

Activision Blizzard, Inc.
Form 10-Q
May 06, 2015
[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 March 31, 2015

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 April 29, 2015 was 726,186,329.

Table of Contents

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Table of Contents

	<u>Cautionary Statement</u>	3
PART I.	FINANCIAL INFORMATION	
Item 1.	Financial Statements (Unaudited)	
	<u>Condensed Consolidated Balance Sheets at March 31, 2015 and December 31, 2014</u>	4
	<u>Condensed Consolidated Statements of Operations for the three months ended March 31, 2015 and March 31, 2014</u>	5
	<u>Condensed Consolidated Statements of Comprehensive Income for the three months ended March 31, 2015 and March 31, 2014</u>	6
	<u>Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2015 and March 31, 2014</u>	7
	<u>Condensed Consolidated Statement of Changes in Shareholders' Equity for the three months ended March 31, 2015</u>	8
	<u>Notes to Condensed Consolidated Financial Statements</u>	9
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	45
Item 4.	<u>Controls and Procedures</u>	47
PART II.	OTHER INFORMATION	48
Item 1.	<u>Legal Proceedings</u>	48
Item 1A.	<u>Risk Factors</u>	51
Item 6.	<u>Exhibits</u>	51
	<u>SIGNATURE</u>	52
	<u>EXHIBIT INDEX</u>	53
	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 facts 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 financial or operating performance; (4) statements relating to the outcome or impact of pending or threatened litigation; and (5) statements of assumptions underlying such statements. Activision Blizzard, Inc. (Activision Blizzard) generally uses words such as outlook, forecast, will, could, should, would, to be, plan, plans, believes, may, might, expects, intends, intends as, anticipates, estimate, future, positioned, potential, project, remain, scheduled, set to, subject to, upcoming 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. Risks and uncertainties that may affect our future results include, but are not limited to: sales levels of our titles; increasing concentration of revenue among a small number of titles; our ability to predict consumer preferences, including interest in specific genres, such as first-person action, massively multiplayer online, toys to life and music-based games, and preferences among hardware platforms; the amount of our debt and the limitations imposed by the covenants in the agreements governing our debt; the adoption rate and availability of new hardware (including peripherals) and related software, particularly during console transitions; counterparty risks relating to customers, licensees, licensors and manufacturers; maintenance of relationships with key personnel, customers, financing providers, licensees, licensors, manufacturers, vendors, and third-party developers, including the ability to attract, retain and develop key personnel and developers that can create high quality titles; changing business models, including digital delivery of content and the increased prevalence of free-to-play games; product delays or defects; competition including from used games and other forms of entertainment; rapid changes in technology and industry standards; possible declines in software pricing; product returns and price protection; the identification of suitable future acquisition opportunities and potential challenges associated with geographic expansion; the seasonal and cyclical nature of the interactive game market; litigation risks and associated costs; protection of proprietary rights; shifts in consumer spending trends; capital market risks; applicable regulations; domestic and international economic, financial and political conditions and policies; tax rates and foreign exchange rates; the impact of the current macroeconomic environment; and the other factors identified in Risk Factors included in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2014. 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 Inc.'s names, abbreviations thereof, logos, and product and service designators are all either the registered or unregistered trademarks or trade names of Activision Blizzard. All other product or service names are the property of their respective owners.

Table of Contents
ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Amounts in millions, except share data)

	At March 31, 2015	At December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 4,465	\$ 4,848
Short-term investments	5	10
Accounts receivable, net of allowances of \$234 and \$383 at March 31, 2015 and December 31, 2014, respectively	208	659
Inventories, net	102	123
Software development	358	452
Intellectual property licenses	5	5
Deferred income taxes, net	365	368
Other current assets	355	444
Total current assets	5,863	6,909
Long-term investments	9	9
Software development	46	20
Intellectual property licenses	18	18
Property and equipment, net	158	157
Other assets	138	85
Intangible assets, net	28	29
Trademark and trade names	433	433
Goodwill	7,084	7,086
Total assets	\$ 13,777	\$ 14,746
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 123	\$ 325
Deferred revenues	1,161	1,797
Accrued expenses and other liabilities	615	592
Total current liabilities	1,899	2,714
Long-term debt, net	4,075	4,324
Deferred income taxes, net	124	114
Other liabilities	441	361
Total liabilities	6,539	7,513
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Common stock, \$0.000001 par value, 2,400,000,000 shares authorized, 1,154,580,858 and 1,150,605,926 shares issued at March 31, 2015 and December 31, 2014, respectively		
Additional paid-in capital	9,968	9,924
Less: Treasury stock, at cost, 428,676,471 shares at March 31, 2015 and December 31, 2014	(5,709)	(5,762)
Retained earnings	3,598	3,374
Accumulated other comprehensive income (loss)	(619)	(303)
Total shareholders' equity	7,238	7,233
Total liabilities and shareholders' equity	\$ 13,777	\$ 14,746

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

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 March 31,	
	2015	2014
Net revenues		
Product sales	\$ 784	\$ 769
Subscription, licensing, and other revenues	494	342
Total net revenues	1,278	1,111
Costs and expenses		
Cost of sales product costs	209	225
Cost of sales online	53	58
Cost of sales software royalties and amortization	148	57
Cost of sales intellectual property licenses	3	2
Product development	145	143
Sales and marketing	92	104
General and administrative	86	95
Total costs and expenses	736	684
Operating income	542	427
Interest and other expense, net	50	51
Income before income tax expense	492	376
Income tax expense	98	83
Net income	\$ 394	\$ 293
Earnings per common share		
Basic	\$ 0.54	\$ 0.40
Diluted	\$ 0.53	\$ 0.40
Weighted-average number of shares outstanding		
Basic	723	709
Diluted	731	720
Dividends per common share	\$ 0.23	\$ 0.20

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 COMPREHENSIVE INCOME

(Unaudited)

(Amounts in millions)

	For the Three Months Ended March 31,	
	2015	2014
Net income	\$ 394	\$ 293
Other comprehensive income (loss):		
Foreign currency translation adjustment	(330)	(5)
Unrealized gains on forward contracts designated as hedges, net of deferred income taxes of \$0 million for the three months ended March 31, 2015 and 2014	14	
Other comprehensive income (loss)	\$ (316)	\$ (5)
Comprehensive income	\$ 78	\$ 288

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 Three Months Ended March 31,	
	2015	2014
Cash flows from operating activities:		
Net income	\$ 394	\$ 293
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	(3)	6
Provision for inventories	6	9
Depreciation and amortization	20	19
Amortization of capitalized software development costs and intellectual property licenses (1)	142	51
Amortization of debt discount and debt financing costs	2	2
Stock-based compensation expense (2)	23	29
Excess tax benefits from stock awards	(14)	(17)
Changes in operating assets and liabilities:		
Accounts receivable, net	438	290
Inventories	10	5
Software development and intellectual property licenses	(77)	(71)
Other assets	108	111
Deferred revenues	(567)	(298)
Accounts payable	(208)	(189)
Accrued expenses and other liabilities	(65)	(104)
Net cash provided by operating activities	209	136
Cash flows from investing activities:		
Proceeds from maturities of available-for-sale investments		21
Capital expenditures	(21)	(37)
Decrease in restricted cash	5	4
Net cash used in investing activities	(16)	(12)
Cash flows from financing activities:		
Proceeds from issuance of common stock to employees	27	119
Tax payment related to net share settlements on restricted stock rights	(3)	(13)
Excess tax benefits from stock awards	14	17
Repayment of long-term debt	(250)	(375)
Net cash used in financing activities	(212)	(252)
Effect of foreign exchange rate changes on cash and cash equivalents	(364)	(3)
Net decrease in cash and cash equivalents	(383)	(131)
Cash and cash equivalents at beginning of period	4,848	4,410
Cash and cash equivalents at end of period	\$ 4,465	\$ 4,279

(1) Excludes deferral and amortization of stock-based compensation expense.

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

- (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 STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Three Months Ended March 31, 2015

(Unaudited)

(Amounts and shares in millions)

	Common Stock		Treasury Stock		Additional	Retained	Accumulated	Total
	Shares	Amount	Shares	Amount	Paid-In	Earnings	Other	Shareholders
					Capital		Comprehensive	Equity
							Income (Loss)	
Balance at December 31, 2014	1,151	\$	(429)	\$ (5,762)	\$ 9,924	\$ 3,374	\$ (303)	\$ 7,233
Components of comprehensive income:								
Net income						394		394
Other comprehensive income (loss)							(316)	(316)
Issuance of common stock pursuant to employee stock options	2				27			27
Issuance of common stock pursuant to restricted stock rights	3							
Restricted stock surrendered for employees' tax liability	(1)				(18)			(18)
Tax benefit associated with employee stock awards					13			13
Stock-based compensation expense related to employee stock options and restricted stock rights					22			22
Dividends (\$0.23 per common share)						(170)		(170)
Indemnity on tax attributes assumed in connection with the Purchase Transaction (see Note 9)				53				53
Balance at March 31, 2015	1,155	\$	(429)	\$ (5,709)	\$ 9,968	\$ 3,598	\$ (619)	\$ 7,238

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

1. Description of Business and Basis of Consolidation and Presentation

Activision Blizzard, Inc. (Activision Blizzard) is a leading global developer and publisher of interactive entertainment. The terms Activision Blizzard, the Company, we, us, and our are used to refer collectively to Activision Blizzard, Inc. and its subsidiaries. We currently offer games for video game consoles, personal computers (PC), and handheld, mobile and tablet devices. We maintain significant operations in the United States (U.S.), Canada, the United Kingdom (U.K.), France, Germany, Ireland, Italy, Sweden, Spain, the Netherlands, Australia, South Korea and China.

The Business Combination and Share Repurchase

Activision Blizzard is the result of the 2008 business combination (Business Combination) by and among the Company (then known as 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. As a result of the consummation of the Business Combination, Activision, Inc. was renamed Activision Blizzard, Inc. and Vivendi became a majority shareholder of Activision.

On October 11, 2013, we repurchased approximately 429 million shares of our common stock, pursuant to a stock purchase agreement (the Stock Purchase Agreement) we entered into with Vivendi and ASAC II LP (ASAC), an exempted limited partnership established under the laws of the Cayman Islands, acting by its general partner, ASAC II LLC (together with ASAC, the ASAC Entities). Pursuant to the terms of the Stock Purchase Agreement, we acquired all of the capital stock of Amber Holding Subsidiary Co., a Delaware corporation and wholly-owned subsidiary of Vivendi (New VH), which was the direct owner of approximately 429 million shares of our common stock, for a cash payment of \$5.83 billion, or \$13.60 per share, before taking into account the benefit to the Company of certain tax attributes of New VH assumed in the transaction (collectively, the Purchase Transaction). Immediately following the completion of the Purchase Transaction, ASAC purchased from Vivendi 172 million shares of our common stock, pursuant to the Stock Purchase Agreement, for a cash payment of \$2.34 billion, or \$13.60 per share (the Private Sale). Robert A. Kotick, our Chief Executive Officer, and Brian G. Kelly, Chairman of our Board of Directors, are affiliates of ASAC II LLC. Refer to Note 6 of the Notes to Condensed Consolidated Financial Statements for further information regarding the financing of the Purchase Transaction.

On May 28, 2014, Vivendi sold approximately 41 million shares, or approximately 50% of its then-current holdings, of our common stock in a registered public offering. Vivendi received proceeds of approximately \$850 million from that sale; we did not receive any proceeds.

As of March 31, 2015, we had approximately 726 million shares of common stock issued and outstanding. At that date: (i) Vivendi held 41 million shares, or approximately 6% of the outstanding shares of our common stock; (ii) ASAC held 172 million shares, or approximately 24% of the outstanding shares of our common stock; and (iii) our other stockholders held approximately 70% of the outstanding shares of our common stock. The common stock of Activision Blizzard is traded on The NASDAQ Stock Market under the ticker symbol ATVI.

Operating Segments

Based upon our organizational structure, we conduct our business through three operating segments as follows:

(i) Activision Publishing, Inc.

Activision Publishing, Inc. (Activision) is a leading global developer and publisher of interactive software products and content. Activision delivers content to a broad range of gamers, ranging from children to adults, and from core gamers to mass-market consumers to value buyers seeking budget-priced software, in a variety of geographies. Activision develops games based on internally-developed properties, including games in the Call of Duty® and Skylanders® franchises, and to a lesser extent, based on licensed intellectual properties. Additionally, we have established a long-term alliance with Bungie to publish its game universe, *Destiny*. Activision sells games through both retail and digital online channels. Activision currently offers games that operate on the Microsoft Corporation (Microsoft) Xbox One (Xbox One) and Xbox 360 (Xbox 360), Nintendo Co. Ltd. (Nintendo) Wii U (Wii U) and Wii (Wii), and Sony Computer Entertainment, Inc. (Sony) PlayStation 4 (PS4) and PlayStation 3 (PS3) console systems (Xbox One, Wii U, and PS4 are collectively referred to as next-generation ; Xbox 360, Wii, and PS3 are collectively referred to as prior-generation); the PC; the Nintendo 3DS, Nintendo Dual Screen, and Sony PlayStation Vita handheld game systems; and mobile and tablet devices.

Table of Contents

(ii) *Blizzard Entertainment, Inc.*

Blizzard Entertainment, Inc. (*Blizzard*) is a leader in the subscription-based massively multi-player online role-playing game category in terms of both subscriber base and revenues generated through its World of Warcraft® franchise, which it develops, hosts and supports. Blizzard also develops, markets, and sells role-playing action and strategy games for the PC, console, mobile and tablet platforms, including games in the multiple-award winning Diablo®, StarCraft®, and Hearthstone®: Heroes of Warcraft franchises. In addition, Blizzard maintains a proprietary online game-related service, Battle.net®. Blizzard distributes its products and generates revenues worldwide through various means, including: subscriptions; sales of prepaid subscription cards; value-added services, such as in-game purchases and services; retail sales of physical boxed products; online download sales of PC products; purchases and downloads via third-party console, mobile and tablet platforms; and licensing of software to third-party or related-party companies that distribute World of Warcraft, Diablo, StarCraft and Hearthstone: Heroes of Warcraft products. In addition, Blizzard is the creator of *Heroes of the Storm* , a new free-to-play online hero brawler that is currently in closed beta testing.

(iii) *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.

Basis of Consolidation and Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC) and accounting principles generally accepted in the United States of America (U.S. GAAP) for interim reporting. Accordingly, certain notes or other information that are normally required by U.S. GAAP have been condensed or omitted if they substantially duplicate the disclosures contained in the annual audited consolidated financial statements. The year-end condensed balance sheet data was derived from audited financial statements but does not include all disclosures required by U.S. GAAP. 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, 2014.

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 and accompanying notes. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for the fair statement of our financial position and results of operations in accordance with U.S. GAAP have been included in the accompanying unaudited condensed consolidated financial statements. Actual results could differ from these estimates and assumptions.

The accompanying condensed consolidated financial statements include the accounts and operations of the Company. All intercompany accounts and transactions have been eliminated.

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

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.

2. Inventories, Net

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

	At March 31, 2015	At December 31, 2014
Finished goods	\$ 90	\$ 112
Purchased parts and components	12	11
Inventories, net	\$ 102	\$ 123

Inventory reserves were \$50 million and \$52 million at March 31, 2015 and December 31, 2014, respectively.

Table of Contents

3. Software Development and Intellectual Property Licenses

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

	At March 31, 2015	At December 31, 2014
Internally developed software costs	\$ 247	\$ 262
Payments made to third-party software developers	157	210
Total software development costs	\$ 404	\$ 472
Intellectual property licenses	\$ 23	\$ 23

Amortization of capitalized software development costs and intellectual property licenses was the following (amounts in millions):

	For the Three Months Ended March 31, 2015	For the Three Months Ended March 31, 2014
Amortization of capitalized software development costs and intellectual property licenses	\$ 147	\$ 58

4. Intangible Assets, Net

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

	Estimated useful lives	Gross carrying amount	At March 31, 2015 Accumulated amortization	Net carrying amount
Acquired definite-lived intangible assets:				
License agreements and other	3 - 10 years	\$ 98	\$ (92)	\$ 6
Internally-developed franchises	11 - 12 years	309	(287)	22
Total definite-lived intangible assets		\$ 407	\$ (379)	\$ 28
Acquired indefinite-lived intangible assets:				
Activision trademark	Indefinite			386
Acquired trade names	Indefinite			47
Total indefinite-lived intangible assets				\$ 433

Table of Contents

At December 31, 2014				
	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
Acquired definite-lived intangible assets:				
License agreements and other	3 - 10 years	\$ 98	\$ (92)	\$ 6
Internally-developed franchises	11 - 12 years	309	(286)	23
Total definite-lived intangible assets		\$ 407	\$ (378)	\$ 29
Acquired indefinite-lived intangible assets:				
Activision trademark	Indefinite			386
Acquired trade names	Indefinite			47
Total indefinite-lived intangible assets				\$ 433

Amortization expense of intangible assets was \$1 million and \$2 million for the three months ended March 31, 2015 and 2014, respectively.

