

Activision Blizzard, Inc.

Form 10-Q

November 06, 2009

**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 September 30, 2009

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.)

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

3100 Ocean Park Boulevard, Santa Monica, CA  
(Address of principal executive offices)

90405  
(Zip Code)

(310) 255-2000

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

The number of shares of the registrant's Common Stock outstanding at October 30, 2009 was 1,268,298,995.

Table of Contents

**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**

**Table of Contents**

	<u>Explanatory Note</u>	3
	<u>Cautionary Statement</u>	3
<b><u>PART I.</u></b>	<b><u>FINANCIAL INFORMATION</u></b>	
<b><u>Item 1.</u></b>	<b><u>Financial Statements (Unaudited)</u></b>	
	<u>Condensed Consolidated Balance Sheets at September 30, 2009 and December 31, 2008</u>	4
	<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2009 and September 30, 2008</u>	5
	<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2009 and September 30, 2008</u>	6
	<u>Condensed Consolidated Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2009</u>	7
	<u>Notes to Condensed Consolidated Financial Statements</u>	8
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	26
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	42
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b>	43
<b><u>PART II.</u></b>	<b><u>OTHER INFORMATION</u></b>	43
<b><u>Item 1.</u></b>	<b><u>Legal Proceedings</u></b>	43
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b>	44
<b><u>Item 2.</u></b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	44
<b><u>Item 6.</u></b>	<b><u>Exhibits</u></b>	44
	<b><u>SIGNATURE</u></b>	45
	<b><u>EXHIBIT INDEX</u></b>	46
	<b>CERTIFICATIONS</b>	



Table of Contents

**EXPLANATORY NOTE**

*On July 9, 2008, a business combination (the Business Combination ) by and among Activision, Inc., Sego Merger Corporation, a wholly-owned subsidiary of Activision, Inc., Vivendi S.A. ( Vivendi ), VGAC LLC, a wholly-owned subsidiary of Vivendi, and Vivendi Games, Inc. ( Vivendi Games ), a wholly-owned subsidiary of VGAC LLC, was consummated. As a result of the consummation of the Business Combination, Activision, Inc. was renamed Activision Blizzard, Inc. For accounting purposes, the Business Combination is treated as a reverse acquisition, with Vivendi Games deemed to be the acquirer. The historical financial statements of Activision Blizzard, Inc. prior to July 10, 2008 are those of Vivendi Games (see Note 1 of Condensed Consolidated Financial Statements for more details).*

**CAUTIONARY STATEMENT**

*This Quarterly Report on Form 10-Q contains, or incorporates by reference, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements consist of any statement other than a recitation of historical fact and include, but are not limited to, (1) projections of revenues, expenses, income or loss, earnings or loss per share, cash flow or other financial items; (2) statements of our plans and objectives, including those relating to product releases; (3) statements of future economic performance; and (4) statements of assumptions underlying such statements. We generally use words such as anticipate, believe, could, estimate, expect, forecast, future, intend, may, outlook, plan, positioned, potential, project, remain, scheduled, set to, subject to, to be, upcoming, will, and other similar expressions to help identify forward-looking statements. Forward-looking statements are subject to business and economic risk, reflect management's current expectations, estimates and projections about our business, and are inherently uncertain and difficult to predict. Our actual results could differ materially. The forward-looking statements contained herein speak only at the date on which this Form 10-Q was first filed. Risks and uncertainties that may affect our future results include, but are not limited to, sales levels of our titles, shifts in consumer spending trends, the impact of the current macroeconomic environment, the seasonal and cyclical nature of the interactive game market, any further difficulties related to World of Warcraft in China, our ability to predict consumer preferences among competing hardware platforms, declines in software pricing, product returns and price protection, product delays, retail acceptance of our products, adoption rate and availability of new hardware (including peripherals) and related software, industry competition, rapid changes in technology, industry standards and customer preferences, protection of proprietary rights, litigation, maintenance of relationships with key personnel, customers, licensees, licensors, vendors and third-party developers, counterparty risks relating to customers, licensees, licensors and manufacturers, domestic and international economic, financial and political conditions and policies, foreign exchange rates and tax rates, integration of recent acquisitions and the identification of suitable future acquisition opportunities, and the other factors identified in Risk Factors included in Part II, Item 1A of this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2008. 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. Forward-looking statements believed to be true when made 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.*

Table of Contents

**Part I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

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

(Unaudited)

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

	At September 30, 2009	At December 31, 2008
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 2,360	\$ 2,958
Short-term investments	361	44
Accounts receivable, net of allowances of \$230 million and \$268 million at September 30, 2009 and December 31, 2008, respectively	228	974
Inventories	351	262
Software development	253	235
Intellectual property licenses	65	35
Deferred income taxes, net	727	536
Intangible assets, net	1	14
Other current assets	162	201
Total current assets	4,508	5,259
Long-term investments	22	78
Software development	15	1
Intellectual property licenses		5
Property and equipment, net	133	149
Other assets	12	30
Intangible assets, net	1,168	1,283
Trademark and trade names	433	433
Goodwill	7,161	7,227
Total assets	\$ 13,452	\$ 14,465
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 282	\$ 319
Deferred revenues	471	923
Accrued expenses and other liabilities	532	842
Total current liabilities	1,285	2,084
Deferred income taxes, net	685	615
Other liabilities	190	239
Total liabilities	2,160	2,938
Commitments and contingencies (Note 16)		
Shareholders' equity:		
Common stock, \$.000001 par value per share, 2,400,000,000 shares authorized, 1,356,273,202 and 1,325,206,032 shares issued at September 30, 2009 and December 31, 2008, respectively		
Additional paid-in capital	12,332	12,170
Less: Treasury stock, at cost, 88,802,250 and 12,967,265 shares at September 30, 2009 and December 31, 2008, respectively	(960)	(126)
Accumulated deficit	(75)	(474)
Accumulated other comprehensive loss	(5)	(43)
Total shareholders' equity	11,292	11,527
Total liabilities and shareholders' equity	\$ 13,452	\$ 14,465

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**

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

(Unaudited)

(Amounts in millions, except per share data)

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	2008	2009	2008
<b>Net revenues</b>				
Product sales	\$ 411	\$ 413	\$ 1,848	\$ 553
Subscription, licensing, and other revenues	292	298	874	834
<b>Total net revenues</b>	<b>703</b>	<b>711</b>	<b>2,722</b>	<b>1,387</b>
<b>Costs and expenses</b>				
Cost of sales product costs	185	279	762	350
Cost of sales software royalties and amortization	54	50	212	88
Cost of sales intellectual property licenses	45	36	163	45
Cost of sales massively multi-player online role-playing game ( MMORPG )	55	43	158	123
Product development	122	200	362	414
Sales and marketing	128	142	329	220
General and administrative	106	94	301	172
Restructuring	(1)	61	29	61
<b>Total costs and expenses</b>	<b>694</b>	<b>905</b>	<b>2,316</b>	<b>1,473</b>
<b>Operating income (loss)</b>	<b>9</b>	<b>(194)</b>	<b>406</b>	<b>(86)</b>
<b>Investment and other income, net</b>	<b>11</b>	<b>24</b>	<b>21</b>	<b>28</b>
<b>Income (loss) before income tax expense (benefit)</b>	<b>20</b>	<b>(170)</b>	<b>427</b>	<b>(58)</b>
<b>Income tax expense (benefit)</b>	<b>5</b>	<b>(62)</b>	<b>28</b>	<b>(22)</b>
<b>Net income (loss)</b>	<b>\$ 15</b>	<b>\$ (108)</b>	<b>\$ 399</b>	<b>\$ (36)</b>
<b>Earnings (loss) per common share, basic</b>	<b>\$ 0.01</b>	<b>\$ (0.08)</b>	<b>\$ 0.31</b>	<b>\$ (0.04)</b>
<b>Earnings (loss) per common share, diluted</b>	<b>\$ 0.01</b>	<b>\$ (0.08)</b>	<b>\$ 0.30</b>	<b>\$ (0.04)</b>
<b>Weighted-average shares outstanding</b>				
Basic	1,271	1,271	1,289	816
Diluted	1,297	1,271	1,320	816



**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)

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

	For the nine months ended September 30,	
	2009	2008
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 399	\$ (36)
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Deferred income taxes	(70)	(109)
Depreciation and amortization	187	144
Impairment charges		24
Unrealized gain on auction rate securities classified as trading securities	(3)	
Unrealized loss on put option from UBS	3	
Amortization and write-off of capitalized software development costs and intellectual property licenses (1)	192	120
Stock-based compensation expense (2)	109	47
Tax (shortfall) benefit from employee stock option exercises	(1)	2
Excess tax benefits from stock option exercises	(68)	(17)
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	748	306
Inventories	(89)	(135)
Software development and intellectual property licenses	(229)	(119)
Other assets	53	(11)
Deferred revenues	(452)	10
Accounts payable	(39)	26
Accrued expenses and other liabilities	(370)	(127)
Net cash provided by operating activities	370	125
<b>Cash flows from investing activities:</b>		
Capital expenditures	(41)	(24)
Proceeds from sale of investments	2	
Proceeds from maturities of investments	9	
Cash acquired through the business combination, net of cash payments to effect acquisitions		1,137
Increase in restricted cash	(40)	(35)
Purchase of short-term investments	(228)	
Net cash (used in) provided by investing activities	(298)	1,078
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common stock to employees	63	19
Repurchase of common stock	(834)	
Repurchase of stock through tender offer		(2)
Return of capital to Vivendi		(79)
Issuance of additional common stock related to the business combination		1,731
Excess tax benefits from stock option exercises	68	17
Net cash transfers to Vivendi and affiliated companies		(79)
Net cash (used in) provided by financing activities	(703)	1,607
Effect of foreign exchange rate changes on cash and cash equivalents	33	(30)
Net (decrease) increase in cash and cash equivalents	(598)	2,780
Cash and cash equivalents at beginning of period	2,958	62
Cash and cash equivalents at end of period	\$ 2,360	\$ 2,842

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

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

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



Table of Contents

**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY**

For the Nine Months ended September 30, 2009

(Unaudited)

(Amounts in millions)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock Shares	Treasury Stock Amount	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Shareholders Equity
<b>Balance at December 31, 2008</b>	1,325	\$	\$ 12,170	(13)	\$ (126)	\$ (474)	\$ (43)	\$ 11,527
Components of comprehensive income:								
Net income						399		399
Foreign currency translation adjustment							38	38
Total comprehensive income								437
Issuance of common stock pursuant to employee stock options and restricted stock rights	28		63					63
Stock-based compensation expense related to employee stock options and restricted stock rights			117					117
Tax shortfall from employee stock option exercises			(1)					(1)
Issuance of contingent consideration	3		2					2
Shares repurchased				(76)	(834)			(834)
Return of capital to Vivendi related to settlement of pre-Business Combination taxes			(19)					(19)
<b>Balance at September 30, 2009</b>	1,356	\$	\$ 12,332	(89)	\$ (960)	\$ (75)	\$ (5)	\$ 11,292

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. Background and basis of presentation**

*Business*

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

*(i) Activision Publishing, Inc.*

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

*(ii) Blizzard Entertainment, Inc.*

Blizzard Entertainment, Inc. ( Blizzard ) is a leader in terms of subscriber base and revenues generated in the subscription-based massively multi-player online role-playing game ( MMORPG ) category. Blizzard internally develops and publishes PC-based computer games and maintains its proprietary online-game related service, Battle.net. Our Blizzard business involves the development, marketing, sales and support of role playing action and strategy games. Blizzard also develops, hosts, and supports its online subscription-based games in the MMORPG category. Blizzard is the development studio and publisher best known as the creator of World of Warcraft and the multiple award winning Diablo, StarCraft, and Warcraft franchises. Blizzard distributes its products and generates revenues worldwide through various means, including: subscription revenues (which consist of fees from individuals playing World of Warcraft, prepaid cards and other ancillary online revenues); retail sales of physical boxed products; electronic download sales of PC products; and licensing of software to third-party companies that distribute World of Warcraft in China, Russia, and Taiwan. Blizzard is currently developing new games, including sequels to the StarCraft and Diablo franchises. Blizzard has entered into licensing arrangements for *World of Warcraft*, *StarCraft II*, Battle.net and *Warcraft III* with an

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

affiliated company of NetEase.com, Inc. in China for a term of 3 years.

### (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.

### *Business Combination*

On July 9, 2008, a business combination (the Business Combination ) by and among Activision, Inc., Sego Merger Corporation, a wholly-owned subsidiary of Activision, Inc., Vivendi, VGAC LLC, a wholly-owned subsidiary of Vivendi, and Vivendi Games, a wholly-owned subsidiary of VGAC LLC, was consummated. As a result of the consummation of the Business Combination, Activision, Inc. was renamed Activision Blizzard, Inc. For accounting purposes, the Business Combination is treated as a reverse acquisition, with Vivendi Games deemed to be the acquirer. The historical financial statements of Activision Blizzard, Inc. prior to July 10, 2008 are those of Vivendi Games. See Note 1 of the Notes to Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2008 for a more complete discussion of the Business Combination.

Activision Blizzard continues to operate as a public company traded on NASDAQ under the ticker symbol ATVI and now conducts the combined business operations of Activision, Inc. and Vivendi Games including its subsidiary, Blizzard.

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

### Table of Contents

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

#### *Activision Blizzard's non-core exit operations*

Activision Blizzard's non-core exit operations ( Other or Non-Core ) represent legacy Vivendi Games divisions or business units that we have exited, divested or wound down as part of our restructuring and integration efforts as a result of the Business Combination described above, but do not meet the criteria for separate reporting of discontinued operations. Prior to July 1, 2009, Non-Core activities were managed as a stand-alone operating segment, however, in light of the decreasing significance of Non-Core activities, as of that date we ceased their management as a separate operating segment and consequently we are no longer providing separate operating segment disclosure and have reclassified our prior periods' segment presentation so that it conforms to the current periods' presentation.

