Breaking Records

ACTIVISION®

2003 Annual Report

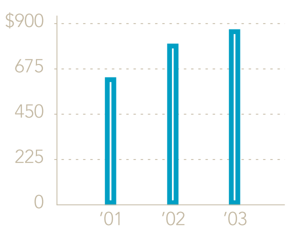
for 11 Years

Financial Highlights

In thousands of dollars, except per share data	2003	2002	2001
Net revenues	$864,116	$786,434	$620,183
Operating income	94,847	80,574	39,807
Net earnings	66,180	52,238	20,507
Earnings per common share:			
Basic earnings per share	0.69	0.69	0.37
Diluted earnings per share	0.64	0.59	0.33

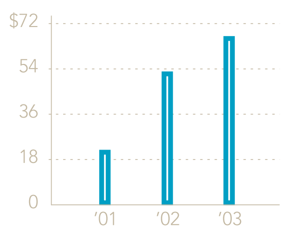
NET REVENUES

(in millions of dollars)



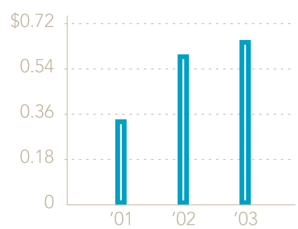
NET EARNINGS

(in millions of dollars)



DILUTED EPS

(per common share)



To our shareholders:

Fiscal 2003 proved to be a hallmark year for Activision, culminating in our 11th consecutive year of revenue growth. Net revenues for the fiscal year increased to $864 million and net earnings rose 27% to a record $0.64 per diluted share. For fiscal years 1999 through 2003, Activision's compounded annual revenue and net income growth rates are 19% and 45%, respectively.

Along with posting record results, we significantly strengthened the company's financial position. We generated $79 million in free cash flow and grew shareholder equity 39% from $430 million to $598 million. We continued our company-wide program to reduce costs and improved our operating margin by 73 basis points in the last fiscal year for a total improvement of 456 basis points over the past two years.

As an investment in our future, our board of directors authorized a $350 million share buy back program under which we repurchased approximately $100 million of shares of the company's common stock and entered into approximately $110 million of structured stock purchase transactions. We finished the year with more than $400 million in cash and short-term investments, lower inventories and all-time low days sales outstanding. Today, Activision maintains one of the strongest balance sheets in our industry.

We broadened our development capabilities during the fiscal year through the acquisition of two new studios, Z-Axis and Luxoflux, each of which have created game franchises that have sold more than one million units. We also purchased an equity interest in Infinity Ward, a newly formed studio comprised of former members of the team that developed the blockbuster PC game *Medal of Honor Allied Assault*™.

Our business is built in part on Activision's skill at turning licensed properties into great video games. This year, we entered into four multi-year partnership agreements that will not only expand the range of our product offerings but also enhance consistency and predictability of our future financial results.

We extended our relationship with world-renowned skateboarder Tony Hawk through a licensing agreement that expires in 2015. We also expanded our long-term strategic alliance with Marvel Enterprises and signed a multi-year extension to our current video game licensing agreements. The expanded agreements grant us the exclusive rights to develop and publish video game products based on Marvel's comic book franchises Spider-Man®, X-Men™, Fantastic Four™ and Iron Man™ through 2009.

Beginning in fiscal year 2005, we will be publishing games based on four upcoming DreamWorks' computer-animated feature films: "Shrek 2," "Sharkslayer™," "Madagascar™," and "Over the Hedge™." Additionally, the company was named master video game licensee for Lemony Snicket's A Series of Unfortunate Events, the best-selling children's book series that Nickelodeon Movies is developing as a feature film.

We further augmented our product portfolio by entering into an agreement with U.K.-based Lionhead Studios for the exclusive worldwide rights to its new project titled *The Movies*™ for the PC and all video game console platforms. Additionally, we forged partnerships with premier PC game developers Valve L.L.C. and Stainless Steel Studios to publish several of their upcoming games.


Robert A. Kotick


Brian G. Kelly


Ronald Doornink

Our progress spanned all facets of our business worldwide. We continued our market leadership positions in both the superheroes and action sports genres with *Spider-Man*® and *Tony Hawk's Pro Skater*® ending the calendar year as top-five franchises in North America for the console and hand-held platforms. Additionally, *Soldier of Fortune II: Double Helix*™, LucasArts' *Star Wars*®*: Jedi Outcast*™, *Street Hoops*™, *Medieval: Total War, Tenchu: Wrath of Heaven*™ and *Cabela's Big Game Hunter*™ performed well worldwide.

While there is good reason to be proud of our record accomplishments in 2003, we decided to significantly strengthen our development strategies in order to retain industry leadership in a very competitive environment. We lengthened the production schedules for several of our titles, as games continue to require more sophisticated production values. Concurrent with this decision, we eliminated a significant number of smaller, non-core projects. These changes should allow us to focus on developing top-quality games and allocate our production and marketing resources against titles with the highest probability of success. Additionally, we modified our action sports strategy and are now positioning each title individually in order to better differentiate each sport. This approach allows each game to be marketed in the most efficient manner.

The progress we made in reinforcing our financial foundation, development capabilities and brand franchises could not have occurred without the support of our employees and partners. Everything we do calls on the imaginative, intellectual and entrepreneurial talents of the people who work here. More than any other assets, their integrity, insight and innovation, passion and commitment are the reason Activision enjoys a reputation of being one of the world's best interactive entertainment companies.

We enter fiscal year 2004 with a strong record of earnings growth, a broad portfolio of products that are well aligned with market demographics, strengthened development resources and a solid balance sheet that provides us with the financial flexibility to capitalize on both near-term and future business opportunities.

As we strive to add value in everything we do, for all of our stakeholders, we will continue to leverage Activision's fundamental strengths—a business philosophy focused on long-term objectives and a well-balanced product portfolio based on some of the world's most recognizable brands. These strengths and the continued support of our employees, customers, business partners and shareholders position us well to benefit from the opportunities presented by existing game platforms as well as emerging technologies and take our company to new levels of achievement.

Sincerely,

Robert A. Kotick
Chairman and CEO

Brian G. Kelly
Co-Chairman

Ronald Doornink
President

Maintaining brand leadership:

Every day, Activision touches the lives of people around the world. From the moment a consumer stands in front of a store shelf, they are assessing the performance, quality and value of Activision's brands. It is consumers who decide whether or not our brands live up to their promise to deliver compelling interactive entertainment experiences.

Activision has been changing the way consumers spend their leisure time for the past 24 years. In the process, we have built one of the largest portfolios of recognized brands and today we are one of the most valuable interactive entertainment companies in the world.

In fiscal 2004, we look to continue our track record of creativity and innovation with a dynamic game slate that spans several genres including high profile Hollywood licenses, new action sports titles, driving, first-person action and role-playing games.

Best-selling franchises in North America

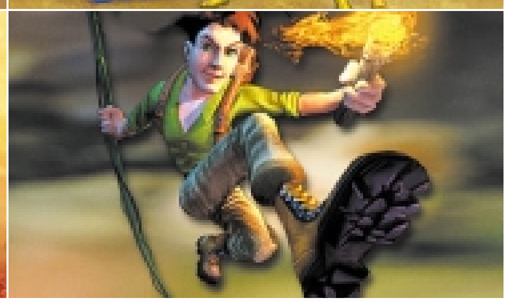
ACTIVISION IS ONE OF THE MOST RECOGNIZED NAMES IN INTERACTIVE ENTERTAINMENT.

For calendar 2002, *Spider-Man®* and *Tony Hawk's Pro Skater®* were two of the top five best-selling franchises in North America for the console and hand-held platforms.

Providing enhanced financial stability

ACTIVISION'S BALANCED PRODUCT PORTFOLIO INCLUDES BOTH LICENSED AND ORIGINAL PROPERTIES.

Recognized brands provide enhanced financial stability and predictability which gives us the flexibility to create additional financial upside by developing new properties based on original game concepts.



Deepening our development capabilities:

Activision's strong financial position enabled the company to make two key acquisitions during the fiscal year, bringing our total number of wholly-owned development studios to eight. We have stringent criteria for acquiring development talent and seek to acquire companies with whom we have a history of working and who have a track record of making great games. In addition, the companies must have strong management capabilities to effectively manage production budgets to bring in quality games on time; have proprietary technologies; and have development competencies in genres that align with our product slate.

To ensure consistency and quality for our games, we partner our internal studio capabilities with our brand franchises. This strategy enables us to pair great developers with key brands and provides the developers with the ability to create and maintain a long-term vision for the franchise, capitalize on hardware advancements and improve the brand as they push the technological envelope.

A partner of choice around the world

IN FISCAL 2003, THE COMPANY FORGED ALLIANCES WITH SUCH PREMIER DEVELOPERS AS:

Peter Molyneux's Lionhead Studios, Gabe Newell's Valve Software and Rick Goodman's Stainless Steel Studios. The company also expanded its long-standing partnership with renowned PC developer id Software and acquired two development studios—Luxoflux and Z-Axis.

Emerging platform opportunities:

The incorporation of microprocessors into numerous electronic devices is enabling Activision to deliver our games to consumers in exciting and different ways. In addition to the growing installed base of console and hand-held platforms, new, more powerful platforms continue to be introduced. These new systems, coupled with the opportunities that will be presented by the next-generation of consoles following the PlayStation 2, Xbox and GameCube, will continue to transform game systems into mass-market home entertainment devices that should fuel the industry's growth to unprecedented levels.

In 2004, Sony expects to launch a new portable electronic device, the PSP, targeted toward the 13–24 year old demographic. Additionally, Sony is planning to incorporate a DVD recorder and hard drive into PlayStation 2.

As emerging technologies expand the number of game players beyond previous levels, Activision is poised to capitalize on new business opportunities that will generate additional revenues, further extend the reach of our brands and deliver new types of gaming experiences to consumers worldwide.

Emerging technologies

UNIMAGINABLE INTERACTIVE GAMING EXPERIENCES

Emerging technologies will provide consumers in different time zones, continents and cultures with previously unimaginable interactive gaming experiences.

Leveraging our multi-platform capabilities

TAKE ADVANTAGE OF THE GROWTH AND MARGIN ENHANCEMENT OPPORTUNITIES

By continuing to leverage our multi-platform capabilities, Activision looks to take advantage of the growth and margin enhancement opportunities afforded by new platforms.

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, 2003 are derived from our audited consolidated financial statements. The Consolidated Balance Sheets as of March 31, 2003 and 2002 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, 2003, and the report thereon, are included elsewhere in this Annual Report.

(In thousands, except per share data)		Restated(1)			
Year ended March 31,	2003(2)	2002(2)	2001	2000	1999
Statement of Operations Data:					
Net revenues	$ 864,116	$786,434	$620,183	$572,205	$436,526
Cost of sales—product costs	440,977	435,725	324,907	319,422	260,041
Cost of sales—intellectual property licenses and software royalties and amortization	124,196	99,006	89,702	91,238	36,990
Income (loss) from operations	94,847	80,574	39,807	(30,325)	26,667
Income (loss) before income tax provision (benefit)	103,407	83,120	32,544	(38,736)	23,636
Net income (loss)	66,180	52,238	20,507	(34,088)	14,891
Basic earnings (loss) per share	0.69	0.69	0.37	(0.61)	0.29
Diluted earnings (loss) per share	0.64	0.59	0.33	(0.61)	0.28
Basic weighted average common shares outstanding	96,239	75,977	55,947	55,556	51,438
Diluted weighted average common shares outstanding	103,655	89,183	61,650	55,556	53,847
Cash Provided by (Used in):					
Operating activities	90,975	111,792	81,565	2,883	(42,341)
Investing activities	(155,101)	(8,701)	(8,631)	(25,041)	(3,800)
Financing activities	64,090	50,402	2,547	42,028	7,220
As of March 31,	2003(2)	2002(2)	2001	2000	1999
Balance Sheet Data:					
Working capital	$ 422,500	$333,199	$182,980	$158,225	$136,355
Cash, cash equivalents and short-term investments	406,954	279,007	125,550	49,985	33,037
Capitalized software development and intellectual property licenses	107,921	56,742	42,205	40,808	45,016
Goodwill	68,019	35,992	10,316	12,347	21,647
Total assets	704,816	556,887	359,957	309,737	283,345
Long-term debt	2,671	3,122	63,401	73,778	61,143
Shareholders' equity	597,740	430,091	181,306	132,009	127,190

(1) Consolidated financial information for fiscal years 2002–1999 has been restated for the effect of our three-for-two stock split effected in the form of a 50% stock dividend to shareholders of record as of May 16, 2003, payable June 6, 2003.

(2) Effective April 1, 2001, we adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangibles." SFAS No. 142 addresses financial accounting and reporting requirements for acquired goodwill and other intangible assets. Under SFAS No. 142, goodwill is deemed to have an indefinite useful life and should not be amortized but rather tested at least annually for impairment. In accordance with SFAS No. 142, we have not amortized goodwill during the years ended March 31, 2003 and 2002. See Note 7 of Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

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

Our products cover game categories such as action/adventure, action sports, racing, role-playing, simulation, first-person action and strategy. We currently offer our products in versions that operate on the Sony PlayStation 2 ("PS2"), Sony PlayStation ("PS1"), Nintendo GameCube ("GameCube") and Microsoft Xbox ("Xbox") console systems, Nintendo Game Boy Advance ("GBA") hand-held device and the personal computer ("PC"). In prior years, we have also offered our products on the Nintendo 64 ("N64") and Sega Dreamcast ("Dreamcast") console systems and Nintendo Game Boy Color ("GBC") hand-held device. Sony recently announced that it would be reentering the hand-held hardware market with the introduction of its hand-held gaming device, PlayStation Portable ("PSP"). PSP is currently expected to be released in the fourth quarter of calendar 2004. We expect that we will develop titles for this new platform.

Our publishing business involves the development, marketing and sale of products, either directly, by license or through our affiliate label program with third-party publishers. In the United States, we primarily sell our products on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses and office super-stores. We conduct our international publishing activities through offices in the United Kingdom ("UK"), Germany, France, 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 United Kingdom, the Netherlands and Germany that provide logistical and sales services to third-party publishers of interactive entertainment software, our own publishing operations and manufacturers of interactive entertainment hardware.

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

Our focus with respect to future game development will be on big, well-established brands that we believe we can build into successful game franchises such as our superheroes and action sports brands. With regard to our superheroes brands, we recently exercised an option to develop and publish the video game based on the sequel to the "Spider-Man" movie which is expected to be theatrically released in the spring of 2004. *Spider-Man: The Movie* was a key release for the first quarter of fiscal 2003 and has continued to perform strongly throughout fiscal 2003. In December 2002, we expanded our long-term alliance with Marvel Enterprises through an exclusive, multi-year, licensing agreement that expires in 2009. The agreement extends our exclusive rights to develop and publish video games based on Marvel's comic book franchises Spider-Man, X-MEN, Fantastic Four and Iron Man. The agreement additionally provides us the rights to develop video games in conjunction with motion pictures and television series involving X-MEN, Fantastic Four and Iron Man. Further, another of our key strategies is to continue to be a leader in the action sports category. In October 2002, we released *Tony Hawk's Pro Skater 4* across multiple platforms. We will continue to promote our action sports franchises with the release of titles for existing franchises such as *Tony Hawk's Underground* and *Street Hoops* and new action sports titles, such as *Wakeboarding Unleashed,* as well as titles related to motor cross and snowboarding. We will also continue to develop new intellectual properties, such as the upcoming titles *True Crime: Streets of L.A.* and *Call of Duty,* which we hope to establish as franchise properties.

