

P X A R
ANIMATION STUDIOS

Annual Report 2004



P I X A R



EXECUTIVE OFFICERS OF THE COMPANY

The executive officers of Pixar and their ages as of March 1, 2005 are as follows:

Name	Age	Position
Steve Jobs	50	Chairman and Chief Executive Officer
Edwin Catmull	59	President
Simon Bax	45	Executive Vice President, Chief Financial Officer, Secretary
John Lasseter	48	Executive Vice President, Creative
Sarah McArthur	47	Executive Vice President, Production
Lois J. Scali	56	Executive Vice President, General Counsel

Pixar's executive officers are appointed by, and serve at the discretion of, the Board of Directors. Each executive officer is an employee of Pixar. There is no family relationship between any executive officer or director of Pixar.

Mr. Jobs

is a co-founder of Pixar and has served as Chairman since March 1991 and as Chief Executive Officer since February 1986. He has been a director of Pixar since February 1986. In addition, Mr. Jobs is currently Chief Executive Officer and a member of the Board of Directors of Apple Computer, Inc.

Dr. Catmull

is a co-founder of Pixar and has served as President since January 2001. Dr. Catmull also served as Chief Technical Officer from the Company's inception until January 2001. Previously he was Vice President of the Computer Division of Lucasfilm, Ltd., where he managed four development efforts in the areas of computer graphics, video editing, video games and digital audio. Dr. Catmull has been honored with three Scientific and Technical Engineering Awards from The Academy of Motion Picture Arts and Sciences for his work, including an Oscar(r). He also won the Coons Award, which is the highest achievement in the computer graphics field, for his lifetime contributions and was awarded the animation industry's Ub Iwerks Award. Dr. Catmull is a member of the Academy of Motion Picture Arts and Sciences and the National Academy of Engineering. Dr. Catmull earned his B.S. degrees in computer science and physics and his Ph.D. in computer science from the University of Utah.

Mr. Bax

has served as Executive Vice President and Chief Financial Officer since May of 2004. From September 2001 to April 2004, Mr. Bax served as a consultant and acted as a principal in two partnerships formed to raise funds to co-finance films with a major studio. From June 2003 to present, Mr. Bax has served as chairman at SmartJog S.A., a company that provides secure digital content delivery between film and television distributors and broadcast facilities throughout the world. From 1994 through 2001, Mr. Bax was Chief Financial Officer for Fox Filmed Entertainment where he managed finance, information technology and strategic planning related to the production and distribution of all films produced by the company's Motion Picture Group. In addition, he oversaw the financial functions of Twentieth Century Fox Television and Fox Television Studios, and was responsible for studio operations worldwide. Mr. Bax is a graduate of Gonville and Caius College at

the University of Cambridge in England. He is currently a member of the Academy of Motion Picture Arts and Sciences and the British Academy of Film and Television Arts.

Mr. Lasseter

is a two-time Academy Award(r)-winning director and animator. In addition to serving as head of all of Pixar Animation Studios' films and projects as Executive Vice President, Creative, he directed Toy Story, (the first feature-length computer animated film), A Bug's Life and Toy Story 2. He is the Executive Producer of Monsters, Inc., Finding Nemo and The Incredibles and in 2001 he was given an honorary doctorate degree from the American Film Institute and in 2003 and 2004, he was awarded the Art Directors Guild's coveted Honorary Contribution to Cinematic Imagery Award. Mr. Lasseter is currently directing his fourth feature film, Cars.

Mr. Lasseter directed the first computer-animated feature film, Toy Story, for which he received a Special Achievement Oscar(r) and was nominated for Best Original Screenplay, the first animated film ever to receive an Oscar(r) nomination for screenplay. Mr. Lasseter has written and directed a number of short films and television commercials while at Pixar: Luxo Jr.

