TAKE TWO INTERACTIVE SOFTWARE INC
Form 10-Q
March 13, 2006
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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 l934.

For the quarterly period ended January 31, 2006

Commission file number 0-29230

TAKE-TWO INTERACTIVE SOFTWARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**51-0350842**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

622 Broadway, New York, New York 10012
(Address of principal executive offices including 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, and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act). Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

As of March 7, 2006, there were 71,525,426 shares of the Registrant s Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Condensed Consolidated Balance Sheets (Unaudited)
As of January 31, 2006 and October 31, 2005
(In thousands, except share and per share data)

	January 31, 2006	October 31, 2005
ASSETS		
Current assets		
Cash and cash equivalents	$ **142,897**	$ 107,195
Accounts receivable, net of allowances of $91,170 and $69,904 at January 31, 2006 and October 31, 2005, respectively	**84,282**	198,068
Inventories	**107,413**	136,227
Software development costs	**77,529**	88,826
Licenses	**6,717**	7,651
Prepaid taxes and taxes receivable	**60,864**	40,307
Prepaid expenses and other current assets	**23,429**	24,025
Deferred tax assets	**10,875**	10,943
Total current assets	**514,006**	613,242
Fixed assets, net	**48,215**	48,617
Software development costs, net of current portion	**40,401**	19,602
Licenses, net of current portion	**4,417**	2,330
Goodwill	**190,851**	179,893
Intangibles, net	**60,481**	58,666
Deferred tax assets	**6,078**	5,506
Other assets	**4,204**	5,020
Total assets	$ **868,653**	$ 932,876
LIABILITIES and STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ **79,887**	$ 133,353
Accrued expenses and other current liabilities	**93,694**	90,702
Income taxes payable	**6,701**	10,220
Total current liabilities	**180,282**	234,275
Other long-term liabilities	**1,070**	2,467
Total liabilities	**181,352**	236,742
Stockholders equity		
Common stock, par value $.01 per share; 100,000,000 shares authorized; 71,470,746 and 70,667,421 shares issued and outstanding at January 31, 2006 and October 31, 2005, respectively	**715**	707
Additional paid-in capital	**426,628**	418,053
Deferred compensation		(11,189)

Retained earnings		**258,755**		287,877
Accumulated other comprehensive income		**1,203**		686
Total stockholders equity		**687,301**		696,134
Total liabilities and stockholders equity	**$**	**868,653**	$	932,876

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Condensed Consolidated Statements of Operations (Unaudited)
For the three months ended January 31, 2006 and 2005
(In thousands, except per share data)

	Three months ended January 31,	
	2006	**2005**
Net revenues	**$ 264,981**	$ 502,474
Cost of goods sold		
Product costs	**160,853**	237,485
Royalties	**32,867**	80,209
Software development costs	**15,594**	4,205
Total cost of goods sold	**209,314**	321,899
Gross profit	**55,667**	180,575
Operating expenses		
Selling and marketing	**41,644**	50,931
General and administrative	**38,453**	28,687
Research and development	**17,709**	23,417
Depreciation and amortization	**6,651**	4,786
Total operating expenses	**104,457**	107,821
Income (loss) from operations	**(48,790)**	72,754
Interest income, net	**253**	540
Income (loss) before income taxes	**(48,537)**	73,294
Provision (benefit) for income taxes	**(19,415)**	18,045
Net income (loss)	**$ (29,122)**	$ 55,249
Per share data:		
Basic:		
Weighted average common shares outstanding	**71,429**	68,529
Net income (loss) per share	**$ (0.41)**	$ 0.81
Diluted:		
Weighted average common shares outstanding	**71,429**	69,774
Net income (loss) per share	**$ (0.41)**	$ 0.79

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (Unaudited)
For the three months ended January 31, 2006 and 2005
(In thousands)