We will also continue to evaluate emerging brands that we believe have potential to become successful game franchises. For example, in August, 2002, we entered into an exclusive licensing agreement to develop and publish video games for the best-selling children's book series, Lemony Snicket's A Series of Unfortunate Events which is being developed for a feature film by Paramount Pictures and Nickelodeon Movies. In December 2002, we also entered into a multi-year, multi-property, publishing agreement with DreamWorks SKG that grants us the exclusive rights to publish video games based on DreamWorks SKG's "Shrek 2," and three other upcoming computer-animated films, "Sharkslayer," "Madagascar" and "Over the Hedge," as well as their sequels.

In addition to acquiring or creating high profile intellectual property, we will also continue our focus on establishing and maintaining relationships with talented and experienced software development teams. During fiscal 2003, we bolstered our internal development capabilities with the acquisitions of two privately held interactive software development companies, Z-Axis and Luxoflux, as well as a 30% capital investment in a third, Infinity Ward. We have additionally entered into development agreements with other top-level, third-party developers such as id Software, Valve, Stainless Steel, Spark and Lionhead Studios.

We intend to utilize these developer relationships, new intellectual property acquisitions, and our existing library of intellectual property to further focus our future game development on big, well-established brands that we believe have the potential to become franchise properties with sustainable consumer appeal and brand recognition. We also intend to create a small number of new intellectual properties that we believe have the potential to join this list of franchise properties. Accordingly, we have chosen to eliminate certain smaller and non-core projects from our development plan and expect to reduce the number of titles to be released in fiscal 2004. Additionally, to maintain the competitiveness of our products and to take advantage of increasingly sophisticated technology associated with new hardware platforms, we intend to increase the amount of time spent play-testing new products, to conduct more extensive product quality evaluations and to lengthen product development schedules to allow time to make the improvements indicated by our testing and evaluations. In many cases, this will result in an increase in future product development costs. Further, as a result of the expected increase in the length of product development schedules, the expected release dates of certain fiscal 2004 titles have been shifted to fiscal 2005.

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 elsewhere in this Annual Report. 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. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection. We may permit product returns from, or grant price protection to, our customers on unsold merchandise under certain conditions. Price protection, when granted and applicable, allows customers a credit against amounts they owe us with respect to merchandise unsold by them. 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.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Allowances for Returns, Price Protection, Doubtful Accounts and Inventory Obsolescence. 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. 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 based upon historical experience, customer inventory levels and changes in the demand and acceptance of our products by the end consumer. 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. Material differences may result in the amount and timing of our revenue for any period if management makes different judgments or utilizes different estimates.

Similarly, management must make estimates of the uncollectibility of our accounts receivable. In estimating the allowance for doubtful accounts, we analyze historical bad debts, customer concentrations, customer credit worthiness, 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 Standards ("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. 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. The following criteria are used to evaluate expected product performance: historical performance of comparable products using comparable technology; orders for the product prior to its release; and estimated performance of a sequel product based on the performance of the product on which the sequel is based.

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

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

Intellectual Property Licenses. Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks or copyrights 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. The following criteria are used to evaluate expected product performance: 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 trademark or copyright will be utilized. As intellectual property license contracts may extend for multiple years, the amortization of capitalized intellectual property license costs relating to such contracts may extend beyond one year. For intellectual property included in products that have been released, we evaluate the future recoverability of capitalized amounts on a quarterly basis. The primary evaluation criterion is actual title performance.

Significant management judgments and estimates are utilized in the assessment of the recoverability of capitalized costs.

Management's Discussion and Analysis of Financial Condition and Results of Operations

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

(In thousands)

Year ended March 31,	2003		2002		2001	
Net revenues	$864,116	100%	$786,434	100%	$620,183	100%
Costs and expenses:						
Cost of sales—product costs	440,977	51	435,725	56	324,907	52
Cost of sales—software royalties and amortization	79,194	9	58,892	7	49,864	8
Cost of sales—intellectual property licenses	45,002	5	40,114	5	39,838	6
Product development	56,971	7	40,960	5	41,396	8
Sales and marketing	100,646	12	86,161	11	85,378	14
General and administrative	46,479	5	44,008	6	38,993	6
Total costs and expenses	769,269	89	705,860	90	580,376	94
Income from operations	94,847	11	80,574	10	39,807	6
Investment income, net	8,560	1	2,546	1	(7,263)	(1)
Income before income tax provision	103,407	12	83,120	11	32,544	5
Income tax provision	37,227	4	30,882	4	12,037	2
Net income	$ 66,180	8%	$ 52,238	7%	$ 20,507	3%
Net revenues by territory:						
United States	$432,261	50%	$404,905	51%	$352,893	57%
Europe	413,125	48	368,799	47	256,228	41
Other	18,730	2	12,730	2	11,062	2
Total net revenues	$864,116	100%	$786,434	100%	$620,183	100%
Net revenues by segment/platform mix:						
Publishing:						
Console	$466,116	76%	$312,986	57%	$278,486	60%
Hand-held	49,966	8	119,177	22	71,042	15
PC	99,893	16	117,345	21	116,534	25
Total publishing net revenues	615,975	71	549,508	70	466,062	75
Distribution:						
Console	208,505	84	167,709	71	107,611	70
Hand-held	14,103	6	39,865	17	9,754	6
PC	25,533	10	29,352	12	36,756	24
Total distribution net revenues	248,141	29	236,926	30	154,121	25
Total net revenues	$864,116	100%	$786,434	100%	$620,183	100%
Operating income by segment:						
Publishing	$ 79,139	9%	$ 68,675	9%	$ 35,687	5%
Distribution	15,708	2	11,899	1	4,120	1
Total operating income	$ 94,847	11%	$ 80,574	10%	$ 39,807	6%

Results of Operations—Fiscal Years Ended March 31, 2003 and 2002

Net income for the year ended March 31, 2003 was $66.2 million or $0.64 per diluted share, as compared to $52.2 million or $0.59 per diluted share for the year ended March 31, 2002.

Net Revenues. Net revenues for the year ended March 31, 2003 increased 10% from the prior fiscal year, from $786.4 million to $864.1 million. This increase was generated by our publishing business and, to a lesser degree, our distribution business.

Publishing net revenues for the year ended March 31, 2003 increased 12% from the prior fiscal year, from $549.5 million to $616.0 million. The following table details our publishing net revenues by platform as a percentage of total publishing net revenues for the years ended March 31, 2003 and 2002:

Year ended March 31,	2003	2002
Publishing Net Revenues		
PC	16%	21%
Console	76%	57%
PlayStation 2	42	20
Microsoft Xbox	12	6
Nintendo GameCube	12	3
PlayStation	9	21
Nintendo 64	1	6
Sega Dreamcast	—	1
Hand-held	8%	22%
Game Boy Advance	7	15
Game Boy Color	1	7
Total publishing net revenues	100%	100%

There were several factors that affected the fiscal 2003 net revenue performance of our publishing business. First, positively impacting our performance, was an improvement in console sales. Our publishing console net revenues for the year ended March 31, 2003 increased 49% from the prior fiscal year, from $313.0 million to $466.1 million. Fiscal 2003 publishing console net revenues reflect the simultaneous cross-platform, multi-national releases of *Spider-Man: The Movie* in the first quarter and *Tony Hawk's Pro Skater 4* in the third quarter. In addition publishing console net revenue performance was also driven by the following releases: *Tenchu: Wrath of Heaven, Street Hoops 2* and *Cabela's Big Game Hunter* for PS2. Second, publishing hand-held net revenues for the year ended March 31, 2003 decreased by 58% from the prior fiscal year, from $119.2 million to $50.0 million. This decrease reflects the fact that the GBA hardware was launched in June 2001. Our GBA software sales for the year ended March 31, 2002 benefited from the related hardware launch. We also released fewer titles for the hand-held platforms in fiscal 2003—11 titles, in comparison to 19 titles in fiscal 2002. Additionally, the average retail price of titles for hand-held devices was lower in fiscal 2003 than in fiscal 2002. Third, PC net revenues for the year ended March 31, 2003 decreased 15% from the prior fiscal year, from $117.3 million to $99.9 million. Though the number of PC titles released in fiscal 2003 was relatively consistent with fiscal 2002, during fiscal 2002, we released *Return to Castle Wolfenstein* for the PC, which was one of our top performing titles of fiscal 2002. PC net revenues for the year ended March 31, 2002 reflect that title's worldwide, strong performance. Lastly, net revenues from our international publishing business for the year ended March 31, 2003 benefited by approximately $14.1 million from a year-over-year strengthening of the Euro and the Great British Pound ("GBP") in relation to the U.S. dollar. Excluding the impact of foreign currency fluctuations, our domestic publishing business and our international publishing business experienced similar year-over-year improvements for the reasons detailed above.

The platform mix of our future publishing net revenues will be impacted by a number of factors, including the ability of hardware manufacturers to continue to increase their installed hardware bases, the introduction

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of new hardware platforms, as well as the timing of key product releases from our own product release schedule. We expect that net revenues from console titles will continue to represent the largest component of our publishing net revenues with PS2 having the largest percentage of that business due to its larger installed hardware base. We expect net revenues from hand-held titles to remain the smallest component of our publishing net revenues. However, with the introduction of PSP in fiscal 2005, we may see an increase in our hand-held business over fiscal 2003. Our net revenues from PC titles will be primarily driven by our product release schedule.

A significant portion of our revenues and profits are derived from a relatively small number of popular titles and brands each year as revenues and profits are significantly affected by our ability to release highly successful or "hit" titles. For example, for the year ended March 31, 2003, 30% of our consolidated net revenues and 43% of worldwide publishing net revenues were derived from net revenues from our *Spider-Man: The Movie* and *Tony Hawk's Pro Skater 4* 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 impacts operating profits resulting in a disproportionate amount of operating income being derived from these select titles. We expect that a limited number of titles and brands will continue to produce a disproportionately large amount of our net revenues and profits.

As discussed in the "Overview" section of "Management's Discussion and Analysis of Financial Condition and Results of Operations," in connection with our focus of future game development on big, well-established brands that we believe have the potential to become game franchise properties with sustainable consumer appeal, we have chosen to eliminate certain smaller and non-core projects from our development plan and expect to reduce the number of titles released in fiscal 2004. Further, as a result of an expected increase in the length of product development schedules, the expected release dates of certain fiscal 2004 titles have been shifted to fiscal 2005. Because of these and other factors, we currently expect fiscal 2004 net revenues to be less than those of fiscal 2003, but we currently expect that we will resume net revenue growth in fiscal 2005.

Another factor that could affect fiscal 2004 net revenue performance is software pricing. While we expect console launch pricing to hold at $49.99 through the holidays, we believe that we could see price declines thereafter.

Distribution net revenues for the year ended March 31, 2003 increased 5% from the prior fiscal year, from $236.9 million to $248.1 million. The increase was due to the positive impact of the year-over-year strengthening of the Euro and the GBP in relation to the U.S. dollar. Distribution console net revenues for the year ended March 31, 2003 also benefited from the international hardware launches of Xbox and GameCube in March 2002 and May 2002, respectively. It additionally benefited from the price reduction on PS2 hardware that was effective September 2001, as this resulted in both an increase in sales of PS2 hardware, as well as an increase in sales of PS2 software due to the corresponding larger installed hardware base. This increase was partially offset by declines in distribution hand-held and PC net revenues for the reasons detailed in the discussion of publishing net revenues. The mix of distribution net revenues between hardware and software sales remained relatively constant year-over-year at approximately 38% hardware and 62% software. The mix of future distribution net revenues will be driven by a number of factors including the occurrence of hardware price reductions instituted by hardware manufacturers, the introduction of new hardware platforms and our ability to establish and maintain distribution agreements with hardware manufacturers and third-party software publishers. We expect software sales as a percentage of total distribution net revenues in fiscal 2004 to increase slightly from fiscal 2003.

Domestic net revenues increased 7% from $404.9 million for the year ended March 31, 2002, to $432.3 million for the year ended March 31, 2003 for the reasons detailed above in the discussion of our publishing business net revenues. International net revenues increased by 13% from $381.5 million for the year ended March 31, 2002, to $431.9 million for the year ended March 31, 2003 for the reasons detailed above in the discussion of our publishing business, as well as the result of the year-over-year strengthening of the Euro and the GBP in relation to the U.S. dollar.

Costs and Expenses. Cost of sales—product costs represented 51% and 56% of consolidated net revenues for the year ended March 31, 2003 and 2002, respectively. There were two primary factors that affected cost of sales—product costs as a percentage of consolidated net revenues. First, the product mix of our publishing business for the year ended March 31, 2003 reflects a lower proportion of net revenues from titles for hand-held devices, as compared to the year ended March 31, 2002. Titles for hand-held devices generally have the highest manufacturing per unit cost of all platforms. Second, our manufacturing costs for console titles for the year ended March 31, 2003 benefited from the economies of scale due to the high volume of *Spider-Man: The Movie* units manufactured.

Cost of sales—software royalties and amortization for the year ended March 31, 2003 increased as a percentage of publishing net revenues from the prior fiscal year, from 11% to 13%. In absolute dollars, cost of sales—software royalties and amortization for the year ended March 31, 2003 also increased from the prior fiscal year, from $58.9 million to $79.2 million. The increases reflect the change in the product mix of our publishing business. Though titles for hand-held devices generally have the highest per unit manufacturing cost of all platforms, they have the lowest product development cost structure. In the year ended March 31, 2002 in which titles for hand-held devices accounted for a higher proportion of publishing net revenues, the related cost of sales—software royalties and amortization was correspondingly low. This is in comparison to the year ended March 31, 2003 in which console titles accounted for a higher proportion of publishing net revenues. Console titles such as PS2, Xbox and GameCube have high product development cost structures, and the release of titles on these platforms will result in a correspondingly high cost of sales—software royalties and amortization. In addition, we recorded during the fourth quarter of fiscal 2003 approximately $8.0 million related to an assessment of the recoverability of capitalized development costs pertaining to certain products.

