

Activision Blizzard, Inc.
Form 10-Q
November 05, 2010
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

x

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

For the Quarterly Period Ended September 30, 2010

OR

o

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

For the transition period from to

Commission File Number 1-15839

ACTIVISION BLIZZARD, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

95-4803544

(I.R.S. Employer Identification No.)

3100 Ocean Park Boulevard, Santa Monica, CA

(Address of principal executive offices)

90405

(Zip Code)

(310) 255-2000

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer ☒

Accelerated Filer ☐

Non-accelerated filer ☐

(Do not check if a smaller reporting company)

Smaller reporting company ☐

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

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

The number of shares of the registrant's Common Stock outstanding at October 29, 2010 was 1,206,030,404.

Table of Contents

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Table of Contents

	<u>Cautionary Statement</u>	3
<u>PART I.</u>	<u>FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	<u>Financial Statements (Unaudited)</u>	
	<u>Condensed Consolidated Balance Sheets at September 30, 2010 and December 31, 2009</u>	4
	<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2010 and September 30, 2009</u>	5
	<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 and September 30, 2009</u>	6
	<u>Condensed Consolidated Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2010</u>	7
	<u>Notes to Condensed Consolidated Financial Statements</u>	8
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	36
<u>Item 4.</u>	<u>Controls and Procedures</u>	37
<u>PART II.</u>	<u>OTHER INFORMATION</u>	37
<u>Item 1.</u>	<u>Legal Proceedings</u>	37
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	38
<u>Item 6.</u>	<u>Exhibits</u>	38
<u>SIGNATURE</u>		39
<u>EXHIBIT INDEX</u>		40
CERTIFICATIONS		

Table of Contents

CAUTIONARY STATEMENT

This Quarterly Report on Form 10-Q contains, or incorporates by reference, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements consist of any statement other than a recitation of historical fact and include, but are not limited to: (1) projections of revenues, expenses, income or loss, earnings or loss per share, cash flow or other financial items; (2) statements of our plans and objectives, including those relating to product releases; (3) statements of future economic performance; and (4) statements of assumptions underlying such statements. We generally use words such as anticipate, believe, could, estimate, expect, forecast, future, intend, may, outlook, plan, positioned, potential, project, remain, scheduled, set to, subject to, to be, upcoming, will, and other similar expressions to help identify forward-looking statements. Forward-looking statements are subject to business and economic risk, reflect management's current expectations, estimates and projections about our business, and are inherently uncertain and difficult to predict. Our actual results could differ materially. The forward-looking statements contained herein speak only at the date on which this Quarterly Report on Form 10-Q was first filed. Risks and uncertainties that may affect our future results include, but are not limited to, sales levels of Activision Blizzard's titles, shifts in consumer spending trends, the impact of the current macroeconomic environment, the seasonal and cyclical nature of the interactive game market, Activision Blizzard's ability to predict consumer preferences among competing hardware platforms, possible declines in software pricing, product returns and price protection, product delays, retail acceptance of Activision Blizzard's products, adoption rate and availability of new hardware (including peripherals) and related software, industry competition, including from used games, and from other forms of entertainment, litigation risks and associated costs, rapid changes in technology, industry standards, business models, including online and used games and consumer preferences including interest in specific genres such as music, first-person action and massively multiplayer online games, protection of proprietary rights, maintenance of relationships with key personnel, customers, licensees, licensors, vendors, and third-party developers, including the ability to attract, retain and develop key personnel and developers that can create high quality hit titles, counterparty risks relating to customers, licensees, licensors and manufacturers, domestic and international economic, financial and political conditions and policies, foreign exchange rates and tax rates, and the identification of suitable future acquisition opportunities, and potential challenges associated with geographic expansion, and the other factors identified in Risk Factors included in our Annual Report on Form 10-K for the year ended December 31, 2009. The forward-looking statements contained herein are based upon information available to us as of the date of this Quarterly Report on Form 10-Q and we assume no obligation to update any such forward-looking statements. Although these forward-looking statements are believed to be true when made, they may ultimately prove to be incorrect. These statements are not guarantees of our future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and may cause actual results to differ materially from current expectations.

Activision Blizzard's names, abbreviations thereof, logos, and product and service designators are all either the registered or unregistered trademarks or trade names of Activision Blizzard.

[Table of Contents](#)**Part I. FINANCIAL INFORMATION****Item 1. Financial Statements****ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)

(Amounts in millions, except share data)

	At September 30, 2010	At December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,123	\$ 2,768
Short-term investments	726	477
Accounts receivable, net of allowances of \$203 million and \$317 million at September 30, 2010 and December 31, 2009, respectively	246	739
Inventories	258	241
Software development	248	224
Intellectual property licenses	26	55
Deferred income taxes, net	419	498
Other current assets	102	327
Total current assets	4,148	5,329
Long-term investments	23	23
Software development	37	10
Intellectual property licenses	36	28
Property and equipment, net	169	138
Other assets	14	9
Intangible assets, net	566	618
Trademark and trade names	433	433
Goodwill	7,144	7,154
Total assets	\$ 12,570	\$ 13,742
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 238	\$ 302
Deferred revenues	622	1,426
Accrued expenses and other liabilities	533	779
Total current liabilities	1,393	2,507
Deferred income taxes, net	231	270
Other liabilities	200	209
Total liabilities	1,824	2,986
Commitments and contingencies (Note 12)		
Shareholders' equity:		

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Common stock, \$0.000001 par value, 2,400,000,000 shares authorized, 1,376,067,589 and 1,364,117,675 shares issued at September 30, 2010 and December 31, 2009, respectively

Additional paid-in capital	12,313	12,376
Less: Treasury stock, at cost, 170,214,263 and 113,686,498 at September 30, 2010 and December 31, 2009, respectively	(1,848)	(1,235)
Retained earnings (accumulated deficit)	290	(361)
Accumulated other comprehensive loss	(9)	(24)
Total shareholders' equity	10,746	10,756
Total liabilities and shareholders' equity	\$ 12,570	\$ 13,742

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(Amounts in millions, except per share data)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Net revenues				
Product sales	\$ 397	\$ 411	\$ 2,025	\$ 1,848
Subscription, licensing, and other revenues	348	292	994	874
Total net revenues	745	703	3,019	2,722
Costs and expenses				
Cost of sales product costs	194	185	765	762
Cost of sales software royalties and amortization	61	54	211	212
Cost of sales intellectual property licenses	33	45	105	163
Cost of sales massively multi-player online role-playing game (MMORPG)	61	55	168	158
Product development	119	122	366	362
Sales and marketing	111	128	294	329
General and administrative	111	106	245	301
Restructuring		(1)		29
Total costs and expenses	690	694	2,154	2,316
Operating income	55	9	865	406
Investment and other income, net	14	11	15	21
Income before income tax expense	69	20	880	427
Income tax expense	18	5	229	28
Net income	\$ 51	\$ 15	\$ 651	\$ 399
Earnings per common share				
Basic	\$ 0.04	\$ 0.01	\$ 0.53	\$ 0.31
Diluted	\$ 0.04	\$ 0.01	\$ 0.52	\$ 0.30
Weighted-average shares outstanding				
Basic	1,212	1,271	1,230	1,289
Diluted	1,227	1,297	1,245	1,320
Dividends per common share	\$	\$	\$ 0.15	\$

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

(Amounts in millions)

	For the Nine Months Ended September 30,	
	2010	2009
Cash flows from operating activities:		
Net income	\$ 651	\$ 399
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	51	(70)
Depreciation and amortization	97	187
Gain on auction rate securities (ARS) classified as trading securities	(7)	(3)
Loss on ARS rights from UBS	7	3
Amortization and write-off of capitalized software development costs and intellectual property licenses (1)	182	192
Stock-based compensation expense (2)	94	109
Tax (shortfall) benefit from employee stock option exercises		(1)
Excess tax benefits from stock option exercises	(11)	(68)
Changes in operating assets and liabilities:		
Accounts receivable	471	748
Inventories	(19)	(89)
Software development and intellectual property licenses	(238)	(229)
Other assets	218	53
Deferred revenues	(810)	(452)
Accounts payable	(60)	(39)
Accrued expenses and other liabilities	(243)	(370)
Net cash provided by operating activities	383	370
Cash flows from investing activities:		
Proceeds from maturities of investments	473	9
Proceeds from sale of available-for-sale investments		2
Payment of contingent consideration	(4)	
Purchases of short-term investments	(681)	(228)
Capital expenditures	(76)	(41)
(Increase) decrease in restricted cash	(35)	(40)
Net cash used in investing activities	(323)	(298)
Cash flows from financing activities:		
Proceeds from issuance of common stock to employees	54	63
Repurchase of common stock	(613)	(834)
Dividends paid	(187)	
Excess tax benefits from stock option exercises	11	68
Net cash used in financing activities	(735)	(703)
Effect of foreign exchange rate changes on cash and cash equivalents	30	33
Net (decrease) increase in cash and cash equivalents	(645)	(598)

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Cash and cash equivalents at beginning of period		2,768		2,958
Cash and cash equivalents at end of period	\$	2,123	\$	2,360

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

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the nine months ended September 30, 2010

(Unaudited)

(Amounts in millions)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock Shares	Treasury Stock Amount	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total Shareholders Equity
Balance at December 31, 2009	1,364	\$	\$ 12,376	(114)	\$ (1,235)	\$ (361)	\$ (24)	\$ 10,756
Components of comprehensive income:								
Net income						651		651
Foreign currency translation adjustment							15	15
Total comprehensive income								666
Issuance of common stock pursuant to employee stock options and restricted stock rights	12		54					54
Stock-based compensation expense related to employee stock options and restricted stock rights			72					72
Dividends (\$0.15 per common share)			(189)					(189)
Shares repurchased				(56)	(613)			(613)
Balance at September 30, 2010	1,376	\$	\$ 12,313	(170)	\$ (1,848)	\$ 290	\$ (9)	\$ 10,746

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Description of Business and Business Combination

Description of Business

Activision Blizzard, Inc. is a worldwide online, personal computer (PC), console, handheld and mobile game publisher. The terms Activision Blizzard, the Company, we, us, and our are used to refer collectively to Activision Blizzard, Inc. and its subsidiaries.

