ATARI

1990
ANNUAL REPORT

Profile

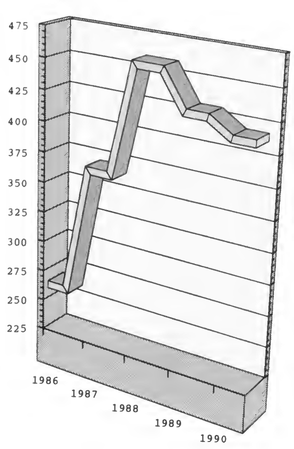
Atari Corporation is one of the largest manufacturers of personal computers and video game systems in the world. Through creative application of advanced technologies, the Company offers its customers a wide range of computers and entertainment game systems. The Company also produces an expanding library of computer and video game software, as well as peripherals and accessories that are sold in almost every major country in the world.

Atari is a multi-national company employing approximately 1260 people throughout the world. Corporate headquarters, including computer and video game product design, are located in Sunnyvale, California. R&D centers are located in the United States, England, Japan, and Taiwan. Manufacturing is carried out in Taiwan, Japan, and by various subcontractors in the Far East. The Company operates through wholly owned subsidiaries in Australia, Austria, Belgium, Canada, Denmark, France, Germany, Hong Kong, Israel, Italy, Japan, Mexico, the Netherlands, Norway, Spain, Sweden, Switzerland, Taiwan, the United Kingdom, and the United States.

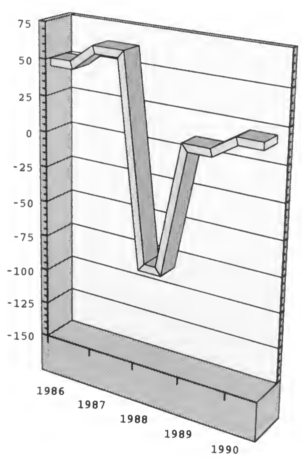
During the year 1990, Atari Corporation improved its balance sheet and took steps to reduce inventory and operating expenses. While our subsidiaries in Europe showed overall sales growth with good increases in the United Kingdom and France, our business in North America continued to experience severe competition in the video game and computer markets and sales were down in 1990.

For the year ended December 31, 1990, net income was $14.9 million on sales of $411.5 million. This compares with net income of $4.0 million on sales of $423.6 million in 1989. During the second half of 1990, the Company repurchased approximately 40% of its 5¼% convertible subordinated debentures which resulted in a gain of $21.1 million. In the fourth quarter of 1990, the Company provided significant inventory reserves, including its traditional U.S. video game products, to reflect current market value. In addition, having substantially completed its liquidation of the remaining assets and liabilities of its discontinued operations, excess reserves were adjusted in discontinued operations of $14.6 million. Our performance in 1990 was disappointing from a sales and operating profit point of view. However as a result of the reasons above, the Company's balance sheet improved which resulted in net income of $14.9 million for the year.

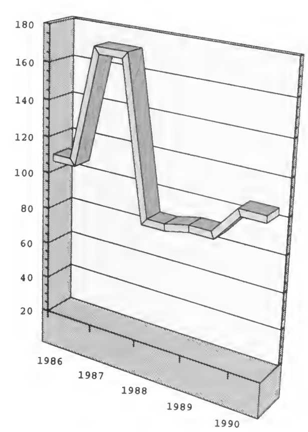
Net Sales
(in millions)



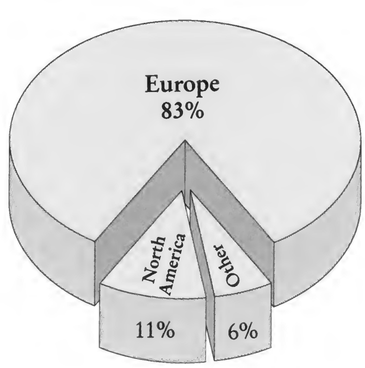
Net Income
(in millions)



Shareholder's Equity
(in millions)



Sales by Geographic Region

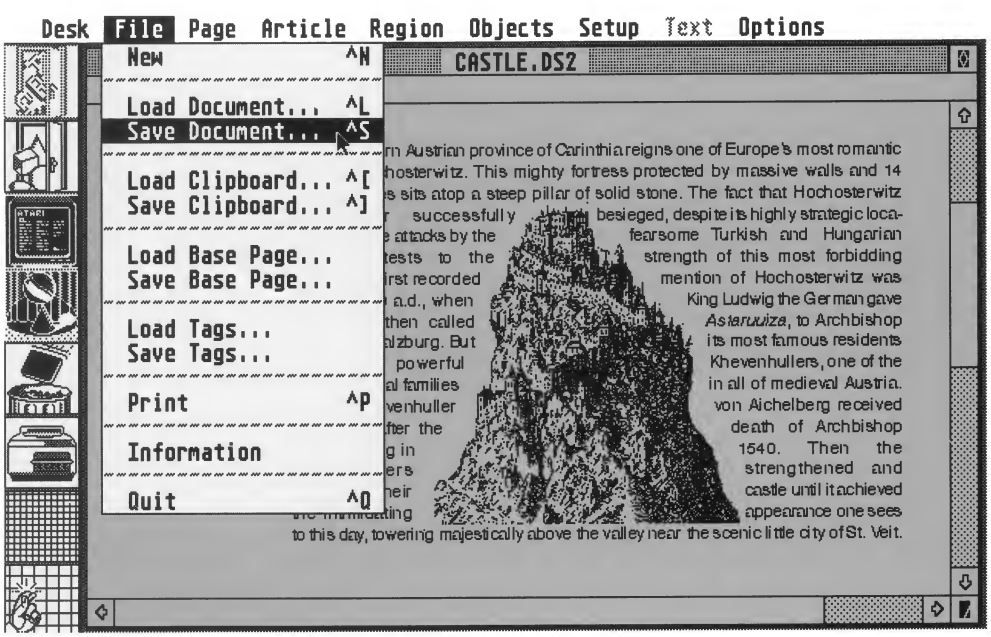


We are investing in new product R&D and this should help position the Company in the years to come. We are also concentrating on reducing our operating costs by various means including the expansion of independent subcontractors for production purposes.

In the third quarter of 1990, Atari started shipping the Atari TT030™ personal computer, based on the powerful Motorola® MC68030™ microprocessor. The TT030, along with the MEGA STE™, a 68000 based computer, add advanced products to our flagship line of personal computers. The STE™ and TT™ line continues to attract top software developers throughout the world and we are continuing to develop new hardware and software for this family of products. At the recent Hannover Fair (March 1991) in Germany, the Atari ST™ compatible Notebook portable and the innovative Atari STylus™ portable were introduced. The two machines have long battery life and the Atari STylus features a pen oriented operation with character recognition.

