Meritage Homes CORP
Form 10-Q
November 04, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2010

Or

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

For the transition period from __________ to __________

Commission File Number 1-9977

MERITAGE HOMES CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**86-0611231**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

17851 North 85th Street, Suite 300 Scottsdale, Arizona	**85255**
(Address of Principal Executive Offices)	(Zip Code)

(480) 515-8100

(Registrant s Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by a checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Date File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Common shares outstanding as of November 2, 2010: 32,125,986

MERITAGE HOMES CORPORATION
FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2010
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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

MERITAGE HOMES CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	September 30, 2010	December 31, 2009
Assets:		
Cash and cash equivalents	$ 145,324	$ 249,331
Investments and securities	265,571	125,699
Restricted cash	8,948	16,348
Income tax receivable	0	92,509
Other receivables	20,782	22,934
Real estate	744,808	675,037
Real estate not owned	4,105	10,527
Deposits on real estate under option or contract	10,887	8,636
Investments in unconsolidated entities	11,196	11,882
Property and equipment, net	15,064	15,251
Intangibles, net	2,511	3,590
Prepaid expenses and other assets	11,465	10,923
Total assets	$ 1,240,661	$ 1,242,667
Liabilities:		
Accounts payable	$ 29,501	$ 30,296
Accrued liabilities	94,369	103,236
Home sale deposits	7,839	9,501
Liabilities related to real estate not owned	4,027	9,200
Senior and senior subordinated notes	605,623	605,009
Total liabilities	741,359	757,242
Stockholders Equity:		
Preferred stock, par value $0.01. Authorized 10,000,000 shares; none issued and outstanding at September 30, 2010 and December 31, 2009	0	0
Common stock, par value $0.01. Authorized 125,000,000 shares; issued and outstanding 40,002,903 and 39,710,958 shares at September 30, 2010 and December 31, 2009, respectively	400	397
Additional paid-in capital	467,232	461,403
Retained earnings	220,443	212,398
Treasury stock at cost, 7,891,250 shares at September 30, 2010 and December 31, 2009	(188,773)	(188,773)

Total stockholders equity		499,302		485,425
Total liabilities and stockholders equity	$	1,240,661	$	1,242,667

See accompanying notes to condensed consolidated financial statements

MERITAGE HOMES CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Home closing revenue	$ 233,803	$ 231,816	$ 725,790	$ 683,208
Land closing revenue	0	0	1,222	1,285
Total closing revenue	233,803	231,816	727,012	684,493
Cost of home closings	(190,562)	(198,279)	(590,809)	(594,816)
Cost of land closings	0	0	(964)	(1,195)
Real estate impairments	(680)	(10,354)	(1,526)	(86,943)
Land impairments	0	(281)	0	(540)
Total cost of closings and impairments	(191,242)	(208,914)	(593,299)	(683,494)
Home closing gross profit	42,561	23,183	133,455	1,449
Land closing gross (loss)/profit	0	(281)	258	(450)
Total closing gross profit	42,561	22,902	133,713	999
Commissions and other sales costs	(19,624)	(18,382)	(58,452)	(55,625)
General and administrative expenses	(15,678)	(14,269)	(47,100)	(41,913)
Earnings/(loss) from unconsolidated entities, net	1,243	(899)	3,832	1,350
Interest expense	(8,425)	(8,853)	(25,273)	(28,515)
Other income, net	654	1,862	4,637	6,512
(Loss)/gain on extinguishment of debt	0	0	(3,454)	9,390
Income/(loss) before income taxes	731	(17,639)	7,903	(107,802)
Benefit from/(provision for) income taxes	488	(146)	142	(1,940)
Net income/(loss)	$ 1,219	$ (17,785)	$ 8,045	$ (109,742)
Income/(loss) per common share:				
Basic	$ 0.04	$ (0.56)	$ 0.25	$ (3.52)
Diluted	0.04	(0.56)	0.25	(3.52)
Weighted average number of shares:				
Basic	32,095	31,718	32,038	31,197
Diluted	32,297	31,718	32,277	31,197

See accompanying notes to condensed consolidated financial statements

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MERITAGE HOMES CORPORATION AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended September 30,	
	2010	**2009**
Cash flows from operating activities:		
Net income/(loss)	$ 8,045	$ (109,742)
Adjustments to reconcile net income/(loss) to net cash provided by operating activities:		
Depreciation and amortization	6,139	6,547
Real-estate-related impairments	1,526	87,483
Stock-based compensation	4,062	4,512
Loss/(gain) on early extinguishment of debt, net of transaction costs	3,454	(9,390)
Equity in earnings from unconsolidated entities (includes $0.1 and $2.8 million of joint venture impairments in 2010 and 2009, respectively)	(3,832)	(1,350)
Distributions of earnings from unconsolidated entities	5,236	5,341
Other operating expenses	(266)	0
Changes in assets and liabilities:		
(Increase)/decrease in real estate	(70,883)	87,589
(Increase)/decrease in deposits on real estate under option or contract	(1,038)	7,131
Decrease in receivables and prepaid expenses and other assets	96,638	117,149
Decrease in accounts payable and accrued liabilities	(9,256)	(40,991)
(Decrease)/increase in home sale deposits	(1,662)	3,155
Net cash provided by operating activities	38,163	157,434
Cash flows from investing activities:		
Investments in unconsolidated entities	(546)	(1,218)
Distributions of capital from unconsolidated entities	152	1,153
Purchases of property and equipment	(5,039)	(2,128)
Proceeds from sales of property and equipment	65	128
Purchase of investment securities	(240,716)	0
Proceeds from sales and maturities of investment securities	100,220	0
Decrease/(increase) in restricted cash	7,400	(18,604)
Net cash used in investing activities	(138,464)	(20,669)
Cash flows from financing activities:		
Repayments of senior notes	(197,543)	0
Proceeds from issuance of senior notes	195,134	0
Debt issuance costs	(3,067)	0
Proceeds from stock option exercises	1,770	4,263
Net cash (used in)/provided by financing activities	(3,706)	4,263

Net (decrease)/increase in cash and cash equivalents	(104,007)	141,028
Cash and cash equivalents at beginning of period	249,331	205,923
Cash and cash equivalents at end of period	$ 145,324	$ 346,951

See supplemental disclosures of cash flow information at Note 10.

See accompanying notes to condensed consolidated financial statements

MERITAGE HOMES CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009

NOTE 1 ORGANIZATION AND BASIS OF PRESENTATION

Organization. Meritage Homes is a leading designer and builder of single-family detached and attached homes in the historically high-growth regions of the western and southern United States based on the number of home closings. We offer first-time, move-up, active adult and luxury homes to our targeted customer base. We have operations in three regions: West, Central and East, which are comprised of 12 metropolitan areas in Arizona, Texas, California, Nevada, Colorado and Florida. Through our predecessors, we commenced our homebuilding operations in 1985. Meritage Homes Corporation was incorporated in 1988 in the State of Maryland.

Our homebuilding and marketing activities are conducted under the name of Meritage Homes in each of our markets, except for Arizona and Texas, where we also operate under the name of Monterey Homes. At September 30, 2010, we were actively selling homes in 150 communities, with base prices ranging from approximately $89,900 to $971,900.

Basis of Presentation. The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2009. The condensed consolidated financial statements include the accounts of Meritage Homes Corporation and those of our consolidated subsidiaries, partnerships and other entities in which we have a controlling financial interest, and of variable interest entities (see Note 3) in which we are deemed the primary beneficiary (collectively, us , we , our and the Company). Intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the accompanying financial statements include all adjustments necessary for the fair presentation of our results for the interim periods presented. Results for interim periods are not necessarily indicative of results to be expected for the full year.

Restricted Cash. Restricted cash consists of amounts held in restricted accounts as collateral for our letter of credit arrangements that were established to replace those previously available under our Credit Facility. See Note 5 for additional discussion of the termination of our Credit Facility during 2009.

Investments and Securities. Our investments and securities are comprised of both treasury securities and deposits with banks that are FDIC-insured and secured by treasury-backed investments. All of our investments are classified as held-to-maturity and are recorded at amortized cost as we have both the ability and intent to hold them until their respective maturities. The contractual lives of these investments are typically less than 18 months. The amortized cost of the investments approximates fair value.

Real Estate. Real estate is stated at cost unless the community or land is determined to be impaired, at which point the inventory is written down to fair value as required by Accounting Standards Codification (ASC) Subtopic 360-10, *Property, Plant and Equipment* (ASC 360-10). Inventory includes the costs of land acquisition, land development, home construction, capitalized interest, real estate taxes, direct overhead costs incurred during development and home construction that benefit the entire community and impairments, if any. Land and development costs are typically allocated and transferred to homes under construction when construction begins. Home construction costs are accumulated on a per-home basis. Cost of home closings includes the specific construction costs of the home and all related land acquisition, land development and other common costs (both incurred and estimated to be incurred) that are allocated based upon the total number of homes expected to be closed in each community or phase. Any changes to the estimated total development costs of a community or phase are allocated to the remaining homes in the community or phase. When a home closes, we may have incurred costs for goods and services that have not yet been paid. Therefore, an accrual to capture such obligations is recorded in connection with the home closing and charged directly to cost of sales.

Typically, a community s life cycle ranges from three to five years, commencing with the acquisition of the entitled land and continuing through the land development phase and concluding with the sale, construction and closing of the homes. Actual community lives will vary based on the size of the community, the sales absorption rate and whether

the land purchased was raw or finished lots. Master-planned communities encompassing several phases and super-block land parcels may have significantly longer lives and projects involving smaller finished lot purchases may be significantly shorter.

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All of our land inventory and related real estate assets are reviewed for recoverability quarterly, as our inventory is considered long-lived in accordance with GAAP. Impairment charges are recorded if the fair value of an asset is less than its carrying amount. Our determination of fair value is based on projections and estimates. Changes in these expectations may lead to a change in the outcome of our impairment analysis, and actual results may also differ from our assumptions. Our analysis is completed on a quarterly basis at a community level with each community or land parcel evaluated individually. For those assets deemed to be impaired, the impairment recognized is measured as the amount by which the assets carrying amount exceeds their fair value. The impairment of a community is allocated to each lot on a straight-line basis.

Existing and continuing communities. When projections for the remaining income expected to be earned from existing communities are no longer positive, the underlying real estate assets are deemed not fully recoverable, and further analysis is performed to determine the required impairment. The fair value of the community s assets is determined using either a discounted cash flow model for build-out projects or a market-based approach for projects to be sold. Impairments are charged to cost of home closings in the period during which it is determined that the fair value is less than the assets carrying amount. If a market-based approach is used, we determine fair value based on recent comparable purchase and sale activity in the local market, adjusted for known variances as determined by our knowledge of the region and general real estate expertise. If a discounted cash flow approach is used, we compute our fair value based on a proprietary model. Our key estimates in deriving fair value under our cash flow model are (i) home selling prices in the community adjusted for current and expected sales discounts and incentives, (ii) costs related to the community both land development and home construction including costs spent to date and budgeted remaining costs to spend, (iii) projected sales absorption rates, reflecting any product mix change strategies implemented to stimulate the sales pace and expected cancellation rates, (iv) alternative land uses including disposition of all or a portion of the land owned and (v) our discount rate, which is currently 14-16% and varies based on the perceived risk inherent in the community s other cash flow assumptions. These assumptions vary widely across different communities and geographies and are largely dependent on local market conditions. Community-level factors that may impact our key estimates include:

- The presence and significance of local competitors, including their offered product type and competitive actions;
- Economic and related demographic conditions for the population of the surrounding community; and
- Desirability of the particular community, including unique amenities or other favorable or unfavorable attributes.

These local circumstances may significantly impact our assumptions and the resulting computation of fair value and are, therefore, closely evaluated by our division personnel in their creation of the discounted cash flow models. The models are also evaluated by regional and corporate personnel for consistency and integration, as decisions that affect pricing or absorption at one community may have resulting consequences for neighboring communities. We typically do not project market improvements in our discounted cash flow models, but may do so in limited circumstances in the latter years of a long-lived community. In certain cases, we may elect to stop development (mothball) an existing community if we believe the economic performance of the community would be maximized by deferring development for a period of time to allow market conditions to improve. The decision may be based on financial and/or operational metrics. If we decide to mothball a project, we will impair it to its fair value as discussed above and then cease future development activity until such a time where management believes that market conditions will improve and economic performance will be maximized. Quarterly, we review all communities, including mothballed communities, for potential impairments.

Option deposits and pre-acquisition costs. We also evaluate assets associated with future communities for impairments on a quarterly basis. Using similar techniques described in the existing and continuing communities section above, we determine if the contribution margins to be generated by our future communities are acceptable to us. If the projections indicate that a community is still meeting our internal investment guidelines and is generating a profit, those assets are determined to be fully recoverable and no impairments are required. In cases where we decide

to abandon a project, we will fully impair all assets related to such project and will expense and accrue any additional costs that we are contractually obligated to incur. In certain circumstances, we may also elect to continue with a project because it is expected to generate positive cash flows, even though it may not be generating an accounting profit, or due to other strategic factors. In such cases, we will impair our pre-acquisition costs and deposits, as necessary, to record an impairment to bring the book value to fair value. Refer to Note 2 of these consolidated financial statements for further information regarding our impairments.

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Deposits. Deposits paid related to land options and contracts to purchase land are capitalized when incurred and classified as deposits on real estate under option or contract until the related land is purchased. Deposits are recorded as a component of real estate at the time the deposit is used to offset the acquisition price of the lots based on the terms of the underlying agreements. To the extent they are non-refundable, deposits are charged to expense if the land acquisition is terminated or no longer considered probable. As our exposure associated with these non-refundable deposits is limited to the deposit amount, we do not consider the options a contractual obligation. The review of the likelihood of the acquisition of contracted lots is completed quarterly in conjunction with the real estate impairment analysis noted above. Our deposits were $10.9 million and $8.6 million as of September 30, 2010 and December 31, 2009 respectively.

Off-Balance-Sheet Arrangements Joint Ventures. Historically, we have participated in land development joint ventures as a means of accessing larger parcels of land and lot positions, expanding our market opportunities, managing our risk profile and leveraging our capital base; however, in recent years, such ventures have not been a significant avenue for us to access desired lots. We currently have one active venture. We also participate in six mortgage and title business joint ventures. The mortgage joint ventures are engaged in mortgage brokerage activities, and they originate and provide services to both our clients and other homebuyers. See Note 4 for additional information.

Off-Balance-Sheet Arrangements Other. We often acquire lots from various development entities pursuant to option and purchase agreements. The purchase price typically approximates the market price at the date the contract is executed, although in light of recent economic conditions over the last couple of years, we have been successful in renegotiating more preferential terms on some lots we have under contract. See Note 3 for further discussion.

We provide letters of credit and performance, maintenance and other bonds in support of our related obligations with respect to option deposits and the development of our projects. The amount of these obligations outstanding at any time varies depending on the stage and level of our development activities. In the event a letter of credit or bond is drawn upon, we would be obligated to reimburse the issuer. We believe it is unlikely that any significant amounts of these letters of credit or bonds will be drawn upon. The table below outlines our letter of credit and surety bond obligations (in thousands):

	September 30, 2010		December 31, 2009	
	Outstanding	Estimated work remaining to complete	Outstanding	Estimated work remaining to complete
Sureties:				
Sureties related to joint ventures	$ 1,594	$ 32	$ 1,672	$ 32
Sureties related to owned projects and lots under contract	61,382	25,063	93,744	31,145
Total sureties	$ 62,976	$ 25,095	$ 95,416	$ 31,177
Letters of Credit:				
LOC in lieu of deposit for contracted lots	$ 0	N/A	$ 4,414	N/A
LOC for land development	2,060	N/A	3,977	N/A
LOC for general corporate operations	6,653	N/A	6,607	N/A
Total letters of credit	$ 8,713	N/A	$ 14,998	N/A

Accrued Liabilities. Accrued liabilities consist of the following (in thousands):

	At September 30, 2010	At December 31, 2009
Accruals related to real estate development and construction activities	$ 14,258	$ 19,832
Payroll and other benefits	13,659	9,714
Accrued taxes	7,464	4,592
Warranty reserves	29,912	33,541
Other accruals	29,076	35,557
Total	$ 94,369	$ 103,236

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Warranty Reserves. We have certain obligations related to post-construction warranties and defects for closed homes. With the assistance of an actuary, we have estimated these reserves based on the number of home closings and historical data and trends for our communities. We also use industry averages with respect to similar product types and geographic areas in markets where our experience is incomplete to draw a meaningful conclusion. We regularly review our warranty reserves and adjust them, as necessary, to reflect changes in trends as information becomes available. A summary of changes in our warranty reserves follows (in thousands):

	Three Months Ended September 30,		Nine months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Balance, beginning of period	$ 31,197	$ 28,596	$ 33,541	$ 28,891
Additions to reserve from new home deliveries	1,742	716	5,434	2,105
Warranty claims	(2,758)	(1,549)	(8,717)	(3,617)
Adjustments to pre-existing reserves	(269)	1,739	(346)	2,123
Balance, end of period	$ 29,912	$ 29,502	$ 29,912	$ 29,502

Warranty reserves are included in accrued liabilities on the accompanying condensed consolidated balance sheets, and additions and adjustments to the reserves are included in cost of home closings within the accompanying condensed consolidated statements of operations.

Our warranty represents reserves for post-construction warranties and defects for closed homes. These reserves are intended to cover costs associated with our contractual and statutory warranty obligations, which include, among other items, claims involving defective workmanship and materials. We believe that our total reserves, coupled with the general liability insurance we maintain, are sufficient to cover our general warranty obligations.

As of September 30, 2010, we have confirmed that 90 homes we built in 2005 and 2006 were constructed using defective Chinese drywall installed by subcontractors. Eighty-seven of those homes are located in Florida and three are located in the Houston, Texas area. We recently discovered the three Houston area homes and we are still conducting investigations to determine if other Texas homes are impacted, although it currently appears that the exposure in Texas may be isolated. The $29.9 million of warranty reserves we have recorded as of September 30, 2010 include $1.1 million of net reserves for the completion of our repair of the affected homes and the resulting damage related to defective Chinese drywall. If our continuing investigations reveal other homes containing defective Chinese drywall, it may be necessary to increase our warranty reserves. We are seeking recovery of the costs we have incurred or expect to incur related to defective Chinese drywall from the manufacturers, suppliers, and installers of the defective drywall and their insurers as well as from our general liability insurance carrier.

Recently Issued Accounting Pronouncements. In January 2010, the Financial Accounting Standards Board (FASB) amended ASC Subtopic 820-10, *Fair Value Measurements and Disclosures Overall*. The amendment requires additional disclosures and provides clarification regarding existing disclosures for recurring and nonrecurring fair value measurements. The amendment became effective on January 1, 2010 for us and did not have any material impact to our existing disclosures.

In May 2009, the FASB amended ASC Subtopic 810-10, *Consolidation* (ASC 810-10). The amendment revised prior guidance and accounting and reporting requirements for entities involvement with variable interest entities. The new provisions of ASC 810-10 became effective on January 1, 2010 for us. Refer to Note 3 for additional discussion of the impact of the amendment.

NOTE 2 REAL ESTATE AND CAPITALIZED INTEREST

Real estate consists of the following (in thousands):

	At September 30, 2010	At December 31, 2009
Homes under contract under construction (1)	$ 114,363	$ 114,769
Finished home sites and home sites under development	431,341	407,592
Unsold homes, completed and under construction (1)	101,998	73,442
Model homes (1)	39,938	37,601
Land held for development or sale (2)	57,168	41,633
	$ 744,808	$ 675,037

(1) Also includes the allocated land and land development costs associated with each lot for these homes.

(2) Includes communities that we have decided to stop development (mothball) where we have determined that the current economic performance would be maximized by deferring development. In the future, such communities may either be re-opened or sold to third parties. We do not capitalize interest for such mothballed assets, and all

costs of land ownership (i.e. property taxes, homeowner association dues, etc.) are expensed as incurred.

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As previously noted, in accordance with ASC 360-10, each of our land inventory and related real estate assets is reviewed for recoverability when impairment indicators are present, as our inventory is considered long-lived in accordance with GAAP. Due to the current economic environment, we evaluate all of our real estate assets for impairment on a quarterly basis. ASC 360-10 requires impairment charges to be recorded if the fair value of such assets is less than their carrying amounts. Our determination of fair value is based on projections and estimates. Based on these reviews of all our communities, we recorded the following real-estate and joint-venture impairment charges during the three- and nine-month periods ended September 30, 2010 and 2009 (in thousands):

	Three Months Ended September 30,		**Nine months Ended September 30,**	
	2010	**2009**	**2010**	**2009**
Terminated option/purchase contracts and related pre-acquisition costs:				
West	$ 0	$ 0	$ 0	$ 5,922
Central	0	3,224	50	59,213
East	0	0	0	544
Total	$ 0	$ 3,224	$ 50	$ 65,679
Real estate inventory impairments (1):				
West	$ 38	$ 2,385	$ 131	$ 10,882
Central	597	2,453	1,300	6,807
East	45	2,292	45	3,575
Total	$ 680	$ 7,130	$ 1,476	$ 21,264
Impairments of joint venture investments:				
West	$ 112	$ 55	$ 112	$ 274
Central	0	2,556	0	2,556
East	0	0	0	0
Total	$ 112	$ 2,611	$ 112	$ 2,830
Impairments of land held for sale:				
West	$ 0	$ 0	$ 0	$ 323
Central	0	281	0	217
East	0	0	0	0
Total	$ 0	$ 281	$ 0	$ 540
Total impairments:				
West	$ 150	$ 2,440	$ 243	$ 17,401
Central	597	8,514	1,350	68,793
East	45	2,292	45	4,119

Total	$	792	$	13,246	$	1,638	$	90,313

(1) Included in the real estate inventory impairments are impairments of individual homes in a community where the underlying lots in the community were not also impaired, as follows (in thousands):

	Three Months Ended September 30,		Nine months Ended September 30,	
	2010	2009	2010	2009
Individual home impairments:				
West	$ 38	$ 535	$ 131	$ 7,410
Central	597	1,420	1,300	5,503
East	45	876	45	2,159
Total	$ 680	$ 2,831	$ 1,476	$ 15,072

The tables below reflect the number of communities with real estate inventory impairments for the three- and nine-month periods ended September 30, 2009, excluding home-specific impairments (as noted above) and the fair value of these communities as of September 30, 2009 (dollars in thousands). The only such impairment for the nine-month period ended September 30, 2010 related to one community in the Central Region and aggregated $50,000 and there were no such impairments for the three months ended September 30, 2010.

	Three Months Ended September 30, 2009		
			Fair Value of Communities
	Number of Communities Impaired	Impairment Charges	Impaired (Carrying Value less Impairments)
West	4	$ 1,850	$ 11,750
Central	6	1,033	6,482
East	3	1,416	9,505
Total	13	$ 4,299	$ 27,737

	Nine months Ended September 30, 2009		
			Fair Value of Communities
	Number of Communities Impaired	Impairment Charges	Impaired (Carrying Value less Impairments)
West	6	$ 3,472	$ 12,599
Central	8	1,304	7,868
East	3	1,416	9,505
Total	17	$ 6,192	$ 29,972

Subject to sufficient qualifying assets, we capitalize interest incurred in connection with the development and construction of real estate. Completed homes and land not actively under development do not qualify for interest capitalization. Capitalized interest is allocated to real estate when incurred and charged to cost of closings when the

related property is delivered. A summary of our capitalized interest is as follows (in thousands):

	Three Months Ended September 30,		Nine months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Capitalized interest, beginning of period	$ 12,437	$ 19,584	$ 14,187	$ 29,779
Interest incurred	10,848	11,414	32,593	36,419
Interest expensed	(8,425)	(8,853)	(25,273)	(28,515)
Interest amortized to cost of home, land closings and impairments	(3,183)	(4,540)	(9,830)	(20,078)
Capitalized interest, end of period	$ 11,677	$ 17,605	$ 11,677	$ 17,605

At September 30, 2010, approximately $750,000 of the capitalized interest is related to our joint venture investments and is a component of Investments in unconsolidated entities on our condensed consolidated balance sheets.

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NOTE 3 VARIABLE INTEREST ENTITIES AND CONSOLIDATED REAL ESTATE NOT OWNED

In June 2009, FASB revised its guidance regarding the determination of a primary beneficiary of a variable interest entity (VIE). In December 2009, ASC 810, *Consolidation*, was amended to incorporate this guidance. The amendments to ASC 810 replace the prior quantitative computations for determining which entity, if any, is the primary beneficiary of the VIE with a methodology based on both (1) the ability of an entity to control the activities of a VIE that most significantly impact the VIE s economic performance and (2) the obligation to absorb losses of the VIE and/or the right to receive benefits from the VIE. The amendments also increased the required disclosures about a reporting entity s involvement with VIEs. We adopted the amended provisions of ASC 810 on January 1, 2010. The adoption resulted in a deconsolidation of several VIEs that were previously reported as Real estate not owned in our consolidated balance sheets.

Based on the provisions of the relevant accounting guidance, we have concluded that when we enter into an option or purchase agreement to acquire land or lots from an entity and pay a non-refundable deposit, a VIE may be created because we are deemed to have provided subordinated financial support that will absorb some or all of an entity s expected losses if they occur. Since adopting the new provisions of ASC 810, for each VIE, we assess whether we are the primary beneficiary by first determining if we have the ability to control the activities of the VIE that most significantly impact its economic performance. Such activities include, but are not limited to, the ability to determine the budget and scope of land development work, if any; the ability to control financing decisions for the VIE; the ability to acquire additional land into the VIE or dispose of land in the VIE not under contract with Meritage; and the ability to change or amend the existing option contract with the VIE. If we are not determined to control such activities, we are not considered the primary beneficiary of the VIE. If we do have the ability to control such activities, we will continue our analysis by determining if we are expected to absorb a potentially significant amount of the VIE s losses or, if no party absorbs the majority of such losses, if we will benefit from potentially a significant amount of the VIE s expected gains. If we are the primary beneficiary of the VIE, we will consolidate the VIE in our financial statements and reflect such assets and liabilities as Real estate not owned. The liabilities related to consolidated VIEs are excluded from our debt covenant calculations. Prior to the adoption of the amended guidance of ASC 810, we determined if we were the primary beneficiary of a VIE solely by reviewing the expected losses and residual returns based on a probability of future cash flows.

In most cases, creditors of the entities with which we have option agreements have no recourse against us and the maximum exposure to loss in our option agreements is limited to non-refundable option deposits and any capitalized pre-acquisition costs. Often, we are at risk for items over budget related to land development on property we have under option if we are the land developer. In these cases, we have contracted to complete development at a fixed cost on behalf of the land owner and any budget savings or shortfalls are borne by us. Some of our option deposits may be refundable to us if certain contractual conditions are not performed by the party selling the lots.

The table below presents a summary of our lots under option or contract at September 30, 2010 (dollars in thousands):

			Option/Earnest Money Deposits	
	Number of Lots	**Purchase Price**	**Cash**	**Letters of Credit**
Option contracts recorded on balance sheet as real estate not owned (1), (2)	125	$ 4,105	$ 78	$ 0
Option contracts not recorded on balance sheet non-refundable, committed (1)	2,407	98,590	10,101	0
Purchase contracts not recorded on balance sheet non-refundable, committed (1)	309	10,149	450	0
Total committed (on and off balance sheet)	2,841	112,844	10,629	0

Purchase contracts not recorded on balance sheet refundable deposits, uncommitted (3)	1,308		18,186		336		0
Total uncommitted	1,308		18,186		336		0
Total lots under option or contracts	4,149		131,030		10,965		0
Total option contracts not recorded on balance sheet	4,024	$	126,925	$	10,887(4)	$	0

(1) Deposits are non-refundable except if certain contractual conditions are not performed by the selling party.

(2) The purpose and nature of these consolidated lot option contracts (VIEs) is to provide us the option to purchase these lots in the future, in anticipation of building homes on these lots in the future. Specific performance contracts, if any, are included in this balance.

(3) Deposits are refundable at our sole discretion. We have not completed our acquisition evaluation process and we have not internally committed to purchase these lots.

(4) Amount is reflected in our condensed

consolidated balance sheet in the line item Deposits on real estate under option or contract as of September 30, 2010.

Generally, our options to purchase lots remain effective so long as we purchase a pre-established minimum number of lots each month or quarter, as determined by the respective agreement. Although the pre-established number is typically structured to approximate our expected rate of home construction starts, during a weakened homebuilding market, as we have recently been experiencing, we may purchase lots at an absorption level that exceeds our sales and home starts pace to meet the pre-established minimum number of lots or we may try to restructure our original contract to include terms that more accurately reflect our revised sales pace expectations.

NOTE 4 INVESTMENTS IN UNCONSOLIDATED ENTITIES

In the past, we have entered into homebuilding and land development joint ventures as a means of accessing larger parcels of land and lot positions, expanding our market opportunities, managing our risk profile and leveraging our capital base. Based on the structure of these joint ventures, they may or may not be consolidated into our results. Our joint venture partners generally are other homebuilders, land sellers or other real estate investors. We generally do not have a controlling interest in these ventures, which means our joint venture partners could cause the venture to take actions we disagree with, or fail to take actions we believe should be undertaken, including the sale of the underlying property to repay debt or recoup all or part of the partners investments. As of September 30, 2010, we had one active land venture. Due to the current homebuilding environment, although we view our involvement with land joint ventures to be beneficial, we do not view such involvement as critical to the success of our homebuilding operations.

We also participate in six mortgage and title business joint ventures. The mortgage joint ventures are engaged in mortgage activities and they originate and provide services to both our clients and other homebuyers. Although some of these ventures originate mortgage loans, we have limited recourse related to any mortgages originated by these ventures. Our investments in mortgage and title joint ventures as of September 30, 2010 and December 31, 2009 were $1.4 million and $1.0 million, respectively.

For land development joint ventures, we, and in some cases our joint venture partners, usually have an option or other similar arrangement to purchase portions of the land held by the joint venture. Option prices are generally negotiated at prices that approximate market value when we enter into the option contract. For these ventures, our share of the joint venture profit relating to lots we purchase from the joint ventures is deferred until homes are delivered by us and title passes to a homebuyer. Therefore, we allocate the portion of such joint venture profit to the land acquired by us as a reduction in the basis of the property.

In connection with our joint ventures, we may also provide certain types of guarantees to associated lenders and municipalities. These guarantees can be classified into three categories: (i) Repayment Guarantees, (ii) Bad Boy Guarantees , and (iii) Completion Guarantees, described in more detail below (in thousands). Additionally, see Note 1 to these consolidated financial statements for a summary of our joint venture surety obligations.

	At September 30, 2010	At December 31, 2009
Repayment guarantees (1)	$ 7,884	$ 8,188
Bad Boy guarantees	61,170	60,917
Completion guarantees (2)	0	0
Total guarantees	$ 69,054	$ 69,105

(1)

Balance includes $7.1 million of Bad Boy guarantee, but since the triggering of such guarantee is beyond our control, this guarantee is classified as a repayment guarantee.