In 2008, a business combination (the Business Combination) by and among Activision, Inc., Sego Merger Corporation, a wholly-owned subsidiary of Activision, Inc., Vivendi S.A. (Vivendi), VGAC LLC, a wholly-owned subsidiary of Vivendi, and Vivendi Games, Inc. (Vivendi Games), a wholly-owned subsidiary of VGAC LLC was consummated. As a result of the consummation of the Business Combination, Activision, Inc. was renamed Activision Blizzard, Inc. (Activision Blizzard).

The common stock of Activision Blizzard is traded on The NASDAQ Stock Market under the ticker symbol ATVI. Vivendi owned approximately 60% of Activision Blizzard s outstanding common stock at September 30, 2010.

We maintain significant operations in the United States, Canada, the United Kingdom, France, Germany, Ireland, Italy, Spain, Australia, Sweden, South Korea, China and the Netherlands.

Basis of Consolidation and Presentation

Activision Blizzard prepared the accompanying unaudited condensed consolidated financial statements in accordance with the rules and regulations of the Securities and Exchange Commission for interim reporting. As permitted under those rules and regulations, certain notes or other information that are normally required by accounting principles generally accepted in the United States of America (U.S. GAAP) have been condensed or omitted if they substantially duplicate the disclosures contained in the annual audited consolidated financial statements. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation of our financial position and results of operations in accordance with U.S. GAAP have been included.

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

The accompanying unaudited condensed consolidated financial statements include the accounts and operations of Activision Blizzard. All intercompany accounts and transactions have been eliminated. The condensed consolidated financial statements have been prepared in conformity with U.S. GAAP. The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements. Actual results could differ from these estimates and assumptions.

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

The Company considers events or transactions that occur after the balance sheet date, but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosures.

Table of Contents

2. Inventories

Our inventories consist of the following (amounts in millions):

	At September 30, 2010	At December 31, 2009
Finished goods	\$ 212	\$ 201
Purchased parts and components	46	40
	\$ 258	\$ 241

3. Intangible assets, net

Intangible assets, net consist of the following (amounts in millions):

	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
At September 30, 2010				
Acquired definite-lived intangible assets:				
License agreements	3 - 10 years	\$ 173	\$ (75)	\$ 98
Game engines	2 - 5 years	61	(44)	17
Internally developed franchises	11 - 12 years	574	(129)	445
Favorable leases	1 - 4 years	5	(4)	1
Distribution agreements	4 years	18	(13)	5
Acquired indefinite-lived intangible assets:				
Activision trademark	Indefinite	386		386
Acquired trade names	Indefinite	47		47
Total		\$ 1,264	\$ (265)	\$ 999

	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
At December 31, 2009				
Acquired definite-lived intangible assets:				
License agreements	3 - 10 years	\$ 173	\$ (65)	\$ 108
Developed software	1 - 2 years	288	(288)	
Game engines	2 - 5 years	61	(33)	28
Internally developed franchises	11 - 12 years	574	(101)	473
Favorable leases	1 - 4 years	5	(4)	1
Distribution agreements	4 years	18	(10)	8
Other intangibles	0 - 2 years	5	(5)	
Acquired indefinite-lived intangible assets:				

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Activision trademark	Indefinite	386	386
Acquired trade names	Indefinite	47	47
Total		\$ 1,557	\$ (506) \$ 1,051

Amortization expense of intangible assets was \$21 million and \$50 million for the three and nine months ended September 30, 2010, respectively. Amortization expense of intangible assets was \$39 million and \$129 million for the three and nine months ended September 30, 2009, respectively.

The gross carrying amount as of September 30, 2010 and December 31, 2009 in the tables above reflect a new cost basis for

Table of Contents

license agreements, game engines and internally developed franchises due to impairment charges taken for the year ended December 31, 2009. The new cost basis includes the original gross carrying amount, less accumulated amortization and impairment charges of the impaired assets as of December 31, 2009.

At September 30, 2010, future amortization of definite-lived intangible assets is estimated as follows (amounts in millions):

2010 (remaining three months)	\$	74
2011		113
2012		94
2013		67
2014		50
Thereafter		168
Total	\$	566

4. Income taxes

The income tax expense of \$18 million for the three months ended September 30, 2010 reflects an effective tax rate of 26%. The effective tax rate of 26% for the three months ended September 30, 2010 differs from the statutory rate of 35% primarily due to foreign income taxes provided at lower rates, geographic mix in profitability, recognition of California research and development credits and IRC 199 domestic production deductions. We did not record a tax benefit for federal research credits during the quarter ended September 30, 2010 since, as of September 30, 2010, the federal research credit had not yet been approved for use in 2010.

For the nine months ended September 30, 2010, the tax rate is based on our projected annual effective tax rate for 2010, and also includes certain discrete tax items recorded during the period. Our tax expense of \$229 million for the nine months ended September 30, 2010 reflects an effective tax rate of 26% which differs from the effective tax rate of 7% for the nine months ended September 30, 2009 primarily due to tax benefits recorded during the prior period related to the release of valuation allowances on foreign net operating losses and the impact of changes to California tax laws.

5. Software development and intellectual property licenses

The following table summarizes the components of our software development and intellectual property licenses (amounts in millions):

	At September 30, 2010	At December 31, 2009
Internally developed software costs	\$ 182	\$ 182
Payments made to third-party software developers	103	52

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Total software development costs	\$	285	\$	234
Intellectual property licenses	\$	62	\$	83

Amortization, write-offs and impairments are comprised of the following (amounts in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Amortization of capitalized software development costs and intellectual property licenses	\$	50	\$	41
Write-offs and impairments		1		2

[Table of Contents](#)

6. Comprehensive income and accumulated other comprehensive loss

Comprehensive Income

The components of comprehensive income for the three and nine months ended September 30, 2010 and 2009 were as follows (amounts in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net income	\$ 51	\$ 15	\$ 651	\$ 399
Other comprehensive income:				
Foreign currency translation adjustment	48	9	15	38
Other comprehensive income	48	9	15	38
Comprehensive income	\$ 99	\$ 24	\$ 666	\$ 437

The components of accumulated other comprehensive loss at September 30, 2010 and December 31, 2009 were as follows (amounts in millions):

	At September 30, 2010	At December 31, 2009
Foreign currency translation adjustment	\$ (7)	\$ (22)
Unrealized depreciation on investments, net of deferred income taxes of \$(1) and \$(2) for September 30, 2010 and December 31, 2009	(2)	(2)
Accumulated other comprehensive loss	\$ (9)	\$ (24)

Income taxes were not provided for foreign currency translation items as these are considered indefinite investments in non-U.S. subsidiaries.

7. Fair value measurements

Fair Value Measurements on a Recurring Basis

Financial Accounting Standards Board (FASB) literature regarding fair value measurements for financial and non-financial assets and liabilities establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 Quoted prices in active markets for identical assets or liabilities.
- Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets or other inputs that are observable or can be corroborated by observable market data.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The table below segregates all assets and liabilities that are measured at fair value on a recurring basis (which means they are so measured at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date (amounts in millions):

Table of Contents

Fair Value Measurements at September 30, 2010 Using					
	As of September 30, 2010	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
Financial assets:					
Money market funds	\$ 1,826	\$ 1,826	\$	\$	Cash and cash equivalents
U.S. treasuries with original maturities of three months or less	200	200			Cash and cash equivalents
Mortgage backed securities	1		1		Short-term investments
U.S. treasuries and government sponsored agency debt securities	658	658			Short-term investments
ARS held through Morgan Stanley Smith Barney LLC	23			23	Long-term investments
Foreign exchange contract derivatives	3		3		Other assets current
Total financial assets at fair value	\$ 2,711	\$ 2,684	\$ 4	\$ 23	
Financial liabilities:					
Other financial liability	\$ (10)	\$	\$	(10)	Other liabilities current
Total financial liabilities at fair value	\$ (10)	\$	\$	(10)	

Fair Value Measurements at December 31, 2009 Using					
	As of December 31, 2009	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
Financial assets:					
Money market funds	\$ 2,304	\$ 2,304	\$	\$	Cash and cash equivalents
Mortgage backed securities	2		2		Short-term investments
ARS held through UBS	54			54	Short-term investments
U.S. government sponsored agency debt securities	389	389			Short-term investments
ARS held through Morgan Stanley Smith Barney LLC	23			23	Long-term investments
ARS rights from UBS (a)	7			7	Other assets current
Total financial assets at fair value	\$ 2,779	\$ 2,693	\$ 2	\$ 84	
Financial liabilities:					
Other financial liability	\$ (23)	\$	\$	(23)	Other liabilities current
Total financial liabilities at fair value	\$ (23)	\$	\$	(23)	

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

(a) Auction Rate Securities (ARS) rights from UBS represent an offer from UBS providing us with the right to require UBS to purchase our ARS held through UBS at par value. To value the ARS rights, we considered the intrinsic value, time value of money, and our assessment of the credit worthiness of UBS. We exercised our ARS rights with UBS on June 30, 2010.

Other financial liability represents the earn-out liability from a previous acquisition. The earn-out liability was recorded at fair value at the date of the Business Combination, as it will be settled by a variable number of shares of our common stock based on the average of the closing prices on each of the five business days immediately preceding issuance of the shares. When

Table of Contents

estimating the fair value, we considered our projection of revenues from the related titles under the earn-out provisions. For the nine months ended September 30, 2010, there was a \$13 million decrease in our fair value estimate of this financial liability, which was recorded in investment and other income, net.

The following table provides a reconciliation of the beginning and ending balances of our financial assets and financial liabilities classified as Level 3 by major categories (amounts in millions) at September 30, 2010:

	Level 3			
	ARS (a)	ARS rights from UBS (b)	Total financial assets at fair value	Other financial liabilities
Balance at January 1, 2010	\$ 77	\$ 7	\$ 84	\$ (23)
Total gains or (losses) (realized/unrealized) included in investment and other income, net	7	(7)		13
Purchases or acquired sales, issuances and settlements	(61)		(61)	
Balance at September 30, 2010	\$ 23	\$	\$ 23	\$ (10)

The amount of total gains or (losses) for the period included in investment and other income, net attributable to the change in unrealized gains or losses relating to assets and liabilities still held at September 30, 2010

\$	\$	\$	\$	13
----	----	----	----	----

The following table provides a reconciliation of the beginning and ending balances of our financial assets and financial liabilities classified as Level 3 by major categories (amounts in millions) at September 30, 2009:

Table of Contents

				Level 3			
	ARS (a)		ARS rights from UBS (b)		Total financial assets at fair value		Other financial liabilities
Balance at January 1, 2009	\$	78	\$	10	\$	88	\$ (31)
Total gains or (losses) (realized/unrealized) included in investment and other income, net		2		(3)		(1)	8
Purchases or acquired sales, issuances and settlements		(4)				(4)	
Balance at September 30, 2009	\$	76	\$	7	\$	83	\$ (23)
The amount of total gains or (losses) for the period included in investment and other income, net attributable to the change in unrealized gains or losses relating to assets and liabilities still held at September 30, 2009							
	\$	2	\$	(3)	\$	(1)	\$ 8

(a) Fair value measurements have been estimated using an income-approach model (specifically, discounted cash-flow analysis). When estimating the fair value, we consider both observable market data and non-observable factors, including credit quality, duration, insurance wraps, collateral composition, maximum rate formulas, comparable trading instruments, and the likelihood of redemption. Significant assumptions used in the analysis include estimates for interest rates, spreads, cash flow timing and amounts, and holding periods of the securities. Assets measured at fair value using significant unobservable inputs (Level 3) represent 1% of our financial assets measured at fair value on a recurring basis at September 30, 2010.