As a result of our new marketing approach and a lower retail price point, the Atari Portfolio®, our one pound portable P.C. advanced organizer, is doing well. New Portfolio software titles are being released in 1991 which should enhance the Portfolio's position in the marketplace. The Atari line of MS-DOS® compatibles suffered from a continuing severe shortage of Intel® 80386 microprocessors. With recent product announcements in the 80386 market-

Wrapping type around an irregular object.
*A feature from **DeskSet II** by G.O. Graphics, Inc.*



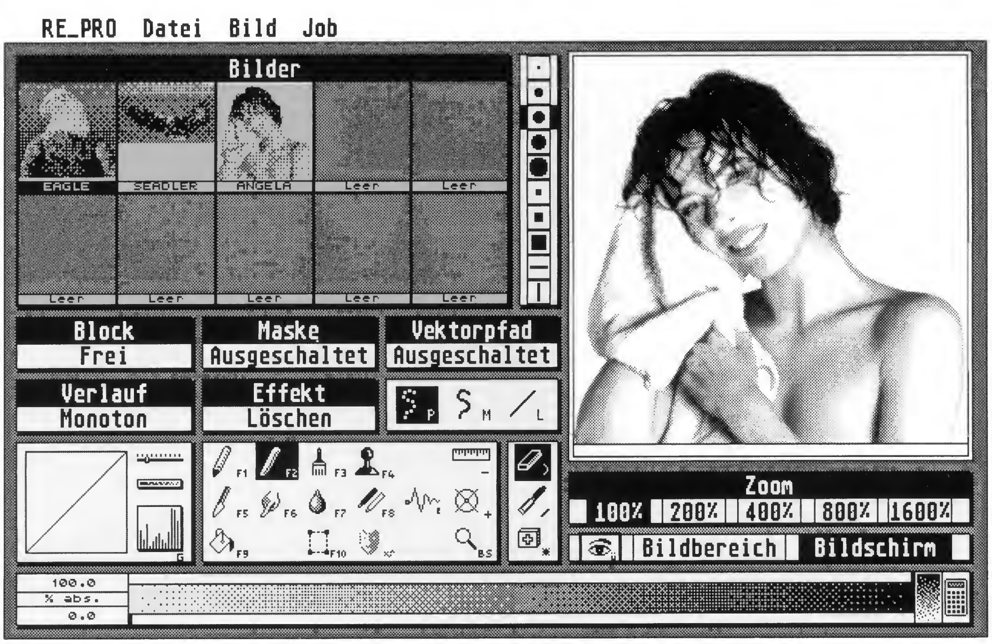
place, we hope that this shortage will subside during the second half of 1991 and that we can reestablish this line in our distribution network.

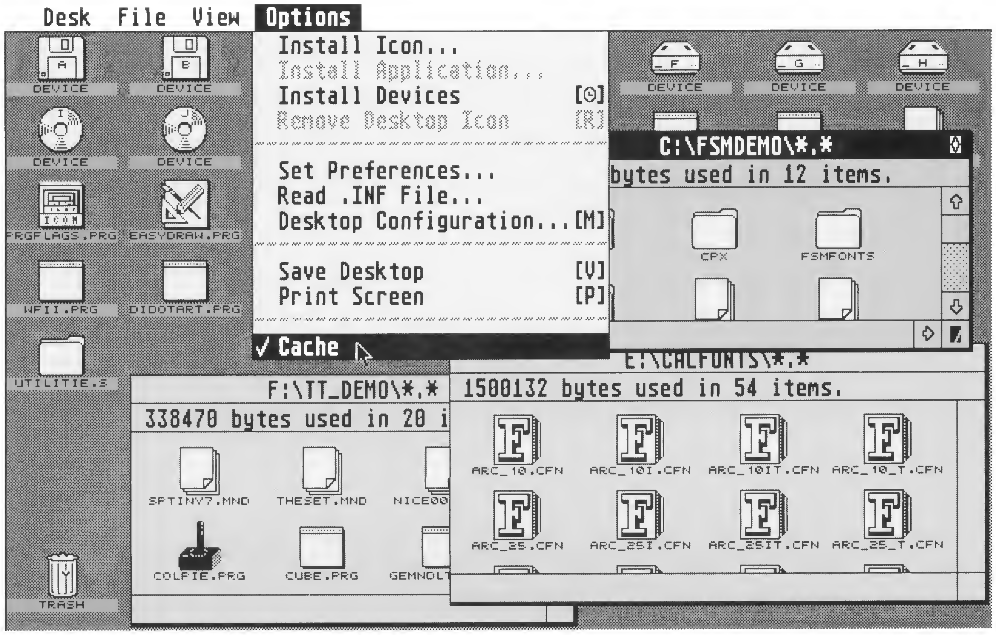
In our video game business we are very pleased with the consumer response to the new marketing campaign and lower retail price points of the Atari Lynx™ as announced at the January 1991 Consumer Electronics Show. As a result of the release of only 12 titles during 1990, and the higher launch price, sales of the Lynx were slow. However, with the new marketing campaign and the plan to make available for sale over 40 titles in 1991, we expect a much broader mass market appeal. The Atari 2600® and 7800™ continue to sell well in Europe while the market for these two products in North America is extremely slow. New table top video game consoles are planned for introduction in 1992.

While we look at 1991 with caution due to the worldwide economic downturn, we are confident that our present and future products will be well received. Thank you all for your continued support.

Sam Tramiel, President

Retouche Professional ***by 3K Computerbild provides leading technology for professional preparation of materials for printing.***



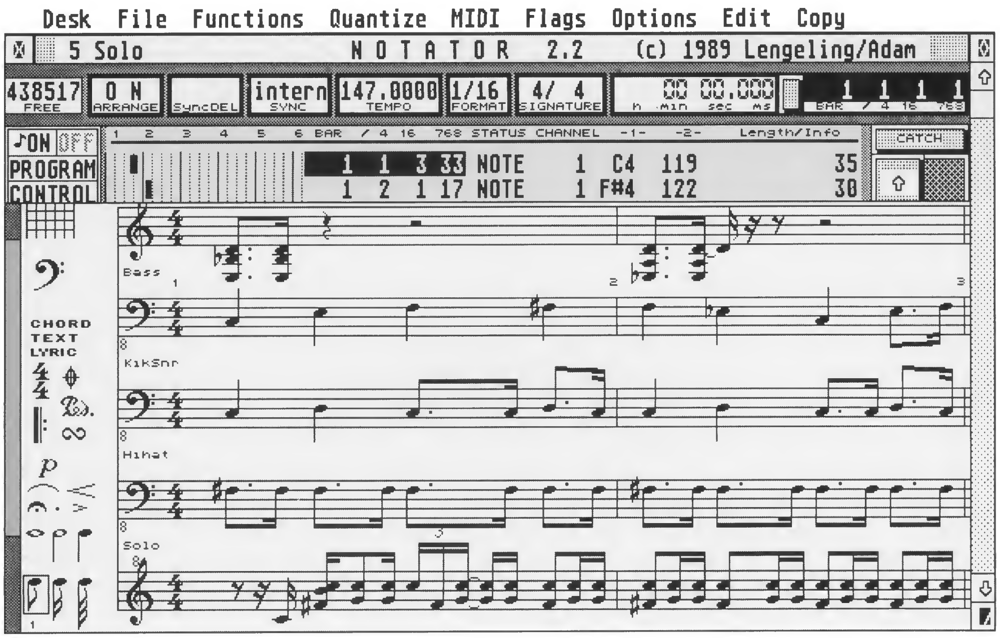


The Atari TT030 displays an easier than ever graphic interface.

