

ACTIVISION INC /NY
Form 10-K
June 09, 2006

**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, 2006

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

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(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:

Preferred Stock Purchase Rights
Common Stock, par value \$.000001 per share
(Title of Class)

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

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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

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The aggregate market value of the Common Stock of the registrant held by non-affiliates of the registrant on September 30, 2005 was \$4,115,244,011.

The number of shares of the registrant's Common Stock outstanding as of May 31, 2006 was 277,879,080.

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 2006 Annual Meeting of Shareholders, are incorporated by reference into Part III of this Annual Report.

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SIGNATURES

PART I

Item 1. BUSINESS

(a) General

Activision, Inc. (Activision, the Company, or we) is a leading international publisher of interactive entertainment software products. We have built a company with a diverse portfolio of products that spans a wide range of categories and target markets and that is used on a variety of game hardware platforms and operating systems. We have created, licensed, and acquired a group of highly recognizable brands, which we market to a variety of consumer demographics. Our fiscal 2006 product portfolio included such best-selling products as *Call of Duty 2*, *Call of Duty 2: Big Red One*, *Tony Hawk's American Wasteland* (THAW), *Madagascar*, *Ultimate Spider-Man*, *Quake IV*, *GUN*, *True Crime: New York City*, and *X-Men Legends II*.

Our products cover diverse game categories including action/adventure, action sports, racing, role-playing, simulation, first-person action, and strategy. Our target customer base ranges from casual players to game enthusiasts, children to adults, and mass-market consumers to value buyers. We currently offer our products primarily in versions that operate on the Sony PlayStation 2 (PS2), Nintendo GameCube (GameCube), Microsoft Xbox (Xbox), 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 this current-generation of hardware platforms is significant and we anticipate the fiscal 2006 release of the Xbox360 and the upcoming calendar 2006 releases of the Sony PlayStation 3 (PS3) and the Nintendo Wii (Wii) will further expand the software market over the next few years by expanding the installed base. We successfully executed our strategy of having a high-quality product presence at the launch of the Xbox360, releasing four titles concurrent with the console launch, and are currently developing additional titles for the Xbox360. We are currently developing three launch titles for the PS3, *Call of Duty 3*, *Marvel: Ultimate Alliance*, and *Tony Hawk's Project 8*, and three launch titles for the Wii, *Call of Duty 3*, *Marvel: Ultimate Alliance*, and *Tony Hawk's Downhill Jam*. Our plan is to have a significant presence at the launch of both the PS3 and the Wii while marketing to current-generation platforms as long as this remains 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.

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. During fiscal 2006, we continued to enhance our internal product development capabilities with the acquisition of two game developers, Toys for Bob, Inc. and Beenox, Inc. Additionally, in May 2006, we entered into an agreement to acquire video game publisher RedOctane Inc., the publisher of the popular Guitar Hero franchise. See Note 3 to the Consolidated Financial Statements included in

(b)

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 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) **Forward-Looking Statements**

In connection with the Private Securities Litigation Reform Act of 1995 (the "Litigation Reform Act"), we are hereby disclosing certain cautionary information to be used in connection with written materials (including this Annual Report on Form 10-K) and oral statements made by or on behalf of our employees and representatives that may contain "forward-looking statements" within the meaning of the Litigation Reform Act. Such statements consist of any statement other than a recitation of historical fact and can be identified by the use of forward-looking terminology such as "may," "expect," "anticipate," "estimate," or "continue" or the negative thereof or other variations thereon or comparable terminology. You are cautioned that all forward-looking statements are necessarily speculative and there are numerous risks and uncertainties that could cause actual events or results to differ materially from those referred to in such forward-looking statements. These forward-looking statements are subject to business and economic risk and reflect management's current expectations and are inherently uncertain and difficult to predict. The discussion in Item 1A of this Annual Report on Form 10-K highlights some of the more important risks identified by management, but should not be assumed to be the only factors that could affect future performance. You are cautioned that we do not have a policy of updating or revising forward-looking statements, and thus you should not assume that silence by the Company over time means that actual events are bearing out as estimated in such forward-looking statements.