In June 2010, we sold the remainder of our ARS held with UBS at par and recognized a gain of \$7 million included within investment and other income, net in our condensed consolidated statement of operations.

(b) ARS rights from UBS represented an offer from UBS providing us with the right to require UBS to purchase our ARS held through UBS at par value. To value the ARS rights, we considered the intrinsic value, time value of money, and our assessment of the credit worthiness of UBS. We exercised our ARS rights with UBS on June 30, 2010 and recorded a loss of \$7 million included within investment and other income in our condensed consolidated statement of operations.

The carrying amount of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses is a reasonable approximation of fair value due to their short-term nature. Our U.S. treasuries and government-sponsored agency debt securities and mortgage-backed securities are carried at fair value with fair values estimated based on quoted market prices or estimated based on quoted market prices of financial instruments with similar characteristics.

Foreign Currency Forward Contracts Not Designated as Hedges

We transact business in various currencies other than the U.S. dollar and have significant international sales and expenses denominated in currencies other than the U.S. dollar, subjecting us to currency exchange rate risks. To mitigate our risk from foreign currency fluctuations we

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

periodically enter into currency derivative contracts, principally swaps and forward contracts with maturities of twelve months or less, with Vivendi as our principal counterparty. We do not hold or purchase any foreign currency contracts for trading or speculative purposes and we do not designate these forward contracts or swaps as hedging instruments. Accordingly, we report the fair value of these contracts in our condensed consolidated balance sheet with changes in fair value recorded in our condensed consolidated statement of operations. The fair value of foreign currency contracts is estimated based on the prevailing exchange rates of the various hedged currencies as of the end of the period.

Table of Contents**Fair Value Measurements on a Non-Recurring Basis**

We measure the fair value of certain assets on a non-recurring basis, generally annually or when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. For the nine-month period ended September 30, 2010, there were no impairment charges related to assets that are measured on a non-recurring basis.

The table below presents intangible assets that are not subject to recurring fair value measurement at December 31, 2009 (amounts in millions):

		Fair Value Measurements at December 31, 2009 Using			
	As of December 31, 2009	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Non-financial assets:					
Intangible assets, net	\$ 278	\$	\$	\$ 278	\$ 409
Total non-financial assets at fair value	\$ 278	\$	\$	\$ 278	\$ 409

In the fourth quarter of 2009, with the franchise and industry results of the holiday season, our outlook for the console platforms was significantly revised. With the continued economic downturn within our industry in 2009 and the change in the buying habits of casual consumers, we reassessed our overall expectations as of December 31, 2009. We considered these economic changes during our 2010 planning process conducted during the months of November and December 2009, which resulted in a strategy change to focus on fewer title releases in the casual and music genres. As we consider this a triggering event, we updated our future projected revenues streams for certain franchises in the casual games and music genres. We performed recoverability and, where applicable, impairment tests on the related intangible assets in accordance with ASC Subtopic 360-10.

Determining whether impairment has occurred requires various estimates and assumptions, including determining which cash flows are directly related to the potentially impaired asset, the estimated remaining useful life over which cash flows will occur, the amount of these cash flows and the asset's residual value, if any. For intangible assets that did not pass the recoverability test, measurement of an impairment loss requires a determination of fair value, which is based on the best information available. Considering the characteristics of the assets being valued and the availability of information, we used the income approach, which presumes that the value of an asset can be estimated by the net economic benefit to be received over the estimated remaining useful life of the asset, discounted to present value. We derived the required cash flow estimates from our historical experience and our internal business plans and applied an appropriate discount rate. Based on this analysis, we recorded impairment charges of \$24 million, \$12 million and \$373 million to license agreements, game engines and internally developed franchises intangible assets, respectively, in the quarter ended December 31, 2009 within our Activision operating segment.

8. Operating segments and geographic region

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Our operating segments are consistent with our internal organizational structure, the manner in which our operations are reviewed and managed by our Chief Executive Officer, who is our Chief Operating Decision Maker (CODM), the manner in which operating performance is assessed and resources are allocated, and the availability of separate financial information. We do not aggregate operating segments.

Currently, we operate under three operating segments:

Activision Publishing, Inc.

Activision Publishing, Inc. (Activision) is a leading international publisher of interactive software products and peripherals. Activision develops and publishes video games on various consoles, handheld platforms and the PC platform through internally

Table of Contents

developed franchises and license agreements. Activision currently offers games that operate on the Sony Computer Entertainment, Inc. (Sony) PlayStation 2 (PS2), Sony PlayStation 3 (PS3), Nintendo Co. Ltd. (Nintendo) Wii (Wii), and Microsoft Corporation (Microsoft) Xbox 360 (Xbox 360) console systems; the Sony PlayStation Portable (PSP), Nintendo Dual Screen (NDS) and Nintendo DSi handheld devices; the PC; and the Apple iPhone and iPad. Our Activision business involves the development, marketing, and sale of products through retail channels or digital downloads, by license, or from our affiliate label program with certain third-party publishers. Activision's products cover diverse game categories including action/adventure, action sports, racing, role-playing, simulation, first-person action, music, and strategy. Activision's target customer base ranges from casual players to core gamers, and from children to adults.

Blizzard Entertainment, Inc.

Blizzard Entertainment, Inc. (Blizzard) is a leader in terms of subscriber base and revenues generated in the subscription-based massively multi-player online role-playing game (MMORPG) category. Blizzard internally develops and publishes PC-based computer games and maintains its proprietary online-game related service, Battle.net. Our Blizzard business involves the development, marketing, sales and support of role playing action and strategy games. Blizzard also develops, hosts, and supports its online subscription-based games in the MMORPG category. Blizzard is the development studio and publisher best known as the creator of *World of Warcraft* and the multiple award winning Diablo, StarCraft, and World of Warcraft franchises. Blizzard distributes its products and generates revenues worldwide through various means, including: subscription revenues (which consist of fees from individuals playing *World of Warcraft*, prepaid cards and other value added service revenues such as realm transfers, faction changes, and other character customizations within the *World of Warcraft* game play); retail sales of physical boxed products; electronic download sales of PC products; and licensing of software to third-party or related party companies that distribute *World of Warcraft* and *StarCraft II*.

Activision Blizzard Distribution

Activision Blizzard Distribution (Distribution) consists of operations in Europe that provide warehousing, logistical, and sales distribution services to third-party publishers of interactive entertainment software, our own publishing operations, and manufacturers of interactive entertainment hardware.

The CODM reviews segment performance exclusive of the impact of the change in deferred net revenues and related cost of sales with respect to certain of our online-enabled games, stock-based compensation expense, restructuring expense, amortization of intangible assets and purchase price accounting related adjustments, integration and transaction costs, and other. Information on the operating segments and reconciliations of total net revenues and total segment income (loss) from operations to consolidated net revenues and operating income for the three and nine months ended September 30, 2010 and 2009 are presented below (amounts in millions):

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Table of Contents

	Three Months Ended September 30,			
	2010	2009	2010	2009
	Net Revenues		Income (loss) from operations	
Activision	\$ 314	\$ 415	\$ (43)	\$ (43)
Blizzard	481	286	246	116
Distribution	62	54	1	2
Operating segments total	857	755	204	75
Reconciliation to consolidated net revenues / operating income:				
Net effect from deferral of net revenues and related cost of sales	(112)	(52)	(97)	9
Stock-based compensation expense			(34)	(36)
Restructuring				1
Amortization of intangible assets and purchase price accounting related adjustments			(18)	(33)
Integration and transaction costs				(7)
Consolidated net revenues / operating income	\$ 745	\$ 703	\$ 55	\$ 9

	Nine Months Ended September 30,			
	2010	2009	2010	2009
	Net Revenues		Income (loss) from operations	
Activision	\$ 983	\$ 1,211	\$ (88)	\$ (49)
Blizzard	1,086	867	559	393
Distribution	185	202	(1)	6
Operating segments total	2,254	2,280	470	350
Reconciliation to consolidated net revenues / operating income:				
Net effect from deferral of net revenues and related cost of sales	765	441	539	341
Stock-based compensation expense			(94)	(107)
Restructuring			(3)	(29)
Amortization of intangible assets and purchase price accounting related adjustments			(47)	(117)
Integration and transaction costs				(24)
Other*		1		(8)
Consolidated net revenues / operating income	\$ 3,019	\$ 2,722	\$ 865	\$ 406

Geographic information for the three and nine months ended September 30, 2010 and 2009 is based on the location of the selling entity. Net revenues from external customers by geographic region were as follows (amounts in millions):

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Table of Contents

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net revenues by geographic region:				
North America	\$ 406	\$ 378	\$ 1,675	\$ 1,458
Europe	281	287	1,142	1,088
Asia Pacific	58	38	202	175
Total geographic region net revenues	745	703	3,019	2,721
Other*				1
Total consolidated net revenues	\$ 745	\$ 703	\$ 3,019	\$ 2,722

Net revenues by platform were as follows (amounts in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net revenues by platform:				
MMORPG	\$ 289	\$ 306	\$ 890	\$ 952
Console	298	286	1,642	1,334
Hand-held	23	30	101	127
PC and other	73	27	201	106
Total platform net revenues	683	649	2,834	2,519
Distribution	62	54	185	202
Other*				1
Total consolidated net revenues	\$ 745	\$ 703	\$ 3,019	\$ 2,722

*Represents Non-Core activities, which are legacy Vivendi Games divisions or business units that we have exited, divested or wound down as part of our restructuring and integration efforts as a result of the Business Combination. Prior to July 1, 2009, Non-Core activities were managed as a stand-alone operating segment; however, in light of the minimal activities and insignificance of Non-Core activities, as of that date we ceased their management as a separate operating segment and consequently, we are no longer providing separate operating segment disclosure and have reclassified our prior periods' segment presentation so that it conforms to the current period's presentation.