(1986 Academy Award(r) nominee), Red's Dream (1987), Tin Toy (1988 Academy Award(r) Winner) and Knick Knack (1989), which was produced as a 3D stereoscopic film. Tin Toy was the first computer animated film to win an Oscar(r), when it won the 1988 Academy Award(r) for Best Animated Short Film. Mr. Lasseter also designed and animated the Stained Glass Knight character in the 1985 Steven Spielberg production, Young Sherlock Holmes. Mr. Lasseter joined Lucasfilm's Computer Division in 1984, and was a founding member of Pixar when it was formed in February 1986. Prior to this, he spent five years as an animator at The Walt Disney Company, where he worked on such films as The Fox and the Hound and Mickey's Christmas Carol. He earned his B.F.A. in film from the California Institute of the Arts where he produced two animated films, each winners of the student Academy Award(r) for Animation: Lady and the Lamp in 1979 and Nightmare in 1980. His very first award came at the age of five when he won \$15.00 from the Model Grocery Market in Whittier, California for a crayon drawing of the Headless Horseman.

Overview

Pixar was formed in 1986 when Steve Jobs purchased the computer division of Lucasfilm and incorporated it as a separate company. In 1991, we entered into a feature film agreement (the "Feature Film Agreement") with Walt Disney Pictures, a wholly owned subsidiary of the Walt Disney Company (together with its subsidiaries and affiliates collectively referred to herein as "Disney"), for the development and production of up to three animated feature films to be marketed and distributed by Disney. It was pursuant to the Feature Film Agreement that Toy Story was developed, produced, and distributed. Our share of revenues and expenses from Toy Story is governed by the terms of the Feature Film Agreement.

In February 1997, we entered into the Co-Production Agreement (which, except for certain economic provisions applicable to Toy Story, superseded the Feature Film Agreement) with Disney pursuant to which we, on an exclusive basis, agreed to produce five original computer-animated feature-length theatrical motion pictures (the "Pictures") for distribution by Disney. Pixar and Disney agreed to co-finance the production costs of the Pictures, co-own the Pictures (with Disney having exclusive distribution and exploitation rights), co-brand the Pictures, and share equally in the profits of each Picture and any related merchandise as well as other ancillary products, after recovery of all marketing and distribution costs (which Disney finances), a distribution fee paid to Disney and any other predefined fees or costs, including any participations provided to talent. The Co-Production Agreement generally provides that we will be responsible for the production of each Picture, while Disney will be responsible for the marketing, promotion, publicity, advertising and distribution of each Picture.

The Co-Production Agreement also contemplates that with respect to theatrical sequels, made-for-home video sequels, television productions, interactive media products and other derivative works related to the Pictures, we will have the opportunity to co-finance and produce such products or to earn passive royalties on such products. We will not share in any theme park revenues generated as a result of the Pictures. Pursuant to the Co-Production Agreement, in addition to co-financing the production costs of the Pictures, Disney

will reimburse us for our share of certain general and administrative costs and certain research and development costs that benefit the productions of the Pictures.

Our second feature film, A Bug's Life, was released in November 1998 and counted as the first original Picture under the Co-Production Agreement. In November 1999, Toy Story 2, our third animated feature film was released. As a theatrical sequel, Toy Story 2 is a derivative work of the original Toy Story and therefore it does not count toward the five original Pictures to be produced under the Co-Production Agreement. As a derivative work, Toy Story 2 is treated as a Picture under the Co-Production Agreement, and all the provisions applicable to the five original Pictures apply.

In November 2001, we released Monsters, Inc., our fourth animated feature film, which counts as the second original Picture under the Co-Production Agreement. In May 2003, we released Finding Nemo, our fifth animated feature film, which counts as the third original Picture under the Co-Production Agreement. In November 2004, we released The Incredibles, our sixth animated feature film, which counts as the fourth original Picture under the Co-Production Agreement.



We are currently in production on Cars, which is scheduled for release on June 9, 2006. Cars will be produced and distributed under the Co-Production Agreement and will count as the fifth and final film of the Pictures to be produced under the Co-Production Agreement. We are also in production on our first feature film outside of our Disney relationship. The term of the Co-Production Agreement continues until we deliver our fifth and final Picture, Cars, to Disney. However, since our April 2003 delivery of Finding Nemo to Disney, we have had the right to negotiate and enter into another distribution agreement with any third party. In January 2004, we announced that we had ended our discussions with Disney regarding extending our relationship with them by entering into a new arrangement for films released beyond Cars.

Since that time, we have had preliminary meetings with various major motion picture studios regarding a potential distribution agreement for the films we release after Cars, and we continue to explore our options with respect to a future distribution agreement.