#### *Basis of Presentation*

Activision Blizzard prepared the accompanying unaudited Condensed Consolidated Financial Statements in accordance with the rules and regulations of the Securities and Exchange Commission for interim reporting. As permitted under those rules and regulations, certain notes or other information that are normally required by accounting principles generally accepted in the United States of America ( U.S. GAAP ) have been condensed or omitted if they substantially duplicate the disclosures contained in the annual audited Consolidated Financial Statements. The unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation of our financial position and results of operations in accordance with U.S. GAAP have been included.

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

The prior year condensed consolidated balance sheet as of December 31, 2008 and condensed consolidated statement of cash flows for the nine months ended September 30, 2008 have been adjusted to correct immaterial errors related to the elimination of intercompany receivables and payables. The corrections reduced accounts receivable and accounts payable line items in the December 31, 2008 condensed consolidated balance sheet by \$236 million, and the September 30, 2008 condensed consolidated balance sheet (not presented herein) by \$82 million, which increased the change in accounts receivable and decreased the change in accounts payable reflected in the condensed consolidated statement of cash flows for the nine months ended September 30, 2008 by \$82 million. These corrections had no impact on net income, earnings (loss) per share, working capital or net cash provided by operating, investing and financing activities.

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



## 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. Subsequent events have been evaluated through November 6, 2009, the date of issuance of these financial statements.

### 2. Summary of significant accounting policies

#### *Financial Instruments*

The estimated fair values of financial instruments have been determined using available market information and valuation methodologies described below. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein may not be indicative of the amounts that we could realize in a current market exchange. The use of different market assumptions or valuation methodologies may have a material effect on the estimated fair value amounts.

The carrying amount of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses are a reasonable approximation of fair value due to their short-term nature. At September 30, 2009, our \$361 million of short-term investments included \$54 million of auction rate securities ( ARS ) classified as trading, \$228 million of U.S. government agency securities

Table of Contents

classified as available-for-sale, \$77 million of restricted cash, and \$2 million of mortgage-backed securities. The U.S. government agency securities and mortgage-backed securities are carried at fair value with fair values estimated based on quoted market prices. Long-term investments represent ARS classified as available-for-sale. Both short-term and long-term ARS, which are comprised of student loan backed securities, are carried at fair value with fair values estimated using an income-approach model (discounted cash-flow analysis).

*Other-Than-Temporary Impairments*

A debt security is considered to be other-than-temporarily impaired if the present value of cash flows expected to be collected are less than the security's amortized cost basis (the difference being defined as the credit loss) or if the fair value of the security is less than the security's amortized cost basis and we intend, or more-likely-than-not will be required, to sell the security before recovery of the security's amortized cost basis. If an other-than-temporary impairment exists, the charge to earnings is limited to the amount of credit loss if we do not intend to sell the security, and it is more-likely-than-not that we will not be required to sell the security, before recovery of the security's amortized cost basis. Any remaining difference between fair value and amortized cost is recognized in other comprehensive income, net of applicable taxes. Otherwise, the entire difference between fair value and amortized cost is charged to earnings.

*Derivative Financial Instruments*

On January 1, 2009, we adopted an amendment issued by the Financial Accounting Standards Board ( FASB ) regarding disclosures about derivative investments and hedging activities. The adoption of such amendment had no financial impact on our Condensed Consolidated Financial Statements and only required additional financial statement disclosures. We have applied the requirements of the amendment on a prospective basis. Accordingly, disclosures related to interim periods prior to the date of adoption have not been presented. At September 30, 2009, no financial statement disclosures were included in our Condensed Consolidated Financial Statements due to immateriality.

**3. Inventories**

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

	At September 30, 2009		At December 31, 2008	
Finished goods	\$	320	\$	251
Purchased parts and components		31		11
	\$	351	\$	262

**4. Goodwill**

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

The changes in the carrying amount of goodwill by operating segment for the nine months ended September 30, 2009 are as follows (amounts in millions):

	Activision	Blizzard	Distribution	Total
Balance at December 31, 2008	\$ 7,037	\$ 178	\$ 12	\$ 7,227
Issuance of contingent consideration	2			2
Goodwill acquired	3			3
Purchase accounting adjustments	(6)			(6)
Tax benefit credited to goodwill	(67)			(67)
Effect of foreign exchange rate changes	2			2
Balance at September 30, 2009	\$ 6,971	\$ 178	\$ 12	\$ 7,161

Issuance of contingent consideration consists of additional purchase consideration paid during 2009 in relation to previous acquisitions. The tax benefit credited to goodwill represents the tax deduction resulting from the exercise of stock options that



Table of Contents

were outstanding and vested at the consummation of the Business Combination and included in the purchase price of Activision, Inc. to the extent that the tax deduction did not exceed the fair value of those options.

## 5. Intangible assets, net

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

		At September 30, 2009		
	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
<b>Finite-lived intangible assets:</b>				
License agreements	3 - 10 years	\$ 209	\$ (26)	\$ 183
Developed software	1 - 2 years	288	(286)	2
Game engines	2 - 5 years	133	(66)	67
Internally developed franchises	11 - 12 years	1,124	(218)	906
Favorable leases	1 - 4 years	5	(3)	2
Distribution agreements	4 years	18	(9)	9
Total finite-lived intangible assets		1,777	(608)	1,169
<b>Indefinite-lived intangible assets:</b>				
Activision trademark	Indefinite	386		386
Acquired trade names	Indefinite	47		47
Total		\$ 2,210	\$ (608)	\$ 1,602

		At December 31, 2008		
	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
<b>Finite-lived intangible assets:</b>				
License agreements	3 - 10 years	\$ 207	\$ (12)	\$ 195
Developed software	1 - 2 years	286	(272)	14
Game engines	2 - 5 years	134	(42)	92
Internally developed franchises	11 - 12 years	1,124	(145)	979
Favorable leases	1 - 4 years	5	(1)	4
Distribution agreements	4 years	17	(5)	12
Other intangibles	0 - 2 years	5	(4)	1
Total finite-lived intangible assets		1,778	(481)	1,297
<b>Indefinite-lived intangible assets:</b>				
Activision trademark	Indefinite	386		386
Acquired trade names	Indefinite	47		47
Total		\$ 2,211	\$ (481)	\$ 1,730

**Amortization expense of intangible assets for the three and nine months ended September 30, 2009 was \$39 million and \$129 million, respectively. Amortization expense of intangible assets for the three and nine months ended September 30, 2008 was \$90 million and \$92 million, respectively.**

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

At September 30, 2009, future amortization of finite-lived intangible assets is estimated as follows (amounts in millions):

2009 (remaining three months)	\$	153
2010		213
2011		146
2012		123
2013		106
Thereafter		428
Total	\$	1,169

Table of Contents

6. Income taxes

The income tax expense of \$5 million for the three months ended September 30, 2009 reflects an effective tax rate of 26%. The effective tax rate of 26% for the three months ended September 30, 2009 differs from the statutory rate of 35% primarily due to foreign income taxes provided at lower rates, geographic mix in profitability, recognition of research and development credits and IRC 199 domestic production deductions.

For the nine months ended September 30, 2009, the tax rate is based on our projected annual effective tax rate for 2009, and also includes certain discrete tax benefits recorded during the period. Our tax expense of \$28 million for the nine months ended September 30, 2009 reflects an effective tax rate of 7% which differs from the statutory rate of 35% for the nine months ended September 30, 2008 primarily due to lower foreign income tax rates and certain discrete tax benefits recorded during the period related to the release of valuation allowances on foreign net operating losses and the impact of changes to California tax laws.

We evaluate our deferred tax assets, including net operating losses, to determine if a valuation allowance is required. We assess whether a valuation allowance should be established or released based on the consideration of all available evidence using a more likely than not standard. In making such judgments, significant weight is given to evidence that can be objectively verified. At December 31, 2008 we had a foreign net operating loss valuation allowance of \$23 million. The ultimate realization of the foreign net operating losses depends upon the generation of future taxable income during the periods in which those temporary differences become deductible. We currently expect to realize these net operating losses through taxable income; therefore, in the first quarter of 2009, we released a valuation allowance of \$23 million against our deferred tax assets.

California Senate Bill No.15 was enacted in February 20, 2009 and contains significant changes to the state of California tax landscape. When there is an enacted change in tax laws or rate, we adjust our deferred tax liabilities and assets to reflect the change. During the nine months ended September 30, 2009, we reduced our net deferred tax liabilities and tax provision by \$10 million.

Prior to the Business Combination, Vivendi Games' income taxes are presented in the financial statements as if Vivendi Games were a stand-alone taxpayer even though Vivendi Games' operating results are included in the consolidated federal, certain foreign, and state and local income tax returns of Vivendi or Vivendi's subsidiaries. Based on the subsequent filing of these tax returns by Vivendi or Vivendi's subsidiaries, we determined that the amount paid by Vivendi Games was greater than the actual amount due (and settled) based upon filing of these returns. This difference between the amount paid and the actual amount due (and settled) represents a return of capital to Vivendi, which was required in accordance with the terms of the Business Combination agreement immediately prior to the close of the Business Combination. This difference has resulted in no additional payment to Vivendi and no impact to our consolidated statement of cash flows for the nine months ended September 30, 2009.

7. Software development costs and intellectual property licenses

At September 30, 2009, capitalized software development costs included \$211 million of internally developed software costs and \$57 million of payments made to third-party software developers. At December 31, 2008, capitalized software development costs included \$173 million of internally developed software costs and \$63 million of payments made to third-party software developers. Capitalized intellectual property

licenses were \$65 million and \$40 million at September 30, 2009 and December 31, 2008, respectively. Amortization of capitalized software development costs and intellectual property licenses for the three months ended September 30, 2009 and 2008 was \$41 million and \$19 million, respectively. Write-offs and impairments were \$2 million and \$62 million for the three months ended September 30, 2009 and 2008, respectively. Amortization of capitalized software development costs and intellectual property licenses for the nine months ended September 30, 2009 and 2008 were \$210 million and \$26 million, respectively. Write-offs and impairments were \$2 million and \$94 million for the nine months ended September 30, 2009 and 2008, respectively.

**8. Restructuring**

**We have substantially completed our implementation of our organizational restructuring plan as a result of the Business Combination described in Note 1 of the Notes to Condensed Consolidated Financial Statements. This organizational restructuring plan included the integration of different operations to streamline the combined organization of Activision Blizzard.**

**The primary goals of the organizational restructuring were to rationalize the title portfolio and consolidate certain corporate functions so as to realize the synergies of the Business Combination.**

Table of Contents

The following table details the changes in restructuring reserves included in accrued expenses and other liabilities in the Condensed Consolidated Balance Sheets for the nine months ended September 30, 2009 (amounts in millions):

	Severance		Facilities costs		Total
Balance at December 31, 2008	\$	37	\$	7	\$ 44
Costs charged to expense		21		8	29
Costs paid or otherwise settled		(42)		(5)	(47)
Foreign exchange and other		(1)		(1)	(2)
Balance at September 30, 2009	\$	15	\$	9	\$ 24

The total restructuring reserve balance and the net restructuring charges are presented below by operating segment (amounts in millions):

	Restructuring Reserve Balance		Restructuring Charges Nine months ended September 30, 2009
	At September 30, 2009	At December 31, 2008	
Activision	\$ 24	\$ 44	\$ 8
Blizzard			
Distribution			4
Total operating segments	24	44	12
Other (i)			17
Total	\$ 24	\$ 44	\$ 29

(i) Represents legacy Vivendi Games divisions or business units that the Company has exited, divested, or wound down as part of its restructuring and integration efforts as a result of the Business Combination. Currently, Non-Core activities, which are handled by certain functional departments of our Activision segment, are insignificant to Activision Blizzard's financial condition and results of operations. Prior to July 1, 2009, Non-Core activities were managed as a stand-alone operating segment, however, in light of the decreasing significance of Non-Core activities, as of that date we ceased their management as a separate operating segment and consequently we are no longer providing separate operating segment disclosure and have reclassified our prior periods' segment presentation so that it conforms to the current periods presentation.

## 9. Comprehensive income (loss) and accumulated other comprehensive income (loss)

### *Comprehensive Income (Loss)*

The components of comprehensive income (loss) for the three and nine months ended September 30, 2009 and 2008 were as follows (amounts in millions):

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

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Net income (loss)	\$ 15	\$ (108)	\$ 399	\$ (36)
Other comprehensive income (loss):				
Foreign currency translation adjustment	9	(26)	38	(25)
Unrealized depreciation on investments, net of taxes		(2)		(2)
Other comprehensive income (loss)	9	(28)	38	(27)
Comprehensive income (loss)	\$ 24	\$ (136)	\$ 437	\$ (63)

*Accumulated Other Comprehensive Income (Loss)*

For the nine months ended September 30, 2009 the components of accumulated other comprehensive loss were as follows (amounts in millions):

Table of Contents

	Foreign currency translation adjustment	Unrealized depreciation on investments	Accumulated other comprehensive loss
Balance at December 31, 2008	\$ (41)	\$ (2)	\$ (43)
Other comprehensive income	38		38
Balance at September 30, 2009	\$ (3)	\$ (2)	\$ (5)

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

**10. Investment and other income, net**

Investment and other income, net comprises the following (amounts in millions):

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Interest income	\$ 4	\$ 17	\$ 16	\$ 22
Interest expense	(1)		(3)	
Net realized gain on investments		4		4
Unrealized gain on trading securities	1		3	
Unrealized loss on put option from UBS	(1)		(3)	
Net realized and unrealized gains on foreign exchange contracts and swaps with Vivendi		3		2
Change in fair value of other financial liability	8		8	
Investment and other income, net	\$ 11	\$ 24	\$ 21	\$ 28

**11. Investments***Available-for-Sale Investments*

The following table summarizes our short-term and long-term investments classified as available-for-sale at September 30, 2009 and December 31, 2008 (amounts in millions):

At September 30, 2009

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

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
<b>Short-term investments:</b>				
Mortgage-backed securities	\$ 2	\$	\$	\$ 2
U.S. government agency securities	228			228
<b>Long-term investments:</b>				
Taxable auction rate securities	27		(5)	22
Total available-for-sale investments	\$ 257	\$	\$ (5)	\$ 252

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
<b>At December 31, 2008</b>				
<b>Short-term investments:</b>				
Mortgage-backed securities	\$ 8	\$	\$ (1)	\$ 7
<b>Long-term investments:</b>				
Taxable auction rate securities	27		(4)	23
Total available-for-sale investments	\$ 35	\$	\$ (5)	\$ 30



Table of Contents

The following table illustrates the gross unrealized losses on available-for-sale securities and the fair value of those securities, aggregated by investment category at September 30, 2009 and December 31, 2008. The table also illustrates the length of time that they have been in a continuous unrealized loss position at September 30, 2009 and December 31, 2008 (amounts in millions):

At September 30, 2009	Less than 12 months		12 months or more		Total	
	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
Taxable auction rate securities	\$	\$	\$ (5)	\$ 22	\$ (5)	\$ 22

  

At December 31, 2008	Less than 12 months		12 months or more		Total	
	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
Mortgage-backed securities	\$ (1)	\$ 7	\$	\$	\$ (1)	\$ 7
Taxable auction rate securities	(4)	23			(4)	23
Total	\$ (5)	\$ 30	\$	\$	\$ (5)	\$ 30

The total unrealized loss of \$5 million at September 30, 2009 is due to the taxable ARS held through Morgan Stanley Smith Barney LLC, which is 51% owned by Morgan Stanley and 49% owned by Citigroup, Inc., as a result of failed auctions. (The ARS were held directly through a wholly owned subsidiary of Citigroup, Inc. until the Morgan Stanley Smith Barney LLC joint-venture closed in the second quarter 2009.) Our investments in ARS are all backed by higher education student loans.