(e) **Narrative Description of Business**

Our objective is to be a worldwide leader in the development, publishing, and distribution of quality interactive entertainment software 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 Comics properties, including Spider-Man and X-Men. We have a multi-year, multi-property, publishing agreement with DreamWorks LLC that grants us the exclusive rights to publish video games based on DreamWorks Animation SKG's theatrical release Shrek 2, which was released in the first quarter of fiscal 2005, Shark Tale, which was released in the second quarter of fiscal 2005, Madagascar, which was released in the first quarter of fiscal 2006, Over the Hedge, which was released in the first quarter of fiscal 2007, and all of their respective forthcoming sequels, including Shrek the Third and Madagascar 2. As part of our agreement with DreamWorks Animation SKG, 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 Rex Havoc 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 2006, we have released seven 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*. Recently we have also signed agreements with Hasbro Properties Group to develop and publish video games based on the Transformers brand and with MGM Interactive and EON Productions Ltd. to develop and publish video games based on the James Bond license.

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, 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, GameCube, Xbox, and the next-generation Xbox360 console systems, GBA, PSP, and NDS hand-held devices, and the PC. We are developing products for the PS3 and Wii next-generation console systems which are expected to be released in calendar 2006. 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

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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.

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

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. We have established ourselves as a leader in the value software publishing business with products under our Cabela's, Rapala's, 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, GameCube, Xbox, and Xbox360 console systems; GBA, PSP, and NDS hand-held devices; and PCs. We are also developing products for the PS3 and Wii next-generation console systems expected to be released in calendar 2006. In order to maintain general access to the console systems and hand-held devices marketplace, we have maintained licenses for PS2, GameCube, Xbox, 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 and other character or story 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, 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

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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. 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

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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

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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

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

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 10% of consolidated net revenues for the year ended March 31, 2006. For the year ended March 31, 2005, our largest customer, Wal-Mart, accounted for 23% 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, 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 Australia. 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 Australia 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

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, 2006, sales for Sony, Nintendo, and Microsoft accounted for approximately 24%, 3%, and 3%, 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

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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 *Ultimate Spider-Man*, *Tony Hawk's American Wasteland*, *Call of Duty 2*, *X-Men Legends II: Rise of the Apocalypse* (*X-Men Legends II*), and *Fantastic Four* for various hand-held wireless devices, such as Nokia's N-Gage wireless platform, as well as many traditional wireless handsets. We also develop and optimize many of our titles for consoles that support online play, such as PS2, Xbox Live on both the Xbox and Xbox360, and the up-coming Sony PS3 and Nintendo Wii next-generation 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.

Manufacturing

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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

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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 Ltd.; Sega Enterprises, Ltd.; Take-Two Interactive Software, Inc.; THQ Inc.; Ubi Soft Entertainment; and Vivendi Universal

Publishing. 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

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As of March 31, 2006, we had 2,149 employees, including 1,370 in product development, 167 in North American publishing, 156 in international publishing, 150 in operations, corporate finance and administration, and 306 in European distribution activities.

As of March 31, 2006, 292 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.

Item 1A. RISK FACTORS

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.

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

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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 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). In fiscal 2004, 35% of our consolidated net revenues (49% of worldwide publishing net revenues) was derived from three brands, which accounted for 17%, 14%, and 4% of consolidated net revenues (24%, 20%, and 5% of worldwide publishing net revenues). 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.

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The life of any one game product is relatively short, in many cases less than one year. The life cycle of a title 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.

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

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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.

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

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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. In fiscal 2006, Microsoft released Xbox360 and in calendar 2006, Sony and Nintendo plan to introduce their respective next-generation hardware platforms, the Playstation 3 and Wii, respectively. We began selling games for the Xbox360 concurrently with its launch and are developing titles for the next-generation console systems being developed by Sony and Nintendo. Delays in the launch, shortages, technical problems, or lack of consumer acceptance of the next-generation platforms could adversely affect our sales of products for these platforms. In addition, 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.

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

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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 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.

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

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The interactive entertainment software industry is highly seasonal, with the highest levels of consumer demand occurring during the 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. 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 year end holiday buying season.

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

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We have experienced a decrease in the average price of our titles for current-generation platforms. As the interactive entertainment industry transitions to next-generation video game platforms, we expect there to be fewer current-generation titles able to command premium price points, 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 current-generation titles to continue to decline, which may have a negative effect on our margins and operating results.