The Atari TT030 system, which began shipping during the fall of last year has brought to the marketplace a new level of performance in desktop publishing, high speed graphics, and professional image processing.

The power, speed, and superb resolution of the TT030, enhanced by its Motorola MC68030 CPU running at 32 MHz, enables the Atari system to professionally handle the preparation of materials for printing and desktop publishing software. Final results, which determine computer selection at the outset, meet the most demanding standards of expert lithographers.

The graphs illustrated on page one of this report were created with SciGraph™, a high-end graphing and vector drawing program from Scilab. The captions, along with all of the report text and financial data in this book are the product of DeskSet™ II, from G.O. Graphics, Inc. This program contains text editing and page layout capabilities. Print-ready output was produced on the Compugraphic® 8400 typesetting system using G.O. Graphics' Typesetter Driver Option™ card interface.



NOTATOR™ from C-LAB® is an all encompassing MIDI composition and production system.

Setting text into or around an irregular shape or image has always been a tedious, time consuming effort by traditional methods. DeskSet II makes it easy and sets new standards for outstanding graphic presentations.

Retouche Professional™ is a state-of-the-art image processing package developed by 3K Computerbild. It provides 256 levels of gray tones. Halftones are impeccable. Controls for elegant contrasts and brightness are complemented by an extensive range of filters to achieve artistic effects. This program offers a "jobs" feature for organizing scanned images, masks, type, and line art for assembly of distinct elements into combined photo montages. There are over 120 selectable halftone screens to match the appropriate screen angle and dot pattern for a particular output device and a desired printing press. Retouche CD™, a color design program, is also available.

Reflecting the power and ease of use of the new Atari system is its thoroughly detailed graphic user interface. An operator can actually customize on-screen icons and keyboard equivalents, making data organization more convenient than ever.

The essence of Atari's advanced technology remains its TOS® operating system. It provides the broadest horizon for creative license in personal computing and in the arts. In addition to quality print output, Atari computers continue to generate the contemporary sounds of musicians around the world. Working with NOTATOR, the powerful composition and production program from C-Lab, new dimensions in audio are being explored by such artists as Terry Riley, pioneer of "Minimalism," Jean-Michel Jarre, renowned composer, and Star Parodi, keyboardist for The Posse, Arsenio Hall's TV band. Atari systems also help to create the soundtracks, and sound effects in many movie hits such as Oliver Stone's, "The Doors," a Tri Star Pictures release.

Financial Contents

December 31, 1990 and 1989 (amounts in thousands, except share amounts)	*1990*	*1989*
Assets		
CURRENT ASSETS:		
Cash and equivalents (including $2,892 and $3,884 held as restricted balances in 1990 and 1989 respectively—Note 5)	**$ 36,919**	$ 54,912
Trade receivables (less allowances for returns and doubtful accounts: 1990, $9,738; 1989, $10,579)	**95,844**	99,296
Inventories (Note 3)	**114,331**	129,881
Prepaid expenses	**5,817**	4,726
Other current tax assets	**1,352**	10,322
Total current assets	**254,263**	299,137
PROPERTY—Net (Note 4)	**13,639**	13,900
OTHER ASSETS	**4,736**	9,939
TOTAL	**$ 272,638**	$ 322,976
Liabilities and Shareholders' Equity		
CURRENT LIABILITIES:		
Notes payable (Note 5)	**$ 28,231**	$ 35,433
Accounts payable	**74,252**	84,072
Net current liabilities of discontinued operations (Note 2)	**—**	11,868
Income taxes payable	**427**	367
Accrued liabilities (Note 7)	**19,452**	27,835
Total current liabilities	**122,362**	159,575
LONG-TERM OBLIGATIONS (Note 5)	**49,016**	77,402
COMMITMENTS (Note 6) AND CONTINGENT LIABILITIES (Note 11)		
SHAREHOLDERS' EQUITY (Note 9):		
Preferred stock, $.01 par value—authorized 10,000,000 shares; none outstanding	**—**	—
Common stock, $.01 par value—authorized, 100,000,000 shares; outstanding: 1990, 57,743,042 shares; 1989, 57,697,835 shares	**577**	577
Additional paid-in capital	**143,529**	143,226
Notes receivable from sale of common stock	**(614)**	(827)
Accumulated deficit	**(41,054)**	(55,928)
Accumulated translation adjustments	**(1,178)**	(1,049)
Total shareholders' equity	**101,260**	85,999
TOTAL	**$ 272,638**	$ 322,976

See notes to consolidated financial statements.

Years Ended December 31, 1990, 1989 and 1988 (amounts in thousands, except per share amounts)	*1990*	*1989*	*1988*
NET SALES	$ 411,471	$ 423,606	$ 452,201
COSTS AND EXPENSES:			
Cost of sales	319,791	309,419	280,448
Research and development	22,875	24,613	21,364
Marketing and distribution	72,048	66,423	71,874
General and administrative	21,977	19,473	18,923
Total operating expenses	436,691	419,928	392,609
OPERATING INCOME (LOSS)	(25,220)	3,678	59,592
Other income (expense)—net	9,893	971	(1,657)
Interest income	2,511	4,107	5,351
Interest expense	(6,562)	(6,287)	(4,783)
Income (loss) before income taxes	(19,378)	2,469	58,503
Provision (credit) for income taxes (Note 8)	1,469	(1,548)	19,100
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EXTRAORDINARY CREDIT	(20,847)	4,017	39,403
Discontinued operations (Note 2):			
Loss from operations	—	—	(67,166)
Disposition of operations	14,634	—	(57,055)
INCOME (LOSS) BEFORE EXTRAORDINARY CREDIT	(6,213)	4,017	(84,818)
Extraordinary credit—gain on extinguishment of 5¼% convertible subordinated debentures, no tax effect due to utilization of loss carryforwards (Note 5)	21,087	—	—
NET INCOME (LOSS)	$ 14,874	$ 4,017	$ (84,818)
EARNINGS (LOSS) PER COMMON AND COMMON EQUIVALENT SHARE:			
Primary:			
Income (loss) from continuing operations	$ (.36)	$ .07	$ .68
Income (loss) before extraordinary credit	$ (.11)	$ .07	$ (1.46)
Net income (loss)	$ .26	$ .07	$ (1.46)
Fully diluted:			
Income (loss) from continuing operations	$ (.36)	$ .07	$ .67
Income (loss) before extraordinary credit	$ (.11)	$ .07	$ (1.31)
Net income (loss)	$ .26	$ .07	$ (1.31)
Number of shares used in computations:			
Primary	57,739	58,079	57,964
Fully diluted	57,739	58,142	62,562

See notes to consolidated financial statements.

