

Activision Blizzard, Inc.
Form 10-Q
August 04, 2015
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the Quarterly Period Ended June 30, 2015

OR

☐ **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 ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

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

The number of shares of the registrant's Common Stock outstanding at July 28, 2015 was 729,020,389.

--

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 June 30, 2015 and December 31, 2014</u>	4
	<u>Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2015 and June 30, 2014</u>	5
	<u>Condensed Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2015 and June 30, 2014</u>	6
	<u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and June 30, 2014</u>	7
	<u>Condensed Consolidated Statement of Changes in Shareholders' Equity for the six months ended June 30, 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>	25
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	46
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>	49
Item 6.	<u>Exhibits</u>	49
	<u>SIGNATURE</u>	50
	<u>EXHIBIT INDEX</u>	51
	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 entertainment 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 June 30 2015	At December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 4,416	\$ 4,848
Short-term investments	105	10
Accounts receivable, net of allowances of \$157 and \$383, at June 30, 2015 and December 31, 2014, respectively	201	659
Inventories, net	117	123
Software development	338	452
Intellectual property licenses	26	5
Deferred income taxes, net	346	368
Other current assets	502	444
Total current assets	6,051	6,909
Long-term investments	9	9
Software development	80	20
Intellectual property licenses		18
Property and equipment, net	179	157
Other assets	153	85
Intangible assets, net	26	29
Trademark and trade names	433	433
Goodwill	7,084	7,086
Total assets	\$ 14,015	\$ 14,746
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 198	\$ 325
Deferred revenues	837	1,797
Accrued expenses and other liabilities	510	592
Total current liabilities	1,545	2,714
Long-term debt, net	4,077	4,324
Deferred income taxes, net	126	114
Other liabilities	466	361
Total liabilities	6,214	7,513
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Common stock, \$0.000001 par value, 2,400,000,000 shares authorized, 1,157,546,478 and 1,150,605,926 shares issued at June 30, 2015 and December 31, 2014, respectively		
Additional paid-in capital	10,163	9,924
Less: Treasury stock, at cost, 428,676,471 shares at June 30, 2015 and December 31, 2014	(5,627)	(5,762)
Retained earnings	3,810	3,374

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

Accumulated other comprehensive loss	(545)	(303)
Total shareholders' equity	7,801	7,233
Total liabilities and shareholders' equity	\$ 14,015	\$ 14,746

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 June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
Net revenues				
Product sales	\$ 528	\$ 587	\$ 1,311	\$ 1,357
Subscription, licensing and other revenues	516	383	1,011	724
Total net revenues	1,044	970	2,322	2,081
Costs and expenses				
Cost of sales - product costs	156	187	364	412
Cost of sales - online	53	56	106	115
Cost of sales - software royalties and amortization	85	46	233	102
Cost of sales - intellectual property licenses	3	11	7	13
Product development	149	112	294	255
Sales and marketing	164	141	256	245
General and administrative	102	107	188	202
Total costs and expenses	712	660	1,448	1,344
Operating income	332	310	874	737
Interest and other expense, net	50	50	100	101
Income before income tax expense	282	260	774	636
Income tax expense	70	56	168	139
Net income	\$ 212	\$ 204	\$ 606	\$ 497
Earnings per common share				
Basic	\$ 0.29	\$ 0.28	\$ 0.82	\$ 0.68
Diluted	\$ 0.29	\$ 0.28	\$ 0.81	\$ 0.67
Weighted-average number of shares outstanding				
Basic	727	716	725	712
Diluted	735	725	734	723
Dividends per common share	\$	\$	\$ 0.23	\$ 0.20

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 COMPREHENSIVE INCOME

(Unaudited)

(Amounts in millions)

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2015	2014		2015	2014	
Net income	\$ 212	\$ 204	\$	606	\$ 497	
Other comprehensive income (loss):						
Foreign currency translation adjustment	85	(19)		(245)	(24)	
Unrealized gains (losses) on forward contracts designated as hedges, net of deferred income taxes of \$0 million for the periods ended June 30, 2015 and 2014	(8)			6		
Unrealized losses on investments, net of deferred income taxes of \$0 million for the periods ended June 30, 2015 and 2014	(3)			(3)		
Total other comprehensive income (loss)	\$ 74	\$ (19)	\$	(242)	\$ (24)	
Comprehensive income	\$ 286	\$ 185	\$	364	\$ 473	

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 Six Months Ended June 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$ 606	\$ 497
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	20	(21)
Provision for inventories	12	20
Depreciation and amortization	40	38
Amortization of capitalized software development costs and intellectual property licenses ¹	225	97
Amortization of debt discount and debt financing costs	4	3
Stock-based compensation expense ²	43	52
Excess tax benefits from stock awards	(23)	(23)
Changes in operating assets and liabilities:		
Accounts receivable, net	445	402
Inventories	(9)	1
Software development and intellectual property licenses	(171)	(161)
Other assets	166	182
Deferred revenues	(903)	(622)
Accounts payable	(122)	(190)
Accrued expenses and other liabilities	11	(33)
Net cash provided by operating activities	344	242
Cash flows from investing activities:		
Proceeds from maturities of available-for-sale investments		21
Purchases of available-for-sale investments	(100)	
Capital expenditures	(49)	(62)
Decrease in restricted cash	5	7
Net cash used in investing activities	(144)	(34)
Cash flows from financing activities:		
Proceeds from issuance of common stock to employees	61	137
Tax payment related to net share settlements on restricted stock rights	(24)	(34)
Excess tax benefits from stock awards	23	23
Dividends paid	(170)	(147)
Repayment of long-term debt	(250)	(375)
Net cash used in financing activities	(360)	(396)
Effect of foreign exchange rate changes on cash and cash equivalents	(272)	(23)
Net decrease in cash and cash equivalents	(432)	(211)
Cash and cash equivalents at beginning of period	4,848	4,410
Cash and cash equivalents at end of period	\$ 4,416	\$ 4,199

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

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

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

[Table of Contents](#)

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Six Months Ended June 30, 2015

(Unaudited)

(Amounts and shares in millions, except per share data)

	Common Stock		Treasury Stock		Additional	Retained	Accumulated	Total
	Shares	Amount	Shares	Amount	Paid-In Capital	Earnings	Other Comprehensive Income (Loss)	Shareholders' Equity
Balance at December 31, 2014	1,151	\$	(429)	\$ (5,762)	\$ 9,924	\$ 3,374	\$ (303)	\$ 7,233
Components of comprehensive income:								
Net income						606		606
Other comprehensive income (loss)							(242)	(242)
Issuance of common stock pursuant to employee stock options	5				61			61
Issuance of common stock pursuant to restricted stock rights	3							
Restricted stock surrendered for employees' tax liability	(1)				(24)			(24)
Tax benefit associated with employee stock awards					22			22
Stock-based compensation expense related to employee stock options and restricted stock rights					45			45
Dividends (\$0.23 per common share)						(170)		(170)
Indemnity on tax attributes assumed in connection with the Purchase Transaction (see Note 9)				68				68
Shareholder lawsuit settlement in connection with the Purchase Transaction (see Note 12)				67	135			202
Balance at June 30, 2015	1,158	\$	(429)	\$ (5,627)	\$ 10,163	\$ 3,810	\$ (545)	\$ 7,801

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

Table of Contents

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Description of Business and 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 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; the Company did not receive any proceeds.

As of June 30, 2015, we had approximately 729 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%

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

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®, Skylanders® and Guitar Hero® 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 free-to-play online hero brawler released on June 2, 2015.

(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.