At March 31, 2015, future amortization of definite-lived intangible assets is estimated as follows (amounts in millions):

2015 (remaining nine months)	\$ 10
2016	8
2017	5
2018	3
2019	2
Total	\$ 28

5. Fair Value Measurements

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 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; and

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

- 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, including certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

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

The table below segregates all financial assets that are measured at fair value on a recurring basis 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):

Fair Value Measurements at March 31, 2015 Using					
	As of March 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
Financial Assets:					
Recurring fair value measurements:					
Money market funds	\$ 4,271	\$ 4,271	\$	\$	Cash and cash equivalents
Foreign government treasury bills	34	34			Cash and cash equivalents
Foreign currency forward contracts designated as hedges	14		14		Other current assets
Auction rate securities (ARS)	9			9	Long-term investments
Total recurring fair value measurements	\$ 4,328	\$ 4,305	\$ 14	\$ 9	

Fair Value Measurements at December 31, 2014 Using					
	As of December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
Recurring fair value measurements:					
Money market funds	\$ 4,475	\$ 4,475	\$	\$	Cash and cash equivalents
Foreign government treasury bills	40	40			Cash and cash equivalents
ARS	9			9	Long-term investments
Total recurring fair value measurements	\$ 4,524	\$ 4,515	\$	\$ 9	

Table of Contents

The following tables provide a reconciliation of the beginning and ending balances of our financial assets classified as Level 3 by major categories (amounts in millions) at March 31, 2015 and 2014, respectively:

		Level 3		Total financial assets at fair value
	ARS (a)			
Balance at December 31, 2014	\$	9	\$	9
Total unrealized gains included in other comprehensive income				
Balance at March 31, 2015	\$	9	\$	9

		Level 3		Total financial assets at fair value
	ARS (a)			
Balance at December 31, 2013	\$	9	\$	9
Total unrealized gains included in other comprehensive income				
Balance at March 31, 2014	\$	9	\$	9

(a) Fair value measurements have been estimated using an income-approach model. 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. At March 31, 2015, assets measured at fair value using significant unobservable inputs (Level 3), all of which were ARS, represent less than 1% of our financial assets measured at fair value on a recurring basis.

Foreign Currency Forward Contracts

The Company transacts business in various foreign currencies and has significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. In addition, the Company transacts intercompany business in various foreign currencies other than its functional currency, subjecting us to variability in the functional currency-equivalent cash flows. To mitigate our foreign currency risk resulting from our foreign currency-denominated monetary assets, liabilities and earnings and our foreign currency risk related to functional currency-equivalent cash flows resulting from our intercompany transactions, we periodically enter into currency derivative contracts, principally forward contracts with maturities of generally less than one year. We report the fair value of these contracts within Other current assets or Other current liabilities in our condensed consolidated balance sheets based on the prevailing exchange rates of the various hedged currencies as of the end of the relevant period.

We do not hold or purchase any foreign currency forward contracts for trading or speculative purposes.

Table of Contents

Foreign Currency Forward Contracts Not Designated as Hedges

For foreign currency forward contracts entered into to mitigate risk from foreign currency-denominated monetary assets, liabilities, and earnings that are not designated as hedging instruments in accordance with FASB Accounting Standards Codification (ASC) Topic 815, changes in the estimated fair value of these derivatives are recorded within General and administrative expenses and Interest and other investment income (expense), net in our condensed consolidated statements of operations, depending on the nature of the underlying transactions.

At March 31, 2015 there were no outstanding foreign currency forward contracts not designated as hedges. At December 31, 2014, there was one outstanding foreign currency forward contract not designated as a hedge; the notional amount of that foreign currency forward contract was \$11 million and the fair value was not material. For the three months ended March 31, 2015 and 2014, pre-tax net losses related to these forward contracts were not material.

Foreign Currency Forward Contracts Designated as Hedges

For foreign currency forward contracts entered into to hedge forecasted intercompany cash flows that are subject to foreign currency risk and which we designated as cash flow hedges in accordance with ASC Topic 815, we assess the effectiveness of these cash flow hedges at inception and on an ongoing basis to determine if the hedges are effective at providing offsetting changes in cash flows of the hedged items. We record the effective portion of changes in the estimated fair value of these derivatives in Accumulated other comprehensive income (loss) and subsequently reclassify the related amount of accumulated other comprehensive income (loss) to earnings within General and administrative expense when the hedged item impacts earnings. We measure hedge ineffectiveness, if any, and if it is determined that a derivative has ceased to be a highly effective hedge, we will discontinue hedge accounting for the derivative.

The gross notional amount of all outstanding foreign currency forward contracts designated as cash flow hedges was approximately \$213 million at March 31, 2015. During the three months ended March 31, 2015, there was no ineffectiveness relating to these hedges. The net unrealized gains of approximately \$14 million related to these contracts at March 31, 2015 are expected to be reclassified into earnings within the next twelve months. We did not have any outstanding foreign currency forward contracts designated as cash flow hedges at December 31, 2014, or for the three months ended March 31, 2014.

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 three months ended March 31, 2015 and 2014, there were no impairment charges related to assets that are measured on a non-recurring basis.

6. Debt

The proceeds from the credit facilities and the unsecured senior notes, as described below, were used to fund the Purchase Transaction disclosed in Note 1 of the Notes to Condensed Consolidated Financial Statements.

Credit Facilities

On October 11, 2013, in connection and simultaneously with the Purchase Transaction, we entered into a credit agreement (the "Credit Agreement") for a \$2.5 billion secured term loan facility maturing in October 2020 (the "Term Loan"), and a \$250 million secured revolving credit facility maturing in October 2018 (the "Revolver" and, together with the Term Loan, the "Credit Facilities"). A portion of the Revolver can be used to issue letters of credit of up to \$50 million, subject to the availability of the Revolver. To date, we have not drawn on the Revolver and there are no letters of credit issued and outstanding as of March 31, 2015 and December 31, 2014.

Borrowings under the Term Loan and the Revolver bear interest, payable on a quarterly basis, at an annual rate equal to an applicable margin plus, at our option, (A) a base rate determined by reference to the highest of (a) the interest rate in effect determined by the administrative agent as its prime rate, (b) the federal funds rate plus 0.5%, and (c) the London InterBank Offered Rate ("LIBOR") rate for an interest period of one month plus 1.00%, or (B) LIBOR. LIBOR borrowings under the Term Loan will be subject to a LIBOR floor of 0.75%. At March 31, 2015, the Credit Facilities bore interest at 3.25%. In certain circumstances, our applicable interest rate under the Credit Facilities will increase.

In addition to paying interest on outstanding principal balances under the Credit Facilities, we are required to pay the lenders a commitment fee on unused commitments under the Revolver. Commitment fees are recorded within Interest and other investment income (expense), net on the condensed consolidated statement of operations. We are also required to pay customary letter of credit fees, if any, and agency fees.

Table of Contents

The terms of the Credit Agreement required quarterly principal repayments of 0.25% of the Term Loan's original principal amount, with the balance due on the maturity date. On February 11, 2014, we made a voluntary repayment of \$375 million on our Term Loan. This repayment satisfied the required quarterly principal repayments for the entire term of the Credit Agreement. On February 11, 2015, we made an additional voluntary repayment of \$250 million on our Term Loan.

The Credit Facilities are guaranteed by certain of the Company's U.S. subsidiaries, whose assets represent approximately 70% of our consolidated assets. The Credit Agreement contains customary covenants that place restrictions in certain circumstances on, among other things, the incurrence of debt, granting of liens, payment of dividends, sales of assets and mergers and acquisitions. If our obligations under the Revolver exceed 15% of the total facility amount as of the end of any fiscal quarter (subject to certain exclusions for letters of credit), we are also subject to certain financial covenants. A violation of any of these covenants could result in an event of default under the Credit Agreement. Upon the occurrence of such event of default or certain other customary events of default, payment of any outstanding amounts under the Credit Agreement may be accelerated, and the lenders' commitments to extend credit under the Credit Agreement may be terminated. In addition, an event of default under the Credit Agreement could, under certain circumstances, permit the holders of other outstanding unsecured debt, including the debt holders described below, to accelerate the repayment of such obligations. The Company was in compliance with the terms of the Credit Facilities as of March 31, 2015.

Unsecured Senior Notes

On September 19, 2013, we issued, at par, \$1.5 billion of 5.625% unsecured senior notes due September 2021 (the 2021 Notes) and \$750 million of 6.125% unsecured senior notes due September 2023 (the 2023 Notes) and, together with the 2021 Notes, the Notes) in a private offering to qualified institutional buyers made in accordance with Rule 144A under the Securities Act of 1933, as amended.

The Notes are general senior obligations of the Company and rank *pari passu* in right of payment to all of the Company's existing and future senior indebtedness, including the Credit Facilities described above. The Notes are guaranteed on a senior basis by certain of our U.S. subsidiaries. The Notes and related guarantees are not secured and are effectively subordinated to any of the Company's existing and future indebtedness that is secured, including the Credit Facilities. The Notes contain customary covenants that place restrictions in certain circumstances on, among other things, the incurrence of debt, granting of liens, payment of dividends, sales of assets and mergers and acquisitions. The Company was in compliance with the terms of the Notes as of March 31, 2015.

Interest on the Notes is payable semi-annually in arrears on March 15 and September 15 of each year. As of March 31, 2015 and December 31, 2014, we had interest payable of \$5 million and \$38 million, respectively, related to the Notes, recorded within Accrued expenses and other liabilities in our condensed consolidated balance sheet.

We may redeem the 2021 Notes on or after September 15, 2016 and the 2023 Notes on or after September 15, 2018, in whole or in part on any one or more occasions, at specified redemption prices, plus accrued and unpaid interest. At any time prior to September 15, 2016, with respect to the 2021 Notes, and at any time prior to September 15, 2018, with respect to the 2023 Notes, we may also redeem some or all of the Notes by paying a make-whole premium, plus accrued and unpaid interest. Upon the occurrence of one or more qualified equity offerings, we may also redeem up to 35% of the aggregate principal amount of each of the 2021 Notes and 2023 Notes outstanding with the net cash proceeds from such offerings. The Notes are repayable, in whole or in part and at the option of the holders, upon the occurrence of a change in control and a ratings downgrade, at a purchase price equal to 101% of principal, plus accrued and unpaid interest. These redemption options are considered clearly and closely related to the Notes and are not accounted for separately upon issuance.

Fees associated with the closing of the Term Loan and the Notes are recorded as debt discount, which reduce the carrying value of the Term Loan and the Notes. The debt discount is amortized over the respective terms of the Term Loan and the Notes. Amortization expense related to the debt discount is recorded within Interest and other investment income (expense), net in our condensed consolidated statement of operations.

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

Table of Contents

A summary of our debt is as follows (amounts in millions):

	Gross Carrying Amount	March 31, 2015 Unamortized Discount	Net Carrying Amount
Term Loan	\$ 1,869	\$ (10)	\$ 1,859
2021 Notes	1,500	(22)	1,478
2023 Notes	750	(12)	738
Total long-term debt	\$ 4,119	\$ (44)	\$ 4,075

	Gross Carrying Amount	December 31, 2014 Unamortized Discount	Net Carrying Amount
Term Loan	\$ 2,119	\$ (10)	\$ 2,109
2021 Notes	1,500	(23)	1,477
2023 Notes	750	(12)	738
Total long-term debt	\$ 4,369	\$ (45)	\$ 4,324

For the three months ended March 31, 2015 and March 31, 2014, interest expense was \$49 million and \$51 million, respectively, amortization of the debt discount for the Credit Facilities and Notes was \$1 million and \$2 million, respectively, and commitment fees for the Revolver were not material.

As of March 31, 2015, the scheduled maturities and contractual principal repayments of our debt for each of the five succeeding years are as follows (amounts in millions):

For the year ending December 31,	
2015 (remaining nine months)	\$
2016	
2017	
2018	
2019	
Thereafter	4,119
Total	\$ 4,119

As of March 31, 2015 and December 31, 2014, the carrying value of the Term Loan approximates the fair value, based on Level 2 inputs (observable market prices in less than active markets), as the interest rate is variable over the selected interest period and is similar to current rates at which we can borrow funds. Based on Level 2 inputs, the fair values of the 2021 Notes and 2023 Notes were \$1,599 million and \$819 million, respectively, as of March 31, 2015 and \$1,586 million and \$810 million, respectively, as of December 31, 2014.

Deferred Financing Costs

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

Costs incurred to obtain our long-term debt are recorded as deferred financing costs within Other assets non-current in our condensed consolidated balance sheets and are amortized over the terms of the respective debt agreements using a straight-line basis for costs related to the Revolver and the interest earned method for costs related to the Term Loan and Notes. Amortization expense related to the deferred financing costs is recorded within Interest and other investment income (expense), net in our condensed consolidated statements of operations. For the three months ended March 31, 2015 and 2014, this amount was not material.

[Table of Contents](#)

7. Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) at March 31, 2015 and 2014, were as follows (amounts in millions):

	Foreign currency translation adjustments	For the Three Months Ended March 31, 2015 Unrealized gain on available-for- sale securities	Unrealized gain on forward contracts	Total
Balance at December 31, 2014	\$ (304)	\$ 1	\$	\$ (303)
Other comprehensive income (loss) before reclassifications	(330)		14	(316)
Balance at March 31, 2015	\$ (634)	\$ 1	\$ 14	\$ (619)

	Foreign currency translation adjustments	For the Three Months Ended March 31, 2014 Unrealized gain on available-for- sale securities	Unrealized gain on forward contracts	Total
Balance at December 31, 2013	\$ 67	\$ 1	\$	\$ 68
Other comprehensive income (loss) before reclassifications	(5)			(5)
Balance at March 31, 2014	\$ 62	\$ 1	\$	\$ 63

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

8. Operating Segments and Geographic Region

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 we assess operating performance and allocate resources, and the availability of separate financial information. Currently, we conduct our business through three operating segments: Activision, Blizzard and Distribution (see Note 1 of the Notes to Condensed Consolidated Financial Statements). We do not aggregate operating segments.

Table of Contents

The CODM reviews segment performance exclusive of the impact of the change in deferred revenues and related cost of sales with respect to certain of our online-enabled games, stock-based compensation expense, amortization of intangible assets as a result of purchase price accounting, and fees and other expenses (including legal fees, costs, expenses and accruals) related to the Purchase Transaction and related debt financings. The CODM does not review any information regarding total assets on an operating segment basis, and accordingly, no disclosure is made with respect thereto. Information on the operating segments and reconciliations of total net revenues and total segment operating income to consolidated net revenues from external customers and consolidated income before income tax expense for the three months ended March 31, 2015 and 2014 are presented below (amounts in millions):

	2015		Three Months Ended March 31, 2014		2015 Income (loss) from operations before income tax expense		2014	
	Net revenues							
Activision	\$	303	\$	237	\$	66	\$	2
Blizzard		352		462		139		239
Distribution		48		73		(1)		(1)
Operating segments total		703		772		204		240
Reconciliation to consolidated net revenues / consolidated income before income tax expense:								
Net effect from deferral of net revenues and related cost of sales		575		339		362		219
Stock-based compensation expense						(23)		(30)
Amortization of intangible assets						(1)		(2)
Consolidated net revenues / operating income	\$	1,278	\$	1,111	\$	542	\$	427
Interest and other expense, net						50		51
Consolidated income before income tax expense					\$	492	\$	376

Geographic information presented below for the three months ended March 31, 2015 and 2014 is based on the location of the selling entity. Net revenues from external customers by geographic region were as follows (amounts in millions):

	Three months ended March 31,	
	2015	2014
Net revenues by geographic region:		
North America	\$ 704	\$ 563
Europe	464	462
Asia Pacific	110	86
Total consolidated net revenues	\$ 1,278	\$ 1,111

The Company's net revenues in the U.S. were 53%, and 48% of consolidated net revenues for the three months ended March 31, 2015 and 2014, respectively. The Company's net revenues in the U.K. were 12% and 15% of consolidated net revenues for the three months ended March 31, 2015 and 2014, respectively. The Company's net revenues in France were 8% and 13% of consolidated net revenues for the three months ended March 31, 2015 and 2014, respectively. No other country's net revenues exceeded 10% of consolidated net revenues.

Table of Contents

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

	Three Months Ended March 31,	
	2015	2014
Net revenues by platform:		
Console	\$ 758	\$ 654
Online (1)	272	201
PC	114	100
Mobile and other(2)	86	83
Total Activision Blizzard net revenues	1,230	1,038
Distribution	48	73
Total consolidated net revenues	\$ 1,278	\$ 1,111

(1) Revenues from online consist of revenues from all *World of Warcraft* products, including subscriptions, boxed products, expansion packs, licensing royalties, and value-added services.

(2) Revenues from mobile and other include revenues from handheld, mobile and tablet devices, as well as non-platform specific game related revenues such as standalone sales of toys and accessories products from the Skylanders franchise and other physical merchandise and accessories.

