

TAKE TWO INTERACTIVE SOFTWARE INC  
Form 10-Q  
February 06, 2013

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

**For the quarterly period ended December 31, 2012**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 0-29230**

**TAKE-TWO INTERACTIVE SOFTWARE, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**51-0350842**  
(I.R.S. Employer  
Identification No.)

**622 Broadway**  
**New York, New York**  
(Address of principal executive offices)

**10012**  
(Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data 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  No

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

Accelerated filer

Smaller reporting company

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Non-accelerated filer

(Do not check if a  
smaller reporting company)

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

As of February 1, 2013, there were 91,642,586 shares of the Registrant's Common Stock outstanding.

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(All other items in this report are inapplicable)

[Table of Contents](#)**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****TAKE-TWO INTERACTIVE SOFTWARE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except per share amounts)

	December 31, 2012 (Unaudited)	March 31, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 448,723	\$ 420,279
Accounts receivable, net of allowances of \$62,746 and \$51,002 at December 31, 2012 and March 31, 2012, respectively	94,241	45,035
Inventory	29,687	22,477
Software development costs and licenses	199,813	211,224
Prepaid expenses and other	45,426	44,602
<b>Total current assets</b>	<b>817,890</b>	<b>743,617</b>
Fixed assets, net		
Software development costs and licenses, net of current portion	74,327	104,755
Goodwill	228,786	228,169
Other intangibles, net	9,301	16,266
Other assets	35,776	37,671
<b>Total assets</b>	<b>\$ 1,189,781</b>	<b>\$ 1,149,427</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 42,263	\$ 46,681
Accrued expenses and other current liabilities	211,425	156,768
Deferred revenue	26,348	13,864
Liabilities of discontinued operations	1,181	1,412
<b>Total current liabilities</b>	<b>281,217</b>	<b>218,725</b>
Long-term debt		
Other long-term liabilities	330,311	316,340
Liabilities of discontinued operations, net of current portion	12,480	16,316
	959	2,319
<b>Total liabilities</b>	<b>624,967</b>	<b>553,700</b>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value, 5,000 shares authorized		
Common stock, \$.01 par value, 200,000 and 150,000 shares authorized at December 31, 2012 and March 31, 2012, respectively; 93,659 and 90,215 shares issued and outstanding at December 31, 2012 and March 31, 2012, respectively	937	902

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Additional paid-in capital	<b>819,871</b>	799,431
Accumulated deficit	<b>(263,303)</b>	(211,339)
Accumulated other comprehensive income	<b>7,309</b>	6,733
<b>Total stockholders' equity</b>	<b>564,814</b>	595,727
Total liabilities and stockholders' equity	<b>\$ 1,189,781</b>	\$ 1,149,427

See accompanying Notes.

Table of Contents**TAKE-TWO INTERACTIVE SOFTWARE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)****(in thousands, except per share amounts)**

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Net revenue	\$ 415,773	\$ 236,325	\$ 914,996	\$ 677,739
Cost of goods sold	216,299	126,467	561,517	412,389
Gross profit	199,474	109,858	353,479	265,350
Selling and marketing	60,724	40,228	205,582	143,684
General and administrative	32,880	29,705	106,891	86,067
Research and development	22,369	16,823	57,001	49,340
Depreciation and amortization	2,509	2,854	7,828	9,383
Total operating expenses	118,482	89,610	377,302	288,474
Income (loss) from operations	80,992	20,248	(23,823)	(23,124)
Interest and other, net	(8,094)	(6,190)	(23,562)	(14,203)
Income (loss) from continuing operations before income taxes	72,898	14,058	(47,385)	(37,327)
Provision (benefit) for income taxes	2,021	(127)	4,947	4,368
Income (loss) from continuing operations	70,877	14,185	(52,332)	(41,695)
Income (loss) from discontinued operations, net of taxes	488	(81)	368	(285)
Net income (loss)	\$ 71,365	\$ 14,104	\$ (51,964)	\$ (41,980)
Earnings (loss) per share:				
Continuing operations	\$ 0.76	\$ 0.16	\$ (0.61)	\$ (0.50)
Discontinued operations	\$			(0.01)
Basic earnings (loss) per share	\$ 0.76	\$ 0.16	\$ (0.61)	\$ (0.51)
Continuing operations	\$ 0.66	\$ 0.16	\$ (0.61)	\$ (0.50)
Discontinued operations				(0.01)
Diluted earnings (loss) per share	\$ 0.66	\$ 0.16	\$ (0.61)	\$ (0.51)

See accompanying Notes.

Table of Contents**TAKE-TWO INTERACTIVE SOFTWARE, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)**

(in thousands)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Net income (loss)	\$ 71,365	\$ 14,104	\$ (51,964)	\$ (41,980)
Other comprehensive income (loss):				
Foreign currency translation adjustment	(360)	(2,783)	(42)	(12,023)
Change in unrealized gains on derivative instruments, net	449		618	
Other comprehensive income (loss)	\$ 89	\$ (2,783)	\$ 576	\$ (12,023)
Comprehensive income (loss)	\$ 71,454	\$ 11,321	\$ (51,388)	\$ (54,003)

See accompanying Notes.

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## TAKE-TWO INTERACTIVE SOFTWARE, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

	Nine Months Ended December 31,	
	2012	2011
<b>Operating activities:</b>		
Net loss	\$ (51,964)	\$ (41,980)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization and impairment of software development costs and licenses	189,319	117,158
Depreciation and amortization	7,828	9,383
(Income) loss from discontinued operations	(368)	285
Amortization and impairment of intellectual property	6,678	979
Stock-based compensation	22,778	23,463
Amortization of discount on Convertible Notes	13,971	7,294
Amortization of debt issuance costs	1,521	1,014
Other, net	735	778
Changes in assets and liabilities, net of effect from purchases of businesses:		
Accounts receivable	(49,206)	30,943
Inventory	(7,210)	2,062
Software development costs and licenses	(150,479)	(147,315)
Prepaid expenses, other current and other non-current assets	(474)	4,125
Deferred revenue	12,484	(1,640)
Accounts payable, accrued expenses and other liabilities	47,072	(59,574)
Net cash used in discontinued operations	(1,223)	(1,580)
Net cash provided by (used in) operating activities	41,462	(54,605)
<b>Investing activities:</b>		
Purchase of fixed assets	(12,317)	(7,984)
Net cash used in discontinued operations		(1,475)
Net cash used in investing activities	(12,317)	(9,459)
<b>Financing activities:</b>		
Proceeds from exercise of employee stock options		238
Proceeds from issuance of Convertible Notes		250,000
Payment of debt issuance costs		(6,875)
Net cash provided by financing activities		243,363
Effects of foreign currency exchange rates on cash and cash equivalents	(701)	(6,342)
Net increase in cash and cash equivalents	28,444	172,957
Cash and cash equivalents, beginning of period	420,279	280,359
Cash and cash equivalents, end of period	\$ 448,723	\$ 453,316



See accompanying Notes.

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**TAKE-TWO INTERACTIVE SOFTWARE, INC.**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**(Dollars in thousands, except share and per share amounts)**

**1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

Take-Two Interactive Software, Inc. (the "Company," "we," "us," or similar pronouns) was incorporated in the state of Delaware in 1993. We are a leading developer, marketer and publisher of interactive entertainment for consumers around the globe. The Company develops and publishes products through its two wholly-owned labels Rockstar Games and 2K, which publishes its titles under the 2K Games, 2K Sports and 2K Play brands. Our products are designed for console systems, handheld gaming systems and personal computers, including smart phones and tablets, and are delivered through physical retail, digital download, online platforms and cloud streaming services.

**Basis of Presentation**

The accompanying Unaudited Condensed Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries and reflect all normal and recurring adjustments necessary for the fair presentation of our financial position, results of operations and cash flows. All material inter-company accounts and transactions have been eliminated in consolidation. The preparation of these Unaudited Condensed Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in these Unaudited Condensed Consolidated Financial Statements and accompanying notes. As permitted under U.S. generally accepted accounting principles, interim accounting for certain expenses, including income taxes, are based on full year assumptions when appropriate. Actual results could differ materially from those estimates.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"), although we believe that the disclosures are adequate to make the information presented not misleading. These Unaudited Condensed Consolidated Financial Statements and accompanying notes should be read in conjunction with our annual consolidated financial statements and the notes thereto, included in our Annual Report on Form 10-K for the year ended March 31, 2012.

Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

**Discontinued Operations**

In February 2010, we completed the sale to SYNnex Corporation ("Synnex") of our Jack of All Games third party distribution business, which primarily distributed third party interactive entertainment software, hardware and accessories in North America. The financial information of our distribution business has been classified as discontinued operations in these Unaudited Condensed Consolidated Financial Statements for all of the periods presented. See Note 2 for additional information regarding discontinued operations. Unless otherwise noted, amounts and disclosures throughout the Notes to Unaudited Condensed Consolidated Financial Statements relate to the Company's continuing operations.

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**TAKE-TWO INTERACTIVE SOFTWARE, INC.**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(Dollars in thousands, except share and per share amounts)**

**1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Financial Instruments**

The carrying amounts of our financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, approximate fair value because of their short maturities. We consider all highly liquid instruments purchased with original maturities of three months or less to be cash equivalents. At December 31, 2012 and March 31, 2012 we had \$8,291 and \$16,464, respectively, of cash on deposit reported as a component of prepaid expenses and other in the accompanying Condensed Consolidated Balance Sheets because its use was restricted.

As of December 31, 2012, the estimated fair value of the Company's 4.375% Convertible Notes due 2014 and the Company's 1.75% Convertible Notes due 2016 was \$168,746 and \$238,125, respectively. See Note 8 for additional information regarding our Convertible Notes. The fair value was determined using observable market data for the Convertible Notes and its embedded option feature.

We transact business in various foreign currencies and have significant sales and purchase transactions denominated in foreign currencies, subjecting us to foreign currency exchange rate risk. From time to time, we use hedging programs in an effort to mitigate the effect of foreign currency exchange rate movements.

***Cash Flow Hedging Activities***

We use foreign currency forward contracts to mitigate foreign currency exchange rate risk associated with forecasted transactions involving non-functional currency denominated expenditures. These contracts, which are designated and qualify as cash flow hedges, are accounted for as derivatives whereby the fair value of the contracts is reported as either assets or liabilities on our Condensed Consolidated Balance Sheets. The effective portion of gains or losses resulting from changes in the fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income (loss) in stockholders' equity. The gross amount of the effective portion of gains or losses resulting from changes in the fair value of these hedges is subsequently reclassified into cost of goods sold or research and development expenses, as appropriate, in the period when the forecasted transaction is recognized in our Condensed Consolidated Statements of Operations. In the event that the gains or losses in accumulated other comprehensive income (loss) are deemed to be ineffective, the ineffective portion of gains or losses resulting from changes in fair value, if any, is reclassified to interest and other, net, in our Condensed Consolidated Statements of Operations. In the event that the underlying forecasted transactions do not occur, or it becomes probable that they will not occur, within the defined hedge period, the gains or losses on the related cash flow hedges are reclassified from accumulated other comprehensive income (loss) to interest and other, net, in our Condensed Consolidated Statements of Operations. During the reporting periods, all forecasted transactions occurred, and therefore, there were no such gains or losses reclassified into interest and other, net. We do not enter into derivative financial contracts for speculative or trading purposes. At December 31, 2012, we had \$7,843 of forward contracts outstanding to buy foreign currencies in exchange for U.S. dollars all of which have maturities of less than one year. At March 31, 2012, we had \$10,192 of forward contracts outstanding to buy foreign currencies in exchange for U.S. dollars all of which have maturities of less than one year. As of December 31, 2012, the fair value of these outstanding forward contracts was \$552 and is included in prepaid expenses and other. As of March 31, 2012, the fair value

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**TAKE-TWO INTERACTIVE SOFTWARE, INC.**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(Dollars in thousands, except share and per share amounts)**

**1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

of these outstanding forward contracts was immaterial and is included in accrued expenses and other current liabilities.

