

Activision Blizzard, Inc.  
Form 10-Q  
November 09, 2011  
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**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, 2011

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

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

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The number of shares of the registrant's Common Stock outstanding at November 1, 2011 was 1,144,219,705.

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**ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**

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**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 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 and market conditions within the video game industry, Activision Blizzard's ability to predict consumer preferences, including interest in specific genres such as first-person action and massively multiplayer online games and preferences among competing 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, rapid changes in technology and industry standards, litigation risks and associated costs, protection of proprietary rights, maintenance of relationships with key personnel, customers, licensees, licensors, vendors, and third-party developers, including the ability to attract, retain and develop key personnel and developers that can create high quality hit 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, and the identification of suitable future acquisition opportunities and potential challenges associated with geographic expansion, and the other factors identified in Risk Factors included in Part II, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010. 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'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**Part I. FINANCIAL INFORMATION****Item 1. Financial Statements****ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)

(Amounts in millions, except share data)

	At September 30, 2011	At December 31, 2010
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 2,469	\$ 2,812
Short-term investments	432	696
Accounts receivable, net of allowances of \$221 million and \$377 million at September 30, 2011 and December 31, 2010, respectively	139	640
Inventories	207	112
Software development	150	147
Intellectual property licenses	42	45
Deferred income taxes, net	507	648
Other current assets	136	299
Total current assets	4,082	5,399
Long-term investments	25	23
Software development	114	55
Intellectual property licenses	13	28
Property and equipment, net	167	169
Other assets	15	15
Intangible assets, net	138	160
Trademark and trade names	433	433
Goodwill	7,126	7,132
Total assets	\$ 12,113	\$ 13,414
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 250	\$ 363
Deferred revenues	487	1,726
Accrued expenses and other liabilities	542	838
Total current liabilities	1,279	2,927
Deferred income taxes, net	95	120
Other liabilities	168	164
Total liabilities	1,542	3,211
Commitments and contingencies (Note 14)		
Shareholders' equity:		

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Common stock, \$0.000001 par value, 2,400,000,000 shares authorized, 1,142,796,893 and 1,382,479,839 shares issued at September 30, 2011 and December 31, 2010, respectively

Additional paid-in capital	9,751	12,353
Less: Treasury stock, at cost, 0 and 199,159,987 shares at September 30, 2011 and December 31, 2010, respectively		(2,194)
Retained earnings	849	57
Accumulated other comprehensive income (loss)	(29)	(13)
Total shareholders' equity	10,571	10,203
Total liabilities and shareholders' equity	\$ 12,113	\$ 13,414

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

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

(Unaudited)

(Amounts in millions, except per share data)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Net revenues</b>				
Product sales	\$ 369	\$ 397	\$ 2,197	\$ 2,025
Subscription, licensing, and other revenues	385	348	1,151	994
Total net revenues	754	745	3,348	3,019
<b>Costs and expenses</b>				
Cost of sales product costs	138	194	650	765
Cost of sales massively multi-player online role-playing game ( MMORPG )	59	61	181	168
Cost of sales software royalties and amortization	24	61	133	211
Cost of sales intellectual property licenses	16	33	69	105
Product development	133	118	390	361
Sales and marketing	115	110	264	291
General and administrative	104	113	333	253
Restructuring	3		24	
Total costs and expenses	592	690	2,044	2,154
Operating income	162	55	1,304	865
Investment and other income, net	3	14	7	15
Income before income tax expense	165	69	1,311	880
Income tax expense	17	18	325	229
Net income	\$ 148	\$ 51	\$ 986	\$ 651
<b>Earnings per common share</b>				
Basic	\$ 0.13	\$ 0.04	\$ 0.84	\$ 0.53
Diluted	\$ 0.13	\$ 0.04	\$ 0.84	\$ 0.52
<b>Weighted-average shares outstanding</b>				
Basic	1,140	1,212	1,151	1,230
Diluted	1,148	1,227	1,160	1,245
Dividends per common share	\$	\$	\$ 0.165	\$ 0.15

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 Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 986	\$ 651
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Deferred income taxes	124	51
Depreciation and amortization	77	97
Loss on disposal of property and equipment	1	
Amortization and write-off of capitalized software development costs and intellectual property licenses (1)	151	182
Stock-based compensation expense (2)	61	94
Excess tax benefits from stock option exercises	(21)	(11)
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	516	471
Inventories	(96)	(19)
Software development and intellectual property licenses	(181)	(238)
Other assets	170	218
Deferred revenues	(1,268)	(810)
Accounts payable	(117)	(60)
Accrued expenses and other liabilities	(301)	(243)
Net cash provided by operating activities	102	383
<b>Cash flows from investing activities:</b>		
Proceeds from maturities of investments	603	473
Payment of contingent consideration	(3)	(4)
Purchases of short-term investments	(325)	(681)
Capital expenditures	(47)	(76)
Increase in restricted cash	(18)	(35)
Net cash provided by (used in) investing activities	210	(323)
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of common stock to employees	39	54
Repurchase of common stock	(524)	(613)
Dividends paid	(194)	(187)
Excess tax benefits from stock option exercises	21	11
Net cash used in financing activities	(658)	(735)
Effect of foreign exchange rate changes on cash and cash equivalents	3	30
Net decrease in cash and cash equivalents	(343)	(645)
Cash and cash equivalents at beginning of period	2,812	2,768
Cash and cash equivalents at end of period	\$ 2,469	\$ 2,123

- (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, 2011

(Unaudited)

(Amounts in millions)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock Shares	Treasury Stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
<b>Balance at December 31, 2010</b>	<b>1,382</b>	<b>\$</b>	<b>\$ 12,353</b>	<b>(199)</b>	<b>\$ (2,194)</b>	<b>\$ 57</b>	<b>\$ (13)</b>	<b>\$ 10,203</b>
Components of comprehensive income:								
Net income						986		986
Unrealized appreciation on investments, net of taxes							2	2
Foreign currency translation adjustment							(18)	(18)
Total comprehensive income								970
Issuance of common stock pursuant to employee stock options and restricted stock rights	7		39					39
Stock-based compensation expense related to employee stock options and restricted stock rights			77					77
Dividends (\$0.165 per common share) (See Note 13)						(194)		(194)
Shares repurchased (See Note 13)				(47)	(524)			(524)
Retirement of treasury shares	(246)		(2,718)	246	2,718			
<b>Balance at September 30, 2011</b>	<b>1,143</b>	<b>\$</b>	<b>\$ 9,751</b>		<b>\$</b>	<b>\$ 849</b>	<b>\$ (29)</b>	<b>\$ 10,571</b>

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

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**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. is a worldwide online, personal computer ( PC ), console, handheld and mobile game publisher. The terms Activision Blizzard, the Company, we, us, and our are used to refer collectively to Activision Blizzard, Inc. and its subsidiaries.

The common stock of Activision Blizzard is traded on The NASDAQ Stock Market under the ticker symbol ATVI. Vivendi S.A. ( Vivendi ) owned approximately 63% of Activision Blizzard s outstanding common stock at September 30, 2011.

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

*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, 2010. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for 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 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.

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. Summary of significant accounting policies**

### *Revenue Recognition*

#### *Revenue Arrangements with Multiple Deliverables*

On January 1, 2011, we adopted amendments to an accounting standard related to revenue recognition for arrangements with multiple deliverables (which standard, as amended, is referred to herein as the new accounting principles ). The new accounting principles establish a selling price hierarchy for determining the selling price of a deliverable and require the application of the relative selling price method to allocate the arrangement consideration to each deliverable in a multiple deliverables revenue arrangement. Certain of our revenue arrangements have multiple deliverables and, as such, are accounted for under the new accounting principles. These revenue arrangements include product sales consisting of both software and hardware deliverables (such as peripherals or other ancillary collectors items sold together with physical boxed software) and our sales of *World of Warcraft* boxed products, expansion packs and value-added services, each of which is considered with the related subscription

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services for these purposes. Our assessment of deliverables and units of accounting does not change under the new accounting principles.

Pursuant to the guidance of ASU 2009-13, when a revenue arrangement contains multiple elements, such as hardware and software products, licenses and/or services, we allocate revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its vendor-specific-objective-evidence ( VSOE ) if it is available, third-party evidence ( TPE ) if VSOE is not available, or best estimated selling price ( BESP ) if neither VSOE nor TPE is available. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy. If the arrangement contains more than one software deliverable, the arrangement consideration allocated to the software deliverables as a group is then allocated to each software deliverable using the guidance for recognizing software revenue.

As noted above, when neither VSOE nor TPE is available for a deliverable, we use BESP. We do not have significant revenue arrangements that require BESP for the three or nine months ended September 30, 2011. The inputs we use to determine the selling price of our significant deliverables include the actual price charged by the Company for a deliverable that the Company sells separately, which represents the VSOE, and the wholesale prices of the same or similar products, which represents TPE. The pattern and timing of revenue recognition for deliverables and allocation of the arrangement consideration did not change upon the adoption of the new accounting principles. Also, we do not expect the adoption of the new accounting principles to have a material effect on our financial statements in the periods after our initial adoption.

*Product Sales*

We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers and once any performance obligations have been completed. Certain products are sold to customers with a street date (*i.e.*, the earliest date these products may be sold by retailers). For these products, we recognize revenue on the later of the street date and the sale date. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection.

For our software products with online functionality, we evaluate whether those features or functionality are more than an inconsequential separate deliverable in addition to the software product. This evaluation is performed for each software product and any online transaction, such as a digital download of a title or product add-ons, when it is released.

When we determine that a software title contains online functionality that constitutes a more-than-inconsequential separate service deliverable in addition to the product, principally because of its importance to gameplay, we consider our performance obligations for this title to extend beyond the sale of the game. VSOE of fair value does not exist for the online functionality, as we do not separately charge for this component of the title. As a result, we recognize all of the software-related revenue from the sale of the title ratably over the estimated service period, which is estimated to begin the month after the later of the sale date and the street date of the title. In addition, we initially defer the costs of sales for the title (excluding intangible asset amortization), and recognize the costs of sales as the related revenues are recognized. Cost of sales includes manufacturing costs, software royalties and amortization, and intellectual property licenses costs.

We recognize revenues from *World of Warcraft* boxed product, expansion packs and value-added services, in each case with the related subscription service revenue, ratably over the estimated service periods beginning upon activation of the software and delivery of the related

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services. Revenues attributed to the sale of *World of Warcraft* boxed software and related expansion packs are classified as product sales and revenues attributable to subscriptions and other value-added services are classified as subscription, licensing and other revenues.

Revenues for software products with more-than-inconsequential separate service deliverables and *World of Warcraft* products are recognized over the estimated service periods, which range from a minimum of five months to a maximum of less than a year.



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For our software products with features we consider to be incidental to the overall product offering and an inconsequential deliverable, such as products which provide limited online features at no additional cost to the consumer, we recognize the related revenue from them upon the transfer of title and risk of loss of the product to our customer.

With respect to online transactions, such as online downloads of titles or product add-ons that do not include a more-than-inconsequential separate service deliverable, revenue is recognized when the fee is paid by the online customer to purchase online content, the product is available for download and is activated for gameplay. In addition, persuasive evidence of an arrangement must exist and collection of the related receivable must be probable.

Sales incentives and other consideration given by us to our customers, such as rebates and product replacement fees, are considered adjustments of the selling price of our products and are reflected as reductions to revenue. Sales incentives and other consideration that represent costs incurred by us for assets or services received, such as the appearance of our products in a customer's national circular ad, are reflected as sales and marketing expenses when the benefit from the sales incentive is separable from sales to the same customer and we can reasonably estimate the fair value of the benefit.