	Three months ended January 31,	
	2006	2005
Cash flows from operating activities:		
Net income (loss)	$ (29,122)	$ 55,249
Adjustment to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	6,651	4,786
Loss on disposal of fixed assets		15
Amortization of intellectual property and other	2,077	3,365
Amortization of compensatory restricted stock	305	4,802
Stock-based compensation related to compensatory stock options	4,528	
Amortization of software development costs and licenses	27,526	14,614
Write-off of software development costs and licenses	520	3,364
Provision for doubtful accounts, returns and sales allowances	58,416	50,630
Tax benefit from exercise of compensatory stock and stock options		3,750
Foreign currency transaction (gain) loss	(890)	147
Changes in operating assets and liabilities, net of effects of acquisitions:		
Decrease in accounts receivable	55,670	115,630
Decrease in inventories	29,094	20,363
Increase in software development costs	(35,048)	(41,530)
Increase in licenses	(6,096)	(3,297)
Increase in prepaid taxes and taxes receivable	(20,557)	(23,135)
Decrease in prepaid expenses and other current assets	2,726	27,654
Decrease (increase) in other non-current assets	759	(602)
Decrease in accounts payable	(53,553)	(78,421)
(Decrease) increase in accrued expenses and other liabilities	(2,393)	34,733
Decrease in income taxes payable	(1,154)	(2,641)
Net cash provided by operating activities	39,459	189,476
Cash flows from investing activities:		
Purchase of fixed assets	(6,456)	(5,651)
Acquisition of intangible assets		(20,000)
Acquisitions, net of cash acquired	1,143	(23,244)
Net cash used in investing activities	(5,313)	(48,895)
Cash flows from financing activities:		
Proceeds from exercise of stock options	1,071	7,365
Excess tax benefit from exercise of compensatory stock and stock options	24	
Other financing		(27)
Net cash provided by financing activities	1,095	7,338
Effect of foreign exchange rates	461	56
Net increase in cash for the period	35,702	147,975
Cash and cash equivalents, beginning of the period	107,195	155,095

Cash and cash equivalents, end of the period	**$ 142,897**	$ 303,070

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (Unaudited) (continued)
For the three months ended January 31, 2006 and 2005
(In thousands)

	Three months ended January 31,	
	2006	**2005**
Supplemental information on businesses acquired:		
Fair value of assets acquired:		
Current assets	**$ 112**	$ 111
Non-current assets	**421**	1,196
Intangible assets	**5,284**	7,980
Goodwill	**11,445**	29,433
Less: liabilities assumed		
Current liabilities	**(200)**	(3,275)
Deferred income taxes	**(1,620)**	(3,192)
Net assets of businesses acquired, excluding cash acquired	**$ 15,442**	$ 32,253
Cash paid for businesses acquired	**$ 857**	$ 24,000
Less: cash acquired	**(2,000)**	(756)
Net cash paid (acquired) for businesses	**(1,143)**	23,244
Additional consideration in connection with acquisitions	**4,085**	6,416
Contingent and deferred consideration		2,593
Issuance of unregistered common stock in connection with acquisitions	**12,500**	
Total consideration, net of cash acquired	**$ 15,442**	$ 32,253
Supplemental cash flow information:		
Issuance of warrants to licensor	**$**	$ 1,183
Cash paid for taxes	**5,321**	18,821
Cash paid for interest	**163**	50

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Condensed Consolidated Statements of Stockholders Equity (Unaudited)
For the year ended October 31, 2005 and the three months ended January 31, 2006
(In thousands)

	Common Stock												
	Shares		Amount		Additional Paid-in Capital		Deferred Compensation		Retained Earnings		Accumulated Other Comprehensive Income (loss)		Total
Balance, October 31, 2004	68,159	$	682	$	381,928	$	(3,896)	$	250,402	$	6,354	$	635,470
Foreign currency translation adjustment											(5,668)		(5,668)
Net income									37,475				37,475
Comprehensive income													31,807
Purchase of treasury shares, retired	(925)		(9)		(24,920)								(24,929)
Exchange of treasury shares, retired	(367)		(4)		(8,307)								(8,311)
Proceeds from exercise of stock options and warrants	2,753		27		31,196								31,223
Amortization of deferred compensation							14,860						14,860
Issuance of common stock in connection with acquisition	82		1		1,999								2,000
Issuance of compensatory stock and stock options	965		10		22,688		(22,153)						545
Tax benefit in connection with the exercise of compensatory stock and stock options					12,286								12,286
Issuance of warrants to licensor					1,183								1,183
Balance, October 31, 2005	70,667	$	707	$	418,053	$	(11,189)	$	287,877	$	686	$	696,134
Foreign currency translation adjustment											517		517

