million) irrevocable standby letter of credit. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. The standby letter of credit does not require a compensating balance and is collateralized by substantially all of the assets of the subsidiary and expires in August 2007. No borrowings were outstanding as of March 31, 2007 or 2006.

Commitments

In the normal course of business, we enter into contractual arrangements with third parties for non-cancelable operating lease agreements for our offices, for the development of products, as well as for the rights to intellectual property. Under these agreements, we commit to provide specified payments to a lessor, developer, or intellectual property holder, based upon contractual arrangements. Typically, the payments to third-party developers are conditioned upon the achievement by the developers of contractually specified development milestones. These payments to third-party developers and intellectual property holders typically are deemed to be advances and are recoupable against future royalties earned by the developer or intellectual property holder based on the sale of the related game. Additionally, in connection with certain intellectual property right acquisitions and development agreements, we will commit to spend specified amounts for marketing support for the related game(s) which is to be developed or in which the intellectual property will be utilized. Additionally, we lease certain of our facilities and equipment under non-cancelable operating lease agreements. Assuming all contractual provisions are met, the total future minimum commitments for these and other contractual arrangements in place as of March 31, 2007, are scheduled to be paid as follows (amounts in thousands):

Edgar Filing: ACTIVISION INC /NY - Form 10-K

| Fiscal year ending March 31, | Contractual Obligations | | | |
|------------------------------|--------------------------------|-------------------|-----------|------------|
| | Facility & Equipment Leases | Developer & IP | Marketing | Total |
| 2008 | \$ 14,213 | \$ 67,836 | \$ 40,254 | \$ 122,303 |
| 2009 | 13,131 | 31,579 | 30,679 | 75,389 |
| 2010 | 12,070 | 29,936 | 100 | 42,106 |
| 2011 | 9,854 | 30,586 | 13,100 | 53,540 |
| 2012 | 5,543 | 16,586 | | 22,129 |
| Thereafter | 17,783 | 47,586 | | 65,369 |
| Total | \$ 72,594 | \$ 224,109 | \$ 84,133 | \$ 380,836 |

As of March 31, 2007 and 2006, we did not have any relationships with unconsolidated entities or financial parties, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market, or credit risk that could arise if we had engaged in such relationships.

Related Parties

Edgar Filing: ACTIVISION INC /NY - Form 10-K

From August 2001 until September 2005, one of the members of our Board of Directors was an individual who is a partner in a law firm that has provided legal services to Activision for more than ten years. For the years ended March 31, 2005 and 2004, the years presented in this Annual Report for which that person was a member of the Board of Directors, the fees we paid to the law firm were an insignificant portion of the law firm's total revenues. We believe that the fees charged to us by the law firm were competitive with the fees charged by other law firms.

Financial Disclosure

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

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

Recently Issued Accounting Standards and Laws

In February 2006, the FASB issued Statement No. 155 (SFAS No. 155), *Accounting for Certain Hybrid Financial Instruments—An amendment of FASB Statements No. 133 and 140*. SFAS No. 155 amends FASB Statements No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* to resolve issues addressed in Statement 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets*. SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133; establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and amends Statement 140 to eliminate the prohibition on a qualifying

special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. We do not expect that the adoption of SFAS No. 155 will have a material effect on our financial position or results of operations.

In March 2006, the FASB issued Statement No. 156 (SFAS No. 156), *Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140*. SFAS No. 156 amends Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations; requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; permits either the amortization method or the fair value measurement method, as subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities; permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights; and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective in the first fiscal year that begins after September 15, 2006. We do not expect that the adoption of SFAS No. 156 will have a material effect on our financial position or results of operations.

In July 2006, the FASB issued Final Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS No. 109. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest, and penalties, accounting in interim periods, disclosure, and transition. In addition, FIN 48 excludes income taxes from the scope of SFAS No. 5, *Accounting for Contingencies*. FIN 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the consolidated balance sheets prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. We are currently evaluating the effect that the adoption of FIN 48 will have on our results of operations and financial position.

In September 2006, the FASB issued Statement No. 157 (SFAS No. 157), *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We do not expect that the adoption of SFAS No. 157 will have a material effect on our financial position or results of operations.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, *Financial Statements – Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. SAB 108 requires the use of both the iron curtain and rollover approach in quantifying the materiality of misstatements. SAB 108 also discusses the implications of misstatements uncovered upon the application of SAB 108 in situations when a registrant has historically been using either the iron curtain approach or the rollover approach. SAB 108 is effective for fiscal years ending after November 15, 2006. The adoption of SAB 108 had no impact on our financial position or results of operations.

In September 2006, the FASB issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS No. 158). This new standard aims to make it easier for investors, employees, retirees and other parties to understand and assess an employer's financial position and its ability to fulfill the obligations under its benefit plans. SFAS No. 158 requires employers to fully recognize in their financial statements the obligations associated with single-employer defined benefit pension plans, retiree healthcare plans, and other postretirement plans. Specifically, it requires a company to (1) recognize on its balance sheet an asset for a plan's overfunded status or a liability for a plan's underfunded status, (2) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and (3) recognize changes in the funded status of a plan through comprehensive income in the year in which the changes occur. The adoption of SFAS No. 158 had no impact on our financial position or results of operations.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The provisions of SFAS No. 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007. We are evaluating if we will adopt SFAS No. 159 and what impact the adoption will have on our Consolidated Financial Statements if we adopt.

Inflation

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

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the potential loss arising from fluctuations in market rates and prices. Our market risk exposures primarily include fluctuations in interest rates, foreign currency exchange rates, and market prices. Our market risk sensitive instruments are classified as instruments entered into for purposes other than trading. Our views on market risk are not necessarily indicative of actual results that may occur and do not represent the maximum possible gains and losses that may occur, since actual gains and losses will differ from those estimated, based upon actual fluctuations in interest rates, foreign currency exchange rates, market prices, and the timing of transactions.

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We manage our interest rate risk by maintaining an investment portfolio consisting primarily of debt instruments with high credit quality and relatively short average maturities. We also manage our interest rate risk by maintaining sufficient cash and cash equivalent balances such that we are typically able to hold our investments to maturity. As of March 31, 2007, our cash equivalents and short-term investments included debt securities of \$652.8 million.

The following table presents the amounts and related weighted average interest rates of our investment portfolio as of March 31, 2007 (amounts in thousands):

| | Average Interest Rate | Amortized Cost | Fair Value |
|--------------------------------|----------------------------------|---------------------------|-----------------------|
| Cash equivalents: | | | |
| Fixed rate | 5.04% | \$ 89,863 | \$ 89,829 |
| Variable rate | 5.25 | 106,986 | 106,986 |
| Short-term investments: | | | |
| Fixed rate | 4.89% | \$ 564,324 | \$ 562,940 |

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

Foreign Currency Exchange Rate Risk

We transact business in many different foreign currencies and may be exposed to financial market risk resulting from fluctuations in foreign currency exchange rates, particularly EUR, GBP, and AUD. The volatility of EUR, GBP, and AUD (and all other applicable currencies) will be monitored frequently throughout the coming year. When appropriate, we enter into hedging transactions in order to mitigate our risk from foreign currency fluctuations. We will continue to use hedging programs in the future and may use currency forward contracts, currency options, and/or other derivative financial instruments commonly utilized to reduce financial market risks if it is determined that such hedging activities are appropriate to reduce risk. We do not hold or purchase any foreign currency contracts for trading purposes. As of March 31, 2007, accrued expenses included approximately \$90,000 of pre-tax unrealized losses for the estimated fair value of outstanding foreign currency exchange forward contracts, which was recorded in earnings as the contracts did not qualify as hedging instruments. As of March 31, 2006, we had no outstanding foreign exchange forward contracts.

Market Price Risk

With regard to the structured stock repurchase transactions described in Note 15 in the Notes to the Consolidated Financial Statements, at those times when we have structured stock repurchase transactions outstanding, it is possible that at settlement we could take delivery of shares at an effective repurchase price higher than the then market price. As of March 31, 2007, we had no structured stock repurchase transactions outstanding.

Item 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of March 31, 2007 and 2006

Consolidated Statements of Operations for the Years Ended March 31, 2007, 2006, and 2005

Consolidated Statements of Changes in Shareholders' Equity for the Years Ended March 31, 2007, 2006, and 2005

Consolidated Statements of Cash Flows for the Years Ended March 31, 2007, 2006, and 2005

Notes to Consolidated Financial Statements

Schedule II-Valuation and Qualifying Accounts and Reserves as of March 31, 2007, 2006, and 2005

Item 15. Exhibit Index

All other schedules of Activision are omitted because of the absence of conditions under which they are required or because the required information is included elsewhere in the financial statements or in the notes thereto.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

Item 9A. CONTROLS AND PROCEDURES

1) Definition and Limitations of Disclosure Controls and Procedures.

Our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) are designed to reasonably assure that: (i) information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) information is accumulated and communicated to management, including our Chief Executive Officers and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in our periodic reports. Inherent limitations to any system of disclosure controls and procedures include, but are not limited to, the possibility of human error and the circumvention or overriding of such controls by one or more persons. In addition, we have designed our system of controls based on certain assumptions, which we believe are reasonable, about the likelihood of future events, and our system of controls may therefore not achieve its desired objectives under all possible future events.

2) Evaluation of Disclosure Controls and Procedures.

Our management, with the participation of the Chief Executive Officers and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2007. Based on this controls evaluation, and subject to the limitations described above, the Chief Executive Officers and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported on a timely basis.

3) Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our management, with the participation of our Chief Executive Officers and Chief Financial Officer, conducted an evaluation of the effectiveness, as of March 31, 2007, of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of March 31, 2007.

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

Our assessment of the effectiveness of our internal control over financial reporting as of March 31, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report included in this annual report on Form 10-K.

4) Changes in Internal Control Over Financial Reporting

There were changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15(d)-15(f) under the Exchange Act) during the last quarter of this period covered by this report that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting related to the remediation of the previously identified material weakness as discussed below within the Remediation of the Material Weakness.

5) Remediation of the Material Weakness.

During the quarter ended March 31, 2007, we made the following changes that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

New policies and procedures for our stock option grant practices were approved on November 21, 2006 by the Joint Compensation and Nominating and Governance Committee of our Board, and became effective January 1, 2007. Our new option granting policies and procedures are designed to ensure internal control surrounding the pricing and modification of option grants is adequate, and also provide the Compensation Committee with the full ability to review and approve all grants prior to pricing on a date set on or after the date of the Compensation Committee action. Some of the highlights of the new option granting process are:

All proposed grants during the month are verified so as to comply with pre-approved grant guidelines and other financial and legal requirements by the seventh day of the following month. For these purposes, a team of legal,

human resources and finance personnel (Cross Functional Team) has been established to review each proposed grant for compliance with documentation and procedures. No grant is issued until such compliance is established and the grant is approved by the Compensation Committee.

The Compensation Committee meets at least quarterly, to review and approve all documented and verified proposed grants submitted by the Cross Functional Team. All grants approved by the Compensation Committee are effective, and priced based on the closing price of our stock, on a date set by the Compensation Committee that is on or after the date of Compensation Committee action. Details of the grant (including the exercise price) are communicated to the grantees promptly following approval and pricing.

All new hire offer letters and employee renewal agreements provide that all grants and terms of grants are subject to approval by the Compensation Committee.

Stock option data is entered into Equity Edge, our stock option tracking software, promptly (and only) after grant approval is received from the Compensation Committee.

In addition, we have realigned certain internal responsibilities related to the granting and reporting of stock options. In this regard, the employment contract of our former head of human resources, which expired on March 31, 2007, was not renewed; a new head of human resources is being recruited and, in the interim, responsibilities for stock option granting and reporting have been reassigned. To further enhance our corporate governance practices, we have established and filled a position of principal compliance officer, with a reporting line directly to the Nominating and Governance Committee, and are reviewing the configuration of the Compensation Committee of the Board.

In addition, consistent with the recommendations of the Special Subcommittee, we have disengaged from our prior outside corporate counsel and have engaged new outside corporate counsel.

Finally, Board meetings include more senior executives and human resources, finance and legal personnel have received additional training on options and compliance issues.

Management evaluated the design and operation of these new controls and concluded that these controls were in place, designed and operating effectively as of March 31, 2007. Management has concluded that the additional controls described above have remediated our previously disclosed material weakness in our internal control over financial reporting.

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Edgar Filing: ACTIVISION INC /NY - Form 10-K

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2007 Annual Meeting of Shareholders, entitled Proposal 1 Election of Directors, Executive Officers and Key Employees, Section 16(a) Beneficial Ownership Reporting Compliance, Corporate Governance Matters Code of Ethics for Senior Executive and Senior Financial Officers and Corporate Governance Matters Board of Directors and Committees Audit Committee to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

Item 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2007 Annual Meeting of Shareholders, entitled Executive Compensation, Director Compensation and Compensation Committee Report to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

Edgar Filing: ACTIVISION INC /NY - Form 10-K

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2007 Annual Meeting of Shareholders, entitled "Equity Compensation Plan Information" and "Security Ownership of Certain Beneficial Owners and Management" to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Edgar Filing: ACTIVISION INC /NY - Form 10-K

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2007 Annual Meeting of Shareholders, entitled Certain Relationships and Related Transactions and Corporate Governance Matters Board of Directors and Committees Director Independence to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2007 Annual Meeting of Shareholders, entitled "Independent Registered Public Accounting Firm's Fees" to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

PART IV

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

- (a)
1. Financial Statements See Item 8. Consolidated Financial Statements and Supplementary Data Index for Financial Statements and Schedule on page 62 herein.
 2. Financial Statement Schedule The following financial statement schedule of Activision, Inc. for the fiscal years ended March 31, 2007, 2006, and 2005 is filed as part of this report and should be read in conjunction with the Consolidated Financial Statements of Activision, Inc.:

Schedule II Valuation and Qualifying Accounts and Reserves

Other financial statement schedules are omitted because the information called for is not required or is shown either in the Consolidated Financial Statements or the notes thereto.

3. Exhibits Required by Item 601 of Regulation S-K

**Exhibit
Number**

Exhibit

- 3.1 Amended and Restated Certificate of Incorporation of Activision Holdings, dated June 9, 2000 (incorporated by reference to Exhibit 2.5 of Activision's Form 8-K, filed June 16, 2000).
- 3.2 Certificate of Amendment of Amended and Restated Certificate of Incorporation of Activision Holdings dated as of June 9, 2000 (incorporated by reference to Exhibit 2.7 of Activision's Form 8-K, filed June 16, 2000).
- 3.3 Certificate of Designation of Series A Junior Preferred Stock of Activision, Inc. dated as of December 27, 2001 (incorporated by reference to Exhibit 3.4 of Activision's Form 10-Q for the quarter ended December 31, 2001).
- 3.4 Certificate of Amendment of Amended and Restated Certificate of Incorporation, as amended, of Activision, Inc., dated as of April 4, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed April 5, 2005).
- 3.5 Certificate of Designation of Series A Junior Preferred Stock of Activision, Inc. dated August 4, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed August 5, 2005).
- 3.6 Second Amended and Restated Bylaws of Activision, Inc. dated September 15, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed September 19, 2005).

- 4.1 Rights Agreement dated as of April 18, 2000, between Activision, Inc. 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 Activision's Registration Statement on Form 8-A, Registration No. 001-15839, filed April 19, 2000).
- 10.1 Activision, Inc. 1991 Stock Option and Stock Award Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-K for the year ended March 31, 2002).
- 10.2 Activision, Inc. 1998 Incentive Plan, as amended (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended September 30, 2001).
- 10.3 Activision, Inc. 1999 Incentive Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2002).
- 10.4 Activision, Inc. 2001 Incentive Plan, as amended (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended June 30, 2002).
- 10.5 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).
- 10.6 Activision, Inc. 2002 Executive Incentive Plan (incorporated by reference to Exhibit 4.1 of Activision's Form S-8, Registration No. 333-100114 filed September 26, 2002).
- 10.7 Activision, Inc. 2002 Studio Employee Retention Incentive Plan (incorporated by reference to Exhibit 4.1 of Activision's Form S-8, Registration No. 333-103323 filed February 19, 2003).
- 10.8 Activision, Inc. Second Amended and Restated 2002 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K, filed March 8, 2005).
- 10.9 Activision, Inc. 2002 Second Amended and Restated Employee Stock Purchase Plan for International Employees (incorporated by reference to Exhibit 10.2 of Activision's Form 8-K, filed March 8, 2005).
- 10.10 Activision, Inc. Amended and Restated 2003 Incentive Plan, effective as of July 26, 2005 (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2005).