We did not have any single external customer that accounted for 10% or more of net revenues for either of the three or nine months ended September 30, 2010 or 2009.

9. Goodwill

The changes in the carrying amount of goodwill by operating segment for the nine months ended September 30, 2010 are as follows (amounts in millions):

	Activision	Blizzard	Distribution	Total
Balance at December 31, 2009	\$ 6,964	\$ 178	\$ 12	\$ 7,154
Tax benefit credited to goodwill	(10)			(10)

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Balance at September 30, 2010	\$	6,954	\$	178	\$	12
						7,144

The tax benefit credited to goodwill represents the tax deduction resulting from the exercise of stock options that were outstanding and vested at the consummation of the Business Combination and included in the purchase price of Activision, Inc., to the extent that the tax deduction did not exceed the fair value of those options. Conversely, to the extent that the tax deduction did exceed the fair value of those options, the tax benefit is credited to additional paid-in capital.

Table of Contents**10. Computation of basic/diluted earnings per common share**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Numerator:				
Consolidated net income	\$ 51	\$ 15	\$ 651	\$ 399
Less: Distributed earnings to common shareholders			(187)	
Less: Distributed earnings to unvested share-based awards that participate in earnings			(2)	
Undistributed earnings	51	15	462	399
Less: Undistributed earnings allocated to unvested share-based awards that participate in earnings			(4)	(3)
Undistributed earnings allocated to common shareholders	51	15	458	396
Add back: Distributed earnings to common shareholders			187	
Numerator for basic and diluted earnings per common share - income available to common shareholders	51	15	645	396
Denominator:				
Denominator for basic earnings per common share - weighted-average common shares outstanding	1,212	1,271	1,230	1,289
Effect of potential dilutive common shares under the treasury stock method: Employee stock options	15	26	15	31
Denominator for diluted earnings per common share - weighted-average common shares outstanding plus dilutive effect of employee stock options	1,227	1,297	1,245	1,320
Basic earnings per common share	\$ 0.04	\$ 0.01	\$ 0.53	\$ 0.31
Diluted earnings per common share	\$ 0.04	\$ 0.01	\$ 0.52	\$ 0.30

Our unvested restricted stock rights (including restricted stock units and restricted stock awards) are considered participating securities since these securities have non-forfeitable rights to dividends or dividend equivalents during the contractual period of the award. Since the unvested restricted stock rights are considered participating securities, we are required to use the two-class method in our computation of basic and diluted earnings per common share. For the three and nine months ended September 30, 2010, we had outstanding unvested restricted stock rights with respect to 11 million shares of common stock on a weighted-average basis. For the three and nine months ended September 30, 2009, we had outstanding unvested restricted stock rights with respect to 10 million shares of common stock on a weighted-average basis.

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Potential common shares are not included in the denominator of the diluted earnings per common share calculation when

Table of Contents

inclusion of such shares would be anti-dilutive. Therefore, options to acquire 25 million and 24 million shares of common stock were not included in the calculation of diluted earnings per common share for the three and nine months ended September 30, 2010, respectively, and options to acquire 18 million shares and 19 million shares of common stock were not included in the calculation of diluted earnings per common share for the three and nine months ended September 30, 2009, respectively, as the effect of their inclusion would be anti-dilutive.

11. Capital transactions

Repurchase Program

On November 5, 2008, we announced that our Board of Directors authorized a stock repurchase program (the 2008-2009 Stock Repurchase Program) under which we were authorized to repurchase up to \$1 billion of our common stock. On July 31, 2009, our Board of Directors authorized an increase of \$250 million to the 2008-2009 Stock Repurchase Program bringing the total authorization to \$1.25 billion. On February 10, 2010, we announced that our Board of Directors authorized a new stock repurchase program (the 2010 Stock Repurchase Program) under which we may repurchase up to \$1 billion of our common stock until the earlier of December 31, 2010 or a determination by our Board of Directors to discontinue the repurchase program.

In January 2010, we settled a \$15 million purchase of 1.3 million shares of our common stock that we had agreed to repurchase in December 2009 pursuant to the 2008-2009 Stock Repurchase Program, completing that program. During the nine months ended September 30, 2010, we have repurchased 55 million shares of our common stock for \$598 million pursuant to the 2010 Stock Repurchase Program.

Dividend

On February 10, 2010, Activision Blizzard's Board of Directors declared a cash dividend of \$0.15 per common share payable on April 2, 2010 to shareholders of record at the close of business on February 22, 2010, and on April 2, 2010, we made a cash dividend payment of \$187 million to such shareholders. On October 22, 2010, the Company made dividend equivalent payments of \$2 million related to this cash dividend to the holders of restricted stock units.

12. Commitments and contingencies

At September 30, 2010, we did not have any significant changes to our commitments since December 31, 2009. See Note 18 of the Notes to Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the year ended December 31, 2009 for more information regarding our commitments.

Legal Proceedings

After concluding an internal human resources inquiry into breaches of contract and insubordination by two senior employees at Infinity Ward, the Company terminated its employment of Jason West and Vince Zampella on March 1, 2010. On March 3, 2010, West and Zampella filed a complaint against the Company in Los Angeles Superior Court for breach of contract and wrongful termination, among other claims. West and Zampella are seeking damages, including punitive damages, in excess of \$36 million and declaratory relief. On April 9, 2010, the Company filed a cross complaint against West and Zampella, asserting claims for breach of contract and fiduciary duty, among other claims. The Company is seeking damages and declaratory relief.

In addition, 38 current and former employees of Infinity Ward filed a complaint against the Company in Los Angeles Superior Court on April 27, 2010 (*Alderman et al. v. Activision Publishing, Inc. et al.*). An amended complaint was filed on July 8, 2010, which added seven additional plaintiffs. On October 5, 2010, five plaintiffs, all current employees of Infinity Ward, filed dismissals without prejudice. There are currently 40 plaintiffs in the case. The plaintiffs have asserted claims for breach of contract, violation of the Labor Code of the State of California, conversion and other claims. The plaintiffs claim that the Company failed to pay them bonuses and other compensation allegedly owed to them in an amount at least between \$75 and \$125 million, plus punitive damages. On October 12, 2010, the court consolidated this matter with the West and Zampella matter.

On August 10, 2010, the Company filed a demurrer to various causes of action in the amended Alderman complaint. On October 15, 2010, the court overruled the demurrer with respect to all causes of action other than conversion, for which it was sustained. The court gave the Alderman plaintiffs 20 days to further amend the complaint. Discovery is proceeding.

The trial date for the consolidated cases is set for May 23, 2011.

Table of Contents

The Company has accrued and will continue to accrue appropriate amounts related to bonuses and other monies allegedly owed in connection with this matter. The Company does not expect this lawsuit to have a material impact on the Company.

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

Credit Facilities

Effective July 23, 2010, we terminated our unsecured credit agreement with Vivendi, the lender, which provided for a revolving credit facility of up to \$475 million.

13. Related party transactions

Treasury

Our foreign currency risk management program seeks to reduce risks arising from foreign currency fluctuations. We use derivative financial instruments, primarily currency forward contracts and swaps, with Vivendi as our principal counterparty. The gross notional amount of outstanding foreign exchange swaps was \$401 million at September 30, 2010. The gross notional amount of outstanding foreign exchange swaps was \$120 million at December 31, 2009. A pre-tax net unrealized loss of \$1 million and gain of \$3 million for the three and nine months ended September 30, 2010, respectively, resulted from the foreign exchange contracts and swaps with Vivendi and were recognized in the condensed consolidated statements of operations.

Other

Activision Blizzard has entered into various transactions and agreements, including cash management services, investor agreement, and music royalty agreements with Vivendi and its subsidiaries and affiliates. Effective July 23, 2010, we terminated our unsecured credit agreement with Vivendi, the lender, which provided for a revolving credit facility of up to \$475 million. None of these services, transactions and agreements with Vivendi and its subsidiaries and affiliates is material either individually or in the aggregate to the condensed consolidated financial statements as a whole.

14. Recently issued accounting pronouncements

In October 2009, the FASB issued an update to *Revenue Recognition Multiple-Deliverable Revenue Arrangements*. This update establishes the accounting and reporting guidance for arrangements including multiple revenue-generating activities. This update provides amendments to the criteria for separating deliverables, measuring and allocating arrangement consideration to one or more units of accounting. The amendments in this update also establish a selling price hierarchy for determining the selling price of a deliverable. Significantly enhanced disclosures are also required to provide information about a vendor's multiple-deliverable revenue arrangements, including information about the nature and terms, significant deliverables, and its performance within arrangements. The amendments also require providing information about the significant judgments made and changes to those judgments and about how the application of the relative selling-price method affects the timing or amount of revenue recognition. The amendments in this update are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. We do not expect the adoption of this update to have a material impact on our condensed consolidated financial statements.

In October 2009, the FASB issued an update to *Software Certain Revenue Arrangements That Include Software Elements*. This update changes the accounting model for revenue arrangements that include both tangible products and software elements that are essential to the functionality, and excludes these products from the scope of current software revenue guidance. The new guidance will include factors to help companies determine which software elements are considered essential to the functionality. The amendments will now subject software-enabled products to other revenue guidance and disclosure requirements, such as guidance surrounding revenue arrangements with multiple- deliverables. The amendments in this update are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. We do not expect the adoption of this update to have a material impact on our condensed consolidated financial statements.

Table of Contents

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

Business Overview

Activision Blizzard, Inc. is a worldwide online, personal computer (PC), console, and handheld game publisher. The terms Activision Blizzard, the Company, we, us, and our are used to refer collectively to Activision Blizzard, Inc. and its subsidiaries. Based upon our organizational structure, we conduct our business through three operating segments as follows:

Activision Publishing, Inc.