Supplemental Cash Flow Information: Non-cash investing activities

As of June 30, 2015 and 2014, the Company had accrued capital expenditures of \$18 million and \$8 million, respectively, recorded within Accounts Payable and Accrued expenses and other liabilities.

[Table of Contents](#)

2. Inventories, Net

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

	At June 30, 2015	At December 31, 2014
Finished goods	\$ 72	\$ 112
Purchased parts and components	45	11
Inventories, net	117	123

Inventory reserves were \$52 million at June 30, 2015 and December 31, 2014.

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 June 30, 2015	At December 31, 2014
Internally-developed software costs	\$ 259	\$ 262
Payments made to third-party software developers	159	210
Total software development costs	\$ 418	\$ 472
Intellectual property licenses	\$ 26	\$ 23

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

	For the Three Months Ended June 30, 2015	For the Three Months Ended June 30, 2014	For the Six Months Ended June 30, 2015	For the Six Months Ended June 30, 2014
Amortization of capitalized software development costs and intellectual property licenses	\$ 85	\$ 50	\$ 232	\$ 108

4. Intangible Assets, Net

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

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

At June 30, 2015

	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	(289)	20
Total definite-lived intangible assets		\$ 407	\$ (381)	\$ 26
Acquired indefinite-lived intangible assets:				
Activision trademark	Indefinite			386
Acquired trade names	Indefinite			47
Total indefinite-lived intangible assets				\$ 433

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

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 \$2 million and \$3 million for the three and six months ended June 30, 2015, respectively. Amortization expense of intangible assets was \$1 million and \$3 million for the three and six months ended June 30, 2014, respectively.

At June 30, 2015, future amortization of definite-lived intangible assets is estimated as follows (amounts in millions):

2015 (remaining six months)	\$ 8
2016	8
2017	5
2018	3
2019	2
Total	\$ 26

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

- 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 June 30, 2015 Using					
	As of June 30, 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	\$ 4,274	\$ 4,274	\$	\$	Cash and cash equivalents
Foreign government treasury bills	34	34			Cash and cash equivalents
U.S. treasuries and government agency securities	100	100			Short-term investments
Foreign currency forward contracts designated as hedges	6		6		Other current assets
Auction rate securities (ARS)	9			9	Long-term investments
Total recurring fair value measurements	\$ 4,423	\$ 4,408	\$ 6	\$ 9	

	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	

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 June 30, 2015 and 2014, respectively:

	ARS (a)	Level 3	Total financial assets at fair value
Balance at December 31, 2014	\$	9	\$ 9
Total unrealized gains included in other comprehensive income			
Balance at June 30, 2015	\$	9	\$ 9

Balance at December 31, 2013	\$	9	\$ 9
Total unrealized gains included in other comprehensive income			
Balance at June 30, 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 June 30, 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.

Table of Contents

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.

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 expense, net in our condensed consolidated statements of operations, depending on the nature of the underlying transactions.

At June 30, 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 and six months ended June 30, 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 \$150 million at June 30, 2015 and \$119 million at June 30, 2014. At December 31, 2014, there were no outstanding foreign currency forward contracts

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

designated as cash flow hedges. During the three and six months ended June 30, 2015 and 2014, there was no ineffectiveness relating to these hedges. The net unrealized gains of approximately \$6 million related to these contracts at June 30, 2015 are expected to be reclassified into earnings within the next twelve months.

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 and six months ended June 30, 2015 and 2014, there were no impairment charges related to assets that are measured on a non-recurring basis.

Table of Contents

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 were no letters of credit issued and outstanding under the Revolver at either June 30, 2015 or 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 June 30, 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 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.

The terms of the Credit Agreement require 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 69% 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 June 30, 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 June 30, 2015.

Table of Contents

Interest on the Notes is payable semi-annually in arrears on March 15 and September 15 of each year. As of June 30, 2015 and December 31, 2014, we had interest payable of \$38 million 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 expense, net in our condensed consolidated statement of operations.

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

	Gross Carrying Amount	At June 30, 2015 Unamortized Discount	Net Carrying Amount
Term Loan	\$ 1,869	\$ (9)	\$ 1,860
2021 Notes	1,500	(22)	1,478
2023 Notes	750	(11)	739
Total long-term debt	\$ 4,119	\$ (42)	\$ 4,077
	Gross Carrying Amount	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 and six months ended June 30, 2015, interest expense was \$48 million and \$97 million, respectively, amortization of the debt discount for the Credit Facilities and Notes was \$2 million and \$3 million, respectively, and commitment fees for the Revolver were not material. For the three and six months ended June 30, 2014, interest expense was \$50 million and \$101 million, respectively, amortization of the debt discount for the Credit Facilities and Notes was \$2 million and \$3 million, respectively, and commitment fees for the Revolver were not material.

Table of Contents

As of June 30, 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 six months)	\$	
2016		
2017		
2018		
2019		
Thereafter		4,119
Total	\$	4,119

As of June 30, 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 \$1,575 million and \$814 million, respectively, as of June 30, 2015 and \$1,586 million and \$810 million, respectively, as of December 31, 2014.

Deferred Financing Costs

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 and six months ended June 30, 2015 and 2014, this amount was not material.

7. Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) at June 30, 2015 and 2014, were as follows (amounts in millions):

	Foreign currency translation adjustments	For the Six Months Ended June 30, 2015 Unrealized gain (loss) on forward contracts	Unrealized gain (loss) on available- for-sale securities	Total
Balance at December 31, 2014	\$ (304)	\$	\$ 1	\$ (303)
Other comprehensive income (loss) before reclassifications	(245)	8	(3)	(240)
Amounts reclassified from accumulated other comprehensive income (loss)		(2)		(2)
Balance at June 30, 2015	\$ (549)	\$ 6	\$ (2)	\$ (545)

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

	Foreign currency translation adjustments	Unrealized gain on forward contracts	Unrealized gain on available-for-sale securities	Total
Balance at December 31, 2013	\$ 67	\$	\$ 1	\$ 68
Other comprehensive income (loss) before reclassifications	(24)			(24)
Balance at June 30, 2014	\$ 43	\$	\$ 1	\$ 44

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

Table of Contents

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.

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 and six months ended June 30, 2015 and 2014 are presented below (amounts in millions):

	2015	2014	Three Months Ended June 30, 2015	2014
	Net revenues		Income (loss) from operations before income tax expense	
Activision	\$	313	\$	252
Blizzard		385		340
Distribution		61		66
Operating segments total		759		658

Reconciliation to consolidated net revenues / consolidated income before income tax expense:

Net effect from deferral of net revenues and related cost of sales		285		312		181		220
Stock-based compensation expense						(21)		(22)
Amortization of intangible assets						(1)		(1)
Consolidated net revenues / operating income	\$	1,044	\$	970	\$	332	\$	310
Interest and other expense, net						50		50
Consolidated income before income tax expense					\$	282	\$	260

Activision	\$	616	\$	489	\$	121	\$	(29)
Blizzard		737		801		256		383
Distribution		109		140		(1)		(1)
Operating segments total		1,462		1,430		376		353

Reconciliation to consolidated net revenues / consolidated income before income tax expense:

Net effect from deferral of net revenues and related cost of sales		860		651		545		440
---	--	-----	--	-----	--	-----	--	-----

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

Stock-based compensation expense					(44)		(53)
Amortization of intangible assets					(3)		(3)
Consolidated net revenues / operating income	\$	2,322	\$	2,081	\$	874	\$ 737
Interest and other expense, net					100		101
Consolidated income before income tax expense					\$ 774	\$	636

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

Table of Contents

Geographic information presented below for the three and six months ended June 30, 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 June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net revenues by geographic region:				
North America	\$ 551	\$ 471	\$ 1,255	\$ 1,035
Europe	388	395	852	856
Asia Pacific	105	104	215	190
Total consolidated net revenues	\$ 1,044	\$ 970	\$ 2,322	\$ 2,081

The Company's net revenues in the U.S. were 50% and 46% of consolidated net revenues for the three months ended June 30, 2015 and 2014, respectively. The Company's net revenues in the U.K. were 14% of consolidated net revenues for the three months ended both June 30, 2015 and 2014. The Company's net revenues in France were 10% and 16% of consolidated net revenues for the three months ended June 30, 2015 and 2014, respectively. No other country's net revenues exceeded 10% of consolidated net revenues.