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.11 Form of Stock Option Certificate for grants issued pursuant to the 1998 Incentive Plan of Activision, Inc. (adopted May 24, 2005) (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K, filed May 31, 2005).
- 10.12 Form of Stock Option Certificate for grants issued pursuant the 1999 Incentive Plan of Activision, Inc. (adopted May 24, 2005) (incorporated by reference to Exhibit 10.2 of Activision's Form 8-K, filed May 31, 2005).
- 10.13 Form of Stock Option Agreement for grants issued pursuant the 2001 Incentive Plan of Activision, Inc. (adopted May 24, 2005) (incorporated by reference to Exhibit 10.3 of Activision's Form 8-K, filed May 31, 2005).
- 10.14 Form of Stock Option Agreement for grants issued pursuant the 2002 Executive Incentive Plan of Activision, Inc. (adopted May 24, 2005) (incorporated by reference to Exhibit 10.4 of Activision's Form 8-K, filed May 31, 2005).
- 10.15 Form of Executive Stock Option Agreement for grants to Robert Kotick or Brian Kelly issued pursuant the 2003 Incentive Plan of Activision, Inc. (adopted May 2005) (incorporated by reference to Exhibit 10.40 of Activision's Form 10-K for the year ended March 31, 2005).
- 10.16 Form of Non-Executive Stock Option Agreement for grants to non-executives issued pursuant the 2003 Incentive Plan of Activision, Inc. (adopted May 2005) (incorporated by reference to Exhibit 10.41 of Activision's Form 10-K for the year ended March 31, 2005).
- 10.17 Form of Non-Employee Director Stock Option Agreement for grants to non-employee directors issued pursuant the 2003 Incentive Plan of Activision, Inc. (adopted May 2005).
- 10.18 Notice of Share Option Award for grants to persons other than non-employee directors issued pursuant to the 2003 Incentive Plan of Activision, Inc. (adopted June 13, 2007).
- 10.19 Notice of Share Option Award for grants to non-employee directors issued pursuant to the 2003 Incentive Plan of Activision, Inc. (adopted June 13, 2007).
- 10.20 Notice of Restricted Share Award for grants issued pursuant to the 2003 Incentive Plan of Activision, Inc. (adopted June 13, 2007).

- 10.21 Notice of Restricted Share Unit Award for grants issued pursuant to the 2003 Incentive Plan of Activision, Inc. (adopted June 13, 2007).
- 10.22 Amended and Restated Employment Agreement, dated May 22, 2000, between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended September 30, 2000).
- 10.23 Amendment, dated July 22, 2002, to Employment Agreement dated May 22, 2000 between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended September 30, 2002).
- 10.24 Amendment, dated December 29, 2006, to Employment Agreement dated May 22, 2000 between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K filed January 8, 2007).
- 10.25 Stock Option Agreement, dated May 22, 2000, between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ending September 30, 2000).
- 10.26 Amended and Restated Employment Agreement, dated May 22, 2000, between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ending September 30, 2000).
- 10.27 Amendment, dated July 22, 2002, to Employment Agreement dated May 22, 2000 between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended September 30, 2002).
- 10.28 Amendment, dated December 29, 2006, to Employment Agreement dated May 22, 2000 between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K filed January 8, 2007).
- 10.29 Employment Agreement, dated July 22, 2002, between Ronald Doornink and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.6 of Activision's Form 10-Q for the quarter ended June 30, 2002).
- 10.30 Amendment, dated February 27, 2003, to Employment Agreement dated July 22, 2002 between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.34 of Activision's Form 10-K for the year ended March 31, 2005).

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.31 Amendment, dated June 1, 2004, to Employment Agreement dated July 22, 2002, between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended June 30, 2004).
- 10.32 Amendment, dated June 15, 2005, to Employment Agreement dated July 22, 2002 between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended June 30, 2005).
- 10.33 Employment agreement, dated November 20, 2002, between Activision Publishing, Inc. and George Rose (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended December 31, 2002).
- 10.34 Amendment, dated March 30, 2005, to the Employment Agreement dated November 20, 2002 between Activision Publishing, Inc. and George Rose (incorporated by reference to Exhibit 10.51 of Activision's Form 10-K for the year ended March 31, 2005).
- 10.35 Employment Agreement, dated May 10, 2005, between Charles J. Huebner and Activision Publishing, Inc (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended December 31, 2005).
- 10.36 Amendment, dated March 30, 2007, to Employment Agreement dated May 10, 2005 between Charles J. Huebner and Activision Publishing, Inc.
- 10.37 Employment Agreement, dated June 15, 2005, between Michael Griffith and Activision Publishing, Inc (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended June 30, 2005).
- 10.38 Stock Option Agreement, dated June 15, 2005, between Michael Griffith and Activision, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended June 30, 2005).
- 10.39 Restricted Stock Agreement, dated June 15, 2005, between Michael Griffith and Activision, Inc. (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended June 30, 2005).
- 10.40 Employment Agreement, dated September 9, 2005, between Thomas Tippl and Activision Publishing, Inc (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended September 30, 2005).
- 10.41 Stock Option Agreement, dated October 3, 2005, between Thomas Tippl and Activision, Inc. (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended September 30, 2005).

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.42 Restricted Stock Agreement, dated October 3, 2005, between Thomas Tippl and Activision, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended September 30, 2005).
- 10.43 Employment Agreement, dated September 18, 2006, between Brian Hodous and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended December 31, 2006).
- 10.44 Letter Agreement, dated September 6, 2006, between Brian Hodous and Activision, Inc.
- 10.45 Stock Option Agreement, dated as of November 3, 2006, between Activision and Brian Hodous.
- 10.46 Restricted Stock Agreement, dated as of November 3, 2006, between Activision and Brian Hodous.
- 10.47 Restricted Stock Agreement, dated as of November 3, 2006, between Activision and Brian Hodous.
- 10.48 Employment Agreement, dated October 1, 2006, between Robin Kaminsky and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended December 31, 2006).
- 10.49 PlayStation 2 CD-ROM/DVD-ROM Licensed Publisher Agreement, dated as of April 1, 2000, between Sony Computer Entertainment America Inc. and Activision, Inc. (incorporated by reference to Exhibit 10.9 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
- 10.50 Letter regarding Modification of Territory for PlayStation 2 CD-ROM/DVD-ROM Licensed Publisher Agreement, dated as of June 11, 2004, from Sony Computer Entertainment America Inc. to Activision, Inc.
- 10.51 PlayStation 2 Licensed Publisher Agreement, dated as of March 23, 2001, between Sony Computer Entertainment Europe Limited and Activision UK Limited (incorporated by reference to Exhibit 10.10 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
- 10.52 PlayStation Portable (PSP) Licensed PSP Publisher Agreement, dated September 15, 2004, between Sony Computer Entertainment America Inc. and Activision, Inc. (incorporated by reference to Exhibit 10.46 of Activision's Form 10-K for the year ended March 31, 2005).*

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.53 PlayStation Portable (PSP) Licensed PSP Publisher Agreement, dated September 27, 2005, between Sony Computer Entertainment Europe Limited and Activision UK Limited (incorporated by reference to Exhibit 10.60 of Activision's Form 10-K for year ended March 31, 2006).*
- 10.54 Global PlayStation 3 Format Licensed Publisher Agreement, dated March 5, 2007, between Sony Computer Entertainment America, Inc. and Activision, Inc.*
- 10.55 First Renewal License Agreement for the Game Boy Advance Video Game System (EEA, Australia, and New Zealand), dated September 14, 2004, between Nintendo Co., Ltd. and Activision, Inc. (incorporated by reference to Exhibit 10.44 of Activision's Form 10-K for the year ended March 31, 2005).*
- 10.56 First Addendum to First Renewal License Agreement for the Game Boy Advance Video Game System (EEA, Australia and New Zealand), dated June 20, 2006, between Nintendo Co., Ltd. and Activision, Inc.
- 10.57 Confidential License Agreement for Nintendo GameCube (Western Hemisphere), dated as of November 9, 2001, between Nintendo of America Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.1 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
- 10.58 First Amendment to the Confidential License Agreement for Nintendo GameCube (Western Hemisphere), dated November 9, 2004, between Nintendo of America, Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.45 of Activision's Form 10-K for the year ended March 31, 2005).
- 10.59 First Renewal License Agreement for the Nintendo GameCube System (EEA), dated June 20, 2006, between Nintendo, Co., Ltd. and Activision, Inc.*
- 10.60 Confidential License Agreement for the Nintendo DS (Western Hemisphere), dated as of October 11, 2004, between Nintendo Co., Ltd. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.42 of Activision's Form 10-K for the year ended March 31, 2005).*
- 10.61 License Agreement for the Nintendo DS System (EEA, Australia and New Zealand), dated June 20, 2006, between Nintendo Co., Ltd. and Activision, Inc.*
- 10.62 Microsoft Corporation Xbox Publisher License Agreement, dated as of July 18, 2001, between Microsoft Corporation and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.5 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.63 Amendment to Microsoft Corporation Xbox Publisher License Agreement, dated as of April 19, 2002, between Microsoft Licensing, Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.6 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
- 10.64 Xbox Live Distribution Amendment to the Xbox Publisher Licensing Agreement, dated as of October 28, 2002, between Microsoft Licensing, Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.7 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
- 10.65 Amendment to the Xbox Publisher Licensing Agreement, dated as of March 1, 2005, between Microsoft Licensing, GP, and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.47 of Activision's Form 10-K for the year ended March 31, 2005).*
- 10.66 Microsoft Corporation Xbox 360 Publisher License Agreement, dated as of October 25, 2005, between Microsoft Licensing, GP and Activision Publishing, Inc (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended December 31, 2005).*
- 10.67 Xbox 360 Disc Program Addendum to the Xbox 360 Publisher License Agreement, dated as of December 15, 2005, between Microsoft Licensing, GP and Activision Publishing, Inc (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended December 31, 2005).*
- 10.68 Amendment to the Xbox 360 Publisher Licensing Agreement (Platinum/Classic Hits Program), dated as of October 1, 2006, by and between Microsoft Licensing, GP and Activision, Inc.*
- 10.69 Xbox Live Server Platform Addendum to the Xbox 360 Publisher Licensing Agreement, dated as of February 6, 2007, by and between Microsoft Licensing, GP and Activision Publishing, Inc.
- 10.70 Chart of Compensation to Non-Employee Directors (incorporated by reference to Exhibit 10.6 of Activision's Form 10-Q for the quarter ended December 31, 2005).
- 14.1 Code of Ethics for Senior Executive and Senior Financial Officers (incorporated by reference to Exhibit 14.1 of Activision's Form 10-K for the year ended March 31, 2004).
- 21.1 Principal subsidiaries of Activision.
- 23.1 Consent of Independent Registered Public Accounting Firm.

- 31.1 Certification of Robert A. Kotick pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Michael Griffith pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.3 Certification of Thomas Tippl pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted 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 Michael Griffith pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.3 Certification of Thomas Tippl pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*Portions omitted pursuant to a request for confidential treatment.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: June 14, 2007

ACTIVISION, INC.

By: */s/ Michael Griffith*
Michael Griffith
President and Chief Executive Officer,
Activision Publishing, Inc.
(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| | | |
|---------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------|---------------|
| By: <i>/s/ Robert A. Kotick</i> (Robert A. Kotick) | Chairman, Chief Executive Officer, Activision, Inc., and Director | June 14, 2007 |
| By: <i>/s/ Brian G. Kelly</i> (Brian G. Kelly) | Co-Chairman and Director | June 14, 2007 |
| By: <i>/s/ Michael Griffith</i> (Michael Griffith) | President and Chief Executive Officer of Activision Publishing, Inc. and Principal Executive Officer of Activision, Inc. | June 14, 2007 |
| By: <i>/s/ Thomas Tippl</i> (Thomas Tippl) | Chief Financial Officer of Activision Publishing, Inc. and Principal Financial and Accounting Officer of Activision, Inc. | June 14, 2007 |
| By: <i>/s/ Robert J. Corti</i> (Robert J. Corti) | Director | June 14, 2007 |
| By: <i>/s/ Ronald Doornink</i> (Ronald Doornink) | Director | June 14, 2007 |
| By: <i>/s/ Barbara S. Isgur</i> (Barbara S. Isgur) | Director | June 14, 2007 |
| By: <i>/s/ Robert J. Morgado</i> (Robert J. Morgado) | Director | June 14, 2007 |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

By: */s/ Peter J. Nolan*
(Peter J. Nolan)

Director

June 14, 2007

By: */s/ Richard Sarnoff*
(Richard Sarnoff)

Director

June 14, 2007

Report of Independent Registered Public Accounting Firm

Edgar Filing: ACTIVISION INC /NY - Form 10-K

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

We have completed integrated audits of Activision, Inc.'s consolidated financial statements and of its internal control over financial reporting as of March 31, 2007, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the index appearing under Item 8, present fairly, in all material respects, the financial position of Activision, Inc. and its subsidiaries at March 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements the Company changed the manner in which it accounts for share-based compensation in fiscal 2007.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of March 31, 2007 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A

Edgar Filing: ACTIVISION INC /NY - Form 10-K

company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable

F-1

assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

PricewaterhouseCoopers LLP

Los Angeles, California

June 14, 2007

F-2

Part II. Financial Information.

Item 8. Financial Statements.

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

(In thousands, except share data)

| | As of March 31, | | | |
|----------------------------------------------------------------------------------------------------------|-----------------|-----------|------|-----------|
| | 2007 | | 2006 | |
| Assets | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | \$ | 384,409 | \$ | 354,331 |
| Short-term investments | | 570,440 | | 590,629 |
| Accounts receivable, net of allowances of \$91,418 and \$98,253 at March 31, 2007 and 2006, respectively | | 148,694 | | 28,782 |
| Inventories | | 91,231 | | 61,483 |
| Software development | | 107,779 | | 40,260 |
| Intellectual property licenses | | 27,784 | | 4,973 |
| Deferred income taxes | | 51,564 | | 9,664 |
| Other current assets | | 19,332 | | 25,933 |
| Total current assets | | 1,401,233 | | 1,116,055 |
| Software development | | 23,143 | | 20,359 |
| Intellectual property licenses | | 72,490 | | 82,073 |
| Property and equipment, net | | 46,540 | | 45,368 |
| Deferred income taxes | | 48,791 | | 52,545 |
| Other assets | | 6,376 | | 1,409 |
| Goodwill | | 195,374 | | 100,446 |
| Total assets | \$ | 1,793,947 | \$ | 1,418,255 |
| Liabilities and Shareholders' Equity | | | | |
| Current liabilities: | | | | |
| Accounts payable | \$ | 136,517 | \$ | 88,994 |
| Accrued expenses | | 204,652 | | 104,862 |
| Total current liabilities | | 341,169 | | 193,856 |
| Other liabilities | | 41,246 | | 1,776 |
| Total liabilities | | 382,415 | | 195,632 |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

| | | | | |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----|-----------|----|-----------|
| | | | | |
| Commitments and contingencies (Note 13) | | | | |
| | | | | |
| Shareholders' equity: | | | | |
| Preferred stock, \$.000001 par value, 3,750,000 shares authorized, no shares issued at March 31, 2007 and 2006 | | | | |
| Series A Junior Preferred stock, \$.000001 par value, 1,250,000 shares authorized, no shares issued at March 31, 2007 and 2006 | | | | |
| Common stock, \$.000001 par value and 450,000,000 shares authorized, 283,310,734 and 277,020,898 shares issued and outstanding at March 31, 2007 and 2006, respectively | | | | |
| Additional paid-in capital | | 963,553 | | 867,297 |
| Retained earnings | | 427,777 | | 341,990 |
| Accumulated other comprehensive income | | 20,202 | | 16,369 |
| Unearned compensation | | | | (3,033) |
| | | | | |
| Total shareholders' equity | | 1,411,532 | | 1,222,623 |
| Total liabilities and shareholders' equity | \$ | 1,793,947 | \$ | 1,418,255 |

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

ACTIVISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

| | 2007 | For the fiscal years ended March 31, 2006 | 2005 |
|--------------------------------------------------------------|--------------|----------------------------------------------|--------------|
| Net revenues | \$ 1,513,012 | \$ 1,468,000 | \$ 1,405,857 |
| Costs and expenses: | | | |
| Cost of sales product costs | 799,587 | 734,874 | 658,949 |
| Cost of sales software royalties and amortization | 132,353 | 147,822 | 123,800 |
| Cost of sales intellectual property licenses | 46,125 | 57,666 | 62,197 |
| Product development | 133,073 | 132,651 | 87,776 |
| Sales and marketing | 196,213 | 283,395 | 230,299 |
| General and administrative | 132,514 | 96,366 | 63,228 |
| Total costs and expenses | 1,439,865 | 1,452,774 | 1,226,249 |
| Income from operations | 73,147 | 15,226 | 179,608 |
| Investment income, net | 36,678 | 30,630 | 13,092 |
| Income before income tax provision | 109,825 | 45,856 | 192,700 |
| Income tax provision | 24,038 | 5,605 | 57,643 |
| Net income | \$ 85,787 | \$ 40,251 | \$ 135,057 |
| Basic earnings per share | \$ 0.31 | \$ 0.15 | \$ 0.54 |
| Weighted average common shares outstanding | 281,114 | 273,177 | 250,023 |
| Diluted earnings per share | \$ 0.28 | \$ 0.14 | \$ 0.49 |
| Weighted average common shares outstanding assuming dilution | 305,339 | 294,002 | 277,712 |