With the launch of the Xbox360 we have priced our next-generation titles at a premium retail price of \$59.99. We also plan to offer our next-generation titles for the PS3 at the same premium pricing. We expect to continue to price next-generation titles at premium pricing, 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.

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

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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 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 products and related promotional materials and the ability to change the fee they charge for the manufacturing of products, that 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, as online capabilities for video game platforms emerge, our platform licensors will control our ability to provide online game capabilities for our console platform products and will in large part establish the financial terms on which these services are offered to consumers. Currently, Microsoft provides online capabilities for the Xbox and Xbox360 and Sony provides online capabilities for PS2 products. We expect Sony will also provide online capabilities for PS3 products. In each case, compatibility code and the consent of the licensor are required for us to include online capabilities in our products. In addition, the business model for Microsoft's and Sony's online businesses for their video game products may compete with our online business. As these capabilities become more significant, the failure or refusal of our licensors to approve our products, or the successful deployment by these licensors of services competitive to ours, 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. Starting in fiscal 2005 and continuing into fiscal 2007, our platform licensors have begun to introduce new hardware platforms into the market. 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 future 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.

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

Software products 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.

Inadequate intellectual property protections could prevent us from enforcing or defending our proprietary technology.

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We regard our software as proprietary and rely on a combination of copyright, 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 and trademarks. We are aware that some unauthorized copying occurs within the computer software industry, and if a significantly greater amount of unauthorized copying of our interactive entertainment 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 international markets. 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. 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.

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 inadvertently infringe upon the intellectual property rights of others. Our products often utilize complex, cutting edge technology that may become subject to the 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, 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 rely on independent third parties to develop some of our software products.

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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 in a few cases, 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.

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. 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 Computer Entertainment, Nintendo Co. Ltd., and Microsoft Corporation 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 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. While many new products are regularly introduced, only a relatively small number of hit titles account for a significant portion of net revenue. 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, offer competitive products at lower price points, or if we do not continue to develop consistently high-quality and well-received products, our revenue, margins, and profitability will decline.

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

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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 we do not have long-term contracts for the sale of our products.

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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 10% of consolidated net revenues for the year ended March 31, 2006. For the year ended March 31, 2005, our largest customer, Wal-Mart, accounted for 23% of consolidated net revenues. 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.

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

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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 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.

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Our CD Contact, NBG, and Centrosoft 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. These services are generally performed under limited term contracts. Although we expect to use reasonable efforts to retain these vendors, we may not be successful in this regard. The cancellation or non-renewal of one or more of these contracts could significantly harm our business and financial results. Sony, Nintendo, and Microsoft products accounted for approximately 24%, 3%, and 3%, respectively, of our worldwide distribution net revenues for fiscal 2006.

Our international revenues may be subject to regulatory requirements as well as currency fluctuations.

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Our international revenues have accounted for a significant portion of our total revenues. International sales and licensing accounted for 52%, 50%, and 53% of our consolidated net revenues in fiscal 2006, 2005, and 2004, 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. Currency exchange rate fluctuations may in the future have a material negative impact on revenues from international sales and licensing and thus our business and financial results.

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

The Entertainment Software Rating Board, sometimes referred to as the ESRB, requires game publishers to provide consumers with information relating to graphic violence, profanity, or sexually explicit material 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. Our software titles receive a rating of E (age 6 and older), E10+ (age 10 and older), T (age 13 and over), or M (age 17 and over). Many of our titles have received an M rating. None of our titles have received the AO 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.

The ESRB requires publishers to conduct pertinent content audit certifications with respect to certain top selling titles, the objective of which is to assess what portion, if any, of the games on the market include undisclosed pertinent content on the disc that undermines the accuracy of the ESRB rating. This self audit procedure applies to certain current titles and may be applied to additional titles in the future. We are currently conducting a self audit in accordance with the ESRB's requirements. It is possible that there may be content in our games that could be determined to be pertinent content that causes a change to our current ESRB rating. In such event, we may be required to record a reserve for anticipated product returns and inventory obsolescence which could expose us to additional litigation, administrative fines and penalties, and other potential liabilities, and could adversely affect our operating results.