Long-lived assets by geographic region at March 31, 2015 and December 31, 2014 were as follows (amounts in millions):

	At March 31,	At December 31,
	2015	2014
Long-lived assets* by geographic region:		
North America	\$ 129	\$ 122
Europe	24	29
Asia Pacific	5	6
Total long-lived assets by geographic region	\$ 158	\$ 157

*The only long-lived assets that we classify by region are our long-term tangible fixed assets, which only include property, plant and equipment assets; all other long-term assets are not allocated by location.

We did not have any single external customers that accounted for 10% or more of consolidated net revenues for the three months ended March 31, 2015 and 2014.

9. Income Taxes

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

The Company accounts for its provision for income taxes in accordance with ASC 740, *Income Taxes*, which requires an estimate of the annual effective tax rate for the full year to be applied to the interim period, taking into account year-to-date amounts and projected results for the full year. The provision for income taxes represents federal, foreign, state and local income taxes. Our effective tax rate differs from the statutory U.S. income tax rate due to the effect of state and local income taxes, tax rates in foreign jurisdictions and certain nondeductible expenses. Our effective tax rate could fluctuate significantly from quarter to quarter based on recurring and nonrecurring factors including, but not limited to: variations in the estimated and actual level of pre-tax income or loss by jurisdiction; changes in the mix of income by tax jurisdiction (as taxes are levied at relatively lower statutory rates in foreign regions and relatively higher statutory rates in the U.S.); changes in enacted tax laws and regulations, rulings and interpretations thereof, including with respect to tax credits, state and local income taxes; developments in tax audits and other matters; and certain nondeductible expenses. Changes in judgment from the evaluation of new information resulting in the recognition, derecognition or remeasurement of a tax position taken in a prior annual period are recognized separately in the quarter of the change.

The income tax expense of \$98 million for the three months ended March 31, 2015 reflects an effective tax rate of 19.9%, which is lower than the effective tax rate of 22.1% for the three months ended March 31, 2014. This decrease is primarily due to an increase in the amount of foreign earnings, which are taxed at relatively lower statutory rates, as compared to domestic earnings, which are taxed at relatively higher statutory rates, in the estimated effective annual tax rate.

Table of Contents

The effective tax rate of 19.9% for the three months ended March 31, 2015 differed from the U.S. statutory rate of 35.0%, primarily due to the tax benefit from foreign earnings taxed at relatively lower statutory rates, recognition of California research and development credits, and the federal domestic production deductions, offset by increases to the Company's reserve for uncertain tax positions.

The overall effective income tax rate for the year could be different from the effective tax rate for the three months ended March 31, 2015 and will be dependent, in part, on our profitability for the remainder of the year, as well as the other factors described above.

The Internal Revenue Service (IRS) is currently examining Activision Blizzard's federal tax returns for the 2008 through 2011 tax years. Additionally, the IRS is currently reviewing our application for an advanced pricing agreement (APA) with respect to the transfer pricing methodology that would be used by the Company for tax years 2010 through 2024. If ongoing discussions with the IRS result in an APA, this could result in a different allocation of profits and losses under the Company's transfer pricing agreements. Such allocation could have a positive or negative impact on our provision for uncertain tax positions for the period in which such an agreement is reached and the relevant periods thereafter.

In addition, Vivendi Games' tax return for the 2008 tax year is under examination by the Internal Revenue Service and several state taxing authorities. While Vivendi Games' results for the period January 1, 2008 through July 9, 2008 are included in the consolidated federal and certain foreign, state and local income tax returns filed by Vivendi or its affiliates, Vivendi Games' results for the period July 10, 2008 through December 31, 2008 are included in the consolidated federal and certain foreign, state and local income tax returns filed by Activision Blizzard. Additionally, the Company has several state and non-U.S. audits pending. Although the final resolution of the Company's global tax disputes is uncertain, based on current information, in the opinion of the Company's management, the ultimate resolution of these matters are not expected to have a material adverse effect on the Company's consolidated financial position, liquidity or results of operations. However, an unfavorable resolution of the Company's global tax disputes could have a material adverse effect on our business and results of operations in the period in which the matters are ultimately resolved.

In connection with the Purchase Transaction, we assumed certain tax attributes of New VH, generally consisting of New VH's net operating loss (NOL) carryforwards of approximately \$760 million, which represent a potential future tax benefit of approximately \$266 million. The utilization of such NOL carryforwards will be subject to certain annual limitations and will begin to expire in 2021. The Company also obtained indemnification from Vivendi against losses attributable to the disallowance of claimed utilization of such NOL carryforwards of up to \$200 million in unrealized tax benefits in the aggregate, limited to taxable years ending on or prior to December 31, 2016. No benefit for these tax attributes or indemnification was recorded upon the close of the Purchase Transaction, as the benefit from these tax attributes did not meet the more-likely-than-not standard. For the three months ended March 31, 2015, we utilized \$152 million of the NOL, which resulted in a tax benefit of \$53 million, and a corresponding reserve was established as the position did not meet the more-likely-than-not standard. As of March 31, 2015, an indemnification asset of \$121 million has been recorded in Other Assets, and, correspondingly, the same amount has been recorded as a reduction to the consideration paid for the shares repurchased in Treasury Stock (see Note 1 of the Notes to Condensed Consolidated Financial Statements for details about the share repurchase).

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):

	For the Three Months Ended March 31,	
	2015	2014
Numerator:		
Consolidated net income	\$ 394	\$ 293
Less: Distributed earnings to unvested stock-based awards that participate in earnings	(4)	(5)
Less: Undistributed earnings allocated to unvested stock-based awards that participate in earnings	(3)	(3)
Numerator for basic and diluted earnings per common share income available to common shareholders	\$ 387	\$ 285
Denominator:		
Denominator for basic earnings per common share - weighted-average common shares outstanding	723	709
Effect of potential dilutive common shares under the treasury stock method:	8	11
Denominator for diluted earnings per common share - weighted-average common shares outstanding plus dilutive common shares under the treasury stock method	731	720
Basic earnings per common share	\$ 0.54	\$ 0.40
Diluted earnings per common share	\$ 0.53	\$ 0.40

Certain of our unvested restricted stock rights (including certain restricted stock units, restricted stock awards, and performance shares) met the definition of participating securities based on their rights to dividends or dividend equivalents. Therefore, we are required to use the two-class method in our computation of basic and diluted earnings per common share. For the three months ended March 31, 2015 and 2014, on a weighted-average basis, we had outstanding unvested restricted stock rights with respect to 10 million and 17 million shares of common stock, respectively, that are participating in earnings.

Certain of our employee-related restricted stock rights are contingently issuable upon the satisfaction of pre-defined performance measures. These shares are included in the weighted-average dilutive common shares only if the performance measures are met as of the end of the reporting period. Approximately 4 million and 3 million shares are not included in the computation of diluted earnings per share for the three months ended March 31, 2015 and 2014, respectively, as their respective performance measures had not yet been met.

Potential common shares are not included in the denominator of the diluted earnings per common share calculation when the inclusion of such shares would be anti-dilutive, such as in a period in which a net loss is recorded. Therefore, options to acquire 6 million and 3 million shares of common stock were not included in the calculation of diluted earnings per common share for the three months ended March 31, 2015 and 2014, respectively, as the effect of their inclusion would be anti-dilutive.

11. Capital Transactions

Repurchase Programs

On February 3, 2015, our Board of Directors authorized a stock repurchase program under which we may repurchase up to \$750 million of our common stock during the two-year period from February 9, 2015 through February 8, 2017. As of March 31, 2015, we have not repurchased any shares under this program.

Table of Contents

Dividend

On February 3, 2015, our Board of Directors declared a cash dividend of \$0.23 per common share, payable on May 13, 2015, to shareholders of record at the close of business on March 30, 2015. As such, we have included \$170 million of dividends payable in Accrued expense and other liabilities and Other liabilities on our condensed consolidated balance sheet as of March 31, 2015.

On February 6, 2014, our Board of Directors declared a cash dividend of \$0.20 per common share, payable on May 14, 2014, to shareholders of record at the close of business on March 19, 2014. On May 14, 2014, we made an aggregate cash dividend payment of \$143 million to such shareholders, and on May 30, 2014, we made related dividend equivalent payments of \$4 million to holders of restricted stock rights.

12. Commitments and Contingencies

Legal Proceedings

We are subject to various legal proceedings and claims. SEC regulations govern disclosure of legal proceedings in periodic reports and ASC Topic 450 governs the disclosure of loss contingencies and accrual of loss contingencies in respect of litigation and other claims. We record an accrual for a potential loss when it is probable that a loss will occur and the amount of the loss can be reasonably estimated. When the reasonable estimate of the potential loss is within a range of amounts, the minimum of the range of potential loss is accrued, unless a higher amount within the range is a better estimate than any other amount within the range. Moreover, even if an accrual is not required, we provide additional disclosure related to litigation and other claims when it is reasonably possible (*i.e.*, more than remote) that the outcomes of such litigation and other claims include potential material adverse impacts on us.

The outcomes of legal proceedings and other claims are subject to significant uncertainties, many of which are outside of our control. There is significant judgment required in the analysis of these matters, including the probability determination and whether a potential exposure can be reasonably estimated. In making these determinations, we, in consultation with outside counsel, examine the relevant facts and circumstances on a quarterly basis assuming, as applicable, a combination of settlement and litigated outcomes and strategies. Moreover, legal matters are inherently unpredictable and the timing of development of factors on which reasonable judgments and estimates can be based can be slow. As such, there can be no assurance that the final outcome of any legal matter will not materially and adversely affect our business, financial condition, results of operations, profitability, cash flows or liquidity.

Purchase Transaction Matters

On August 1, 2013, a purported shareholder of the Company filed a shareholder derivative action in the Superior Court of the State of California, County of Los Angeles, captioned *Miller v. Kotick, et al.*, No. BC517086. The complaint names our Board of Directors and Vivendi as defendants, and the Company as a nominal defendant. The complaint alleges that our Board of Directors committed breaches of fiduciary duties, waste of corporate assets and unjust enrichment in connection with Vivendi's sale of its stake in the Company and that Vivendi also breached its

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

fiduciary duties. The plaintiff further alleges that demand by it on our Board of Directors to institute action would be futile because a majority of our Board of Directors is not independent and a majority of the individual defendants face a substantial likelihood of liability for approving the transactions contemplated by the Stock Purchase Agreement. The complaint seeks, among other things, damages sustained by the Company, rescission of the transactions contemplated by the Stock Purchase Agreement, an order restricting our Chief Executive Officer and our Chairman from purchasing additional shares of our common stock and an order directing us to take necessary actions to improve and reform our corporate governance and internal procedures to comply with applicable law, including ordering a shareholder vote on certain amendments to our by-laws or charter that would require half of our Board of Directors to be independent of Messrs. Kotick and Kelly and Vivendi and a proposal to appoint a new independent Chairman of the Board of Directors. On January 28, 2014, the parties filed a stipulation and proposed order temporarily staying the California action. On February 6, 2014, the court entered the order granting a stay of the California action.

In addition, on August 14, 2013, we received a letter dated August 9, 2013, from a shareholder seeking, pursuant to Section 220 of the Delaware General Corporation Law, to inspect the books and records of the Company to ascertain whether the Purchase Transaction and Private Sale were in the best interests of the Company. In response to that request, we provided the stockholder with certain materials under a confidentiality agreement. On September 11, 2013, a complaint was filed under seal by the same stockholder in the Court of Chancery of the State of Delaware in an action captioned *Pacchia v. Kotick et al.*, C.A. No. 8884-VCL. A public version of that complaint was filed on September 16, 2013. The allegations in the complaint were substantially similar to the allegations in the above referenced matter filed on August 1, 2013. On October 25, 2013, Pacchia filed an amended complaint under seal. The amended complaint added claims on behalf of an alleged class of Activision stockholders other than the Company's Chief Executive Officer and Chairman, Vivendi, ASAC, investors in ASAC and other stockholders affiliated with the investors of ASAC. The added class claims are against the Company's Chief Executive Officer and Chairman, the Vivendi affiliated directors, the members of the special committee of the Board of Directors formed in connection with the Company's consideration of the transactions with Vivendi and ASAC, and Vivendi for breach of fiduciary duty, as well as aiding and abetting a

Table of Contents

breach of fiduciary duty against ASAC. The amended complaint removed the derivative claims for waste of corporate assets and disgorgement but continued to allege derivative claims for breach of fiduciary duties. The amended complaint seeks, among other things, certification of a class, damages, reformation of the Private Sale, and disgorgement of any alleged profits received by the Company's Chief Executive Officer, Chairman and ASAC. On October 29, 2013, Pacchia filed a motion to consolidate the *Pacchia* case with the *Hayes* case described below. On November 2, 2013, the Court of Chancery consolidated the *Pacchia* and *Hayes* cases and ordered the plaintiffs to file supplemental papers related to determining lead plaintiff and lead counsel no later than November 8, 2013. On December 3, 2013, the court selected Pacchia as lead plaintiff. Pacchia filed a second amended complaint on December 11, 2013, and Activision filed an answer on January 31, 2014. Also on January 31, 2014, the special committee, ASAC, Messrs. Kotick and Kelly, Vivendi and the Vivendi-affiliated directors each filed motions to dismiss certain claims in the second amended complaint. On February 21, 2014, Pacchia filed a third amended complaint under seal. In response to Pacchia's filing of a third amended complaint, the special committee, ASAC, Messrs. Kotick and Kelly, Vivendi and the Vivendi-affiliated directors each filed motions to dismiss certain claims in the third amended complaint. On June 6, 2014, the Court of Chancery denied the defendants' motions to dismiss such claims, with the exception of a breach of contract claim. Subsequently, Pacchia filed a fourth amended complaint containing substantially all of his prior claims, but with the addition of new allegations gleaned from discovery in the matter. ASAC filed a motion to dismiss the re-pleaded breach of contract claim and the other defendants filed answers in response to the fourth amended complaint.

On September 11, 2013, another stockholder of the Company filed a putative class action and stockholder derivative action in the Court of Chancery of the State of Delaware, captioned *Hayes v. Activision Blizzard, Inc., et al.*, No. 8885-VCL. The complaint names our Board of Directors, Vivendi, New VH, the ASAC Entities, Davis Selected Advisers, L.P. ("Davis") and Fidelity Management & Research Co. ("FMR") as defendants, and the Company as a nominal defendant. The complaint alleges that the defendants violated certain provisions of our Amended and Restated Certificate of Incorporation by failing to submit the matters contemplated by the Stock Purchase Agreement for approval by a majority of our stockholders (other than Vivendi and its controlled affiliates); that our Board of Directors committed breaches of their fiduciary duties in approving the Stock Purchase Agreement; that Vivendi violated fiduciary duties owed to other stockholders of the Company in entering into the Stock Purchase Agreement; that our Chief Executive Officer and our Chairman usurped a corporate opportunity from the Company; that our Board of Directors and Vivendi have engaged in actions to entrench our Board of Directors and officers in their offices; that the ASAC Entities, Davis and FMR aided and abetted breaches of fiduciary duties by the Board of Directors and Vivendi; and that our Chief Executive Officer and our Chairman, the ASAC Entities, Davis and FMR will be unjustly enriched through the Private Sale. The complaint seeks, among other things, the rescission of the Private Sale; an order requiring the transfer to the Company of all or part of the shares that are the subject of the Private Sale; an order implementing measures to eliminate or mitigate the alleged entrenching effects of the Private Sale; an order requiring our Chief Executive Officer and our Chairman, the ASAC Entities, Davis and FMR to disgorge to the Company the amounts by which they have allegedly been unjustly enriched; and alleged damages sustained by the class and the Company. In addition, the stockholder sought a temporary restraining order preventing the defendants from consummating the transactions contemplated by the Stock Purchase Agreement without stockholder approval. Following a hearing on the motion for a temporary restraining order, on September 18, 2013, the Court of Chancery issued a preliminary injunction order, enjoining the consummation of the transactions contemplated by the Stock Purchase Agreement pending (a) the issuance of a final decision after a trial on the merits; (b) receipt of a favorable Activision Blizzard stockholder vote on the transactions contemplated by the Stock Purchase Agreement under Section 9.1(b) of our Amended and Restated Certificate of Incorporation or (c) modification of such preliminary injunction order by the Court of Chancery or the Delaware Supreme Court. On September 20, 2013, the Court of Chancery certified its order issuing the preliminary injunction for interlocutory appeal to the Delaware Supreme Court. The defendants moved the Delaware Supreme Court to accept and hear the appeal on an expedited basis. On September 23, 2013, the Delaware Supreme Court accepted the appeal of the Court of Chancery's decision and granted the defendant's motion to hear the appeal on an expedited basis.

Following a hearing on October 10, 2013, the Delaware Supreme Court reversed the Court of Chancery's order issuing a preliminary injunction, and determined that the Stock Purchase Agreement was not a merger, business combination or similar transaction that would require a vote of Activision's unaffiliated stockholders under the charter.

On October 29, 2013, an amended complaint was filed. It added factual allegations but no new claims or relief. Also on October 29, 2013, Hayes filed a motion to consolidate the *Hayes* case with the *Pacchia* case. As noted above, on November 2, 2013, the Court of Chancery consolidated the *Pacchia* and *Hayes* cases and ordered the plaintiffs to file supplemental papers related to determining lead plaintiff and lead counsel no later than November 8, 2013. See the discussion above related to the *Pacchia* matter (now the consolidated matter) for any further updates to the

status of the litigation.