(2) As our completion guarantees typically require funding from a third party, we believe these guarantees do not represent a potential cash obligation for us, as they require only non-financial performance.

Repayment Guarantees. We and/or our land development joint venture partners occasionally provide limited repayment guarantees on a pro rata basis on the debt of the land development joint ventures. If such a guarantee were ever to be called, the maximum exposure to Meritage would generally be only our pro-rata share of the amount of debt outstanding that was in excess of the fair value of the underlying land securing the debt. At September 30, 2010 and December 31, 2009, our share of these limited pro rata repayment guarantees related to two joint ventures and was approximately $7.9 million and $8.2 million, respectively, of which $7.1 million is a bad boy guaranty (see below for a discussion about bad boy guarantees); however, as the other joint venture partners could trigger such a guaranty without our consent, we have classified this $7.1 million as a repayment guaranty.

Bad Boy Guarantees. In addition, we and/or our joint venture partners occasionally provide guarantees that are only applicable if and when the joint venture directly, or indirectly through agreement with its joint venture partners or other third parties, causes the joint venture to voluntarily file a bankruptcy or similar liquidation or reorganization action or take other actions that are fraudulent or improper (commonly referred to as bad boy guarantees). These types of guarantees typically are on a pro rata basis among the joint venture partners and are designed to protect the secured lender s remedies with respect to its mortgage or other secured lien on the joint venture or the joint venture s underlying property. To date, no such guarantees have been invoked and we believe that the actions that would trigger a guarantee would generally be disadvantageous to the joint venture and to us, and therefore are unlikely to occur; however, there can be no assurances that certain of our ventures will not elect to take actions that could trigger a bad boy guarantee, as it is possible that it could be considered in their economic best interest to do so. At September 30, 2010 and December 31, 2009, we had one such guaranty (exclusive of the guaranty classified as a repayment guaranty) totaling approximately $61.2 million and $60.9 million, respectively. These bad boy guarantees, as defined, unless invoked as described above, are not considered guarantees of indebtedness under our senior and senior subordinated indentures.

Completion Guarantees. If there is development work to be completed, we and our joint venture partners are also typically obligated to the project lender(s) to complete construction of the land development improvements if the joint venture does not perform the required development. Provided we and the other joint venture partners are in compliance with these completion obligations, the project lenders are generally obligated to fund these improvements through any financing commitments available under the applicable joint venture development and construction loans. In addition, we and our joint venture partners have from time to time provided unsecured indemnities to joint venture project lenders. These indemnities generally obligate us to reimburse the project lenders only for claims and losses related to matters for which such lenders are held responsible and our exposure under these indemnities is limited to specific matters such as environmental claims. As part of our project acquisition due diligence process to determine potential environmental risks, we generally obtain, or the joint venture entity generally obtains, an independent environmental review. Per the guidance of ASC Subtopic 460-10, *Guarantees,* we believe these other guarantees are either not applicable or not material to our financial results.

Surety Bonds. We and our joint venture partners also indemnify third party surety providers with respect to performance bonds issued on behalf of certain of our joint ventures. If a joint venture does not perform its obligations, the surety bond could be called. If these surety bonds are called and the joint venture fails to reimburse the surety, we and our joint venture partners would be obligated to make such payments. These surety indemnity arrangements are generally joint and several obligations with our joint venture partners. Although a majority of the required work may have been performed, these bonds are typically not released until all development specifications have been met. None of these bonds have been called to date and we believe it is unlikely that any of these bonds will be called. See Note 1 of these consolidated financial statements for detail of our surety bonds.

The joint venture obligations, guarantees and indemnities discussed above are generally provided by us or one or more of our subsidiaries. In joint ventures involving other homebuilders or developers, support for these obligations is generally provided by the parent companies of the joint venture partners. In connection with our periodic real estate impairment reviews, we may accrue for any such commitments where we believe our obligation to pay is probable and can be reasonably estimated. In such situations, our accrual represents the portion of the total joint venture obligation related to our relative ownership percentage. In the limited cases where our venture partners, some of whom are homebuilders or developers who may be experiencing financial difficulties as a result of current market

conditions, may be unable to fulfill their pro rata share of a joint venture obligation, we may be fully responsible for these commitments if such commitments are joint and several. We continue to monitor these matters and reserve for these obligations if and when they become probable and can be reasonably estimated. As of September 30, 2010 and December 31, 2009, we did not have any such reserves. See discussion below regarding outstanding litigation for certain of our joint ventures and corresponding reserves.

Summarized condensed financial information related to unconsolidated joint ventures that are accounted for using the equity method follows (in thousands):

	At September 30, 2010	At December 31, 2009
Assets:		
Cash	$ 4,146	$ 6,734
Real estate	487,261	512,931
Other assets	4,801	6,023
Total assets	$ 496,208	$ 525,688
Liabilities and equity:		
Accounts payable and other liabilities	$ 5,263	$ 8,899
Notes and mortgages payable	328,165	350,966
Equity of:		
Meritage (1)	35,653	40,516
Others	127,127	125,307
Total liabilities and equity	$ 496,208	$ 525,688

	Three Months Ended September 30,		Nine months Ended September 30,	
	2010	2009	2010	2009
Revenues	$ 8,903	$ 6,527	$ 19,343	$ 14,510
Costs and expenses	(6,376)	(24,552)	(13,059)	(28,796)
Net earnings/(losses) of unconsolidated entities	$ 2,527	$ (18,025)	$ 6,284	$ (14,286)
Meritage s share of pre-tax earnings/(loss) (1) (2) (3)	$ 1,362	$ (3,259)	$ 4,059	$ (1,162)

(1) Balance represents Meritage s interest, as reflected in the financial records of the respective joint ventures. This balance may differ from the balance reflected in our financial

statements due to the following reconciling items: (i) timing differences for revenue and distributions recognition, (ii) step-up basis and corresponding amortization, (iii) income deferrals as discussed in Note (3) below and (iv) differences in timing or amounts of joint-venture asset impairments by us and the joint venture, including the cessation of allocation of losses from joint ventures in which we have previously impaired our investment balance to zero.

(2) The joint venture financial statements above represent the most recent information available to us. For joint ventures where we have impaired our investment, the joint venture partners may

have not yet reached a consensus or finalized the write-down amount or reached that conclusion in a different accounting period from us and, therefore, the financial statements of the ventures may not yet reflect any real estate impairment charges or reflect them in a different quarter or fiscal year. We believe, in some cases, that the fair values of the ventures assets may be less than the related debt. For the three and nine months ended September 30, 2010, we recorded $112,000 of such impairments, and for the three and nine months ended September 30, 2009, we recorded $2.6 and $2.8 million, respectively, of such impairments. As our portion of

pre-tax earnings is recorded on the accrual basis and included both actual earnings reported to us as well as accrued expected earnings for the period noted above not yet provided to us by our joint venture partners, our relative portion of total net earnings of the unconsolidated joint ventures in our statements of operations may reflect a different time frame than that represented by the joint ventures financials.

(3) Our share of pre-tax earnings is recorded in Earnings/(loss) from unconsolidated entities, net on our consolidated statements of operations and excludes joint venture profit related to lots we purchased from the joint ventures. Such profit is deferred until homes are delivered by us

and title passes
to a homebuyer.

Our investments in unconsolidated entities include $0.9 million at September 30, 2010 and December 31, 2009, related to the difference between the amounts at which our investments are carried and the amount of our portion of the venture s equity. These amounts are amortized as the assets of the respective joint ventures are sold. We amortized approximately $0 and $71,000 of such assets in the first nine months of 2010 and 2009, respectively.

Of the joint venture assets and liabilities in the table above, $442.6 million and $305.8 million, respectively, relates to one inactive joint venture in which we have a 20% interest as of September 30, 2010. Of our Bad Boy debt guarantees, the entire $61.2 million at September 30, 2010 relates to this venture. This venture owns one large asset that was purchased near the peak of the market and the venture is currently in default of its debt agreements. Although we and our joint venture partners have attempted to work with the lenders to renegotiate the debt, we have not reached any satisfactory alternatives. All of this debt is non-recourse to the partners and our associated joint venture investment has been fully impaired as of September 30, 2010. At this time we believe there is limited exposure to us from this investment.

The balance of the other venture assets and liabilities noted in the table above primarily represent our one active land venture, six mortgage ventures and other various inactive ventures in which we have a total investment of $11.2 million. As of September 30, 2010, we believe these ventures are in compliance with their respective debt agreements, and except for $0.8 million of our limited repayment guarantees, the debt is non-recourse to us. These ventures have no Bad Boy guarantees.

In addition to joint ventures accounted for under the equity method summarized in the above table, our investments in unconsolidated entities include two joint ventures recorded under the cost method. These joint ventures were formed to acquire large parcels of land in Nevada, to perform off-site development work and to sell lots to the joint venture members and other third parties. Our ownership percentage in these two ventures is 3.53% in one of the ventures and 4.09% in the other. The lenders of both ventures have filed lawsuits against the joint ventures and/or their members alleging liability under the completion guarantees executed severally by each of the members and their parent companies, including Meritage. We continue to dispute allegations contained in each of the lawsuits and intend to vigorously defend our position regarding liability under these completion guarantees and related claims. We have fully impaired our investment in these joint ventures in previous periods. One of these ventures has already been dis-possessed of its land holdings and is now considered inactive while the other venture that still has land holdings and corresponding debt has a $7.1 million Bad Boy guaranty allocable to Meritage that could be triggered upon events beyond our control and, accordingly, is disclosed as a limited repayment guaranty. In one of the ongoing lawsuits related to this venture, all members of the joint venture participated in arbitration regarding their respective performance obligations in response to one of the members claims. On July 6, 2010, the arbitration decision was issued, which denied the specific performance claim, but did award damages to one member on other claims. We and other members have submitted motions to vacate or modify that decision and are awaiting a decision on these motions. In any event, we believe our potential share of the award, if any, will not be material to our financial position and that our existing legal reserves are sufficient to cover the expected claim. Although the final disposition of these suits remains uncertain, we do not, at this time, anticipate outcomes that will be materially adverse to us. See Note 11 for breakdown of our investments in consolidated entities by Region.

NOTE 5 SENIOR AND SENIOR SUBORDINATED NOTES AND OTHER BORROWINGS

Senior and senior subordinated notes consist of the following (in thousands):

	At September 30, 2010	At December 31, 2009
7.0% senior notes due 2014. At September 30, 2010, and December 31, 2009, there was approximately $0 and $38,000 in unamortized premium, respectively	$ 0	$ 130,038
6.25% senior notes due 2015. At September 30, 2010 and December 31, 2009, there was approximately $629,000 and $904,000 in unamortized discount, respectively	284,371	349,096
7.731% senior subordinated notes due 2017	125,875	125,875
7.15% senior notes due 2020. At September 30, 2010 and December 31, 2009, there was approximately $4.6 million and $0 in unamortized discount, respectively	195,377	0
	$ 605,623	$ 605,009

The indentures for our 6.25% senior notes and 7.731% senior subordinated notes contain covenants that require maintenance of certain minimum financial ratios, place limitations on investments we can make, and the payment of dividends and redemptions of equity, and limit the incurrence of additional indebtedness, asset dispositions, mergers, certain investments and creations of liens, among other items. As of and for the quarter ended September 30, 2010, we

believe we were in compliance with our covenants. The indenture for our 7.15% senior notes contains covenants including, among others, limitations on the amount of secured debt we may incur, and limitations on sale and leaseback transactions and mergers. The covenants contained in the 7.15% senior notes are generally no more restrictive, and in many cases less restrictive, than the covenants contained in the indentures for the 6.25% senior notes and 7.731% senior subordinated notes.

Obligations to pay principal and interest on the senior and senior subordinated notes are guaranteed by all of our wholly-owned subsidiaries (collectively, the Guarantor Subsidiaries), each of which is directly or indirectly 100% owned by Meritage Homes Corporation. Such guarantees are full and unconditional, and joint and several. We do not provide separate financial statements of the Guarantor Subsidiaries because Meritage (the parent company) has no independent assets or operations, the guarantees are full and unconditional and joint and several, and any subsidiaries of Meritage Homes Corporation other than the non-guarantor subsidiaries are, individually and in the aggregate, minor. There are no significant restrictions on the ability of the Company or any Guarantor Subsidiary to obtain funds from their respective subsidiaries, as applicable, by dividend or loan.

During the three months ended June 30, 2010, we completed an offering of $200 million aggregate principal amount of 7.15% senior notes due 2020. The notes were issued at a 97.567% discount to par value. Concurrent with the issuance of the 2020 notes, we repurchased all of our $130 million 7.0% senior notes maturing 2014 and $65 million of our 6.25% senior notes maturing 2015. In connection with these transactions, we recorded a $3.5 million net loss on early extinguishment of debt, which is reflected in our statement of operations for the nine months ended September 30, 2010.

During the nine months ended September 30, 2009, we retired $24.1 million of our 7.731% senior subordinated notes maturing in 2017 by issuing approximately 783,000 shares of our common stock in a privately negotiated transaction. The transaction was completed at an average discount of 41% from the face value of the notes, resulting in a $9.4 million gain on early extinguishment of debt which is reflected in our statement of operations for the nine months ended September 30, 2009.

In September 2009, we voluntarily terminated our Senior Unsecured Credit Facility (the Credit Facility). There were no penalties or costs associated with the termination, although we recorded a non-cash charge in the third quarter of 2009 of approximately $800,000 to write off previously capitalized origination fees that were scheduled to amortize through May 2011. We did not believe we would need the Credit Facility to finance our operations during the foreseeable future and that it was in our interest to terminate the facility to avoid non-use and other fees. Prior to and as of the date of termination, we were in compliance with all of the covenants, limitations and restrictions of the Credit Facility.

In connection with the Credit Facility termination, we entered into secured letter of credit arrangements with the three banks that have issued outstanding letters of credit under the Credit Facility. The aggregate capacity of these secured letters of credit is approximately $65 million. These outstanding letters of credit are secured by corresponding pledges of restricted cash accounts, totaling of $8.9 million and $16.3 million at September 30, 2010 and December 31, 2009, respectively, and are reflected as restricted cash on our consolidated balance sheets.

NOTE 6 FAIR VALUE DISCLOSURES

Effective January 1, 2009, we adopted ASC Subtopic 820-10, *Fair Value Measurement and Disclosure,* for non-recurring fair value measurements of our non-financial assets and liabilities. This guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This standard establishes a three-level hierarchy for fair value measurements based upon the significant inputs used to determine fair value. Observable inputs are those which are obtained from market participants external to the company while unobservable inputs are generally developed internally, utilizing management s estimates, assumptions and specific knowledge of the assets/liabilities and related markets. The three levels are defined as follows:

Level 1 Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 Valuation is determined from quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar instruments in markets that are not active, or by model-based techniques in which all significant inputs are observable in the market.

Level 3 Valuation is derived from model-based techniques in which at least one significant input is unobservable and based on the company s own estimates about the assumptions that market participants would use to value the asset or liability.

If the only observable inputs are from inactive markets or for transactions which the company evaluates as distressed , the use of Level 1 inputs should be modified by the company to properly address these factors, or the reliance of such inputs may be limited, with a greater weight attributed to Level 3 inputs.

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A summary of our long lived real-estate assets measured at fair value on September 30, 2010 is as follows (in thousands):

		Fair Value Measurements at Reporting Date Using		
Description:	**As of September 30, 2010**	**Level 1**	**Level 2**	**Level 3**
Long-lived real-estate assets	$ 8,865	0	0	$ 8,865
Investments in unconsolidated entities	$ 0	0	0	$ 0

Of the total $744.8 million of long lived real-estate assets, some of which have previously been written down to fair value, long-lived assets held and used with an initial basis of $9.5 million were impaired and written down to their fair value of $8.9 million during the three months ended September 30, 2010, resulting in an impairment of $680,000, which is included in our consolidated statement of operations for the three months ended September 30, 2010. Additionally, $112,000 of investments in unconsolidated entities were fully impaired to a net zero value during the quarter ended September 30, 2010.

Financial Instruments. The fair value of our fixed-rate debt is derived from quoted market prices by independent dealers and is as follows (in thousands):

	September 30, 2010		December 31, 2009	
	Aggregate Principal	**Estimated Fair Value**	**Aggregate Principal**	**Estimated Fair Value**
Financial Liabilities:				
7.00% senior notes	N/A	N/A	$ 130,000	$ 124,150
6.25% senior notes	$ 285,000	$ 275,593	$ 350,000	$ 322,000
7.731% senior subordinated notes	$ 125,875	$ 111,955	$ 125,875	$ 104,004
7.15% senior notes	$ 200,000	$ 185,696	N/A	N/A

Due to the short-term nature of other financial assets and liabilities, we consider the carrying amounts of our other short-term financial instruments to approximate fair value.

NOTE 7 INCOME/(LOSS) PER SHARE

Basic and diluted income/(loss) per common share was calculated as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Basic weighted average number of shares outstanding	32,095	31,718	32,038	31,197
Effect of dilutive securities:				
Stock options and restricted stock (1)	202	0	239	0
Diluted weighted average shares outstanding	32,297	31,718	32,277	31,197
Net income/(loss)	$ 1,219	$ (17,785)	$ 8,045	$ (109,742)

Basic income/(loss) per share	$	0.04	$	(0.56)	$	0.25	$	(3.52)
Diluted income/(loss) per share (1)	$	0.04	$	(0.56)	$	0.25	$	(3.52)
Antidilutive stock options not included in the calculation of diluted income per share		1,040		1,704		737		1,704

(1) For periods with a net loss, basic weighted average shares outstanding are used for diluted calculations as required by GAAP because all options and non-vested shares outstanding are considered anti-dilutive.

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NOTE 8 STOCK-BASED COMPENSATION

We have two stock compensation plans, the Meritage Stock Option Plan, which was adopted in 1997 and amended from time to time (the 1997 Plan), and the 2006 Stock Incentive Plan that was adopted in 2006 and amended from time to time (the 2006 Plan and together with the 1997 Plan, the Plans). The Plans were approved by our stockholders and are administered by our Board of Directors. The provisions of the Plans are generally consistent with the exception that the 2006 Plan allows for the grant of stock appreciation rights, restricted stock awards, performance share awards and performance-based awards in addition to the non-qualified and incentive stock options allowed under the 1997 Plan. The Plans authorize awards to officers, key employees, non-employee directors and consultants for up to 7,750,000 shares of common stock, of which 872,549 shares remain available for grant at September 30, 2010. We believe that such awards provide a means of performance-based compensation to attract and retain qualified employees and better align the interests of our employees with those of our stockholders. Option awards are granted with an exercise price equal to the market price of Meritage stock at the date of grant, and generally have a five-year ratable vesting period and a seven-year contractual term. Restricted stock awards are usually granted with either a three-year or five-year ratable vesting period.

The fair value of option awards is estimated using a Black-Scholes option pricing model that uses the assumptions noted in the following table. Expected volatilities are based on a combination of implied volatilities from traded options on our stock and historical volatility of our stock. Expected term/life, which represents the period of time that options granted are expected to be outstanding, is estimated using historical data. The risk-free interest rate is based on the U.S. Treasury yield curve for the expected term of the grant. Groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The Black-Scholes assumptions used for stock options grants during the first nine months of 2009 are as follows. We only granted non-vested shares in 2010.

	Nine Months Ended September 30, 2009
Expected volatility	86.51%
Expected dividends	0%
Expected term (in years)	3.68
Risk-free interest rate	1.60%
Weighted average grant date fair value of options granted	$ 8.69

As of September 30, 2010, we had $9.2 million of total unrecognized compensation cost related to non-vested stock-based compensation arrangements granted under the Plans that will be recognized on a straight-line basis over the remaining respective vesting periods a weighted-average period of 2.39 years. For the three months ended September 30, 2010 and 2009, our total stock-based compensation expense was $1.6 million and $2.2 million, respectively. For the nine months ended September 30, 2010 and 2009, our total stock-based compensation expense was $4.1 million and $4.5 million, respectively. We granted 315,000 non-vested shares during the first nine months of 2010. We also granted an additional 67,500 non-vested shares that will only vest if certain performance criteria are met. The expense associated with these performance-based non-vested shares will only be recognized when it is determined to be probable that the target performance thresholds will be met and the shares will vest.

NOTE 9 INCOME TAXES

Components of the income tax benefit/(provision) are (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Federal	$ 589	$ (138)	$ 519	$ (1,916)
State	(101)	(8)	(377)	(24)

Total	$	488	$	(146)	$	142	$	(1,940)

Unrecognized tax benefits were $4.7 million at September 30, 2010 and relate to items from prior years. The entire balance is due to the limited reopening of expired statutes of limitation for years to which the 2009 loss was carried back pursuant to the Worker, Homeowner and Business Assistance Act of 2009, which extended the permitted carryback period for net operating losses. Interest and penalties are accrued on unrecognized tax benefits and included in federal income tax expense. The total amount of interest and penalties on uncertain tax positions included in income tax expense for the three months ended September 30, 2010 was $30,000 of interest on the positions reopened due to the 2009 loss carryback.

In accordance with ASC 740-10, *Income Taxes*, we evaluate our deferred tax assets, including the benefit from net operating losses (NOLs), to determine if a valuation allowance is required. Companies must assess whether a valuation allowance should be established based on the consideration of all available evidence using a more likely than not standard with significant weight being given to evidence that can be objectively verified. This assessment considers, among other matters, the nature, frequency and severity of current and cumulative losses, forecasts of future profitability, the length of statutory carryforward periods, our experience with operating losses and our experience of utilizing tax credit carryforwards and tax planning alternatives. Given the downturn in the homebuilding industry over the past several years, the degree of the economic recession, the instability and deterioration of the financial markets, and the resulting uncertainty in projections of our future taxable income, we recorded a full valuation allowance against our deferred tax assets during 2008. We continue to maintain a full non-cash valuation allowance against the entire amount of our remaining net deferred tax assets at September 30, 2010 as we have determined that the weight of the negative evidence exceeds that of the positive evidence and it continues to be more likely than not that we will not be able to utilize all of our deferred tax assets relating to our federal and state NOL carryovers. Although we have fully reserved our deferred tax asset, we have not forfeited our right to carry forward tax losses 20 years and apply such tax losses against taxable income in such years, thereby reducing our future tax obligations. Therefore, during any periods where we earn taxable income, we anticipate being able to reverse a portion of our previously recognized tax valuation allowance.

At September 30, 2010 and December 31, 2009, we had a valuation allowance of $88.4 million ($61.8 million federal and $26.6 million state) and $92.6 million ($65.2 million federal and $27.4 million state), respectively, against deferred tax assets. Our future deferred tax asset realization depends on sufficient taxable income in the carryforward periods under existing tax laws, which currently would allow us to offset future federal taxable income generated through 2029. State deferred tax assets include $21.4 million of state net operating loss carryovers as of December 31, 2009 that begin to expire in 2012. On an ongoing basis, we will continue to review all available evidence to determine if and when we expect to realize our deferred tax assets and state NOL carryovers.

At September 30, 2010, the income tax payable of $1.9 million primarily consists of tax and interest amounts that we expect to pay within one year for having amended a prior-year federal tax return. We collected $90.5 million of our December 31, 2009 receivable in the first quarter of 2010. The federal loss carryback period reverted back to two years for our 2010 fiscal year and there is no available taxable income in the two-year carryback period for us to utilize any tax loss coming out of 2010.

We conduct business and are subject to tax in the U.S. and several states. With few exceptions, we are no longer subject to U.S. federal, state, or local income tax examinations by taxing authorities for years prior to 2005. Due to the recently enacted Act, the federal statutes of limitations reopened on a limited basis for years to which the 2009 loss was carried back. In 2008, the IRS commenced an audit of our consolidated U.S. tax return and refund claim for 2007. The audit is now complete. There were no audit adjustments to report that would materially affect our deferred tax assets or income tax payable at September 30, 2010.

The tax benefits from our net operating losses, built-in losses, and tax credits would be materially reduced or potentially eliminated if we experienced an ownership change as defined under IRC §382. Based on our analysis performed as of September 30, 2010, we do not believe that we have experienced an ownership change. As a protective measure, we held a Special Meeting of Stockholders on February 16, 2009, and our stockholders approved an amendment to our Articles of Incorporation that restricted certain transfers of our common stock. The amendment will help us avoid an unintended ownership change and thereby preserve the value of our tax benefits for future utilization.

NOTE 10 SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

The following presents certain supplemental cash flow information (in thousands):

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash paid/(received) during the period for:		
Interest, net of interest capitalized	$ 24,708	$ 27,935
Income taxes	$ (94,640)	$ (107,624)
Non-cash operating activities (decrease)/increase:		
Real estate not owned	$ (6,422)	$ 5,826
Non-cash investing activities:		
Distributions from unconsolidated entities	$ 294	$ 261
Non-cash financing activities:		
Equity issued for debt extinguishment	$ 0	$ 14,312

NOTE 11 OPERATING AND REPORTING SEGMENTS

As defined in ASC Subtopic 280-10, *Segment Reporting*, we have six operating segments (the six states in which we operate). These segments are engaged in the business of acquiring and developing land, constructing homes, marketing and selling those homes, and providing warranty and customer service. We aggregate our operating segments into a reporting segment based on similar long-term economic characteristics and geographical proximity. Our reporting segments are as follows:

West: California and Nevada
Central: Texas, Arizona and Colorado
East: Florida

Management s evaluation of segment performance is based on segment operating income/(loss), which we define as homebuilding and land revenue less cost of home construction, commissions and other sales costs, land development and other land sales costs and other costs incurred by or allocated to each segment, including impairments. Each reportable segment follows the same accounting policies described in Note 1, Business and Summary of Significant Accounting Policies, to the consolidated financial statements in our 2009 Annual Report on Form 10-K. Operating results for each segment may not be indicative of the results for such segment had it been an independent, stand-alone entity. The following is our segment information (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenue (1):				
West	$ 47,207	$ 26,954	$ 127,126	$ 99,766
Central	161,658	192,246	535,682	548,885
East	24,938	12,616	64,204	35,842
Consolidated total	233,803	231,816	727,012	684,493
Operating income/(loss) (2):				
West	3,316	(4,307)	6,474	(23,053)
Central	6,830	2,661	32,446	(52,466)
East	2,874	(2,620)	5,989	(4,963)

Segment operating income/(loss)	13,020	(4,266)	44,909	(80,482)
Corporate and unallocated (3)	(5,761)	(5,483)	(16,748)	(16,057)
Earnings/(loss) from unconsolidated entities, net	1,243	(899)	3,832	1,350
Interest expense	(8,425)	(8,853)	(25,273)	(28,515)
Other income, net	654	1,862	4,637	6,512
(Loss)/gain on extinguishment of debt	0	0	(3,454)	9,390
Income/(loss) before income taxes	$ 731	$ (17,639)	$ 7,903	$ (107,802)

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	At September 30, 2010				
	West	Central	East	Corporate and Unallocated (4)	Total
Deposits on real estate under option or contract	$ 200	$ 10,515	$ 172	$ 0	$ 10,887
Real estate	166,667	528,863	49,278	0	744,808
Investments in unconsolidated entities	158	10,540	97	401	11,196
Other assets	6,602	41,329	3,585	422,254	473,770
Total assets	$ 173,627	$ 591,247	$ 53,132	$ 422,655	$ 1,240,661

	At December 31, 2009				
	West	Central	East	Corporate and Unallocated (4)	Total
Deposits on real estate under option or contract	$ 25	$ 8,340	$ 271	$ 0	$ 8,636
Real estate	142,829	499,319	32,889	0	675,037
Investments in unconsolidated entities	260	11,339	64	219	11,882
Other assets	10,498	41,529	1,248	493,837	547,112
Total assets	$ 153,612	$ 560,527	$ 34,472	$ 494,056	$ 1,242,667

(1) Revenue includes the following land closing revenue, by segment: nine months ended September 30, 2010 $1.2 million in Central Region; nine months ended September 30, 2009 $1.3 million in Central Region.

(2)

See Note 2 of this Quarterly Report on Form 10-Q for a breakout of real estate-related impairments by region.

(3) Balance consists primarily of corporate costs and shared service functions such as finance and treasury that are not allocated to the reporting segments.

(4) Balance consists primarily of cash and other corporate assets not allocated to the reporting segments.

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

Overview and Outlook

During the third quarter of 2010, the homebuilding industry s results were negatively impacted by the expiration of the home-buyer tax credit as well as concerns about a double-dip recession driven by the recent news of the weak national and global economies. The tax credit purchase deadline of April 30, 2010 generated increased sales volume for the first four months of the year and translated into stronger closings for the second quarter of 2010. Subsequent to April 30, 2010, the entire homebuilding industry experienced larger-than-anticipated declines in sales, which we believe were further exacerbated by a general weakness in the national and global markets. In the third quarter of the year, national new home start permits continued to reflect weakness, decreasing 9.6 % from the second quarter of the year. Additionally, while unemployment rates improved marginally throughout 2010 to 9.6% as of September 2010 from 10.0% at December 2009, as reported by the US Department of Labor, we believe that as long as these unemployment rates continue to remain at these historically high levels, they will be a likely limiting factor in making a home-buying decision and will continue to impact the sales pace of the industry. Therefore, although we have had some early indications that certain of our markets may have reached a bottom, we do not know if the national homebuilding market has reached a bottom and we expect continued volatility for the next several quarters as the economy s anticipated recovery may be uneven.

Summary Company Results

As noted above, our results for the quarter ended September 30, 2010 reflect the difficult sales environment experienced after the homebuyer tax credit expiration earlier this year. Additionally, the weakness of the general economy and the homebuilding markets in particular are evidenced by the fluctuations in our operational results for the first nine months of 2010.

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Total home closing revenue was $233.8 million and $725.8 million for the three and nine months ended September 30, 2010, respectively, increasing 0.9% and 6.2% from the same periods last year. We generated net income of $1.2 million and $8.0 million for the three- and nine-month periods ended September 30, 2010 as compared to loss of $(17.8) and $(109.7) million for the same periods in 2009. Quarter-over-quarter home closing revenue remained relatively consistent; however, our results reflected a 20.7% increase in average sales price, primarily due to changes in geographic mix and increased sales in our higher-priced in-fill communities, offset by a 16.5% decrease in closing units in line with our 12.4% decrease in the average number of active communities in the third quarter of 2010 as compared to 2009. The net income improvements both quarter- and year-to-date are the result of fewer real-estate-related impairments recorded, with only $792,000 (pre-tax) in the third quarter of 2010 as compared to $13.2 million in the same period in 2009 and $1.6 million versus $90.3 million year-to-date 2010 and 2009, respectively. Our year-to-date 2010 results also include $3.5 million of losses from early extinguishment of debt, while the nine months ending September 30, 2009 include $9.4 million of gains from early extinguishment of debt.
At September 30, 2010, our backlog of $242.4 million reflects a decrease of 40.1% or $162.4 million when compared to the backlog at September 30, 2009 and a $50.2 million or 17.2% decrease from our June 30, 2010 balance of $292.6 million. We believe the decline is mainly due to the expiration of the federal homebuyer tax credit program, which negatively impacted sales volume for the past several months and the decrease in average actively selling communities as discussed. In the third quarter of 2010, our cancellation rate on sales orders increased to 24% of gross orders as compared to 20% in the same period a year ago, which is in line with our historical rate of mid 20 s.

