

Activision Blizzard, Inc.  
Form 10-Q  
May 06, 2014  
[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 March 31, 2014

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-15839

## ACTIVISION BLIZZARD, INC.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**95-4803544**

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

**3100 Ocean Park Boulevard, Santa Monica, CA**

(Address of principal executive offices)

**90405**

(Zip Code)

**(310) 255-2000**

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer

Accelerated Filer

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

Smaller reporting company

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

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

The number of shares of the registrant's Common Stock outstanding at April 29, 2014 was 714,998,372.

---

Table of Contents

**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**

**Table of Contents**

	<u>Cautionary Statement</u>	3
<b>PART I.</b>	<b>FINANCIAL INFORMATION</b>	
Item 1.	Financial Statements (Unaudited)	
	<u>Condensed Consolidated Balance Sheets at March 31, 2014 and December 31, 2013</u>	4
	<u>Condensed Consolidated Statements of Operations for the three months ended March 31, 2014 and March 31, 2013</u>	5
	<u>Condensed Consolidated Statements of Comprehensive Income for the three months ended March 31, 2014 and March 31, 2013</u>	6
	<u>Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2014 and March 31, 2013</u>	7
	<u>Condensed Consolidated Statement of Changes in Shareholders' Equity for the three months ended March 31, 2014</u>	8
	<u>Notes to Condensed Consolidated Financial Statements</u>	9
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	27
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	43
Item 4.	<u>Controls and Procedures</u>	44
<b>PART II.</b>	<b>OTHER INFORMATION</b>	45
Item 1.	<u>Legal Proceedings</u>	45
Item 1A.	<u>Risk Factors</u>	47
Item 6.	<u>Exhibits</u>	48
	<u>SIGNATURE</u>	49
	<u>EXHIBIT INDEX</u>	50
	CERTIFICATIONS	

Table of Contents

**CAUTIONARY STATEMENT**

*This Quarterly Report on Form 10-Q contains, or incorporates by reference, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements consist of any statement other than a recitation of historical facts and include, but are not limited to: (1) projections of revenues, expenses, income or loss, earnings or loss per share, cash flow or other financial items; (2) statements of our plans and objectives, including those relating to product releases; (3) statements of future financial or operating performance; (4) statements about the impact of the recently consummated transactions involving the repurchase of shares from Vivendi, S.A., and the debt financing related thereto; and (5) statements of assumptions underlying such statements. Activision Blizzard, Inc. ( Activision Blizzard ) generally uses words, such as outlook, forecast, will, could, should, would, to be, plans, believes, may, expects, intends, anticipates, estimate, future, positioned, potential, project, remain, scheduled, set to, subject to, upcoming and other similar expressions to help identify forward-looking statements. Forward-looking statements are subject to business and economic risk, reflect management's current expectations, estimates and projections about our business, and are inherently uncertain and difficult to predict. Our actual results could differ materially. Risks and uncertainties that may affect our future results include, but are not limited to, sales levels of Activision Blizzard's titles, increasing concentration of titles, shifts in consumer spending trends, the impact of the current macroeconomic environment, Activision Blizzard's ability to predict consumer preferences, including interest in specific genres, such as first-person action, massively multiplayer online games and toys to life, and preferences among hardware platforms, the seasonal and cyclical nature of the interactive game market, changing business models, including digital delivery of content, competition including from used games and other forms of entertainment, possible declines in software pricing, product returns and price protection, product delays, adoption rate and availability of new hardware (including peripherals) and related software, particularly during the ongoing console transition, rapid changes in technology and industry standards, the current regulatory environment, litigation risks and associated costs, protection of proprietary rights, maintenance of relationships with key personnel, customers, financing providers, licensees, licensors, vendors, and third-party developers, including the ability to attract, retain and develop key personnel and developers that can create high quality titles, counterparty risks relating to customers, licensees, licensors and manufacturers, domestic and international economic, financial and political conditions and policies, foreign exchange rates and tax rates, the identification of suitable future acquisition opportunities and potential challenges associated with geographic expansion, capital market risks, the possibility that expected benefits related to the recently consummated transactions with Vivendi S.A. may not materialize as expected, the amount of our debt and the limitations imposed by the covenants in the agreements governing our debt, and the other factors identified in Risk Factors included in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013. The forward-looking statements contained herein are based upon information available to us as of the date of this Quarterly Report on Form 10-Q and we assume no obligation to update any such forward-looking statements. Although these forward-looking statements are believed to be true when made, they may ultimately prove to be incorrect. These statements are not guarantees of our future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and may cause actual results to differ materially from current expectations.*

*Activision Blizzard Inc.'s names, abbreviations thereof, logos, and product and service designators are all either the registered or unregistered trademarks or trade names of Activision Blizzard. All other product or service names are the property of their respective owners.*

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

(Unaudited)

(Amounts in millions, except share data)

	At March 31, 2014	At December 31, 2013
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 4,279	\$ 4,410
Short-term investments	8	33
Accounts receivable, net of allowances of \$264 and \$381 at March 31, 2014 and December 31, 2013, respectively	219	510
Inventories, net	158	171
Software development	361	367
Intellectual property licenses	12	11
Deferred income taxes, net	336	321
Other current assets	321	418
Total current assets	5,694	6,241
Long-term investments	9	9
Software development	44	21
Property and equipment, net	152	138
Other assets	66	35
Intangible assets, net	41	43
Trademark and trade names	433	433
Goodwill	7,089	7,092
Total assets	\$ 13,528	\$ 14,012
<b>Liabilities and Shareholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 166	\$ 355
Deferred revenues	1,092	1,389
Accrued expenses and other liabilities	635	636
Current portion of long-term debt		25
Total current liabilities	1,893	2,405
Long-term debt, net	4,320	4,668
Deferred income taxes, net	86	66
Other liabilities	305	251
Total liabilities	6,604	7,390
Commitments and contingencies (Note 13)		
Shareholders equity:		
Common stock, \$0.000001 par value, 2,400,000,000 shares authorized, 1,143,446,956 and 1,132,385,424 shares issued at March 31, 2014 and December 31, 2013, respectively		
Additional paid-in capital	9,812	9,682
Less: Treasury stock, at cost, 428,676,471 shares at March 31, 2014 and December 31, 2013	(5,783)	(5,814)
Retained earnings	2,832	2,686
Accumulated other comprehensive income	63	68

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

Total shareholders' equity		6,924		6,622
Total liabilities and shareholders' equity	\$	13,528	\$	14,012

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

Table of Contents

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

(Unaudited)

(Amounts in millions, except per share data)

	<b>For the Three Months Ended</b>	
	<b>2014</b>	<b>March 31,</b>
		<b>2013</b>
<b>Net revenues</b>		
Product sales	\$ 769	\$ 990
Subscription, licensing, and other revenues	342	334
Total net revenues	1,111	1,324
<b>Costs and expenses</b>		
Cost of sales — product costs	225	260
Cost of sales — online	58	57
Cost of sales — software royalties and amortization	57	61
Cost of sales — intellectual property licenses	2	38
Product development	143	125
Sales and marketing	104	107
General and administrative	95	89
Total costs and expenses	684	737
Operating income	427	587
Interest and other investment income (expense), net	(51)	2
Income before income tax expense	376	589
Income tax expense	83	133
Net income	\$ 293	\$ 456
<b>Earnings per common share</b>		
Basic	\$ 0.40	\$ 0.40
Diluted	\$ 0.40	\$ 0.40
<b>Weighted-average number of shares outstanding</b>		
Basic	709	1,113
Diluted	720	1,120
Dividends per common share	\$ 0.20	\$ 0.19

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





Table of Contents

**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

(Amounts in millions)

Net income	\$	293	\$ 456
<b>Other comprehensive income (loss):</b>			
Foreign currency translation adjustment		(5)	(70)
Unrealized gains on investments, net of deferred income taxes of \$0 million for March 31, 2014 and 2013			1
Other comprehensive income (loss)	\$	(5)	\$ (69)
Comprehensive income	\$	288	\$ 387

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)

	<b>For the Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 293	\$ 456
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Deferred income taxes	6	140
Provision for inventories	9	8
Depreciation and amortization	19	24
Amortization and write-off of capitalized software development costs and intellectual property licenses (1)	51	83
Amortization of debt discount and debt financing costs	2	
Stock-based compensation expense (2)	29	27
Excess tax benefits from stock awards	(17)	(4)
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable, net	290	463
Inventories	5	39
Software development and intellectual property licenses	(71)	(73)
Other assets	111	93
Deferred revenues	(298)	(511)
Accounts payable	(189)	(149)
Accrued expenses and other liabilities	(104)	(271)
Net cash provided by operating activities	136	325
<b>Cash flows from investing activities:</b>		
Proceeds from maturities of available-for-sale investments	21	113
Purchases of available-for-sale investments		(26)
Capital expenditures	(37)	(17)
Decrease (increase) in restricted cash	4	10
Net cash provided by (used in) investing activities	(12)	80
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common stock to employees	119	33
Tax payment related to net share settlements on restricted stock rights	(13)	(14)
Excess tax benefits from stock awards	17	4
Repayment of long-term debt	(375)	
Net cash provided by (used in) financing activities	(252)	23
Effect of foreign exchange rate changes on cash and cash equivalents	(3)	(88)
Net (decrease) increase in cash and cash equivalents	(131)	340
Cash and cash equivalents at beginning of period	4,410	3,959
Cash and cash equivalents at end of period	\$ 4,279	\$ 4,299

- (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 Three Months Ended March 31, 2014

(Unaudited)

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

	Common Stock		Treasury Stock		Additional	Retained	Accumulated	Total
	Shares	Amount	Shares	Amount	Paid-In	Earnings	Other	Shareholders
					Capital	(Accumulated	Comprehensive	Equity
						Deficit)	Income (Loss)	
<b>Balance at December 31, 2013</b>	<b>1,132</b>	<b>\$</b>	<b>(429)</b>	<b>\$ (5,814)</b>	<b>\$ 9,682</b>	<b>\$ 2,686</b>	<b>\$ 68</b>	<b>\$ 6,622</b>
Components of comprehensive income:								
Net income						293		293
Other comprehensive income (loss)							(5)	(5)
Issuance of common stock pursuant to employee stock options	10				119			119
Issuance of common stock pursuant to restricted stock rights	2							
Restricted stock surrendered for employees tax liability	(1)				(27)			(27)
Tax benefit associated with employee stock awards					11			11
Stock-based compensation expense related to employee stock options and restricted stock rights					27			27
Dividends (\$0.20 per common share)						(147)		(147)
Indemnity on tax attributes assumed in connection with the Purchase Transaction (see Note 10)				31				31
<b>Balance at March 31, 2014</b>	<b>1,143</b>	<b>\$</b>	<b>(429)</b>	<b>\$ (5,783)</b>	<b>\$ 9,812</b>	<b>\$ 2,832</b>	<b>\$ 63</b>	<b>\$ 6,924</b>

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

Table of Contents

**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

(Unaudited)

**1. Description of Business and Basis of Consolidation and Presentation**

*Description of Business*

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

*The Business Combination and Recently Consummated Share Repurchase*

Activision Blizzard is the result of the 2008 business combination ( Business Combination ) by and among the Company (then known as Activision, Inc.), SeGO Merger Corporation, a wholly-owned subsidiary of Activision, Inc., Vivendi S.A. ( Vivendi ), VGAC LLC, a wholly-owned subsidiary of Vivendi, and Vivendi Games, Inc. ( Vivendi Games ), a wholly-owned subsidiary of VGAC LLC. As a result of the consummation of the Business Combination, Activision, Inc. was renamed Activision Blizzard, Inc. and Vivendi became a majority shareholder of Activision. The common stock of Activision Blizzard is traded on The NASDAQ Stock Market under the ticker symbol ATVI.

On October 11, 2013, we repurchased approximately 429 million shares of our common stock, pursuant to a stock purchase agreement (the Stock Purchase Agreement ) we entered into on July 25, 2013, with Vivendi and ASAC II LP ( ASAC ), an exempted limited partnership established under the laws of the Cayman Islands, acting by its general partner, ASAC II LLC. Pursuant to the terms of the Stock Purchase Agreement, we acquired all of the capital stock of Amber Holding Subsidiary Co., a Delaware corporation and wholly-owned subsidiary of Vivendi ( New VH ), which was the direct owner of approximately 429 million shares of our common stock, for a cash payment of \$5.83 billion, or \$13.60 per share, before taking into account the benefit to the Company of certain tax attributes of New VH assumed in the transaction (collectively, the Purchase Transaction ). Immediately following the completion of the Purchase Transaction, ASAC purchased from Vivendi 172 million shares of Activision Blizzard's common stock, pursuant to the Stock Purchase Agreement, for a cash payment of \$2.34 billion, or \$13.60 per share (the Private Sale ). Refer to Note 7 of the Notes to Condensed Consolidated Financial Statements for further information regarding the financing of the Purchase Transaction.