Cost of sales—intellectual property licenses for the year ended March 31, 2003 remained constant as a percentage of publishing net revenues with the prior fiscal year at 7%. In absolute dollars, cost of sales—intellectual property licenses for the year ended March 31, 2003 increased from the prior fiscal year, from $40.1 million to $45.0 million. During the fourth quarter of fiscal 2003, we recorded an approximate $7.0 million related to an assessment of the recoverability of certain of our investments in long-term licensing agreements. We recorded additional costs relating to common stock warrants issued in connection with those licensing agreements. The impact of these costs was partially offset by the fact that one of our top performing titles released in fiscal 2002 had a higher intellectual property royalty rate structure than the majority of the top performing titles released in fiscal 2003.

Product development expenses for the year ended March 31, 2003 increased as a percentage of publishing net revenues from the prior fiscal year, from 7% to 9%. In absolute dollars, product development expense for the year ended March 31, 2003 also increased from the prior fiscal year, from $41.0 million to $57.0 million. These increases reflect the change in the product mix of titles in development—more console and less hand-held—during fiscal 2003. The cost to develop titles for current console systems, such as PS2, Xbox and GameCube, is higher than the cost to develop titles for the legacy console systems and hand-held devices. Additionally, we had more titles in development during fiscal 2003 than fiscal 2002. Lastly, in the fourth quarter of fiscal 2003, we decided to eliminate certain smaller and non-core projects from our future development plan. The cost relating to the cancellation of those titles was approximately $2.6 million.

As discussed in the "Overview" section of "Management's Discussion and Analysis of Financial Condition and Results of Operations," in order to maintain the competitiveness of our products and to take advantage of increasingly sophisticated technology associated with new hardware platforms, we intend to increase the amount of time spent play-testing new products, to conduct more extensive product quality evaluations and to lengthen product development schedules to allow time to make the improvements indicated by the testing and evaluations. In many cases, this will result in an increase in future product development costs.

Sales and marketing expenses of $100.6 million and $86.2 million represented 12% and 11% of consolidated net revenues for the year ended March 31, 2003 and 2002, respectively. The increase in sales and

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marketing expense dollars for the year ended March 31, 2003 from the prior fiscal year was the result of increased costs in both our publishing and distribution businesses. The increase in sales and marketing expense dollars in our publishing business was the result of a significant marketing program in support of the simultaneous cross-platform, multi-national release of *Spider-Man: The Movie* during the first quarter of fiscal 2003, as well as increased TV and print ads in support of second, third and fourth quarter releases such as *Street Hoops, Tony Hawk's Pro Skater 4* and *Tenchu: Wrath of Heaven.* Additionally, in the year ended March 31, 2003, we provided sponsorship for select action sports tours/tournaments in support of our Activision action sports brands. The increase in sales and marketing expense dollars in our distribution business was due to an increasing percentage of our distribution business being generated from large national accounts. Such large national accounts generally result in increased sales costs.

General and administrative expenses for the year ended March 31, 2003 increased $2.5 million from the prior fiscal year, from $44.0 million to $46.5 million. As a percentage of consolidated net revenues, general and administrative expenses remained relatively constant year-over-year at approximately 5% to 6% as a result of our continued focus on building operating efficiencies and controlling costs. The increase in absolute dollars was primarily due to the incurrence in the first quarter of fiscal 2003 of an approximate $2.0 million charge for the relocation of our UK distribution facility due to the increased growth of our UK distribution and UK publishing businesses.

Operating Income. Operating income for the year ended March 31, 2003 was $94.8 million, compared to $80.6 million in the prior fiscal year. The increase reflects improvements in both our publishing and distribution businesses. Publishing operating income improvement reflects, as previously discussed, the benefits generated by the release of hit titles, the decrease in cost of sales—product costs due to changes in product mix and our continued focus on building operating efficiencies and controlling costs. Distribution operating income improvement includes the distribution of a very successful third-party publisher's title in several countries and reductions in headcount related expenses.

Investment Income, Net. Investment income, net for the year ended March 31, 2003 was $8.6 million as compared to $2.5 million for the year ended March 31, 2002. The increase is primarily due to higher average cash and short-term investment balances during fiscal 2003, partially offset by lower market rates.

Provision for Income Taxes. The income tax provision of $37.2 million for the year ended March 31, 2003 reflects our effective income tax rate of 36%. The significant items that generated the variance between our effective rate and our statutory rate of 35% were state taxes and an increase in our deferred tax asset valuation allowance, partially offset by research and development tax credits and the impact of foreign tax rate differentials. The realization of deferred tax assets depends primarily on the generation of future taxable income. We believe that it is more likely than not that we will generate taxable income sufficient to realize the benefit of net deferred tax assets recognized.

Results of Operations—Fiscal Years Ended March 31, 2002 and 2001

Net income for the year ended March 31, 2002 was $52.2 million or $0.59 per diluted share, as compared to $20.5 million or $0.33 per diluted share for the year ended March 31, 2001.

Net Revenues. Net revenues for the year ended March 31, 2002 increased 27% from the prior fiscal year, from $620.2 million to $786.4 million. This increase was driven by the performance of both our publishing business and our distribution business.

Publishing net revenues for the year ended March 31, 2002 increased 18% from $466.1 million to $549.5 million. This increase primarily was due to publishing console and hand-held net revenues, combined, increasing 24% from $349.5 million to $432.2 million. The increase in publishing console and hand-held net revenues was attributable to the release in fiscal 2002 of several titles for next generation platforms (PS2, Xbox, GameCube, GBA) that sold very well in both the domestic and international marketplaces, as well as continuing strong worldwide sales for titles released on legacy platforms. Such titles included *Tony Hawk's Pro Skater 3* for PS2, GameCube and PS1, *Tony Hawk's Pro Skater 2* for GBA, N64 and PS1, *Wreckless: The Yakuza Missions* for Xbox, as well as *Mat Hoffman's Pro BMX* for PS1, GBA and GBC.

A significant portion of our revenues is derived from products based on a relatively small number of popular brands each year. In fiscal 2002, 50% of our worldwide net publishing revenues (35% of consolidated net revenues) was derived from two brands, one of which accounted for 44% and the other of which accounted for 6% of worldwide net publishing revenues (31% and 4%, respectively, of consolidated net revenues). In fiscal 2001, two brands accounted for 49% of our worldwide net publishing revenues (37% of consolidated net revenues), one of which accounted for 39% and the other of which accounted for 10% of worldwide net publishing revenues (29% and 8%, respectively, of consolidated net revenues). We expect that a limited number of popular brands will continue to produce a disproportionately large amount of our revenues. In fiscal 2002, 56% of publishing console and hand-held net revenues were derived from sales of titles for next generation platforms while 44% were derived from sales of titles for legacy platforms (PS1, N64, Dreamcast, GBC). 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. We expect sales from existing generation platform titles to decline and sales from next generation platform titles to increase as the installed base of next generation platforms grows. Publishing PC net revenues for the year ended March 31, 2002 remained relatively consistent with the prior year, increasing from $116.5 million to $117.3 million. Our PC business was flat primarily due to the fact that, despite the successful launch of *Return to Castle Wolfenstein* for the PC in the third quarter of fiscal 2002, there were fewer premium PC titles released in the year ended March 31, 2002, as compared to the year ended March 31, 2001.

Distribution net revenues for the year ended March 31, 2002 increased 54% from the prior fiscal year, from $154.1 million to $236.9 million, primarily driven by an increase in our distribution console and hand-held net revenues. Distribution console and hand-held net revenues, combined, for the year ended March 31, 2002 increased 77% over the prior fiscal year, from $117.4 million to $207.6 million. We are the sole distributor of Sony products in the independent channel in the UK. Accordingly, we benefited from the price reduction on PS2 hardware that was effective September 2001, as this resulted in both an increase in sales of PS2 hardware, as well as an increase in sales of PS2 software due to the corresponding larger installed hardware base. Additionally, in fiscal 2002, we began distributing Nintendo products within the UK. These items, along with the improved market conditions in Europe, have resulted in the continued improvements in our distribution business.

Domestic net revenues grew 15% from $352.9 million to $404.9 million. International net revenues increased by 43% from $267.3 million to $381.5 million. The increase in domestic net revenues is reflective of the improvements in our publishing business as described above, and the increase in international net revenues is reflective of the improvements in our publishing and distribution businesses as described above.

Costs and Expenses. Cost of sales—product costs represented 56% and 52% of consolidated net revenues for the year ended March 31, 2002 and 2001, respectively. The increase in cost of sales—product costs as a percentage of consolidated net revenues for the year ended March 31, 2002 was due to the increase in distribution net revenues as a percentage of total consolidated net revenues, as well as a change in the product mix of our publishing business. Distribution net revenues have a higher per unit cost as compared to publishing net revenues. The product mix of our publishing business for the year ended March 31, 2002 reflects a heavier concentration of console products and hand-held devices. Console products generally have a higher manufacturing per unit cost than PCs. Products for hand-held devices generally have the highest manufacturing per unit cost of all platforms.

Cost of sales—software royalties and amortization remained flat at 11% of publishing net revenues for the years ended March 31, 2002 and 2001.

Cost of sales—intellectual property licenses decreased as a percentage of publishing net revenues to 7% for the year ended March 31, 2002, from 9% for the year ended March 31, 2001. The decrease is reflective of the fact that in the year ended March 31, 2001, several of our top performing titles were products with high intellectual property royalty rates.

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Product development expenses of $41.0 million and $41.4 million represented 7% and 9% of publishing net revenues for the year ended March 31, 2002 and 2001, respectively. The decrease in product development expenses as a percentage of publishing net revenue is reflective of the fact that during the year ended March 31, 2002, a higher proportion of product development expenditures were incurred subsequent to the establishment of technological feasibility as compared to the prior fiscal year in which more product development expenditures were incurred prior to the establishment of technological feasibility and were, accordingly, charged directly to product development expense. In addition, our "Greenlight Process" for the selection, development, production and quality assurance of our products has exercised rigorous control over product development expenditures.

Sales and marketing expenses of $86.2 million and $85.4 million represented 11% and 14% of consolidated net revenues for the year ended March 31, 2002 and 2001, respectively. This decrease as a percentage of consolidated net revenues reflects our ability to generate savings by building on the existing awareness of our branded products and sequel titles sold during fiscal 2002. It also reflects the savings we receive from the increased success of releasing a higher proportion of our branded products simultaneously on multiple platforms.

General and administrative expense for the year ended March 31, 2002 increased 13%, from $39.0 million to $44.0 million. As a percentage of consolidated net revenues, general and administrative expenses remained relatively constant at approximately 6%. The increase in the dollar amount of general and administrative expenses was due to an increase in worldwide administrative support needs and headcount related expenses. Partially offsetting this increase was a decrease in amortization of intangibles, which is included in general and administrative expenses, from $1.5 million for the year ended March 31, 2001 to zero for the year ended March 31, 2002. Effective April 1, 2001, we adopted the provisions of SFAS No. 142, "Goodwill and Other Intangibles." SFAS No. 142 addresses financial accounting and reporting requirements for acquired goodwill and other intangible assets. Under SFAS No. 142, goodwill is deemed to have an indefinite useful life and should not be amortized but rather tested at least annually for impairment. As such, we did not record goodwill amortization for the year ended March 31, 2002.

Operating Income. Operating income for the year ended March 31, 2002, was $80.6 million, compared to $39.8 million in the prior fiscal year. The increase in operating income for the year ended March 31, 2002 over the prior fiscal year was primarily due to an increase in the success of our publishing business due to branding, cross platform releases and operating efficiencies obtained via the leveraging of our infrastructure and, to a lesser degree, an increase in our distribution business resulting from the growth of the next generation hardware and software markets.

Investment Income, Net. Investment income, net changed to $2.5 million of investment income for the year ended March 31, 2002, from $7.3 million of interest expense for the year ended March 31, 2001. This change was due to our improved cash position in fiscal 2002 resulting in higher investment income, the elimination of bank borrowings and the conversion and/or redemption of our $60.0 million convertible subordinated notes in the first quarter of fiscal 2002.

Provision for Income Taxes. The income tax provision of $30.9 million for the year ended March 31, 2002, reflects our effective income tax rate of approximately 37%. The significant items generating the variance between our effective rate and our statutory rate of 35% are state taxes and an increase in our deferred tax asset valuation allowance which is partially offset by research and development tax credits and the impact of foreign tax rate differentials. The realization of deferred tax assets is dependent on the generation of future taxable income. We believe that it is more likely than not that we will generate sufficient taxable income to realize the benefit of net deferred tax assets recognized.

Quarterly Operating Results

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

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

		Restated[1]						
Quarter ended	March 31, 2003[2]	Dec. 31, 2002	Sept. 30, 2002	June 30, 2002	March 31, 2002	Dec. 31, 2001	Sept. 30, 2001	June 30, 2001
Net revenues	$125,001	$378,685	$169,172	$191,258	$164,912	$371,341	$139,604	$110,577
Operating income (loss)	(14,444)	66,761	11,334	31,196	16,862	61,801	3,144	(1,235)
Net income (loss)	(7,957)	44,347	9,086	20,704	10,884	39,110	2,215	29
Basic earnings (loss) per share	(0.08)	0.44	0.09	0.23	0.13	0.50	0.03	0.00
Diluted earnings (loss) per share	(0.08)	0.42	0.08	0.21	0.12	0.44	0.03	0.00

(1) Consolidated financial information has been restated for the effect of our three-for-two stock split effected in the form of a 50% stock dividend to shareholders of record as of May 16, 2003, payable June 6, 2003.

(2) See Note 1, "Summary of Significant Accounting Policies—Software Development Costs and Intellectual Property Licenses" of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

Liquidity and Capital Resources

As of March 31, 2003, our primary source of liquidity is comprised of $285.6 million of cash and cash equivalents and $121.4 million of short-term investments. We believe that we have sufficient working capital ($422.5 million at March 31, 2003), as well as proceeds available from our international credit facilities (described below), to finance our operational requirements for at least the next twelve months, including purchases of inventory and equipment, the funding of the development, production, marketing and sale of new products and the acquisition of intellectual property rights for future products from third parties.

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

Cash Flows. Our cash and cash equivalents were $285.6 million at March 31, 2003 compared to $279.0 million at March 31, 2002. Activity in cash and cash equivalents for the year ended March 31, 2003 included $91.0 million and $64.1 million provided by operating and financing activities, respectively, offset by $155.1 million utilized in investing activities. The principal components comprising cash flows from operating activities included favorable operating results, tax benefits from stock option and warrant exercises and decreases in accounts receivable, partially offset by the timing of payments on accounts payable and our continued investment in software development and intellectual property licenses. We spent approximately $151.6 million and $77.0 million in the year ended March 31, 2003 and 2002, respectively, in connection with the acquisition of publishing or distribution rights for products being developed by third parties, the execution of new license agreements granting us long-term rights to intellectual property of third parties, as well as the capitalization of product development costs relating to internally developed products. We expect that we will continue to make significant expenditures relating to our investment in software development and intellectual property licenses.