Company Actions and Positioning

In response to the sustained downturn in our industry over the last several years, we are executing the following initiatives to differentiate ourselves from other production builders and focus on profitability:

- Launching our company-wide operating strategy, Meritage Forward, and the roll-out of associated initiatives such as the Simply Smart Series™, a lower-cost alternative for our first-time buyers, our 99-day closing guarantee and Meritage Green, our energy-efficient prototype communities;
- Managing our total lot supply to align with our Meritage Forward strategy by contracting for reasonably-priced lots in select locations;
- Exercising tight control over cash flows;
- Renegotiating construction costs with our subcontractors where possible;
- Redesigning product offering to reduce costs and sales prices and tailor our product to meet today s buyers affordability demands;
- Changing sales and marketing efforts to generate additional traffic;
- Continuing to consolidate overhead functions at all of our divisions and corporate offices to reduce general and administrative burden;
- Monitoring our customer satisfaction scores and working toward improving them based on the results of the surveys.

We continue to believe that many of our communities, particularly our newer acquisitions, are located in highly-sought after markets that should compete well in the marketplace. In these locations, we believe the value and desirability of the community will allow us to maintain our pricing and reasonable absorptions, despite the current economic conditions. Although due to the duration and extent of the economic down cycle we are unable to predict the timing or extent of a recovery, we continue to believe in the long-term viability of the domestic homebuilding market and that builders with in-depth industry expertise will benefit when the housing market recovers.

Critical Accounting Policies

The accounting policies we deem most critical to us and that involve the most difficult, subjective or complex judgments include revenue recognition, valuation of real estate, warranty reserves, off-balance-sheet arrangements, valuation of deferred tax assets and share-based payments. There have been no significant changes to our critical accounting policies during the nine months ended September 30, 2010 compared to those disclosed in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, included in our 2009 Annual Report on Form 10-K.

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The tables below present operating and financial data that we consider most critical to managing our operations (dollars in thousands):

Home Closing Revenue

	Three Months Ended September 30,		Quarter over Quarter	
	2010	2009	Chg $	Chg %
Total				
Dollars	$ 233,803	$ 231,816	$ 1,987	0.9%
Homes closed	848	1,015	(167)	(16.5)%
Avg sales price	$ 275.7	$ 228.4	$ 47.3	20.7%
West Region				
California				
Dollars	$ 43,803	$ 20,319	$ 23,484	115.6%
Homes closed	112	62	50	80.6%
Avg sales price	$ 391.1	$ 327.7	$ 63.4	19.3%
Nevada				
Dollars	$ 3,404	$ 6,635	$ (3,231)	(48.7)%
Homes closed	17	33	(16)	(48.5)%
Avg sales price	$ 200.2	$ 201.1	$ (0.9)	(0.4)%
West Region Totals				
Dollars	$ 47,207	$ 26,954	$ 20,253	75.1%
Homes closed	129	95	34	35.8%
Avg sales price	$ 365.9	$ 283.7	$ 82.2	29.0%
Central Region				
Arizona				
Dollars	$ 41,387	$ 38,617	$ 2,770	7.2%
Homes closed	167	213	(46)	(21.6)%
Avg sales price	$ 247.8	$ 181.3	$ 66.5	36.7%
Texas				
Dollars	$ 107,663	$ 142,697	$ (35,034)	(24.6)%
Homes closed	425	611	(186)	(30.4)%
Avg sales price	$ 253.3	$ 233.5	$ 19.8	8.5%
Colorado				
Dollars	$ 12,608	$ 10,932	$ 1,676	15.3%
Homes closed	39	36	3	8.3%
Avg sales price	$ 323.3	$ 303.7	$ 19.6	6.5%
Central Region Totals				
Dollars	$ 161,658	$ 192,246	$ (30,588)	(15.9)%
Homes closed	631	860	(229)	(26.6)%
Avg sales price	$ 256.2	$ 223.5	$ 32.7	14.6%
East Region				
Florida				
Dollars	$ 24,938	$ 12,616	$ 12,322	97.7%
Homes closed	88	60	28	46.7%

Avg sales price	$ 283.4	$ 210.3	$ 73.1	34.8%

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Home Closing Revenue

	Nine Months Ended September 30,		Year over Year	
	2010	2009	Chg $	Chg %
Total				
Dollars	$ 725,790	$ 683,208	$ 42,582	6.2%
Homes closed	2,863	2,837	26	0.9%
Avg sales price	$ 253.5	$ 240.8	$ 12.7	5.3%
West Region				
California				
Dollars	$ 114,498	$ 76,042	$ 38,456	50.6%
Homes closed	323	218	105	48.2%
Avg sales price	$ 354.5	$ 348.8	$ 5.7	1.6%
Nevada				
Dollars	$ 12,628	$ 23,724	$ (11,096)	(46.8)%
Homes closed	65	112	(47)	(42.0)%
Avg sales price	$ 194.3	$ 211.8	$ (17.5)	(8.3)%
West Region Totals				
Dollars	$ 127,126	$ 99,766	$ 27,360	27.4%
Homes closed	388	330	58	17.6%
Avg sales price	$ 327.6	$ 302.3	$ 25.3	8.4%
Central Region				
Arizona				
Dollars	$ 119,147	$ 111,063	$ 8,084	7.3%
Homes closed	548	563	(15)	(2.7)%
Avg sales price	$ 217.4	$ 197.3	$ 20.1	10.2%
Texas				
Dollars	$ 382,592	$ 403,535	$ (20,943)	(5.2)%
Homes closed	1,578	1,679	(101)	(6.0)%
Avg sales price	$ 242.5	$ 240.3	$ 2.2	0.9%
Colorado				
Dollars	$ 32,721	$ 33,002	$ (281)	(0.9)%
Homes closed	110	105	5	4.8%
Avg sales price	$ 297.5	$ 314.3	$ (16.8)	(5.3)%
Central Region Totals				
Dollars	$ 534,460	$ 547,600	$ (13,140)	(2.4)%
Homes closed	2,236	2,347	(111)	(4.7)%
Avg sales price	$ 239.0	$ 233.3	$ 5.7	2.4%
East Region				
Florida				
Dollars	$ 64,204	$ 35,842	$ 28,362	79.1%
Homes closed	239	160	79	49.4%
Avg sales price	$ 268.6	$ 224.0	$ 44.6	19.9%

Home Orders (1)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Quarter over Quarter Chg $	Quarter over Quarter Chg %
Total				
Dollars	$ 183,571	$ 254,347	$ (70,776)	(27.8)%
Homes ordered	706	1,098	(392)	(35.7)%
Avg sales price	$ 260.0	$ 231.6	$ 28.4	12.3%
West Region				
California				
Dollars	$ 29,614	$ 40,483	$ (10,869)	(26.8)%
Homes ordered	86	130	(44)	(33.8)%
Avg sales price	$ 344.3	$ 311.4	$ 32.9	10.6%
Nevada				
Dollars	$ 2,279	$ 6,637	$ (4,358)	(65.7)%
Homes ordered	11	33	(22)	(66.7)%
Avg sales price	$ 207.2	$ 201.1	$ 6.1	3.0%
West Region Totals				
Dollars	$ 31,893	$ 47,120	$ (15,227)	(32.3)%
Homes ordered	97	163	(66)	(40.5)%
Avg sales price	$ 328.8	$ 289.1	$ 39.7	13.7%
Central Region				
Arizona				
Dollars	$ 39,214	$ 40,490	$ (1,276)	(3.2)%
Homes ordered	156	212	(56)	(26.4)%
Avg sales price	$ 251.4	$ 191.0	$ 60.4	31.6%
Texas				
Dollars	$ 82,584	$ 134,948	$ (52,364)	(38.8)%
Homes ordered	347	597	(250)	(41.9)%
Avg sales price	$ 238.0	$ 226.0	$ 12	5.3%
Colorado				
Dollars	$ 12,603	$ 10,342	$ 2,261	21.9%
Homes ordered	39	35	4	11.4%
Avg sales price	$ 323.2	$ 295.5	$ 27.7	9.4%
Central Region Totals				
Dollars	$ 134,401	$ 185,780	$ (51,379)	(27.7)%
Homes ordered	542	844	(302)	(35.8)%
Avg sales price	$ 248.0	$ 220.1	$ 27.9	12.7%
East Region				
Florida				
Dollars	$ 17,277	$ 21,447	$ (4,170)	(19.4)%
Homes ordered	67	91	(24)	(26.4)%
Avg sales price	$ 257.9	$ 235.7	$ 22.2	9.4%

(1) Home orders for any period represent the aggregate sales price of all homes ordered, net of cancellations. We do not include orders contingent upon the sale of a customer s existing home or any other material contingency as a sales contract until the contingency is removed.

Home Orders (1)

	Nine Months Ended September 30,		Year over Year	
	2010	**2009**	**Chg $**	**Chg %**
Total				
Dollars	$ 680,666	$ 749,963	$ (69,297)	(9.2)%
Homes ordered	2,670	3,232	(562)	(17.4)%
Avg sales price	$ 254.9	$ 232.0	$ 22.9	9.9%
West Region				
California				
Dollars	$ 108,156	$ 93,688	$ 14,468	15.4%
Homes ordered	312	287	25	8.7%
Avg sales price	$ 346.7	$ 326.4	$ 20.3	6.2%
Nevada				
Dollars	$ 11,651	$ 19,549	$ (7,898)	(40.4)%
Homes ordered	59	99	(40)	(40.4)%
Avg sales price	$ 197.5	$ 197.5	$ 0	0%
West Region Totals				
Dollars	$ 119,807	$ 113,237	$ 6,570	5.8%
Homes ordered	371	386	(15)	(3.9)%
Avg sales price	$ 322.9	$ 293.4	$ 29.5	10.1%
Central Region				
Arizona				
Dollars	$ 126,743	$ 119,295	$ 7,448	6.2%
Homes ordered	560	621	(61)	(9.8)%
Avg sales price	$ 226.3	$ 192.1	$ 34.2	17.8%
Texas				
Dollars	$ 330,582	$ 431,725	$ (101,143)	(23.4)%
Homes ordered	1,375	1,899	(524)	(27.6)%
Avg sales price	$ 240.4	$ 227.3	$ 13.1	5.8%
Colorado				
Dollars	$ 36,903	$ 32,910	$ 3,993	12.1%
Homes ordered	118	107	11	10.3%
Avg sales price	$ 312.7	$ 307.6	$ 5.1	1.7%
Central Region Totals				
Dollars	$ 494,228	$ 583,930	$ (89,702)	(15.4)%
Homes ordered	2,053	2,627	(574)	(21.9)%
Avg sales price	$ 240.7	$ 222.3	$ 18.4	8.3%
East Region				
Florida				
Dollars	$ 66,631	$ 52,796	$ 13,835	26.2%
Homes ordered	246	219	27	12.3%
Avg sales price	$ 270.9	$ 241.1	$ 29.8	12.4%

(1) Home orders for any period represent the aggregate sales price of all homes ordered, net of cancellations. We do not include orders contingent upon the sale of a customer s existing home or any other material contingency as a sales contract until the contingency is removed.

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	Three Months Ended September 30,			
	2010		2009	
	Beginning	Ending	Beginning	Ending
Active Communities				
Total	148	150	178	162
West Region				
California	12	13	12	9
Nevada	5	5	12	6
West Region Total	17	18	24	15
Central Region				
Arizona	33	32	31	28
Texas	78	82	108	102
Colorado	7	8	4	3
Central Region Total	118	122	143	133
East Region (Florida)	13	10	11	14

	Nine Months Ended September 30,			
	2010		2009	
	Beginning	Ending	Beginning	Ending
Active Communities				
Total	153	150	178	162
West Region				
California	7	13	12	9
Nevada	6	5	12	6
West Region Total	13	18	24	15
Central Region				
Arizona	26	32	31	28
Texas	98	82	109	102
Colorado	6	8	3	3
Central Region Total	130	122	143	133
East Region (Florida)	10	10	11	14

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Cancellation Rates (1)				
Total	24%	20%	20%	23%
West Region				
California	20%	11%	16%	19%
Nevada	27%	20%	18%	20%
West Region Total	20%	13%	16%	19%
Central Region				
Arizona	14%	11%	13%	13%
Texas	30%	25%	25%	28%
Colorado	22%	10%	18%	16%
Central Region Total	26%	21%	22%	24%
East Region (Florida)	14%	16%	15%	16%

(1) Cancellation rates are computed as the number of cancelled units for the period divided by the gross sales units for the same period.

Order Backlog (1)

	Nine Months Ended September 30,		Year over Year	
	2010	**2009**	**Chg $**	**Chg %**
Total				
Dollars	$ 242,411	$ 404,786	$ (162,375)	(40.1)%
Homes in backlog	902	1,676	(774)	(46.2)%
Avg sales price	$ 268.7	$ 241.5	$ 27.2	11.3%
West Region				
California				
Dollars	$ 27,980	$ 51,556	$ (23,576)	(45.7)%
Homes in backlog	78	156	(78)	(50.0)%
Avg sales price	$ 358.7	$ 330.5	$ 28.2	8.5%
Nevada				
Dollars	$ 1,694	$ 2,278	$ (584)	(25.6)%
Homes in backlog	8	12	(4)	(33.3)%
Avg sales price	$ 211.8	$ 189.8	$ 22	11.6%
West Region Totals				
Dollars	$ 29,674	$ 53,834	$ (24,160)	(44.9)%
Homes in backlog	86	168	(82)	(48.8)%
Avg sales price	$ 345.0	$ 320.4	$ 24.6	7.7%
Central Region				
Arizona				
Dollars	$ 39,706	$ 50,443	$ (10,737)	(21.3)%
Homes in backlog	159	248	(89)	(35.9)%
Avg sales price	$ 249.7	$ 203.4	$ 46.3	22.8%
Texas				
Dollars	$ 129,554	$ 258,345	$ (128,791)	(49.9)%
Homes in backlog	512	1,107	(595)	(53.7)%
Avg sales price	$ 253.0	$ 233.4	$ 19.6	8.4%
Colorado				
Dollars	$ 15,638	$ 13,173	$ 2,465	18.7%
Homes in backlog	47	46	1	2.2%
Avg sales price	$ 332.7	$ 286.4	$ 46.3	16.2%
Central Region Totals				
Dollars	$ 184,898	$ 321,961	$ (137,063)	(42.6)%
Homes in backlog	718	1,401	(683)	(48.8)%
Avg sales price	$ 257.5	$ 229.8	$ 27.7	12.1%
East Region				
Florida				
Dollars	$ 27,839	$ 28,991	$ (1,152)	(4.0)%
Homes in backlog	98	107	(9)	(8.4)%
Avg sales price	$ 284.1	$ 270.9	$ 13.2	4.9%

(1) Our backlog represented net sales that have not yet closed.

Operating Results

Companywide. Home closing revenue for the three months ended September 30, 2010 increased $2.0 million or 0.9% when compared to the same period in the prior year, primarily due to the 20.7% increase in average sales price, partially offset by a 16.5% unit decrease, or 167 fewer closings. The 392 sales unit decrease for the quarter ended September 30, 2010 over the prior year period was also partially offset by average sales price increase of 12.3%. These increases in average sales prices reflect the higher sales prices earned by our new closer-in communities and the shift in our sales mix to higher-priced markets outside of Texas, particularly California and Florida. The overall year-over-year sales declines translated to a decrease to our backlog of 774 units, down to 902 homes as of September 30, 2010 as compared to 1,676 homes at September 30, 2009. Our sales and backlog were also impacted by the 12.4% decrease in our average actively-selling community count from 170 at the three months ended September 30, 2009 to 149 for September 30, 2010.

Closing units for the nine months ended September 30, 2010 increased 26 homes or 0.9% over 2009, primarily due to the success of our new communities, which are experiencing higher absorption rates than our legacy communities and the high volume of closings in the first half of the year that we believe were at least partially driven by the federal tax credits. Lower sales volume of 2,670 units in the first nine months of 2010 as compared to 3,232 in the same period of 2009 reflects the softer demand in recent months, largely caused by the April 30, 2010 contract signing deadline for the homebuyer tax credit and the continuing consumer sentiment regarding current economic conditions.

West. In the third quarter of 2010, home closings in our West Region increased 34 units or 35.8%, for total revenue of $47.2 million, a 75.1% or $20.3 million increase as compared to 2009. These results were primarily due to the 50 unit and $23.5 million revenue increases in our California markets. We have been reloading our land position in California over the last 12 months, and the positive trends are the result of the increased volume of new stores located in sought-after markets. Sales in the third quarter of 2010 dipped 32.3% to $31.9 million on 97 units as compared to $47.1 million on 163 units in the same quarter of last year, due to the weak demand for homes after the expiration of the tax credit. The decreases in recent sales activity coupled with strong closings volume led to the $24.2 million or 44.9% decrease in our ending backlog as of September 30, 2010 versus 2009.

For the nine months ended September 30, 2010, home closings in our West Region increased 58 units to 388 closings, resulting in a 27.4% increase in home closing revenue as compared to the same period in the prior year. Sales in the first nine months of 2010 decreased 15 units, but increased 10.1% in average sales prices, resulting in a net 2010 increase of $6.6 million to $119.8 million of sales volume over the same period of 2009. The Region s average sales price increases reflect the roll-out of our new subdivisions in desirable sub-markets that provide quality homes that are designed to compete with resales and foreclosures, while the unit declines continue to highlight the difficult homebuilding environment.

Central. In the third quarter of 2010, home closings in our Central Region decreased 229 units, or 26.6%, partially offset by a 14.6% increase in average sales price, for total revenue of $161.7 million, a 15.9% or $30.6 million decrease compared to the third quarter of 2009. Although Texas remained a relatively good market, during the third quarter of 2010 it experienced a 41.9% decrease in sales units, due in part to its 23.8% decrease in average active communities for the same period as compared to the prior year. The decrease in active communities is a result of scheduled closing of our older communities and redeployment of our capital to select markets that presented better opportunities to purchase discounted lots that are anticipated to generate higher margins. This strategy has resulted in the rebalancing of assets from Texas into other markets, primarily Arizona, California and Florida.

Arizona volumes were also impacted by the softening markets as recent housing demand was weak, with 21.6% reductions in closed units and 26.4% reductions in sold units; however, the shift to newer communities contributed to higher sales prices that partially offset the unit declines. The successful acquisition of new land positions in Colorado also contributed to the Region s performance, with 39 closings and $12.6 million of associated revenue. Colorado was our only state that did not experience any sales deterioration in the third quarter of 2010 as compared to 2009, with a 21.9% increase in orders dollars, primarily due to increased community count. The slower sales pace and steady closings in most of our Arizona and Texas communities led to the Region s 48.8% decline in ending backlog to 718 units with a value of $184.9 million as of September 30, 2010 compared to $322.0 million as of September 30, 2009, however, average sales prices of homes in backlog increased to $257,500 in 2010, as compared to $229,800 in 2009,

primarily due to product mix and a shift of the composition of the Region to in-fill communities with higher average sales prices.

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Year-to-date, the Region s revenues experienced a slight dip to $534.5 million of closings volume on 2,236 closings, a $13.1 million decrease from the prior year. The 574-unit and $89.7 million decreases in sales in the first nine months of 2010 echo the declines experienced in the third quarter.

East. In the third quarter of 2010, home closings in our East Region increased 46.7%, for total revenue of $24.9 million, a 97.7% increase in home closing revenue as compared to the third quarter of 2009. The increase in closing volume is an indicator of the success that our new Florida communities are experiencing. The Region experienced a 24-unit decrease in orders for the quarter ended September 30, 2010 with 67 units as compared to 91 in the same period in the prior year, partially offset by a $22,200 increase in average sales price due to the mix of homes from our new communities. Although our East Region experienced a decline consistent with our overall operations due to weak post tax-credit housing demand, as the Region s community supply is primarily comprised of well-located lots purchased in the last two years at depressed pricing, we believe the low lot basis has helped the overall performance of this Region.

The Region s home closings for the nine months ended September 30, 2010 increased 79 units, or 49.4%, with a 19.9% increase in average sales price. These increases generated total revenue of $64.2 million for the nine months ended September 30, 2010, a 79.1% increase over the same period a year ago. Year-to-date orders for the nine months ended September 30, 2010 increased 12.3% to 246 units as compared to the same period one year ago. The same factors that impacted the third quarter performance also impacted the year-to-date results.

Operating Information (dollars in thousands)

	Three Months Ended September 30,				Nine months Ended September 30,			
	2010		2009		2010		2009	
	Dollars	% of Home Closing Revenue	Dollars	% of Home Closing Revenue	Dollars	% of Home Closing Revenue	Dollars	% of Home Closing Revenue
Home Closing Gross Profit/(Loss)								
Total	$ 42,561	18.2%	$ 23,183	10.0%	$ 133,455	18.4%	$ 1,449	0.2%
Add back Impairments	680		10,354		1,526		86,943	
Adjusted Gross Margin	$ 43,241	18.5%	$ 33,537	14.5%	$ 134,981	18.6%	$ 88,392	12.9%
West	$ 8,241	17.5%	$ 790	2.9%	$ 21,589	17.0		

The income tax provision of $186.0 million for the year ended March 31, 2008 reflects our effective income tax rate of 35%. While our effective income tax rate for the year equals our statutory rate there are certain items that would normally generate a variance between the two rates. Those items are the federal and state research and development tax credits and the impact of foreign tax rate differentials partially offset by state taxes. However, the net effect for the year is approximately zero.

The aforementioned effective income tax rate for the year ended March 31, 2008 of 35% differs from our effective income tax rate of 22% for the year ended March 31, 2007 due to an increase in pretax income for fiscal 2008 versus the pretax income for fiscal 2007, without a corresponding increase in the benefit of book/tax differences. The lower effective income tax rate in fiscal 2007 was also due to the reversal of valuation allowance.

Net Income

Net income for the year ended March 31, 2008 was $344.9 million or $1.10 per diluted earnings per share, as compared to net income of $85.8 million or $0.28 per diluted earnings per share for the year ended March 31, 2007.

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

Net Revenues

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

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

The increase in consolidated net revenues for fiscal 2007 was driven by the following:

Strong performance of our North American publishing unit led to a year over year increase in net revenues of $43.3 million or 6%. In the third quarter fiscal 2007, we released a focused but high quality slate of titles, which resulted in strong consumer demand for our new releases in the third quarter, continuing reorders in the fourth quarter and strong price realization. In fiscal 2007, our major releases included *Call of Duty 3, Guitar Hero 2, Marvel: Ultimate Alliance, Tony Hawk's Project 8, Over the Hedge, X-Men: Official Game, Shrek Smash N' Crash, Tony Hawk's Downhill Jam*, *Series of Poker Tournament of Champions, Pimp My Ride*, and titles for our Cabela's History Channel and new Barbie franchises. In fiscal 2006, we released the following

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major releases: *Doom 3* for the Xbox, *Madagascar, Fantastic Four, Ultimate Spider-Man, X-Men Legends II, THAW, Call of Duty 2, Call of Duty 2: Big Red One, GUN, True Crime: New York City, Quake 4, Shrek SuperSlam, The Movies, Cabela's Dangerous Hunts 2,* and *World Series of Poker.*

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

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

Partially offset by:

A decrease in publishing net revenues from our European publishing operations primarily due to a more focused slate in fiscal 2007, and a decrease in our affiliate business as only one title, LucasArts' *Star Wars Lego 2* was released in 2007, whereas two strong affiliate titles, LucasArts' *Star Wars: Episode III Revenge of the Sith* and LucasArts' *Star Wars Battlefront II,* were released in fiscal 2006.

North America Publishing Net Revenues (amounts in thousands)

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

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

International Publishing Net Revenues (amounts in thousands)

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

International publishing net revenues decreased by 18% from $444.6 million for the year ended March 31, 2006 to $365.7 million for the year ended March 31, 2007. Additionally, international publishing net revenues as a percentage of consolidated net revenues decreased from 30% for the year ended March 31, 2006 to 24% for the year ended March 31, 2007. The decrease in international publishing net revenues was primarily due to the decrease in the number of titles released internationally in fiscal 2007. Additionally, in Europe, our net revenues were impacted by a decrease in revenues from our affiliate titles. Fiscal 2006 included the successful LucasArts' titles, *Star Wars:*

Revenge of the Sith and *Star Wars Battlefront II,* while fiscal 2007 included one major affiliate label release, LucasArts' *Lego Star Wars II: The Original Trilogy*. The decrease in international publishing net revenues was partially offset by a year over year strengthening of the EUR and the GBP in relation to the USD, which increased reported net revenues for fiscal 2007 by approximately $24.2 million. Excluding the impact of changing foreign currency rates, our international publishing net revenues decreased 23% year over year.

Publishing Net Revenues by Platform

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

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

Personal Computer Net Revenues (amounts in thousands)

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

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

Sony PlayStation 3 Net Revenues (amounts in thousands)

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

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

Sony PlayStation 2 Net Revenues (amounts in thousands)

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

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

Microsoft Xbox360 Net Revenues (amounts in thousands)

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

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

Microsoft Xbox Net Revenues (amounts in thousands)

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

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

Nintendo Wii Net Revenues (amounts in thousands)

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

The Nintendo Wii was released in November 2006. Consistent with our goal of having a significant presence at the launch of each next generation platform, we released five titles concurrently with the release of Wii; *Call of Duty 3, Marvel: Ultimate Alliance, World Series of Poker: Tournament of Champions, Rapala Tournament Fishing*, and *Tony Hawk's Downhill Jam.* With the strong consumer demand for the platform, our five releases performed well, three of which were top ten Wii titles in the third quarter fiscal 2007, according to NPD Funworld: *Call of Duty 3, Marvel Ultimate Alliance and Tony Hawk's Downhill Jam.*

Nintendo GameCube Net Revenues (amounts in thousands)

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

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

Hand-held Net Revenues (amounts in thousands)

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

Net revenues from sales of titles for the hand-held platforms decreased 3% from $158.9 million for the year ended March 31, 2006 to $153.4 million for the year ended March 31, 2007. Hand-held net revenues as a percentage of publishing net revenues decreased slightly from 14% to 13%. Within the hand-held platforms, net revenues for the GBA platform decreased 39%, from $79.7 million for the prior fiscal year, to $48.5 million for fiscal 2007, PSP decreased by 4%, from $52.0 million to $49.9 million, and net revenues for the NDS doubled from $27.1 million for fiscal 2006 to $54.9 million for the current year. The decrease in net revenues for GBA is primarily related to slower GBA sales due to wider acceptance of the NDS platform. The net revenue increase for NDS reflects the strong performance of our key fiscal 2007 titles which includes *Over the Hedge, Tony Hawk's Downhill Jam, X-Men: The Official Game, Spider-Man: Battle for New York* and LucasArts' *Star Wars Lego 2* in Europe, as the platform continued to gain consumer acceptance and market share. PSP net revenues for fiscal 2007 were slightly lower than the previous year. In fiscal 2006, we released a stronger PSP slate and our titles performed well with the consumer excitement for the March 2005 North America platform launch, and the September 2005 European platform launch. The 2006 slate included *Tony Hawk's Underground 2, Spider-Man: The Movie 2, X-Men Legends 2, World Series of Poker,* and two affiliate titles in Europe. Our key releases in fiscal 2007 were *Marvel: Ultimate Alliance, Tony Hawk's Project 8, Call of Duty: Roads to Victory,* and one European affiliate title, LucasArts' *Star Wars Lego 2.*

Distribution Net Revenues (amounts in thousands)

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

Distribution net revenues for the year ended March 31, 2007 increased 26% from the prior fiscal year, from $313.3 million to $394.0 million. Foreign exchange rates increased reported distribution net revenues by approximately $27.3 million for the year ended March 31, 2007. Excluding the impact of the changing foreign currency rates, our distribution net revenues increased $53.3 million or 17% year over year. This year over year increase was primarily due to the strong releases for certain third-party publishers, increased hardware sales primarily related to the launch of two new platforms in fiscal 2007, the PS3 and the Nintendo Wii, as well as ongoing sales of NDS and PSP hardware, and the addition of a new customer in the second quarter fiscal 2007.

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

Costs and Expenses

Cost of Sales Product Costs (amounts in thousands)

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

"Cost of sales product costs" represented 52% and 50% of consolidated net revenues for the years ended March 31, 2007 and 2006, respectively. In absolute dollars, "cost of sales product costs" increased 9% from $734.9 million for the year ended March 31, 2006 to $799.6 million for the year

ended March 31, 2007. The primary factors affecting the increase in "cost of sales product costs" in absolute dollars and as a percentage of consolidated net revenues were:

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

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

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

Partially offset by:

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

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

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

"Cost of sales software royalties and amortization" for the year ended March 31, 2007 decreased as a percentage of publishing net revenues from the prior fiscal year, from 13% to 12%. In absolute dollars, "cost of sales software royalties and amortization" for the year ended March 31, 2007 also decreased from the prior fiscal year, from $147.8 million to $132.4 million. The decreases were mainly due to:

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

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

Cost of Sales Intellectual Property Licenses (amounts in thousands)

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

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

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Product Development (amounts in thousands)

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

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

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

Increases in product development expenses of $4.8 million in fiscal 2007 related to stock-based compensation expense as a result of the implementation of SFAS No. 123R.

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

Partially offset by:

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

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

Sales and Marketing (amounts in thousands)

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

Sales and marketing expenses of $196.2 million and $283.4 million represented 13% and 19% of consolidated net revenues for the years ended March 31, 2007 and 2006, respectively. The decrease in both absolute dollars and as a percentage of net revenues was a result of the implementation of a more targeted media program which worked more efficiently helped by the overall strength and high quality of our fiscal 2007 title slate. We also released fewer titles in fiscal 2007 compared to fiscal 2006, when we had the largest slate of new releases in our history. The decreases were partially offset by expenses of $5.1 million in fiscal 2007 related to stock-based compensation expense as a result of the implementation of SFAS No. 123R, as well as sales and marketing expenses associated with the acquisition of the Guitar Hero franchise.

General and Administrative (amounts in thousands)

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

General and administrative expenses of $132.5 million and $96.4 million represented 9% and 7% of consolidated net revenues for the years ended March 31, 2007 and 2006, respectively. The increases were primarily due to increased legal expenses and professional fees relating primarily to our internal review of historical stock option granting practices, the consolidation of RedOctane into our results of operations, amortization of intangible assets related to the RedOctane acquisition, and stock-based compensation expense of $10.0 million in fiscal 2007 as a result of the implementation of SFAS No. 123R. These increases were partially offset by the benefits of our cost optimization program launched in the fourth quarter fiscal 2006 and gains on foreign currency.