*Subscription Revenues*

Subscription revenues are derived from *World of Warcraft*, a game that is playable through Blizzard's servers on a subscription-only basis. After the first month of free usage that is included with the *World of Warcraft* boxed software, the *World of Warcraft* end user may enter into a subscription agreement for additional future access. Revenues associated with the sale of subscriptions via boxed software and prepaid subscription cards, as well as prepaid subscriptions sales, are deferred until the subscription service is activated by the consumer and recognized ratably over the subscription period. Revenue from internet gaming rooms in Asia is recognized upon usage of the time packages sold. Value-added service revenues associated with subscriptions are recognized ratably over the estimated service periods.

*Licensing Revenues*

Third-party licensees in Russia, China and Taiwan distribute and host Blizzard's *World of Warcraft* game in their respective countries under license agreements with Blizzard. We receive royalties from the licensees as a result. We recognize these royalties as revenues based on the end users' activation of the underlying prepaid time, if all other performance obligations have been completed, or based on usage by the end user when we have continuing service obligations. We recognize any upfront licensing fee received over the term of the contracts.

With respect to license agreements that provide customers the right to make multiple copies in exchange for guaranteed amounts, revenue is generally recognized upon delivery of a master copy. Per copy royalties on sales that exceed the guarantee are recognized as earned. In addition, persuasive evidence of an arrangement must exist and collection of the related receivable must be probable.

*Breakage Revenues*

*World of Warcraft* boxed product sales and subscription revenues are recognized upon activation of the game. We analyze historical activation patterns over time to determine when the likelihood of activation ever occurring becomes remote. We recognize revenues from subscriptions that have not yet been activated, prepaid subscription cards, as well as prepaid subscription sales, when the likelihood of future activation occurring is remote (defined as breakage revenues ).

*Other Revenues*

Other revenues primarily include licensing activity of intellectual property other than software to third-parties. Revenue is recorded upon receipt of licensee statements, or upon the receipt of cash, provided the license period has begun.

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

	At September 30, 2011		At December 31, 2010	
Finished goods	\$	143	\$	98
Purchased parts and components		64		14
Inventories	\$	207	\$	112

**4. Intangible assets, net**

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

		At September 30, 2011		
	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
Acquired definite-lived intangible assets:				
License agreements	3 - 10 years	\$ 88	\$ (77)	\$ 11
Game engines	2 - 5 years	32	(32)	
Internally-developed franchises	11 - 12 years	309	(184)	125
Distribution agreements	4 years	18	(16)	2
Acquired indefinite-lived intangible assets:				
Activision trademark	Indefinite	386		386
Acquired trade names	Indefinite	47		47
Total		\$ 880	\$ (309)	\$ 571

		At December 31, 2010		
	Estimated useful lives	Gross carrying amount	Accumulated amortization	Net carrying amount
Acquired definite-lived intangible assets:				
License agreements	3 - 10 years	\$ 88	\$ (74)	\$ 14
Game engines	2 - 5 years	32	(30)	2
Internally-developed franchises	11 - 12 years	309	(167)	142
Distribution agreements	4 years	18	(16)	2
Acquired indefinite-lived intangible assets:				
Activision trademark	Indefinite	386		386
Acquired trade names	Indefinite	47		47
Total		\$ 880	\$ (287)	\$ 593

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Amortization expense of intangible assets was \$7 million and \$22 million for the three and nine months ended September 30, 2011, respectively. Amortization expense of intangible assets was \$21 million and \$50 million for the three and nine months ended September 30, 2010, respectively.

The carrying amounts as of September 30, 2011 and December 31, 2010 in the tables above reflect a new cost basis for license agreements, game engines and internally-developed franchises due to impairment charges taken for the year ended December 31, 2010. The new cost basis represents the original gross carrying amount, less accumulated amortization and impairment charges of the impaired assets as of December 31, 2010.

At September 30, 2011, future amortization of definite-lived intangible assets is estimated as follows (amounts in millions):

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2011 (remaining three months)	\$	48
2012		36
2013		18
2014		10
2015		8
Thereafter		18
Total	\$	138

**5. Income taxes**

The income tax expense of \$17 million for the three months ended September 30, 2011 reflected an effective tax rate of 10.7%. The effective tax rate of 10.7% for the three months ended September 30, 2011 differed from the statutory rate of 35.0%, primarily due to foreign income taxes levied at relatively lower rates, geographic mix in profitability, recognition of federal and California research and development credits and federal domestic production deductions and the beneficial impact from certain discrete items recognized in the quarter as we filed our tax returns.

For the nine months ended September 30, 2011, the tax rate was based on our projected annual effective tax rate for 2011, and also included certain discrete tax items recorded during the period. Our tax expense of \$325 million for the nine months ended September 30, 2011 reflected an effective tax rate of 24.8%, which was slightly lower than the effective tax rate of 26.0% for the nine months ended September 30, 2010, primarily due to the recognition of federal research and development credits and lower taxes in certain states.

The overall effective income tax rate for the year could be different from the effective tax rate for the three and nine months ended September 30, 2011 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 2011 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 lower statutory rates and/or higher than anticipated in our domestic region where taxes are levied at higher statutory rates.

The Internal Revenue Service ( IRS ) is currently examining the Company's federal tax returns for the 2009 tax year. The Company also 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 the Company's business and results of operations in an interim period in which the matters are ultimately resolved.

**6. Software development and intellectual property licenses**

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

	At September 30, 2011		At December 31, 2010	
Internally developed software costs	\$	172	\$	142
Payments made to third-party software developers		92		60
Total software development costs	\$	264	\$	202
Intellectual property licenses	\$	55	\$	73

Amortization, write-offs and impairments are comprised of the following (amounts in millions):

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	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Amortization of capitalized software development costs and intellectual property licenses	\$ 28	\$ 50	\$ 158	\$ 217
Write-offs and impairments		1		16

**7. Comprehensive income and accumulated other comprehensive income (loss)***Comprehensive Income*

The components of comprehensive income were as follows (amounts in millions):

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Net income	\$ 148	\$ 51	\$ 986	\$ 651
Other comprehensive income (loss):				
Foreign currency translation adjustment	(58)	48	(18)	15
Unrealized appreciation on investments, net of taxes			2	
Other comprehensive income (loss)	(58)	48	(16)	15
Comprehensive income	\$ 90	\$ 99	\$ 970	\$ 666

The components of accumulated other comprehensive income (loss) were as follows (amounts in millions):

	At September 30,		At December 31,	
	2011		2010	
Foreign currency translation adjustment	\$ (29)	\$	(11)	\$
Unrealized depreciation on investments, net of deferred income taxes of \$0 at September 30, 2011 and \$(1) at December 31, 2010			(2)	
Accumulated other comprehensive income (loss)	\$ (29)	\$	(13)	\$

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

**8. Fair value measurements**

**Fair Value Measurements on a Recurring Basis**

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.
- 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.



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The table below segregates all assets that are measured at fair value on a recurring basis (which means they are so 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 September 30, 2011 Using					Balance Sheet Classification
	As of September 30, 2011	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
<b>Financial assets:</b>						
Money market funds	\$ 2,329	\$ 2,329	\$	\$		Cash and cash equivalents
U.S. treasuries with original maturities of three months or less	11	11				Cash and cash equivalents
U.S. treasuries and government agency securities	391	391				Short-term investments
ARS held through Morgan Stanley Smith Barney LLC	25			25		Long-term investments
Total financial assets at fair value	\$ 2,756	\$ 2,731	\$	\$ 25		

	Fair Value Measurements at December 31, 2010 Using					Balance Sheet Classification
	As of December 31, 2010	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
<b>Financial assets:</b>						
Money market funds	\$ 2,216	\$ 2,216	\$	\$		Cash and cash equivalents
U.S. treasuries and foreign government bonds with original maturities of three months or less	332	332				Cash and cash equivalents
U.S. treasuries and government agency securities	672	672				Short-term investments
ARS held through Morgan Stanley Smith Barney LLC	23			23		Long-term investments
Foreign exchange contract derivatives	1			1		Other assets current
Total financial assets at fair value	\$ 3,244	\$ 3,220	\$ 1	\$ 23		

The following tables provide a reconciliation of the beginning and ending balances of our financial assets and financial liabilities classified as Level 3 by major categories (amounts in millions) at September 30, 2011 and 2010, respectively:



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		Level 3		Total financial assets at fair value
	ARS (a)			
Balance at January 1, 2011	\$	23	\$	23
Total unrealized gains included in other comprehensive income		2		2
Balance at September 30, 2011	\$	25	\$	25

		Level 3		Total financial assets at fair value	Other financial liabilities			
	ARS (a)	ARS rights from UBS (b)						
Balance at January 1, 2010	\$	77	\$	7	\$	84	\$	(23)
Total gains (losses) (realized/unrealized) included in investment and other income, net		7		(7)				13
Purchases of acquired sales, issuances and settlements		(61)				(61)		
Balance at September 30, 2010	\$	23	\$	\$	23	\$	(10)	
The amount of total gains(losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2010	\$		\$		\$		\$	13

(a) Fair value measurements of the auction rate securities ( ARS ) have been estimated using an income-approach model (specifically, discounted cash-flow analysis). 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. Assets measured at fair value using significant unobservable inputs (Level 3) represent 1% of our financial assets measured at fair value on a recurring basis at September 30, 2011.

In June 2010, we sold the remainder of our ARS held with UBS at par and recognized a gain of \$7 million, which is included within investment and other income, net in our condensed consolidated statement of operations for the nine months ended September 30, 2010.

(b) ARS rights from UBS represented an offer from UBS providing us with the right to require UBS to purchase our ARS held through UBS at par value. To value the ARS rights, we considered the intrinsic value, time value of money, and our assessment of the credit worthiness of UBS. We exercised our ARS rights with UBS on June 30, 2010 and recorded a loss of \$7 million, which is included within investment and other income, net in our condensed consolidated statement of operations for the nine months ended September 30, 2010.

*Foreign Currency Forward Contracts Not Designated as Hedges*

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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, primarily swaps and forward contracts with maturities of twelve months or less, with Vivendi as our principal counterparty. We do not hold or purchase any foreign currency contracts for trading or speculative purposes and we do not designate these forward contracts or swaps as hedging instruments.

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Accordingly, we report the fair value of these contracts in our condensed consolidated balance sheet with changes in fair value recorded in our condensed consolidated statement of operations. 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 period.

**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 nine-month period ended September 30, 2011, there were no impairment charges related to assets that are measured on a non-recurring basis.

The table below presents intangible assets that are not subject to recurring fair value measurement at December 31, 2010 (amounts in millions):

	Fair Value Measurements at December 31, 2010 Using				Total Losses
	As of December 31, 2010	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Non-financial assets:					
Intangible assets, net	\$	\$	\$	\$	\$ 326
Total non-financial assets at fair value	\$	\$	\$	\$	\$ 326

We considered the continued economic downturn within our industry in 2010 and the change in the buying habits of casual consumers while planning for 2011 during the fourth quarter of 2010. This resulted in a significant revision of our outlook for retail sales of software and a strategy change to, among other things, focus on fewer title releases in the casual genre and discontinue the development of music-based titles. As we considered this change in strategy to be an indicator of a potential impairment of our intangible assets, we updated our future projected revenue streams for certain franchises in the casual games and music genres. We performed recoverability tests and, where applicable, measured the impairment of the related intangible assets in accordance with ASC Subtopic 360-10.

Determining whether an impairment has occurred requires various estimates and assumptions, including determining which cash flows are directly related to the potentially impaired asset, the estimated remaining useful life over which these cash flows will occur, the amount of these cash flows and the asset's residual value, if any. For intangible assets that do not pass the recoverability test, the measurement of an impairment loss requires a determination of fair value, which is based on the best information available. Based on the characteristics of the assets being valued and the availability of information, the Company used the income approach, which presumes that the value of an asset can be estimated by the net economic benefit to be received over the estimated remaining useful life of the asset, discounted to present value. We derived the required cash flow estimates from our historical experience and our internal business plans and applied an appropriate discount rate. Based on this analysis, we recorded impairment charges of \$67 million, \$9 million and \$250 million to license agreements, game engines and internally-developed franchises intangible assets, respectively, for the year ended December 31, 2010 within our Activision Publishing Inc. segment.