The cash used in investing activities primarily was the result of the investment of excess cash balances into short-term investment vehicles. The goal of our short-term investments is to maximize return while minimizing risk, maintaining liquidity, coordinating with anticipated working capital needs and providing for prudent investment diversification. Cash used in investing activities was also the result of business combinations and equipment purchases. On May 20, 2002, we acquired all of the outstanding ownership interests of Z-Axis, Ltd. ("Z-Axis"), a privately held interactive software development company, in exchange for $12.5 million in cash and 373,785 shares of our common stock valued at approximately $8.2 million. Then, on October 4, 2002, we acquired all of the outstanding ownership interests of Luxoflux Inc. ("Luxoflux"), a privately held interactive software development company, in exchange for $9.0 million in cash. We have historically financed our acquisitions through the issuance of shares of common stock or a combination of common stock and cash. We will continue to evaluate potential acquisition candidates as to the benefit they bring to us and as to our ability to make such acquisitions.

The cash provided by financing activities primarily is the result of proceeds from the June 7, 2002 issuance of 11,250,000 shares of our common stock for proceeds of approximately $247.3 million, net of offering costs, partially offset by cash used to purchase treasury stock and enter into structured stock repurchase transactions. During fiscal 2003, our Board of Directors authorized a buyback program under which we can repurchase up to $350.0 million of our common stock. Under the program, shares may be purchased as determined by management, from time to time, in the open market or in privately negotiated transactions, including privately negotiated structured option transactions and through transactions in the options markets. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time or from time to time without prior notice. As of March 31, 2003, we had repurchased approximately 10.8 million shares of our common stock at an average cost of $9.39 per share for which $93.8 million was settled in cash as of March 31, 2003 and $7.6 million was settled in cash in April 2003. Additionally, under the Board approved buyback program, we entered into a series of structured stock repurchase transactions in the aggregate amount of $110.0 million. These transactions may be settled in cash or stock depending on the market price of our common stock on the date of the settlement. Upon settlement, we will either have our capital investment returned with a premium or receive up to approximately 12.8 million 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.

Credit Facilities. We currently have revolving credit facilities with our CentreSoft subsidiary located in the United Kingdom (the "UK Facility") and our NBG subsidiary located in Germany (the "German Facility"). As of March 31, 2003, the UK Facility provided Centresoft with the ability to borrow up to Great British Pounds ("GBP") 8.6 million ($13.5 million), including issuing letters of credit, on a revolving basis. Furthermore, as of March 31, 2003, under the UK Facility, Centresoft provided a EUR 1.0 million ($1.1 million) guarantee for the benefit of our CD Contact subsidiary. The UK Facility bears interest at LIBOR plus 1.5%, is collateralized by substantially all of the assets of the subsidiary and expires in October 2003. The UK Facility also contains various covenants that require the subsidiary to maintain specified financial ratios related to, among others, fixed charges. As of March 31, 2003, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of March 31, 2003. The German Facility provided for revolving loans up to EUR 0.8 million ($0.8 million) as of March 31, 2003, bears interest at a Eurocurrency rate plus 2.5%, is collateralized by the subsidiary's accounts receivable, inventory and certain property and equipment and expires June 2003. No borrowings were outstanding against the German Facility as of March 31, 2003.

Commitments. In connection with our purchases of Nintendo GameCube and Game Boy software for distribution in North America and Europe, Nintendo requires us to provide either standby letters of credit or cash prepayment prior to accepting purchase orders. As of March 31, 2003, there were no drawdowns on standby letters of credit.

In the normal course of business, we enter into contractual arrangements with third parties for the development of products, as well as for the rights to intellectual property. Under these agreements, we commit to provide specified payments to a developer or intellectual property holder, based upon contractual arrangements. Assuming all contractual provisions are met, the total future minimum contract commitment for contracts in place as of March 31, 2003 is approximately $138.1 million and is scheduled to be paid as follows (amounts in thousands):

Year ended March 31,	
2004	$ 89,175
2005	28,066
2006	12,300
2007	6,075
2008 and thereafter	2,501
Total	$138,117

Inflation

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

Recently Issued Accounting Standards

In January 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure, an amendment of FASB Statement No. 123." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. It also requires disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for annual and interim periods beginning after December 15, 2002. We adopted SFAS 148 in the fourth quarter of fiscal 2003. As we elected not to change to the fair value based method of accounting for stock-based employee compensation, the adoption of SFAS No. 148 did not have an impact upon our financial condition or results of operations.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies the accounting guidance on derivative instruments (including certain derivative instruments embedded in other contracts) and hedging activities that fall within the scope of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is effective for all contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. The guidance is to be applied prospectively. We are currently assessing the impact of SFAS No. 149 on our financial position and results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 changes the accounting guidance for certain financial instruments that, under previous guidance, could be classified as equity or "mezzanine" equity by now requiring those instruments to be classified as liabilities (or assets in some circumstances) in the statement of financial position. Further, SFAS No. 150 requires disclosure regarding the terms of those instruments and settlement alternatives. SFAS No. 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. We are currently assessing the impact of SFAS No. 150 on our financial position and results of operations.

Quantitative and Qualitative Disclosures About Market Risk

Market risk is the potential loss arising from fluctuations in market rates and prices. Our market risk exposures primarily include fluctuations in interest rates, foreign currency exchange rates and market prices. Our market risk sensitive instruments are classified as "other than trading." Our views on market risk are

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not necessarily indicative of actual results that may occur and do not represent the maximum possible gains and losses that may occur, since actual gains and losses will differ from those estimated, based upon actual fluctuations in interest rates, foreign currency exchange rates and market prices and the timing of transactions.

Interest Rate Risk. Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We manage our interest rate risk by maintaining an investment portfolio consisting primarily of debt instruments with high credit quality and relatively short average maturities. We also manage our interest rate risk by maintaining sufficient cash and cash equivalent balances such that we are typically able to hold our investments to maturity. As of March 31, 2003, our cash equivalents and short-term investments included debt securities of $284.1 million.

The following table presents the amounts and related weighted average interest rates of our investment portfolio as of March 31, 2003 (amounts in thousands):

	Average Interest Rate	Amortized Cost	Fair Value
Cash equivalents:			
Fixed rate	1.35%	$162,699	$162,699
Variable rate	1.21	35,507	35,507
Short-term investments:			
Fixed rate	2.21%	$121,266	$121,400

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

Foreign Currency Exchange Rate Risk. We transact business in many different foreign currencies and may be exposed to financial market risk resulting from fluctuations in foreign currency exchange rates, particularly GBP and EUR. The volatility of GBP and EUR (and all other applicable currencies) will be monitored frequently throughout the coming year. When appropriate, we enter into hedging transactions in order to mitigate our risk from foreign currency fluctuations. We will continue to use hedging programs in the future and may use currency forward contracts, currency options and/or other derivative financial instruments commonly utilized to reduce financial market risks if it is determined that such hedging activities are appropriate to reduce risk. We do not hold or purchase any foreign currency contracts for trading purposes. As of March 31, 2003, we had no outstanding hedging contracts.

Market Price Risk. With regard to the structured stock repurchase transactions described in Note 15 in the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report, it is possible that at settlement we could take delivery of shares at an effective repurchase price higher than the then market price.

Report of Independent Accountants

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statement of operations, shareholders' equity and cash flows present fairly, in all material respects, the financial position of Activision, Inc. and its subsidiaries at March 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Los Angeles, California
June 6, 2003

Consolidated Balance Sheets

(In thousands, except share data)	March 31, 2003	March 31, 2002
Assets		
Current assets:		
Cash and cash equivalents	$ 285,554	$279,007
Short-term investments	121,400	—
Accounts receivable, net of allowances of $57,356 and $42,019 at March 31, 2003 and 2002, respectively	15,822	76,733
Inventories	19,577	20,736
Software development	26,791	36,263
Intellectual property licenses	8,906	6,326
Deferred income taxes	38,290	22,608
Other current assets	10,565	15,200
Total current assets	526,905	456,873
Software development	35,281	3,254
Intellectual property licenses	36,943	10,899
Property and equipment, net	22,265	17,832
Deferred income taxes	10,322	28,795
Other assets	5,081	3,242
Goodwill	68,019	35,992
Total assets	$ 704,816	$556,887
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	$ 147	$ 168
Accounts payable	45,602	64,410
Accrued expenses	58,656	59,096
Total current liabilities	104,405	123,674
Long-term debt, less current portion	2,671	3,122
Total liabilities	107,076	126,796
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, $.000001 par value, 3,750,000 shares authorized, no shares issued at March 31, 2003 and 2002	—	—
Series A Junior Preferred stock, $.000001 par value, 1,250,000 shares authorized, no shares issued at March 31, 2003 and 2002	—	—
Common stock, $.000001 par value, 125,000,000 shares authorized, 107,372,727 and 91,551,395 shares issued and 90,084,245 and 85,058,256 shares outstanding at March 31, 2003 and 2002, respectively	—	—
Additional paid-in capital	592,295	397,528
Retained earnings	130,564	64,384
Less: Treasury stock, at cost, 17,288,482 and 6,493,139 shares as of March 31, 2003 and 2002, respectively	(121,685)	(20,323)
Accumulated other comprehensive loss	(3,434)	(11,498)
Total shareholders' equity	597,740	430,091
Total liabilities and shareholders' equity	$ 704,816	$556,887

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

Consolidated Statements of Operations

(In thousands, except per share data)

For the years ended March 31,	2003	2002	2001
Net revenues	$864,116	$786,434	$620,183
Costs and expenses:			
Cost of sales—product costs	440,977	435,725	324,907
Cost of sales—software royalties and amortization	79,194	58,892	49,864
Cost of sales—intellectual property licenses	45,002	40,114	39,838
Product development	56,971	40,960	41,396
Sales and marketing	100,646	86,161	85,378
General and administrative	46,479	44,008	38,993
Total costs and expenses	769,269	705,860	580,376
Income from operations	94,847	80,574	39,807
Investment income, net	8,560	2,546	(7,263)
Income before income tax provision	103,407	83,120	32,544
Income tax provision	37,227	30,882	12,037
Net income	$ 66,180	$ 52,238	$ 20,507
Basic earnings per share	$ 0.69	$ 0.69	$ 0.37
Weighted average common shares outstanding	96,239	75,977	55,947
Diluted earnings per share	$ 0.64	$ 0.59	$ 0.33
Weighted average common shares outstanding—assuming dilution	103,655	89,183	61,650

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

Consolidated Statements of Changes in Shareholders' Equity

(In thousands) For the years ended March 31, 2003, 2002 and 2001	Common Stock Shares	Common Stock Amounts	Additional Paid-In Capital	Retained Earnings (Deficit)	Treasury Stock Shares	Treasury Stock Amounts	Accumulated Other Comprehensive Loss	Shareholders' Equity
Balance, March 31, 2000	59,598	$—	$ 151,714	$ (8,361)	(1,125)	$ (5,278)	$ (6,066)	$ 132,009
Components of comprehensive income:								
Net income for the year	—	—	—	20,507	—	—	—	20,507
Foreign currency translation adjustment	—	—	—	—	—	—	(5,311)	(5,311)
Total comprehensive income								15,196
Issuance of common stock pursuant to warrants and common stock warrants	225	—	1,050	—	—	—	—	1,050
Issuance of common stock and common stock options to employees	8,052	—	32,538	—	—	—	—	32,538
Tax benefit attributable to employee stock options and common stock warrants	—	—	11,832	—	—	—	—	11,832
Tax benefit derived from net operating loss carryforward utilization	—	—	3,652	—	—	—	—	3,652
Purchase of treasury shares	—	—	—	—	(5,364)	(14,971)	—	(14,971)
Balance, March 31, 2001	67,875	—	200,786	12,146	(6,489)	(20,249)	(11,377)	181,306
Components of comprehensive income:								
Net income for the year	—	—	—	52,238	—	—	—	52,238
Foreign currency translation adjustment	—	—	—	—	—	—	(121)	(121)
Total comprehensive income								52,117
Issuance of common stock pursuant to warrants and common stock warrants	1,555	—	1,044	—	—	—	—	1,044
Issuance of common stock and common stock options to employees	13,160	—	63,053	—	—	—	—	63,053
Tax benefit attributable to employee stock options and common stock warrants	—	—	48,513	—	—	—	—	48,513
Issuance of common stock pursuant to conversion of convertible subordinated notes	7,144	—	58,651	—	—	—	—	58,651
Issuance of common stock to effect business combinations	1,817	—	25,481	—	—	—	—	25,481
Purchase of treasury shares	—	—	—	—	(4)	(74)	—	(74)
Balance, March 31, 2002	91,551	—	397,528	64,384	(6,493)	(20,323)	(11,498)	430,091
Components of comprehensive income:								
Net income for the year	—	—	—	66,180	—	—	—	66,180
Unrealized appreciation on short-term investments	—	—	—	—	—	—	134	134
Foreign currency translation adjustment	—	—	—	—	—	—	7,930	7,930
Total comprehensive income								74,244
Issuance of common stock pursuant to underwritten public offering	11,250	—	247,291	—	—	—	—	247,291
Issuance of common stock to employees	3,999	—	20,547	—	—	—	—	20,547
Issuance of common stock pursuant to warrants and common stock warrants	46	—	2,184	—	—	—	—	2,184
Tax benefit attributable to employee stock options and common stock warrants	—	—	23,884	—	—	—	—	23,884
Structured stock repurchase transactions	—	—	(110,000)	—	—	—	—	(110,000)
Issuance of common stock to effect business combinations	527	—	10,861	—	—	—	—	10,861
Purchase of treasury shares	—	—	—	—	(10,795)	(101,362)	—	(101,362)
Balance, March 31, 2003	107,373	$—	$ 592,295	$130,564	(17,288)	$(121,685)	$ (3,434)	$ 597,740

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

Consolidated Statements of Cash Flows

(In thousands)

For the years ended March 31,	2003	2002	2001
Cash flows from operating activities:			
Net income	$ 66,180	$ 52,238	$ 20,507
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income taxes	3,355	(23,352)	(6,597)
Depreciation and amortization	11,880	7,350	7,674
Amortization of capitalized software development costs and intellectual property licenses	100,415	62,456	68,925
Tax benefit of stock options and warrants exercised	23,884	48,513	11,832
Change in operating assets and liabilities (net of effects of acquisitions):			
Accounts receivable	61,922	(2,010)	30,027
Inventories	1,159	23,152	(5,283)
Software development and intellectual property licenses	(151,594)	(76,993)	(65,964)
Other assets	1,836	(1,753)	6,062
Accounts payable	(19,072)	3,357	21,361
Accrued expenses and other liabilities	(8,990)	18,834	(6,979)
Net cash provided by operating activities	90,975	111,792	81,565
Cash flows from investing activities:			
Cash used in business acquisitions (net of cash acquired)	(21,199)	—	—
Capital expenditures	(11,877)	(9,150)	(9,780)
Purchase of short-term investments	(408,175)	—	—
Proceeds from sales and maturities of short-term investments	287,145	—	—
Minority capital investment	(1,500)	—	—
Other	505	449	1,149
Net cash used in investing activities	(155,101)	(8,701)	(8,631)
Cash flows from financing activities:			
Proceeds from issuance of common stock to employees	20,547	59,836	32,538
Proceeds from issuance of common stock pursuant to warrants	—	1,044	1,050
Borrowing under line-of-credit agreements	—	—	577,590
Payment under line-of-credit agreements	—	—	(581,618)
Payment on term loan	—	(8,550)	(11,450)
Notes payable, net	(720)	(1,792)	(592)
Redemption of convertible subordinated notes	—	(62)	—
Proceeds from issuance of common stock pursuant to underwritten public offering, net of offering costs	248,072	—	—
Purchase of structured stock repurchase agreements	(110,000)	—	—
Purchase of treasury stock	(93,809)	(74)	(14,971)
Net cash provided by financing activities	64,090	50,402	2,547
Effect of exchange rate changes on cash	6,583	(36)	84
Net increase in cash and cash equivalents	6,547	153,457	75,565
Cash and cash equivalents at beginning of period	279,007	125,550	49,985
Cash and cash equivalents at end of period	$ 285,554	$279,007	$ 125,550

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

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Business. Activision, Inc. ("Activision" 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 growing variety of consumer demographics.