Net loss					(29,122)		(29,122)
Comprehensive loss							(28,605)
Deferred compensation			(11,189)	11,189			
Proceeds from exercise of stock options and warrants	86	1	1,070				1,071
Stock based compensation expense related to compensatory stock options			5,811				5,811
Amortization of deferred compensation			305				305
Issuance of common stock in connection with acquisition	679	7	12,493				12,500
Issuance of compensatory restricted stock, net of forfeitures and cancellations	39		61				61
Excess tax benefit in connection with the exercise of compensatory stock and stock options			24				24
Balance, January 31, 2006	**71,471**	**$ 715**	**$ 426,628**	**$**	**$ 258,755**	**$ 1,203**	**$ 687,301**

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
(Dollars in thousands, except per share amounts)

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

Take-Two Interactive Software, Inc. (the Company) was incorporated in the State of Delaware in September 1993. The Company develops, publishes and distributes interactive software games designed for personal computers, video game consoles and handheld platforms.

2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION

Basis of Presentation

The unaudited condensed consolidated financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the financial statements do not include all information and disclosures necessary for a presentation of the Company s financial position, results of operations and cash flows in conformity with generally accepted accounting principles in the United States of America. In the opinion of management, the financial statements reflect all adjustments (consisting only of normal recurring accruals) necessary for a fair statement of the Company s financial position, results of operations and cash flows. The results of operations for an interim period are not necessarily indicative of the results for the full year. The financial statements should be read in conjunction with the audited financial statements and notes thereto contained in the Company s Annual Report on Form 10-K for the fiscal year ended October 31, 2005.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reported periods. The most significant estimates and assumptions relate to the adequacy of allowances for returns, price concessions and doubtful accounts; the amortization and recoverability of software development costs, licenses and other intangibles; valuation of inventories, fair value of stock compensation and realization of deferred income taxes. Actual amounts could differ significantly from these estimates.

At January 31, 2006, the Company s accounts receivable balance is net of reserves of approximately $1,185 for remaining product returns primarily related to the Company s North American retail inventory of *Grand Theft Auto: San Andreas* as a result of the re-rating of the title by the Entertainment Software Rating Board (ESRB) in July 2005.

Stock Split

In April 2005, the Company effected a three-for-two stock split in the form of a stock dividend. Accordingly, all share and per share data in the accompanying unaudited condensed consolidated financial statements and notes thereto give retroactive effect to the stock split.

Financial Instruments

The carrying amounts of the Company s financial instruments, including cash and cash equivalents, accounts receivable, income tax receivable and payable, accounts payable and accrued liabilities, approximate fair value because of their short maturities. The Company considers all highly liquid instruments purchased with original maturities of three months or less to be cash equivalents.

The Company transacts business in various foreign currencies and has significant sales and purchase transactions denominated in foreign currencies. The Company uses forward exchange contracts to seek to mitigate foreign currency risk associated with foreign currency assets and liabilities, primarily certain intercompany receivables and payables. The Company does not designate foreign currency forward contracts as hedging instruments under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. As a result, the Company marks to market its foreign currency forward contracts each period and any gains and losses are recognized in net income. At January 31, 2006, the Company had no outstanding foreign currency forward contracts.

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(Dollars in thousands, except per share amounts)

Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

Recently Issued Accounting Pronouncements

Effective November 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) (SFAS 123(R)), Share-Based Payment, which revised Statement of Financial Accounting Standards 123 (SFAS 123), Accounting for Stock-Based Compensation. Refer to Note 3 to the unaudited condensed consolidated financial statements for further information. There were no other accounting policies adopted during the first quarter of fiscal 2006 that had a material effect on the Company s financial condition and results of operations.

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154, Accounting Changes and Error Corrections (SFAS 154), which replaces APB Opinion No. 20, Accounting Changes and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements An Amendment of APB Opinion No. 28. SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management does not believe the adoption of SFAS 154 will have a material impact on the Company s condensed consolidated financial statements.