We have produced six highly successful films to date, and we believe that this success, combined with our strong financial resources, position us to negotiate a new distribution arrangement with a major studio that will provide us with, among other things, (1) better economic terms than we currently have under the Co-Production Agreement and (2) full ownership of our films. With respect to the distribution of our films after Cars, we currently are not pursuing alternatives, other than entering into such an agreement with a major studio. Although we look forward to a more favorable distribution agreement for films released after Cars, we also understand that distributing our films through another studio may increase some of the risks we face in the motion picture industry. See “- Relationship with Disney,”

Risk Factors

We experience intense competition with respect to our animated feature films and software” and we face various distribution risks with respect to our feature films. Pixar and Disney jointly finance all production costs relating to the Pictures on an equal basis. Pursuant to the terms of the Co-Production Agreement the parties established a mutually acceptable funding mechanism to ensure that sums would be available in a timely manner to fund production costs. In practice, Pixar prepares funding requests for forecasted film production costs and Disney funds its share on a monthly basis at approximately the beginning of the month. All payments to Pixar from Disney for development and production of Toy Story under the Feature Film Agreement, and the Pictures under the Co-Production Agreement have been recorded as cost reimbursements.

Accordingly, no revenue has been recognized for such reimbursements; rather, we have netted the reimbursements against the related costs. These reimbursed costs through the end of fiscal 2004 are set forth in Note 4 of Notes to Financial Statements.

Competition

We experience intense competition with respect to our animated feature films, animation products, and software.

Animated Feature Films.

Our animated feature films compete and will continue to compete with family-oriented, animated and live action feature films and other family-oriented entertainment products produced by major movie studios, including Disney (as somewhat limited by the Co-Production Agreement),

DreamWorks Animation SKG, (“DreamWorks”)
Warner Bros. Entertainment (“Warner Bros.”)
Sony Pictures Entertainment (“Sony”)
Fox Entertainment Group Inc. (“Fox”)
Paramount Pictures (“Paramount”)
Lucasfilm Ltd. (“Lucasfilm”)
Universal Studios, Inc. (“Universal”)
MGM/UA, and Studio Ghibli as well as numerous other independent motion picture production companies.

In 2004, competition continued to intensify in the family-oriented, animated and live action feature film market. Some of the family-oriented animated and live action feature films that were released domestically during the 2004 holiday period that competed with The Incredibles, which was released domestically on November 5, 2004, included the following:

- **Shark Tale by DreamWorks**
- **The Polar Express by Warner Bros.**
- **The SpongeBob Squarepants Movie by Paramount**
- **National Treasure by Disney**
- **Christmas with the Kranks by Sony**
- **Lemony Snicket’s A Series of Unfortunate Events by Paramount**
- **Fat Albert by Fox.**

The Incredibles was released on home video in the domestic marketplace on March 15, 2005 and will compete with many of the same films from its theatrical release as well as other direct-to-video features and library titles re-released on home video.



Our films will continue to compete with the feature films of other movie studios for optimal release dates, audience acceptance and exhibition outlets. In addition, we compete and will continue to compete with other movie studios for the services of performing artists and the services of other creative and technical personnel, particularly in the fields of animation and technical direction. Some of the other movie studios with which we compete have significantly greater financial, marketing and other resources than we do.

There appears to be increasing widespread acceptance for CGI animated films. In 2005, a significant increase is expected in the number of CGI animated films to be released, a trend that we expect to carry through 2006 and beyond. Animated feature films currently in production for major studios that are primarily CGI include:

A Day With Wilbur Robinson
American Dog
Chicken Little
Flushed Away
Ice Age 2
Madagascar
Open Season
Over the Hedge
Rapunzel Unbraided
Shrek 3
Surf's Up
The Barnyard
The Wild
Valiant

among others. Some studios have also announced publicly that they intend to release multiple CGI films per year. In addition to box office and home video competition, other family-oriented films may continue to compete with *The Incredibles*, *Finding Nemo*, and our film library with respect to related television, merchandise, and other future revenue sources.

