

Activision Blizzard, Inc.
Form 10-K
March 01, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2009

OR

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

**For the transition period from _____ to _____
Commission File Number 1-15839**

ACTIVISION BLIZZARD, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

95-4803544

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

3100 Ocean Park Blvd., Santa Monica, CA

(Address of principal executive offices)

90405

(Zip Code)

Registrant's telephone number, including area code: **(310) 255-2000**

Securities registered pursuant to Section 12(b) of the Act:

Title of each Class
Common Stock, par value \$.000001 per share

Name of Each Exchange on Which Registered
The NASDAQ Global Select Market

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Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated Filer Accelerated Filer Non-accelerated Filer Smaller Reporting Company

(Do not check if a smaller reporting company)

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

The aggregate market value of the registrant's Common Stock held by non-affiliates on June 30, 2009 as reported on the NASDAQ was \$7,039,447,050.

The number of shares of the registrant's Common Stock outstanding at February 22, 2010 was 1,249,909,250.

Documents Incorporated by Reference

Portions of the registrant's definitive Proxy Statement, to be filed with the Securities and Exchange Commission with respect to the 2010 Annual Meeting of Shareholders, are incorporated by reference into Part III of this Annual Report.

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PART I

EXPLANATORY NOTE

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

CAUTIONARY STATEMENT

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

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.

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Item 1. BUSINESS

Overview

Activision Blizzard is a worldwide online, personal computer ("PC"), console, and handheld game publisher. Through Activision Publishing, Inc. ("Activision"), we are a leading international publisher of interactive software products and peripherals. Activision develops and publishes video games on various consoles, handheld platforms and the PC platform through internally developed franchises and license agreements. Activision currently offers games that operate on the Sony Computer Entertainment Inc. ("Sony") PlayStation 2 ("PS2"), Sony PlayStation 3 ("PS3"), Nintendo Co. Ltd. ("Nintendo") Wii ("Wii"), and Microsoft Corporation ("Microsoft") Xbox 360 ("Xbox 360") console systems; the Sony PlayStation Portable ("PSP") and Nintendo Dual Screen ("NDS") handheld devices; the PC; the Apple iPhone ("iPhone"); and the new handheld game system Nintendo DSi. Through Blizzard Entertainment, Inc. ("Blizzard"), we are the leader in terms of subscriber base and revenues generated in the subscription-based massively multiplayer online role-playing game ("MMORPG") category. Blizzard internally develops and publishes PC-based computer games and maintains its proprietary online-game related service, Battle.net.

Our Activision business involves the development, marketing, and sale of products directly, by license, and through our affiliate label program with certain third-party publishers. Activision's products cover diverse game categories including action/adventure, action sports, racing, role-playing, simulation, first-person action, music, and strategy. Activision's target customer base ranges from casual players to core gamers, and children to adults. During 2009, Activision released *Call of Duty: Modern Warfare 2*, *Guitar Hero V*, *DJ Hero*, *Band Hero*, *Tony Hawk: Ride*, and *PROTOTYPE* and continued to publish licensed products, with titles such as *Monsters vs. Aliens*, *Ice Age: Dawn of the Dinosaurs*, *Bakugan Battle Brawlers*, *Transformers: Revenge of the Fallen*, *X-Men Origins: Wolverine*, *Marvel Ultimate Alliance 2*, and several other titles. Activision is currently developing sequels to the Guitar Hero and Call of Duty franchises, *True Crime*, an action thriller through United Front Games, *Blur* through Bizarre Creations for the racing genre and *Singularity* a first person action game through Raven Software, among other titles.

Our Blizzard business involves the development, marketing, sales and support of role playing action and strategy games. Blizzard also develops, hosts, and supports its online subscription-based games in the MMORPG category. Blizzard is the development studio and publisher best known as the creator of *World of Warcraft* and the multiple award winning Diablo, StarCraft, and World of Warcraft franchises. Blizzard distributes its products and generates revenues worldwide through various means, including: subscriptions (which consist of fees from individuals playing *World of Warcraft*, including from sales of prepaid-cards and other value added services); retail sales of physical "boxed" products; electronic download sales of PC products; and licensing of software to third-party companies that distribute *World of Warcraft* in Russia, China and Taiwan. Blizzard has released two expansion packs to *World of Warcraft*; *World of Warcraft: The Burning Crusade* and *World of Warcraft: Wrath of the Lich King*. Blizzard is currently developing new games, including a new expansion pack to the World of Warcraft franchise, *Cataclysm*, *StarCraft II: Wings of Liberty*, which will be released with the new and improved Battle.net, and sequels to the Diablo franchise.

Our distribution business 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 Company

Activision, Inc. was originally incorporated in California in 1979 and was reincorporated in Delaware in December 1992. In June 2000, Activision, Inc. reorganized into a holding company organizational structure. As described in the explanatory note above, Activision, Inc. consummated a

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business combination with Vivendi Games during the year ended December 31, 2008 and was renamed Activision Blizzard, Inc. Activision Blizzard is a public company traded on the NASDAQ under the ticker symbol "ATVI."

Our Strategy

Our objective is to continue to be a worldwide leader in the development, publishing, and distribution of quality interactive entertainment software, peripheral products, and online games that deliver a highly satisfying consumer entertainment experience. Through Blizzard, we plan to maintain and build upon our worldwide leadership position of online subscription-based games in the MMORPG category.

Continue to Improve Profitability. We continually strive to manage risk and increase our operating leverage and efficiency with the goal of increased profitability. We believe that the key factors affecting our future profitability will be the success rate of our core properties, proven franchises and genres, and our ability to leverage the continued growth of online and digital revenue opportunities.