As a result of the Purchase Transaction and the Private Sale, we ceased to be a controlled company and, as of March 31, 2014, we had approximately 715 million shares of our common stock issued and outstanding, of which Vivendi held approximately 12%, ASAC held approximately 24% and our other stockholders held approximately 64%.

*Operating Segments*

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

**(i) Activision Publishing, Inc.**

Activision Publishing, Inc. ( Activision ) is a leading international developer and publisher of interactive software products and content. Activision develops games based on internally-developed properties, including games in the Call of Duty® and Skylanders franchises, and to a lesser extent, based on licensed intellectual properties. Additionally, we have established a long-term alliance with Bungie to release its next big-action game universe, *Destiny*, in September 2014. Activision sells games through both retail channels and digital downloads. Activision delivers content to a broad range of gamers, ranging from children to adults, and from core gamers to mass-market consumers to value buyers seeking budget-priced software, in a variety of geographies. Activision currently offers games that operate on the Microsoft Corporation ( Microsoft ) Xbox One ( Xbox One ) and Xbox 360 ( Xbox 360 ), Nintendo Co. Ltd. ( Nintendo ) Wii U ( Wii U ) and Wii ( Wii ), and Sony Co. Entertainment, Inc. ( Sony ) PlayStation 4 ( PS4 ) and PlayStation 3 ( PS3 ) console systems (Xbox One, Wii U, and PS4 are collectively referred to as next-generation ; Xbox 360, Wii, and PS3 are collectively referred to as current-generation ); the PC; the Nintendo 3DS, Nintendo Dual Screen, and Sony PlayStation Vita handheld game systems; and other handheld and mobile devices.

Table of Contents

**(ii) *Blizzard Entertainment, Inc.***

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

**(iii) *Activision Blizzard Distribution***

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

***Basis of Consolidation and Presentation***

Activision Blizzard prepared the accompanying unaudited condensed consolidated financial statements in accordance with the rules and regulations of the Securities and Exchange Commission for interim reporting. As permitted under those rules and regulations, certain notes or other information that are normally required by accounting principles generally accepted in the United States of America ( *U.S. GAAP* ) have been condensed or omitted if they substantially duplicate the disclosures contained in the annual audited consolidated financial statements. The year-end condensed balance sheet data was derived from audited financial statements but does not include all disclosures required by *U.S. GAAP*. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2013. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for the fair statement of our financial position and results of operations in accordance with *U.S. GAAP* have been included in the accompanying unaudited condensed consolidated financial statements.

The accompanying condensed consolidated financial statements include the accounts and operations of the Company. 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 and accompanying notes. Actual results could differ from these estimates and assumptions.

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



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

**2. Inventories, Net**

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

	<b>At March 31, 2014</b>	<b>At December 31, 2013</b>
Finished goods	\$ 139	\$ 149
Purchased parts and components	19	22
Inventories, net	\$ 158	\$ 171

Table of Contents

Inventory reserves were \$47 million and \$42 million at March 31, 2014 and December 31, 2013, respectively.

**3. Software Development and Intellectual Property Licenses**

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

	At March 31, 2014		At December 31, 2013	
Internally developed software costs	\$	186	\$	189
Payments made to third-party software developers		219		199
Total software development costs	\$	405	\$	388
Intellectual property licenses	\$	12	\$	11

Amortization, write-offs and impairments of capitalized software development costs and intellectual property licenses are comprised of the following (amounts in millions):

Amortization of capitalized software development costs and intellectual property licenses	\$	58	\$	62
Write-offs and impairments				26

**4. Intangible Assets, Net**

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

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

Table of Contents

	At March 31, 2014			
	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
Acquired definite-lived intangible assets:				
License agreements and other	3 - 10 years	\$ 98	\$ (90)	\$ 8
Internally-developed franchises	11 - 12 years	309	(276)	33
Total definite-lived intangible assets		\$ 407	\$ (366)	\$ 41
Acquired indefinite-lived intangible assets:				
Activision trademark	Indefinite			386
Acquired trade names	Indefinite			47
Total indefinite-lived intangible assets				\$ 433

	At December 31, 2013			
	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
Acquired definite-lived intangible assets:				
License agreements and other	3 - 10 years	\$ 98	\$ (90)	\$ 8
Internally-developed franchises	11 - 12 years	309	(274)	35
Total definite-lived intangible assets		\$ 407	\$ (364)	\$ 43
Acquired indefinite-lived intangible assets:				
Activision trademark	Indefinite			386
Acquired trade names	Indefinite			47
Total indefinite-lived intangible assets				\$ 433

Amortization expense of intangible assets was \$2 million and \$3 million for the three months ended March 31, 2014 and 2013, respectively.

At March 31, 2014, future amortization of definite-lived intangible assets is estimated as follows (amounts in millions):

2014 (remaining nine months)	\$ 13
2015	12
2016	7
2017	4
2018	3
Thereafter	2
Total	\$ 41

**5. Goodwill**

The changes in the carrying amount of goodwill by operating segment for the three months ended March 31, 2014 are as follows (amounts in millions):



Table of Contents

	Activision	Blizzard	Total
Balance at December 31, 2013	\$ 6,914	\$ 178	\$ 7,092
Tax benefit credited to goodwill	(3)		(3)
Balance at March 31, 2014	\$ 6,911	\$ 178	\$ 7,089

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

**6. Fair Value Measurements**

Financial Accounting Standards Board ( FASB ) literature regarding fair value measurements for financial and non-financial assets and liabilities establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

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

**Fair Value Measurements on a Recurring Basis**

The table below segregates all of our financial assets that are measured at fair value on a recurring basis into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date (amounts in millions):

Fair Value Measurements at March 31, 2014 Using	
Quoted Prices in Active	Significant


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


	As of March 31, 2014	Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
Recurring fair value measurements:					
Money market funds	\$ 4,017	\$ 4,017	\$	\$	Cash and cash equivalents
Foreign government treasury bills	36	36			Cash and cash equivalents
Auction rate securities ( ARS )	9			9	Long-term investments
Total recurring fair value measurements	\$ 4,062	\$ 4,053	\$	\$ 9	

Table of Contents

	Fair Value Measurements at December 31, 2013 Using					Balance Sheet Classification
	As of December 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
Recurring fair value measurements:						
Money market funds	\$ 4,000	\$ 4,000	\$	\$		Cash and cash equivalents
Foreign government treasury bills	30	30				Cash and cash equivalents
U.S. treasuries and government agency securities	21	21				Short-term investments
ARS	9			9		Long-term investments
Total recurring fair value measurements	\$ 4,060	\$ 4,051	\$	\$ 9		

The following tables provide a reconciliation of the beginning and ending balances of our financial assets classified as Level 3 by major categories (amounts in millions) at March 31, 2014 and 2013, respectively:

			
Balance at December 31, 2013	\$	9	\$ 9
Total unrealized gains included in other comprehensive income			
Balance at March 31, 2014	\$	9	\$ 9

			
Balance at December 31, 2012	\$	8	\$ 8
Total unrealized gains included in other comprehensive income		1	1
Balance at March 31, 2013	\$	9	\$ 9

(a) Fair value measurements have been estimated using an income-approach model. When estimating the fair value, we consider both observable market data and non-observable factors, including credit quality, duration, insurance wraps, collateral composition, maximum rate formulas, comparable trading instruments, and the likelihood of redemption. Significant assumptions used in the analysis include estimates for interest rates, spreads, cash flow timing and amounts, and holding periods of the securities. At March 31, 2014, assets measured at fair value using significant unobservable inputs (Level 3), all of which were ARS, represent less than 1% of our financial assets measured at fair value on a recurring basis.

Table of Contents

*Foreign Currency Forward Contracts Not Designated as Hedges*

We transact business in various currencies other than the U.S. dollar and have significant international sales and expenses denominated in currencies other than the U.S. dollar, subjecting us to currency exchange rate risks. To mitigate our risk from foreign currency fluctuations we periodically enter into currency derivative contracts, principally forward contracts with maturities which are generally 12 months or less. All foreign currency contracts are backed, in amount and by maturity, by an identified economic underlying item. In recent years, Vivendi has been our principal counterparty for our currency derivative contracts, but in connection with the Purchase Transaction described in Note 1 of the Notes to Condensed Consolidated Financial Statements, we terminated our cash management services agreement with Vivendi as of October 31, 2013. Further, we have not had any outstanding currency derivative contracts with Vivendi as the counterparty since July 3, 2013. Since the consummation of the Purchase Transaction, our counterparties for our currency derivative contracts have been large and reputable commercial or investment banks. We did not have any outstanding foreign currency contracts at March 31, 2014. The gross notional amount of outstanding foreign currency contracts was \$34 million at December 31, 2013. The fair value of foreign currency contracts is estimated based on the prevailing exchange rates of the various hedged currencies as of the end of the relevant period and was not material as of December 31, 2013.

We do not hold or purchase any foreign currency contracts for trading or speculative purposes and we do not designate these contracts as hedging instruments. Accordingly, we report the fair value of these contracts within *Other current assets* or *Other current liabilities* in our condensed consolidated balance sheets and the changes in fair value within *General and administrative expense* and *Interest and other investment income (expense), net* in our condensed consolidated statements of operations, depending on the nature of the contracts. For the three months ended March 31, 2014 and 2013, pre-tax net losses and gains were not material.

**Fair Value Measurements on a Non-Recurring Basis**

We measure the fair value of certain assets on a non-recurring basis, generally annually or when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. For the three months ended March 31, 2014 and 2013, there were no impairment charges related to assets that are measured on a non-recurring basis.

**7. Debt**

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

*Credit Facilities*

On October 11, 2013, in connection and simultaneously with the Purchase Transaction, we entered into a credit agreement (the *Credit Agreement*) for a \$2.5 billion secured term loan facility maturing in October 2020 (the *Term Loan*), and a \$250 million secured revolving credit facility maturing in October 2018 (the *Revolver* and, together with the Term Loan, the *Credit Facilities*). A portion of the Revolver can be used to issue letters of credit of up to \$50 million, subject to the availability of the Revolver. To date, we have not drawn on the Revolver.



Borrowings under the Term Loan and the Revolver bear interest, payable on a quarterly basis, at an annual rate equal to an applicable margin plus, at our option, (A) a base rate determined by reference to the highest of (a) the interest rate in effect determined by the administrative agent as its prime rate, (b) the federal funds rate plus 0.5%, and (c) the London InterBank Offered Rate ( LIBOR ) rate for an interest period of one month plus 1.00%, or (B) LIBOR. Further, LIBOR borrowings under the Term Loan will be subject to a LIBOR floor of 0.75%. At March 31, 2014, the Term Loan bore interest at 3.25%. In certain circumstances, our applicable interest rate under the Credit Facilities will increase.

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

We are required to make quarterly principal repayments of 0.25% of the Term Loan's original principal amount, with the balance due on the maturity date. On February 11, 2014, we made a voluntary repayment of \$375 million on our Term Loan. This repayment satisfied the required quarterly principal repayments. Since this voluntary principal repayment was not a contractual requirement as of December 31, 2013 and the Board of Directors did not approve the repayment until January 2014, only the contractual principal repayment of \$25 million for 2014 has been reflected as Current portion of long-term debt in our condensed consolidated balance sheet as of December 31, 2013. Amounts borrowed under the Term Loan and repaid may not be re-borrowed.

Table of Contents

The Credit Facilities are guaranteed by certain of the Company's U.S. subsidiaries, whose assets represent approximately 69% of our consolidated assets. The Credit Agreement contains customary covenants that place restrictions in certain circumstances on, among other things, the incurrence of debt, granting of liens, payment of dividends, sales of assets and mergers and acquisitions. If our obligations under the Revolver exceed 15% of the total amount of that facility as of the end of any fiscal quarter (subject to certain exclusions for letters of credit), we are also subject to certain financial covenants. A violation of any of these covenants could result in an event of default under the Credit Agreement. Upon the occurrence of such event of default or certain other customary events of default, payment of any outstanding amounts under the Credit Agreement may be accelerated, and the lenders' commitments to extend credit under the Credit Agreement may be terminated. In addition, an event of default under the Credit Agreement could, under certain circumstances, permit the holders of other outstanding unsecured debt, including the debt holders described below, to accelerate the repayment of such obligations. The Company was in compliance with the terms of the Credit Facilities as of March 31, 2014.

***Unsecured Senior Notes***

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

The Notes are general senior obligations of the Company and rank *pari passu* in right of payment to all of the Company's existing and future senior indebtedness, including the Credit Facilities described above. The Notes are guaranteed on a senior basis by certain of our U.S. subsidiaries. The Notes and related guarantees are not secured and are effectively subordinated to any of the Company's existing and future indebtedness that is secured, including the Credit Facilities. The Notes contain customary covenants that place restrictions in certain circumstances on, among other things, the incurrence of debt, granting of liens, payment of dividends, sales of assets and mergers and acquisitions. The Company was in compliance with the terms of the Notes as of March 31, 2014.