3. STOCK-BASED COMPENSATION

Effective November 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) (SFAS 123(R)), Share-Based Payment, which revised Statement of Financial Accounting Standards 123 (SFAS 123), Accounting for Stock-Based Compensation. SFAS 123(R) requires all share-based payment transactions with employees, including grants of employee stock options, to be recognized as compensation expense over the requisite service period based on their relative fair values. Prior to the adoption of SFAS 123(R), stock-based compensation expense related to employee stock options was not recognized in the statement of operations if the exercise price was at least equal to the market value of the common stock on the grant date, in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. Prior to November 1, 2005, the Company had adopted the disclosure-only provisions under SFAS 123.

The Company elected to use the Modified Prospective Application (MPA) method for implementing SFAS 123(R). Under the MPA method, prior periods are not restated and new awards are valued and accounted for prospectively upon adoption. Outstanding prior stock option awards that are non-vested as of October 31, 2005 are recognized as compensation expense in the statement of operations over the remaining requisite service period.

The Company has stock-based compensation plans under which directors, officers and other employees receive stock options and restricted stock awards. Generally, stock options are granted with an exercise price equal to the market value of a share of common stock on the date of grant, expire within five years and vest over three years. As of January 31, 2006, the Company s 2002 stock option plan provides for a total of 11.0 million shares to be issued of which approximately 1.0 million shares are available for grant. As of January 31, 2006, the Company s Incentive Stock Plan (restricted stock awards) provides for a total of 2.5 million shares to be issued of which approximately 1.2 million shares are available for grant.

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(Dollars in thousands, except per share amounts)

The following table summarizes the activity in options under the Company s stock based compensation plans:

	Shares (in thousands)	Weighted Average Exercise Price
Options outstanding at October 31, 2005	7,495	$ 20.47
Granted-exercise price equal to fair value	65	18.13
Granted-exercise price less than fair value		
Exercised	(86)	12.87
Forfeited	(65)	19.56
Options outstanding at January 31, 2006	7,409	$ 20.55
Options exercisable at January 31, 2006	3,964	$ 18.50

As of January 31, 2006, the weighted average remaining contractual term of the Company s options outstanding and exercisable is 3.3 years and 2.7 years, respectively. As of January 31, 2006, due to the Company s stock price, there is no aggregate intrinsic value related to options outstanding or exercisable. As of January 31, 2006, the total unrecognized compensation cost related to outstanding non-vested stock options is $35.9 million.

The weighted average per share fair values of options granted were $8.62 and $12.68 for the three months ended January 31, 2006 and 2005. The fair value of the Company s options was estimated using the Black-Scholes option-pricing model. This model requires the input of assumptions regarding a number of complex and subjective variables that will usually have a significant impact on the fair value estimate. These variables include, but are not limited to, the volatility of the Company s stock price and employee stock option exercise behaviors. The assumptions and variables used for the current period grants were developed based on SFAS 123(R) and SEC guidance contained in Staff Accounting Bulletin (SAB) No. 107, Share-Based Payment. The following table summarizes the assumptions and variables used by the Company to compute the weighted average fair value of stock option grants:

	Three months ended January 31,	
	2006	2005
Risk free interest rate	4.5%	3.6%
Expected stock price volatility	55.0%	67.6%
Expected term until exercise (years)	4.1	4.6
Dividends	None	None

For the three months ended January 31, 2006, the Company used a combination of historical volatility and the implied volatility for publicly traded options on the Company s stock as the expected volatility assumption required in the Black-Scholes option-pricing model consistent with SFAS 123(R) and SAB 107. Prior to fiscal 2006, the Company had used its historical stock price volatility in accordance with SFAS 123 for purposes of its pro forma information. The selection of the implied volatility approach was based upon the availability of actively traded options on the Company s stock and the Company s assessment that implied volatility is more representative of future stock price trends than historical volatility.

SFAS 123(R) requires the recognition of stock-based compensation for the number of awards that are ultimately expected to vest. As a result, for most awards, recognized stock compensation was reduced for estimated forfeitures prior to vesting primarily based on a historical annual forfeiture rate of approximately 7%. Estimated forfeitures will be reassessed at each balance sheet date and may change based on new facts and circumstances. Prior to October 31, 2005, actual forfeitures were accounted for as they occurred for purposes of required pro forma stock compensation disclosures.