Create Shareholder Value. We continue to focus and enhance shareholder return in growing operating margin, maintaining a strong balance sheet, and producing strong cash flow generation.

Grow Through Continued Strategic Acquisitions and Alliances. We intend to continue to evaluate the expansion of our resources and intellectual properties library through acquisitions, strategic relationships, and key license transactions. We will also continue to evaluate opportunities to increase our proven development expertise through the acquisition of, or investment in, selected experienced software development firms.

Competition

We compete for the leisure time and discretionary spending of consumers with other video game companies, as well as with other providers of different forms of entertainment, such as motion pictures, television, social networking, online casual entertainment and music.

The interactive entertainment industry is intensely competitive and new interactive entertainment software products and platforms are regularly introduced. Our competitors vary in size from small companies with limited resources to large corporations with greater financial, marketing, and product development resources than we have. Due to their different focuses and allocation of resources, certain of our competitors spend more money and time on developing and testing products, undertake more extensive marketing campaigns, adopt more aggressive pricing policies, pay higher fees to licensors for desirable motion picture, television, sports and character properties, and pay more to third-party software developers. In addition, competitors with large product lines and popular titles typically have greater leverage with retailers, distributors, and other customers who may be willing to promote titles with less consumer appeal in return for access to such competitor's most popular titles. We believe that the main competitive factors in the interactive entertainment industry include: product features and playability; brand name recognition; compatibility of products with popular platforms; access to distribution channels; quality of products; ease of use; price; marketing support; and quality of customer service.

We compete primarily with other publishers of personal computer and video game console interactive entertainment software. In addition to third-party software competitors, integrated video game console hardware and software companies such as Sony, Nintendo, and Microsoft compete directly with us in the development of software titles for their respective platforms. In addition, certain major media companies, such as Walt Disney Company and Time Warner, Inc., which have been investing in video game products, have increased competition within the industry. Further, a number of software publishers have developed and commercialized, or are currently developing, online games for

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use by consumers over the Internet, and we expect new competitors to continue to emerge in the MMORPG category.

Employees

We had approximately 7,000 total full-time and part-time employees at December 31, 2009. At December 31, 2009, 191 of our full-time employees were subject to term employment agreements with us. These agreements generally commit the employees to employment terms of between one and five years from the commencement of their respective agreements. Most of the employees subject to these agreements are executive officers or key members of the product development, sales, or marketing divisions. These individuals perform services for us as executives, directors, producers, associate producers, computer programmers, game designers, sales directors, or marketing product managers. In our experience, entering into employment agreements with these employees reduces our turnover during the development, production, and distribution phases of our entertainment software products and allows us to plan more effectively for future development and marketing activities.

A small number of our employees in France, Spain and Germany are subject to collective bargaining agreements. To date, we have not experienced any labor-related work stoppages.

Intellectual Property

Like other entertainment companies, our business is significantly based on the creation, acquisition, exploitation and protection of intellectual property. Some of this intellectual property is in the form of software code, patented technology, and other technology and trade secrets that we use to develop our games and to make them run properly. Other intellectual property is in the form of audio-visual elements that consumers can see, hear and interact with when they are playing our games.

We develop products from wholly-owned intellectual properties we create within our own studios. We also acquire the rights to include proprietary intellectual property in our products through acquisitions. In addition, we also obtain intellectual property through licenses and service agreements. These agreements typically limit our use of the licensed rights in products for specific time periods. In addition, our products that play on game consoles and handheld platforms include technology that is owned by the console, or wireless device manufacturer, and licensed non-exclusively to us for use. We also license technology from providers other than console manufacturers. While we may have renewal rights for some licenses, our business and the justification for the development of many of our products is dependent on our ability to continue to obtain the intellectual property rights from the owners of these rights on reasonable terms and at reasonable rates.

We actively engage in enforcement and other activities to protect our intellectual property. We typically own the copyright to the software code, as well as the brand or title name trademark under which our products are marketed. We register copyrights and trademarks in the United States and other countries as appropriate.

We often distribute our PC products using copy protection technology or other technological protection measures to prevent piracy and the use of unauthorized copies of our products. In addition, console manufacturers typically incorporate technological protections and other security measures in their consoles in an effort to prevent the use of unlicensed product. We are actively engaged in enforcement and other activities to protect against unauthorized copying and piracy, including monitoring online channels for distribution of pirated copies, and participating in various enforcement initiatives, education programs and legislative activity around the world.

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Operating Segments

We operate three operating segments: (i) Activision Publishing publishing interactive entertainment software and peripherals which includes Activision Publishing, Inc. and studios, assets, and titles previously included in Vivendi Games' Sierra Entertainment operating segment prior to the Business Combination ("Activision"), (ii) Blizzard Entertainment, Inc. and its subsidiaries publishing real-time strategy, role-playing PC games and online subscription-based games in the MMORPG category ("Blizzard"), and (iii) Activision Blizzard Distribution distribution of interactive entertainment software and hardware products ("Distribution"). These three operating segments form Activision Blizzard's core operations. Activision Blizzard's non-core exit operations ("Non-Core") represent legacy Vivendi Games' divisions or business units we have exited, divested or wound down as part of our restructuring and integration efforts as a result of the Business Combination, but that do not meet the criteria for separate reporting of discontinued operations. Prior to July 1, 2009, Non-Core activities were managed as a stand-alone operating segment; however, in light of the minimal activities and insignificance of Non-Core activities, as of that date we ceased their management as a separate operating segment and consequently we are no longer providing separate operating segment disclosure and have reclassified our prior periods' segment presentation so that it conforms to the current periods' presentation. In accordance with the provisions of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") regarding disclosures about segments of an enterprise and related information, all prior period segment information has been restated to conform to this new segment presentation.