Further, on September 18, 2013, the Company received a letter from another purported stockholder of the Company, Milton Pfeiffer, seeking, pursuant to Section 220 of the Delaware General Corporation Law, to inspect the books and records of the Company to investigate potential wrongdoing or mismanagement in connection with the approval of the Stock Purchase Agreement. On November 11, 2013, Pfeiffer filed a lawsuit in the Court of Chancery of the State of Delaware pursuant to Delaware Section 220 containing claims similar to *Hayes*, *Pacchia* and *Miller*. The Company answered on November 27, 2013. On January 21, 2014, the Court of Chancery entered the parties' stipulation and order of dismissal.

Table of Contents

On December 17, 2013, the Company received a letter from Mark Benston requesting certain books and records of the Company pursuant to Section 220 of the Delaware General Corporation Law. Benston is represented by the same law firm as Pfeiffer. On January 2, 2014, Benston filed a lawsuit in the Court of Chancery of the State of Delaware pursuant to Delaware Section 220 containing claims similar to *Hayes, Pacchia, Pfeiffer and Miller*. The Company answered on January 17, 2014. On February 14, 2014, the Court of Chancery entered the parties' stipulation and order of dismissal.

On March 14, 2014, Benston filed a putative class action and derivative complaint in the Court of Chancery, captioned *Benston v. Vivendi S.A. et al.*, No. 9447-VCL. The complaint makes claims similar to *Hayes, Pacchia, Pfeiffer and Miller*, but also adds J.P. Morgan Chase & Co. and J.P. Morgan Securities LLC as defendants and a so-called *Brophy* claim for insider trading against certain of the defendants. Benston and his attorneys petitioned the Court of Chancery to appoint them as co-lead plaintiff and co-lead counsel, respectively, for purposes of pursuing the *Brophy* claim as part of the consolidated *Pacchia* litigation. On June 6, 2014, the Court of Chancery denied Benston's motion for a leadership role in the consolidated *Pacchia* litigation. As a result, Pacchia continues to serve as the lead plaintiff in the consolidated cases.

Certain of defendants filed a motion to dismiss the breach of contract claim set forth in the Fourth Amended Complaint. Pacchia obtained leave to file a Fifth Amended Complaint, which adds additional color to his allegations of wrongdoing based on information learned in discovery, including with respect to the appointment and subsequent election of several of the directors to our Board of Directors. For the most part, fact and expert discovery was completed in the *Pacchia* matter, including the exchange of expert damage and other reports. Pacchia's expert's reports allege damages to the Company in excess of \$540 million and to the purported class in excess of \$640 million, in addition to disgorgement claims, which could, in theory, exceed \$1 billion. Defendants' experts' reports maintain there are no damages to the Company or to the purported class because the Purchase Transaction and the Private Sale were the best transactions available to the parties and the alternate transactions hypothesized by the plaintiff were inferior.

For the quarter ended September 30, 2014, we accrued a loss contingency in our consolidated financial statements in connection with this matter. The accrual related to potential liabilities associated with legal fees, costs and expenses for services already received prior to the quarter's end, where such fees, costs and expenses had not yet been paid at the quarter's end, and the Company's potential contribution toward the potential settlement of the matter. Although the Company has D&O insurance in connection with the consolidated litigation in a total amount up to \$200 million, various insurers have raised arguments that they believe give them the right to deny coverage for a portion of these fees, costs and expenses, as well as for all or a portion of the ultimate liability which may occur in settlement or at trial. Under our Amended and Restated Certificate of Incorporation and certain agreements with members of our Board of Directors, the Company has indemnification obligations to the director defendants to advance fees, costs and expenses and to pay liabilities which arise in connection with their service to the Company, in each case, to the maximum extent permitted by Delaware law. In light of these indemnification obligations and the positions taken by the parties and the various insurers, we determined that a liability was probable and estimable, and accordingly, an accrual was required, as of the quarter ended September 30, 2014.

On November 19, 2014, the Company announced that an agreement had been reached to settle the Pacchia matter. The Company believes the settlement agreement, which acknowledges no wrongdoing on the part of any party, is in the best interest of the Company and all of its shareholders. Pursuant to the settlement agreement, multiple insurance companies, along with various defendants, will pay \$275 million to a settlement fund (Settlement Fund). Payment of reasonable and customary fees and costs of plaintiff's attorney, likely not to exceed \$72.5 million, will be made from the Settlement Fund. The remaining balance of the Settlement Fund, likely to be at least \$202.5 million, will be paid to the Company and will be recorded within Shareholders' equity in our consolidated balance sheet. Other terms of the settlement agreement include the addition of two unaffiliated persons to the Company's Board of Directors, an adjustment of certain voting rights and a global release of claims against the defendants. On December 29, 2014, the Company filed a Current Report on Form 8-K, describing and attaching the Stipulation of Compromise and Settlement, which was filed with the Delaware Chancery Court with respect to the settlement of the Pacchia matter (the Stipulation). Pursuant to the Stipulation, the Company has notified the applicable shareholders of the settlement agreement. Applicable shareholders were provided an opportunity to object to the settlement, which is subject to approval by the Delaware Chancery Court.

Objections to the Stipulation have been filed by several shareholders. The plaintiff in the *Hayes* matter has objected to the settlement on the grounds that a portion of the \$275 million Settlement Fund should be reallocated to the members of the class, that the amount of any attorney's fee award should be reduced and that the court should deny any special award to the plaintiff in the *Pacchia* matter. In the absence of such a reallocation, Hayes argues the court should deny approval of the settlement and appoint Hayes and his counsel to lead the class-based claims. Hayes also contends the notice of settlement provided by the Company is inadequate. The Company disputes this allegation. The plaintiffs in the *Benston* and *Pfeiffer* matters have also filed applications to the court requesting that their counsel receive an attorney's fee award of \$7.25 million to be paid out of the attorneys' fees contemplated by the proposed Settlement. Certain defendants have also filed objections to the \$50,000 special award requested by the *Pacchia* plaintiff. The Delaware Court of Chancery held a hearing on March 4, 2015, to consider the approval of the Stipulation, and a decision by the court is expected on or before June 2, 2015.

Table of Contents

Since the Stipulation does not require the Company to pay any liability on behalf of its defendant directors, the Company reversed the accrual described above as of December 31, 2014. The reversal of the accrual was partially offset by a new accrual for liabilities associated with legal fees, costs and expenses for services already received prior to the year's end, where such fees, costs and expenses had not yet been paid at the year's end.

Due to the inherent uncertainties of litigation, including the possibility that the Delaware Chancery Court does not approve the Stipulation, other potential outcomes are reasonably possible, including outcomes which could include an increase in the Company's liability. The Company believes the possibility that this lawsuit will have a material impact on the Company's business, financial condition, results of operation or liquidity is remote. However, if this assessment is incorrect, then an unfavorable resolution of this lawsuit could have a material adverse effect on the Company's business, financial condition, results of operation or liquidity, particularly in the period in which any potential liabilities may be recognized.

We believe that the defendants have meritorious defenses. If the Delaware Chancery Court does not approve the Stipulation and the parties are not otherwise able to settle the matter subsequently, then we believe the defendants intend to defend the lawsuit and other related cases vigorously at trial. However, these lawsuits and any other lawsuits are subject to inherent uncertainties and the actual outcome and costs will depend upon many unknown factors. The outcome of litigation is necessarily uncertain, and the Company could be forced to expend significant resources in the defense of these lawsuits and the Company and the defendants may not prevail. The Company also may be subject to additional claims in connection with the Purchase Transaction and Private Sale. Monitoring and defending against legal actions is time consuming for our management and detracts from our ability to fully focus our internal resources on our business.

Other Matters

In addition, we are party to routine claims, suits, investigations, audits and other proceedings arising from the ordinary course of business, including with respect to intellectual property rights, contractual claims, labor and employment matters, regulatory matters, tax matters, unclaimed property matters, compliance matters, and collection matters. In the opinion of management, after consultation with legal counsel, such routine claims and lawsuits are not significant and we do not expect them to have a material adverse effect on our business, financial condition, results of operations, or liquidity.

13. Related Party Transactions

Transactions with Vivendi and Its Affiliates

As part of the Business Combination in 2008, we entered into various transactions and agreements, including cash management services agreements, a tax sharing agreement and an investor agreement, with Vivendi and its subsidiaries. In connection with the consummation of the Purchase Transaction, we terminated the cash management arrangements with Vivendi and amended our investor agreement with Vivendi. We are also party to a number of agreements with subsidiaries and other affiliates of Vivendi, including music licensing and distribution arrangements and promotional arrangements, none of which were impacted by the Purchase Transaction. None of these services, transactions and agreements with Vivendi and its affiliates were material, either individually or in the aggregate, to the consolidated financial statements as a whole. As discussed in Note 1 of the Notes to Condensed Consolidated Financial Statements, on May 28, 2014 Vivendi sold 41 million shares,

reducing its ownership interest below 10%, and is no longer considered a related party.

Transactions with ASAC's Affiliates

Pursuant to the Stock Purchase Agreement, the Company and each of Mr. Kotick, the Company's Chief Executive Officer, and Mr. Kelly, the Company's Chairman of the board of directors, entered into a waiver and acknowledgement letters (together, the "Waivers"), which provide, among other things, (i) that the Purchase Transaction, Private Sale, any public offerings by Vivendi and restructurings by Vivendi and its subsidiaries contemplated by the Stock Purchase Agreement and other transaction documents, shall not (or shall be deemed not to) constitute a "change in control" (or similar term) under their respective employment arrangements, including their employment agreements with the Company, the Company's 2008 Incentive Plan or any award agreements in respect of awards granted thereunder, or any Other Benefit Plans and Arrangements (as defined in the Waivers), (ii) (A) that the shares of our common stock acquired by ASAC and held or controlled by the ASAC Investors (as defined in the Waivers) in connection with the Transactions (as defined in the Waivers) will not be included in or count toward, (B) that the ASAC Investors will not be deemed to be a group for purposes of, and (C) any changes in the composition in the Board of Directors of the Company, in connection with or during the one-year period following the consummation of the Transactions will not contribute towards, a determination that a "change in control" or similar term has occurred with respect to Messrs. Kotick and Kelly's employment arrangements with the Company, and (iii) for the waiver by Messrs. Kotick and Kelly of their rights to change in control payments or benefits under their employment agreements with the Company, the Company's 2008 Incentive Plan or any award agreements in respect of awards granted thereunder, and any Other Benefit Plans and Arrangements (in each case, with respect to all current and future grants, awards, benefits or entitlements) in connection with or as a consequence of the Transactions.

Table of Contents

Also pursuant to the Stock Purchase Agreement, on October 11, 2013, we, ASAC and, for the limited purposes set forth therein, Messrs. Kotick and Kelly entered into the Stockholders Agreement. The Stockholders Agreement contains various agreements among the parties regarding voting rights, transfer rights, and a standstill agreement, among other things.

14. Recently issued accounting pronouncements

Revenue recognition

In May 2014, the FASB issued new accounting guidance related to revenue recognition. The new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue upon the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective beginning January 1, 2017 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. We are evaluating the adoption method as well as the impact of this new accounting guidance on our financial statements.

Stock-based compensation

In June 2014, the FASB issued new guidance related to stock compensation. The new standard requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which the requisite service has already been rendered. The new standard is effective for fiscal years beginning after December 15, 2015 and can be applied either prospectively or retrospectively to all awards outstanding as of the beginning of the earliest annual period presented as an adjustment to opening retained earnings. Early adoption is permitted. The adoption of this guidance will not have a material impact on the Company's consolidated financial statements.

Consolidations

In February 2015, the FASB issued new guidance related to consolidations. The new standard amends certain requirements for determining whether a variable interest entity must be consolidated. The new standard is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted. We are evaluating the impact, if any, of adopting this new accounting guidance on our financial statements.

Debt Issuance Costs

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

In April 2015, the FASB issued new guidance related to the presentation of debt issuance costs in financial statements. The new standard requires an entity to present such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs will continue to be reported as interest expense. It is effective for annual reporting periods beginning after December 15, 2015. The new guidance will be applied retrospectively to each prior period presented. The adoption of this guidance will not have a material impact on our financial statements.

Internal-Use Software

In April 2015, the FASB issued new guidance related to internal-use software. The new standard relates to a customer's accounting for fees paid in cloud computing arrangements. The amendment provides guidance for customers to determine whether such arrangements include software licenses. If a cloud arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new standard is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted. We are evaluating the impact, if any, of adopting this new accounting guidance on our 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 leading global developer and publisher of interactive entertainment. The terms "Activision Blizzard," "the Company," "we," "us," and "our" are used to refer collectively to Activision Blizzard, Inc. and its subsidiaries.

Operating Segments

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 global developer and publisher of interactive software products and content. Activision delivers content to a broad range of gamers, ranging from children to adults, and from core gamers to mass-market consumers to "value" buyers seeking budget-priced software, in a variety of geographies. Activision develops games based on internally-developed properties, including games in the Call of Duty® and Skylanders® franchises, and to a lesser extent, based on licensed intellectual properties. Additionally, we have established a long-term alliance with Bungie to publish its game universe, *Destiny*. Activision sells games through both retail and digital online channels. Activision currently offers games that operate on the Microsoft Corporation ("Microsoft") Xbox One ("Xbox One") and Xbox 360 ("Xbox 360"), Nintendo Co. Ltd. ("Nintendo") Wii U ("Wii U") and Wii ("Wii"), and Sony Computer Entertainment, Inc. ("Sony") PlayStation 4 ("PS4") and PlayStation 3 ("PS3") console systems (Xbox One, Wii U, and PS4 are collectively referred to as "next-generation"; Xbox 360, Wii, and PS3 are collectively referred to as "prior-generation"); the personal computer ("PC"); the Nintendo 3DS, Nintendo Dual Screen, and Sony PlayStation Vita handheld game systems; and mobile and tablet devices.

Table of Contents

Blizzard Entertainment, Inc.

Blizzard Entertainment, Inc. (*Blizzard*) is a leader in the subscription-based massively multi-player online role-playing game category in terms of both subscriber base and revenues generated through its World of Warcraft® franchise, which it develops, hosts and supports. Blizzard also develops, markets, and sells role-playing action and strategy games for the PC, console, mobile and tablet platforms, including games in the multiple-award winning Diablo®, StarCraft®, and Hearthstone®: Heroes of Warcraft franchises. In addition, Blizzard maintains a proprietary online game-related service, Battle.net®. Blizzard distributes its products and generates revenues worldwide through various means, including: subscriptions; sales of prepaid subscription cards; value-added services, such as in-game purchases and services; retail sales of physical boxed products; online download sales of PC products; purchases and downloads via third-party console, mobile and tablet platforms; and licensing of software to third-party or related-party companies that distribute World of Warcraft, Diablo and StarCraft products. In addition, Blizzard is the creator of *Heroes of the Storm* , a new free-to-play online hero brawler that is currently in closed beta testing.

Activision Blizzard Distribution

Our distribution segment (*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.

Business Highlights

For the three months ended March 31, 2015, Activision Blizzard had net revenues of \$1.3 billion, as compared to net revenues of \$1.1 billion for the same period in 2014. For the three months ended March 31, 2015, Activision Blizzard had earnings per diluted share of \$0.53, as compared to earnings per diluted share of \$0.40 for the same period in 2014.

On February 3, 2015, our Board of Directors declared a cash dividend of \$0.23 per common share, payable on May 13, 2015, to shareholders of record at the close of business on March 30, 2015. As such, we have included \$170 million of dividends payable in *Accrued expense and other liabilities* and *Other liabilities* on our condensed consolidated balance sheet as of March 31, 2015.

According to The NPD Group with respect to North America, GfK Chart-Track with respect to Europe, and Activision Blizzard internal estimates, including toys and accessories, during the first quarter of 2015:

- Activision had two of the top five videogame franchises in North America and Europe.
- *Skylanders Trap Team* was the #1 console title globally.

Activision Blizzard Recent and Upcoming Product Releases

We have recently released the following titles and games, among other titles:

- On January 11, 2015, Activision entered open beta for *Call of Duty Online*, a free-to-play game available in China.
- On January 13, 2015, Blizzard began closed beta for *Heroes of the Storm*, its upcoming free-to-play online team brawler featuring iconic heroes from Blizzard games.
- Activision released *Call of Duty: Advanced Warfare Havoc* (*Havoc*), the first downloadable content pack for *Call of Duty: Advanced Warfare* on the Xbox One and Xbox 360 on January 27, 2015 and on other platforms on February 26, 2015.
- Activision released *Call of Duty: Advanced Warfare Ascendance* (*Ascendance*), the second downloadable content pack for *Call of Duty: Advanced Warfare* on the Xbox One and Xbox 360 platforms on March 31, 2015. *Ascendance* is expected to be released on other platforms in the second quarter of 2015.
- On April 2, 2015, Blizzard released *Blackrock Mountain*TM, the latest addition to *Hearthstone: Heroes of Warcraft* content.
- On April 7, 2015, Blizzard launched the WoW Token System, which enables *World of Warcraft* players to exchange game-time Tokens, purchased at \$20, to other players for in-game gold, which provides players with a secure method for purchasing gold in-game.
- On April 23, 2015, Blizzard began open beta for the action role-playing game *Diablo III: Reaper of Souls* in China.