***Balance Sheet Hedging Activities***

We use foreign currency forward contracts to mitigate foreign currency exchange rate risk associated with non-functional currency denominated cash balances and inter-company funding loans, non-functional currency denominated accounts receivable and non-functional currency denominated accounts payable. These transactions are not designated as hedging instruments and are accounted for as derivatives whereby the fair value of the contracts is reported as either assets or liabilities on our Condensed Consolidated Balance Sheets, and gains and losses resulting from changes in the fair value are reported in interest and other, net, in our Condensed Consolidated Statements of Operations. We do not enter into derivative financial contracts for speculative or trading purposes. At December 31, 2012, we had \$24,975 of forward contracts outstanding to sell foreign currencies in exchange for U.S. dollars all of which have maturities of less than one year. At March 31, 2012, we had \$4,005 of forward contracts outstanding to buy foreign currencies in exchange for U.S. dollars and \$28,304 of forward contracts outstanding to sell foreign currencies in exchange for U.S. dollars all of which have maturities of less than one year. For the three months ended December 31, 2012 and 2011, we recorded gains of \$1,016 and \$360, respectively, related to foreign currency forward contracts in interest and other, net on the Condensed Consolidated Statements of Operations. For the nine months ended December 31, 2012 and 2011, we recorded gains of \$1,260 and \$597, respectively, related to foreign currency forward contracts in interest and other, net on the Condensed Consolidated Statements of Operations. As of December 31, 2012 and March 31, 2012, the fair value of these outstanding forward contracts was immaterial and is included in accrued expenses and other current liabilities.

**Recently Issued Accounting Pronouncements**

***Comprehensive Income***

On April 1, 2012, the Company adopted new guidance related to the presentation of comprehensive income. The main provisions of the new guidance provide that an entity that reports items of other comprehensive income has the option to present comprehensive income as (i) a single statement that presents the components of net income and total net income, the components of other comprehensive income and total other comprehensive income and a total for comprehensive income or (ii) in two separate but consecutive statements, whereby an entity must present the components of net income and total net income in the first statement and that statement is immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income and a total for comprehensive income. The new rules eliminate the option to present the components of other comprehensive income as part of the statement of stockholders' equity. These new rules are to be applied retrospectively and become effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2011 (April 1, 2012 for the Company), with early adoption permitted. The adoption of this new guidance did not have a material impact on our Unaudited Condensed Consolidated Financial Statements.

Table of Contents**TAKE-TWO INTERACTIVE SOFTWARE, INC.****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)****(Dollars in thousands, except share and per share amounts)****2. DISCONTINUED OPERATIONS**

In February 2010, we completed the sale of our Jack of All Games third party distribution business, which primarily distributed third party interactive entertainment software, hardware and accessories in North America, for approximately \$44,000, including \$37,250 in cash, subject to purchase price adjustments, and up to an additional \$6,750 subject to the achievement of certain items, which were not met. In April 2011, we settled on the purchase adjustments and as a result the purchase price was lowered by \$1,475. Consequently, the net purchase price after the settlement was \$35,775. The sale has allowed us to focus our resources on our publishing operations. The financial information of our distribution business has been classified as discontinued operations in the Unaudited Condensed Consolidated Financial Statements for all of the periods presented. The following is a summary of the liabilities of discontinued operations primarily related to a liability for a lease assumption without economic benefit less estimates of sublease income. The lease matures on September 30, 2014.

	December 31, 2012	March 31, 2012
Liabilities of discontinued operations:		
Current:		
Accrued expenses and other current liabilities	\$ 1,181	\$ 1,412
Total current liabilities	1,181	1,412
Other non-current liabilities	959	2,319
Total liabilities of discontinued operations	\$ 2,140	\$ 3,731

**3. MANAGEMENT AGREEMENT**

In March 2007, we entered into a management services agreement (as amended, the "Management Agreement") with ZelnickMedia Corporation ("ZelnickMedia"), whereby ZelnickMedia provides us with certain management, consulting and executive level services. Strauss Zelnick, the President of ZelnickMedia, serves as our Executive Chairman and Chief Executive Officer and Karl Slatoff, a partner of ZelnickMedia, serves as our Chief Operating Officer. In May 2011, we entered into a new management agreement (the "New Management Agreement") with ZelnickMedia pursuant to which ZelnickMedia continues and will continue to provide management, consulting and executive level services to the Company through May 2015. As part of the New Management Agreement, Mr. Zelnick serves as Executive Chairman and Chief Executive Officer and Mr. Slatoff serves as Chief Operating Officer. In September 2011, the New Management Agreement, which upon effectiveness, superseded and replaced the Management Agreement was approved by the Company's stockholders at the Company's 2011 Annual Meeting. The New Management Agreement provides for the annual management fee to remain at \$2,500, subject to annual increases in the amount of 3% over the term of the agreement, and the maximum annual bonus was increased to \$3,500 from \$2,500, subject to annual increases in the amount of 3% over the term of the agreement, based on the Company achieving certain performance thresholds. For the three months ended December 31, 2012 and 2011, we recorded an expense of \$2,446 and a benefit of \$250, respectively, and for the nine months ended December 31, 2012 and 2011, we recorded an expense of \$4,635 and \$1,875, respectively, of consulting expense (a component of general and administrative expenses) in consideration for ZelnickMedia's services.

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**TAKE-TWO INTERACTIVE SOFTWARE, INC.**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(Dollars in thousands, except share and per share amounts)**

**3. MANAGEMENT AGREEMENT (Continued)**

Pursuant to the Management Agreement, in August 2007, we issued stock options to ZelnickMedia to acquire 2,009,075 shares of our common stock at an exercise price of \$14.74 per share, which vested over 36 months and expire 10 years from the date of grant. In June 2008, pursuant to the Management Agreement, we granted 600,000 shares of restricted stock to ZelnickMedia that vested annually over a three year period and 900,000 shares of market-based restricted stock that could have vested over a four year period through June 2012, provided that the Company's Total Shareholder Return (as defined in the relevant grant agreements) was at or higher than the 75<sup>th</sup> percentile of the NASDAQ Industrial Index measured annually on a cumulative basis. Because the price of our common stock did not achieve its performance targets, the 900,000 shares of market-based restricted stock were forfeited in June 2012. For the three months and nine months ended December 31, 2011, we recorded an expense of \$1 and \$508, respectively, of stock-based compensation (a component of general and administrative expenses) related to the shares of restricted stock granted pursuant to the Management Agreement.

In addition, pursuant to the New Management Agreement, we granted 1,100,000 shares of restricted stock to ZelnickMedia that will vest annually through April 1, 2015 and 1,650,000 shares of market-based restricted stock that will be eligible to vest through April 1, 2015, based on the Company's Total Shareholder Return (as defined in the relevant grant agreements) relative to the Total Shareholder Return of the companies that constitute the NASDAQ Composite Index measured annually on a cumulative basis. To earn all of the shares of market-based restricted stock, the Company must perform at the 75<sup>th</sup> percentile, or top quartile, of the NASDAQ Composite Index. Each reporting period, we remeasure the fair value of the unvested portion of the shares of market-based restricted stock granted to ZelnickMedia. The unvested portion of the shares of restricted stock granted pursuant to the New Management Agreement as of December 31, 2012 and March 31, 2012 was 2,169,750 and 2,750,000 shares, respectively. For the three months ended December 31, 2012 and 2011, we recorded an expense of \$1,613 and \$6,095, respectively, of stock-based compensation (a component of general and administrative expenses) related to the shares of restricted stock granted pursuant to the New Management Agreement. For the nine months ended December 31, 2012 and 2011, we recorded an expense of \$2,354 and \$6,427, respectively, of stock-based compensation (a component of general and administrative expenses) related to the shares of restricted stock granted pursuant to the New Management Agreement.

**4. FAIR VALUE MEASUREMENTS**

We follow a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of "observable inputs" and minimize the use of "unobservable inputs." The three levels of inputs used to measure fair value are as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for markets that are not active or other inputs that are observable or can be corroborated by observable market data.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models,

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discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The table below segregates all assets that are measured at fair value on a recurring basis (which is measured at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date.

	December 31, 2012	Quoted prices in active markets for identical assets (level 1)	Significant other observable inputs (level 2)	Significant unobservable inputs (level 3)
Bank-time deposits	\$ 212,103	\$ 212,103	\$	\$
Money market funds	\$ 84,009	\$ 84,009	\$	\$

**5. INVENTORY**

Inventory balances by category are as follows:

	December 31, 2012	March 31, 2012
Finished products	\$ 26,088	\$ 20,076
Parts and supplies	3,599	2,401
Inventory	\$ 29,687	\$ 22,477

Estimated product returns included in inventory at December 31, 2012 and March 31, 2012 were \$1,231 and \$1,610, respectively.

**6. SOFTWARE DEVELOPMENT COSTS AND LICENSES**

Details of our capitalized software development costs and licenses are as follows:

	December 31, 2012		March 31, 2012	
	Current	Non-current	Current	Non-current
Software development costs, internally developed	\$ 192,237	\$ 34,415	\$ 154,557	\$ 84,315
Software development costs, externally developed	3,858	36,912	53,542	14,440
Licenses	3,718	3,000	3,125	6,000
Software development costs and licenses	\$ 199,813	\$ 74,327	\$ 211,224	\$ 104,755

Software development costs and licenses as of December 31, 2012 and March 31, 2012 included \$253,712 and \$313,090, respectively, related to titles that have not been released.

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## TAKE-TWO INTERACTIVE SOFTWARE, INC.

## Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

(Dollars in thousands, except share and per share amounts)

## 7. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

	December 31, 2012	March 31, 2012
Software development royalties	\$ 57,077	\$ 31,689
Income tax payable and deferred tax liability	46,382	38,490
Licenses	28,137	32,706
Compensation and benefits	25,132	15,435
Marketing and promotions	21,626	9,771
Rent and deferred rent obligations	6,451	5,511
Professional fees	6,324	4,387
Deferred consideration for acquisitions	2,498	1,399
Other	17,798	17,380
Accrued expenses and other current liabilities	\$ 211,425	\$ 156,768

## 8. LONG-TERM DEBT

*Credit Agreement*

In October 2011, we entered into a Second Amended and Restated Credit Agreement (the "Credit Agreement") which amended and restated our July 2007 Credit Agreement. The Credit Agreement provides for borrowings of up to \$100,000, which may be increased by up to \$40,000 pursuant to the terms of the Credit Agreement, and is secured by substantially all of our assets and the equity of our subsidiaries. The Credit Agreement expires on October 17, 2016. Revolving loans under the Credit Agreement bear interest at our election of (a) 1.50% to 2.00% above a certain base rate (4.75% at December 31, 2012), or (b) 2.50% to 3.00% above the LIBOR Rate (approximately 2.71% at December 31, 2012), with the margin rate subject to the achievement of certain average liquidity levels. We are also required to pay a monthly fee on the unused available balance, ranging from 0.375% to 0.50% based on availability. We had no outstanding borrowings at December 31, 2012 and March 31, 2012.

Availability under the Credit Agreement is restricted by our United States and United Kingdom based accounts receivable and inventory balances. The Credit Agreement also allows for the issuance of letters of credit in an aggregate amount of up to \$25,000.

Information related to availability on our Credit Agreement is as follows:

	December 31, 2012	March 31, 2012
Available borrowings	\$ 98,336	\$ 79,069
Outstanding letters of credit	1,664	1,664

We recorded interest expense and fees related to the Credit Agreement of \$160 and \$215 for the three months ended December 31, 2012 and 2011, respectively, and \$479 and \$1,090 for the nine months ended December 31, 2012 and 2011, respectively.



