

ACTIVISION BLIZZARD, INC.

FORM 10-K (Annual Report)

Filed 02/27/18 for the Period Ending 12/31/17

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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, 2017

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)

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

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, a smaller reporting company, or emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

(Do not check if a
smaller reporting company)

Smaller Reporting Company

Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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, 2017 (based on the closing sale price as reported on the Nasdaq) was \$42,587,342,045.

The number of shares of the registrant's Common Stock outstanding at February 20, 2018 was 758,631,663.

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 2018 Annual Meeting of Shareholders which is expected to be held on June 26, 2018, are incorporated by reference into Part III of this Annual Report.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

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PART I

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 facts and include, but are not limited to: (1) projections of revenues, expenses, income or loss, earnings or loss per share, cash flow, or other financial items; (2) statements of our plans and objectives, including those related to releases of products or services; (3) statements of future financial or operating performance, including the impact of tax items thereon; and (4) statements of assumptions underlying such statements. Activision Blizzard, Inc. generally uses words such as "outlook," "forecast," "will," "could," "should," "would," "to be," "plan," "plans," "believes," "may," "might," "expects," "intends," "intends as," "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 risks, reflect management's current expectations, estimates and projections about our business, and are inherently uncertain and difficult to predict.

The company cautions that a number of important factors could cause Activision Blizzard, Inc.'s actual future results and other future circumstances to differ materially from those expressed in any forward-looking statements. Some of the risk factors that could cause our actual results to differ from those stated in forward-looking statements can be found in "Risk Factors" included in Part I, Item 1A of this Annual Report on Form 10-K. 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. Although these forward-looking statements are believed to be true when made, they may ultimately prove to be incorrect. These statements are not guarantees of our future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and may cause actual results to differ materially from current expectations.

Activision Blizzard Inc.'s names, abbreviations thereof, logos, and product and service designators are all either the registered or unregistered trademarks or trade names of Activision Blizzard. All other product or service names are the property of their respective owners. All dollar amounts referred to in, or contemplated by, this Annual Report on Form 10-K refer to United States ("U.S.") dollars, unless otherwise explicitly stated to the contrary.

Item 1. BUSINESS

Overview

Activision Blizzard, Inc. is a leading global developer and publisher of interactive entertainment content and services. We develop and distribute content and services on video game consoles, personal computers ("PC"), and mobile devices. We also operate esports events and leagues and create film and television content based on our games. The terms "Activision Blizzard," the "Company," "we," "us," and "our" are used to refer collectively to Activision Blizzard, Inc. and its subsidiaries.

The Company was originally incorporated in California in 1979 and was reincorporated in Delaware in December 1992. In connection with the 2008 business combination (the "Business Combination") by and among the Company (then known as Activision, Inc.), Vivendi S.A. ("Vivendi"), and Vivendi Games, Inc. ("Vivendi Games"), an indirect wholly-owned subsidiary of Vivendi, we were renamed Activision Blizzard, Inc.

The common stock of Activision Blizzard is traded on The Nasdaq Stock Market under the ticker symbol "ATVI."

The King Acquisition

On February 23, 2016 (the "King Closing Date"), we acquired King Digital Entertainment, a leading interactive mobile entertainment company ("King"), by purchasing all of its outstanding shares (the "King Acquisition"). We made this acquisition because we believed that the addition of King's highly complementary mobile business positioned us as a global leader in interactive entertainment across mobile, console, and PC platforms, and aligned us for future growth. The aggregate purchase price of approximately \$5.8 billion was funded with \$3.6 billion of existing cash and \$2.2 billion of cash from new debt issued by the Company. King's results of operations since the King Closing Date are included in our consolidated financial statements.

Our Strategy and Vision

Our objective is to continue to be a worldwide leader in the development, publishing, and distribution of high-quality interactive entertainment content and services, as well as related media, that deliver engaging entertainment experiences on a year-round basis. In pursuit of this objective we focus on three strategic pillars: expanding audience reach; driving deep consumer engagement; and providing more opportunities for player investment.

Expanding audience reach. Building on our strong established franchises and creating new franchises through compelling new content is at the core of our business. We endeavor to reach as many consumers as possible either through: (1) the purchase of our content and services; (2) engagement in our free-to-play games, which allow consumers to play games with no up-front cost but provide for player investment through sales of downloadable content or via microtransactions; or (3) engagement in other types of media based on our franchises, such as esports and film and television content.

Driving deep consumer engagement. Our high-quality entertainment content not only expands our audience reach, but it also drives deep engagement with our franchises. We design our games, as well as related media, to provide a depth of content that keeps consumers engaged for a long period of time following a game's release, delivering more value to our players and additional growth opportunities for our franchises.

Providing more opportunities for player investment. Increasingly, our consumers are connected to our games online through consoles, PCs, and mobile devices. This allows us to offer additional digital player investment opportunities directly to our consumers on a year-round basis. In addition to purchasing full games or subscriptions, players can invest in certain of our games and franchises by purchasing incremental "in-game" content (including larger downloadable content or smaller content, via microtransactions). These digital revenue streams tend to be recurring and have relatively higher profit margins. Further, if executed properly, additional player investment can increase engagement as it provides more frequent and incremental content for our players. In addition, we believe there is an opportunity for advertising within certain of our franchises, as well as opportunities to drive new forms of player investment through esports, film and television, and consumer products. We are in the early stages of developing these new revenue streams.

Our strategy is ultimately aimed at creating shareholder value and enhancing returns. We strive to increase profitability, cash flows, and return on capital—and to do so while keeping our company a great place to work for our employees.

Reportable Segments

As part of the continued implementation of our esports strategy, we instituted changes to our internal organization and reporting structure such that the Major League Gaming ("MLG") business now operates as a division of Blizzard Entertainment, Inc. ("Blizzard"). As such, commencing with the

second quarter of 2017, MLG, which was previously a separate operating segment, is now a component of the Blizzard operating segment. MLG is responsible for the operations of the Overwatch League™, along with other esports events, and will also continue to serve as a multi-platform network for other Activision Blizzard esports content.

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

(i) *Activision Publishing, Inc.*

Activision Publishing, Inc. ("Activision"), is a leading global developer and publisher of interactive software products and entertainment content, particularly for the console platform. Activision primarily delivers content through retail and digital channels, including full-game and in-game sales, as well as by licensing software to third-party or related-party companies that distribute Activision products. Activision develops, markets, and sells products based on our internally developed intellectual properties, as well as some licensed properties. We have also established a long-term alliance with Bungie to publish its game universe, *Destiny*.

Activision's key product franchises include: *Call of Duty*®, a first-person shooter for the console and PC platforms, and *Destiny*, an online universe of first-person action gameplay (which we call a "shared-world shooter") for the console and PC platforms. *Call of Duty*, Activision's leading franchise, has been the number one console franchise globally for eight of the last nine years, based on data from The NPD Group, GfK Chart-Track, and GSD, and our internal estimates.

(ii) *Blizzard Entertainment, Inc.*

Blizzard is a leading global developer and publisher of interactive software products and entertainment content, particularly for the PC platform. Blizzard primarily delivers content through retail and digital channels, including subscriptions, full-game, and in-game sales, as well as by licensing software to third-party or related-party companies that distribute Blizzard products. Blizzard also maintains a proprietary online gaming service, *Blizzard Battle.net*®, which facilitates digital distribution of Blizzard content, along with Activision's *Destiny 2* PC content, online social connectivity, and the creation of user-generated content. As noted above, Blizzard also includes the activities of our MLG business, which is responsible for the operations of the Overwatch League, along with other esports events, and will also continue to serve as a multi-platform network for other Activision Blizzard esports content.

Blizzard's key product franchises include: *World of Warcraft*®, a subscription-based massive multi-player online role-playing game ("MMORPG") for PC; *StarCraft*®, a real-time strategy PC franchise; *Diablo*®, an action role-playing franchise for the PC and console platforms; *Hearthstone*®, an online collectible card franchise for the PC and mobile platforms; *Heroes of the Storm*®, a free-to-play team brawler for PC; and *Overwatch*®, a team-based first-person shooter for the PC and console platforms. *World of Warcraft*, which was initially launched in November 2004, is the leading subscription-based MMORPG in the world.

(iii) *King Digital Entertainment*

King is a leading global developer and publisher of interactive entertainment content and services, particularly on mobile platforms, such as Google Inc.'s ("Google") Android and Apple Inc.'s ("Apple") iOS. King also distributes its content and services on the PC platform, primarily via Facebook, Inc. ("Facebook"). King's games are free to play, however, players can acquire in-game items, either with virtual currency the players purchase or directly using real currency.

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King's key product franchises, all of which are for the mobile and PC platforms, include: Candy Crush™, which features "match three" games; Farm Heroes™, which also features "match three" games; and Bubble Witch™, which features "bubble shooter" games. King had two of the top 10 highest-grossing titles in the U.S. mobile app stores for the last 17 quarters in a row, according to App Annie Intelligence and internal estimates for the Apple App Store and the Google Play Store combined.

Other

We also engage in other businesses that do not represent reportable segments, including:

- the Activision Blizzard Studios ("Studios") business, which is devoted to creating original film and television content based on our library of globally recognized intellectual properties, and which, in October 2017, released the second season of the animated TV series *Skylanders™ Academy* on Netflix; and
- the Activision Blizzard Distribution ("Distribution") business, which consists of operations in Europe that provide warehousing, logistics, and sales distribution services to third-party publishers of interactive entertainment software, our own publishing operations, and manufacturers of interactive entertainment hardware.

Products

We develop interactive entertainment content and services, principally for console, PC, and mobile devices, and we market and sell our games through retail and digital distribution channels. Our products span various genres, including first-person shooter, action/adventure, role-playing, strategy, and "match three," among others. We primarily offer the following products and services:

- full-games, which typically provide access to main game content, primarily for console or PC;
- downloadable content, which provides players with additional in-game content to purchase following the purchase of a full game;
- microtransactions, which typically provide relatively small pieces of additional in-game content or enhancements to gameplay, generally at relatively low price points; and
- subscriptions for players in our World of Warcraft franchise that provide for continual access to the game content.

Providing additional opportunities for player investment outside of full-game purchases has allowed us to shift from our historical seasonality to a more consistently recurring and year-round revenue model. In addition, if executed properly, it allows us to increase player engagement as it provides more frequent and incremental content for our players.

Product Development and Support

We focus on developing enduring franchises backed by well-designed, high-quality games with regular content updates. We build interactive entertainment content with the potential for broad reach, sustainable engagement and year-round player investment. It is our experience that enduring franchises then serve as the basis for sequels, prequels and related new products and content that can be released over an extended period of time. We believe that the development and distribution of products and content based on proven franchises enhances predictability of revenues and the probability of high unit volume sales and operating profits. We intend to continue development of owned franchises in the future.

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We develop and produce our titles using a model in which a group of creative, technical, and production professionals, including designers, producers, programmers, artists, and sound engineers, in coordination with our marketing, finance, analytics, sales, and other professionals, has responsibility for the entire development and production process, including the supervision and coordination of internal and, where appropriate, external resources. We believe this model allows us to deploy the best resources for a given task, by supplementing our internal expertise with top-quality external resources on an as-needed basis.

While most of the content for our franchises is developed by internal studios, we periodically engage independent third-party developers to create content on our behalf. From time to time, we also acquire the license rights to publish and/or distribute software products that are, or will be, independently created by third-party developers. Since 2010, Activision has been in a long-term exclusive relationship with Bungie, the developer of game franchises including Halo, Myth, and Marathon, to publish games in the Destiny franchise. During the term of the agreement, Activision has exclusive, worldwide rights to publish and distribute on multiple platforms all future Bungie games based on Destiny.

We provide various forms of product support. Central technology and development teams review, assess, and provide support to products throughout the development process. Quality assurance personnel are also involved throughout the development and production of published content. We subject all such content to extensive testing before public release to ensure compatibility with appropriate hardware systems and configurations and to minimize the number of bugs and other defects found in the products. To support our content, we generally provide 24-hour game support to players through various means, primarily online and by telephone.

Marketing, Sales, and Distribution

Many of our products contain software that enables us to connect with our gamers directly. This provides a significant marketing tool that allows us to communicate and market directly to our customers, including through customized advertising and in-game messaging based on customer preferences and trends. Our marketing efforts also include activities on Facebook, Twitter, Twitch, YouTube and other online social networks, other online advertising, other public relations activity, 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 the digital online services provided by our partners. From time to time, we also receive marketing support from hardware manufacturers, producers of consumer products related to a game, and retailers in connection with their own promotional efforts, as well as co-marketing from promotional partners.

Our physical products are available for sale in outlets around the world. These products are sold primarily on a direct basis to mass-market retailers (e.g., Target, Wal-Mart), consumer electronics stores (e.g., Best Buy), discount warehouses, game specialty stores (e.g., GameStop), and other stores (e.g., Amazon) or through third-party distribution and licensing arrangements.

Most of our products and content are also available in a digital format, which allows consumers to purchase and download the content at their convenience directly to their console, PC, or mobile device through our platform partners, including Microsoft Corporation ("Microsoft"), Sony Interactive Entertainment Inc. ("Sony"), Apple, Google, Nintendo Co., Ltd. ("Nintendo"), and Facebook. Blizzard utilizes its proprietary online gaming service, Blizzard Battle.net, to distribute most of Blizzard's content directly to PC consumers.

In addition to serving as a distribution platform, Blizzard Battle.net offers players communications features, social networking, player matching and digital content delivery and is designed to allow people

to connect regardless of which of our games on Blizzard Battle.net they are playing. It attracts millions of active players, making it one of the largest online game-related services in the world.

Manufacturing

We prepare master program copies for our products on each release platform. With respect to products for Microsoft, Sony, and Nintendo consoles, our disk duplication, packaging, printing, manufacturing, warehousing, assembly and shipping are performed by third-party subcontractors or distribution facilities owned by us.