Table of Contents**9. Restructuring**

On February 3, 2011, the Board of Directors of the Company approved a restructuring plan (the 2011 Restructuring ) involving a focus on the development and publication of a reduced slate of titles on a going-forward basis, including the discontinuation of the development of music-based games, the closure of the related business unit and the cancellation of other titles then in production, along with a related reduction in studio headcount and corporate overhead.

The following table details the amount of the 2011 Restructuring reserves included in accrued expenses and other liabilities in the condensed consolidated balance sheet at September 30, 2011 (amounts in millions):

	Severance	Facilities costs	Contract termination costs	Total
Balance at December 31, 2010	\$	\$	\$	\$
Costs charged to expense	19	4	1	24
Costs paid or otherwise settled	(14)		(1)	(15)
Balance at September 30, 2011	\$ 5	\$ 4	\$	\$ 9

The 2011 Restructuring charges for the three and nine months ended September 30, 2011 were \$3 million and \$24 million, respectively. These charges, as well as the 2011 Restructuring reserve balances at September 30, 2011, were recorded within our Activision Publishing, Inc. segment. We have substantially completed the 2011 Restructuring and we do not expect to incur significant additional restructuring expenses relating thereto.

We have completed our implementation of our organizational restructuring plan as a result of the business combination (the Business Combination ) by and among the Company (then known as Activision, Inc.), Sego Merger Corporation, a wholly-owned subsidiary of the Company, Vivendi S.A. ( Vivendi ), VGAC LLC, a wholly-owned subsidiary of Vivendi, and Vivendi Games, Inc., a wholly-owned subsidiary of VGAC LLC, consummated in July 2008. There were minimal cash payments and no additional charges in our condensed consolidated statement of operations for the three and nine months ended September 30, 2011 relating to that restructuring and we do not expect to incur additional restructuring expenses relating thereto.

**10. 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 operating performance is assessed and resources are allocated, and the availability of separate financial information. We do not aggregate operating segments.

Currently, we operate under three operating segments:

***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 both internally-developed and licensed intellectual property. Activision markets and sells games it develops and, through our affiliate label program, games developed by certain third-party publishers. We sell games both through retail channels and by digital download. Activision currently offers games that operate on the Sony Computer Entertainment, Inc. ( Sony ) PlayStation 3 ( PS3 ), Nintendo Co. Ltd. ( Nintendo ) Wii ( Wii ), and Microsoft Corporation ( Microsoft ) Xbox 360 ( Xbox 360 ) console systems; the Nintendo Dual Screen ( DS ) handheld game systems; the PC; Apple iOS devices and other handheld and mobile devices.

***Blizzard Entertainment, Inc.***

Blizzard Entertainment, Inc. ( Blizzard ) develops, markets and sells role-playing action and strategy PC-based computer games, including games in the multiple-award winning Diablo and StarCraft franchises. Blizzard also develops, hosts, and supports its online subscription-based games in the massively multi-player online role-playing game ( MMORPG ) category in which it is a leader in terms of both subscriber base and revenues generated through its World of Warcraft franchise. Blizzard also maintains a proprietary online-game related service, Battle.net. Blizzard distributes its products and generates revenues



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worldwide through various means, including: subscriptions (which consist of fees from individuals playing *World of Warcraft*, prepaid cards and other value-added service revenues such as realm transfers, faction changes, and other character customizations within the *World of Warcraft* gameplay); 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* and *StarCraft II*.

***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.

The CODM reviews segment performance exclusive of the impact of the change in deferred net 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, and impairment of intangible assets. 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 segment net revenues from external customers and total segment income (loss) from operations to consolidated net revenues and income before income tax expense for the three and nine months ended September 30, 2011 and 2010 are presented below (amounts in millions):

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	Three months ended September 30,			
	2011	2010	2011	2010
	Net revenues		Income from operations before income tax expense	
Activision	\$ 253	\$ 314	\$ (36)	\$ (43)
Blizzard	297	481	120	246
Distribution	77	62	1	1
Operating segments total	627	857	85	204
Reconciliation to consolidated net revenues / operating income and consolidated income before income tax expense:				
Net effect from deferral of net revenues and related cost of sales	127	(112)	105	(97)
Stock-based compensation expense			(18)	(34)
Restructuring			(3)	
Amortization of intangible assets			(7)	(18)
Consolidated net revenues / operating income	\$ 754	\$ 745	162	55
Investment and other income, net			3	14
Consolidated income before income tax expense			\$ 165	\$ 69

	Nine months ended September 30,			
	2011	2010	2011	2010
	Net revenues		Income from operations before income tax expense	
Activision	\$ 898	\$ 983	\$ 42	\$ (88)
Blizzard	968	1,086	425	559
Distribution	214	185	1	(1)
Operating segments total	2,080	2,254	468	470
Reconciliation to consolidated net revenues / operating income and consolidated income before income tax expense:				
Net effect from deferral of net revenues and related cost of sales	1,268	765	943	539
Stock-based compensation expense			(61)	(94)
Restructuring			(24)	(3)
Amortization of intangible assets			(22)	(47)
Consolidated net revenues / operating income	\$ 3,348	\$ 3,019	\$ 1,304	\$ 865
Investment and other income, net			7	15
Consolidated income before income tax expense			\$ 1,311	\$ 880

Geographic information for the three and nine months ended September 30, 2011 and 2010 is based on the location of the selling entity. Net revenues from external customers by geographic region were as follows (amounts in millions):

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	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Net revenues by geographic region:				
North America	\$ 360	\$ 406	\$ 1,687	\$ 1,675
Europe	323	281	1,385	1,142
Asia Pacific	71	58	276	202
Total consolidated net revenues	\$ 754	\$ 745	\$ 3,348	\$ 3,019

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

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Net revenues by platform:				
Online subscriptions*	\$ 336	\$ 289	\$ 1,090	\$ 890
Console	277	298	1,711	1,642
Hand-held	19	23	82	101
PC and Other	45	73	251	201
Total platform net revenues	677	683	3,134	2,834
Distribution	77	62	214	185
Total consolidated net revenues	\$ 754	\$ 745	\$ 3,348	\$ 3,019

\*Revenue from online subscriptions consists of revenue from all *World of Warcraft* products, including subscriptions, boxed products, expansion packs, licensing royalties, and value-added services.

We did not have any single external customer that accounted for 10% or more of net revenues for the three or nine months ended September 30, 2011 and 2010.

**11. Goodwill**

The changes in the carrying amount of goodwill by operating segment for the nine months ended September 30, 2011 are as follows (amounts in millions):

	Activision	Blizzard	Distribution	Total
Balance at December 31, 2010	\$ 6,942	\$ 178	\$ 12	\$ 7,132
Tax benefit credited to goodwill	(8)			(8)
Issuance of contingent consideration	3			3
Foreign exchange	(1)			(1)
Balance at September 30, 2011	\$ 6,936	\$ 178	\$ 12	\$ 7,126

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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.

Issuance of contingent consideration consists of additional purchase consideration paid during 2011 in relation to a previous acquisition.

### **12. 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):

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	Three months ended September 30, 2011		2010		Nine months ended September 30, 2011		2010	
<b>Numerator:</b>								
Consolidated net income	\$	148	\$	51	\$	986	\$	651
Less: Distributed earnings to unvested stock-based awards that participate in earnings						(3)		(2)
Less: Undistributed earnings allocated to unvested stock-based awards that participate in earnings		(2)				(11)		(4)
Numerator for basic and diluted earnings per common share - net income available to common shareholders		146		51		972		645
<b>Denominator:</b>								
Denominator for basic earnings per common share - weighted-average common shares outstanding		1,140		1,212		1,151		1,230
Effect of potential dilutive common shares under the treasury stock method:								
Employee stock options		8		15		9		15
Denominator for diluted earnings per common share - weighted-average common shares outstanding plus dilutive effect of employee stock options		1,148		1,227		1,160		1,245
Basic earnings per common share	\$	0.13	\$	0.04	\$	0.84	\$	0.53
Diluted earnings per common share	\$	0.13	\$	0.04	\$	0.84	\$	0.52

Our unvested restricted stock rights are considered participating securities since these securities have non-forfeitable rights to dividends or dividend equivalents during the contractual period of the award. Since the unvested restricted stock rights are considered participating securities, we are required to use the two-class method in our computation of basic and diluted earnings per common share. For both the three and nine months ended September 30, 2011, we had outstanding unvested restricted stock rights for 17 million shares of common stock on a weighted-average basis. For both the three and nine months ended September 30, 2010, we had outstanding unvested restricted stock rights for 11 million shares of common stock on a weighted-average basis.

Potential common shares are not included in the denominator of the diluted earnings per common share calculation when inclusion of such shares would be anti-dilutive. Therefore, options to acquire 23 million and 31 million shares of common stock were not included in the calculation of diluted earnings per common share for the three and nine months ended September 30, 2011, respectively, and options to acquire 25 million and 24 million shares of common stock were not included in the calculation of diluted earnings per common share for the three and nine months ended September 30, 2010, respectively, as the effect of their inclusion would be anti-dilutive.

**13. Capital transactions**

*Repurchase Program*

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On February 3, 2011, our Board of Directors authorized a new stock repurchase program (the 2011 Stock Repurchase Program ) under which we may repurchase up to \$1.5 billion of our common stock, on terms and conditions to be determined by the Company, until the earlier of March 31, 2012 and a determination by the Board of Directors to discontinue the repurchase

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program. During the nine months ended September 30, 2011, we repurchased 45 million shares of our common stock for \$502 million pursuant to the 2011 Stock Repurchase Program. Additionally, in October 2011, we settled the purchase of 0.5 million shares of our common stock that we had committed to repurchase in September 2011 pursuant to this program for \$6 million.

On February 10, 2010, our Board of Directors authorized a stock repurchase program (the 2010 Stock Repurchase Program ) under which we were authorized to repurchase up to \$1 billion of our common stock. The 2010 Stock Repurchase Program expired on December 31, 2010. In January 2011, we settled a \$22 million purchase of 1.8 million shares of our common stock that we had committed to repurchase in December 2010 pursuant to the 2010 Stock Repurchase Program.

*Dividend*

On February 9, 2011, our Board of Directors approved a cash dividend of \$0.165 per common share to be paid on May 11, 2011 to shareholders of record as of March 16, 2011, and on May 11, 2011, we made a cash dividend payment of \$192 million to such shareholders. On August 12, 2011, the Company made dividend equivalent payments of \$2 million related to this cash dividend to the holders of restricted stock units.

**14. Commitments and contingencies**

At September 30, 2011, we did not have any significant changes to our commitments since December 31, 2010. See Note 18 of the Notes to Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the year ended December 31, 2010 for more information regarding our commitments.

*Legal Proceedings*

After concluding an internal human resources inquiry into breaches of contract and insubordination by two senior employees at Infinity Ward, the Company terminated its employment of Jason West and Vince Zampella on March 1, 2010. On March 3, 2010, West and Zampella filed a complaint against the Company in Los Angeles Superior Court for breach of contract and wrongful termination, among other claims. In their complaint, West and Zampella alleged damages, including punitive damages, in excess of \$36 million and declaratory relief, an amount they have since significantly increased during discovery. On April 9, 2010, the Company filed a cross complaint against West and Zampella, asserting claims for breach of contract and fiduciary duty, among other claims. The Company is seeking damages and declaratory relief.

In addition, 38 current and former employees of Infinity Ward filed a complaint against the Company in Los Angeles Superior Court on April 27, 2010 (*Alderman et al. v. Activision Publishing, Inc. et al.*). An amended complaint was filed on July 8, 2010, which added seven additional plaintiffs. On October 5, 2010, five plaintiffs, all current employees of Infinity Ward, filed dismissals without prejudice. There are currently 40 plaintiffs in the case. The plaintiffs have asserted claims for breach of contract, violation of the Labor Code of the State of California, conversion and other claims. In their complaint, the plaintiffs claimed that the Company failed to pay them bonuses and other compensation allegedly owed to them in an amount at least between \$75 million and \$125 million, plus punitive damages, an amount they have since increased in discovery responses to approximately \$300 million, plus punitive damages. On October 12, 2010, the court consolidated this

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matter with the West and Zampella matter.