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**TAKE-TWO INTERACTIVE SOFTWARE, INC.**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(Dollars in thousands, except share and per share amounts)**

**8. LONG-TERM DEBT (Continued)**

The Credit Agreement contains covenants that substantially limit us and our subsidiaries' ability to: create, incur, assume or be liable for indebtedness; dispose of assets outside the ordinary course of business; acquire, merge or consolidate with or into another person or entity; create, incur or allow any lien on any of their respective properties; make investments; or pay dividends or make distributions (each subject to certain limitations); or optionally prepay any indebtedness (subject to certain exceptions, including an exception permitting the redemption of the Company's unsecured convertible senior notes upon the meeting of certain minimum liquidity requirements). In addition, the Credit Agreement provides for certain events of default such as nonpayment of principal and interest, breaches of representations and warranties, noncompliance with covenants, acts of insolvency, default on indebtedness held by third parties and default on certain material contracts (subject to certain limitations and cure periods). The Credit Agreement also contains a requirement that we maintain an interest coverage ratio of more than one to one for the trailing twelve month period, if certain average liquidity levels fall below \$30,000. As of December 31, 2012, we were in compliance with all covenants and requirements outlined in the Credit Agreement.

***4.375% Convertible Notes Due 2014***

In June 2009, we issued \$138,000 aggregate principal amount of 4.375% Convertible Notes due 2014 (the "4.375% Convertible Notes"). The issuance of the 4.375% Convertible Notes included \$18,000 related to the exercise of an over-allotment option by the underwriters. Interest on the 4.375% Convertible Notes is payable semi-annually in arrears on June 1<sup>st</sup> and December 1<sup>st</sup> of each year, and commenced on December 1, 2009. The 4.375% Convertible Notes mature on June 1, 2014, unless earlier redeemed or repurchased by the Company or converted.

The 4.375% Convertible Notes are convertible at an initial conversion rate of 93.6768 shares of our common stock per \$1 principal amount of 4.375% Convertible Notes (representing an initial conversion price of approximately \$10.675 per share of common stock for a total of approximately 12,927,000 underlying conversion shares) subject to adjustment in certain circumstances. Holders may convert the 4.375% Convertible Notes at their option prior to the close of business on the business day immediately preceding December 1, 2013 only under the following circumstances: (1) during any fiscal quarter commencing after July 31, 2009, if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any 10 consecutive trading day period (the "measurement period") in which the trading price per \$1 principal amount of 4.375% Convertible Notes for each day of that measurement period was less than 98% of the product of the last reported sale price of our common stock and the applicable conversion rate on each such day; (3) if we call the 4.375% Convertible Notes for redemption, at any time prior to the close of business on the third scheduled trading day prior to the redemption date; or (4) upon the occurrence of specified corporate events. On and after December 1, 2013 until the close of business on the third scheduled trading day immediately preceding the maturity date, holders may convert their 4.375% Convertible Notes at any time, regardless of the foregoing circumstances. Upon conversion, the 4.375% Convertible Notes may be settled, at our election, in cash, shares of our common stock, or a combination of cash and shares of the Company's common stock.

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**TAKE-TWO INTERACTIVE SOFTWARE, INC.**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(Dollars in thousands, except share and per share amounts)**

**8. LONG-TERM DEBT (Continued)**

At any time on or after June 5, 2012, the Company may redeem all of the outstanding 4.375% Convertible Notes for cash, but only if the last reported sale of our common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the trading day prior to the date we provide notice of redemption to holders of the 4.375% Convertible Notes exceeds 150% of the conversion price in effect on each such trading day. The redemption price will equal 100% of the principal amount of the 4.375% Convertible Notes to be redeemed, plus all accrued and unpaid interest (including additional interest, if any) to, but excluding, the redemption date.

Upon the occurrence of certain fundamental changes involving the Company, holders of the 4.375% Convertible Notes may require us to purchase all or a portion of their 4.375% Convertible Notes for cash at a price equal to 100% of the principal amount of the notes to be purchased, plus accrued and unpaid interest (including additional interest, if any) to, but excluding, the fundamental change purchase date.

The indenture governing the 4.375% Convertible Notes contains customary terms and covenants and events of default. If an event of default (as defined therein) occurs and is continuing, the Trustee by notice to the Company, or the holders of at least 25% in aggregate principal amount of the 4.375% Convertible Notes then outstanding by notice to the Company and the Trustee, may, and the Trustee at the request of such holders shall, declare 100% of the principal of and accrued and unpaid interest (including additional interest, if any) on all the 4.375% Convertible Notes to be due and payable. In the case of an event of default arising out of certain bankruptcy events, 100% of the principal of and accrued and unpaid interest (including additional interest, if any), on the 4.375% Convertible Notes will automatically become due and payable immediately. As of December 31, 2012, we were in compliance with all covenants and requirements outlined in the indenture governing the 4.375% Convertible Notes.

The 4.375% Convertible Notes are senior unsecured obligations and rank senior in right of payment to our existing and future indebtedness that may be expressly subordinated in right of payment to the 4.375% Convertible Notes; equal in right of payment to our existing and future indebtedness that is not so subordinated; junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness incurred by our subsidiaries.

In connection with the offering of the 4.375% Convertible Notes, we entered into convertible note hedge transactions which are expected to reduce the potential dilution to our common stock upon conversion of the 4.375% Convertible Notes. The convertible note hedge transactions allow the Company to receive shares of its common stock related to the excess conversion value that it would convey to the holders of the 4.375% Convertible Notes upon conversion. The transactions include options to purchase approximately 12,927,000 shares of common stock at \$10.675 per share, expiring on June 1, 2014, for a total cost of approximately \$43,600, which was charged to additional paid-in capital.

Separately, the Company entered into a warrant transaction with a strike price of \$14.945 per share. The warrants will be net share settled and will cover approximately 12,927,000 shares of the Company's common stock and expire on August 30, 2014, for total proceeds of approximately \$26,300, which was credited to additional paid-in capital.

A portion of the net proceeds from the 4.375% Convertible Notes offering was used to pay the net cost of the convertible note hedge transactions (after such cost was partially offset by proceeds from

Table of Contents**TAKE-TWO INTERACTIVE SOFTWARE, INC.****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)****(Dollars in thousands, except share and per share amounts)****8. LONG-TERM DEBT (Continued)**

the sale of the warrants). We recorded approximately \$3,410 of banking, legal and accounting fees related to the issuance of the 4.375% Convertible Notes which were capitalized as debt issuance costs and will be amortized to interest and other, net over the term of the 4.375% Convertible Notes.

The following table provides additional information related to our 4.375% Convertible Notes:

	December 31, 2012	March 31, 2012
Additional paid-in capital	\$ 42,018	\$ 42,018
Principal amount of 4.375% Convertible Notes	\$ 138,000	\$ 138,000
Unamortized discount of the liability component	15,324	22,369
Net carrying amount of 4.375% Convertible Notes	\$ 122,676	\$ 115,631
Carrying amount of debt issuance costs	\$ 967	\$ 1,479

The following table provides the components of interest expense related to our 4.375% Convertible Notes:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Cash interest expense (coupon interest expense)	\$ 1,509	\$ 1,509	\$ 4,527	\$ 4,527
Non-cash amortization of discount on 4.375% Convertible Notes	2,425	2,131	7,045	6,191
Amortization of debt issuance costs	171	171	512	512
Total interest expense related to 4.375% Convertible Notes	\$ 4,105	\$ 3,811	\$ 12,084	\$ 11,230

**1.75% Convertible Notes Due 2016**

On November 16, 2011, we issued \$250,000 aggregate principal amount of 1.75% Convertible Notes due 2016 (the "1.75% Convertible Notes" and together with the 4.375% Convertible Notes, the "Convertible Notes"). Interest on the 1.75% Convertible Notes is payable semi-annually in arrears on June 1<sup>st</sup> and December 1<sup>st</sup> of each year, commencing on June 1, 2012. The 1.75% Convertible Notes mature on December 1, 2016, unless earlier repurchased by the Company or converted. The Company does not have the right to redeem the 1.75% Convertible Notes prior to maturity.

The 1.75% Convertible Notes are convertible at an initial conversion rate of 52.3745 shares of our common stock per \$1 principal amount of 1.75% Convertible Notes (representing an initial conversion price of approximately \$19.093 per share of common stock for a total of approximately 13,094,000 underlying conversion shares) subject to adjustment in certain circumstances. Holders may convert the 1.75% Convertible Notes at their option prior to the close of business on the business day immediately preceding June 1, 2016 only under the following circumstances: (1) during any fiscal quarter commencing after March 31, 2012, if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is greater than or equal to 130% of the applicable

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**TAKE-TWO INTERACTIVE SOFTWARE, INC.**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(Dollars in thousands, except share and per share amounts)**

**8. LONG-TERM DEBT (Continued)**

conversion price on each applicable trading day; (2) during the five business day period after any 10 consecutive trading day period (the "measurement period") in which the trading price per \$1 principal amount of 1.75% Convertible Notes for each day of that measurement period was less than 98% of the product of the last reported sale price of our common stock and the applicable conversion rate on each such day; or (3) upon the occurrence of specified corporate events. On and after June 1, 2016 until the close of business on the business day immediately preceding the maturity date, holders may convert their 1.75% Convertible Notes at any time, regardless of the foregoing circumstances. Upon conversion, the 1.75% Convertible Notes may be settled, at our election, in cash, shares of our common stock, or a combination of cash and shares of the Company's common stock.

Upon the occurrence of certain fundamental changes involving the Company, holders of the 1.75% Convertible Notes may require us to purchase all or a portion of their 1.75% Convertible Notes for cash at a price equal to 100% of the principal amount of the notes to be purchased, plus accrued and unpaid interest (including additional interest, if any) to, but excluding, the fundamental change purchase date.

The indenture governing the 1.75% Convertible Notes contains customary terms and covenants and events of default. If an event of default (as defined therein) occurs and is continuing, the Trustee by notice to the Company, or the holders of at least 25% in aggregate principal amount of the 1.75% Convertible Notes then outstanding by notice to the Company and the Trustee, may, and the Trustee at the request of such holders shall, declare 100% of the principal of and accrued and unpaid interest (including additional interest, if any) on all the 1.75% Convertible Notes to be due and payable. In the case of an event of default arising out of certain bankruptcy events, 100% of the principal of and accrued and unpaid interest (including additional interest, if any), on the 1.75% Convertible Notes will automatically become due and payable immediately. As of December 31, 2012, we were in compliance with all covenants and requirements outlined in the indenture governing the 1.75% Convertible Notes.

The 1.75% Convertible Notes are senior unsecured obligations and rank senior in right of payment to our existing and future indebtedness that is expressly subordinated in right of payment to the 1.75% Convertible Notes; equal in right of payment to our existing and future indebtedness that is not so subordinated; effectively junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all existing and future indebtedness incurred by our subsidiaries.

In accounting for the \$6,875 of banking, legal and accounting fees related to the issuance of the 1.75% Convertible Notes, we allocated \$5,428 to the liability component and \$1,447 to the equity component. Debt issuance costs attributable to the liability component are being amortized to interest and other, net over the term of the 1.75% Convertible Notes, and issuance costs attributable to the equity component were netted with the equity component in additional paid-in capital.