Activision Publishing, Inc. (Activision) is a leading international publisher of interactive software products and peripherals. Activision develops and publishes video games on various consoles, handheld platforms and the PC platform through internally developed franchises and license agreements. Activision currently offers games that operate on the Sony Computer Entertainment, Inc. (Sony) PlayStation 2 (PS2), Sony PlayStation 3 (PS3), Nintendo Co. Ltd. (Nintendo) Wii (Wii), and Microsoft Corporation (Microsoft) Xbox 360 (Xbox 360) console systems; the Sony PlayStation Portable (PSP), Nintendo Dual Screen (NDS) and Nintendo DSi handheld devices; the PC; and the Apple iPhone and iPad. Our Activision business involves the development, marketing, and sale of products through retail channels or digital downloads, by license, or from our affiliate label program with certain third-party publishers. Activision's products cover diverse game categories including action/adventure, action sports, racing, role-playing, simulation, first-person action, music, and strategy. Activision's target customer base ranges from casual players to core gamers, and from children to adults.

Blizzard Entertainment, Inc.

Blizzard Entertainment, Inc. (Blizzard) is a leader in terms of subscriber base and revenues generated in the subscription-based massively multi-player online role-playing game (MMORPG) category. Blizzard internally develops and publishes PC-based computer games and maintains its proprietary online-game related service, Battle.net. Our Blizzard business involves the development, marketing, sales and support of role playing action and strategy games. Blizzard also develops, hosts, and supports its online subscription-based games in the MMORPG category. Blizzard is the development studio and publisher best known as the creator of *World of Warcraft* and the multiple award winning Diablo, StarCraft, and World of Warcraft franchises. Blizzard distributes its products and generates revenues worldwide through various means, including: subscription revenues (which consist of fees from individuals playing *World of Warcraft*, prepaid cards and other value added service revenues such as realm transfers, faction changes, and other character customizations within the *World of Warcraft* game play); retail sales of physical boxed products; electronic download sales of PC products; and licensing of software to third-party or related party companies that distribute *World of Warcraft* and *StarCraft II*.

Activision Blizzard Distribution

Activision Blizzard Distribution (Distribution) consists of operations in Europe that provide warehousing, logistical, and sales distribution services to third-party publishers of interactive entertainment software, our own publishing operations, and manufacturers of interactive

entertainment hardware

The significant factors impacting our business environment are discussed below. For additional discussion refer to the Business Overview section in the Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2009.

Business Highlights

According to The NPD Group with respect to the U.S., and Charttrack and Gfk for Europe, during the three months ended September 30, 2010:

- Activision's Call of Duty and Blizzard's StarCraft were two of the top-10 best selling franchises in the U.S. and Europe;
- *StarCraft II: Wings of Liberty* was the #4 best selling title overall, and the #1 best selling PC title in the U.S. and Europe;
- Activision Blizzard was the #2 third party publisher and the #1 PC publisher in the U.S. and Europe;

and, during the nine months ended September 30, 2010:

- Call of Duty was the #1 best selling third-party franchise in the U.S. and Europe; and
- *StarCraft II: Wings of Liberty* was the #1 best selling PC title in the U.S. and Europe.

Table of Contents

During the third quarter ended September 30, 2010, Blizzard Entertainment announced that the subscriber base for *World of Warcraft* had exceeded 12 million players worldwide.

Product Release Highlights

The following games, among other titles, were released during the nine months ended September 30, 2010:

Activision Publishing:

- *Guitar Hero: Warriors of Rock*
- *Spider-Man: Shattered Dimensions*
- *Call of Duty: Modern Warfare 2* map packs
- *Singularity*
- *Transformers: War For Cybertron*
- *Blur*
- *Shrek Forever After*
- *How to Train Your Dragon*
- *Cabela's Monster Buck Hunter*
- *Zhu Zhu Pets*

Blizzard Entertainment:

- *StarCraft II: Wings of Liberty*

On August 31, 2010, Blizzard Entertainment and NetEase.com Inc. launched *World of Warcraft: Wrath of the Lich King*, the second expansion for *World of Warcraft*, in mainland China.

Activision Blizzard Upcoming Product Releases

The more notable games upcoming for release in the fourth quarter of 2010 include:

Activision Publishing:

- *Call of Duty: Black Ops*
- *GoldenEye 007*
- *James Bond 007: Bloodstone*
- *DJ Hero 2*
- *Bakugan: Defenders of the Core*
- *Cabela's Dangerous Hunts*
- *Tony Hawk: SHRED*

Blizzard Entertainment:

- *World of Warcraft: Cataclysm.*

Management's Overview of Business Trends

We provide our products through both the retail channel and through electronically delivered methods. Many of our video games that are available through retailers as physical boxed products such as DVDs are also available by direct digital download through the Internet (both from websites that we own and from others owned by third parties to whom we license our products). We also offer downloadable content and add-ons to our products (*e.g.*, map packs and additional songs). Electronically delivered content is generally offered to consumers for a one-time fee. Our subscription based services are also digitally delivered. We continue to focus on and grow our digital download and online revenues. This has become an increasingly important part of our business. For the quarter ended September 30, 2010, our sales through digital online channels grew more than 15% year-over-year.

Conditions in the retail part of the industry have remained challenging for the first nine months of 2010. In the U.S. and Europe, retail sales within the industry experienced combined overall decreases of 8% and 10% for the three and nine months ended September 30, 2010, respectively, as compared to the same periods in 2009, according to The NPD Group with respect to the U.S. and Charttrack and Gfk with

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

respect to Europe. This is driven by significant contraction in sales in the music and casual games genres, with consumer demand continuing to concentrate around a few key core titles. Sony PlayStation 3 and Microsoft Xbox 360 software retail sales experienced an increase of 17% for the first nine months of 2010 as compared to the same period in 2009, driven by the stronger performance of core titles.

Table of Contents

This concentration of retail revenues among key core titles has continued as a trend in the overall interactive software industry. According to The NPD Group, the top 10 titles accounted for 23% of the sales in the U.S. video game industry for the nine months ended September 30, 2010. Similarly, a significant portion of our revenues has historically been derived from video games based on a few popular franchises and these video games are responsible for a disproportionately high percentage of our profits. We expect that a limited number of popular franchises will continue to produce a disproportionately high percentage of our revenues and profits. For example, our four key franchises of World of Warcraft, Call of Duty, StarCraft and Guitar Hero, accounted for over 81% of our net revenues for the nine months ended September 30, 2010.

Consolidated Statements of Operations Data

The following table sets forth consolidated statements of operations data for the periods indicated in dollars and as a percentage of total net revenues (amounts in millions):

	Three Months Ended September 30, 2010				Nine Months Ended September 30, 2010				Nine Months Ended September 30, 2009			
Net revenues:												
Product sales	\$	397	53%	\$	411	58%	\$	2,025	67%	\$	1,848	68%
Subscription, licensing, and other revenues		348	47		292	42		994	33		874	32
Total net revenues		745	100		703	100		3,019	100		2,722	100
Costs and expenses:												
Cost of sales product costs		194	27		185	26		765	25		762	28
Cost of sales software royalties and amortization		61	8		54	8		211	7		212	8
Cost of sales intellectual property licenses		33	4		45	7		105	3		163	6
Cost of sales MMORPG		61	8		55	8		168	6		158	6
Product development		119	16		122	17		366	12		362	13
Sales and marketing		111	15		128	18		294	10		329	12
General and administrative		111	15		106	15		245	8		301	11
Restructuring					(1)						29	1
Total costs and expenses		690	93		694	99		2,154	71		2,316	85
Operating income		55	7		9	1		865	29		406	15
Investment and other income, net		14	2		11	2		15			21	1
Income before income tax expense		69	9		20	3		880	29		427	16
Income tax expense		18	2		5	1		229	7		28	1
Net income	\$	51	7%	\$	15	2%	\$	651	22%	\$	399	15%

[Table of Contents](#)

Operating Segment Results

Our operating segments are consistent with our internal organizational structure, the manner in which our operations are reviewed and managed by our Chief Executive Officer, who is our Chief Operating Decision Maker (CODM), the manner in which operating performance is assessed and resources are allocated, and the availability of separate financial information. We do not aggregate operating segments.

The CODM reviews segment performance exclusive of the impact of the change in deferred net revenues and related cost of sales with respect to certain of our online-enabled games, stock-based compensation expense, restructuring expense, amortization of intangible assets and purchase price accounting related adjustments, integration and transaction costs, and other. Information on the operating segments and reconciliations of total segment net revenues and total segment income (loss) from operations to consolidated net revenues and operating income for the three and nine months ended September 30, 2010 and 2009 are presented below (amounts in millions):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2010	2009	Increase (Decrease)	2010	2009	Increase (Decrease)
Segment net revenues:						
Activision	\$ 314	\$ 415	\$ (101)	\$ 983	\$ 1,211	\$ (228)
Blizzard	481	286	195	1,086	867	219
Distribution	62	54	8	185	202	(17)
Operating segment net revenue total	857	755	102	2,254	2,280	(26)
Reconciliation to consolidated net revenues:						
Net effect from deferral of net revenues	(112)	(52)		765	441	
Other*					1	
Consolidated net revenues	\$ 745	\$ 703		\$ 3,019	\$ 2,722	
Segment income (loss) from operations:						
Activision	\$ (43)	\$ (43)	\$	\$ (88)	\$ (49)	\$ (39)
Blizzard	246	116	130	559	393	166
Distribution	1	2	(1)	(1)	6	(7)
Operating segment income from operations total	204	75	129	470	350	120
Reconciliation to consolidated operating income:						
Net effect from deferral of net revenues and related cost of sales	(97)	9		539	341	
Stock-based compensation expense	(34)	(36)		(94)	(107)	
Restructuring		1		(3)	(29)	
Amortization of intangible assets and purchase price accounting related adjustments	(18)	(33)		(47)	(117)	
Integration and transaction costs		(7)			(24)	
Other*					(8)	

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Total consolidated operating income	\$	55	\$	9	\$	865	\$	406
-------------------------------------	----	----	----	---	----	-----	----	-----

** Represents Non-Core activities, which are legacy Vivendi Games divisions or business units that we have exited, divested or wound down as part of our restructuring and integration efforts as a result of the Business Combination. Prior to July 1, 2009, Non-Core activities were managed as a stand-alone operating segment; however, in light of the minimal activities and insignificance of Non-Core activities, as of that date we ceased their management as a separate operating segment and consequently, we are no longer providing separate operating segment disclosure and have reclassified our prior periods' segment presentation so that it conforms to the current period's presentation.*

Table of Contents

Segment Net Revenues

Activision

Activision's net revenues decreased for the three and nine months ended September 30, 2010 as compared to the same periods in 2009. For the three-month period, revenues decreased primarily due to the release of fewer key titles in 2010 than in 2009, and weaker sales of games in the music and casual games genres. Activision released two key titles, *Guitar Hero: Warriors of Rock* and *Spider-Man: Shattered Dimensions*, in the quarter ended September 30, 2010, whereas we released three key titles in the quarter ended September 30, 2009. For the nine-month period, revenues decreased primarily due to the release of fewer key titles in 2010 than in 2009, weaker sales of games in the music and casual genres and limited success from new intellectual property offerings. In the first nine months of 2010, Activision released seven key titles, compared to the release of eleven key titles in the first nine months of 2009. In addition, *Blur* and *Singularity*, two new intellectual properties that were released in the second quarter of 2010, had only limited market success. While establishing successful new intellectual property has always been difficult, the current economic environment has made it particularly challenging in 2010. For both the three- and nine-month periods, these negative impacts on net revenues were partially offset by the continued strong performance from *Call of Duty: Modern Warfare 2*, which was released in the fourth quarter of 2009, the launch of the *Call of Duty: Modern Warfare 2 Stimulus Package* map pack on Microsoft Xbox Live (XBLive) in the first quarter of 2010 and on PlayStation Network (PSN) in the second quarter of 2010, and the launch of the *Call of Duty: Modern Warfare 2 Resurgence* map pack on XBLive in the second quarter of 2010 and on PSN in the third quarter of 2010.