Table of Contents

Management's Overview of Business Trends

Console Platform Transition

In November 2013, Sony released the PS4 and Microsoft released the Xbox One, their respective next-generation game consoles and entertainment systems. According to The NPD Group and GfK Chart-Track in North America and Europe, as of March 31, 2015, the combined installed base of PS4 and Xbox One hardware was approximately 26 million units, as compared to the combined installed base of PS3 and Xbox 360 hardware of approximately 123 million units.

When new console platforms are announced or introduced into the market, consumers may reduce their purchases of game console software products for prior-generation console platforms in anticipation of new platforms becoming available. During these periods, sales of the game console software products we publish may slow or even decline until new platforms are introduced and achieve wide consumer acceptance. In prior cycles, as the next-generation installed base grew, software sales declines abated and software sales grew.

During platform transitions, we simultaneously incur costs to develop and market new titles for prior-generation video game platforms, which may not sell at premium prices, and to develop and market products for next-generation platforms, which may have a smaller installed base until the next-generation platforms achieve wide consumer acceptance. We continually monitor console hardware sales and manage our product delivery on each of the prior- and next-generation platforms in a manner we believe to be most effective to maximize our revenue opportunities and achieve the desired return on our investments in product development. In the long term, we expect the next-generation consoles to drive industry growth and expand our opportunities.

Digital Online Channel Revenues

We provide our products through both retail and digital distribution channels. Many of our video games that are available through retailers as physical boxed software products are also available digitally (from our websites and from websites and digital distribution channels owned by third parties). In addition, we offer players digital downloadable content as add-ons to our products (*e.g.*, new multi-player content packs), generally for a one-time fee. We also offer subscription-based services and other value-added services for *World of Warcraft* and microtransactions for *Hearthstone: Heroes of Warcraft*, all of which are digitally delivered and hosted by Battle.net. We have further plans to introduce games based on some of our most successful franchises which operate online on a free-to-play model with microtransactions, including Blizzard's *Heroes of the Storm* and Activision's *Call of Duty Online*, which both entered beta during the three months ended March 31, 2015.

We currently define sales via digital online channels as revenues from subscriptions, licensing royalties, value-added services, downloadable content, and digitally distributed products. This definition may differ from that used by our competitors or other companies.

According to Activision Blizzard internal estimates, overall market digital gaming revenues for the three months ended March 31, 2015 increased by approximately 19% as compared to the same period in 2014. The primary drivers of the increase in digital gaming revenues were

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

increases in consumer purchases of full games via digital channels and an increase in mobile gaming revenues. Digital revenues are an important part of our business, and we continue to focus on and develop products, such as downloadable content, that can be delivered via digital online channels. The amount of our digital revenues in any period may fluctuate depending, in part, on the timing and nature of our specific product releases. Our sales of digital downloadable content are driven in part by sales of, and engagement by players in, our retail products. As such, lower revenues in our retail distribution channels in the current year may impact our digital online channels revenues in the subsequent year.

For the three months ended March 31, 2015, revenues through digital online channels increased by \$202 million, as compared to the same period in 2014, and represented 45% of our total consolidated net revenues, as compared to 34% for the same period in 2014. On a non-GAAP basis (which excludes the impact of deferred revenues), revenues through digital online channels for the three months ended March 31, 2015 increased by \$11 million, as compared to the same period in 2014, and represented 76% of our total non-GAAP net revenues, as compared to 68% for the same period in 2014.

Table of Contents

Conditions in the Retail Distribution Channels

Conditions in the retail distribution channels of the interactive entertainment industry continued to be challenging during the first three months of 2015. In North America and Europe, retail sales of video games declined by 3%, as compared to the same period in 2014, according to The NPD Group and GfK Chart-Track. The continued shift of video game purchases to digital distribution channels has impacted the ongoing decline in retail console software sales.

Further, while the new console cycle has started strongly and demand for next-generation games was higher than expected, the demand for prior-generation games declined at a faster pace than the growth of sales for next-generation titles, resulting in the overall decline in sales in the retail distribution channels. According to The NPD Group and GfK Chart-Track, retail sales from prior-generation platform games declined by 51% for the three months ended March 31, 2015, as compared to the same period in 2014. However, the increase in digitally distributed games, including full-game downloads, add-on content, and free-to-play games, has partially offset the negative trends in the retail distribution channels.

Please refer to the reconciliation between GAAP and non-GAAP financial measures later in this document for further discussions of digital and retail online channels.

The Business Combination and Share Repurchase

Activision Blizzard is the result of the 2008 business combination (*Business Combination*) by and among the Company (then known as 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. As a result of the consummation of the Business Combination, Activision, Inc. was renamed Activision Blizzard, Inc. and Vivendi became a majority shareholder of Activision.

On October 11, 2013, we repurchased approximately 429 million shares of our common stock, pursuant to a stock purchase agreement (the *Stock Purchase Agreement*) we entered into with Vivendi and ASAC II LP (*ASAC*), an exempted limited partnership established under the laws of the Cayman Islands, acting by its general partner, ASAC II LLC (together with ASAC, the *ASAC Entities*). Pursuant to the terms of the Stock Purchase Agreement, we acquired all of the capital stock of Amber Holding Subsidiary Co., a Delaware corporation and wholly-owned subsidiary of Vivendi (*New VH*), which was the direct owner of approximately 429 million shares of our common stock, for a cash payment of \$5.83 billion, or \$13.60 per share, before taking into account the benefit to the Company of certain tax attributes of New VH assumed in the transaction (collectively, the *Purchase Transaction*). Immediately following the completion of the Purchase Transaction, ASAC purchased from Vivendi 172 million shares of our common stock, pursuant to the Stock Purchase Agreement, for a cash payment of \$2.34 billion, or \$13.60 per share (the *Private Sale*). Robert A. Kotick, our Chief Executive Officer, and Brian G. Kelly, Chairman of our Board of Directors, are affiliates of ASAC II LLC. Refer to Note 6 of the Notes to Condensed Consolidated Financial Statements for further information regarding the financing of the Purchase Transaction.

On May 28, 2014, Vivendi sold approximately 41 million shares, or approximately 50% of its then-current holdings, of our common stock in a registered public offering. Vivendi received proceeds of approximately \$850 million from that sale; we did not receive any proceeds.

As of March 31, 2015, we had approximately 726 million shares of common stock issued and outstanding. At that date: (i) Vivendi held 41 million shares, or approximately 6% of the outstanding shares of our common stock; (ii) ASAC held 172 million shares, or approximately 24% of the outstanding shares of our common stock; and (iii) our other stockholders held approximately 70% of the outstanding shares of our common stock. The common stock of Activision Blizzard is traded on The NASDAQ Stock Market under the ticker symbol ATVI.

Table of Contents

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 March 31,			
		2015		2014	
Net revenues:					
Product sales		\$	784	61%	\$ 769 69%
Subscription, licensing, and other revenues			494	39	342 31
Total net revenues			1,278	100	1,111 100
Costs and expenses:					
Cost of sales	product costs		209	16	225 20
Cost of sales	online		53	4	58 5
Cost of sales	software royalties and amortization		148	12	57 5
Cost of sales	intellectual property licenses		3		2
Product development			145	11	143 13
Sales and marketing			92	7	104 9
General and administrative			86	7	95 9
Total costs and expenses			736	57	684 61
Operating income			542	43	427 39
Interest and other expense, net			50	4	51 5
Income before income tax expense			492	39	376 34
Income tax expense			98	8	83 7
Net income		\$	394	31%	\$ 293 27%

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 we assess operating performance and allocate resources, and the availability of separate financial information. We do not aggregate operating segments.

Table of Contents

The CODM reviews segment performance exclusive of the impact of the change in deferred revenues and related cost of sales with respect to certain of our online-enabled games, stock-based compensation expense, amortization of intangible assets as a result of purchase price accounting, and fees and other expenses (including legal fees, costs, expenses and accruals) related to the Purchase Transaction and related debt financings. The CODM does not review any information regarding total assets on an operating segment basis, and accordingly, no disclosure is made with respect thereto. Information on the operating segments and reconciliations of total net revenues and total segment operating income to consolidated net revenues from external customers and consolidated income before income tax expense for the three months ended March 31, 2015 and 2014 are presented in the table below (amounts in millions):

	Three Months Ended March 31,		
	2015	2014	Increase / (Decrease)
Segment net revenues:			
Activision	\$ 303	\$ 237	\$ 66
Blizzard	352	462	(110)
Distribution	48	73	(25)
Operating segment net revenues total	703	772	(69)
Reconciliation to consolidated net revenues:			
Net effect from deferral of net revenues	575	339	
Consolidated net revenues	\$ 1,278	\$ 1,111	
Segment income from operations:			
Activision	\$ 66	\$ 2	\$ 64
Blizzard	139	239	(100)
Distribution	(1)	(1)	
Operating segment income from operations total	204	240	(36)
Reconciliation to consolidated operating income and consolidated income before income tax expense:			
Net effect from deferral of net revenues and related cost of sales	362	219	
Stock-based compensation expense	(23)	(30)	
Amortization of intangible assets	(1)	(2)	
Consolidated operating income	542	427	
Interest and other expense, net	50	51	
Consolidated income before income tax expense	\$ 492	\$ 376	

Segment Net Revenues

Activision

Activision's net revenues increased for the three months ended March 31, 2015, as compared to 2014, primarily due to higher sales of *Call of Duty: Advanced Warfare* and its two downloadable content packs released during the three months ended March 31, 2015, *Havoc* and *Ascendance*, as compared to *Call of Duty: Ghosts* and its downloadable content pack released during the same period in 2014, revenues from *Call of Duty: Advanced Warfare*'s new digital content known as Supply Drops, as well as revenues from *Destiny* and its first expansion pack

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

The Dark Below. These increases were partially offset by a decrease in revenues from the Skylanders franchise.

Blizzard

Blizzard's net revenues decreased for the three months ended March 31, 2015, as compared to 2014, primarily due to revenues included in the three months ended March 31, 2014 from *Diablo III: Reaper of Souls*TM, which was released in March 2014, and lower revenues from *World of Warcraft* due to the impact of foreign exchange rates. The decreases were partially offset by revenues during the three months ended March 31, 2015 from *Heroes of the Storm*.

Table of Contents

At March 31, 2015, the global subscriber* base for World of Warcraft was approximately 7.1 million, compared to over 10 million subscribers at December 31, 2014, and approximately 7.6 million subscribers at March 31, 2014. As we have seen following past expansion releases, subscribership declined in the first quarter of 2015 following the release of the latest expansion pack, *Warlords of Draenor™*, in the fourth quarter of 2014. The subscriber decline was primarily attributable to the East, with a smaller relative decrease in the West. In general, the average revenue per subscriber is lower in the East than in the West (where the East includes China, Taiwan, and South Korea, and the West includes North America, Europe, Australia, and Latin America). *World of Warcraft*'s revenue performance at constant foreign exchange rates has been more stable, driven by continued strong uptake on value added services, and price increases in select regions, which partially offset subscriber declines, particularly in the East. Going forward, Blizzard expects to continue delivering new game content in all regions that is intended to further appeal to the gaming community.

Distribution

Distribution's net revenues decreased for the three months ended March 31, 2015, as compared to 2014, primarily due to a decline in revenues from the distribution of next-generation hardware, which was introduced in the fourth quarter of 2013.

Segment Income from Operations

Activision

Activision's operating income increased for the three months ended March 31, 2015, as compared to 2014, primarily due to higher revenues, as described above.

Blizzard

Blizzard's operating income decreased for the three months ended March 31, 2015, as compared to 2014, primarily due to lower revenues, as described above, partially offset by lower sales and marketing spending due to the timing of our title releases. In the first quarter of 2014, we had higher sales and marketing spending to support the launch of *Diablo III: Reaper of Souls*.

Foreign Exchange Impact

Changes in foreign exchange rates had a negative impact of \$68 million on Activision Blizzard's segment net revenues for the three months ended March 31, 2015, as compared to the same period in the previous year. The changes are primarily due to changes in the value of the United States (U.S.) dollar relative to the euro and British pound.

Non-GAAP Financial Measures

The analysis of revenues by distribution channel is presented both on a GAAP (including the impact from the change in deferred revenues) and non-GAAP (excluding the impact from the change in deferred revenues) basis. We use this non-GAAP measure internally when evaluating our operating performance, when planning, forecasting and analyzing future periods, and when assessing the performance of our management team. We believe this is appropriate because this non-GAAP measure enables an analysis of performance based on the timing of actual transactions with our customers, which is consistent with the way the Company is measured by investment analysts and industry data sources, and facilitates comparison of operating performance between periods. In addition, excluding the impact from the change in deferred net revenue provides a much more timely indication of trends in our sales and other operating results. While we believe that this non-GAAP measure is useful in evaluating our business, this information should be considered as supplemental in nature and is not meant to be considered in isolation from, as a substitute for, or as more important than, the related financial information prepared in accordance with GAAP. In addition, this non-GAAP financial measure may not be the same as any non-GAAP measure presented by another company. This non-GAAP financial measure has limitations in that it does not reflect all of the items associated with our GAAP revenues. We compensate for the limitations resulting from the exclusion of the change in deferred revenues by considering the impact of that item separately and by considering our GAAP, as well as non-GAAP, revenues.

* *World of Warcraft* subscribers include individuals who have paid a subscription fee or have an active prepaid card to play *World of Warcraft*, as well as those who have purchased the game and are within their free month of access. Internet Game Room players who have accessed the game over the last thirty days are also counted as subscribers. The above definition excludes all players under free promotional subscriptions, expired or cancelled subscriptions, and expired prepaid cards. Subscribers in licensee territories are defined along the same rules.

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

Table of Contents

The following table provides reconciliation between GAAP and non-GAAP net revenues by distribution channel for the three months ended March 31, 2015 and 2014 (amounts in millions):

	For the Three Months Ended March 31,		
	2015	2014	Increase/ (decrease)
GAAP net revenues by distribution channel			
Retail channels	\$ 649	\$ 659	\$ (10)
Digital online channels (1)	581	379	202
Total Activision and Blizzard	1,230	1,038	192
Distribution	48	73	(25)
Total consolidated GAAP net revenues	1,278	1,111	167
Change in deferred net revenues (2)			
Retail channels	(532)	(487)	(45)
Digital online channels (1)	(43)	148	(191)
Total changes in deferred net revenues	(575)	(339)	(236)
Non-GAAP net revenues by distribution channel			
Retail channels	117	172	(55)
Digital online channels (1)	538	527	11
Total Activision and Blizzard	655	699	(44)
Distribution	48	73	(25)
Total non-GAAP net revenues (3)	\$ 703	\$ 772	\$ (69)

(1) We define revenues from digital online channels as revenues from subscriptions, licensing royalties, value-added services, downloadable content, and digitally distributed products.

(2) We have determined that some of our titles' online functionality represents an essential component of gameplay and as a result, represents a more-than-inconsequential separate deliverable. As such, we recognize revenues attributed to these titles over the estimated service periods, which range from five months to less than one year. In the table above, we present the amount of net revenues for each period as a result of this accounting treatment.

(3) Total non-GAAP net revenues presented also represents our total operating segment net revenues.

The decrease in GAAP net revenues from retail channels for the three months ended March 31, 2015, as compared to 2014, was primarily due to lower recognition of deferred revenues from *Call of Duty: Advanced Warfare*, as compared to *Call of Duty: Ghosts*, a decrease in our Distribution segment revenues, lower recognition of deferred revenues from *Call of Duty* catalog titles, and lower revenues from the Skylanders franchise. The decreases were largely offset by revenues from *Destiny*, which was released in September 2014.

The increase in GAAP net revenues from digital online channels for the three months ended March 31, 2015, as compared to 2014, was primarily due to the recognition of deferred revenues from *World of Warcraft: Warlords of Draenor*, which was released in November 2014, revenues from *Destiny* and its first expansion pack, *The Dark Below*, without a comparable release in the prior period, and revenues from *Hearthstone: Heroes of Warcraft* and its first expansion pack, *Hearthstone: Heroes of Warcraft – Goblins vs Gnomes*, which was released in

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

December 2014 and did not have a comparable release in the prior period, higher digital download revenues from the Call of Duty franchise, and revenues from *Heroes of the Storm*.

The decrease in non-GAAP net revenues from retail channels for the three months ended March 31, 2015, as compared to 2014, was primarily due to lower revenues from *Diablo III: Reaper of Souls*, which was released on PC in March 2014, a decrease in our Distribution segment revenues, and lower revenues from *Skylanders Trap Team*, which was released in the fourth quarter of 2014, as compared to *Skylanders SWAP Force*, which was released in the fourth quarter of 2013. The decreases were partially offset by higher revenues from *Call of Duty: Advanced Warfare*, as compared to *Call of Duty: Ghosts*.