Our business, products, and distribution are subject to increasing regulation in key territories of content, consumer piracy, and online delivery. 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 web sites. 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 advertising of interactive entertainment software. Other countries, such as Germany, have adopted laws regulating content both in packaged goods and those transmitted over the Internet that are stricter than current United States laws.

Several proposals have been made for federal legislation in the United States to regulate our industry, including a bill, referred to as The Family Entertainment Protection Act, which was recently introduced into the

Senate. Such bill proposes to prohibit the sale of M rated, AO rated, and Rating Pending products to under-17 audiences. If the bill is adopted into law, it may limit the potential market for our M rated products, and adversely affect our operating results. We may also be required to modify our products or alter our marketing strategies to comply with new regulations, which could delay the release of our products. Due to the uncertainties regarding such regulations, confusion in the marketplace may occur, and we are unable to predict what effect, if any, such regulations would have on our business. In addition, a number of state legislative bodies in states such as Illinois, California, New York, and Washington introduced various forms of legislation designed to regulate and control sales of video games deemed inappropriate for sales to minors. In the event such legislation is adopted and enforced, the sales of our products in states with such laws may be negatively affected.

Our products may be subject to legal claims.

In prior fiscal years, two lawsuits, *Linda Sanders, et al. v. Meow Media, Inc., et al.*, United States District Court for the District of Colorado, and *Joe James, et al. v. Meow Media, Inc., et al.*, United States District Court for the Western District of Kentucky, Paducah Division, 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.

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.

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.

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

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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.

Our stock price is highly volatile.

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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.

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.

Financial Information about Foreign and Domestic Operations and Export Sales

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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 and 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 we file with or furnish to the SEC.

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, 2006:

PROPERTY	LOCATION	SQ FT	OWNERSHIP	LEASE EXPIRATION
Corporate Offices	Santa Monica, CA, USA	122,200	Lease	December 2010
Product Development Facilities				
China	Shanghai, China	500	Lease	December 2006
Beenox, Inc.	Quebec City, Quebec, Canada	4,400	Lease	January 2010
Motion Capture Studio	Los Angeles, CA, USA	11,500	Lease	March 2009
Infinity Ward, Inc.	Encino, CA, USA	35,300	Lease	October 2012
Luxoflux, Inc.	Santa Monica, CA, USA	14,800	Lease	January 2009
Neversoft Entertainment, Inc.	Woodland Hills, CA, USA	53,300	Lease	September 2014
Raven Studios	Middleton, WI, USA	35,300	Lease	May 2015
Shaba Games, Inc.	San Francisco, CA, USA	23,300	Lease	February 2008
Toys For Bob, Inc.	Novato, CA, USA	9,500	Lease	July 2006
Treyarch Corporation	Santa Monica, CA, USA	56,200	Lease	November 2009
Vicarious Visions, Inc.	Mountain View, CA, USA	3,100	Lease	June 2007
Vicarious Visions, Inc.	Menands, NY, USA	37,100	Lease	May 2016
Z-Axis, Ltd.	Foster City, CA, USA	24,000	Lease	August 2007
Publishing Facilities				
Australia Publishing	Sydney, Australia	2,200	Lease	July 2006
France Publishing	Bezons, France	4,000	Lease	October 2009
German Publishing	Burglengenfeld, Germany	2,200	Own	N/A
Japan Publishing	Tokyo, Japan	1,900	Lease	April 2007
United Kingdom Publishing	Stockley Park, UK	15,000	Lease	September 2015
Value Publishing	Eden Prairie, MN, USA	14,000	Lease	May 2008
Italy Publishing	Legnano, Italy	2,700	Lease	September 2009
Spain Publishing	Madrid, Spain	3,400	Lease	April 2009
Nordic Publishing	Stockholm, Sweden	3,500	Lease	July 2010
Distribution Facilities				
German Distribution	Burglengenfeld, Germany	40,900	Own	N/A
Netherlands Distribution-offices	Breda, the Netherlands	2,500	Lease	January 2007
Netherlands Distribution-warehouse	Venlo, the Netherlands	44,600	Own	N/A
United Kingdom Distribution	Birmingham, UK	163,100	Lease	May 2011-2018

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

Item 3. LEGAL PROCEEDINGS

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

days of the order. Rather than file a new complaint, the Plaintiff agreed to dismiss the entire case with prejudice. The Order dismissing the action with prejudice was entered on June 17, 2005.