Interest on the Notes is payable semi-annually in arrears on March 15 and September 15 of each year, commencing on March 15, 2014. As of March 31, 2014 and December 31, 2013, we had interest payable of \$6 million and \$38 million, respectively, related to the Notes recorded within Accrued expenses and other liabilities in our condensed consolidated balance sheets.

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

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

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

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

Table of Contents

	Gross Carrying Amount	March 31, 2014 Unamortized Discount	Net Carrying Amount
Term Loan	\$ 2,119	\$ (12)	\$ 2,107
2021 Notes	1,500	(25)	1,475
2023 Notes	750	(12)	738
Total debt	\$ 4,369	\$ (49)	\$ 4,320
Less: current portion of long-term debt			
Total long-term debt	\$ 4,369	\$ (49)	\$ 4,320

	Gross Carrying Amount	December 31, 2013 Unamortized Discount	Net Carrying Amount
Term Loan	\$ 2,494	\$ (12)	\$ 2,482
2021 Notes	1,500	(26)	1,474
2023 Notes	750	(13)	737
Total debt	\$ 4,744	\$ (51)	\$ 4,693
Less: current portion of long-term debt	(25)		(25)
Total long-term debt	\$ 4,719	\$ (51)	\$ 4,668

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

As of March 31, 2014, the scheduled maturities and contractual principal repayments of our debt for each of the five succeeding years are as follows (amounts in millions):

For the year ending December 31,	
2014 (remaining nine months)	\$
2015	
2016	
2017	
2018	
Thereafter	4,369
Total	\$ 4,369

As of March 31, 2014 and December 31, 2013, the carrying value of the Term Loan approximates the fair value, based on Level 2 inputs, as the interest rate is variable over the selected interest period and is similar to current rates at which we can borrow funds. Based on Level 2 inputs (observable market prices in less than active market), the fair values of the 2021 Notes and 2023 Notes were \$1,599 million and \$816 million, respectively, at March 31, 2014 and \$1,559 million and \$785 million, respectively, at December 31, 2013.

**Deferred Financing Costs**

Costs incurred to obtain our long-term debt are recorded as deferred financing costs within Other assets non-current in our condensed consolidated balance sheets and are amortized over the terms of the respective debt agreements using a straight-line basis for costs related to the

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

Revolver and the interest earned method for costs related to the Term Loan and Notes. Amortization expense related to the deferred financing costs is recorded within Interest and other investment income (expense), net in our condensed consolidated statement of operations. For the three months ended March 31, 2014, this amount was not material.

Table of Contents**8. Accumulated Other Comprehensive Income (Loss)**

The components of accumulated other comprehensive income (loss) at March 31, 2014 and 2013, were as follows (amounts in millions):

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

	For the Three Months Ended March 31, 2013			Total
	Foreign currency translation adjustments		Unrealized gain on available-for-sale securities	
Balance at December 31, 2012	\$ (26)	\$	\$	(26)
Other comprehensive income (loss) before reclassifications	(70)	1		(69)
Amounts reclassified from accumulated other comprehensive income (loss)				
Balance at March 31, 2013	\$ (96)	\$ 1	\$	(95)

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

**9. Operating Segments and Geographic Region**

Our operating segments are consistent with our internal organizational structure, the manner in which our operations are reviewed and managed by our Chief Executive Officer, who is our Chief Operating Decision Maker ( CODM ), the manner in which we assess operating performance and allocate resources, and the availability of separate financial information. Currently, we conduct our business through three operating segments: Activision, Blizzard and Distribution (see Note 1 of the Notes to Condensed Consolidated Financial Statements). We do not aggregate operating segments.

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

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

2014 and 2013 are presented below (amounts in millions):

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

Table of Contents

	Three Months Ended March 31,			
	2014	2013	2014	2013
	Net revenues		Income (loss) from operations operations before income tax expense	
Activision	\$ 237	\$ 423	\$ 2	\$ 112
Blizzard	462	330	239	135
Distribution	73	51	(1)	
Operating segments total	772	804	240	247
Reconciliation to consolidated net revenues / consolidated income before income tax expense:				
Net effect from deferral of net revenues and related cost of sales	339	520	219	369
Stock-based compensation expense			(30)	(26)
Amortization of intangible assets			(2)	(3)
Consolidated net revenues / operating income	\$ 1,111	\$ 1,324	427	587
Interest and other investment income (expense), net			(51)	2
Consolidated income before income tax expense			\$ 376	\$ 589

Geographic information presented below for the three months ended March 31, 2014 and 2013 is based on the location of the selling entity. Net revenues from external customers by geographic region were as follows (amounts in millions):

	Three Months Ended March 31,	
	2014	2013
Net revenues by geographic region:		
North America	\$ 563	\$ 738
Europe	462	487
Asia Pacific	86	99
Total consolidated net revenues	\$ 1,111	\$ 1,324

The Company's net revenues in the U.S. were 48%, and 53% of consolidated net revenues for the three months ended March 31, 2014 and 2013, respectively. The Company's net revenues in the U.K. were 15% and 12% of consolidated net revenues for the three months ended March 31, 2014 and 2013, respectively. The Company's net revenues in France were 13% and 12% of consolidated net revenues for the three months ended March 31, 2014 and 2013, respectively. No other country's net revenues exceeded 10% of consolidated net revenues.

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

	Three Months Ended March 31,	
	2014	2013
Net revenues by platform:		
Console	\$ 654	\$ 749
Online (1)	201	275
PC	100	93
Mobile and other (2)	83	156
Total Activision Blizzard net revenues	1,038	1,273



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

Distribution		73		51
Total consolidated net revenues	\$	1,111	\$	1,324

Table of Contents

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

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

Long-lived assets by geographic region at March 31, 2014 and December 31, 2013 were as follows (amounts in millions):

	At March 31, 2014	At December 31, 2013
Long-lived assets* by geographic region:		
North America	\$ 107	\$ 102
Europe	36	29
Asia Pacific	9	7
Total long-lived assets by geographic region	\$ 152	\$ 138

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

We did not have any single external customers that accounted for 10% or more of consolidated net revenues for the three months ended March 31, 2014 and 2013.

## 10. Income Taxes

The Company accounts for its provision for income taxes in accordance with Accounting Standards Codification ( ASC ) 740, *Income Taxes*, which requires an estimate of the annual effective tax rate for the full year to be applied to the respective interim period, taking into account year-to-date amounts and projected results for the full year. The provision for income taxes represents federal, foreign, state and local income taxes. Our effective tax rate differs from the statutory U.S. income tax rate due to the effect of state and local income taxes, tax rates in foreign jurisdictions and certain nondeductible expenses. Our effective tax rate will change from quarter to quarter based on recurring and nonrecurring factors including, but not limited to, the geographical mix of our earnings, changes in projected results for various jurisdictions, enacted tax legislation, including certain business tax credits, state and local income taxes, tax audit settlements, and the interaction of various global tax strategies. Changes in judgment from the evaluation of new information resulting in the recognition, derecognition or remeasurement of a tax position taken in a prior annual period are recognized separately in the quarter of the change.

The income tax expense of \$83 million for the three months ended March 31, 2014 reflected an effective tax rate of 22.1%, which is slightly lower than the effective tax rate of 22.6% for the three months ended March 31, 2013. This decrease is primarily due to a deferred tax benefit in the current year in foreign jurisdictions and is partially offset by the expiration of the federal research credit.

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

The effective tax rate of 22.1% for the three months ended March 31, 2014 differed from the U.S. statutory rate of 35.0%, primarily due to the amount of foreign earnings at relatively lower statutory rates, as compared to domestic earnings at relatively higher statutory rates, recognition of California research and development credits and federal domestic production deductions, offset by increases to the Company's reserve for uncertain tax positions.

The overall effective income tax rate for the year could be different from the effective tax rate for the three months ended March 31, 2014 and will be dependent, in part, on our profitability for the remainder of the year. In addition, our effective income tax rates for the remainder of 2014 and future periods will depend on a variety of factors, such as changes in the mix of income by tax jurisdiction, applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audits and other matters, and variations in the estimated and actual level of annual pre-tax income or loss. Further, the effective tax rate could fluctuate significantly on a quarterly basis and could be adversely affected by the extent that income (loss) before income tax expenses (benefit) is lower than anticipated in foreign regions, where taxes are levied at relatively lower statutory rates, and/or higher than anticipated in the United States, where taxes are levied at relatively higher statutory rates.

Table of Contents

The Internal Revenue Service is currently examining Activision Blizzard's federal tax returns for the 2008 and 2009 tax years and Vivendi Games' tax returns for the 2005 through 2008 tax years. While Vivendi Games' results for the period January 1, 2008 through July 9, 2008 are included in the consolidated federal and certain foreign, state and local income tax returns filed by Vivendi or its affiliates, Vivendi Games' results for the period July 10, 2008 through December 31, 2008 are included in the consolidated federal and certain foreign, state and local income tax returns filed by Activision Blizzard. Additionally, the Company has several state and non-U.S. audits pending. Although the final resolution of the Company's global tax disputes is uncertain, based on current information, in the opinion of the Company's management, the ultimate resolution of these matters will not have a material adverse effect on the Company's consolidated financial position, liquidity or results of operations. However, an unfavorable resolution of the Company's global tax disputes could have a material adverse effect on our business and results of operations in the period in which the matters are ultimately resolved.

In connection with the Purchase Transaction, we assumed certain tax attributes of New VH, which generally consist of New VH's net operating loss (NOL) carryforwards of approximately \$676 million, which represent a potential future tax benefit of approximately \$237 million. The utilization of such NOL carryforwards will be subject to certain annual limitations and will begin to expire in 2021. The Company also obtained indemnification from Vivendi against losses attributable to the disallowance of claimed utilization of such NOL carryforwards of up to \$200 million in unrealized tax benefits in the aggregate, limited to taxable years ending on or prior to December 31, 2016. No benefit for these tax attributes or indemnification was recorded upon the close of the Purchase Transaction as the benefit from these tax attributes did not meet the more-likely-than-not standard.

For the quarter ended March 31, 2014, we utilized \$87 million of the NOL, which resulted in a benefit of \$31 million, and a corresponding reserve was established as the position did not meet the more-likely-than-not standard. For the period ended March 31, 2014, an indemnification asset of \$31 million has been recorded in Other Assets, and correspondingly, the same amount has been recorded as a reduction to the consideration paid for the shares repurchased in Treasury Stock (see Note 1 of the Notes to Condensed Consolidated Financial Statements for details about the share repurchase).

**11. Computation of Basic/Diluted Earnings Per Common Share**

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

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Numerator:</b>		
Consolidated net income	\$ 293	\$ 456
Less: Distributed earnings to unvested stock-based awards that participate in earnings	(5)	(5)
Less: Undistributed earnings allocated to unvested stock-based awards that participate in earnings	(3)	(5)
Numerator for basic and diluted earnings per common share - income available to common shareholders	285	446
<b>Denominator:</b>		
Denominator for basic earnings per common share - weighted-average common shares outstanding	709	1,113
	11	7

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

Effect of potential dilutive common shares under the treasury stock method: Employee stock options and others

Denominator for diluted earnings per common share - weighted- average common shares outstanding plus dilutive effect of employee stock options and others	720	1,120
Basic earnings per common share	\$ 0.40	\$ 0.40
Diluted earnings per common share	\$ 0.40	\$ 0.40

Certain of our unvested restricted stock rights (including restricted stock units, restricted stock awards, and performance shares) met the definition of participating securities based on their respective rights to dividends or dividend equivalents.

Table of Contents

Therefore, we are required to use the two-class method in our computation of basic and diluted earnings per common share. For the three months ended March 31, 2014 and 2013, we had outstanding unvested restricted stock rights that are participating in earnings with respect to 17 million and 26 million shares of common stock on a weighted-average basis, respectively.

Potential common shares are not included in the denominator of the diluted earnings per common share calculation when the inclusion of such shares would be anti-dilutive. Therefore, options to acquire 3 million and 14 million shares of common stock were not included in the calculation of diluted earnings per common share for the three months ended March 31, 2014 and 2013, respectively, as the effect of their inclusion would be anti-dilutive.

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

See Note 1 of the Notes to Condensed Consolidated Financial Statements for details of the Purchase Transaction which reduced outstanding shares as compared to prior year.

## **12. Capital Transactions**

### *Stock Purchase Agreement*

On October 11, 2013, as described in Note 1 of the Notes to Condensed Consolidated Financial Statements, we completed the Purchase Transaction, repurchasing approximately 429 million shares of our common stock for a cash payment of \$5.83 billion, pursuant to the terms of the Stock Purchase Agreement (refer to Note 7 of the Notes to Condensed Consolidated Financial Statements for financing details of the Purchase Transaction). The repurchased shares were recorded in Treasury Stock in our condensed consolidated balance sheet.