The Company's net revenues in the U.S. were 52% and 47% of consolidated net revenues for the six months ended June 30, 2015 and 2014, respectively. The Company's net revenues in the U.K. were 13% and 14% of consolidated net revenues for the six months ended June 30, 2015 and 2014, respectively. The Company's net revenues in France were 8% and 15% of consolidated net revenues for the six months ended June 30, 2015 and 2014, respectively. No other country's net revenues exceeded 10% of consolidated net revenues.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net revenues by platform:				
Console	\$ 559	\$ 479	\$ 1,317	\$ 1,134
Online ¹	221	195	492	395
PC	149	182	263	281
Mobile and other ²	54	48	141	131
Total Activision Blizzard net revenues	983	904	2,213	1,941
Distribution	61	66	109	140
Total consolidated net revenues	\$ 1,044	\$ 970	\$ 2,322	\$ 2,081

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.

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

Long-lived assets by geographic region at June 30, 2015 and December 31, 2014 were as follows (amounts in millions):

	At June 30, 2015		At December 31, 2014	
Long-lived assets ¹ by geographic region:				
North America	\$	145	\$	122
Europe		26		29
Asia Pacific		8		6
Total long-lived assets by geographic region	\$	179	\$	157

¹ 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.

Table of Contents

9. Income Taxes

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 \$70 million for the three months ended June 30, 2015 reflects an effective tax rate of 25%, which is higher than the effective tax rate of 22% for the three months ended June 30, 2014. This increase is primarily due to an increase in the estimated annual effective tax rate due to the projected mix of earnings in different jurisdictions taxed at different rates.

The income tax expense of \$168 million for the six months ended June 30, 2015 reflects an effective tax rate of 22%, which is comparable to the effective tax rate of 22% for the six months ended June 30, 2014.

The effective tax rates of 25% and 22% for the three and six months ended June 30, 2015, respectively, differed from the U.S. statutory rate of 35%, 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 and six months ended June 30, 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. During the three months ended June 30, 2015, the Company transitioned the review of its transfer pricing methodology from the advanced pricing agreement review process to the IRS examination team. Their review 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 a determination 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.

The final resolution of the Company's global tax disputes is uncertain. There is significant judgment required in the analysis of disputes, including the probability determination and estimation of the potential exposure. 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.

Table of Contents

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 six months ended June 30, 2015, we utilized \$194 million of the NOL, which resulted in a tax benefit of \$68 million, and a corresponding reserve was established as the position did not meet the more-likely-than-not standard. As of June 30, 2015, an indemnification asset of \$136 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).

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 June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
Numerator:				
Consolidated net income	\$ 212	\$ 204	\$ 606	\$ 497
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	(2)	(4)	(5)	(8)
Numerator for basic and diluted earnings per common share - income available to common shareholders	\$ 210	\$ 200	\$ 597	\$ 484
Denominator:				
Denominator for basic earnings per common share - weighted-average common shares outstanding	727	716	725	712
Effect of potential dilutive common shares under the treasury stock method:				
Employee stock options and awards	8	9	9	11
Denominator for diluted earnings per common share - weighted-average common shares outstanding plus dilutive common shares under the treasury stock method	735	725	734	723
Basic earnings per common share	\$ 0.29	\$ 0.28	\$ 0.82	\$ 0.68
Diluted earnings per common share	\$ 0.29	\$ 0.28	\$ 0.81	\$ 0.67

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 and six months ended June 30, 2015, on a weighted-average basis, we had outstanding unvested restricted stock rights with respect to 9 million and 10 million shares of common stock, respectively, that are participating in earnings. For the three and six months ended June 30, 2014, on a weighted-average basis, we had

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

outstanding unvested restricted stock rights with respect to 16 million shares of common stock 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 3 million shares are not included in the computation of diluted earnings per share for the three and six months ended June 30, 2015 as their respective performance measures had not yet been met. Approximately 3 million shares are not included in the computation of diluted earnings per share for the three and six months ended June 30, 2014 as their respective performance measures had not yet been met.

Table of Contents

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 1 million and 6 million shares of common stock were not included in the calculation of diluted earnings per common share for the three and six months ended June 30, 2015, respectively, and options to acquire 2 million and 3 million shares of common stock were not included in the calculation of diluted earnings per common share for the three and six months ended June 30, 2014, respectively, as the effect of their inclusion would be anti-dilutive.

11. Capital Transactions

Repurchase Program

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 June 30, 2015, we have not repurchased any shares under this program.

Dividends

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. On May 13, 2015, we made an aggregate cash dividend payment of \$167 million to such shareholders, and on May 29, 2015, we made related dividend equivalent payments of \$3 million to certain holders of restricted stock rights.

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 certain 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

In prior periods, the Company reported on litigation related to the Purchase Transaction. During the period ended June 30, 2015, the cases were resolved and dismissed with prejudice. As part of the resolution of the claims, we received a settlement payment of \$202 million in July 2015 from Vivendi, ASAC, and our insurers. We recorded the settlement within Shareholders' equity with the receivable in Other current assets in our condensed consolidated balance sheet as of June 30, 2015.

Table of Contents

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 them. 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 waiver and acknowledgment 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.

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. In connection with the settlement of the litigation related to the Purchase Transaction, the parties to the Stockholders Agreement amended that agreement on May 28, 2015.

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, 2018 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.

Table of Contents

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.

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:

(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®, Skylanders®, and Guitar Hero® 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.

(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 and StarCraft products. In addition, Blizzard is the creator of *Heroes of the Storm*, a free-to-play online hero brawler released on June 2, 2015.

(iii) 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 June 30, 2015, Activision Blizzard had net revenues of \$1,044 million, as compared to net revenues of \$970 million for the same period in 2014. For the three months ended June 30, 2015, Activision Blizzard had earnings per diluted share of \$0.29, as compared to earnings per diluted share of \$0.28 for the same period in 2014.

For the six months ended June 30, 2015, Activision Blizzard had net revenues of \$2.3 billion, as compared to net revenues of \$2.1 billion for the same period in 2014. For the six months ended June 30, 2015, Activision Blizzard had earnings per diluted share of \$0.81, as compared to earnings per diluted share of \$0.67 for the same period in 2014.

For the three and six months ended June 30, 2015, digital online channel revenues were 55% and 50%, respectively, of consolidated net revenues, compared to 49% and 41% for the three and six months ended June 30, 2014.

Table of Contents

For the three and six months ended June 30, 2015, non-GAAP digital online channel revenues were 81% and 79%, respectively, of consolidated net revenues, compared to 73% and 70% for the three and six months ended June 30, 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. On May 13, 2015, we made an aggregate cash dividend payment of \$167 million to such shareholders, and on May 29, 2015, we made related dividend equivalent cash payments of \$3 million to certain holders of restricted stock rights.