Activision Publishing Segment ("Activision") Business Overview

Strategy

Create, Acquire, and Maintain Strong Franchises. Activision focuses on development and publishing activities principally for products that are, or have the potential to become, franchises with sustainable mass consumer appeal and recognition. It is our experience that these products can then serve as the basis for sequels, prequels, and related new products that can be released over an extended period of time. We believe that the publishing and distribution of products based on proven franchises enhances predictability of revenues and the probability of high unit volume sales and operating profits. We own a number of successful intellectual properties such as the Call of Duty and Guitar Hero franchises. We intend to continue to develop owned franchises in the future. We have also entered into a series of strategic relationships with the owners of intellectual properties pursuant to which we have acquired the rights to publish products based on franchises such as DreamWorks' Animation LLC ("DreamWorks"), Harrah's Entertainment, Inc. ("Harrah"), Hasbro Properties Group ("Hasbro"), MGM Interactive and EON Productions Ltd. ("MGM & EON"), Mattel, Inc. ("Mattel"), Marvel Entertainment, Inc. ("Marvel"), and professional skateboarder Tony Hawk, to develop video games based on their intellectual property.

Execute Disciplined Product Selection and Development Processes. The success of our publishing business depends, in significant part, on our ability to develop high quality games that will generate high unit volume sales. Our publishing units have implemented a formal control process for the selection, development, production, and quality assurance of our products. We apply this process, which we refer to as the "Greenlight Process," to all of our products, whether externally or internally developed. The Greenlight Process includes in-depth reviews of each project at several important stages of development by a team that includes many of our highest-ranking operating managers and coordination between our sales and marketing personnel and development staff at each step in the process.

We develop our products using a combination of our internal development resources and external development resources acting under contract with us. We typically select our external developers based

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on their track records and expertise in producing products in the same category. One developer will often produce the same game for multiple platforms and will produce sequels to the original game. We believe that selecting and using development resources in this manner allows us to leverage the particular expertise of our internal and external development resources, which we believe enhances the quality of our products and timing of releases.

Create and Maintain Diversity in Product Mix, Platforms, and Markets. We believe that maintaining a diversified mix of products can reduce our operating risks and enhance profitability. Therefore, we develop and publish products spanning a wide range of genres, including action/adventure, action sports, racing, role-playing, simulation, first-person action, music-based gaming, and strategy. We also develop products designed for target audiences ranging from casual players to core gamers, children to adults, and mass-market consumers to "value" buyers who seek budget-priced software. Presently, the majority of products that we develop, publish, and distribute operate on the PS3, Xbox 360, and Wii console systems, the PSP, NDS and the iPhone, and the PC. We offer games with localized content in different geographies and both online and offline. We typically offer our products for use on multiple platforms to reduce the risks associated with any single platform, leverage our costs over a larger installed hardware base, and increase unit sales.

Products

Activision has been best known for our action/adventure, action sports, role-playing, simulation, first-person action, and music video game products. We have had long-term success in the first person action categories through the Call of Duty original intellectual property, including the latest release, *Call of Duty: Modern Warfare 2*, and we plan on continuing to develop this franchise. Call of Duty has achieved approximately \$3 billion life-to-date revenue. We are a leading company in the music-based gaming genre with the Guitar Hero franchise, which combines interactive software with hardware peripherals. We expanded the franchise with the additions of *DJ Hero* and *Band Hero* releases during 2009. *Band Hero* is accompanied by hardware peripherals consisting of a guitar, drum, and microphone, and *DJ Hero* is accompanied with a turntable peripheral. We have been successful in the superheroes category with our releases of titles based on the Spider-Man and X-Men properties, including the 2009 release of *Marvel Ultimate Alliance 2* and *X-Men Origins: Wolverine*. Our Tony Hawk franchise has been a leader in the action sports genre, and we have a recently released game, *Tony Hawk: Ride*, to continue the strength of this franchise with an innovative skateboard controller. We have continued our success with the DreamWorks animated movie titles, with the 2009 release of *Monsters vs. Aliens*. We have expanded our portfolio in the action/adventure genre with the launch of a new internally developed intellectual property, *PROTOTYPE*. Further, we released *Bakugan Battle Brawlers*, which is based on the top-rated television series and a best-selling toy.

In 2010, we plan to release a diversified lineup of games based on Activision's best-selling franchises including Call of Duty, Guitar Hero, and Tony Hawk, together with other well-known titles such as True Crime, Spider-Man, and Bakugan, and a select number of new intellectual property franchises such as *Blur* and *Singularity*.

Product Development and Support

Activision develops and produces titles using a model in which a core group of creative, production, and technical professionals, in coordination with our marketing and finance departments, have responsibility for the entire development and production process including the supervision and coordination of internal and external resources. This team assembles the necessary creative elements to complete a title using, where appropriate, outside programmers, artists, animators, scriptwriters, musicians and songwriters, sound effects and special effects experts, and sound and video studios. Activision believes that this model allows us to supplement internal expertise with top quality external resources on an as-needed basis.