Blizzard

Blizzard's net revenues increased for the three and nine months ended September 30, 2010 as compared to the same periods in 2009 primarily as a result of the release of *StarCraft II: Wings of Liberty* in the third quarter of 2010. Additionally, net revenues increased due to the growth in sales of value added services related to *World of Warcraft*, which consist of transactions such as realm transfers, faction changes, and other character customizations within the *World of Warcraft* game play.

Distribution

Distribution's net revenues increased for the three months ended September 30, 2010 as compared to the same period in 2009, primarily due to stronger sales from non-retail distribution customers.

Distribution's net revenues decreased for the nine months ended September 30, 2010 as compared to the same period in 2009, primarily due to weakness in the interactive software industry in the United Kingdom (U.K.) resulting in lower sales from U.K. independent retailers and warehousing services.

Segment Income (Loss) from Operations

Activision

Activision's operating loss for the three months ended September 30, 2010 was equivalent to the operating loss for the same period in 2009. The decrease in net revenues described above was offset by a positive shift in the sales mix of higher-margin products, a decrease in sales and marketing expenses, and savings realized from headcount reductions within certain administrative functions in the first quarter of 2010.

Activision's operating loss increased for the nine months ended September 30, 2010 as compared to the same period in 2009 due to the lower revenues as discussed above from the release of fewer titles in 2010 than in 2009 and weaker sales of games in the music and casual games, along with limited market success on the two new intellectual properties, *Blur* and *Singularity*. These impacts were partially offset by a positive shift in the sales mix of higher-margin products and lower sales and marketing expenses.

Blizzard

Blizzard's operating income increased for the three and nine months ended September 30, 2010 as compared to the same periods in 2009 primarily as a result of the release of *StarCraft II: Wings of Liberty* in the third quarter of 2010 and the increase in sales of value added services.

[Table of Contents](#)

Consolidated Results

Net Revenues by Geographic Region

The following table details our consolidated net revenues by geographic region for the three months ended September 30, 2010 and 2009 (amounts in millions):

	Three Months Ended September 30,		Increase (Decrease)	
	2010	2009		
Geographic region net revenues:				
North America	\$ 406	\$ 378	\$	28
Europe	281	287		(6)
Asia Pacific	58	38		20
Consolidated net revenues	\$ 745	\$ 703	\$	42

The (increase) / decrease in deferred revenues by geographic region for the three months ended September 30, 2010 and 2009 was as follows (amounts in millions):

	Three Months Ended September 30,		(Increase) Decrease	
	2010	2009		
(Increase)/decrease in deferred revenues by geographic region:				
North America	\$ (41)	\$ (26)	\$	(15)
Europe	(53)	(22)		(31)
Asia Pacific	(18)	(4)		(14)
Total impact on consolidated net revenues	\$ (112)	\$ (52)	\$	(60)

Consolidated net revenues for North America and Asia Pacific increased primarily due to the release of *StarCraft II: Wings of Liberty* in the third quarter of 2010, the continued success of the Call of Duty franchise, in particular *Call of Duty: Modern Warfare 2*, and higher revenues from sales of *World of Warcraft* s value added services. These positive impacts on net revenues for North America and Asia Pacific were partially offset by fewer title releases in 2010 as compared to 2009, and the lower sales of games in the music and casual game genres. Consolidated net revenues for Europe decreased primarily due to lower sales of games in the music and casual games genres and unfavorable effects of foreign exchange rates. Partially offsetting these negative impacts on net revenues for Europe was the release of *StarCraft II: Wings of Liberty*, the continued strength of the Call of Duty franchise and further growth in sales of *World of Warcraft* s value added services. The release of the *StarCraft II: Wings of Liberty* is the primary reason that more revenue was deferred in all regions during the three months ended September 30, 2010 as compared to the same period in 2009.

The following table details our consolidated net revenues by geographic region for the nine months ended September 30, 2010 and 2009 (amounts in millions):

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

	Nine Months Ended September 30,			Increase (Decrease)
	2010	2009		
Geographic region net revenues:				
North America	\$ 1,675	\$ 1,458	\$	217
Europe	1,142	1,088		54
Asia Pacific	202	175		27
Total geographic region net revenues	3,019	2,721		298
Other		1		(1)
Consolidated net revenues	\$ 3,019	\$ 2,722	\$	297

Table of Contents

The (increase) / decrease in deferred revenues by geographic region for the nine months ended September 30, 2010 and 2009 was as follows (amounts in millions):

	Nine Months Ended September 30,		(Increase)
	2010	2009	Decrease
(Increase)/decrease in deferred revenues by geographic region:			
North America	\$ 462	\$ 287	\$ 175
Europe	280	147	133
Asia Pacific	23	7	16
Total change in deferred revenues by geographic region	765	441	324
Other		1	(1)
Total impact on consolidated net revenues	\$ 765	\$ 442	\$ 323

Consolidated net revenues increased in all regions for the nine months ended September 30, 2010 as compared to the same period in 2009 primarily due to the release of the *StarCraft II: Wings of Liberty* in the third quarter of 2010, the success of the Call of Duty franchise, in particular *Call of Duty: Modern Warfare 2*, and higher revenues from sales of *World of Warcraft*'s value added services. These positive impacts on net revenues were partially offset by the impact of the weaker sales of games in the music and casual game genres, the continuing weakness of the interactive software sales in the retail channel, and unfavorable effects of foreign exchange rates.

The success of the Call of Duty franchise is the primary reason that more deferred revenue was recognized during the nine months ended September 30, 2010 as compared to the same period in 2009, partially offset by the additional deferral of revenue as a result of the release of *StarCraft II: Wings of Liberty* in the third quarter of 2010.

Foreign Exchange Impact

Changes in foreign exchange rates had a negative impact of approximately \$30 million and \$25 million on Activision Blizzard's net revenues for the three and nine months ended September 30, 2010, respectively, as compared to the same periods in 2009. The change is primarily due to the strengthening of the U.S. dollar relative to the British pound and euro in 2010 compared to 2009.

Table of Contents

Net Revenues by Platform

The following table details our net revenues by platform and as a percentage of total consolidated net revenues for the three months ended September 30, 2010 and 2009 (amounts in millions):

	Three Months Ended September 30, 2010	% of total consolidated net revenues	Three Months Ended September 30, 2009	% of total consolidated net revenues	Increase (Decrease)
Platform net revenues:					
MMORPG	\$ 289	39%	\$ 306	44%	(17)
PC and other	73	10	27	4	46
Console					
Sony PlayStation 3	109	15	73	10	36
Sony PlayStation 2	6	1	37	5	(31)
Microsoft Xbox 360	127	16	104	15	23
Nintendo Wii	56	8	72	10	(16)
Total console	298	40	286	40	12
Handheld	23	3	30	4	(7)
Total platform net revenues	683	92	649	92	34
Distribution	62	8	54	8	8
Total consolidated net revenues	\$ 745	100%	\$ 703	100%	42

The (increase) / decrease in deferred revenues by platform for the three months ended September 30, 2010 and 2009 was as follows (amounts in millions):

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	(Increase) Decrease
(Increase)/decrease in deferred revenues by platform:			
MMORPG	\$ 7	\$ 31	(24)
PC and other	(141)	(3)	(138)
Console			
Sony PlayStation 3	5	(34)	39
Microsoft Xbox 360	26	(38)	64
Nintendo Wii	(9)	(8)	(1)
Total console	22	(80)	102
Total impact on consolidated net revenues	\$ (112)	\$ (52)	(60)

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Table of Contents

The following table details our net revenues by platform and as a percentage of total consolidated net revenues for the nine months ended September 30, 2010 and 2009 (amounts in millions):

	Nine Months Ended September 30, 2010	% of total consolidated net revenues	Nine Months Ended September 30, 2009	% of total consolidated net revenues	Increase (Decrease)
Platform net revenues:					
MMORPG	\$ 890	29%	\$ 952	35%	\$ (62)
PC and other	201	7	106	4	95
Console					
Sony PlayStation 3	595	20	356	13	239
Sony PlayStation 2	29	1	121	4	(92)
Microsoft Xbox 360	751	25	533	20	218
Nintendo Wii	267	9	324	12	(57)
Total console	1,642	55	1,334	49	308
Handheld	101	3	127	5	(26)
Total platform net revenues	2,834	94	2,519	93	315
Distribution	185	6	202	7	(17)
Other			1		(1)
Total consolidated net revenues	\$ 3,019	100%	\$ 2,722	100%	\$ 297

The (increase) / decrease in deferred revenues by platform for the nine months ended September 30, 2010 and 2009 was as follows (amounts in millions):

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009	(Increase) Decrease
(Increase)/decrease in deferred revenues by platform:			
MMORPG	\$ 13	\$ 106	\$ (93)
PC and other	(81)	26	(107)
Console			
Sony PlayStation 3	317	84	233
Microsoft Xbox 360	425	145	280
Nintendo Wii	91	80	11
Total console	833	309	524
Other		1	(1)
Total impact on consolidated net revenues	\$ 765	\$ 442	\$ 323

Net revenues from MMORPG decreased for the three and nine months ended September 30, 2010 as compared to the same periods in 2009 primarily as a result of lower deferred and boxed revenue recognized from the *World of Warcraft: Wrath of Lich King* expansion pack, which was released in the fourth quarter of 2008. This decrease in revenue was partially offset by higher revenues from sales of *World of Warcraft* s value added services. Net revenues from PC and other increased for the three and nine months ended September 30, 2010 as compared to the same periods in 2009 primarily as a result of the release of *StarCraft II: Wings of Liberty*. Net revenues from Sony PlayStation 3 and Microsoft Xbox 360 increased for the three and nine months ended September 30, 2010 as compared to the same periods in 2009 primarily as a result of the success of the Call of Duty franchise, in particular, *Call of Duty: Modern Warfare 2* and its associated map packs in downloadable content formats. Sony PlayStation 2 platform revenues continued to decline due to the aging lifecycle of the Sony PlayStation 2 platform as consumers are now almost fully transitioned to the current generation platforms. Net revenues from Nintendo Wii and Handheld decreased for the three and

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

nine months ended September 30, 2010 as compared to the same periods in 2009 primarily as a result of the impact of the weaker sales of games in the casual game genre.