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 six months of 2015:

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

Activision Blizzard 2015 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.
- 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 and on other platforms on April 30, 2015.

- On April 2, 2015, Blizzard released *Blackrock Mountain*, the latest addition to *Hearthstone: Heroes of Warcraft* content and on April 14, 2015, *Hearthstone: Heroes of Warcraft* was released on iOS and Android smartphones.
- 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 released the action role-playing game *Diablo III: Reaper of Souls* in China.
- On May 19, 2015, Activision released *House of Wolves*, the second expansion to *Destiny*.
- On June 2, 2015, Blizzard released *Heroes of the Storm*, its free-to-play online team brawler.
- Activision released *Call of Duty: Advanced Warfare Supremacy* (*Supremacy*), the third downloadable content pack for *Call of Duty: Advanced Warfare* on the Xbox One and Xbox 360 platforms on June 2, 2015 and on other platforms on July 2, 2015.
- In September 2015, Activision expects to release *The Taken King*, the expansion to *Destiny*, as well as *Skylanders SuperChargers*, the next iteration in the Skylanders franchise.

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 June 30, 2015, the combined installed base of PS4 and Xbox One hardware was approximately 29 million units, an approximate 153% growth over the combined installed base of approximately 11 million as of June 30, 2014. While the combined installed base of PS3 and Xbox 360 hardware was approximately 123 million units as of June 30, 2015, at the comparable point in their release cycle, the prior-generation platforms had only 19 million units installed.

Table of Contents

When new console platforms are announced or introduced into the market, consumers 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 published slowed or even declined until the new platforms were introduced and achieved 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 and to develop and market products for next-generation platforms, which 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.

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), subscription-based services, value-added services and microtransactions across our various video games. We have also introduced games based on some of our most successful franchises which operate online on a free-to-play model with microtransactions.

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

According to Activision Blizzard internal estimates, overall industry digital gaming revenues for the six months ended June 30, 2015 increased by approximately 19% as compared to the same period in 2014. The primary drivers of the increase in digital gaming revenues were increases in microtransactions and consumer purchases of full games via digital channels. 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 June 30, 2015, revenues through digital online channels increased by \$93 million, as compared to the same period in 2014, and represented 55% of our total consolidated net revenues, as compared to 49% 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 June 30, 2015 increased by \$130 million, as compared to the same period in 2014, and represented 81% of our total non-GAAP net revenues, as compared to 73% for the same period in 2014.

For the six months ended June 30, 2015, revenues through digital online channels increased by \$296 million, as compared to the same period in 2014, and represented 50% of our total consolidated net revenues, as compared to 41% 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 six months ended June 30, 2015 increased by

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

\$142 million, as compared to the same period in 2014, and represented 79% of our total non-GAAP net revenues, as compared to 70% for the same period in 2014.

Conditions in the Retail Distribution Channels

Conditions in the retail distribution channels of the interactive entertainment industry continued to be challenging during the first six months of 2015. In North America and Europe, retail sales of video games declined by 7%, 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 retail demand for prior-generation games declined at a faster pace than the growth of retail 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 55% for the six months ended June 30, 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 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.

Table of Contents

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 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; the Company did not receive any proceeds.

As of June 30, 2015, we had approximately 729 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 June 30,				Six Months Ended June 30,							
	2015		2014		2015		2014					
Net revenues												
Product sales	\$	528	51%	\$	587	61%	\$	1,311	56%	\$	1,357	65%
Subscription, licensing and other revenues		516	49		383	39		1,011	44		724	35
Total net revenues		1,044	100		970	100		2,322	100		2,081	100
Costs and expenses												
Cost of sales - product costs		156	15		187	19		364	16		412	20
Cost of sales - online		53	5		56	6		106	4		115	5
Cost of sales - software royalties and amortization		85	8		46	5		233	10		102	5
Cost of sales - intellectual property licenses		3			11	1		7			13	1
Product development		149	14		112	12		294	13		255	12
Sales and marketing		164	16		141	14		256	11		245	12
General and administrative		102	10		107	11		188	8		202	10
Total costs and expenses		712	68		660	68		1,448	62		1,344	65
Operating income		332	32		310	32		874	38		737	35
Interest and other expense, net		50	5		50	5		100	5		101	4
Income before income tax expense		282	27		260	27		774	33		636	31
Income tax expense		70	7		56	6		168	7		139	7
Net income	\$	212	20%	\$	204	21%	\$	606	26%	\$	497	24%

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.

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

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 and six months ended June 30, 2015 and 2014 are presented in the table below (amounts in millions):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2015	2014	Increase / (Decrease)	2015	2014	Increase / (Decrease)
Segment net revenues:						
Activision	\$ 313	\$ 252	\$ 61	\$ 616	\$ 489	\$ 127
Blizzard	385	340	45	737	801	(64)
Distribution	61	66	(5)	109	140	(31)
Operating segment net revenues total	759	658	101	1,462	1,430	32
Reconciliation to consolidated net revenues:						
Net effect from deferral of net revenues	285	312		860	651	
Consolidated net revenues	\$ 1,044	\$ 970		\$ 2,322	\$ 2,081	
Segment income from operations:						
Activision	\$ 57	\$ (31)	\$ 88	\$ 121	\$ (29)	\$ 150
Blizzard	117	145	(28)	256	383	(127)
Distribution	(1)	(1)		(1)	(1)	
Operating segment income from operations total	173	113	60	376	353	23
Reconciliation to consolidated operating income and consolidated income before income tax expense:						
Net effect from deferral of net revenues and related cost of sales	181	220		545	440	
Stock-based compensation expense	(21)	(22)		(44)	(53)	
Amortization of intangible assets	(1)	(1)		(3)	(3)	
Consolidated operating income	332	310		874	737	
Interest and other expense, net	50	50		100	101	
Consolidated income before income tax expense	\$ 282	\$ 260		\$ 774	\$ 636	

Segment Net Revenues

Activision

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

Activision's net revenues increased for the three months ended June 30, 2015, as compared to 2014, primarily due to: sales of *Destiny* and its second expansion pack, *House of Wolves*, along with revenues from expansion passes which include both the first and second expansion packs; higher revenues from *Call of Duty: Advanced Warfare* and its two downloadable content packs released during the three months ended June 30, 2015, *Ascendance* and *Supremacy*, as compared to *Call of Duty: Ghosts* and its two downloadable content packs released during the same period in 2014; and revenues from *Call of Duty: Advanced Warfare*'s new digital content known as supply drops, introduced in March 2015, which provide additional content such as customized weapons and character gear. These increases were partially offset by a decrease in revenues from titles based on licensed intellectual property released during the three months ended June 30, 2014, including *The Amazing Spider-Man 2*TM and *Transformers*TM: *Rise of the Dark Spark*, with no corresponding releases during the three months ended June 30, 2015.

Table of Contents

Activision's net revenues increased for the six months ended June 30, 2015, as compared to 2014, primarily due to: sales of *Destiny* and its associated expansion packs, *The Dark Below* and *House of Wolves*, and from expansion passes which include both the first and second expansion packs; higher revenues from *Call of Duty: Advanced Warfare* and its three downloadable content packs released during the six months ended June 30, 2015, *Havoc*, *Ascendance* and *Supremacy*, as compared to *Call of Duty: Ghosts* and its three downloadable content packs released during the same period in 2014; and revenues from *Call of Duty: Advanced Warfare*'s new digital supply drops content. These increases were partially offset by a decrease in revenues from titles based on licensed intellectual property released during the six months ended June 30, 2014, including *The Amazing Spider-Man 2* and *Transformers: Rise of the Dark Spark*, with no corresponding releases during the six months ended June 30, 2015, and a decrease in revenues from the Skylanders franchise.