Table of Contents**TAKE-TWO INTERACTIVE SOFTWARE, INC.****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)****(Dollars in thousands, except share and per share amounts)****8. LONG-TERM DEBT (Continued)**

The following table provides additional information related to our 1.75% Convertible Notes:

	December 31, 2012	March 31, 2012
Additional paid-in capital	\$ 51,180	\$ 51,180
Principal amount of 1.75% Convertible Notes	\$ 250,000	\$ 250,000
Unamortized discount of the liability component	42,365	49,291
Net carrying amount of 1.75% Convertible Notes	\$ 207,635	\$ 200,709
Carrying amount of debt issuance costs	\$ 4,105	\$ 4,979

The following table provides the components of interest expense related to our 1.75% Convertible Notes:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Cash interest expense (coupon interest expense)	\$ 1,094	\$ 547	\$ 3,282	\$ 547
Non-cash amortization of discount on 1.75% Convertible Notes	2,347	1,103	6,926	1,103
Amortization of debt issuance costs	288	151	874	151
Total interest expense related to 1.75% Convertible Notes	\$ 3,729	\$ 1,801	\$ 11,082	\$ 1,801

Table of Contents**TAKE-TWO INTERACTIVE SOFTWARE, INC.****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)****(Dollars in thousands, except share and per share amounts)****9. EARNINGS (LOSS) PER SHARE ("EPS")**

The following table sets forth the computation of basic and diluted EPS (shares in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
<b>Computation of Basic EPS:</b>				
Net income (loss)	\$ 71,365	\$ 14,104	\$ (51,964)	\$ (41,980)
Less: net income allocated to participating securities	(5,808)	(939)		
Net income (loss) for basic EPS calculation	\$ 65,557	\$ 13,165	\$ (51,964)	\$ (41,980)
Total weighted average shares outstanding basic	93,338	89,523	85,382	83,003
Less: weighted average participating shares outstanding	(7,596)	(5,958)		
Weighted average common shares outstanding basic	85,742	83,565	85,382	83,003
Basic EPS	\$ 0.76	\$ 0.16	\$ (0.61)	\$ (0.51)
<b>Computation of Diluted EPS:</b>				
Net income (loss)	\$ 71,365	\$ 14,104	\$ (51,964)	\$ (41,980)
Less: net income allocated to participating securities	(5,808)	(939)		
Add: interest expense, net of tax, on Convertible Notes	7,834			
Net income (loss) for diluted EPS calculation	\$ 73,391	\$ 13,165	\$ (51,964)	\$ (41,980)
Weighted average common shares outstanding basic	85,742	83,565	85,382	83,003
Add: dilutive effect of common stock equivalents	26,021			
Weighted average common shares outstanding diluted	111,763	83,565	85,382	83,003
Diluted EPS	\$ 0.66	\$ 0.16	\$ (0.61)	\$ (0.51)

The Company incurred a net loss for the nine months ended December 31, 2012 and 2011; therefore, the basic and diluted weighted average shares outstanding exclude the impact of unvested share-based awards that are considered participating restricted stock and all common stock equivalents because their impact would be antidilutive.

Our unvested restricted stock rights (including restricted stock units, time-based and market-based restricted stock awards) are considered participating restricted stock since these securities have non-forfeitable rights to dividends or dividend equivalents during the contractual period of the award, and thus require the two-class method of computing EPS. The calculation of EPS for common stock shown above excludes the income attributable to the unvested restricted stock rights from the numerator and excludes the dilutive impact of those awards from the denominator. For the nine months ended December 31, 2012 and 2011, we had approximately 7,754,000 and 6,225,000, respectively, of unvested share-based awards that are considered participating restricted stock which are excluded due to the net loss for those periods.

The Company defines common stock equivalents as unexercised stock options, common stock equivalents underlying the Convertible Notes (see Note 8) and warrants outstanding during the period. Common stock equivalents are measured using the treasury stock method, except for the Convertible



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**TAKE-TWO INTERACTIVE SOFTWARE, INC.**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(Dollars in thousands, except share and per share amounts)**

**9. EARNINGS (LOSS) PER SHARE ("EPS") (Continued)**

Notes, which are assessed for their impact on diluted EPS using the more dilutive of the treasury stock method or the if-converted method. Under the provisions of the if-converted method, the Convertible Notes are assumed to be converted and included in the denominator of the EPS calculation and the interest expense, net of tax, recorded in connection with the Convertible Notes is added back to the numerator.

In connection with the issuance of our 4.375% Convertible Notes in June 2009, the Company purchased convertible note hedges (see Note 8) which were excluded from the calculation of diluted EPS because their impact is always considered antidilutive since the call option would be exercised by the Company when the exercise price is lower than the market price. Also in connection with the issuance of our 4.375% Convertible Notes, the Company entered into warrant transactions (see Note 8).

Other common stock equivalents excluded from the diluted EPS calculation were unexercised stock option awards of approximately 2,009,000 and 2,293,000 for the nine months ended December 31, 2012 and 2011, respectively, because their effect would be antidilutive. For the three months ended December 31, 2012 and 2011, the Company excluded from its diluted EPS calculation approximately 2,009,000 and 2,293,000, respectively, of common stock equivalents which were antidilutive because the common stock equivalents' exercise prices exceeded the average fair market value of the Company's common stock.

For the three and nine months ended December 31, 2012, we issued approximately 1,652,000 and 4,490,000 shares, respectively, of common stock in connection with restricted stock awards. During the three and nine months ended December 31, 2012, we canceled approximately 78,000 and 1,076,000 shares, respectively, of unvested restricted stock awards.

**10. SEGMENT AND GEOGRAPHIC INFORMATION**

We operate in one reportable segment in which we are a publisher of interactive software games designed for console systems, handheld gaming systems and personal computers, including smart phones and tablets, and are delivered through physical retail, digital download, online platforms and cloud streaming services. Our reporting segment is based upon our internal organizational structure, the manner in which our operations are managed and the criteria used by our Chief Executive Officer, our chief operating decision maker ("CODM") to evaluate performance. The Company's operations involve similar products and customers worldwide. We are centrally managed and the CODM primarily uses consolidated financial information supplemented by sales information by product category, major product title and platform to make operational decisions and assess financial performance. Our business consists of our Rockstar Games and 2K labels which have been aggregated into a single reportable segment (the "publishing segment") based upon their similar economic characteristics, products and distribution methods. Revenue earned from our publishing segment is primarily derived from the sale of internally developed software titles and software titles developed on our behalf by third-parties.



Table of Contents**TAKE-TWO INTERACTIVE SOFTWARE, INC.****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

(Dollars in thousands, except share and per share amounts)

**10. SEGMENT AND GEOGRAPHIC INFORMATION (Continued)**

We attribute net revenue to geographic regions based on product destination. Net revenue by geographic region was as follows:

Net revenue by geographic region:	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
United States	\$ 271,555	\$ 153,768	\$ 530,642	\$ 354,547
Europe	87,788	50,391	243,600	212,114
Canada and Latin America	26,018	13,985	70,878	53,880
Asia Pacific	30,412	18,181	69,876	57,198
<b>Total net revenue</b>	<b>\$ 415,773</b>	<b>\$ 236,325</b>	<b>\$ 914,996</b>	<b>\$ 677,739</b>

Net revenue by product platform was as follows:

Net revenue by product platform:	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Microsoft Xbox 360	\$ 178,527	\$ 91,190	\$ 402,031	\$ 296,519
Sony PlayStation 3	140,377	91,147	315,315	259,787
PC and other	73,559	26,773	160,145	69,010
Nintendo Wii	8,769	10,167	11,394	15,729
Sony PSP	4,560	6,555	9,967	13,528
Nintendo DS	5,263	6,459	8,421	13,187
Sony PlayStation 2	4,718	4,034	7,723	9,979
<b>Total net revenue</b>	<b>\$ 415,773</b>	<b>\$ 236,325</b>	<b>\$ 914,996</b>	<b>\$ 677,739</b>

**11. COMMITMENTS AND CONTINGENCIES**

At December 31, 2012, we did not have any significant changes to our commitments since March 31, 2012. See Note 13 of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended March 31, 2012 for more information regarding our commitments.

***Income Taxes***

Based on the progress and possible settlement of certain audits, we believe it is reasonably possible that our liability for gross unrecognized tax benefits will decrease by approximately \$5,330 during the next 12 months. See Note 13 of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended March 31, 2012 for more information regarding our gross unrecognized tax benefits.

***Legal and Other Proceedings***

We are, or may become, subject to demands and claims (including intellectual property claims) and are involved in routine litigation in the ordinary course of business which we do not believe to be

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**TAKE-TWO INTERACTIVE SOFTWARE, INC.**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(Dollars in thousands, except share and per share amounts)**

**11. COMMITMENTS AND CONTINGENCIES (Continued)**

material to our business or financial statements. We have appropriately accrued amounts related to certain of these claims and legal and other proceedings. While it is reasonably possible that a loss may be incurred in excess of the amounts accrued in our financial statements, we believe that such losses, unless otherwise disclosed, would not be material.

**12. SUBSEQUENT EVENT**

In January 2013, our board of directors authorized the repurchase of up to 7,500,000 shares of our common stock. The authorization permits the Company to purchase shares from time to time through a variety of methods, including in the open market or through privately negotiated transactions, in accordance with applicable securities laws. It does not obligate the Company to make any purchases at any specific time or situation. Repurchases are subject to the availability of stock, prevailing market conditions, the trading price of the stock, the Company's financial performance and other conditions. The program may be suspended or discontinued at any time for any reason.

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

**CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS**

*The statements contained herein which are not historical facts are considered forward-looking statements under federal securities laws and may be identified by words such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "potential," "predicts," "projects," "seeks," "will," or words of similar meaning and include, but are not limited to, statements regarding the outlook for the Company's future business and financial performance. Such forward-looking statements are based on the current beliefs of our management as well as assumptions made by and information currently available to them, which are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. Actual outcomes and results may vary materially from these forward-looking statements based on a variety of risks and uncertainties including those contained herein, in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2012, in the section entitled "Risk Factors," and the Company's other periodic filings with the SEC. All forward-looking statements are qualified by these cautionary statements and speak only as of the date they are made. The Company undertakes no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.*

Our Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is provided in addition to the accompanying Unaudited Condensed Consolidated Financial Statements and notes to assist readers in understanding our results of operations, financial condition and cash flows. The following discussion should be read in conjunction with the MD&A and our annual consolidated financial statements and the notes thereto, included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2012.

**Overview**

***Our Business***

We are a leading developer, marketer and publisher of interactive entertainment for consumers around the globe. We develop and publish products through our two wholly-owned labels Rockstar Games and 2K, which publishes its titles under the 2K Games, 2K Sports and 2K Play brands. Our products are designed for console gaming systems such as Sony's PlayStation®3 ("PS3") and PlayStation®2 ("PS2"), Microsoft's Xbox 360® ("Xbox 360") and Nintendo's Wii ("Wii") and Wii U ("Wii U"); handheld gaming systems such as Nintendo's DS ("DS"), Nintendo's 3DS ("3DS") and Sony's PlayStation Portable ("PSP"); and personal computers, including smartphones and tablets. We deliver our products through physical retail, digital download, online platforms and cloud streaming services.

We endeavor to be the most creative, innovative and efficient company in our industry. Our core strategy is to capitalize on the popularity of video games by developing and publishing high-quality interactive entertainment experiences across a range of genres. We focus on building compelling entertainment franchises by publishing a select number of titles for which we can create sequels and add-on content. Most of our intellectual property is internally owned and developed, which we believe best positions us financially and competitively. We have established a portfolio of proprietary software content for the major hardware platforms in a wide range of genres, including action, adventure, racing, role-playing, sports and strategy, which we distribute worldwide. We believe that our commitment to creativity and innovation is a distinguishing strength, enabling us to differentiate our products in the marketplace by combining advanced technology with compelling storylines and characters that provide unique gameplay experiences for consumers. We have created, acquired or licensed a group of highly recognizable brands to match the broad consumer demographics we serve, ranging from adults to children and game enthusiasts to casual gamers. Another cornerstone of our strategy is to support the success of our products in the marketplace through innovative marketing programs and global distribution on all platforms and through all channels that are relevant to our target audience.

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Our revenue is primarily derived from the sale of internally developed software titles and software titles developed by third-parties for our benefit. Operating margins are dependent in part upon our ability to continually release new, commercially successful software products and to effectively manage their development costs. We have internal development studios located in Australia, Canada, China, Czech Republic, the United Kingdom, and the United States.

Software titles published by our Rockstar Games label are primarily internally developed. We expect Rockstar Games, our wholly-owned publisher of the *Grand Theft Auto*, *Max Payne*, *Midnight Club*, *Red Dead* and other popular franchises, to continue to be a leader in the action / adventure product category and create groundbreaking entertainment by leveraging our existing titles as well as developing new brands. We believe that Rockstar has established a uniquely original, popular cultural phenomenon with its *Grand Theft Auto* series, which is the interactive entertainment industry's most iconic and critically acclaimed brand and has sold-in over 125 million units. Rockstar continues to expand on our established franchises by developing sequels, offering downloadable episodes and content, and releasing titles for smartphones and tablets such as *Grand Theft Auto III 10<sup>th</sup> Anniversary Edition*, *Max Payne Mobile*, and *Grand Theft Auto: Vice City 10<sup>th</sup> Anniversary Edition*. In May 2011, Rockstar released the commercially successful and critically acclaimed *L.A. Noire*, which became the first video game ever chosen as an official selection of the Tribeca Film Festival and has become another key franchise for the Company. Rockstar is also well known for developing brands in other genres, including the *Bully* and *Manhunt* franchises.