### *Dividend*

On February 6, 2014, our Board of Directors declared a cash dividend of \$0.20 per common share, payable on May 14, 2014, to shareholders of record at the close of business on March 19, 2014. As such, we have included \$147 million of dividends payable in Accrued expense and other liabilities and Other liabilities on our condensed consolidated balance sheet as of March 31, 2014.

On February 7, 2013, our Board of Directors declared a cash dividend of \$0.19 per common share, payable on May 15, 2013, to shareholders of record at the close of business on March 20, 2013. On May 15, 2013, we made an aggregate cash dividend payment of \$212 million to such

shareholders, and on May 31, 2013, we made related dividend equivalent payments of \$4 million to the holders of restricted stock rights.

### 13. Commitments and Contingencies

#### *Letters of Credit*

As described in Note 7 of the Notes to Condensed Consolidated Financial Statements, a portion of our Revolver can be used to issue letters of credit of up to \$50 million, subject to the availability of the Revolver. At March 31, 2014, we did not issue any letter of credit under the Revolver.

#### *Legal Proceedings*

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

Table of Contents

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

*Purchase Transaction Matters*

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

In addition, on August 14, 2013, we received a letter dated August 9, 2013 from a shareholder seeking, pursuant to Section 220 of the Delaware General Corporation Law, to inspect the books and records of the Company to ascertain whether the Purchase Transaction and Private Sale were in the best interests of the Company. In response to that request, we provided the stockholder with certain materials under a confidentiality agreement. On September 11, 2013, a complaint was filed under seal by the same stockholder in the Court of Chancery of the State of Delaware in an action captioned *Pacchia v. Kotick et al.*, C.A. No. 8884-VCL. A public version of that complaint was filed on September 16, 2013. The allegations in the complaint were substantially similar to the allegations in the above referenced matter filed on August 1, 2013. On October 25, 2013, Pacchia filed an amended complaint under seal. The amended complaint added claims on behalf of an alleged class of Activision stockholders other than the Company's Chief Executive Officer and Chairman, Vivendi, ASAC, investors in ASAC and other stockholders affiliated with the investors of ASAC. The added class claims are against the Company's Chief Executive Officer and Chairman, the Vivendi-affiliated directors, the members of the special committee of the Board formed in connection with the Company's consideration of the transactions with Vivendi and ASAC, and Vivendi for breach of fiduciary duty, as well as aiding and abetting a breach of fiduciary duty against ASAC. The amended complaint removed the derivative claims for waste of corporate assets and disgorgement but continued to allege derivative claims for breach of fiduciary duties. The amended complaint seeks, among other things, certification of a class, damages, reformation of the Private Sale, and disgorgement of any alleged profits received by the Company's Chief Executive Officer, Chairman and ASAC. On October 29, 2013, Pacchia filed a motion to consolidate the *Pacchia* case with the *Hayes* case described below. On November 2, 2013, the Court of Chancery consolidated the *Pacchia* and *Hayes* cases and ordered the plaintiffs to file supplemental papers related to determining lead plaintiff and lead counsel no later than November 8, 2013. On December 3, 2013, the court selected Pacchia as lead plaintiff. Pacchia filed a second amended complaint on December 11, 2013 and Activision filed an answer on January 31, 2014. Also on January 31, 2014, the special committee, ASAC, Messrs. Kotick and Kelly, Vivendi and the Vivendi-affiliated directors each filed motions to dismiss certain claims in the second amended complaint. On February 21, 2014, Pacchia filed a third amended complaint under seal. In response to Pacchia's filing of a third amended complaint, the special committee, ASAC, Messrs. Kotick and Kelly, Vivendi and the Vivendi-affiliated directors each filed motions to dismiss certain claims in the third amended complaint. The Court of Chancery has set a hearing date of June 6, 2014 to consider the motions to dismiss such claims. The trial is scheduled for December 2014.





Table of Contents

On September 11, 2013, another stockholder of the Company filed a putative class action and stockholder derivative action in the Court of Chancery of the State of Delaware, captioned *Hayes v. Activision Blizzard, Inc., et al.*, No. 8885-VCL. The complaint names our Board of Directors, Vivendi, New VH, ASAC, the General Partner of ASAC, Davis Selected Advisers, L.P. ( Davis ) and Fidelity Management & Research Co. ( FMR ) as defendants, and the Company as a nominal defendant. The complaint alleges that the defendants violated certain provisions of our Amended and Restated Certificate of Incorporation by failing to submit the matters contemplated by the Stock Purchase Agreement for approval by a majority of our stockholders (other than Vivendi and its controlled affiliates); that our Board of Directors committed breaches of their fiduciary duties in approving the Stock Purchase Agreement; that Vivendi violated fiduciary duties owed to other stockholders of the Company in entering into the Stock Purchase Agreement; that our Chief Executive Officer and our Chairman usurped a corporate opportunity from the Company; that our Board of Directors and Vivendi have engaged in actions to entrench our Board of Directors and officers in their offices; that the ASAC Entities, Davis and FMR aided and abetted breaches of fiduciary duties by the Board of Directors and Vivendi; and that our Chief Executive Officer and our Chairman, the ASAC Entities, Davis and FMR will be unjustly enriched through the Private Sale. The complaint seeks, among other things, the rescission of the Private Sale; an order requiring the transfer to the Company of all or part of the shares that are the subject of the Private Sale; an order implementing measures to eliminate or mitigate the alleged entrenching effects of the Private Sale; an order requiring our Chief Executive Officer and our Chairman, the ASAC Entities, Davis and FMR to disgorge to the Company the amounts by which they have allegedly been unjustly enriched; and alleged damages sustained by the class and the Company. In addition, the stockholder sought a temporary restraining order preventing the defendants from consummating the transactions contemplated by the Stock Purchase Agreement without stockholder approval. Following a hearing on the motion for a temporary restraining order, on September 18, 2013, the Court of Chancery issued a preliminary injunction order, enjoining the consummation of the transactions contemplated by the Stock Purchase Agreement pending (a) the issuance of a final decision after a trial on the merits; (b) receipt of a favorable Activision Blizzard stockholder vote on the transactions contemplated by the Stock Purchase Agreement under Section 9.1(b) of our Amended and Restated Certificate of Incorporation or (c) modification of such preliminary injunction order by the Court of Chancery or the Delaware Supreme Court. On September 20, 2013, the Court of Chancery certified its order issuing the preliminary injunction for interlocutory appeal to the Delaware Supreme Court. The defendants moved the Delaware Supreme Court to accept and hear the appeal on an expedited basis. On September 23, 2013, the Delaware Supreme Court accepted the appeal of the Court of Chancery's decision and granted the defendant's motion to hear the appeal on an expedited basis. Following a hearing on October 10, 2013, the Delaware Supreme Court reversed the Court of Chancery's order issuing a preliminary injunction, and determined that the Stock Purchase Agreement was not a merger, business combination or similar transaction that would require a vote of Activision's unaffiliated stockholders under the charter.

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

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

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

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

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

We believe that the defendants have meritorious defenses and intend to defend each of these lawsuits vigorously. However, these lawsuits and any other lawsuits are subject to inherent uncertainties and the actual outcome and costs will depend upon many unknown factors. The outcome of litigation is necessarily uncertain, and the Company could be forced to expend significant resources in the defense of these lawsuits and may not prevail.

The Company also may be subject to additional claims in connection with the Purchase Transaction and Private Sale.

Table of Contents

Monitoring and defending against legal actions is time consuming for our management and detracts from our ability to fully focus our internal resources on our business activities. In addition, the Company may incur substantial legal fees and costs in connection with litigation and, although coverage may be available under relevant insurance policies, coverage could be denied or prove to be insufficient. Under our Amended and Restated Certificate of Incorporation and the indemnification agreements that the Company has entered into with our officers and directors, the Company may be required in certain circumstances to indemnify and advance expenses to them in connection with their participation in proceedings arising out of their service to us. There can be no assurance that any of these payments will not be material.

The Company is not currently able to estimate the range of possible losses or costs to us from these lawsuits and related indemnification obligations, as they are in the early stages and it cannot be determined how long it may take to resolve these matters. Moreover, the Company cannot be certain what the impact on our operations or financial position will be if any of the purported stockholder plaintiffs are successful in having the Stockholders Agreement dated October 11, 2013 among the Company, ASAC and, for limited purposes, Messrs. Kotick and Kelly (the Stockholders Agreement ) reformed. A decision adverse to the Company on these actions could result in the reformation of the Stockholders Agreement and could have a material adverse effect on our business, reputation, financial condition, results of operations, profitability, cash flows or liquidity.

*Other Matters*

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

**14. Related Party Transactions**

*Transactions with Vivendi and Its Affiliates*

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

*Transactions with ASAC's Affiliates*

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

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

Table of Contents

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

**15. Recently issued accounting pronouncements**

*Accounting for cumulative translation adjustments*

In February 2013, the FASB issued an update to the authoritative guidance related to the release of cumulative translation adjustments into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a foreign entity. This update will be effective for fiscal years beginning after December 15, 2013. Upon adoption of this guidance on January 1, 2014, there was no material impact on our consolidated financial statements.

*Presentation of unrecognized tax benefits*

In July 2013, the FASB issued an update to the authoritative guidance related to the presentation of an unrecognized tax benefit in the financial statements. The update will require entities to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss or other tax credit carryforwards when settlement in this manner is available under the tax laws. This update is effective for fiscal years beginning after December 15, 2013. Upon our adoption of this guidance, Deferred income taxes, net under non-current liabilities increased by approximately \$46 million, and correspondingly, Other liabilities under non-current liabilities decreased by the same amount in our condensed consolidated balance sheet as of December 31, 2013 to conform with the presentation as of March 31, 2014.

Table of Contents

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

**Recently Consummated Share Repurchase and Related Debt Financing**

On October 11, 2013, we repurchased approximately 429 million shares of our common stock, pursuant to a stock purchase agreement (the "Stock Purchase Agreement") we entered into on July 25, 2013, with Vivendi and ASAC II LP ("ASAC"), an exempted limited partnership established under the laws of the Cayman Islands, acting by its general partner, ASAC II LLC. Pursuant to the terms of the Stock Purchase Agreement, we acquired all of the capital stock of Amber Holding Subsidiary Co., a Delaware corporation and wholly-owned subsidiary of Vivendi ("New VH"), which was the direct owner of approximately 429 million shares of our common stock, for a cash payment of \$5.83 billion, or \$13.60 per share, before taking into account the benefit to the Company of certain tax attributes of New VH assumed in the transaction (collectively, the "Purchase Transaction"). The Purchase Transaction was funded with a combination of \$1.2 billion of cash on hand, the net proceeds from a \$2.5 billion secured term loan facility, maturing in October 2020 (the "Term Loan"), and the net proceeds from the issuance of \$1.5 billion of 5.625% unsecured senior notes due September 2021 (the "2021 Notes") and \$750 million of 6.125% unsecured senior notes due September 2023 (the "2023 Notes") and, together with the 2021 Notes, the "Notes"). The repurchased shares were recorded in "Treasury Stock" in our condensed consolidated balance sheets.

Immediately following the completion of the Purchase Transaction, ASAC purchased from Vivendi 172 million shares of Activision Blizzard common stock, pursuant to the Stock Purchase Agreement, for a cash payment of \$2.34 billion, or \$13.60 per share (the "Private Sale"). Robert A. Kotick, our Chief Executive Officer, and Brian G. Kelly, Chairman of our Board of Directors, are affiliates of ASAC II LLC.

As a result of the Purchase Transaction and the Private Sale, we ceased to be a controlled company and, as of March 31, 2014, we had approximately 715 million shares of our common stock issued and outstanding, of which Vivendi held approximately 12%, ASAC held approximately 24% and our other stockholders held approximately 64%.

For further details of our debt financing, refer to "Liquidity and Capital Resources" below, and Note 7 of the Notes to Condensed Consolidated Financial Statements.

**Business Overview**

Activision Blizzard, Inc. is a leading global developer and publisher of interactive entertainment. The terms "Activision Blizzard," "the Company," "we," "us," and "our" are used to refer collectively to Activision Blizzard, Inc. and its subsidiaries. We publish games for video game consoles, personal computers ("PC"), and handheld, mobile and tablet devices. Based upon our organizational structure, we conduct our business through three operating segments as follows:

*Activision Publishing, Inc.*

Activision Publishing, Inc. ( Activision ) is a leading international developer and publisher of interactive software products and content. Activision develops games based on internally-developed properties, including games in the Call of Duty® and Skylanders franchises, and to a lesser extent, based on licensed intellectual properties. Additionally, we have established a long-term alliance with Bungie to release its next big-action game universe, *Destiny*, in September 2014. Activision sells games through both retail channels and digital downloads. Activision delivers content to a broad range of gamers, ranging from children to adults, and from core gamers to mass-market consumers to value buyers seeking budget-priced software, in a variety of geographies. Activision currently offers games that operate on the Microsoft Corporation ( Microsoft ) Xbox One ( Xbox One ) and Xbox 360 ( Xbox 360 ), Nintendo Co. Ltd. ( Nintendo ) Wii U ( Wii U ) and Wii ( Wii ), and Sony Co. Entertainment, Inc. ( Sony ) PlayStation 4 ( PS4 ) and PlayStation 3 ( PS3 ) console systems (Xbox One, Wii U, and PS4 are collectively referred to as next-generation ; Xbox 360, Wii, and PS3 are collectively referred to as current-generation ); the PC; the Nintendo 3DS, Nintendo Dual Screen, and Sony PlayStation Vita handheld game systems; and other handheld and mobile devices.