Based upon our analysis of the available-for-sale investments with unrealized losses, we have concluded that the gross unrealized losses of \$5 million at September 30, 2009 were temporary in nature. We do not intend to sell the investment securities that are in an unrealized loss position and do not consider that it is more-likely-than-not that we will be required to sell the investment securities before recovery of their amortized cost basis, which may be maturity. We have not identified any issues related to the ultimate repayment of principal as a result of credit concerns on these securities. However, facts and circumstances may change which could result in a decline in fair value considered to be other-than-temporary in the future.

The following table summarizes the contractually stated maturities of our investments classified as available-for-sale at September 30, 2009 (amounts in millions):

At September 30, 2009	Amortized cost	Fair value
U.S. government agency securities due in 1 year or less	\$ 228	\$ 228
Mortgage-backed securities (not due at a single maturity date)	2	2
Due after ten years	27	22
	\$ 257	\$ 252

*Trading Investments*

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

In connection with our acceptance of the UBS offer in November 2008, (see Note 3 and Note 6 of the Notes to Consolidated Financial Statements of our Annual Report on Form 10-K for the year ended December 31, 2008 for more details), resulting in our right to require UBS AG ( UBS ) to purchase our ARS held through UBS (which are different from the taxable ARS discussed above under Available-for-Sale Investments) at par value beginning on June 30, 2010 (the Rights ), we reclassified our investments in the ARS from available-for-sale to trading securities. The reclassification to trading securities reflects management's intent to exercise the Rights during the period between June 30, 2010 and July 3, 2012, which results in the securities being held for the purpose of selling them in the near future. Prior to our agreement with UBS, our intent was to hold the ARS until the market recovered. At the time of reclassification, the unrealized loss on our ARS was \$5 million. This unrealized loss was included in accumulated other comprehensive income (loss). Upon reclassification to trading securities, we immediately recognized in investment income, net, the \$5 million unrealized loss not previously recognized in earnings. Subsequently, we recognized an additional decline in fair value of \$2 million for a total unrealized loss of \$7 million, included in investment and other income, net, in our Consolidated Statements of Operations for the year ended December 31, 2008. The fair value of the ARS held through UBS totaled \$54 million and \$55 million at September 30, 2009 and December 31, 2008, respectively. This change in the fair value of the ARS held through UBS represents redemptions of \$4 million and unrealized gains of \$3 million included in investment and other income, net for the nine months ended September 30, 2009.

We continue to monitor the ARS market and consider its impact (if any) on the fair value of our investments. If the market conditions deteriorate further, we may be required to record additional unrealized losses in earnings, which may be offset by corresponding increases in value of the UBS arrangement.

Table of Contents**12. Fair value measurements**

The three levels of inputs used to measure fair value are as follows:

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

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

	Fair Value Measurements at Reporting Date Using				Balance Sheet Classification
	At September 30, 2009	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Financial assets:</b>					
Money market funds	\$ 2,293	\$ 2,293	\$	\$	Cash and cash equivalents
Mortgage-backed securities	2		2		Short-term investments
Auction rate securities held through UBS	54			54	Short-term investments
U.S. government agency securities	228	228			Short-term investments
Auction rate securities held through Morgan Stanley Smith Barney LLC	22			22	Long-term investments
Put option from UBS	7			7	Other assets current
Total financial assets at fair value	\$ 2,606	\$ 2,521	\$ 2	\$ 83	
<b>Financial liabilities:</b>					

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

Other financial liability	23	23	Other liabilities non-current
Total financial liabilities at fair value	\$ 23	\$	\$ 23

Table of Contents

	Fair Value Measurements at Reporting Date Using					Balance Sheet Classification
	At December 31, 2008	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
<b>Financial assets:</b>						
Money market funds	\$ 2,609	\$ 2,609	\$	\$		Cash and cash equivalents
Mortgage-backed securities	7		7			Short-term investments
Auction rate securities held through UBS and Citigroup, Inc.	78				78	Long-term investments
Put option from UBS	10				10	Other assets non-current
Foreign exchange contract derivatives	5		5			Other assets current
<b>Total financial assets at fair value</b>	<b>\$ 2,709</b>	<b>\$ 2,609</b>	<b>\$ 12</b>	<b>\$ 88</b>		
<b>Financial liabilities:</b>						
Foreign exchange contract derivatives	\$ 2	\$	\$ 2	\$		Other liabilities current
Other financial liability	31				31	Other liabilities non-current
<b>Total financial liabilities at fair value</b>	<b>\$ 33</b>	<b>\$</b>	<b>\$ 2</b>	<b>\$ 31</b>		

Other financial liability represents the earn-out liability from a previous acquisition. The earn-out liability was recorded at fair value at the date of the Business Combination as it will be settled by a variable number of shares of our common stock based on the average closing price for the five business days immediately preceding issuance of the shares. When estimating the fair value, we considered our projection of revenues from the related titles under the earn-out provisions. For the nine months ended September 30, 2009, there was an \$8 million change in our fair value estimate of this financial liability, which was recorded in investment and other income, net.

The following table provides a reconciliation of the beginning and ending balances of our financial assets and financial liabilities classified as Level 3 (amounts in millions):

	Level 3
Balance at December 31, 2008, net	\$ 57
Total realized/unrealized gains/losses included in earnings	7
Cash settlement	(4)
Balance at September 30, 2009, net	\$ 60

**13. Operating segments, geographic regions, and platforms**

Our operating segments are a reflection of our internal organizational structure, the manner in which our operations are reviewed and managed by our Chief Executive Officer, our Chief Operating Decision Maker ( CODM ), the manner in which operating performance is assessed and

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

resources are allocated, and the availability of separate financial information.

Prior to the Business Combination, Vivendi Games managed its business in two main divisions: Blizzard Entertainment and Sierra Entertainment (including Sierra online and Vivendi Games Mobile). As a result of the Business Combination, we provide our CODM financial information based upon management's new organizational structure.

Currently, we operate under three operating segments: (i) Activision, which publishes interactive entertainment software and peripherals, which includes businesses operated by Activision, Inc. prior to the Business Combination and certain studios, assets, and titles previously included in Vivendi Games' Sierra Entertainment operating segment prior to the Business Combination, (ii) Blizzard, which publishes traditional games and online subscription-based games in the MMORPG category, (iii) Distribution, which distributes interactive entertainment software and hardware products.

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

### Table of Contents

Prior to July 1, 2009 we operated a fourth operating segment, Non-Core, which represented legacy Vivendi Games divisions or business units that the Company had exited, divested, or wound down as part of its restructuring and integration efforts as a result of the Business Combination. At July 1, 2009 in light of the decreasing significance of Non-Core activities, we ceased management of Non-Core as a separate operating segment and consequently we are no longer providing separate operating segment disclosure with respect to Non-Core and have reclassified our prior periods segment presentation so that it conforms to the current periods presentation.

As the historical financial statements prior to July 10, 2008 are those of Vivendi Games, net revenues and segment income (loss) from the business operated by Activision, Inc. prior to the Business Combination are not included for the period January 1, 2008 through July 9, 2008, but are included for the entire three and nine month periods ended September 30, 2009. Also, the Activision operating segment includes Vivendi Games titles retained after the Business Combination.

The CODM reviews segment performance exclusive of the impact of the deferred net revenues and related cost of sales, stock-based compensation expense, restructuring expense, amortization of intangible assets and purchase price accounting related adjustments, integration and transaction costs, and other. Information on the operating segments and reconciliations of total net revenues and total segment income from operations to consolidated net revenues and operating income (loss) for the three and nine months ended September 30, 2009 and 2008 are presented below (amounts in millions):

	Three months ended September 30,				
	2009	2008		2008	
	Net revenues		Segment income (loss) from operations		
Activision	\$	415	\$ 364	\$ (43)	\$ (26)
Blizzard		286	297	116	146
Distribution		54	56	2	2
Operating segments total		755	717	75	122
Reconciliation to consolidated net revenues / operating income (loss):					
Net effect from deferral of net revenues and related cost of sales		(52)	(12)	9	(12)
Stock-based compensation expense				(36)	(26)
Restructuring income (expense)				1	(61)
Amortization of intangible assets and purchase price accounting related adjustments				(33)	(90)
Integration and transaction costs				(7)	(17)
Other*			6		(110)
Consolidated net revenues / operating income (loss)	\$	703	\$ 711	\$ 9	\$ (194)

	Nine months ended September 30,				
	2009	2008		2008	
	Net revenues		Segment income (loss) from operations		
Activision	\$	1,211	\$ 457	\$ (49)	\$ (61)
Blizzard		867	866	393	447
Distribution		202	56	6	3
Operating segments total		2,280	1,379	350	389

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

Reconciliation to consolidated net revenues / operating income (loss):

Net effect from deferral of net revenues and related cost of sales	441	(8)	341	(7)
Stock-based compensation expense			(107)	(47)
Restructuring expense			(29)	(61)
Amortization of intangible assets and purchase price accounting related adjustments			(117)	(92)
Integration and transaction costs			(24)	(17)
Other*	1	16	(8)	(251)
Consolidated net revenues / operating income (loss)	\$ 2,722	\$ 1,387	\$ 406	\$ (86)



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

Table of Contents

Geographic information for the three and nine months ended September 30, 2009 and 2008 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 September 30, 2009		September 30, 2008		Nine months ended September 30, 2009		September 30, 2008	
North America	\$	378	\$	295	\$	1,458	\$	591
Europe		287		348		1,088		627
Asia Pacific		38		62		175		153
Total geographic region net revenues		703		705		2,721		1,371
Other*				6		1		16
Total consolidated net revenues	\$	703	\$	711	\$	2,722	\$	1,387

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

	Three months ended September 30, 2009		September 30, 2008		Nine months ended September 30, 2009		September 30, 2008	
MMORPG	\$	301	\$	271	\$	939	\$	828
Console		286		272		1,334		335
Handheld		30		81		127		102
PC and other		32		25		119		50
Total platform net revenues		649		649		2,519		1,315
Distribution		54		56		202		56
Other*				6		1		16
Total consolidated net revenues	\$	703	\$	711	\$	2,722	\$	1,387

\*Represents Non-Core activities, which are handled by certain functional departments of our Activision segment and are insignificant to Activision Blizzard's financial condition and results of operations. Prior to July 1, 2009, Non-Core activities were managed as a stand-alone operating segment, however, in light of the decreasing significance of Non-Core activities, as of that date we ceased their management as a separate operating segment and consequently we are no longer providing separate operating segment disclosure and have reclassified our prior periods' segment presentation so that it conforms to the current periods' presentation.

We did not have any single external customer that accounted for 10% or more of consolidated net revenues for either of the three or nine months ended September 30, 2009 or 2008.

Table of Contents**14. Computation of earnings (loss) per common share**

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

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
<b>Numerator:</b>				
Consolidated net income (loss)	\$ 15	\$ (108)	\$ 399	\$ (36)
Net income allocated to unvested share-based awards that participate in earnings			(3)	
Numerator for basic and diluted earnings per common share income (loss) available to common shareholders	\$ 15	\$ (108)	\$ 396	\$ (36)
<b>Denominator:</b>				
Denominator for basic earnings per common share weighted-average common shares outstanding	1,271	1,271	1,289	816
<b>Effect of potential dilutive common shares under treasury stock method:</b>				
Employee stock options	26		31	
Denominator for diluted earnings per common share weighted-average common shares outstanding plus potential dilutive effect of employee stock options	1,297	1,271	1,320	816
Basic earnings (loss) per common share	\$ 0.01	\$ (0.08)	\$ 0.31	\$ (0.04)
Diluted earnings (loss) per common share	\$ 0.01	\$ (0.08)	\$ 0.30	\$ (0.04)

On January 1, 2009, we adopted the new accounting guidance for determining whether instruments granted in share-based payment transactions are participating securities and, as a result, unvested share-based awards which include the right to receive non-forfeitable dividends or dividend equivalents are considered to participate with common stock in undistributed earnings. Companies that issue share-based awards considered to be participating securities are required to calculate basic and diluted earnings per common share amounts under the two-class method. The two-class method excludes from earnings per common share calculations any dividends paid or owed to participating securities and any undistributed earnings considered to be attributable to participating securities. The accounting guidance requires retrospective application to all prior-period earnings per share data presented. Our unvested restricted stock rights (including restricted stock units, restricted stock awards, and performance shares) are considered participating securities since these securities have non-forfeitable rights to dividends or dividend equivalents during the contractual period of the award. Since the unvested restricted stock rights are considered participating securities, we are required to use the two-class method in our computation of basic and diluted net earnings per common share. For both the three and nine months ended September 30, 2009, we had outstanding unvested restricted stock rights with respect to 10 million shares of common stock on a weighted-average basis. The adoption did not change our basic or diluted earnings per common share for the three and nine months ended September 30, 2009.