On January 18, 2011, the court granted the Company's motion to amend its cross complaint against West and Zampella to add allegations with respect to them and to add Electronic Arts, Inc. as a party. On January 31, 2011, the case was transferred to the complex division.

Some of the parties have filed, and are likely to file, additional pre-trial motions, including dispositive motions, and discovery continues in the ordinary course of the litigation. The court has set a trial date of May 7, 2012.

The Company has accrued, and will continue to accrue, appropriate amounts related to bonuses and other monies allegedly owed in connection with this matter. Due to the inherent uncertainties of litigation, other potential outcomes are reasonably possible, including outcomes which are above the amount of the accrual. The Company does not expect this lawsuit to have a material impact on the Company's business, financial condition, results of operation or liquidity. However, an unfavorable resolution of this lawsuit above the amount of the accrual could have a material adverse effect on the Company's business and results of operations in an interim period in which the lawsuit is ultimately resolved.



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

**15. Related party transactions**

*Treasury*

Our foreign currency risk management program seeks to reduce risks arising from foreign currency fluctuations. We use derivative financial instruments, primarily currency forward contracts and swaps, with Vivendi as our principal counterparty. The gross notional amount of outstanding foreign exchange swaps was \$61 million and \$138 million at September 30, 2011 and December 31, 2010, respectively. A pre-tax net unrealized loss of less than a million and loss of \$1 million for the three months ended September 30, 2011 and 2010, respectively, resulted from the foreign exchange contracts and swaps with Vivendi and were recognized in the condensed consolidated statements of operations. A pre-tax net unrealized loss of less than a million and unrealized gain of \$3 million for the nine months ended September 30, 2011 and 2010, respectively, resulted from the foreign exchange contracts and swaps with Vivendi and were recognized in the condensed consolidated statements of operations.

*Other*

Activision Blizzard has entered into various transactions and agreements, including cash management services, investor agreement, and music royalty agreements with Vivendi and its subsidiaries and affiliates. None of these services, transactions and agreements with Vivendi and its subsidiaries and affiliates is material either individually or in the aggregate to the condensed consolidated financial statements as a whole.

**16. Recently issued accounting pronouncements**

In May 2011, the FASB issued an update to the accounting rules for fair value measurement to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards ( IFRS ). This update changes certain fair value measurement principles and enhances the disclosure requirements for fair value measurements. This update does not extend the use of fair value accounting, but provides guidance on how it should be applied where its use is already required or permitted by other standards within U.S. GAAP or IFRS. This update is effective for interim and annual periods beginning after December 15, 2011 and is applied prospectively. Early adoption is prohibited. We are currently evaluating the impact, if any, of this new accounting update on our consolidated financial statements.

In June 2011, the FASB issued an update to the accounting on comprehensive income to increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. GAAP and IFRS. This update requires that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update

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does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. Further, this update does not affect how earnings per share is calculated or presented. This update is effective for interim and annual periods beginning after December 15, 2011 and is applied retrospectively. Early adoption is permitted. We do not expect that the adoption of this guidance will have a material impact on our consolidated financial statements.

In September 2011, the FASB issued an update to the authoritative guidance related to goodwill impairment testing. This update gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount before performing the two-step test mandated prior to the update. If, after assessing the totality of events and circumstances, a company determines it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then it must perform the two-step test. Otherwise, a company may skip the two-step test. Companies are not required to perform the qualitative assessment and may, instead proceed directly to the first step of the two-part test. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. While we are in the process of assessing whether we will early adopt this update, we currently do not expect that adopting it will have a material impact on our consolidated financial statements.

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

**Business Overview**

Activision Blizzard, Inc. is a worldwide online, personal computer ( PC ), console, handheld and mobile 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 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 both internally-developed and licensed intellectual property. Activision markets and sells games it develops and, through our affiliate label program, games developed by certain third-party publishers. We sell games both through retail channels and by digital download. Activision currently offers games that operate on the Sony Computer Entertainment, Inc. ( Sony ) PlayStation 3 ( PS3 ), Nintendo Co. Ltd. ( Nintendo ) Wii ( Wii ), and Microsoft Corporation ( Microsoft ) Xbox 360 ( Xbox 360 ) console systems; the Nintendo Dual Screen ( DS ) handheld game systems; the PC; Apple iOS devices and other handheld and mobile devices.

***Blizzard Entertainment, Inc.***

Blizzard Entertainment, Inc. ( Blizzard ) develops, markets and sells role-playing action and strategy PC-based computer games, including games in the multiple-award winning Diablo and StarCraft franchises. Blizzard also develops, hosts, and supports its online subscription-based games in the massively multi-player online role-playing game ( MMORPG ) category in which it is a leader in terms of both subscriber base and revenues generated through its World of Warcraft franchise. Blizzard also maintains a proprietary online-game related service, Battle.net. Blizzard distributes its products and generates revenues worldwide through various means, including: subscriptions (which consist of fees from individuals playing *World of Warcraft*, prepaid cards and other value-added service revenues such as realm transfers, faction changes, and other character customizations within the *World of Warcraft* gameplay); 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* and *StarCraft II*.

***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 Highlights***

For the three months ended September 30, 2011, Activision Blizzard had net revenues of \$754 million as compared to net revenues of \$745 million in the same period in 2010, and earnings per diluted share of \$0.13 as compared to earnings per diluted share of \$0.04 in the same period in 2010.

For the three months ended September 30, 2011, net revenues from digital online channels (as defined below) increased by 18% year-over-year to \$427 million, or 57% of total consolidated net revenues, as compared to \$363 million, or 49% of total consolidated net revenues, in the same period in 2010. Further, for the three months ended September 30, 2011, net revenues from digital online channels, excluding the impact of changes in deferred net revenues (a non-GAAP financial measure), increased by 6% year-over-year to \$386 million, or 62% of total consolidated net revenues as compared to \$363 million, or 42% of total consolidated net revenues, in the same period in 2010. Please refer to the reconciliation between GAAP and non-GAAP financial measures below.

For the nine months ended September 30, 2011, Activision Blizzard had net revenues of \$3.3 billion as compared to net revenues of \$3.0 billion in the same period in 2010, and earnings per diluted share of \$0.84 as compared to earnings per diluted share of \$0.52 in the same period in 2010.

For the nine months ended September 30, 2011, net revenues from digital online channels grew by 25% year-over-year to \$1.3 billion, or 38% of total consolidated net revenues, as compared to \$1.0 billion, or 34% of total consolidated net revenues, in the same period in 2010. Further, net revenues from digital online channels, excluding the impact of changes in deferred net revenues (a non-GAAP financial measure), grew by 16% year-over-year to \$1.3 billion, or 60% of total consolidated net

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revenues, for the nine months ended September 30, 2011 as compared to \$1.1 billion, or 48% of total consolidated net revenues, in the same period in 2010.

According to The NPD Group, with respect to the U.S., and Charttrack and Gfk, with respect to Europe, during the nine months ended September 30, 2011, based on sales from retail channels, *Call of Duty: Black Ops* was the #1 best selling title in dollars for all platforms in aggregate in the U.S. and Europe for each of the first three quarters of 2011, and *StarCraft II: Wings of Liberty* was the #1 best-selling PC title in dollars in the U.S. and Europe.

***Additional Highlights***

On February 3, 2011, our Board of Directors approved a new stock repurchase program (the 2011 Stock Repurchase Program) under which we may repurchase up to \$1.5 billion of our common stock until the earlier of March 31, 2012 or a determination by the Board of Directors to discontinue the repurchase program. As of September 30, 2011, we have repurchased 45 million shares of common stock under this program for an aggregate purchase price of approximately \$502 million. Additionally, in October 2011, we settled the purchase of 0.5 million shares of our common stock that we had committed to repurchase in September 2011 pursuant to this program for \$6 million.

On February 9, 2011, the Board of Directors declared a cash dividend of \$0.165 per common share to be paid on May 11, 2011 to shareholders of record as of March 16, 2011. On May 11, 2011, we made an aggregate cash dividend payment of \$192 million to such shareholders. On August 12, 2011, we made dividend equivalent payments of \$2 million related to this cash dividend to the holders of restricted stock units.

***Product Release Highlights***

During the nine months ended September 30, 2011, we released the following *Call of Duty: Black Ops* downloadable content packs on Microsoft's Xbox 360, Sony's PlayStation Network and the PC: *Call of Duty: Black Ops First Strike*, *Call of Duty: Black Ops Escalation*, *Call of Duty: Black Ops Annihilation*, and *Call of Duty: Black Ops Reurrection*. In addition, we released *Transformers: Dark of the Moon*, *X-Men: Destiny*, *Nascar The Game 2011*, *Wipeout: In the Zone* and *Cabela's Big Game Hunter 2012*, as well as a selection of other casual titles. In July 2011, we launched *World of Warcraft: Cataclysm* in China. We also released Lucas Arts' title *Lego Star Wars III*, which we publish on behalf of Lucas Arts in Europe and certain countries in Asia Pacific.

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

On October 16, 2011, we launched *Skylanders: Spyro's Adventure*, a new intellectual property that combines the use of toys with video games delivering a new game play experience to our audiences. In October 2011, we also released *Spiderman: Edge of Time* and *Wipeout: Season 2*. On November 1, 2011, we released *Cabela's Survival: Shadows of Katmai*, *Cabela's Adventure Camp* and *GoldenEye 007: Reloaded* from the James Bond franchise. On November 8, 2011, we released the next installment in the Call of Duty franchise, *Call of Duty: Modern Warfare 3*, and debuted *Call of Duty: Elite*, an innovative new digital platform that provides both free services and premium subscription-based services for the Call of Duty franchise. Further, during the fourth quarter of 2011, we also expect to release *Rapala for Kinect* and a selection of other casual

titles.

Looking forward, Blizzard has announced its intention to ship *Diablo III* in early 2012, and has announced plans for the fourth *World of Warcraft* expansion *World of Warcraft: Mists of Pandaria*.

#### **Management's Overview of Business Trends**

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 (both from websites that we own and from others owned by third parties). We also offer downloadable content as add-ons to our products (*e.g.*, new multi-player content packs). Such digital online-delivered content is generally offered to consumers for a one-time fee. We also offer subscription based services for *World of Warcraft*, which are digitally delivered and hosted by Blizzard Entertainment's proprietary online-game related service, Battle.net. In November 2011, we launched *Call of Duty: Elite*, an innovative new digital platform that provides both free services and premium subscription-based services for the Call of Duty franchise. Digital revenues have become an increasingly important part of our business and we continue to focus on and develop products that can be delivered via digital online channels. We currently define digital online channel-related sales as revenues from subscriptions and licensing royalties, value added services, downloadable content, digitally distributed products and wireless devices. This definition may differ from that used by our competitors or other companies. For the quarter ended September 30, 2011, our sales through digital online channels grew by \$64 million as compared to the same period in 2010. For the nine months ended September 30, 2011, our

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sales through digital online channels grew by \$252 million as compared to the same period in 2010. We believe, based on our internal estimates, that sales in the overall video games digital market for the nine-month period were up double digits year-over-year.

Conditions in the retail channels of the video games industry have remained challenging during the first nine months of 2011. In the U.S. and Europe, retail sales within the industry experienced a combined overall decrease of 8% for the first nine months of 2011, as compared to the same period in 2010, according to The NPD Group, Charttrack and Gfk. The majority of the overall decline is attributable to the weakened market for software for the Nintendo Wii and handheld platforms, which declined by 18% year-over-year, while sales for high definition platforms (*i.e.*, Xbox 360 and PS3) and PC declined by just 1% in that same period, all according to The NPD Group, Charttrack and Gfk. Since our more focused slate of titles is concentrated on products for high definition platforms and involves limited offerings in the music and casual genres, particularly on Nintendo Wii and handheld platforms, and an increasing portion of our revenues is from digital channels, our results have been less impacted by the overall decline in retail software sales than the overall industry.