In addition, on March 12, 2004, a shareholder derivative lawsuit captioned *Frank Capovilla, Derivatively on Behalf of Activision, Inc. v. Robert Kotick, et al.* was filed, purportedly on behalf of Activision, which in large measure asserts the identical claims set forth in the federal class action lawsuit. That complaint was filed in California Superior Court for the County of Los Angeles. On August 11, 2005, in light of the ruling dismissing with prejudice the complaint in the earlier filed federal securities class action, plaintiffs in the shareholder derivative action filed an amended complaint, dropping most of the causes of action, and focusing only on the allegations of insider trading and breaches of fiduciary duty that were based on the same claimed misrepresentations set forth in the dismissed federal securities class action. On September 15, 2005, Activision and the individual defendants filed separate demurrers to the Derivative Action and a motion to strike plaintiff's jury demand. Prior to the hearing on the demurrers, the parties came to a resolution of the action and agreed to a stipulation of settlement to be submitted to the court for preliminary approval. No cash recovery is to be paid to the plaintiff pursuant to the stipulation of settlement, which also stated that the Company vigorously denied any assertion of wrongdoing or liability. In furtherance of the settlement, the Company agreed to pay \$200,000 in plaintiffs' fees, to be funded by the Company's D&O insurance carrier. The settlement acknowledged that, after the time the derivative action was filed, the Company implemented certain enhancements to its corporate governance policies. Notice of Settlement was mailed and emailed to shareholders as well as posted on the Company's website. No objections to settlement were received. At a hearing held on May 22, 2006, the Court approved the settlement and released and dismissed the alleged claims.

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 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

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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 May 31, 2006, there were approximately 2,650 holders of record of our common stock.

	High	Low
<u>Fiscal 2005</u>		
First Quarter ended June 30, 2004	\$ 9.61	\$ 7.74
Second Quarter ended September 30, 2004	9.23	6.84
Third Quarter ended December 31, 2004	11.53	7.02
Fourth Quarter ended March 31, 2005	14.04	10.19
<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

On May 31, 2006, the last reported sales price of our common stock was \$13.08.

Cash Dividends

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We paid no cash dividends in our fiscal years 2006 or 2005 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

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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 years ended March 31, 2006 and March 31, 2005. We repurchased approximately 3.4 million shares of our common stock for \$12.4 million in the years ended March 31, 2004. In addition, approximately 3.1 million shares of common stock were acquired in the year ended March 31, 2004 as a result of the settlement of \$10.0 million of structured stock repurchase transactions entered into in fiscal 2003. As of March 31, 2006, 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 \$.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

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Information for our equity compensation plans in effect as of March 31, 2006 is as follows (amounts in thousands, except per share amounts):

Plan Category	(a)		(b)	(c)
	Number of securities to be issued upon exercise of outstanding options, warrants and rights		Weighted-average exercise price of outstanding options, warrants and rights	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	23,929	\$	8.17	13,673
Equity compensation plans not approved by security holders	25,344	\$	4.28	733
Total	49,273	\$	6.17	14,406

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, 2006 are derived from our audited consolidated financial statements except basic and diluted earnings per share and basic and diluted weighted average shares outstanding which have been restated for the effect of our stock splits. The Consolidated Balance Sheets as of March 31, 2006 and 2005 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, 2006, and the report thereon, are included elsewhere in this Form 10-K (in thousands, except per share data).

