

Activision Blizzard, Inc.

Form 10-Q

November 06, 2009

**Table of Contents**

## **UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549



## FORM 10-Q

(Mark one)

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

**For the Quarterly Period Ended September 30, 2009**

**OR**

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

**For the transition period from**                      **to**

**Commission File Number 1-15839**

# ACTIVISION BLIZZARD, INC.

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**95-4803544**  
(I.R.S. Employer Identification No.)

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

**90405**  
(Zip Code)

**(310) 255-2000**

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated Filer ☒

Accelerated Filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

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

Table of Contents

**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**

**Table of Contents**

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



Table of Contents

**EXPLANATORY NOTE**

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

**CAUTIONARY STATEMENT**

*This Quarterly Report on Form 10-Q contains, or incorporates by reference, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements consist of any statement other than a recitation of historical fact and include, but are not limited to, (1) projections of revenues, expenses, income or loss, earnings or loss per share, cash flow or other financial items; (2) statements of our plans and objectives, including those relating to product releases; (3) statements of future economic performance; and (4) statements of assumptions underlying such statements. We generally use words such as anticipate, believe, could, estimate, expect, forecast, future, intend, may, outlook, plan, positioned, potential, project, remain, scheduled, set to, subject to, to be, upcoming, will, and other similar expressions to help identify forward-looking statements. Forward-looking statements are subject to business and economic risk, reflect management's current expectations, estimates and projections about our business, and are inherently uncertain and difficult to predict. Our actual results could differ materially. The forward-looking statements contained herein speak only at the date on which this Form 10-Q was first filed. Risks and uncertainties that may affect our future results include, but are not limited to, sales levels of our titles, shifts in consumer spending trends, the impact of the current macroeconomic environment, the seasonal and cyclical nature of the interactive game market, any further difficulties related to World of Warcraft in China, our ability to predict consumer preferences among competing hardware platforms, declines in software pricing, product returns and price protection, product delays, retail acceptance of our products, adoption rate and availability of new hardware (including peripherals) and related software, industry competition, rapid changes in technology, industry standards and customer preferences, protection of proprietary rights, litigation, maintenance of relationships with key personnel, customers, licensees, licensors, vendors and third-party developers, counterparty risks relating to customers, licensees, licensors and manufacturers, domestic and international economic, financial and political conditions and policies, foreign exchange rates and tax rates, integration of recent acquisitions and the identification of suitable future acquisition opportunities, and the other factors identified in Risk Factors included in Part II, Item 1A of this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2008. The forward-looking statements contained herein are based upon information available to us as of the date of this Quarterly Report on Form 10-Q and we assume no obligation to update any such forward-looking statements. Forward-looking statements believed to be true when made may ultimately prove to be incorrect. These statements are not guarantees of our future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and may cause actual results to differ materially from current expectations.*

Table of Contents

**Part I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

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(Unaudited)

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

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

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



Table of Contents

**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

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(Unaudited)

(Amounts in millions, except per share data)

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



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



Table of Contents

**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

(Amounts in millions)

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

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

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

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



[Table of Contents](#)
**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY**

For the Nine Months ended September 30, 2009

(Unaudited)

(Amounts in millions)

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

*Business*

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

(i) Activision Publishing, Inc.

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

(ii) Blizzard Entertainment, Inc.

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

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

### (iii) Activision Blizzard Distribution

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

### *Business Combination*

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

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

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### Table of Contents

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

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

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

#### *Basis of Presentation*

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

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

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

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



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The Company considers events or transactions that occur after the balance sheet date, but before the financial statements are issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosures. Subsequent events have been evaluated through November 6, 2009, the date of issuance of these financial statements.

### 2. Summary of significant accounting policies

#### *Financial Instruments*

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

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

Table of Contents

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

*Other-Than-Temporary Impairments*

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

*Derivative Financial Instruments*

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

**3. Inventories**

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

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

**4. Goodwill**

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

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

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



## Table of Contents

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

## 5. Intangible assets, net

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

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

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

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

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

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

Table of Contents

**6. Income taxes**

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

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

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

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

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

**7. Software development costs and intellectual property licenses**

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

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

**8. Restructuring**

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

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

## Table of Contents

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

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

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

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

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

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

### Comprehensive Income (Loss)

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

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

## *Accumulated Other Comprehensive Income (Loss)*

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

Table of Contents

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

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

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

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

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

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

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

At September 30, 2009

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

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



# Table of Contents

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

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

  

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

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

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

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

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

## Trading Investments

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

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

Table of Contents

**12. Fair value measurements**

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

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

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

**Fair Value Measurements at  
Reporting Date Using**