Operating Income (amounts in thousands)

	March 31, 2007	% of Segment Net Revenues	March 31, 2006	% of Segment Net Revenues	Increase/ (Decrease)	Percent Change
Publishing	$ 64,076	6%	$ (6,715)	(1)%	$ 70,791	1,054%
Distribution	9,071	2%	21,941	7%	(12,870)	(59)%
Consolidated	$ 73,147	5%	$ 15,226	1%	$ 57,921	380%

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

The strong performance of our fiscal 2007 titles.

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

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

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

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

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

Partially offset by:

Stock-based compensation expenses of $22.4 million for the year ended March 31, 2007 as a result of the implementation of SFAS No. 123R.

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

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

Distribution operating income for the year ended March 31, 2007 decreased over the same period last year, from $21.9 million to $9.1 million. The decrease in operating income in 2007 was primarily due to increased business from large mass-market customers for which we earn smaller margins, an

increase in hardware sales which carries a lower margin than software, and higher reserves for inventory obsolescence.

Investment Income, Net (amounts in thousands)

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

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

Provision for Income Taxes (amounts in thousands)

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

The income tax provision of $24.0 million for the year ended March 31, 2007 reflects our effective income tax rate of 22%. This is higher than prior years as a result of an increase in pretax income for the year ended March 31, 2007, versus the amount of pretax income for the year ended March 31, 2006, without a corresponding increase in the benefit of book/tax differences. The significant items that generated the variance between our effective rate and our statutory rate of 35% were research and development tax credits, the impact of foreign tax rate differentials, and the elimination of the valuation allowance for research and development tax credits, partially offset by state taxes and the establishment of tax reserves for these credits and other deferred tax assets.

Net Income

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

Selected Quarterly Operating Results

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

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

	For the quarters ended							
	March 31, 2008	Dec. 31, 2007	Sept. 30, 2007	June 30, 2007	March 31, 2007	Dec. 31, 2006	Sept. 30, 2006	June 30, 2006
Net revenues	$ 602,451	$ 1,482,484	$ 317,746	$ 495,455	$ 312,512	$ 824,259	$ 188,172	$ 188,069
Cost of sales	350,229	762,290	204,956	327,960	216,007	483,180	141,078	137,800
Operating income (loss)	54,533	404,534	(9,545)	30,092	(29,114)	173,120	(37,410)	(33,449)
Net income (loss)	44,163	272,196	698	27,826	(14,422)	142,820	(24,302)	(18,309)
Basic earnings (loss) per share	0.15	0.93	0.00	0.10	(0.05)	0.51	(0.09)	(0.07)
Diluted earnings (loss) per share	0.14	0.86	0.00	0.09	(0.05)	0.46	(0.09)	(0.07)

Liquidity and Capital Resources

Sources of Liquidity

	As of and for the years ended March 31,		
	2008	2007	Increase/ (Decrease)
	(amounts in thousands)		
Cash and cash equivalents	$ 1,396,250	$ 384,409	$ 1,011,841
Short-term investments	52,962	570,440	(517,478)
	$ 1,449,212	$ 954,849	$ 494,363
Percentage of total assets	57%	53%	
Cash flows provided by operating activities	$ 573,500	$ 27,162	$ 546,338
Cash flows provided by (used in) investing activities	326,291	(35,242)	361,533
Cash flows provided by financing activities	105,163	27,968	77,195

As of March 31, 2008, our primary source of liquidity is comprised of $1,396.3 million of cash and cash equivalents and $53.0 million of short-term investments. Over the last two years, our primary sources of liquidity have included cash on hand at the beginning of the year and cash flows generated from continuing operations. We have also generated cash flows from the issuance of our common stock to employees through the exercise of options, which is described in more detail below in "Cash Flows from Financing Activities." We have not utilized debt financing as a significant source of cash flows. However, we do have available at certain of our international locations credit facilities, which are described below in "Credit Facilities," that can be utilized if needed.

Following the closing of our proposed business combination with Vivendi Games, Inc. (see Note 20 of the Notes to Consolidated Financial Statements included in Item 8), Activision Blizzard, Inc. ("Activision Blizzard") will commence a cash tender offer for up to 146.5 million of its shares at $27.50 per share. If the tender offer is fully subscribed, the aggregate consideration will be approximately $4.028 billion. Under the terms of the business combination agreement ("BCA"), we and Vivendi S.A. ("Vivendi") have agreed the purchase of the shares tendered in the tender offer will be funded as follows: (a) the first $2.928 billion of the aggregate consideration will be funded by Activision Blizzard with proceeds from the share purchase described in Note 20 of the Notes to Consolidated Financial Statements included in Item 8, available cash on hand and, if necessary, borrowings made under one or more new credit facilities; (b) if the aggregate consideration is more than $2.928 billion, Vivendi has agreed to purchase from Activision Blizzard, at a purchase price of $27.50 per share, additional newly issued shares of Activision Blizzard common stock in an amount equal to the lesser of (x) $700.0 million and (y) the excess of the aggregate consideration over $2.928 billion, which amount will be used to fund the amount of the aggregate consideration that is in excess of $2.928 billion; and (c) if the aggregate consideration exceeds $3.628 billion, Activision Blizzard will fund the additional amount of the aggregate consideration that is in excess of $3.628 billion (up to the maximum aggregate consideration of $4.028 billion) through borrowings made under the new credit facilities issued by Vivendi (see below and Note 21 of the Notes to Consolidated Financial Statements included in Item 8.)

On April 29, 2008, we, acting on behalf of Activision Blizzard, entered into a senior unsecured credit agreement (the "Credit Agreement") with Vivendi. Borrowings under the Credit Agreement cannot be effected until the consummation of the transactions contemplated by the business combination agreement described above (the "Transactions.") After the closing of the Transactions, among other things, the Company's name will be changed to Activision Blizzard.

After the closing of the Transactions, the Credit Agreement will provide Activision Blizzard with (i) a term loan credit facility (the "Tranche A Facility") in an aggregate amount of up to $400.0 million to be applied to fund that portion of the post-closing tender offer consideration in excess of

$3.628 billion as set forth in the BCA, (ii) a term loan credit facility (the "Tranche B Facility") in an aggregate amount of up to $150.0 million to be applied to repay certain indebtedness of Vivendi Games after the closing in accordance with the terms of the BCA, and (iii) a revolving credit facility (the "Revolving Facility," and collectively with the Tranche A Facility and the Tranche B Facility, the "New Credit Facilities") in an aggregate amount of up to $475.0 million to be used after the closing of the Transactions for general corporate purposes. In the event the BCA terminates prior to the closing of the Transactions, the New Credit Facilities will terminate effective on the same date (see Note 21 of the Notes to Consolidated Financial Statements included in Item 8).

We believe that we have sufficient working capital ($1,423.3 million at March 31, 2008), as well as proceeds available from our international credit facilities, to finance our operational requirements for at least the next twelve months, including purchases of inventory and equipment, the funding of the development, production, marketing and sale of new products, the acquisition of intellectual property rights for future products from third parties and the completion of the tender offer in connection with the combination with Vivendi Games.

Cash Flows from Operating Activities

The primary source of cash flows provided by operating activities typically have included the collection of customer receivables generated by the sale of our products, offset by payments to vendors for the manufacture, distribution, and marketing of our products, third-party developers and intellectual property holders, and our own employees. For the years ended March 31, 2008 and 2007, cash flows from operating activities were $573.5 million and $27.2 million, respectively. The principal components comprising cash flows from operating activities for the year ended March 31, 2008 included an increase in amounts collected from customers due to increased net revenues, an increase in accounts payable, accrued expenses and other liabilities partially offset by the increase in inventory and accounts receivables. See an analysis of the change in key balance sheet accounts below in "Key Balance Sheet Accounts." We expect that a primary source of future liquidity, both short-term and long-term, will be the result of cash flows from continuing operations.

A significant operating use of our cash relates to our continued investment in software development and intellectual property licenses. We spent approximately $168.8 million and $166.1 million for the years ended March 31, 2008 and 2007, 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. Our future cash commitments relating to these investments are detailed below in "Commitments." Cash flows from operations are affected by our ability to release highly successful or "hit" titles. Though many of these titles have substantial production or acquisition costs and marketing expenditures, once a title recoups these costs, incremental net revenues typically will directly and positively impact cash flows.

Cash Flows from Investing Activities

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

For the years ended March 31, 2008 and 2007, cash flows provided by and used in investing activities were $326.3 million and $35.2 million, respectively. For the year ended March 31, 2008, cash

flows provided by investing activities were primarily the result of proceeds from sales and maturities of investments, as offset by cash paid for business acquisitions, capital expenditures, and purchases of short-term investments. The increase in cash flows provided by investing activities versus the prior year was primarily related to our investment activities as we had a bigger net proceeds from sales and maturities of investments, particularly in the fourth quarter fiscal 2008 as compared to that of fiscal 2007. Such activities were carried out in anticipation of the close of the BCA with Vivendi and the related tender offer (see Note 20 of the Notes to Consolidated Financial Statements included in Item 8), and are part of the reason for the substantial increase in cash and cash equivalents of approximately $1 billion. We have historically financed our acquisitions through the issuance of shares of common stock or a combination of common stock and cash.

Due to uncertainties surrounding the timing of liquidation of our auction rate securities, which are comprised of AAA-rated student-loan-backed taxable securities, all our investments in such securities were classified as long-term investments in our consolidated balance sheets as of March 31, 2008. Liquidity for these auction rate securities is typically provided by an auction process which allows holders to sell their notes and resets the applicable interest rate at pre-determined intervals, usually every 7 to 35 days. On an industry-wide basis, many auctions have failed, and there is, as yet, no meaningful secondary market for these instruments. Each of the auction rate securities in our investment portfolio as of March 31, 2008 has experienced a failed auction and there is no assurance that future auctions for these securities will succeed. An auction failure means that the parties wishing to sell their securities could not be matched with an adequate volume of buyers. In the event that there is a failed auction, the indenture governing the security requires the issuer to pay interest at a contractually defined rate that is generally above market rates for other types of similar short-term instruments. The securities for which auctions have failed will continue to earn interest at the contractual rate and be auctioned every 7 to 35 days until the auction succeeds, the issuer calls the securities or they mature. As a result, our ability to liquidate and fully recover the carrying value of our auction rate securities in the near term may be limited or not exist.

As there is not yet any meaningful secondary market for these securities, quoted market prices are not available. We estimated the fair market value using valuation models, which take into account both observable market data and non-observable factors, including credit quality, duration, insurance wraps, collateral composition, maximum rate formulas, comparable trading instruments, and likelihood of redemption. Accordingly, we consider the values generated by such valuation models to represent management's best estimate of fair value for the purposes of applying the Statement of Financial Accounting Standards No. 115 *Accounting for Certain Investments in Debt and Equity Securities*.

The change in fair value of the auction rate securities of $4.3 million was recorded as a component of comprehensive income (loss) in the Consolidated Statement of Changes in Shareholders' Equity for the year ended March 31, 2008, as the decline in fair value is not considered to be "other-than-temporary." We have the intent and ability to hold these securities for a period of time sufficient for a recovery of fair value up to (or beyond) the initial cost of the investment.

Based on our other available cash and expected operating cash flows and financing, we do not anticipate the potential lack of liquidity on these investments will affect our ability to execute our current business plan or to consummate the proposed post-closing tender offer described in Note 20 of the Notes to Consolidated Financial Statements included in Item 8. Additionally we have received indications from certain lenders that we may borrow against the par value of the securities at competitive rates.

Cash Flows from Financing Activities

The primary source of cash from financing activities has been transactions involving our common stock, including the issuance of shares of common stock to employees. We have not utilized debt

financing as a significant source of cash flows. However, we do have available at certain of our international locations, credit facilities, which are described below in "Credit Facilities," that can be utilized if needed.

For the years ended March 31, 2008 and 2007, cash flows provided by financing activities were $105.2 million and $28.0 million, respectively. The increase in cash provided by financing activities for the year ended March 31, 2008 was the result of the issuance of common stock related to employee equity incentive and stock purchase plans. The increase in stock option exercises was primarily due to the performance of our share price and the release in June 2007 of the suspension of stock option exercises implemented while we were not current with the filings we are required to make pursuant to the Exchange Act.

During fiscal 2003, our Board of Directors authorized a buyback program under which we can repurchase up to $350.0 million of our common stock. Under the program, shares may be purchased as determined by management and within certain guidelines, from time to time, in the open market or in privately negotiated transactions, including privately negotiated structured stock repurchase transactions and through transactions in the options markets. Depending on market conditions and other factors, these purchases may be commenced or suspended at any time or from time to time without prior notice. As of March 31, 2008, we had approximately $226.2 million available for utilization under the buyback program. We actively manage our capital structure as a component of our overall business strategy. Accordingly, in the future, when we determine that market conditions are appropriate, we may seek to achieve long term value for the shareholders through, among other things, new debt or equity financings or refinancings, share repurchases, and other transactions involving our equity or debt securities.

Key Balance Sheet Accounts

Accounts Receivable

	March 31, 2008	March 31, 2007	Increase/ (Decrease)
	(amounts in thousands)		
Gross accounts receivable	$ 332,831	$ 240,112	$ 92,719
Net accounts receivable	203,420	148,694	54,726

The increase in gross accounts receivable was primarily the result of increased sales volume in the fourth quarter fiscal 2008 of our successful titles *Call of Duty 4: Modern Warfare* and *Guitar Hero III: Legends of Rock* leading to higher net revenues for the fourth quarter fiscal 2008 of $602.5 million compared to $312.5 million for the fourth quarter fiscal 2007.

Reserves for returns, price protection and bad debt increased from $91.4 million at March 31, 2007 to $129.4 million at March 31, 2008 whereas reserves as a percentage of gross receivables increased from 38% to 39% at March 31, 2007 and 2008, respectively. This was the result of increases in revenues during the fourth quarter fiscal 2008 as compared to the fourth quarter fiscal 2007. Reserves for returns and price protection are a function of the number of units and pricing of titles in retail inventory, which has been consistently applied. (see description of *Allowances for Returns, Price Protection, Doubtful Accounts, and Inventory Obsolescence* in Item 7: *Critical Accounting Policies and Estimates*).

Inventories

	March 31, 2008	March 31, 2007	Increase/ (Decrease)
	(amounts in thousands)		
Inventories	$ 146,874	$ 91,231	$ 55,643

The increase in inventories at March 31, 2008 compared to March 31, 2007 is primarily the result of the expanding Guitar Hero franchise, and larger slate of titles when compared to fiscal 2007 across all console platforms and our continued international business growth.

Software Development

	March 31, 2008	March 31, 2007	Increase/ (Decrease)
	(amounts in thousands)		
Software development	$ 109,786	$ 130,922	$ (21,136)

Software development decreased from $130.9 million at March 31, 2007 to $109.8 million at March 31, 2008. The decrease in software development was primarily the result of an increase in amortization related to the increase in the number of titles released in fiscal 2008 and stock option expenses for the year ended March 31, 2008, partially offset by our continued investment in Activision's future product slate of titles.

Intellectual Property Licenses

	March 31, 2008	March 31, 2007	Increase/ (Decrease)
	(amounts in thousands)		
Intellectual Property Licenses	$ 83,551	$ 100,274	$ (16,723)

Intellectual property licenses decreased from $100.3 million at March 31, 2007 to $83.6 million at March 31, 2008. The decrease in intellectual property licenses primarily resulted from the amortization of intellectual property licenses upon releases of titles during fiscal 2008.

Accounts Payable

	March 31, 2008	March 31, 2007	Increase/ (Decrease)
	(amounts in thousands)		
Accounts payable	$ 129,896	$ 136,517	$ (6,621)

The slight decrease in accounts payable of $6.6 million from March 31, 2007 to March 31, 2008 primarily reflects the timing of the payment of several items.

Accrued Expenses and Other Liabilities

	March 31, 2008	March 31, 2007	Increase/ (Decrease)
	(amounts in thousands)		
Accrued expenses and other liabilities	$ 426,175	$ 204,652	$ 221,523

The increase in accrued expenses and other liabilities was primarily driven by:

Taxes payable as a result of improved profitability leading to utilization of all of our net operating loss carryforwards.

Increased annual bonuses as a result of our record financial performance.

Increased royalties payable due to higher net revenues.

See Note 9 of the Notes to Consolidated Financial Statements included in Item 8 for details of accrued expenses and other liabilities.

Capital Requirements

For the fiscal year ending March 31, 2009, we anticipate total capital expenditures of approximately $35.6 million. Capital expenditures will be primarily for computer hardware and software purchases and various corporate projects.

Credit Facilities

We have revolving credit facilities with our Centresoft subsidiary located in the UK (the "UK Facility") and our NBG subsidiary located in Germany (the "German Facility.")

The UK Facility provided Centresoft with the ability to borrow up to GBP 12.0 million ($23.9 million), including issuing letters of credit, on a revolving basis as of March 31, 2008. Furthermore, under the UK Facility, Centresoft provided a GBP 0.6 million ($1.2 million) guarantee for the benefit of our CD Contact subsidiary as of March 31, 2008. The UK Facility bore interest at LIBOR plus 2.0% as of March 31, 2008, is collateralized by substantially all of the assets of the subsidiary and expires in March 2009. 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, 2008, we were in compliance with these covenants.

The German Facility provided for revolving loans up to EUR 0.5 million ($0.8 million) as of March 31, 2008, bore interest at a Eurocurrency rate plus 2.5%, is collateralized by certain of the subsidiary's property and equipment and has no expiration date. No borrowings were outstanding against the German Facility as of March 31, 2008.

As of March 31, 2008, we maintained a $10.0 million irrevocable standby letter of credit. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. Under the terms of this arrangement, we are required to maintain on deposit with the bank a compensating balance, restricted as to use, of not less than the sum of the available amount of the letter of credit plus the aggregate amount of any drawings under the letter of credit that have been honored thereunder but not reimbursed. At March 31, 2008, the $10.0 million deposit is included in short-term investments as restricted cash. No borrowings were outstanding as of March 31, 2008.

As of March 31, 2008, our publishing subsidiary located in the UK maintained a EUR 7.0 million ($11.0 million) irrevocable standby letter of credit. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. The standby letter of credit does not require a compensating balance and is collateralized by substantially all of the assets of the subsidiary and expires in February 2009. No borrowings were outstanding as of March 31, 2008.

Commitments

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

facilities and equipment under non-cancelable operating lease agreements. Assuming all contractual provisions are met, the total future minimum commitments for these and other contractual arrangements in place as of March 31, 2008, are scheduled to be paid as follows (amounts in thousands):

	Contractual Obligations(1)			
	Facility & Equipment Leases	**Developer & IP**	**Marketing**	**Total**
Fiscal years ending March 31,				
2009	$ 19,343	$ 110,771	$ 41,401	$ 171,515
2010	17,028	31,041	22,100	70,169
2011	14,553	34,086	13,100	61,739
2012	10,256	16,586		26,842
2013	8,791	21,586		30,377
Thereafter	31,201	26,001		57,202
Total	$ 101,172	$ 240,071	$ 76,601	$ 417,844

(1) We have omitted FIN 48 liabilities from this table due to the inherent uncertainty regarding the timing of potential issue resolution. Specifically, either (a) the underlying positions have not been fully enough developed under audit to quantify at this time or, (b) the years relating to the issues for certain jurisdictions are not currently under audit. At the adoption date of April 1, 2007, we had $65.5 million of unrecognized tax benefits. At March 31, 2008, we had $74.2 million of unrecognized tax benefits.

Off Balance Sheet Arrangements

As of March 31, 2008 and 2007, we did not have any relationships with unconsolidated entities or financial parties, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we do not have any off balance sheet arrangements and are not exposed to any financing, liquidity, market, or credit risk that could arise if we had engaged in such relationships.

Financial Disclosure

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

Our Disclosure Committee, which operates under the Board approved Disclosure Committee Charter and Disclosure Controls & Procedures Policy, includes senior management representatives and assists executive management in its oversight of the accuracy and timeliness of our disclosures, as well as in implementing and evaluating our overall disclosure process. As part of our disclosure process, senior finance and operational representatives from all of our corporate divisions and business units prepare quarterly reports regarding their current quarter operational performance, future trends, subsequent events, internal controls, changes in internal controls, and other accounting and disclosure-

relevant information. These quarterly reports are reviewed by certain key corporate finance representatives. These corporate finance representatives also conduct quarterly interviews on a rotating basis with the preparers of selected quarterly reports. The results of the quarterly reports and related interviews are reviewed by the Disclosure Committee. Finance representatives also conduct reviews with our senior management team, our internal and external counsel, and other appropriate personnel involved in the disclosure process, as appropriate. Additionally, senior finance and operational representatives provide internal certifications regarding the accuracy of information they provide that is utilized in the preparation of our periodic public reports filed with the Securities and Exchange Commission. Financial results and other financial information also are reviewed with the Audit Committee of the Board of Directors on a quarterly basis. As required by applicable regulatory requirements, the Chief Executive Officers and the Chief Financial Officer review and make various certifications regarding the accuracy of our periodic public reports filed with the Securities and Exchange Commission, our disclosure controls and procedures, and our internal control over financial reporting. With the assistance of the Disclosure Committee, we will continue to assess and monitor our disclosure controls and procedures, and our internal control over financial reporting, and will make refinements as necessary.

Recently Issued Accounting Standards

In December 2007, the FASB issued Statement No. 141(R), *Business Combinations* ("SFAS No. 141(R).") This Statement provides greater consistency in the accounting and financial reporting of business combinations. It requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose the nature and financial effect of the business combination. Also in December 2007, the FASB issued Statement No. 160. *Non-controlling Interests in Consolidated Financial Statements* ("SFAS No. 160.") This Statement amends Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 141(R) and SFAS No. 160 are required to be adopted simultaneously and are effective for the first annual reporting period beginning on or after December 15, 2008 with earlier adoption being prohibited. We do not currently have any non-controlling interests in our subsidiaries, and accordingly the adoption of SFAS No. 160 is not expected to have a material impact on our financial statements. We are currently evaluating the impact from the adoption of SFAS No. 141R on our Consolidated Financial Statements.

In September 2006, the FASB issued Statement No. 157 ("SFAS No. 157"), *Fair Value Measurements.* SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities and is effective for fiscal years beginning after November 15, 2008 for non-financial assets and liabilities. The adoption of SFAS No. 157 is not expected to have a material effect on our financial position or results of operations.

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

In June 2007, the FASB ratified the Emerging Issues Task Force's ("EITF") consensus conclusion on EITF 07-03, *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development.* EITF 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under this conclusion, an entity is required to defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-03 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007 and requires prospective application for new contracts entered into after the effective date. The adoption of EITF 07-03 is not expected to have a material impact on our Consolidated Financial Statements.

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133* ("SFAS No. 161.") SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The guidance in SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS No. 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. We are currently assessing the impact of SFAS No. 161.

Inflation

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

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We manage our interest rate risk by maintaining an investment portfolio consisting primarily of debt instruments with high credit quality and relatively short average maturities. We also manage our interest rate risk by maintaining sufficient cash and cash equivalent balances such that we are typically able to hold our investments to maturity. As of March 31, 2008, our cash equivalents and short-term investments included debt securities of $1,171.4 million. Also, as of March 31, 2008, we classified our investments in auction rate securities of $91.2 million as long-term investments (see Note 1 of the Notes to Consolidated Financial Statements included in Item 8 for summary of significant accounting policies.)

The following table presents the amounts and related weighted average interest rates of our investment portfolio as of March 31, 2008 (amounts in thousands):

	Average Interest Rate	Amortized Cost	Fair Value
Cash equivalents:			
Variable rate	3.09%	$ 1,129,980	$ 1,129,980
Short-term investments:			
Fixed rate	5.21%	$ 41,619	$ 41,411
Long-term investments:			
Variable rate	6.09%	$ 95,538	$ 91,215

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

Currency Exchange Rate Risk

We transact business in many different foreign currencies and may be exposed to financial market risk resulting from fluctuations in currency exchange rates, particularly EUR, GBP, and AUD. The volatility of EUR, GBP, and AUD (and all other applicable currencies) will be monitored frequently throughout the coming year. When appropriate, we enter into hedging transactions in order to mitigate our risk from 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 currency contracts for trading purposes. As of March 31, 2008, we had no outstanding exchange forward contracts. As of March 31, 2007, accrued expenses included approximately $90,000 of pre-tax unrealized losses for the estimated fair value of outstanding currency exchange forward contracts.

Market Price Risk

With regard to the structured stock repurchase transactions described in Note 15 of the Notes to Consolidated Financial Statements included in Item 8, at those times when we have structured stock repurchase transactions outstanding, it is possible that at settlement we could take delivery of shares at an effective repurchase price higher than the then market price. As of March 31, 2008, we had no structured stock repurchase transactions outstanding.

Item 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets as of March 31, 2008 and 2007	F-2
Consolidated Statements of Operations for the Years Ended March 31, 2008, 2007, and 2006	F-3
Consolidated Statements of Changes in Shareholders' Equity for the Years Ended March 31, 2008, 2007, and 2006	F-4
Consolidated Statements of Cash Flows for the Years Ended March 31, 2008, 2007, and 2006	F-5
Notes to Consolidated Financial Statements	F-6
Schedule II Valuation and Qualifying Accounts as of March 31, 2008, 2007, and 2006	F-49
Item 15. Exhibit Index	E-1

Other financial statement schedules are omitted because the information called for is not applicable or is shown either in the consolidated financial statements or the notes thereto.

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

None.

Item 9A. CONTROLS AND PROCEDURES

1) Definition and Limitations of Disclosure Controls and Procedures.

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

2) Evaluation of Disclosure Controls and Procedures.

Our management, with the participation of the Chief Executive Officers and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2008. Based on this controls evaluation, and subject to the limitations described above, the Chief Executive Officers and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported on a timely basis.

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

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our management, with the participation of our Chief Executive Officers and Chief Financial Officer, conducted an evaluation of the effectiveness, as of March 31, 2008, of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control Integrated Framework. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of March 31, 2008.

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

The effectiveness of our internal control over financial reporting as of March 31, 2008 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report included in this annual report on Form 10-K.

4) Changes in Internal Control Over Financial Reporting

There have not been any changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2008 Annual Meeting of Shareholders, entitled "Proposal 1 Election of Directors," "Executive Officers and Key Employees," "Section 16(a) Beneficial Ownership Reporting Compliance," "Corporate Governance Matters Code of Ethics for Senior Executive and Senior Financial Officers" and "Corporate Governance Matters Board of Directors and Committees Audit Committee" to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

Item 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2008 Annual Meeting of Shareholders, entitled "Executive Compensation," "Director Compensation" and "Compensation Committee Report" to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

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

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2008 Annual Meeting of Shareholders, entitled "Equity Compensation Plan Information" and "Security Ownership of Certain Beneficial Owners and Management" to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

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

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2008 Annual Meeting of Shareholders, entitled "Certain Relationships and Related Transactions" and "Corporate Governance Matters Board of Directors and Committees Director Independence" to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2008 Annual Meeting of Shareholders, entitled "Independent Registered Public Accounting Firm's Fees" to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year covered by this Form 10-K.

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULE

(a)

1. *Financial Statements* See Item 8. Consolidated Financial Statements and Supplementary Data for index to Financial Statements and Financial Statement Schedule on page 75 herein.

2.

Financial Statement Schedule The following financial statement schedule of Activision, Inc. for the fiscal years ended March 31, 2008, 2007, and 2006 is filed as part of this report and should be read in conjunction with the consolidated financial statements of Activision, Inc.:

Schedule II Valuation and Qualifying Accounts

Other financial statement schedules are omitted because the information called for is not applicable or is shown either in the consolidated financial statements or the notes thereto.

3.

Exhibits Required by Item 601 of Regulation S-K

2.1	Business Combination Agreement, dated as of December 1, 2007, by and among Activision, Inc., Sego Merger Corporation, Vivendi S.A., VGAC LLC and Vivendi Games, Inc. (incorporated by reference to Exhibit 2.1 of Activision's Form 8-K, filed December 6, 2007).
3.1	Amended and Restated Certificate of Incorporation of Activision Holdings, dated June 9, 2000 (incorporated by reference to Exhibit 2.5 of Activision's Form 8-K, filed June 16, 2000).
3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation of Activision Holdings dated as of June 9, 2000 (incorporated by reference to Exhibit 2.7 of Activision's Form 8-K, filed June 16, 2000).
3.3	Certificate of Designation of Series A Junior Preferred Stock of Activision, Inc. dated as of December 27, 2001 (incorporated by reference to Exhibit 3.4 of Activision's Form 10-Q for the quarter ended December 31, 2001).
3.4	Certificate of Amendment of Amended and Restated Certificate of Incorporation, as amended, of Activision, Inc., dated as of April 4, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed April 5, 2005).
3.5	Certificate of Designation of Series A Junior Preferred Stock of Activision, Inc. dated August 4, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed August 5, 2005).
3.6	Third Amended and Restated By-Laws of Activision, Inc., dated September 27, 2007 (incorporated by reference to Exhibit 3.6 to Activision's Registration Statement on Form S-8, Registration No. 333-146431, filed October 1, 2007).
4.1	Rights Agreement dated as of April 18, 2000, between Activision. Inc. and Continental Stock Transfer & Trust Company, which includes as exhibits the form of Right Certificates as Exhibit A, the Summary of Rights to Purchase Series A Junior Preferred Stock as Exhibit B and the form of Certificate of Designation of Series A Junior Preferred Stock of Activision as Exhibit C, (incorporated by reference to Activision's Registration Statement on Form 8-A, Registration No. 001-15839, filed April 19, 2000).
4.2	Amendment No. 1 to the Rights Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Continental Stock Transfer & Trust Company, as rights agent (incorporated by reference to Exhibit 4.1 of Activision's Form 8-K, filed December 6, 2007).
10.1	Activision, Inc. 1991 Stock Option and Stock Award Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-K for the year ended March 31, 2002).

10.2	Amendment to the 1991 Stock Option and Stock Award Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.1 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.3	Activision, Inc. 1998 Incentive Plan, as amended (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended September 30, 2001).
10.4	Amendment to the 1998 Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.2 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.5	Activision, Inc. 1999 Incentive Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2002).
10.6	Amendment to the 1999 Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.3 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.7	Activision, Inc. 2001 Incentive Plan, as amended (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended June 30, 2002).
10.8	Amendment to the 2001 Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.4 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.9	Activision, Inc. 2002 Incentive Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2003).
10.10	Amendment to the 2002 Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.5 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.11	Activision, Inc. 2002 Executive Incentive Plan (incorporated by reference to Exhibit 4.1 of Activision's Form S-8, Registration No. 333-100114 filed September 26, 2002).
10.12	Amendment to the 2002 Executive Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.6 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.13	Activision, Inc. 2002 Studio Employee Retention Incentive Plan (incorporated by reference to Exhibit 4.1 of Activision's Form S-8, Registration No. 333-103323 filed February 19, 2003).
10.14	Amendment to the 2002 Studio Employee Retention Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.7 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.15	Activision, Inc. Third Amended and Restated 2002 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.2 of Activision's Current Report on Form 8-K filed October 23, 2006).
10.16	Activision, Inc. Second Amended and Restated 2002 Employee Stock Purchase Plan for International Employees (incorporated by reference to Exhibit 10.1 of Activision's Current Report on Form 8-K filed October 23, 2006).
10.17	Activision, Inc. Sub-Plan to the Second Amended And Restated 2002 Employee Stock Purchase Plan for International Employees for Eligible Employees in the European Economic Area.
10.18	Australian Addendum to the Activision, Inc. Sub-Plan to the Second Amended And Restated 2002 Employee Stock Purchase Plan for International Employees for Eligible Employees.