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

ACTIVISION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the fiscal years ended March 31, 2007, 2006, and 2005

| (In thousands) | Common Stock Shares | Common Stock Amount | Additional Paid-In Capital | Retained Earnings | Treasury Stock Shares | Treasury Stock Amount | Accumulated Other Comprehensive Income (Loss) | Unearned Compensation | Shareholders' Equity |
|------------------------------------------------------------------------------|------------------------|------------------------|----------------------------------|----------------------|--------------------------|--------------------------|--------------------------------------------------------|--------------------------|-------------------------|
| Balance, March 31, 2004 | 296,669 | \$ | \$ 797,626 | \$ 166,682 | (52,525) | \$ (144,128) | \$ 9,961 | \$ | \$ 830,141 |
| Components of comprehensive income: | | | | | | | | | |
| Net income for the year | | | | 135,057 | | | | | 135,057 |
| Unrealized depreciation on short-term investments | | | | | | | (3,317) | | (3,317) |
| Foreign currency translation adjustment | | | | | | | 4,974 | | 4,974 |
| Total comprehensive income | | | | | | | | | 136,714 |
| Issuance of common stock to employees | 22,255 | | 68,192 | | | | | | 68,192 |
| Issuance of common stock pursuant to warrants and common stock warrants | 1,497 | | 4,462 | | | | | | 4,462 |
| Stock-based compensation | | | 3,368 | | | | | | 3,368 |
| Tax benefit attributable to employee stock options and common stock warrants | | | 53,206 | | | | | | 53,206 |
| Issuance of common stock to effect business combinations | 145 | | 1,191 | | | | | | 1,191 |
| Retirement of treasury shares | (52,525) | | (144,128) | | 52,525 | 144,128 | | | |
| Balance, March 31, 2005 | 268,041 | | 783,917 | 301,739 | | | 11,618 | | 1,097,274 |
| Components of comprehensive income: | | | | | | | | | |
| Net income for the year | | | | 40,251 | | | | | 40,251 |
| Unrealized appreciation on short-term investments | | | | | | | 10,576 | | 10,576 |
| Foreign currency translation adjustment | | | | | | | (5,825) | | (5,825) |
| Total comprehensive income | | | | | | | | | 45,002 |
| Issuance of common stock to employees | 8,782 | | 45,188 | | | | | | 45,188 |
| Stock-based compensation | | | 2,632 | | | | | | 2,632 |
| Restricted stock grant | | | 3,500 | | | | | (3,500) | |
| Cash distribution for fractional shares | (7) | | (100) | | | | | | (100) |
| Amortization of unearned compensation | | | | | | | | 467 | 467 |
| Tax benefit attributable to employee stock options | | | 29,367 | | | | | | 29,367 |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

| | | | | | | | | | |
|------------------------------------------------------------------------------|----------------|-----------|-------------------|-------------------|-----------|------------------|----------------|---------------------|--|
| and common stock warrants | | | | | | | | | |
| Issuance of common stock to effect business combinations | 205 | | 2,793 | | | | | 2,793 | |
| Balance, March 31, 2006 | 277,021 | | 867,297 | 341,990 | | 16,369 | (3,033) | 1,222,623 | |
| Components of comprehensive income: | | | | | | | | | |
| Net income for the year | | | | 85,787 | | | | 85,787 | |
| Unrealized depreciation, net of tax on short-term investments | | | | | | (8,224) | | (8,224) | |
| Foreign currency translation adjustment | | | | | | 12,057 | | 12,057 | |
| Total comprehensive income | | | | | | | | 89,620 | |
| Issuance of common stock to employees | 3,532 | | 18,956 | | | | | 18,956 | |
| Stock-based compensation | | | 32,077 | | | | | 32,077 | |
| Tax benefit attributable to employee stock options and common stock warrants | | | | 11,338 | | | | 11,338 | |
| Issuance of common stock to effect business combinations | 2,758 | | 36,918 | | | | | 36,918 | |
| Reclassification of unearned compensation | | | (3,033) | | | | 3,033 | | |
| Balance, March 31, 2007 | 283,311 | \$ | \$ 963,553 | \$ 427,777 | \$ | \$ 20,202 | \$ | \$ 1,411,532 | |

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

ACTIVISION, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

| | For the fiscal years ended March 31, | | | | | |
|----------------------------------------------------------------------------------------------------------|--------------------------------------|-----------|------|-----------|------|-----------|
| | 2007 | | 2006 | | 2005 | |
| Cash flows from operating activities: | | | | | | |
| Net income | \$ | 85,787 | \$ | 40,251 | \$ | 135,057 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | | | |
| Deferred income taxes | | (44,092) | | (28,453) | | (674) |
| Depreciation and amortization | | 30,155 | | 14,634 | | 10,702 |
| Realized gain on sale of short term investments | | (1,823) | | (4,297) | | (471) |
| Amortization and write-offs of capitalized software development costs and intellectual property licenses | | 91,456 | | 173,602 | | 134,799 |
| Amortization of stock compensation expenses | | 25,522 | | 3,099 | | 3,368 |
| Tax benefit of stock options and warrants exercised | | 11,338 | | 29,367 | | 53,206 |
| Excess tax benefit from stock option exercises | | (9,012) | | | | |
| Change in operating assets and liabilities (net of effects of acquisitions): | | | | | | |
| Accounts receivable, net | | (108,802) | | 80,405 | | (46,527) |
| Inventories | | (26,124) | | (13,465) | | (21,591) |
| Software development and intellectual property licenses | | (166,138) | | (193,927) | | (126,938) |
| Other assets | | 7,294 | | (2,038) | | 1,543 |
| Accounts payable | | 41,115 | | (19,985) | | 35,413 |
| Accrued expenses and other liabilities | | 90,486 | | 6,814 | | 37,422 |
| Net cash provided by operating activities | | 27,162 | | 86,007 | | 215,309 |
| Cash flows from investing activities: | | | | | | |
| Cash used in business acquisitions (net of cash acquired) | | (30,545) | | (6,890) | | (21,382) |
| Capital expenditures | | (17,935) | | (30,406) | | (14,941) |
| Increase in restricted cash | | | | (7,500) | | |
| Purchase of short-term investments | | (479,533) | | (242,568) | | (868,723) |
| Proceeds from sales and maturities of short-term investments | | 492,771 | | 201,568 | | 761,150 |
| Net cash used in investing activities | | (35,242) | | (85,796) | | (143,896) |
| Cash flows from financing activities: | | | | | | |
| Proceeds from issuance of common stock to employees and common stock pursuant to warrants | | 18,956 | | 45,088 | | 72,654 |
| Excess tax benefit from stock option exercises | | 9,012 | | | | |
| Net cash provided by financing activities | | 27,968 | | 45,088 | | 72,654 |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

| | | | | | | | |
|--------------------------------------------------|----|---------|----|---------|----|---------|--|
| Effect of exchange rate changes on cash | | 10,190 | | (4,576) | | 4,421 | |
| | | | | | | | |
| Net increase in cash and cash equivalents | | 30,078 | | 40,723 | | 148,488 | |
| | | | | | | | |
| Cash and cash equivalents at beginning of period | | 354,331 | | 313,608 | | 165,120 | |
| | | | | | | | |
| Cash and cash equivalents at end of period | \$ | 384,409 | \$ | 354,331 | \$ | 313,608 | |

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

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

For the year ended March 31, 2007

1. Summary of Significant Accounting Policies

Business

Activision, Inc. (Activision, the Company, or we) is a leading international publisher of interactive entertainment software and peripheral products. We have built a company with a diverse portfolio of products that spans a wide range of categories and target markets and that is used on a variety of game hardware platforms and operating systems. We have created, licensed, and acquired a group of highly recognizable brands, which we market to a variety of consumer demographics. Our products cover diverse game categories including action/adventure, action sports, racing, role-playing, simulation, first-person action, music-based gaming and strategy. Our target customer base ranges from casual players to game enthusiasts, children to adults, and mass-market consumers to value buyers. We currently offer our products primarily in versions that operate on the Sony PlayStation 2 (PS2), Sony PlayStation 3 (PS3), Nintendo Wii (Wii), and Microsoft Xbox 360 (Xbox360) console systems, Nintendo Game Boy Advance (GBA), Sony PlayStation Portable (PSP), and Nintendo Dual Screen (NDS) hand-held devices, and the personal computer (PC). In prior years, we have also offered our products on the Sony PlayStation (PS1), Microsoft Xbox (Xbox), Nintendo GameCube (NGC), and Nintendo 64 (N64) console systems, and the Nintendo Game Boy Color (GBC) hand-held device.

Our publishing business involves the development, marketing, and sale of products directly, by license, or through our affiliate label program with certain third-party publishers. Our distribution business consists of operations in Europe that provide logistical and sales services to third-party publishers of interactive entertainment software, our own publishing operations, and manufacturers of interactive entertainment hardware.

We maintain operations in the United States, Canada, the United Kingdom (UK), Germany, France, Italy, Spain, Japan, Australia, Sweden, South Korea, and the Netherlands. In fiscal year 2007, international operations contributed approximately 50% of consolidated net revenues.

Principles of Consolidation

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

Cash, Cash Equivalents, and Short-term Investments

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

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

Restricted Cash Compensating Balances

As of March 31, 2007 and 2006, we maintained a \$7.5 million irrevocable standby letter of credit. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. Under the terms of this arrangement, we are required to maintain on deposit with the bank a compensating balance, restricted as to use, of not less than the sum of the available amount of the letter of credit plus the aggregate amount of any drawings under the letter of credit that have been honored thereunder but not reimbursed. At March 31, 2007 and 2006, the \$7.5 million deposit is included in short-term investments as restricted cash.

Concentration of Credit Risk

Financial instruments which potentially subject us to concentration of credit risk consist principally of temporary cash investments and accounts receivable. We place our temporary cash investments with financial institutions. At various times during the fiscal years ended March 31, 2007, 2006, and 2005, we had deposits in excess of the Federal Deposit Insurance Corporation (FDIC) limit at these financial institutions.

Our customer base includes retail outlets and distributors, including mass-market retailers, consumer electronics stores, discount warehouses, and game specialty stores in the United States and countries worldwide. We perform ongoing credit evaluations of our customers and maintain allowances for potential credit losses. We generally do not require collateral or other security from our customers. We had two customers, Wal-Mart and GameStop, that accounted for 22% and 8% of consolidated net revenues for the fiscal year ended March 31, 2007 and 26% and 6% of consolidated gross accounts receivable at March 31, 2007. These customers were customers of both our publishing and distribution businesses. We had two customers, Wal-Mart and Gamestop, that accounted for 22% and 10% of consolidated net revenues for the year ended March 31, 2006 and 43% and 4% of consolidated gross accounts receivable at March 31, 2006. For the fiscal year ended March 31, 2005, our largest customer, Wal-Mart, accounted for 23% of consolidated net revenues.

Financial Instruments

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

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

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

We utilize forward contracts in order to reduce financial market risks. These instruments are used to hedge foreign currency exposures of underlying assets or liabilities. Our accounting policies for these instruments are based on whether they meet the criteria for designation as hedging transactions. Changes in fair value of derivatives that are designated as cash flow hedges, are highly effective, and qualify as hedging instruments, are recorded in other comprehensive income until the underlying hedged item is recognized in earnings within the financial statement line item consistent with the hedged item. Any ineffective portion of a derivative change in fair value is immediately recognized in earnings. Changes in fair value of derivatives that do not qualify as hedging instruments are recorded in earnings. The fair value of foreign currency contracts is estimated based on the spot rate of the various hedged currencies as of the end of the period. As of March 31, 2007, accrued expenses included approximately \$90,000 of pre-tax unrealized losses for the estimated fair value of outstanding foreign currency exchange forward contracts, which was recorded in earnings as the contracts did not qualify as hedging instruments. As of March 31, 2006, we had no outstanding foreign exchange forward contracts.

Equity Investments

From time to time, we may make a capital investment and hold a minority interest in a third-party developer in connection with entertainment software products to be developed by such developer for us. We account for those capital investments over which we have the ability to exercise significant influence using the equity method. For

F-8

those investments over which we do not have the ability to exercise significant influence, we account for our investment using the cost method.

Software Development Costs and Intellectual Property Licenses

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

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

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

Significant management judgments and estimates are utilized in the assessment of when technological feasibility is established, as well as in the ongoing assessment of the recoverability of capitalized costs. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional costs to be incurred. If revised forecasted or actual product sales are less than, and/or revised forecasted or actual costs are greater than, the original forecasted amounts utilized in the initial recoverability analysis, the net realizable value may be lower than originally estimated in any given quarter, which could result in an impairment charge.

Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks, copyrights, software, technology, music 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.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

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 costs to be incurred. If revised forecasted or actual product sales are less than, and/or revised forecasted or actual costs are greater than, the original forecasted amounts utilized in the initial recoverability analysis, the net realizable value may be lower than originally estimated in any given quarter, which could result in an impairment charge. Additionally, as noted above, as many of our intellectual property licenses extend for multiple products over multiple years, we also assess the recoverability of capitalized intellectual property license costs based on certain qualitative factors such as the success of other products and/or entertainment vehicles utilizing the intellectual property, whether there are any future planned theatrical releases or television series based on the intellectual property and the rights holder's continued promotion and exploitation of the intellectual property. Material differences may result in the amount and timing of charges for any period if management makes different judgments or utilizes different estimates in evaluating these qualitative factors.

Inventories

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

Property and Equipment

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

Goodwill

We account for goodwill using the provisions of SFAS No. 142, Goodwill and Other Intangibles. SFAS No. 142 addresses financial accounting and reporting requirements for acquired goodwill and other intangible assets. Under SFAS No. 142, goodwill is deemed to have an indefinite useful life and should not be amortized but rather tested at least annually for impairment. An impairment loss should be recognized if the carrying amount of goodwill is not recoverable and its carrying amount exceeds its fair value. Our impairment tests as of March 31, 2007, 2006, and 2005 did not indicate that goodwill was impaired. In accordance with SFAS No. 142, we have not amortized goodwill during the fiscal years ended March 31, 2007, 2006, and 2005.

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 (i.e., a date on which products are made widely available by retailers). For these products we recognize revenue no earlier than the street date. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection. With respect to license agreements that provide customers the right to make multiple copies in exchange for guaranteed amounts, revenue is recognized upon delivery of such copies. Per copy royalties on sales that exceed the guarantee are recognized as earned. With respect to on-line transactions, such as electronic downloads of titles or product add-ons, revenue is recognized when the fee is paid by the on-line customer to purchase online content and we are notified by the

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

Allowances for Returns, Price Protection, Doubtful Accounts, and Inventory Obsolescence

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

We may permit product returns from, or grant price protection to, our customers under certain conditions. In general, price protection refers to the circumstances when we elect to decrease the wholesale price of a product by a certain amount and, when granted and applicable, allows customers a credit against amounts owed by such customers to us with respect to open and/or future invoices. The conditions our customers must meet to be granted the right to return products or price protection are, among other things, compliance with applicable payment terms, and consistent delivery to us of inventory and sell-through reports. We may also consider other factors, including the facilitation of slow-moving inventory and other market factors. Management must make estimates of potential future product returns and price protection related to current period product revenue. We estimate the amount of future returns and price protection for current period product revenue utilizing historical experience and information regarding inventory levels and the demand and acceptance of our products by the end consumer. The following factors are used to estimate the amount of future returns and price protection for a particular title: historical performance of titles in similar genres; historical performance of the hardware platform; historical performance of the brand; console hardware life cycle; Activision sales force and retail customer feedback; industry pricing; weeks of on-hand retail channel inventory; absolute quantity of on-hand retail channel inventory; our warehouse on-hand inventory levels; the title's recent sell-through history (if available); marketing trade programs; and competing titles. The relative importance of these factors varies among titles depending upon, among other items, genre, platform, seasonality, and sales strategy. Significant management judgments and estimates must be made and used in connection with establishing the allowance for returns and price protection in any accounting period. Based upon historical experience we believe our estimates are reasonable. However, actual returns and price protection could vary materially from our allowance estimates due to a number of reasons including, among others, a lack of consumer acceptance of a title, the release in the same period of a similarly themed title by a competitor, or technological obsolescence due to the emergence of new hardware platforms. Material differences may result in the amount and timing of our revenue for any period if factors or market conditions change or if management makes different judgments or utilizes different estimates in determining the allowances for returns and price protection. For example, a 1% change in our March 31, 2007 allowance for returns and price protection would impact net revenues by \$0.9 million.

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

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

F-11

our products. Significant changes in demand for our products would impact management's estimates in establishing our inventory provision.

Shipping and Handling

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

Advertising Expenses

We expense advertising as incurred, except for production costs associated with media advertising which are deferred and charged to expense the first time the related ad is run. Advertising expenses for the fiscal years ended March 31, 2007, 2006, and 2005 were approximately \$98.4 million, \$192.6 million, and \$150.7 million, respectively, and are included in sales and marketing expense in the Consolidated Statements of Operations.