Years Ended December 31, 1990, 1989 and 1988 (amounts in thousands)	*Common Stock* *Shares*	*Common Stock* *Amount*	*Additional Paid-In Capital*	*Notes Receivable From Sale of Common Stock*	*Accumulated Deficit*	*Accumulated Translation Adjustments*	*Total*
BALANCES, JANUARY 1, 1988	57,703	$ 577	$ 142,247	$ (1,417)	$ 24,873	$ 1,375	$ 167,655
Stock options exercised	60	1	440	—	—	—	441
Common stock repurchased	(24)	(1)	(29)	—	—	—	(30)
Payments on notes receivable	—	—	—	276	—	—	276
Translation adjustments	—	—	—	—	—	(293)	(293)
Net loss	—	—	—	—	(84,818)	—	(84,818)
BALANCES, DECEMBER 31, 1988	57,739	577	142,658	(1,141)	(59,945)	1,082	83,231
Stock options exercised	110	1	734	—	—	—	735
Common stock repurchased	(151)	(1)	(166)	—	—	—	(167)
Payments on notes receivable	—	—	—	314	—	—	314
Translation adjustments	—	—	—	—	—	(2,131)	(2,131)
Net income	—	—	—	—	4,017	—	4,017
BALANCES, DECEMBER 31, 1989	57,698	577	143,226	(827)	(55,928)	(1,049)	85,999
Stock options exercised	50	—	308	—	—	—	308
Common stock repurchased	(5)	—	(5)	—	—	—	(5)
Payments on notes receivable	—	—	—	213	—	—	213
Translation adjustments	—	—	—	—	—	(129)	(129)
Net income	—	—	—	—	14,874	—	14,874
BALANCES, DECEMBER 31, 1990	57,743	$ 577	$ 143,529	$ (614)	$ (41,054)	$ (1,178)	$ 101,260

See notes to consolidated financial statements.

Years Ended December 31, 1990, 1989 and 1988
(amounts in thousands)

	1990	*1989*	*1988*
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net cash provided (used) by continuing operations	$ 2,374	$ (5,897)	$ 2,169
Net cash provided (used) by discontinued operations	2,766	(35,533)	(19,810)
Net cash provided (used) by operating activities	5,140	(41,430)	(17,641)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net short-term investments and restricted cash	—	—	18,008
Other assets	1,334	(4,108)	4,808
Property purchases	(4,039)	(5,552)	(2,481)
Sale of property	130	305	224
Net cash provided (used) by investing activities	(2,575)	(9,355)	20,559
CASH FLOWS FROM FINANCING ACTIVITIES:			
5¼% convertible subordinated debentures extinguished	(6,890)	—	—
Additions to borrowings	148	—	—
Net short-term borrowings (repayments)	(7,620)	15,871	9,330
Issuance of common stock, net	516	882	687
Net cash provided (used) by financing activities	(13,846)	16,753	10,017
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND EQUIVALENTS	(6,712)	(2,946)	2,869
NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS	(17,993)	(36,978)	15,804
CASH AND EQUIVALENTS:			
Beginning of year	54,912	91,890	76,086
End of year	$ 36,919	$ 54,912	$ 91,890
OTHER CASH FLOW INFORMATION (FROM CONTINUING OPERATIONS):			
Interest paid	$ 7,792	$ 6,167	$ 4,732
Income taxes paid (refunded)	$ (7,561)	$ 9,520	$ 14,534
NONCASH INVESTING AND FINANCING ACTIVITIES:			
Issuance of debt in exchange for land and building	$ —	$ 2,402	$ —
RECONCILIATION OF NET INCOME (LOSS) TO NET CASH PROVIDED (USED) BY CONTINUING OPERATIONS:			
Net income (loss)	$ 14,874	$ 4,017	$ (84,818)
Discontinued operations	(14,634)	—	124,221
Gain from extinguishment of 5¼% convertible subordinated debentures	(21,087)	—	—
Depreciation and amortization	4,739	2,483	2,076
Provision for doubtful accounts	1,999	1,083	1,060
Provision for sales returns and allowances	3,447	4,797	14,626
Changes in operating assets and liabilities:			
Trade receivables	9,159	(8,393)	(14,033)
Inventories	15,550	(10,429)	2,022
Prepaid expenses and other assets	3,206	(1,185)	(1,280)
Other current tax assets	8,970	—	(10,322)
Accounts payable	(13,534)	31,351	(14,851)
Income taxes payable	256	(10,028)	(7,119)
Accrued liabilities	(10,571)	(19,593)	(9,413)
Net cash provided (used) by continuing operations	$ 2,374	$ (5,897)	$ 2,169

See notes to consolidated financial statements.

Note 1. Organization and Significant Accounting Policies

Organization The Company designs, manufactures, sells and services personal computers, video games and related software and peripheral products. The principal methods of distribution are through computer specialty dealers and mass market retailers. Effective December 1988 the Company decided to discontinue its consumer electronics and home entertainment products operations acquired in 1987.

Principles of Consolidation The consolidated financial statements include the Company and its subsidiaries. All transactions and balances between the companies are eliminated.

Cash and Equivalents Cash equivalents are stated at cost, which approximates market value; have maturities not exceeding ninety days upon acquisition; and generally consist of certificates of deposit, time deposits, treasury notes and commercial paper.

Inventories Inventories are stated at the lower of cost or market. Cost is computed using standard costs which approximate cost on a first-in, first-out basis.

Property Property is stated at cost. Depreciation is computed using the straight-line method based on estimated useful lives of the assets of 2 to 30 years. Leasehold improvements are amortized over the estimated useful life or lease term, as appropriate.

Revenue Recognition Sales are recognized upon shipment.

Income Taxes The Company has adopted Statement of Financial Accounting Standards No. 96 (SFAS 96) "Accounting for Income Taxes". SFAS 96 requires the asset and liability method approach for financial accounting and reporting of income taxes.

Foreign Currency Translation Assets and liabilities of operations outside the United States, except for operations that are highly integrated with operations of the Company (principally in Taiwan), are translated into United States dollars using current exchange rates, and the effects of foreign currency translation adjustments are deferred and included as a component of shareholders' equity. For operations that are highly integrated, foreign currency translation adjustments are included in operations. Exchange and translation gains (losses) included in other income (expense) for the years 1990, 1989 and 1988 were $9,852,000, $(2,278,000) and $(4,779,000), respectively.

Earnings (Loss) per Common and Common Equivalent Share Per share amounts are computed based on the weighted average number of common and, when dilutive, common equivalent shares (stock options) outstanding during each period.