Microsoft, Sony, and Nintendo generally specify or control the manufacturing and assembly of finished products and license their hardware technologies to us for which we pay an applicable royalty per unit once the manufacturer fills the product order, even if the units do not ultimately sell. We deliver the master materials to the licensor or its approved replicator, who then manufactures the finished goods and delivers them to us for distribution under our label.

Significant Customers and Top Franchises

Customers

While the Company does sell directly to end consumers in certain instances, such as sales through Blizzard's proprietary online gaming service platform, Blizzard Battle.net, in other instances our customers may be platform providers, such as Sony, Microsoft, Google, and Apple, or retailers, such as Wal-Mart and GameStop, who act as distributors of our content to end consumers. For the year ended December 31, 2017, we had three customers—Apple, Sony, and Google—who accounted for 16%, 14%, and 10%, respectively, of net revenues. For the year ended December 31, 2016, we had two customers—Sony and Apple—who each accounted for 13% of net revenues. For the year ended December 31, 2015, we had two customers—Sony and Microsoft—who accounted for 12% and 10%, respectively, of net revenues.

We had three customers—Sony, Microsoft, and Apple—who accounted for 17%, 14%, and 10%, respectively, of consolidated gross receivables at December 31, 2017. We had three customers—Sony, Microsoft, and Wal-Mart—who accounted for 17%, 10%, and 10%, respectively, of consolidated gross receivables at December 31, 2016.

Top Franchises

For the years ended December 31, 2017 and 2016, our top four franchises—Call of Duty, Candy Crush, World of Warcraft, and Overwatch—collectively accounted for 66% and 69% of our net revenues, respectively. For the year ended December 31, 2015, our top four franchises—Call of Duty, World of Warcraft, Destiny, and Hearthstone—collectively accounted for 75% of our net revenues.

Competition

We compete for the leisure time and discretionary spending of consumers with other interactive entertainment companies, as well as with providers of different forms of entertainment, such as film, television, social networking, music and other consumer products.

The interactive entertainment industry is intensely competitive and new interactive entertainment software products and platforms are regularly introduced. We believe that the main competitive factors in the interactive entertainment industry include: product features, game quality, and playability; brand name recognition; compatibility of products with popular platforms; access to distribution channels; online capability and functionality; ease of use; price; marketing support; and quality of customer service.

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We compete with other publishers of video game console, PC, and mobile interactive entertainment software. In addition to third-party software competitors, integrated video game console hardware and software companies, such as Microsoft, Sony, and Nintendo, compete directly with us in the development of software titles for their respective platforms. A number of software publishers have developed and commercialized, or are currently developing, online games for use by consumers.

Intellectual Property

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

We develop a majority of our products based on wholly-owned intellectual properties, such as Call of Duty, World of Warcraft, and Candy Crush, among others. In other cases, we obtain intellectual property through licenses and service agreements, such as for our Destiny franchise. Further, our products that play on consoles and mobile platforms include technology that is owned by the platform provider and is licensed non-exclusively to us for use in the relevant product. We also license technology from providers other than console manufacturers in developing our content and services. While we may have renewal rights for some licenses, our business 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 are actively engaged in enforcement of our copyright, trademark, patent, and trade secret rights against potential infringers of those rights along with other protective activities, including monitoring online channels for distribution of pirated copies and participating in various enforcement initiatives, education programs and legislative activity around the world. For our PC products, we use technological protection measures to prevent piracy and the use of unauthorized copies of our products. For other platforms, the platform providers typically incorporate technological protections and other security measures in their platforms to prevent the use of unlicensed products on those platforms.

Executive Officers

Our executive officers and their biographical summaries are provided below:

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|---------------------|------------|--|
| Robert A. Kotick | 54 | Chief Executive Officer of Activision Blizzard |
| Collister Johnson | 41 | President and Chief Operating Officer of Activision Blizzard |
| Dennis Durkin | 47 | Chief Corporate Officer of Activision Blizzard |
| Spencer Neumann | 48 | Chief Financial Officer of Activision Blizzard |
| Eric Hirshberg | 49 | President and Chief Executive Officer of Activision |
| Michael Morhaime | 50 | President and Chief Executive Officer of Blizzard |
| Brian Stolz | 42 | Chief People Officer of Activision Blizzard |
| Christopher Walther | 51 | Chief Legal Officer of Activision Blizzard |
| Riccardo Zacconi | 50 | Chief Executive Officer of King |

Robert A. Kotick, Chief Executive Officer of Activision Blizzard

Robert A. Kotick has been a director of Activision Blizzard since February 1991, following his purchase of a significant interest in the Company, which was then on the verge of insolvency. Mr. Kotick was our Chairman and Chief Executive Officer from February 1991 until July 2008, when

he became our President and Chief Executive Officer in connection with the Business Combination. Mr. Kotick served as our President from July 2008 until June 2017, when Mr. Johnson began serving as our President and Chief Operating Officer. Mr. Kotick remains the Chief Executive Officer of Activision Blizzard. Mr. Kotick is also a member of the board of directors of The Coca-Cola Company, a multinational beverage corporation, and the boards of trustees for The Center for Early Education and the Harvard-Westlake School. He is also vice chairman of the board and chairman of the committee of trustees of the Los Angeles County Museum of Art. In addition, Mr. Kotick is the founder and co-chairman of the Call of Duty Endowment, a nonprofit, public benefit corporation that seeks to help organizations that provide job placement and training services for veterans.

Collister Johnson, President and Chief Operating Officer of Activision Blizzard

Collister "Cody" Johnson has served as our President and Chief Operating Officer since June 2017. Prior to that, he served as the chief operating officer and co-founder of Altschool, a public benefit, education technology company, from April 2016 until May 2017. Prior to joining Altschool, he held a number of positions of increasing responsibility at the Company from 2008 to 2016, serving as the chief financial officer and head of operations of Activision, one of our principal operating units, chief operating officer of Activision studios, and senior vice president and chief of staff to our Chief Executive Officer. Mr. Johnson holds a B.A. degree in ethics, politics and economics from Yale University and an M.B.A. degree from Stanford University.

Dennis Durkin, Chief Corporate Officer of Activision Blizzard

Dennis Durkin became our Chief Corporate Officer in June 2017. Prior to this, Mr. Durkin served as our Chief Financial Officer since joining the Company in March 2012. Prior to joining the Company, Mr. Durkin held a number of positions of increasing responsibility at Microsoft Corporation, a computing hardware and software manufacturer, most recently serving as the corporate vice president and chief operating and financial officer of Microsoft Corporation's interactive entertainment business, which included the Xbox console business. Prior to joining Microsoft Corporation's interactive entertainment business in 2006, Mr. Durkin worked on Microsoft Corporation's corporate development and strategy team, including two years where he was based in London, England, driving pan-European activity. Before joining Microsoft Corporation, Mr. Durkin was a financial analyst at Alex. Brown and Company. Mr. Durkin holds a B.A. degree in government from Dartmouth College and an M.B.A. degree from Harvard University.

Spencer Neumann, Chief Financial Officer of Activision Blizzard

Spencer Neumann has served as our Chief Financial Officer since May 2017. Prior to joining the Company, Mr. Neumann held a number of positions of increasing responsibility at The Walt Disney Company, most recently serving as the chief financial officer and executive vice president of Global Guest Experience of Walt Disney Parks and Resorts, from 2012 until May 2017. From 2005 to 2012, Mr. Neumann worked at the private equity firms of Providence Equity Partners and Summit Partners. Prior to that, Mr. Neumann held several other roles with Disney, which he initially joined in 1992, including executive vice president of the ABC Television Network from 2001 to 2004 and chief financial officer of the Walt Disney Internet Group from 1999 to 2001. He is also a member of the national board of directors of Make-A-Wish America. Mr. Neumann holds a B.A. degree in economics from Harvard University and an M.B.A. degree from Harvard University.

Eric Hirshberg, President and Chief Executive Officer of Activision

Eric Hirshberg became the President and Chief Executive Officer of Activision in September 2010. Prior to joining us, Mr. Hirshberg served in positions of increasing responsibility with Deutsch LA, a marketing and advertising agency, most recently serving as its co-chief executive officer and its chief

creative officer. Prior to working at Deutsch LA, Mr. Hirshberg worked at Fattal & Collins, a marketing and advertising agency. Mr. Hirshberg holds a B.F.A. degree from the University of California at Los Angeles.

Michael Morhaime, President and Chief Executive Officer of Blizzard

Michael Morhaime became Chief Executive Officer of Blizzard and an executive officer of Activision Blizzard in July 2008 in connection with the Business Combination. Mr. Morhaime co-founded Blizzard in February 1991, and transitioned to the role of Blizzard's President in April 1998. Mr. Morhaime served on the executive committee of Vivendi Games from January 1999, when Blizzard became a subsidiary of Vivendi Games, until the consummation of the Business Combination, when Blizzard became a subsidiary of the Company. Mr. Morhaime holds a B.S. degree in electrical engineering from the University of California at Los Angeles.

Brian Stolz, Chief People Officer of Activision Blizzard

Brian Stolz became our Chief People Officer in May 2016. Prior to joining the Company, Mr. Stolz served as senior vice president of the neurology, dental, and generics businesses of Valeant Pharmaceuticals, a pharmaceutical company. Before that, Mr. Stolz served as Valeant's executive vice president of administration and its chief human capital officer. Prior to joining Valeant, Mr. Stolz held positions as a principal at ghSMART, a leadership consulting and advisory firm, and as an associate principal at McKinsey & Co., a strategy consulting firm. Mr. Stolz holds a B.S. degree in finance from Georgetown University and an M.B.A. degree from Harvard University.

Christopher Walther, Chief Legal Officer of Activision Blizzard

Christopher Walther became our Chief Legal Officer in November 2009 and served as our Secretary from February 2010 until February 2011. Prior to joining us, Mr. Walther held a number of positions of increasing responsibility within the legal department of The Procter & Gamble Company from 1992 to 2009, including serving as the general counsel for Central and Eastern Europe, Middle East and Africa, general counsel for Northeast Asia and, most recently, as general counsel for Western Europe. Mr. Walther also led Procter & Gamble's corporate and securities and mergers and acquisitions practices. Before joining Procter & Gamble, Mr. Walther served as a law clerk for Senior Judge Harry W. Wellford of the United States Sixth Circuit Court of Appeals. Since 2012, Mr. Walther has served on the board of directors of the Alliance for Children's Rights. Mr. Walther has also served as our representative on the board of directors of the Entertainment Software Association since 2013. Mr. Walther holds a B.A. degree in history and Spanish from Centre College and a J.D. degree from the University of Kentucky College of Law.

Riccardo Zacconi, Chief Executive Officer of King

Riccardo Zacconi serves as the Chief Executive Officer of King and became an executive officer of Activision Blizzard in February 2016 in connection with the King Acquisition. Mr. Zacconi co-founded King in March 2003, and has served as its chief executive officer since its founding. Prior to founding King, Mr. Zacconi served as vice president of European sales and marketing at uDate.com, an online dating service, from 2002 until that company's acquisition later that year. From 2001 to 2002, Mr. Zacconi served as entrepreneur in residence at Benchmark Capital Partners, a venture capital firm. Prior to joining Benchmark Capital, he was managing director for Spray Network, an online messaging portal based in Hamburg, Germany, from 1999 until its sale in 2000. Prior to 1999, Mr. Zacconi served in various investment and consulting positions of increasing responsibility with The Boston Consulting Group and LEK Consulting, both of which are management consulting firms. Mr. Zacconi holds a B.A. degree in economics from LUISS University in Italy.

Employees

At December 31, 2017, we had approximately 9,800 total full-time and part-time employees. At December 31, 2017, approximately 175 of our full-time employees were subject to fixed-term employment agreements with us.

The majority of our employees in France, Germany, Spain, and Italy are subject to collective agreements as a part of normal business practices in those countries. In addition, certain employees in those countries are subject to collective bargaining agreements. To date, we have not experienced any labor-related work stoppages.

Additional Financial Information

See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 13 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 return. 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. See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" for information regarding product development expense during the past three years.

Available Information

Our website, located at <https://www.activisionblizzard.com>, allows free-of-charge access to our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and amendments to those documents filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). 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").

Our SEC filings are also available to the public over the Internet at the SEC's website at <https://www.sec.gov>. Additionally, the public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

Item 1A. RISK FACTORS

We wish to caution the reader that the following important risk factors, and those risk factors described elsewhere in this report or in our other filings with the SEC, could cause our actual results to differ materially from those stated in forward - looking statements contained in this document and elsewhere. These risks are not presented in order of importance or probability of occurrence. Further, the risks described below are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also impair our business operations. Any of these risks may have a material adverse effect on our business, reputation, financial condition, results of operations, profitability, cash flows, liquidity, or stock price.

If we do not consistently deliver popular, high-quality content in a timely manner, or if consumers prefer competing products, our business may be negatively impacted.

Consumer preferences for games are usually cyclical and difficult to predict, and even the most successful content remains popular for only limited periods of time, unless refreshed with new content or otherwise enhanced. In order to remain competitive, we must continuously develop new products or enhancements to our existing products. These products or enhancements may not be well-received by consumers, even if well-reviewed and of high quality. Further, competitors may develop content that imitates or competes with our best-selling games, potentially taking sales away from them or reducing our ability to charge the same prices we have historically charged for our products. These competing products may take a larger share of consumer spending than anticipated, which could cause product sales to fall below expectations. If we do not continue to develop consistently high-quality and well-received games, if our marketing fails to resonate with our consumers, if consumers lose interest in a genre of games we produce, if the use of cross-promotion within our mobile games to retain consumers becomes less effective, or if our competitors develop more successful products or offer competitive products at lower prices, our revenues and profit margins could decline. Further, a failure by us to develop a high-quality product, or our development of a product that is otherwise not well-received, could potentially result in additional expenditures to respond to consumer demands, harm our reputation, and increase the likelihood that our future products will not be well-received. The increased importance of downloadable content to our business amplifies these risks, as downloadable content for poorly-received games typically generates lower-than-expected sales. In addition, our own best-selling products could compete with our other games, reducing sales for those other games.