10.19	Activision, Inc. Amended and Restated 2003 Incentive Plan (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2005).
10.20	Amendment to the 2003 Executive Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.9 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.21	Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 99.1 to Activision's Registration Statement on Form S-8, Registration No. 333-146431, filed October 1, 2007).
10.22	Australian Addendum to the Activision, Inc. 2007 Incentive Plan.
10.23	Form of Stock Option Certificate for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 1998 Incentive Plan (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K, filed May 31, 2005).
10.24	Form of Stock Option Certificate for grants to persons other than non-employee directors issued pursuant the Activision, Inc. 1999 Incentive Plan (incorporated by reference to Exhibit 10.2 of Activision's Form 8-K, filed May 31, 2005).
10.25	Form of Stock Option Agreement for grants to persons other than non-employee directors issued pursuant the Activision, Inc. 2001 Incentive Plan (incorporated by reference to Exhibit 10.3 of Activision's Form 8-K, filed May 31, 2005).
10.26	Form of Stock Option Agreement for grants to persons other than non-employee directors issued pursuant the Activision, Inc. 2002 Executive Incentive Plan (incorporated by reference to Exhibit 10.4 of Activision's Form 8-K, filed May 31, 2005).
10.27	Form of Executive Stock Option Agreement for grants to Robert Kotick or Brian Kelly issued pursuant the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.40 of Activision's Form 10-K for the year ended March 31, 2005).
10.28	Form of Non-Executive Stock Option Agreement for grants to persons other than Robert Kotick or Brian Kelly and non-employee directors issued pursuant the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.41 of Activision's Form 10-K for the year ended March 31, 2005).
10.29	Form of Non-Employee Director Stock Option Agreement for grants to non-employee directors issued pursuant the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.17 of Activision's Form 10-K for the year ended March 31, 2007).
10.30	Notice of Share Option Award for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.18 of Activision's Form 10-K for the year ended March 31, 2007).
10.31	Notice of Share Option Award for grants to non-employee directors issued pursuant to the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.19 of Activision's Form 10-K for the year ended March 31, 2007).
10.32	Notice of Restricted Share Award for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.20 of Activision's Form 10-K for the year ended March 31, 2007).
10.33	Notice of Restricted Share Unit Award for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.21 of Activision's Form 10-K for the year ended March 31, 2007).

10.34	Notice of Stock Option Award for grants to persons other than non-employee directors pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.9 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.35	Notice of Stock Option Award for grants to non-employee directors pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.10 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.36	Notice of Restricted Share Award for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.11 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.37	Notice of Restricted Share Unit Award for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.12 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.38	Notice of Restricted Share Unit Award for grants to non-employee directors upon their initial election to the board or upon their tenth continuous year of service on the board issued pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.13 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.39	Notice of Restricted Share Unit Award for grants to non-employee directors upon their reelection to the board (other than in connection with 10 years of continuous service) issued pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.14 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.40	Employment Agreement, dated July 22, 2002, between Ronald Doornink and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.6 of Activision's Form 10-Q for the quarter ended June 30, 2002).
10.41	Amendment, dated February 27, 2003, to Employment Agreement dated July 22, 2002 between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.34 of Activision's Form 10-K for the year ended March 31, 2005).
10.42	Amendment, dated June 1, 2004, to Employment Agreement dated July 22, 2002, between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended June 30, 2004).
10.43	Amendment, dated June 15, 2005, to Employment Agreement dated July 22, 2002 between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended June 30, 2005).
10.44	Amendment, dated June 4, 2007, to Employment Agreement dated July 22, 2002 between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2007).
10.45	Employment Agreement, dated June 15, 2005, between Michael Griffith and Activision Publishing, Inc (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended June 30, 2005).
10.46	Amendment to Employment Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Michael Griffith (incorporated by reference to Exhibit 10.7 of Activision's Form 8-K, filed December 6, 2007).
10.47	Stock Option Agreement, dated June 15, 2005, between Michael Griffith and Activision, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended June 30, 2005).

10.48	Restricted Stock Agreement, dated June 15, 2005, between Michael Griffith and Activision, Inc. (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended June 30, 2005).
10.49	Employment Agreement, dated September 9, 2005, between Thomas Tippl and Activision Publishing, Inc (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended September 30, 2005).
10.50	Stock Option Agreement, dated October 3, 2005, between Thomas Tippl and Activision, Inc. (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended September 30, 2005).
10.51	Restricted Stock Agreement, dated October 3, 2005, between Thomas Tippl and Activision, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended September 30, 2005).
10.52	Employment Agreement, dated September 18, 2006, between Brian Hodous and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended December 31, 2006).
10.53	Letter Agreement, dated September 6, 2006, between Brian Hodous and Activision, Inc. (incorporated by reference to Exhibit 10.44 of Activision's Form 10-K for the year ended March 31, 2007).
10.54	Notice of Share Option Award to, dated as of November 3, 2006, to Brian Hodous (incorporated by reference to Exhibit 10.45 of Activision's Form 10-K for the year ended March 31, 2007).
10.55	Notice of Restricted Stock Award, dated as of November 3, 2006, to Brian Hodous (incorporated by reference to Exhibit 10.46 of Activision's Form 10-K for the year ended March 31, 2007).
10.56	Notice of Restricted Stock Award, dated as of November 3, 2006, to Brian Hodous (incorporated by reference to Exhibit 10.47 of Activision's Form 10-K for the year ended March 31, 2007).
10.57	Employment Agreement, dated October 1, 2006, between Robin Kaminsky and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended December 31, 2006).
10.58	Notice of Share Option Award to Robin Kaminsky, dated as of October 19, 2006 (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.59	Notice of Share Option Award to Robin Kaminsky, dated as of October 19, 2006 (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.60	Notice of Restricted Stock Award to Robin Kaminsky, dated as of October 19, 2006 (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.61	Notice of Restricted Stock Award to Robin Kaminsky, dated as of October 19, 2006, between Activision and Robin Kaminsky (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended September 30, 2007).

10.62	Employment Agreement, dated September 11, 2007, between George Rose and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.7 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.63	Notice of Share Option Award to George Rose, dated September 28, 2007 (incorporated by reference to Exhibit 10.12 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.64	Notice of Restricted Share Unit Award to George Rose, dated September 28, 2007 (incorporated by reference to Exhibit 10.13 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.65	Employment Agreement, dated September 12, 2007, between Ann Weiser and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.8 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.66	Notice of Share Option Award to Ann Weiser, dated September 28, 2007 (incorporated by reference to Exhibit 10.14 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.67	Notice of Restricted Share Unit Award to Ann Weiser, dated September 28, 2007 (incorporated by reference to Exhibit 10.15 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.68	Amended and Restated Employment Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.3 of Activision's Form 8-K, filed December 6, 2007).
10.69	Replacement Bonus Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.5 of Activision's Form 8-K, filed December 6, 2007).
10.70	Stock Option Agreement, dated May 22, 2000, between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ending September 30, 2000).
10.71	Notice of Stock Option Award to Robert A. Kotick, dated December 5, 2007.
10.72	Amended and Restated Employment Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.4 of Activision's Form 8-K, filed December 6, 2007).
10.73	Replacement Bonus Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.6 of Activision's Form 8-K, filed December 6, 2007).
10.74	Stock Option Agreement, dated May 22, 2000, between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ending September 30, 2000).
10.75	PlayStation 2 CD-ROM/DVD-ROM Licensed Publisher Agreement, dated as of April 1, 2000, between Sony Computer Entertainment America Inc. and Activision, Inc. (incorporated by reference to Exhibit 10.9 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*

10.76	Letter regarding Modification of Territory for PlayStation 2 CD-ROM/DVD-ROM Licensed Publisher Agreement, dated as of June 11, 2004, from Sony Computer Entertainment America Inc. to Activision, Inc. (incorporated by reference to Exhibit 10.50 of Activision's Form 10-K for the year ended March 31, 2007).
10.77	PlayStation 2 Licensed Publisher Agreement, dated as of March 23, 2001, between Sony Computer Entertainment Europe Limited and Activision UK Limited (incorporated by reference to Exhibit 10.10 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
10.78	PlayStation Portable ("PSP") Licensed PSP Publisher Agreement, dated September 15, 2004, between Sony Computer Entertainment America Inc. and Activision, Inc. (incorporated by reference to Exhibit 10.46 of Activision's Form 10-K for the year ended March 31, 2005).*
10.79	PlayStation Portable ("PSP") Licensed PSP Publisher Agreement, dated September 27, 2005, between Sony Computer Entertainment Europe Limited and Activision UK Limited (incorporated by reference to Exhibit 10.60 of Activision's Form 10-K for year ended March 31, 2006).*
10.80	Global PlayStation 3 Format Licensed Publisher Agreement, dated March 5, 2007, between Sony Computer Entertainment America, Inc. and Activision. Inc (incorporated by reference to Exhibit 10.54 of Activision's Form 10-K for the year ended March 31, 2007).*
10.81	Confidential License Agreement for the Nintendo DS (Western Hemisphere), dated as of October 11, 2004, between Nintendo Co., Ltd. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.8 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.82	First Amendment to Confidential License Agreement for Nintendo DS (Western Hemisphere), dated as of July 16, 2007, between Nintendo Co., Ltd. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.6 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.83	License Agreement for the Nintendo DS System (EEA, Australia and New Zealand), dated June 20, 2006, between Nintendo Co., Ltd. and Activision, Inc. (incorporated by reference to Exhibit 10.61 of Activision's Form 10-K for the year ended March 31, 2007).*
10.84	Confidential License Agreement for the Wii Console (Western Hemisphere), dated September 12, 2007, between Nintendo of America, Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.9 of Activision's Form 10-Q for the quarter ended September 30, 2007).*
10.85	Confidential License Agreement for the Wii Console (EEA, Australia and New Zealand), dated December 3, 2007, between Nintendo Co., Ltd., Activision, Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.8 of Activision's Form 10-Q for the quarter ended December 31, 2007).*
10.86	Microsoft Corporation Xbox 360 Publisher License Agreement, dated as of October 25, 2005, between Microsoft Licensing, GP and Activision Publishing, Inc (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended December 31, 2005).*
10.87	Xbox 360 Disc Program Addendum to the Xbox 360 Publisher License Agreement, dated as of December 15, 2005, between Microsoft Licensing, GP and Activision Publishing, Inc (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended December 31, 2005).*

10.88	Amendment to the Xbox 360 Publisher Licensing Agreement (Platinum/Classic Hits Program), dated as of October 1, 2006, by and between Microsoft Licensing, GP and Activision, Inc. (incorporated by reference to Exhibit 10.68 of Activision's Form 10-K for the year ended March 31, 2007).*
10.89	Xbox Live Server Platform Addendum to the Xbox 360 Publisher Licensing Agreement, dated as of February 6, 2007, by and between Microsoft Licensing, GP and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.69 of Activision's Form 10-K for the year ended March 31, 2007).
10.90	Chart of Compensation Paid to Non-Employee Directors (incorporated by reference to Exhibit 10.10 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.91	Voting and Lock-Up Agreement, dated as of December 1, 2007, by and among Activision, Inc., Vivendi S.A. and Robert A. Kotick (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K, filed December 6, 2007).
10.92	Voting and Lock-Up Agreement, dated as of December 1, 2007, by and among Activision, Inc., Vivendi S.A. and Brian G. Kelly (incorporated by reference to Exhibit 10.2 of Activision's Form 8-K, filed December 6, 2007).
14.1	Code of Ethics for Senior Executive and Senior Financial Officers (incorporated by reference to Exhibit 14.1 of Activision's Form 10-K for the year ended March 31, 2004).
21.1	Principal subsidiaries of Activision.
23.1	Consent of Independent Registered Public Accounting Firm.
31.1	Certification of Robert A. Kotick pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Michael Griffith pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3	Certification of Thomas Tippl pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Michael Griffith pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.3	Certification of Thomas Tippl pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1	Risk Factors from Preliminary Proxy Statement Filed by Activision on April 30, 2008.
99.2	Stipulation of Settlement, dated May 8, 2008 in In re Activision, Inc. Shareholder Derivative Litigation.
99.3	Order Preliminarily Approving Derivative Settlement and Providing for Notice, dated May 13, 2008 in In re Activision, Inc. Shareholder Derivative Litigation.

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* Portions omitted pursuant to a request for confidential treatment.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 30, 2008

ACTIVISION, INC.

By: /s/ MICHAEL GRIFFITH

Michael Griffith
President and Chief Executive Officer,
Activision Publishing, Inc.
(Principal Executive Officer)

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

By:	/s/ ROBERT A. KOTICK (Robert A. Kotick)	Chairman, Chief Executive Officer, Activision, Inc., and Director	May 30, 2008
By:	/s/ BRIAN G. KELLY (Brian G. Kelly)	Co-Chairman and Director	May 30, 2008
By:	/s/ MICHAEL GRIFFITH (Michael Griffith)	President and Chief Executive Officer of Activision Publishing, Inc. and Principal Executive Officer of Activision, Inc.	May 30, 2008
By:	/s/ THOMAS TIPPL (Thomas Tippl)	Chief Financial Officer of Activision Publishing, Inc. and Principal Financial and Accounting Officer of Activision, Inc.	May 30, 2008
By:	/s/ ROBERT J. CORTI (Robert J. Corti)	Director	May 30, 2008
By:	/s/ RONALD DOORNINK (Ronald Doornink)	Director	May 30, 2008
By:	/s/ BARBARA S. ISGUR (Barbara S. Isgur)	Director	May 30, 2008

By:	/s/ ROBERT J. MORGADO	Director	May 30, 2008
	(Robert J. Morgado)		
By:	/s/ PETER J. NOLAN	Director	May 30, 2008
	(Peter J. Nolan)		
By:	/s/ RICHARD SARNOFF	Director	May 30, 2008
	(Richard Sarnoff)		

Report of Independent Registered Public Accounting Firm

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

In our opinion, the consolidated financial statements listed in the index appearing under Item 8, present fairly, in all material respects, the financial position of Activision, Inc. and its subsidiaries at March 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2008 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 8 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of March 31, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for share-based compensation in fiscal 2007. As discussed in Note 12 to the consolidated financial statements, the Company changed the manner in which it accounts for uncertain tax positions in fiscal 2008.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

PricewaterhouseCoopers LLP
Los Angeles, California
May 30, 2008

ACTIVISION, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share data)

	As of March 31,	
	2008	2007
Assets		
Current assets:		
Cash and cash equivalents	$ 1,396,250	$ 384,409
Short-term investments	52,962	570,440
Accounts receivable, net of allowances of $129,411 and $91,418 at March 31, 2008 and 2007, respectively	203,420	148,694
Inventories	146,874	91,231
Software development	96,182	107,779
Intellectual property licenses	18,661	27,784
Deferred income taxes	41,242	51,564
Other current assets	23,804	19,332
Total current assets	1,979,395	1,401,233
Long-term investments	91,215	
Software development	13,604	23,143
Intellectual property licenses	64,890	72,490
Property and equipment, net	54,528	46,540
Deferred income taxes	32,825	48,791
Other assets	15,055	6,376
Goodwill	279,161	195,374
Total assets	$ 2,530,673	$ 1,793,947
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 129,896	$ 136,517
Accrued expenses and other liabilities	426,175	204,652
Total current liabilities	556,071	341,169
Other liabilities	26,710	41,246
Total liabilities	582,781	382,415
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, $.000001 par value, 3,750,000 shares authorized, no shares issued at March 31, 2008 and 2007		
Series A Junior Preferred stock, $.000001 par value, 1,250,000 shares authorized, no shares issued at March 31, 2008 and 2007		
Common stock, $.000001 par value and 450,000,000 shares authorized, 294,651,325 and 283,310,734 shares issued and outstanding at March 31, 2008 and 2007, respectively		
Additional paid-in capital	1,148,880	963,553
Retained earnings	772,660	427,777
Accumulated other comprehensive income	26,352	20,202
Total shareholders' equity	1,947,892	1,411,532

	As of March 31,	
Total liabilities and shareholders' equity	$ 2,530,673	$ 1,793,947

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

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ACTIVISION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

	For the fiscal years ended March 31,		
	2008	**2007**	**2006**
Net revenues	$ 2,898,136	$ 1,513,012	$ 1,468,000
Costs and expenses:			
Cost of sales product costs	1,240,605	799,587	734,874
Cost of sales software royalties and amortization	294,279	132,353	147,822
Cost of sales intellectual property licenses	110,551	46,125	57,666
Product development	269,535	133,073	132,651
Sales and marketing	308,143	196,213	283,395
General and administrative	195,409	132,514	96,366
Total costs and expenses	2,418,522	1,439,865	1,452,774
Income from operations	479,614	73,147	15,226
Investment income, net	51,254	36,678	30,630
Income before income tax provision	530,868	109,825	45,856
Income tax provision	185,985	24,038	5,605
Net income	$ 344,883	$ 85,787	$ 40,251
Basic earnings per share	$ 1.19	$ 0.31	$ 0.15
Weighted average common shares outstanding	288,957	281,114	273,177
Diluted earnings per share	$ 1.10	$ 0.28	$ 0.14
Weighted average common shares outstanding assuming dilution	314,731	305,339	294,002

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

ACTIVISION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the fiscal years ended March 31, 2008, 2007, and 2006

(Amounts in thousands)

	Common Stock						
	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned Compensation	Shareholders' Equity
Balance, March 31, 2005	**268,041**	**$**	**$ 783,917**	**$ 301,739**	**$ 11,618**	**$**	**$ 1,097,274**
Components of comprehensive income:							
Net income for the year				40,251			40,251
Unrealized appreciation on short-term investments, net of taxes					10,576		10,576
Foreign currency translation adjustment					(5,825)		(5,825)
Total comprehensive income							45,002
Issuance of common stock to employees	8,782		45,188				45,188
Stock-based compensation			2,632				2,632
Restricted stock grant			3,500			(3,500)	
Cash distribution for fractional shares	(7)		(100)				(100)
Amortization of unearned compensation						467	467
Tax benefit attributable to employee stock options and common stock warrants			29,367				29,367
Issuance of common stock to effect business combinations	205		2,793				2,793
Balance, March 31, 2006	**277,021**		**867,297**	**341,990**	**16,369**	**(3,033)**	**1,222,623**
Components of comprehensive income:							
Net income for the year				85,787			85,787
Unrealized depreciation on short-term investments, net of taxes					(8,224)		(8,224)
Foreign currency translation adjustment					12,057		12,057
Total comprehensive income							89,620
Issuance of common stock to employees	3,532		18,956				18,956
Stock-based compensation			32,077				32,077
Tax benefit attributable to employee stock options and common stock warrants			11,338				11,338
Issuance of common stock to effect business combinations	2,758		36,918				36,918
Reclassification of unearned compensation			(3,033)			3,033	
Balance, March 31, 2007	**283,311**		**963,553**	**427,777**	**20,202**		**1,411,532**
Components of comprehensive income:							
Net income for the year				344,883			344,883
Unrealized depreciation on investments, net of taxes					(1,896)		(1,896)
					8,046		8,046

	Common Stock				Accumulated Other Comprehensive Income (Loss)		
Foreign currency translation adjustment							
Total comprehensive income							351,033
Issuance of common stock pursuant to employee stock options, restricted stock rights, employee stock purchase plans and employee bonuses	9,954		49,869				49,869
Stock-based compensation expense related to employee stock options, restricted stock rights, and employee stock purchase plans			55,322				55,322
Tax benefit associated with employee stock options			57,335				57,335
Issuance of common stock to effect business combinations (see note 8)	1,386		25,864				25,864
Employee tender offer (see note 14)			(3,063)				(3,063)
Balance, March 31, 2008	**294,651**	**$**	**$ 1,148,880**	**$ 772,660**	**$ 26,352**	**$**	**$ 1,947,892**

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

ACTIVISION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

	For the fiscal years ended March 31,		
	2008	**2007**	**2006**
Cash flows from operating activities:			
Net income	$ 344,883	$ 85,787	$ 40,251
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income taxes	24,550	(44,092)	(28,453)
Depreciation and amortization	34,128	30,155	14,634
Loss on disposal of property and equipment	1,522		
Realized gain on sale of short term investments	(1,103)	(1,823)	(4,297)
Amortization and write-offs of capitalized software development costs and intellectual property licenses(1)	209,419	91,456	173,602
Stock-based compensation expense(2)	53,565	25,522	3,099
Tax benefit of stock options and warrants exercised	57,335	11,338	29,367
Excess tax benefits from stock option exercises	(57,151)	(9,012)	
Change in operating assets and liabilities (net of effects of acquisitions):			
Accounts receivable, net	(52,416)	(108,802)	80,405
Inventories	(55,643)	(26,124)	(13,465)
Software development and intellectual property licenses	(168,768)	(166,138)	(193,927)
Other assets	(11,816)	7,294	(2,038)
Accounts payable	(6,497)	41,115	(19,985)
Accrued expenses and other liabilities	201,492	90,486	6,814
Net cash provided by operating activities	573,500	27,162	86,007
Cash flows from investing activities:			
Cash used in business acquisitions (net of cash acquired)	(68,797)	(30,545)	(6,890)
Capital expenditures	(29,400)	(17,935)	(30,406)
Proceeds from disposal of property and equipment	243		
Increase in restricted cash	(4,050)		(7,500)
Purchase of investments	(556,643)	(479,533)	(242,568)
Proceeds from sales and maturities of investments	984,938	492,771	201,568
Net cash provided by (used in) investing activities	326,291	(35,242)	(85,796)
Cash flows from financing activities:			
Proceeds from issuance of common stock to employees and common stock pursuant to warrants	48,012	18,956	45,088
Excess tax benefits from stock option exercises	57,151	9,012	
Net cash provided by financing activities	105,163	27,968	45,088
Effect of exchange rate changes on cash	6,887	10,190	(4,576)
Net increase in cash and cash equivalents	1,011,841	30,078	40,723
Cash and cash equivalents at beginning of period	384,409	354,331	313,608
Cash and cash equivalents at end of period	$ 1,396,250	$ 384,409	$ 354,331

	For the fiscal years ended March 31,		

(1)
Excludes amortization of stock-based compensation expense.

(2)
Includes the net effects of capitalization and amortization of stock-based compensation expense.

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

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Business

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

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

We maintain operations in the United States, Canada, the United Kingdom ("UK"), Germany, France, Italy, Spain, Japan, Australia, Sweden, South Korea, Norway, and the Netherlands. In fiscal 2008, operations outside of North America contributed approximately 39% of consolidated net revenues.

Principles of Consolidation

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

Cash, Cash Equivalents, and Investments

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

Short-term investments generally mature between three and thirty months. Investments with maturities beyond one year may be classified as short-term based on their liquid nature and because such securities represent the investment of cash that is available for current operations. All other investments that are not classified as short-term are classified as long-term investments. All of our investments are classified as available-for-sale and are carried at fair market value with unrealized appreciation (depreciation) reported, net of taxes, as a component of accumulated other comprehensive income (loss) in shareholders' equity. The specific identification method is used to determine the cost of securities disposed with realized gains and losses reflected in investment income, net.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

Restricted Cash Compensating Balances

We maintained an irrevocable standby letter of credit in the amount of a $10.0 million as of March 31, 2008 and $7.5 million as of March 31, 2007. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. Under the terms of this arrangement, we are required to maintain with the issuing bank a compensating balance, restricted as to use, of not less than the sum of the available amount of the letter of credit plus the aggregate amount of any drawings under the letter of credit that have been honored thereunder but not reimbursed. At March 31, 2008 and 2007, $11.6 million and $7.5 million, respectively, of restricted cash is included in short-term investments, most of which is related to that standby letter of credit.

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, 2008, 2007, and 2006, we had deposits in excess of the Federal Deposit Insurance Corporation ("FDIC") limit at these financial institutions.

Our customer base includes retail outlets and distributors, including mass-market retailers, consumer electronics stores, discount warehouses, and game specialty stores in the United States and countries worldwide. We perform ongoing credit evaluations of our customers and maintain allowances for potential credit losses. We generally do not require collateral or other security from our customers. We had two customers, Wal-Mart and GameStop, that accounted for 14% and 13% of consolidated net revenues for the fiscal year ended March 31, 2008 and 17% and 10% of consolidated gross accounts receivable at March 31, 2008, respectively. These customers were customers of both our publishing and distribution businesses. We had two customers, Wal-Mart and Gamestop, that accounted for 22% and 8% of consolidated net revenues for the year ended March 31, 2007 and 26% and 6% of consolidated gross accounts receivable at March 31, 2007, respectively. For the fiscal year ended March 31, 2006, our two largest customers, Wal-Mart and GameStop, accounted for 22% and 10% of consolidated net revenues, respectively.

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.

Cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses have been recorded at the fair value due to their short-term nature. Short-term investments are carried at fair value with fair values estimated based on quoted market prices. Long-term investments are comprised of AAA-rated student loan backed taxable auction rate securities. On an industry-wide basis, many auctions have failed, including those for our auction rate securities, and as of yet, a meaningful secondary market for these instruments has not emerged. As a result, quoted market prices are not available, and we estimated the fair market value using valuation models, which take into account both

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

observable market data and non-observable factors including credit quality, duration, insurance wraps, collateral composition, maximum rate formulas, comparable trading instruments, and likelihood of redemption. Accordingly, we consider the values generated by such valuation models to represent management's best estimate of fair value for the purposes of applying the Statement of Financial Accounting Standards No. 115 *Accounting for Certain Investments in Debt and Equity Securities*.

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

We utilize forward contracts in order to reduce financial market risks. These instruments are used to hedge foreign currency exposures of underlying assets or liabilities. Our accounting policies for these instruments are based on whether they meet the criteria for designation as hedging transactions. Changes in fair value of derivatives that are designated as cash flow hedges, are highly effective, and qualify as hedging instruments, are recorded in other comprehensive income until the underlying hedged item is recognized in earnings. Any ineffective portion of a derivative's 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, 2008, we had no outstanding foreign exchange forward contracts. As of March 31, 2007, accrued expenses included approximately $90,000 of pre-tax unrealized losses for the estimated fair value of outstanding foreign currency exchange forward contracts.

Software Development Costs and Intellectual Property Licenses

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

We account for software development costs in accordance with Statement of Financial Accounting Standards No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*. Software development costs are capitalized once the technological feasibility of a product is established and such costs are determined to be recoverable. Technological feasibility of a product encompasses both technical design documentation and game design documentation. Significant management judgments and estimates are utilized in the assessment of when technological feasibility is established. For products where proven technology exists, this may occur early in the development cycle. Technological feasibility is evaluated on a product-by-product basis. Prior to a product's release, we expense, as part of "cost of sales software royalties and amortization," capitalized costs when we believe such amounts are not recoverable. Capitalized costs for those products that are cancelled or abandoned are charged to product development expense in the period of cancellation. Amounts related to software development which are not capitalized are charged immediately to product development expense.

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 for the specific product, generally resulting in an amortization period of six months or less.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks, copyrights, software, technology, music or other intellectual property or proprietary rights in the development of our products. Depending upon the agreement with the rights holder, we may obtain the rights to use acquired intellectual property in multiple products over multiple years, or alternatively, for a single product. Prior to the related product's release, we expense, as part of "cost of sales intellectual property licenses," capitalized intellectual property costs when we believe such amounts are not recoverable. Capitalized intellectual property costs for those products that are cancelled or abandoned are charged to product development expense in the period of cancellation.

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

We evaluate the future recoverability of capitalized software development costs and intellectual property licenses on a quarterly basis. For products that have been released in prior periods, the primary evaluation criterion is actual title performance. For products that are scheduled to be released in future periods, recoverability is evaluated based on the expected performance of the specific products to which the costs relate or in which the licensed trademark or copyright is to be used. Criteria used to evaluate expected product performance include: historical performance of comparable products developed with comparable technology; orders for the product prior to its release; and, for any sequel product, estimated performance based on the performance of the product on which the sequel is based. Further, 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.

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

Inventories

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

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

Property and Equipment

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

Goodwill and Other Intangible Assets

We account for goodwill using the provisions of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*. ("SFAS No. 142.") Under SFAS No. 142, goodwill is deemed to have an indefinite useful life and is not amortized but rather tested at least annually for impairment at the reporting unit level. An impairment loss is recognized if the carrying amount of goodwill is not recoverable and its carrying amount exceeds its fair value. Our impairment tests as of March 31, 2008, 2007, and 2006 did not indicate that goodwill was impaired. Our reporting units are determined based on the guidance provided by SFAS No. 142 and EITF Issue D-101 "Clarification of Reporting Unit Guidance in Paragraph 30 of SFAS No. 142," and at March 31, 2008 consisted of our publishing and distribution operating segments. In accordance with SFAS No. 142, we have not amortized goodwill during the fiscal years ended March 31, 2008, 2007, and 2006. SFAS No. 142 also requires that intangible assets with definite lives be amortized over their estimated useful lives and reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets* ("SFAS No. 144") when events or circumstances indicate that the carrying value may not be recoverable. The Company determined there was no impairment of intangible assets for the years ended March 31, 2008, 2007, and 2006.

Revenue Recognition

We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers, and once any performance obligations have been completed. Certain products are sold to customers with a street date (the earliest date these products may be sold by retailers). For these products we recognize revenue on the later of the street date or the sale date. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection. With respect to license agreements that provide customers the right to make multiple copies in exchange for guaranteed amounts, revenue is recognized upon delivery of a master copy. Per copy royalties on sales that exceed the guarantee are recognized as earned. Some of our software products provide limited online features at no additional cost to the consumer. Generally, we consider such features to be incidental to the overall product offering and an inconsequential deliverable. Accordingly, we do not defer any revenue related to products containing these limited online features. In instances where online features or additional functionality is considered a substantive deliverable in addition to the software product, we take this into account when applying our revenue recognition policy. This evaluation is performed for each software product when it is released. In fiscal 2008, we determined that one of our software titles, *Enemy Territory: Quake Wars* (which is primarily an online multiplayer personal computer ("PC") game), contains online functionality that constitutes a more-than-inconsequential separate service deliverable in addition to the product, principally because of its importance to game play. As such, our performance obligations for this title extend beyond the sale

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

of the game, which is unique compared to other previously released titles. Vendor-specific objective evidence of fair value ("VSOE") does not exist for the online functionality, as we do not separately charge for this component of the title. As a result, we are recognizing all of the revenue from the sale of this title ratably over an estimated service period, which is currently estimated to be six months beginning the month after shipment. In addition, we are deferring the costs of sales for this title, which includes: manufacturing costs, software royalties and amortization, and intellectual property licenses. Overall, online play functionality is still an emerging area for us. As we move forward, we will monitor this developing functionality and its significance for our products.