Fully diluted earnings (loss) per share includes the dilutive effect of the conversion of the 5¼% convertible subordinated debentures for the period they were outstanding (see Note 5) and the additional dilutive effect of stock options. Interest expense of $3,938,000 ($2,652,000 net of income taxes) related to the 5¼% convertible subordinated debentures has been added to net income, income before extraordinary item and income from continuing operations, respectively, in calculating fully diluted earnings (loss) per share for 1988. The conversion of the 5¼% convertible subordinated debentures is antidilutive in 1990 and 1989 and is excluded from the fully diluted earnings (loss) per share computations.

Fiscal Year The Company has a 52/53 week fiscal year which ends on the Saturday closest to December 31. Fiscal years 1990, 1989 and 1988, all have 52 weeks. For simplicity of presentation, the date December 31 is used to represent the fiscal year end.

Reclassifications Certain reclassifications have been made to the prior years' consolidated financial statements to conform to the 1990 presentation. Such reclassifications had no effect on net income or the accumulated deficit.

Note 2. Discontinued Operations

In 1988, the Company provided $64.8 million (before allocation of income tax benefits of $7.8 million) for its discontinued operations. As a result of a change in the Company's strategy for disposal, operating losses during the phase-out period have exceeded the $12 million reserve for such losses included in the $64.8 million provision in 1988. These higher losses were offset by the settlement of certain obligations at lower than estimated amounts. As of December 31, 1990, the Company has substantially completed its disposition and as a result, $14.6 million (no tax effect due to utilization of loss carryforwards) of the previously estimated loss was determined not to be required and has been reflected in discontinued operations in 1990.

Net sales of the discontinued operation for 1990, 1989 and 1988 were nil, $111.4 million and $253.0 million, respectively. Net losses for 1989 and 1988 were $37.4 million and $67.2 million (net of income tax benefits in 1988 of $9.5 million), respectively.

Net current and noncurrent assets and liabilities of discontinued operations consist of the following (in thousands):

	December 31, 1990	December 31, 1989
Current assets	$ —	$ 10,481
Noncurrent assets	12,000	38,793
Total assets	12,000	49,274
Current liabilities	7,005	20,839
Noncurrent liabilities	2,314	12,912
Total liabilities	9,319	33,751
Net assets before discontinuation accruals	2,681	15,523
Accrued discontinuation costs and losses	(2,456)	(27,391)
Net assets (liabilities) of discontinued operations	$ 225	$ (11,868)

Net assets of discontinued operations are included in other assets in the 1990 consolidated balance sheet.

Note 3. Inventories

Inventories at December 31 consist of the following (in thousands):

	1990	1989
Finished goods	$ 83,435	$ 78,110
Raw materials and work-in-process	30,896	51,771
Total	$ 114,331	$ 129,881

Note 4. Property

Property at December 31 consists of the following (in thousands):

	1990	1989
Land	$ 5,504	$ 4,803
Buildings	3,964	3,626
Machinery and equipment	12,307	10,196
Furniture and fixtures	2,922	2,142
Leasehold improvements	1,754	839
Total	26,451	21,606
Accumulated depreciation and amortization	(12,812)	(7,706)
Property (net)	$ 13,639	$ 13,900

Note 5. Debt Obligations

At December 31, 1990, the Company was obligated for $28.2 million of overdrafts and short-term borrowings payable to banks under borrowing facilities of its subsidiaries at rates ranging from 9.4% to 15.2%. Certain of the borrowings are collateralized by manufacturing facilities in the Far East.

In April 1987, the Company sold $75 million principal amount of 5¼% convertible subordinated debentures due April 29, 2002. The debentures may be redeemed at the Company's option, upon payment of a premium. The debentures, at the option of the holders, are convertible into common stock at $16.31 per share. At December 31, 1990, 2,827,831 shares of common stock were reserved for conversion. Default with respect to other indebtedness of the Company in an aggregate amount exceeding $5 million would result in an event of default whereby the outstanding debentures would be due and payable immediately.

In 1990, the Company reacquired in the open market and extinguished $28.9 million face value of these debentures for $6.9 million, net of purchased interest. The extinguishment resulted in an extraordinary credit of $21.1 million, net of deferred issuance costs with no tax effect due to the utilization of loss carryforwards, or $.37 per share.

In addition, at December 31, 1990, the Company has a term loan outstanding of $2.9 million for the purchase of land and building in France. The loan is due in fourteen equal annual installments through 2004. Approximately half of the amount bears interest at a fixed rate of 9.6%, the remainder bears interest at the French prime rate plus 1.2% (11.45% at December 31, 1990). The loan is secured by the related land and building.

At December 31, 1990, an aggregate of $13.7 million in multicurrency bank credit arrangements was available to the Company and its subsidiaries with various interest rates and security arrangements.

Note 6. Commitments

The Company leases various facilities and equipment under noncancellable operating lease arrangements. The major facilities leases are for terms ranging from one to seven years and are accounted for as operating leases. These leases generally provide renewal options of five additional years. Minimum future lease payments under all noncancellable operating leases as of December 31, 1990 are as follows (in thousands):

1991	$ 4,847
1992	4,008
1993	3,414
1994	2,804
1995	2,602
Later years	1,943
Total minimum lease payments	$ 19,618

Rent expense for all operating leases was $3,935,000, $3,149,000 and $2,879,000 for the years 1990, 1989 and 1988, respectively.

Note 7. Accrued Liabilities

Accrued liabilities at December 31 consist of the following (in thousands):

	1990	1989
Accrued royalties	**$ 4,337**	$ 5,932
Other	**15,115**	21,903
Total	**$ 19,452**	$ 27,835

Note 8. Income Taxes

The provision (credit) for income taxes consists of (in thousands):

	1990	1989	1988
Current:			
Federal	**$ —**	$ —	$ 12,556
Foreign	**1,469**	(1,548)	6,736
State	**—**	—	622
Total current	**1,469**	(1,548)	19,914
Deferred:			
Federal	**—**	—	(814)
State	**—**	—	—
Total deferred	**—**	—	(814)
Provision (credit) for income taxes	**$ 1,469**	$ (1,548)	$ 19,100

The current portion of the provision (credit) for foreign income taxes are net of benefits from loss carryforwards of $500,000, $2,823,000 and $3,189,000 in 1990, 1989 and 1988, respectively.

Deferred income taxes are recorded to reflect the tax consequences on future years of differences between the income tax bases of assets and liabilities and the financial reporting bases. Differences that give rise to deferred income taxes relate to accrued liabilities and allowances. Income (loss) before income taxes for the years 1990, 1989 and 1988 includes income of $4,843,000, $313,000 and $22,382,000, respectively, from the Company's foreign subsidiaries. The temporary difference relating to the earnings of foreign subsidiaries for which a deferred tax liability has not been recognized assuming repatriation approximates $40,450,000 at December 31, 1990. The additional income taxes which may become due if those earnings were to be remitted to the United States are not material. However, it is management's intent that these earnings remain invested indefinitely.