Investment Income, Net

Edgar Filing: ACTIVISION INC /NY - Form 10-K

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

| | For the fiscal years ended March 31, | | | | | |
|----------------------------------|--------------------------------------|--------|------|--------|------|--------|
| | 2007 | | 2006 | | 2005 | |
| Interest income | \$ | 34,952 | \$ | 26,595 | \$ | 12,898 |
| Interest expense | | (97) | | (262) | | (277) |
| Net realized gain on investments | | 1,823 | | 4,297 | | 471 |
| | | | | | | |
| Investment income, net | \$ | 36,678 | \$ | 30,630 | \$ | 13,092 |

Income Taxes

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

Foreign Currency Translation

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

Comprehensive Income

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

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities or the disclosure of gain or loss contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Earnings Per Common Share

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

Stock-Based Compensation

On April 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options and employee stock purchases related to the Employee Stock Purchase Plan (employee stock purchases), based on estimated fair values. SFAS 123R supersedes our previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123R. We have applied the provisions of SAB 107 in our adoption of SFAS 123R.

We adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of April 1, 2006, the first day of our fiscal year 2007. The Company's Consolidated Financial Statements as of and for the fiscal year ended March 31, 2007 reflect the impact of SFAS 123R. In accordance with the modified prospective transition method, the Company's Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R. See Note 14 for additional information.

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 123(R)-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards (FSP 123R-3). We have elected not to adopt the alternative transition method provided in the FSP 123R-3 for calculating the tax effects of stock-based compensation pursuant to SFAS 123R. We followed paragraph 81 of SFAS No. 123R to calculate the initial pool (APIC pool) of excess tax benefits and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123R.

SFAS 123R requires companies to estimate the fair value of share-based payment awards on the measurement date using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Consolidated Statement of Operations. Stock-based compensation expense recognized under SFAS 123R for the fiscal year ended March 31, 2007 was \$25.5 million. Prior to the adoption of SFAS 123R, the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS 123). Under APB 25, compensation expense was 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 was recorded on the measurement date only if the current market price of the underlying stock exceeded the stock option or other stock-based award's exercise price. For the fiscal years ended March 31, 2006 and 2005, we recognized \$3.1 million and \$3.4

million, respectively, in stock-based compensation expense related to employee stock options and restricted stock, under APB 25. See Note 14 for additional information.

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in our Consolidated Statements of Operations for the fiscal year ended March 31, 2007 includes compensation expense for share-based payment awards granted prior to, but not yet vested as of, April 1, 2006 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123, and compensation expense for the share-based payment awards granted subsequent to April 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. As stock-based compensation expense recognized in the Consolidated Statements of Operations for the fiscal year ended March 31, 2007 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

As of April 1, 2005, we changed our method of valuation for share-based awards to a binomial-lattice model from the Black-Scholes option-pricing model (Black-Scholes model) which was used for options granted prior to April 1, 2005 for FAS 123 fair value disclosures. For additional information, see Note 14. Our determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to our expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

2. Stock Splits

In February 2005, the Board of Directors approved a four-for-three split of our outstanding common shares effected in the form of a 33-1/3% stock dividend. The split was paid March 22, 2005 to shareholders of record as of March 7, 2005. In September 2005, the Board of Directors approved a four-for-three split of our outstanding common shares effected in the form of a 33-1/3% stock dividend. The split was paid October 24, 2005 to shareholders of record as of October 10, 2005. The par value of our common stock was maintained at the pre-split amount of \$.000001. The Consolidated Financial Statements and Notes thereto, including all share and per share data, have been restated as if the stock splits had occurred as of the earliest period presented.

On March 7, 2005, in connection with our March 22, 2005 stock split, all shares of common stock held as treasury stock were formally cancelled and restored to the status of authorized but unissued shares of common stock.

3. Acquisitions

During the three years ended March 31, 2007, we separately completed the acquisition of four privately held interactive software development companies. We accounted for these acquisitions in accordance with SFAS No. 141, Business Combinations. SFAS No. 141 addresses financial accounting and reporting for business combinations, requiring that the purchase method be used to account and report for all business combinations. These acquisitions have further enabled us to implement our multi-platform development strategy by bolstering our internal product development capabilities for console systems and personal computers and strengthening our position in the first-person action, action/adventure, music-based gaming and action sports game categories. A significant portion of the purchase price for all of these acquisitions was assigned to goodwill as the primary asset we acquired in each of the transactions was an assembled workforce with proven technical and design talent with a history of high quality product creation. Pro forma Consolidated Statements of Operations for these acquisitions, are not

shown, as they would not differ materially from reported results.

RedOctane, Inc.

On June 6, 2006, we completed our acquisition of 100% of RedOctane, Inc. (RedOctane) for an aggregate accounting purchase price of \$99.9 million, including transaction costs, consisting of \$30.9 million in cash and 2,382,077 shares of Activision common stock valued at approximately \$30.0 million based upon prevailing market prices which was issued on the closing date, and \$39.0 million payable in Activision common stock

within two years of the closing date, which is recorded in other liabilities. In addition, in the event the net income of the business over a certain period of time exceeds specified target levels by certain amounts, certain former shareholders of RedOctane will be entitled to an additional amount of up to \$51.0 million payable in shares of Activision common stock. The contingent consideration will be recorded as an additional element of the purchase price if those contingencies are achieved. Based in Sunnyvale, California, RedOctane is a publisher, developer, and distributor of interactive entertainment software, hardware and accessories. RedOctane offers its interactive entertainment products in versions that operate on the PS2, Xbox 360, and PC, and its leading software product offering is *Guitar Hero*. RedOctane also designs, manufactures, and markets high quality video game peripherals and accessories. This acquisition provides Activision with an early leadership position in music-based gaming, which we expect will be one of the fastest growing genres in the coming years.

The results of operations of RedOctane and the estimated fair market values of the acquired assets and liabilities have been included in the Consolidated Financial Statements since the date of acquisition. Pro forma Consolidated Statements of Operations for this acquisition are not shown, as they would not differ materially from reported results. The acquired, finite-lived intangible assets are being amortized over estimated lives ranging from 0.6 to 1.6 years. Goodwill has been included in the publishing segment of our business and is non-deductible for tax purposes.

Purchase Price Allocation

The purchase price for the RedOctane transaction was allocated to assets acquired and liabilities assumed as set forth below (in thousands):

| | | |
|---------------------------------|----|----------|
| Current assets | \$ | 17,530 |
| Property and equipment, net | | 207 |
| Other assets | | 1,033 |
| Goodwill | | 87,004 |
| Trademark and other intangibles | | 16,700 |
| Deferred tax liability | | (6,496) |
| Other liabilities | | (16,033) |
| Total consideration | \$ | 99,945 |

Purchased Intangible Assets

The following table presents details of the purchased finite-lived intangible assets acquired in the RedOctane acquisition (in thousands):

| | Estimated Useful Life (in years) | Amount |
|---------------------------------|-------------------------------------------|----------|
| Finite-lived intangibles: | | |
| Trademark | 1.3 | \$ 1,000 |
| Development-related intangibles | 0.6-1.6 | 15,700 |

| | | |
|--------------------------------|----|--------|
| Total finite-lived intangibles | \$ | 16,700 |
|--------------------------------|----|--------|

F-15

Edgar Filing: ACTIVISION INC /NY - Form 10-K

The following tables present details of our total purchased finite-lived intangible assets which are included in other current assets as of March 31, 2007 (in thousands):

| | Gross | Accumulated Amortization | Net |
|-------------------|-----------|-----------------------------|----------|
| Trademark | \$ 1,000 | \$ 660 | \$ 340 |
| Other intangibles | 15,700 | 11,042 | 4,658 |
| Total | \$ 16,700 | \$ 11,702 | \$ 4,998 |

The estimated future amortization expense of purchased, finite-lived intangible assets as of March 31, 2007 is as follows (in thousands):

| Fiscal year ending March 31, | Amount |
|------------------------------|----------|
| 2008 | \$ 4,998 |
| 2009 | |
| 2010 | |
| 2011 | |
| Thereafter | |
| Total | \$ 4,998 |

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

The following table summarizes our cash, cash equivalents and short-term investments as of March 31, 2007 (amounts in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|----------------------------|-------------------|------------------------------|-------------------------------|---------------|
| Cash and cash equivalents: | | | | |
| Cash and time deposits | \$ 187,594 | \$ | \$ | \$ 187,594 |
| Commercial paper | 86,776 | | (34) | 86,742 |
| Money market instruments | 106,986 | | | 106,986 |
| Corporate bonds | 3,087 | | | 3,087 |
| Cash and cash equivalents | 384,443 | | (34) | 384,409 |
| Short-term investments: | | | | |
| U.S. agency issues | 191,840 | 8 | (1,011) | 190,837 |
| Corporate bonds | 103,006 | 39 | (148) | 102,897 |
| Mortgage-backed securities | 33,142 | | (199) | 32,943 |
| Taxable auction rate notes | 114,698 | | | 114,698 |
| Asset-backed securities | 7,754 | 2 | (7) | 7,749 |
| Commercial paper | 92,018 | | (67) | 91,951 |
| Certificate of deposit | 21,866 | 2 | (3) | 21,865 |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

| | | | | | | | |
|---------------------------------------------------|----|---------|----|----|----|---------|------------|
| Restricted cash | | 7,500 | | | | | 7,500 |
| | | | | | | | |
| Short-term investments | | 571,824 | | 51 | | (1,435) | 570,440 |
| | | | | | | | |
| Cash, cash equivalents and short-term investments | \$ | 956,267 | \$ | 51 | \$ | (1,469) | \$ 954,849 |

F-16

Edgar Filing: ACTIVISION INC /NY - Form 10-K

The following table summarizes our cash, cash equivalents, and short-term investments as of March 31, 2006 (amounts in thousands):

| | Amortized Cost | | Gross Unrealized Gains | | Gross Unrealized Losses | | Fair Value | |
|---------------------------------------------------|-------------------|---------|------------------------------|--------|-------------------------------|---------|---------------|---------|
| Cash and cash equivalents: | | | | | | | | |
| Cash and time deposits | \$ | 162,403 | \$ | | \$ | | \$ | 162,403 |
| Commercial paper | | 141,086 | | 4 | | (155) | | 140,935 |
| Money market instruments | | 37,560 | | | | | | 37,560 |
| U.S. agency issues | | 13,436 | | | | (3) | | 13,433 |
| | | | | | | | | |
| Cash and cash equivalents | | 354,485 | | 4 | | (158) | | 354,331 |
| | | | | | | | | |
| Short-term investments: | | | | | | | | |
| U.S. agency issues | | 259,055 | | | | (3,444) | | 255,611 |
| Corporate bonds | | 171,207 | | 1 | | (1,376) | | 169,832 |
| Mortgage-backed securities | | 55,139 | | | | (459) | | 54,680 |
| Common stock | | 47,868 | | 12,880 | | | | 60,748 |
| Asset-backed securities | | 16,866 | | | | (47) | | 16,819 |
| Commercial paper | | 15,016 | | | | (26) | | 14,990 |
| Certificate of deposit | | 10,468 | | | | (19) | | 10,449 |
| Restricted cash | | 7,500 | | | | | | 7,500 |
| | | | | | | | | |
| Short-term investments | | 583,119 | | 12,881 | | (5,371) | | 590,629 |
| | | | | | | | | |
| Cash, cash equivalents and short-term investments | \$ | 937,604 | \$ | 12,885 | \$ | (5,529) | \$ | 944,960 |

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

The following table summarizes the final maturities of our investments in securities as of March 31, 2007 (amounts in thousands):

| | Amortized Cost | | Fair Value | |
|-----------------------------------------|-------------------|---------|---------------|---------|
| Due after one year or less | \$ | 378,929 | \$ | 378,105 |
| Due after one year through two years | | 83,333 | | 83,251 |
| Due after two years through three years | | 14,465 | | 14,158 |
| | | 476,727 | | 475,514 |
| | | | | |
| Auction rate notes | | 114,698 | | 114,698 |
| Certificate of deposit | | 21,866 | | 21,865 |
| Asset/mortgage backed securities | | 40,896 | | 40,692 |
| | | | | |
| Total investments in securities | \$ | 654,187 | \$ | 652,769 |

For the years ended March 31, 2007, 2006, and 2005 net realized gains on investments consisted of \$1.8 million, \$4.3 million, and \$471,000 of gross realized gains, respectively, and no gross realized losses.

F-17

In accordance with EITF 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, the fair value of investments in an unrealized loss position for which an other-than-temporary impairment has not been recognized was \$496.2 million and \$672.4 million at March 31, 2007 and 2006, respectively, with related gross unrealized losses of \$1.5 million and \$5.5 million, respectively. At March 31, 2007, the gross unrealized losses were comprised mostly of unrealized losses on U.S. agency issues, corporate bonds, and mortgage-backed securities with \$1.1 million of unrealized loss being in a continuous unrealized loss position for twelve months or greater. At March 31, 2006, the gross unrealized losses were comprised mostly of unrealized losses on U.S. agency issues, corporate bonds, and mortgage-backed securities with \$3.9 million of unrealized loss being in a continuous unrealized loss position for twelve months or greater.

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

5. Software Development Costs and Intellectual Property Licenses

As of March 31, 2007, capitalized software development costs included \$94.3 million of internally developed software costs and \$36.6 million of payments made to third-party software developers. As of March 31, 2006, capitalized software development costs included \$45.0 million of internally developed software costs and \$15.6 million of payments made to third-party software developers. Capitalized intellectual property licenses were \$100.3 million and \$87.0 million as of March 31, 2007 and 2006, respectively. Amortization and write-offs of capitalized software development costs and intellectual property licenses, including capitalized stock-based compensation expense, was \$94.0 million, \$173.6 million, and \$134.8 million for the years ended March 31, 2007, 2006, and 2005, respectively.

6. Inventories

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

| | As of March 31, | | | |
|--------------------------------|-----------------|--------|------|--------|
| | 2007 | | 2006 | |
| Finished goods | \$ | 89,048 | \$ | 58,876 |
| Purchased parts and components | | 2,183 | | 2,607 |
| | \$ | 91,231 | \$ | 61,483 |

For the year ended March 31, 2006, we had write downs of inventory costs for certain titles in the amount of \$14.5 million.

7. Property and Equipment, Net

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

| | As of March 31, | |
|--------------------------------------|-----------------|-----------|
| | 2007 | 2006 |
| Land | \$ 612 | \$ 557 |
| Buildings | 4,915 | 4,463 |
| Leasehold improvements | 19,816 | 18,904 |
| Computer equipment | 61,382 | 50,795 |
| Office furniture and other equipment | 19,879 | 18,480 |
| Total cost of property and equipment | 106,604 | 93,199 |
| Less accumulated depreciation | (60,064) | (47,831) |
| Property and equipment, net | \$ 46,540 | \$ 45,368 |

Depreciation expense for the years ended March 31, 2007, 2006, and 2005 was \$17.8 million, \$14.2 million, and \$10.6 million, respectively.

8. Goodwill

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

| | Publishing | Distribution | Total |
|---------------------------------------------|------------|--------------|------------|
| Balance as of March 31, 2005 | \$ 85,899 | \$ 5,762 | \$ 91,661 |
| Goodwill acquired during the year | 6,459 | | 6,459 |
| Issuance of contingent consideration | 2,793 | | 2,793 |
| Adjustment-prior period purchase allocation | (260) | | (260) |
| Effect of foreign currency exchange rates | 203 | (410) | (207) |
| Balance as of March 31, 2006 | 95,094 | 5,352 | 100,446 |
| Goodwill acquired during the year | 87,257 | | 87,257 |
| Issuance of contingent consideration | 6,918 | | 6,918 |
| Adjustment-prior period purchase allocation | 51 | | 51 |
| Effect of foreign currency exchange rates | 22 | 680 | 702 |
| Balance as of March 31, 2007 | \$ 189,342 | \$ 6,032 | \$ 195,374 |

9. Accrued Expenses

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

| | As of March 31, | |
|--------------------------------------|-----------------|------------|
| | 2007 | 2006 |
| Accrued royalties payable | \$ 21,583 | \$ 8,961 |
| Accrued selling and marketing costs | 23,909 | 24,637 |
| Affiliate label program payable | 1,846 | 1,121 |
| Income tax payable | 55,530 | 2,253 |
| Accrued payroll related costs | 63,249 | 33,434 |
| Accrued customer payments | 2,088 | 5,077 |
| Accrued professional and legal costs | 9,494 | 11,568 |
| Other | 26,953 | 17,811 |
| Total accrued expenses | \$ 204,652 | \$ 104,862 |

10. Operations by Reportable Segments and Geographic Area

We operate two business segments: (i) publishing of interactive entertainment software and peripherals and (ii) distribution of interactive entertainment software and hardware products.