With respect to online transactions, such as electronic downloads of titles or product add-ons, revenue is recognized when the fee is paid by the online customer to purchase online content and we are notified by the online retailer that the product has been downloaded. In addition, in order to recognize revenue for both product sales and licensing transactions, persuasive evidence of an arrangement must exist and collection of the related receivable must be probable.

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

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

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

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

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

channel inventory; absolute quantity of on-hand retail channel inventory; our warehouse on-hand inventory levels; the title's recent sell-through history (if available); marketing trade programs; and competing titles. The relative importance of these factors varies among titles depending upon, among other items, genre, platform, seasonality, and sales strategy. Significant management judgments and estimates must be made and used in connection with establishing the allowance for returns and price protection in any accounting period. Based upon historical experience we believe our estimates are reasonable. However, actual returns and price protection could vary materially from our allowance estimates due to a number of reasons including, among others, a lack of consumer acceptance of a title, the release in the same period of a similarly themed title by a competitor, or technological obsolescence due to the emergence of new hardware platforms. Material differences may result in the amount and timing of our revenue for any period if factors or market conditions change or if management makes different judgments or utilizes different estimates in determining the allowances for returns and price protection. For example, a 1% change in our March 31, 2008 allowance for returns and price protection would impact net revenues by $1.3 million.

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

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

Shipping and Handling

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

Advertising Expenses

We expense advertising as incurred, except for production costs associated with media advertising which are deferred and charged to expense the first time the related ad is run. Advertising expenses for the fiscal years ended March 31, 2008, 2007, and 2006 were approximately $180.3 million, $98.4 million, and $192.6 million, respectively, and are included in sales and marketing expense in the Consolidated Statements of Operations.

Income Taxes

We account for income taxes using Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ("SFAS No. 109.") 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

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Foreign Currency Translation

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

Comprehensive Income

Comprehensive income includes net income, unrealized appreciation (depreciation) on short-term and long-term investments and foreign currency translation adjustments.

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. However, potential common shares are not included in the denominator of the diluted earnings per share calculation when inclusion of such shares would be anti-dilutive, such as in a period in which a net loss is recorded.

Stock-Based Compensation

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

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

We adopted SFAS No. 123R using the modified prospective transition method, which requires the application of the accounting standard as of April 1, 2006, the first day of our fiscal 2007. Therefore, commencing from our fiscal 2007, the Company's Consolidated Financial Statements reflect the impact of SFAS No. 123R. The Company's Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123R in accordance with the modified prospective transition method. See Note 14 for additional information.

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

SFAS No. 123R requires companies to estimate the fair value of share-based payment awards on the measurement date using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Consolidated Statement of Operations. Stock-based compensation expense recognized under SFAS No. 123R for the fiscal years ended March 31, 2008 and March 31, 2007 was $53.6 million and $25.5 million, respectively. Prior to the adoption of SFAS No. 123R, the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB No. 25 as allowed under Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ("SFAS No. 123.") Under APB No. 25, compensation expense was recorded for the issuance of stock options and other stock-based compensation based on the intrinsic value of the stock options and other stock-based compensation on the date of grant or measurement date. Under the intrinsic value method, compensation expense was recorded on the measurement date only if the current market price of the underlying stock exceeded the stock option or other stock-based award's exercise price. For the fiscal year ended March 31, 2006, we recognized $3.1 million in stock-based compensation expense related to employee stock options and restricted stock, under APB No. 25. See Note 14 for additional information.

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in our Consolidated Statements of Operations for the fiscal year ended March 31, 2008 includes compensation expense for share-based payment awards granted prior to, but not yet vested as of, April 1, 2006 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 123, and compensation expense for the share-based payment awards granted subsequent to April 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. As stock-based compensation expense recognized in the Consolidated Statements of Operations for the fiscal year ended March 31, 2008 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Investment Income, Net

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

	For the fiscal years ended March 31,		
	2008	2007	2006
Interest income	$ 50,289	$ 34,952	$ 26,595
Interest expense	(138)	(97)	(262)
Net realized gain on investments	1,103	1,823	4,297
Investment income, net	$ 51,254	$ 36,678	$ 30,630

3. Acquisitions

Bizarre Creations

On September 26, 2007, we acquired 100% of Bizarre Creations Limited ("Bizarre Creations") for an aggregate purchase price of $67.4 million in cash. In addition, in the event that certain financial performance measures of Bizarre Creations' business over a certain period of time (currently estimated to be 5 years from fiscal 2008) exceed specified target levels, the former shareholders of Bizarre Creations will be entitled to an additional amount of up to $40.0 million payable in shares of our common stock. The contingent consideration will be recorded as an addition to the purchase price if the specified target levels are met. Based in the United Kingdom (the "UK,") Bizarre Creations is a video game developer focusing on the racing category with its multi-million unit selling franchise Project Gotham Racing, a series for the Microsoft Xbox and the Microsoft Xbox360 platforms. Bizarre Creations has also developed and owns the Geometry Wars intellectual property. We expect that Bizarre Creations will play a role in our growth strategy as we develop intellectual property for the racing genre, expand our development capability and capacity for other genres and utilize Bizarre Creations' proprietary development technology.

The results of operations of Bizarre Creations and the estimated fair market values of the acquired assets and liabilities have been included in our Consolidated Financial Statements since the date of acquisition. Pro forma consolidated statements of operations for this acquisition are not shown, as they would not differ materially from reported results. The acquired finite-lived intangible assets are being amortized over the estimated useful lives in proportion to the economic benefits consumed, which for some intangible assets are approximated by using the straight-line method. Goodwill has been included in the publishing segment of our business and is amortized over 15 years for tax purposes.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

3. Acquisitions (Continued)

Purchase Price Allocation

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

Current assets	$ 4,352
Property and equipment, net	2,203
Goodwill	55,833
Trademark, acquired contracts and acquired technologies	9,500
Deferred tax liability	(1,876)
Other liabilities	(2,639)
Total consideration	$ 67,373

Purchased Intangible Assets

The following table presents the components of the purchased finite-lived intangible assets acquired in the Bizarre Creations acquisition (amounts in thousands):

	Estimated Useful Life (in years)	Amount
Finite-lived intangibles:		
Trademark	8	$ 1,100
Acquired contracts	0.5	2,800
Acquired technologies	1 - 5	5,600
Total finite-lived intangibles		$ 9,500

The following table presents the gross and net balances, and accumulated amortization of the components of our purchased finite-lived intangible assets acquired in the Bizarre Creations acquisition as of March 31, 2008 (amounts in thousands):

	Gross	Accumulated Amortization	Effect of foreign currency rates	Net
Trademark	$ 1,100	$	$ (27)	$ 1,073
Acquired contracts	2,800	(2,767)	(33)	
Acquired technologies	5,600	(690)	(130)	4,780
Total	$ 9,500	$ (3,457)	$ (190)	$ 5,853

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

3. Acquisitions (Continued)

The estimated future amortization expense of our purchased finite-lived intangible assets acquired in the Bizarre Creations acquisition as of March 31, 2008 is as follows (amounts in thousands):

Fiscal years ending March 31,	Amount
2009	$ 683
2010	1,125
2011	1,500
2012	1,125
2013	750
Thereafter	670
Total	$ 5,853

DemonWare

On May 11, 2007, we completed our acquisition of DemonWare, Ltd., a provider of network middleware technologies for console and PC games headquartered in Dublin, Ireland. We expect the acquisition to enable us to gain efficiencies related to online game development and to position us to take advantage of the growth in online gameplay that is expected to be driven by the next-generation consoles. The acquisition is immaterial to fiscal 2008 earnings per share and cash flow.

RedOctane, Inc.

On June 6, 2006, we completed our acquisition of 100% of RedOctane, Inc. ("RedOctane") for an aggregate accounting purchase price of $99.9 million, including transaction costs, consisting of $30.9 million in cash and 2,382,077 shares of Activision common stock valued at approximately $30.0 million based upon prevailing market prices which was issued on the closing date, and $39.0 million payable in Activision common stock within two years of the closing date, which is recorded in accrued expenses and other liabilities at March 31, 2008 and in other liabilities at March 31, 2007. In addition, in the event the net income of the business over a certain period of time exceeds specified target levels by certain amounts, certain former shareholders of RedOctane will be entitled to an additional amount of up to $51.0 million payable in shares of Activision common stock. The contingent consideration will be recorded as an additional element of the purchase price if those contingencies are achieved. We issued part of the contingent considerations in fiscal 2008 as the contingency was achieved (see Note 8 for additional information.) Based in Sunnyvale, California, RedOctane is a publisher, developer, and distributor of interactive entertainment software, hardware and accessories. RedOctane offers its interactive entertainment products in versions that operate on the PS2, Xbox 360, and PC, and its leading software product offering is Guitar Hero. RedOctane also designs, manufactures, and markets high quality video game peripherals and accessories.

The results of operations of RedOctane and the estimated fair market values of the acquired assets and liabilities have been included in the Consolidated Financial Statements since the date of acquisition. The acquired, finite-lived intangible assets are being amortized over estimated lives ranging from 0.6 to 1.6 years. Goodwill has been included in the publishing segment of our business and is non-deductible for tax purposes.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

3. Acquisitions (Continued)

Purchase Price Allocation

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

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

Purchased Intangible Assets

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

	Estimated Useful Life (in years)	Amount
Finite-lived intangibles:		
Trademark	1.3	$ 1,000
Development-related intangibles	0.6-1.6	15,700
Total finite-lived intangibles		$ 16,700

At March 31, 2008, the purchased finite-lived intangible assets acquired in the RedOctane acquisition were fully amortized. At March 31, 2007, the net purchased finite-lived intangible assets were $5.0 million which were included in other current assets.

During the three years ended March 31, 2008, we separately completed the acquisition of other three privately held interactive software development companies. We accounted for these acquisitions in accordance with SFAS No. 141, which addresses financial accounting and reporting for business combinations, requiring that the purchase method be used to account and report for all business combinations. These acquisitions have further enabled us to implement our multi-platform development strategy by bolstering our internal product development capabilities for console systems and personal computers and strengthening our position in the first-person action, action/adventure, music-based gaming and action sports game categories. A significant portion of the purchase price for all of these acquisitions was assigned to goodwill as the primary asset that 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 all of these acquisitions in aggregate are not shown, as they would not differ materially from each year's reported results.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

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

The following table summarizes our cash, cash equivalents, short-term and long-term investments as of March 31, 2008 (amounts in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash and time deposits	$ 266,270	$	$	$ 266,270
Money market instruments	1,129,980			1,129,980
Cash and cash equivalents	1,396,250			1,396,250
Short-term investments:				
U.S. agency issues	7,168	45		7,213
Corporate bonds	17,031	71		17,102
Mortgage-backed securities	11,927	5	(332)	11,600
Commercial paper	5,493	3		5,496
Restricted cash	11,551			11,551
Short-term investments	53,170	124	(332)	52,962
Cash, cash equivalents and short-term investments	$ 1,449,420	$ 124	$ (332)	$ 1,449,212
Long-term investments:				
Taxable auction rate notes	95,538		(4,323)	91,215
	$ 95,538	$	$ (4,323)	$ 91,215
Total cash, cash equivalent, short-term and long-term investments	$ 1,544,958	$ 124	$ (4,655)	$ 1,540,427

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

4. Cash, Cash Equivalents, Short-Term and Long-Term Investments (Continued)

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash and time deposits	$ 187,594	$	$	$ 187,594
Commercial paper	86,776		(34)	86,742
Money market instruments	106,986			106,986
Corporate bonds	3,087			3,087
Cash and cash equivalents	384,443		(34)	384,409
Short-term investments:				
U.S. agency issues	191,840	8	(1,011)	190,837
Corporate bonds	103,006	39	(148)	102,897
Mortgage-backed securities	33,142		(199)	32,943
Taxable auction rate notes	114,698			114,698
Asset-backed securities	7,754	2	(7)	7,749
Commercial paper	92,018		(67)	91,951
Certificate of deposit	21,866	2	(3)	21,865
Restricted cash	7,500			7,500
Short-term investments	571,824	51	(1,435)	570,440
Cash, cash equivalents and short-term investments	$ 956,267	$ 51	$ (1,469)	$ 954,849

In accordance with EITF 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* and FSP SFAS No. 115-1 and SFAS No. 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* investments are reviewed periodically to identify possible impairment. When evaluating the investments, the Company reviews factors such as the length of time and extent to which fair value has been below the cost basis, the financial condition of the issuer, and the Company's ability and intent to hold the investment for a period of time which may be an amount of time sufficient to recover the anticipated market value. The following table illustrates the gross unrealized losses on securities available-for-sale and the fair value of those securities, aggregated by investment category as of March 31, 2008. The table also illustrates the length of time that they have been in a continuous unrealized loss position as of March 31, 2008 (amounts in thousands):

	Less than 12 months		12 months or more		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Taxable auction rate notes	$ (4,323)	$ 91,215	$	$	$ (4,323)	$ 91,215
Mortgage-backed securities	(2)	1,890	(330)	5,322	(332)	7,212
Total temporarily impaired securities	$ (4,325)	$ 93,105	$ (330)	$ 5,322	$ (4,655)	$ 98,427

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

4. Cash, Cash Equivalents, Short-Term and Long-Term Investments (Continued)

Our investment portfolio usually consists of government and corporate securities with effective maturities of less than 30 months, except for auction rate securities classified as long-term investments as of March 31, 2008 that have stated maturities of up to 39 years. The $4.7 million gross unrealized losses on securities available-for-sale represents 0.3% of total investments and cash and cash equivalents at amortized cost. These unrealized losses consist primarily of individual securities with unrealized losses of less than 10% of each security's amortized cost. The unrealized loss position of approximately $0.3 million of more than 12 months relates to a mortgage-backed security with a decline of approximately 6% of amortized cost.

Based upon our analysis of the impaired securities, which includes consideration of the status of debt servicing, the financial condition of the issuer, and our intent and ability to hold the securities until they mature or recover their costs, we have concluded that the gross unrealized losses of $4.7 million at March 31, 2008 were temporary in nature. We have the intent and ability to hold these securities for a period of time sufficient for a recovery of fair value up to (or beyond) the initial cost of the investment. We expect to realize the full value of all of these investments upon maturity or sale. However, facts and circumstances may change which could result in a decline in fair value considered to be other-than-temporary in the future.

The following table illustrates the gross unrealized losses on securities available-for-sale and the fair value of those securities, aggregated by investment category as of March 31, 2007. The table also illustrates the length of time that they have been in a continuous unrealized loss position as of March 31, 2007 (amounts in thousands):

	Less than 12 months		12 months or more		Total	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
U.S. agency issues	$ (23)	$ 17,146	$ (988)	$ 162,505	$ (1,011)	$ 179,651
Corporate bonds	(123)	57,285	(25)	12,796	(148)	70,081
Commercial paper	(100)	178,694			(100)	178,694
Taxable auction rate notes		10,006				10,006
Mortgage-backed securities	(126)	19,994	(80)	18,784	(206)	38,778
Asset-backed securities				64		64
Certificate of deposit	(4)	18,936			(4)	18,936
Total temporarily impaired securities	$ (376)	$ 302,061	$ (1,093)	$ 194,149	$ (1,469)	$ 496,210

The increase from March 31, 2007 to March 31, 2008 in the total unrealized losses is predominantly due to the taxable auction rate notes category and relates primarily to the recent failed auctions. All of our investments in auction rate securities were classified as long-term investments at March 31, 2008 due to the recent failed auctions and uncertainties of the timing of liquidation. Our investments in auction rate securities are all backed by higher education student loans.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

4. Cash, Cash Equivalents, Short-Term and Long-Term Investments (Continued)

The following table summarizes the contractually stated maturities of our investments in corporate bonds, commercial paper, and U.S. agency issues as of March 31, 2008 (amounts in thousands):

	Amortized Cost	Fair Value
Due after one year or less	$ 26,615	$ 26,669
Due after one year through two years	3,077	3,142
Due after two years through three years		
	$ 29,692	$ 29,811

For the years ended March 31, 2008, 2007, and 2006 gross realized gains on investments were $1.5 million, $1.8 million, and $4.3 million, respectively. Gross realized losses were $0.4 million for the year ended March 31, 2008, and zero for the years ended March 31, 2007 and 2006. The proceeds from the sale of available-for-sale securities were $193.0 million, $4.0 million, and $27.4 million for the years ended March 31, 2008, 2007, and 2006, respectively.

5. Software Development Costs and Intellectual Property Licenses

As of March 31, 2008, capitalized software development costs included $97.8 million of internally developed software costs and $12.0 million of payments made to third-party software developers. As of March 31, 2007, capitalized software development costs included $94.3 million of internally developed software costs and $36.6 million of payments made to third-party software developers. Capitalized intellectual property licenses were $83.6 million and $100.3 million as of March 31, 2008 and 2007, respectively. Amortization and write-offs of capitalized software development costs and intellectual property licenses, including capitalized stock-based compensation expense, was $220.3 million, $94.0 million, and $173.6 million for the years ended March 31, 2008, 2007, and 2006, respectively.

6. Inventories

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

	As of March 31,	
	2008	2007
Finished goods	$ 144,549	$ 89,048
Purchased parts and components	2,325	2,183
	$ 146,874	$ 91,231

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

7. Property and Equipment, Net

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

	As of March 31,	
	2008	2007
Land	$ 722	$ 612
Buildings	5,818	4,915
Leasehold improvements	25,895	19,816
Computer equipment	74,700	61,382
Office furniture and other equipment	25,439	19,879
Total cost of property and equipment	132,574	106,604
Less accumulated depreciation	(78,046)	(60,064)
Property and equipment, net	$ 54,528	$ 46,540

Depreciation expense for the years ended March 31, 2008, 2007, and 2006 was $23.3 million, $17.8 million, and $14.2 million, respectively.

8. Goodwill

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

	Publishing	Distribution	Total
Balance as of March 31, 2006	$ 95,094	$ 5,352	$ 100,446
Goodwill acquired during the year	87,257		87,257
Issuance of contingent consideration	6,918		6,918
Adjustment-prior period purchase allocation	51		51
Effect of foreign currency exchange rates	22	680	702
Balance as of March 31, 2007	189,342	6,032	195,374
Goodwill acquired during the year	58,609		58,609
Issuance of contingent consideration	25,864		25,864
Adjustment-prior period purchase allocation	(318)		(318)
Effect of foreign currency exchange rates	(430)	62	(368)
Balance as of March 31, 2008	$ 273,067	$ 6,094	$ 279,161

Goodwill acquired during the year represents goodwill of $55.8 million and $2.8 million related to the acquisitions of Bizarre Creations and DemonWare, respectively. See Note 3 for additional information. Issuance of contingent consideration consists of additional purchase consideration related to the acquisition of RedOctane Inc. and Vicarious Visions Inc. for $22.7 million and $3.1 million, respectively, which was paid in shares of our common stock.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

9. Accrued Expenses and Other Liabilities

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

	As of March 31,	
	2008	**2007**
Accrued royalties payable	$ 43,894	$ 21,583
Accrued selling and marketing costs	51,174	23,909
Common stock payable RedOctane	39,000	
Income tax payable	83,953	55,530
Accrued payroll related costs	125,279	63,249
Accrued professional and legal costs	49,827	9,494
Other	33,048	30,887
Total accrued expenses	$ 426,175	$ 204,652

10. Operations by Reportable Segments and Geographic Area

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

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

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

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, 2008 is as follows (amounts in thousands):

	For the year ended March 31, 2008		
	Publishing	**Distribution**	**Total**
Total segment revenues	$ 2,645,494	$ 392,970	$ 3,038,464
Revenue from sales between segments	(140,328)		(140,328)
Revenues from external customers	$ 2,505,166	$ 392,970	$ 2,898,136
Operating income	$ 461,718	$ 17,896	$ 479,614
Total assets	$ 2,371,661	$ 159,012	$ 2,530,673

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

10. Operations by Reportable Segments and Geographic Area (Continued)

	For the year ended March 31, 2007		
	Publishing	**Distribution**	**Total**
Total segment revenues	$ 1,199,764	$ 393,974	$ 1,593,738
Revenue from sales between segments	(80,726)		(80,726)
Revenues from external customers	$ 1,119,038	$ 393,974	$ 1,513,012
Operating income	$ 64,076	$ 9,071	$ 73,147
Total assets	$ 1,618,195	$ 175,752	$ 1,793,947

	For the year ended March 31, 2006		
	Publishing	**Distribution**	**Total**
Total segment revenues	$ 1,286,294	$ 313,337	$ 1,599,631
Revenue from sales between segments	(131,631)		(131,631)
Revenues from external customers	$ 1,154,663	$ 313,337	$ 1,468,000
Operating income (loss)	$ (6,715)	$ 21,941	$ 15,226
Total assets	$ 1,293,014	$ 125,241	$ 1,418,255

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

	For the years ended March 31,		
	2008	**2007**	**2006**
North America	$ 1,761,753	$ 753,376	$ 710,040
Europe	1,037,257	718,973	717,494
Other	99,126	40,663	40,466
Total	$ 2,898,136	$ 1,513,012	$ 1,468,000

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

	For the years ended March 31,		
	2008	**2007**	**2006**
Console	$ 2,398,593	$ 1,125,457	$ 1,008,758

	For the years ended March 31,		
Hand-held	314,217	275,650	235,834
PC	185,326	111,905	223,408
Total	$ 2,898,136	$ 1,513,012	$ 1,468,000

A significant portion of our revenues is derived from products based on a relatively small number of popular franchises each year. In fiscal 2008, 65% of our consolidated net revenues and 75% of worldwide publishing net revenues were derived from three franchises. In fiscal 2007, 39% of our consolidated net revenues and 52% of worldwide publishing net revenues were derived from three franchises. In fiscal 2006, 30% of our consolidated net revenues and 38% of worldwide publishing net revenues were derived from three franchises.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

10. Operations by Reportable Segments and Geographic Area (Continued)

We had two customers, Wal-Mart and GameStop, that accounted for 14% and 13% of consolidated net revenues for the fiscal year ended March 31, 2008 and 17% and 10% of consolidated gross accounts receivable at March 31, 2008, respectively. These customers were customers of both our publishing and distribution businesses. We had two customers, Wal-Mart and Gamestop, that accounted for 22% and 8% of consolidated net revenues for the year ended March 31, 2007 and 26% and 6% of consolidated gross accounts receivable at March 31, 2007, respectively. For the fiscal year ended March 31, 2006, our two largest customers, Wal-Mart and GameStop, accounted for 22% and 10% of consolidated net revenues, respectively.

11. Computation of Earnings Per Share

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

	For the years ended March 31,		
	2008	**2007**	**2006**
Numerator:			
Numerator for basic and diluted earnings per share income available to common shareholders	$ 344,883	$ 85,787	$ 40,251
Denominator:			
Denominator for basic earnings per share weighted average common shares outstanding	288,957	281,114	273,177
Effect of dilutive securities:			
Employee stock options and stock purchase plan	25,062	23,611	20,232
Warrants to purchase common stock	712	614	593
Potential dilutive common shares	25,774	24,225	20,825
Denominator for diluted earnings per share weighted average common shares outstanding plus assumed conversions	314,731	305,339	294,002
Basic earnings per share	$ 1.19	$ 0.31	$ 0.15
Diluted earnings per share	$ 1.10	$ 0.28	$ 0.14

Options to purchase approximately 7.1 million, 7.9 million, and 1.0 million shares of common stock for the years ended March 31, 2008, 2007, and 2006, respectively, were not included in the calculation of diluted earnings per share because their effect would be antidilutive.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

12. Income Taxes

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

	For the years ended March 31,		
	2008	**2007**	**2006**
Income (loss) before income taxes:			
Domestic	$ 463,792	$ 99,210	$ 52,321
Foreign	67,076	10,615	(6,465)
	$ 530,868	$ 109,825	$ 45,856
Income tax expense (benefit):			
Current:			
Federal	$ 87,126	$ 34,342	$
State	8,659	15,325	308
Foreign	9,820	3,842	4,383
Total current	105,605	53,509	4,691
Deferred:			
Federal	11,040	(17,074)	(11,095)
State	5,873	(19,608)	(7,266)
Foreign	6,132	(4,127)	(10,092)
Total deferred	23,045	(40,809)	(28,453)
Add back benefit credited to additional paid-in capital:			
Tax benefit related to stock option and warrant exercises	57,335	11,338	29,367
Income tax provision	$ 185,985	$ 24,038	$ 5,605

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

	For the years ended March 31,		
	2008	**2007**	**2006**
Federal income tax provision at statutory rate	35.0%	35.0%	35.0%
State taxes, net of federal benefit	3.6	4.1	4.3
Research and development credits	(3.8)	(8.5)	(36.2)
Decremental effect of foreign tax rates	(0.6)	(3.6)	(10.5)
Increase (decrease) in valuation allowance		(26.6)	18.0
Increase (decrease) in tax reserves	1.1	18.8	(2.2)
Other	(0.3)	2.7	3.8

For the years ended March 31,		
35.0%	21.9%	12.2%

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ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

12. Income Taxes (Continued)

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 assets are as follows (amounts in thousands):

	As of March 31,	
	2008	**2007**
Deferred tax assets:		
Allowance for doubtful accounts	$ 421	$ 369
Allowance for sales returns and price protection	18,835	14,094
Inventory reserve	894	1,507
Accrued payroll related costs	12,732	5,996
Accrued professional and legal costs	17,913	2,901
Amortization and depreciation	5,293	1,566
Tax credit carryforwards	25,619	89,014
Net operating loss carryforwards	1,740	29,822
Stock-based compensation	30,058	11,879
Other	15,394	6,057
Deferred tax assets	128,899	163,205
Valuation allowance	(382)	(382)
Deferred tax assets, net of valuation allowance	128,517	162,823
Deferred tax liabilities:		
Capitalized development expenses	43,766	50,159
State taxes	10,684	12,309
Deferred tax liabilities	54,450	62,468
Net deferred tax assets	$ 74,067	$ 100,355

As of March 31, 2008, our available federal net operating loss carryforward of approximately $1.0 million is subject to certain limitations as defined under Section 382 of the Internal Revenue Code. The net operating loss carryforwards will begin to expire in 2023. We have various state net operating loss carryforwards totaling $14.4 million which are not subject to limitations under Section 382 of the Internal Revenue Code and will begin to expire in 2013. We have tax credit carryforwards of $0.8 million and $24.6 million for federal and state purposes, respectively, which begin to expire in fiscal 2016.

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 assets will be realized.

Cumulative undistributed earnings of foreign subsidiaries for which no deferred taxes have been provided approximated $168.1 million at March 31, 2008. Deferred income taxes on these earnings have not been provided as these amounts are considered to be permanent in duration.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

12. Income Taxes (Continued)

We adopted the provisions of Financial Accounting Standards Board Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* ("FIN 48") an interpretation of SFAS No. 109 on April 1, 2007. Implementation of FIN 48 did not result in a material adjustment to the liability for unrecognized income tax benefits. At the adoption date of April 1, 2007, we had $65.5 million of unrecognized tax benefits, of which $26.2 million would affect our effective tax rate if recognized. As of March 31, 2008, we had approximately $74.2 million in total unrecognized tax benefits of which $30.0 million would affect our effective tax rate if recognized. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (amounts in thousands):-

Unrecognized tax benefits balance at April 1, 2007	$ 65,472
Gross increase for tax positions of prior years	3,370
Gross decrease for tax positions of prior years	(697)
Gross increase for tax positions of current year	6,032
Gross decrease for tax positions of current year	
Settlements	
Lapse of statute of limitations	
Unrecognized tax benefits balance at March 31, 2008	$ 74,177

In addition, consistent with the provisions of FIN 48, we reclassified $23.5 million of income tax liabilities from current to non-current liabilities because payment of cash or settlement is not anticipated within one year of the balance sheet date. These non-current income tax liabilities are recorded in other liabilities in the Consolidated Balance Sheets as of March 31, 2008.

We recognize interest and penalties related to uncertain tax positions in income tax expense. As of March 31, 2008, we had approximately $609,000 of accrued interest related to uncertain tax positions. For the year ended March 31, 2008, we recorded $69,000 of interest expense related to uncertain tax positions.

The tax years 2002 through 2007 remain open to examination by the major taxing jurisdictions to which we are subject, including United States of America ("U.S.") and non-U.S. locations. We are currently under audit by the Internal Revenue Service and the California Franchise Tax Board, and it is reasonably possible that the current portion of our unrecognized tax benefits will significantly decrease within the next twelve months due to the outcome of these audits.

13. Commitments and Contingencies

Credit Facilities

We have revolving credit facilities with our Centresoft subsidiary located in the UK (the "UK Facility") and our NBG subsidiary located in Germany (the "German Facility.") The UK Facility provided Centresoft with the ability to borrow up to Great British Pounds ("GBP") 12.0 million ($23.9 million) and GBP 12.0 million ($23.6 million), including issuing letters of credit, on a revolving basis as of March 31, 2008 and 2007, respectively. Furthermore, under the UK Facility, Centresoft provided a GBP 0.6 million ($1.2 million) and a GBP 0.6 million ($1.2 million) guarantee for the benefit of our CD Contact subsidiary as of March 31, 2008 and 2007, respectively. The UK Facility bore interest at LIBOR plus 2.0% as of March 31, 2008 and 2007, is collateralized by substantially all

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

13. Commitments and Contingencies (Continued)

of the assets of the subsidiary and expires in March 2009. 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, 2008 and 2007, we were in compliance with these covenants. No borrowings were outstanding against the UK Facility as of March 31, 2008 or 2007. The German Facility provided for revolving loans up to EUR 0.5 million ($0.8 million) as of March 31, 2008 and EUR 0.5 million ($0.7 million) as of March 31, 2007, bore interest at a Eurocurrency rate plus 2.5%, is collateralized by certain of the subsidiary's property and equipment and has no expiration date. No borrowings were outstanding against the German Facility as of March 31, 2008 or 2007.

As of March 31, 2008 and 2007, we maintained a $10.0 million and $7.5 million irrevocable standby letter of credit, respectively. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. Under the terms of this arrangement, we are required to maintain on deposit with the bank a compensating balance, restricted as to use, of not less than the sum of the available amount of the letter of credit plus the aggregate amount of any drawings under the letter of credit that have been honored thereunder but not reimbursed. At March 31, 2008 and 2007, the $10.0 million and $7.5 million deposit is included in short-term investments as restricted cash, respectively. No borrowings were outstanding as of March 31, 2008 or 2007.

As of March 31, 2008 and 2007, our publishing subsidiary located in the UK maintained a EUR 7.0 million ($11.0 million) and EUR $4.0 million ($5.3 million) irrevocable standby letter of credit, respectively. The standby letter of credit is required by one of our inventory manufacturers to qualify for payment terms on our inventory purchases. The standby letter of credit does not require a compensating balance and is collateralized by substantially all of the assets of the subsidiary and expires in February 2009. No borrowings were outstanding as of March 31, 2008 or 2007.