The increase in non-GAAP net revenues from digital online channels for the three months ended March 31, 2015, as compared to 2014, was primarily due to revenues from higher digital downloads from the Call of Duty franchise, driven by *Call of Duty: Advanced Warfare*, revenues from *Heroes of the Storm*, and revenues from *Destiny* and its first expansion pack, *The Dark Below*. These increases were partially offset by lower revenues from *Diablo III: Reaper of Souls*, which was released on PC in March 2014, and from *World of Warcraft* 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 March 31, 2015 and 2014 (amounts in millions):

	For the Three Months Ended March 31,		
	2015	2014	Increase/ (decrease)
Geographic region net revenues:			
North America	\$ 704	\$ 563	\$ 141
Europe	464	462	2
Asia Pacific	110	86	24
Consolidated net revenues	\$ 1,278	\$ 1,111	\$ 167

The increase/(decrease) in deferred revenues recognized by geographic region for the three months ended March 31, 2015 and 2014 was as follows (amounts in millions):

	For the Three Months Ended March 31,		
	2015	2014	Increase/ (Decrease)
Increase/(decrease) in deferred revenues recognized by geographic region:			
North America	\$ 350	\$ 233	\$ 117
Europe	196	125	71
Asia Pacific	29	(19)	48
Total impact on consolidated net revenues	575	339	236

Consolidated net revenues in all regions increased for the three months ended March 31, 2015, as compared to 2014. As previously discussed, the increase in the Company's consolidated net revenues in 2015, as compared to the same period in 2014, was mainly due to revenues from the launch of *Destiny* and its first expansion pack, *The Dark Below*, which were released in September and December 2014, respectively, recognition of deferred revenues from *World of Warcraft: Warlords of Draenor*, which was released in November 2014, and from *Hearthstone: Heroes of Warcraft - Goblins vs Gnomes*, the first expansion pack for *Hearthstone: Heroes of Warcraft*, which was released in December 2014, and revenues from *Heroes of the Storm*. The increases were partially offset by lower revenues recognized from the Call of Duty and Skylanders franchises. For Europe, the increase was largely offset by the negative foreign exchange impact, and the decrease in our Distribution segment revenues.

For all regions, the increase in deferred revenues recognized for the three months ended March 31, 2015, as compared to 2014, was primarily attributed to recognition of deferred revenues from *Destiny* and *The Dark Below*, from *Diablo III: Reaper of Souls*, which was released on PC in March 2014, from *Diablo III: Reaper of Souls - Ultimate Evil Edition*™, which was released on consoles in August 2014, and from *World of Warcraft: Warlords of Draenor*, which was released in November 2014. The increase was partially offset by lower revenues recognized from the

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

Call of Duty franchise and from *Diablo III* for the PS3 and the Xbox 360, which was released in September 2013, as well as from the deferral of revenues from *Heroes of the Storm*.

Foreign Exchange Impact

Changes in foreign exchange rates had a negative impact of \$107 million on our consolidated net revenues for the three months ended March 31, 2015, as compared to the same period in the previous year. The changes are primarily due to changes in the value of the U.S. dollar relative to the euro and British pound.

Table of Contents

Net Revenues by Platform

The following tables detail our net revenues by platform and as a percentage of total consolidated net revenues for the three months ended March 31, 2015 and 2014 (amounts in millions):

	Three Months Ended March 31, 2015	% of total (3) consolidated net revs.	Three Months Ended March 31, 2014	% of total (3) consolidated net revs.	Increase/ (Decrease)
Platform net revenues:					
Online (1)	\$ 272	21%	\$ 201	18%	\$ 71
PC	114	9	100	9	14
Next-generation (PS4, Xbox One, Wii U)	434	34	108	10	326
Prior-generation (PS3, Xbox 360, Wii)	324	25	546	49	(222)
Total Console	758	59	654	59	104
Mobile and other (2)	86	7	83	7	3
Total Activision Blizzard	1,230	96	1,038	93	192
Distribution	48	4	73	7	(25)
Total consolidated net revenues	\$ 1,278	100%	\$ 1,111	100%	\$ 167

The increase / (decrease) in deferred revenues recognized by platform for the three months ended March 31, 2015 and 2014 was as follows (amounts in millions):

	For the Three Months Ended March 31,		
	2015	2014	Increase/ (Decrease)
Increase/(decrease) in deferred revenues recognized by platform:			
Online (1)	\$ 63	\$ (26)	\$ 89
PC	(13)	(139)	126
Next-generation (PS4, Xbox One, Wii U)	301	76	225
Prior-generation (PS3, Xbox 360, Wii)	225	428	(203)
Total console	526	504	22
Mobile and other (2)	(1)		(1)
Total impact on consolidated net revenues	\$ 575	\$ 339	\$ 236

(1) Revenues from online consists of revenues from all *World of Warcraft* products, including subscriptions, boxed products, expansion packs, licensing royalties, and value-added services.

(2) Revenues from mobile and other includes revenues from handheld, tablet, and mobile devices, as well as non-platform specific game-related revenues such as standalone sales of toys and accessories products from our Skylanders franchise and other physical merchandise and accessories.

(3) The percentages of total are presented as calculated. Therefore the sum of these percentages, as presented, may differ due to the impact of rounding.

Table of Contents

Net revenues from online increased for the three months ended March 31, 2015, as compared to 2014, primarily due to recognition of previously deferred revenues from *World of Warcraft: Warlords of Draenor*, which was released in November 2014, and from value-added services driven by the launch of the *World of Warcraft* paid character boost.

Net revenues from PC increased for the three months ended March 31, 2015, as compared to 2014, due to revenues from *Hearthstone: Heroes of Warcraft* and *Heroes of the Storm*.

Net revenues from next-generation consoles increased for the three months ended March 31, 2015, as compared to 2014. The increase was primarily attributable to an increase in the number of titles released for the next-generation console platforms, as well as increasing consumer adoption of the PS4 and Xbox One. Since the introduction of the PS4 and Xbox One in the fourth quarter of 2013, we have released the following titles, among others, on next-generation consoles: *Call of Duty: Ghosts* and *Skylanders SWAP Force* in the fourth quarter of 2013; *The Amazing Spider-Man 2* and *Transformers: Rise of the Dark Spark* in the second quarter of 2014; *Diablo III: Reaper of Souls – Ultimate Evil Edition* and *Destiny* in the third quarter of 2014, and *Call of Duty: Advanced Warfare* and *Skylanders Trap Team* in the fourth quarter of 2014.

Net revenues from prior-generation consoles decreased for the three months ended March 31, 2015, as compared to 2014, primarily due to lower revenues recognized from the Call of Duty franchise, from the Skylanders franchise, and from the transition of players from prior-generation to next-generation platforms. The decreases were partially offset by revenues from the Destiny franchise.

Net revenues from mobile and other increased slightly for the three months ended March 31, 2015, as compared to 2014, primarily due to an increase in mobile and tablet platform revenues from the release of *Hearthstone: Heroes of Warcraft* on the iPad and Android tablets in April and December 2014, respectively, and the release of its first expansion pack, *Hearthstone: Heroes of Warcraft – Goblins vs Gnomes*. The increase was partially offset by lower revenues from sales of standalone toys and accessories from the Skylanders franchise.

Deferred revenues recognized for online increased for the three months ended March 31, 2015, as compared to 2014, primarily due to revenues from *World of Warcraft: Warlords of Draenor* and from value-added services revenues for *World of Warcraft*, primarily from the paid character boost.

Deferred revenues recognized for PC increased for the three months ended March 31, 2015, as compared to 2014, primarily due to the deferral of revenues from *Diablo III: Reaper of Souls* and *Hearthstone: Heroes of Warcraft* upon their respective releases in the first quarter of 2014. The increase was partially offset by the deferral of revenue for the three months ended March 31, 2015 from *Heroes of the Storm*.

The increase in deferred revenues recognized for next-generation consoles for the three months ended March 31, 2015, as compared to 2014, was due to the increased number of titles released for the next-generation console platforms, as well as increasing consumer adoption of the PS4 and Xbox One, as discussed above.

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

The decrease in deferred revenues recognized for prior-generation consoles for the three months ended March 31, 2015, as compared to 2014, was primarily due to the increasing consumer adoption of the next-generation consoles.

Table of Contents

Costs and Expenses

Cost of Sales

The following tables detail the components of cost of sales in dollars and as a percentage of total consolidated net revenues for the three months ended March 31, 2015 and 2014 (amounts in millions):

	March 31, 2015	% of consolidated net revs.	March 31, 2014	% of consolidated net revs.	Increase (Decrease)
Product costs	\$ 209	16%	\$ 225	20%	\$ (16)
Online	53	4	58	5	(5)
Software royalties and amortization	148	12	57	5	91
Intellectual property licenses	3		2		1
Total cost of sales	\$ 413	32%	\$ 342	30%	\$ 71

Total cost of sales for the three months ended March 31, 2015 increased as compared to the same period in 2014, reflecting the increase in consolidated net revenues. Cost of sales – product costs decreased primarily due to lower revenues from the Distribution segment, which typically has higher product costs. Cost of sales – software royalties and amortization increased primarily due to the amortization of deferred royalties for *Destiny* with no comparable amortization in the three months ended March 31, 2014.

Product Development (amounts in millions)

	March 31, 2015	% of consolidated net revs.	March 31, 2014	% of consolidated net revs.	Increase (Decrease)
Product development	\$ 145	11%	\$ 143	13%	\$ 2

Product development costs did not significantly change for the three months ended March 31, 2015, as compared to 2014.

Sales and Marketing (amounts in millions)

	March 31, 2015	% of consolidated net revs.	March 31, 2014	% of consolidated net revs.	Increase (Decrease)
--	-------------------	-----------------------------------	-------------------	-----------------------------------	------------------------

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

Sales and marketing	\$	92	7%	\$	104	9%	\$	(12)
---------------------	----	----	----	----	-----	----	----	------

Sales and marketing expenses decreased for the three months ended March 31, 2015, as compared to 2014, primarily driven by the timing of marketing spending for our title releases. Sales and marketing activities during the first quarter of 2014 were mainly to support the launch of *Diablo III: Reaper of Souls*, and there was no comparable investment during the first quarter of 2015. The decrease was partially offset by the media spending for the Guitar Hero® franchise and *Heroes of the Storm* in anticipation of upcoming releases.

General and Administrative (amounts in millions)

		March 31, 2015	% of consolidated net revs.		March 31, 2014	% of consolidated net revs.		Increase (Decrease)
General and administrative	\$	86	7%	\$	95	9%	\$	(9)

General and administrative expenses decreased for the three months ended March 31, 2015, as compared to 2014, primarily due to a favorable foreign exchange impact on revaluation, and lower stock compensation expense for the three months ended March 31, 2015.

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

Table of Contents

Interest and Other Expense, Net (amounts in millions)

	March 31, 2015	% of consolidated net revs.	March 31, 2014	% of consolidated net revs.	Increase (Decrease)
Interest and other expense, net	\$ 50	4%	\$ 51	5%	\$ (1)

Interest and other expense, net, did not significantly change for the three months ended March 31, 2015, as compared to the same period in 2014.

Income Tax Expense (amounts in millions)

	March 31, 2015	% of Pretax income	March 31, 2014	% of Pretax income	Increase (Decrease)
Income tax expense	\$ 98	19.9%	\$ 83	22.1%	\$ 15

The Company accounts for its provision for income taxes in accordance with ASC 740, *Income Taxes*, which requires an estimate of the annual effective tax rate for the full year to be applied to the interim period, taking into account year-to-date amounts and projected results for the full year. The provision for income taxes represents federal, foreign, state and local income taxes. Our effective tax rate differs from the statutory U.S. income tax rate due to the effect of state and local income taxes, tax rates in foreign jurisdictions and certain nondeductible expenses. Our effective tax rate could fluctuate significantly from quarter to quarter based on recurring and nonrecurring factors including, but not limited to: variations in the estimated and actual level of pre-tax income or loss by jurisdiction; changes in the mix of income by tax jurisdiction (as taxes are levied at relatively lower statutory rates in foreign regions and relatively higher statutory rates in the U.S.); changes in enacted tax laws and regulations, rulings and interpretations thereof, including with respect to tax credits, state and local income taxes; developments in tax audits and other matters; and certain nondeductible expenses. Changes in judgment from the evaluation of new information resulting in the recognition, derecognition or remeasurement of a tax position taken in a prior annual period are recognized separately in the quarter of the change.

The income tax expense of \$98 million for the three months ended March 31, 2015 reflects an effective tax rate of 19.9%, which is lower than the effective tax rate of 22.1% for the three months ended March 31, 2014. This decrease is primarily due to an increase in the amount of foreign earnings, which are taxed at relatively lower statutory rates, as compared to domestic earnings, which are taxed at relatively higher statutory rates, in the estimated effective annual tax rate.

The effective tax rate of 19.9% for the three months ended March 31, 2015 differed from the U.S. statutory rate of 35.0%, primarily due to the tax benefit from foreign earnings taxed at relatively lower statutory rates, recognition of California research and development credits, and the federal domestic production deductions, offset by increases to the Company's reserve for uncertain tax positions.

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

The overall effective income tax rate for the year could be different from the effective tax rate for the three months ended March 31, 2015 and will be dependent, in part, on our profitability for the remainder of the year, as well as the other factors described above.

Table of Contents

The Internal Revenue Service (IRS) is currently examining Activision Blizzard's federal tax returns for the 2008 through 2011 tax years. Additionally, the IRS is currently reviewing our application for an advanced pricing agreement (APA) with respect to the transfer pricing methodology that would be used by the Company for tax years 2010 through 2024. If ongoing discussions with the IRS result in an APA, this could result in a different allocation of profits and losses under the Company's transfer pricing agreements. Such allocation could have a positive or negative impact on our provision for uncertain tax positions for the period in which such an agreement is reached and the relevant periods thereafter.

In addition, Vivendi Games' tax return for the 2008 tax year is under examination by the Internal Revenue Service and several state taxing authorities. While Vivendi Games' results for the period January 1, 2008 through July 9, 2008 are included in the consolidated federal and certain foreign, state and local income tax returns filed by Vivendi or its affiliates, Vivendi Games' results for the period July 10, 2008 through December 31, 2008 are included in the consolidated federal and certain foreign, state and local income tax returns filed by Activision Blizzard. Additionally, the Company has several state and non-U.S. audits pending. Although the final resolution of the Company's global tax disputes is uncertain, based on current information, in the opinion of the Company's management, the ultimate resolution of these matters are not expected to have a material adverse effect on the Company's consolidated financial position, liquidity or results of operations. However, an unfavorable resolution of the Company's global tax disputes could have a material adverse effect on our business and results of operations in the period in which the matters are ultimately resolved.

In connection with the Purchase Transaction, we assumed certain tax attributes of New VH, which generally consist of New VH's net operating loss (NOL) carryforwards of approximately \$760 million, which represent a potential future tax benefit of approximately \$266 million. The utilization of such NOL carryforwards will be subject to certain annual limitations and will begin to expire in 2021. The Company also obtained indemnification from Vivendi against losses attributable to the disallowance of claimed utilization of such NOL carryforwards of up to \$200 million in unrealized tax benefits in the aggregate, limited to taxable years ending on or prior to December 31, 2016. No benefit for these tax attributes or indemnification was recorded upon the close of the Purchase Transaction, as the benefit from these tax attributes did not meet the more-likely-than-not standard. For the three months ended March 31, 2015, we utilized \$152 million of the NOL, which resulted in a benefit of \$53 million, and a corresponding reserve was established as the position did not meet the more-likely-than-not standard. As of March 31, 2015, an indemnification asset of \$121 million has been recorded in Other Assets, and, correspondingly, the same amount has been recorded as a reduction to the consideration paid for the shares repurchased in Treasury Stock (see Note 1 of the Notes to Condensed Consolidated Financial Statements for details about the share repurchase).

Liquidity and Capital Resources

Sources of Liquidity (amounts in millions)

	At March 31, 2015	At December 31, 2014	Increase (Decrease)
Cash and cash equivalents	\$ 4,465	\$ 4,848	\$ (383)
Short-term investments	5	10	(5)
	\$ 4,470	\$ 4,858	\$ (388)
Percentage of total assets	32%	33%	

For the Three Months Ended March 31,

Increase

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

	2015	2014	(Decrease)
Cash flows provided by operating activities	\$ 209	\$ 136	\$ 73
Cash flows used in investing activities	(16)	(12)	(4)
Cash flows used in financing activities	(212)	(252)	40
Effect of foreign exchange rate changes	(364)	(3)	(361)
Net decrease in cash and cash equivalents	\$ (383)	\$ (131)	\$ (252)

Table of Contents

Cash Flows Provided by Operating Activities

The primary drivers of cash flows provided by operating activities typically include the collection of customer receivables generated by the sale of our products and digital and subscription revenues, partially offset by payments to vendors for the manufacturing, distribution and marketing of our products, payments for customer service support for our subscribers, payments to third-party developers and intellectual property holders, payments for interest on our debt, payments for software development, payments for tax liabilities, and payments to our workforce.