Our products cover game categories such as action/adventure, action sports, racing, role-playing, simulation, first-person action and strategy game categories. We currently offer our products in versions that operate on the Sony PlayStation 2 ("PS2"), Sony PlayStation ("PS1"), Nintendo GameCube ("GameCube") and Microsoft Xbox ("Xbox") console systems, Nintendo Game Boy Advance ("GBA") hand-held device and the personal computer ("PC"). Our target audiences range from game enthusiasts and children to mass-market consumers and "value" buyers.

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

We maintain operations in the U.S., Canada, the United Kingdom, France, Germany, Japan, Australia, Sweden and the Netherlands. In fiscal year 2003, international operations contributed approximately 50% of net revenues.

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

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

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

Concentration of Credit Risk. Financial instruments which potentially subject us to concentration of credit risk consist principally of temporary cash investments and accounts receivable. We place our temporary cash investments with financial institutions. At various times during the fiscal years ended March 31, 2003 and 2002, we had deposits in excess of the Federal Deposit Insurance Corporation ("FDIC") limit at these financial institutions.

Our customer base includes retail outlets and distributors, including mass-market retailers, consumer electronics stores, discount warehouses and office super-stores in the United States and countries worldwide. We perform ongoing credit evaluations of our customers and maintain allowances for potential credit losses. We generally do not require collateral or other security from our customers. As of and for the year ended March 31, 2003, 2002 and 2001, we had one customer that accounted for 16%, 14% and 10%, respectively, of consolidated net revenues and 46%, 22% and 9%, respectively, of consolidated accounts receivable, net. This customer was the same customer in all periods and was a customer of both our publishing and distribution businesses in fiscal 2003 and 2002 and a customer of solely our publishing business in fiscal 2001.

Notes to Consolidated Financial Statements

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

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

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

We utilize forward contracts in order to reduce financial market risks. These instruments are used to hedge foreign currency exposures of underlying assets, liabilities, or certain forecasted foreign currency denominated transactions. Our accounting policies for these instruments are based on whether they meet the criteria for designation as hedging transactions. Changes in fair value of derivatives that are designated as cash flow hedges, are highly effective, and qualify as hedging instruments, are recorded in other comprehensive income until the underlying hedged item is recognized in earnings. Any ineffective portion of a derivative change in fair value is immediately recognized in earnings. Changes in fair value of derivatives that do not qualify as hedging instruments are recorded in earnings. The fair value of foreign currency contracts is estimated based on the spot rate of the various hedged currencies as of the end of the period. As of March 31, 2003 and 2002, we had no outstanding foreign exchange forward contracts.

Equity Investments. From time to time, we may make a capital investment and hold a minority interest in a third-party developer in connection with entertainment software products to be developed by such developer for us. We account for those capital investments in which we have a 20% or greater ownership interest or over which we have the ability to exercise significant influence using the equity method. For those investments in which we hold less than a 20% ownership interest or over which we do not have the ability to exercise significant influence, we account for our investment using the cost method.

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

We account for software development costs in accordance with 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. 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. The following criteria are used to evaluate expected product performance: 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.

Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks or copyrights 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. The following criteria are used to evaluate expected product performance: 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 trademark or copyright will be utilized. As intellectual property license contracts may extend for multiple years, the amortization of capitalized intellectual property license costs relating to such contracts may extend beyond one year. For intellectual property included in products that have been released, we evaluate the future recoverability of capitalized amounts on a quarterly basis. The primary evaluation criterion is actual title performance.

As of March 31, 2003, capitalized software development costs included $26.0 million of internally developed software costs and $36.1 million of payments made to third-party software developers. As of March 31, 2002, capitalized software development costs included $16.0 million of internally developed software costs and $23.5 million of payments made to third-party software developers. Capitalized intellectual property licenses were $45.8 million and $17.2 million as of March 31, 2003 and 2002, respectively. Amortization and write-offs of capitalized software development costs and intellectual property licenses, combined, was $100.4 million, $62.5 million and $68.9 million for the year ended March 31, 2003, 2002 and 2001, respectively. For the year ended March 31, 2003, amortization and write-offs of capitalized software development costs and intellectual property licenses included approximately $15.0 million recorded in the fourth quarter as the result of the assessment of the recoverability of capitalized development costs relating to certain projects and certain of our investments in long-term licensing agreements.

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

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

Notes to Consolidated Financial Statements

Goodwill. Effective April 1, 2001, we adopted the provisions of SFAS No. 142, "Goodwill and Other Intangibles." SFAS No. 142 addresses financial accounting and reporting requirements for acquired goodwill and other intangible assets. Under SFAS No. 142, goodwill is deemed to have an indefinite useful life and should not be amortized but rather tested at least annually for impairment. An impairment loss should be recognized if the carrying amount of goodwill is not recoverable and its carrying amount exceeds its fair value. In accordance with SFAS No. 142, we have not amortized goodwill during the years ended March 31, 2003 and 2002.

Revenue Recognition. We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers. We may permit product returns from, or grant price protection to, our customers on unsold merchandise under certain conditions. Price protection, when granted and applicable, allows customers a credit against amounts they owe us with respect to merchandise unsold by them. 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 from product sales is reflected after deducting the estimated allowance for returns and price protection. 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 based upon historical experience, customer inventory levels and changes in the demand and acceptance of our products by the end consumer.

Sales incentives or other consideration given by us to our customers is accounted for in accordance with 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.

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

Advertising Expenses. We expense advertising as incurred, except for production costs associated with media advertising which are deferred and charged to expense the first time the related ad is run. Advertising expenses for the year ended March 31, 2003, 2002 and 2001 were approximately $60.0 million, $50.3 million and $47.7 million, respectively, and are included in sales and marketing expense in the consolidated statements of operations.

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

Year ended March 31,	2003	2002	2001
Interest expense	$ (933)	$(1,188)	$(9,399)
Interest income	9,259	3,734	2,136
Net realized gain on short-term investments	234	—	—
Investment income, net	$8,560	$ 2,546	$(7,263)

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

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

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

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

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

Stock-Based Compensation and Pro Forma Information. Under SFAS No. 123 "Accounting for Stock-Based Compensation," compensation expense is recorded for the issuance of stock options and other stock-based compensation based on the fair value of the stock options and other stock-based compensation on the date of grant or measurement date. Alternatively, SFAS No. 123 allows companies to continue to account for the issuance of stock options and other stock-based compensation in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Under APB No. 25, compensation expense is recorded for the issuance of stock options and other stock-based compensation based on the intrinsic value of the stock options and other stock-based compensation on the date of grant or measurement date. Under the intrinsic value method, compensation expense is recorded on the date of grant or measurement date only if the current market price of the underlying stock exceeds the stock option or other stock-based compensation exercise price. At March 31, 2003, we had several stock-based employee compensation plans, which are described more fully in Note 13. We account for those plans under the recognition and measurement principles of APB Opinion No. 25 and related Interpretations. No stock-based employee compensation cost is reflected in net income for any years presented, as all options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation (amounts in thousands, except per share data):

Year ended March 31,	2003	2002	2001
Net income, as reported	$ 66,180	$ 52,238	$20,507
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(21,004)	(12,622)	(8,976)
Pro forma net income	$ 45,176	$ 39,616	$11,531
Earnings per share			
Basic—as reported	$ 0.69	$ 0.69	$ 0.37
Basic—pro forma	$ 0.47	$ 0.52	$ 0.21
Diluted—as reported	$ 0.64	$ 0.59	$ 0.33
Diluted—pro forma	$ 0.44	$ 0.45	$ 0.19

The fair value of options granted in the years ended March 31, 2003, 2002 and 2001 has been estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted average assumptions:

	Option Plans and Other Employee Options			Purchase Plan			Director Warrant Plan		
	2003	2002	2001	2003	2002	2001	2003	2002	2001
Expected life (in years)	3	2	2	0.5	0.5	0.5	3	2	2
Risk free interest rate	1.51%	3.24%	4.09%	1.13%	2.16%	4.09%	1.51%	3.24%	4.09%
Volatility	69%	70%	70%	69%	70%	70%	69%	70%	70%
Dividend yield	—	—	—	—	—	—	—	—	—

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because our options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in the opinion of management, the existing models do not necessarily provide a reliable single measure of the fair value of our options. For options granted during fiscal 2003, the per share weighted average fair value of options with exercise prices equal to market value on date of grant was $6.56. For options granted during fiscal 2002, the per share weighted average fair value of options with exercise prices equal to market value on date of grant was $4.57. For options granted during fiscal 2001, the per share weighted average fair value of options with exercise prices equal to market value on date of grant and exercise prices greater than market value were $1.39 and $0.59, respectively. The per share weighted average estimated fair value of Employee Stock Purchase Plan shares granted during the year ended March 31, 2003, 2002 and 2001 was $3.26, $2.94, and $1.55, respectively.

The effects on pro forma disclosures of applying SFAS No. 123 are not likely to be representative of the effects on pro forma disclosures of future years.

Common stock warrants are granted to non-employees in connection with the development of software and acquisition of licensing rights for intellectual property. In accordance with the Financial Accounting Standards Board's Emerging Issues Task Force ("EITF") No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring or in Connection With Selling Goods or Services," the fair value of common stock warrants granted is determined as of the measurement date and is capitalized, expensed and amortized consistent with our policies relating to software development and intellectual property license costs.

Related Parties. As of March 31, 2002, we had $3.1 million of loans due from employees. The loans bore interest at 6.75% and were primarily due from Activision executives. There were no such loans outstanding as of March 31, 2003.

In August 2001, we elected to our Board of Directors an individual who is a partner in a law firm that has provided legal services to Activision for more than ten years. For the years ended March 31, 2003 and 2002, the fees we paid to the law firm account for less than 1% of the firm's total revenues. The rates charged to us were at arm's length, and we believe that the fees are competitive with the fees charged by other law firms.

Recently Issued Accounting Standards. In January 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure, an amendment of FASB Statement No. 123." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. It also requires disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for annual and interim periods beginning after December 15, 2002. We adopted SFAS No. 148 in the fourth quarter of fiscal 2003. As we elected not to change to the fair value based method of accounting for stock-based employee compensation, the adoption of SFAS No. 148 did not have an impact upon our financial condition or results of operations.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies the accounting guidance on derivative instruments (including certain derivative instruments embedded in other contracts) and hedging activities that fall within the scope of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is effective for all contracts entered into or modified after June 30, 2003, with certain exceptions, and for hedging relationships designated after June 30, 2003. The guidance is to be applied prospectively. We are currently assessing the impact of SFAS No. 149 on our financial position and results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 changes the accounting guidance for certain financial instruments that, under previous guidance, could be classified as equity or "mezzanine" equity by now requiring those instruments to be classified as liabilities (or assets in some circumstances) in the statement of financial position. Further, SFAS No. 150 requires disclosure regarding the terms of those instruments and settlement alternatives. SFAS No. 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. We are currently assessing the impact of SFAS No. 150 on our financial position and results of operations.

Reclassifications. Certain amounts in the consolidated financial statements have been reclassified to conform with the current year's presentation. These reclassifications had no effect on net income, shareholders' equity or net increase in cash and cash equivalents.

2. Stock Split

In April 2003, the Board of Directors approved a three-for-two split of our outstanding common shares effected in the form of a 50% stock dividend. The split is payable on June 6, 2003 to shareholders of record as of May 16, 2003. The par value of our common stock will be maintained at the pre-split amount of $.000001. The consolidated financial statements and Notes thereto, including all share and per share data, have been restated as if the stock split had occurred as of the earliest period presented.

Notes to Consolidated Financial Statements

3. Acquisitions

During the three years ended March 31, 2003, we separately completed the acquisition of five privately held interactive software development companies. We accounted for these acquisitions in accordance with SFAS No. 141, "Business Combinations." SFAS No. 141 was issued on July 20, 2001 and addresses financial accounting and reporting for business combinations, requiring that the purchase method be used to account and report for all business combinations. These acquisitions have further enabled us to implement our multi-platform development strategy by bolstering our internal product development capabilities for console systems and personal computers and strengthening our position in the first-person action, action and action sports game categories. A significant portion of the purchase price for all of these acquisitions was assigned to goodwill as the primary asset we acquired in each of the transactions was an assembled workforce with proven technical and design talent with a history of high quality product creation. Pro forma consolidated statements of operations for these acquisitions are not shown, as they would not differ materially from reported results.

Fiscal 2003 Transactions

Acquisition of Luxoflux. Effective October 4, 2002, we acquired all of the outstanding ownership interests of Luxoflux, Inc., ("Luxoflux"), a privately held interactive software development company, in exchange for $9.0 million in cash. Luxoflux is an experienced, multi-platform, console software developer. The purchase price of the transaction, including acquisition costs, was approximately $9.2 million and has been allocated to assets acquired and liabilities assumed as follows (amounts in thousands):

Current assets	$ 537
Property and equipment	83
Other assets	15
Goodwill	9,098
Current liabilities	(508)
	$ 9,225

Approximately 165,000 shares of our common stock may be issued to Luxoflux's equity holders and employees over the course of several years, depending on the satisfaction of certain product performance requirements and other criteria. This contingent consideration will be recorded as an additional element of the purchase price for Luxoflux when those contingencies are resolved.

Acquisition of Z-Axis. Effective May 20, 2002, we acquired all of the outstanding ownership interests of Z-Axis, Ltd. ("Z-Axis"), a privately held interactive software development company, in exchange for $12.5 million in cash and 373,785 shares of our common stock valued at approximately $8.2 million. Z-Axis is an experienced, multi-platform, console software developer. The purchase price of the transaction, including acquisition costs, was valued at approximately $20.9 million and has been allocated to assets acquired and liabilities assumed as follows (amounts in thousands):

Current assets	$ 1,645
Other intangibles	113
Property and equipment	172
Other assets	20
Goodwill	20,250
Current liabilities	(1,334)
	$20,866

Approximately 139,500 additional shares of our common stock may be issued to Z-Axis' equity holders over the course of several years, depending on the satisfaction of certain product performance requirements and other criteria. This contingent consideration will be recorded as an additional element of the purchase price for Z-Axis when those contingencies are resolved.