At December 31, 1990, the Company has an operating loss carryforward of approximately $42,800,000 for financial reporting purposes which will expire in 2005. At December 31, 1990, the Company has foreign tax credits of $4,000,000 which expire through 1994.

The effective income tax rates for 1990, 1989 and 1988 were 8%, (63)% and 33%, respectively, and differ from the federal statutory rate of 34% as follows (in thousands):

	1990	1989	1988
Computed at federal statutory rates	**$ (6,589)**	$ 840	$ 19,891
Effect of foreign tax assessment on purchase price allocations	**—**	—	1,231
Effect of losses providing no tax benefit	**9,585**	1,963	20
Tax benefit of foreign loss carryforwards	**(500)**	(2,823)	(3,189)
Effect of foreign tax rates different than statutory rates and foreign loss carrybacks	**(741)**	(795)	1,133
Effect of foreign and research tax credits	**—**	—	(1,469)
State income taxes, net of federal tax benefit	**—**	—	411
Effect of discontinued operations	**—**	(733)	—
Other	**(286)**	—	1,072
Provision (credit) for income taxes	**$ 1,469**	$ (1,548)	$ 19,100

Note 9. Shareholders' Equity

Common Stock Founders and employees of the Company have purchased 33,422,466 common shares under stock purchase agreements at fair market value as determined by the Board of Directors. The employees' shares generally vest 20% at the end of each of the initial five years of employment. At December 31, 1990, 109,000 unvested shares were subject to repurchase.

The Company's stock option plan and restricted stock plan provide for the issuance of up to 3,000,000 shares of common stock through the issuance of incentive stock options to employees, and non-qualified stock options and restricted stock to employees, directors and consultants. Under the plans, stock options or restricted stock may be granted at not less than fair market value as determined by the Board of Directors. Stock options become exercisable as established by the Board (generally ratably over five years) and expire up to ten years from date of grant. The Company's right to repurchase restricted stock lapses over a maximum period of five years. At December 31, 1990, options for approximately 726,791 shares were exercisable and options for 455,442 shares were available for future grant. At December 31, 1990, no restricted stock under the restricted stock plan had been issued.

At December 31, 1990 the Company had reserved 5,581,224 shares of common stock for issuance under the stock plans and for conversion of the 5¼% debentures.

Additional information with respect to the stock option plan is as follows:

	Number of Options	Option Price Range Per Share Low		High	Total
Outstanding, Jan. 1, 1988	1,505,564	$1.00	-	$13.87	$10,014,125
Granted	897,000	5.75	-	8.63	6,256,500
Exercised	(60,771)	1.00	-	6.94	(440,401)
Cancelled	(468,344)	3.00	-	13.87	(3,432,556)
Outstanding, Dec. 31, 1988	1,873,449	1.00	-	13.06	12,397,668
Granted	682,900	5.13	-	14.00	4,582,600
Exercised	(109,546)	1.00	-	8.63	(734,943)
Cancelled	(559,602)	5.50	-	12.00	(4,083,997)
Outstanding, Dec. 31, 1989	1,887,201	1.00	-	14.00	12,161,328
Granted	1,102,000	1.88	-	9.63	5,628,250
Exercised	(50,207)	1.00	-	7.75	(308,402)
Cancelled	(641,043)	2.50	-	13.00	(3,962,675)
Outstanding, Dec. 31, 1990	2,297,951	$1.00	-	$14.00	$13,518,501

Note 10. Segment Information

The Company operates in one industry segment– the design, manufacture, sale and servicing of consumer electronic products.

The Company's foreign operations consist of manufacturing facilities in the Far East and distribution facilities in Europe, Australia, and North America. Transfers between geographic areas are accounted for at amounts generally above cost and in accordance with the rules and regulations of the respective governing tax authorities. Corporate assets are cash and equivalents. The following tables present a summary of operations by geographic region (in thousands):

	1990	1989	1988
Revenues from unaffiliated customers:			
North America	$ 46,291	$ 76,773	$133,189
Export sales from North America	10,523	16,704	14,883
Europe	341,670	307,381	291,645
Other	12,987	22,748	12,484
Total	$ 411,471	$423,606	$452,201
Transfers from geographic areas (eliminated in consolidation):			
North America	$ 501,552	$432,915	$363,824
Europe	38,237	42,214	15,942
Other	247,834	295,527	310,073
Total	$ 787,623	$770,656	$689,839
Operating income (loss):			
North America	$ (33,754)	$ (1,618)	$ 35,188
Europe	7,011	(2,194)	13,974
Other	1,523	7,490	10,430
Total	$ (25,220)	$ 3,678	$ 59,592
Identifiable assets at December 31:			
North America	53,442	$ 55,973	$ 56,812
Europe	134,857	139,616	122,716
Other	47,420	72,475	47,227
Corporate assets	36,919	54,912	91,890
Total	$ 272,638	$322,976	$318,645

Note 11. Contingent Liabilities

Certain claims and suits arising in the ordinary course of business have been filed or are pending against the Company. In the opinion of management, all such matters have been adequately provided for, are without merit, or are such that if settled unfavorably would not have a material adverse effect on the Company's consolidated financial position.

The Company is both a plaintiff and defendant in several lawsuits arising out of its acquisition of operations which were subsequently discontinued. The Company is presently prosecuting and or defending these actions and intends to continue to do so. The Company believes these actions will not have a material adverse effect on the Company's consolidated financial position.

Note 12. Quarterly Financial Data (Unaudited)

Summarized quarterly financial data for 1990 and 1989 are as follows (in thousands except per share data):

Year Ended December 31, 1990	*First Quarter*	*Second Quarter*	*Third Quarter*	*Fourth Quarter*
Net sales	$85,547	$84,895	$89,146	$151,883
Gross margin	25,942	27,923	20,035	17,780
Income (loss) from continuing operations	1,548	1,525	(3,855)	(20,065)
Income (loss) before extraordinary credit	1,548	1,525	(3,855)	(5,431)
Net income	1,548	1,525	3,003	8,798
Earnings (loss) per common and common equivalent share:				
Primary:				
Income (loss) from continuing operations	.03	.03	(.07)	(.35)
Income (loss) before extraordinary credit**	.03	.03	(.07)	(.09)
Net income	.03	.03	.05	.15
Fully diluted:				
Income (loss) from continuing operations	.03	.03	(.07)	(.35)
Income (loss) before extraordinary credit**	.03	.03	(.07)	(.09)
Net income	.03	.03	.05	.15

Year Ended December 31, 1989	*First Quarter*	*Second Quarter*	*Third Quarter*	*Fourth Quarter*
Net sales	$88,776	$82,740	$81,444	$170,646
Gross margin	30,376	28,104	17,678	38,029
Income (loss) from continuing operations	3,288	327	(5,395)	5,797
Net income (loss)	3,288	327	(5,395)	5,797*
Earnings (loss) per common and common equivalent share:				
Primary:				
Income (loss) from continuing operations**	.06	.01	(.09)	.10
Net income (loss)**	.06	.01	(.09)	.10
Fully diluted:				
Income (loss) from continuing operations**	.06	.01	(.09)	.10
Net income (loss)**	.06	.01	(.09)	.10

* *See Note 8.*

** *The sum of per share amounts for the four quarters does not equal the annual amount as reported on the consolidated statements of operations due to rounding.*

To the Shareholders and Board of Directors
of Atari Corporation:

We have audited the accompanying consolidated balance sheets of Atari Corporation and its subsidiaries as of December 31, 1990 and 1989, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1990. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of Atari Corporation and its subsidiaries at December 31, 1990 and 1989, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1990 in conformity with generally accepted accounting principles.