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In addition, Activision often seeks out and engages independent third-party developers to create products on our behalf. We either own these products or have unlimited rights to commercially exploit these products. In other circumstances, a third-party developer may retain ownership of the intellectual property and/or technology included in the product and reserves certain exploitation rights. Activision typically selects these independent third-party developers based on their expertise in developing products in a specific category for specific platforms. Each of our third-party developers is under contract with us for specific or multiple titles. From time to time, Activision also acquires the license rights to publish and/or distribute software products that are or will be independently created by third-party developers. In such cases, the agreements with these developers provide us with exclusive publishing and/or distribution rights for a specific period of time, often for specified platforms and territories. In either case, Activision often has the ability to publish and/or distribute sequels, conversions, enhancements, and add-ons to the product initially being produced by the independent developer and Activision frequently has the right to engage the services of the original developer with regard to the further product development.

In consideration for the services that independent third-party developers provide, the developers receive a royalty, which is generally based on net sales of the developed products. Typically, developers also receive an advance, which Activision recoups from the royalties otherwise payable to the developers. The advance generally is paid in "milestone" stages. The payment at each stage is tied to the completion and delivery of a detailed performance milestone. Working with independent developers allows us to reduce our fixed development costs, share development risks with the third-party developers, take advantage of the third-party developers' expertise in connection with certain categories of products or certain platforms, and gain access to proprietary development technologies.

Activision provides various forms of product support to both our internally and externally developed titles. Activision quality assurance personnel are involved throughout the development and production of each title published. Activision subjects all such products to extensive testing before release to ensure compatibility with all appropriate hardware systems and configurations and to minimize the number of bugs and other defects found in the products. To support our products after release, Activision provides its customers online access on a 24-hour basis as well as live telephone operators who answer the help lines during regular business hours.

Marketing, Sales, and Distribution

Activision's marketing efforts include online activities (such as the creation of World Wide Web pages to promote specific titles and build user communities around our franchises), public relations, print and broadcast advertising, coordinated in-store and industry promotions (including merchandising and point of purchase displays), participation in cooperative advertising programs, direct response vehicles, and product sampling through demonstration software distributed through the Internet or on compact discs. From time to time, we also receive marketing support from hardware manufacturers and retailers in connection with their own promotional efforts. In addition, certain of our products contain software that enables customers to "electronically register" their purchases with us online.

We believe that our strong proven franchises and genres generate a loyal and devoted customer base that continues to purchase our sequels as a result of their dedication to the franchise and satisfaction from previous product purchases. We therefore market these sequels and expansion packs toward the established market as well as to broader audiences. In addition, for marketing titles based on licensed properties, we believe that we derive benefits from our continued marketing of these licensed properties as well as marketing and promotional activities of the property owners.

North America. Our products are available for sale or rental in thousands of retail outlets in North America. Our North American retail customers include, among others, Best Buy, GameStop, Target, Toys "R" Us, and Wal-Mart.

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In the United States ("U.S.") and Canada, our products are sold primarily on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses, and game specialty stores. We believe that a direct relationship with retail accounts results in more effective inventory management, merchandising, and communications than would be possible through indirect relationships. We have implemented electronic data interchange linkages with many of our retailers to facilitate the placing and shipping of orders. We also sell our products to a limited number of distributors.

International. Our products are sold internationally on a direct-to-retail basis, through third-party distribution and licensing arrangements, and through our wholly-owned European distribution subsidiaries. We conduct our international publishing activities through offices in the United Kingdom ("U.K."), Germany, France, Italy, Spain, Norway, the Netherlands, Sweden, Australia, China, Ireland, and Singapore. We seek to maximize our worldwide revenues and profits by releasing high quality foreign language releases concurrently with English language releases and by continuing to expand the number of direct selling relationships we maintain with key retailers in major territories.

On a worldwide basis, our largest customers, GameStop and Wal-Mart, each accounted for approximately 10% and 11% of consolidated revenues for the years ended December 31, 2009 and 2008, respectively.

Digital Distribution. Some of our products are sold in, or only in, a digital format, which allows consumers to purchase and download the game at their convenience. We partner with digital distributors to leverage this growing method of distribution. We also make available to our consumer value added downloadable contents to enhance their gaming experience through Microsoft, Sony and Nintendo's digital online services.

Affiliate Labels. In addition to our own products, we distribute a select number of interactive entertainment products that are developed and marketed by other third-party publishers through our "affiliate label" programs in North America, Europe, and the Asia Pacific region. The distribution of other publishers' products allows us to increase the efficiencies of our sales force and provides us with the ability to better ensure adequate shelf presence at retail stores for all of the products that we distribute. Revenues that we receive from distributing other publishers' titles mitigate the risk that a particular title or titles published by us fails to meet expectations. Services we provide under our affiliate label programs include order solicitation, in-store marketing, logistics and order fulfillment, and sales channel management, as well as other accounting and general administrative functions. Our current affiliate label partners include LucasArts, as well as several affiliate label partners in our "value" business, which offers budget-priced software to the public. Each affiliate label relationship is unique and may pertain only to distribution in certain geographic territories and may be further limited only to specific titles or titles for specific platforms.

Manufacturing

Activision prepares a set of master program copies, documentation, and packaging materials for our products for each hardware platform on which the product will be released. We also manufacture separate hardware peripherals, such as the guitar, drum and microphone for *Guitar Hero World Tour* and *Band Hero*, the new turntable for *DJ Hero*, and the new skateboard controller for *Tony Hawk: Ride*. With respect to products for use on the Sony, Nintendo, and Microsoft systems, our disk and hardware peripheral duplication, packaging, printing, manufacturing, warehousing, assembly, and shipping are performed by third-party subcontractors and Company-owned distribution facilities.