	2006	2005	For the years ended March 31,		2003	2002
			2004			
Statement of Operations Data:						
Net revenues	\$ 1,468,000	\$ 1,405,857	\$ 947,656	\$ 864,116	\$ 786,434	
Cost of sales – product costs	734,874	658,949	475,541	440,977	435,725	
Cost of sales – intellectual property licenses and software royalties and amortization	205,488	185,997	91,606	124,196	99,006	
Income from operations	17,957	184,571	109,817	94,847	80,574	
Income before income tax provision	48,587	197,663	115,992	103,407	83,120	
Net income	41,899	138,335	77,715	66,180	52,238	
Basic earnings per share (1)	0.15	0.55	0.33	0.26	0.26	
Diluted earnings per share (1)	0.14	0.50	0.30	0.24	0.22	
Basic weighted average common shares outstanding (1)	273,177	250,023	236,887	256,639	202,607	
Diluted weighted average common shares outstanding (1)	299,437	278,860	257,588	276,413	237,821	
Net Cash Provided By (Used In):						
Operating activities	86,007	215,309	67,403	90,975	111,792	
Investing activities	(85,796)	(143,896)	(170,155)	(301,547)	(8,701)	
Financing activities	45,088	72,654	117,569	64,090	50,402	
	2006	2005	As of March 31,		2003	2002
			2004			
Balance Sheet Data:						
Working capital	\$ 923,892	\$ 915,413	\$ 675,796	\$ 422,500	\$ 333,199	
Cash, cash equivalents and short-term investments	944,960	840,864	587,649	406,954	279,007	
Capitalized software development and intellectual property licenses	147,665	127,340	135,201	107,921	56,742	
Goodwill	100,446	91,661	76,493	68,019	35,992	
Total assets	1,419,523	1,306,963	968,817	704,816	556,887	
Long-term debt				2,671	3,122	
Shareholders' equity	1,225,584	1,099,912	832,738	597,740	430,091	

(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 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 2006 product portfolio included such best-selling products as *Call of Duty 2*, *Call of Duty 2: Big Red One*, *Tony Hawk's American Wasteland (THAW)*, *Madagascar*, *Ultimate Spider-Man*, *Quake IV*, *GUN*, *True Crime: New York City*, and *X-Men Legends II*.

Our products cover diverse game categories including action/adventure, action sports, racing, role-playing, simulation, first-person action, and strategy. Our target customer base ranges from casual players to game enthusiasts, children to adults, and mass-market consumers to value buyers. We currently offer our products primarily in versions that operate on the PS2, GameCube, Xbox, and Xbox360 console systems, GBA, PSP, and NDS hand-held devices, and the PC. The installed base for this current-generation of hardware platforms is significant and the fiscal 2006 release of the Xbox360 and the upcoming calendar 2006 releases of the PS3 and Wii, will further expand the software market. We successfully executed our strategy of having a high-quality product presence at the launch of the Xbox360, releasing four titles concurrent with the console launch, and are currently developing additional titles for the Xbox360. We are also currently developing three launch titles for the PS3, *Call of Duty 3*, *Marvel: Ultimate Alliance*, and *Tony Hawk's Project 8*, and three launch titles for the Wii, *Call of Duty 3*, *Marvel: Ultimate Alliance*, and *Tony Hawk's Downhill Jam*. Our plan is to have a significant presence at the launch of both the PS3 and the Wii while marketing 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 the United States and Canada, we primarily sell our products on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses, and game specialty stores. We conduct our international publishing activities through offices in the United Kingdom (UK), Germany, France, Italy, Spain, the Netherlands, Australia, Sweden, Canada, and Japan. Our products are sold internationally on a direct-to-retail basis, through third-party distribution and licensing arrangements and through our wholly-owned European distribution subsidiaries. Our distribution business consists of operations located in the UK, the Netherlands, and Germany that provide logistical and sales services to third-party publishers of interactive entertainment software, our own publishing operations, and manufacturers of interactive entertainment hardware.

Our profitability is directly affected by the mix of revenues from our publishing and distribution businesses. Operating margins realized from our publishing business are 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 producing higher margins than hardware.

Our Focus

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

Our fiscal 2006 big proposition releases included well-established brands, which were backed by high-profile intellectual property and/or highly anticipated motion picture releases. For example, we have a long-term relationship with Marvel Enterprises through an exclusive licensing agreement. During the third quarter of fiscal 2006, we further extended our exclusive licensing agreement with Marvel Enterprises by signing a multi-year extension to our current video game 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 franchises Spider-Man and X-Men. Through fiscal 2006, games based on the Spider-Man and X-Men franchises have generated more than \$785.7 million in net revenue worldwide. Our fiscal 2006 release schedule included titles based on Marvel's Spider-Man, X-Men, and Fantastic 4, which was part of our previous licensing agreement. In the first