*Blizzard Entertainment, Inc.*

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



Table of Contents

*Activision Blizzard Distribution*

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

**Business Highlights**

For the three months ended March 31, 2014, Activision Blizzard had net revenues of \$1.1 billion, as compared to net revenues of \$1.3 billion for the same period in 2013. Earnings per diluted share were \$0.40 for the three months ended both March 31, 2014 and 2013.

As a result of the Purchase Transaction, we reduced our common shares outstanding by approximately 429 million shares, which has resulted in a lower weighted-average share count since the transaction closed on October 11, 2013. Additionally, for the three months ended March 31, 2014, interest expense of \$51 million and associated tax benefits of \$19 million were included in our consolidated net income, partially offsetting the earnings per share benefits from the reduction in our share count. For details of our debt arrangements, our interest expense, and cash paid for interest, refer to Note 7 of the Notes to Condensed Consolidated Financial Statements included in Item 1, and *Interest and Other Investment Income(Expense), Net*, and *Liquidity and Capital Resources* in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2, of this Quarterly Report on Form 10-Q.

According to The NPD Group with respect to North America, GfK Chart-Track with respect to Europe, and Activision Blizzard internal estimates, during the first quarter of 2014:

- In North America and Europe combined, Activision Publishing had the #1 and #2 best-selling titles *Skylanders SWAP Force* , including accessory packs and figures, and *Call of Duty: Ghosts* .
- In North America and Europe combined, Activision Publishing's *Skylanders SWAP Force* was the #1 best-selling kids game overall in dollars.
- Blizzard Entertainment had the #1 PC title in dollars in both North America and Europe with *Diablo III: Reaper of Souls* .
- As of March 31, 2014, Blizzard Entertainment's *World of Warcraft* remains the #1 subscription-based MMORPG, with approximately 7.6 million subscribers.

***Activision Blizzard Recent and Upcoming Product Releases***

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

- On March 10, 2014, Blizzard began accepting pre-purchases for *World of Warcraft: Warlords of Draenor*<sup>TM</sup>, which includes a character level 90 boost and value-added services, both of which are available immediately upon purchase. *World of Warcraft: Warlords of Draenor* is expected to be released on or before December 20, 2014.
- Blizzard commercially released *Hearthstone: Heroes of Warcraft* on the PC on March 11, 2014, and released it on the iPad in April 2014.
- On March 25, 2014, Blizzard released *Diablo III: Reaper of Souls* , the first expansion pack to Blizzard's action role-playing game *Diablo III*.
- On April 3, 2014, Activision released the second digital downloadable map pack for *Call of Duty: Ghosts*, *Call of Duty: Ghosts Devastation* ( *Devastation* ) on the Xbox One and Xbox 360. *Devastation* is expected to be released on other platforms later in the second quarter of 2014.

Table of Contents

**Management's Overview of Business Trends**

*Online Content and Digital Downloads*

We provide our products through both retail channels and digital online delivery methods. Many of our video games that are available through retailers as physical boxed software products, such as DVDs, are also available by direct digital download over the Internet (from our websites and from websites owned by third parties). In addition, we offer players digital downloadable content as add-ons to our products (e.g., new multi-player content packs), generally for a one-time fee. We also offer subscription-based services for *World of Warcraft*, which are digitally delivered and hosted by Battle.net, Blizzard's proprietary online-game related service.

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

For the three months ended March 31, 2014, revenues through digital online channels increased slightly by \$2 million, as compared to the same period in 2013, and represented 34% of our total consolidated net revenues in the first quarter of 2014, as compared to 28% in the first quarter of 2013. Digital online channel revenues were a greater portion of total revenues in 2014 as compared to the prior year, because of the year-over-year decrease in retail channel revenues. The slight increase in digital revenues year-over-year was mainly attributed to revenues from *Hearthstone: Heroes of Warcraft*, and the recognition of deferred revenues for *Call of Duty: Black Ops II* digital downloadable content, partially offset by lower recognition of deferred revenues from *World of Warcraft: Mists of Pandaria*, which was released in 2012, and lower subscription revenues from *World of Warcraft*. On a non-GAAP basis (which excludes the impact of deferred revenues), revenues through digital online channels for the three months ended March 31, 2014 increased by \$98 million, as compared to the same period in 2013, and represented 68% of our total non-GAAP net revenues in the first quarter of 2014 as compared to 53% in 2013. This increase was primarily due to revenues from *Diablo III: Reaper of Souls*, which was released in March 2014, and *Hearthstone: Heroes of Warcraft*, which was commercially released in March 2014, as compared to *StarCraft II: Heart of the Swarm*®, which was released in March 2013, and was partially offset by lower sales of digital downloadable content for *Call of Duty: Ghosts*, as compared to *Call of Duty: Black Ops II* in 2013.

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

Our sales of digital downloadable content are driven in part by our sales of retail products. Lower revenues in our retail distribution channel in the current year might impact our digital online channel revenues in the subsequent year. Digital revenues remain an important part of our business, and we continue to focus on and develop products that can be delivered via digital online channels. The amount of our digital revenues in any period may fluctuate depending, in part, on the timing and nature of our specific product releases.

We have further plans to introduce games, based on some of our most successful franchises, which operate online on a free-to-play model with microtransactions. These games include Blizzard's *Heroes of the Storm*, and Activision's *Call of Duty Online*.

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

### *Conditions in the Retail Distribution Channels*

Conditions in the retail channels of the video games industry continued to be challenging during the first three months of 2014. In the U.S. and Europe, retail sales of video games declined by 24% as compared to the same period in 2013, according to The NPD Group and GfK Chart-Track. The decline was partially attributed to fewer releases in the first quarter of 2014, as compared to 2013, and the shift of Easter sales, which were in the first quarter of 2013, into the second quarter of 2014, as well as the overall impact of the console transition.

### *Concentration of Top Titles*

The industry's top five titles (including accessory packs and figures) accounted for 13% of the total industry software sales for the first quarter of 2014 and 2013. However, the top five titles' sales decreased by 25% for the three months ended March 31, 2014, as compared to the same period in 2013, reflecting the overall challenge of the console transition. The console transition has negatively impacted sales of current-generation titles, which declined at a faster pace than the growth of sales for next-generation titles.

Table of Contents

*Console Platform Transition*

In November 2012, Nintendo released the Wii U, and in November 2013, Sony released the PS4 and Microsoft released the Xbox One, their respective next-generation game consoles and entertainment systems. According to The NPD Group and GfK Chart-Track, as of March 31, 2014, the installed base of PS4 and Xbox One hardware in the U.S. and Europe was approximately 11 million units.

When new console platforms are announced or introduced into the market, consumers may reduce their purchases of game console software products for current console platforms in anticipation of new platforms becoming available. During these periods, sales of the game console software products we publish may slow or even decline until new platforms are introduced and achieve wide consumer acceptance. Platform transitions may have a comparable impact on sales of downloadable content, amplifying the impact on our revenue. During platform transitions, we simultaneously incur costs to develop and market new titles for current-generation video game platforms, which may not sell at premium prices, and to develop and market products for next-generation platforms, which may not generate immediate or near-term revenues. We continually monitor console hardware sales and manage our product delivery on each of the current- and next-generation platforms in a manner we believe to be most effective to maximize our revenue opportunities and achieve the desired return on our investments in product development. Long term, we expect the new consoles to drive industry growth and expand our opportunities.

While the new console cycle has started strongly and demand for next-generation games was higher than expected, we expect that this will result in a lower-than-expected demand for current-generation games. For example, for the quarter ended March 31, 2014, we experienced slower catalog sales of *Call of Duty: Ghosts*, which was released in the fourth-quarter of 2013, than catalog sales of *Call of Duty: Black Ops II*, which was released in the fourth-quarter of 2012, during the same period in 2013. We believe this is partly attributable to the console platform transition.

Table of Contents**Consolidated Statements of Operations Data**

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

	<b>Three Months Ended March 31,</b>			
	<b>2014</b>		<b>2013</b>	
<b>Net revenues:</b>				
Product sales	\$ 769	69%	\$ 990	75%
Subscription, licensing, and other revenues	342	31	334	25
<b>Total net revenues</b>	<b>1,111</b>	<b>100</b>	<b>1,324</b>	<b>100</b>
<b>Costs and expenses:</b>				
Cost of sales — product costs	225	20	260	20
Cost of sales — online	58	5	57	4
Cost of sales — software royalties and amortization	57	5	61	5
Cost of sales — intellectual property licenses	2		38	3
Product development	143	13	125	9
Sales and marketing	104	9	107	8
General and administrative	95	9	89	7
<b>Total costs and expenses</b>	<b>684</b>	<b>61</b>	<b>737</b>	<b>56</b>
<b>Operating income</b>	<b>427</b>	<b>39</b>	<b>587</b>	<b>44</b>
Interest and other investment income (expense), net	(51)	(5)	2	
<b>Income before income tax expense</b>	<b>376</b>	<b>34</b>	<b>589</b>	<b>44</b>
Income tax expense	83	7	133	10
<b>Net income</b>	<b>\$ 293</b>	<b>27%</b>	<b>\$ 456</b>	<b>34%</b>

**Operating Segment Results**

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

The CODM reviews segment performance exclusive of the impact of the change in deferred revenues and related cost of sales with respect to certain of our online-enabled games, stock-based compensation expense, amortization of intangible assets as a result of purchase price accounting, and fees and other expenses related to the Purchase Transaction and related debt financings. The CODM does not review any information regarding total assets on an operating segment basis, and accordingly, no disclosure is made with respect thereto. Information on the operating segments and reconciliations of total net revenues and total segment operating income to consolidated net revenues from external customers and consolidated income before income tax expense for the three months ended March 31, 2014 and 2013 are presented in the table below (amounts in millions):



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

Table of Contents

	Three Months Ended March 31,		
	2014	2013	Increase/ (Decrease)
<b>Segment net revenues:</b>			
Activision	\$ 237	\$ 423	\$ (186)
Blizzard	462	330	132
Distribution	73	51	22
Operating segment net revenues total	772	804	(32)
<b>Reconciliation to consolidated net revenues:</b>			
Net effect from deferral of net revenues	339	520	
Consolidated net revenues	\$ 1,111	\$ 1,324	
<b>Segment income from operations:</b>			
Activision	\$ 2	\$ 112	\$ (110)
Blizzard	239	135	104
Distribution	(1)		(1)
Operating segment income from operations total	240	247	(7)
<b>Reconciliation to consolidated operating income and consolidated income before income tax expense:</b>			
Net effect from deferral of net revenues and related cost of sales	219	369	
Stock-based compensation expense	(30)	(26)	
Restructuring			
Amortization of intangible assets	(2)	(3)	
Consolidated operating income	427	587	
Interest and other investment income (expense), net	(51)	2	
Consolidated income before income tax expense	\$ 376	\$ 589	

*Segment Net Revenues*

Activision

Activision's net revenues decreased for the three months ended March 31, 2014, as compared to the same period in 2013, primarily due to lower revenues from the Skylanders franchise, lower revenues from *Call of Duty: Ghosts*, as compared to *Call of Duty: Black Ops II*, and lower revenues from our value business, which released fewer titles in the first quarter of 2014 than in the first quarter of 2013.

Blizzard

Blizzard's net revenues increased for the three months ended March 31, 2014, as compared to the same period in 2013, primarily due to revenues from *Diablo III: Reaper of Souls*, which was released in March 2014, *Hearthstone: Heroes of Warcraft*, and value-added services from *World of Warcraft: Warlords of Draenor* available immediately upon pre-purchase, as compared to revenues in the prior year from *StarCraft II: Heart of the Swarm*, which was released in March 2013, and was partially offset by higher subscription revenues in the prior period from *World of Warcraft*.