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

According to the accounting guidance, our unvested restricted stock rights are not considered to participate with common stock in undistributed losses. Therefore, the two-class method in our computation of basic and diluted net earnings per common share for the three and nine months ended September 30, 2008 does not apply as there were losses during these periods. As such, the adoption did not change our basic or diluted earnings per common share for the three and nine months ended September 30, 2008.

On July 9, 2008, Vivendi obtained control of Activision, Inc. through acquisition of the majority of the outstanding common stock of Activision, Inc. For accounting purposes, Vivendi Games is deemed to be the acquirer (reverse acquisition - see Note 1 of the Notes to Condensed Consolidated Financial Statements). The historical financial statements prior to July 10, 2008, are those of Vivendi Games. Further, earnings per common share for periods prior to the Business Combination are retrospectively adjusted to reflect the number of split adjusted shares received by Vivendi, former parent of Vivendi Games.

Potential common shares are not included in the denominator of the diluted earnings per common share calculation when inclusion of such shares would be anti-dilutive. Therefore, options to acquire 18 million shares and 19 million shares of common

Table of Contents

stock were not included in the calculation of diluted earnings per common share for the three and nine months ended September 30, 2009, respectively, as the effect of their inclusion would be anti-dilutive.

**15. Capital transactions**

*Repurchase Program*

On November 5, 2008, we announced that our Board of Directors authorized a stock repurchase program under which we may repurchase up to \$1 billion of our common stock. Under this program, we may repurchase our common stock from time to time on the open market or in private transactions, including structured or accelerated transactions. We will determine the timing and amount of repurchases based on our evaluation of market conditions and other factors. The repurchase program may be suspended or discontinued by the Company at any time.

On July 31, 2009, our Board of Directors authorized an increase of \$250 million to the stock repurchase program bringing the total authorization to \$1.25 billion.

Since inception, we have repurchased 89 million shares of our common stock for \$960 million under the repurchase program. At September 30, 2009, we had \$290 million available for utilization under the repurchase program.

**16. Commitments and contingencies**

We did not have any significant changes to our commitments since December 31, 2008. See Note 18 of the Notes to Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the year ended December 31, 2008 for more information regarding our commitments.

*Legal Proceedings*

On February 8, 2008, the Wayne County Employees Retirement System filed a lawsuit challenging the Business Combination in the Delaware Court of Chancery. The suit is a putative class action filed against the parties to the Business Combination agreement, as well as certain current and former members of our Board of Directors. The plaintiff alleges, among other things, that our current and former directors named therein failed to fulfill their fiduciary duties with regard to the Business Combination by surrendering the negotiating process to conflicted management, that those breaches were aided and abetted by Vivendi and those of its subsidiaries named in the complaint, and that the preliminary proxy statement filed by the Company on January 31, 2008 contained certain statements that the plaintiff alleges are false and misleading. The plaintiff seeks an order from the court that, among other things, certifies the case as a class action, enjoins the Business Combination, requires the defendants to disclose all material information, declares that the Business Combination is in breach of the directors' fiduciary duties and therefore

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

unlawful and unenforceable, awards the plaintiff and the putative class damages for all profits and special benefits obtained by the defendant in connection with the Business Combination and tender offer, and awards the plaintiff its cost and expense, including attorney's fees.

After various initial motions were filed and ruled upon, on May 8, 2008, the plaintiff filed an amended complaint that, among other things, added allegations relating to a revised preliminary proxy statement filed by the Company on April 30, 2008. Additional motions were then filed, including a motion for preliminary injunction filed by the plaintiff and a motion to dismiss filed by Vivendi and its subsidiaries. On June 14, 2008, the plaintiff filed a motion for leave to file a second amended complaint. On June 30, 2008, the court granted Vivendi and its subsidiaries motion to dismiss, pursuant to a stipulation with the plaintiff, and on July 1, 2008, denied the plaintiff's motion for preliminary injunction.

On December 23, 2008, the plaintiff filed an amended motion for leave to file a second amended complaint. The court granted the motion on January 14, 2009 and the second amended complaint was deemed filed on the same date. The second amended complaint asserts claims similar to the ones made in the original complaint, challenging Activision's Board of Directors' actions in connection with the negotiation and approval of the Business Combination, as well as disclosures made to our shareholders and certain amendments made to our certificate of incorporation in connection therewith. In addition, the second amended complaint asserts that Activision's Board of Directors breached its fiduciary duties in approving and recommending those amendments to the certificate of incorporation. Among other things, the plaintiff seeks certification of the action as a class action, a declaration that amendments made to the certificate of incorporation are invalid and unenforceable, a declaration that our directors breached their fiduciary duties, rescission of the Business Combination and related transactions, and damages, interest, fees and costs. On July 24, 2009, the court granted the Company's motion to dismiss the complaint for failure to state a claim.

On August 21, 2009, the plaintiff filed a notice of appeal of the Court's dismissal. The plaintiff filed its appellate brief on October 5, 2009 and Activision filed its opposition on November 4, 2009.

Table of Contents

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

**17. Stock-based compensation**

*Restricted Stock Rights*

The following table summarizes our restricted stock rights (including restricted stock units, restricted stock, and performance shares) activity for the nine months ended September 30, 2009 (amounts in thousands, except per share amounts):

	Restricted Stock Rights	Weighted- Average Grant Date Fair Value
Balance at December 31, 2008	10,267	\$ 14.52
Granted	1,264	12.04
Vested	(1,045)	11.53
Forfeited	(118)	11.47
Balance at September 30, 2009	10,368	12.82

At September 30, 2009, \$56 million of total unrecognized compensation cost related to Activision Blizzard restricted stock rights is expected to be recognized over a weighted-average period of 1.8 years.

*Stock Option Activity*

Stock option activity for the nine months ended September 30, 2009 is as follows (amounts in millions, except number of shares in thousands and per share amounts):

	Shares	Weighted- average exercise price	Weighted-average remaining contractual term	Aggregate intrinsic value
Outstanding at December 31, 2008	97,841	\$ 6.53		
Granted	4,422	11.76		
Exercised	(26,691)	2.60		
Forfeited	(883)	9.28		
Outstanding at September 30, 2009	74,689	8.21	6.36	\$ 350

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

Vested and expected to vest at September 30, 2009	70,623	\$	8.00	\$	344
Exercisable at September 30, 2009	41,833		5.91	4.98	281

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (i.e. the difference between our closing stock price on the last trading day of the period and the exercise price, times the number of shares for options where the exercise price is below the closing stock price) that would have been received by the option holders had all option holders exercised their options on that date. This amount changes over time based on the changes in the fair market value of our stock. Total intrinsic value of options exercised was \$58 million and \$243 million for the three and nine months ended September 30, 2009, respectively.

At September 30, 2009, \$69 million of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.4 years.

Income tax benefits from stock option exercises were \$68 million for the nine months ended September 30, 2009. We present excess tax benefits or shortfall from the exercise of stock options, if any, as financing cash flows, rather than operating cash flows.

Table of Contents

*Blizzard Equity Plan ( BEP )*

In 2006, Blizzard implemented the BEP, an equity incentive plan denominated in U.S. dollars. Under the BEP, restricted shares of Blizzard stock and other cash settled awards were granted to certain key executives and employees of Blizzard.

At September 30, 2009, unrecognized compensation expense under the BEP was \$5 million, which will be recognized over the following three months. At September 30, 2009, accrued expenses and other liabilities in our Condensed Consolidated Balance Sheet included \$83 million related to this plan.

*Vivendi Corporate Plan*

There were no new grants from Vivendi during the three and nine months ended September 30, 2009. During the three and nine months ended September 30, 2009 there were no material changes to the components of the cash-settled instruments. At September 30, 2009, other liabilities included \$10 million relating to the Vivendi Corporate Plan.

*Method and Assumptions on Valuation of Stock Options*

Our stock options have features that differentiate them from exchange-traded options. These features include lack of transferability, early exercise, vesting restrictions, pre- and post-vesting termination provisions, blackout dates, and time-varying inputs. In addition, some of the options have non-traditional features, such as accelerated vesting upon the satisfaction of certain performance conditions that must be reflected in the valuation. A binomial-lattice model was selected as it is better able to explicitly address these features than closed-form models such as the Black-Scholes model, and is able to reflect expected future changes in model inputs, including changes in volatility, during the option's contractual term.

We have estimated the expected future changes in model inputs during the option's contractual term. The inputs required by our binomial-lattice model include expected volatility, risk-free interest rate, risk-adjusted stock return, dividend yield, contractual term, and vesting schedule, as well as measures of employees' forfeiture, exercise, and post-vesting termination behavior. Statistical methods were used to estimate employee rank-specific termination rates. These termination rates, in turn, were used to model the number of options that are expected to vest and post-vesting termination behavior. Employee rank-specific estimates of expected time-to-exercise ( ETTE ) were used to reflect employee exercise behavior. ETTE was estimated by using statistical procedures to first estimate the conditional probability of exercise occurring during each time period, which is conditional on the option surviving to that time period, and then using those probabilities to estimate ETTE. The model was calibrated by adjusting parameters controlling exercise and post-vesting termination behavior so that the measures output by the model matched values of these measures that were estimated from historical data.

The following tables present the weighted-average assumptions and the weighted-average fair value at grant date using the binomial-lattice model:



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

	<b>Employee and director options for three months ended September 30, 2009</b>	<b>Employee and director options for nine months ended September 30, 2009</b>
Expected life (in years)	5.64	6.37
Risk free interest rate	4.06%	3.54%
Volatility	52.70%	54.04%
Dividend yield		
Weighted-average fair value at grant date	\$ 5.63	\$ 5.79

To estimate volatility for the binomial-lattice model, we use methods that consider the implied volatility method based upon the volatilities for exchange-traded options on our stock to estimate short-term volatility, the historical method (annualized standard deviation of the instantaneous returns on Activision Blizzard's stock) during the option's contractual term to estimate long-term volatility, and a statistical model to estimate the transition or mean reversion from short-term volatility to long-term volatility. Based on these methods, for options granted during the nine months ended September 30, 2009, the expected stock price volatility ranged from 41.56% to 60.77%, with a weighted-average volatility of 54.04%.

As is the case for volatility, the risk-free rate is assumed to change during the option's contractual term. Consistent with the calculation required by a binomial lattice model, the risk-free rate reflects the interest from one time period to the next (forward rate) as opposed to the interest rate from the grant date to the given time period (spot rate). Since we do not currently have a plan to pay dividends, we have assumed that the dividend yield is zero.

Table of Contents

The expected life of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is an output from the binomial-lattice model. The expected life of employee stock options depends on all of the underlying assumptions and calibration of our model. A binomial-lattice model can be viewed as assuming that employees will exercise their options when the stock price equals or exceeds an exercise boundary. The exercise boundary is not constant, but continually declines as the option's expiration date approaches. The exact placement of the exercise boundary depends on all of the model inputs as well as the measures that are used to calibrate the model to estimated measures of employees' exercise and termination behavior.

As stock-based compensation expense recognized in the Condensed Consolidated Statement of Operations for the three and nine months ended September 30, 2009 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

*Accuracy of Fair Value Estimates*

We developed the assumptions used in the binomial-lattice model, including model inputs and measures of employees' exercise and post-vesting termination behavior. Our ability to accurately estimate the fair value of share-based payment awards at the grant date depends upon the accuracy of the model and our ability to accurately forecast model inputs as long as ten years into the future. These inputs include, but are not limited to, expected stock price volatility, risk-free rate, dividend yield, and employee termination rates. Although the fair value of employee stock options is determined using an option-pricing model, the estimates that are produced by this model may not be indicative of the fair value observed between a willing buyer and a willing seller. Unfortunately, it is difficult to determine if this is the case, as markets do not currently exist that permit the active trading of employee stock option and other share-based instruments.

*Stock-based Compensation Expense*

The following table sets forth the total stock-based compensation expense resulting from stock options, restricted stock rights, the BEP, and the Vivendi Corporate Plan included in our Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2009 and 2008 (amounts in millions):

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Cost of sales – software royalties and amortization	\$ 3	\$ 1	\$ 18	\$ 1
Product development	11	7	28	34
Sales and marketing	2	4	9	6
General and administrative	20	15	52	6
Restructuring			2	
Stock-based compensation expense before income taxes	36	26	109	47
Income tax benefit	(13)	(10)	(43)	(19)
Total stock-based compensation expense, net of income tax benefit	\$ 23	\$ 16	\$ 66	\$ 28

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

As a result of the reverse acquisition accounting treatment for the Business Combination, previously issued Activision, Inc. stock options and restricted stock rights granted to employees and directors outstanding and unvested at the date of the Business Combination, were accounted for as an exchange of awards. The fair value of the outstanding vested and unvested awards was measured on the date of the acquisition, and for unvested awards, which required service subsequent to the date of the Business Combination, a portion of the awards' fair values was allocated to future service and will be recognized over the remaining future requisite service period. As a result of this fair value measurement of stock-based payment awards on the date of the acquisition, we estimate that we incurred an additional \$5 million and \$30 million of stock-based compensation expense for the three and nine months ended September 30, 2009, respectively.

Table of Contents

Stock option expenses included in the development costs of computer software are capitalized as discussed in Note 3 of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2008. The following table summarizes stock-based compensation included in our Consolidated Balance Sheets as a component of software development (amounts in millions):

		<b>Software development</b>
Balance at December 31, 2008	\$	36
Stock-based compensation expense capitalized during period		37
Amortization of capitalized stock-based compensation expense		(25)
Balance at September 30, 2009	\$	48

**18. Related party transactions**

*Treasury*

Our foreign currency risk policy seeks to reduce risks arising from foreign currency fluctuations. We use derivative financial instruments, primarily currency forward contracts and swaps, with Vivendi as our principal counterparty. The gross notional amount of outstanding foreign exchange swaps was \$246 million at September 30, 2009. The notional amounts of outstanding forward foreign exchange contracts and foreign exchange swaps were \$126 million and \$118 million, respectively, at December 31, 2008. See Note 10 of the Notes to Condensed Consolidated Financial Statements for pre-tax net realized and unrealized gains (losses) that resulted from foreign exchange contracts and swaps with Vivendi and were recognized in our Condensed Consolidated Statements of Operations.