Deloitte & Touche

Deloitte & Touche
San Jose, California
March 8, 1991

Introduction

The Company commenced operations in May 1984, and in July 1984, acquired certain computer and video game system assets from, and assumed certain liabilities of, Warner Communications, Inc®. ("WCI"). In November 1986 the Company conducted its initial public offering pursuant to which it raised $54.9 million, of which $36.2 million was used to retire acquisition indebtedness to WCI. In April 1987, the Company completed the sale of $75 million of 5¼% Convertible Subordinated Debentures due 2002. On October 4, 1987, the Company completed the purchase of all the outstanding shares of The Federated Group, Inc., ("Federated") a retailer of consumer electronics products, for a cash purchase price of approximately $64 million. In March 1989, as a result of Federated's losses and cash flow requirements, the Board of Directors approved the Company's decision to discontinue its Federated operation. During fiscal 1990, the Company substantially completed the disposition of the assets and liabilities of its former Federated business and realized a gain of $14.6 million from the liquidation of certain reserves originally established in 1988. See Note 2 of Notes to the Consolidated Financial Statements for information concerning discontinued operations.

Results of Operations for the Year Ended December 31, 1990

The Company experienced a 3% decline in net sales from $423.6 million in 1989 to $411.5 million in 1990. Sales of the ST, STE, and MEGA™ range of products constituted the majority of net sales but remained relatively unchanged compared to 1989. New products, particularly the TT series, Portfolio and Lynx,™ each of which were shipped in commercial volume during 1990, constituted approximately 16.4% of net sales for 1990 compared to under 10% for 1989. This sales growth was offset by a corresponding decrease in sales of XE™ computer and traditional video game products, especially in the U.S. market. The effects of exchange rate changes resulted in increased dollar values of international sales compared to last year. This increase offset the erosion of average selling prices resulting from continuing competitive pressure.

Gross margins as a percentage of net sales declined from 27% in 1989 to 22% in 1990, principally due to a higher level of inventory write downs in 1990, and, to a lesser extent, to a change in product mix from higher margin traditional video game products to lower margin computer products. During 1990 the Company continued to experience increased competitive pressure on its traditional video game products, especially the NTSC versions sold in the U.S. Accordingly, inventories of those products and related components were substantially written down, to reflect estimated realizable value.

Research and development expense decreased by $1.7 million (7%) in 1990 compared to 1989. On-going development efforts continued in the development of new products across both personal computer and game areas of the consumer product market. These efforts included ST Notebook,™ a portable for the brief case, STylus, an ST device whereby data input is by means of a stylus rather than a keyboard, and additional software to support the Company's product offerings.

Marketing and distribution expenses increased $5.6 million (8%) in 1990 compared to 1989 principally due to the effects of changes in exchange rates during 1990 compared to 1989.

General and administrative expenses were $22.0 million in 1990 compared to $19.5 million in 1989, an increase of $2.5 million or 13%. The increase is mainly attributable to the higher dollar costs of general and administration expenses incurred in overseas subsidiaries, which were affected by the change in exchange rates between 1990 and 1989.

In 1990, other income of $9.9 million was principally exchange gains, whereas in 1989 other income of $1.0 million was net of exchange losses of $2.3 million.

Interest income decreased by $1.6 million to $2.5 million in 1990 reflecting lower cash deposits resulting mainly from $6.9 million expended on the repurchase of debentures during 1990.

Interest expense in 1990 increased slightly by $.3 million to $6.6 million, principally as a result of borrowings at higher interest rates for much of 1990. The increase in interest expense was partially offset by the Company's repurchase of a portion of its 5¼% convertible subordinated debentures during the second half of the year.

The provision for income taxes in 1990 was $1.5 million, compared to a tax credit of $1.5 million in 1989.

During 1990, the Company incurred a loss from continuing operations of $20.8 million compared to income of $4.0 million in 1989. In addition to the factors noted above, the Company's results were adversely impacted by general recessionary conditions and a decline in discretionary consumer spending. The Company continues to experience intense competition and pricing pressure across its product lines and remains subject to a continued weakness in sales to Europe, its principal geographic market, as well as to the effect of exchange rate fluctuations.

During 1990 the Company substantially completed its disposition of the remaining assets and liabilities of its discontinued operations. As a result, the Company realized a gain of $14.6 million, consisting of the adjustment of excess reserves from discontinued operations. During fiscal 1990, the Company repurchased $28.9 million in face amount of its 5¼% convertible subordinated debentures, which resulted in an extraordinary credit of $21.1 million. These transactions had no tax effect due to the utilization of loss carryforwards.

For the reasons as stated above, net income for the year 1990 was $14.9 million as compared to net income of $4.0 million in 1989.

Results of Operations for the Year Ended December 31, 1989

Income from continuing operations was $4.0 million in 1989 compared to $39.4 million in 1988, due to a combination of lower sales and reduced gross margins.

Net sales for the year ended December 31, 1989 were $423.6 million compared to $452.2 million the previous year, a reduction of 6%. International sales accounted for 82% of the total net sales and were therefore subject to the influence of fluctuations in foreign exchange rates compared to the U.S. dollar. The change in exchange rates was responsible for a 7% reduction in sales in 1989 compared to 1988. Sales of ST and PC products increased by 9% to $322.0 million, or 76%, of total net sales in 1989, from $296.5 million, or 66%, of total net sales in 1988. Conversely, sales of game products such as the 2600 and 7800 game systems and the range of older XE 8 bit computers decreased by 35% to $101.6 million, or 24%, of total net sales for the year ended December 31, 1989, from $155.5 million, or 34%, of total net sales in 1988. Two significant new products, the Portfolio hand held computer and the Lynx color portable game system, which were launched late in 1989, contributed sales of $25.5 million.

Gross margin declined from $171.8 million in 1988 to $114.2 million in the year ended December 31, 1989. This was partly due to a 6% reduction in sales volume, and partly due to a reduction in gross margin from 38% to 27% resulting from the adverse change in exchange rates, a reduction in average selling prices, and a change in product mix between the higher margin game software products and lower margin computer hardware sales. Availability and price of DRAM returned to stable and cheaper levels during 1989 but the high prices paid for DRAM in inventory continued to impact margins for the year as a whole.