2K Games has published a variety of popular entertainment properties across multiple genres and platforms and we expect 2K Games to continue to develop new and successful franchises in the future. 2K Games' internally owned and developed franchises include the critically acclaimed, multi-million unit selling *BioShock*, *Mafia*, and *Sid Meier's Civilization* series. 2K Games has also published titles that were externally developed, such as *Borderlands*, which has become a key franchise for 2K Games since its release in October 2009. 2K Games successfully launched *Borderlands 2* in September 2012 and is supporting the title with four add-on content campaigns.

2K Sports publishes realistic sports simulation titles, including our flagship *NBA 2K* series, which has been the top-ranked NBA basketball video game for 12 years running, the *Major League Baseball 2K* series, and our *Top Spin* tennis series. We develop most of our 2K Sports software titles through our internal development studios. 2K Sports has secured long-term licensing agreements with the National Basketball Association ("NBA"). On January 9, 2013, 2K Sports announced that it had reached an agreement with Major League Baseball, the Major League Baseball Players Association, and Major League Baseball Advanced Media to release *Major League Baseball 2K13*, the next iteration of the popular *MLB 2K* franchise.

2K Play focuses on developing and publishing titles for the casual and family-friendly games market. 2K Play titles are developed by both internal development studios and third-party developers. Internally developed titles include *Carnival Games* and *Let's Cheer!*. 2K Play also has an agreement with Nickelodeon to publish video games based on its top rated Nick Jr. titles such as *Dora the Explorer*; *Go, Diego, Go!*; *Ni Hao, Kai-lan* and *The Backyardigans*. Throughout the summer and fall of 2012, 2K Play released a new slate of mobile games, including *Comedy Central's Indecision Game* our first mobile social game *House Pest Starring Fiasco the Cat*, *Gridblock* and *Herd, Herd, Herd*. We expect family-oriented gaming to continue to be a component of our business in the future.

We also have expansion initiatives in the rapidly growing Asia markets, where our strategy is to broaden the distribution of our existing products, expand our business in Japan, and establish an online gaming presence, especially in China and Korea. 2K Sports has secured a multi-year license from the NBA to develop an online version of the NBA simulation game in China, Taiwan, South Korea and Southeast Asia. On October 24, 2012, *NBA 2K Online*, the free-to-play NBA simulation game co-developed by 2K Sports and Tencent, launched commercially on the Tencent Games portal in China.

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In addition, during the summer of 2012, 2K Games released our first mobile social game for Japan, *NBA 2K All Stars* on GREE.

**Discontinued operations**

In February 2010, we completed the sale to SYNEX Corporation ("Synnex") of our Jack of All Games third-party distribution business, which primarily distributed third-party interactive entertainment software, hardware and accessories in North America for approximately \$44.0 million, including \$37.3 million in cash, subject to purchase price adjustments, and up to an additional \$6.7 million, subject to the achievement of certain items, which were not met. In April 2011, we settled on the purchase price adjustments and as a result the purchase price was lowered by \$1.5 million. Consequently, the net purchase price after the settlement was \$35.8 million. The financial information of our distribution business has been classified as discontinued operations in the Unaudited Condensed Consolidated Financial Statements for all of the periods presented. See Note 2 to our Unaudited Condensed Consolidated Financial Statements for additional information regarding discontinued operations.

***Trends and Factors Affecting our Business***

*Product Release Schedule.* Our financial results are affected by the timing of our product releases and the commercial success of those titles. Our *Grand Theft Auto* products in particular have historically accounted for a substantial portion of our revenue. Sales of *Grand Theft Auto* products generated approximately 10.9% of the Company's net revenue for the nine months ended December 31, 2012. The timing of our *Grand Theft Auto* releases varies significantly, which in turn may impact our financial performance on a quarterly and annual basis.

*Economic Environment and Retailer Performance.* We continue to monitor economic conditions that may unfavorably affect our businesses, such as deteriorating consumer demand, pricing pressure on our products, credit quality of our receivables, and foreign currency exchange rates. Our business is dependent upon a limited number of customers who account for a significant portion of our revenue. Our five largest customers accounted for approximately 51.0% and 40.3% of net revenue for the nine months ended December 31, 2012 and 2011, respectively. As of December 31, 2012 and March 31, 2012, amounts due from our five largest customers comprised approximately 57.8% and 61.3% of our gross accounts receivable balance, respectively, with our significant customers (those that individually comprised more than 10% of our gross accounts receivable balance) accounting for approximately 32.3% and 40.6% of such balance at December 31, 2012 and March 31, 2012, respectively. The economic environment has affected our customers in the past, and may do so in the future. Bankruptcies or consolidations of our large retail customers could seriously hurt our business, due to uncollectible accounts receivables and the concentration of purchasing power among the remaining large retailers. Certain of our large customers sell used copies of our games, which may negatively affect our business by reducing demand for new copies of our games. While the downloadable content that we now offer for certain of our titles may serve to reduce used game sales, we expect used game sales to continue to adversely affect our business.

*Hardware Platforms.* The majority of our products are made for the hardware platforms developed by three companies—Sony, Microsoft and Nintendo. Note 10 to our Unaudited Condensed Consolidated Financial Statements, "Segment and Geographic Information," discloses that Sony, Microsoft and Nintendo hardware platforms comprised approximately 82.5% of the Company's net revenue by product platform for the nine months ended December 31, 2012. The success of our business is dependent upon the consumer acceptance of these platforms and the continued growth in the installed base of these platforms. When new hardware platforms are introduced, demand for software based on older platforms declines, which may negatively affect our business. Additionally, our development costs are generally higher for titles based on new platforms, and we have limited ability to

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predict the consumer acceptance of new platforms, which may affect our sales and profitability. As a result, our strategy is to focus our development efforts on a select number of the highest quality titles for these platforms, while also expanding our offerings for emerging platforms such as mobile and online games.

*Online Content and Digital Distribution.* The interactive entertainment software industry is delivering a growing amount of content through digital online delivery methods. We provide a variety of online delivered products and services. A number of our titles that are available through retailers as packaged goods products are also available through direct digital download on the Internet (from websites we own and others owned by third-parties). We also offer downloadable add-on content for our packaged goods titles. In addition, we are publishing an expanding variety of titles for tablets and smartphones, which are delivered to consumers through digital download through the Internet. We expect online delivery of games and game services to become an increasing part of our business over the long-term.

### **Product Releases**

We released the following key titles during the nine months ended December 31, 2012:

<b>Title</b>	<b>Publishing Label</b>	<b>Internal or External Development</b>	<b>Platform(s)</b>	<b>Date Released</b>
<i>Max Payne 3</i>	Rockstar Games	Internal	PS3, Xbox 360	May 15, 2012
<i>Max Payne 3</i>	Rockstar Games	Internal	PC	June 1, 2012
<i>Spec Ops: The Line</i>	2K Games	External	PS3, Xbox 360, PC	June 26, 2012
<i>Borderlands 2</i>	2K Games	External	PS3, Xbox 360, PC	September 18, 2012
<i>NBA® 2K13</i>	2K Sports	Internal	PS3, PSP, Xbox 360, Wii, PC	October 2, 2012
<i>XCOM: Enemy Unknown</i>	2K Games	Internal	PS3, Xbox 360, PC	October 9, 2012
<i>NBA® 2K13</i>	2K Sports	Internal	Wii U	November 19, 2012

### **Product Pipeline**

We have announced the following future key titles to date (this list does not represent all titles currently in development):

<b>Title</b>	<b>Publishing Label</b>	<b>Internal or External Development</b>	<b>Platform(s)</b>	<b>Expected Release Date</b>
<i>Major League Baseball 2K13</i>	2K Sports	Internal	PS3, Xbox 360	March 5, 2013
<i>BioShock® Infinite</i>	2K Games	Internal	PS3, Xbox 360, PC	March 26, 2013
<i>Grand Theft Auto V</i>	Rockstar Games	Internal	PS3, Xbox 360	September 17, 2013
<i>XCOM®</i>	2K Games	Internal	PS3, Xbox 360, PC	Fiscal year 2014

### **Critical Accounting Policies and Estimates**

Our most critical accounting policies, which are those that require significant judgment, include: revenue recognition; allowances for returns, price concessions and other allowances; capitalization and recognition of software development costs and licenses; fair value estimates including inventory obsolescence, valuation of goodwill, intangible assets and long-lived assets; valuation and recognition of stock-based compensation; and income taxes. In-depth descriptions of these can be found in our Annual Report on Form 10-K for the fiscal year ended March 31, 2012.

Table of Contents**Recently Issued Accounting Pronouncements****Comprehensive Income**

On April 1, 2012, the Company adopted new guidance related to the presentation of comprehensive income. The main provisions of the new guidance provide that an entity that reports items of other comprehensive income has the option to present comprehensive income as (i) a single statement that presents the components of net income and total net income, the components of other comprehensive income and total other comprehensive income and a total for comprehensive income or (ii) in two separate but consecutive statements, whereby an entity must present the components of net income and total net income in the first statement and that statement is immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income and a total for comprehensive income. The new rules eliminate the option to present the components of other comprehensive income as part of the statement of stockholders' equity. These new rules are to be applied retrospectively and become effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2011 (April 1, 2012 for the Company), with early adoption permitted. The adoption of this new guidance did not have a material impact on our Unaudited Condensed Consolidated Financial Statements.

**Results of Operations**

Consolidated operating results, net revenue by geographic region and net revenue by platform as a percentage of net revenue are as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Net revenue	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	52.0%	53.5%	61.4%	60.8%
Gross profit	48.0%	46.5%	38.6%	39.2%
Selling and marketing	14.6%	17.0%	22.5%	21.2%
General and administrative	7.9%	12.6%	11.7%	12.7%
Research and development	5.4%	7.1%	6.2%	7.3%
Depreciation and amortization	0.6%	1.2%	0.8%	1.4%
Total operating expenses	28.5%	37.9%	41.2%	42.6%
Income (loss) from operations	19.5%	8.6%	(2.6)%	(3.4)%
Interest and other, net	(2.0)%	(2.7)%	(2.6)%	(2.1)%
Income (loss) from continuing operations before income taxes	17.5%	5.9%	(5.2)%	(5.5)%
Provision (benefit) for income taxes	0.5%	(0.1)%	0.5%	0.7%
Income (loss) from continuing operations	17.0%	6.0%	(5.7)%	(6.2)%
Income (loss) from discontinued operations, net of taxes	0.2%	0.0%	0.0%	0.0%
Net income (loss)	17.2%	6.0%	(5.7)%	(6.2)%
<b>Net revenue by geographic region:</b>				
United States	65.3%	65.1%	58.0%	52.3%
International	34.7%	34.9%	42.0%	47.7%
<b>Net revenue by platform:</b>				
Console	79.9%	83.2%	80.5%	85.9%
PC and other	17.7%	11.3%	17.5%	10.2%
Handheld	2.4%	5.5%	2.0%	3.9%

Table of Contents**Three Months Ended December 31, 2012 Compared to December 31, 2011**

(thousands of dollars)	2012	%	2011	%	Increase/ (decrease)	% Increase/ (decrease)
Net revenue	\$ 415,773	100.0%	\$ 236,325	100.0%	\$ 179,448	75.9%
Product costs	99,020	23.8%	68,803	29.1%	30,217	43.9%
Software development costs and royalties(1)	77,641	18.7%	27,236	11.5%	50,405	185.1%
Licenses	31,735	7.6%	20,521	8.7%	11,214	54.6%
Internal royalties	7,903	1.9%	9,907	4.2%	(2,004)	(20.2)%
Cost of goods sold	216,299	52.0%	126,467	53.5%	89,832	71.0%
<b>Gross profit</b>	<b>\$ 199,474</b>	<b>48.0%</b>	<b>\$ 109,858</b>	<b>46.5%</b>	<b>\$ 89,616</b>	<b>81.6%</b>

(1)

Includes \$1,790 and \$794 of stock-based compensation expense in 2012 and 2011, respectively.