Cash flows provided by operating activities were higher for the three months ended March 31, 2015, as compared to the same period in 2014, primarily due to higher net income for the period and changes in our working capital accounts, including higher cash receipts due to higher accounts receivable balances from the prior period, partially offset by higher payment of bonuses for the three months ended March 31, 2015, as compared to the same period in 2014.

Cash Flows Used in Investing Activities

The primary drivers of cash flows provided used in investing activities typically include the net effect of purchases and sales/maturities of short-term investments, capital expenditures, and changes in restricted cash balances.

Cash flows used in investing activities were \$16 million for the three months ended March 31, 2015, as compared to cash flows used in investing activities of \$12 million for the three months ended March 31, 2014. The decrease in cash flows was primarily due to a decrease in investments maturing in the three months ended March 31, 2015, as compared to the prior year. This was partially offset by lower capital expenditure during the three months ended March 31, 2015.

Cash Flows Used in Financing Activities

The primary drivers of cash flows used in financing activities typically include the proceeds from, and repayments of, our long-term debt, transactions involving our common stock, such as the issuance of shares of common stock to employees, the repurchase of our common stock and the payment of dividends.

Cash flows used in financing activities were lower during the three months ended March 31, 2015, as compared to the same period in 2014, primarily due to a lower partial repayment of our Term Loan in 2015 of \$250 million, as compared to the \$375 million partial repayment of our Term Loan in 2014. Partially offsetting the impact of this lower repayment amount was a decrease in proceeds from the issuance of common stock to employees with proceeds of \$27 million in the three months ended March 31, 2015, compared to \$119 million for the three months ended March 31, 2014.

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

Effect of Foreign Exchange Rate Changes

Changes in foreign exchange rates had a negative impact of \$364 million and \$3 million on our cash and cash equivalents for the three months ended March 31, 2015 and 2014, respectively. The change is primarily due to changes in the value of the U.S. dollar relative to the euro and British pound.

Other Liquidity and Capital Resources

Our primary sources of liquidity are typically cash and cash equivalents, investments, and cash flows provided by operating activities. In addition, as described below, we have availability of \$250 million, subject to certain restrictions, under a secured revolving credit facility. With our cash and cash equivalents and short-term investments of \$4.5 billion at March 31, 2015, 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 (\$4.0 billion at March 31, 2015) to finance our operational and financing requirements for at least the next twelve months, including: purchases of inventory and equipment; the development, production, marketing and sale of new products; provision of customer service for our subscribers; acquisition of intellectual property rights for future products from third parties; funding of dividends; and payments related to debt obligations.

As of March 31, 2015, the amount of cash and cash equivalents held outside of the U.S. by our foreign subsidiaries was \$3.5 billion, as compared to \$3.6 billion as of December 31, 2014. If these funds are needed in the future for our operations in the U.S., we would accrue and pay the required U.S. taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

Table of Contents

Debt

On September 19, 2013, we issued, at par, \$1.5 billion of 5.625% unsecured senior notes due September 2021 (the 2021 Notes) and \$750 million of 6.125% unsecured senior notes due September 2023 (the 2023 Notes and, together with the 2021 Notes, the Notes). Interest on the Notes is payable semi-annually in arrears on March 15 and September 15 of each year, commencing on March 15, 2014. As of March 31, 2015, the Notes had a carrying value of \$2.2 billion.

We may redeem the 2021 Notes on or after September 15, 2016 and the 2023 Notes on or after September 15, 2018, in whole or in part on any one or more occasions, at specified redemption prices, plus accrued and unpaid interest. At any time prior to September 15, 2016, with respect to the 2021 Notes, and at any time prior to September 15, 2018, with respect to the 2023 Notes, we may also redeem some or all of the Notes by paying a make-whole premium , plus accrued and unpaid interest. In addition, upon the occurrence of one or more qualified equity offerings, we may also redeem up to 35% of the aggregate principal amount of each of the 2021 Notes and 2023 Notes outstanding with the net cash proceeds from such offerings. The Notes are repayable, in whole or in part and at the option of the holders, upon the occurrence of a change in control and a ratings downgrade, at a purchase price equal to 101% of principal, plus accrued and unpaid interest.

On October 11, 2013, we entered into a credit agreement (the Credit Agreement) for a \$2.5 billion secured term loan facility maturing in October 2020 (the Term Loan), and a \$250 million secured revolving credit facility maturing in October 2018 (the Revolver and, together with the Term Loan, the Credit Facilities). A portion of the Revolver can be used to issue letters of credit of up to \$50 million, subject to the availability of the Revolver. To date, we have not drawn on the Revolver and there are no letters of credit issued and outstanding as of March 31, 2015 and December 31, 2014.

As of March 31, 2015, the outstanding balance of our Term Loan was \$1.9 billion. Borrowings under the Term Loan and Revolver bear interest at an annual rate equal to an applicable margin plus, at our option, (A) a base rate determined by reference to the highest of (a) the interest rate in effect determined by the administrative agent as its prime rate, (b) the federal funds rate plus 0.5%, and (c) the London InterBank Offered Rate (LIBOR) rate for an interest period of one month plus 1.00%, or (B) LIBOR. Further, LIBOR borrowings under the Term Loan will be subject to a LIBOR floor of 0.75%. At March 31, 2015, the Term Loan bore interest at 3.25%. In certain circumstances, our interest rate under the Credit Facilities will increase.

In addition to paying interest on outstanding principal balances under the Credit Facilities, we are required to pay the lenders a commitment fee on unused commitments under the Revolver. We are also required to pay customary letter of credit fees and agency fees.

The Credit Agreement required quarterly principal repayments of 0.25% of the Term Loan s original principal amount, with the balance due on the maturity date. On February 11, 2014, we made a voluntary partial repayment of \$375 million on our Term Loan. This repayment satisfied the required quarterly principal repayments for the entire term of the Credit Agreement. On February 11, 2015, we made an additional voluntary principal repayment, this time in the amount of \$250 million, which reduced the balance due on the maturity date. The 2015 repayment reduced the Term Loan s outstanding principal balance to \$1.9 billion and based on this reduced balance, we expect our contractual interest payments in the future will be reduced by approximately \$8 million annually, based on the interest rate of 3.25% at March 31, 2015. Amounts borrowed under the Term Loan and repaid may not be re-borrowed.

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

Agreements governing our indebtedness, including the indenture governing the Notes and the Credit Agreement, impose operating and financial restrictions on our activities under certain conditions. These restrictions require us to comply with or maintain certain financial tests and ratios. In addition, the indenture and the Credit Agreement limit or prohibit our ability to, among other things: incur additional debt or make additional guarantees; pay distributions or dividends and repurchase stock; make other restricted payments, including without limitation, certain restricted investments; create liens; enter into agreements that restrict dividends from subsidiaries; engage in transactions with affiliates; and enter into mergers, consolidations or sales of substantially all of our assets.

In addition, if, in the future, we borrow under the Revolver, as described in Note 6 of the Notes to Condensed Consolidated Financial Statements, we may be required, during certain periods where outstanding revolving loans exceed a certain threshold, to maintain a maximum senior secured net leverage ratio calculated pursuant to a financial maintenance covenant under the Credit Agreement.

The Company was in compliance with the terms of the Notes and Credit Facilities as of March 31, 2015.

Capital Expenditures

For the year ending December 31, 2015, we anticipate total capital expenditures of approximately \$100 million, primarily for computer hardware and software purchases. Through the first three months of 2015, we made aggregate capital expenditures of \$23 million.

Table of Contents

Off-balance Sheet Arrangements

At March 31, 2015 and December 31, 2014, Activision Blizzard had no significant relationships with unconsolidated entities or financial parties, often referred to as structured finance or special purpose entities, 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 of Directors-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 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 interviews 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 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 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:

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

- Revenue Recognition including Revenue Arrangements with Multiple Deliverables
- Allowances for Returns, Price Protection, Doubtful Accounts, and Inventory Obsolescence
- Software Development Costs and Intellectual Property Licenses
- Income Taxes
- Fair Value Estimates (including Assessment of Impairment of Assets)
- Stock-Based Compensation

During the three months ended March 31, 2015, there were no significant changes to the above 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, 2014, for a more complete discussion of our critical accounting policies and estimates.

Table of Contents

Recently Issued Accounting Pronouncements

Revenue recognition

In May 2014, the FASB issued new accounting guidance related to revenue recognition. The new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition standard provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue upon the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. This guidance will be effective beginning January 1, 2017 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. We are evaluating the adoption method as well as the impact of this new accounting guidance on our financial statements.

Stock-based compensation

In June 2014, the FASB issued new guidance related to stock compensation. The new standard requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which the requisite service has already been rendered. The new standard is effective for fiscal years beginning after December 15, 2015 and can be applied either prospectively or retrospectively to all awards outstanding as of the beginning of the earliest annual period presented as an adjustment to opening retained earnings. Early adoption is permitted. The adoption of this guidance will not have a material impact on the Company's consolidated financial statements.

Consolidations

In February 2015, the FASB issued new guidance related to consolidations. The new standard amends certain requirements for determining whether a variable interest entity must be consolidated. The new standard is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted. We are evaluating the impact, if any, of adopting this new accounting guidance on our financial statements.

Debt Issuance Costs

In April 2015, the FASB issued new guidance related to the presentation of debt issuance costs in financial statements. The new standard requires an entity to present such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs will continue to be reported as interest expense. It is effective for annual reporting periods beginning after December 15, 2015. The new guidance will be applied retrospectively to each prior period presented. The adoption of this guidance will not have a material impact on our financial statements.

Internal-Use Software

In April 2015, the FASB issued new guidance related to internal-use software. The new standard relates to a customer's accounting for fees paid in cloud computing arrangements. The amendment provides guidance for customers to determine whether such arrangements include software licenses. If a cloud arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new standard is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted. We are evaluating the impact, if any, of adopting this new accounting guidance on our 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 foreign currency exchange rates and interest rates.

Table of Contents

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. Revenues and related expenses generated from our international operations are generally denominated in their respective local currencies. Primary currencies include euros, British pounds, Australian dollars, South Korean won and Swedish krona. To the extent the U.S. dollar strengthens against foreign currencies, the translation of these foreign currency-denominated transactions results in reduced revenues, operating expenses, net income and cash flows from our international operations. Similarly, our revenues, operating expenses, net income and cash flows will increase for our international operations if the U.S. dollar weakens against foreign currencies. Since we have significant international sales, but incur the majority of our costs in the U.S., the impact of foreign currency fluctuations, particularly the strengthening of the U.S. dollar may have an asymmetric and disproportional impact on our business. We monitor currency volatility throughout the year.

To mitigate our foreign currency risk resulting from our foreign currency-denominated monetary assets, liabilities and earnings and our foreign currency risk related to functional currency-equivalent cash flows resulting from our intercompany transactions, we periodically enter into currency derivative contracts, principally forward contracts with maturities of generally less than one year. The counterparties for our currency derivative contracts are large and reputable commercial or investment banks. We report the fair value of these contracts within Other current assets or Other current liabilities in our condensed consolidated balance sheets based on the prevailing exchange rates of the various hedged currencies as of the end of the relevant period.

We do not hold or purchase any foreign currency forward contracts for trading or speculative purposes.

Foreign Currency Forward Contracts Not Designated as Hedges

For foreign currency forward contracts entered into to mitigate risk from foreign currency-denominated monetary assets, liabilities, and earnings that are not designated as hedging instruments in accordance with FASB Accounting Standards Codification (ASC) Topic 815, changes in the estimated fair value of these derivatives are recorded within General and administrative expenses and Interest and other investment income (expense), net in our condensed consolidated statements of operations, depending on the nature of the underlying transactions.

At March 31, 2015 there were no outstanding foreign currency forward contracts not designated as hedges. At December 31, 2014, there was one outstanding foreign currency forward contract not designated as a hedge; the notional amount of that foreign currency forward contract was \$11 million and the fair value was not material. For the three months ended March 31, 2015 and 2014, pre-tax net losses related to these forward contracts were not material.

Foreign Currency Forward Contracts Designated as Hedges

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

For foreign currency forward contracts entered into to hedge forecasted intercompany cash flows that are subject to foreign currency risk and which we designated as cash flow hedges in accordance with ASC Topic 815, we assess the effectiveness of these cash flow hedges at inception and on an ongoing basis to determine if the hedges are effective at providing offsetting changes in cash flows of the hedged items. We record the effective portion of changes in the estimated fair value of these derivatives in Accumulated other comprehensive income (loss) and subsequently reclassify the related amount of accumulated other comprehensive income (loss) to earnings within General and administrative expense when the hedged item impacts earnings. We measure hedge ineffectiveness, if any, and if it is determined that a derivative has ceased to be a highly effective hedge, we will discontinue hedge accounting for the derivative.

The gross notional amount of all outstanding foreign currency forward contracts designated as cash flow hedges was approximately \$213 million at March 31, 2015. During the three months ended March 31, 2015, there was no ineffectiveness relating to these hedges. The net unrealized gains of approximately \$14 million related to these contracts at March 31, 2015 are expected to be reclassified into earnings within the next twelve months. We did not have any outstanding foreign currency forward contracts designated as cash flow hedges at December 31, 2014, or for the three months ended March 31, 2014.

In the absence of the hedging activities described above, for the three months ended March 31, 2015, a hypothetical adverse foreign currency exchange rate movement of 10% would have resulted in potential declines of our net income of approximately \$31 million. This sensitivity analysis assumes a parallel adverse shift of all foreign currency exchange rates against the U.S. dollar; however, all foreign currency exchange rates do not always move in such manner and actual results may differ materially.

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio and variable rate debt under the Credit Facilities. We do not currently use derivative financial instruments to manage interest rate risk. As of March 31, 2015, a hypothetical interest rate change on our variable rate debt of one percent (100 basis points) would change interest expense on an annual basis by approximately \$19 million. Because we have a 0.75% LIBOR floor in our Term Loan, our interest expense will only increase if the underlying interest rate increases to a level that exceeds the LIBOR floor. This estimate does not include the effects of other actions that we may take in the future to mitigate this risk or any changes in our financial structure.

Table of Contents

Our investment portfolio consists primarily of money market funds and government securities with high credit quality and short average maturities. 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 March 31, 2015, our \$4.47 billion of cash and cash equivalents were comprised primarily of money market funds. At March 31, 2015, our \$5 million of short-term investments included \$5 million of restricted cash. We also had \$9 million in auction rate securities at fair value classified as long-term investments at March 31, 2015. The Company has determined that, based on the composition of our investment portfolio as of March 31, 2015, there was no material interest rate risk exposure to the Company's consolidated financial condition, results of operations or liquidity as of that date.

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 Securities Exchange Act of 1934 (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 March 31, 2015, the end of the period covered by this report. Based on this evaluation, the principal executive officer and principal financial officer concluded that, at March 31, 2015, 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.

Management's Report on Internal Control Over Financial Reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our management, with the participation of our principal executive officer and principal financial officer, conducted an evaluation of the effectiveness, as of March 31, 2015, of our internal control over financial reporting using the

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

criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control - Integrated Framework (2013). Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of March 31, 2015.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

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.

Table of Contents

Part II. Other Information

Item 1. Legal Proceedings

We are subject to various legal proceedings and claims. SEC regulations govern disclosure of legal proceedings in periodic reports and ASC Topic 450 governs the disclosure of loss contingencies and accrual of loss contingencies in respect of litigation and other claims. We record an accrual for a potential loss when it is probable that a loss will occur and the amount of the loss can be reasonably estimated. When the reasonable estimate of the potential loss is within a range of amounts, the minimum of the range of potential loss is accrued, unless a higher amount within the range is a better estimate than any other amount within the range. Moreover, even if an accrual is not required, we provide additional disclosure related to litigation and other claims when it is reasonably possible (*i.e.*, more than remote) that the outcomes of such litigation and other claims include potential material adverse impacts on us.

The outcomes of legal proceedings and other claims are subject to significant uncertainties, many of which are outside of our control. There is significant judgment required in the analysis of these matters, including the probability determination and whether a potential exposure can be reasonably estimated. In making these determinations, we, in consultation with outside counsel, examine the relevant facts and circumstances on a quarterly basis assuming, as applicable, a combination of settlement and litigated outcomes and strategies. Moreover, legal matters are inherently unpredictable and the timing of development of factors on which reasonable judgments and estimates can be based can be slow. As such, there can be no assurance that the final outcome of any legal matter will not materially and adversely affect our business, financial condition, results of operations, profitability, cash flows or liquidity.