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quarter of fiscal 2006 we released the video game, *Fantastic 4*, just prior to the theatrical release of *Fantastic 4*. We also released *Ultimate Spider-Man* and *X-Men Legends II: Rise of the Apocalypse* (*X-Men Legends II*) in the second quarter of fiscal 2006 in North America and in the third quarter of fiscal 2006 internationally. In fiscal 2007, under this agreement, we plan to release *X-Men: The Official Game* around the theatrical release of *X-Men: The Last Stand* and *Marvel: Ultimate Alliance*. In addition, through our licensing agreement with Spider-Man Merchandising, LP, we will be developing and publishing video games based on Columbia Pictures/Marvel Enterprises, Inc.'s upcoming feature film *Spider-Man 3*, which is expected to be released in May 2007. In addition, during the third quarter of fiscal 2006, we signed an agreement with Spider-Man Merchandising, LP to extend our 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 fiscal 2006, we have released seven successful titles in the Tony Hawk franchise with cumulative net revenues of \$1.1 billion, including the most recent, *THAW*, which was released in the third quarter of fiscal 2006. We will continue to build on the Tony Hawk franchise in fiscal 2007 with the release of *Tony Hawk's Project 8* and *Tony Hawk's Downhill Jam*.

We continue to develop a number of original intellectual properties which are developed and owned by Activision. For example, in the third quarter of fiscal 2006 we released *Call of Duty 2* on the PC and Xbox360 and *Call of Duty 2: Big Red One*, on the GameCube, PS2, and Xbox. According to NPD Funworld, *Call of Duty 2* was the top selling Xbox360 title of the year. These titles were the fourth and fifth releases based upon this original intellectual property following two other PC titles, *Call of Duty* and *Call of Duty: United Offensive*, and one other console title, *Call of Duty: Finest Hour*. In the third quarter of fiscal 2006, we also released *True Crime: New York City*, which was based upon our fiscal 2004 original intellectual property *True Crime: Streets of LA*, and *GUN*, a new original intellectual property. According to NPD Funworld, we have developed the number one new original intellectual property title in each of the past three years which included *True Crime: Streets of LA* in calendar 2003, *Call of Duty: Finest Hour* in calendar 2004, and *GUN* in calendar 2005. We expect to develop a variety of games on multiple platforms based on these original properties as well as continue to invest in developing other original intellectual properties.

We will also continue to evaluate and exploit emerging brands that we believe have potential to become successful game franchises. For example, we have a multi-year, multi-property, publishing agreement with DreamWorks LLC that grants us the exclusive rights to publish video games based on DreamWorks Animation SKG's theatrical release *Shrek 2*, which was released in the first quarter of fiscal 2005, *Shrek Tale*, which was released in the second quarter of fiscal 2005, *Madagascar*, which was released in the first quarter of fiscal 2006, *Over the Hedge*, which was released in the first quarter of fiscal 2007, and all of their respective sequels, including *Shrek the Third* and *Madagascar 2*. In addition, during the third quarter of fiscal 2006, we further enhanced our agreement with DreamWorks Animation SKG by signing a multi-year agreement which grants us the exclusive video game rights to four upcoming feature films, *Bee Movie*, *Kung Fu Panda*, *Rex Havoc*, and *How to Train Your Dragon*, as well as potential future films in the *Shrek* franchise beyond the upcoming *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. In fiscal 2007, we plan on releasing our second title under this alliance, *World Series of Poker: Tournament of Champions*.

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 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 May 2006 we signed an agreement with MGM Interactive and EON Productions Ltd. granting us the rights to develop and publish interactive entertainment games based on the James Bond license through 2014.

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In addition to acquiring or creating high profile intellectual property, we have also continued our focus on establishing and maintaining relationships with talented and experienced software development teams. We have strengthened our internal development capabilities through the acquisition of several development companies with talented and experienced teams including the acquisitions of developers Toys For Bob, Inc. in April 2005 and Beenox, Inc.

in May 2005. Additionally, in May 2006 we entered into an agreement to acquire video game publisher RedOctane Inc., the publisher of the popular Guitar Hero franchise. We have development agreements with other top-level, third-party developers such as id Software, Inc., Edge of Reality, Ltd., and Splash Damage, Ltd.