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

At March 31, 2014, the worldwide subscriber\* base for World of Warcraft was approximately 7.6 million, compared to approximately 7.8 million at December 31, 2013, and approximately 8.3 million subscribers at March 31, 2013. Subscriber engagement in the March quarter was supported by the introduction of new value-added services, which partially offset the impact of fewer promotional activities than in the December quarter. Since December 31, 2010, when the subscriber base reached a new peak of more than 12 million, subscriber levels have trended downward by similar amounts in both the East and the West (where the East includes China, Taiwan, and South Korea, and the West includes North America, Europe, Australia, and Latin America). In general, the average revenue per subscriber is lower in the East than in the West. Looking forward, Blizzard Entertainment expects to continue to deliver new game content in all regions that is intended to further appeal to the gaming community.

---

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

Table of Contents

Distribution

Distribution's net revenues increased for the three months ended March 31, 2014, as compared to the same period in 2013, primarily due to revenues from the distribution of recently introduced next-generation console hardware.

*Segment Income from Operations*

Activision

For the three months ended March 31, 2014, Activision's operating income decreased, as compared to the same period in 2013, primarily due to lower revenues as described above, partially offset by lower costs of sales—product costs and lower intellectual property expenses due to the write-down of capitalized costs in the first quarter of 2013.

Blizzard

For the three months ended March 31, 2014, Blizzard's operating income increased, as compared to the same period in 2013, primarily due to higher revenues as described above.

**Non-GAAP Financial Measures**

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

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

The following table provides a reconciliation between GAAP and non-GAAP net revenues by distribution channel for the three months ended March 31, 2014 and 2013 (amounts in millions):

Table of Contents

	Three Months Ended March 31,		
	2014	2013	Increase/ (decrease)
<b>GAAP net revenues by distribution channel</b>			
Retail channels	\$ 659	\$ 896	\$ (237)
Digital online channels(1)	379	377	2
Total Activision and Blizzard	1,038	1,273	(235)
<b>Distribution</b>			
Total consolidated GAAP net revenues	1,111	1,324	(213)
<b>Change in deferred net revenues(2 )</b>			
Retail channels	(487)	(572)	85
Digital online channels(1)	148	52	96
Total changes in deferred net revenues	(339)	(520)	181
<b>Non-GAAP net revenues by distribution channel</b>			
Retail channels	172	324	(152)
Digital online channels(1)	527	429	98
Total Activision and Blizzard	699	753	(54)
<b>Distribution</b>			
Total non-GAAP net revenues (3)	\$ 772	\$ 804	\$ (32)

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

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

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

The decrease in GAAP net revenues from retail channels for the three months ended March 31, 2014, as compared to the same period in 2013, was primarily due to the lower performance of *Call of Duty: Ghosts*, as compared to *Call of Duty: Black Ops II*, lower revenues from the Skylanders franchise, lower revenues from our value business, which released fewer titles, and lower revenues from Call of Duty catalog titles. The decreases were partially offset by the recognition of previously deferred revenues from *Diablo III* for the PS3 and the Xbox 360, which was released in September 2013.

The decrease in non-GAAP net revenues from retail channels for the three months ended March 31, 2014, as compared to the same period in 2013, was primarily due to lower revenues from the Skylanders franchise and the lower performance of *Call of Duty: Ghosts*, as compared to *Call of Duty: Black Ops II*, partially offset by higher revenues from *Diablo III: Reaper of Souls*, which was released in March 2014, as compared to revenues from the release of *StarCraft II: Heart of the Swarm*, which was released in March 2013.

The slight increase in GAAP net revenues from digital online channels for the three months ended March 31, 2014, as compared to the same period in 2013, was primarily due to revenues from *Hearthstone: Heroes of Warcraft*, and the recognition of deferred revenues for *Call of Duty:*

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

*Black Ops II* digital downloadable content, partially offset by lower recognition of deferred revenues from *World of Warcraft: Mists of Pandaria*, which was released in 2012, and lower subscription revenues from *World of Warcraft*.

The increase in non-GAAP net revenues from digital online channels for the three months ended March 31, 2014, as compared to the same period in 2013, was primarily due to revenues from *Diablo III: Reaper of Souls*, which was released in March 2014, and *Hearthstone: Heroes of Warcraft*, which was commercially released in March 2014, as compared to revenues in the prior year from *StarCraft II: Heart of the Swarm*, which was released in March 2013, partially offset by the lower performance of digital downloadable content for *Call of Duty: Ghosts* in the current year, as compared to digital downloadable content for *Call of Duty: Black Ops II* in 2013.

### Consolidated Results

*Net Revenues by Geographic Region*

Table of Contents

The following table details our consolidated net revenues by geographic region for the three months ended March 31, 2014 and 2013 (amounts in millions):

	Three Months Ended March 31,			Increase/ (decrease) 2014 v 2013
	2014	2013		
Geographic region net revenues:				
North America	\$ 563	\$ 738	\$	(175)
Europe	462	487		(25)
Asia Pacific	86	99		(13)
Consolidated net revenues	\$ 1,111	\$ 1,324	\$	(213)

The increase/(decrease) in deferred revenues recognized by geographic region for the three months ended March 31, 2014 and 2013 was as follows (amounts in millions):

	Three Months Ended March 31,			Increase/ (decrease)
	2014	2013		
Increase/(decrease) in deferred revenues recognized by geographic region:				
North America	\$ 233	\$ 315	\$	(82)
Europe	125	169		(44)
Asia Pacific	(19)	36		(55)
Total impact on consolidated net revenues	339	520		(181)

As previously discussed, the decrease in the Company's net revenues for the three months ended March 31, 2014, as compared to the same period in 2013, was mainly due to lower revenues from *Call of Duty: Ghosts*, as compared to *Call of Duty: Black Ops II*, lower revenues from our Skylanders franchise and Call of Duty catalog titles, and the release of fewer titles from our value business. Net revenues in North America and Europe were also impacted by lower recognition of previously deferred revenues from *World of Warcraft: Mists of Pandaria*. In all regions, the decreases were partially offset by revenues from *Hearthstone: Heroes of Warcraft*, which had no comparable title in the prior period. The decreases in North America and Europe were also partially offset by the recognition of previously deferred revenues from *Call of Duty: Black Ops II* digital downloadable content. Additionally, in Europe, the decreases were partially offset by the increase in revenues from the Distribution segment.

The deferred revenues recognized for the three months ended March 31, 2014, as compared to the same period in 2013, were negatively impacted by the lower recognition of deferred revenues from *Call of Duty: Ghosts*, which was released in November 2013, as compared to the recognition of deferred revenues from *Call of Duty: Black Ops II*, which was released in November 2012, lower recognition of deferred revenues from Call of Duty catalog titles, and overall higher deferral of revenues, primarily from *Diablo III: Reaper of Souls*, which was released in March 2014, as compared to deferral of revenues for *StarCraft II: Heart of the Swarm*, which was released in March 2013, and from value-added services from *World of Warcraft: Warlords of Draenor*. These negative impacts were partially offset by the recognition of previously deferred revenues from digital downloadable content of *Call of Duty: Black Ops II*, and from *Diablo III* for the PS3 and the Xbox 360. In North America and Asia Pacific, the decrease in deferred revenues recognized was also due to a higher deferral of revenues from *Hearthstone: Heroes of Warcraft*.

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

### *Foreign Exchange Impact*

Changes in foreign exchange rates had a positive impact of \$18 million on Activision Blizzard's net revenues for the three months ended March 31, 2014, as compared to the same period in 2013. The change is primarily due to the movement of the U.S. dollar relative to the Euro and British Pound.

### *Net Revenues by Platform*

The following tables detail our net revenues by platform and as a percentage of total consolidated net revenues for the three months ended March 31, 2014 and 2013 (amounts in millions):

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

Table of Contents

	Three Months Ended March 31, 2014	% of total(3) consolidated net revs.	Three Months Ended March 31, 2013	% of total(3) consolidated net revs.	Increase/ (Decrease)
Platform net revenues:					
Online (1)	201	18	275	21	(74)
PC	100	9	93	7	7
Next-generation (PS4, Xbox One, WiiU)					
	108	10	7	1	101
Current-generation (PS3, Xbox 360, Wii)					
	546	49	742	56	(196)
Total console	654	59	749	57	(95)
Mobile and other (2)	83	7	156	12	(73)
Total Activision Blizzard	1,038	93	1,273	96	(235)
Distribution	73	7	51	4	22
Total consolidated net revenues	\$ 1,111	100%	\$ 1,324	100%	\$ (213)

The increase / (decrease) in deferred revenues recognized by platform for three months ended March 31, 2014 and 2013 was as follows (amounts in millions):

	Three Months Ended March 31,		Increase/ (Decrease)
	2014	2013	
Increase/(decrease) in deferred revenues recognized by platform:			
Online (1)	(26)	47	(73)
PC	(139)	(28)	(111)
Next-generation (PS4, Xbox One, WiiU)			
	76	4	72
Current-generation (PS3, Xbox 360, Wii)			
	428	497	(69)
Total console	504	501	3
Mobile and other (2)			
Total impact on consolidated net revenues	\$ 339	\$ 520	\$ (181)

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

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

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



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

Net revenues from online decreased for the three months ended March 31, 2014, as compared to the same period in 2013, due to lower recognition of previously deferred revenues from *World of Warcraft: Mists of Pandaria*, which was released in September 2012, lower subscription revenues from *World of Warcraft* and lower revenues from *Call of Duty Elite*, which was discontinued as a paid service in 2013. The decreases were partially offset by higher revenues from value-added services for *World of Warcraft*.

Table of Contents

Net revenues from PC increased for the three months ended March 31, 2014, as compared to the same period in 2013, due to revenues from *Hearthstone: Heroes of Warcraft*, which had no comparable title in the prior year, partially offset by lower recognition of previously deferred revenues from *Diablo III*.

Net revenues from next-generation consoles increased for the three months ended March 31, 2014, as compared to the same period in 2013, due to the introduction of the PS4 and Xbox One in the fourth quarter of 2013. We released *Call of Duty: Ghosts* and *Skylanders SWAP Force* on next-generation consoles in the fourth quarter of 2013.

Net revenues from current-generation consoles decreased for the three months ended March 31, 2014, as compared to the same period in 2013, primarily due to lower revenues from *Call of Duty: Ghosts*, as compared to *Call of Duty: Black Ops II*, lower revenues from Call of Duty catalog titles, lower revenues from our value business with fewer titles released, and lower sales from our Skylanders franchise, partially offset by the recognition of previously deferred revenues from *Diablo III* for the PS3 and the Xbox 360, which was released in September 2013.

Net revenues from mobile and other decreased for the three months ended March 31, 2014, as compared to the same period in 2013, primarily due to lower revenues from the Skylanders franchise, our value business, and handheld platforms.

The decrease in deferred revenues recognized for online for the three months ended March 31, 2014, as compared to the same period in 2013, was due to the deferral of revenues of the pre-purchases for *World of Warcraft: Warlords of Draenor*, and lower revenues recognized from *World of Warcraft: Mists of Pandaria*, which was released in September 2012.

The decrease in deferred revenues recognized for PC for the three months ended March 31, 2014, as compared to the same period in 2013, was due to the higher deferral of revenues from *Diablo III: Reaper of Souls*, which was released in March 2014, as compared to revenues deferred from *StarCraft II: Heart of the Swarm*, which was released in March 2013, and the deferral of revenues from *Hearthstone: Heroes of Warcraft*.

The increase in deferred revenues recognized for next-generation consoles for the three months ended March 31, 2014, as compared to the same period in 2013, was due to the introduction of the PS4 and Xbox One in the fourth quarter of 2014. We released *Call of Duty: Ghosts* and *Skylanders SWAP Force* on next-generation consoles in the fourth quarter of 2013.

The decrease in deferred revenues recognized for current-generation consoles for the three months ended March 31, 2014, as compared to the same period in 2013, was due to the lower recognition of deferred revenues from *Call of Duty: Ghosts* digital downloadable content, as compared to the recognition of deferred revenues from *Call of Duty: Black Ops II* digital downloadable content in the first quarter of 2013, and was partially offset by the recognition of previously deferred revenues from *Diablo III* for the PS3 and the Xbox 360, which was released in September 2013.

*Costs and Expenses*

*Cost of Sales*

The following tables detail the components of cost of sales in dollars and as a percentage of total consolidated net revenues for the three months ended March 31, 2014 and 2013 (amounts in millions):

	<b>March 31, 2014</b>	<b>% of consolidated net revs.</b>	<b>March 31, 2013</b>	<b>% of consolidated net revs.</b>	<b>Increase (Decrease)</b>
Product costs	\$ 225	20%	\$ 260	20%	\$ (35)
Online	58	5	57	4	1
Software royalties and amortization	57	5	61	5	(4)
Intellectual property licenses	2		38	3	(36)

Total cost of sales decreased for the three months ended March 31, 2014, as compared to the same period in 2013. Overall, the decreases were attributable to lower revenues for the period and a higher proportion of relatively higher-margin digital online sales.

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

### Table of Contents

Cost of sales – product costs decreased for the three months ended March 31, 2014, as compared to the same period in 2013, primarily due to lower retail and physical product sales. The decrease was partially offset by higher product costs due to increased revenues from our Distribution segment.