Additionally, consumer expectations regarding the quality, performance and integrity of our products and services are high. Consumers may be critical of our brands, games, services and/or business practices for a wide variety of reasons, and such negative reactions may not be foreseeable or within our control to manage effectively. For example, if our games or services, such as our proprietary online gaming service, do not function as consumers expect, whether because they fail to function as advertised or otherwise, our sales may suffer. The risk that this may occur is particularly pronounced with respect to our games with online features because they involve ongoing consumer expectations, which we may not be able to consistently satisfy. Our games with online features are also frequently updated, increasing the risk that a game may contain significant "bugs." If any of these issues occur, consumers may stop playing the game and may be less likely to return to the game as often in the future, which may negatively impact our business.

Further, delays in product releases or disruptions following the commercial release of one or more new products could negatively impact our business on our revenues and reputation and could cause our results of operations to be materially different from expectations. If we fail to release our products in a timely manner, or if we are unable to continue to extend the life of existing games by adding features and functionality that will encourage continued engagement with the game, our business may be negatively impacted.

Additionally, the amount of lead time and cost involved in the development of high-quality products is increasing, and the longer the lead time involved in developing a product and the greater the allocation of financial resources to such product, the more critical it is that we accurately predict consumer demand for such product. If our future products do not achieve expected consumer acceptance or generate sufficient revenues upon introduction, we may not be able to recover the substantial up-front development and marketing costs associated with those products.

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

We follow a franchise model and a significant portion of our revenues has historically been derived from products based on a relatively small number of popular franchises. These products are responsible for a disproportionately high percentage of our profits. For example, revenues associated with the Call of Duty, Candy Crush, World of Warcraft, and Overwatch franchises, collectively, accounted for approximately 66% of our net revenues—and a significantly higher percentage of our operating income—for 2017. We expect that a relatively limited number of popular franchises will continue to 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 could negatively impact our business. Additionally, if the popularity of a franchise declines, we may have to write off the unrecovered portion of the underlying intellectual property assets, which could negatively impact our business.

We may be unable to effectively manage the continued growth in the scope and complexity of our business, including our expansion into new business models that are untested and into adjacent business opportunities with large, established competitors.

We have experienced significant growth in the scope and complexity of our business, including through the acquisition of King and the development of our MLG, Studios and consumer products businesses, and remain ambitious as to the future growth in the scope and complexity of our business. Our future success depends, in part, on our ability to manage this expanded business and our aspirations for continued expansion. We have dedicated resources both to new business models that are largely untested, as is the case with esports, and to adjacent business opportunities in which very large competitors have an established presence, as is the case with our Studios and consumer products businesses. We do not know to what extent our future expansions will be successful. Further, even if successful, the growth of our business could create significant challenges for our management, operational, and financial resources, and could increase existing strain on, and divert focus from, our core businesses. If not managed effectively, this growth could result in the over-extension of our operating infrastructure, and our management systems, information technology systems, and internal controls and procedures may not be adequate to support this growth. Failure to adequately manage our growth in any of these ways may cause damage to our brand or otherwise negatively impact our business. Further, any failure by these new businesses may damage our reputation or otherwise negatively impact our core business of interactive software products and entertainment content.

The increasing importance of free-to-play games to our business exposes us to the risks of that business model, including the dependence on a relatively small number of consumers for a significant portion of revenues and profits from any given game.

As a result of, among other things, the King Acquisition, we are more dependent on our ability to develop, enhance and monetize free-to-play games, such as the games in our Candy Crush franchise and *Hearthstone*. As such, we are increasingly exposed to the risks of the free-to-play business model. For example, we may invest in the development of new free-to-play interactive entertainment products that do not achieve significant commercial success, in which case our revenues from those products likely will be lower than anticipated and we may not recover our development costs. Further, if: (1) we

are unable to continue to offer free-to-play games that encourage consumers to purchase our virtual currency and subsequently use it to buy our virtual items; (2) we fail to offer monetization features that appeal to these consumers; (3) these consumers do not continue to play our free-to-play games or purchase virtual items at the same rate; (4) our platform providers make it more difficult or expensive for players to purchase our virtual currency; or (5) we cannot encourage significant additional consumers to purchase virtual items in our free-to-play games, our business may be negatively impacted.

Furthermore, as there are relatively low barriers to entry to developing mobile or online free-to-play or other casual games, we expect new competitors to enter the market and existing competitors to allocate more resources to developing and marketing competing games and applications. We compete, or may compete, with a vast number of small companies and individuals who are able to create and launch casual games and other content using relatively limited resources and with relatively limited start-up time or expertise. Competition for the attention of consumers on mobile devices is intense, as the number of applications on mobile devices has been increasing dramatically, which, in turn, has required increased marketing to garner consumer awareness and attention. This increased competition could negatively impact our business. In addition, a continuing industry shift to free-to-play games could result in a deprioritization of our other products by traditional retailers and distributors.

Our industry is subject to rapid technological change, and if we do not adapt to, and appropriately allocate our resources among, emerging technologies and business models, our business may be negatively impacted.

Technology changes rapidly in the interactive entertainment industry. We must continually anticipate and adapt our products, distribution channels and business models to emerging technologies and delivery platforms in order to stay competitive. Forecasting our revenues and profitability for these new products, distribution channels and business models is inherently uncertain and volatile, and if we invest in the development of interactive entertainment products or distribution channels incorporating a new technology or for a new platform that does not achieve significant commercial success, whether because of competition or otherwise, we may not recover the often substantial "up front" costs of developing and marketing those products and distribution channels, or recover the opportunity cost of diverting management and financial resources away from other products or distribution channels. Further, our competitors may adapt to an emerging technology or business model more quickly or effectively than we do, creating products that are technologically superior to ours, more appealing to consumers, or both.

If, on the other hand, we elect not to pursue the development of products incorporating a new technology or for new platforms, or otherwise elect not to pursue new business models, that achieve significant commercial success, it may have adverse consequences. It may take significant time and resources to shift product development resources to that technology, platform or business model, as the case may be, and may be more difficult to compete against existing products incorporating that technology or for that platform or against companies using that business model.

The increasing importance of digital sales to our business exposes us to the risks of that business model, including greater competition.

The proportion of our revenues derived from digital content delivery, as compared to traditional retail sales, continues to increase. The increased importance of digital content delivery in our industry increases our potential competition, as the minimum capital needed to produce and publish a digitally delivered game, particularly a new game for mobile platforms, may be significantly less than that needed to produce and publish one that is purchased through retail distribution and is played on a game console or PC. Also, while digitally-distributed products generally have higher profit margins than retail sales, the risk profile for us, as the publisher, may be increased as business shifts to digital distribution, since the volume of initial orders from retailers for physical discs could be reduced.

Further, the providers of the platforms through which we digitally distribute content are also publishers of their own content distributed on those platforms, and, therefore, a platform provider may give priority to its own products or those of our competitors.

Competition within, and to, the interactive entertainment industry is intense, and competitors may succeed in reducing our sales.

Within the interactive entertainment industry, we compete with other publishers of interactive entertainment software, both within and outside the United States. Our competitors include very large corporations with significantly greater financial, marketing and product development resources than we have. Our larger competitors may be able to leverage their greater financial, technical, personnel and other resources to provide larger budgets for development and marketing and make higher offers to licensors and developers for commercially desirable properties, as well as adopt more aggressive pricing policies to develop more commercially successful video game products than we do. In addition, competitors with large product lines and popular games typically have greater leverage with retailers, distributors and other customers, who may be willing to promote products with less consumer appeal in return for access to those competitors' more popular games.

Additionally, we compete with other forms of entertainment and leisure activities. As our business continues to expand in complexity and scope, we have increased exposure to additional competitors, including those with access to large existing user bases and control over distribution channels. Further, it is difficult to predict and prepare for rapid changes in consumer demand that could materially alter public preferences for different forms of entertainment and leisure activities. Failure to adequately identify and adapt to these competitive pressures could negatively impact our business.

If we are unable to sustain traditional pricing levels for our products, our business may be negatively impacted.

If we are unable to sustain traditional pricing levels for our console or PC titles or the associated downloadable content, whether due to competitive pressure, because retailers or other third parties elect to price these products at a lower price, or otherwise, it could have a negative impact on our business. Further, our decisions around the development of new game content are grounded in assumptions about eventual pricing levels. If there is price compression in the market after these decisions are made, it could have a negative impact on our business.

If we do not continue to attract and retain skilled personnel, we will be unable to effectively conduct our business.

Our employees are our greatest asset. As such, our success depends to a significant extent on our ability to identify, attract, hire, retain, and utilize the abilities of qualified personnel, particularly personnel with the specialized skills needed to create and sell the high-quality, well-received content upon which our business is substantially dependent. Our industry is generally characterized by a high level of employee mobility, competitive compensation programs, and aggressive recruiting among competitors for employees with technical, marketing, sales, engineering, product development, creative, and/or management skills. We may have difficulties in attracting and retaining skilled personnel or may incur significant costs in order to do so. If we are unable to attract additional qualified employees or retain and utilize the services of key personnel, it could have a negative impact on our business.

We rely on external developers to develop some of our software products.

We rely on external software developers to develop some of our software products. Because we depend on these developers, we are subject to the following risks:

- continuing strong demand for top-tier developers' resources, combined with the recognition they receive in connection with their work, may cause developers who worked for us in the past either to work for a competitor in the future or to renegotiate agreements with us on terms less favorable to us;
- limited financial resources and business expertise and inability to retain skilled personnel may force developers out of business prior to completing products for us or require us to fund additional costs;
- a competitor may acquire the business of one or more key developers or sign them to exclusive development arrangements and, in either case, we would not be able to continue to engage such developers' services for our products, except for any period of time for which the developer is contractually obligated to complete development for us; and
- reliance on external developers reduces our visibility into, and control over, development schedules and operational outcomes compared to those when utilizing internal development resources.

Increased competition for skilled third-party software developers also has compelled us to agree to make significant advance payments on royalties to game developers. If the products subject to these arrangements do not generate sufficient revenues to recover these royalty advances, we would have to write off unrecovered portions of these payments, which could negatively impact our business. Typically, we pay developers a royalty based on a percentage of net revenues from product sales, less agreed upon deductions, but from time to time, we have agreed to pay developers fixed per unit product royalties after royalty advances are fully recouped. To the extent that sales prices of products on which we have agreed to pay a fixed per unit royalty are marked down, it could negatively impact our business.

We engage in strategic transactions and may encounter difficulties in integrating acquired businesses or otherwise realizing the anticipated benefits of the transactions.

As part of our business strategy, from time to time, we acquire, make investments in, or enter into strategic alliances and joint ventures with, complementary businesses. These transactions may involve significant risks and uncertainties, including: (1) in the case of an acquisition, (i) the potential for the acquired business to underperform relative to our expectations and the acquisition price, (ii) the potential for the acquired business to cause our financial results to differ from expectations in any given period, or over the longer-term, (iii) unexpected tax consequences from the acquisition, or the tax treatment of the acquired business's operations going forward, giving rise to incremental tax liabilities that are difficult to predict, (iv) difficulty in integrating the acquired business, its operations and its employees in an efficient and effective manner, (v) any unknown liabilities or internal control deficiencies assumed as part of the acquisition, and (vi) the potential loss of key employees of the acquired businesses, and, (2) in the case of an investment, alliance or joint venture, (i) our ability to cooperate with our partner, (ii) our partner having economic, business or legal interests or goals that are inconsistent with ours, and (iii) the potential that our partner may be unable to meet its economic or other obligations, which may require us to fulfill those obligations alone. Further, any such transaction may involve the risk that our senior management's attention will be excessively diverted from our other operations, the risk that our industry does not evolve as anticipated and that any intellectual property or personnel skills acquired do not prove to be those needed for our future

success, and the risk that our strategic objectives, cost savings or other anticipated benefits are otherwise not achieved.

Our debt could adversely affect our business.

As of December 31, 2017, the Company had approximately \$4.4 billion of long-term debt outstanding. Our debt burden could have important consequences, including: increasing our vulnerability to general adverse economic and industry conditions; limiting our flexibility in planning for, or reacting to, changes in our business and our industry; requiring the dedication of a substantial portion of any cash flow from operations for the payment of principal and interest on our indebtedness, thereby reducing the availability of cash flow to fund our operations, growth strategy, working capital, capital expenditures, future business opportunities, and other general corporate purposes; exposing us to the risk of increased interest rates with respect to any borrowings that are at floating rates of interest; restricting us from making strategic acquisitions or causing us to make non-strategic divestitures; limiting our ability to obtain additional financing for working capital, capital expenditures, research and development, acquisitions and general corporate or other purposes; limiting our ability to adjust to changing market conditions; and placing us at a competitive disadvantage relative to competitors who are less highly leveraged.

Agreements governing our indebtedness, including our credit agreement and the indentures governing our notes, impose operating and financial restrictions on our activities. These restrictions require us to comply with or maintain certain financial tests and ratios. In addition, under certain circumstances, our credit agreement and indentures may limit or prohibit other activities. In addition, we are required to maintain a maximum total net debt ratio calculated pursuant to a financial maintenance covenant under our credit agreement. Further, various risks, uncertainties and events beyond our control could affect our ability to comply with these covenants. Failure to comply with any of the covenants in our financing agreements could result in a default under those agreements and under other agreements containing cross-default provisions. Such a default would permit lenders to accelerate the maturity of the debt under these agreements. Under these circumstances, we might not have sufficient funds or other resources to satisfy all of our obligations, including our obligations under our credit agreement or the indentures governing our notes. In addition, the limitations imposed by financing agreements on our ability to incur additional debt and to take other actions might significantly impair our ability to obtain other financing. There can be no assurances that we will be granted waivers or amendments to these agreements if for any reason we are unable to comply with these agreements or that we will be able to refinance our debt on terms acceptable to us, or at all.