Net revenue increased \$179.4 million for the three months ended December 31, 2012 as compared to the prior year. This increase is primarily driven by \$163.4 million in net revenue from the current fiscal year's releases mainly *Borderlands 2* in September 2012 and *XCOM: Enemy Unknown* in October 2012 and higher sales of our *NBA 2K* franchise, as well as approximately \$12.7 million in higher sales of our *Grand Theft Auto* franchise.

Net revenue on consoles accounted for 79.9% of our total net revenue for the three months ended December 31, 2012 as compared to 83.2% for the prior year primarily due to the increased proportion of total net revenue on PC and other platforms. PC and other sales increased to 17.7% of our total net revenue for the three months ended December 31, 2012 as compared to 11.3% for the prior year primarily due to an increase in net revenue resulting from the October 2012 release of *XCOM: Enemy Unknown* with proportionally higher PC sales and the September 2012 PC release of *Borderlands 2*, partially offset by a decrease in net revenue from the November 2011 PC release of *L.A. Noire: The Complete Edition*. Handheld sales accounted for 2.4% of our total net revenue for the three months ended December 31, 2012 as compared to 5.5% for the prior year primarily due to the increased proportion of total net revenue on PC and other platforms.

Gross profit as a percentage of net revenue for the three months ended December 31, 2012 was 48.0% as compared to 46.5% for the prior year. The increase was primarily due to improved pricing mix from the releases of *Borderlands 2* in September 2012 and *XCOM: Enemy Unknown* in October 2012 as well as from our *NBA 2K* franchise, partially offset by higher software development costs and royalties primarily associated with the September 2012 release of *Borderlands 2*, the October 2012 release of *XCOM: Enemy Unknown* and the May 2012 release of *Max Payne 3*.

Net revenue earned outside of the United States accounted for 34.7% of our total net revenue for the three months ended December 31, 2012 which was in line with 34.9% in the prior year. Foreign currency exchange rates decreased net revenue and gross profit by \$0.8 million for the three months ended December 31, 2012 as compared to the prior year.



Table of Contents**Operating Expenses**

(thousands of dollars)	2012	% of net revenue	2011	% of net revenue	Increase/ (decrease)	% Increase/ (decrease)
Selling and marketing	\$ 60,724	14.6%	\$ 40,228	17.0%	\$ 20,496	50.9%
General and administrative	32,880	7.9%	29,705	12.6%	3,175	10.7%
Research and development	22,369	5.4%	16,823	7.1%	5,546	33.0%
Depreciation and amortization	2,509	0.6%	2,854	1.2%	(345)	(12.1)%
<b>Total operating expenses(1)</b>	<b>\$ 118,482</b>	<b>28.5%</b>	<b>\$ 89,610</b>	<b>37.9%</b>	<b>\$ 28,872</b>	<b>32.2%</b>

(1)

Includes stock-based compensation expense, which was allocated as follows:

	2012	2011
Selling and marketing	\$ 1,701	\$ 1,336
General and administrative	\$ 4,324	\$ 7,828
Research and development	\$ 866	\$ 845

Foreign currency exchange rates decreased total operating expenses by \$0.2 million for the three months ended December 31, 2012 as compared to the prior year.

Selling and marketing

Selling and marketing expenses increased \$20.5 million for the three months ended December 31, 2012, as compared to the prior year primarily due to a \$14.9 million increase in advertising expenses incurred primarily for the upcoming releases of *Grand Theft Auto V* and *BioShock Infinite*, the October 2012 release of *XCOM: Enemy Unknown*, *Borderlands 2* and for our *NBA 2K* franchise, as compared to advertising expenses incurred in the prior year primarily for *Max Payne 3* and *Spec Ops: The Line*. Also contributing to the increase in selling and marketing expenses is a \$4.0 million increase in personnel costs primarily due to higher performance-based incentive compensation as a result of the Company's performance.

General and administrative

General and administrative expenses increased \$3.2 million for the three months ended December 31, 2012, as compared to the prior year primarily due to an increase of \$5.0 million for personnel costs and an increase of \$2.7 million for consulting expenses, primarily due to higher performance-based incentive compensation as a result of the Company's performance. Partially offsetting the increase in general and administrative expenses is a decrease of \$4.5 million in stock-based compensation expense for stock-based awards granted to ZelnickMedia, primarily reflecting the Company's relative stock price performance (see Note 3 to our Unaudited Condensed Consolidated Financial Statements for additional information).

General and administrative expenses for the three months ended December 31, 2012 and 2011 include occupancy expense (primarily rent, utilities and office expenses) of \$4.0 million and \$3.6 million, respectively, related to our development studios.

Research and development

Research and development expenses increased \$5.5 million for the three months ended December 31, 2012 as compared to the prior year primarily due to a \$5.0 million increase in personnel-related costs primarily due to increased headcount and higher performance-based incentive compensation as a result of the Company's performance.

Table of Contents**Interest and other, net**

Interest and other, net was an expense of \$8.1 million for the three months ended December 31, 2012, as compared to an expense of \$6.2 million for the three months ended December 31, 2011, primarily due to interest expense associated with the November 2011 issuance of the 1.75% Convertible Notes.

**Provision (Benefit) for income taxes**

For the three months ended December 31, 2012, income tax expense was \$2.0 million, as compared to income tax benefit of \$0.1 million for the three months ended December 31, 2011. The increase was primarily attributable to discrete tax benefits related to the resolution of certain foreign tax examinations during the three months ended December 31, 2011 as well as higher earnings subject to tax in foreign jurisdictions during the three months ended December 31, 2012.

Our effective tax rate differed from the federal statutory rate primarily due to changes in valuation allowances and changes in gross unrecognized tax benefits during the periods.

We are regularly audited by domestic and foreign taxing authorities. Audits may result in tax assessments in excess of amounts claimed and the payment of additional taxes. We believe that our tax positions comply with applicable tax law, and that we have adequately provided for reasonably foreseeable tax assessments.

**Net income and earnings per share**

For the three months ended December 31, 2012, our net income was \$71.4 million, as compared to net income of \$14.1 million in the prior year. Earnings per share for the three months ended December 31, 2012 was \$0.76 for basic and \$0.66 for diluted earnings as compared to earnings per share of \$0.16 for basic and diluted earnings for the three months ended December 31, 2011. Basic weighted average shares outstanding increased compared to the prior year period primarily due to the vesting of restricted stock awards over the last twelve months. Diluted weighted average shares outstanding increased compared to the prior year period primarily due to the inclusion of common stock equivalents underlying the 4.375% Convertible Notes and the 1.75% Convertible Notes. See Note 9 to our Unaudited Condensed Consolidated Financial Statements for additional information regarding earnings per share.

**Nine Months Ended December 31, 2012 Compared to December 31, 2011**

(thousands of dollars)	2012	%	2011	%	Increase/ (decrease)	% Increase/ (decrease)
Net revenue	\$ 914,996	100.0%	\$ 677,739	100.0%	\$ 237,257	35.0%
Software development costs and royalties(1)	260,180	28.4%	129,086	19.0%	131,094	101.6%
Product costs	244,593	26.7%	207,391	30.6%	37,202	17.9%
Licenses	47,483	5.2%	42,914	6.3%	4,569	10.6%
Internal royalties	9,261	1.1%	32,998	4.9%	(23,737)	(71.9)%
Cost of goods sold	561,517	61.4%	412,389	60.8%	149,128	36.2%
<b>Gross profit</b>	<b>\$ 353,479</b>	<b>38.6%</b>	<b>\$ 265,350</b>	<b>39.2%</b>	<b>\$ 88,129</b>	<b>33.2%</b>

(1) Includes \$8,034 and \$4,379 of stock-based compensation expense in 2012 and 2011, respectively.

Net revenue increased \$237.3 million for the nine months ended December 31, 2012 as compared to the prior year. This increase is primarily driven by \$497.9 million in net revenue from the current

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fiscal year's releases mainly *Borderlands 2* in September 2012, *Max Payne 3* in May 2012, *XCOM: Enemy Unknown* in October 2012 and *Spec Ops: The Line* in June 2012 and higher sales of our *NBA 2K* franchise, as well as approximately \$15.6 million in higher sales of our *Grand Theft Auto* franchise. These increases were partially offset by \$248.2 million in lower sales of the previous fiscal year's releases mainly *L.A. Noire*, which released in May 2011, and *Duke Nukem Forever*, which released in June 2011.

Net revenue on consoles decreased to 80.5% of our total net revenue for the nine months ended December 31, 2012 as compared to 85.9% for the same period in the prior year primarily due to the increased proportion of total net revenue on PC and other platforms. PC and other sales increased to 17.5% of our total net revenue for the nine months ended December 31, 2012 as compared to 10.2% for the prior year primarily due to an increase in net revenue resulting from the September 2012 PC release of *Borderlands 2*, the October 2012 release of *XCOM: Enemy Unknown* with proportionally higher PC sales and the June 2012 PC releases of *Max Payne 3* and *Sid Meier's Civilization® V: Gods & Kings*, partially offset by the decrease in net revenue from the June 2011 release of *Duke Nukem Forever* on the PC. Handheld sales accounted for 2.0% of our total net revenue for the nine months ended December 31, 2012 as compared to 3.9% for the prior year primarily due to the increased proportion of total net revenue on PC and other platforms.

Gross profit as a percentage of net revenue for the nine months ended December 31, 2012 was 38.6% as compared to 39.2% for the prior year. The decrease was primarily due to higher software development costs and royalties primarily associated with the September 2012 release of *Borderlands 2*, the May 2012 release of *Max Payne 3*, the October 2012 release of *XCOM: Enemy Unknown* and the June 2012 release of *Spec Ops: The Line*. Partially offsetting the decrease in gross profit was improved pricing mix from the releases of *Borderlands 2* in September 2012 and *XCOM: Enemy Unknown* in October 2012 and lower internal royalty expense, which was primarily due to higher income generated in the prior year from the May 2011 release of *L.A. Noire*.

Net revenue earned outside of the United States accounted for 42.0% of our total net revenue for the nine months ended December 31, 2012 as compared to 47.7% in the prior year. The year-over-year decrease as a percentage of net revenue earned outside of the United States was primarily due to the September 2012 global release of *Borderlands 2* which had proportionally higher net revenue in the United States. Foreign currency exchange rates decreased net revenue and gross profit by \$9.6 million and \$4.8 million, respectively, for the nine months ended December 31, 2012 as compared to the prior year.

### *Operating Expenses*

(thousands of dollars)	2012	% of net revenue	2011	% of net revenue	Increase/ (decrease)	% Increase/ (decrease)
Selling and marketing	\$ 205,582	22.5%	\$ 143,684	21.2%	\$ 61,898	43.1%
General and administrative	106,891	11.7%	86,067	12.7%	20,824	24.2%
Research and development	57,001	6.2%	49,340	7.3%	7,661	15.5%
Depreciation and amortization	7,828	0.8%	9,383	1.4%	(1,555)	(16.6)%
<b>Total operating expenses(1)</b>	<b>\$ 377,302</b>	<b>41.2%</b>	<b>\$ 288,474</b>	<b>42.6%</b>	<b>\$ 88,828</b>	<b>30.8%</b>

(1)

Includes stock-based compensation expense, which was allocated as follows:

	2012	2011
Selling and marketing	\$ 4,234	\$ 4,016
General and administrative	\$ 8,723	\$ 12,099
Research and development	\$ 1,787	\$ 2,969

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Foreign currency exchange rates decreased total operating expenses by \$3.8 million for the nine months ended December 31, 2012 as compared to the prior year.