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(Dollars in thousands, except per share amounts)

Restricted stock awards are expensed on a straight-line basis over the vesting period, which typically range from one to four years. The following table summarizes the activity in non-vested restricted stock under the Company s stock based compensation plans:

	Shares (in thousands)	Weighted Average Grant Date Fair Value
Non-vested restricted stock at October 31, 2005	600	$ 23.03
Granted	45	19.24
Vested	(52)	22.35
Forfeited	(6)	19.00
Non-vested restricted stock at January 31, 2006	587	$ 22.84

The following table summarizes the components and classification of stock-based compensation expense in the Company s condensed consolidated statements of operations:

	Three months ended January 31,	
	2006	**2005**
Stock options	**$ 4,528**	$
Restricted stock	**305**	4,802
Total stock-based compensation expense	**$ 4,833**	$ 4,802
Cost of goods sold	**$**	$
Selling and marketing	**707**	1,133
General and administrative	**3,193**	943
Research and development	**933**	2,726
Total stock-based compensation expense	**$ 4,833**	$ 4,802

Effective November 1, 2005, in connection with the adoption of SFAS 123(R), the Company capitalizes stock-based compensation costs as software development costs. Stock-based compensation expense for the three months ended January 31, 2006 excludes approximately $1.3 million in stock option costs which were capitalized as software development costs in connection with the development of software titles. In prior periods, the Company s disclosures regarding the pro forma impact on net income of stock-based compensation do not reflect the capitalization of these costs. For the three months ended January 31, 2005, stock-based compensation expense of approximately $0.9 million would have been capitalized.

Amortization of such capitalized costs as a component of costs of goods sold is recorded on a title-by-title basis based on the greater of the proportion of current year sales to the total of current and estimated future sales for the title or the straight-line method over the remaining estimated useful life of the title. At each balance sheet date, the Company will evaluate the recoverability of capitalized software costs based on undiscounted future cash flows and charge to cost of goods sold any amounts that are deemed unrecoverable.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
(Dollars in thousands, except per share amounts)

For the three months ended January 31, 2005, had the compensation cost for the Company s stock option plans been determined based on the fair value at the grant date for awards consistent with the provisions of SFAS 123, the Company s net income and net income per share would have been adjusted to the pro forma amounts indicated below:

		Three months ended January 31, 2005
Net income, as reported	$	55,249
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects		2,934
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects		(6,841)
Pro forma net income	$	51,342
Earnings per share:		
Basic as reported	$	0.81
Basic pro forma	$	0.75
Diluted as reported	$	0.79
Diluted pro forma	$	0.73

4. BUSINESS ACQUISITIONS

The acquisitions described below have been accounted for as purchase transactions. Accordingly, the results of operations and financial position of the acquired businesses are included in the Company s condensed consolidated financial statements from the respective dates of acquisition. To the extent that the purchase price allocation for these acquisitions is preliminary, the Company does not expect that the final purchase price allocation will be materially different. Pro forma information has not been provided as the impact of these acquisitions was not material.

In November 2005, the Company acquired all of the outstanding capital stock of Firaxis Games, Inc. (Firaxis), a developer of PC and strategy titles, including the *Civilization* franchise. The purchase price of approximately $15,442 consisted of $12,500 of unregistered common stock and $4,085 of development advances previously paid to Firaxis reduced by net cash acquired of $1,143. In connection with the acquisition, the Company recorded $5,284 of identifiable intangible assets, comprised of $1,130 of non-competition agreements and $4,154 of intellectual property, $11,445 of goodwill, which is not deductible for tax purposes, $333 of net assets and $1,620 of deferred tax liabilities, on a preliminary basis. The Company also agreed to make additional payments of $11,250 based on future product sales, of which approximately $10,000 will be recorded as additional purchase price when the conditions requiring their payment are met and $1,250 will be recorded as employee compensation expense.

In August 2005, the Company acquired all of the outstanding membership interests in Irrational Studios (Irrational), the developer of certain of the Company s titles. The purchase price consisted of $4,212 in cash and $2,000 of unregistered common stock, which was payable at closing, $1,550 of development advances previously paid to Irrational and $2,000 of deferred consideration which is payable in equal amounts on the first and second anniversary of the acquisition. In connection with the acquisition, the Company recorded $2,250 of identifiable intangible assets, $7,665 of goodwill, which is deductible for tax purposes, $187 of non-current assets and $340 of net current liabilities, on a preliminary basis. The Company also agreed to make additional payments of $2,000 based on the delivery of products which will be recorded as additional purchase price when the conditions requiring their payment are met.