The decrease in cost of sales – software royalties and amortization for the three months ended March 31, 2014, as compared to the same period in 2013, was primarily due to the release of fewer titles by our value business.

The decrease in cost of sales – intellectual property licenses for the three months ended March 31, 2014, as compared to the same period in 2013, was due to the write down of intellectual property licenses in the first quarter of 2013, with no comparable write-downs in the first quarter of 2014.

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

	<b>March 31, 2014</b>	<b>% of consolidated net revs.</b>	<b>March 31, 2013</b>	<b>% of consolidated net revs.</b>	<b>Increase (Decrease)</b>
Product development	\$ 143	13%	\$ 125	9%	\$ 18

Product development costs increased for the three months ended March 31, 2014, as compared to the same period in 2013, primarily due to higher bonus accruals as a result of strong Blizzard's performance, higher product development costs for upcoming releases, and the timing of capitalized product development costs based on the technological feasibility of our products.

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

	<b>March 31, 2014</b>	<b>% of consolidated net revs.</b>	<b>March 31, 2013</b>	<b>% of consolidated net revs.</b>	<b>Increase (Decrease)</b>
Sales and marketing	\$ 104	9%	\$ 107	8%	\$ (3)

Sales and marketing expenses decreased slightly for the three months ended March 31, 2014, as compared to the same period in 2013, primarily driven by differences in the timing of our releases.

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

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

	March 31, 2014	% of consolidated net revs.	March 31, 2013	% of consolidated net revs.	Increase (Decrease)
General and administrative	\$ 95	9%	\$ 89	7%	\$ 6

General and administrative expenses increased for the three months ended March 31, 2014, as compared to the same period in 2013, primarily due to higher bonus accruals and higher personnel costs partially offset by lower legal expenses (including legal-related accruals, settlements, and fees).

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

### Table of Contents

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

	March 31, 2014	% of consolidated net revs.	March 31, 2013	% of consolidated net revs.	Increase (Decrease)
Interest and other investment income (expense), net	\$ (51)	(5)%	\$ 2	%\$	(53)

Interest and other investment income (expense), net was (\$51) million for the three months ended March 31, 2014, as compared to \$2 million in the same period in 2013, due to interest expense incurred from the Notes issued in September 2013 and the Term Loan entered into in October 2013 in connection with the Purchase Transaction.

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

	March 31, 2014	% of Pretax income	March 31, 2013	% of Pretax income	Increase (Decrease)
Income tax expense	\$ 83	22.1%	\$ 133	22.6%	\$ (50)

The income tax expense of \$83 million for the three months ended March 31, 2014 reflected an effective tax rate of 22.1%, which is slightly lower than the effective tax rate of 22.6% for the three months ended March 31, 2013. This decrease is primarily due to a deferred tax benefit in the current year in foreign jurisdictions and is partially offset by the expiration of the federal research credit.

The effective tax rate of 22.1% for the three months ended March 31, 2014 differed from the U.S. statutory rate of 35.0%, primarily due to the amount of foreign earnings at relatively lower statutory rates, as compared to domestic earnings at relatively higher statutory rates, recognition of California research and development credits and federal domestic production deductions, offset by increases to the company's reserve for uncertain tax positions.

The overall effective income tax rate in future periods will depend on a variety of factors, such as changes in the mix of income by tax jurisdiction, applicable accounting rules, applicable tax laws and regulations, and rulings and interpretations thereof, developments in tax audits and other matters, and variations in the estimated and actual level of annual pre-tax income or loss. Further, the effective tax rate could fluctuate significantly on a quarterly basis and could be adversely affected by the extent that income (loss) before income tax expenses (benefit) is lower than anticipated in foreign regions where taxes are levied at relatively lower statutory rates and/or higher than anticipated in the United States where taxes are levied at relatively higher statutory rates.

In connection with the Purchase Transaction, we assumed certain tax attributes of New VH, which generally consist of New VH's net operating loss (NOL) carryforwards of approximately \$676 million, which represent a potential future tax benefit of approximately \$237 million. The

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

utilization of such NOL carryforwards will be subject to certain annual limitations and will begin to expire in 2021. The Company also obtained indemnification from Vivendi against losses attributable to the disallowance of claimed utilization of such NOL carryforwards of up to \$200 million in unrealized tax benefits in the aggregate, limited to taxable years ending on or prior to December 31, 2016. No benefit for these tax attributes or indemnification was recorded upon the close of the Purchase Transaction as the benefit from these tax attributes did not meet the more-likely-than-not standard.

For the quarter ended March 31, 2014, we utilized \$87 million of the NOL, which resulted in a benefit of \$31 million, and a corresponding reserve was established as the position did not meet the more-likely-than-not standard. For the period ended March 31, 2014, an indemnification asset of \$31 million has been recorded in Other Assets, and correspondingly, the same amount has been recorded as a reduction to the consideration paid for the shares repurchased in Treasury Stock (see Note 1 of the Notes to Condensed Consolidated Financial Statements for details about the share repurchase).

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

	At March 31, 2014		At December 31, 2013		Increase (Decrease)
Cash and cash equivalents	\$	4,279	\$	4,410	\$ (131)
Short-term investments		8		33	(25)
	\$	4,287	\$	4,443	\$ (156)
Percentage of total assets		32%		32%	

	Three Months Ended March 31,			Increase (Decrease)	
	2014	2013			
Cash flows provided by operating activities	\$	136	\$	325	\$ (189)
Cash flows provided by (used in) investing activities		(12)		80	(92)
Cash flows provided by (used in) financing activities		(252)		23	(275)
Effect of foreign exchange rate changes		(3)		(88)	85
Net increase (decrease) in cash and cash equivalents	\$	(131)	\$	340	\$ (471)

*Cash Flows Provided by Operating Activities*

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

Cash flows provided by operating activities decreased for the three months ended March 31, 2014 as compared to the same period in 2013. The decrease was primarily attributed to lower net income for the period and changes in our working capital accounts, including lower cash receipts due to lower accounts receivable balances from the prior period and payment of interest, partially offset by lower payment of bonuses. Cash flows provided by operating activities for the three months ended March 31, 2014 also included approximately \$82 million of interest paid for the Notes and Term Loan, which were not outstanding in the three months ended March 31, 2013.

*Cash Flows Provided by (Used in) Investing Activities*



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

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

Cash flows used in investing activities were \$12 million during the three months ended March 31, 2014, as compared to cash flows provided by investing activities of \$80 million for the three months ended March 31, 2013, primarily due to higher capital expenditures and lower proceeds from the maturity of short-term investments. Cash flows related to investing activities reflected the receipt of \$21 million in proceeds from the maturity of investments, the majority of which consisted of other government agency securities, and capital expenditures, primarily related to property and equipment, of \$37 million.

### *Cash Flows Used in Financing Activities*

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

Table of Contents

Cash flows used in financing activities were higher during the three months ended March 31, 2014, as compared to the same period in 2013, primarily due to the \$375 million partial repayment of our Term Loan and \$13 million for taxes paid in connection with the vesting of employees' restricted stock rights. Cash flows from financing activities for the three months ended March 31, 2014 reflected proceeds of \$119 million from the issuance of shares of our common stock to employees in connection with stock option exercises.

*Other Liquidity and Capital Resources*

Our primary sources of liquidity are typically cash and cash equivalents, investments, and cash flows provided by operating activities. In addition, as described below, we have availability of \$250 million, subject to certain restrictions, under a secured revolving credit facility. With our cash and cash equivalents and short-term investments of \$4.3 billion at March 31, 2014, 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 (\$3.8 billion at March 31, 2014) to finance our operational and financing requirements for at least the next twelve months, including: purchases of inventory and equipment; the development, production, marketing and sale of new products; provision of customer service for our subscribers; acquisition of intellectual property rights for future products from third parties; funding of dividends; and interest payments related to debt obligations.

As of March 31, 2014, the amount of cash and cash equivalents held outside of the U.S. by our foreign subsidiaries was \$3.5 billion, as compared to \$3.3 billion as of December 31, 2013. If these funds are needed in the future for our operations in the U.S., we would accrue and pay the required U.S. taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

*Debt*

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

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

On October 11, 2013, in connection and simultaneously with the Purchase Transaction, we entered into a credit agreement (the Credit Agreement ) for a \$2.5 billion secured term loan facility maturing in October 2020 (the Term Loan ), and a \$250 million secured revolving credit facility maturing in October 2018 (the Revolver and, together with the Term Loan, the Credit Facilities ). A portion of the Revolver can be used

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

to issue letters of credit of up to \$50 million, subject to the availability of the Revolver. To date, we have not drawn on the Revolver.

As of March 31, 2014, the outstanding balance of our Term Loan was \$2.1 billion. Borrowings under the Term Loan and Revolver bear interest at an annual rate equal to an applicable margin plus, at our option, (A) a base rate determined by reference to the highest of (a) the interest rate in effect determined by the administrative agent as its prime rate, (b) the federal funds rate plus 0.5%, and (c) the London InterBank Offered Rate ( LIBOR ) rate for an interest period of one month plus 1.00%, or (B) LIBOR. Further, LIBOR borrowings under the Term Loan will be subject to a LIBOR floor of 0.75%. At March 31, 2014, the Term Loan bore interest at 3.25%. In certain circumstances, our interest rate under the Credit Facilities will increase.

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

Table of Contents

In addition, if, in the future, we borrow under the Revolver, as described in Note 7 of the Notes to Condensed Consolidated Financial Statements, we may be required, during certain periods where outstanding revolving loans exceed a certain threshold, to maintain a maximum senior secured net leverage ratio calculated pursuant to a financial maintenance covenant under the Credit Agreement.

*Dividends*

On February 6, 2014, our Board of Directors declared a cash dividend of \$0.20 per common share, payable on May 14, 2014, to shareholders of record at the close of business on March 19, 2014.

*Capital Expenditures*

For the year ending December 31, 2014, we anticipate total capital expenditures of approximately \$100 million, primarily for computer hardware and software purchases. Through the first three months of 2014, we made aggregate capital expenditures of \$37 million.

**Off-balance Sheet Arrangements**

At March 31, 2014 and December 31, 2013, Activision Blizzard had no significant relationships with unconsolidated entities or financial parties, often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes, that have or are reasonably likely to have a material future effect on our financial condition, changes in financial condition, revenues or expenses, results of operation, liquidity, capital expenditures, or capital resources.

**Financial Disclosure**

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

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

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

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

Table of Contents

**Critical Accounting Policies and Estimates**

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The accounting policies that reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

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

During the three months ended March 31, 2014, there were no significant changes to the above critical accounting policies and estimates. Refer to Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2013, for a more complete discussion of our critical accounting policies and estimates.

**Recently Issued Accounting Pronouncements**

*Accounting for cumulative translation adjustments*

In February 2013, the FASB issued an update to the authoritative guidance related to the release of cumulative translation adjustments into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a foreign entity. This update will be effective for fiscal years beginning after December 15, 2013. Upon adoption of this guidance on January 1, 2014, there was no material impact on our consolidated financial statements.

*Presentation of unrecognized tax benefits*

In July 2013, the FASB issued an update to the authoritative guidance related to the presentation of an unrecognized tax benefit in the financial statements. The update will require entities to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss or other tax credit carryforwards when settlement in this manner is available under the tax laws. This update is effective for fiscal years beginning after December 15, 2013. Upon our adoption of this guidance, Deferred income taxes, net under non-current liabilities increased by approximately \$46 million, and correspondingly, Other liabilities under non-current liabilities decreased by the same amount in our condensed consolidated balance sheet as of December 31, 2013 to confirm with presentation as of March 31, 2014.

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

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

#### **Foreign Currency Exchange Rate Risk**

We transact business in many different foreign currencies and may be exposed to financial market risk resulting from fluctuations in foreign currency exchange rates. Revenues and related expenses generated from our international operations are generally denominated in their respective local currencies. Primary currencies include Euros, British pounds, Australian dollars, South Korean won and Swedish krona. To the extent the U.S. dollar strengthens against foreign currencies, the translation of these foreign currency-denominated transactions results in reduced revenues, operating expenses, and net income from our international operations. Similarly, our revenues, operating expenses and net income will increase for our international operations if the U.S. dollar weakens against foreign currencies. We monitor currency volatility throughout the year.

Table of Contents

To mitigate our foreign currency exchange rate exposure resulting from our foreign currency-denominated monetary assets, liabilities and earnings, we periodically enter into currency derivative contracts, principally forward contracts with maturities of generally less than one year. All foreign currency economic hedging transactions are backed, in amount and by maturity, by an identified economic underlying item. In recent years, Vivendi was our principal counterparty for our currency derivative contracts, but we have not had any outstanding currency derivative contracts with Vivendi as the counterparty since July 3, 2013. Further, in connection with the Purchase Transaction, we terminated our cash management services agreement with Vivendi as of October 31, 2013. Since the consummation of the Purchase Transaction, the counterparties for our currency derivative contracts have been large and reputable commercial or investment banks. We did not have any outstanding foreign currency contracts at March 31, 2014. The gross notional amount of outstanding foreign currency contracts was \$34 million at December 31, 2013.