For both of the acquisitions, goodwill has been included in the publishing segment of our business and is non-deductible for tax purposes. The results of operations of Luxoflux and Z-Axis are included in our consolidated statement of operations beginning October 4, 2002 and May 20, 2002, respectively.

Fiscal 2002 Transactions

Acquisition of Shaba. On March 27, 2002, we acquired all of the outstanding ownership interests of Shaba Games, Inc. ("Shaba"), a privately held interactive software development company, in exchange for 387,932 shares of our common stock. Shaba is an experienced, multi-platform console software developer with a focus on action and action sports video games. The purchase price of the transaction, including acquisition costs, was valued at approximately $7.4 million with approximately $6.1 million of the purchase price being assigned to goodwill. This goodwill has been included in the publishing segment of our business and is deductible for tax purposes. The results of operations of Shaba are included in our consolidated statement of operations beginning March 27, 2002.

Approximately 103,500 additional shares of our common stock may be issued to Shaba's equity holders and employees over the course of several years, depending on the satisfaction of certain product performance requirements and other criteria. This contingent consideration will be recorded as an additional element of the purchase price for Shaba when those contingencies are resolved.

Acquisition of Gray Matter. On December 30, 1999, we acquired a 40% interest in the outstanding capital stock of Gray Matter Interactive Studios, Inc., formerly known as Video Games West ("Gray Matter"), a privately held software development company, as well as an option to purchase the remaining 60% of outstanding capital stock. Gray Matter was the developer for our first person action PC product, *Return to Castle Wolfenstein*. Effective January 9, 2002, we exercised our option to acquire the remaining 60% of outstanding capital stock of Gray Matter in exchange for 200,535 shares of our common stock. The purchase price of the transaction, including acquisition costs, was valued at approximately $3.6 million with $3.3 million of the purchase price being assigned to goodwill. This goodwill has been included in the publishing segment of our business and is non-deductible for tax purposes. The results of operations of Gray Matter are included in our consolidated statement of operations beginning January 9, 2002.

Acquisition of Treyarch. Effective October 1, 2001, we acquired all of the outstanding ownership interests of Treyarch Invention, LLC ("Treyarch"), a privately held interactive software development company, in exchange for 1,228,442 shares of our common stock. Treyarch is an experienced, multi-platform console software developer with a focus on action and action sports video games. As part of the original acquisition agreement, approximately 360,000 additional shares of our common stock could also be issued to Treyarch's equity holders and employees over the course of several years, depending on the satisfaction of certain product performance requirements and other criteria. This contingent consideration would be recorded as an additional element of the purchase price for Treyarch when those contingencies are resolved. In July 2002 in connection with the satisfaction of certain of those product performance requirements, we issued to Treyarch equity holders and employees, 152,453 of our common shares with an assigned value of $2.7 million. The purchase price of the transaction, including the issuance of additional shares in July 2002, forgiveness of a note receivable and acquisition costs, was valued at approximately $18.2 million with approximately $17.2 million of the purchase price being assigned to goodwill. This goodwill has been included in the publishing segment of our business and is non-deductible for tax purposes. The results of operations of Treyarch are included in our consolidated statement of operations beginning October 1, 2001.

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

The following table summarizes our cash, cash equivalents and short-term investments as of March 31, 2003 (amounts in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash and time deposits	$ 87,348	$ —	$ —	$ 87,348
Money market funds	35,507	—	—	35,507
Auction rate notes	162,699	—	—	162,699
Cash and cash equivalents	285,554	—	—	285,554
Short-term investments:				
Corporate bonds	16,712	34	—	16,746
Taxable senior debt	2,253	—	—	2,253
U.S. agency issues	52,055	65	(12)	52,108
Asset-backed bonds	39,224	122	(75)	39,271
Municipal bonds	11,022	—	—	11,022
Short-term investments	121,266	221	(87)	121,400
Cash, cash equivalents and short-term investments	$406,820	$221	$(87)	$406,954

As of March 31, 2002, we held no short-term investments. Our cash and cash equivalents were comprised of the following as of March 31, 2002 (amounts in thousands):

Cash	$ 61,310
Money market funds	217,697
	$279,007

The following table summarizes the maturities of our investments in debt securities as of March 31, 2003 (amounts in thousands):

	Amortized Cost	Fair Value
Due in one year or less	$207,704	$207,762
Due after one year through two years	37,037	37,066
	244,741	244,828
Asset-backed securities	39,224	39,271
Total	$283,965	$284,099

For the year ended March 31, 2003, net realized gains on short-term investments consisted of $350,000 of gross realized gains and $116,000 of gross realized losses.

5. Inventories

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

March 31,	2003	2002
Purchased parts and components	$ 1,129	$ 892
Finished goods	18,448	19,844
	$19,577	$20,736

6. Property and Equipment, Net

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

March 31,	2003	2002
Land	$ 270	$ 214
Buildings	5,200	4,236
Computer equipment	31,483	27,618
Office furniture and other equipment	9,724	6,884
Leasehold improvements	4,893	3,740
Total cost of property and equipment	51,570	42,692
Less accumulated depreciation	(29,305)	(24,860)
Property and equipment, net	$ 22,265	$ 17,832

Depreciation expense for the year ended March 31, 2003, 2002 and 2001 was $8.1 million, $6.2 million and $4.8 million, respectively.

7. Goodwill and Other Intangible Assets

Goodwill. We adopted SFAS No. 142 effective April 1, 2001. The following table reconciles net income and earnings per share as reported for the years ended March 31, 2003, 2002 and 2001 to net income and earnings per share as adjusted to exclude goodwill amortization (amounts in thousands, except per share data).

Year ended March 31,	2003	2002	2001
Reported net income	$66,180	$52,238	$20,507
Add back: Goodwill amortization	—	—	1,502
Adjusted net income	$66,180	$52,238	$22,009
Basic earnings per share:			
Reported net income	$ 0.69	$ 0.69	$ 0.37
Goodwill amortization	—	—	0.02
Adjusted net income	$ 0.69	$ 0.69	$ 0.39
Diluted earnings per share:			
Reported net income	$ 0.64	$ 0.59	$ 0.33
Goodwill amortization	—	—	0.03
Adjusted net income	$ 0.64	$ 0.59	$ 0.36

Goodwill amortization for the year ended March 31, 2001 is included in the general and administrative expense line item in the consolidated statement of operations.

Notes to Consolidated Financial Statements

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

	Publishing	Distribution	Total
Balance as of March 31, 2001	$ 5,941	$4,375	$10,316
Goodwill acquired during the year	25,685	—	25,685
Effect of foreign currency exchange rates	—	(9)	(9)
Balance as of March 31, 2002	31,626	4,366	35,992
Goodwill acquired during the year	29,348	—	29,348
Issuance of contingent consideration	2,668	—	2,668
Adjustment—prior period purchase allocation	(448)	—	(448)
Effect of foreign currency exchange rates	—	459	459
Balance as of March 31, 2003	$63,194	$4,825	$68,019

Acquired Intangible Assets. Acquired intangible assets are as follows (amounts in thousands):

	March 31, 2003		March 31, 2002	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized Intangible Assets				
Acquired software development and royalty agreements	$113	$(113)	$84	$—

Acquired intangible assets are included in the consolidated balance sheets in other current assets. For the year ended March 31, 2003, aggregate amortization expense related to acquired intangible assets was $113,400. There was no such amortization for the year ended March 31, 2002.

8. Accrued Expenses

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

March 31,	2003	2002
Accrued royalties payable	$ 6,430	$13,824
Accrual for settlement of treasury stock purchases	7,553	—
Accrued selling and marketing costs	8,737	9,169
Income tax payable	6,940	3,055
Accrued bonus and vacation pay	12,287	13,863
Other	16,709	19,185
Total	$58,656	$59,096

9. Operations by Reportable Segments and Geographic Area

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

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

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

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

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

Information on the reportable segments for the three years ended March 31, 2003 is as follows (amounts in thousands):

Year ended March 31, 2003	Publishing	Distribution	Total
Total segment revenues	$615,975	$248,141	$864,116
Revenue from sales between segments	(57,462)	57,462	—
Revenues from external customers	$558,513	$305,603	$864,116
Operating income	$ 79,139	$ 15,708	$ 94,847
Total assets	$619,132	$ 85,684	$704,816

Year ended March 31, 2002	Publishing	Distribution	Total
Total segment revenues	$549,508	$236,926	$786,434
Revenue from sales between segments	(50,632)	50,632	—
Revenues from external customers	$498,876	$287,558	$786,434
Operating income	$ 68,675	$ 11,899	$ 80,574
Total assets	$455,432	$101,455	$556,887

Year ended March 31, 2001	Publishing	Distribution	Total
Total segment revenues	$466,062	$154,121	$620,183
Revenue from sales between segments	(39,331)	39,331	—
Revenues from external customers	$426,731	$193,452	$620,183
Operating income	$ 35,687	$ 4,120	$ 39,807
Total assets	$271,488	$ 88,469	$359,957

Geographic information for the three years ended March 31, 2003 is based on the location of the selling entity. Revenues from external customers by geographic region were as follows (amounts in thousands):

Year ended March 31,	2003	2002	2001
United States	$432,261	$404,905	$352,893
Europe	413,125	368,799	256,228
Other	18,730	12,730	11,062
Total	$864,116	$786,434	$620,183

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

Year ended March 31,	2003	2002	2001
Console	$674,621	$480,695	$386,097
Hand-held	64,069	159,042	80,796
PC	125,426	146,697	153,290
Total	$864,116	$786,434	$620,183

Notes to Consolidated Financial Statements

A significant portion of our revenues is derived from products based on a relatively small number of popular brands each year. In fiscal 2003, 38% of our consolidated net revenues (52% of worldwide publishing net revenues) was derived from two brands, one of which accounted for 20% and the other of which accounted for 18% of consolidated net revenues (27% and 25%, respectively, of worldwide publishing net revenues). In fiscal 2002, two brands accounted for 35% of our consolidated net revenues (50% of worldwide publishing net revenues), one of which accounted for 31% and the other of which accounted for 4% of consolidated net revenues (44% and 6%, respectively, of worldwide publishing net revenues). In fiscal 2001, two brands accounted for 37% of our consolidated net revenues (49% of worldwide publishing net revenues), one of which accounted for 29% and the other of which accounted for 8% of consolidated net revenues (39% and 10%, respectively, of worldwide publishing net revenues).

10. Computation of Earnings Per Share

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

Year ended March 31,	2003	2002	2001
Numerator:			
Numerator for basic and diluted earnings per share— income available to common shareholders	$66,180	$52,238	$20,507
Denominator:			
Denominator for basic earnings per share— weighted average common shares outstanding	96,239	75,977	55,947
Effect of dilutive securities:			
Employee stock options and stock purchase plan	6,852	12,432	5,296
Warrants to purchase common stock	564	774	407
Potential dilutive common shares	7,416	13,206	5,703
Denominator for diluted earnings per share— weighted average common shares outstanding plus assumed conversions	103,655	89,183	61,650
Basic earnings per share	$ 0.69	$ 0.69	$ 0.37
Diluted earnings per share	$ 0.64	$ 0.59	$ 0.33

Outstanding stock options of approximately 5,199,000, 158,000 and 5,262,000 for the year ended March 31, 2003, 2002 and 2001, respectively, were not included in the calculation of diluted earnings per share because their effect would be antidilutive. Convertible subordinated notes were also not included in the calculations of diluted earnings per share, for the years applicable, because their effect would be antidilutive.

11. Income Taxes

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

Year ended March 31,	2003	2002	2001
Income before income taxes:			
Domestic	$ 78,761	$ 67,553	$24,276
Foreign	24,646	15,567	8,268
	$103,407	$ 83,120	$32,544
Income tax expense (benefit):			
Current:			
Federal	$ 1,703	$ 648	$ 394
State	413	20	112
Foreign	7,872	5,053	4,351
Total current	9,988	5,721	4,857
Deferred:			
Federal	1,794	(18,751)	(5,610)
State	3,065	(4,555)	(1,761)
Foreign	(1,504)	(46)	(479)
Total deferred	3,355	(23,352)	(7,850)
Add back benefit credited to additional paid-in capital:			
Tax benefit related to stock option and warrant exercises	23,884	48,513	11,378
Tax benefit related to utilization of pre-bankruptcy net operating loss carryforwards	—	—	3,652
	23,884	48,513	15,030
Income tax provision	$ 37,227	$ 30,882	$12,037

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

Year ended March 31,	2003	2002	2001
Federal income tax provision at statutory rate	35.0%	35.0%	35.0%
State taxes, net of federal benefit	2.4	3.5	3.3
Nondeductible amortization	—	—	1.3
Research and development credits	(6.0)	(1.8)	(5.7)
Incremental (decremental) effect of foreign tax rates	(0.2)	(1.4)	1.4
Increase of valuation allowance	2.1	2.4	4.0
Rate changes	0.8	—	(1.5)
Other	1.9	(0.5)	(0.8)
	36.0%	37.2%	37.0%

Notes to Consolidated Financial Statements

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

March 31,	2003	2002
Deferred asset:		
Allowance for doubtful accounts	$ 1,538	$ 542
Allowance for sales returns	10,511	10,670
Inventory reserve	775	971
Vacation and bonus reserve	2,409	2,316
Amortization and depreciation	4,794	4,731
Tax credit carryforwards	25,741	17,193
Net operating loss carryforwards	47,399	55,127
Other	3,946	2,323
Deferred asset	97,113	93,873
Valuation allowance	(27,606)	(30,479)
Net deferred asset	69,507	63,394
Deferred liability:		
Capitalized research expenses	18,775	9,105
State taxes	2,120	2,886
Deferred liability	20,895	11,991
Net deferred asset	$ 48,612	$ 51,403

In accordance with Statement of Position ("SOP") 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code," issued by the AICPA, benefits from loss carryforwards arising prior to our reorganization are recorded as additional paid-in capital. During the year ended March 31, 2001, $3.7 million was recorded as additional paid-in capital.

The tax benefits associated with certain net operating loss carryovers relate to employee stock options. A valuation allowance of $12.7 million relates to these items and will be credited to additional paid-in capital when realized. Additionally, $3.8 million of related valuation allowance was released and credited to additional paid-in capital during the year ended March 31, 2003.

As of March 31, 2003, our available federal net operating loss carryforward of $117.2 million is subject to certain limitations as defined under Section 382 of the Internal Revenue Code. The net operating loss carryforwards expire between 2007 and 2023. We have various state net operating loss carryforwards which are not subject to limitations under Section 382 of the Internal Revenue Code. We have tax credit carryforwards of $15.9 million and $9.9 million for federal and state purposes, respectively, which begin to expire in 2006.