We may not be able to borrow funds under our revolving credit facility if we are not able to meet the conditions to borrowing under that facility.

We view our revolving credit facility as a source of available liquidity. This facility contains various conditions, covenants and representations with which we must be in compliance in order to borrow funds. We have not borrowed under the revolving credit facility to date, but if we wish to do so, there can be no assurance that we will be in compliance with these conditions, covenants and representations at such time.

We may be involved in legal proceedings that have a negative impact on our business.

From time to time, we are involved in claims, suits, government investigations, audits and proceedings arising in the ordinary course of our business, including actions with respect to intellectual property, competition and antitrust matters, privacy matters, tax matters, labor and employment matters, unclaimed property matters, compliance and commercial claims. In addition, negative consumer sentiment about our business practices may result in inquiries or investigations from

regulatory agencies and consumer groups, as well as litigation, which, regardless of their outcome, may be damaging to our reputation.

Claims, suits, government investigations, audits and proceedings are inherently difficult to predict and their results are subject to significant uncertainties, many of which are outside of our control. Regardless of the outcome, such legal proceedings can have a materially adverse impact on us due to legal costs, diversion of management resources and other factors. In addition, it is possible that a resolution of one or more such proceedings could result in reputational harm, substantial settlements, judgments, fines or penalties, criminal sanctions, consent decrees or orders preventing us from offering certain features, functionalities, products or services, requiring us to change our development process or other business practices.

There is also inherent uncertainty in determining reserves for these matters. There is significant judgment required in the analysis of these matters, including assessing the probability of potential outcomes and determining whether a potential exposure can be reasonably estimated. In making these determinations, we, in consultation with outside counsel, examine the relevant facts and circumstances on a quarterly basis assuming, as applicable, a combination of settlement and litigated outcomes and strategies. Further, it may take time to develop factors on which reasonable judgments and estimates can be based. If we fail to establish appropriate reserves, our business could be negatively impacted.

Issues with the toys, accessories or hardware peripherals utilized in certain of our games may lead to product liability, personal injury or property damage claims, recalls, replacements of products, or regulatory actions by governmental authorities.

We may experience issues with toys, accessories or peripherals that may lead to product liability, personal injury or property damage claims, recalls, replacements of products, or regulatory actions by governmental authorities. Any of these activities could result in increased governmental scrutiny, harm to our reputation, reduced demand by consumers for our products, decreased willingness by our customers to purchase, or by our partners to provide marketing support for, those products, denial or increased cost for insurance coverage, or additional safety and testing requirements, any of which could negatively impact our business.

Lawsuits have been filed, and may continue to be filed, against publishers of interactive entertainment software products.

In prior years, lawsuits have been filed against numerous interactive entertainment companies, including against us, by the families of victims of violence, alleging that interactive entertainment products influence the behavior of the perpetrators of such violence. These lawsuits have been dismissed, but similar additional lawsuits could be filed in the future. Although our general liability insurance carrier has agreed to defend lawsuits of this nature with respect to the prior lawsuits, it is uncertain whether insurance carriers would do so in the future, or if such insurance carriers would cover all or any amounts for which we might be liable if such future lawsuits are not decided in our favor. Further, any such lawsuit could result in increased governmental scrutiny, harm to our reputation, reduced demand by consumers for our products, or decreased willingness by our customers to purchase, or by our partners to provide marketing support for, those products. Such results could divert development and management resources, increase legal fees and other costs and have other negative impacts on our business.

We are exposed to seasonality in the sale of our products.

The interactive entertainment industry is somewhat seasonal, with the highest levels of consumer demand occurring during the year-end holiday buying season in the fourth quarter of the calendar year. As a result, our sales have historically been highest during the second half of the year, particularly for

our Activision segment. Receivables and credit risk are likewise higher during the second half of the year, as retailers increase their purchases of our products in anticipation of the holiday season. Delays in development, approvals or manufacturing could affect the timing of the release of products, causing us to miss key selling periods such as the year-end holiday buying season, which could negatively impact our business.

Our business may be harmed if our distributors, retailers, development and licensing partners, or other third parties with whom we do business act in ways that put our brand at risk.

In many cases, our business partners are given access to sensitive and proprietary information or control over our intellectual property in order to provide services and support to our team. These third parties may misappropriate our information or intellectual property and engage in unauthorized use of it or otherwise act in a way that places our brand at risk. The failure of these third parties to provide adequate services and technologies, the failure of third parties to adequately maintain or update their services and technologies or the misappropriation or misuse of this information or intellectual property could result in a disruption to our business operations or an adverse effect on our reputation, and may negatively impact our business.

We use open source software in connection with certain of our games and services, which may pose particular risks to our proprietary software, products, and services in a manner that could have a negative impact on our business.

We use open source software in connection with certain of our games and the services we offer. Some open source software licenses require users who distribute open source software as part of their software to publicly disclose all or part of the source code to such software or make available any derivative works of the open source code on unfavorable terms or at no cost. The terms of various open source licenses have not been interpreted by courts, and there is a risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our use of the open source software. Were it determined that our use was not in compliance with a particular license, we may be required to release our proprietary source code, pay damages for breach of contract, re-engineer our games or products, discontinue distribution in the event re-engineering cannot be accomplished on a timely basis, or take other remedial action that may divert resources away from our game development efforts, any of which could negatively impact our business.

We may be subject to intellectual property claims.

As the number of interactive entertainment software products increases and the features and content of these products continue to overlap, software developers have increasingly become subject to infringement claims. Further, many of our products are highly realistic and feature materials that are based on real-world things or people, which may also be the subject of claims of infringement of the intellectual property of others, including right of publicity, trademark, and unfair competition claims. In addition, our products often utilize complex, cutting-edge technology that may become subject to emerging intellectual property claims of others. Although we take steps to avoid knowingly violating the intellectual property rights of others, third parties may still claim infringement, particularly since there are many companies that focus exclusively on enforcing patent rights.

From time to time, we receive communications from third parties regarding such claims. Existing or future infringement claims against us, whether meritorious or not, may be time consuming, distracting to management and expensive to defend. Further, intellectual property litigation or claims could force us to do one or more of the following:

- cease selling, incorporating, supporting or using products or services that incorporate the challenged intellectual property;

- obtain a license from the holder of the infringed intellectual property, which, if available at all, may not be available on commercially favorable terms;
- redesign the affected interactive entertainment software products, which could result in additional costs, delay introduction and possibly reduce commercial appeal of the affected products; or
- pay damages to the holder of the infringed intellectual property for past infringements.

Our products are subject to the threat of piracy and unauthorized copying, and inadequate intellectual property laws and other protections could prevent us from enforcing or defending our proprietary technologies. We may also face legal risks arising out of user-generated content. Further, the use of unauthorized "cheat" programs or the use of other unauthorized software modifications by users could impact multiplayer gameplay or lead to reductions in microtransactions in our games.

We regard our software as proprietary and rely on a variety of methods, including a combination of copyright, patent, trademark and trade secret laws and employee and third-party nondisclosure agreements, to protect our proprietary rights. We own or license various copyrights, patents, trademarks and trade secrets. The process of registering and protecting these rights in various jurisdictions is expensive and time-consuming. Further, we are aware that some unauthorized copying occurs, and if a significantly greater amount of unauthorized copying of our software products were to occur, it could negatively impact our business.

Piracy is a persistent problem for us, and policing the unauthorized sale, distribution and use of our products is difficult, expensive, and time-consuming. Further, the laws of some countries in which our products are, or may be, distributed either do not protect our products and intellectual property rights to the same extent as the laws of the United States, or are poorly enforced. In addition, though we take steps to make the unauthorized sale, distribution and use of our products more difficult and to enforce and police our rights, as do the manufacturers of consoles and the operators of other platforms on which many of our games are played, our efforts and the efforts of the console manufacturers and platform operators may not be successful in controlling the piracy of our products in all instances. Technology designed to circumvent the protection measures used by console manufacturers and platform operators or by us in our products, the increasing availability of broadband access to the Internet, the refusal of Internet service providers to remove infringing content in certain instances and the ability to download pirated copies of games from various Internet sites and peer-to-peer networks could result in an expansion in piracy.

In addition, "cheating" programs or other unauthorized software tools and modifications that enable consumers to cheat in games could negatively impact the volume of microtransactions or purchases of downloadable content. In addition, vulnerabilities in the design of our applications and of the platforms upon which they run could be discovered after their release, which may result in lost revenue opportunities. This may lead to lost revenues from paying consumers or increased cost of developing technological measures to respond to these, either of which could negatively impact our business.

We also cannot be certain that existing intellectual property laws will provide adequate protection for our products in connection with emerging technologies.

Due to our reliance on third-party platforms, platform providers are frequently able to influence our products and costs.

Generally, when we develop interactive entertainment software products for hardware platforms offered by Sony, Microsoft, or Nintendo, the physical products are replicated exclusively by that hardware manufacturer or their approved replicator. The agreements with these manufacturers include

certain provisions, such as approval rights over all software products and related promotional materials and the ability to change the fee they charge for the manufacturing of products, which allow the hardware manufacturers substantial influence over the cost and the release schedule of such interactive entertainment software products. In addition, because each of the manufacturers is also a publisher of games for its own hardware platforms and manufactures products for all of its other licensees, a manufacturer may give priority to its own products or those of our competitors. Accordingly, Sony, Microsoft, or Nintendo could cause unanticipated delays in the release of our products, as well as increases to projected development, manufacturing, marketing or distribution costs, any of which could negatively impact our business.

The platform providers also control the networks over which consumers purchase digital products and services for their platforms and through which we provide online game capabilities for our console platform products. The control that the platform providers have over the fee structures and/or retail pricing for products and services for their platforms and online networks could impact the volume of purchases of our products made over their networks and our profitability. With respect to certain downloadable content and microtransactions, the networks provided by these platform providers are the exclusive means of selling and distributing this content. Further, increased competition for limited premium "digital shelf space" has placed the platform providers in an increasingly better position to negotiate favorable terms of sale. If the platform provider establishes terms that restrict our offerings on its platform, or significantly impact the financial terms on which these products or services are offered to our customers, or does not renew our license or approve the inclusion of online capabilities in our console products, our business could be negatively impacted.

We also derive significant revenues from the distribution of free-to-play games on third-party mobile and web platforms such as the Apple App Store, the Google Play Store, and Facebook, and most of the virtual currency we sell is purchased using the payment processing systems of these platform providers. These platforms also serve as significant online distribution platforms for our games. If these platforms modify their current discovery mechanisms, communication channels available to developers, operating systems, terms of service or other policies (including fees), or they develop their own competitive offerings, our business could be negatively impacted. Further, if these platform providers are required to change how they label free-to-play games or take payment for in-app purchases or change how the personal information of consumers is made available to developers, our business could be negatively impacted.

Our business is highly dependent on the success and availability of video game platforms manufactured by third parties, as well as our ability to develop commercially successful products for these platforms.

We derive a substantial portion of our revenues from the sale of products for play on video game platforms manufactured by third parties, such as Sony's PS4, Microsoft's Xbox One, and Nintendo's Wii U and Switch. For example, sales of products for consoles accounted for 34% of our consolidated net revenues in 2017. The success of our console business is driven in large part by our ability to accurately predict which platforms will be successful in the marketplace and our ability to develop commercially successful products for these platforms. We also rely on the availability of an adequate supply of these video game consoles and the continued support for these consoles by their manufacturers. We must make product development decisions and commit significant resources well in advance of the anticipated introduction of a new platform, and development costs for new console platforms may be greater than those costs for the then-current console platforms. If increased costs are not offset by higher revenues and other cost efficiencies, our business could be negatively impacted. If the platforms for which we develop new software products or modify existing products do not attain significant market acceptance, we may not be able to recover our development costs, which could be significant.

The importance of retail sales to our business exposes us to the risks of that business model.

In the United States and Canada, our "boxed" products are often sold on a direct basis to mass-market retailers, consumer electronics stores, discount warehouses and game specialty stores. Our "boxed" 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. Our sales are made primarily on a purchase order basis without long-term agreements or other forms of commitments, and our retail customers and distributors have generally been reducing the levels of inventory they are willing to carry. The loss of, or significant reduction in sales to, any of Activision's principal retail customers or distributors could have adverse consequences. In addition, having such a large portion of our retail total net revenues concentrated in a few customers reduces our negotiating leverage with these customers.

Further, the concentration of sales in a small number of large customers also makes 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. 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. 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 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. Further, 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. A payment default by, or the insolvency or business failure of, a significant business partner could negatively impact our business.

Moreover, the importance of retail sales to our business exposes us to the risk of product returns and price protection with respect to our distributors and retailers. In some cases, return policies allow distributors and retailers to return defective, shelf-worn, damaged and certain other products in accordance with terms granted. Price protection, when granted and applicable, allows these distributors and retailers a credit against amounts owed with respect to merchandise unsold by them. We may permit product returns from, or grant price protection to, distributors and retail customers who meet certain conditions. These conditions may include compliance with applicable payment terms, delivery of weekly inventory and sales information and consistent participation in the launches of premium title releases. We may also consider other factors, including the facilitation of slow-moving inventory and other industry factors. Activision also offers a 90-day limited warranty to end users that Activision products will be free from manufacturing defects. Although we maintain a reserve for returns and price protection, and although we may place limits on product returns and price protection, we could be forced to accept substantial product returns and provide substantial price protection to maintain our relationships with retailers and our access to distribution channels. We face similar issues and risks, including exposure to risk of chargebacks, with respect to end users to whom we sell products directly, whether through our proprietary online gaming service or otherwise.