Blizzard

Blizzard's net revenues increased for the three months ended June 30, 2015, as compared to 2014, primarily due to higher revenues from *Hearthstone: Heroes of Warcraft* and the release of its latest adventure, *Blackrock Mountain*, revenues from *Heroes of the Storm*, which was released on June 2, 2015, and the release of *Diablo III: Reaper of Souls* in China, a free-to-play version of the game with premium content and microtransactions available for purchase. In addition to already having been released on PC, iPad, and Android tablets in the prior year, *Hearthstone: Heroes of Warcraft* was released on iPhone and Android smartphones in April 2015, which contributed to the current period revenue increase. The increases were partially offset by declines in revenue from the World of Warcraft franchise.

Blizzard's net revenues decreased for the six months ended June 30, 2015, as compared to 2014, primarily due to revenues included in the six months ended June 30, 2014 from *Diablo III: Reaper of Souls*, which was released in March 2014, and lower revenues from *World of Warcraft* due to a smaller subscriber base. The decreases were partially offset by revenues during the six months ended June 30, 2015 from *Hearthstone: Heroes of Warcraft*, *Heroes of the Storm* and the release of *Diablo III: Reaper of Souls* in China.

At June 30, 2015, the global subscriber* base for World of Warcraft was approximately 5.6 million subscribers, compared to approximately 7.1 million subscribers at March 31, 2015, and approximately 6.8 million subscribers at June 30, 2014. As we have seen following past expansion releases, subscribership declined in the first half 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). Going forward, Blizzard expects to continue delivering new game content in all regions that is intended to further appeal to the gaming community, however there could be further declines in the subscriber numbers. While World of Warcraft subscribers have declined, Blizzard's revenues were up for the three months, as Blizzard further diversifies its business and portfolio of franchises. Revenues from *Hearthstone: Heroes of Warcraft*, *Heroes of the Storm*, and *Diablo III* contributed to growth in Blizzard revenues and overall gaming community size.

Distribution

Distribution's net revenues decreased for the three and six months ended June 30, 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 and six months ended June 30, 2015, as compared to 2014, primarily due to higher revenues, as described above, an increased percentage of revenues coming from online digital channels which typically have higher margins, and improved operating margins from the Skylanders franchise, partially offset by increased sales and marketing spend for the upcoming Guitar Hero release, with no comparative spending in the prior year, and increased product development costs primarily due to studio bonus expenses.

Blizzard

Blizzard's operating income decreased for the three months ended June 30, 2015, as compared to 2014, primarily due to higher sales and marketing spending for our releases, primarily relating to the Hearthstone: Heroes of Warcraft franchise and *Heroes of the Storm*, higher product development spending, and lower capitalization but higher amortization of capitalized software costs, partially offset by higher revenues as described above.

Blizzard's operating income decreased for the six months ended June 30, 2015, primarily due to higher sales and marketing spending for our releases, primarily relating to the Hearthstone: Heroes of Warcraft franchise and *Heroes of the Storm*, higher product development spending and lower capitalization but higher amortization of capitalized software costs.

* *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 canceled subscriptions, and expired prepaid cards. Subscribers in licensees' territories are defined along the same rules.

Table of Contents

Foreign Exchange Impact

Changes in foreign exchange rates had a negative impact of \$87 million and \$154 million on Activision Blizzard's segment net revenues for the three and six months ended June 30, 2015, respectively, as compared to the same periods 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.

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 and six months ended June 30, 2015 and 2014 (amounts in millions):

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2015	2014	Increase/ (decrease)	2015	2014	Increase/ (decrease)
GAAP net revenues by distribution channel						
Retail channels	\$ 414	\$ 428	\$ (14)	\$ 1,063	\$ 1,087	\$ (24)
Digital online channels (1)	569	476	93	1,150	854	296
Total Activision and Blizzard	983	904	79	2,213	1,941	272
Distribution	61	66	(5)	109	140	(31)
Total consolidated GAAP net revenues	1,044	970	74	2,322	2,081	241
Change in deferred net revenues (2)						
Retail channels	(327)	(317)	(10)	(859)	(804)	(55)
Digital online channels (1)	42	5	37	(1)	153	(154)
Total changes in deferred net revenues	(285)	(312)	27	(860)	(651)	(209)
Non-GAAP net revenues by distribution channel						
Retail channels	87	111	(24)	204	283	(79)
Digital online channels (1)	611	481	130	1,149	1,007	142
Total Activision and Blizzard	698	592	106	1,353	1,290	63
Distribution	61	66	(5)	109	140	(31)
Total non-GAAP net revenues (3)	\$ 759	\$ 658	\$ 101	\$ 1,462	\$ 1,430	\$ 32

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

Retail Channel Net Revenues

The decrease in GAAP net revenues from retail channels for the three months ended June 30, 2015, as compared to 2014, was primarily due to lower revenues recognized from the Call of Duty franchise, as well as revenues from *The Amazing Spider-Man 2*, which was released during the three months ended June 30, 2014 with no corresponding release in the current period. This was partially offset by revenues recognized from *Destiny* and its associated expansion packs, without a comparable release in the prior period.

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

The decrease in GAAP net revenues from retail channels for the six months ended June 30, 2015, as compared to 2014, was primarily due to lower revenues recognized from the Call of Duty franchise, revenues from *The Amazing Spider-Man 2*, which was released during the six months ended June 30, 2014 with no corresponding release in the six months ended June 30, 2015, and from the Diablo franchise due to the timing of title releases. This was partially offset by revenues recognized from *Destiny* and its associated expansion packs, without a comparable release in the prior period.

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

Table of Contents

The decrease in non-GAAP net revenues from retail channels for the three months ended June 30, 2015, as compared to 2014, was primarily due to lower revenues from titles based on licensed intellectual property released during the three months ended June 30, 2014, including *The Amazing Spider-Man 2* and *Transformers: Rise of the Dark Spark*, with no corresponding releases in the current period, partially offset by higher revenues from the Call of Duty franchise.

The decrease in non-GAAP net revenues from retail channels for the six months ended June 30, 2015, as compared to 2014, was primarily due to lower revenues from titles based on licensed intellectual property released during the six months ended June 30, 2014, including *The Amazing Spider-Man 2* and *Transformers: Rise of the Dark Spark*, with no corresponding releases in the current period, and lower revenues from *Diablo III: Reaper of Souls*. These decreases were partially offset by higher revenues from the Call of Duty franchise.

Digital Online Channel Net Revenues

The increase in GAAP net revenues from digital online channels for the three and six months ended June 30, 2015, as compared to 2014, was primarily due to the recognition of revenues from *Destiny* and its associated expansion packs, without comparable releases in the prior periods, revenues recognized from *Hearthstone: Heroes of Warcraft*, higher revenues recognized from *Call of Duty: Advanced Warfare* and its downloadable content packs released during the three months ended June 30, 2015, as compared to *Call of Duty: Ghosts* and its downloadable content packs released during the prior period, including revenues recognized from *Call of Duty: Advanced Warfare*'s new digital content known as "supply drops" and revenues recognized from *Heroes of the Storm* which was released on June 2, 2015 with no comparable release during the prior periods. These increases were partially offset by lower revenues recognized from the Diablo franchise due to the timing of title releases.