The Co-Production Agreement provides that we will develop and produce five original computer-animated feature films. Because Disney co-finances the films developed and produced under the Co-Production Agreement, distributes the films under the "Walt Disney Pictures" label and enjoys financial benefits in the event that such films achieve significant box office revenues, we believe that Disney desires such films to

be successful. Nonetheless, during its long history, Disney has been a very successful producer and distributor of its own animated feature films. While the Co-Production Agreement imposes restrictions prohibiting Disney and its affiliates from releasing animated films or live action family films within certain release windows from our films, it is likely that other family-oriented motion pictures distributed by Disney or its affiliates will overlap in the market and compete with our animated feature films.

For example, *Pirates of the Caribbean: The Curse of the Black Pearl*, *Spy Kids 3D: Game Over*, and *Freaky Friday*, competed directly with *Finding Nemo* for domestic theatrical market share during summer 2003. The home video releases of *Pirates of the Caribbean: The Curse of the Black Pearl* and *Freaky Friday* have also competed with *Finding Nemo* in the worldwide home video market. Disney's *National Treasure* and Miramax's *Finding Neverland* were released on November 19, 2004 and competed with the worldwide theatrical release of *The Incredibles*, and the home video release of these films may also compete with *The Incredibles* in the worldwide home video market. After the release of *Cars*, Disney can begin to release its movies during our release windows.

This could have an adverse impact on the commercial success required for us to profit from future films. Our contractual arrangement with Disney also presents other risks. See "Risk Factors - The Co-Production Agreement imposes several risks and restrictions on us." We believe that the primary competitive factors in the market for animated feature films include creative content and talent, product quality, technology, access to distribution channels and marketing resources. Due in part to our creative and technical resources and to the Co-Production Agreement with Disney, pursuant to which Disney co-finances the production of the feature films, markets the feature films and provides creative assistance and access to significant distribution channels, we believe that we presently compete favorably with respect to each of these factors.



Computer Graphics

Special Effects Firms.

We also expect to compete with computer graphics special effects firms, including ILM, Rhythm & Hues/VIFX, Tippett Studios, WETA Digital, Digital Domain, and Sony Pictures Imageworks. These computer graphics special effects firms may be capable of creating their own three-dimensional computer-animated feature films or may produce three-dimensional computer-animated feature films for movie studios that compete with us. For example, ILM has already created and produced three-dimensional character animation which was used for several central characters in the live action film Star Wars Episode II: Attack of the Clones, and ILM has a royalty-free, paid-up license to use our RenderMan(r) software and to obtain at no cost all enhancements and upgrades thereto. Other computer graphics special effects firms have licensed or may license RenderMan(r). Accordingly, our RenderMan(r) software may not provide us with a competitive advantage. We also compete, or may in the future compete, with the above firms with respect to animation products other than feature films.

We expect competition to persist, intensify and increase in each of our business areas in the future. Some of our current and potential competitors have longer operating histories, larger installed customer bases and significantly greater financial, technical, marketing and other resources than we do. There can be no assurance that we will be able to compete successfully against current or future competitors. Such competition could materially adversely affect our business, operating results or financial condition.



What's Renderman ?

Leading digital effects houses and computer graphics specialists use Pixar's RenderMan® because it is the highest quality renderer available anywhere and has been production tested through successful use in feature films for over ten years. Pixar's RenderMan is stable, fast, and efficient for handling complex surface appearances and images.

RenderMan's powerful shading language and anti-aliased motion blur allow designers to believably integrate stunning synthetic effects with live-action footage. In addition, RenderMan is backed by Pixar's technical staff, who know the challenges of creating digital effects. RenderMan is used for Pixar's own feature film productions

Pixar's RenderMan® was used in 41 of the last 44 films nominated for a Best Visual Effects. In addition, RenderMan has won an Oscar® from the Academy of Motion Pictures Arts & Sciences. Here is a selection of movies scheduled for 2005 alone which have relied upon Pixar's RenderMan®

Bewitched	Batman Begins
Charlie and the Chocolate Factory	Constantine
Chicken Little	Jarhead
Flight Plan	Kingdom of Heaven
Harry Potter and the Goblet of Fire	The Lion, The Witch and The Wardrobe
King Kong	Star Wars: Episode III - Revenge of the Sith
Wallace & Gromit - Curse of the Were-Rabbit	Valiant
War of the Worlds	Zathura