Commitments

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

Additionally, we lease certain of our facilities and equipment under non-cancelable operating lease agreements. Assuming all contractual provisions are met, the total future minimum commitments for

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

13. Commitments and Contingencies (Continued)

these and other contractual arrangements in place as of March 31, 2008, are scheduled to be paid as follows (amounts in thousands):

	Contractual Obligations(1)			
	Facility & Equipment Leases	**Developer and IP**	**Marketing**	**Total**
Fiscal years ending March 31,				
2009	$ 19,343	$ 110,771	$ 41,401	$ 171,515
2010	17,028	31,041	22,100	70,169
2011	14,553	34,086	13,100	61,739
2012	10,256	16,586		26,842
2013	8,791	21,586		30,377
Thereafter	31,201	26,001		57,202
Total	$ 101,172	$ 240,071	$ 76,601	$ 417,844

(1)
We have omitted FIN 48 liabilities from this table due to the inherent uncertainty regarding the timing of potential issue resolution. Specifically, either (a) the underlying positions have not been fully enough developed under audit to quantify at this time or, (b) the years relating to the issues for certain jurisdictions are not currently under audit. At the adoption date of April 1, 2007, we had $65.5 million of unrecognized tax benefits. At March 31, 2008, we had $74.2 million of unrecognized tax benefits.

Facilities rent expense for the years ended March 31, 2008, 2007, and 2006 was approximately $18.3 million, $14.8 million, and $14.2 million, respectively.

Compensation Guarantee

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

Legal Proceedings

On February 8, 2008, the Wayne County Employees' Retirement System filed a lawsuit challenging the transactions contemplated by the business combination agreement, dated as of December 1, 2007, among us, a wholly owned subsidiary of ours established in connection with the proposed transaction, Vivendi, S.A., Vivendi Games, Inc., a wholly owned subsidiary of Vivendi, S.A., and VGAC, a wholly

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

13. Commitments and Contingencies (Continued)

owned subsidiary of Vivendi, S.A., and the sole stockholder of Vivendi Games, Inc. The suit is a putative class action filed against the parties to that business combination agreement as well as certain members of our Board of Directors. The plaintiff alleges, among other things, that our directors named therein failed to fulfill their fiduciary duties with regard to the transactions by "surrendering" the negotiating process to "conflicted management," that those breaches were aided and abetted by Vivendi, S.A., and those of its subsidiaries named in the complaint, and that a preliminary proxy statement contains certain statements that the plaintiff alleges are false and misleading. The plaintiff seeks an order from the court that, among other things, certifies the case as a class action, enjoins the transaction, requires the defendants to disclose all material information, declares that the transaction is in breach of the directors' fiduciary duties and therefore unlawful and unenforceable, awards the plaintiff and the putative class damages for all profits and special benefits obtained by the defendant in connection with the transaction and tender offer, and awards the plaintiff its cost and expense, including attorney's fees.

In a ruling on March 12, 2008, the court initially declined to schedule a preliminary injunction hearing or allow broad discovery, pending the Company's filing of a revised preliminary proxy statement in connection with the proposed transactions. The court did order the parties to initiate discovery of core documents, and the Company made an initial production of documents. On March 7, 2008, the Company filed a motion to dismiss the complaint, the grounds for which were detailed in a brief filed on April 30, 2008. On April 30, 2008, the Company also filed a motion to stay discovery in the case pending a ruling on the motion to dismiss. Separately, on March 6, 2008, Vivendi, S.A., and those of its subsidiaries named in the complaint filed a motion to dismiss the sole claim alleged against them.

On May 8, 2008, the plaintiff filed an amended complaint that, among other things, added allegations relating to a revised preliminary proxy statement filed by the Company on April 30, 2008. That same date, the plaintiff also renewed its motion for expedited proceedings. On May 13, 2008, the Company moved to dismiss the amended complaint. On May 14, 2008, Vivendi and its subsidiaries named in the amended complaint also moved to dismiss. On May 22, 2008, the court scheduled a combined hearing for June 30, 2008 on the plaintiff's motion for a preliminary injunction and the defendants' motions to dismiss, but withheld a ruling on the plaintiff's motion for expedited discovery, pending further briefing. On May 28, 2008, the court ordered that expedited discovery proceed as to certain claims and that final briefing on the motions to be heard on June 30, 2008 be filed with the court on June 27, 2008. The Company intends to defend itself vigorously, and no amounts have been recorded in the Company's consolidated financial statements as of March 31, 2008.

In July 2006, individuals and/or entities claiming to be our stockholders filed derivative lawsuits, purportedly on our behalf, against certain current and former members of our Board of Directors as well as several of our current and former officers. Three derivative actions have been filed in Los Angeles Superior Court: Vazquez v. Kotick, et al ., L.A.S.C. Case No. BC355327 (filed July 12, 2006); Greuer v. Kotick, et al. L.A.S.C. Case No. SC090343 (filed July 12, 2006); and Amalgamated Bank v. Baker, et al., L.A.S.C. Case No. BC356454 (filed August 3, 2006). These actions have been consolidated by the court under the caption In re Activision Shareholder Derivative Litigation, L.A.S.C. Master File No. SC090343 (West, J.). Four derivative actions have been filed in the United States District Court for the Central District of California: Pfeiffer v. Kotick, et al., C.D. Cal. Case No. CV06-4771 MRP (JTLx) (filed July 31, 2006), Hamian v. Kotick, et al., C.D. Cal. Case No. CV06-5375 MRP (JLTx) (filed August 25, 2006) Abdelnur vs. Kotick et al., C.D. Cal. Case

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

13. Commitments and Contingencies (Continued)

No. CV07-3575 AHM (PJWx) (filed June 1, 2007), and Scarborough v. Kotick et al., C.D. Cal. Case No. CV07-4602 SVW (PLAx) (filed July 18, 2007). These actions have also been consolidated, under the caption In re Activision, Inc. Shareholder Derivative Litigation, C.D. Cal. Case No. CV06-4771 MRP (JTLx) (Pfaelzer, J.). The consolidated complaints allege, among other things, purported improprieties in our issuance of stock options. Plaintiffs seek various relief on our behalf, including damages, restitution of benefits obtained from the alleged misconduct, equitable relief, including an accounting and rescission of option contracts; and various corporate governance reforms. We expect that defense expenses associated with the matters will be covered by our directors and officers insurance, subject to the terms and conditions of the applicable policies.

On or about December 4, 2007, we, the plaintiffs, and certain of our current and former officers and directors notified the court in the federal action that we had reached agreement in principle to settle the shareholder derivative litigation pending against such current and former directors and officers of ours. On January 17, 2008, the parties amended that agreement to, among other things, include the plaintiffs in the state court action as parties thereto. The nonbinding agreement in principle was subject, among other things, to the negotiation of a binding definitive settlement agreement addressing all settlement terms, as well as to further approval by the parties and the court.

Effective as of May 8, 2008, the parties signed a Stipulation of Settlement with respect to these matters. In entering into the Stipulation of Settlement, neither we nor any of the settling parties has admitted to any liability or wrongdoing. Under the terms of the Stipulation of Settlement, which is subject to court approval, we will adopt, implement and/or maintain certain corporate governance and internal control measures, relating principally to the following: board composition, structure and practices, director independence standards, stock ownership and compensation, and education; shareholder proposal evaluation process; nomination procedures for shareholder-nominated directors; shareholder meeting procedures; executive compensation policies and procedures; insider trading controls; and stock option granting procedures. We have agreed to keep these measures in place for a period of three years, subject to certain exceptions. The Stipulation of Settlement also addresses matters relating to the agreements by certain of our current and former directors and officers to reimburse the Company in connection with the receipt of options that required measurement date corrections. In the case of options already exercised, the agreements allowed reimbursement to be made either by cancellation of vested but unexercised options with a value equivalent to the additional exercise price or by payment of additional exercise price. In the case of options not yet exercised, the exercise price to be paid upon future exercise of those options is increased. In the aggregate, settling defendants have elected to cancel options to acquire approximately 800,000 shares of our common stock and have agreed to increases in the exercise prices of approximately 16.1 million options. The modification of these options did not result in any incremental compensation expense. In addition, the Stipulation of Settlement provides for us to pay $10,000,000 to plaintiffs' attorneys for their fees and expenses, subject to court approval of such fees and expenses and subject to our reservation of all rights against our D&O insurance carriers, reinsurers and co-insurers. In anticipation of the settlement, the Company had recorded a legal expense accrual of approximately $10.0 million as a probable and reasonable estimate in its consolidated financial statements as of March 31, 2008. The Stipulation of Settlement provides that plaintiffs' attorneys will also be entitled to 15% (up to $750,000) of any payment made by our insurance carriers to us in connection with the settlement. We have not reached agreements with our insurers related to the settlement. The stipulation also provides for the forgiveness of approximately $2.3 million in legal fees previously billed to us by former outside corporate counsel.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

13. Commitments and Contingencies (Continued)

The Stipulation of Settlement was filed in federal court on May 12, 2008 and was preliminarily approved by the U.S. District Court for the Central District of California by order dated May 13, 2008 and entered on May 14, 2008. The settlement is subject to final court approval after notice and a hearing at which shareholders will have the opportunity to object, which is currently scheduled to be held on July 21, 2008. The court will then decide whether to approve the settlement as fair, adequate and in the best interest of our stockholders. While we believe that the settlement meets these criteria, there can be no guarantee that the settlement will receive the required court approval. If final approval is granted, all claims against all defendants in the litigation will be dismissed with prejudice, and all claims that were or could have been brought by any derivative plaintiff, and all claims that arise from or relate to the matters or occurrences that were or could have been alleged in the federal and state derivative actions, will be fully, finally and forever released. The individual settling defendants make no admission of wrongdoing under the Stipulation of Settlement, and they have denied (and continue to deny) all charges of wrongdoing and liability and each and all of the claims and contentions alleged in the derivative actions.

On July 24, 2006, we received a letter of informal inquiry from the SEC requesting certain documents and information relating to our historical stock option grant practices. Thereafter, in early June 2007, the SEC issued a formal order of non-public investigation, pursuant to which it subpoenaed documents from us related to the investigation, and testimony and documents from certain current and former directors, officers and employees of ours. The Company has made an offer of settlement to the Staff of the SEC, which the SEC Staff has indicated it is prepared to recommend to the SEC. The tentative settlement of the SEC's investigation, which would allege violations of various provisions of the Federal securities laws, is subject to agreement on the specific language of the settlement documents, and then to review and approval by the SEC. There can be no assurance that a final settlement will be approved. In connection with the proposed settlement, the Company would not be required to pay a monetary penalty. Under the proposed settlement, the Company would settle this matter without admitting or denying the SEC's findings.

In addition, we are party to other routine claims and suits brought by us and against us in the ordinary course of business, including disputes arising over the ownership of intellectual property rights, contractual claims, employment laws, regulations and relationships, and collection matters. In the opinion of management, after consultation with legal counsel, the outcome of such routine claims and lawsuits will not have a material adverse effect on our business, financial condition, results of operations, or liquidity.

14. Stock-Based Compensation and Employee Benefit Plans

Equity Incentive Plans

On July 30, 2007, our Board of Directors adopted the Activision 2007 Incentive Plan (the "2007 Plan,") subject to shareholder approval, and reserved 15,000,000 shares for issuance thereunder and, on September 27, 2007, the 2007 Plan was approved by our shareholders and became effective.

Upon the effective date of the 2007 Plan, we ceased to make awards under the following equity incentive plans (collectively, the "Rolled-Up Plans"), although such plans will remain in effect and continue to govern outstanding awards: (i) Activision, Inc. 1998 Incentive Plan, as amended; (ii) Activision, Inc. 1999 Incentive Plan, as amended; (iii) Activision, Inc. 2001 Incentive Plan, as amended; (iv) Activision, Inc. 2002 Incentive Plan, as amended; (v) Activision, Inc. 2002 Executive

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Stock-Based Compensation and Employee Benefit Plans (Continued)

Incentive Plan, as amended; (vi) Activision, Inc. 2002 Studio Employee Retention Incentive Plan, as amended; and (vii) Activision, Inc. 2003 Incentive Plan, as amended. The number of shares available for issuance under the 2007 Plan was increased by an additional 2,685,577 shares of our common stock to reflect the shares reserved for issuance but not subject to outstanding awards under the Rolled-Up Plans at the time the 2007 Plan became effective. Additionally, the number of shares of our common stock reserved for issuance under the 2007 Plan may be further increased from time to time by: (i) the number of shares relating to awards outstanding under any Rolled-Up Plan that: (a) expire, or are forfeited, terminated or cancelled, without the issuance of shares; (b) are settled in cash in lieu of shares; or (c) are exchanged, prior to the issuance of shares of our common stock, for awards not involving our common stock; and (ii) if the exercise price of any option outstanding under any Rolled-Up Plan is, or the tax withholding requirements with respect to any award outstanding under any Rolled-Up Plan are, satisfied by withholding shares otherwise then deliverable in respect of the award or the actual or constructive transfer to us shares already owned, the number of shares equal to the withheld or transferred shares. As of March 31, 2008, we had approximately 16.1 million shares of our common stock reserved for future issuance under the 2007 Plan. Shares issued in connection with awards made under the 2007 Plan are generally issued as new stock issuances.

The 2007 Plan authorizes the Compensation Committee of our Board of Directors to provide equity-based compensation in the form of stock options, share appreciation rights, restricted stock, restricted stock units, performance shares, performance units and other performance- or value-based awards structured by the Compensation Committee within parameters set forth in the 2007 Plan, including custom awards that are denominated or payable in, valued in whole or in part by reference to, or otherwise based on or related to, shares of our common stock, or factors that may influence the value of our common stock or that are valued based on our performance or the performance of any of our subsidiaries or business units or other factors designated by the Compensation Committee, as well as incentive bonuses, for the purpose of providing incentives and rewards for superior performance to the directors, officers, employees of, and consultants to, Activision and its subsidiaries.

While the Compensation Committee has broad discretion to create equity incentives, our equity-based compensation program currently primarily utilizes a combination of options and restricted stock units. Such awards generally have time-based vesting schedules, vesting annually over periods of three to five years, or vest in their entirety on an anniversary of date of grant, subject to possible earlier vesting if certain performance measures are met, and all such awards which are options generally expire ten years from the grant date. Under the terms of the 2007 Plan, the exercise price for options must be equal to or greater than the closing price per share of our common stock on the date the award is granted, as reported on the NASDAQ.

In February 2008, we discovered that, due to an error, the record date for our September 27, 2007 annual meeting was not in technical compliance with Delaware law or our bylaws, which require such record date to be not more than sixty (60) nor less than ten days (10) before the date of such meeting. In connection with the business combination (see Note 20), Vivendi has agreed to re-approve and ratify all actions and proposals approved by our shareholders at such meeting, and to vote against any actions and proposals not approved by our shareholders at such meeting, by written consent of the shareholders as permitted under our bylaws promptly after the closing of the transaction. If the transaction is not consummated for any reason, we intend to have such actions and proposals ratified at a special meeting of our shareholders called for such purpose or at our next annual stockholder meeting. We have determined that options and restricted stock rights granted under the 2007 Plan have

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Stock-Based Compensation and Employee Benefit Plans (Continued)

met the definition of a grant date in accordance with SFAS No. 123(R), as we have the ability and intent to grant options and restricted stock rights under the Roll-Up Plans in view of the technical non-compliance described above. Further, we have also established a mutual understanding with the employees as to the terms of these grants. Accordingly, stock-based compensation has been recorded for these options and restricted stock rights grants.

Restricted Stock Units and Restricted Stock

We grant restricted stock units and restricted stock (collectively referred to as "restricted stock rights") under the 2007 Plan to employees around the world. Restricted stock units entitle the holders thereof to receive shares of our common stock at the end of a specified period of time. Restricted stock is issued and outstanding upon grant; however, restricted stock holders are restricted from selling the shares until they vest. Upon vesting of restricted stock rights, we may withhold shares otherwise deliverable to satisfy tax withholding requirements. Restricted stock rights are subject to forfeiture and transfer restrictions. Vesting for restricted stock rights is based upon the holders' continued employment with us. If the vesting conditions are not met, unvested restricted stock rights will be forfeited.

The following table summarizes our restricted stock rights activity for the fiscal year ended March 31, 2008:

	Restricted Stock Rights	Weighted-Average Grant Date Fair Value
Balance as of March 31, 2007	333,475	$ 14.28
Activity for the fiscal year ended March 31, 2008:		
Granted	576,718	21.53
Vested	(23,195)	15.57
Forfeited	(10,150)	20.75
Balance as of March 31, 2008	876,848	$ 18.97

As of March 31, 2008, $9.1 million of total unrecognized compensation cost related to restricted stock rights is expected to be recognized over a weighted-average period of 1.64 years.

Non-Plan Employee Stock Options

In connection with prior employment agreements between the Company and Robert A. Kotick, our Chairman and Chief Executive Officer, and Brian G. Kelly, our Co-Chairman, Mr. Kotick and Mr. Kelly were granted options to purchase our common stock. The Board of Directors approved the granting of these options. As of March 31, 2008, options to purchase approximately 8,304,800 shares under such grants were outstanding with a weighted-average exercise price of $2.05.

Employee Stock Purchase Plan

Effective October 1, 2005, the Board of Directors approved the Activision, Inc. Third Amended and Restated 2002 Employee Stock Purchase Plan and the Activision, Inc. Second Amended and Restated 2002 Employee Stock Purchase Plan for International Employees (together, the "ESPP"). Under the ESPP, up to an aggregate of 4,000,000 shares of our common stock may be purchased by

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Stock-Based Compensation and Employee Benefit Plans (Continued)

eligible employees during two six-month offering periods that commence each April 1 and October 1 (the "Offering Period"). Common stock is purchased by the ESPP participants at a price per share generally equal to 85% of the lower of the fair market value of our common stock on the first day of the Offering Period and the fair market value of our common stock on the purchase date (the last day of the Offering Period). Employees may purchase shares having a value not exceeding 15% of their gross compensation during an Offering Period and are limited to a maximum of $10,000 in value for any two purchases within the same calendar year. On June 13, 2007, employees purchased 228,242 shares of our common stock at a purchase price of $12.835 per share. On September 28, 2007, employees purchased 126,008 shares of our common stock at a purchase price of $16.099 per share. On March 31, 2008, the most recent purchase date employees purchased 208,311 shares of our common stock at a purchase price of $18.862. As of March 31, 2008, we had approximately 1.0 million shares of our common stock reserved for future issuance under the ESPP. Shares issued in connection with purchases made under the ESPP are generally issued as new stock issuances.

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. No third-party warrants were granted during the years ended March 31, 2008 and 2007. As of March 31, 2008 and 2007, respectively, third-party warrants to purchase 919,800 and 936,000 shares of our common stock were outstanding with a weighted-average exercise price of $4.59 and $4.54 per share, respectively.

In accordance with the Financial Accounting Standards Board's Emerging Issues Task Force ("EITF") Issue 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in conjunction with Selling Goods or Services*, we measure the fair value of the securities on the measurement date. The fair value of each warrant is capitalized and amortized to expense when the related product is released and the related revenue is recognized. Additionally, as more fully described in Note 1, the recoverability of capitalized software development costs and intellectual property licenses is evaluated on a quarterly basis with amounts determined as not recoverable being charged to expense. In connection with the evaluation of capitalized software development costs and intellectual property licenses, any capitalized amounts for related third-party warrants are additionally reviewed for recoverability with amounts determined as not recoverable being amortized to expense. As of March 31, 2006, capitalized amounts of third-party warrants were fully amortized.

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 92% of their pre-tax salary, up to the maximum amount allowed by law. We contribute an amount equal to 20% of each dollar contributed by a participant. Our matching contributions to the plan were approximately $1.8 million, $1.5 million, and $1.3 million for the years ended March 31, 2008, 2007 and 2006, respectively.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Stock-Based Compensation and Employee Benefit Plans (Continued)

The following table sets forth the total stock-based compensation expense (amounts in thousands) resulting from stock options, restricted stock rights, and the ESPP included in our Consolidated Statements of Operations in accordance with SFAS No. 123R for the fiscal years ended March 31, 2008 and March 31, 2007, and APB No. 25 for the fiscal year ended March 31, 2006:

	For the years ended March 31,		
	2008	2007	2006
Cost of sales software royalties and amortization	$ 10,898	$ 2,503	$
Product development	17,610	5,728	869
Sales and marketing	6,833	5,267	175
General and administrative	18,224	12,024	2,055
Stock-based compensation expense before income taxes	53,565	25,522	3,099
Income tax benefit	(20,944)	(9,979)	(1,208)
Total stock-based compensation expense, net of income tax benefit	$ 32,621	$ 15,543	$ 1,891

Additionally, stock option expenses are capitalized in accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed* as discussed in Note 1. For the year ended March 31, 2008, stock-based compensation costs in the amount of $13.7 million were capitalized and $10.9 million of capitalized stock-based compensation costs were amortized. The following table summarizes stock-based compensation included in our Consolidated Balance Sheets as a component of software development (amounts in thousands):

	Software Development
Balance as of March 31, 2006	$
Stock-based compensation expense capitalized during period	9,069
Amortization of capitalized stock-based compensation expense	(2,503)
Balance as of March 31, 2007	6,566
Stock-based compensation expense capitalized during period	13,690
Amortization of capitalized stock-based compensation expense	(10,898)
Balance as of March 31, 2008	$ 9,358

Net cash proceeds from the exercise of stock options were $48.0 million, $19.0 million, and $45.1 million for the years ended March 31, 2008, 2007, and 2006, respectively. Income tax benefit from stock option exercises was $57.3 million, $11.3 million, and $29.4 million for the years ended March 31, 2008, 2007, and 2006, respectively. In accordance with SFAS No. 123R, we present excess tax benefits from the exercise of stock options, if any, as financing cash flows rather than operating cash flows.

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

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Stock-Based Compensation and Employee Benefit Plans (Continued)

net income per common share disclosures for stock-based awards, as if the fair-value-based method defined in SFAS No. 123 had been applied.

The following table illustrates the effect on net income after tax and net earnings per common share as if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation during the year ended March 31, 2006 (amounts in thousands, except per share amounts):

	For the year ended March 31, 2006
Net income, as reported	$ 40,251
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	1,589
Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects	(16,175)
Pro forma net income	$ 25,665
Earnings per share	
Basic as reported	$ 0.15
Basic pro forma	$ 0.09
Diluted as reported	$ 0.14
Diluted pro forma	$ 0.09

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

As of April 1, 2005, the Company began estimating the value of employee stock options on the date of grant using a binomial-lattice model. Prior to April 1, 2005 the value of each employee stock option was estimated on the date of grant using the Black-Scholes model for the purpose of the pro forma financial information in accordance with SFAS No. 123.

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

Consistent with SFAS No. 123R, we have attempted to reflect expected future changes in model inputs during the option's contractual term. The inputs required by our binomial-lattice model include expected volatility, risk-free interest rate, risk-adjusted stock return, dividend yield, contractual term, and vesting schedule, as well as measures of employees' forfeiture, exercise, and post-vesting

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Stock-Based Compensation and Employee Benefit Plans (Continued)

termination behavior. Statistical methods were used to estimate employee rank- specific termination rates. These termination rates, in turn, were used to model the number of options that are expected to vest and post-vesting termination behavior. Employee rank-specific estimates of Expected Time-To-Exercise ("ETTE") were used to reflect employee exercise behavior. ETTE was estimated by using statistical procedures to first estimate the conditional probability of exercise occurring during each time period, conditional on the option surviving to that time period and then using those probabilities to estimate ETTE. The model was calibrated by adjusting parameters controlling exercise and post-vesting termination behavior so that the measures output by the model matched values of these measures that were estimated from historical data. The weighted-average estimated value of employee stock options granted during the years ended March 31, 2008, 2007, and 2006 was $9.21, $5.86, and $5.09 per share, respectively, using the binomial-lattice model with the following weighted-average assumptions:

	Employee and Director Options and Warrants			Employee Stock Purchase Plan		
	For the years ended March 31,			For the years ended March 31,		
	2008	2007	2006	2008	2007	2006
Expected life (in years)	5.41	4.87	4.85	0.5	0.5	0.5
Risk free interest rate	4.70%	4.99%	5.17%	4.61%	4.71%	3.05%
Volatility	51%	54%	48%	38%	43%	42%
Dividend yield						
Weighted-average fair value at grant date	$ 9.21	$ 5.86	$ 5.09	$ 5.49	$ 3.72	$ 3.11

To estimate volatility for the binomial-lattice model, we use methods or capabilities that are discussed in SFAS No. 123R and SAB No. 107. These methods include the implied volatility method based upon the volatilities for exchange-traded options on our stock to estimate short-term volatility, the historical method (annualized standard deviation of the instantaneous returns on Activision's stock) during the option's contractual term to estimate long-term volatility and a statistical model to estimate the transition or "mean reversion" from short-term volatility to long-term volatility. Based on these methods, for options granted during the year ended March 31, 2008, the expected stock price volatility ranged from 34% to 53%, with a weighted-average volatility of 51%. For options granted during the year ended March 31, 2007, the expected stock price volatility ranged from 38% to 56%, with a weighted average volatility of 54%. For options granted during the year ended March 31, 2006, the expected stock price volatility ranged from 40% to 55%, with a weighted average volatility of 48%.

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

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is, as required by SFAS No. 123R, an output by the binomial-lattice model. The expected life of employee stock options depends on all of the underlying assumptions and calibration of our model. A binomial-lattice model can be viewed as assuming that employees will exercise their options when the stock price equals or exceeds an exercise boundary. The exercise boundary is not constant but continually declines as one approaches the option's expiration

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Stock-Based Compensation and Employee Benefit Plans (Continued)

date. The exact placement of the exercise boundary depends on all of the model inputs as well as the measures that are used to calibrate the model to estimated measures of employees' exercise and termination behavior.

As stock-based compensation expense recognized in the Consolidated Statement of Operations for the year ended March 31, 2008 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

Accuracy of Fair Value Estimates

We developed the assumptions used in the binomial-lattice model, including model inputs and measures of employees' exercise and post-vesting termination behavior. Our ability to accurately estimate the fair value of share-based payment awards as of the grant date depends upon the accuracy of the model and our ability to accurately forecast model inputs as long as ten years into the future. These inputs include, but are not limited to, expected stock price volatility, risk-free rate, dividend yield, and employee termination rates. Although the fair value of employee stock options is determined in accordance with SFAS No. 123R and SAB No. 107 using an option-pricing model, the estimates that are produced by this model may not be indicative of the fair value observed between a willing buyer/willing seller. Unfortunately, it is difficult to determine if this is the case, because markets do not currently exist that permit the active trading of employee stock option and other share-based instruments.

Stock option activity for the year ended March 31, 2008 is as follows (amounts in thousands, except per share amounts):

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at March 31, 2007	49,429	$ 7.18		
Granted	11,457	20.52		
Exercised	(9,918)	6.53		
Forfeited	(2,313)	9.48		
Outstanding at March 31, 2008	48,655	$ 10.67	5.94	$ 809,420
Exercisable at March 31, 2008	26,816	$ 5.98	3.93	$ 572,001
Vested and expected to vest at March 31, 2008	45,469	$ 10.20	5.12	$ 778,006

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (i.e., the difference between our closing stock price on the last trading day of the period and the exercise price, times the number of shares for options where the exercise price is below the closing stock price) that would have been received by the option holders had all option holders exercised their options on that date. This amount changes based on the fair market value of our stock. Total intrinsic value of options actually exercised was $165.4 million, $32.0 million, and $77.9 million for the years ended March 31, 2008, 2007, and 2006, respectively.

As of March 31, 2008, $70.0 million of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.59 years.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Stock-Based Compensation and Employee Benefit Plans (Continued)

On June 8, 2007, consistent with Internal Revenue Service guidance, the Company commenced an offer to amend the exercise price of unexercised options subject to Section 409A of the Internal Revenue Code held by employees who were not executive officers, in order to eliminate those employees' Section 409A tax liability. Pursuant to the offer, which closed on July 6, 2007, we made a cash payment in January 2008 to the employees who accepted the offer, totaling approximately $4.1 million, which represents the difference between the original exercise price of each amended option and the amended exercise price of each amended option. The offer with respect to all eligible options is considered a modification of those options for financial reporting purposes. Pursuant to the accounting standards in effect under SFAS No. 123R, the incremental fair value of approximately $1.0 million and the remaining portion of approximately $3.1 million, created as a result of the cash payment that become payable pursuant to the terms of the offer, were recognized as compensation expense and equity, respectively, at the expiration of the offer period on July 6, 2007.

15. Capital Transactions

Buyback Program

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

Under the buyback program, we did not repurchase any shares of our common stock in the years ended March 31, 2008, 2007 and 2006. As of March 31, 2008, we had approximately $226.2 million available for utilization under the buyback program and no outstanding stock repurchase transactions.

Shareholders' Rights Plan

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

In the event that any person or group acquires 15% or more of our outstanding common stock each holder of a right (other than such person or members of such group) will thereafter have the right to receive upon exercise of such right, in lieu of shares of Series A Junior Preferred Stock, the number of shares of common stock of Activision having a value equal to two times the then current exercise price of the right. If we are acquired in a merger or other business combination transaction after a person has acquired 15% or more of our common stock, each holder of a right will thereafter have the

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

15. Capital Transactions (Continued)

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.

We have amended the Rights Plan concurrent with the execution of the business combination agreement with Vivendi (see Note 20) to provide that (a) the Rights Plan will not be triggered by the business combination agreement or the transaction and (b) the Rights Plan will terminate upon the completion of the transaction and all rights existing under the Rights Plan will be extinguished.