In June 2005, the Company acquired all of the outstanding capital stock of Gaia Capital Group and its wholly-owned subsidiaries (Gaia), the developers of certain of the Company s titles for console and handheld platforms. The purchase price consisted of $5,748 in cash, $4,055 of development advances previously paid to Gaia and deferred consideration of $1,597. In connection with the acquisition, the Company recorded $3,940 of identifiable intangible assets, $7,918 of goodwill, which is deductible for tax purposes, $528 of non-current assets, and $986 of net current liabilities, on a preliminary basis.

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TAKE-TWO INTERACTIVE SOFTWARE, INC. and SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements
(Dollars in thousands, except per share amounts)

In January 2005, the Company acquired from SEGA all of the outstanding capital stock of Visual Concepts Entertainment and its wholly-owned subsidiary, Kush Games, the developers of certain of the Company s sports titles, and certain intellectual property rights associated with these products. The purchase price consisted of $27,794 in cash, $1,866 of prepaid royalties previously advanced to SEGA and contingent consideration of $2,593 based on the release of certain titles. In connection with the acquisition, the Company recorded $7,980 of identifiable intangible assets, $29,433 of goodwill, which is not deductible for tax purposes, $1,196 of non-current assets, $3,164 of net current liabilities and $3,192 of deferred tax liabilities related to identifiable intangible assets.

5. INCOME TAXES

The provision (benefit) for income taxes for the three months ended January 31, 2006 and 2005 is based on the Company s estimated annualized effective tax rates for the respective years. The estimated annualized effective tax rate for the three months ended January 31, 2006 is a benefit of 40.0% compared to an estimated annualized effective tax rate for the comparable period in fiscal 2005, which was an expense of 24.6%. The higher estimated annual effective tax rate in fiscal 2006 is primarily attributable to forecasted losses in higher tax rate jurisdictions and the U.S. tax benefit of the extraterritorial income exclusion. The lower effective tax rate for the comparable period in fiscal 2005 was primarily attributable to a higher proportion of forecasted earnings in lower tax rate jurisdictions.

At each balance sheet date, the Company evaluates its estimated annual effective tax rate based on updated information on forecasted income generated in each of its jurisdictions. Any revisions to the rates are recorded in the current period to reflect management s current best estimate of the annual effective tax rate.

Recent tax legislation replaced the extraterritorial income (ETI) exclusion, subject to a phase-out of the exclusion. The Company currently derives benefits from the ETI exclusion, which is limited to 80% and 60% of the otherwise allowable exclusion in calendar years 2005 and 2006, respectively. There will be no ETI deduction available after calendar year 2006. This recent legislation replaces the ETI with a deduction from taxable income based on certain qualified income from domestic production activities. The Company does not expect to benefit from this deduction in fiscal 2006.

This legislation also provides for a one-time 85% dividends received deduction on repatriation of foreign earnings, which was applicable to the Company if utilized by December 31, 2005. Historically, the Company has considered undistributed earnings of its foreign subsidiaries to be indefinitely reinvested and, accordingly, no incremental taxes have been provided thereon. The Company did not repatriate any foreign earnings under this provision. The total amount of undistributed earnings of foreign subsidiaries was approximately $173,000 as of January 31, 2006.

The Company adopted FAS 123(R) on November 1, 2005, which requires, among other items, the recognition of stock option expense in the results of operations. As a result of the adoption of SFAS 123(R), the income tax effects of compensatory stock options are included in the computation of the income tax expense (benefit), and deferred tax assets and liabilities, subject to certain prospective adjustments to stockholders equity for the differences between the income tax effects of expenses recognized in the results of operations and the related amounts deducted for income tax purposes. Prior to the Company s adoption of SFAS 123(R), the tax benefits relating to the income tax deductions for compensatory stock options were recorded directly to stockholders equity.

6. NET INCOME (LOSS) PER SHARE

The following table provides a reconciliation of basic net income (loss) per share to diluted net income (loss) per share for the three months ended January 31, 2006 and 2005:

Net Income (loss)	Shares (in thousands)	Per Share Amount