Further, retailers typically have a limited amount of shelf space and promotional resources, and there is intense competition for high-quality retail shelf space and promotional support from retailers. Competition for shelf space may intensify and may require us to increase our marketing expenditures. Retailers with limited shelf space typically devote the most and highest quality shelf space to those products expected to be best sellers. We cannot be certain that our new products will consistently achieve such "best seller" status. Due to increased competition for limited shelf space, retailers and distributors are in an increasingly better position to negotiate favorable terms of sale, including price discounts, price protection, marketing and display fees and product return policies. Our products

constitute a relatively small percentage of most retailers' sales volume. We cannot be certain that retailers will continue to purchase our products or provide those products with adequate levels of shelf space and promotional support on acceptable terms.

Additionally, we make provisions for retail inventory price protection based upon certain assumed lowest prices and if competitive pressures force us to lower our prices below those levels, it could similarly have a negative impact on our business. Further, because we pay a licensing fee to the console hardware manufacturer for each physical copy of a product manufactured for that manufacturer's game platform regardless of whether that product is actually sold, if we overestimate demand and make too many physical "boxed" copies of any title, we will incur unrecoverable manufacturing costs for unsold units.

We are a global company and are subject to the risks and uncertainties of conducting business outside the U.S.

We conduct business throughout the world, and we derive a substantial amount of our revenues and profits from international trade, particularly from Europe, Asia and Australia. Moving forward, we expect that international sales will continue to account for a significant portion of our total revenues and profits and, moreover, that sales in emerging markets in Asia and elsewhere will be an increasingly important part of our international sales. As such, we are, and may be increasingly, subject to risks inherent in foreign trade generally, as well as risks inherent in doing business in emerging markets, including increased tariffs and duties, compliance with economic sanctions, fluctuations in currency exchange rates, shipping delays, increases in transportation costs, international political, regulatory and economic developments, unexpected changes to laws, regulatory requirements and enforcement on us and our platform partners and differing local business practices, all of which may impact profit margins or make it more difficult, if not impossible, for us to conduct business in foreign markets.

A deterioration in relations between either us or the United States and any country in which we have significant operations or sales, or the implementation of government regulations in such a country, could result in the adoption or expansion of trade restrictions, including economic sanctions, that could have a negative impact on our business. For instance, to operate in China, all games must have regulatory approval. A decision by the Chinese government to revoke its approval for any of our games or to decline to approve any products we desire to sell in China in the future could have a negative impact on our business. Additionally, in the past, legislation has been implemented in China that has required modifications to our software. The future implementation of similar laws or regulations in China or any other country in which we have operations or sales may restrict or prohibit the sale of our products or may require engineering modifications to our products that are not cost-effective, if even feasible at all, or could degrade the consumer experience to the point where consumers cease to purchase such products. Further, the enforcement of regulation of mobile and other games with an online element in China remains uncertain, and further changes, either in the regulations or their enforcement, could have a negative impact on our business in China.

We are also subject to risks that our operations outside the United States could be conducted by our employees, contractors, third-party partners, representatives or agents in ways that violate the Foreign Corrupt Practices Act, the U.K. Anti-Bribery Act or other similar anti-bribery laws, as well as the 2017 U.K. Criminal Finances Act or other similar financial crime laws. While we have policies and procedures, as well as training for our employees, intended to secure compliance with these laws, our employees, contractors, third-party partners, representatives or agents may take actions that violate our policies. Moreover, it may be more difficult to oversee the conduct of any such persons who are not our employees, potentially exposing us to greater risk from their actions.

Additionally, in June 2016, voters in the United Kingdom approved an advisory referendum to withdraw from the European Union (the "E.U."), commonly referred to as "Brexit." The United

Kingdom commenced withdrawal proceedings with the E.U. in March 2017. These proceedings have created political and economic uncertainty, particularly in the United Kingdom and the E.U., and this uncertainty may persist for years. The uncertainty surrounding the terms of the United Kingdom's withdrawal and its consequences could adversely impact consumer and investor confidence and the level of sales of discretionary items, including our products. Any of these effects could negatively impact our business.

In addition, cultural differences may affect consumer preferences and limit the international popularity of games that are popular in the U.S, or require us to modify the content of the games or the method by which we charge our customers for the games to be successful. If we do not correctly assess consumer preferences in the countries in which we sell our products, or if the other risks discussed herein come to fruition, it could negatively impact our business.

Changes in tax rates or exposure to additional tax liabilities could negatively impact our business.

We are subject to income taxes in the United States and other jurisdictions. In the ordinary course of business there are many transactions and calculations where the ultimate income tax determination is uncertain. Significant judgment is required in determining our worldwide income tax provision. Although we believe our income tax estimates are reasonable, the ultimate outcomes may have a material adverse effect on the Company's consolidated financial position, liquidity, or results of operations.

Our income tax liability and effective tax rate could be adversely affected by a variety of factors, including changes in our business, the mix of earnings in countries with differing statutory tax rates, changes in tax laws or tax rulings, changes in interpretations of existing laws, or developments in tax examinations or investigations. Any of these factors could have a material adverse effect on the Company's consolidated financial position, liquidity, or results of operations or require us to change the manner in which we operate our business. The tax regimes we are subject to or operate under are unsettled and may be subject to significant change. The E.U. and its member states, and a number of other countries are actively pursuing fundamental changes to the tax laws applicable to multinational companies like us. Furthermore, tax authorities may choose to examine or investigate our tax reporting or tax liability, including under transfer pricing or permanent establishment theories. These proceedings may lead to adjustments or proposed adjustments to our income taxes or provisions for uncertain tax positions.

On December 22, 2017, tax reform legislation known as the Tax Cuts and Jobs Act (the "U.S. Tax Reform Act") was enacted in the United States. The U.S. Tax Reform Act introduces significant changes to U.S. income tax law that will have a meaningful impact on our financial position and effective tax rate. Accounting for the income tax effects of the U.S. Tax Reform Act requires complex new calculations to be performed and significant judgments in interpreting the legislation. Additional guidance may be issued on how the provisions of the U.S. Tax Reform Act will be applied or otherwise administered that is different from our interpretation. Due to the timing of enactment and the complexity in determining the income tax effects of the U.S. Tax Reform Act, we made reasonable estimates of the effects and recorded provisional amounts in our financial statements for the year ended December 31, 2017. We may make adjustments to the provisional amounts as we collect and prepare the data necessary to finalize our calculations, interpret the U.S. Tax Reform Act and any additional guidance issued, and consider the effects of any additional actions we may take as a result of the U.S. Tax Reform Act. These adjustments could materially affect our financial position and results of operations as well as our effective tax rate in the period in which these adjustments are made.

In late 2017, we received a Notice of Reassessment from the French Tax Authority ("FTA") related to transfer pricing concerning intercompany transactions involving one of our French subsidiaries for the 2011 through 2013 tax years. We disagree with the proposed assessment and intend to vigorously

contest it. We plan to pursue all remedies available to us to successfully resolve this matter, including administrative remedies with the FTA, and judicial remedies, if necessary. While we believe our tax provisions at December 31, 2017 are appropriate, until such time as this matter is ultimately resolved we could be subject to significant additional tax liabilities. In addition to the risk of additional tax for years 2011 through 2013, if litigation regarding this matter were adversely determined and/or if the FTA were to seek adjustments of a similar nature for subsequent years, we could be subject to significant additional tax liabilities.

We are also required to pay taxes other than income taxes, such as payroll, sales, use, value-added, net worth, property, and goods and services taxes, in both the United States and various other jurisdictions. Tax authorities regularly examine these non-income taxes. The outcomes from these examinations, changes in the business, changes in applicable tax rules or other tax matters may have a negative impact on our business.

Fluctuations in currency exchange rates could negatively impact our business.

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 euros, British pounds, Australian dollars, South Korean won, Chinese yuan, and Swedish krona, which could fluctuate against the U.S. dollar. Since we have significant international sales, but incur the majority of our costs in the United States, the impact of foreign currency fluctuations, particularly the strengthening of the U.S. dollar, may have an asymmetric and disproportional impact on our business. We have, in the past, utilized currency derivative contracts to hedge certain foreign exchange exposures and managed these exposures with natural offsets. However, there can be no assurance that we will continue our hedging programs, or that we will be successful in managing exposure to currency exchange rate risks whether or not we do so.

Our games are subject to scrutiny regarding the appropriateness of their content. If we fail to receive our target ratings for certain titles, or if our retailers refuse to sell such titles due to what they perceive to be objectionable content, it could have a negative impact on our business.

Our console and PC games are subject to ratings by the Entertainment Software Rating Board (the "ESRB"), a self-regulatory body based in the U.S. that provides U.S. and Canadian consumers of interactive entertainment software with ratings information, including information on the content in such software, such as violence, nudity or sexual content, along with an assessment of the suitability of the content for certain age groups. Certain other countries have also established content rating systems as prerequisites for product sales in those countries. In addition, certain stores use other ratings systems, such as Apple's use of its proprietary "App Rating System" and Google Play's use of the International Age Rating Coalition (IARC) rating system. If we are unable to obtain the ratings we have targeted for our products, it could have a negative impact on our business. In some instances, we may be required to modify our products to comply with the requirements of the rating systems, which could delay or disrupt the release of any given product, or may prevent its sale altogether in certain territories. Further, if one of our games is "re-rated" for any reason, a ratings organization could require corrective actions, which could include a recall, retailers could refuse to sell it and demand that we accept the return of any unsold or returned copies or consumers could demand a refund for copies previously purchased.

Additionally, retailers may decline to sell interactive entertainment software containing what they judge to be graphic violence or sexually explicit material or other content that they deem inappropriate for their businesses, whether because a product received a certain rating by the ESRB or other content rating system, or otherwise. If retailers decline to sell our products based upon their opinion that they contain objectionable themes, graphic violence or sexually explicit material or other generally

objectionable content, we might be required to modify particular titles or forfeit the revenue opportunity of selling such titles with that retailer.

Further, throughout the history of the interactive entertainment industry, many interactive software products have included hidden content and/or hidden gameplay features, some of which have been accessible through the use of in-game codes or other technological means, that are intended to enhance the gameplay experience. In some cases, such undisclosed content or features have been considered to be objectionable. While publishers are required to disclose pertinent hidden content during the ESRB ratings process, in a few cases, publishers have failed to disclose hidden content, and the ESRB has required the recall of the game, changed the rating or associated content descriptors originally assigned to the product, required the publisher to change the game or game packaging and/or imposed fines on the publisher. Retailers have on occasion reacted to the discovery of such undisclosed content by removing these games from their shelves, refusing to sell them and demanding that their publishers accept them as product returns. Likewise, some interactive entertainment software consumers have reacted to the revelation of undisclosed content by refusing to purchase such games, demanding refunds for games they have already purchased, refraining from buying other games published by the company whose game contained the objectionable material, and, on at least one occasion, filing a lawsuit against the publisher of the product containing such content.

We have implemented preventive measures designed to reduce the possibility of objectionable undisclosed content from appearing in the interactive software products we publish. Nonetheless, these preventive measures are subject to human error, circumvention, overriding and reasonable resource constraints. If an interactive software product we publish is found to contain undisclosed content, we could be subject to any of these consequences.

Our business, products, and distribution are subject to increasing regulation in key territories. If we do not successfully respond to these regulations, our business could be negatively impacted.

Legislation is continually being introduced, and litigation and regulatory enforcement actions are taking place, that may affect the way in which we, and other industry participants, may offer content and features, and distribute and advertise our products. The video game industry continues to evolve, and new and innovative business opportunities are often subject to new attempts at regulation. Many foreign countries, such as China and Germany, have laws that permit governmental entities to restrict or prohibit marketing or distribution of interactive entertainment software products because of the content therein (and similar legislation has been introduced at one time or another at the federal and state levels in the United States). Further, the growth and development of electronic commerce and virtual items and currency may prompt calls for more stringent consumer protection laws that may impose additional burdens or limitations on operations of companies such as ours conducting business through the Internet and mobile devices. We are subject to laws and regulations related to protection of minors, consumer privacy, accessibility, advertising, taxation, payments, intellectual property, distribution, and antitrust, among others. Also, existing laws or new laws regarding the marketing of in-app purchases, regulation of currency, banking institutions, virtual currencies, unclaimed property, and money laundering may be interpreted to cover virtual currency or goods. Furthermore, the growth and development of electronic commerce and virtual items and currency may prompt calls for more stringent consumer protection laws that may impose additional burdens or limitations on operations of companies such as ours conducting business through the Internet and mobile devices. The adoption and enforcement of legislation that restricts the marketing, content, business model, or sales of our products in countries in which we do business may harm the sales of our products, as the products we are able to offer to our customers and the size of the potential market for our products may be limited. We may be required to modify certain product development processes or products or alter our marketing strategies to comply with regulations, which could be costly or delay the release of our products. The laws and regulations affecting our products vary by territory and may be inconsistent with one another.

imposing conflicting or uncertain restrictions. Failure to comply with any applicable legislation may also result in government-imposed fines or other penalties, as well as harm to our reputation. Moreover, the public dialogue concerning interactive entertainment may have an adverse impact on our reputation and consumers' willingness to purchase our products. Because the King Acquisition has significantly increased our user population, it may subject us to laws and regulations in additional jurisdictions and exacerbate the potential adverse impact on our business.

Although we have structured and operate our skill tournaments with applicable laws in mind, including any applicable laws relating to gambling, and believe that playing these games does not constitute gambling, our skill tournaments could in the future become subject to gambling-related rules and regulations and expose us to civil and criminal penalties. We also sometimes offer consumers of our online and casual games various types of contests and promotional opportunities. We are subject to laws in a number of jurisdictions concerning the operation and offering of such activities and games, many of which are still evolving and could be interpreted in ways that could harm our business. Further, some of our online games and other services include random digital item mechanics, which may become subject to regulations in various jurisdictions. If these were to occur, we might be required to seek licenses, authorizations, or approvals from relevant regulators, the granting of which may be dependent on us meeting certain capital and other requirements, and we may be subject to additional regulation and oversight, such as reporting to regulators, all of which could significantly increase our operating costs. Changes in current laws or regulations or the imposition of new laws and regulations in the United States, Europe, or elsewhere regarding these activities may lessen the growth of casual game services and impair our business.