PC and other had more revenue deferred as a result of the release of the *StarCraft II: Wings of Liberty*, whereas the success of the Call of Duty franchise is the primary reason that we recognized more deferred console revenue during the three and nine months ended September 30, 2010 as compared to the same periods in 2009.

Table of Contents

Costs and Expenses

Cost of Sales

The following table details the components of cost of sales in dollars and as a percentage of total consolidated net revenues for the three months ended September 30, 2010 and 2009 (amounts in millions):

	Three Months Ended September 30, 2010	% of consolidated net revenues	Three Months Ended September 30, 2009	% of consolidated net revenues	Increase (Decrease)
Product costs	\$ 194	27%	\$ 185	26%	\$ 9
Software royalties and amortization	61	8	54	8	7
Intellectual property licenses	33	4	45	7	(12)
MMORPG	61	8	55	8	6

Total cost of sales increased for the three months ended September 30, 2010 as compared to the same periods in 2009 primarily due to:

- The stronger performance of the Call of Duty franchise and the release of *StarCraft II: Wings of Liberty*;
- Recognition of more deferred cost of sales from prior quarters, consistent with higher recognition of deferred revenues, during the three months ended September 30, 2010 as compared to the three months ended September 30, 2009; and
- Continued focus on customer service for our subscribers.

The increases were partially offset by:

- Lower cost of sales resulting from the shift to selling more software versus peripherals in the music genre; and
- Lower intellectual property license expenses due to the decrease in amortization of intangible assets.

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

The following table details the components of cost of sales in dollars and as a percentage of total consolidated net revenues for the nine months ended September 30, 2010 and 2009 (amounts in millions):

	Nine Months Ended September 30, 2010	% of consolidated net revenues	Nine Months Ended September 30, 2009	% of consolidated net revenues	Increase (Decrease)
Product costs	\$ 765	25%	\$ 762	28%	\$ 3
Software royalties and amortization	211	7	212	8	(1)
Intellectual property licenses	105	3	163	6	(58)
MMORPG	168	6	158	6	10

Total cost of sales decreased for the nine months ended September 30, 2010 as compared to the same periods in 2009 primarily due to:

- The change in business mix with lower revenues, and accordingly, lower product costs, generated from the Distribution segment and lower cost of sales resulting from the shift to selling more software versus peripherals in the music genre;
- Lower intellectual property license expenses due to the release of a greater number of key titles in 2009 versus 2010 along with the weaker sales of games in the music and casual games genres; and

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Table of Contents

- Additionally, lower intellectual property license expenses due to the decrease in amortization of intangible assets.

The decreases were partially offset by:

- The stronger performance of the Call of Duty franchise and the release of *StarCraft II: Wings of Liberty*;
- Recognition of more deferred cost of sales from prior quarters, consistent with higher recognition of deferred revenues, during the nine months ended September 30, 2010 as compared to the nine months ended September 30, 2009; and
- Continued focus on customer service for our subscribers.

Product Development (amounts in millions)

	September 30, 2010	% of consolidated net revenues	September 30, 2009	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	\$ 119	16%	\$ 122	17%	\$ (3)
Nine Months Ended	366	12	362	13	4

Product development costs changed slightly for the three and nine months ended September 30, 2010 as compared to the same periods in 2009. The decrease for the three-month period resulted from slightly higher capitalization of costs in the current year for upcoming title releases. The increase for the nine-month period was primarily attributable to increased product development expenses for our slate of future titles, and was partially offset by higher capitalization of costs related to upcoming title releases, and the benefits realized from headcount reductions at certain studios primarily in the first quarter of 2010 to align the Company's resources with its upcoming product slate.

Sales and Marketing (amounts in millions)

	September 30, 2010	% of consolidated net revenues	September 30, 2009	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	\$ 111	15%	\$ 128	18%	\$ (17)
Nine Months Ended	294	10	329	12	(35)

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Sales and marketing expenses decreased for the three and nine months ended September 30, 2010 as compared to the same periods in 2009 as a result of a reduction in the number of major title releases and the timing of our releases in 2010 versus 2009, along with a strategic effort to focus 2010 marketing efforts in the fourth quarter of 2010 to correspond with the holiday season. The decrease was partially offset by the continued marketing support for the Call of Duty franchise.

General and Administrative (amounts in millions)

	September 30, 2010	% of consolidated net revenues	September 30, 2009	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	\$ 111	15%	\$ 106	15%	\$ 5
Nine Months Ended	245	8	301	11	(56)

General and administrative expenses increased slightly for the three months ended September 30, 2010, as compared to the same period in 2009, primarily due to accrued bonuses. General and administrative expenses decreased for the nine months ended September 30, 2010, as compared to the same period in 2009, principally due to favorable foreign exchange effects, integration costs incurred in the prior year due to the business combination with Vivendi Games, the benefits realized from the headcount reductions within certain administrative functions in the first quarter of 2010, and lower stock option expense.

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Table of Contents

Investment and other income, net (amounts in millions)

	September 30, 2010	% of consolidated net revenues	September 30, 2009	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	\$ 14	2%	\$ 11	2%	\$ 3
Nine Months Ended	15		21	1	(6)

Investment and other income, net increased for the three months ended September 30, 2010, as compared to the same period in 2009, primarily as a result of a reduction of certain financial liabilities. Investment and other income, net decreased for the nine months ended September 30, 2010, as compared to the same period in 2009, primarily due to lower interest rates.

Income Tax Expense (amounts in millions)

	September 30, 2010	% of Pretax income	September 30, 2009	% of Pretax income	Increase (Decrease)
Three Months Ended	\$ 18	26%	\$ 5	25%	\$ 13
Nine Months Ended	229	26	28	7	201

The income tax expense of \$18 million for the three months ended September 30, 2010 reflects an effective tax rate of 26%. The effective tax rate of 26% for the three months ended September 30, 2010 differs from the statutory rate of 35% primarily due to foreign income taxes provided at lower rates, geographic mix in profitability, recognition of California research and development credits and IRC 199 domestic production deductions. We did not record a tax benefit for federal research credits during the quarter ended September 30, 2010 since as of September 30, 2010, the federal research credit had not yet been approved for use in 2010.

For the nine months ended September 30, 2010, the tax rate is based on our projected annual effective tax rate for 2010, and also includes certain discrete tax items recorded during the period. Our tax expense of \$229 million for the nine months ended September 30, 2010 reflects an effective tax rate of 26% which differs from the effective tax rate of 7% for the nine months ended September 30, 2009 primarily due to tax benefits recorded during the prior period related to the release of valuation allowances on foreign net operating losses and the impact of changes to California tax laws.

The overall effective income tax rate for the year could be different from the effective tax rate for the nine months ended September 30, 2010 and will be dependent on our profitability for the remainder of the year. In addition, our effective income tax rates for the remainder of 2010 and future periods will depend on a variety of factors, such as changes in the mix of income by tax jurisdiction, applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audit and other matters, and variations in the estimated and actual level of annual pre-tax income or loss. In particular, we did not record a tax benefit during the quarter ended September 30, 2010 for federal research credits that may be reinstated and extended retroactively.

Liquidity and Capital Resources

Sources of Liquidity (amounts in millions)

	At September 30, 2010		At December 31, 2009		Increase (Decrease)
Cash and cash equivalents	\$	2,123	\$	2,768	\$ (645)
Short-term investments		726		477	249
	\$	2,849	\$	3,245	\$ (396)
Percentage of total assets		23%		24%	

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

Table of Contents

	Nine Months Ended September 30,		Increase
	2010	2009	(Decrease)
Cash flows provided by operating activities	\$ 383	\$ 370	\$ 13
Cash flows used in investing activities	(323)	(298)	(25)
Cash flows used in financing activities	(735)	(703)	(32)
Effect of foreign exchange rate changes	30	33	(3)
Net decrease in cash and cash equivalents	\$ (645)	\$ (598)	\$ (47)

Cash Flows from Operating Activities

Cash flows provided by operating activities were higher for the nine months ended September 30, 2010, as compared to the same period in 2009. For the nine months ended September 30, 2010, the primary drivers of cash flows provided by operating activities included the collection of customer receivables generated by the sale of our products and our subscription revenues, partially offset by payments to vendors for the manufacturing, distribution and marketing of our products, payments to third-party developers and intellectual property holders, tax liabilities, and payments to our workforce.

A significant operating use of our cash relates to our continued focus on customer service for our subscribers, and investment in software development and intellectual property licenses. We expect that we will continue to make significant expenditures in these areas.

Cash Flows Used in Investing Activities

Cash flows used in investing activities were higher for the nine months ended September 30, 2010, as compared to the same period in 2009. Cash flows used in investing activities during the nine months ended September 30, 2010 reflect the purchase of \$681 million of short-term investments, capital expenditures of \$76 million, primarily for property and equipment, and the receipt of \$473 million in proceeds from maturity of investments, the majority of which consisted of U.S. treasury and government sponsored agency debt securities.

The primary drivers of cash flows used in investing activities have typically included capital expenditures, acquisitions and the net effect of purchases and sales/maturities of short-term investments.