*Others*

Activision Blizzard has entered into various transactions and agreements, including treasury management services, investor agreement, internal group reporting services, credit facilities arrangement and music royalty agreements with Vivendi and its subsidiaries and affiliates. None of these services, transactions and agreements with Vivendi and its subsidiaries and affiliates is material either individually or in the aggregate to the Condensed Consolidated Financial Statements as a whole.

**19. Recently issued accounting pronouncements**

In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for the consolidation of variable interest entities (VIEs), which amends the evaluation criteria to identify the primary beneficiary of a variable interest entity. Additionally, this amendment requires ongoing reassessments of whether an enterprise is the primary beneficiary of the variable interest entity. This amendment is effective for financial statements issued for fiscal years beginning after November 15, 2009. We are currently evaluating the impact from the adoption of this amendment on our consolidated financial statements.

In October 2009, the FASB issued an update to *Revenue Recognition - Multiple-Deliverable Revenue Arrangements*. This update establishes the accounting and reporting guidance for arrangements including multiple revenue-generating activities. This update provides amendments to the criteria for separating deliverables, measuring and allocating arrangement consideration to one or more units of accounting. The amendments in this update also establish a selling price hierarchy for determining the selling price of a deliverable. Significantly enhanced disclosures are also required to provide information about a vendor's multiple-deliverable revenue arrangements, including information about the nature and terms, significant deliverables, and its performance within arrangements. The amendments also require providing information about the significant judgments made and changes to those judgments and about how the application of the relative selling-price method affects the timing or amount of revenue recognition. The amendments in this update are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. Early application is permitted. We are currently evaluating the impact, if any, of this new accounting update on our consolidated financial statements.

In October 2009, the FASB issued an update to *Software - Certain Revenue Arrangements That Include Software Elements*. This update changes the accounting model for revenue arrangements that include both tangible products and software elements that are essential to the functionality, and scopes these products out of current software revenue guidance. The new guidance will include factors to help companies determine what software elements are considered essential to the functionality. The amendments will now subject software-enabled products to other revenue guidance and disclosure requirements, such as guidance surrounding revenue arrangements with multiple-deliverables. The amendments in this update are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. Early application is permitted. We are currently evaluating the impact, if any, of this new accounting update on our consolidated financial statements.

**Table of Contents**

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

**Business Overview**

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

*(i) Activision Publishing, Inc.*

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

*(ii) Blizzard Entertainment, Inc.*

Blizzard Entertainment, Inc. ( Blizzard ) is a leader in terms of subscriber base and revenues generated in the subscription-based massively multi-player online role-playing game ( MMORPG ) category. Blizzard internally develops and publishes PC-based computer games and maintains its proprietary online-game related service, Battle.net. Our Blizzard business involves the development, marketing, sales and support of role playing action and strategy games. Blizzard also develops, hosts, and supports its online subscription-based games in the MMORPG category. Blizzard is the development studio and publisher best known as the creator of World of Warcraft and the multiple award-winning Diablo, StarCraft, and Warcraft franchises. Blizzard distributes its products and generates revenues worldwide through various means, including: subscription revenues (which consist of fees from individuals playing World of Warcraft, prepaid cards and other ancillary online revenues); retail sales of physical boxed products; electronic download sales of PC products; and licensing of software to third-party companies that distribute World of Warcraft in China, Russia, and Taiwan. Blizzard is currently developing new games, including sequels to the StarCraft and Diablo franchises. Blizzard has entered into licensing arrangements for *World of Warcraft*, *StarCraft II*, Battle.net and *Warcraft III* with an affiliated company of NetEase.com, Inc. in China for a term of 3 years.

*(iii) Activision Blizzard Distribution*

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

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.

### *Business Combination*

On July 9, 2008, a business combination (the Business Combination ) by and among Activision, Inc., Sego Merger Corporation, a wholly-owned subsidiary of Activision, Inc., Vivendi S.A. ( Vivendi ), VGAC LLC, a wholly-owned subsidiary of Vivendi, and Vivendi Games, Inc. ( Vivendi Games ), a wholly-owned subsidiary of VGAC LLC, was consummated. As a result of the consummation of the Business Combination, Activision, Inc. was renamed Activision Blizzard, Inc. For accounting purposes, the Business Combination is treated as a reverse acquisition, with Vivendi Games deemed to be the acquirer. The historical financial statements of Activision Blizzard, Inc. prior to July 10, 2008 are those of Vivendi Games. See Note 1 of the Notes to Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2008 for a more complete discussion of the Business Combination.

### *Activision Blizzard's non-core exit operations*

Activision Blizzard's non-core exit operations ( Other or Non-Core ) represent legacy Vivendi Games divisions or business units that we have exited, divested, or wound down as part of our restructuring and integration efforts as a result of the Business Combination described above, but do not meet the criteria for separate reporting of discontinued operations. Prior to July 1, 2009, Non-Core activities were managed as a stand-alone operating segment, however, in light of the decreasing significance of Non-Core activities, as of that date we ceased their management as a separate operating segment and consequently we are no longer

Table of Contents

providing separate operating segment disclosure and have reclassified our prior periods' segment presentation so that it conforms to the current periods' presentation.

**Management's Overview of Business Trends**

*Business Highlights*

According to the NPD Group with respect to the U.S. market, and Charttrack, and Gfk, for the European market during the three months ended September 30, 2009:

- Activision Blizzard grew its U.S. market share across all platforms by 3.1 points to 13.3% from 10.2% in the previous year;
- Activision Blizzard increased its combined U.S. and European market share across all platforms by 1.2 points to 12.3% from 11.1% in the previous year;
- *Guitar Hero 5* and *Guitar Hero World Tour* were two of the top-10 best selling titles in the U.S.;
- *Guitar Hero* and *Call of Duty* were two of the top-10 best selling franchises in the U.S.; and
- *Guitar Hero* was the #1 best-selling third-party console and handheld franchise in Europe.

During the nine months ended September 30, 2009:

- *Guitar Hero World Tour* and *Call of Duty: World at War* were the number #1 and #2 third-party best selling titles, respectively, in the U.S. and Europe;
- Activision Blizzard grew its U.S. market share of the music/dance category by 5 points to 51%, from 46% in the previous year;
- *Guitar Hero* was the #1 best-selling third-party franchise in the U.S. and Europe; and
- *Call of Duty* was the #2 best-selling third-party franchise in the U.S. and Europe.

*Other Business Highlights*



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

On September 19, 2009, paid subscriptions of Blizzard's *World of Warcraft* were resumed in China after an interruption as a result of a license transfer in June 2009.

### *Activision 2009 Releases*

Activision expects to continue to build its success in releasing games based on proven franchises such as Call of Duty, Guitar Hero, Transformers, X-Men, Spiderman, and Tony Hawk.

Games released during the nine months ended September 30, 2009 included:

- *Monsters vs. Aliens;*
- *Guitar Hero: Metallica;*
- *X-Men Origins: Wolverine;*
- *Guitar Hero: Modern Hits;*
- *PROTOTYPE;*
- *Guitar Hero: Smash Hits;*
- *Transformers: Revenge of the Fallen;*
- *Ice Age: Dawn of the Dinosaurs;*
- *Wolfenstein: Return to the Castle;*
- *Guitar Hero 5;*
- *Marvel Ultimate Alliance 2;* and
- the first, second, and third map packs for *Call of Duty: World at War.*

The more notable games, among other titles, scheduled for release during the fourth quarter of 2009 include:

- *Bakugan Battle Brawlers;*
- *DJ Hero;*
- *Band Hero;*

- *Call of Duty: Modern Warfare 2; and*
- *Tony Hawk: Ride.*

Table of Contents*Economic Conditions*

The video games industry in the U.S. and Europe had combined overall decreases of 21% and 19% in sales revenues for the three and nine months ended September 30, 2009, respectively, as compared to the same periods in 2008, according to the NPD Group with respect to the U.S. market and, Charttrack and Gfk with respect to the European market, resulting from a weakening economy in 2009 with retailers focused on reducing inventories, and the release of fewer blockbuster titles this quarter as compared to a year ago. In this challenging macroeconomic environment, Activision Blizzard gained market share during the three months ended September 30, 2009 as compared to the same period in 2008.

**Consolidated Statements of Operations Data**

**Note** As the historical financial statements prior to July 10, 2008 are those of Vivendi Games, the financial information of the businesses operated by Activision, Inc. prior to the Business Combination are included from the date of the Business Combination (i.e. from July 10, 2008 onwards), but not for prior periods.

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

	Three months ended September 30, 2009		2008		Nine months ended September 30, 2009		2008					
<b>Net revenues:</b>												
Product sales	\$	411	58%	\$	413	58%	\$	1,848	68%	\$	553	40%
Subscription, licensing, and other revenues		292	42		298	42		874	32		834	60
<b>Total net revenues</b>		<b>703</b>	<b>100</b>		<b>711</b>	<b>100</b>		<b>2,722</b>	<b>100</b>		<b>1,387</b>	<b>100</b>
<b>Costs and expenses:</b>												
Cost of sales product costs		185	26		279	39		762	28		350	25
Cost of sales software royalties and amortization		54	8		50	7		212	8		88	6
Cost of sales intellectual property licenses		45	7		36	5		163	6		45	3
Cost of sales MMORPG		55	8		43	6		158	6		123	9
Product development		122	17		200	28		362	13		414	30
Sales and marketing		128	18		142	20		329	12		220	16
General and administrative		106	15		94	13		301	11		172	13
Restructuring		(1)			61	9		29	1		61	4
<b>Total costs and expenses</b>		<b>694</b>	<b>99</b>		<b>905</b>	<b>127</b>		<b>2,316</b>	<b>85</b>		<b>1,473</b>	<b>106</b>
<b>Operating income (loss)</b>		<b>9</b>	<b>1</b>		<b>(194)</b>	<b>(27)</b>		<b>406</b>	<b>15</b>		<b>(86)</b>	<b>(6)</b>
<b>Investment and other income, net</b>		<b>11</b>	<b>2</b>		<b>24</b>	<b>3</b>		<b>21</b>	<b>1</b>		<b>28</b>	<b>2</b>

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

<b>Income (loss) before income tax expense (benefit)</b>	20	3	(170)	(24)	427	16	(58)	(4)
<b>Income tax expense (benefit)</b>	5	1	(62)	(9)	28	1	(22)	(1)
<b>Net income (loss)</b>	\$ 15	2%	\$ (108)	(15)%	\$ 399	15%	\$ (36)	(3)%

Table of Contents**Three and Nine Months ended September 30, 2009 highlights***Operating Highlights (amounts in millions)*

	Three months ended September 30,			Nine months ended September 30,		
	2009	2008	Increase/ (Decrease)	2009	2008	Increase/ (Decrease)
<b>Segment net revenues:</b>						
Activision	\$ 415	\$ 364	\$ 51	\$ 1,211	\$ 457	\$ 754
Blizzard	286	297	(11)	867	866	1
Distribution	54	56	(2)	202	56	146
Operating segments total	755	717	38	2,280	1,379	901
<b>Reconciliation to consolidated net revenues:</b>						
Net effect from deferral net revenues	(52)	(12)		441	(8)	
Other*		6		1	16	
Consolidated net revenues	703	711		2,722	1,387	
<b>Segment income (loss) from operations:</b>						
Activision	(43)	(26)	(17)	(49)	(61)	12
Blizzard	116	146	(30)	393	447	(54)
Distribution	2	2		6	3	3
Operating segments total	75	122	(47)	350	389	(39)
<b>Reconciliation to consolidated operating income (loss):</b>						
Net effect from deferral of net revenues and related costs of sales	9	(12)		341	(7)	
Stock-based compensation expense	(36)	(26)		(107)	(47)	
Restructuring	1	(61)		(29)	(61)	
Amortization of intangible assets and purchase price accounting related adjustments	(33)	(90)		(117)	(92)	
Integration and transaction costs	(7)	(17)		(24)	(17)	
Other*		(110)		(8)	(251)	
Consolidated operating income (loss)	\$ 9	\$ (194)		\$ 406	\$ (86)	

\*Represents Non-Core activities, which are handled by certain functional departments of our Activision segment and are insignificant to Activision Blizzard's financial condition and results of operations. Prior to July 1, 2009, Non-Core activities were managed as a stand-alone operating segment, however, in light of the decreasing significance of Non-Core activities, as of that date we ceased their management as a separate operating segment and consequently we are no longer providing separate operating segment disclosure and have reclassified our prior periods' segment presentation so that it conforms to the current periods' presentation.

**Note** We provide discussion and analysis of the Activision segment for the nine months ended September 30, 2009 and 2008 in the Supplemental Pro Forma Information section as the pro forma basis provides greater comparability.

*Segment Net Revenues Highlights*

Activision

For the three months ended September 30, 2009, Activision's net revenues increased as the historical financial statements prior to July 10, 2008 are those of Vivendi Games, which resulted in net revenues from the Activision segment (business formerly operated by Activision, Inc. prior to the Business Combination) being included for the entire three months ended September 30, 2009, but only for the period from July 10, 2008 through September 30, 2008 in the three months ended September 30, 2008.

Additionally, the three months ended September 30, 2009 included the key releases of *Guitar Hero 5*, *Marvel Ultimate Alliance 2*, *Wolfenstein: Return to the Castle*, and our third map pack for *Call of Duty: World at War*, whereas during the same period of the prior year revenues were mainly driven by catalogue sales from our Guitar Hero franchise and *Call of Duty: Modern Warfare*, and the European launch of *Star Wars: The Force Unleashed*. For the three months ended September 2009, catalogue sales from our

Table of Contents

Guitar Hero and Call of Duty franchises remained major revenue contributors and leading franchises.