The continuing downward pressure in the retail channels suggests an increasing shift towards digital distribution. Consistent with that, we experienced year-over-year growth of net revenues from digital online channels as a percentage of our total net revenues. This digital revenue growth positively impacted operating margin, and helped us achieve favorable operating margins for the three and nine months ended September 30, 2011. We intend to continue to invest resources and capital in our higher-margin products that can be delivered via digital online channels for the remainder of 2011, as we seek to extend our leadership to be the largest digital video games publisher and expand our core brands in this channel. Please refer to the reconciliation between GAAP and non-GAAP financial measures below.

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

	Three months ended September 30,				Nine months ended September 30,							
	2011		2010		2011		2010					
<b>Net revenues:</b>												
Product sales	\$	369	49%	\$	397	53%	\$	2,197	66%	\$	2,025	67%
Subscription, licensing, and other revenues		385	51		348	47		1,151	34		994	33
Total net revenues		754	100		745	100		3,348	100		3,019	100
<b>Costs and expenses:</b>												
Cost of sales product costs		138	18		194	27		650	19		765	25
Cost of sales MMORPG		59	8		61	8		181	5		168	6
Cost of sales software royalties and amortization		24	3		61	8		133	4		211	7
Cost of sales intellectual property licenses		16	2		33	4		69	2		105	3
Product development		133	18		118	16		390	12		361	12
Sales and marketing		115	15		110	15		264	8		291	10
General and administrative		104	14		113	15		333	10		253	8
Restructuring		3						24	1			
Total costs and expenses		592	78		690	93		2,044	61		2,154	71
Operating income		162	22		55	7		1,304	39		865	29
Investment and other income, net		3			14	2		7			15	
Income before income tax expense		165	22		69	9		1,311	39		880	29
Income tax expense		17	2		18	2		325	10		229	7
Net income	\$	148	20%	\$	51	7%	\$	986	29%	\$	651	22%

**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 operating performance is assessed and resources are allocated, and the availability of separate financial information. We do not aggregate operating segments.



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The CODM reviews segment performance exclusive of the impact of the change in deferred net 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, and impairment of intangible assets. 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 segment net revenues and total segment income (loss) from operations to consolidated net revenues and income before income tax expense from external customers for the three and nine months ended September 30, 2011 and 2010 are presented below (amounts in millions):

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	Three months ended September 30,			Nine months ended September 30,		
	2011	2010	Increase (Decrease)	2011	2010	Increase (Decrease)
<b>Segment net revenues:</b>						
Activision	\$ 253	\$ 314	\$ (61)	\$ 898	\$ 983	\$ (85)
Blizzard	297	481	(184)	968	1,086	(118)
Distribution	77	62	15	214	185	29
Operating segment net revenue total	627	857	(230)	2,080	2,254	(174)
<b>Reconciliation to consolidated net revenues:</b>						
Net effect from deferral of net revenues	127	(112)		1,268	765	
Consolidated net revenues	\$ 754	\$ 745		\$ 3,348	\$ 3,019	
<b>Segment income (loss) from operations:</b>						
Activision	\$ (36)	\$ (43)	\$ 7	\$ 42	\$ (88)	\$ 130
Blizzard	120	246	(126)	425	559	(134)
Distribution	1	1		1	(1)	2
Operating segment income from operations total	85	204	(119)	468	470	(2)
<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	105	(97)		943	539	
Stock-based compensation expense	(18)	(34)		(61)	(94)	
Restructuring	(3)			(24)	(3)	
Amortization of intangible assets	(7)	(18)		(22)	(47)	
Consolidated operating income	162	55		1,304	865	
Investment and other income, net	3	14		7	15	
Consolidated income before income tax expense	\$ 165	\$ 69		\$ 1,311	\$ 880	

*Segment Net Revenues*

Activision

Activision's net revenues decreased for the three and nine months ended September 30, 2011 as compared to the same periods in 2010, primarily due to a more focused slate, with the release of fewer key titles in 2011 than in 2010 and lower catalogue sales of games in the music and casual games genres. Activision released three titles in the third quarter of 2011, *X-Men: Destiny*, *Cabela's Big Game Hunter 2012* and *Quest for Zhu*, as compared to eight titles in the third quarter of 2010. These lower net revenues were partially offset by the continued strong catalogue performance from the Call of Duty franchise, the stronger performance of downloadable content packs associated with *Call of Duty: Black Ops* as compared to the downloadable content packs associated with *Call of Duty: Modern Warfare 2* released in the prior year, as well as a greater

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number of content packs for the Call of Duty franchise released in the current year versus the prior year, and favorable movement in foreign exchange rates. Further, the release in the first quarter of 2011 of *Lego Star Wars III*, which we publish on behalf of Lucas Arts in Europe and certain countries in Asia Pacific, generated additional net revenues in the current year.

### Blizzard

Blizzard's net revenues decreased for the three and nine months ended September 30, 2011 as compared to the same periods in 2010, primarily because there were no new releases during 2011 as compared to the release of *StarCraft II: Wings of Liberty* in July

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2010. These lower net revenues were partially offset by net revenues generated in 2011 from *World of Warcraft: Cataclysm*, which was released in December 2010, and *World of Warcraft: Wrath of the Lich King*, which was released in China in August 2010, the increasing sales of value-added services in China since their launch in December 2010, and favorable movement in foreign exchange rates. At September 30, 2011, the worldwide subscriber base for *World of Warcraft* was 10.3 million, compared to a subscriber base of 11.1 million at June 30, 2011. Despite an initial increase in subscribers following the launch of *World of Warcraft: Cataclysm* in China early in the quarter, the majority of the decline in subscribers for the quarter occurred in Asia. In general, the average revenue per subscriber is lower in Asia than in the U.S. and Europe. Looking forward, the company's objective is to deliver new game content for *World of Warcraft* in all regions to further appeal to the gaming community.

Distribution

Distribution's net revenues increased for the three and nine months ended September 30, 2011 as compared to the same periods in 2010, primarily due to several additional sales opportunities and favorable movement in foreign exchange rates.

*Segment Income from Operations*

Activision

For the three months ended September 30, 2011, Activision's operating loss decreased slightly as compared to the same period in the prior year, despite the decrease in Activision's net revenues as previously described. The improvement was primarily attributable to a greater mix of products with higher margins, including products distributed through digital online channels, cost savings realized from the 2011 Restructuring, and a decrease in amortization of capitalized software development costs and intellectual property license expenses as we have fewer titles released during the period of 2011 as compared to the same period in 2010. However, an increase in sales and marketing in support of the launch of *Skylanders: Spyro's Adventure* and the Call of Duty franchise, and additional legal expenses, negatively impacted operating income in the quarter.

For the nine months ended September 30, 2011, Activision's operating income increased substantially over the prior year, from an operating loss of \$88 million to operating income of \$42 million, despite the decrease in Activision's net revenues as previously described. Similar to the third quarter, the increased operating income was primarily attributable to a greater mix of products with higher margins and cost savings realized from the 2011 Restructuring. The increase in Activision's operating income for the nine months was also attributable to a decrease in amortization of capitalized software development costs and intellectual property license expenses as we have fewer titles released during the period of 2011 as compared to the same period in 2010, and a decrease in product development expenses. These improvements to operating income were partially offset by an increase in legal expenses.

Blizzard

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Blizzard's operating income decreased for the three and nine months ended September 30, 2011 as compared to the same periods in 2010, primarily as a result of the decrease in net revenues previously described, as well as Blizzard's investment in customer services and data centers, and lower capitalization of product development costs. Partially offsetting these negative impacts, Blizzard's results were positively impacted by a decrease in sales and marketing expenses as compared to the same periods in 2010, which were primarily incurred to support the release of *StarCraft II: Wings of Liberty* in July 2010, and favorable movement in foreign exchange rates.

### Non-GAAP Financial Measures

The analysis of revenues by distribution channel is presented both on a GAAP (including the impact from change in deferred revenues) and non-GAAP (excluding the impact from change in deferred revenues) basis. We use this non-GAAP measure internally to monitor our operating performance. 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. In addition, excluding the impact from 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 or as a substitute for the related financial information prepared in accordance with GAAP. In addition, this non-GAAP financial measure may not be the same as non-GAAP measures presented by other companies.

We currently define digital online channels-related sales as revenues from subscriptions and licensing royalties, value added services, downloadable content, digitally distributed products, and wireless devices.

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The following table provides a reconciliation between GAAP and non-GAAP net revenues by distribution channel for the three and nine months ended September 30, 2011 and 2010 (amounts in millions):

	Three months ended September 30,		Increase	Nine months ended September 30,		Increase
	2011	2010	(Decrease)	2011	2010	(Decrease)
<b>GAAP net revenues by distribution channel</b>						
Retail channels	\$ 250	\$ 320	\$ (70)	\$ 1,856	\$ 1,808	\$ 48
Digital online channels	427	363	64	1,278	1,026	252
Total Activision and Blizzard	677	683	(6)	3,134	2,834	300
Distribution	77	62	15	214	185	29
Total consolidated GAAP net revenues	754	745	9	3,348	3,019	329
<b>Change in deferred net revenues</b>						
Retail channels	(86)	112		(1,240)	(816)	
Digital online channels	(41)			(28)	51	
Total changes in deferred net revenues	(127)	112		(1,268)	(765)	
<b>Non-GAAP net revenues by distribution channel</b>						
Retail channels	164	432	(268)	616	992	(376)
Digital online channels	386	363	23	1,250	1,077	173
Total Activision and Blizzard	550	795	(245)	1,866	2,069	(203)
Distribution	77	62	15	214	185	29
Total non-GAAP net revenues (1)	\$ 627	\$ 857	\$ (230)	\$ 2,080	\$ 2,254	\$ (174)

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

The increases in GAAP net revenues from digital online channels for the three and nine months ended September 30, 2011 as compared to the same periods of 2010 were primarily due to the continuing success of the Call of Duty franchise and revenues generated from World of Warcraft franchise, as well as the digital release of *StarCraft II: Wings of Liberty* in July 2010, resulting in more deferred revenues recognized during the periods as compared to the same periods in 2010.

The increases in non-GAAP net revenues from digital online channels for the three and nine months ended September 30, 2011 as compared to the same periods of 2010 were attributable to the stronger performance of downloadable content packs associated with *Call of Duty: Black Ops*, as well as a greater number of content packs released in 2011 versus the prior year, a higher number of full game downloads from the Call of Duty and World of Warcraft franchises, and favorable movement in foreign exchange rates. These increases were partially offset by the decrease of full game downloads of *StarCraft II: Wings of Liberty* which was released in July 2010. The decreases in non-GAAP net revenues from retail channels for the three and nine months ended September 30, 2011 as compared to the same periods in 2010 were the result of our more focused slate, with the release of fewer key titles, and directionally consistent with the conditions in the retail channels of the video games industry. The decrease was partially offset by the continued strong performance of the Call of Duty franchise and revenues generated from the World of Warcraft franchise.