The increase in non-GAAP net revenues from digital online channels for the three and six months ended June 30, 2015, as compared to 2014, was primarily due to revenues from *Destiny* and its associated expansion packs, without comparable releases in the prior periods, revenues recognized from *Hearthstone: Heroes of Warcraft*, higher revenues from *Call of Duty: Advanced Warfare* and its downloadable content packs released during the three and six months ended June 30, 2015, as compared to *Call of Duty: Ghosts* and its downloadable content packs released during the same period in 2014, including revenues from *Call of Duty: Advanced Warfare*'s new digital "supply drops" content and revenues from *Heroes of the Storm* which was released on June 2, 2015 with no comparable release during the prior periods. These were partially offset by lower revenues recognized from *World of Warcraft*, primarily due to a decline in the subscriber base, and for the six months ended June 30, 2015, lower revenues recognized from the Diablo franchise due to the timing of title releases.

Consolidated Results

Net Revenues by Geographic Region

The following table details our consolidated net revenues by geographic region for the three and six months ended June 30, 2015 and 2014 (amounts in millions):

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

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2015	2014	Increase/ (Decrease)	2015	2014	Increase/ (Decrease)
Geographic region net revenues:						
North America	\$ 551	\$ 471	\$ 80	\$ 1,255	\$ 1,035	\$ 220
Europe	388	395	(7)	852	856	(4)
Asia Pacific	105	104	1	215	190	25
Consolidated net revenues	\$ 1,044	\$ 970	\$ 74	\$ 2,322	\$ 2,081	\$ 241

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

Table of Contents

The increase/(decrease) in deferred revenues recognized by geographic region for the three and six months ended June 30, 2015 and 2014 was as follows (amounts in millions):

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2015	2014	Increase/ (Decrease)	2015	2014	Increase/ (Decrease)
Increase/(decrease) in deferred revenues recognized by geographic region:						
North America	\$ 198	\$ 177	\$ 21	\$ 548	\$ 411	\$ 137
Europe	113	113		309	237	72
Asia Pacific	(26)	22	(48)	3	3	
Total impact on consolidated net revenues	285	312	(27)	860	651	209

North America

Net revenues increased in North America for the three and six months ended June 30, 2015, as compared to 2014. This was mainly due to revenues recognized from *Destiny* and its expansion packs, which had no comparable title releases during the prior periods, from *World of Warcraft*, primarily associated with *World of Warcraft: Warlords of Draenor* and value added services, and from *Hearthstone: Heroes of Warcraft* and its associated expansions and adventures. These increases were partially offset by revenues from the release of *The Amazing Spider-Man 2* in the prior periods, with no comparable release in the current periods. Additionally, for the six months ended June 30, 2015, the increase in net revenues was partially offset by lower revenues recognized from Call of Duty catalog titles.

The increase in deferred revenues recognized for the three and six months ended June 30, 2015, as compared to 2014, was primarily attributed to recognition of deferred revenues from *Destiny* and from *World of Warcraft*, primarily associated with *World of Warcraft: Warlords of Draenor* and value added services. Additionally, during the six months ended June 30, 2015, the increase in deferred revenues recognized was attributable to *Diablo III: Reaper of Souls*, which was released on PC in March 2014, and *Diablo III: Reaper of Souls Ultimate Evil Edition*, which was released on consoles in August 2014. These increases were partially offset by lower deferred revenues recognized from the Call of Duty franchise.

Europe

Net revenues decreased in Europe for the three and six months ended June 30, 2015, as compared to 2014. The decrease was mainly due to lower net revenues recognized from the *Diablo* franchise, Call of Duty catalog titles, *The Amazing Spider-Man 2*, which did not have a comparable release in 2015, and from the Distribution segment. These decreases were partially offset by revenues from *Destiny* and its expansion packs, which had no comparable title releases during the prior periods, from *Hearthstone: Heroes of Warcraft* and its associated expansions and adventures, and from the launch of *Heroes of the Storm* in 2015.

Deferred revenues recognized for the three months ended June 30, 2015, as compared to 2014, remained consistent between periods. This was attributable to the increase in deferred revenues recognized from *World of Warcraft*, primarily associated with *World of Warcraft: Warlords of*

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

Draenor and value added services, and from *Destiny*, offset by a decrease in deferred revenues recognized from *Call of Duty: Advanced Warfare*, as compared to *Call of Duty: Ghosts*, and the Diablo franchise.

The increase in deferred revenues recognized for the six months ended June 30, 2015, as compared to 2014, was primarily attributed to the recognition of deferred revenues from *Destiny* and from *World of Warcraft*, primarily associated with *World of Warcraft: Warlords of Draenor* and value added services. These increases were partially offset by a decrease in deferred revenues recognized from *Call of Duty: Advanced Warfare*, as compared to *Call of Duty: Ghosts*, as well as decreased deferred revenues from the Call of Duty catalog.

Asia Pacific

Net revenues increased in Asia Pacific for the three and six months ended June 30, 2015, as compared to 2014. The increase was mainly due to revenues from *Destiny* and its expansion packs, which had no comparable title releases during the prior year, along with minor increases to revenues across our other various franchises, partially offset by decreased revenues from *Diablo III: Reaper of Souls*, which was released in March 2014.

Table of Contents

Deferred revenues recognized decreased for the three months ended June 30, 2015, as compared to 2014, primarily due to lower deferred revenues recognized from the Diablo III and Hearthstone franchises, partially offset by increased deferred revenues recognized from the World of Warcraft franchise.

Deferred revenues recognized remained flat for the six months ended June 30, 2015, as compared to 2014, primarily due to increased deferred revenues recognized from *Destiny* and its expansions packs and from the World of Warcraft franchise, offset by decreased deferred revenues recognized from the Call of Duty and Hearthstone franchises.

Foreign Exchange Impact

Changes in foreign exchange rates had a negative impact of \$103 million and \$210 million on our consolidated net revenues for the three and six months ended June 30, 2015, respectively, as compared to the same periods 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.

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 and six months ended June 30, 2015 and 2014 (amounts in millions):

	Three Months Ended June 30, 2015	% of total (3) consolidated net revs.	Three Months Ended June 30, 2014	% of total (3) consolidated net revs.	Increase/ (Decrease)
Platform net revenues:					
Online (1)	\$ 221	21%	\$ 195	20%	\$ 26
PC	149	14	182	19	(33)
Next-generation (PS4, Xbox One, Wii U)	317	30	137	14	180
Prior-generation (PS3, Xbox 360, Wii)	242	23	342	35	(100)
Total Console	559	54	479	49	80
Mobile and other (2)	54	5	48	5	6
Total Activision Blizzard	983	94	904	93	79
Distribution	61	6	66	7	(5)
Total consolidated net revenues	\$ 1,044	100%	\$ 970	100%	\$ 74

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

Table of Contents

	Six Months Ended June 30, 2015	% of total (3) consolidated net revs.	Six Months Ended June 30, 2014	% of total (3) consolidated net revs.	Increase/ (Decrease)
Platform net revenues:					
Online (1)	\$ 492	21%	\$ 395	19%	\$ 97
PC	263	11	281	14	(18)
Next-generation (PS4, Xbox One, Wii U)	751	32	245	12	506
Prior-generation (PS3, Xbox 360, Wii)	566	24	889	43	(323)
Total Console	1,317	57	1,134	54	183
Mobile and other (2)	141	6	131	6	10
Total Activision Blizzard	2,213	95	1,941	93	272
Distribution	109	5	140	7	(31)
Total consolidated net revenues	\$ 2,322	100%	\$ 2,081	100%	\$ 241

The increase / (decrease) in deferred revenues recognized by platform for the three and six months ended June 30, 2015 and 2014 was as follows (amounts in millions):

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2015	2014	Increase/ (Decrease)	2015	2014	Increase/ (Decrease)
Increase/(decrease) in deferred revenues recognized by platform:						
Online (1)	\$ 64	\$ (6)	\$ 70	\$ 126	\$ (33)	\$ 159
PC	(36)	51	(87)	(48)	(88)	40
Next-generation (PS4, Xbox One, Wii U)	152	70	82	453	146	307
Prior-generation (PS3, Xbox 360, Wii)	131	208	(77)	355	637	(282)
Total console	283	278	5	808	783	25
Mobile and other (2)	(26)	(11)	(15)	(26)	(11)	(15)
Total impact on consolidated net revenues	\$ 285	\$ 312	\$ (27)	\$ 860	\$ 651	\$ 209

(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.