Blizzard

Blizzard's net revenues slightly decreased for the three months ended September 30, 2009 as compared to the same period of the prior year primarily due to an interruption of paid subscriptions for *World of Warcraft* in China from June 2009 to September 19, 2009 as a result of a license transfer. This decrease was partially offset by an increase in other ancillary online revenues.

Consolidated Net Revenues

We estimate that changes in foreign exchange rates had an unfavorable impact of approximately \$37 million to Activision Blizzard's consolidated net revenues for the three months ended September 30, 2009 as compared to the same period in 2008 as the U.S. dollar strengthened primarily in relation to the British pound, euro, Australian dollar, Korean won, and Swedish krona.

*Segment Income (Loss) from Operations Highlights*

Activision

For the three months ended September 30, 2009, Activision's operating loss increased as the historical financial statements prior to July 10, 2008 are those of Vivendi Games, which resulted in operating losses from the businesses formerly operated by Activision, Inc. prior to the Business Combination being included for the entire three months ended September 30, 2009, but only for the period from July 10, 2008 through September 30, 2008 in the three months ended September 30, 2008.

Additionally for the three months ended September 30, 2009, the increase in Activision's operating loss as compared to the same period in 2008 was principally attributable to the following:

- Increased marketing and trade promotion spending to generate sales in a challenging macro-economic and competitive environment;
- Higher amortization of capitalized software development costs of new releases during the period as compared to the same period in 2008 when revenues were primarily driven by catalogue sales; and
- Higher general and administrative expenses due to the unfavorable impact of foreign exchange rates.

These factors were partially offset by lower operating expenses due in part to the cost containment strategies that we implemented and synergies resulting from our restructuring efforts from the Business Combination.

Blizzard

For the three and nine months ended September 30, 2009, the decrease in Blizzard's segment income as compared to the same periods in 2008 was principally attributable to the following:

- An interruption of paid subscriptions for *World of Warcraft* in China from June 2009 to September 19, 2009 as a result of a license transfer;
- Incremental investments made by Blizzard for customer service and product development of its sequels to the StarCraft and Diablo franchises;
- A higher share of annual marketing costs spent earlier in 2009 as compared to the same period in 2008 when the majority of spending was allocated to *World of Warcraft: Wrath of the Lich King*, which was released in the three months ended December 31, 2008; and
- Higher general and administrative expenses as a result of the unfavorable impact of foreign exchange rates.

These factors were partially offset by an increase in other ancillary online revenues.



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

Table of Contents

*Supplemental Pro Forma Information*

The consummation of the Business Combination has resulted in the businesses operated by Activision, Inc. prior to the Business Combination being included from the date of the Business Combination (i.e. from July 10, 2008 onwards), but not for prior periods. In the following table, we combine Activision, Inc.'s financial information with Activision Blizzard's reported financial information to show the comparable three and nine months pro forma periods ended September 30, 2008 of Activision Blizzard. This pro forma information is for informational purposes only and does not reflect any operating efficiencies or inefficiencies which may have resulted from the Business Combination and therefore is not necessarily indicative of results that would have been achieved had the business been combined during the periods presented. We have included schedules of reconciliation of the reported consolidated and segment financial information to the pro forma consolidated and segment financial information. Further, see Note 13 to the Condensed Consolidated Financial Statements for details of our segment presentation.

(Amounts in millions)	Three months ended September 30,			Nine months ended September 30,		
	2009	2008	Increase/ (Decrease)	2009	2008	Increase/ (Decrease)
<b>Pro forma segment net revenues:</b>						
Activision	\$ 415	\$ 399	\$ 16	\$ 1,211	\$ 1,584	\$ (373)
Blizzard	286	297	(11)	867	866	1
Distribution	54	74	(20)	202	239	(37)
Pro forma operating segments total	755	770	(15)	2,280	2,689	(409)
<b>Reconciliation to pro forma consolidated net revenues:</b>						
Net effect from deferral net revenues	(52)	(12)		441	(8)	
Other*		6		1	16	
Pro forma consolidated net revenues	703	764		2,722	2,697	
<b>Pro forma segment income (loss) from operations:</b>						
Activision	(43)	(36)	(7)	(49)	101	(150)
Blizzard	116	146	(30)	393	447	(54)
Distribution	2	3	(1)	6	8	(2)
Pro forma operating segments total	75	113	(38)	350	556	(206)
<b>Reconciliation to pro forma consolidated operating income (loss):</b>						
Net effect from deferral of net revenues and related costs of sales	9	(12)		341	(7)	
Stock-based compensation expense	(36)	(23)		(107)	(120)	
Restructuring	1	(61)		(29)	(61)	
Amortization of intangible assets and purchase price accounting related adjustments	(33)	(89)		(117)	(400)	
Integration and transaction costs	(7)	(13)		(24)	(29)	
Other*		(110)		(8)	(251)	
Pro forma consolidated operating income (loss)	\$ 9	\$ (195)		\$ 406	\$ (312)	

\*Represents Non-Core activities, which are handled by certain functional departments of our Activision segment and are insignificant to Activision Blizzard's financial condition and results of operations. Prior to July 1, 2009, Non-Core activities were managed as a stand-alone operating segment, however, in light of the decreasing significance of Non-Core activities, as of that date we ceased their management as a

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

*separate operating segment and consequently we are no longer providing separate operating segment disclosure and have reclassified our prior periods' segment presentation so that it conforms to the current periods' presentation.*

**Note** We provide discussion and analysis of the Activision segment for the three months ended September 30, 2009 and 2008 under *Operating Highlights* above. In this section, we provide discussion and analysis of our Activision segment operating results in the nine months ended September 30, 2009 as compared to the same period in 2008.

Table of Contents

*Pro forma Activision Segment Net Revenues*

For the nine months ended September 30, 2009, Activision net revenues decreased as compared to the same period of the previous year primarily due to weaker market conditions in 2009 driven by declining consumer spending and from the stronger performance of the Guitar Hero franchise in the prior year period.

*Pro forma Activision Segment Income (Loss) From Operations*

Activision's operating loss increased in the nine months ended September 30, 2009 as compared to the same period of the prior year, which was mainly attributable to:

- Stronger performance from the Guitar Hero franchise in the prior year period;
- Higher amortization of capitalized software development costs and IP license expense from the new releases in the current period as compared to the same period in 2008;
- Increased marketing and trade promotion spending to generate sales in a challenging macro-economic and competitive environment; and
- Higher general and administrative expenses due to the unfavorable impact of foreign exchange rates.

These factors were partially offset by:

- Strong performance from the Call of Duty franchise catalogue sales and *Call of Duty: World at War* map packs;
- A decrease in product costs mainly due to the higher product costs for the nine months ended September 30, 2008 associated with the releases of Lucas Arts' titles; and
- Lower operating expenses due in part to the cost containment strategies we implemented and synergies resulting from our restructuring efforts from the Business Combination.

Table of Contents*Schedules of Reconciliation of Reported Consolidated and Segment Financial Information to Pro Forma Consolidated and Segment Financial Information for the Three and Nine Months ended September 30, 2008*

For the three months ended September 30, 2008, the pro forma Activision Blizzard financial information represents the combination of the financial information of Activision, Inc. for the nine day period from July 1, 2008 through July 9, 2008 and Activision Blizzard's reported financial information for the three months ended September 30, 2008. Activision, Inc.'s financial information from July 1, 2008 through July 9, 2008 has not been audited.

(Amounts in millions)	For the three months ended September 30, 2008				
	Reported	Activision, Inc.	Pro forma adjustments(i)	Pro forma Activision Blizzard	
<b>Consolidated net revenues</b>	\$ 711	\$ 53	\$	\$	764
Reconciliation to segment net revenues:					
Net effect from deferral net revenues	12				12
Other(ii)	(6)				(6)
<b>Total segment net revenues</b>	\$ 717	\$ 53	\$	\$	770
<b>Segment net revenues</b>					
Activision	\$ 364	\$ 35	\$	\$	399
Blizzard	297				297
Distribution	56	18			74
<b>Total segment net revenues</b>	\$ 717	\$ 53	\$	\$	770
<b>Consolidated operating income (loss)</b>	\$ (194)	\$ (50)	\$ 49	\$	(195)
Reconciliation to segment operating income (loss):					
Net effect from deferral of net revenues and cost of sales	12				12
Stock-based compensation	26	3	(6)		23
Restructuring	61				61
Amortization of intangible assets and purchase price accounting related adjustments	90		(1)		89
Integration and transaction costs	17	38	(42)		13
Other(ii)	110				110
<b>Total segment income (loss) from operations</b>	\$ 122	\$ (9)	\$	\$	113
<b>Segment income (loss) from operations</b>					
Activision	\$ (26)	\$ (10)	\$	\$	(36)
Blizzard	146				146
Distribution	2	1			3
<b>Total segment income (loss) from operations</b>	\$ 122	\$ (9)	\$	\$	113
<b>Consolidated net income (loss)</b>	\$ (108)	\$ (43)	\$ 30	\$	(121)

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

Table of Contents

For the nine months ended September 30, 2008, the pro forma Activision Blizzard financial information represents the combination of the financial information of Activision, Inc. for the six months ended June 30, 2008, and the nine day period from July 1, 2008 through July 9, 2008 and Activision Blizzard's reported financial information for the nine months ended September 30, 2008. Neither Activision, Inc.'s financial information for the six months ended June 30, 2008, which was extracted from quarterly information, nor Activision, Inc.'s financial information from July 1, 2008 through July 9, 2008 has been audited.

(Amounts in millions)	For the nine months ended September 30, 2008			
	Reported	Activision, Inc.	Pro forma adjustments(i)	Pro forma Activision Blizzard
<b>Consolidated net revenues</b>	\$ 1,387	\$ 1,310	\$	\$ 2,697
Reconciliation to segment net revenues:				
Net effect from deferral net revenues	8			8
Other(ii)	(16)			(16)
<b>Total segment net revenues</b>	\$ 1,379	\$ 1,310	\$	\$ 2,689
<b>Segment net revenues</b>				
Activision	\$ 457	\$ 1,127	\$	\$ 1,584
Blizzard	866			866
Distribution	56	183		239
<b>Total segment net revenues</b>	\$ 1,379	\$ 1,310	\$	\$ 2,689
<b>Consolidated operating income (loss)</b>	\$ (86)	\$ 85	\$ (311)	\$ (312)
Reconciliation to segment operating income (loss):				
Net effect from deferral of net revenues and cost of sales	7			7
Stock-based compensation	47	32	41	120
Restructuring	61			61
Amortization of intangible assets and purchase price accounting related adjustments	92		308	400
Integration and transaction costs	17	50	(38)	29
Other(ii)	251			251
<b>Total segment income (loss) from operations</b>	\$ 389	\$ 167	\$	\$ 556
<b>Segment income (loss) from operations</b>				
Activision	\$ (61)	\$ 162	\$	\$ 101
Blizzard	447			447
Distribution	3	5		8
<b>Total segment income (loss) from operations</b>	\$ 389	\$ 167	\$	\$ 556
<b>Consolidated net income (loss)</b>	\$ (36)	\$ 60	\$ (190)	\$ (166)

(i) The pro forma adjustments include a \$1 million decrease and \$308 million increase of amortization expense resulting from the application of the purchase method of accounting for the three and nine months ended September 30, 2008, respectively, elimination of Activision, Inc.'s historical transaction costs of \$42 million and \$38 million for the three and nine months ended September 30, 2008, respectively, and a decrease of \$6 million and an increase of \$41 million in stock-based compensation expense associated with the increase in the fair value of Activision, Inc.'s unvested stock awards at the closing date of the transaction for the three and nine months ended September 30, 2008, respectively. Pro forma adjustments are tax effected at the combined federal and state statutory rate of 39.4%.

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

(ii) Represents Non-Core activities, which are handled by certain functional departments of our Activision segment and are insignificant to Activision Blizzard's financial condition and results of operations. Prior to July 1, 2009, Non-Core activities were managed as a stand-alone operating segment, however, in light of the decreasing significance of Non-Core activities, as of that date we ceased their management as a separate operating segment and consequently we are no longer providing separate operating segment disclosure and have reclassified our prior periods' segment presentation so that it conforms to the current periods' presentation.

### *Cash Flow Highlights (amounts in millions)*

	<b>For the nine months ended September 30,</b>		<b>Increase/ (Decrease)</b>
	<b>2009</b>	<b>2008</b>	
Cash flows provided by operating activities	\$ 370	\$ 125	\$ 245
Cash flows (used in) provided by investing activities	(298)	1,078	(1,376)
Cash flows (used in) provided by financing activities	(703)	1,607	(2,310)

For the nine months ended September 30, 2009, the primary drivers of cash flows provided by operating activities included the collection of customer receivables generated by the sale of our products and our subscription revenues, partially offset by payments to vendors for the manufacture, distribution and marketing of our products, third-party developers, and intellectual property holders, tax and to our employees. Cash flows used in investing activities reflect that we purchased short-term investments totaling \$228 million, made capital expenditures of \$41 million primarily for property and equipment, and experienced an increase in restricted cash of \$40 million during the nine months ended September 30, 2009. Cash flows used in financing activities primarily reflect our repurchase of 76 million shares of our common stock for \$834 million under the stock repurchase program, partially offset by \$63 million of proceeds from issuance of common stock to employees.

Table of Contents**Results of Operations Three and Nine Months Ended September 30, 2009 and 2008***Net Revenues*

The following table details our consolidated net revenues by geographic region for the three and nine months ended September 30, 2009 and 2008 (amounts in millions):

	Three months ended September 30,			Nine months ended September 30,		
	2009	2008	Increase/ (Decrease)	2009	2008	Increase/ (Decrease)
Net revenues by geographic region:						
North America	\$ 378	\$ 295	\$ 83	\$ 1,458	\$ 591	\$ 867
Europe	287	348	(61)	1,088	627	461
Asia Pacific	38	62	(24)	175	153	22
Total net revenues by geographic region	703	705	(2)	2,721	1,371	1,350
Other		6	(6)	1	16	(15)
Total consolidated net revenues	\$ 703	\$ 711	\$ (8)	\$ 2,722	\$ 1,387	\$ 1,335

For the three months ended September 30, 2009, net revenues from Europe and Asia Pacific decreased as compared to the same period in 2008 primarily due to the deferral of net revenues for titles released during the three months ended September 30, 2009. Net revenues from *Star Wars: The Force Unleashed*, which was released in the international region in the three months ended September 30, 2008, were not subject to deferral accounting treatment. For the three months ended September 30, 2009, the net revenues from North America increased principally due to the impact of the net amortization of deferred revenues mainly resulting from the releases of *World of Warcraft: Wrath of the Lich King* and *Call of Duty: World at War* in the December quarter of 2008.