To maintain protection over their hardware technologies, Sony, Nintendo, and Microsoft generally specify or control the manufacturing and assembly of finished products. We deliver the master materials to the licensor or its approved replicator, which then manufactures finished goods and delivers them to us for distribution under our label. We use manufacturers authorized by Sony, Nintendo, or Microsoft

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to make the hardware peripherals for *Guitar Hero* titles, *Band Hero*, *DJ Hero*, and *Tony Hawk: Ride*. At the time our product unit orders are filled by the manufacturer, we become responsible for the costs of manufacturing and the applicable per unit royalty on such units, even if the units do not ultimately sell.

Blizzard Entertainment Segment ("Blizzard") Business Overview

Strategy

Maintain and Build upon Our Leadership Position in the MMORPG Category and PC Online Categories. Blizzard plans to maintain and build upon our leadership position in the MMORPG genre by regularly providing new content and game features to further solidify the loyalty of our subscriber base, as well as to expand the global game footprint to new markets.

We believe that the PC online market will remain a growing category throughout the world. The large and growing PC installed base in all regions and the continuing development of broadband connectivity facilitates online games and community experiences while creating access to new potential customers. Given the success of *World of Warcraft* and *StarCraft* in Asia, we expect to continue to be well positioned to capture the growing consumer demand in this region. Blizzard is among the few companies with video game franchises created and developed in the U.S. that have gained and retained success in Asia. *World of Warcraft* and *StarCraft* are strong brands in Asia. Titles in those series have been among the most played games in the region for many years and support a thriving professional gaming industry, particularly in South Korea. During 2009, Blizzard entered into licensing arrangements for *World of Warcraft*, *StarCraft II*, *Battle.net* and *Warcraft III* with an affiliated company of NetEase.com, Inc. in China. Further, as *World of Warcraft* is a server-based game, only playable online, Blizzard is one of the few companies that can target markets that have been dominated by piracy and monetize former illegitimate players as well as expand in markets that have not been penetrated by consoles, but offer a large PC installed base.

Products

Blizzard is a leading company in the subscription-based MMORPG category. *World of Warcraft* was initially launched in November 2004 in North America, Australia, and New Zealand; and was subsequently launched in South Korea, Europe, China, Singapore, Taiwan, Hong Kong, and Macau in 2005; Malaysia in 2006; and Thailand in 2007. As of December 31, 2009, *World of Warcraft* had approximately 11.5 million active subscribers. *World of Warcraft* is available in various languages based on the regions in which it is played and has earned awards and praise from publications around the world. Blizzard launched an expansion pack to *World of Warcraft*, *World of Warcraft: The Burning Crusade*, in January 2007 in North America, Europe, Australia, New Zealand, Singapore, Malaysia, and Thailand; in South Korea in February 2007; Taiwan, Hong Kong, and Macau in April 2007; and China in September 2007. Blizzard launched the second *World of Warcraft* expansion pack, *World of Warcraft: Wrath of the Lich King*, in November 2008 in all territories except China, where we intend to launch in 2010. Blizzard plans to launch the third installment of the *World of Warcraft* expansion pack, *World of Warcraft: Cataclysm* in 2010. Revenues associated with the *World of Warcraft* franchises accounted for 98%, 97%, and 97% of Blizzard's consolidated net revenues for the years ended December 31, 2009, 2008, and 2007, respectively.

Additionally, in the PC online category, in 2010, Blizzard plans to release *StarCraft II: Wings of Liberty* together with the new and improved *Battle.net*, which will provide integration of gameplay and community, customer services, and digital distribution of content in 2010. Blizzard has also announced the development of a sequel for *Diablo*, an action role-playing game.

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Product Development and Support

As a development studio, creator and publisher of the World of Warcraft, Diablo, and StarCraft franchises, Blizzard focuses on creating well-designed, high quality games. Product development is handled internally by a strong core group of talented designers, producers, programmers, artists, and sound engineers. To maintain its current subscribers and attract new subscribers, Blizzard continues to develop new patches to upgrade *World of Warcraft*. In addition to its headquarters in Irvine, California, Blizzard maintains offices in or around Austin, Texas; Paris, France; Cork, Ireland; Seoul, South Korea; Shanghai, China; and Taipei, Taiwan, to provide 24/7 game support to *World of Warcraft* players in their native language, enhance online community management, and tailor marketing initiatives to specific regions.

Marketing, Sales, and Distribution

Blizzard distributes its product and generates revenues worldwide through various means: subscriptions (which consist of fees from individuals playing *World of Warcraft*, prepaid cards, and other value added services such as the ability to change "factions", the ability to transfer "realms" and the ability to purchase a virtual pet), retail sales of physical "boxed" product, electronic download sales of PC products, and licensing of software to third-party companies that distribute *World of Warcraft* in Russia, China and Taiwan. In addition, Blizzard operates a free online game service, Battle.net, which attracts millions of active players, making it one of the largest online-game related services in the world. Battle.net is a service that allows players to connect and play Blizzard games and strengthens brand loyalty among current Blizzard gamers.

Activision Blizzard Distribution Segment ("Distribution") Business Overview

We distribute interactive entertainment hardware and software products in Europe through our European distribution subsidiaries: Centresoft in the U.K.; and NBG in Germany. These subsidiaries act as wholesalers in the distribution of products and also provide packaging, logistical and sales services. They provide services to our publishing operations and to various third-party publishers, including Sony, Nintendo, and Microsoft. Centresoft is Sony's exclusive distributor of PlayStation products to the independent market sector of the U.K.

We entered into the distribution business to obtain distribution capacity in Europe for our own products, while supporting the distribution infrastructure with third-party sales, and to diversify our operations in the European market. Centresoft and our other distribution subsidiaries operate in accordance with strict confidentiality procedures to provide independent services to various third-party publishers.