Net revenues from online increased for the three and six months ended June 30, 2015, as compared to 2014, primarily due to the recognition of previously deferred revenues from the expansion pack *World of Warcraft: Warlords of Draenor*, which was released in November 2014, and from associated value-added services including a paid character boost. This was partially offset by lower subscriptions revenues.

Table of Contents

Net revenues from PC decreased for the three and six months ended June 30, 2015, as compared to 2014, primarily due to lower revenues recognized from *Diablo III: Reaper of Souls*, which was released in March 2014, from *StarCraft II: Heart of the Swarm*®, which was released in March 2013, and from Call of Duty catalog titles. This was partially offset by revenues from *Heroes of the Storm*, which had no comparable title release during the prior periods, and from the Hearthstone: Heroes of Warcraft franchise, which was first launched on PC in March 2014.

Net revenues from next-generation consoles increased for the three and six months ended June 30, 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. Additionally, in 2015, we have released multiple expansion or map packs for *Destiny* and *Call of Duty: Advanced Warfare* on the next-generation consoles.

Net revenues from prior-generation consoles decreased for the three and six months ended June 30, 2015, as compared to 2014, primarily due to lower revenues recognized from the Call of Duty franchise and from *Diablo III* released on the PS3 and Xbox 360 in September 2013, revenues recognized during the prior period for *The Amazing Spider-Man 2*, and from the transition of players from prior-generation to next-generation platforms. These decreases were partially offset by revenues recognized from the *Destiny* franchise.

Net revenues from mobile and other increased for the three and six months ended June 30, 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 iPad and Android tablets in April and December 2014, respectively, along with the release on iPhone and Android smartphones in April 2015, and the associated release of its first expansion pack and adventures. These increases were 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 and six months ended June 30, 2015, as compared to 2014, primarily due to the recognition of deferred revenues from *World of Warcraft: Warlords of Draenor* and from value-added services revenues for *World of Warcraft*, primarily from a paid character boost.

Deferred revenues recognized for PC decreased for the three months ended June 30, 2015, as compared to 2014, primarily due to the recognition of deferred revenues during the prior period from *Diablo III: Reaper of Souls* and *Hearthstone: Heroes of Warcraft* upon their respective releases in the first quarter of 2014, without comparable activity during the current period.

Deferred revenues recognized for PC increased for the six months ended June 30, 2015, as compared to 2014, primarily due to the recognition of deferred 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 revenues for the six months ended June 30, 2015 from *Heroes of the Storm*.

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

The increase in deferred revenues recognized for next-generation consoles for the three and six months ended June 30, 2015, as compared to 2014, was due to the increased number of titles released for next-generation console platforms, as well as increasing consumer adoption of the PS4 and Xbox One, as discussed above.

The decrease in deferred revenues recognized for prior-generation consoles for the three and six months ended June 30, 2015, as compared to 2014, was primarily due to the increasing consumer adoption of next-generation console platforms.

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 and six months ended June 30, 2015 and 2014 (amounts in millions):

	Three Months Ended June 30, 2015	% of consolidated net revs.	Three Months Ended June 30, 2014	% of consolidated net revs.	Increase (Decrease)
Product costs	\$ 156	15%	\$ 187	19%	\$ (31)
Online	53	5	56	6	(3)
Software royalties and amortization	85	8	46	5	39
Intellectual property licenses	3		11	1	(8)
Total cost of sales	\$ 297	28%	\$ 300	31%	\$ (3)

	Six Months Ended June 30, 2015	% of consolidated net revs.	Six Months Ended June 30, 2014	% of consolidated net revs.	Increase (Decrease)
Product costs	\$ 364	16%	\$ 412	20%	\$ (48)
Online	106	4	115	5	(9)
Software royalties and amortization	233	10	102	5	131
Intellectual property licenses	7		13	1	(6)
Total cost of sales	\$ 710	30%	\$ 642	31%	\$ 68

Total cost of sales for the three months ended June 30, 2015 decreased as compared to the same period in 2014. Cost of sales – product costs decreased primarily due to lower revenues from our Distribution segment and our value business, each of which typically have relatively higher product costs, and an increase from digital online channel revenues, which have relatively lower product costs. Cost of sales – software royalties and amortization increased primarily due to the amortization of deferred royalties for *Destiny* and its associated expansion packs, with no comparable amortization during the three months ended June 30, 2014, as well as Blizzard software costs due to product releases.

Total cost of sales for the six months ended June 30, 2015 increased as compared to the same period in 2014, reflective of the increase in consolidated net revenues. Cost of sales – product costs decreased primarily due to lower revenues from the Distribution segment and our value business, each of which typically have relatively higher product costs, and an increase from digital online channel revenues, which have relatively lower product costs. Cost of sales – software royalties and amortization increased primarily due to the amortization of deferred royalties for *Destiny* and its two expansion packs, *The Dark Below* and *House of Wolves*, released on December 8, 2014 and May 9, 2015, respectively, with no comparable amortization during the six months ended June 30, 2014, as well as Blizzard software costs due to product releases.

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

Product Development (amounts in millions)

	June 30, 2015	% of consolidated net revs.	June 30, 2014	% of consolidated net revs.	Increase (Decrease)
Three Months Ended	\$ 149	14%	\$ 112	12%	\$ 37
Six Months Ended	\$ 294	13%	\$ 255	12%	\$ 39

Product development costs increased for the three and six months ended June 30, 2015, as compared to 2014, primarily from increased costs to support our future title releases, a decrease in costs capitalized, increased studio bonuses reflecting strong performance, primarily related to *Call of Duty: Advanced Warfare*, as well as increased Blizzard product development costs.

Sales and Marketing (amounts in millions)

	June 30, 2015	% of consolidated net revs.	June 30, 2014	% of consolidated net revs.	Increase (Decrease)
Three Months Ended	\$ 164	16%	\$ 141	14%	\$ 23
Six Months Ended	\$ 256	11%	\$ 245	12%	\$ 11

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

Table of Contents

Sales and marketing costs increased for the three and six months ended June 30, 2015, as compared to 2014, primarily driven by the timing of marketing spending to support our title releases, specifically, the launch of *Heroes of the Storm* in June 2015, additional spending on the *Hearthstone: Heroes of Warcraft* franchise, and marketing for the planned re-launch of *Guitar Hero*. These costs were partially offset by lower sales and marketing spending, as compared to the prior periods, on the *Skylanders* and *Destiny* franchises, and higher spending in the prior periods related to the launch of *Diablo III: Reaper of Souls* in March 2014.