We do not hold or purchase any foreign currency contracts for trading or speculative purposes and we do not designate these contracts as hedging instruments. Accordingly, we report the fair value of these contracts within Other current assets or Other current liabilities in our condensed consolidated balance sheet and the changes in fair value within General and administrative expense or Interest and other investment income (expense), net in our condensed consolidated statement of operations, depending on the nature of the contracts. For the three months ended March 31, 2014 and 2013, pre-tax net losses and gains were not material.

In the absence of the hedging activities described above, for the period ended March 31, 2014, a hypothetical adverse foreign currency exchange rate movement of 10% would have resulted in potential declines of our net income of approximately \$23 million. This sensitivity analysis assumes a parallel adverse shift of all foreign currency exchange rates against the U.S. dollar; however, all foreign currency exchange rates do not always move in such manner and actual results may differ materially.

**Interest Rate Risk**

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio and variable rate debt under the Credit Facilities. We do not currently use derivative financial instruments to manage interest rate risk. As of March 31, 2014, a hypothetical change in the interest rate paid on our variable rate debt of one percent would change interest expense on an annual basis by approximately \$21 million. This estimate does not include the effects of other actions that we may take in the future to mitigate this risk or any changes in our financial structure.

Our investment portfolio consists primarily of money market funds and government securities with high credit quality and short average maturities. Because short-term securities mature relatively quickly and must be reinvested at the then-current market rates, interest income on a portfolio consisting of cash, cash equivalents or short-term securities is more subject to market fluctuations than a portfolio of longer term securities. Conversely, the fair value of such a portfolio is less sensitive to market fluctuations than a portfolio of longer-term securities. At March 31, 2014, our \$4.28 billion of cash and cash equivalents were comprised primarily of money market funds. At March 31, 2014, our \$8 million of short-term investments consists of restricted cash. We also had \$9 million in auction rate securities at fair value classified as long-term investments at March 31, 2014. The Company has determined that, based on the composition of our investment portfolio as of March 31, 2014, there was no material interest rate risk exposure to the Company's consolidated financial condition, results of operations or liquidity as of that date.

**Item 4. Controls and Procedures**



**Definition and Limitations of Disclosure Controls and Procedures.**

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

**Evaluation of Disclosure Controls and Procedures.**

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures at March 31, 2014, the end of the period covered by this report. Based on this evaluation, the principal executive officer and principal financial officer concluded that, at March 31, 2014, 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.

Table of Contents

**Changes in Internal Control Over Financial Reporting.**

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

**PART II. Other Information**

**Item 1. Legal Proceedings**

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

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

*Purchase Transaction Matters*

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

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

order temporarily staying the California action. On February 6, 2014, the court entered the order granting a stay of the California action.

In addition, on August 14, 2013, we received a letter dated August 9, 2013 from a shareholder seeking, pursuant to Section 220 of the Delaware General Corporation Law, to inspect the books and records of the Company to ascertain whether the Purchase Transaction and Private Sale were in the best interests of the Company. In response to that request, we provided the stockholder with certain materials under a confidentiality agreement. On September 11, 2013, a complaint was filed under seal by the same stockholder in the Court of Chancery of the State of Delaware in an action captioned *Pacchia v. Kotick et al.*, C.A. No. 8884-VCL. A public version of that complaint was filed on September 16, 2013. The allegations in the complaint were substantially similar to the allegations in the above referenced matter filed on August 1, 2013. On October 25, 2013, Pacchia filed an amended complaint under seal. The amended complaint added claims on behalf of an alleged class of Activision stockholders other than the Company's Chief Executive Officer and Chairman, Vivendi, ASAC, investors in ASAC and other stockholders affiliated with the investors of ASAC. The added class claims are against the Company's Chief Executive Officer and Chairman, the Vivendi affiliated directors, the members of the special committee of the Board formed in connection with the Company's consideration of the transactions with Vivendi and ASAC, and Vivendi for breach of fiduciary duty, as well as aiding and abetting a breach of fiduciary duty against ASAC. The amended complaint removed the derivative claims for waste of corporate assets and disgorgement but continued to allege derivative claims for breach of fiduciary duties. The amended complaint seeks, among other things, certification of a class, damages, reformation of the Private Sale, and disgorgement of any alleged profits received by the Company's Chief Executive Officer, Chairman and ASAC. On October 29, 2013, Pacchia filed a motion to consolidate the *Pacchia* case with the *Hayes* case described below. On November 2, 2013, the Court of Chancery consolidated the *Pacchia* and *Hayes* cases and ordered the plaintiffs to file supplemental papers related to determining lead plaintiff and lead counsel no later than November 8, 2013. On December 3, 2013, the court selected Pacchia as lead plaintiff. Pacchia filed a second amended complaint on December 11, 2013 and Activision filed an answer on January 31, 2014. Also on January 31, 2014, the special committee, ASAC, Messrs. Kotick and Kelly, Vivendi and the Vivendi-affiliated directors each filed motions to dismiss certain claims in the second amended complaint. On February 21, 2014, Pacchia filed a third amended complaint under seal. In response to Pacchia's filing of a third amended complaint, the special committee, ASAC, Messrs. Kotick and Kelly, Vivendi and the Vivendi-affiliated directors each filed motions to dismiss certain claims in the third amended complaint. The Court of Chancery has set a hearing date of June 6, 2014 to consider the motions to dismiss such claims. The trial is scheduled for December 2014.

Table of Contents

On September 11, 2013, another stockholder of the Company filed a putative class action and stockholder derivative action in the Court of Chancery of the State of Delaware, captioned *Hayes v. Activision Blizzard, Inc., et al.*, No. 8885-VCL. The complaint names our Board of Directors, Vivendi, New VH, ASAC, the General Partner of ASAC, Davis Selected Advisers, L.P. ( Davis ) and Fidelity Management & Research Co. ( FMR ) as defendants, and the Company as a nominal defendant. The complaint alleges that the defendants violated certain provisions of our Amended and Restated Certificate of Incorporation by failing to submit the matters contemplated by the Stock Purchase Agreement for approval by a majority of our stockholders (other than Vivendi and its controlled affiliates); that our Board of Directors committed breaches of their fiduciary duties in approving the Stock Purchase Agreement; that Vivendi violated fiduciary duties owed to other stockholders of the Company in entering into the Stock Purchase Agreement; that our Chief Executive Officer and our Chairman usurped a corporate opportunity from the Company; that our Board of Directors and Vivendi have engaged in actions to entrench our Board of Directors and officers in their offices; that the ASAC Entities, Davis and FMR aided and abetted breaches of fiduciary duties by the Board of Directors and Vivendi; and that our Chief Executive Officer and our Chairman, the ASAC Entities, Davis and FMR will be unjustly enriched through the Private Sale. The complaint seeks, among other things, the rescission of the Private Sale; an order requiring the transfer to the Company of all or part of the shares that are the subject of the Private Sale; an order implementing measures to eliminate or mitigate the alleged entrenching effects of the Private Sale; an order requiring our Chief Executive Officer and our Chairman, the ASAC Entities, Davis and FMR to disgorge to the Company the amounts by which they have allegedly been unjustly enriched; and alleged damages sustained by the class and the Company. In addition, the stockholder sought a temporary restraining order preventing the defendants from consummating the transactions contemplated by the Stock Purchase Agreement without stockholder approval. Following a hearing on the motion for a temporary restraining order, on September 18, 2013, the Court of Chancery issued a preliminary injunction order, enjoining the consummation of the transactions contemplated by the Stock Purchase Agreement pending (a) the issuance of a final decision after a trial on the merits; (b) receipt of a favorable Activision Blizzard stockholder vote on the transactions contemplated by the Stock Purchase Agreement under Section 9.1(b) of our Amended and Restated Certificate of Incorporation or (c) modification of such preliminary injunction order by the Court of Chancery or the Delaware Supreme Court. On September 20, 2013, the Court of Chancery certified its order issuing the preliminary injunction for interlocutory appeal to the Delaware Supreme Court. The defendants moved the Delaware Supreme Court to accept and hear the appeal on an expedited basis. On September 23, 2013, the Delaware Supreme Court accepted the appeal of the Court of Chancery's decision and granted the defendant's motion to hear the appeal on an expedited basis. Following a hearing on October 10, 2013, the Delaware Supreme Court reversed the Court of Chancery's order issuing a preliminary injunction, and determined that the Stock Purchase Agreement was not a merger, business combination or similar transaction that would require a vote of Activision's unaffiliated stockholders under the charter.

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

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

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



Table of Contents

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

We believe that the defendants have meritorious defenses and intend to defend each of these lawsuits vigorously. However, these lawsuits and any other lawsuits are subject to inherent uncertainties and the actual outcome and costs will depend upon many unknown factors. The outcome of litigation is necessarily uncertain, and the Company could be forced to expend significant resources in the defense of these lawsuits and may not prevail.

The Company also may be subject to additional claims in connection with the Purchase Transaction and Private Sale. Monitoring and defending against legal actions is time consuming for our management and detracts from our ability to fully focus our internal resources on our business activities. In addition, the Company may incur substantial legal fees and costs in connection with litigation and, although coverage may be available under relevant insurance policies, coverage could be denied or prove to be insufficient. Under our Amended and Restated Certificate of Incorporation and the indemnification agreements that the Company has entered into with our officers and directors, the Company may be required in certain circumstances to indemnify and advance expenses to them in connection with their participation in proceedings arising out of their service to us. There can be no assurance that any of these payments will not be material.

The Company is not currently able to estimate the range of possible losses or costs to us from these lawsuits and related indemnification obligations, as they are in the early stages and it cannot be determined how long it may take to resolve these matters. Moreover, the Company cannot be certain what the impact on our operations or financial position will be if any of the purported stockholder plaintiffs are successful in having the Stockholders Agreement dated October 11, 2013 among the Company, ASAC and, for limited purposes, Messrs. Kotick and Kelly (the Stockholders Agreement) reformed. A decision adverse to the Company on these actions could result in the reformation of the Stockholders Agreement and could have a material adverse effect on our business, reputation, financial condition, results of operations, profitability, cash flows or liquidity.

*Other Matters*

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

**Item 1A. Risk Factors**

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

Various risks associated with our business are described in Part I, Item 1A, Risk Factors, of our Annual Report on Form 10-K for the year ended December 31, 2013.

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

#### *Issuer Purchase of Equity Securities*

The following table provides the number of shares purchased and average price paid per share during the quarter ended March 31, 2014, the total number of shares purchased as part of publicly announced plans or programs, and the approximate dollar value of shares that may yet be purchased under the plans or programs at March 31, 2014. For the three months ended March 31, 2014, there was no repurchase program authorized.

Table of Contents

Period	Total number of shares purchased	Average price paid per share	Total numbers of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs
January 1, 2014 - January 31, 2014		\$		\$
February 1, 2014 - February 28, 2014	45,006(1)	19.94		
March 1, 2014 - March 31, 2014				
<b>Total</b>	<b>45,006</b>	<b>\$ 19.94</b>		

---

(1) Consists of transactions under the Company's equity compensation plans involving the delivery to the Company of shares of our common stock, with an average value of \$19.94 per share as of the date of delivery, to satisfy tax withholding obligations in connection with the vesting of restricted stock awards to our employees.

**Item 6. Exhibits**

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



Table of Contents

**SIGNATURE**

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

Date: May 6, 2014

ACTIVISION BLIZZARD, INC.

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

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

Table of Contents

**EXHIBIT INDEX**

<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	Second Amended and Restated Bylaws of the Company, adopted as of October 11, 2013 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed October 18, 2013).
10.1*	Notice of Assignment of Walther Employment Agreement to Activision Blizzard, Inc. dated December 22, 2011.
10.2*	Amendment, dated as of July 15, 2013, to Employment Agreement between Christopher Walther and the Company.
10.3*	Notice of Restricted Share Unit Award, dated as of August 6, 2012, to Christopher Walther.
10.4*	Notice of Restricted Share Unit Award, dated as of August 5, 2013, to Christopher Walther.
31.1	Certification of Robert A. Kotick pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Dennis Durkin pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Dennis Durkin pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.

---

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

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at March 31, 2014 and December 31, 2013, (ii) Condensed Consolidated Statements of Operations for the three months ended March 31, 2014 and March 31, 2013, (iii) Condensed Consolidated Statements of Comprehensive Income for the three months ended March 31, 2014 and March 31, 2013, (iv) Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2014

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

and March 31, 2013; (v) Condensed Consolidated Statement of Changes in Shareholders' Equity for the three months ended March 31, 2014; and (vi) Notes to Condensed Consolidated Financial Statements.