Post-Business Combination net revenues consisting of \$690 million in North America, \$507 million in Europe and \$54 million in Asia Pacific from the businesses previously operated by Activision, Inc. for the six month period ended June 30, 2009 were included in the nine months ended September 30, 2009, however, net revenues from the Activision business for the six month period ended June 30, 2008 were not included in the nine months ended September 30, 2008.

*Net Revenues by Platform*

The following table details our net revenues by platform and as a percentage of total platform net revenues for the three months ended September 30, 2009 and 2008 (amounts in millions):

Three months ended	% of total platform	Three months ended	% of total platform	Increase/ (Decrease)
--------------------	---------------------	--------------------	---------------------	----------------------

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

	September 30, 2009	net revs.	September 30, 2008	net revs.	
Net revenues:					
MMORPG	\$ 301	46%	\$ 271	42%	\$ 30
PC and other	32	5	25	4	7
Console					
Sony PlayStation 3	73	11	60	9	13
Sony PlayStation 2	37	6	57	9	(20)
Microsoft Xbox360	104	16	72	11	32
Nintendo Wii	72	11	83	13	(11)
Total console	286	44	272	42	14
Handheld	30	5	81	12	(51)
Total net revenues by platform	649	100	649	100	
Distribution	54		56		(2)
Other			6		(6)
Total consolidated net revenues	\$ 703	\$	711	\$	(8)



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

### Table of Contents

The following table details our net revenues by platform and as a percentage of total platform net revenues for the nine months ended September 30, 2009 and 2008 (amounts in millions):

	Nine months ended September 30, 2009	% of total platform net revs.	Nine months ended September 30, 2008	% of total platform net revs.	Increase/ (Decrease)
<b>Net revenues:</b>					
MMORPG	\$ 939	37%	\$ 828	63%	\$ 111
PC and other	119	5	50	4	69
<b>Console</b>					
Sony PlayStation 3	356	14	77	6	279
Sony PlayStation 2	121	5	80	6	41
Microsoft Xbox360	533	21	88	6	445
Nintendo Wii	324	13	90	7	234
<b>Total console</b>	<b>1,334</b>	<b>53</b>	<b>335</b>	<b>25</b>	<b>999</b>
<b>Handheld</b>	<b>127</b>	<b>5</b>	<b>102</b>	<b>8</b>	<b>25</b>
<b>Total net revenues by platform</b>	<b>2,519</b>	<b>100</b>	<b>1,315</b>	<b>100</b>	<b>1,204</b>
Distribution	202		56		146
Other	1		16		(15)
<b>Total consolidated net revenues</b>	<b>\$ 2,722</b>		<b>\$ 1,387</b>		<b>\$ 1,335</b>

Net revenues from MMORPG increased for the three and nine months ended September 30, 2009 as compared to the same periods in 2008 primarily due to the impact of net amortization of deferred revenues mainly resulting from the release of *World of Warcraft: Wrath of the Lich King* in the December quarter of 2008.

For the three months ended September 30, 2009, the pricing actions made by Sony and Microsoft on their PS3 and XB360 platforms, respectively, early in the quarter, has resulted in higher software sales for these platforms. Nintendo announced a price cut of its Wii platform late in the third quarter of 2009, the effect of which will be determined in the fourth quarter of 2009. Our handheld related software sales decreased for the three months ended September 30, 2009 as compared to the same period in 2008 due to the absence of a blockbuster handheld specific title release in the three months ended September 30, 2009.

### *Costs and Expenses*

#### *Cost of Sales*

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

The following table details the components of cost of sales in dollars and as a percentage of total consolidated net revenues for the three months ended September 30, 2009 and 2008 (amounts in millions):

	<b>Three months</b>		<b>Three months</b>		
	<b>ended</b>	<b>% of</b>	<b>ended</b>	<b>% of</b>	
	<b>September 30,</b>	<b>consolidated</b>	<b>September 30,</b>	<b>consolidated</b>	<b>Increase/</b>
	<b>2009</b>	<b>net revenues</b>	<b>2008</b>	<b>net revenues</b>	<b>(Decrease)</b>
Product costs	\$ 185	26%	\$ 279	39%	\$ (94)
Software royalties and amortization	54	8	50	7	4
Intellectual property licenses	45	7	36	5	9
MMORPG	55	8	43	6	12

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

### Table of Contents

For the three months ended September 30, 2009, costs of sales decreased as compared to the same period in 2008 primarily due to:

- The release in the three months ended September 30, 2008 of Lucas Arts affiliated title *Star Wars: The Force Unleashed*, which had higher product and distribution costs as compared to releases in the same period in 2009; and
- A decrease of intangible amortization and other purchase price accounting related adjustments.

These factors were partially offset by higher net deferrals of costs of sales in the three months ended September 30, 2009 as compared to the same period in 2008.

The following table details the components of cost of sales in dollars and as a percentage of total consolidated net revenues for the nine months ended September 30, 2009 and 2008 (amounts in millions):

	Nine months ended September 30, 2009	% of consolidated net revenues	Nine months ended September 30, 2008	% of consolidated net revenues	Increase/ (Decrease)
Product costs	\$ 762	28%	\$ 350	25%	\$ 412
Software royalties and amortization	212	8	88	6	124
Intellectual property licenses	163	6	45	3	118
MMORPG	158	6	123	9	35

For the nine months ended September 30, 2009, costs of sales increased as compared to the same period in 2008 primarily due to:

- Post-Business Combination product costs of \$530 million, software royalties and amortization of \$151 million, and intellectual property licenses of \$112 million from businesses previously operated by Activision, Inc., for the six month period ended June 30, 2009 were included in the nine months ended September 30, 2009, however, costs of sales from the Activision business for the six month period ended June 30, 2008 were not included in the nine months ended September 30, 2008;
- An increase in amortization of intangible assets and other purchase price accounting related adjustments; and
- Incremental investments made by Blizzard for customer service.

These factors were partially offset by higher net deferrals of costs of sales in the nine months ended September 30, 2009 as compared to the same period in 2008.

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

### *Product Development (amounts in millions)*

	September 30, 2009	% of consolidated net revenues	September 30, 2008	% of consolidated net revenues	Increase/ (Decrease)
Three months ended	\$ 122	17%	\$ 200	28%	\$ (78)
Nine months ended	362	13	414	30%	(52)

For the three months ended September 30, 2009, product development costs decreased as compared to the same period of the prior year primarily due to the implementation of our organizational restructuring including title portfolio rationalization. This resulted in the elimination of Non-Core product development expenses. Excluding the effect of the elimination of these Non-Core product development expenses, we incurred higher product development expenses for the three months ended September 30, 2009 as compared to the same period of the prior year to support our larger slate of releases for the future.

For the nine months ended September 30, 2009, product development costs decreased as compared to the same period in 2008 primarily attributable to a reduction of product development costs as a result of the implementation of our organizational restructuring including title portfolio rationalization. This resulted in the elimination of Non-Core product development expenses. This decrease was partially offset by post-Business Combination product development costs of \$143 million from businesses previously operated by Activision, Inc., for the six month period ended June 30, 2009 included in the nine months ended September 30, 2009, however, product development costs from the Activision business for the six month period ended June 30, 2008 were not included in the nine months ended September 30, 2008.

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

### Table of Contents

#### *Sales and Marketing (amounts in millions)*

	September 30, 2009	% of consolidated net revenues	September 30, 2008	% of consolidated net revenues	Increase/ (Decrease)
Three months ended	\$ 128	18%	\$ 142	20%	\$ (14)
Nine months ended	329	12	220	16	109

For the three months ended September 30, 2009, sales and marketing decreased as compared to the same period in 2008 principally due to the wind down of Non-Core activities and the amortization of intangible assets related to customer relationships of \$36 million for the three months ended September 30, 2008. This was partially offset by an increased level of investment in marketing and trade promotions to generate sales in a challenging macro-economic and competitive environment.

Post-Business Combination sales and marketing of \$147 million from businesses previously operated by Activision, Inc., for the six month period ended June 30, 2009 were included in the nine months ended September 30, 2009, however, sales and marketing from the Activision business for the six month period ended June 30, 2008 were not included in the nine months ended September 30, 2008. This increase was partially offset by a decrease in Non-Core sales and marketing expenses and amortization of intangible assets during the nine months ended September 30, 2009.

#### *General and Administrative (amounts in millions)*

	September 30, 2009	% of consolidated net revenues	September 30, 2008	% of consolidated net revenues	Increase/ (Decrease)
Three months ended	\$ 106	15%	\$ 94	13%	\$ 12
Nine months ended	301	11	172	13	129

For the three months ended September 30, 2009, general and administrative expenses increased compared to the same period in 2008 primarily due to higher share-based compensation expenses and foreign exchange losses from the revaluation of transaction exposures.

For the nine months ended September 30, 2009, general and administrative expense increased as compared to the same period in 2008 primarily due to:

- Post-Business Combination general and administrative expenses of \$114 million from businesses previously operated by Activision, Inc., for the six month period ended June 30, 2009 were included in the nine months ended September 30, 2009, however, general and administrative expenses from the Activision business for the six month period ended June 30, 2008 were not included in the nine months ended

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

September 30, 2008;

- Increases in stock-based compensation expense; and
  
- Foreign exchange losses from revaluation of our transaction exposures.

These factors were partially offset by the cost containment strategy we implemented and synergies resulting from our restructuring efforts from the Business Combination.

*Restructuring (amounts in millions)*

	September 30, 2009	% of consolidated net revenues	September 30, 2008	% of consolidated net revenues	Increase/ (Decrease)
Three months ended	\$ (1)	%	\$ 61	9%	\$ (62)
Nine months ended	29	1	61	4	(32)

In the third quarter of 2008, we implemented an organizational restructuring as a result of the Business Combination. This organizational restructuring was to integrate different operations and to streamline the combined Activision Blizzard organization. The implementation of the organizational restructuring resulted in the following restructuring charges: severance costs, contract termination costs, fixed asset write-off on disposals, impairment charges on acquired trade names, prepaid royalties, intellectual property licenses, impairment charges on goodwill, and loss on disposal of assets/liabilities. At June 30, 2009, we had completed the majority of our organizational restructuring activities as a result of the Business Combination. See Note 8 of the Notes to Condensed Consolidated Financial Statements for more detail.

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

### Table of Contents

#### *Investment and Other Income, Net (amounts in millions)*

	September 30 2009	% of consolidated net revenues	September 30, 2008	% of consolidated net revenues	Increase/ (Decrease)
Three months ended	\$ 11	2%	\$ 24	3%	\$ (13)
Nine months ended	21	1	28	2	(7)

Investment and other income, net is comprised of interest income and expense, unrealized gains and losses on trading securities, our auction rate securities put option from UBS and foreign exchange contracts and swaps with Vivendi, and changes in the fair values of certain other financial liabilities.

Investment and other income, net decreased for the three and nine months ended September 30, 2009, as compared to the same period of the prior year primarily as a result of lower cash and cash equivalents balances, lower interest rates and less gain on foreign exchange contracts. Partially offsetting these decreases was an \$8 million increase due to the reduction of our financial liability for the three months ended September 30, 2009.

#### *Income Tax Expense (Benefit) (amounts in millions)*

	September 30, 2009 Income tax expense	% of pre-tax income (loss)	September 30, 2008 Income tax benefit	% of pre-tax income (loss)
Three months ended	\$ 5	26%	\$ (62)	37%
Nine months ended	28	7	(22)	38

The income tax expense of \$5 million for the three months ended September 30, 2009 reflects an effective tax rate of 26%. The effective tax rate of 26% for the three months ended September 30, 2009 differs from the statutory rate of 35% primarily due to foreign income taxes provided at lower rates, recognition of research and development credits and IRC 199 domestic production deductions.

For the nine months ended September 30, 2009 the tax rate is based on our projected annual effective tax rate for 2009, and also includes certain discrete tax benefits recorded during the period. Our tax expense of \$28 million for the nine months ended September 30, 2009 reflects an effective tax rate of 7% which differs from the statutory rate of 35% for the nine months ended September 30, 2008 primarily due to foreign income taxes provided at lower rates and certain discrete tax benefits recorded during the period related to the release of valuation allowances on foreign net operating losses and the impact of changes to California tax laws.

The overall effective income tax rate for the year could be different from the tax rates in effect for the nine months ended September 30, 2009 and will be dependent on our profitability for the remainder of the year. In addition, our effective income tax rates for the remainder of 2009 and future periods will depend on a variety of factors, such as changes in the geographic mix of income, applicable accounting rules, applicable tax

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

laws and regulations, rulings and interpretations thereof, developments in tax audit and other matters, and variations in the estimated and actual level of annual pre-tax income or loss.

We historically have considered undistributed earnings of our foreign subsidiaries to be indefinitely reinvested outside of the United States and, accordingly, no U.S. taxes have been provided thereon. We currently intend to continue to indefinitely reinvest the undistributed earnings of our foreign subsidiaries outside of the United States of America.

On May 4, 2009, President Obama's administration announced several proposals to reform U.S. tax laws, including a proposal to further limit foreign tax credits and a proposal to defer tax deductions allocable to non-U.S. earnings until earnings are repatriated. It is unclear whether these proposed tax reforms will be enacted or, if enacted, what the scope of the reforms will be. Depending on their content, such reforms, if enacted, could have a material effect on our operating results and financial condition.