Selling and marketing

Selling and marketing expenses increased \$61.9 million for the nine months ended December 31, 2012, as compared to the prior year primarily due to a \$54.0 million increase in advertising expenses primarily incurred for the releases of *Borderlands 2* in September 2012, *Max Payne 3* in May 2012, *Spec Ops: The Line* in June 2012 and *XCOM: Enemy Unknown* in October 2012, as compared to advertising expenses incurred in the prior year for the releases of *L.A. Noire* in May 2011 and *Duke Nukem Forever* in June 2011. Also contributing to the increase in selling and marketing expenses is a \$5.7 million increase in personnel costs primarily due to higher performance-based incentive compensation as a result of the Company's performance.

General and administrative

General and administrative expenses increased \$20.8 million for the nine months ended December 31, 2012, as compared to the prior year primarily due to a \$15.0 million contractual provision that was triggered in June 2012, an increase of \$6.2 million for personnel costs and an increase of \$2.8 million for consulting expenses, primarily due to higher performance-based incentive compensation as a result of the Company's performance. Partially offsetting the increase in general and administrative expenses is a decrease of \$4.1 million in stock-based compensation expense for stock-based awards granted to ZelnickMedia, primarily reflecting the Company's relative stock price performance (see Note 3 to our Unaudited Condensed Consolidated Financial Statements for additional information).

General and administrative expenses for the nine months ended December 31, 2012 and 2011 include occupancy expense (primarily rent, utilities and office expenses) of \$11.8 million and \$11.3 million, respectively, related to our development studios.

Research and development

Research and development expenses increased \$7.7 million for the nine months ended December 31, 2012 as compared to the prior year primarily due to an \$7.9 million increase in personnel-related costs primarily due to increased headcount and higher performance-based incentive compensation as a result of the Company's performance.

***Interest and other, net***

Interest and other, net was an expense of \$23.6 million for the nine months ended December 31, 2012, as compared to an expense of \$14.2 million for the nine months ended December 31, 2011, primarily due to interest expense associated with the November 2011 issuance of the 1.75% Convertible Notes.

***Provision for income taxes***

For the nine months ended December 31, 2012, income tax expense was \$4.9 million, as compared to income tax expense of \$4.4 million for the nine months ended December 31, 2011. The increase was primarily attributable to discrete tax benefits related to the resolution of certain foreign tax examinations during the nine months ended December 31, 2011 and an increase in state taxes during the nine months ended December 31, 2012, partially offset by lower income and tax rates in foreign jurisdictions during the nine months ended December 31, 2012.

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Our effective tax rate differed from the federal statutory rate primarily due to changes in valuation allowances and changes in gross unrecognized tax benefits during the periods.

We are generally no longer subject to audit for U.S. federal income tax returns for periods prior to our fiscal year ended October 31, 2010 and state income tax returns for periods prior to fiscal year ended October 31, 2004. With few exceptions, we are no longer subject to income tax examinations in non-U.S. jurisdictions for years prior to fiscal year ended October 31, 2005. U.S. federal taxing authorities have completed their audit of fiscal years ending October 31, 2008 and 2009. Certain U.S. state taxing authorities are currently examining our income tax returns from fiscal years ended October 31, 2004 through October 31, 2009. In addition, tax authorities in certain non-U.S. jurisdictions are currently examining our income tax returns. Based on the progress and possible settlement of certain audits, we believe it is reasonably possible that our liability for gross unrecognized tax benefits will decrease by approximately \$5.3 million during the next 12 months.

We are regularly audited by domestic and foreign taxing authorities. Audits may result in tax assessments in excess of amounts claimed and the payment of additional taxes. We believe that our tax positions comply with applicable tax law, and that we have adequately provided for reasonably foreseeable tax assessments.

***Net loss and net loss per share***

For the nine months ended December 31, 2012, our net loss was \$52.0 million, as compared to a net loss of \$42.0 million in the prior year. Net loss per share for the nine months ended December 31, 2012 was \$0.61 as compared to a net loss per share of \$0.51 for the nine months ended December 31, 2011. Basic and diluted weighted average shares outstanding increased compared to the prior year period primarily due to the vesting of restricted stock awards over the last twelve months. See Note 9 to our Unaudited Condensed Consolidated Financial Statements for additional information regarding net loss per share.

**Liquidity and Capital Resources**

Our primary cash requirements have been to fund (i) the development, manufacturing and marketing of our published products, (ii) working capital, (iii) acquisitions and (iv) capital expenditures. We expect to rely on funds provided by our operating activities, our Credit Agreement and our Convertible Notes to satisfy our working capital needs.

***Credit Agreement***

In October 2011, we entered into a Second Amended and Restated Credit Agreement (the "Credit Agreement") which amended and restated our July 2007 Credit Agreement. The Credit Agreement provides for borrowings of up to \$100.0 million, which may be increased by up to \$40.0 million pursuant to the terms of the Credit Agreement, and is secured by substantially all of our assets and the equity of our subsidiaries. The Credit Agreement expires on October 17, 2016. Revolving loans under the Credit Agreement bear interest at our election of (a) 1.50% to 2.00% above a certain base rate (4.75% at December 31, 2012), or (b) 2.50% to 3.00% above the LIBOR Rate (approximately 2.71% at December 31, 2012), with the margin rate subject to the achievement of certain average liquidity levels. We are also required to pay a monthly fee on the unused available balance, ranging from 0.375% to 0.50% based on availability.

Availability under the Credit Agreement is restricted by our United States and United Kingdom based accounts receivable and inventory balances. The Credit Agreement also allows for the issuance of letters of credit in an aggregate amount of up to \$25.0 million.

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As of December 31, 2012, there was \$98.3 million available to borrow under the Credit Agreement. At December 31, 2012, we had no outstanding borrowings under the Credit Agreement and \$1.7 million of letters of credit outstanding.

The Credit Agreement contains covenants that substantially limit us and our subsidiaries' ability to: create, incur, assume or be liable for indebtedness; dispose of assets outside the ordinary course of business; acquire, merge or consolidate with or into another person or entity; create, incur or allow any lien on any of their respective properties; make investments; or pay dividends or make distributions (each subject to certain limitations); or optionally prepay any indebtedness (subject to certain exceptions, including an exception permitting the redemption of the Company's unsecured convertible senior notes upon the meeting of certain minimum liquidity requirements). In addition, the Credit Agreement provides for certain events of default such as nonpayment of principal and interest, breaches of representations and warranties, noncompliance with covenants, acts of insolvency, default on indebtedness held by third parties and default on certain material contracts (subject to certain limitations and cure periods). The Credit Agreement also contains a requirement that we maintain an interest coverage ratio of more than one to one for the trailing twelve month period, if certain average liquidity levels fall below \$30.0 million. As of December 31, 2012, we were in compliance with all covenants and requirements outlined in the Credit Agreement.

***4.375% Convertible Notes Due 2014***

In June 2009, we issued \$138.0 million aggregate principal amount of 4.375% Convertible Notes due 2014 (the "4.375% Convertible Notes"). Interest on the 4.375% Convertible Notes is payable semi-annually in arrears on June 1<sup>st</sup> and December 1<sup>st</sup> of each year, and commenced on December 1, 2009. The 4.375% Convertible Notes mature on June 1, 2014, unless earlier redeemed or repurchased by the Company or converted.

The 4.375% Convertible Notes are convertible at an initial conversion rate of 93.6768 shares of our common stock per \$1,000 principal amount of 4.375% Convertible Notes (representing an initial conversion price of approximately \$10.675 per share of common stock for a total of approximately 12,927,000 underlying conversion shares) subject to adjustment in certain circumstances. Holders may convert the 4.375% Convertible Notes at their option prior to the close of business on the business day immediately preceding December 1, 2013 only under the following circumstances: (1) during any fiscal quarter commencing after July 31, 2009, if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any 10 consecutive trading day period (the "measurement period") in which the trading price per \$1,000 principal amount of 4.375% Convertible Notes for each day of that measurement period was less than 98% of the product of the last reported sale price of our common stock and the applicable conversion rate on each such day; (3) if we call the 4.375% Convertible Notes for redemption, at any time prior to the close of business on the third scheduled trading day prior to the redemption date; or (4) upon the occurrence of specified corporate events. On and after December 1, 2013 until the close of business on the third scheduled trading day immediately preceding the maturity date, holders may convert their 4.375% Convertible Notes at any time, regardless of the foregoing circumstances. Upon conversion, the 4.375% Convertible Notes may be settled, at our election, in cash, shares of our common stock, or a combination of cash and shares of our common stock.

At any time on or after June 5, 2012, the Company may redeem all of the outstanding 4.375% Convertible Notes for cash, but only if the last reported sale of our common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the trading day prior to the date we provide notice of redemption to holders of the 4.375% Convertible Notes exceeds 150% of the conversion price in effect on each such trading day. The redemption price will equal 100% of the

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principal amount of the 4.375% Convertible Notes to be redeemed, plus all accrued and unpaid interest (including additional interest, if any) to, but excluding, the redemption date.

The indenture governing the 4.375% Convertible Notes contains customary terms and covenants and events of default. As of December 31, 2012, we were in compliance with all covenants and requirements outlined in the indenture governing the 4.375% Convertible Notes.

***1.75% Convertible Notes Due 2016***

On November 16, 2011, we issued \$250.0 million aggregate principal amount of 1.75% Convertible Notes due 2016 (the "1.75% Convertible Notes" and together with the 4.375% Convertible Notes, the "Convertible Notes"). Interest on the 1.75% Convertible Notes is payable semi-annually in arrears on June 1<sup>st</sup> and December 1<sup>st</sup> of each year, commencing on June 1, 2012. The 1.75% Convertible Notes mature on December 1, 2016, unless earlier repurchased by the Company or converted. The Company does not have the right to redeem the 1.75% Convertible Notes prior to maturity.

The 1.75% Convertible Notes are convertible at an initial conversion rate of 52.3745 shares of our common stock per \$1,000 principal amount of 1.75% Convertible Notes (representing an initial conversion price of approximately \$19.093 per share of common stock for a total of approximately 13,094,000 underlying conversion shares) subject to adjustment in certain circumstances. Holders may convert the 1.75% Convertible Notes at their option prior to the close of business on the business day immediately preceding June 1, 2016 only under the following circumstances: (1) during any fiscal quarter commencing after March 31, 2012, if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day; (2) during the five business day period after any 10 consecutive trading day period (the "measurement period") in which the trading price per \$1,000 principal amount of 1.75% Convertible Notes for each day of that measurement period was less than 98% of the product of the last reported sale price of our common stock and the applicable conversion rate on each such day; or (3) upon the occurrence of specified corporate events. On and after June 1, 2016 until the close of business on the business day immediately preceding the maturity date, holders may convert their 1.75% Convertible Notes at any time, regardless of the foregoing circumstances. Upon conversion, the 1.75% Convertible Notes may be settled, at our election, in cash, shares of our common stock, or a combination of cash and shares of the Company's common stock.

The indenture governing the 1.75% Convertible Notes contains customary terms and covenants and events of default. As of December 31, 2012, we were in compliance with all covenants and requirements outlined in the indenture governing the 1.75% Convertible Notes.

***Financial Condition***

We are subject to credit risks, particularly if any of our receivables represent a limited number of customers or are concentrated in foreign markets. If we are unable to collect our accounts receivable as they become due, it could adversely affect our liquidity and working capital position.

Generally, we have been able to collect our accounts receivable in the ordinary course of business. We do not hold any collateral to secure payment from customers. We have trade credit insurance on the majority of our customers to mitigate accounts receivable risk.

A majority of our trade receivables are derived from sales to major retailers and distributors. Our five largest customers accounted for approximately 51.0% and 40.3% of net revenue for the nine months ended December 31, 2012 and 2011, respectively. As of December 31, 2012 and March 31, 2012, amounts due from our five largest customers comprised approximately 57.8% and 61.3% of our gross accounts receivable balance, respectively, with our significant customers (those that individually

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comprised more than 10% of our gross accounts receivable balance) accounting for approximately 32.3% and 40.6% of such balance at December 31, 2012 and March 31, 2012, respectively. We believe that the receivable balances from these largest customers do not represent a significant credit risk based on past collection experience, although we actively monitor each customer's credit worthiness and economic conditions that may impact our customers' business and access to capital. We are monitoring the current global economic conditions, including credit markets and other factors as it relates to our customers in order to manage the risk of uncollectible accounts receivable.