At March 31, 2003, our deferred income tax asset for tax credit carryforwards and net operating loss carryforwards was reduced by a valuation allowance of $27.6 million as compared to $30.5 million in the prior fiscal year. Realization of the deferred tax assets is dependent upon the continued generation of sufficient taxable income prior to expiration of tax credits and loss carryforwards. Although realization is not assured, management believes it is more likely than not that the net carrying value of the deferred tax asset will be realized.

Cumulative undistributed earnings of foreign subsidiaries for which no deferred taxes have been provided approximated $43.7 million at March 31, 2003. Deferred income taxes on these earnings have not been provided as these amounts are considered to be permanent in duration.

12. Long-Term Debt

As of March 31, 2003 and 2002, long-term debt and the current portion of long-term debt were comprised of mortgage notes payable.

Credit Facilities. In June 1999, we obtained a $100.0 million revolving credit facility and a $25.0 million term loan with a syndicate of banks (the "U.S. Facility"). The revolving portion of the U.S. Facility provided us with the ability to borrow up to $100.0 million, including issuing letters of credit up to $80.0 million, on a revolving basis against eligible accounts receivable and inventory. The term loan had a three-year term with principal amortization on a straight-line quarterly basis beginning December 31, 1999, a borrowing rate based on the banks' base rate (which was generally equivalent to the published prime rate) plus 2% or LIBOR plus 3% and was to expire June 2002. The revolving portion of the U.S. Facility had a borrowing rate based on the banks' base rate plus 1.75% or LIBOR plus 2.75%. In May 2001, we accelerated our repayment of the outstanding balance under the term loan portion of the U.S. Facility. In connection with the accelerated repayment, we amended the U.S. Facility (the "Amended and Restated U.S. Facility"). The Amended and Restated U.S. Facility eliminated the term loan, reduced the revolver to $78.0 million and reduced the interest rate to the banks' base rate plus 1.25% or LIBOR plus 2.25%. The Amended and Restated U.S. Facility required us to maintain specified financial ratios related to net worth and fixed charges and was collateralized by substantially all of our assets. As of March 31, 2002, there were no borrowings and $5.8 million letters of credit outstanding against the revolving portion of the Amended and Restated U.S. Facility. The Amended and Restated U.S. Facility expired in August 2002. Due to our improved financial position, including significant cash, cash equivalent and short-term investment balances and minimal debt, we did not seek additional bank financing upon the expiration of the Amended and Restated U.S. Facility.

We have a revolving credit facility through our CD Contact subsidiary in the Netherlands (the "Netherlands Facility"). The Netherlands Facility permitted revolving credit loans and letters of credit up to Euro ("EUR") 1.5 million ($1.7 million) and EUR 4.5 million ($3.9 million) as of March 31, 2003 and 2002, respectively, based upon eligible accounts receivable balances, was due on demand, bore interest at a Eurocurrency rate plus 1.25% and 1.50% as of March 31, 2003 and 2002, respectively, and was collateralized by the subsidiary's accounts receivable and inventory. As of March 31, 2002, the Netherlands Facility was additionally collateralized by a EUR 2.3 million ($2.0 million) guarantee made by our Centresoft subsidiary through its bank facility. As of March 31, 2003 and 2002, there were no borrowings or letters of credit outstanding under the Netherlands Facility. The Netherlands Facility was originally scheduled to expire in August 2003. However, due to the improved liquidity position of the subsidiary, the Netherlands Facility was terminated on April 1, 2003 and additional bank financing was not sought.

We also have revolving credit facilities with our CentreSoft subsidiary located in the United Kingdom (the "UK Facility") and our NBG subsidiary located in Germany (the "German Facility"). The UK Facility provided Centresoft with the ability to borrow up to Great British Pounds ("GBP") 8.6 million ($13.5 million) and GBP 8.5 million ($12.1 million), including issuing letters of credit, on a revolving basis as of March 31, 2003 and 2002, respectively. Furthermore, under the UK Facility, Centresoft provided a EUR 2.3 ($2.0 million) guarantee which served as collateral for the Netherlands Facility as of March 31, 2002. A EUR 1.0 million ($1.1 million) guarantee was similarly provided under the UK Facility for the benefit of CD Contact relating to other matters as of March 31, 2003. The UK Facility bore interest at LIBOR plus 1.5% and LIBOR plus 2% as of March 31, 2003 and 2002, respectively, is collateralized by substantially all of the assets of the subsidiary and expires in October 2003. The UK Facility also contains various covenants that require the subsidiary to maintain specified financial ratios related to, among others, fixed charges. As of March 31, 2003 and 2002, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of March 31, 2003 or 2002. The German Facility provided for revolving loans up to EUR 0.8 million ($0.8 million) and EUR 2.5 million ($2.2 million) as of March 31, 2003 and 2002, respectively, bore interest at a Eurocurrency rate plus 2.5%, is collateralized by the subsidiary's accounts receivable, inventory and certain property and equipment and expires June 2003. No borrowings were outstanding against the German Facility as of March 31, 2003 or 2002.

Notes to Consolidated Financial Statements

Mortgage Notes Payable. Mortgage notes payable were $2.8 million and $3.3 million as of March 31, 2003 and 2002, respectively. Mortgage notes payable relate to the land, office and warehouse facilities of our German subsidiary as of March 31, 2003 and of our German and Netherlands subsidiaries as of March 31, 2002. The Netherlands subsidiary's mortgage note was repaid in full in fiscal 2003. The German mortgage note bears interest at 5.45%, is due in bi-annual installments of EUR 73,900 ($79,700), is collateralized by the related assets and matures December 2018. Prior to repayment, the Netherlands mortgage note bore interest at 5.35%, was payable in quarterly installments of EUR 11,300 ($12,200) and was collateralized by the related assets.

Private Placement of Convertible Subordinated Notes. In December 1997, we completed the private placement of $60.0 million principal amount of 6¾% convertible subordinated notes due 2005 (the "Notes"). The Notes were convertible, in whole or in part, at the option of the holder at any time after December 22, 1997 (the date of original issuance) and prior to the close of business on the business day immediately preceding the maturity date, unless previously redeemed or repurchased, into our common stock at a conversion price of $8.389 per share, subject to adjustment in certain circumstances. During the three months ended June 30, 2001, we called for the redemption of the Notes. In connection with that call, holders converted to common stock approximately $58.7 million aggregate principal amount of their Notes, net of conversion costs. The remaining Notes were redeemed for cash.

Annual maturities of long-term debt are as follows (amounts in thousands):

Year ended March 31,	
2004	$ 147
2005	159
2006	159
2007	159
2008 and thereafter	2,194
Total	$ 2,818

13. Commitments and Contingencies

Developer and Intellectual Property Contracts. In the normal course of business we enter into contractual arrangements with third parties for the development of products, as well as for the rights to intellectual property. Under these agreements, we commit to provide specified payments to a developer, or intellectual property holder, based upon contractual arrangements. Assuming all contractual provisions are met, the total future minimum contract commitment for contracts in place as of March 31, 2003 is approximately $138.1 million, which is scheduled to be paid as follows (amounts in thousands):

Year ended March 31,	
2004	$ 89,175
2005	28,066
2006	12,300
2007	6,075
2008 and thereafter	2,501
Total	$138,117

Lease Obligations. We lease certain of our facilities under non-cancelable operating lease agreements. Total future minimum lease commitments as of March 31, 2003 are as follows (amounts in thousands):

Year ended March 31,	
2004	$ 7,135
2005	6,394
2006	5,471
2007	4,979
2008 and thereafter	16,536
Total	$ 40,515

Facilities rent expense for the year ended March 31, 2003, 2002 and 2001 was approximately $7.6 million, $5.3 million and $4.7 million, respectively.

Legal Proceedings. We are party to routine claims and suits brought against us in the ordinary course of business, including disputes arising over the ownership of intellectual property rights and collection matters. In the opinion of management, the outcome of such routine claims will not have a material adverse effect on our business, financial condition, results of operations or liquidity.

14. Stock Compensation and Employee Benefit Plans

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

On February 28, 1992, the shareholders of Activision approved the Activision 1991 Stock Option and Stock Award Plan, as amended, (the "1991 Plan") which permits the granting of "Awards" in the form of non-qualified stock options, incentive stock options ("ISOs"), stock appreciation rights ("SARs"), restricted stock awards, deferred stock awards and other common stock-based awards to directors, officers, employees, consultants and others. The total number of shares of common stock available for distribution under the 1991 Plan is 17,025,000. The 1991 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were no shares remaining available for grant under the 1991 Plan as of March 31, 2003.

On September 23, 1998, the shareholders of Activision approved the Activision 1998 Incentive Plan, as amended (the "1998 Plan"). The 1998 Plan permits the granting of "Awards" in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred stock awards and other common stock-based awards to directors, officers, employees, consultants and others. The total number of shares of common stock available for distribution under the 1998 Plan is 6,750,000. The 1998 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 4,500 shares remaining available for grant under the 1998 Plan as of March 31, 2003.

On April 26, 1999, the Board of Directors approved the Activision 1999 Incentive Plan, as amended (the "1999 Plan"). The 1999 Plan permits the granting of "Awards" in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred share awards and other common stock-based awards to directors, officers, employees, consultants and others. The total number of shares of common stock available for distribution under the 1999 Plan is 11,250,000. The 1999 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 55,500 shares remaining available for grant under the 1999 Plan as of March 31, 2003.

On August 23, 2001, the shareholders of Activision approved the Activision 2001 Incentive Plan, as amended (the "2001 Plan"). The 2001 Plan permits the granting of "Awards" in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred stock awards and other common stock-based awards to directors, officers, employees, consultants and others. The total number of shares of common stock available for distribution under the 2001 Plan is 3,375,000. The 2001 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 18,000 shares remaining available for grant under the 2001 Plan as of March 31, 2003.

On April 4, 2002, the Board of Directors approved the Activision 2002 Incentive Plan (the "2002 Plan"). The 2002 Plan permits the granting of "Awards" in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred share awards and other common stock-based awards to officers (other than executive officers), employees, consultants, advisors and others. The 2002 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. The total number of shares of common stock originally available for distribution under the 2002 Plan was 3,525,000. There were approximately 420,000 shares remaining available for grant under the 2002 Plan as of March 31, 2003. In April 2003, our Board of Directors approved a 3.0 million share increase to the total number of shares available for distribution under the 2002 Plan.

On September 19, 2002, the shareholders of Activision approved the Activision 2002 Executive Incentive Plan (the "2002 Executive Plan"). The 2002 Executive Plan permits the granting of "Awards" in the form of non-qualified stock options, ISOs, SARs, restricted stock awards, deferred share awards and other common stock-based awards to officers, employees, directors, consultants and advisors. The total number of shares of common stock available for distribution under the 2002 Executive Plan is 3,750,000. The 2002 Executive Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. There were approximately 1,018,500 shares remaining available for grant under the 2002 Executive Plan as of March 31, 2003.

On December 16, 2002, the Board of Directors approved the Activision 2002 Studio Employee Retention Incentive Plan, as amended (the "2002 Studio Plan"). The 2002 Studio Plan permits the granting of "Awards" in the form of non-qualified stock options and restricted stock awards to key studio employees (other than executive officers) of Activision, our subsidiaries and affiliates and to contractors and others. The 2002 Studio Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. The total number of shares of common stock available for distribution under the 2002 Studio Plan is 2,250,000. There were approximately 67,500 shares remaining available for grant under the 2002 Studio Plan as of March 31, 2003.

On April 29, 2003, our Board of Directors approved the Activision 2003 Incentive Plan (the "2003 Plan"). The 2003 Plan permits the granting of "Awards" in the form of non-qualified stock options, SARs, restricted stock awards, deferred stock awards and other common stock-based awards to directors, officers, employees, consultants and others. The 2003 Plan requires available shares to consist in whole or in part of authorized and unissued shares or treasury shares. The total number of shares of common stock available for distribution under the 2003 Plan is 9,000,000.

The exercise price for Awards issued under the 1991 Plan, 1998 Plan, 1999 Plan, 2001 Plan, 2002 Plan, 2002 Executive Plan, 2002 Studio Plan and 2003 Plan (collectively, the "Plans") is determined at the discretion of the Board of Directors (or the Compensation Committee of the Board of Directors, which administers the Plans), and for ISOs, is not to be less than the fair market value of our common stock at the date of grant, or in the case of non-qualified options, must exceed or be equal to 85% of the fair market value of our common stock at the date of grant. Options typically become exercisable in installments over a period not to exceed seven years and must be exercised within 10 years of the date of grant. However, certain options granted to executives vest immediately. Historically, stock options have been granted with exercise prices equal to or greater than the fair market value at the date of grant.

Other Employee Stock Options. In connection with prior employment agreements between Activision and Robert A. Kotick, Activision's Chairman and Chief Executive Officer, and Brian G. Kelly, Activision's Co-Chairman, Mr. Kotick and Mr. Kelly were granted options to purchase common stock. The Board of Directors approved the granting of these options. Relating to such grants, as of March 31, 2003, 5,211,000 shares were outstanding with a weighted average exercise price of $4.21, of which, 5,023,500 were exercisable with a weighted average exercise price of $4.27.

We additionally have approximately 486,000 options outstanding to employees as of March 31, 2003, with a weighted average exercise price of $9.28. The Board of Directors approved the granting of these options. Such options have terms similar to those options granted under the Plans. Relating to these options outstanding, 295,500 are exercisable with a weighted average exercise price of $9.28.

We also issue stock options in conjunction with acquisition transactions. As of March 31, 2003, 9,000 options with a weighted average exercise price of $4.45 were outstanding relating to options issued in conjunction with acquisitions completed in fiscal 1999 and 1998. The Board of Directors approved the granting of these options. None of these shares were exercisable as of March 31, 2003.

Director Warrants. The Director Warrant Plan, which expired on December 19, 1996, provided for the automatic granting of warrants ("Director Warrants") to purchase 37,500 shares of common stock to each director of Activision who was not an officer or employee of Activision or any of its subsidiaries. Director

Warrants granted under the Director Warrant Plan vested 25% on the first anniversary of the date of grant, and 12.5% each six months thereafter. The expiration of the Plan had no effect on the outstanding Director Warrants. As of March 31, 2003, there were no shares of common stock available for distribution nor were there any warrants outstanding under the Director Warrant Plan.

During the fiscal year ended March 31, 1997, we issued warrants to purchase 90,000 shares of our common stock, at exercise prices ranging from $5.25 to $6.17 to two of our outside directors in connection with their election to the Board. Such warrants have vesting terms identical to the Directors Warrants and expire within 10 years from the date of grant. Relating to such warrants, as of March 31, 2003, 45,000 shares with a weighted average exercise price of $6.01 were outstanding and exercisable.