### **Consolidated Results**

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*Net Revenues by Geographic Region*

The following table details our consolidated net revenues by geographic region for the three and nine months ended September 30, 2011 and 2010 (amounts in millions):

	Three months ended September 30,		Increase	Nine months ended September 30,		Increase
	2011	2010	(Decrease)	2011	2010	(Decrease)
Geographic region net revenues:						
North America	\$ 360	\$ 406	\$ (46)	\$ 1,687	\$ 1,675	\$ 12
Europe	323	281	42	1,385	1,142	243
Asia Pacific	71	58	13	276	202	74
Consolidated net revenues	\$ 754	\$ 745	\$ 9	\$ 3,348	\$ 3,019	\$ 329

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The increase / (decrease) in deferred revenues recognized by geographic region for the three and nine months ended September 30, 2011 and 2010 was as follows (amounts in millions):

	Three months ended September 30,		Increase	Nine months ended September 30,		Increase
	2011	2010	(Decrease)	2011	2010	(Decrease)
Increase/(decrease) in deferred revenues recognized by geographic region:						
North America	\$ 72	\$ (41)	\$ 113	\$ 703	\$ 462	\$ 241
Europe	45	(53)	98	499	280	219
Asia Pacific	10	(18)	28	66	23	43
Total impact on consolidated net revenues	\$ 127	\$ (112)	\$ 239	\$ 1,268	\$ 765	\$ 503

As previously discussed, the Company's net revenues for the three and nine months ended September 30, 2011 were negatively impacted by a more focused slate in 2011, with the release of fewer key titles than in 2010, lower catalogue sales of games in the music and casual games genres, and no new releases from Blizzard during 2011 as compared to the release of *StarCraft II: Wings of Liberty* in July 2010. These negative impacts largely offset the positive impact of continued strong performance from the Call of Duty franchise and revenues generated from the World of Warcraft franchise. These factors impacted net revenues in all regions.

Consolidated net revenues for North America decreased for the three months ended September 30, 2011 but increased slightly for the nine months ended September 30, 2011 as compared to the same periods in 2010. The decrease for the three-month period is primarily due to the reasons discussed above, and partially offset by the increase in deferred revenues recognized.

Consolidated net revenues for Europe and Asia Pacific increased for the three and nine months ended September 30, 2011 as compared to the same periods in 2010. These increases were primarily due to the increase in deferred revenues recognized in both regions and the favorable effect of foreign currency exchange rates, partially offset by the reasons discussed above. Further, the release in the first quarter of 2011 of *Lego Star Wars III*, which we publish on behalf of Lucas Arts in Europe and certain countries in Asia Pacific, generated additional net revenues in the current year.

The increase in deferred revenues recognized for the three and nine months ended September 30, 2011 was primarily attributable to our Call of Duty and World of Warcraft franchises, particularly the success of the release of *Call of Duty: Black Ops* and of *World of Warcraft: Cataclysm*, each of which were released in the fourth quarter of 2010. Additionally, the launch of *StarCraft II: Wings of Liberty* in the third quarter of 2010 and the revenues from value-added services for *World of Warcraft* also contributed to the increase in deferred revenues recognized. Partially offsetting these impacts was the deferral of additional revenues to future periods due to the timing of releases and greater success of downloadable content packs associated with *Call of Duty: Black Ops* as compared to downloadable content packs associated with *Call of Duty: Modern Warfare 2* in the prior year. Also, there was a decrease in revenues recognized in both the three and nine month periods due to our more focused slate, with the release of few key titles in 2011 than in 2010, and lower catalogue sales of titles in the music and casual game genres.

### *Foreign Exchange Impact*



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Changes in foreign exchange rates are estimated to have a positive impact of approximately \$30 million and \$100 million on Activision Blizzard's net revenues for the three and nine months ended September 30, 2011, respectively, as compared to the same period in 2010. The change is primarily due to the weakening of the U.S. dollar relative to the British pound, the euro, and the Australian dollar in 2011 compared to 2010.

### *Net Revenues by Platform*

The following tables detail our net revenues by platform and as a percentage of total consolidated net revenues for the three and nine months ended September 30, 2011 and 2010 (amounts in millions):

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	Three months ended September 30, 2011	% of total consolidated net revenues	Three months ended September 30, 2010	% of total consolidated net revenues	Increase (Decrease)
<b>Platform net revenues:</b>					
Online subscriptions*	\$ 336	44%	\$ 289	39%	\$ 47
PC and other	45	6	73	10	(28)
<b>Console</b>					
Sony PlayStation 3	96	13	109	15	(13)
Sony PlayStation 2	4	1	6	1	(2)
Microsoft Xbox 360	144	19	127	16	17
Nintendo Wii	33	4	56	8	(23)
Total console	277	37	298	40	(21)
Handheld	19	3	23	3	(4)
Total platform net revenues	677	90	683	92	(6)
Distribution	77	10	62	8	15
Total consolidated net revenues	\$ 754	100%	\$ 745	100%	9

	Nine months ended September 30, 2011	% of total consolidated net revenues	Nine months ended September 30, 2010	% of total consolidated net revenues	Increase (Decrease)
<b>Platform net revenues:</b>					
Online subscriptions*	\$ 1,090	33%	\$ 890	29%	\$ 200
PC and Other	251	8	201	7	50
<b>Console</b>					
Sony PlayStation 3	676	20	595	20	81
Sony PlayStation 2	10	1	29	1	(19)
Microsoft Xbox 360	840	25	751	25	89
Nintendo Wii	185	6	267	9	(82)
Total console	1,711	51	1,642	55	69
Handheld	82	2	101	3	(19)
Total platform net revenues	3,134	94	2,834	94	300
Distribution	214	6	185	6	29
Total consolidated net revenues	\$ 3,348	100%	\$ 3,019	100%	329

\* Revenue from online subscriptions consists of revenue from all *World of Warcraft* products, including subscriptions, boxed products, expansion packs, licensing royalties, and value-added services.

The increase / (decrease) in deferred revenues recognized by platform for the three and nine months ended September 30, 2011 and 2010 was as follows (amounts in millions):

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	Three months ended September 30,		Increase	Nine months ended September 30,		Increase
	2011	2010	(Decrease)	2011	2010	(Decrease)
Increase/(decrease) in deferred revenues recognized by platform:						
Online subscriptions	\$ 62	\$ 7	\$ 55	\$ 185	\$ 13	\$ 172
PC and other	5	(141)	146	129	(81)	210
<b>Console</b>						
Sony PlayStation 3	18	5	13	417	317	100
Microsoft Xbox 360	36	26	10	440	425	15
Nintendo Wii	5	(9)	14	90	91	(1)
Total console	59	22	37	947	833	114
Total handheld	1		1	7		7
Total impact on consolidated net revenues	\$ 127	\$ (112)	\$ 239	\$ 1,268	\$ 765	\$ 503

Net revenues from online subscriptions increased for the three and nine months ended September 30, 2011 as compared to the same periods in 2010, primarily driven by the recognition of deferred revenues from the release of *World of Warcraft: Cataclysm* in December 2010 and increased sales of *World of Warcraft*'s value-added services.

Net revenues from PC and other decreased for the three months ended September 30, 2011 but increased for the nine months ended September 30, 2011 as compared to the same periods in 2010. The decrease for the three month period was due to the release of *StarCraft II: Wings of Liberty* in July 2010 compared to no key title releases on this platform during the third quarter of 2011. However, revenues for the nine months period benefitted from the recognition of the deferred revenues from *StarCraft II: Wings of Liberty* subsequent to its launch.

As previously discussed, a more focused slate in 2011 with the release of fewer key titles than in 2010, and lower catalogue sales of games in the music and casual games genres has resulted in lower overall net revenues for Activision Blizzard in the three and nine months ended September 30, 2011 in comparison to the prior year. Among the console platforms, the Nintendo Wii was the most significantly impacted by this change, with a decrease in revenues for the three and nine months ended September 30, 2011 as compared to same periods in 2010. For the Microsoft Xbox 360 and the Sony PlayStation 3, the continued success of the Call of Duty franchise, particularly revenues recognized in the three and nine months ended September 30, 2011 from *Call of Duty: Black Ops*, which was released in the fourth quarter of 2010, and the stronger performance of the content packs associated with *Call of Duty: Black Ops* as compared to the content packs associated with *Call of Duty: Modern Warfare 2*, had a greater overall positive impact on revenues year-over-year.

### *Costs and Expenses*

#### *Cost of Sales*

The following tables detail the components of cost of sales in dollars and as a percentage of total consolidated net revenues for the three and nine months ended September 30, 2011 and 2010 (amounts in millions):

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	Three months ended September 30, 2011	% of consolidated net revenues	Three months ended September 30, 2010	% of consolidated net revenues	Increase (Decrease)
Product costs	\$ 138	18%	\$ 194	27%	\$ (56)
MMORPG	59	8	61	8	(2)
Software royalties and amortization	24	3	61	8	(37)
Intellectual property licenses	16	2	33	4	(17)

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	Nine months ended September 30, 2011	% of net revenues	Nine months ended September 30, 2010	% of net revenues	Increase (Decrease)
Product costs	\$ 650	19%	\$ 765	25%	\$ (115)
MMORPG	181	5	168	6	13
Software royalties and amortization	133	4	211	7	(78)
Intellectual property licenses	69	2	105	3	(36)

Total cost of sales decreased for the three and nine months ended September 30, 2011 as compared to the same periods in 2010, primarily due to the increasing portion of our net revenues from products with higher margins, including products distributed through digital online channels, lower amortization from capitalized and deferred software development costs and intellectual property license expenses due to fewer title releases, and the decrease in amortization of intangible assets. The decreases were partially offset by Blizzard's increased investment in customer services for our subscribers and the increase in the deferred cost of sales which were recognized consistent with the increase in the deferred revenues recognized during the periods.

*Product Development (amounts in millions)*

	September 30, 2011	% of consolidated net revenues	September 30, 2010	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	\$ 133	18%	\$ 118	16%	\$ 15
Nine Months Ended	390	12	361	12	29

Product development costs increased for the three and nine months ended September 30, 2011 as compared to the same periods in 2010. The increase for the three month period was primarily due to the lower capitalization of costs related to future titles. The increase for the nine month period was primarily due to lower capitalization of costs related to future titles, higher stock-based compensation expense and continuing investment in content for the Call of Duty franchise that can be delivered via digital online channels. The increase in both periods was partially offset by the realization of cost savings from the 2011 Restructuring and a more focused release slate.

*Sales and Marketing (amounts in millions)*

	September 30, 2011	% of consolidated net revenues	September 30, 2010	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	\$ 115	15%	\$ 110	15%	\$ 5
Nine Months Ended	264	8	291	10	(27)

Sales and marketing expenses increased for the three months ended September 30, 2011 as compared to the same period in 2010 due to the investment to support the launches of *Skylanders: Spyro's Adventure*, *Call of Duty: Modern Warfare 3* and *Call of Duty: Elite* in the fourth quarter of 2011.

Sales and marketing expenses decreased for the nine months ended September 30, 2011 as compared to the same period in 2010 due to the reduction in the number of major title releases in 2011 as compared to the same period in 2010. This decrease was partially offset by our continued marketing support for the Call of Duty and World of Warcraft franchises.

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

	September 30, 2011	% of consolidated net revenues	September 30, 2010	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	\$ 104	14%	\$ 113	15%	\$ (9)
Nine Months Ended	333	10	253	8	80

General and administrative expenses decreased for the three months ended September 30, 2011 as compared to the same period in 2010, primarily due to lower stock-based compensation expenses and the favorable impact from foreign currency exchange rate movement. These decreases were partially offset by higher legal expenses.

General and administrative expenses increased for the nine months ended September 30, 2011 as compared to the same period in 2010, primarily due to higher legal expenses and the unfavorable impact from foreign currency exchange rate movement.

#### *Restructuring (amounts in millions)*

	September 30, 2011	% of consolidated net revenues	September 30, 2010	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	\$ 3	%\$	%	%\$	3
Nine Months Ended	24	1			24

As a result of the 2011 Restructuring, we incurred restructuring expenses during the three and nine months ended September 30, 2011. We have substantially completed the 2011 Restructuring and we do not expect to incur additional significant restructuring expenses relating thereto. Restructuring expenses during the three and nine months ended September 30, 2010 were immaterial. See Note 9 of the Notes to Condensed Consolidated Financial Statements for further details.

#### *Investment and other income, net (amounts in millions)*

	September 30, 2011	% of consolidated net revenues	September 30, 2010	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	\$ 3	%\$	14	2%	\$ (11)
Nine Months Ended	7		15		(8)

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Investment and other income, net decreased for the three and nine months ended September 30, 2011, as compared to the same periods in 2010, primarily due to a reduction of certain financial liabilities resulting in a gain recorded in the third quarter of 2010. The decreases were partially offset by higher yields generated from our cash and investment balances.