Change in government regulations relating to the Internet could negatively impact our business.

We rely on our consumers' access to significant levels of Internet bandwidth for the sale and digital delivery of our content and the functionality of our games with online features. Changes in laws or regulations that adversely affect the growth, popularity or use of the Internet, including laws impacting "net neutrality," could decrease the demand for our products and services or increase our cost of doing business. Although certain jurisdictions have implemented laws and regulations intended to prevent Internet service providers from discriminating against particular types of legal traffic on their networks, other jurisdictions may lack such laws and regulations or repeal existing laws or regulations. For example, on December 14, 2017, the Federal Communications Commission voted to repeal net neutrality regulations in the U.S. Given uncertainty around these rules, including changing interpretations, amendments, or repeal, coupled with the potentially significant political and economic power of local Internet service providers and the relatively significant level of Internet bandwidth access our products and services require, we could experience discriminatory or anti-competitive practices that could impede our growth, cause us to incur additional expenses, or otherwise negatively impact our business.

The laws and regulations concerning data privacy are continually evolving. Failure to comply with these laws and regulations could harm our business.

Consumers play certain of our games online using third-party platforms and networks, through online social platforms, and on mobile devices. We collect and store information about our consumers of these games—both personally identifying and non-personally identifying information. We are subject to laws from a variety of jurisdictions regarding privacy and the protection of this information. For example, the E.U. has traditionally taken a broader view than the United States and certain other jurisdictions as to what is considered personal information and has imposed greater obligations under data privacy regulations. The U.S. Children's Online Privacy Protection Act ("COPPA") also regulates the collection, use, and disclosure of personal information from children under 13 years of age. Failure

to comply with COPPA may increase our costs, subject us to expensive and distracting government investigations, and result in substantial fines.

Data privacy protection laws are rapidly changing and likely will continue to do so for the foreseeable future, which could impact our approach to operating and marketing our games. For example, the E.U.'s General Data Protection Regulation (the "GDPR"), which will come into effect in May 2018, imposes a range of new compliance obligations for us and other companies with European users, and increases financial penalties for noncompliance significantly. Regulators have not yet issued clear guidance for many of these new compliance obligations. The U.S. government, including the Federal Trade Commission and the Department of Commerce, is continuing to review the need for greater regulation over the collection of personal information and information about consumer behavior on the Internet and on mobile devices, and the E.U. has proposed reforms to its existing data protection legal framework, including the GDPR. Various government and consumer agencies worldwide have also called for new regulation and changes in industry practices. In addition, in some cases, we are dependent upon our platform providers to solicit, collect and provide us with information regarding our consumers that is necessary for compliance with these various types of regulations.

Player interaction with our games is subject to our privacy policies, end user license agreements ("EULAs"), and terms of service. If we fail to comply with our posted privacy policies, EULAs, or terms of service, or if we fail to comply with existing privacy-related or data protection laws and regulations, it could result in proceedings or litigation against us by governmental authorities or others, which could result in fines or judgments against us, damage our reputation, impact our financial condition and harm our business. If regulators, the media, or consumers raise any concerns about our privacy and data protection or consumer protection practices, even if unfounded, this could also result in fines or judgments against us, damage our reputation, negatively impact our financial condition, and damage our business.

We depend on servers to operate our games with online features and our proprietary online gaming service. If we were to lose server functionality for any reason, our business may be negatively impacted.

Our business relies on the continuous operation of servers, some of which are owned and operated by third parties. Although we strive to maintain more than sufficient server capacity, and provide for active redundancy in the event of limited hardware failure, any broad-based catastrophic server malfunction, a significant service-disrupting attack or intrusion by hackers that circumvents security measures, a failure of disaster recovery service or the failure of a company on which we are relying for server capacity to provide that capacity for whatever reason would likely degrade or interrupt the functionality of our games with online features, and could prevent the operation of such games altogether, any of which could result in the loss of sales for, or in, such games. This risk is particularly pronounced with respect to the mobile games published by King, which rely on a small number of third-party owned data centers located in one city, or with respect to the functioning of our proprietary online gaming service, Blizzard Battle.net, the disruption of which could prevent Blizzard from delivering content digitally or render all of Blizzard's games, as well as *Destiny 2* PC content, unavailable.

We also rely on networks operated by third parties, such as the PlayStation Network, Xbox Live and Steam, for the sale and digital delivery of downloadable console and PC game content and the functionality of our games with online features. Similarly, we rely on the continued operation of the Apple App Store, the Google Play Store, and Facebook for the sale of virtual currency for our free-to-play games. An extended interruption to any of these services could adversely affect our ability to sell and distribute our digital products and operate our games with online features, negatively impacting our business.

Further, insufficient server capacity could also negatively impact our business. Conversely, if we overestimate the amount of server capacity required by our business, we may incur additional operating costs.

We rely on complex information technology systems and networks to operate our business. Any significant data breach or system or network disruption could negatively impact our business.

In the course of our day-to-day business, we and third parties operating on our behalf create, store, and/or use commercially sensitive information, such as the source code and game assets for our interactive entertainment software products and confidential information with respect to our customers, consumers, and employees. A malicious intrusion by hackers or other breach of the systems on which such source code and assets, account information (including personally identifiable information) and other sensitive data (including credit card information maintained in a proprietary database) is stored could lead to piracy of our software, fraudulent activity, disclosure or misappropriation of, or access to, our customers', consumers' or employees' personally identifiable information or our own sensitive business data. We have implemented programs intended to secure our data and systems and prevent unauthorized access to, or loss of, sensitive data. However, because these attacks may remain undetected for prolonged periods of time and the techniques used by criminal hackers and other third parties to breach systems change frequently, we may be unable to anticipate these techniques or implement adequate preventative measures. A data intrusion into a server for a game with online features or for our proprietary online gaming service could also disrupt the operation of such game or platform. If we are subject to data security breaches, or a security-related incident that materially disrupts the availability of our products and services, we may have a loss in sales or subscriptions or be forced to pay damages or incur other costs, including from the implementation of additional security measures, or suffer reputational damage. Additionally, while we maintain insurance policies, they may be insufficient to reimburse us for all losses or all types of claims that may be caused by data breaches or system or network disruptions. Moreover, if there were a public perception that our data protection measures are inadequate, whether or not the case, it could result in reputational damage and potential harm to our business relationships or the public perception of our business model. In addition, such data security breaches may subject us to legal claims or proceedings, including regulatory investigations and actions, especially if there is loss, disclosure, or misappropriation of, or access to, our customers' credit card or other sensitive or personally identifiable information.

Our reported financial results could be significantly impacted by changes in financial accounting standards or by the application of existing or future accounting standards to our business as it evolves.

Our reported financial results are impacted by the accounting policies promulgated by the SEC and national accounting standards bodies and the methods, estimates and judgments that we use in applying our accounting policies. Policies affecting revenue recognition have affected, and could further significantly affect, the way we report revenues related to our products and services. We recognize a majority of the revenues from bundled sales (*i.e.* , video games that include an online service component) on a deferred basis over an estimated service period for such games. In addition, we defer the cost of revenues of those products. Further, as we increase our downloadable content and add new features to our online services, our estimate of the service period may change and we could be required to recognize revenues, and defer related costs, over a shorter or longer period of time. As we enhance, expand and diversify our business and product offerings, the application of existing or future financial accounting standards, particularly those relating to the way we account for revenues and taxes, could have a significant impact on our reported net revenues, net income and earnings per share under accounting principles generally accepted in the United States in any given period.

Provisions in our corporate documents and Delaware state law could delay or prevent a change of control.

Our Amended and Restated Bylaws contain a provision regulating the ability of shareholders to bring matters for action before annual and special meetings. The regulations on shareholder action could make it more difficult for any person seeking to acquire control of the Company to obtain shareholder approval of actions that would support this effort. In addition, our Third Amended and Restated Certificate of Incorporation authorizes the issuance of so-called "blank check" preferred stock. This ability of our Board of Directors to issue and fix the rights and preferences of preferred stock could effectively dilute the interests of any person seeking control or otherwise make it more difficult to obtain control.

Historically, our stock price has been highly volatile.

The trading price of our common stock has been, and could continue to be, subject to wide fluctuations in response to many factors, including for example, but without limitation:

- quarter-to-quarter variations in the results of our operations;
- the announcement of new products;
- the announcement of lower prices on competing products;
- product development or release schedules;
- general conditions in the computer, software, entertainment, media or electronics industries, or in the worldwide economy;
- announcements of developments in the overall worldwide market for interactive entertainment, including announcements of industry sales data;
- the timing of the introduction of new platforms and delays in the actual release of new platforms;
- hardware manufacturers' announcements of price changes for hardware platforms;
- consumer acceptance of hardware platforms;
- consumer spending trends;
- the outcome of lawsuits or regulatory investigations in which we are, or may become, involved;
- changes in earnings estimates or buy/sell recommendations by analysts;
- sales or acquisitions of common stock by our directors or executive management; and
- investor perceptions and expectations regarding our products, plans and strategic position, and those of our competitors and customers.

Catastrophic events may disrupt our business.

Our corporate headquarters and our primary corporate disaster center are located in the Los Angeles, California area and our primary corporate disaster recovery data center is in Las Vegas, Nevada, each of which is near a major earthquake fault. A major earthquake or other catastrophic event that results in the destruction or disruption of any of our critical business or information technology systems, or otherwise prevents us from conducting our normal business operations, could require significant expenditures to resume operations and negatively impact our business. While we maintain insurance coverage for some of these events, the potential liabilities associated with such events could exceed the insurance coverage we maintain. Further, our system redundancy may be ineffective or inadequate and our disaster recovery planning may not be sufficient for all eventualities.

Any such event could also limit the ability of retailers, distributors or our other customers to sell or distribute our products.

If general economic conditions decline, demand for our products could decline.

Purchases of our products and services involve discretionary spending on the part of consumers. Consumers are generally more willing to make discretionary purchases, including purchases of products and services like ours, during periods in which favorable economic conditions prevail. As a result, our products are sensitive to general economic conditions and economic cycles. A reduction or shift in domestic or international consumer spending could result in an increase in our selling and promotional expenses, in an effort to offset that reduction, and could negatively impact our business.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

Our principal corporate and administrative offices are located at 3100 Ocean Park Boulevard, Santa Monica, California. The following is a summary of the principal leased offices we maintained as of December 31, 2017:

| <u>Type of Leased Facility</u> | <u>Americas</u> | <u>EMEA(1)</u> | <u>Asia</u> | <u>Total</u> |
|---|--|----------------|----------------|------------------|
| | <u>Square footage of leased properties</u> | | | |
| Corporate Offices | 152,431 | 1,147 | — | 153,578 |
| Activision Product Development & Publishing Facilities (Activision segment) | 724,122 | 48,343 | 25,838 | 798,303 |
| Blizzard Product Development & Publishing Facilities (Blizzard segment) | 904,773 | 99,922 | 102,898 | 1,107,593 |
| King Product Development & Publishing Facilities (King segment) | 83,885 | 401,469 | 4,189 | 489,543 |
| Distribution and Other Facilities | 23,557 | 101,583 | — | 125,140 |
| Sales offices | 12,267 | 34,747 | 8,055 | 55,069 |
| Total | <u>1,901,035</u> | <u>687,211</u> | <u>140,980</u> | <u>2,729,226</u> |

(1) Consists of the Europe, Middle East, and Africa geographic regions.

In total, we have approximately 100 facility leases in the following 20 countries: Australia, Brazil, Canada, China, France, Germany, Ireland, Italy, Japan, Malta, Mexico, the Netherlands, Romania, Singapore, South Korea, Spain, Sweden, Taiwan, the United Kingdom, and the United States.

The only facilities currently owned by the Company are two European warehouses utilized by the Distribution segment, one located in Burglengenfeld, Germany and the other in Venlo, the Netherlands.

We anticipate no difficulty in extending the leases of our facilities or obtaining comparable facilities in suitable locations, as needed, and we consider our facilities to be adequate for our current needs.

Item 3. LEGAL PROCEEDINGS

As further described in Note 15 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K, on December 28, 2017, we received a Notice of Reassessment from the FTA related to transfer pricing concerning intercompany transactions involving one of our French subsidiaries for the 2011 through 2013 tax years. The total assessment, including penalties and interest, was approximately €571 million (\$680 million). We disagree with the proposed assessment and intend to vigorously contest it. We plan to pursue all remedies available to us to successfully resolve this matter, including administrative remedies with the FTA, and judicial remedies, if necessary. While we believe our tax provisions at December 31, 2017 are appropriate, until such time as this matter is ultimately resolved we could be subject to significant additional tax liabilities. In addition to the risk of additional tax for years 2011 through 2013, if litigation regarding this matter were adversely determined and/or if the FTA were to seek adjustments of a similar nature for subsequent years, we could be subject to significant additional tax liabilities.

In addition, we are party to routine claims, suits, investigations, audits, and other proceedings arising from the ordinary course of business, including with respect to intellectual property rights,

contractual claims, labor and employment matters, regulatory matters, tax matters, unclaimed property matters, compliance matters, and collection matters. In the opinion of management, after consultation with legal counsel, such routine claims and lawsuits are not significant and we do not expect them to have a material adverse effect on our business, financial condition, results of operations, or liquidity.