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

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

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

The accounting policies of these segments are the same as those described in the Summary of Significant Accounting Policies. Transactions between segments are eliminated in consolidation.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Information on the reportable segments for the three years ended March 31, 2007 is as follows (amounts in thousands):

| | For the year ended March 31, 2007 | | |
|-------------------------------------|------------------------------------------|---------------------|--------------|
| | Publishing | Distribution | Total |
| Total segment revenues | \$ 1,119,038 | \$ 393,974 | \$ 1,513,012 |
| Revenue from sales between segments | (80,726) | 80,726 | |
| Revenues from external customers | \$ 1,038,312 | \$ 474,700 | \$ 1,513,012 |
| Operating income | \$ 64,076 | \$ 9,071 | \$ 73,147 |
| Total assets | \$ 1,618,195 | \$ 175,752 | \$ 1,793,947 |

| | For the year ended March 31, 2006 | | |
|-------------------------------------|------------------------------------------|---------------------|--------------|
| | Publishing | Distribution | Total |
| Total segment revenues | \$ 1,154,663 | \$ 313,337 | \$ 1,468,000 |
| Revenue from sales between segments | (131,631) | 131,631 | |
| Revenues from external customers | \$ 1,023,032 | \$ 444,968 | \$ 1,468,000 |
| Operating income (loss) | \$ (6,715) | \$ 21,941 | \$ 15,226 |
| Total assets | \$ 1,293,014 | \$ 125,241 | \$ 1,418,255 |

| | For the year ended March 31, 2005 | | |
|-------------------------------------|------------------------------------------|---------------------|--------------|
| | Publishing | Distribution | Total |
| Total segment revenues | \$ 1,072,729 | \$ 333,128 | \$ 1,405,857 |
| Revenue from sales between segments | (111,676) | 111,676 | |
| Revenues from external customers | \$ 961,053 | \$ 444,804 | \$ 1,405,857 |
| Operating income | \$ 155,863 | \$ 23,745 | \$ 179,608 |
| Total assets | \$ 1,173,866 | \$ 132,053 | \$ 1,305,919 |

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

| | For the years ended March 31, | | |
|---------------|-------------------------------|--------------|--------------|
| | 2007 | 2006 | 2005 |
| North America | \$ 753,376 | \$ 710,040 | \$ 696,325 |
| Europe | 718,973 | 717,494 | 675,074 |
| Other | 40,663 | 40,466 | 34,458 |
| Total | \$ 1,513,012 | \$ 1,468,000 | \$ 1,405,857 |

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

| | For the years ended March 31, | | |
|-----------|-------------------------------|--------------|--------------|
| | 2007 | 2006 | 2005 |
| Console | \$ 1,125,457 | \$ 1,008,758 | \$ 970,399 |
| Hand-held | 275,650 | 235,834 | 161,977 |
| PC | 111,905 | 223,408 | 273,481 |
| Total | \$ 1,513,012 | \$ 1,468,000 | \$ 1,405,857 |

A significant portion of our revenues is derived from products based on a relatively small number of popular brands each year. In fiscal 2007, 39% of our consolidated net revenues (52% of worldwide publishing net revenues) was derived from three brands, which accounted for 17%, 13%, and 9% of consolidated net revenues (23%, 18%, and 11% of worldwide publishing net revenues). In fiscal 2006, 30% of our consolidated net revenues (38% of worldwide publishing net revenues) was derived from three brands, which accounted for 14%, 8%, and 8% of consolidated net revenues (18%, 10%, and 10% of worldwide publishing net revenues). In fiscal 2005, 37% of our consolidated net revenues (48% of worldwide publishing net revenues) was derived from three brands, which accounted for 16%, 11%, and 10% of consolidated net revenues (21%, 14%, and 13% of worldwide publishing net revenues).

11. Computation of Earnings Per Share

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

| | For the years ended March 31, | | |
|------------------------------------------------------------------------------------------------------------------|-------------------------------|-----------|------------|
| | 2007 | 2006 | 2005 |
| Numerator: | | | |
| Numerator for basic and diluted earnings per share - income available to common shareholders | \$ 85,787 | \$ 40,251 | \$ 135,057 |
| Denominator: | | | |
| Denominator for basic earnings per share - weighted average common shares outstanding | 281,114 | 273,177 | 250,023 |
| Effect of dilutive securities: | | | |
| Employee stock options and stock purchase plan | 23,611 | 20,232 | 26,398 |
| Warrants to purchase common stock | 614 | 593 | 1,291 |
| Potential dilutive common shares | 24,225 | 20,825 | 27,689 |
| Denominator for diluted earnings per share - weighted average common shares outstanding plus assumed conversions | 305,339 | 294,002 | 277,712 |
| Basic earnings per share | \$ 0.31 | \$ 0.15 | \$ 0.54 |
| Diluted earnings per share | \$ 0.28 | \$ 0.14 | \$ 0.49 |

Options to purchase approximately 7.9 million, 993,000, and 243,000 shares of common stock for the years ended March 31, 2007, 2006, and 2005, respectively, were not included in the calculation of diluted earnings per share because their effect would be antidilutive.

12. Income Taxes

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

| | For the years ended March 31, | | |
|-----------------------------------------------------------|-------------------------------|-----------|------------|
| | 2007 | 2006 | 2005 |
| Income (loss) before income taxes: | | | |
| Domestic | \$ 99,210 | \$ 52,321 | \$ 169,572 |
| Foreign | 10,615 | (6,465) | 23,128 |
| | \$ 109,825 | \$ 45,856 | \$ 192,700 |
| Income tax expense (benefit): | | | |
| Current: | | | |
| Federal | \$ 34,342 | \$ | \$ (355) |
| State | 15,325 | 308 | 342 |
| Foreign | 3,842 | 4,383 | 5,126 |
| Total current | 53,509 | 4,691 | 5,113 |
| Deferred: | | | |
| Federal | (17,074) | (11,095) | 4,346 |
| State | (19,608) | (7,266) | (2,863) |
| Foreign | (4,127) | (10,092) | (2,159) |
| Total deferred | (40,809) | (28,453) | (676) |
| Add back benefit credited to additional paid-in capital: | | | |
| Tax benefit related to stock option and warrant exercises | 11,338 | 29,367 | 53,206 |
| Income tax provision | \$ 24,038 | \$ 5,605 | \$ 57,643 |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

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

| | For the years ended March 31, | | |
|------------------------------------------------|-------------------------------|--------|-------|
| | 2007 | 2006 | 2005 |
| Federal income tax provision at statutory rate | 35.0% | 35.0% | 35.0% |
| State taxes, net of federal benefit | 4.1 | 4.3 | 2.8 |
| Research and development credits | (8.5) | (36.2) | (6.6) |
| Decremental effect of foreign tax rates | (3.6) | (10.5) | (2.4) |
| Increase (decrease) in valuation allowance | (26.6) | 18.0 | 3.2 |
| Increase (decrease) in tax reserves | 18.8 | (2.2) | (0.9) |
| Other | 2.7 | 3.8 | (1.2) |
| | 21.9% | 12.2% | 29.9% |

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

| | As of March 31, | |
|----------------------------------|-----------------|-----------|
| | 2007 | 2006 |
| Deferred asset: | | |
| Allowance for doubtful accounts | \$ 369 | \$ 739 |
| Allowance for sales returns | 14,094 | 16,200 |
| Inventory reserve | 1,507 | 2,474 |
| Vacation and bonus reserve | 5,996 | 4,993 |
| Amortization and depreciation | 1,566 | 3,970 |
| Tax credit carryforwards | 89,014 | 74,488 |
| Net operating loss carryforwards | 29,822 | 13,770 |
| Stock-based compensation | 11,879 | 3,272 |
| Other | 8,958 | 6,209 |
| Deferred asset | 163,205 | 126,115 |
| Valuation allowance | (382) | (35,555) |
| Net deferred asset | 162,823 | 90,560 |
| Deferred liability: | | |
| Capitalized development expenses | 50,159 | 22,537 |
| State taxes | 12,309 | 5,814 |
| Deferred liability | 62,468 | 28,351 |
| Net deferred asset | \$ 100,355 | \$ 62,209 |

The tax benefits associated with certain net operating loss carryforwards relate to employee stock options. For the year ended March 31, 2006, pursuant to SFAS No. 109, deferred tax assets for net operating losses did not include \$30.9 million relating to these items which will be credited to additional paid-in capital when realized. For the year ended March 31, 2007, \$30.9 million relating to these items was realized and included in deferred tax assets for net operating losses; however, a reserve was established for this amount, as well as a reserve of \$20.6 million for tax credits and foreign taxes. These reserves were established because the tax positions are subject to certain assumptions of the relevant legislative and judicial history that may or may not be accepted by the tax authorities.

As of March 31, 2007, our available federal net operating loss carryforward of approximately \$34.9 million is subject to certain limitations as defined under Section 382 of the Internal Revenue Code. The net operating loss carryforwards expire between 2022 and 2026. We have various state net operating loss carryforwards totaling \$17.6 million which are not subject to limitations under Section 382 of the Internal Revenue Code. We have tax credit carryforwards of \$52.5 million and \$36.5 million for federal and state purposes, respectively, which begin to expire in fiscal year 2008.

At March 31, 2007, our deferred income tax asset for tax credit carryforwards and net operating loss carryforwards was reduced by a valuation allowance of \$0.4 million, as compared to \$35.6 million in the prior fiscal year. In management's judgment, based on the utilization of domestic net operating loss carryforwards in the current fiscal year, it was determined to be more likely than not that the tax credit carryforwards would ultimately be utilized, and consequently, the valuation allowance relating to tax credit carryforwards was reversed.

Realization of the deferred tax assets is dependent upon the continued generation of sufficient taxable income prior to expiration of tax credits and loss carryforwards. Although realization is not assured, management believes it is more likely than not that the net carrying value of the deferred tax asset will be realized.

Cumulative undistributed earnings of foreign subsidiaries for which no deferred taxes have been provided approximated \$97.5 million at March 31, 2007. Deferred income taxes on these earnings have not been provided as these amounts are considered to be permanent in duration.

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

13. **Commitments and Contingencies**

Credit Facilities

We have revolving credit facilities with our Centresoft subsidiary located in the UK (the UK Facility) and our NBG subsidiary located in Germany (the German Facility). The UK Facility provided Centresoft with the ability to borrow up to Great British Pounds (GBP) 12.0 million (\$23.6 million) and GBP 12.0 million (\$21.0 million, including issuing letters of credit, on a revolving basis as of March 31, 2007 and 2006, respectively. Furthermore, under the UK Facility, Centresoft provided a GBP 0.6 million (\$1.2 million) and a GBP 0.6 million (\$1.0 million) guarantee for the benefit of our CD Contact subsidiary as of March 31, 2007 and 2006, respectively. The UK Facility bore interest at LIBOR plus 2.0% as of March 31, 2007 and 2006, is collateralized by substantially all of the assets of the subsidiary and expires in January 2008. The UK Facility also contains various covenants that require the subsidiary to maintain specified financial ratios related to, among others, fixed charges. As of March 31, 2007 and 2006, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of March 31, 2007 or 2006. The German Facility provided for revolving loans up to EUR 0.5 million (\$0.7 million) as of March 31, 2007 and EUR 0.5 million (\$0.6 million) as of March 31, 2006, bore interest at a Eurocurrency rate plus 2.5%, is collateralized by certain of the subsidiary's property and equipment and has no expiration date. No borrowings were outstanding against the German Facility as of March 31, 2007 or 2006.

As of March 31, 2007 and 2006, we maintained a \$7.5 million irrevocable standby letter of credit. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. Under the terms of this arrangement, we are required to maintain on deposit with the bank a compensating balance, restricted as to use, of not less than the sum of the available amount of the letter of credit plus the aggregate amount of any drawings under the letter of credit that have been honored thereunder but not reimbursed. At March 31, 2007 and 2006, the \$7.5 million deposit is included in short-term investments as restricted cash. No borrowings were outstanding as of March 31, 2007 or 2006.

As of March 31, 2007, our publishing subsidiary located in the UK maintained a EUR 4.0 million (\$5.3 million) irrevocable standby letter of credit. As of March 31, 2006, our publishing subsidiary located in the UK maintained a EUR 2.5 million (\$3.0 million) irrevocable standby letter of credit. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. The standby letter of credit does not require a compensating balance and is collateralized by substantially all of the assets of the subsidiary and expires in August 2007. No borrowings were outstanding as of March 31, 2007 or 2006.

Commitments

In the normal course of business, we enter into contractual arrangements with third parties for non-cancelable operating lease agreements for our offices, for the development of products, as well as for the rights to intellectual property. Under these agreements, we commit to provide specified payments to a lessor, developer, or intellectual property holder, based upon contractual arrangements. Typically, the payments to third-party developers are conditioned upon the achievement by the developers of contractually specified development milestones. These payments to third-party developers and intellectual property holders typically are deemed to be advances and are recoupable against future royalties earned by the developer or intellectual property holder based on the sale of the related game. Additionally, in connection with certain intellectual property right acquisitions and development agreements, we will commit to spend specified amounts for marketing support for the related game(s) which is to be developed or in which the intellectual property will be utilized.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Additionally, we lease certain of our facilities and equipment under non-cancelable operating lease agreements. Assuming all contractual provisions are met, the total future minimum commitments for these and other contractual arrangements in place as of March 31, 2007, are scheduled to be paid as follows (amounts in thousands):

| | Contractual Obligations | | | |
|------------------------------|--------------------------------|---------------------|-----------|------------|
| | Facility & Equipment Leases | Developer and IP | Marketing | Total |
| Fiscal year ending March 31, | | | | |
| 2008 | \$ 14,213 | \$ 67,836 | \$ 40,254 | \$ 122,303 |
| 2009 | 13,131 | 31,579 | 30,679 | 75,389 |
| 2010 | 12,070 | 29,936 | 100 | 42,106 |
| 2011 | 9,854 | 30,586 | 13,100 | 53,540 |
| 2012 | 5,543 | 16,586 | | 22,129 |
| Thereafter | 17,783 | 47,586 | | 65,369 |
| Total | \$ 72,594 | \$ 224,109 | \$ 84,133 | \$ 380,836 |

Facilities rent expense for the years ended March 31, 2007, 2006, and 2005 was approximately \$14.8 million, \$14.2 million, and \$10.6 million, respectively.

Compensation Guarantee

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

Legal Proceedings

In July 2006, individuals and/or entities claiming to be stockholders of the Company have filed derivative lawsuits, purportedly on behalf of the Company, against certain current and former members of the Company's Board of Directors as well as several current and former officers of the Company. Three derivative actions have been filed in Los Angeles Superior Court: Vazquez v. Kotick, et al., L.A.S.C. Case No. BC355327 (filed July 12, 2006); Greuer v. Kotick, et al., L.A.S.C. Case No. SC090343 (filed July 12, 2006); and Amalgamated Bank v. Baker, et al., L.A.S.C. Case No. BC356454 (filed August 3, 2006). These actions have been consolidated by the court under the caption In re Activision Shareholder Derivative Litigation, L.A.S.C. Master File No. SC090343 (West, J.). Two derivative actions have been filed in the United States District Court for the Central District of California: Pfeiffer v. Kotick, et al., C.D. Cal. Case No. CV06-4771 MRP (JTLx) (filed July 31, 2006); and Hamian v. Kotick, et al., C.D. Cal. Case No. CV06-5375 MRP (JLTx) (filed August 25, 2006). These actions have also been consolidated, under the caption In re Activision, Inc. Shareholder Derivative Litigation, C.D. Cal. Case No. CV06-4771 MRP (JTLx) (Pfaelzer, J.). The consolidated complaints allege, among other things, purported improprieties in the Company's issuance of stock options. Plaintiffs seek various relief on behalf of the Company, including damages, restitution of benefits obtained from the alleged misconduct, equitable relief, including an accounting and rescission of option contracts; and various corporate governance reforms. The Company expects that defense expenses

Edgar Filing: ACTIVISION INC /NY - Form 10-K

associated with the matters will be covered by its directors and officers insurance, subject to the terms and conditions of the applicable policies.
On May

F-28

24, 2007, the Superior Court granted the Company's motion to stay the state action. The court's order stays the action pending the resolution of motions to dismiss in the federal action, but is without prejudice to any party's right to seek modification of the stay upon a showing of good cause, including a showing that matters may be addressed in the Superior Court without the potential for conflict with or duplication of the federal court proceedings. The Company filed motions to dismiss in the federal action on June 1, 2007, which will be fully briefed by August 15, 2007. The Company was also informed that, on June 1, 2007, a derivative case, *Abdelnur vs. Kotick et al.*, was filed in the United States District Court for the Central District of California, C.D. Case No. CV07-3575 AHM (PJWx), by the same law firm that previously filed the Hamian case, alleging substantially the same claims.

On July 27, 2006, the Company received a letter of informal inquiry from the SEC requesting certain documents and information relating to the Company's historical stock option grant practices. In early June 2007, the SEC informed the Company that the SEC has issued a formal order of non-public investigation, which allows the SEC, among other things, to subpoena witnesses and require the production of documents. The Company is cooperating with the SEC's investigation, and representatives of the special subcommittee of independent members of our Board of Directors established in July 2006 to review our historical stock option granting practices (the Special Subcommittee) and its legal counsel have met with members of the staff of the SEC on several occasions, in person and by telephone (as has the Company's outside legal counsel), to discuss the progress of the Special Subcommittee's investigation and on February 28, 2007 to brief the SEC staff on the Special Subcommittee's findings and recommendations following the substantial completion of the Special Subcommittee's investigation. A representative of the U.S. Department of Justice has attended certain of these meetings and requested copies of certain documents that we have provided to the staff of the SEC. At this time, the Company has not received any grand jury subpoenas or written requests from the Department of Justice.