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

	September 30, 2011	% of Pretax income	September 30, 2010	% of Pretax income	Increase (Decrease)
Three Months Ended	\$ 17	10.7%	\$ 18	26.1%	\$ (1)
Nine Months Ended	325	24.8	229	26.0	96

The income tax expense of \$17 million for the three months ended September 30, 2011 reflected an effective tax rate of 10.7%. The effective tax rate of 10.7% for the three months ended September 30, 2011 differed from the statutory rate of 35.0%, primarily due to foreign income taxes levied at relatively lower rates, geographic mix in profitability, recognition of federal and



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California research and development credits, federal domestic production deductions and the beneficial impact from certain discrete items recognized in the quarter as we filed our tax returns.

For the nine months ended September 30, 2011, the tax rate was based on our projected annual effective tax rate for 2011, and also included certain discrete tax items recorded during the period. Our tax expense of \$325 million for the nine months ended September 30, 2011 reflected an effective tax rate of 24.8%, which was slightly lower than the effective tax rate of 26.0% for the nine months ended September 30, 2010, primarily due to the recognition of federal research and development credits and lower taxes in certain states.

The overall effective income tax rate for the year could be different from the effective tax rate for the three and nine months ended September 30, 2011 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 2011 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 lower statutory rates and/or higher than anticipated in our domestic region where taxes are levied at higher statutory rates.

The IRS is currently examining the Company's federal tax returns for the 2009 tax year. The Company also 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 the Company's business and results of operations in an interim period in which the matters are ultimately resolved.

**Liquidity and Capital Resources**

*Sources of Liquidity (amounts in millions)*

	At September 30, 2011	At December 31, 2010	Increase (Decrease)
Cash and cash equivalents	\$ 2,469	\$ 2,812	\$ (343)
Short-term investments	432	696	(264)
	\$ 2,901	\$ 3,508	\$ (607)
Percentage of total assets	24%	26%	

	Nine months ended September 30,		Increase (Decrease)
	2011	2010	
Cash flows provided by operating activities	\$ 102	\$ 383	\$ (281)
Cash flows provided by (used in) investing activities	210	(323)	533
Cash flows used in financing activities	(658)	(735)	77

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Effect of foreign exchange rate changes		3		30	(27)
Net decrease in cash and cash equivalents	\$	(343)	\$	(645)	\$ 302

### *Cash Flows Provided by Operating Activities*

The primary drivers of cash flows provided by operating activities have typically included the collection of customer receivables generated by the sale of our products and our subscription revenues, partially offset by payments to vendors for the manufacturing, distribution and marketing of our products, payments to third-party developers and intellectual property holders, tax liabilities, and payments to our workforce. A significant operating use of our cash relates to our continued focus on customer service for our subscribers, and investment in software development and intellectual property licenses. Cash flows provided by operating activities were lower for the nine months ended September 30, 2011 as compared to the same period in 2010. The lower cash from operating activities was primarily attributable to the increased use of cash in our operations, such as the payment of taxes, restructuring expenses, and operating expenses for which we had previously accrued.

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

The primary drivers of cash flows from investing activities have typically included capital expenditures, acquisitions and the net effect of purchases and sales/maturities of short-term investments. Cash flows provided by investing activities during the nine months ended September 30, 2011 mainly reflected the purchase of \$325 million of short-term investments, capital expenditures of \$47 million, primarily for property and equipment, and the receipt of \$603 million in proceeds from the maturities of investments, the majority of which consisted of U.S. treasury and government sponsored agency debt securities. Cash flows provided by investing activities were higher for the nine months ended September 30, 2011 as compared to the same period in 2010. The higher cash flows from investing activities were primarily attributable to increased proceeds from the maturities of our investments and decreased purchases of short-term investments.

*Cash Flows Used in Financing Activities*

The primary drivers of cash flows used in financing activities have historically related to transactions involving our common stock, including the issuance of shares of common stock to employees, payment of dividends and the repurchase of our common stock. We have not utilized debt financing as a source of cash flows. Cash flows used in financing activities during the nine months ended September 30, 2011 primarily reflected payment of a cash dividend and dividend equivalents totaling \$194 million to holders of our common stock and restricted stock units and the repurchase of 45 million shares of our common stock for \$502 million under the 2011 Stock Repurchase Program. Under the 2011 Stock Repurchase Program, we may repurchase up to \$1.5 billion of our common stock, on terms and conditions to be determined by the Company, until the earlier of March 2012 and a determination by the Board of Directors to discontinue the program. It also reflected the purchase of 1.8 million shares of our common stock for \$22 million under the stock repurchase program authorized by our Board of Directors on February 10, 2010, which expired on December 31, 2010. On February 9, 2011, the Board of Directors declared a cash dividend of \$0.165 per common share to be paid on May 11, 2011 to shareholders of record as of March 16, 2011. On May 11, 2011, we made a cash dividend payment of \$192 million to such shareholders. On August 12, 2011, we made dividend equivalent payments of \$2 million related to this cash dividend to the holders of restricted stock units. The repurchases and dividend payments were partially offset by \$39 million of proceeds from the issuance of shares of our common stock to employees in connection with stock option exercises. Cash flows used in financing activities were lower for the nine months ended September 30, 2011 as compared to the same period in 2010, primarily due to decreased share repurchase activities during the nine months ended September 30, 2011.

*Other Liquidity and Capital Resources*

In addition to cash flows provided by operating activities, our primary source of liquidity was \$2.9 billion of cash and cash equivalents and short-term investments at September 30, 2011. With our cash and cash equivalents and expected cash flows provided by operating activities, we believe that we have sufficient liquidity to meet daily operations in the foreseeable future. We also believe that we have sufficient working capital (\$2.8 billion at September 30, 2011) to finance our operational requirements for at least the next twelve months, including purchases of inventory and equipment, the development, production, marketing and sale of new products, the provision of customer service for our subscribers, the acquisition of intellectual property rights for future products from third parties, and to fund our stock repurchase program and dividends.

As of September 30, 2011, the amount of cash and cash equivalents held outside of the U.S. by our foreign subsidiaries was \$1.4 billion, compared with \$1.2 billion as of December 31, 2010. If these funds are needed for our operations in the U.S., we would be required to accrue and pay 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.

*Capital Expenditures*

For the year ending December 31, 2011, we anticipate total capital expenditures of approximately \$95 million, primarily for property and equipment. Through the first nine months of 2011, we made aggregate capital expenditures of \$47 million.

**Off-balance Sheet Arrangements**

At September 30, 2011 and December 31, 2010, Activision Blizzard had no significant relationships with unconsolidated entities or financial parties, such as entities 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.

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**Financial Disclosure**

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

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

**Critical Accounting Policies and Estimates**

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

- Revenue Recognition

*Revenue Arrangements with Multiple Deliverables*

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On January 1, 2011, we adopted amendments to an accounting standard related to revenue recognition for arrangements with multiple deliverables (which standard, as amended, is referred to herein as the new accounting principles). The new accounting principles establish a selling price hierarchy for determining the selling price of a deliverable and require the application of the relative selling price method to allocate the arrangement consideration to each deliverable in a multiple deliverables revenue arrangement. Certain of our revenue arrangements have multiple deliverables and, as such, are accounted for under the new accounting principles. These revenue arrangements include product sales consisting of both software and hardware deliverables (such as peripherals or other ancillary collectors items sold together with physical boxed software) and our sales of *World of Warcraft* boxed products, expansion packs and value-added services, each of which is considered with the related subscription services for these purposes. Our assessment of deliverables and units of accounting does not change under the new accounting principles.

Pursuant to the guidance of ASU 2009-13, when a revenue arrangement contains multiple elements, such as hardware and software products, licenses and/or services, we allocate revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its vendor-specific-objective-evidence (VSOE) if it is available,

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third-party evidence ( TPE ) if VSOE is not available, or best estimated selling price ( BESP ) if neither VSOE nor TPE is available. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy. If the arrangement contains more than one software deliverable, the arrangement consideration allocated to the software deliverables as a group is then allocated to each software deliverable using the guidance for recognizing software revenue.

As noted above, when neither VSOE nor TPE is available for a deliverable, we use BESP. We do not have significant revenue arrangements that require BESP for the three or nine months ended September 30, 2011. The inputs we use to determine the selling price of our significant deliverables include the actual price charged by the Company for a deliverable that the Company sells separately, which represents the VSOE, and the wholesale prices of the same or similar products, which represents TPE. The pattern and timing of revenue recognition for deliverables and allocation of the arrangement consideration did not change upon the adoption of the new accounting principles. Also, we do not expect the adoption of the new accounting principles to have a material effect on our financial statements in the periods after our initial adoption.

*Product Sales*

We recognize revenue from the sale of our products upon the transfer of title and risk of loss to our customers and once any performance obligations have been completed. Certain products are sold to customers with a street date (*i.e.*, the earliest date these products may be sold by retailers). For these products, we recognize revenue on the later of the street date and the sale date. Revenue from product sales is recognized after deducting the estimated allowance for returns and price protection.

For our software products with online functionality, we evaluate whether those features or functionality are more than an inconsequential separate deliverable in addition to the software product. This evaluation is performed for each software product and any online transaction, such as a digital download of a title or product add-ons, when the products are released.

When we determine that a software title contains online functionality that constitutes a more than inconsequential separate service deliverable in addition to the product, principally because of its importance to gameplay, we consider our performance obligations for this title to extend beyond the sale of the game. VSOE of fair value does not exist for the online functionality, as we do not separately charge for this component of the title. As a result, we recognize all of the software-related revenue from the sale of the title ratably over the estimated service period, which is estimated to begin the month after the later of the sale date and the street date of the title. In addition, we initially defer the costs of sales for the title (excluding intangible asset amortization), and recognize the costs of sales as the related revenues are recognized. Cost of sales includes manufacturing costs, software royalties and amortization, and intellectual property licenses costs.

We recognize revenues from *World of Warcraft* boxed product, expansion packs and value-added services, in each case with the related subscription service revenue, ratably over the estimated service periods beginning upon activation of the software and delivery of the related services. Revenues attributed to the sale of *World of Warcraft* boxed software and related expansion packs are classified as product sales and revenues attributable to subscriptions and other value-added services are classified as subscription, licensing and other revenues.

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Revenues for software products with more-than-inconsequential separate service deliverables and *World of Warcraft* products are recognized over the estimated service periods, which range from a minimum of five months to a maximum of less than a year.

For our software products with features we consider to be incidental to the overall product offering and an inconsequential deliverable, such as products which provide limited online features at no additional cost to the consumer, we recognize the related revenue from them upon the transfer of title and risk of loss of the product to our customer.

With respect to online transactions, such as online downloads of titles or product add-ons that do not include a more-than-inconsequential separate service deliverable, revenue is recognized when the fee is paid by the online customer to purchase online content, the product is available for download and is activated for gameplay. In addition, persuasive evidence of an arrangement must exist and collection of the related receivable must be probable.



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Sales incentives and other consideration given by us to our customers, such as rebates and product placement fees, are considered adjustments of the selling price of our products and are reflected as reductions to revenue. Sales incentives and other consideration that represent costs incurred by us for assets or services received, such as the appearance of our products in a customer's national circular ad, are reflected as sales and marketing expenses when the benefit from the sales incentive is separable from sales to the same customer and we can reasonably estimate the fair value of the benefit.

- Accounting for Income Taxes

We record a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with FASB income tax guidance (ASC Topic 740), the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. We record a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with the tax effects of the deferred tax liabilities, will be sufficient to fully recover the remaining deferred tax assets. In the event that all or part of the net deferred tax assets are determined not to be realizable in the future, an adjustment to the valuation allowance would be charged to earnings in the period such determination is made. The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of ASC Topic 740 and other complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on our business and results of operations in an interim period in which the uncertainties are ultimately resolved.