Item 4. MINE SAFETY DISCLOSURES

Not applicable

PART II**Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES*****Market Information and Holders***

Our common stock is quoted on the Nasdaq National Market under the symbol "ATVI." The following table sets forth, for the periods indicated, the high and low reported sale prices for our common stock. At February 20, 2018, there were 1,663 holders of record of our common stock.

| | <u>High</u> | <u>Low</u> |
|--|-------------|------------|
| 2017 | | |
| First Quarter Ended March 31, 2017 | \$ 50.40 | \$ 36.18 |
| Second Quarter Ended June 30, 2017 | 61.58 | 48.41 |
| Third Quarter Ended September 30, 2017 | 66.58 | 55.86 |
| Fourth Quarter Ended December 31, 2017 | 67.40 | 57.29 |

| | <u>High</u> | <u>Low</u> |
|--|-------------|------------|
| 2016 | | |
| First Quarter Ended March 31, 2016 | \$ 38.09 | \$ 26.49 |
| Second Quarter Ended June 30, 2016 | 39.99 | 33.03 |
| Third Quarter Ended September 30, 2016 | 45.12 | 39.28 |
| Fourth Quarter Ended December 31, 2016 | 45.55 | 35.12 |

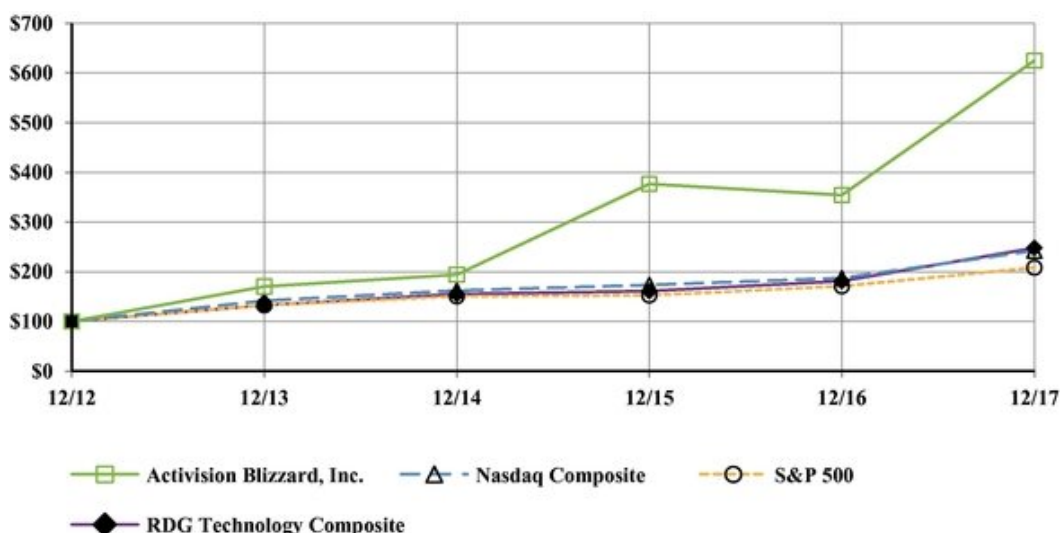
Stock Performance Graph

This performance graph shall not be deemed "filed" for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of Activision Blizzard, Inc. under the Exchange Act or the Securities Act of 1933.

COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN

among Activision Blizzard, Inc., the Nasdaq Composite Index, the S&P 500 Index, and the RDG Technology Composite Index

The following graph and table compare the cumulative total stockholder return on our common stock, the Nasdaq Composite Index, the S&P 500 Index, and the RDG Technology Composite Index. The graph and table assume that \$100 was invested on December 31, 2012, and that dividends were reinvested daily. The stock price performance on the following graph and table is not necessarily indicative of future stock price performance.



| Fiscal year ending December 31: | 12/12 | 12/13 | 12/14 | 12/15 | 12/16 | 12/17 |
|---------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| Activision Blizzard, Inc. | \$ 100.00 | \$ 170.11 | \$ 194.06 | \$ 376.61 | \$ 354.16 | \$ 624.78 |
| Nasdaq Composite | 100.00 | 141.63 | 162.09 | 173.33 | 187.19 | 242.29 |
| S&P 500 | 100.00 | 132.39 | 150.51 | 152.59 | 170.84 | 208.14 |
| RDG Technology Composite | 100.00 | 132.51 | 155.05 | 161.00 | 181.12 | 247.79 |

Cash Dividends

We have paid a dividend annually since 2010. Below is a summary of cash dividends paid over the past three fiscal years, along with the dividend most recently declared by the Board of Directors that will be paid in May 2018:

| <u>Year</u> | <u>Per Share Amount</u> | <u>Record Date</u> | <u>Dividend Payment Date</u> |
|-------------|-------------------------|--------------------|------------------------------|
| 2018 | \$ 0.34 | 3/30/2018 | 5/9/2018 |
| 2017 | \$ 0.30 | 3/30/2017 | 5/10/2017 |
| 2016 | \$ 0.26 | 3/30/2016 | 5/11/2016 |
| 2015 | \$ 0.23 | 3/30/2015 | 5/13/2015 |

Future dividends will depend upon our earnings, financial condition, cash requirements, anticipated future prospects, and other factors deemed relevant by our Board of Directors. Further, agreements governing certain of our indebtedness, as described in Note 11 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K, may, under certain circumstances, limit our ability to pay distributions or dividends. There can be no assurances that dividends will be declared in the future.

10b5-1 Stock Trading Plans

The Company's directors and employees may, at a time they are not aware of material non-public information, enter into plans to purchase or sell shares of our common stock that satisfy the requirements of Exchange Act Rule 10b5-1 ("Rule 10b5-1 Plans"). Rule 10b5-1 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 trade on a pre-arranged, "automatic-pilot" basis.

Trading under Rule 10b5-1 Plans is 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, the Company requires Rule 10b5-1 Plans to be established and maintained in accordance with the Company's "Policy on Establishing and Maintaining 10b5-1 Trading Plans."

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.

Issuer Purchase of Equity Securities

On February 2, 2017, our Board of Directors authorized a stock repurchase program under which we are authorized to repurchase up to \$1 billion of our common stock during the two-year period from February 13, 2017 through February 12, 2019. As of the date hereof, we have not repurchased any shares under this program and the determination as to if and when we make any such stock repurchases will be dependent on market conditions and other factors.

Item 6. SELECTED FINANCIAL DATA

The following table summarizes certain selected consolidated financial data, which should be read in conjunction with our Consolidated Financial Statements and Notes thereto and with Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Annual Report on Form 10-K. The selected consolidated financial data presented below at and for each of the years in the five-year period ended December 31, 2017 is derived from our Consolidated Financial Statements and include the operations of King commencing on the King Acquisition Date. All amounts set forth in the following tables are in millions, except per share data.

| | For the Years Ended December 31, | | | | |
|--------------------------------------|----------------------------------|----------|----------|----------|----------|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| Statement of Operations Data: | | | | | |
| Net revenues | \$ 7,017 | \$ 6,608 | \$ 4,664 | \$ 4,408 | \$ 4,583 |
| Net income(1) | 273 | 966 | 892 | 835 | 1,010 |
| Basic net income per share | 0.36 | 1.30 | 1.21 | 1.14 | 0.96 |
| Diluted net income per share | 0.36 | 1.28 | 1.19 | 1.13 | 0.95 |
| Cash dividends declared per share | 0.30 | 0.26 | 0.23 | 0.20 | 0.19 |
| Operating cash flows | \$ 2,213 | \$ 2,155 | \$ 1,259 | \$ 1,331 | \$ 1,293 |
| Balance Sheet Data: | | | | | |
| Cash and investments(2) | \$ 4,775 | \$ 3,271 | \$ 1,840 | \$ 4,867 | \$ 4,452 |
| Total assets | 18,668 | 17,452 | 15,246 | 14,637 | 13,947 |
| Long-term debt, net(3) | 4,390 | 4,887 | 4,074 | 4,319 | 4,687 |
| Long-term debt, gross | 4,440 | 4,940 | 4,119 | 4,369 | 4,744 |
| Net debt(4) | — | 1,669 | 2,279 | — | 292 |

- (1) Net income includes the impact of significant discrete tax-related impacts, including incremental income tax expense due to the application of the U.S. Tax Reform Act. See further discussion in Note 15 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.
- (2) Cash and investments consists of cash and cash equivalents along with short-term and long-term investments. We had short-term investments of \$62 million and did not have any long-term investments as of December 31, 2017. We had short-term and long-term investments of \$13 million and \$13 million, respectively, as of December 31, 2016, \$8 million and \$9 million, respectively, as of December 31, 2015, \$10 million and \$9 million, respectively, as of December 31, 2014, and \$33 million and \$9 million, respectively, as of December 31, 2013. Cash and investments as of December 31, 2015 excludes \$3,561 million of cash placed in escrow for the King Acquisition.
- (3) For discussion on our debt obligations, see Note 11 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.
- (4) Net debt is defined as long-term debt, gross less cash and investments.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Business Overview

Activision Blizzard, Inc. is a leading global developer and publisher of interactive entertainment content and services. We develop and distribute content and services on video game consoles, PC, and mobile devices. We also operate esports events and leagues and create film and television content based on our games.

The King Acquisition

On February 23, 2016, we completed the King Acquisition for an aggregate purchase price of approximately \$5.8 billion, as further described in Note 20 of the notes to the consolidated financial statements. Our consolidated financial statements include the operations of King commencing on February 23, 2016.

Reportable Segments

As part of the continued implementation of our esports strategy, we instituted changes to our internal organization and reporting structure such that the MLG business now operates as a division of Blizzard. As such, commencing with the second quarter of 2017, MLG, which was previously a separate operating segment, is now a component of the Blizzard operating segment. MLG is responsible for the operations of the Overwatch League, along with other esports events, and will also continue to serve as a multi-platform network for other Activision Blizzard esports content.

Based upon our organizational structure, we conduct our business through three reportable segments: Activision, Blizzard, and King.

(i) Activision

Activision is a leading global developer and publisher of interactive software products and entertainment content, particularly for the console platform. Activision primarily delivers content through retail and digital channels, including full-game and in-game sales, as well as by licensing software to third-party or related-party companies that distribute Activision products. Activision develops, markets, and sells products based on our internally developed intellectual properties, as well as some licensed properties.

(ii) Blizzard

Blizzard is a leading global developer and publisher of interactive software products and entertainment content, particularly for the PC platform. Blizzard primarily delivers content through retail and digital channels, including subscriptions, full-game, and in-game sales, as well as by licensing software to third-party or related-party companies that distribute Blizzard products. Blizzard also maintains a proprietary online gaming service, Blizzard Battle.net, which facilitates digital distribution of Blizzard content, along with Activision's *Destiny 2* content, online social connectivity, and the creation of user-generated content. As noted above, Blizzard also includes the activities of our MLG business, which is responsible for the operations of the Overwatch League, along with other esports events, and will also continue to serve as a multi-platform network for other Activision Blizzard esports content.

(iii) King

King is a leading global developer and publisher of interactive entertainment content and services, particularly on mobile platforms, such as Google's Android and Apple's iOS. King also distributes its

content and services on the PC platform, primarily via Facebook. King's games are free to play, however, players can acquire in-game items, either with virtual currency the players purchase or directly using real currency.

Other

We also engage in other businesses that do not represent reportable segments, including:

- the Studios business, which is devoted to creating original film and television content based on our extensive library of globally recognized intellectual properties; and
- the Distribution business, which consists of operations in Europe that provide warehousing, logistics, and sales distribution services to third-party publishers of interactive entertainment software, our own publishing operations, and manufacturers of interactive entertainment hardware.

Business Results and Highlights

Financial Results

The Company's 2017 financial highlights include:

- consolidated net revenues increased 6% to \$7.0 billion and consolidated operating income decreased 7% to \$1.3 billion, as compared to consolidated net revenues of \$6.6 billion and consolidated operating income of \$1.4 billion in 2016;
- revenues from digital online channels increased 13% to \$5.5 billion, or 78% of consolidated net revenues, as compared to \$4.9 billion, or 74% of consolidated net revenues, in 2016;
- operating margin was 18.7%, as compared to 21.4% in 2016;
- cash flows from operating activities of approximately \$2.21 billion, an increase of 3%, as compared to \$2.16 billion in 2016;
- consolidated net income decreased 72% to \$273 million, as compared to \$966 million in 2016, primarily driven by the impact of significant discrete tax-related impacts, including incremental income tax expense due to the impacts from the U.S. Tax Reform Act, as discussed in "Consolidated Results" below;
- consolidated net income included \$113 million of excess tax benefits from share-based payments, as compared to \$81 million in 2016; and
- diluted earnings per common share decreased 72% to \$0.36, as compared to \$1.28 in 2016, primarily driven by incremental income tax expense due to the impacts from the U.S. Tax Reform Act.

Since certain of our games are hosted online or include online functionality that represents an essential component of gameplay and, as a result, a more-than-inconsequential separate deliverable, we initially defer the software-related revenues from the sale of these games and recognize the attributable revenues over the relevant estimated service periods, which are generally less than a year. Net revenues and operating income for the year ended December 31, 2017, include a net effect of \$139 million and \$71 million, respectively, from the deferrals of net revenues and related cost of revenues.

Release Highlights

Games and downloadable content that were released during 2017, include:

- Activision's four downloadable content packs for *Call of Duty: Infinite Warfare*[™]; and one downloadable content pack for *Call of Duty: Modern Warfare*[®] *Remastered* ;
- Activision's *Call of Duty: Black Ops III Zombies Chronicles* , a downloadable content pack of remastered zombies maps from *Call of Duty: World at War*, *Call of Duty: Black Ops* , and *Call of Duty: Black Ops II* ;
- Activision's *Crash Bandicoot*[™] *N. Sane Trilogy* , a remastered version of the first three Crash Bandicoot games for Playstation 4;
- Activision's *Destiny 2* , the sequel to *Destiny*, and *Curse of Osiris*, the first expansion to *Destiny 2* ;
- Activision's *Call of Duty: WWII*;
- Blizzard's latest expansions to *Hearthstone*—*Journey to Un'Goro*[™], *Knights of the Frozen Throne*[™], and *Kobolds and Catacombs*[™] ;
- Blizzard's *Rise of the Necromancer*[™], a downloadable content pack for *Diablo III* ; and
- King's *Bubble Witch 3 Saga*[™].