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, employment relationships, and collection matters. In the opinion of management, after consultation with legal counsel, the outcome of such routine claims and lawsuits will not have a material adverse effect on our business, financial condition, results of operations, or liquidity.

14. Stock-Based Compensation and Employee Benefit Plans

We have a stock-based compensation program that provides our Board of Directors broad discretion in creating employee equity incentives. This program includes incentive and non-statutory stock options and restricted stock awards granted under various plans, the majority of which are stockholder approved. Stock options are generally time-based, vesting on each annual anniversary of the grant date over periods of three to five years and expire ten years from the grant date, with some options containing performance clauses which would accelerate the vesting into earlier annual periods. Additionally, we have an Employee Stock Purchase Plan (ESPP) that allows employees to purchase shares of common stock at 85% of the fair market value at either the date of enrollment or the date of purchase, whichever is lower. Shares issued as a result of stock option exercises and our ESPP are generally issued as new stock issuances. As of March 31, 2007, we had approximately 11.2 million shares of common stock reserved for future issuance under our stock option plans and ESPP.

Stock Incentive Plans

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

On February 28, 1992, the shareholders of Activision approved the Activision 1991 Stock Option and Stock Award Plan, as amended, (the 1991 Plan) which permits the granting of Awards in the form of non-qualified stock options, incentive stock options (ISOs), stock appreciation rights (SARs), restricted stock awards, deferred stock awards, and other common stock-based awards to directors, officers, employees, consultants, and

Edgar Filing: ACTIVISION INC /NY - Form 10-K

others. The total number of shares of common stock available for distribution under the 1991 Plan is 45,400,000. The 1991 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were no shares remaining available for grant under the 1991 Plan as of March 31, 2007.

F-29

On September 23, 1998, the shareholders of Activision approved the Activision 1998 Incentive Plan, as amended (the 1998 Plan). The 1998 Plan permits the granting of Awards in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred stock awards, and other common stock-based awards to directors, officers, employees, consultants, and others. The total number of shares of common stock available for distribution under the 1998 Plan is 18,000,000. The 1998 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 56,300 shares remaining available for grant under the 1998 Plan as of March 31, 2007.

On April 26, 1999, the Board of Directors approved the Activision 1999 Incentive Plan, as amended (the 1999 Plan). The 1999 Plan permits the granting of Awards in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred share awards, and other common stock-based awards to directors, officers, employees, consultants, and others. The total number of shares of common stock available for distribution under the 1999 Plan is 30,000,000. The 1999 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 84,500 shares remaining available for grant under the 1999 Plan as of March 31, 2007.

On August 23, 2001, the shareholders of Activision approved the Activision 2001 Incentive Plan, as amended (the 2001 Plan). The 2001 Plan permits the granting of Awards in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred stock awards, and other common stock-based awards to directors, officers, employees, consultants, and others. The total number of shares of common stock available for distribution under the 2001 Plan is 9,000,000. The 2001 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 158,300 shares remaining available for grant under the 2001 Plan as of March 31, 2007.

On April 4, 2002, the Board of Directors approved the Activision 2002 Incentive Plan (the 2002 Plan). The 2002 Plan permits the granting of Awards in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred share awards, and other common stock-based awards to officers (other than executive officers), employees, consultants, advisors, and others. The 2002 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. The total number of shares of common stock available for distribution under the 2002 Plan is 17,400,000. There were approximately 167,600 shares remaining available for grant under the 2002 Plan as of March 31, 2007.

On September 19, 2002, the shareholders of Activision approved the Activision 2002 Executive Incentive Plan (the 2002 Executive Plan). The 2002 Executive Plan permits the granting of Awards in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred share awards, and other common stock-based awards to officers, employees, directors, consultants, and advisors. The total number of shares of common stock available for distribution under the 2002 Executive Plan is 10,000,000. The 2002 Executive Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 488,700 shares remaining available for grant under the 2002 Executive Plan as of March 31, 2007.

On December 16, 2002, the Board of Directors approved the Activision 2002 Studio Employee Retention Incentive Plan, as amended (the 2002 Studio Plan). The 2002 Studio Plan permits the granting of Awards in the form of non-qualified stock options and restricted stock awards to key studio employees (other than executive officers) of Activision, its subsidiaries and affiliates, and to contractors and others. The 2002 Studio Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. The total number of shares of common stock available for distribution under the 2002 Studio Plan is 6,000,000. There were approximately 4,200 shares remaining available for grant under the 2002 Studio Plan as of March 31, 2007.

On April 29, 2003, our Board of Directors approved the Activision 2003 Incentive Plan (the 2003 Plan). On September 15, 2005, the shareholders of Activision approved the 2003 Plan. The 2003 Plan permits the granting of Awards in the form of non-qualified stock options, SARs, restricted stock awards, deferred stock awards, and other common stock-based awards to directors, officers, employees, consultants, and others. The 2003 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. The total number of shares of common stock available for distribution under the 2003 Plan is 24,000,000. There were approximately 8,915,300 shares

remaining available for grant under the 2003 Plan as of March 31, 2007.

F-30

Under the terms of the plans, the exercise price for Awards issued under the 1991 Plan, 1998 Plan, 1999 Plan, 2001 Plan, 2002 Plan, 2002 Executive Plan, 2002 Studio Plan, and 2003 Plan (collectively, the Plans) is determined at the discretion of the Board of Directors (or the Compensation Committee of the Board of Directors, which administers the Plans), and under the terms of the plans, the exercise price for ISOs is not to be less than the fair market value of our common stock at the date of grant, and in the case of non-qualified options, the exercise price must exceed or be equal to 85% of the fair market value of our common stock at the date of grant. Options typically become exercisable in installments over a period of three to five years and must be exercised within 10 years of the date of grant. We have recently determined that certain Awards issued in certain past periods were issued with exercise prices below the fair market value of our common stock on the dates that we have determined to be the correct grant and measurement dates for those Awards.

Other Employee Stock Options

In connection with prior employment agreements between Activision and Robert A. Kotick, Activision's Chairman and Chief Executive Officer, and Brian G. Kelly, Activision's Co-Chairman, Mr. Kotick and Mr. Kelly were granted options to purchase common stock. The Board of Directors approved the granting of these options. Relating to such grants, as of March 31, 2007, approximately 8,304,800 options were outstanding with a weighted average exercise price of \$1.74.

We additionally have approximately 9,500 options outstanding to employees as of March 31, 2007, with a weighted average exercise price of \$3.48. The Board of Directors approved the granting of these options. Such options have terms similar to those options granted under the Plans.

Employee Stock Purchase Plan

On April 11, 2005, the Board of Directors approved the 2002 Employee Stock Purchase Plan and on February 11, 2003 the Board approved the 2002 Employee Stock Purchase Plan for International Employees (together, the 2002 Employee Stock Purchase Plan). Under the 2002 Employee Stock Purchase Plan, up to an aggregate of 4,000,000 shares of our common stock may be purchased by eligible employees during two six-month offering periods that commence each April 1 and October 1 (the Offering Period). Common stock is purchased by the Amended 2002 Purchase Plans participants at a price per share generally equal to 85% of the lower of the fair market value of the common stock on the first day of the Offering Period and the fair market value of the common stock on the purchase date (the last day of the Offering Period). Employees may purchase shares having a value not exceeding 15% of their gross compensation during an Offering Period and are limited to a maximum of \$10,000 in value for any two purchases within the same calendar year. On June 13, 2007, the most recent purchase date, employees purchased 228,337 shares of our common stock at a purchase price of \$12.8350 per share.

Non-Employee Warrants

In prior years, we have granted stock warrants to third parties in connection with the development of software and the acquisition of licensing rights for intellectual property. The warrants generally vest upon grant and are exercisable over the term of the warrant. The exercise price of third-party warrants is generally greater than or equal to their fair market value of our common stock at the date of grant. No third-party warrants were granted during the years ended March 31, 2007, 2006, and 2005. As of March 31, 2007 and 2006, third-party warrants to purchase 936,000 shares of common stock were outstanding with a weighted average exercise price of \$4.54 per share.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

In accordance with EITF 96-18, we measure the fair value of the securities on the measurement date. The fair value of each warrant is capitalized and amortized to expense when the related product is released and the related revenue is recognized. Additionally, as more fully described in Note 1, the recoverability of capitalized software development costs and intellectual property licenses is evaluated on a quarterly basis with amounts determined as not recoverable being charged to expense. In connection with the evaluation of capitalized software development costs and intellectual property licenses, any capitalized amounts for related third-party warrants are additionally reviewed for recoverability with amounts determined as not recoverable being amortized to expense. As of March 31, 2006, capitalized amounts of third-party warrants had been fully amortized and there was no amortization related to third-party warrants for the fiscal year ended March 31, 2007. For the fiscal years ended March 31, 2006 and 2005, \$0.5 and \$1.6 million, respectively was amortized and included in cost of sales - software royalties and amortization and/or cost of sales - intellectual property licenses.

Employee Retirement Plan

We have a retirement plan covering substantially all of our eligible employees. The retirement plan is qualified in accordance with Section 401(k) of the Internal Revenue Code. Under the plan, employees may defer up to the lesser of 92% of their pre-tax salary and the maximum amount allowed by law. We contribute an amount equal to 20% of each dollar contributed by a participant. Our matching contributions to the plan were approximately \$1.5 million, \$1.3 million, and \$905,000 for the years ended March 31, 2007, 2006, and 2005, respectively.

Restricted Stock

In June 2005, we issued the rights to 155,763 shares of restricted stock to an employee. Additionally, in October 2005 we issued the rights to 96,712 shares of restricted stock to an employee. These shares all vest over a five-year period and remain subject to forfeiture if vesting conditions are not met. In accordance with APB 25, we recognized unearned compensation in connection with the grant of restricted shares equal to the fair value of our common stock on the date of grant. The fair value of these shares when issued was approximately \$12.84 and \$15.51 per share, respectively, and resulted in a total increase in Additional paid-in capital and Unearned compensation of \$2.0 million and \$1.5 million on the respective balance sheets at the times of grant. Prior to the adoption of SFAS 123R, we reduced unearned compensation and recognized compensation expense over the vesting periods. Upon adoption of SFAS 123R, unearned compensation was reclassified against additional paid in capital and we will increase additional paid in capital and recognize compensation expense over the respective remaining vesting periods. Additionally, in the third quarter of fiscal 2007 we issued the rights to an aggregate of 81,000 shares of restricted stock to various employees. These shares vest over two and three year periods (with some subject to vesting acceleration clauses if the holder achieves certain performance objectives) and remain subject to forfeiture if vesting conditions are not met. In accordance with SFAS 123R we will recognize compensation expense and increase additional paid in capital related to these restricted stock shares over the requisite service period. For the year ended March 31, 2007, we recorded expenses related to these shares of approximately \$981,000, which was included as a component of stock-based compensation expense within General and administrative on the accompanying Consolidated Statements of Operations. Since the issuance dates, we have recognized \$1.4 million of the \$4.8 million total fair value, with the remainder to be recognized over a weighted-average period of 2.88 years.

On April 1, 2006, we adopted the provisions of SFAS 123R, requiring us to recognize expense related to the fair value of our stock-based compensation awards. We elected to use the modified prospective transition method as permitted by SFAS 123R and therefore have not restated our financial results for prior periods. Under this transition method, stock-based compensation expense for the year ended March 31, 2007 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of April 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. Stock-based compensation expense for all stock-based compensation awards granted subsequent to April 1, 2006 was based on the grant-date fair value, estimated in accordance with the provisions of SFAS 123R.

The effect of adopting SFAS 123R in the year ended March 31, 2007 was as follows:

| | For the year ended March 31, 2007 | |
|-------------------------------------------------|--------------------------------------|---------|
| (in thousands except per share data) | | |
| Additional pre-tax stock-based compensation | \$ | 21,436 |
| Additional stock-based compensation, net of tax | | 13,055 |
| Cash flows from operations | | (9,012) |
| Cash flows from financing activities | | 9,012 |
| Effect on earnings per share: | | |
| Basic | \$ | (0.05) |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Diluted \$ (0.04)

The following table sets forth the total stock-based compensation expense resulting from stock options, restricted stock awards, and the ESPP included in our Consolidated Statements of Operations (in thousands) in accordance with SFAS 123R for the fiscal year ended March 31, 2007, and APB 25 for the fiscal years ended March 31, 2006 and 2005:

| | | 2007 | For the year ended March 31, 2006 | 2005 |
|-----------------------------------------------------------|----|---------|--------------------------------------|----------------|
| Cost of sales - software royalties and amortization | \$ | 2,503 | \$ | \$ |
| Product development | | 5,728 | 869 | 1,233 |
| Sales and marketing | | 5,267 | 175 | 241 |
| General and administrative | | 12,024 | 2,055 | 1,894 |
| Stock-based compensation expense before income taxes | | 25,522 | 3,099 | 3,368 |
| Income tax benefit | | (9,979) | (1,208) | (1,310) |
| Total stock-based compensation expense after income taxes | \$ | 15,543 | \$ | 1,891 \$ 2,058 |

F-32

Additionally, stock option expenses are capitalized in accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* as discussed in Note 1. For the year ended March 31, 2007, stock-based compensation costs in the amount of \$9.1 million were capitalized and \$2.5 million of capitalized stock-based compensation costs were amortized. The following table summarizes stock based compensation included in our Consolidated Balance Sheets as a component of software development (in thousands):

| | Software Development |
|--------------------------------------------------------------|---------------------------------|
| Balance, March 31, 2006 | \$ |
| Stock-based compensation expense capitalized during period | 9,069 |
| Amortization of capitalized stock-based compensation expense | (2,503) |
| Balance, March 31, 2007 | \$ 6,566 |

Net cash proceeds from the exercise of stock options were \$19.0 million, \$45.1 million, and \$72.7 million for the years ended March 31, 2007, 2006, and 2005, respectively. Income tax benefit from stock option exercises was \$11.3 million, \$29.4 million, and \$53.2 million for the years ended March 31, 2007, 2006, and 2005, respectively. In accordance with SFAS 123R, we present excess tax benefits from the exercise of stock options, if any, as financing cash flows rather than operating cash flows.

Prior to the adoption of SFAS 123R, we applied SFAS 123, amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS 148), which allowed companies to apply the existing accounting rules under APB 25 and related Interpretations. According to APB 25, a non-cash stock-based compensation expense is recognized for any options granted where the exercise price is lower than the market price on the actual date of grant. This expense is then amortized over the vesting period of the associated option. As required by SFAS 148, prior to the adoption of SFAS 123R, we provided pro forma net income and pro forma net income per common share disclosures for stock-based awards, as if the fair-value-based method defined in SFAS 123 had been applied.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

The following table illustrates the effect on net income after tax and net earnings per common share as if we had applied the fair value recognition provisions of SFAS 123 to stock-based compensation during the years ended March 31, 2006 and 2005 (in thousands, except per share amounts):

| | For the years ended March 31, | |
|---------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------|-------------|
| | 2006 | 2005 |
| Net income, as reported | \$ 40,251 | \$ 135,057 |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects | 1,589 | 2,313 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (16,175) | (14,233) |
| Pro forma net income | \$ 25,665 | \$ 123,137 |
| Earnings per share | | |
| Basic - as reported | \$ 0.15 | \$ 0.54 |
| Basic - pro forma | \$ 0.09 | \$ 0.49 |
| Diluted - as reported | \$ 0.14 | \$ 0.49 |
| Diluted - pro forma | \$ 0.09 | \$ 0.44 |

In the table above, stock-based compensation has been tax effected using our effective tax rate which differs from our statutory rate. Additionally, included in fiscal year 2006 net income, as reported, is \$467,000 of amortization of unearned compensation related to restricted stock.

As of April 1, 2005, the Company began estimating the value of employee stock options on the date of grant using a binomial-lattice model. Prior to April 1, 2005 the value of each employee stock option was estimated on the date of grant using the Black-Scholes model for the purpose of the pro forma financial information in accordance with SFAS 123.

Our employee stock options have features that differentiate them from exchange-traded options. These features include lack of transferability, early exercise, vesting restrictions, pre- and post-vesting termination provisions, blackout dates, and time-varying inputs. In addition, some of the options have non-traditional features, such as accelerated vesting upon the satisfaction of certain performance conditions that must be reflected in the valuation. A binomial-lattice model was selected because it is better able to explicitly address these features than closed-form models such as the Black-Scholes model, and is able to reflect expected future changes in model inputs, including changes in volatility, during the option's contractual term.