Additional Financial Information

See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 14 of the Notes to Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K for certain additional information regarding operating segments and geographic areas. See the Critical Accounting Policies section under Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of our practices with regard to several working capital items, such as rights of returns, and inventory practices. See the Management's Overview of Business Trends under Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of the impact of seasonality on our business.

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Available Information

Our website is located at <http://www.activisionblizzard.com>. Our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), are available free of charge through our website. The information found on our website is not a part of, and is not incorporated by reference into, this or any other report that we file with or furnish to the Securities and Exchange Commission ("SEC").

The public may also read and copy any materials we file with the SEC at the SEC's Public Reference Room at Station Place, 100 F Street, N.E., Washington, D.C. 20549 (information on the operation of the Public Reference Room is available by calling the SEC at 1-800-SEC-0330). The SEC also maintains a web site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>.

Item 1A. RISK FACTORS

A continuing deterioration of general economic conditions could result in a reduction in discretionary spending by consumers that could reduce demand for our products.

Most of our products involve discretionary spending on the part of consumers. Consumers are generally more willing to make discretionary purchases, including purchases of products like ours, during periods in which favorable economic conditions prevail. As a result, our products may be sensitive to general economic conditions and economic cycles. A continuation or worsening of current, adverse worldwide economic conditions, including declining consumer confidence, inflation, recession, rising unemployment and volatile gasoline prices, may lead consumers to delay or reduce purchases of our products. Reduced consumer spending may also require us to incur increased selling and promotional expenses. A reduction or shift in domestic or international consumer spending could negatively impact our business, results of operations and financial condition.

Our business may be harmed if our distributors, retailers or other parties with which we do business cannot honor their existing credit arrangements, default on their obligations to us, or seek protection under the bankruptcy laws.

We rely on various business partners for several important aspects of our business, including distribution of our products, product development, and intellectual property licensing. Some of these business partners are highly-leveraged or small businesses that may be particularly vulnerable to difficult economic conditions. As a result of the current economic downturn, we are subject to increased counterparty risks, including the risks that our business partners may default on their obligations to us or seek protection under the bankruptcy laws.

For example, retailers and distributors in the interactive entertainment industry have from time to time experienced significant fluctuations in their businesses and a number of them have failed. We typically make sales to most retailers and some distributors on unsecured credit, with terms that vary depending upon the customer's credit history, solvency, credit limits, and sales history, as well as whether the customer can obtain sufficient credit insurance. Challenging economic conditions may impair the ability of our customers to pay for products they have purchased, and as a result, our reserves for doubtful accounts and write-off of accounts receivable could increase and, even if increased, may turn out to be insufficient. Moreover, even in cases where we have insolvency risk insurance to protect against a customer's bankruptcy, insolvency, or liquidation, this insurance typically contains a significant deductible and co-payment obligation, and does not cover all instances of non-payment. As a result, a payment default by or the insolvency or business failure of a significant customer could significantly harm our business and financial results.

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The insolvency or business failure of other types of business partners could result in disruptions to the manufacturing or distribution of our products or the cancellation of contractual arrangements that we consider to be favorable.

Current general economic conditions may adversely affect other aspects of our business.

We are unable to predict the likely duration and severity of the current adverse economic conditions in the U.S. and other countries, and all of the effects the current macroeconomic conditions may have on our business. Among other things, because we generally maintain large cash reserves, we are subject to the risk that inflation may cause the real value of our cash and cash equivalents to decline. Furthermore, uncertainties concerning the likely length and severity of the economic downturn cause our forecasts to be subject to even greater risks and uncertainties.

Fluctuations in currency exchange rates may have a negative impact on our results of operations.

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. A substantial portion of our international sales and expenses are denominated in local currencies, including certain major currencies, such as the euro and U.K. pound, and emerging market currencies, such as the Korean won and Chinese renminbi, which could fluctuate against the U.S. dollar. We have, in the past, utilized currency derivative contracts to hedge certain foreign exchange exposures, with hedge tenors of generally less than 12 months, as well as managing these exposures with natural offsets. We may also, from time to time, hedge non-U.S. dollar earnings. Our principal counterparty in respect of currency derivative contracts is Vivendi, though we periodically evaluate and may use similar arrangements with other counterparties. There can be no assurance that we will continue these programs, or that we will be successful in managing exposure to currency exchange rate risks.

Vivendi owns a majority of our outstanding shares of common stock and the interests of Vivendi and its subsidiaries may conflict with the interests of our other shareholders.

Vivendi and its subsidiaries currently own approximately 57% of our issued and outstanding shares of common stock.

As a result of the Business Combination, Vivendi has the ability to nominate a majority of our board of directors and determine the outcome of certain matters submitted to our stockholders, such as the approval of significant transactions and the declaration of dividends on our common stock. As a result, actions that may be supported by a majority of stockholders other than Vivendi may be blocked by Vivendi. In addition, Vivendi's ownership may affect the liquidity in the market for our common stock.

Furthermore, the ownership position and governance rights of Vivendi may discourage a third party from proposing a change of control or other strategic transaction concerning Activision Blizzard. As a result, our common stock may trade at prices that do not reflect a "control premium" to the same extent as do the stocks of similarly situated companies that do not have a stockholder with an ownership interest as large as Vivendi's ownership interest.

We are a "controlled company" within the meaning of NASDAQ rules and, as a result, are exempt from certain corporate governance requirements.

For so long as Vivendi or any other entity or group owns more than 50% of the total voting power of our common shares, we will be a "controlled company" within the meaning of NASDAQ rules and,

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as a result, qualify for exemptions from certain corporate governance requirements. As a controlled company, we are exempt from several NASDAQ standards, including the requirements:

that a majority of our Board consists of independent directors;

that our prospective directors be nominated solely by independent directors; and

that the compensation of our executive officers be determined solely by independent directors.