Research and development expenses increased from $21.4 million, or 5% of net sales, in the year ended December 31, 1988 to $ 24.6 million, or 6% of sales, in the corresponding period of 1989. The increased expenditure relates mainly to the development of the new Portfolio, Lynx, Stacy™ and STE (an enhanced ST) product lines. There was also considerable continuing investment in game software development for the existing range of game products. During 1989, 24 new games were completed.

Marketing and distribution costs declined 8%, from $71.9 million in the year ended December 31, 1988, to $66.4 million in the corresponding period of 1989. Worldwide marketing and advertising levels were cut back during the year in anticipation of increasing pressure on margins. Also, although both the new Portfolio and Lynx products were launched in 1989, constraints in availability and their release late in the year resulted in a limited launch campaign.

General and administrative expenses increased by 3% from $18.9 million in the year ended December 31, 1988 to $19.5 million in the corresponding period of 1989 as a result of increased scale of operations and continuing inflationary pressure on costs in many overseas markets.

Other income for the year ended December 31, 1989 amounted to $1.0 million compared to other expense of $1.7 million for the preceding year, mainly due to fluctuations in the impact of foreign exchange rates.

Interest income declined from $5.4 million to $4.1 million and interest expense increased from $4.8 million to $6.3 million as a result of higher interest rates, lower average cash balances, and higher short term borrowings in 1989 compared to 1988.

In the fourth quarter of 1989, the Company decreased its effective annual tax rate from a credit of 34% to a credit of 63%, due primarily to the utilization of foreign tax loss carryforwards. This resulted in an effective tax rate of a credit of 12% for the fourth quarter of 1989. The effective rate of income tax for 1989 was a credit of 63% compared to a charge of 33% for the year ended December 31, 1988. This was primarily due to the tax benefit of foreign loss carryforwards.

International Sales

Net sales outside North America for 1988, 1989 and 1990 were \$319.0 million, \$346.8 million and \$365.2 million (71%, 82% and 89% of net sales), respectively. For additional operations information by geographic region, see Note 10 of the Notes to Consolidated Financial Statements. The Company's international operations were subject to the risks of fluctuation of the values of the U.S. dollar and foreign currencies. For information concerning the effect of foreign currency transactions on the Company's results of operations through December 31, 1990, see Note 1 of the Notes to Consolidated Financial Statements.

Liquidity and Capital Resources

During 1990, the Company generated \$5.1 million from operating activities, including \$2.8 million as a result of the liquidation of certain discontinued operations. Improvement in use of operating assets and liabilities contributed \$13.0 million which was offset by operating losses of \$10.7 million. In an effort to improve its inventory turns and its liquidity, the Company is attempting to continue to reduce its overall inventory levels.

During the year the Company used \$2.6 million in investing activities principally for additions to tooling and other fixed assets.

Financing activities consumed \$13.8 million, of which \$6.9 million was used to repurchase a portion of the Company's 5¼% convertible subordinated debentures and \$7.6 million was used to reduce short-term borrowings.

The effect of exchange rate changes of \$6.7 million on cash, as well as the items noted above resulted in a decline in the Company's cash balance to \$36.9 million in 1990 compared to \$54.9 million in 1989.

The seasonal nature of the Company's operations requires greater availability of finance facilities in the second and third quarters of the year in order to fund peak working capital requirements.

The Company intends to seek additional bank or institutional credit lines for use in connection with future working capital and capital asset development needs. The Company is in the process of negotiating finance facilities with which to build new office and warehouse premises near Frankfurt, Germany. No other negotiations have commenced with prospective lenders as yet, and no assurance can be given that any such credit lines can be established on terms acceptable to the Company.

The Company believes that existing cash balances together with further facilities of approximately \$13.7 million of multicurrency bank credit agreements, and funds anticipated to be generated from operations, will be sufficient to meet its cash requirements through fiscal 1991.

December 31, (in thousands, except per share data)	1990	1989	1988	1987	1986
STATEMENT OF OPERATIONS DATA:					
Net Sales	**$411,471**	$423,606	$452,201	$362,608*	$258,131*
Income (loss) from continuing operations	**(20,847)**	4,017	39,403	49,409	25,050
Income (loss) before extraordinary credit	**(6,213)**	4,017	(84,818)	44,152	25,050
Net income (loss)	**$ 14,874**	$ 4,017	$ (84,818)	$ 57,429	$ 44,516
PER SHARE DATA:					
Primary:					
Income (loss) from continuing operations	**$ (.36)**	$ .07	$ .68	$ .85	$ .53
Income (loss) before extraordinary credit	**(.11)**	.07	(1.46)	.76	.53
Net income (loss)	**.26**	.07	(1.46)	.99	.95
Fully Diluted:					
Income (loss) from continuing operations	**$ (.36)**	$ .07	$ .67	$ .83	$ .53
Income (loss) before extraordinary credit	**(.11)**	.07	(1.31)	.74	.53
Net income (loss)	**.26**	.07	(1.31)	.96	.95
BALANCE SHEET DATA:					
Working capital	**$131,901**	$139,562	$143,955	$188,499	$ 96,484
Total assets	**272,638**	332,976	318,645	385,902	184,176
Long-term obligations (including current portion)	**49,016**	77,402	75,000	75,000	2,003
Shareholders' equity	**$101,260**	$ 85,999	$ 83,231	$167,655	$105,422

** Net sales for fiscal 1987 and 1986 includes $4,605 and $43,129, respectively, consisting of the liquidation of certain inventories acquired in July 1984 from Warner Communications, Inc.*

Corporate Directory

Directors

JACK TRAMIEL
Chairman of the Board

SAM TRAMIEL
President
Chief Executive Officer

SAMUEL W. L. CHIN
Vice President—Manufacturing
Operational

GREGORY A. PRATT
President, Atari
Computer Corporation

MICHAEL ROSENBERG
Chairman & Chief Executive
Officer—Ross & Roberts, Inc.

LEONARD I. SCHREIBER
Partner—Schreiber & McBride

Officers

JACK TRAMIEL
Chairman of the Board

SAM TRAMIEL
President
Chief Executive Officer

SAMUEL W. L. CHIN
Vice President—Manufacturing
Operational

STEVEN M. KAWALICK
Vice President—Legal,
Secretary

AUGUST J. LIGUORI
Vice President—Finance,
Chief Financial Officer,
Treasurer

RICHARD MILLER
Vice President—Technology

ALWIN STUMPF
Executive Vice President—
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LEONARD TRAMIEL
Vice President
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ANNUAL MEETING
The Annual Meeting of Shareholders will be held on Tuesday, May 14, 1991 at 2:00 p.m. at the Atari Corporate meeting room:

390 Caribbean Drive
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FORM 10-K ANNUAL REPORT
A copy of the Company's Annual Report on Form 10-K (exclusive of exhibits) as filed with the Securities and Exchange Commission is available upon request directly from the Company.

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