Consistent with SFAS 123R, we have attempted to reflect expected future changes in model inputs during the option's contractual term. The inputs required by our binomial-lattice model include expected volatility, risk-free interest rate, risk-adjusted stock return, dividend yield, contractual term, and vesting schedule, as well as measures of employees' forfeiture, exercise, and post-vesting termination behavior. Statistical methods were used to estimate employee type specific termination rates. These termination rates, in turn, were used to model the number of options that are expected to vest and post-vesting termination behavior. Employee type specific estimates of Expected Time-To-Exercise (ETTE) were used to reflect employee exercise behavior. ETTE was estimated by using statistical procedures to first estimate the conditional probability of exercise occurring during each time period, conditional on the option surviving to that time period. These probabilities are then used to estimate ETTE. The model was calibrated by adjusting parameters controlling exercise and post-vesting termination behavior so that the measures output by the model matched values of these measures that were estimated from historical data. The weighted-average estimated value of employee stock options granted during the years ended March 31, 2007, 2006, and 2005 was \$5.86, \$5.09, and \$3.06 per share, respectively,

using the binomial-lattice model with the following weighted-average assumptions:

F-34

| | Employee and Director Options and Warrants For the year ended March 31, | | | Employee Stock Purchase Plan For the year ended March 31, | | |
|-------------------------------------------|-------------------------------------------------------------------------------|---------|---------|-----------------------------------------------------------------|---------|---------|
| | 2007 | 2006 | 2005 | 2007 | 2006 | 2005 |
| Expected life (in years) | 4.87 | 4.85 | 3.20 | 0.5 | 0.5 | 0.5 |
| Risk free interest rate | 4.99% | 5.17% | 3.25% | 4.71% | 3.05% | 2.66% |
| Volatility | 54% | 48% | 48% | 43% | 42% | 46% |
| Dividend yield | | | | | | |
| Weighted-average fair value at grant date | \$ 5.86 | \$ 5.09 | \$ 3.06 | \$ 3.72 | \$ 3.11 | \$ 1.59 |

To estimate volatility for the binomial-lattice model, we use methods or capabilities that are discussed in SFAS 123R and SAB 107. These methods included the implied volatility method based upon the volatilities for exchange-traded options on our stock to estimate short-term volatility, the historical method (annualized standard deviation of the instantaneous returns on Activision's stock) during the option's contractual term to estimate long-term volatility and a statistical model to estimate the transition or mean reversion from short-term volatility to long-term volatility. Based on these methods, for options granted during the year ended March 31, 2007, the expected stock price volatility ranged from 38% to 56%, with a weighted-average volatility of 54%. For options granted during the year ended March 31, 2006, the expected stock price volatility ranged from 40% to 55%, with a weighted average volatility of 48%. For options granted during the year ended March 31, 2005, the expected stock price volatility ranged from 45% to 48%, with a weighted average volatility of 48%.

As is the case for volatility, the risk-free rate is assumed to change during the option's contractual term. Consistent with the calculation required by a binomial lattice model, the risk-free rate reflects the interest from one time period to the next (forward rate) as opposed to the interest rate from the grant date to the given time period (spot rate). Since we do not currently pay dividends and are not expected to pay them in the future, we have assumed that the dividend yield is zero.

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is, as required by SFAS 123R, an output by the binomial-lattice model. The expected life of employee stock options depends on all of the underlying assumptions and calibration of our model. A binomial-lattice model can be viewed as assuming that employees will exercise their options when the stock price equals or exceeds an exercise boundary. The exercise boundary is not constant but continually declines as one approaches the option's expiration date. The exact placement of the exercise boundary depends on all of the model inputs as well as the measures that are used to calibrate the model to estimated measures of employees' exercise and termination behavior.

As stock-based compensation expense recognized in the Consolidated Statement of Operations for the year ended March 31, 2007 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

Accuracy of Fair Value Estimates

The Company uses third-party analyses to assist in developing the assumptions used in the binomial-lattice model, including model inputs and measures of employees' exercise and post-vesting termination behavior. However, we are ultimately responsible for the assumptions used to estimate the fair value of our share-based payment awards.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

Our ability to accurately estimate the fair value of share-based payment awards as of the grant date depends upon the accuracy of the model and our ability to accurately forecast model inputs as long as ten years into the future. These inputs include, but are not limited to, expected stock price volatility, risk-free rate, dividend yield, and employee termination rates. Although the fair value of employee stock options is determined in accordance with SFAS 123R and SAB 107 using an option-pricing model, the estimates that are produced by this model may not

F-35

Edgar Filing: ACTIVISION INC /NY - Form 10-K

be indicative of the fair value observed between a willing buyer/willing seller. Unfortunately, it is difficult to determine if this is the case, because markets do not currently exist that permit the active trading of employee stock option and other share-based instruments.

Stock option activity for the years ended March 31, 2007, 2006, and 2005 is as follows (in thousands, except per share amounts):

| | 2007 | | 2006 | | 2005 | |
|----------------------------------|---------|------------------|---------|------------------|----------|------------------|
| | Shares | Wtd Avg Ex Price | Shares | Wtd Avg Ex Price | Shares | Wtd Avg Ex Price |
| Outstanding at beginning of year | 48,337 | \$ 6.20 | 48,772 | \$ 4.84 | 65,135 | \$ 3.71 |
| Granted | 6,361 | 13.91 | 8,728 | 12.66 | 7,501 | 8.82 |
| Exercised | (3,352) | 5.03 | (8,108) | 4.81 | (22,167) | 2.90 |
| Forfeited | (1,917) | 8.61 | (1,055) | 7.35 | (1,697) | 4.47 |
| Outstanding at end of year | 49,429 | \$ 7.18 | 48,337 | \$ 6.20 | 48,772 | \$ 4.84 |
| Exercisable at end of year | 31,291 | \$ 4.60 | 27,126 | \$ 4.17 | 25,180 | \$ 3.92 |

The following table shows the weighted-average remaining contractual term and aggregate intrinsic value for options outstanding and options exercisable at March 31, 2007 (amounts in thousands):

| | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value |
|-------------------------------|---------------------------------------------|---------------------------|
| Outstanding at March 31, 2007 | 5.97 | \$ 581,459 |
| Exercisable at March 31, 2007 | 4.69 | \$ 448,621 |

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (i.e., the difference between our closing stock price on the last trading day of the period and the exercise price, times the number of shares for options where the exercise price is below the closing stock price) that would have been received by the option holders had all option holders exercised their options on that date. This amount changes based on the fair market value of our stock. Total intrinsic value of options actually exercised was \$32.0 million, \$77.9 million, and \$198.0 million for the years ended March 31, 2007, 2006, and 2005, respectively.

As of March 31, 2007, \$34.0 million of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.61 years.

The following table summarizes information about all employee and director stock options outstanding as of March 31, 2007 (share amounts in thousands):

| | Outstanding Options | | | Exercisable Options | |
|---------------------------|---------------------|-------------------------------------------------------------|--------------------------------|---------------------|--------------------------------|
| | Shares | Remaining Wtd. Avg. Contractual Life (in years) | Wtd. Avg. Exercise Price | Shares | Wtd. Avg. Exercise Price |
| Range of exercise prices: | | | | | |
| \$1.00 to \$1.08 | 665 | 3.11 | \$ 1.05 | 665 | \$ 1.05 |
| \$1.72 to \$1.75 | 8,202 | 1.95 | 1.75 | 8,202 | 1.75 |
| \$1.76 to \$3.53 | 5,354 | 5.09 | 3.34 | 4,714 | 3.34 |
| \$3.54 to \$5.00 | 5,696 | 5.74 | 4.04 | 5,185 | 4.07 |
| \$5.08 to \$5.74 | 4,959 | 5.36 | 5.72 | 4,292 | 5.72 |
| \$5.79 to \$7.73 | 6,605 | 5.96 | 7.12 | 6,032 | 7.10 |
| \$7.75 to \$11.10 | 5,440 | 7.61 | 9.77 | 1,009 | 8.99 |
| \$11.15 to \$13.61 | 8,959 | 8.65 | 12.90 | 779 | 12.14 |
| \$13.62 to \$17.21 | 3,388 | 8.97 | 15.24 | 413 | 15.06 |
| \$18.43 to \$18.43 | 161 | 9.80 | 18.43 | | |
| | 49,429 | 5.97 | \$ 7.18 | 31,291 | \$ 4.60 |

15. Capital Transactions

Buyback Program

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

Under the buyback program, we did not repurchase any shares of our common stock in the years ended March 31, 2007, March 31, 2006 and March 31, 2005. As of March 31, 2007, we had no outstanding structured stock repurchase transactions. Structured stock repurchase transactions are settled in cash or stock-based on the market price of our common stock on the date of the settlement. Upon settlement, we either have our capital investment returned with a premium or receive shares of our common stock, depending, respectively, on whether the market price of our common stock is above or below a pre-determined price agreed in connection with each such transaction. These transactions are recorded in shareholders' equity in the accompanying Consolidated Balance Sheets. As of March 31, 2007, we had approximately \$226.2 million available for utilization under the buyback program and no outstanding stock repurchase transactions.

Shareholders' Rights Plan

On April 18, 2000, our Board of Directors approved a shareholders rights plan (the "Rights Plan"). Under the Rights Plan, each common shareholder at the close of business on April 19, 2000, received a dividend of one right for each share of common stock held. Each right represents the right to purchase one-six hundredths (1/600) of a share, as adjusted on account of stock dividends made since the plan's adoption, of our Series A Junior Preferred Stock at an exercise price of \$6.67 per share, as adjusted on account of stock dividends made since the plan's adoption. Initially, the rights are represented by our common stock certificates and are neither exercisable nor traded separately from our common stock. The rights will only become exercisable if a person or group acquires 15% or more of the common stock of Activision, or announces or commences a tender or exchange offer which would result in the bidder's beneficial ownership of 15% or more of our common stock.

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

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

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

The components of comprehensive income (loss) for the year ended March 31, 2007, 2006, and 2005 were as follows (amounts in thousands):

| | March 31, 2007 | March 31, 2006 | March 31, 2005 |
|---------------------------------------------------------------------|-------------------|-------------------|-------------------|
| Net income | \$ 85,787 | \$ 40,251 | \$ 135,057 |
| Other comprehensive income (loss): | | | |
| Unrealized appreciation (depreciation) on investments, net of taxes | (8,224) | 10,576 | (3,317) |
| Foreign currency translation adjustment | 12,057 | (5,825) | 4,974 |
| Other comprehensive income | 3,833 | 4,751 | 1,657 |
| Comprehensive income | \$ 89,620 | \$ 45,002 | \$ 136,714 |

The components of accumulated other comprehensive income (loss) for the years ended March 31, 2007 and 2006 were as follows (amounts in thousands):

| | Foreign Currency | Unrealized Appreciation (Depreciation) on Investments | Accumulated Other Comprehensive Income (Loss) |
|-----------------------------------|------------------|----------------------------------------------------------------|-----------------------------------------------------|
| Balance, March 31, 2006 | \$ 9,013 | \$ 7,356 | \$ 16,369 |
| Other comprehensive income (loss) | 12,057 | (8,224) | 3,833 |
| Balance, March 31, 2007 | \$ 21,070 | \$ (868) | \$ 20,202 |

Comprehensive income is presented net of taxes of \$0.6 million related to unrealized depreciation on investments. Income taxes were not provided for foreign currency translation items as these are considered indefinite investments in non-U.S. subsidiaries.

17. Supplemental Cash Flow Information

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

| | 2007 | For the years ended March 31, 2006 | 2005 |
|-----------------------------------------------------------------|-----------|---------------------------------------|-----------|
| Non-cash investing and financing activities: | | | |
| Subsidiaries acquired with common stock | \$ 30,000 | \$ 2,793 | \$ 1,191 |
| Change in unrealized appreciation (depreciation) on investments | (8,224) | 10,576 | (3,317) |
| Common stock payable, related to acquisition | 39,000 | | |
| Adjustment-prior period purchase allocation | 51 | (260) | (2,384) |
| Supplemental cash flow information: | | | |
| Cash paid for income taxes | \$ 3,677 | \$ 4,698 | \$ 12,178 |
| Cash received for interest, net | 35,345 | 25,912 | 10,543 |

18. Quarterly Financial and Market Information (Unaudited)

| (Amounts in thousands, except per share data) | June 30(a) | For the quarters ended | | Mar. 31 | For the year ended |
|-----------------------------------------------|------------|------------------------|------------|------------|--------------------|
| | | Sept. 30 | Dec. 31 | | |
| Fiscal 2007: | | | | | |
| Net revenues | \$ 188,069 | \$ 188,172 | \$ 824,259 | \$ 312,512 | \$ 1,513,012 |
| Cost of sales | 137,800 | 141,078 | 483,180 | 216,007 | 978,065 |
| Operating income (loss) | (33,449) | (37,410) | 173,120 | (29,114) | 73,147 |
| Net income (loss) | (18,309) | (24,302) | 142,820 | (14,422) | 85,787 |
| Basic earnings (loss) per share | (0.07) | (0.09) | 0.51 | (0.05) | 0.31 |
| Diluted earnings (loss) per share | (0.07) | (0.09) | 0.46 | (0.05) | 0.28 |
| Common stock price per share: | | | | | |
| High | 15.11 | 16.00 | 18.19 | 19.20 | 19.20 |
| Low | 10.71 | 10.47 | 14.22 | 16.05 | 10.47 |
| Fiscal 2006: | | | | | |
| Net revenues | \$ 241,093 | \$ 222,540 | \$ 816,242 | \$ 188,125 | \$ 1,468,000 |
| Cost of sales | 172,270 | 141,458 | 498,325 | 128,309 | 940,362 |
| Operating income (loss) | (14,319) | (27,788) | 83,893 | (26,560) | 15,226 |
| Net income (loss) | (4,247) | (14,230) | 67,856 | (9,128) | 40,251 |
| Basic earnings (loss) per share | (0.02) | (0.05) | 0.25 | (0.03) | 0.15 |
| Diluted earnings (loss) per share | (0.02) | (0.05) | 0.23 | (0.03) | 0.14 |
| Common stock price per share: | | | | | |
| High | 13.88 | 17.30 | 18.03 | 15.93 | 18.03 |
| Low | 10.64 | 12.07 | 12.94 | 11.81 | 10.64 |

a) On June 7, 2007, we filed an Amended Quarterly Report on Form 10-Q/A to restate our unaudited consolidated financial statements as of June 30, 2006 and for the three months ended June 30, 2006 and 2005 and the related disclosures to correct our stock-based compensation expense and related tax effects as discussed in the Form 10-Q/A.

The following table reflects the impact of the non-cash charges for stock-based compensation expense and related tax effects:

| | For the three months ended June 30, 2006 | | |
|------------------------|------------------------------------------|-------------|-------------|
| | As previously reported | Adjustments | As restated |
| Net revenues | \$ 188,069 | \$ | \$ 188,069 |
| Cost of sales | 137,789 | 11 | 137,800 |
| Operating loss | (32,786) | (663) | (33,449) |
| Net loss | (17,826) | (483) | (18,309) |
| Basic loss per share | (0.06) | (0.01) | (0.07) |
| Diluted loss per share | (0.06) | (0.01) | (0.07) |

19. Recently Issued Accounting Standards and Laws

Edgar Filing: ACTIVISION INC /NY - Form 10-K

In February 2006, the FASB issued Statement No. 155 (SFAS No. 155), *Accounting for Certain Hybrid Financial Instruments* An amendment of FASB Statements No. 133 and 140. SFAS No. 155 amends FASB Statements No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* to resolve issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. SFAS No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation; clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133; establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. We do not expect that the adoption of SFAS No. 155 will have a material effect on our financial position or results of operations.

In March 2006, the FASB issued Statement No. 156 (SFAS No. 156), *Accounting for Servicing of Financial Assets* an amendment of FASB Statement No. 140. SFAS No. 156 amends Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset

by entering into a servicing contract in certain situations; requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; permits either the amortization method or the fair value measurement method, as subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities; permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights; and requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective in the first fiscal year that begins after September 15, 2006. We do not expect that the adoption of SFAS No. 156 will have a material effect on our financial position or results of operations.

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS No. 109. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest, and penalties, accounting in interim periods, disclosure, and transition. In addition, FIN 48 excludes income taxes from the scope of SFAS No. 5, *Accounting for Contingencies*. FIN 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the consolidated balance sheets prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. We are currently evaluating the effect that the adoption of FIN 48 will have on our results of operations and financial position.

In September 2006, the FASB issued Statement No. 157 (SFAS No. 157), *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We do not expect that the adoption of SFAS No. 157 will have a material effect on our financial position or results of operations.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, *Financial Statements – Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. SAB 108 requires the use of both the iron curtain and rollover approach in quantifying the materiality of misstatements. SAB 108 also discusses the implications of misstatements uncovered upon the application of SAB 108 in situations when a registrant has historically been using either the iron curtain approach or the rollover approach. SAB 108 is effective for fiscal years ending after November 15, 2006. The adoption of SAB 108 had no impact on our financial position or results of operations.

In September 2006, the FASB issued Statement No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS No. 158). This new standard aims to make it easier for investors, employees, retirees and other parties to understand and assess an employer’s financial position and its ability to fulfill the obligations under its benefit plans. SFAS No. 158 requires employers to fully recognize in their financial statements the obligations associated with single-employer defined benefit pension plans, retiree healthcare plans, and other postretirement plans. Specifically, it requires a company to (1) recognize on its balance sheet an asset for a plan’s overfunded status or a liability for a plan’s underfunded status, (2) measure a plan’s assets and its obligations that determine its funded status as of the end of the employer’s fiscal year, and (3) recognize changes in the funded status of a plan through comprehensive income in the year in which the changes occur. The adoption of SFAS No. 158 had no impact on our financial position or results of operations.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The provisions of SFAS No. 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007. We are evaluating

F-41

if we will adopt SFAS No. 159 and what impact the adoption will have on our Consolidated Financial Statements if we adopt.