We currently rely on these exemptions and as a result, a majority of our Board is not independent (as defined by the NASDAQ rules). In addition, while we have a nominating and corporate governance committee and a compensation committee, these committees do not consist entirely of independent directors. Accordingly, our stockholders do not have the same protections afforded to stockholders of companies that are subject to all of the NASDAQ corporate governance requirements.

We depend on a relatively small number of franchises for a significant portion of our revenues and profits.

A significant portion of our revenues has historically been derived from products based on a relatively small number of popular franchises and these products are responsible for a disproportionately high percentage of our profits. For example, our top three franchises, Call of Duty, Guitar Hero, and World of Warcraft, accounted for approximately 68% of our net revenues for the year ended December 31, 2009. We expect that a limited number of popular franchises will increasingly produce a disproportionately high percentage of our revenues and profits. Due to this dependence on a limited number of franchises, the failure to achieve anticipated results by one or more products based on these franchises may significantly harm our business and financial results.

Sales of certain titles are affected by hardware peripheral availability, which increases our exposure to imbalances between projected and actual demand.

Some of our titles involve one or more separate hardware peripherals, such as the guitar which accompanies *Guitar Hero* titles, the guitar, drum and microphone which accompany *Band Hero*, the turntable which accompanies *DJ Hero* and the skateboard controller which accompanies *Tony Hawk: Ride*. Typically, we sell such software both in bundles with the hardware peripherals and on a stand-alone basis. Consumers may not want to buy such game software if they cannot also buy the hardware peripherals. If we underestimate demand or otherwise are unable to produce sufficient quantities of the hardware peripherals of an acceptable quality or allocate too few peripherals to geographic markets and hardware platforms where demand exceeds supply, we will forego revenue. This may also create greater opportunities for competitors to develop or gain share with competitive product offerings.

In addition, if we overestimate demand and make too many peripherals, or allocate too many peripherals to geographic markets and hardware platforms where there is insufficient demand, we will incur unrecoverable manufacturing costs for unsold units as well as for unsold game software. In either case, hardware peripheral manufacturing and allocation decisions may negatively affect our financial performance.

The increasing importance and complexity of hardware peripherals in our business increases our exposure to hardware manufacturing and shipping risks, including availability of sufficient third-party manufacturing capacity, and increases in manufacturing and shipping costs.

A limited number of manufacturers are authorized by Sony, Nintendo or Microsoft to make the hardware peripherals for Guitar Hero, and the majority of those manufacturers are located in China. Anything that impacts the ability of those manufacturers to produce or otherwise supply the hardware peripherals for us or increases their costs of production, including the revocation of the first party license to produce the hardware, the utilization of such manufacturer's capacity by one of our competitors, changes in safety, environmental or other regulations applicable to the peripherals and the

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manufacturing thereof, natural or manmade disasters that disrupt manufacturing, transportation or communications, labor shortages, civil unrest or issues generally negatively impacting international companies operating in China, increases in the price of petroleum or other raw materials, increases in fuel prices and other shipping costs, and increases in local labor costs in China, may adversely impact our ability to supply those peripherals to the market and the prices we must pay for those peripherals, and therefore our financial performance. Additionally, the increasing complexity and expense of these hardware peripherals increases the risk of production delays or product defects.

Our sales may decline substantially without warning and in a brief period of time because a substantial portion of our sales are made to a relatively small number of key customers and because we do not have long-term contracts for the sale of our products.

In the U.S. and Canada, Activision has primarily sold its products on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses, and game specialty stores. Activision products are sold internationally on a direct-to-retail basis, through third-party distribution and licensing arrangements and through our wholly-owned European distribution subsidiaries. Activision's sales are made primarily on a purchase order basis without long-term agreements or other forms of commitments. We had two customers, Wal-Mart and GameStop, which each accounted for approximately 10% of our consolidated revenues for the year ended December 31, 2009 and accounted for approximately 18% and 10% of our consolidated gross receivables at December 31, 2009, respectively. The loss of, or significant reduction in sales to, any of Activision's principal retail customers or distributors could significantly harm our business and financial results. The concentration of sales in a small number of large customers also could make us more vulnerable to collection risk if one or more of these large customers becomes unable to pay for our products or seeks protection under the bankruptcy laws. In addition, having such a large portion of our total net revenue concentrated in a few customers reduces our negotiating leverage with these customers.

We may not be able to maintain our distribution relationships with key vendors and customers.

Our NBG and Centresoft subsidiaries distribute interactive entertainment software and hardware products and provide related services in Germany, and the U.K., respectively, and via export in other European countries for a variety of entertainment software publishers, many of which are our competitors, and hardware manufacturers. From time to time, they also maintain exclusive relationships to serve certain retail customers. These services are generally performed subject to limited-term arrangements. Although we expect to use reasonable efforts to retain these vendors and retail customer relationships, we may not be successful in this regard. The cancellation or non-renewal of one or more of these arrangements could adversely affect our business and financial results.

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

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

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As online functionality has become an increasingly important feature of our software products, we may need to defer the recognition of an increasing amount of revenue, which may adversely affect the net revenue, net income and earnings per share that we will report under U.S. GAAP.