Table of Contents**Liquidity and Capital Resources***Sources of Liquidity (amounts in millions)*

	At September 30, 2009		At December 31, 2008		Increase/ (Decrease)
Cash and cash equivalents	\$	2,360	\$	2,958	\$ (598)
Short-term investments		361		44	317
	\$	2,721	\$	3,002	\$ (281)
Percentage of total assets		20%		21%	

	For the nine months ended September 30,				Increase/ (Decrease)
	2009	2008			
Net cash provided by operating activities	\$	370	\$	125	\$ 245
Net cash (used in) provided by investing activities		(298)		1,078	(1,376)
Net cash (used in) provided by financing activities		(703)		1,607	(2,310)

In addition to cash flows provided by operating activities, our primary source of liquidity was \$2.7 billion of cash and cash equivalents and short-term investments at September 30, 2009. With our cash and cash equivalents and expected cash flows provided by operating activities, we believe that we have sufficient liquidity to meet daily operations in the foreseeable future. We also believe that we have sufficient working capital (approximately \$3.2 billion at September 30, 2009), as well as availability under our credit facilities, to finance our operational requirements for at least the next twelve months, including purchases of inventory and equipment, the funding of the development, production, marketing and sale of new products, to finance the acquisition of intellectual property rights for future products from third parties, and to fund the stock repurchase program.

On November 5, 2008, we announced that our Board of Directors authorized a stock repurchase program under which we may repurchase up to \$1 billion worth of our common stock. On July 31, 2009, our Board of Directors authorized an increase of \$250 million to the stock repurchase program bringing the total authorization to \$1.25 billion. Under this program, we may repurchase our common stock from time to time on the open market or in private transactions, including structured or accelerated transactions. We will determine the timing and amount of repurchases based on our evaluation of market conditions and other factors. The repurchase program may be suspended or discontinued by the Company at any time.

At September 30, 2009, we had \$290 million available for utilization under the repurchase program.

*Cash Flows from Operating Activities*

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

The primary drivers of cash flows from operating activities have typically included the collection of customer receivables generated by the sale of our products and our subscription revenues, offset by payments for taxes and to vendors for the manufacture, distribution and marketing of our products, third-party developers, intellectual property holders, and our workforce. A significant operating use of our cash relates to our continued investment in software development and intellectual property licenses. We expect that we will continue to make significant expenditures relating to our investment in software development and intellectual property licenses.

### *Cash Flows from Investing Activities*

The primary drivers of cash flows used in investing activities have typically included capital expenditures, acquisitions of privately held interactive software development companies and publishing companies and the net effect of purchases and sales/maturities of short-term investment instruments.

### *Cash Flows from Financing Activities*

The primary drivers of cash flows provided by financing activities have historically related to transactions involving our common stock, including the issuance of shares of common stock to employees and the public and the purchase of treasury shares. We have not utilized debt financing as a source of cash flows. However, if needed, we may access and utilize the credit facilities that are described in *Credit Facilities* in Note 18 of the Notes to Consolidated Financial Statements included in our Form 10-K for the year ended December 31, 2008.

Table of Contents

For the nine months ended September 30, 2009, cash flows used in financing activities included \$834 million used to purchase Activision Blizzard stock under the stock repurchase program. Since its inception in November 2008, we have repurchased \$960 million worth of our common stock under this program.

*Capital Requirements*

For the year ending December 31, 2009, we anticipate total capital expenditures of approximately \$75 million. Capital expenditures will be primarily for computer hardware and software purchases.

**Off-balance Sheet Arrangements**

At September 30, 2009 and December 31, 2008, Activision Blizzard had no relationships with unconsolidated entities or financial parties, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes, that have or are reasonably likely to have a material future effect on our financial condition, changes in financial condition, revenues or expenses, results of operation, liquidity, capital expenditure, or capital resources.

**Financial Disclosure**

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

Our Disclosure Committee, which operates under the Board-approved Disclosure Committee Charter and Disclosure Controls & Procedures Policy, includes senior management representatives and assists executive management in its oversight of the accuracy and timeliness of our disclosures, as well as in implementing and evaluating our overall disclosure process. As part of our disclosure process, senior finance and operational representatives from all of our corporate divisions and business units prepare quarterly reports regarding their current quarter operational performance, future trends, subsequent events, internal controls, changes in internal controls and other accounting and disclosure-relevant information. These quarterly reports are reviewed by certain key corporate finance executives. These corporate finance representatives also conduct quarterly interviews on a rotating basis with the preparers of selected quarterly reports. The results of the quarterly reports and related interviews are reviewed by the Disclosure Committee. Finance representatives also conduct reviews with our senior management team, our internal and external 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

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

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
- Allowances for Returns, Price Protection, Doubtful Accounts, and Inventory Obsolescence
- Software Development Costs and Intellectual Property Licenses
- Accounting for Income Taxes
- Fair Value Estimates

Table of Contents

- Business Combinations
- Goodwill and Intangible Assets Impairment Assessments
- Stock-Based Compensation

During the nine months ended September 30, 2009, there were no significant changes in our critical accounting policies and estimates. You should 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, 2008 for a more complete discussion of our critical accounting policies and estimates.

**Recently Issued Accounting Pronouncements**

In June 2009, the FASB issued an amendment to the accounting and disclosure requirements for the consolidation of variable interest entities (VIEs), which amends the evaluation criteria to identify the primary beneficiary of a variable interest entity. Additionally, this amendment requires ongoing reassessments of whether an enterprise is the primary beneficiary of the variable interest entity. This amendment is effective for financial statements issued for fiscal years beginning after November 15, 2009. We are currently evaluating the impact from the adoption of this amendment on our consolidated financial statements.

In October 2009, the FASB issued an update to *Revenue Recognition - Multiple-Deliverable Revenue Arrangements*. This update establishes the accounting and reporting guidance for arrangements including multiple revenue-generating activities. This update provides amendments to the criteria for separating deliverables, measuring and allocating arrangement consideration to one or more units of accounting. The amendments in this update also establish a selling price hierarchy for determining the selling price of a deliverable. Significantly enhanced disclosures are also required to provide information about a vendor's multiple-deliverable revenue arrangements, including information about the nature and terms, significant deliverables, and its performance within arrangements. The amendments also require providing information about the significant judgments made and changes to those judgments and about how the application of the relative selling-price method affects the timing or amount of revenue recognition. The amendments in this update are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. Early application is permitted. We are currently evaluating the impact, if any, of this new accounting update on our consolidated financial statements.

In October 2009, the FASB issued an update to *Software - Certain Revenue Arrangements That Include Software Elements*. This update changes the accounting model for revenue arrangements that include both tangible products and software elements that are essential to the functionality, and scopes these products out of current software revenue guidance. The new guidance will include factors to help companies determine what software elements are considered essential to the functionality. The amendments will now subject software-enabled products to other revenue guidance and disclosure requirements, such as guidance surrounding revenue arrangements with multiple-deliverables. The amendments in this update are effective prospectively for revenue arrangements entered into or materially modified in the fiscal years beginning on or after June 15, 2010. Early application is permitted. We are currently evaluating the impact, if any, of this new accounting update on our consolidated financial statements.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

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

**Interest Rate Risk**

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments to manage interest rate risk in our investment portfolio. Our investment portfolio consists primarily of debt instruments with high credit quality and relatively short average maturities and money market funds that invest in such securities. As short-term securities mature relatively quickly and must be reinvested at the then-current market rates, interest income on a portfolio consisting of cash, cash equivalents, or short-term securities is more subject to market fluctuations than a portfolio of longer term securities. Conversely, the fair value of such a portfolio is less sensitive to market fluctuations than a portfolio of longer term securities. At September 30, 2009, our \$2,360 million of cash and cash equivalents were comprised primarily of money market funds. At September 30, 2009, our \$361 million of short-term investments included \$228 million of U.S. government agency securities, \$2 million of mortgage-backed securities, \$54 million of auction rate securities classified as trading, and \$77 million restricted cash. We have \$22 million in auction rate securities at fair value classified as long-term investments at September 30, 2009. Most of our investment portfolio is invested in short-term or variable rate securities. Accordingly, we believe that a sharp change in interest rates would not have a material effect on the value of our short-term investment portfolio.

Table of Contents

**Foreign Currency Exchange Rate Risk**

We transact business in many different foreign currencies and may be exposed to financial market risk resulting from fluctuations in foreign currency exchange rates. Currency volatility is monitored frequently throughout the year. We enter into currency forward contracts and swaps with Vivendi, generally with maturities of twelve months or less, to mitigate our risk associated with our exposures, which are comprised of foreign currency denominated financial assets and liabilities (e.g. intercompany receivables and payables) and earnings. We expect to continue to use economic hedge programs in the future to reduce financial market risks if it is determined that such hedging activities are appropriate to reduce risk. We do not hold or purchase any foreign currency contracts for trading or speculative purposes. All foreign currency economic hedging transactions are backed, in amount and by maturity, by an identified economic underlying item.

The gross notional amount of outstanding foreign exchange swaps was \$246 million at September 30, 2009. The notional amounts of outstanding forward foreign exchange contracts and foreign exchange swaps were \$126 million and \$118 million, respectively, at December 31, 2008. A pre-tax net unrealized gain of less than \$1 million and \$3 million for the three months ended September 30, 2009 and 2008, respectively, resulted from the foreign exchange contracts and swaps with Vivendi and were recognized in the Condensed Consolidated Statements of Operations. A pre-tax net unrealized loss of \$4 million and pre-tax net unrealized gain of \$2 million for the nine months ended September 30, 2009 and 2008, respectively, resulted from the foreign exchange contracts and swaps with Vivendi and were recognized in the Condensed Consolidated Statements of Operations.

**Item 4. Controls and Procedures**

**Controls and Procedures**

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

**2) Evaluation of Disclosure Controls and Procedures.**

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

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures at September 30, 2009, the end of the period covered by this report. Based on this controls evaluation, the principal executive officer and principal financial officer concluded that, at September 30, 2009, 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.

### **3) Changes in Internal Control Over Financial Reporting.**

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

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

The discussion in Note 16 to the Condensed Consolidated Financial Statements regarding legal proceedings is incorporated herein by reference.



Table of Contents**Item 1A. Risk Factors**

Various risk factors associated with our business are included in Part I, Item 1A, Risk Factors, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2008. In addition, the Company notes the following risk:

***Indications of some regulatory uncertainty exist regarding our licensee's ongoing ability to operate World of Warcraft in China on a paying basis without interruption.***

In April 2009, Blizzard agreed to license World of Warcraft to an affiliated company of NetEase.com, Inc. (NetEase) in China for a term of three years. World of Warcraft was unavailable to players in China from June 7, 2009 (local), the date on which our prior license arrangements expired, until July 30, 2009 (local), when NetEase began making the game available to our previous players in China in a test format without charge. Subsequently, NetEase advised us that it received the necessary regulatory approval, and accordingly, relaunched the game to subscribers in China on September 19, 2009. There are indications of ongoing regulatory uncertainty regarding NetEase's operation of World of Warcraft in China, which could impact its ability to continue to make the game available on a paying basis without interruption. Having World of Warcraft unavailable for play or available only on an unpaid basis would result in lost revenues and income, and having it unavailable for a prolonged period could have a negative effect on our reputation and subscriber base in China.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds***Issuer Repurchase of Equity Securities*

The following table provides the number of shares repurchased and average price paid per share during the three months ended September 30, 2009, and the approximate dollar value of shares that may yet be purchased under our \$1.25 billion stock repurchase program at September 30, 2009 (amounts in millions, except number of shares and per share data).

Period	Total number of shares repurchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plan
July 1, 2009 - July 31, 2009	14,420,193	\$ 11.81	14,420,193	\$ 411
August 1, 2009 - August 31, 2009	10,165,785	11.90	10,165,785	290
September 1, 2009 - September 30, 2009				290
Total	24,585,978	\$ 11.85	24,585,978	

(1) All purchases were made pursuant to a stock repurchase program, announced on November 5, 2008, authorized by our Board of Directors pursuant to which we were originally authorized to repurchase up to \$1 billion of our common stock from time to time on the open market or in private transactions, including structured or accelerated transactions. On July 31, 2009, our Board of Directors authorized an increase of \$250 million to the stock repurchase program bringing the total authorization to \$1.25 billion. We will determine the timing and amount of

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

repurchases based on our evaluation of market conditions and other factors. We may suspend or discontinue the stock repurchase program at any time.

### **Item 6. Exhibits**

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

Table of Contents

**SIGNATURE**

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

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

Date: November 6, 2009

ACTIVISION BLIZZARD, INC.

*/s/ Thomas Tippel*

Thomas Tippel

Chief Corporate Officer and Chief Financial Officer,

Principal Financial and Accounting Officer of Activision Blizzard, Inc.

Table of Contents**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Exhibit</b>
3.1	Amended and Restated Certificate of Incorporation of Activision Blizzard, Inc., dated July 9, 2008 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed July 15, 2008).
3.2	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Activision Blizzard, Inc., dated August 15, 2008 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed August 15, 2008).
3.3	Amended and Restated By-Laws of Activision Blizzard, Inc., dated July 9, 2008 (incorporated by reference to Exhibit 3.2 of the Company's Form 8-K, filed July 15, 2008).
3.4	First Amendment to the Amended and Restated By-Laws of Activision Blizzard, Inc., dated July 28, 2008 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed July 31, 2008).
10.1*	Employment Agreement, dated July 31, 2009, between Brian Hodous and Activision Publishing, Inc.
10.2*	Notice of Stock Option Award, dated as of November 6, 2009, to Brian Hodous.
10.3*	Notice of Restricted Share Unit Award, dated as of November 6, 2009, to Brian Hodous.
10.4*	Employment Agreement, dated August 31, 2009, between Christopher Walther and Activision Blizzard, Inc.
10.5*	Employment Agreement, dated September 11, 2009, between George Rose and Activision Blizzard, Inc.
31.1	Certification of Robert A. Kotick pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Thomas Tippl pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Thomas Tippl pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Calculation Linkbase Document.
101.LAB	XBRL Taxonomy Label Linkbase Document.
101.PRE	XBRL Taxonomy Presentation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Document.

## 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 September 30, 2009 and December 31, 2008, (ii) Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2009 and September 30, 2008, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2009 and September 30, 2008; (iv) Condensed Consolidated Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2009; and (v) Notes to Condensed Consolidated Financial Statements.

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