Further, the Company's provision for taxes can fluctuate if estimated earnings are lower than anticipated in our foreign region with a lower tax rate and/or higher than anticipated in our domestic region with higher tax rates.

During the nine months ended September 30, 2011, there were no significant changes in the following policies, which we also consider to be critical in fully understanding and evaluating our reported financial results. 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, 2010 for a more complete discussion of our critical accounting policies and estimates, which also includes the areas listed below.

- Allowances for Returns, Price Protection, Doubtful Accounts, and Inventory Obsolescence
- Software Development Costs and Intellectual Property Licenses
- Fair Value Estimates
- Goodwill and Intangible Assets Impairment Assessments

- Stock-Based Compensation

### **Recently Issued Accounting Pronouncements**

In May 2011, the FASB issued an update to the accounting rules for fair value measurement to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards ( IFRS ). This update changes certain fair value measurement principles and enhances the disclosure requirements for fair value measurements. This update does not extend the use of fair value accounting, but provides guidance on how it should be applied where its use is already required or permitted by other standards within U.S. GAAP or IFRS. This update is effective for interim and annual periods beginning after December 15, 2011 and is applied prospectively. Early adoption is prohibited. We are currently evaluating the impact, if any, of this new accounting update on our consolidated financial statements.

In June 2011, the FASB issued an update to the accounting on comprehensive income to increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. GAAP and IFRS. This update requires that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. Further, this update does not affect how earnings per share is calculated or presented. This update is effective for interim and annual periods beginning after December 15, 2011 and is

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applied retrospectively. Early adoption is permitted. We do not expect that the adoption of this guidance will have a material impact on our consolidated financial statements.

In September 2011, the FASB issued an update to the authoritative guidance related to goodwill impairment testing. This update gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount before performing the two-step test mandated prior to the update. If, after assessing the totality of events and circumstances, a company determines it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then it must perform the two-step test. Otherwise, a company may skip the two-step test. Companies are not required to perform the qualitative assessment and may, instead proceed directly to the first step of the two-part test. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. While we are in the process of assessing whether we will early adopt this update, we currently do not expect that adopting it will have a material impact on our consolidated financial statements.

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

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

**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. Currency volatility is monitored throughout the year. 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 swaps and forward contracts with maturities of twelve months or less. Vivendi is our principal counterparty and the risks of counterparty non-performance associated with these contracts are not considered to be material. We expect to continue to use economic hedge programs in the future to reduce foreign exchange-related volatility if it is determined that such hedging activities are appropriate to reduce risk. We do not hold or purchase any foreign currency contracts for trading or speculative purposes. All foreign currency economic hedging transactions are backed, in amount and by maturity, by an identified economic underlying item. Our foreign exchange forward contracts are not designated as hedging instruments and are accounted for as derivatives whereby the fair value of the contracts are reported as other current assets or other current liabilities in our condensed consolidated balance sheets, and the associated gains and losses from changes in fair value are reported in investment and other income, net and general and administrative expense in the condensed consolidated statements of operations.

The gross notional amount of outstanding foreign exchange swaps was \$61 million and \$138 million at September 30, 2011 and December 31, 2010, respectively. A pre-tax net unrealized loss of less than a million and loss of \$1 million for the three months ended September 30, 2011 and 2010, respectively, and a pre-tax net unrealized loss of less than a million and unrealized gain of \$3 million for the nine months ended September 30, 2011 and 2010, respectively, resulted from the foreign exchange contracts and swaps with Vivendi and were recognized in the condensed consolidated statements of operations.

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The consolidated statements of operations are translated into U.S. dollars at exchange rates indicative of market rates during each applicable period. 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. In the absence of the hedging activities described above, as of September 30, 2011, a hypothetical adverse foreign currency exchange rate movement of 10% would have resulted in potential declines in our net income of approximately \$70 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. We do not use derivative financial instruments to manage interest rate risk in our investment portfolio. Our investment portfolio consists primarily of debt instruments with high credit quality and relatively short average maturities and money market funds that invest in AAA-rated government-backed securities. 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

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fluctuations than a portfolio of longer term securities. At September 30, 2011, our \$2.47 billion of cash and cash equivalents were comprised primarily of money market funds. At September 30, 2011, our \$432 million of short-term investments included \$391 million of U.S. treasury and government sponsored agency debt securities and \$41 million of restricted cash. We had \$25 million in auction rate securities at fair value classified as long-term investments at September 30, 2011. The Company has determined that, based on the composition of our investment portfolio as of September 30, 2011, there was no material interest rate risk exposure to the Company's consolidated financial position, results of operations or cash flows 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 September 30, 2011, the end of the period covered by this report. Based on this evaluation, the principal executive officer and principal financial officer concluded that, at September 30, 2011, 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.

**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**

*Legal Proceedings*

After concluding an internal human resources inquiry into breaches of contract and insubordination by two senior employees at Infinity Ward, the Company terminated its employment of Jason West and Vince Zampella on March 1, 2010. On March 3, 2010, West and Zampella filed a complaint against the Company in Los Angeles Superior Court for breach of contract and wrongful termination, among other claims. In their complaint, West and Zampella alleged damages, including punitive damages, in excess of \$36 million and declaratory relief, an amount they have since significantly increased during discovery. On April 9, 2010, the Company filed a cross complaint against West and Zampella, asserting claims for breach of contract and fiduciary duty, among other claims. The Company is seeking damages and declaratory relief.

In addition, 38 current and former employees of Infinity Ward filed a complaint against the Company in Los Angeles Superior Court on April 27, 2010 (*Alderman et al. v. Activision Publishing, Inc. et al.*). An amended complaint was filed on July 8, 2010, which added seven additional plaintiffs. On October 5, 2010, five plaintiffs, all current employees of Infinity Ward, filed dismissals without prejudice. There are currently 40 plaintiffs in the case. The plaintiffs have asserted claims for breach of contract, violation of the Labor Code of the State of California, conversion and other claims. In their complaint, the plaintiffs claimed that the Company failed to pay them bonuses and other compensation allegedly owed to them in an amount at least between \$75 million and \$125 million, plus punitive damages, an amount they have since increased in discovery responses to

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approximately \$300 million, plus punitive damages. On October 12, 2010, the court consolidated this matter with the West and Zampella matter.

On January 18, 2011, the court granted the Company's motion to amend its cross complaint against West and Zampella to add allegations with respect to them and to add Electronic Arts, Inc. as a party. On January 31, 2011, the case was transferred to the complex division.

Some of the parties have filed, and are likely to file, additional pre-trial motions, including dispositive motions, and discovery continues in the ordinary course of the litigation. The court has set a trial date of May 7, 2012.

The Company has accrued, and will continue to accrue, appropriate amounts related to bonuses and other monies allegedly owed in connection with this matter. Due to the inherent uncertainties of litigation, other potential outcomes are reasonably possible, including outcomes which are above the amount of the accrual. The Company does not expect this lawsuit to have a material impact on the Company's business, financial condition, results of operation or liquidity. However, an unfavorable resolution of this lawsuit above the amount of the accrual could have a material adverse effect on the Company's business and results of operations in an interim period in which the lawsuit is ultimately resolved.

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

**Item 1A. Risk Factors**

The reader should carefully consider, in connection with the other information in this report, the factors discussed in Part I, Item 1A: Risk Factors of the Company's 2010 Annual Report on Form 10-K. These factors could cause our actual results to differ materially from those stated in forward-looking statements contained in this document and elsewhere.

**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 September 30, 2011, the total number of shares purchased as part of our publicly announced repurchase programs, and the approximate dollar value of shares that may yet be purchased under our stock repurchase program at September 30, 2011.

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<b>Period</b>	<b>Total number of shares purchased (1)</b>	<b>Average price paid per share (\$)</b>	<b>Total number of shares purchased as part of publicly announced plans or programs (1)</b>	<b>Approximate dollar value of shares that may yet be purchased under the plans or programs (\$)</b>
July 1, 2011 July 31, 2011		\$		\$ 1,020,884,422
August 1, 2011 August 31, 2011				1,020,884,422
September 1, 2011 September 30, 2011	1,991,457	11.61	1,991,457	997,758,050
Total	1,991,457	11.61	1,991,457	

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(1) These purchases were made pursuant to the stock repurchase program (the 2011 Stock Repurchase Program ) approved by our Board of Directors on February 3, 2011 and announced on February 9, 2011 pursuant to which we may repurchase up to \$1.5 billion of our common stock from time to time on the open market or in private transactions, including structured or accelerated transactions, on terms and conditions to be determined by the Company, until the earlier of March 31, 2012 and a determination by the Board of Directors to discontinue the repurchase program. In addition to the repurchases in the table, in October 2011, we settled the purchase of 0.5 million shares of our common stock that we had committed to repurchase in September 2011 pursuant to the 2011 Stock Repurchase Program for \$6 million.



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**Item 5. Other Information**

*10b5-1 Stock Trading Plan*

The Company's directors and employees may, at a time they are not in possession of material non-public information, enter into plans ( Rule 10b5-1 Plans ) to purchase or sell shares of our common stock that satisfy the requirements of Exchange Act Rule 10b5-1. Rule 10b5-1 permits trading on a pre-arranged, automatic-pilot basis, subject to certain conditions, including that the person for whom the plan is created (or anyone else aware of material non-public information acting on such person's behalf) not exercise any subsequent influence regarding the amount, price and dates of transactions under the plan. In addition, any such plan of the Company's directors and employees is required to be established and maintained in accordance with the Company's Policy on Establishing and Maintaining 10b5-1 Trading Plans .

Rule 10b-5-1 Plans permit persons whose ability to purchase or sell our common stock may otherwise be substantially restricted (by quarterly and special stock-trading blackouts and by their possession from time to time of material nonpublic information) to engage in pre-arranged trading. Trades under a Rule 10b5-1 Plan by our directors and employees are not necessarily indicative of their respective opinions of our current or potential future performance at the time of the trade. Trades by our directors and executive officers pursuant to a Rule 10b5-1 Plan will be disclosed publicly through Form 144 and Form 4 filings with the SEC, in accordance with applicable laws, rules and regulations.

On September 15, 2011, Robert A. Kotick, our Chief Executive Officer, entered into a Rule 10b5-1 Plan. This Rule 10b5-1 Plan will expire no later than November 15, 2012 and, pursuant to this plan, if and when the price of our common stock is equal to or greater than various minimum price thresholds specified in the plan, certain shares covered by the Rule 10b5-1 Plan, up to an aggregate maximum of approximately 4.8 million shares, will be sold on the open market at then-prevailing market prices.

**Item 6. Exhibits**

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

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**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: November 8, 2011

ACTIVISION BLIZZARD, INC.

/s/ THOMAS TIPPL  
Thomas Tippel  
*Chief Operating Officer, 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.*

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**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Exhibit</b>
3.1	Amended and Restated Certificate of Incorporation of Activision Blizzard, Inc., dated July 9, 2008 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed July 15, 2008).
3.2	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Activision Blizzard, Inc., dated August 15, 2008 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed August 15, 2008).
3.3	Amended and Restated By-Laws of Activision Blizzard, Inc., as amended and restated as of February 2, 2010 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed February 5, 2010).
10.1*	Release Agreement, dated as of August 1, 2011, between George Rose and the Company.
10.2*	Consulting Agreement, dated as of August 1, 2011, among George Rose, Suffolk Ventures LLC and the Company.
31.1	Certification of Robert A. Kotick pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Thomas Tipll pursuant to Rule 13a-14(a) under the Securities and Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Robert A. Kotick pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Thomas Tipll 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.

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

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at September 30, 2011 and December 31, 2010, (ii) Condensed Consolidated Statements of Operations for the nine months ended September 30, 2011 and September 30, 2010, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and September 30, 2010; (iv) Condensed Consolidated Statement of Changes in Shareholders' Equity for the nine months ended September 30, 2011; and (v) Notes to Condensed Consolidated Financial Statements.

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