We believe our current cash and cash equivalents and projected cash flow from operations, along with availability under our Credit Agreement will provide us with sufficient liquidity to satisfy our cash requirements for working capital, capital expenditures and commitments through at least the next 12 months.

As of December 31, 2012, the amount of cash and cash equivalents held outside of the U.S. by our foreign subsidiaries was approximately \$143.0 million. These balances are dispersed across various locations around the world. We believe that such dispersion meets the business and liquidity needs of our foreign affiliates. In addition, the Company expects in the foreseeable future to have the ability to generate sufficient cash domestically to support ongoing operations. Consequently, it is the Company's intention to indefinitely reinvest undistributed earnings of its foreign subsidiaries. In the event the Company needed to repatriate funds outside of the U.S., such repatriation may be subject to local laws and tax consequences including foreign withholding taxes or U.S. income taxes. It is not practicable to estimate the tax liability and the Company would try to minimize the tax impact to the extent possible. However, any repatriation may not result in actual cash payments as the taxable event would likely be offset by the utilization of the then available net operating losses and tax credits.

In January 2013, our board of directors authorized the repurchase of up to 7,500,000 shares of our common stock. The authorization permits the Company to purchase shares from time to time through a variety of methods, including in the open market or through privately negotiated transactions, in accordance with applicable securities laws. It does not obligate the Company to make any purchases at any specific time or situation. Repurchases are subject to the availability of stock, prevailing market conditions, the trading price of the stock, the Company's financial performance and other conditions. The program may be suspended or discontinued at any time for any reason.

Our changes in cash flows were as follows:

(thousands of dollars)	Nine Months Ended	
	December 31,	
	2012	2011
Net cash provided by (used in) operating activities	\$ 41,462	\$ (54,605)
Net cash used in investing activities	(12,317)	(9,459)
Net cash provided by financing activities		243,363
Effects of foreign currency exchange rates on cash and cash equivalents	(701)	(6,342)
Net increase in cash and cash equivalents	\$ 28,444	\$ 172,957

At December 31, 2012 we had \$448.7 million of cash and cash equivalents, compared to \$420.3 million at March 31, 2012. Our increase in cash and cash equivalents from March 31, 2012 was primarily a result of net cash provided by operating activities primarily due to cash generated from our strong triple-A titles this year, partially offset by net cash used in investing activities due to purchases of fixed assets.



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***Off-Balance Sheet Arrangements***

As of December 31, 2012 and March 31, 2012, we did not have any relationships with unconsolidated entities or financial parties, such as entities often referred to as structured finance or variable interest 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.

**International Operations**

Net revenue earned outside of the United States is principally generated by our operations in Europe, Canada, Latin America, Asia and Australia. For the three months ended December 31, 2012 and 2011, approximately 34.7% and 34.9%, respectively, of our net revenue was earned outside of the United States. For the nine months ended December 31, 2012 and 2011, approximately 42.0% and 47.7%, respectively, of our net revenue was earned outside of the United States. We are subject to risks inherent in foreign trade, including increased credit risks, tariffs and duties, fluctuations in foreign currency exchange rates, shipping delays and international political, regulatory and economic developments, all of which can have a significant effect on our operating results.

**Fluctuations in Quarterly Operating Results and Seasonality**

We have experienced fluctuations in quarterly operating results as a result of the timing of the introduction of new titles; variations in sales of titles developed for particular platforms; market acceptance of our titles; development and promotional expenses relating to the introduction of new titles; sequels or enhancements of existing titles; projected and actual changes in platforms; the timing and success of title introductions by our competitors; product returns; changes in pricing policies by us and our competitors; the accuracy of retailers' forecasts of consumer demand; the size and timing of acquisitions; the timing of orders from major customers; and order cancellations and delays in product shipment. Sales of our titles are also seasonal, with higher shipments typically occurring in the fourth calendar quarter as a result of increased demand for titles during the holiday season. Quarterly comparisons of operating results are not necessarily indicative of future operating results.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

*Interest Rate Risk*

Historically, fluctuations in interest rates have not had a significant impact on our operating results. Under our Credit Agreement, outstanding balances bear interest at our election of (a) 1.50% to 2.00% above a certain base rate (4.75% at December 31, 2012), or (b) 2.50% to 3.00% above the LIBOR rate (approximately 2.71% at December 31, 2012), with the margin rate subject to the achievement of certain average liquidity levels. Changes in market rates may impact our future interest expense if there is an outstanding balance on our line of credit. The 1.75% Convertible Notes and the 4.375% Convertible Notes pay interest semi-annually at a fixed rate of 1.75% and 4.375%, respectively, per annum and we expect that there will be no fluctuation related to the Convertible Notes impacting our cash component of interest expense. For additional details on our Convertible Notes see Note 8 to our Unaudited Condensed Consolidated Financial Statements.

*Foreign Currency Exchange Rate Risk*

We transact business in foreign currencies and are exposed to risks resulting from fluctuations in foreign currency exchange rates. Accounts relating to foreign operations are translated into United States dollars using prevailing exchange rates at the relevant period end. Translation adjustments are included as a separate component of stockholders' equity. For the nine months ended December 31,

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2012, our foreign currency translation loss adjustment was immaterial. We recognized a foreign currency exchange transaction loss for the nine months ended December 31, 2012 and 2011 of \$0.7 million and \$0.9 million, respectively, in interest and other, net in our Condensed Consolidated Statements of Operations.

*Cash Flow Hedging Activities*

We use foreign currency forward contracts to mitigate foreign currency exchange rate risk associated with forecasted transactions involving non-functional currency denominated expenditures. These contracts, which are designated and qualify as cash flow hedges, are accounted for as derivatives whereby the fair value of the contracts is reported as either assets or liabilities on our Condensed Consolidated Balance Sheets. The effective portion of gains or losses resulting from changes in the fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income (loss) in stockholders' equity. The gross amount of the effective portion of gains or losses resulting from changes in the fair value of these hedges is subsequently reclassified into cost of goods sold or research and development expenses, as appropriate, in the period when the forecasted transaction is recognized in our Condensed Consolidated Statements of Operations. In the event that the gains or losses in accumulated other comprehensive income (loss) are deemed to be ineffective, the ineffective portion of gains or losses resulting from changes in fair value, if any, is reclassified to interest and other, net, in our Condensed Consolidated Statements of Operations. In the event that the underlying forecasted transactions do not occur, or it becomes probable that they will not occur, within the defined hedge period, the gains or losses on the related cash flow hedges are reclassified from accumulated other comprehensive income (loss) to interest and other, net, in our Condensed Consolidated Statements of Operations. During the reporting periods, all forecasted transactions occurred, and therefore, there were no such gains or losses reclassified into interest and other, net. We do not enter into derivative financial contracts for speculative or trading purposes. At December 31, 2012, we had \$7.8 million of forward contracts outstanding to buy foreign currencies in exchange for U.S. dollars all of which have maturities of less than one year. At March 31, 2012, we had \$10.2 million of forward contracts outstanding to buy foreign currencies in exchange for U.S. dollars all of which have maturities of less than one year. As of December 31, 2012, the fair value of these outstanding forward contracts was \$0.6 million and is included in prepaid expenses and other. As of March 31, 2012, the fair value of these outstanding forward contracts was immaterial and is included in accrued expenses and other current liabilities.

*Balance Sheet Hedging Activities*

We use foreign currency forward contracts to mitigate foreign currency exchange rate risk associated with non-functional currency denominated cash balances and inter-company funding loans, non-functional currency denominated accounts receivable and non-functional currency denominated accounts payable. These transactions are not designated as hedging instruments and are accounted for as derivatives whereby the fair value of the contracts is reported as either assets or liabilities on our Condensed Consolidated Balance Sheets, and gains and losses resulting from changes in the fair value are reported in interest and other, net, in our Condensed Consolidated Statements of Operations. We do not enter into derivative financial contracts for speculative or trading purposes. At December 31, 2012, we had \$25.0 million of forward contracts outstanding to sell foreign currencies in exchange for U.S. dollars all of which have maturities of less than one year. At March 31, 2012, we had \$4.0 million of forward contracts outstanding to buy foreign currencies in exchange for U.S. dollars and \$28.3 million of forward contracts outstanding to sell foreign currencies in exchange for U.S. dollars all of which have maturities of less than one year. For the three months ended December 31, 2012 and 2011, we recorded gains of \$1.0 million and \$0.4 million, respectively, related to foreign currency forward contracts in interest and other, net on the Condensed Consolidated Statements of Operations. For the nine months ended December 31, 2012 and 2011, we recorded gains of \$1.3 million and

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\$0.6 million, respectively, related to foreign currency forward contracts in interest and other, net on the Condensed Consolidated Statements of Operations. As of December 31, 2012 and March 31, 2012, the fair value of these outstanding forward contracts was immaterial and is included in accrued expenses and other current liabilities.

Our hedging programs are designed to reduce, but do not entirely eliminate, the effect of currency exchange rate movements. We believe the counterparties to these foreign currency forward contracts are creditworthy multinational commercial banks and that the risk of counterparty nonperformance is not material. Notwithstanding our efforts to mitigate some foreign currency exchange rate risks, there can be no assurance that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations. For the nine months ended December 31, 2012, 42.0% of the Company's revenue was generated outside the United States. Using sensitivity analysis, a hypothetical 10% increase in the value of the U.S. dollar against all currencies would decrease revenues by 4.2%, while a hypothetical 10% decrease in the value of the U.S. dollar against all currencies would increase revenues by 4.2%. In the opinion of management, a substantial portion of this fluctuation would be offset by cost of goods sold and operating expenses incurred in local currency.

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

Based on an evaluation under the supervision and with the participation of management, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures as defined in rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act") were effective as of the end of the period covered by this report to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control Over Financial Reporting*

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2012, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

We are, or may become, subject to demands and claims (including intellectual property claims) and are involved in routine litigation in the ordinary course of business which we do not believe to be material to our business or financial statements. We have appropriately accrued amounts related to certain of these claims and legal and other proceedings. While it is reasonably possible that a loss may be incurred in excess of the amounts accrued in our financial statements, we believe that such losses, unless otherwise disclosed, would not be material.

**Item 1A. Risk Factors**

There have been no material changes to the Risk Factors disclosed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2012.

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**Item 6. Exhibits**

**Exhibits:**

- 10.1 Amendment No. 1 to the Amended and Restated Take-Two Interactive Software, Inc. 2009 Stock Incentive Plan, dated October 29, 2012.+
  - 10.2 Amendment to the Xbox 360 Publisher License Agreement, dated December 11, 2012, between the Company and Microsoft Licensing, GP.\*
  - 31.1 Chief Executive Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 31.2 Chief Financial Officer Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  - 32.1 Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 32.2 Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  
  - 101.INS XBRL Instance Document.
  - 101.SCH XBRL Taxonomy Extension Schema Document.
  - 101.CAL XBRL Taxonomy Calculation Linkbase Document.
  - 101.LAB XBRL Taxonomy Label Linkbase Document.
  - 101.PRE XBRL Taxonomy Presentation Linkbase Document.
  - 101.DEF XBRL Taxonomy Extension Definition Document.
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+ Represents a management contract or compensatory plan or arrangement.

\* Portions hereof have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment in accordance with Exchange Act Rule 24b-2.

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at December 31, 2012 and March 31, 2012, (ii) Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2012 and December 31, 2011, (iii) Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended December 31, 2012 and December 31, 2011, (iv) Condensed Consolidated Statements of Cash Flows for the nine months ended December 31, 2012 and December 31, 2011; and (v) Notes to Unaudited Condensed Consolidated Financial Statements.