Purchase Transaction Matters

On August 1, 2013, a purported shareholder of the Company filed a shareholder derivative action in the Superior Court of the State of California, County of Los Angeles, captioned *Miller v. Kotick, et al.*, No. BC517086. The complaint names our Board of Directors and Vivendi as defendants, and the Company as a nominal defendant. The complaint alleges that our Board of Directors committed breaches of fiduciary duties, waste of corporate assets and unjust enrichment in connection with Vivendi's sale of its stake in the Company and that Vivendi also breached its fiduciary duties. The plaintiff further alleges that demand by it on our Board of Directors to institute action would be futile because a majority of our Board of Directors is not independent and a majority of the individual defendants face a substantial likelihood of liability for approving the transactions contemplated by the Stock Purchase Agreement. The complaint seeks, among other things, damages sustained by the Company, rescission of the transactions contemplated by the Stock Purchase Agreement, an order restricting our Chief Executive Officer and our Chairman from purchasing additional shares of our common stock and an order directing us to take necessary actions to improve and reform our corporate governance and internal procedures to comply with applicable law, including ordering a shareholder vote on certain amendments to our by-laws or charter that would require half of our Board of Directors to be independent of Messrs. Kotick and Kelly and Vivendi and a proposal to appoint a new independent Chairman of the Board of Directors. On January 28, 2014, the parties filed a stipulation and proposed order temporarily staying the California action. On February 6, 2014, the court entered the order granting a stay of the California action.

In addition, on August 14, 2013, we received a letter dated August 9, 2013, from a shareholder seeking, pursuant to Section 220 of the Delaware General Corporation Law, to inspect the books and records of the Company to ascertain whether the Purchase Transaction and Private Sale were in the best interests of the Company. In response to that request, we provided the stockholder with certain materials under a confidentiality agreement. On September 11, 2013, a complaint was filed under seal by the same stockholder in the Court of Chancery of the State of Delaware in an action captioned *Pacchia v. Kotick et al.*, C.A. No. 8884-VCL. A public version of that complaint was filed on September 16, 2013. The allegations in the complaint were substantially similar to the allegations in the above referenced matter filed on August 1, 2013. On October 25,

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

2013, Pacchia filed an amended complaint under seal. The amended complaint added claims on behalf of an alleged class of Activision stockholders other than the Company's Chief Executive Officer and Chairman, Vivendi, ASAC, investors in ASAC and other stockholders affiliated with the investors of ASAC. The added class claims are against the Company's Chief Executive Officer and Chairman, the Vivendi affiliated directors, the members of the special committee of the Board of Directors formed in connection with the Company's consideration of the transactions with Vivendi and ASAC, and Vivendi for breach of fiduciary duty, as well as aiding and abetting a breach of fiduciary duty against ASAC. The amended complaint removed the derivative claims for waste of corporate assets and disgorgement but continued to allege derivative claims for breach of fiduciary duties. The amended complaint seeks, among other things, certification of a class, damages, reformation of the Private Sale, and disgorgement of any alleged profits received by the Company's Chief Executive Officer, Chairman and ASAC. On October 29, 2013, Pacchia filed a motion to consolidate the *Pacchia* case with the *Hayes* case described below. On November 2, 2013, the Court of Chancery consolidated the *Pacchia* and *Hayes* cases and ordered the plaintiffs to file supplemental papers related to determining lead plaintiff and lead counsel no later than November 8, 2013. On December 3, 2013, the court selected Pacchia as lead plaintiff. Pacchia filed a second amended complaint on December 11, 2013, and Activision filed an answer on January 31, 2014. Also on January 31, 2014, the special committee, ASAC, Messrs. Kotick and Kelly, Vivendi and the Vivendi-affiliated directors each filed motions to dismiss certain claims in the second amended complaint. On February 21, 2014, Pacchia filed a third amended complaint under seal. In response to Pacchia's filing of a third amended complaint, the special committee, ASAC, Messrs. Kotick and Kelly, Vivendi and the Vivendi-affiliated directors each filed motions to dismiss certain claims in the third amended complaint. On June 6, 2014, the Court of Chancery denied the defendants' motions to dismiss such claims, with the exception of a breach of contract claim. Subsequently, Pacchia filed a fourth amended complaint containing substantially all of his prior claims, but with the addition of new allegations gleaned from discovery in the matter. ASAC filed a motion to dismiss the re-pleaded breach of contract claim and the other defendants filed answers in response to the fourth amended complaint.

Table of Contents

On September 11, 2013, another stockholder of the Company filed a putative class action and stockholder derivative action in the Court of Chancery of the State of Delaware, captioned *Hayes v. Activision Blizzard, Inc., et al.*, No. 8885-VCL. The complaint names our Board of Directors, Vivendi, New VH, the ASAC Entities, Davis Selected Advisers, L.P. (Davis) and Fidelity Management & Research Co. (FMR) as defendants, and the Company as a nominal defendant. The complaint alleges that the defendants violated certain provisions of our Amended and Restated Certificate of Incorporation by failing to submit the matters contemplated by the Stock Purchase Agreement for approval by a majority of our stockholders (other than Vivendi and its controlled affiliates); that our Board of Directors committed breaches of their fiduciary duties in approving the Stock Purchase Agreement; that Vivendi violated fiduciary duties owed to other stockholders of the Company in entering into the Stock Purchase Agreement; that our Chief Executive Officer and our Chairman usurped a corporate opportunity from the Company; that our Board of Directors and Vivendi have engaged in actions to entrench our Board of Directors and officers in their offices; that the ASAC Entities, Davis and FMR aided and abetted breaches of fiduciary duties by the Board of Directors and Vivendi; and that our Chief Executive Officer and our Chairman, the ASAC Entities, Davis and FMR will be unjustly enriched through the Private Sale. The complaint seeks, among other things, the rescission of the Private Sale; an order requiring the transfer to the Company of all or part of the shares that are the subject of the Private Sale; an order implementing measures to eliminate or mitigate the alleged entrenching effects of the Private Sale; an order requiring our Chief Executive Officer and our Chairman, the ASAC Entities, Davis and FMR to disgorge to the Company the amounts by which they have allegedly been unjustly enriched; and alleged damages sustained by the class and the Company. In addition, the stockholder sought a temporary restraining order preventing the defendants from consummating the transactions contemplated by the Stock Purchase Agreement without stockholder approval. Following a hearing on the motion for a temporary restraining order, on September 18, 2013, the Court of Chancery issued a preliminary injunction order, enjoining the consummation of the transactions contemplated by the Stock Purchase Agreement pending (a) the issuance of a final decision after a trial on the merits; (b) receipt of a favorable Activision Blizzard stockholder vote on the transactions contemplated by the Stock Purchase Agreement under Section 9.1(b) of our Amended and Restated Certificate of Incorporation or (c) modification of such preliminary injunction order by the Court of Chancery or the Delaware Supreme Court. On September 20, 2013, the Court of Chancery certified its order issuing the preliminary injunction for interlocutory appeal to the Delaware Supreme Court. The defendants moved the Delaware Supreme Court to accept and hear the appeal on an expedited basis. On September 23, 2013, the Delaware Supreme Court accepted the appeal of the Court of Chancery's decision and granted the defendant's motion to hear the appeal on an expedited basis.

Following a hearing on October 10, 2013, the Delaware Supreme Court reversed the Court of Chancery's order issuing a preliminary injunction, and determined that the Stock Purchase Agreement was not a merger, business combination or similar transaction that would require a vote of Activision's unaffiliated stockholders under the charter.

On October 29, 2013, an amended complaint was filed. It added factual allegations but no new claims or relief. Also on October 29, 2013, Hayes filed a motion to consolidate the *Hayes* case with the *Pacchia* case. As noted above, on November 2, 2013, the Court of Chancery consolidated the *Pacchia* and *Hayes* cases and ordered the plaintiffs to file supplemental papers related to determining lead plaintiff and lead counsel no later than November 8, 2013. See the discussion above related to the *Pacchia* matter (now the consolidated matter) for any further updates to the status of the litigation.

Further, on September 18, 2013, the Company received a letter from another purported stockholder of the Company, Milton Pfeiffer, seeking, pursuant to Section 220 of the Delaware General Corporation Law, to inspect the books and records of the Company to investigate potential wrongdoing or mismanagement in connection with the approval of the Stock Purchase Agreement. On November 11, 2013, Pfeiffer filed a lawsuit in the Court of Chancery of the State of Delaware pursuant to Delaware Section 220 containing claims similar to *Hayes*, *Pacchia* and *Miller*. The Company answered on November 27, 2013. On January 21, 2014, the Court of Chancery entered the parties' stipulation and order of dismissal.

On December 17, 2013, the Company received a letter from Mark Benston requesting certain books and records of the Company pursuant to Section 220 of the Delaware General Corporation Law. Benston is represented by the same law firm as Pfeiffer. On January 2, 2014, Benston filed a lawsuit in the Court of Chancery of the State of Delaware pursuant to Delaware Section 220 containing claims similar to *Hayes*, *Pacchia*, *Pfeiffer* and *Miller*. The Company answered on January 17, 2014. On February 14, 2014, the Court of Chancery entered the parties' stipulation and order of dismissal.

On March 14, 2014, Benston filed a putative class action and derivative complaint in the Court of Chancery, captioned *Benston v. Vivendi S.A. et al.*, No. 9447-VCL. The complaint makes claims similar to *Hayes*, *Pacchia*, *Pfeiffer and Miller*, but also adds J.P. Morgan Chase & Co. and J.P. Morgan Securities LLC as defendants and a so-called *Brophy* claim for insider trading against certain of the defendants. Benston and his attorneys petitioned the Court of Chancery to appoint them as co-lead plaintiff and co-lead counsel, respectively, for purposes of pursuing the *Brophy* claim as part of the consolidated *Pacchia* litigation. On June 6, 2014, the Court of Chancery denied Benston's motion for a leadership role in the consolidated *Pacchia* litigation. As a result, *Pacchia* continues to serve as the lead plaintiff in the consolidated cases.

Table of Contents

Certain of defendants filed a motion to dismiss the breach of contract claim set forth in the Fourth Amended Complaint. Pacchia obtained leave to file a Fifth Amended Complaint, which adds additional color to his allegations of wrongdoing based on information learned in discovery, including with respect to the appointment and subsequent election of several of the directors to our Board of Directors. For the most part, fact and expert discovery was completed in the *Pacchia* matter, including the exchange of expert damage and other reports. Pacchia's expert's reports allege damages to the Company in excess of \$540 million and to the purported class in excess of \$640 million, in addition to disgorgement claims, which could, in theory, exceed \$1 billion. Defendants' experts' reports maintain there are no damages to the Company or to the purported class because the Purchase Transaction and the Private Sale were the best transactions available to the parties and the alternate transactions hypothesized by the plaintiff were inferior.

For the quarter ended September 30, 2014, we accrued a loss contingency in our consolidated financial statements in connection with this matter. The accrual related to potential liabilities associated with legal fees, costs and expenses for services already received prior to the quarter's end, where such fees, costs and expenses had not yet been paid at the quarter's end, and the Company's potential contribution toward the potential settlement of the matter. Although the Company has D&O insurance in connection with the consolidated litigation in a total amount up to \$200 million, various insurers have raised arguments that they believe give them the right to deny coverage for a portion of these fees, costs and expenses, as well as for all or a portion of the ultimate liability which may occur in settlement or at trial. Under our Amended and Restated Certificate of Incorporation and certain agreements with members of our Board of Directors, the Company has indemnification obligations to the director defendants to advance fees, costs and expenses and to pay liabilities which arise in connection with their service to the Company, in each case, to the maximum extent permitted by Delaware law. In light of these indemnification obligations and the positions taken by the parties and the various insurers, we determined that a liability was probable and estimable, and accordingly, an accrual was required, as of the quarter ended September 30, 2014.

On November 19, 2014, the Company announced that an agreement had been reached to settle the Pacchia matter. The Company believes the settlement agreement, which acknowledges no wrongdoing on the part of any party, is in the best interest of the Company and all of its shareholders. Pursuant to the settlement agreement, multiple insurance companies, along with various defendants, will pay \$275 million to a settlement fund (Settlement Fund). Payment of reasonable and customary fees and costs of plaintiff's attorney, likely not to exceed \$72.5 million, will be made from the Settlement Fund. The remaining balance of the Settlement Fund, likely to be at least \$202.5 million, will be paid to the Company and will be recorded within Shareholders' equity in our consolidated balance sheet. Other terms of the settlement agreement include the addition of two unaffiliated persons to the Company's Board of Directors, an adjustment of certain voting rights and a global release of claims against the defendants. On December 29, 2014, the Company filed a Current Report on Form 8-K, describing and attaching the Stipulation of Compromise and Settlement, which was filed with the Delaware Chancery Court with respect to the settlement of the Pacchia matter (the Stipulation). Pursuant to the Stipulation, the Company has notified the applicable shareholders of the settlement agreement. Applicable shareholders were provided an opportunity to object to the settlement, which is subject to approval by the Delaware Chancery Court.

Objections to the Stipulation have been filed by several shareholders. The plaintiff in the *Hayes* matter has objected to the settlement on the grounds that a portion of the \$275 million Settlement Fund should be reallocated to the members of the class, that the amount of any attorney's fee award should be reduced and that the court should deny any special award to the plaintiff in the *Pacchia* matter. In the absence of such a reallocation, Hayes argues the court should deny approval of the settlement and appoint Hayes and his counsel to lead the class-based claims. Hayes also contends the notice of settlement provided by the Company is inadequate. The Company disputes this allegation. The plaintiffs in the *Benston* and *Pfeiffer* matters have also filed applications to the court requesting that their counsel receive an attorney's fee award of \$7.25 million to be paid out of the attorneys' fees contemplated by the proposed Settlement. Certain defendants have also filed objections to the \$50,000 special award requested by the *Pacchia* plaintiff. The Delaware Court of Chancery held a hearing on March 4, 2015, to consider the approval of the Stipulation, and a decision by the court is expected on or before June 2, 2015.

Since the Stipulation does not require the Company to pay any liability on behalf of its defendant directors, the Company reversed the accrual described above as of December 31, 2014. The reversal of the accrual was partially offset by a new accrual for liabilities associated with legal fees, costs and expenses for services already received prior to the year's end, where such fees, costs and expenses had not yet been paid at the year's end.

Due to the inherent uncertainties of litigation, including the possibility that the Delaware Chancery Court does not approve the Stipulation, other potential outcomes are reasonably possible, including outcomes which could include an increase in the Company's liability. The Company believes the possibility that this lawsuit will have a material impact on the Company's business, financial condition, results of operation or liquidity is remote. However, if this assessment is incorrect, then an unfavorable resolution of this lawsuit could have a material adverse effect on the Company's business, financial condition, results of operation or liquidity, particularly in the period in which any potential liabilities may be recognized.

Table of Contents

We believe that the defendants have meritorious defenses. If the Delaware Chancery Court does not approve the Stipulation and the parties are not otherwise able to settle the matter subsequently, then we believe the defendants intend to defend the lawsuit and other related cases vigorously at trial. However, these lawsuits and any other lawsuits are subject to inherent uncertainties and the actual outcome and costs will depend upon many unknown factors. The outcome of litigation is necessarily uncertain, and the Company could be forced to expend significant resources in the defense of these lawsuits and the Company and the defendants may not prevail. The Company also may be subject to additional claims in connection with the Purchase Transaction and Private Sale. Monitoring and defending against legal actions is time consuming for our management and detracts from our ability to fully focus our internal resources on our business.

Other Matters

In addition, we are party to routine claims, suits, investigations, audits and other proceedings arising from the ordinary course of business, including with respect to intellectual property rights, contractual claims, labor and employment matters, regulatory matters, tax matters, unclaimed property matters, compliance matters, and collection matters. In the opinion of management, after consultation with legal counsel, such routine claims and lawsuits are not significant and we do not expect them to have a material adverse effect on our business, financial condition, results of operations, or liquidity.

Item 1A. Risk Factors

Various risks associated with our business are described in Part I, Item 1A, Risk Factors, of our Annual Report on Form 10-K for the year ended December 31, 2014.

Item 6. Exhibits

The exhibits listed on the accompanying Exhibit Index 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: May 6, 2015

ACTIVISION BLIZZARD, INC.

/s/ DENNIS DURKIN
Dennis Durkin
*Chief Financial Officer and
Principal Financial Officer of
Activision Blizzard, Inc.*

/s/ STEPHEN WEREB
Stephen Wereb
*Chief Accounting Officer and
Principal Accounting Officer of
Activision Blizzard, Inc.*

Table of Contents

EXHIBIT INDEX

Exhibit Number	Exhibit
3.1	Third Amended and Restated Certificate of Incorporation of Activision Blizzard, Inc., dated June 5, 2014 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed June 6, 2014).
3.2	Second Amended and Restated Bylaws of the Company, adopted as of October 11, 2013 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed October 18, 2013).
10.1*	Amendment, dated as of October 30, 2014, to Employment Agreement between Humam Sakhnini and the Company.
10.2*	Notice of Stock Option Award, dated as of November 14, 2014, to Humam Sakhnini.
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 Dennis Durkin 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 Dennis Durkin 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 Extension Calculation Linkbase Document.
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.

* Indicates a management contract or compensatory plan, contract or arrangement in which a director or executive officer of the Company participates.

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at March 31, 2015 and December 31, 2014, (ii) Condensed Consolidated Statements of Operations for the three months ended March 31, 2015 and March 31, 2014, (iii) Condensed Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 31, 2015 and March 31, 2014, (iv) Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2015 and March 31, 2014; (v) Condensed Consolidated Statement of Changes in Shareholders' Equity for the three months ended March 31, 2015; and (vi) Notes to Condensed Consolidated Financial Statements.