Employee Stock Purchase Plans. We have an employee stock purchase plan for all eligible employees (the "Purchase Plan"). Under the Purchase Plan, shares of our common stock may be purchased at six-month intervals at 85% of the lower of the fair market value on the first or last day of each six-month period (the "Offering Period"). Employees may purchase shares having a value not exceeding 10% of their gross compensation during an Offering Period. Employees purchased approximately 76,500 and 67,500 shares at a price of $14.21 and $9.09 per share during the Purchase Plan's offering periods ended September 30, 2002 and 2001, respectively, and approximately 139,500 and 72,000 shares at a price of $8.36 and $9.49 per share during the Purchase Plan's offering periods ended March 31, 2003 and 2002, respectively. The Purchase Plan expired on March 31, 2003.

On July 22, 2002, the Board of Directors approved the 2002 Employee Stock Purchase Plan for eligible domestic employees. The shareholders of Activision subsequently approved the 2002 Employee Stock Purchase Plan on September 19, 2002. Then, on February 11, 2003, the Board of Directors approved the 2002 Employee Stock Purchase Plan For International Employees. The primary terms of the 2002 Employee Stock Purchase Plan and the 2002 Employee Stock Purchase Plan For International Employees (collectively the "2002 Purchase Plans") are the same. Under the 2002 Purchase Plans, up to 750,000 shares of our common stock may be purchased by eligible employees during two overlapping, twelve-month offering periods that commence each April 1 and October 1 (the "2002 Offering Period"). At any point in time, employees may participate in only one 2002 Offering Period. The first day of each 2002 Offering Period is referred to as the "Offering Date." Common stock is purchased by 2002 Purchase Plans participants at 85% of the lesser of fair market value on the Offering Date for the 2002 Offering Period that includes the common stock purchase date or the fair market value on the common stock purchase date. Employees may purchase shares having a value not exceeding 15% of their gross compensation during a 2002 Offering Period, limited to a maximum of 7,500 common shares per common stock purchase date. As of March 31, 2003, no shares had been issued under the 2002 Purchase Plans.

Activity of Employee and Director Options and Warrants. Activity of all employee and director options and warrants during the last three fiscal years was as follows (amounts in thousands, except weighted average exercise price amounts):

	2003		2002		2001	
	Shares	Wtd. Avg. Ex. Price	Shares	Wtd. Avg. Ex. Price	Shares	Wtd. Avg. Ex. Price
Outstanding at beginning of year	19,295	$ 6.25	26,874	$ 4.30	23,247	$4.92
Granted	9,615	14.22	6,164	10.87	15,227	3.07
Exercised	(3,783)	4.83	(13,022)	4.49	(7,875)	4.03
Forfeited	(654)	8.65	(721)	4.90	(3,725)	4.33
Outstanding at end of year	24,473	$ 9.53	19,295	$ 6.25	26,874	$4.30
Exercisable at end of year	11,496	$ 6.43	9,501	$ 5.50	14,724	$4.44

For the years ended March 31, 2003 and 2002, all options were granted at an exercise price equal to the fair market value on the date of grant.

For the year ended March 31, 2001, 9,769,500 options with a weighted average exercise price of $3.19 were granted at an exercise price equal to the fair market value on the date of grant and 5,457,000 options with a weighted average exercise price of $2.86 were granted at an exercise price greater than fair market value on the date of grant.

The following tables summarize information about all employee and director stock options and warrants outstanding as of March 31, 2003 (share amounts in thousands):

	Outstanding Options			Exercisable Options	
	Shares	Remaining Wtd. Avg. Contractual Life (in years)	Wtd. Avg. Exercise Price	Shares	Wtd. Avg. Exercise Price
Range of exercise prices:					
$ 2.11 to $ 4.55	2,880	6.98	$ 2.96	2,105	$ 2.96
$ 4.59 to $ 4.67	4,160	6.04	4.66	4,009	4.67
$ 4.69 to $ 7.53	3,260	5.34	5.85	2,402	5.83
$ 7.67 to $ 9.28	2,513	8.35	8.89	1,257	9.18
$ 9.37 to $ 9.92	2,835	8.77	9.45	417	9.41
$ 9.93 to $13.33	2,419	8.83	11.69	572	11.03
$13.69 to $15.29	2,589	9.31	15.16	16	14.51
$15.55 to $18.27	946	8.97	17.02	138	16.67
$18.41 to $18.41	2,533	9.02	18.41	561	18.41
$18.43 to $22.16	338	9.11	20.34	19	19.10
	24,473	7.70	$ 9.53	11,496	$ 6.43

Non-Employee Warrants. In prior years, we have granted stock warrants to third parties in connection with the development of software and the acquisition of licensing rights for intellectual property. The warrants generally vest upon grant and are exercisable over the term of the warrant. The exercise price of third-party warrants is generally greater than or equal to the fair market value of our common stock at the date of grant. During the fiscal year ended March 31, 2003, we granted warrants to a third party to purchase 225,000 shares of our common stock at an exercise price of $19.83 per share in connection with, and as partial consideration for, a license agreement that allows us to utilize intellectual property owned by the third party in conjunction with an Activision product. The warrants vested upon grant and have a three-year term. The fair value of the warrants was determined using the Black-Scholes pricing model, assuming a risk-free rate of 4.18%, a volatility factor of 70% and expected term as noted above. The per share weighted average estimated fair value of the third-party warrants granted during the year ended March 31, 2003 was $9.71 per share. As of March 31, 2003, 1,323,000 third-party warrants to purchase common stock were outstanding with a weighted average exercise price of $9.37 per share. No non-employee warrants were granted during the years ended March 31, 2002 or 2001. As of March 31, 2002, 1,165,000 third-party warrants to purchase common stock were outstanding with a weighted average exercise price of $11.72 per share. As of March 31, 2001, 2,961,000 third-party warrants to purchase common stock were outstanding with a weighted average exercise price of $4.84 per share.

In accordance with EITF 96-18, we measure the fair value of the securities on the measurement date. The fair value of each warrant is capitalized and amortized to expense when the related product is released and the related revenue is recognized. Additionally, as more fully described in Note 1, the recoverability of capitalized software development costs and intellectual property licenses is evaluated on a quarterly basis with amounts determined as not recoverable being charged to expense. In connection with the evaluation of capitalized software development costs and intellectual property licenses, any capitalized amounts for related third-party warrants are additionally reviewed for recoverability with amounts determined as not recoverable being amortized to expense. For the year ended March 31, 2003, 2002, and

2001, $3.6 million, $1.1 million and $1.4 million, respectively, was amortized and included in cost of sales—software royalties and amortization and/or cost of sales—intellectual property licenses.

Employee Retirement Plan. We have a retirement plan covering substantially all of our eligible employees. The retirement plan is qualified in accordance with Section 401(k) of the Internal Revenue Code. Under the plan, employees may defer up to 15% of their pre-tax salary, but not more than statutory limits. Effective January 1, 2003, we contribute 20% of each dollar contributed by a participant. Prior to January 1, 2003, we contributed 5% of each dollar contributed by a participant. Our matching contributions to the plan were approximately $320,000, $82,000, and $62,000 during the year ended March 31, 2003, 2002, and 2001, respectively.

15. Capital Transactions

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

As of March 31, 2003, we had repurchased approximately 10.8 million shares of our common stock at an average cost of $9.39 per share. Additionally under the Board approved buyback program, we entered into a series of structured stock repurchase transactions in the aggregate amount of $110.0 million. These transactions may be settled in cash or stock depending on the market price of our common stock on the date of the settlement. Upon settlement, we will either have our capital investment returned with a premium or receive up to approximately 12.8 million shares of our common stock, depending, respectively, on whether the market price of our common stock is above or below a pre-determined price agreed in connection with each such transaction. These transactions are recorded in shareholders' equity in the consolidated balance sheet as of March 31, 2003.

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 one-hundredths (1/100) of a share of our Series A Junior Preferred Stock at an exercise price of $40.00. Initially, the rights are represented by our common stock certificates and are neither exercisable nor traded separately from our common stock. The rights will only become exercisable if a person or group acquires 15% or more of the common stock of Activision, or announces or commences a tender or exchange offer which would result in the bidder's beneficial ownership of 15% or more of our common stock.

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

We may redeem the rights for $.01 per right at any time until the first public announcement of the acquisition of beneficial ownership of 15% of our common stock. At any time after a person has acquired 15% or more (but before any person has acquired more than 50%) of our common stock, we may exchange all or part of the rights for shares of common stock at an exchange ratio of one share of common stock per right. The rights expire on April 18, 2010.

16. Accumulated Other Comprehensive Income (Loss)

For the years ended March 31, 2002 and 2001, accumulated other comprehensive loss primarily consisted of foreign currency translation adjustments.

For the year ended March 31, 2003, the components of accumulated other comprehensive loss were as follows (amounts in thousands):

	Foreign Currency	Unrealized Appreciation on Investments	Accumulated Other Comprehensive Income (Loss)
Balance, March 31, 2002	$(11,498)	$ —	$(11,498)
Comprehensive income	7,930	134	8,064
Balance, March 31, 2003	$ (3,568)	$134	$ (3,434)

The amounts above are shown net of taxes. The income taxes related to other comprehensive income were not significant, as income taxes were not provided for foreign currency translation items as these are considered indefinite investments in non-U.S. subsidiaries.

17. Supplemental Cash Flow Information

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

Year ended March 31,	2003	2002	2001
Non-cash investing and financing activities:			
Conversion of convertible subordinated notes, net of conversion costs	$ —	$58,651	$ —
Subsidiaries acquired with common stock	10,861	25,481	—
Issuance of options and common stock warrants	2,184	3,217	—
Stock offering costs	781	—	—
Tax benefit derived from net operating loss carryforward utilization	—	—	3,652
Change in unrealized appreciation on short-term investments	134	—	—
Supplemental cash flow information:			
Cash paid for income taxes	$ 5,491	$ 3,041	$6,753
Cash paid (received) for interest, net	(7,804)	(2,942)	5,720

18. Quarterly Financial and Market Information (Unaudited)

(Amounts in thousands, except per share data)	Quarter ended June 30	Sept. 30	Dec. 31	Mar. 31	Year ended
Fiscal 2003:					
Net revenues	$191,258	$169,172	$378,685	$125,001	$864,116
Operating income (loss)	31,196	11,334	66,761	(14,444)	94,847
Net income (loss)	20,704	9,086	44,347	(7,957)	66,180
Basic earnings (loss) per share	0.23	0.09	0.44	(0.08)	0.69
Diluted earnings (loss) per share	0.21	0.08	0.42	(0.08)	0.64
Common stock price per share:					
High	23.40	21.03	15.92	10.50	23.40
Low	17.55	14.87	8.13	8.68	8.13
Fiscal 2002:					
Net revenues	$110,577	$139,604	$371,341	$164,912	$786,434
Operating income (loss)	(1,235)	3,144	61,801	16,862	80,574
Net income	29	2,215	39,110	10,884	52,238
Basic earnings per share	0.00	0.03	0.50	0.13	0.69
Diluted earnings per share	0.00	0.03	0.44	0.12	0.59
Common stock price per share:					
High	18.29	18.00	19.15	21.83	21.83
Low	9.28	10.05	10.90	15.18	9.28

Market for Registrant's Common Equity and Related Stockholder Matters

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

The following table sets forth for the periods indicated the high and low reported sale prices for our common stock. As of June 9, 2003, there were approximately 2,900 holders of record of our common stock.

	High	Low
Fiscal 2002		
First Quarter ended June 30, 2001	$18.29	$ 9.28
Second Quarter ended September 30, 2001	18.00	10.05
Third Quarter ended December 31, 2001	19.15	10.90
Fourth Quarter ended March 31, 2002	21.83	15.18
Fiscal 2003		
First Quarter ended June 30, 2002	$23.40	$17.55
Second Quarter ended September 30, 2002	21.03	14.87
Third Quarter ended December 31, 2002	15.92	8.13
Fourth Quarter ended March 31, 2003	10.50	8.68

On June 9, 2003, the last reported sales price of our common stock was $11.68.

Dividends

We paid no cash dividends in 2003 or 2002 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 Split

In April 2003, the Board of Directors approved a three-for-two stock split effected in the form of a 50% stock dividend. The stock split is payable at the close of business on June 6, 2003 to shareholders of record as of May 16, 2003 and is effective as of the start of trading on June 9, 2003.

Officers

Robert A. Kotick
Chairman and Chief Executive Officer

Brian G. Kelly
Co-Chairman

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

William J. Chardavoyne
Chief Financial Officer and Executive Vice President

Lawrence Goldberg
Executive Vice President, Worldwide Studios

Michael J. Rowe
Executive Vice President, Human Resources

Richard A. Steele
President, Activision Distribution and Executive Vice President, International Distribution

Kathy P. Vrabeck
Executive Vice President, Global Publishing and Brand Management

George L. Rose
Senior Vice President, Business and Legal Affairs, General Counsel and Secretary

Board of Directors

Robert A. Kotick
Chairman and Chief Executive Officer

Brian G. Kelly
Co-Chairman

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

Barbara S. Isgur
Former Senior Vice President, Stratagem

Steven T. Mayer
Former Chairman, Digital F/X, Inc.

Robert J. Morgado
Chairman, Maroley Media Group

Kenneth L. Henderson
Partner, Bryan Cave LLP

Transfer Agent

Continental Stock Transfer
& Trust Company
17 Battery Place
New York, New York 10004
(212) 509-4000

Auditor

PricewaterhouseCoopers LLP
Los Angeles, California

Bank

US Bank
Los Angeles, California

Corporate Counsel

Bryan Cave LLP
New York, New York

Corporate Headquarters

Activision, Inc.
3100 Ocean Park Boulevard
Santa Monica, California 90405
(310) 255-2000

Offices

Dallas, Texas
Eden Prairie, Minnesota
Eagan, Minnesota
Hayward, California
Madison, Wisconsin
New York, New York
Santa Monica, California
San Francisco, California
Woodland Hills, California

International Offices

Argenteuil, France
Barrie, Canada
Birmingham, United Kingdom
Breda, The Netherlands
Burglengenfeld, Germany
Milan, Italy
Seoul, South Korea
Slough, United Kingdom
Stockholm, Sweden
Sydney, Australia
Tokyo, Japan
Venlo, The Netherlands

Forward-Looking Statements

The statements contained in this report that are not historical facts are "forward-looking statements." The company cautions readers of this report that a number of important factors could cause Activision's actual future results to differ materially from those expressed in any such forward-looking statements. These important factors, and other factors that could affect Activision, are described in the company's Annual Report on Form 10-K for the fiscal year ended March 31, 2003, which was filed with the United States Securities and Exchange Commission. Readers of this Annual Report are referred to this filing.

World Wide Web Site

www.activision.com

E-Mail

IR@activision.com

Annual Meeting

September 18, 2003
The Peninsula Hotel
9882 South Santa Monica Blvd.
Beverly Hills, California 90212

Annual Report on Form 10-K

The company's Annual Report on Form 10-K for the year ended March 31, 2003 is available to shareholders without charge upon request from our corporate offices or through our website.

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ACTIVISION®

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