As online functionality has become a more important component of gameplay, an increasing number of our online-enabled games contain a more-than-inconsequential separate service deliverable in addition to the product, and our performance obligations for these games extend beyond the sale of the games. Vendor-specific objective evidence of fair value does not exist for the online services, as we do not plan to separately charge for this component of online-enabled games. As a result, we recognize revenues from the sale of certain online-enabled games for certain platforms ratably over an estimated service period. In addition, we defer the costs of sales of those titles. If we are required to recognize a greater portion of the revenue of a sale after shipment, or if we are required to recognize revenue over a longer service period, there may be an adverse effect on our reported net revenue, net income and earnings per share under accounting principles generally accepted in the United States of America ("U.S. GAAP").

A substantial portion of our revenue and profitability will depend on the subscription-based massively multiplayer online role-playing game category. If we do not maintain our leadership position in this category, our financial results could suffer.

Activision Blizzard is the leading global developer, publisher and distributor in terms of subscriber base and revenues in the subscription-based MMORPG category, due to the popularity of Blizzard's *World of Warcraft* and related expansion packs. Subscription revenues from this game comprise a significant portion of our consolidated revenues. To remain the leader in the MMORPG category, it is important that we continue to refresh *World of Warcraft* or develop new MMORPG products that are favorably received by both our existing customer base and new customers. A number of software publishers have developed and commercialized or are currently developing online games for use by consumers over the Internet which pose a threat to the popularity of *World of Warcraft*, and we expect new competitors to continue to emerge in the MMORPG category. If consumer demand for *World of Warcraft* games declines and we have not introduced new MMORPG or other products that replace *World of Warcraft's* potentially decreasing revenue, or added other sources of revenue, our financial condition could suffer. Additionally, if new technologies are developed that replace MMORPG games, consumer preferences trend away from MMORPG games or new business models emerge that offer online subscriptions for free or at a substantial discount to current MMORPG subscription fees, our revenue and profitability may decline.

The development of MMORPG products requires substantial up-front expenditures. We may not be able to recover development costs for our future MMORPG products.

Consumer preferences for games are usually cyclical and difficult to predict, and even the most successful titles remain popular for only limited periods of time, unless refreshed with new content. In order to remain competitive in the MMORPG market, we must continuously develop new products and enhancements to existing products. Because of the significant complexity of MMORPG games, these products require a longer development time and are more expensive to create than traditional console game products. In addition, the long lead time involved in developing a MMORPG product and the significant allocation of financial resources that each product requires means it is critical that we accurately predict consumer demand for new MMORPG products. If future MMORPG products do not achieve expected market acceptance or generate sufficient sales and subscription revenues upon introduction, we may not be able to recover the development and marketing costs associated with new products, and our financial results could suffer.

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Our results of operation may suffer if consumer preferences shift away from the genres from which we currently derive the majority of our revenue.

A significant portion of our revenue is derived from products in the music-based gaming, first-person action and MMORPG genres. Consumer preferences for games are difficult to predict, and if interest in those genres declines, even if our share of those genres is stable or expands, we will not be able to sustain the same level of sales of our products in those genres, and our financial results could suffer. For example, we recorded a non-cash impairment charge on finite-lived intangible assets for 2009 as a result of the weaker environment for casual and music games and our net revenues were lower in 2009 as compared to 2008 in part due to this environment.

A substantial portion of Activision Blizzard's revenues is derived from subscriptions paid by World of Warcraft subscribers. If these customers cancel their subscriptions, our results of operations may suffer.

A substantial portion of our revenues is generated by subscription fees paid by consumers who play *World of Warcraft*. Typically, *World of Warcraft* subscribers purchase one to three month memberships that are cancelable, without penalty, at the end of the membership period. If *World of Warcraft* subscribers become dissatisfied, they may choose not to renew their memberships in order to engage in other forms of entertainment (including competing MMORPG offerings) and we may not be able to replace lost subscribers. Additionally, if general economic conditions deteriorate further, consumers may decrease their discretionary spending on entertainment items such as MMORPG games and users may choose not to renew their *World of Warcraft* subscriptions. A decrease in the overall subscription base of *World of Warcraft* could substantially harm our operating results.

We depend on servers to operate our MMORPG business and other games of ours that have online features. If we were to lose server capacity, for any reason, our business could suffer.

Our business relies on the continuous operation of our data servers. Any broad based catastrophic server malfunction, a significant intrusion by hackers that circumvents our security measures, or a failure of our disaster recovery service would likely interrupt the operation of our MMORPG game, *World of Warcraft*, and other games of ours with online features and could result in the loss of sales for such games (including subscription-based sales for *World of Warcraft*). An extended interruption of service could harm our reputation and operating results.

We must project our future server needs and make advance purchases of servers to accommodate expected business demands. If we underestimate the amount of server capacity our business requires or if our business were to grow more quickly than expected, our customers may experience service problems, such as slow or interrupted gaming access. Insufficient server capacity may result in our experiencing decreased sales, a loss of our customer base, and adverse consequences to our reputation. Conversely, if we overestimate the amount of server capacity required by our business, we may incur additional operating costs that would adversely affect our operating margins.

We may not accurately predict the amount of Internet bandwidth necessary to sustain our online gaming businesses.

Our online gaming businesses are dependent on the availability of sufficient Internet bandwidth. An increase in the price of bandwidth could have an adverse effect on operating margins since we may not be able to increase our prices or subscriber levels to compensate for such costs. Because of the importance of our MMORPG business to our revenues and results of operations, our ability to access adequate bandwidth to support our business is critical. To secure bandwidth access, we have entered into arrangements with several bandwidth providers and entered into long-term contracts with some of them to secure future bandwidth capacity. If the price of bandwidth were to decrease, our contractual commitments to pay higher prices could affect our ability to compete with other video game producers.