Cash Flows Used in Financing Activities

Cash flows used in financing activities were higher for the nine months ended September 30, 2010, as compared to the same period in 2009. Cash flows used in financing activities primarily reflect payment of a cash dividend of \$187 million to holders of our common stock and our repurchase of 56 million shares of our common stock for \$613 million under our stock repurchase programs, partially offset by \$54 million of proceeds from issuance of shares of common stock to employees pursuant to stock option exercises.

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

On November 5, 2008, we announced that our Board of Directors authorized a stock repurchase program (the 2008-2009 Stock Repurchase Program) under which we were authorized to repurchase up to \$1 billion of our common stock. On July 31, 2009, our Board of Directors authorized an increase of \$250 million to the 2008-2009 Stock Repurchase Program bringing the total authorization to \$1.25 billion. On February 10, 2010, we announced that our Board of Directors authorized a new stock repurchase program (the 2010 Stock Repurchase Program) under which we may repurchase up to \$1 billion of our common stock until the earlier of December 31, 2010 or a determination by our Board of Directors to discontinue the repurchase program.

In January 2010, we settled a \$15 million purchase of 1.3 million shares of our common stock that we had agreed to repurchase in December 2009 pursuant to the 2008-2009 Stock Repurchase Program, completing that program. During the nine months ended September 30, 2010, we have repurchased 55 million shares of our common stock for \$598 million pursuant to the 2010 Stock Repurchase Program.

The primary drivers of cash flows used in financing activities have historically related to transactions involving our common stock, including the issuance of shares of common stock to employees and the public and the purchase of treasury shares. We have not utilized debt financing as a source of cash flows. Effective July 23, 2010, we terminated our unsecured credit agreement with Vivendi, the lender, which provided for a revolving credit facility of up to \$475 million.

Table of Contents

Other Liquidity and Capital Resources

In addition to cash flows provided by operating activities, our primary source of liquidity was \$2.8 billion of cash and cash equivalents and short-term investments at September 30, 2010. With our cash and cash equivalents and expected cash flows provided by operating activities, we believe that we have sufficient liquidity to meet daily operations in the foreseeable future. We also believe that we have sufficient working capital (\$2.8 billion at September 30, 2010) to finance our operational requirements for at least the next twelve months, including purchases of inventory and equipment, the development, production, marketing and sale of new products, and the provision of customer service for our subscribers, to finance the acquisition of intellectual property rights for future products from third parties, and to fund our stock repurchase program.

Capital Expenditures

For the year ending December 31, 2010, we anticipate total capital expenditures of approximately \$120 million. Through the first nine months of 2010, we have made aggregate capital expenditures of \$76 million. Capital expenditures are expected to be primarily for computer hardware and software purchases and various corporate projects.

Off-balance Sheet Arrangements

At September 30, 2010 and December 31, 2009, Activision Blizzard had no significant relationships with unconsolidated entities or financial parties, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes, that have or are reasonably likely to have a material future effect on our financial condition, changes in financial condition, revenues or expenses, results of operation, liquidity, capital expenditures, or capital resources.

Financial Disclosure

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

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

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

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

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities at the date of the financial statements as well as the reported amounts of revenues

Table of Contents

and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The accounting policies that reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Revenue Recognition
- Allowances for Returns, Price Protection, Doubtful Accounts, and Inventory Obsolescence
- Software Development Costs and Intellectual Property Licenses
- Accounting for Income Taxes
- Fair Value Estimates
- Goodwill and Intangible Assets Impairment Assessments
- Stock-Based Compensation

During the nine months ended September 30, 2010, there were no significant changes in our critical accounting policies and estimates. Refer to Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2009 for a more complete discussion of our critical accounting policies and estimates.

Recently Issued Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued an update to *Revenue Recognition - Multiple-Deliverable Revenue Arrangements*. This update establishes the accounting and reporting guidance for arrangements including multiple revenue-generating activities. This update provides amendments to the criteria for separating deliverables, measuring and allocating arrangement consideration to one or more units of accounting. The amendments in this update also establish a selling price hierarchy for determining the selling price of a deliverable. Significantly enhanced disclosures are also required to provide information about a vendor's multiple-deliverable revenue arrangements, including information about the nature and terms, significant deliverables, and its performance within arrangements. The amendments also require providing information about the significant judgments made and changes to those judgments and about how the application of the relative selling-price method affects the timing or amount of revenue recognition. The amendments in this update are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. We do not expect the adoption of this update to have a material impact on our condensed consolidated financial statements.

In October 2009, the FASB issued an update to *Software - Certain Revenue Arrangements That Include Software Elements*. This update changes the accounting model for revenue arrangements that include both tangible products and software elements that are essential to the functionality, and excludes these products from the scope of current software revenue guidance. The new guidance will include factors to help companies determine which software elements are considered essential to the functionality. The amendments will now subject software-enabled products to other revenue guidance and disclosure requirements, such as guidance surrounding revenue arrangements with multiple-deliverables. The

amendments in this update are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. We do not expect the adoption of this update to have a material impact on our condensed consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the potential loss arising from fluctuations in market rates and prices. Our market risk exposures primarily include fluctuations in interest rates, foreign currency exchange rates and market prices.

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments to manage interest rate risk in our investment portfolio. Our investment portfolio consists primarily of debt instruments with high credit quality and relatively short average maturities and money market funds that invest in such securities. Because short-term securities mature relatively quickly and must be reinvested at the then current market rates, interest income on a portfolio consisting of cash, cash equivalents, or short-term securities is more subject to market fluctuations than a portfolio of longer term securities. Conversely, the fair value of such a portfolio is less sensitive to market fluctuations than a portfolio of longer term securities. At September 30, 2010, our \$2.12 billion of cash and cash equivalents were comprised primarily of money market funds. At September 30, 2010, our \$726 million of short-term investments included \$658 million of U.S. treasury and government sponsored agency debt securities, \$1 million of mortgage-backed securities, and \$67 million of restricted cash. We had \$23 million in auction rate securities at fair value classified as long-term investments at September 30, 2010. Most of our investment portfolio is invested in

Table of Contents

short-term or variable rate securities. Accordingly, we believe that a sharp change in interest rates would not have a material effect on our short-term investment portfolio.

Foreign Currency Exchange Rate Risk

We transact business in many different foreign currencies and may be exposed to financial market risk resulting from fluctuations in foreign currency exchange rates. Currency volatility is monitored throughout the year. To mitigate our foreign currency exchange rate exposure resulting from our foreign currency denominated monetary assets, liabilities and earnings, we periodically enter into currency derivative contracts, principally swaps and forward contracts with maturities of twelve months or less with Vivendi as our principal counterparty. We expect to continue to use economic hedge programs in the future to reduce foreign exchange-related volatility if it is determined that such hedging activities are appropriate to reduce risk. We do not hold or purchase any foreign currency contracts for trading or speculative purposes. All foreign currency economic hedging transactions are backed, in amount and by maturity, by an identified economic underlying item.

The gross notional amount of outstanding foreign exchange swaps was \$401 million at September 30, 2010. The gross notional amount of outstanding foreign exchange swaps was \$120 million at December 31, 2009. A pre-tax net unrealized loss of \$1 million and gain of \$3 million for the three and nine months ended September 30, 2010, respectively, resulted from the foreign exchange contracts and swaps with Vivendi and were recognized in the condensed consolidated statements of operations.

Item 4. Controls and Procedures

Definition and Limitations of Disclosure Controls and Procedures.

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

Evaluation of Disclosure Controls and Procedures.

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures at September 30, 2010, the end of the period covered by this report. Based on this evaluation, the principal

Edgar Filing: Activision Blizzard, Inc. - Form 10-Q

executive officer and principal financial officer concluded that, at September 30, 2010, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized, and reported on a timely basis, and (ii) accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting.

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The discussion in Note 12 to the Condensed Consolidated Financial Statements regarding legal proceedings is incorporated herein by reference.

Table of Contents

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchase of Equity Securities

The following table provides the number of shares purchased and average price paid per share during the quarter ended September 30, 2010, the total number of shares purchased as part of our publicly announced repurchase program, and the approximate dollar value of shares that may yet be purchased under our stock repurchase program at September 30, 2010 (amounts in millions, except the number of shares and per share data).

Period	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs (1)	Approximate dollar value of shares that may yet be purchased under the plans or programs
July 1, 2010 July 31, 2010		\$		\$ 666
August 1, 2010 August 31, 2010	18,052,662	10.94	18,052,662	468
September 1, 2010 September 30, 2010	6,102,300	10.76	6,102,300	402
Total	24,154,962	10.90	24,154,962	

(1) Purchases were made pursuant to the stock repurchase program authorized by our Board of Directors and announced on February 10, 2010, pursuant to which we may repurchase up to \$1 billion of our common stock from time to time on the open market or in private transactions, including structured or accelerated transactions, until the earlier of December 31, 2010 or a determination by our Board of Directors to discontinue the repurchase program. We will determine the timing and amount of repurchases based on our evaluation of market conditions and other factors. We may suspend or discontinue the stock repurchase program at any time.

Item 6. Exhibits

The exhibits listed on the accompanying index to exhibits are hereby incorporated by reference into this Quarterly Report on Form 10-Q.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 5, 2010

ACTIVISION BLIZZARD, INC.

/s/ Thomas Tipl
Thomas Tipl
Chief Operating Officer and Chief Financial Officer
Principal Financial Officer of
Activision Blizzard, Inc.

/s/ Stephen Wereb
Stephen Wereb
Chief Accounting Officer,
Principal Accounting Officer of
Activision Blizzard, Inc.

Table of Contents

EXHIBIT INDEX

Exhibit Number	Exhibit
3.1	Amended and Restated Certificate of Incorporation of Activision Blizzard, Inc., dated July 9, 2008 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed July 15, 2008).
3.2	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Activision Blizzard, Inc., dated August 15, 2008 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed August 15, 2008).
3.3	Amended and Restated By-Laws of Activision Blizzard, Inc., as amended and restated as of February 2, 2010 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed February 5, 2010).
31.1	Certification of Robert A. Kotick pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Thomas Tipler pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Thomas Tipler pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Calculation Linkbase Document.
101.LAB	XBRL Taxonomy Label Linkbase Document.
101.PRE	XBRL Taxonomy Presentation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Document.

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at September 30, 2010 and December 31, 2009, (ii) Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2010 and September 30, 2009, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 and September 30, 2009; (iv) Condensed Consolidated Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2010; and (v) Notes to Condensed Consolidated Financial Statements.

In accordance with Rule 406T of Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Exchange Act, and otherwise is not subject to liability under these sections.