20. Subsequent Events

On May 11, 2007, Activision completed its acquisition of DemonWare, the leading provider of network middleware technologies for console and PC games headquartered in Dublin, Ireland. The acquisition is expected to enable Activision to gain efficiencies related to online game development and to position the company to take advantage of the growth in online gameplay that is expected to be driven by the next-generation consoles.

On June 8, 2007, with respect to unexercised options subject to Section 409A of the Internal Revenue Code held by employees who are not executive officers, Activision commenced an offer to amend the exercise price of these options to eliminate the grantee's Section 409A tax liability consistent with Internal Revenue Service guidance. Pursuant to the offer, the Company will also make a cash payment in January 2008 to employees who accept the offer, in an amount equal to the difference between the original exercise price of each amended option and the amended exercise price of each amended option. The offer with respect to all eligible options is considered a modification of those options for financial reporting purposes. Pursuant to the accounting standards in effect under SFAS 123R (revised 2004), the fair value of the modified options (including for this purpose the cash payments that become payable pursuant to the terms of the offer) will be recognized as compensation expense over the remaining requisite service period with the fair value created as a result of cash payments that become payable pursuant to the terms of the offer recognized as compensation expense at the expiration of the offer period on July 6, 2007. In addition, a portion of the compensation costs associated with the original award may be accelerated and recognized as compensation expense at the expiration of the offer period as a result of the cash payment.

SCHEDULE II

ACTIVISION, INC. AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS
(In thousands)

| Col. A Description | Col. B Balance at Beginning of Period | Col. C Additions (A) | Col. D Deductions (B) | Col. E Balance at End of Period |
|--------------------------------------------------|------------------------------------------------|-------------------------|--------------------------|---------------------------------------|
| Year ended March 31, 2007 | | | | |
| Allowance for sales returns and price protection | \$ 95,150 | \$ 143,456 | \$ (148,963) | \$ 89,643 |
| Allowance for doubtful accounts | 3,103 | (1,804) | 476 | 1,775 |
| Deferred tax valuation allowance | 35,555 | | (35,173) | 382 |
| Year ended March 31, 2006 | | | | |
| Allowance for sales returns and price protection | \$ 67,603 | \$ 262,555 | \$ (235,008) | \$ 95,150 |
| Allowance for doubtful accounts | 1,588 | 5,149 | (3,634) | 3,103 |
| Deferred tax valuation allowance | 25,666 | 9,943 | (54) | 35,555 |
| Year ended March 31, 2005 | | | | |
| Allowance for sales returns and price protection | \$ 44,538 | \$ 172,156 | \$ (149,091) | \$ 67,603 |
| Allowance for doubtful accounts | 2,490 | (1,451) | 549 | 1,588 |
| Deferred tax valuation allowance | 18,857 | 7,703 | (894) | 25,666 |

(A) Includes increases in allowance for sales returns, price protection, doubtful accounts, and deferred tax valuation due to normal reserving terms and allowance accounts acquired in conjunction with acquisitions.

(B) Includes actual write-offs of sales returns, price protection, uncollectible accounts receivable, net of recoveries, and foreign currency translation and other adjustments, and deferred taxes.

EXHIBIT INDEX

| Exhibit Number | Exhibit |
|---------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1 | Amended and Restated Certificate of Incorporation of Activision Holdings, dated June 9, 2000 (incorporated by reference to Exhibit 2.5 of Activision's Form 8-K, filed June 16, 2000). |
| 3.2 | Certificate of Amendment of Amended and Restated Certificate of Incorporation of Activision Holdings dated as of June 9, 2000 (incorporated by reference to Exhibit 2.7 of Activision's Form 8-K, filed June 16, 2000). |
| 3.3 | Certificate of Designation of Series A Junior Preferred Stock of Activision, Inc. dated as of December 27, 2001 (incorporated by reference to Exhibit 3.4 of Activision's Form 10-Q for the quarter ended December 31, 2001). |
| 3.4 | Certificate of Amendment of Amended and Restated Certificate of Incorporation, as amended, of Activision, Inc., dated as of April 4, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed April 5, 2005). |
| 3.5 | Certificate of Designation of Series A Junior Preferred Stock of Activision, Inc. dated August 4, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed August 5, 2005). |
| 3.6 | Second Amended and Restated Bylaws of Activision, Inc. dated September 15, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed September 19, 2005). |
| 4.1 | Rights Agreement dated as of April 18, 2000, between Activision, Inc. 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 Activision's Registration Statement on Form 8-A, Registration No. 001-15839, filed April 19, 2000). |
| 10.1 | Activision, Inc. 1991 Stock Option and Stock Award Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-K for the year ended March 31, 2002). |
| 10.2 | Activision, Inc. 1998 Incentive Plan, as amended (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended September 30, 2001). |

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.3 Activision, Inc. 1999 Incentive Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2002).
- 10.4 Activision, Inc. 2001 Incentive Plan, as amended (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended June 30, 2002).
- 10.5 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).
- 10.6 Activision, Inc. 2002 Executive Incentive Plan (incorporated by reference to Exhibit 4.1 of Activision's Form S-8, Registration No. 333-100114 filed September 26, 2002).
- 10.7 Activision, Inc. 2002 Studio Employee Retention Incentive Plan (incorporated by reference to Exhibit 4.1 of Activision's Form S-8, Registration No. 333-103323 filed February 19, 2003).
- 10.8 Activision, Inc. Second Amended and Restated 2002 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K, filed March 8, 2005).
- 10.9 Activision, Inc. 2002 Second Amended and Restated Employee Stock Purchase Plan for International Employees (incorporated by reference to Exhibit 10.2 of Activision's Form 8-K, filed March 8, 2005).
- 10.10 Activision, Inc. Amended and Restated 2003 Incentive Plan, effective as of July 26, 2005 (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2005).
- 10.11 Form of Stock Option Certificate for grants issued pursuant to the 1998 Incentive Plan of Activision, Inc. (adopted May 24, 2005) (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K, filed May 31, 2005).
- 10.12 Form of Stock Option Certificate for grants issued pursuant the 1999 Incentive Plan of Activision, Inc. (adopted May 24, 2005) (incorporated by reference to Exhibit 10.2 of Activision's Form 8-K, filed May 31, 2005).
- 10.13 Form of Stock Option Agreement for grants issued pursuant the 2001 Incentive Plan of Activision, Inc. (adopted May 24, 2005) (incorporated by reference to Exhibit 10.3 of Activision's Form 8-K, filed May 31, 2005).

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.14 Form of Stock Option Agreement for grants issued pursuant the 2002 Executive Incentive Plan of Activision, Inc. (adopted May 24, 2005) (incorporated by reference to Exhibit 10.4 of Activision's Form 8-K, filed May 31, 2005).
- 10.15 Form of Executive Stock Option Agreement for grants to Robert Kotick or Brian Kelly issued pursuant the 2003 Incentive Plan of Activision, Inc. (adopted May 2005) (incorporated by reference to Exhibit 10.40 of Activision's Form 10-K for the year ended March 31, 2005).
- 10.16 Form of Non-Executive Stock Option Agreement for grants to non-executives issued pursuant the 2003 Incentive Plan of Activision, Inc. (adopted May 2005) (incorporated by reference to Exhibit 10.41 of Activision's Form 10-K for the year ended March 31, 2005).
- 10.17 Form of Non-Employee Director Stock Option Agreement for grants to non-employee directors issued pursuant the 2003 Incentive Plan of Activision, Inc. (adopted May 2005).
- 10.18 Notice of Share Option Award for grants to persons other than non-employee directors issued pursuant to the 2003 Incentive Plan of Activision, Inc. (adopted June 13, 2007).
- 10.19 Notice of Share Option Award for grants to non-employee directors issued pursuant to the 2003 Incentive Plan of Activision, Inc. (adopted June 13, 2007).
- 10.20 Notice of Restricted Share Award for grants issued pursuant to the 2003 Incentive Plan of Activision, Inc. (adopted June 13, 2007).
- 10.21 Notice of Restricted Share Unit Award for grants issued pursuant to the 2003 Incentive Plan of Activision, Inc. (adopted June 13, 2007).
- 10.22 Amended and Restated Employment Agreement, dated May 22, 2000, between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended September 30, 2000).
- 10.23 Amendment, dated July 22, 2002, to Employment Agreement dated May 22, 2000 between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended September 30, 2002).

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.24 Amendment, dated December 29, 2006, to Employment Agreement dated May 22, 2000 between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K filed January 8, 2007).
- 10.25 Stock Option Agreement, dated May 22, 2000, between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ending September 30, 2000).
- 10.26 Amended and Restated Employment Agreement, dated May 22, 2000, between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ending September 30, 2000).
- 10.27 Amendment, dated July 22, 2002, to Employment Agreement dated May 22, 2000 between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended September 30, 2002).
- 10.28 Amendment, dated December 29, 2006, to Employment Agreement dated May 22, 2000 between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K filed January 8, 2007).
- 10.29 Employment Agreement, dated July 22, 2002, between Ronald Doornink and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.6 of Activision's Form 10-Q for the quarter ended June 30, 2002).
- 10.30 Amendment, dated February 27, 2003, to Employment Agreement dated July 22, 2002 between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.34 of Activision's Form 10-K for the year ended March 31, 2005).
- 10.31 Amendment, dated June 1, 2004, to Employment Agreement dated July 22, 2002, between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended June 30, 2004).
- 10.32 Amendment, dated June 15, 2005, to Employment Agreement dated July 22, 2002 between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended June 30, 2005).
- 10.33 Employment agreement, dated November 20, 2002, between Activision Publishing, Inc. and George Rose (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended December 31, 2002).

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.34 Amendment, dated March 30, 2005, to the Employment Agreement dated November 20, 2002 between Activision Publishing, Inc. and George Rose (incorporated by reference to Exhibit 10.51 of Activision's Form 10-K for the year ended March 31, 2005).
- 10.35 Employment Agreement, dated May 10, 2005, between Charles J. Huebner and Activision Publishing, Inc (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended December 31, 2005).
- 10.36 Amendment, dated March 30, 2007, to Employment Agreement dated May 10, 2005 between Charles J. Huebner and Activision Publishing, Inc.
- 10.37 Employment Agreement, dated June 15, 2005, between Michael Griffith and Activision Publishing, Inc (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended June 30, 2005).
- 10.38 Stock Option Agreement, dated June 15, 2005, between Michael Griffith and Activision, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended June 30, 2005).
- 10.39 Restricted Stock Agreement, dated June 15, 2005, between Michael Griffith and Activision, Inc. (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended June 30, 2005).
- 10.40 Employment Agreement, dated September 9, 2005, between Thomas Tippl and Activision Publishing, Inc (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended September 30, 2005).
- 10.41 Stock Option Agreement, dated October 3, 2005, between Thomas Tippl and Activision, Inc. (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended September 30, 2005).
- 10.42 Restricted Stock Agreement, dated October 3, 2005, between Thomas Tippl and Activision, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended September 30, 2005).
- 10.43 Employment Agreement, dated September 18, 2006, between Brian Hodous and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended December 31, 2006).
- 10.44 Letter Agreement, dated September 6, 2006, between Brian Hodous and Activision, Inc.
- 10.45 Stock Option Agreement, dated as of November 3, 2006, between Activision and Brian Hodous.

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.46 Restricted Stock Agreement, dated as of November 3, 2006, between Activision and Brian Hodous.
- 10.47 Restricted Stock Agreement, dated as of November 3, 2006, between Activision and Brian Hodous.
- 10.48 Employment Agreement, dated October 1, 2006, between Robin Kaminsky and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended December 31, 2006).
- 10.49 PlayStation 2 CD-ROM/DVD-ROM Licensed Publisher Agreement, dated as of April 1, 2000, between Sony Computer Entertainment America Inc. and Activision, Inc. (incorporated by reference to Exhibit 10.9 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
- 10.50 Letter regarding Modification of Territory for PlayStation 2 CD-ROM/DVD-ROM Licensed Publisher Agreement, dated as of June 11, 2004, from Sony Computer Entertainment America Inc. to Activision, Inc.
- 10.51 PlayStation 2 Licensed Publisher Agreement, dated as of March 23, 2001, between Sony Computer Entertainment Europe Limited and Activision UK Limited (incorporated by reference to Exhibit 10.10 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
- 10.52 PlayStation Portable (PSP) Licensed PSP Publisher Agreement, dated September 15, 2004, between Sony Computer Entertainment America Inc. and Activision, Inc. (incorporated by reference to Exhibit 10.46 of Activision's Form 10-K for the year ended March 31, 2005).*
- 10.53 PlayStation Portable (PSP) Licensed PSP Publisher Agreement, dated September 27, 2005, between Sony Computer Entertainment Europe Limited and Activision UK Limited (incorporated by reference to Exhibit 10.60 of Activision's Form 10-K for year ended March 31, 2006).*
- 10.54 Global PlayStation 3 Format Licensed Publisher Agreement, dated March 5, 2007, between Sony Computer Entertainment America, Inc. and Activision. Inc.*
- 10.55 First Renewal License Agreement for the Game Boy Advance Video Game System (EEA, Australia, and New Zealand), dated September 14, 2004, between Nintendo Co., Ltd. and Activision, Inc. (incorporated by reference to Exhibit 10.44 of Activision's Form 10-K for the year ended March 31, 2005).*

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.56 First Addendum to First Renewal License Agreement for the Game Boy Advance Video Game System (EEA, Australia and New Zealand), dated June 20, 2006, between Nintendo Co., Ltd. and Activision, Inc.
- 10.57 Confidential License Agreement for Nintendo GameCube (Western Hemisphere), dated as of November 9, 2001, between Nintendo of America Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.1 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
- 10.58 First Amendment to the Confidential License Agreement for Nintendo GameCube (Western Hemisphere), dated November 9, 2004, between Nintendo of America, Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.45 of Activision's Form 10-K for the year ended March 31, 2005).
- 10.59 First Renewal License Agreement for the Nintendo GameCube System (EEA), dated June 20, 2006, between Nintendo, Co., Ltd. and Activision, Inc.*
- 10.60 Confidential License Agreement for the Nintendo DS (Western Hemisphere), dated as of October 11, 2004, between Nintendo Co., Ltd. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.42 of Activision's Form 10-K for the year ended March 31, 2005).*
- 10.61 License Agreement for the Nintendo DS System (EEA, Australia and New Zealand), dated June 20, 2006, between Nintendo Co., Ltd. and Activision, Inc.*
- 10.62 Microsoft Corporation Xbox Publisher License Agreement, dated as of July 18, 2001, between Microsoft Corporation and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.5 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
- 10.63 Amendment to Microsoft Corporation Xbox Publisher License Agreement, dated as of April 19, 2002, between Microsoft Licensing, Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.6 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
- 10.64 Xbox Live Distribution Amendment to the Xbox Publisher Licensing Agreement, dated as of October 28, 2002, between Microsoft Licensing, Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.7 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*

Edgar Filing: ACTIVISION INC /NY - Form 10-K

- 10.65 Amendment to the Xbox Publisher Licensing Agreement, dated as of March 1, 2005, between Microsoft Licensing, GP, and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.47 of Activision's Form 10-K for the year ended March 31, 2005).*
- 10.66 Microsoft Corporation Xbox 360 Publisher License Agreement, dated as of October 25, 2005, between Microsoft Licensing, GP and Activision Publishing, Inc (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended December 31, 2005).*
- 10.67 Xbox 360 Disc Program Addendum to the Xbox 360 Publisher License Agreement, dated as of December 15, 2005, between Microsoft Licensing, GP and Activision Publishing, Inc (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended December 31, 2005).*
- 10.68 Amendment to the Xbox 360 Publisher Licensing Agreement (Platinum/Classic Hits Program), dated as of October 1, 2006, by and between Microsoft Licensing, GP and Activision, Inc.*
- 10.69 Xbox Live Server Platform Addendum to the Xbox 360 Publisher Licensing Agreement, dated as of February 6, 2007, by and between Microsoft Licensing, GP and Activision Publishing, Inc.
- 10.70 Chart of Compensation to Non-Employee Directors (incorporated by reference to Exhibit 10.6 of Activision's Form 10-Q for the quarter ended December 31, 2005).
- 14.1 Code of Ethics for Senior Executive and Senior Financial Officers (incorporated by reference to Exhibit 14.1 of Activision's Form 10-K for the year ended March 31, 2004).
- 21.1 Principal subsidiaries of Activision.
- 23.1 Consent of Independent Registered Public Accounting Firm.
- 31.1 Certification of Robert A. Kotick pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Michael Griffith pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 31.3 Certification of Thomas Tippl pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted 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 Michael Griffith pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.3 Certification of Thomas Tippl pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*Portions omitted pursuant to a request for confidential treatment.