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

The components of comprehensive income (loss) for the years ended March 31, 2008, 2007, and 2006 were as follows (amounts in thousands):

	March 31, 2008	March 31, 2007	March 31, 2006
Net income	$ 344,883	$ 85,787	$ 40,251
Other comprehensive income (loss):			
Unrealized appreciation (depreciation) on investments, net of taxes	(1,896)	(8,224)	10,576
Foreign currency translation adjustment	8,046	12,057	(5,825)
Other comprehensive income	6,150	3,833	4,751
Comprehensive income	$ 351,033	$ 89,620	$ 45,002

The components of accumulated other comprehensive income (loss) for the year ended March 31, 2008 were as follows (amounts in thousands):

	Foreign Currency	Unrealized Appreciation (Depreciation) on Investments	Accumulated Other Comprehensive Income (Loss)
Balance, March 31, 2007	$ 21,070	$ (868)	$ 20,202
Other comprehensive income (loss)	8,046	(1,896)	6,150
Balance, March 31, 2008	$ 29,116	$ (2,764)	$ 26,352

Comprehensive income is presented net of taxes of $1.2 million related to net unrealized depreciation on investments for the year ended March 31, 2008. Income taxes were not provided for foreign currency translation items as these are considered indefinite investments in non-U.S. subsidiaries.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

17. Supplemental Cash Flow Information

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

	For the years ended March 31,		
	2008	**2007**	**2006**
Non-cash investing and financing activities:			
Common Stock issued related to acquisitions	$ 25,864	$ 36,918	$ 2,793
Common Stock related to employee bonuses	1,857		
Change in unrealized appreciation (depreciation) on investments, net of taxes	(1,896)	(8,224)	10,576
Common stock payable, related to acquisition		39,000	
Adjustment-prior period purchase allocation	(318)	51	(260)
Supplemental cash flow information:			
Cash paid for income taxes	$ 48,393	$ 3,677	$ 4,698
Cash paid for interest	108	100	263

18. Quarterly Financial and Market Information (Unaudited)

	For the quarters ended				
	June 30	**Sept. 30**	**Dec. 31**	**Mar. 31**	**For the year ended**
	(Amounts in thousands, except per share data)				
Fiscal 2008:					
Net revenues	$ 495,455	$ 317,746	$ 1,482,484	$ 602,451	$ 2,898,136
Cost of sales	327,960	204,956	762,290	350,229	1,645,435
Operating income (loss)	30,092	(9,545)	404,534	54,533	479,614
Net income	27,826	698	272,196	44,163	344,883
Basic earnings per share	0.10	0.00	0.93	0.15	1.19
Diluted earnings per share	0.09	0.00	0.86	0.14	1.10
Common stock price per share:					
High	21.43	21.91	29.87	29.76	29.87
Low	18.16	16.94	18.81	25.11	16.94
Fiscal 2007:					
Net revenues	$ 188,069	$ 188,172	$ 824,259	$ 312,512	$ 1,513,012
Cost of sales	137,800	141,078	483,180	216,007	978,065
Operating income (loss)	(33,449)	(37,410)	173,120	(29,114)	73,147
Net income (loss)	(18,309)	(24,302)	142,820	(14,422)	85,787
Basic earnings (loss) per share	(0.07)	(0.09)	0.51	(0.05)	0.31
Diluted earnings (loss) per share	(0.07)	(0.09)	0.46	(0.05)	0.28
Common stock price per share:					
High	15.11	16.00	18.19	19.20	19.20
Low	10.71	10.47	14.22	16.05	10.47

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

19. Recently Issued Accounting Standards

In December 2007, the FASB issued Statement No. 141(R), *Business Combinations* ("SFAS No. 141(R).") SFAS No. 141(R) provides greater consistency in the accounting and financial reporting of business combinations. It requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose the nature and financial effect of the business combination. Also in December 2007, the FASB issued Statement No. 160. *Non-controlling Interests in Consolidated Financial Statements* ("SFAS No. 160.") SFAS No. 160 Statement amends Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* to establish accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 141(R) and SFAS No. 160 are required to be adopted simultaneously and are effective for the first annual reporting period beginning on or after December 15, 2008 with earlier adoption being prohibited. We do not currently have any non-controlling interests in our subsidiaries, and accordingly the adoption of SFAS No. 160 is not expected to have a material impact on our financial statements. We are currently evaluating the impact from the adoption of SFAS No. 141R on our Consolidated Financial Statements.

In September 2006, the FASB issued Statement No. 157 ("SFAS No. 157,") *Fair Value Measurements.* SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 applies to other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities and is effective for fiscal years beginning after November 15, 2008 for non-financial assets and liabilities. The adoption of SFAS No. 157 is not expected to have a material effect on our financial position or results of operations.

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

In June 2007, the FASB ratified the Emerging Issues Task Force's ("EITF") consensus conclusion on EITF 07-03, *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development.* EITF 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under this conclusion, an entity is required to defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-03 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007 and requires prospective application for new contracts entered into after the effective date. The adoption of EITF 07-03 is not expected to have a material impact on our Consolidated Financial Statements.

In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133* ("SFAS No. 161") SFAS No. 161 changes

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

19. Recently Issued Accounting Standards (Continued)

the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The guidance in SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS No. 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. We are currently assessing the impact of SFAS No. 161.

20. Business Combination Agreement with Vivendi

On December 2, 2007, we and Vivendi S.A. ("Vivendi") (Euronext Paris: VIV) announced the signing of a definitive agreement to combine Vivendi Games, Inc. ("Vivendi Games,") Vivendi's interactive entertainment business which includes Blizzard Entertainment, Inc., the creator of *World of Warcraft*, a massively multi-player online role-playing game franchise with us. If the transaction closes, we will be renamed Activision Blizzard, Inc. ("Activision Blizzard"), and we expect to continue to operate as a public company traded on NASDAQ under the ticker ATVI. While we will be the legal acquirer and the surviving entity in this transaction, Vivendi Games will be deemed to be the accounting acquirer in the transaction treated as a reverse acquisition for accounting purposes. As such, our historical financial statements after the close of the merger will be those of Vivendi Games. As Activision will be the deemed accounting acquiree, we are charging to expenses all costs related to the merger as incurred.

Under the term of the business combination agreement, we and Vivendi Games will combine our businesses through the merger of a newly formed, wholly owned subsidiary of ours with and into Vivendi Games. As a result of the merger, Vivendi Games, the parent company of Blizzard Entertainment, Inc. and Sierra Entertainment, Inc., will become a wholly owned subsidiary of ours. VGAC LLC, a subsidiary of Vivendi and the sole stockholder of Vivendi Games, will receive approximately 295.3 million newly issued shares of our common stock in the merger, which number is based upon a valuation of Vivendi Games at $8.121 billion and a per share price for our common stock of $27.50.

Simultaneously with the merger, Vivendi will purchase from us 62.9 million newly issued shares of our common stock, at $27.50 per share, for an aggregate purchase price of approximately $1.731 billion. Immediately following completion of the merger and share purchase, Vivendi and its subsidiaries are expected to own approximately 52.2% of the issued and outstanding shares of Activision Blizzard's common stock on a fully diluted basis.

After the closing of the transaction, Activision Blizzard will commence a cash tender offer for up to 146.5 million of its shares (representing approximately 50% of the shares of our common stock outstanding immediately prior to the transaction) at $27.50 per share. If the tender offer is fully subscribed, Vivendi and its subsidiaries are expected to own approximately 68.0% of the issued and outstanding shares of Activision Blizzard's common stock on a fully diluted basis. Under the terms of the business combination agreement, we and Vivendi have agreed the purchase of the shares tendered in the tender offer will be funded as follows: (a) the first $2.928 billion of the aggregate consideration will be funded by Activision Blizzard with proceeds from the share purchase described above, available cash on hand and, if necessary, borrowings made under one or more new credit facilities; (b) if the

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

20. Business Combination Agreement with Vivendi (Continued)

aggregate consideration is more than $2.928 billion, Vivendi has agreed to purchase from Activision Blizzard, at a purchase price of $27.50 per share, additional newly issued shares of Activision Blizzard common stock in an amount equal to the lesser of (x) $700 million and (y) the excess of the aggregate consideration over $2.928 billion, which amount will be used to fund the amount of the aggregate consideration that is in excess of $2.928 billion; and (c) if the aggregate consideration exceeds $3.628 billion, Activision Blizzard will fund the additional amount of the aggregate consideration that is in excess of $3.628 billion (up to the maximum aggregate consideration of $4.028 billion) through borrowings made under the new credit facilities issued by Vivendi (see Note 21).

All information included in the accompanying Consolidated Financial Statements and notes to Consolidated Financial Statements in this report reflects only our results, and does not reflect any impact of the proposed merger.

21. Senior Unsecured Credit Agreement with Vivendi

On April 29, 2008, we entered into a senior unsecured credit agreement (the "Credit Agreement") with Vivendi. Borrowings under the Credit Agreement cannot be effected until the consummation of the transactions contemplated by the business combination agreement ("BCA") described in Note 20 above (the "Transactions.") As previously disclosed, after the closing of the Transactions, among other things, the Company's name will be changed to Activision Blizzard.

After the closing of the Transactions, the Credit Agreement will provide Activision Blizzard with (i) a term loan credit facility (the "Tranche A Facility") in an aggregate amount of up to $400.0 million to be applied to fund that portion of the post-closing tender offer consideration in excess of $3.628 billion as set forth in the BCA, (ii) a term loan credit facility (the "Tranche B Facility") in an aggregate amount of up to $150.0 million to be applied to repay certain indebtedness of Vivendi Games after the closing in accordance with the terms of the BCA, and (iii) a revolving credit facility (the "Revolving Facility," and collectively with the Tranche A Facility and the Tranche B Facility, the "New Credit Facilities") in an aggregate amount of up to $475.0 million to be used after the closing of the Transactions for general corporate purposes. In the event the BCA terminates prior to the closing of the Transactions, the New Credit Facilities will terminate effective on the same date.

Subject to execution of customary closing documentation, the Tranche A Facility will be funded after the end of the tender offer period, in a single borrowing that is limited to the amount, if any, of the aggregate consideration to be paid in respect of the post-closing tender offer in excess of $3.628 billion. The Tranche B Facility will be funded after the consummation of the Transactions. Borrowings under the Revolving Facility will be subject to the foregoing conditions and other customary conditions, such as the truth of representations and warranties and the absence of default.

Borrowings under each of the New Credit Facilities will bear interest by reference to the "LIBOR" (and under limited circumstances, at Vivendi's election, a "Base Rate.") The applicable margin with respect to loans bearing interest with reference to the LIBOR will be (i) 0.85% per annum for loans under the Tranche A Facility and (ii) 1.20% per annum for loans under the Tranche B Facility and the Revolving Facility, respectively. The applicable margin with respect to loans bearing interest with reference to the Base Rate, if any, will be 1.0% lower than the margin applicable to LIBOR borrowings.

ACTIVISION, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

21. Senior Unsecured Credit Agreement with Vivendi (Continued)

Any unused amounts under the Revolving Facility will be subject to a commitment fee of 0.42% per annum accruing from and after the closing of the Transactions.

The Tranche A Facility is payable in full on March 31, 2010. The Tranche B Facility and the Revolving Facility will terminate and be payable in full on March 31, 2011.

The loans under each of the New Credit Facilities may be prepaid in full or in part at any time, without premium or penalty (subject to customary breakage costs for loans bearing interest by reference to LIBOR), at Activision Blizzard's option.

The loans under each of the New Credit Facilities are subject to mandatory prepayment in an amount of 100% of the proceeds from (i) asset sales in excess of $30.0 million in the aggregate (subject to customary reinvestment rights) and (ii) issuance of equity (subject to exceptions for issuance of stock to employees and issuances of the proceeds used to fund permitted acquisitions, investments and/or capital expenditures).

The New Credit Facilities are subject to customary negative covenants, in each case subject to certain exceptions, qualifications and baskets, including limitations on: indebtedness; liens; investments, mergers, consolidations and acquisitions; transactions with affiliates; issuance of preferred stock by subsidiaries; sale and leaseback transactions, restricted payments and certain restrictions with respect to subsidiaries. The limitation on indebtedness provides that Activision Blizzard and its subsidiaries cannot incur consolidated indebtedness, net of unrestricted cash, in excess of $1.5 billion, and that no additional indebtedness may be incurred as long as the ratio of Activision Blizzard's consolidated indebtedness (including the indebtedness to be incurred) minus the amount of unrestricted cash to Activision Blizzard's consolidated earnings before interest, taxes, depreciation and amortization for its most recently ended four quarters would be greater than 1.50 to 1.0. This limitation does not, however, affect Activision Blizzard's ability to borrow under the New Credit Facilities or to incur certain types of limited debt.

The New Credit Facilities also impose a requirement on Activision Blizzard that the ratio of (i) consolidated indebtedness (net of certain cash) to (ii) the sum of its shareholder's equity plus consolidated indebtedness (net of certain cash) not exceed 20.0% at any time.

Events of default under the New Credit Facilities include nonpayment, breaches of representations, warranties or covenants, cross-defaults, bankruptcy or insolvency events, and failures to satisfy material judgments, in most events subject to materiality levels, grace periods and other customary exceptions.

SCHEDULE II

ACTIVISION, INC. AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS

(Amounts in thousands)

Col. A Description	Col. B Balance at Beginning of Period	Col. C Additions(A)	Col. D Deductions(B)	Col. E Balance at End of Period
Year ended March 31, 2008				
Allowance for sales returns and price protection	$ 89,643	$ 217,695	$ 179,970	$ 127,368
Allowance for doubtful accounts	1,775	263	(5)	2,043
Deferred tax valuation allowance	382			382
Year ended March 31, 2007				
Allowance for sales returns and price protection	$ 95,150	$ 143,456	$ 148,963	$ 89,643
Allowance for doubtful accounts	3,103	(1,804)	(476)	1,775
Deferred tax valuation allowance	35,555		35,173	382
Year ended March 31, 2006				
Allowance for sales returns and price protection	$ 67,603	$ 262,555	$ 235,008	$ 95,150
Allowance for doubtful accounts	1,588	5,149	3,634	3,103
Deferred tax valuation allowance	25,666	9,943	54	35,555

(A)
Includes increases in allowance for sales returns, price protection, doubtful accounts, and deferred tax valuation due to normal reserving terms and allowance accounts acquired in conjunction with acquisitions.

(B)
Includes actual write-offs of sales returns, price protection, uncollectible accounts receivable, net of recoveries, and foreign currency translation and other adjustments, and deferred taxes.

EXHIBIT INDEX

Exhibit Number	Exhibit
2.1	Business Combination Agreement, dated as of December 1, 2007, by and among Activision, Inc., Sego Merger Corporation, Vivendi S.A., VGAC LLC and Vivendi Games, Inc. (incorporated by reference to Exhibit 2.1 of Activision's Form 8-K, filed December 6, 2007).
3.7	Amended and Restated Certificate of Incorporation of Activision Holdings, dated June 9, 2000 (incorporated by reference to Exhibit 2.5 of Activision's Form 8-K, filed June 16, 2000).
3.8	Certificate of Amendment of Amended and Restated Certificate of Incorporation of Activision Holdings dated as of June 9, 2000 (incorporated by reference to Exhibit 2.7 of Activision's Form 8-K, filed June 16, 2000).
3.9	Certificate of Designation of Series A Junior Preferred Stock of Activision, Inc. dated as of December 27, 2001 (incorporated by reference to Exhibit 3.4 of Activision's Form 10-Q for the quarter ended December 31, 2001).
3.10	Certificate of Amendment of Amended and Restated Certificate of Incorporation, as amended, of Activision, Inc., dated as of April 4, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed April 5, 2005).
3.11	Certificate of Designation of Series A Junior Preferred Stock of Activision, Inc. dated August 4, 2005 (incorporated by reference to Exhibit 3.1 of Activision's Form 8-K, filed August 5, 2005).
3.12	Third Amended and Restated By-Laws of Activision, Inc., dated September 27, 2007 (incorporated by reference to Exhibit 3.6 to Activision's Registration Statement on Form S-8, Registration No. 333-146431, filed October 1, 2007).
4.1	Rights Agreement dated as of April 18, 2000, between Activision. Inc. and Continental Stock Transfer & Trust Company, which includes as exhibits the form of Right Certificates as Exhibit A, the Summary of Rights to Purchase Series A Junior Preferred Stock as Exhibit B and the form of Certificate of Designation of Series A Junior Preferred Stock of Activision as Exhibit C, (incorporated by reference to Activision's Registration Statement on Form 8-A, Registration No. 001-15839, filed April 19, 2000).
4.2	Amendment No. 1 to the Rights Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Continental Stock Transfer & Trust Company, as rights agent (incorporated by reference to Exhibit 4.1 of Activision's Form 8-K, filed December 6, 2007).
10.1	Activision, Inc. 1991 Stock Option and Stock Award Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-K for the year ended March 31, 2002).
10.2	Amendment to the 1991 Stock Option and Stock Award Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.1 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.3	Activision, Inc. 1998 Incentive Plan, as amended (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended September 30, 2001).
10.4	Amendment to the 1998 Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.2 of Activision's Current Report on Form 8-K filed September 20, 2006).

10.5	Activision, Inc. 1999 Incentive Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2002).
10.6	Amendment to the 1999 Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.3 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.7	Activision, Inc. 2001 Incentive Plan, as amended (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended June 30, 2002).
10.8	Amendment to the 2001 Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.4 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.9	Activision, Inc. 2002 Incentive Plan, as amended (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2003).
10.10	Amendment to the 2002 Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.5 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.11	Activision, Inc. 2002 Executive Incentive Plan (incorporated by reference to Exhibit 4.1 of Activision's Form S-8, Registration No. 333-100114 filed September 26, 2002).
10.12	Amendment to the 2002 Executive Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.6 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.13	Activision, Inc. 2002 Studio Employee Retention Incentive Plan (incorporated by reference to Exhibit 4.1 of Activision's Form S-8, Registration No. 333-103323 filed February 19, 2003).
10.14	Amendment to the 2002 Studio Employee Retention Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.7 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.15	Activision, Inc. Third Amended and Restated 2002 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.2 of Activision's Current Report on Form 8-K filed October 23, 2006).
10.16	Activision, Inc. Second Amended and Restated 2002 Employee Stock Purchase Plan for International Employees (incorporated by reference to Exhibit 10.1 of Activision's Current Report on Form 8-K filed October 23, 2006).
10.17	Activision, Inc. Sub-Plan to the Second Amended And Restated 2002 Employee Stock Purchase Plan for International Employees for Eligible Employees in the European Economic Area.
10.18	Australian Addendum to the Activision, Inc. Sub-Plan to the Second Amended And Restated 2002 Employee Stock Purchase Plan for International Employees for Eligible Employees.
10.19	Activision, Inc. Amended and Restated 2003 Incentive Plan (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2005).

10.20	Amendment to the 2003 Executive Incentive Plan, dated as of September 14, 2006 (incorporated by reference to Exhibit 10.9 of Activision's Current Report on Form 8-K filed September 20, 2006).
10.21	Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 99.1 to Activision's Registration Statement on Form S-8, Registration No. 333-146431, filed October 1, 2007).
10.22	Australian Addendum to the Activision, Inc. 2007 Incentive Plan.
10.23	Form of Stock Option Certificate for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 1998 Incentive Plan (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K, filed May 31, 2005).
10.24	Form of Stock Option Certificate for grants to persons other than non-employee directors issued pursuant the Activision, Inc. 1999 Incentive Plan (incorporated by reference to Exhibit 10.2 of Activision's Form 8-K, filed May 31, 2005).
10.25	Form of Stock Option Agreement for grants to persons other than non-employee directors issued pursuant the Activision, Inc. 2001 Incentive Plan (incorporated by reference to Exhibit 10.3 of Activision's Form 8-K, filed May 31, 2005).
10.26	Form of Stock Option Agreement for grants to persons other than non-employee directors issued pursuant the Activision, Inc. 2002 Executive Incentive Plan (incorporated by reference to Exhibit 10.4 of Activision's Form 8-K, filed May 31, 2005).
10.27	Form of Executive Stock Option Agreement for grants to Robert Kotick or Brian Kelly issued pursuant the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.40 of Activision's Form 10-K for the year ended March 31, 2005).
10.28	Form of Non-Executive Stock Option Agreement for grants to persons other than Robert Kotick or Brian Kelly and non-employee directors issued pursuant the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.41 of Activision's Form 10-K for the year ended March 31, 2005).
10.29	Form of Non-Employee Director Stock Option Agreement for grants to non-employee directors issued pursuant the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.17 of Activision's Form 10-K for the year ended March 31, 2007).
10.30	Notice of Share Option Award for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.18 of Activision's Form 10-K for the year ended March 31, 2007).
10.31	Notice of Share Option Award for grants to non-employee directors issued pursuant to the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.19 of Activision's Form 10-K for the year ended March 31, 2007).
10.32	Notice of Restricted Share Award for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.20 of Activision's Form 10-K for the year ended March 31, 2007).

10.33	Notice of Restricted Share Unit Award for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 2003 Incentive Plan (incorporated by reference to Exhibit 10.21 of Activision's Form 10-K for the year ended March 31, 2007).
10.34	Notice of Stock Option Award for grants to persons other than non-employee directors pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.9 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.35	Notice of Stock Option Award for grants to non-employee directors pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.10 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.36	Notice of Restricted Share Award for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.11 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.37	Notice of Restricted Share Unit Award for grants to persons other than non-employee directors issued pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.12 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.38	Notice of Restricted Share Unit Award for grants to non-employee directors upon their initial election to the board or upon their tenth continuous year of service on the board issued pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.13 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.39	Notice of Restricted Share Unit Award for grants to non-employee directors upon their reelection to the board (other than in connection with 10 years of continuous service) issued pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.14 of Activision's Form 10-Q for the quarter ended December 31, 2007).
10.40	Employment Agreement, dated July 22, 2002, between Ronald Doornink and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.6 of Activision's Form 10-Q for the quarter ended June 30, 2002).
10.41	Amendment, dated February 27, 2003, to Employment Agreement dated July 22, 2002 between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.34 of Activision's Form 10-K for the year ended March 31, 2005).
10.42	Amendment, dated June 1, 2004, to Employment Agreement dated July 22, 2002, between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended June 30, 2004).
10.43	Amendment, dated June 15, 2005, to Employment Agreement dated July 22, 2002 between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended June 30, 2005).
10.44	Amendment, dated June 4, 2007, to Employment Agreement dated July 22, 2002 between Activision Publishing, Inc. and Ronald Doornink (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended June 30, 2007).
10.45	Employment Agreement, dated June 15, 2005, between Michael Griffith and Activision Publishing, Inc (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended June 30, 2005).

10.46	Amendment to Employment Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Michael Griffith (incorporated by reference to Exhibit 10.7 of Activision's Form 8-K, filed December 6, 2007).
10.47	Stock Option Agreement, dated June 15, 2005, between Michael Griffith and Activision, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended June 30, 2005).
10.48	Restricted Stock Agreement, dated June 15, 2005, between Michael Griffith and Activision, Inc. (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended June 30, 2005).
10.49	Employment Agreement, dated September 9, 2005, between Thomas Tippl and Activision Publishing, Inc (incorporated by reference to Exhibit 10.1 of Activision's Form 10-Q for the quarter ended September 30, 2005).
10.50	Stock Option Agreement, dated October 3, 2005, between Thomas Tippl and Activision, Inc. (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended September 30, 2005).
10.51	Restricted Stock Agreement, dated October 3, 2005, between Thomas Tippl and Activision, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended September 30, 2005).
10.52	Employment Agreement, dated September 18, 2006, between Brian Hodous and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended December 31, 2006).
10.53	Letter Agreement, dated September 6, 2006, between Brian Hodous and Activision, Inc. (incorporated by reference to Exhibit 10.44 of Activision's Form 10-K for the year ended March 31, 2007).
10.54	Notice of Share Option Award to, dated as of November 3, 2006, to Brian Hodous (incorporated by reference to Exhibit 10.45 of Activision's Form 10-K for the year ended March 31, 2007).
10.55	Notice of Restricted Stock Award, dated as of November 3, 2006, to Brian Hodous (incorporated by reference to Exhibit 10.46 of Activision's Form 10-K for the year ended March 31, 2007).
10.56	Notice of Restricted Stock Award, dated as of November 3, 2006, to Brian Hodous (incorporated by reference to Exhibit 10.47 of Activision's Form 10-K for the year ended March 31, 2007).
10.57	Employment Agreement, dated October 1, 2006, between Robin Kaminsky and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended December 31, 2006).
10.58	Notice of Share Option Award to Robin Kaminsky, dated as of October 19, 2006 (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.59	Notice of Share Option Award to Robin Kaminsky, dated as of October 19, 2006 (incorporated by reference to Exhibit 10.3 of Activision's Form 10-Q for the quarter ended September 30, 2007).

10.60	Notice of Restricted Stock Award to Robin Kaminsky, dated as of October 19, 2006 (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.61	Notice of Restricted Stock Award to Robin Kaminsky, dated as of October 19, 2006, between Activision and Robin Kaminsky (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.62	Employment Agreement, dated September 11, 2007, between George Rose and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.7 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.63	Notice of Share Option Award to George Rose, dated September 28, 2007 (incorporated by reference to Exhibit 10.12 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.64	Notice of Restricted Share Unit Award to George Rose, dated September 28, 2007 (incorporated by reference to Exhibit 10.13 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.65	Employment Agreement, dated September 12, 2007, between Ann Weiser and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.8 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.66	Notice of Share Option Award to Ann Weiser, dated September 28, 2007 (incorporated by reference to Exhibit 10.14 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.67	Notice of Restricted Share Unit Award to Ann Weiser, dated September 28, 2007 (incorporated by reference to Exhibit 10.15 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.68	Amended and Restated Employment Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.3 of Activision's Form 8-K, filed December 6, 2007).
10.69	Replacement Bonus Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.5 of Activision's Form 8-K, filed December 6, 2007).
10.70	Stock Option Agreement, dated May 22, 2000, between Activision, Inc. and Robert A. Kotick (incorporated by reference to Exhibit 10.2 of Activision's Form 10-Q for the quarter ending September 30, 2000).
10.71	Notice of Stock Option Award to Robert A. Kotick, dated December 5, 2007.
10.72	Amended and Restated Employment Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.4 of Activision's Form 8-K, filed December 6, 2007).
10.73	Replacement Bonus Agreement, dated as of December 1, 2007, by and between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.6 of Activision's Form 8-K, filed December 6, 2007).
10.74	Stock Option Agreement, dated May 22, 2000, between Activision, Inc. and Brian G. Kelly (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ending September 30, 2000).

10.75	PlayStation 2 CD-ROM/DVD-ROM Licensed Publisher Agreement, dated as of April 1, 2000, between Sony Computer Entertainment America Inc. and Activision, Inc. (incorporated by reference to Exhibit 10.9 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
10.76	Letter regarding Modification of Territory for PlayStation 2 CD-ROM/DVD-ROM Licensed Publisher Agreement, dated as of June 11, 2004, from Sony Computer Entertainment America Inc. to Activision, Inc. (incorporated by reference to Exhibit 10.50 of Activision's Form 10-K for the year ended March 31, 2007).
10.77	PlayStation 2 Licensed Publisher Agreement, dated as of March 23, 2001, between Sony Computer Entertainment Europe Limited and Activision UK Limited (incorporated by reference to Exhibit 10.10 of Activision's Form S-3, Registration No. 333-101271, filed January 14, 2003).*
10.78	PlayStation Portable ("PSP") Licensed PSP Publisher Agreement, dated September 15, 2004, between Sony Computer Entertainment America Inc. and Activision, Inc. (incorporated by reference to Exhibit 10.46 of Activision's Form 10-K for the year ended March 31, 2005).*
10.79	PlayStation Portable ("PSP") Licensed PSP Publisher Agreement, dated September 27, 2005, between Sony Computer Entertainment Europe Limited and Activision UK Limited (incorporated by reference to Exhibit 10.60 of Activision's Form 10-K for year ended March 31, 2006).*
10.80	Global PlayStation 3 Format Licensed Publisher Agreement, dated March 5, 2007, between Sony Computer Entertainment America, Inc. and Activision. Inc (incorporated by reference to Exhibit 10.54 of Activision's Form 10-K for the year ended March 31, 2007).*
10.81	Confidential License Agreement for the Nintendo DS (Western Hemisphere), dated as of October 11, 2004, between Nintendo Co., Ltd. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.8 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.82	First Amendment to Confidential License Agreement for Nintendo DS (Western Hemisphere), dated as of July 16, 2007, between Nintendo Co., Ltd. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.6 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.83	License Agreement for the Nintendo DS System (EEA, Australia and New Zealand), dated June 20, 2006, between Nintendo Co., Ltd. and Activision, Inc. (incorporated by reference to Exhibit 10.61 of Activision's Form 10-K for the year ended March 31, 2007).*
10.84	Confidential License Agreement for the Wii Console (Western Hemisphere), dated September 12, 2007, between Nintendo of America, Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.9 of Activision's Form 10-Q for the quarter ended September 30, 2007).*
10.85	Confidential License Agreement for the Wii Console (EEA, Australia and New Zealand), dated December 3, 2007, between Nintendo Co., Ltd., Activision, Inc. and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.8 of Activision's Form 10-Q for the quarter ended December 31, 2007).*

10.86	Microsoft Corporation Xbox 360 Publisher License Agreement, dated as of October 25, 2005, between Microsoft Licensing, GP and Activision Publishing, Inc (incorporated by reference to Exhibit 10.4 of Activision's Form 10-Q for the quarter ended December 31, 2005).*
10.87	Xbox 360 Disc Program Addendum to the Xbox 360 Publisher License Agreement, dated as of December 15, 2005, between Microsoft Licensing, GP and Activision Publishing, Inc (incorporated by reference to Exhibit 10.5 of Activision's Form 10-Q for the quarter ended December 31, 2005).*
10.88	Amendment to the Xbox 360 Publisher Licensing Agreement (Platinum/Classic Hits Program), dated as of October 1, 2006, by and between Microsoft Licensing, GP and Activision, Inc. (incorporated by reference to Exhibit 10.68 of Activision's Form 10-K for the year ended March 31, 2007).*
10.89	Xbox Live Server Platform Addendum to the Xbox 360 Publisher Licensing Agreement, dated as of February 6, 2007, by and between Microsoft Licensing, GP and Activision Publishing, Inc. (incorporated by reference to Exhibit 10.69 of Activision's Form 10-K for the year ended March 31, 2007).
10.90	Chart of Compensation Paid to Non-Employee Directors (incorporated by reference to Exhibit 10.10 of Activision's Form 10-Q for the quarter ended September 30, 2007).
10.91	Voting and Lock-Up Agreement, dated as of December 1, 2007, by and among Activision, Inc., Vivendi S.A. and Robert A. Kotick (incorporated by reference to Exhibit 10.1 of Activision's Form 8-K, filed December 6, 2007).
10.92	Voting and Lock-Up Agreement, dated as of December 1, 2007, by and among Activision, Inc., Vivendi S.A. and Brian G. Kelly (incorporated by reference to Exhibit 10.2 of Activision's Form 8-K, filed December 6, 2007).
14.1	Code of Ethics for Senior Executive and Senior Financial Officers (incorporated by reference to Exhibit 14.1 of Activision's Form 10-K for the year ended March 31, 2004).
21.1	Principal subsidiaries of Activision.
23.1	Consent of Independent Registered Public Accounting Firm.
31.1	Certification of Robert A. Kotick pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Michael Griffith pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3	Certification of Thomas Tippl pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Michael Griffith pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.3	Certification of Thomas Tippl pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1	Risk Factors from Preliminary Proxy Statement Filed by Activision on April 30, 2008.
99.2	Stipulation of Settlement, dated May 8, 2008 in In re Activision, Inc. Shareholder Derivative Litigation.
99.3	Order Preliminarily Approving Derivative Settlement and Providing for Notice, dated May 13, 2008 in In re Activision, Inc. Shareholder Derivative Litigation.

*
Portions omitted pursuant to a request for confidential treatment.

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