General and Administrative (amounts in millions)

	June 30, 2015	% of consolidated net revs.	June 30, 2014	% of consolidated net revs.	Increase (Decrease)
Three Months Ended	\$ 102	10%	\$ 107	11%	\$ (5)
Six Months Ended	\$ 188	8%	\$ 202	10%	\$ (14)

General and administrative expenses decreased for the three and six months ended June 30, 2015, as compared to 2014, primarily due to lower Blizzard bonuses based on operating results, as compared to the prior periods, lower stock compensation expense, and a favorable foreign exchange impact on revaluation and our hedging program for the three and six months ended June 30, 2015.

Interest and Other Expense, Net (amounts in millions)

	June 30, 2015	% of consolidated net revs.	June 30, 2014	% of consolidated net revs.	Increase (Decrease)
Three Months Ended	\$ 50	5%	\$ 50	5%	\$
Six Months Ended	\$ 100	5%	\$ 101	4%	\$ (1)

Interest and other expense, net, did not significantly change for the three and six months ended June 30, 2015, as compared to the same periods in 2014.

Income Tax Expense (amounts in millions)

June 30, 2015

June 30, 2014

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

			% of pretax income			% of pretax income		Increase (Decrease)
Three Months Ended	\$	70	25%	\$	56	22%	\$	14
Six Months Ended	\$	168	22%	\$	139	22%	\$	29

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 \$70 million for the three months ended June 30, 2015 reflects an effective tax rate of 25%, which is higher than the effective tax rate of 22% for the three months ended June 30, 2014. This increase is primarily due to an increase in the estimated annual effective tax rate due to the projected mix of earnings in different jurisdictions taxed at different rates.

Table of Contents

The income tax expense of \$168 million for the six months ended June 30, 2015 reflects an effective tax rate of 22%, which is comparable to the effective tax rate of 22% for the six months ended June 30, 2014.

The effective tax rates of 25% and 22% for the three and six months ended June 30, 2015, respectively, differed from the U.S. statutory rate of 35%, 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 and six months ended June 30, 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. During the three months ended June 30, 2015, the Company transitioned the review of its transfer pricing methodology from the advanced pricing agreement review process to the IRS examination team. Their review 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 a determination 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.

The final resolution of the Company's global tax disputes is uncertain. There is significant judgment required in the analysis of disputes, including the probability determination and estimation of the potential exposure. 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 six months ended June 30, 2015, we utilized \$194 million of the NOL, which resulted in a tax benefit of \$68 million, and a corresponding reserve was established as the position did not meet the more-likely-than-not standard. As of June 30, 2015, an indemnification asset of \$136 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

Liquidity and Capital Resources

Sources of Liquidity (amounts in millions)

	At June 30, 2015	At December 31, 2014	Increase (Decrease)
Cash and cash equivalents	\$ 4,416	\$ 4,848	\$ (432)
Short-term investments	105	10	95
	\$ 4,521	\$ 4,858	\$ (337)
Percentage of total assets	32%	33%	

For the Six Months Ended June 30,

	2015	2014	Increase (Decrease)
Cash flows provided by operating activities	\$ 344	\$ 242	\$ 102
Cash flows used in investing activities	(144)	(34)	(110)
Cash flows used in financing activities	(360)	(396)	36
Effect of foreign exchange rate changes	(272)	(23)	(249)
Net decrease in cash and cash equivalents	\$ (432)	\$ (211)	\$ (221)

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 six months ended June 30, 2015, as compared to the same period in 2014, primarily due to higher net income for the period and adjustments to net income for non-cash charges, including amortization of capitalized software development costs, primarily associated with *Destiny* and its related expansions, offset by changes in our working capital accounts.

Cash Flows Used in Investing Activities

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

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 \$144 million for the six months ended June 30, 2015, as compared to \$34 million for the six months ended June 30, 2014. The increase in cash used was primarily due to \$100 million of purchases of available-for-sale investments for the six months ended June 30, 2015, with no corresponding purchases during the prior year, and a decrease in investments maturing during the six months ended June 30, 2015, as compared to the prior year. This was partially offset by lower capital expenditure during the six months ended June 30, 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 six months ended June 30, 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. This was partially offset by lower proceeds from stock options exercised by our employees and the higher cash dividend payment made during the six months ended June 30, 2015, as compared to 2014.

Table of Contents

Effect of Foreign Exchange Rate Changes

Changes in foreign exchange rates had a negative impact of \$272 million and \$23 million on our cash and cash equivalents for the six months ended June 30, 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 June 30, 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 (\$4.5 billion at June 30, 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; and payments related to debt obligations.

As of June 30, 2015 and December 31, 2014, the amount of cash and cash equivalents held outside of the U.S. by our foreign subsidiaries was \$3.6 billion. 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.

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 June 30, 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.

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

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 were no letters of credit issued and outstanding under the Revolver at either June 30, 2015 or December 31, 2014.

As of June 30, 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 June 30, 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.

Table of Contents

The Credit Agreement requires 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 June 30, 2015. Amounts borrowed under the Term Loan and repaid may not be re-borrowed.

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 may 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 June 30, 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 six months of 2015, we made aggregate capital expenditures of \$49 million.

Off-balance Sheet Arrangements

At June 30, 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

Table of Contents

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:

- 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 six months ended June 30, 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.

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, 2018 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.

Table of Contents

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.

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

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

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 expense, net in our condensed consolidated statements of operations, depending on the nature of the underlying transactions.

Table of Contents

At June 30, 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 and six months ended June 30, 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 \$150 million at June 30, 2015 and \$119 million at June 30, 2014. At December 31, 2014, there were no outstanding foreign currency forward contracts designated as cash flow hedges. During the three and six months ended June 30, 2015, there was no ineffectiveness relating to these hedges. The net unrealized gains of approximately \$6 million related to these contracts at June 30, 2015 are expected to be reclassified into earnings within the next twelve months.

In the absence of the hedging activities described above, for the six months ended June 30, 2015, a hypothetical adverse foreign currency exchange rate movement of 10% would have resulted in potential declines of our net income of approximately \$66 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 June 30, 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.

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

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

June 30, 2015, our \$4.42 billion of cash and cash equivalents were comprised primarily of money market funds. At June 30, 2015, our \$105 million of short-term investments included \$100 million of U.S. treasury and government-sponsored agency debt securities and \$5 million of restricted cash. We also had \$9 million in auction rate securities at fair value classified as long-term investments at June 30, 2015. The Company has determined that, based on the composition of our investment portfolio as of June 30, 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

Table of Contents

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 June 30, 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 June 30, 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 June 30, 2015, of our internal control over financial reporting using the 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 June 30, 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.

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.

Table of Contents

Purchase Transaction Matters

In prior periods, the Company reported on litigation related to the Purchase Transaction. During the period ended June 30, 2015, the cases were resolved and dismissed with prejudice. As part of the resolution of the claims, we received a settlement payment of \$202 million in July 2015 from Vivendi, ASAC, and our insurers. We recorded the settlement within Shareholders' equity with the receivable in Other current assets in our condensed consolidated balance sheet as of June 30, 2015.

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: August 4, 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 May 28, 2015, to the ASAC Stockholders Agreement among the Company, ASAC and, for the limited purposes set forth therein, Mr. Kotick and Mr. Kelly (incorporated by reference to Exhibit 10.2 of the Company's Form 8-K, filed June 2, 2015).
10.2*	Non-Affiliated Director Compensation Program and Stock Ownership Guidelines, as amended and restated as of July 28, 2015.
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.

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

*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 June 30, 2015 and December 31, 2014, (ii) Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2015 and June 30, 2014, (iii) Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2015 and June 30, 2014, (iv) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2015 and June 30, 2014; (v) Condensed Consolidated Statement of Changes in Shareholders' Equity for the six months ended June 30, 2015; and (vi) Notes to Condensed Consolidated Financial Statements.