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

Critical Accounting Policies

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

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

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

Allowances for Returns, Price Protection, Doubtful Accounts, and Inventory Obsolescence. In determining the appropriate unit shipments to our customers, we benchmark our titles using historical and industry data. We closely monitor and analyze the historical performance of our various titles, the performance of products released by other publishers, and the anticipated timing of other releases in order to assess future demands of current and upcoming titles. Initial

volumes shipped upon title launch and subsequent reorders are evaluated to ensure that quantities are sufficient to meet the demands from the retail markets but at the same time, are controlled to prevent excess inventory in the channel.

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

performance of the hardware platform, historical performance of the brand, console hardware life cycle, Activision sales force and retail customer feedback, industry pricing, weeks of on-hand retail channel inventory, absolute quantity of on-hand retail channel inventory, 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 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, 2006 allowance for returns and price protection would impact net revenues by approximately \$1.0 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 impact management's estimates in establishing our allowance for doubtful accounts.

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

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

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

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

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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 and expected title performance.

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

Selected Consolidated Statements of Operations Data

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

	2006		Year ended March 31, 2005		2004	
Net revenues	\$ 1,468,000	100%	\$ 1,405,857	100%	\$ 947,656	100%
Costs and expenses:						
Cost of sales product costs	734,874	50	658,949	47	475,541	50
Cost of sales software royalties and amortization	147,822	10	123,800	9	59,744	6
Cost of sales intellectual property licenses	57,666	4	62,197	5	31,862	3
Product development	131,782	9	86,543	6	97,859	10
Sales and marketing	283,220	19	230,058	16	128,221	14
General and administrative	94,679	7	59,739	4	44,612	5
Total costs and expenses	1,450,043	99	1,221,286	87	837,839	88
Income from operations	17,957	1	184,571	13	109,817	12
Investment income, net	30,630	2	13,092	1	6,175	
Income before income tax provision	48,587	3	197,663	14	115,992	12
Income tax provision	6,688		59,328	4	38,277	4
Net income	\$ 41,899	3%	\$ 138,335	10%	\$ 77,715	8%
Net Revenues by Territory:						
North America	\$ 710,040	48%	\$ 696,325	50%	\$ 446,812	47%
Europe	717,494	49	675,074	48	479,224	51
Other	40,466	3	34,458	2	21,620	2
Total net revenues	\$ 1,468,000	100%	\$ 1,405,857	100%	\$ 947,656	100%
Net Revenues by Segment/Platform Mix:						
Publishing:						
Console	\$ 812,345	55%	\$ 713,947	51%	\$ 508,418	54%
Hand-held	158,861	11	138,695	10	24,945	2
PC	183,457	13	220,087	15	132,369	14
Total publishing net revenues	1,154,663	79	1,072,729	76	665,732	70
Distribution:						
Console	196,413	13	256,452	18	223,802	24
Hand-held	76,973	5	23,282	2	18,361	2
PC	39,951	3	53,394	4	39,761	4

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Total distribution net revenues	313,337	21	333,128	24	281,924	30
Total net revenues	\$ 1,468,000	100%	\$ 1,405,857	100%	\$ 947,656	100%
Operating Income (Loss) by Segment:						
Publishing	\$ (3,984)	%	\$ 160,826	11%	\$ 93,223	10%
Distribution	21,941	1	23,745	2	16,594	2
Total operating income	\$ 17,957	1%	\$ 184,571	13%	\$ 109,817	12%

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

We primarily derive revenue from sales of packaged interactive software games designed for play on video game consoles (such as the PS2, Xbox, 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.

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/	Percent
	2006	2005	(Decrease)	Change
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.

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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.

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

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(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.

Due to uncertainty with regard to the market, software pricing, and first-party hardware plans for current and next-generation consoles, we plan on releasing a more focused slate of titles in fiscal 2007. As a result, we anticipate revenue will decrease in fiscal 2007 in comparison to the record net revenues achieved in fiscal 2006.

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 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	31%	\$ 376,404	26%	\$ 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 26% for the year ended March 31, 2005 to 31% 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. In the coming year, we will continue to focus on expanding our international publishing capabilities and direct-selling efforts in both the European and Asia-Pacific markets.

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						