We also completed the sale of 12 teams for the Overwatch League, the first major global professional esports league with city-based teams. The first preseason matches occurred in December 2017 and the inaugural regular season started in January 2018.

International Sales

International sales are a fundamental part of our business. An important element of our international strategy is to develop content that is specifically directed toward local cultures and customs. Net revenues from international sales accounted for approximately 55%, 55%, and 52% of our total consolidated net revenues for the years ended December 31, 2017, 2016, and 2015, respectively. The majority of our net revenues from foreign countries are generated by consumers in Australia, Canada, China, France, Germany, Italy, Japan, South Korea, Spain, Sweden, and the United Kingdom. Our international business is subject to risks typical of an international business, including, but not limited to, foreign currency exchange rate volatility and changes in local economies. Accordingly, our future results could be materially and adversely affected by changes in foreign currency exchange rates and changes in local economies

Operating Metrics

The following operating metrics are key performance indicators that we use to evaluate our business.

Monthly Active Users

We monitor monthly active users ("MAUs") as a key measure of the overall size of our user base. MAUs are the number of individuals who accessed a particular game in a given month. We calculate average MAUs in a period by adding the total number of MAUs in each of the months in a given period and dividing that total by the number of months in the period. An individual who accesses two of our games would be counted as two users. In addition, due to technical limitations, for Activision and King, an individual who accesses the same game on two platforms or devices in the relevant period would be counted as two users. For Blizzard, an individual who accesses the same game on two platforms or devices in the relevant period would generally be counted as a single user.

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The number of MAUs for a given period can be significantly impacted by the timing of new content releases, since new releases may cause a temporary surge in MAUs. Accordingly, although we believe that overall trending in the number of MAUs can be a meaningful performance metric, period-to-period fluctuations may not be indicative of longer-term trends. The following table details our average MAUs on a sequential quarterly basis for each of our reportable segments (amounts in millions):

| | December 31, 2017 | September 30, 2017 | June 30, 2017 | March 31, 2017 | December 31, 2016 | September 30, 2016 |
|------------|----------------------|-----------------------|------------------|-------------------|----------------------|-----------------------|
| Activision | 55 | 49 | 47 | 48 | 51 | 46 |
| Blizzard | 40 | 42 | 46 | 41 | 41 | 42 |
| King | 290 | 293 | 314 | 342 | 355 | 394 |
| Total | 385 | 384 | 407 | 431 | 447 | 482 |

Average MAUs for the quarter ended December 31, 2017 were comparable to the quarter ended September 30, 2017. The decrease in King's and Blizzard's average MAUs is partially offset by an increase in Activision's average MAUs driven by the Call of Duty franchise due to the launch of *Call of Duty: WWII* in November 2017.

Average MAUs decreased by 62 million, or 14%, for the quarter ended December 31, 2017, as compared to the quarter ended December 31, 2016. The decrease in King's average MAUs is due to decreases across King's franchises that are largely attributable to less engaged users leaving the network and maturity of titles.

Net Bookings

We monitor net bookings as a key operating metric in evaluating the performance of our business. Net bookings is defined as the net amount of products and services sold digitally or sold-in physically in the period, and includes license fees, merchandise, and publisher incentives, among others. Net bookings were as follows (amounts in millions):

| | For the years ended December 31, | | | Increase (Decrease) 2017 v 2016 | Increase (Decrease) 2016 v 2015 |
|--------------|-------------------------------------|----------|----------|---------------------------------------|---------------------------------------|
| | 2017 | 2016 | 2015 | | |
| Net bookings | \$ 7,156 | \$ 6,599 | \$ 4,621 | \$ 557 | \$ 1,978 |

2017 vs. 2016

The increase in net bookings for 2017, as compared to 2016, was primarily due to:

- higher net bookings from King titles, as 2017 includes King net bookings for the full year, while 2016 only included King net bookings for the partial period following the King Closing Date, as well as higher net bookings from the Candy Crush franchise, due to in-game events and features;
- higher net bookings from the Destiny franchise, driven by the release of *Destiny 2* in September 2017;
- higher net bookings from *Call of Duty: WWII*, which was released in November 2017, as compared to *Call of Duty: Infinite Warfare* (which, when referred to herein, is inclusive of *Call of Duty: Modern Warfare Remastered*), the comparable 2016 title;
- higher net bookings from the continued strength of *Call of Duty: Black Ops III*, as compared to prior catalog releases, driven by the downloadable content pack, *Zombies Chronicles*, which was released in May 2017, and the continued strength of microtransactions; and

- net bookings from *Crash Bandicoot N. Sane Trilogy* , which was released in June 2017.

The increase was partially offset by:

- lower net bookings from *Call of Duty: Infinite Warfare* , as compared to the performance of *Call of Duty: Black Ops III* , the comparable 2015 title;
- lower net bookings from *Overwatch* , which was released in May 2016;
- lower net bookings from *World of Warcraft* , driven by the release of *World of Warcraft: Legion*[™] in August 2016, with no comparable release in 2017; and
- lower net bookings from the Skylanders® franchise, due to the release of *Skylanders Imaginators* in October 2016, with no comparable release in 2017.

2016 vs. 2015

The increase in net bookings for 2016, as compared to 2015, was primarily due to:

- new net bookings from King titles following the King Closing Date, primarily driven by the Candy Crush franchise;
- net bookings from *Overwatch* , which was released in May 2016;
- higher net bookings from digital content associated with *Call of Duty: Black Ops III* , which was released in November 2015, as compared to *Call of Duty: Advanced Warfare* , the comparable 2014 title; and
- higher net bookings from *World of Warcraft* , driven by the release of *World of Warcraft: Legion* in August 2016, with no comparable release in 2015.

The increase was partially offset by:

- lower net bookings from *Call of Duty: Infinite Warfare* , which was released in November 2016, as compared to *Call of Duty: Black Ops III* , the comparable 2015 title;
- lower net bookings from the Destiny franchise, as there were two expansion packs in 2015—*House of Wolves* and *The Taken King* —but only one in 2016—*Rise of Iron* ;
- lower net bookings from *Skylanders Imaginators* , which was released in October 2016, as compared to *Skylanders Superchargers* , the comparable 2015 title, as well as lower net bookings from standalone toys and accessories from the Skylanders franchise in 2016; and
- lower net bookings from *Guitar Hero*[®] *Live* , which was released in 2015, with no comparable release in 2016.

Management's Overview of Business Trends

Interactive Entertainment and Mobile Gaming Growth

Our business participates in the global interactive entertainment industry. Games have become an increasingly popular form of entertainment, and we estimate the total industry has grown, on average, 18% over the last three years. The industry continues to benefit from additional players entering the market as interactive entertainment becomes more common place across age groups and as more developing regions gain access to this form of entertainment.

Further, the wide adoption of smart phones globally and the free-to-play business model on those platforms has increased the total addressable market for gaming significantly by introducing gaming to new age groups and new regions and allowing gaming to occur more widely outside the home. Mobile gaming is now estimated to be larger than console and PC gaming and continues to grow at a

significant rate. King is a leading developer of mobile and free-to-play games and our other business units have mobile efforts underway that present the opportunity for us to expand the reach of, and drive additional player investment from, our franchises.

Opportunities to Expand Franchises Outside of Games

Our fans spend significant time investing in our franchises through purchases of our game content, whether through purchases of full games or downloadable content or via microtransactions. Given the passion our players have for our franchises, we believe there are emerging opportunities to drive additional engagement and investment in our franchises outside of games. These opportunities include esports, film and television, and consumer products. Our efforts to build these adjacent opportunities are still relatively nascent, but we view them as potentially significant sources of future revenues.

As part of our efforts to take advantage of the esports opportunity, during 2017 we completed the sale of 12 teams for the Overwatch League. The Overwatch League is the first major global professional esports league with city-based teams. The first preseason matches occurred in December 2017 and the inaugural regular season started in January 2018.

Concentration of Sales Among the Most Popular Franchises

The concentration of retail revenues among key titles has continued as a trend in the overall interactive entertainment industry. According to The NPD Group, the top 10 titles accounted for 36% of the retail sales in the U.S. interactive entertainment industry in 2017. Similarly, a significant portion of our revenues has historically been derived from video games based on a few popular franchises and these video games were responsible for a disproportionately high percentage of our profits. For example, the Call of Duty, Candy Crush, World of Warcraft, and Overwatch franchises, collectively, accounted for 66% of our consolidated net revenues—and a significantly higher percentage of our operating income—for 2017.

The top titles in the industry are also becoming more consistent as players and revenues concentrate more heavily in established franchises. Of the top 10 console franchises in 2017, all 10 are from established franchises. Similarly, according to U.S. rankings for the Apple App Store and Google Play store per App Annie Intelligence as of December 2017, the top 10 mobile games have an average tenure of 22 months.

In addition to investing in and developing sequels and content for our top titles, we are continually exploring additional ways to expand those franchises. Further, while there is no guarantee of success, we invest in new properties in an effort to develop future top franchises. In 2014, we released *Hearthstone* and *Destiny*, in 2015, we released *Heroes of the Storm*, and in 2016, we released *Overwatch*. Additionally, to diversify our portfolio of key franchises and increase our presence in the mobile market, on February 23, 2016, we completed the King Acquisition.

Overall, we do expect that a limited number of popular franchises will continue to produce a disproportionately high percentage of our, and the industry's, revenues and profits in the near future. Accordingly, our ability to maintain our top franchises and our ability to successfully compete against our competitors' top franchises can significantly impact our performance.

Recurring Revenue Business Models and Seasonality

Increased consumer online connectivity has allowed us to offer players new investment opportunities and to shift our business further towards a more consistently recurring and year-round model. Offering downloadable content and microtransactions, in addition to full games, allows our players to access and invest in new content throughout the year. This incremental content not only provides additional high-margin revenues, it can also increase player engagement. Also, mobile games, and free-to-play games more broadly, are generally less seasonal.

While our business is transitioning to a year-round engagement model, the interactive entertainment industry remains somewhat seasonal. We have historically experienced our highest sales volume, particularly for Activision, in the year-end holiday buying season, which occurs in the fourth quarter. Following the acquisition of King, which focuses on free-to-play games which are generally less seasonal, and as we otherwise make the shift to a year-round model, less of our revenues are generated during the fourth quarter. For our reportable segments—Activision, Blizzard, and King—the percentage of our revenue represented by the fourth quarter in each of 2017 and 2016 was 36%, as compared to 46% in 2015.

Expected Upcoming Releases

We expect to release *World of Warcraft: Battle for Azeroth* and our latest Call of Duty game in the second half of 2018. In addition, we expect to deliver ongoing content for our various franchises, including expansion packs for *Hearthstone* and *Destiny 2*, in-game events for *Overwatch*, and map packs for *Call of Duty: WWII*, as well as releases of remastered versions of titles from our library of IP. We also expect to release at least two new mobile titles during 2018, including a social casino game from King.

We will also continue to invest in new opportunities, including new titles across our platforms, and continue to build on our advertising and esports initiatives.

Consolidated Statements of Operations Data

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

| | For the Years Ended December 31, | | | | | |
|--|----------------------------------|------------|---------------|------------|---------------|------------|
| | 2017 | | 2016 | | 2015 | |
| Net revenues | | | | | | |
| Product sales | \$ 2,110 | 30% | \$ 2,196 | 33% | \$ 2,447 | 52% |
| Subscription, licensing, and other revenues | 4,907 | 70 | 4,412 | 67 | 2,217 | 48 |
| Total net revenues | <u>7,017</u> | <u>100</u> | <u>6,608</u> | <u>100</u> | <u>4,664</u> | <u>100</u> |
| Costs and expenses | | | | | | |
| Cost of revenues—product sales: | | | | | | |
| Product costs | 733 | 35 | 741 | 34 | 872 | 36 |
| Software royalties, amortization, and intellectual property licenses | 300 | 14 | 331 | 15 | 370 | 15 |
| Cost of revenues—subscription, licensing, and other: | | | | | | |
| Game operations and distribution costs | 984 | 20 | 851 | 19 | 274 | 12 |
| Software royalties, amortization, and intellectual property licenses | 484 | 10 | 471 | 11 | 69 | 3 |
| Product development | 1,069 | 15 | 958 | 14 | 646 | 14 |
| Sales and marketing | 1,378 | 20 | 1,210 | 18 | 734 | 16 |
| General and administrative | 760 | 11 | 634 | 10 | 380 | 8 |
| Total costs and expenses | <u>5,708</u> | <u>81</u> | <u>5,196</u> | <u>79</u> | <u>3,345</u> | <u>72</u> |
| Operating income | 1,309 | 19 | 1,412 | 21 | 1,319 | 28 |
| Interest and other expense (income), net | 146 | 2 | 214 | 3 | 198 | 4 |
| Loss on extinguishment of debt(1) | 12 | — | 92 | 1 | — | — |
| Income before income tax expense | 1,151 | 16 | 1,106 | 17 | 1,121 | 24 |
| Income tax expense | 878 | 13 | 140 | 2 | 229 | 5 |
| Net income | <u>\$ 273</u> | <u>4%</u> | <u>\$ 966</u> | <u>15%</u> | <u>\$ 892</u> | <u>19%</u> |

- (1) Represents the loss on extinguishment of debt we recognized associated with our refinancing activities. The 2017 loss on extinguishment is comprised of a \$12 million write-off of unamortized discount and deferred financing costs associated with refinancing activities on our tranche of term loans "A" and the 2016 loss on extinguishment was comprised of a premium payment of \$63 million and a write-off of unamortized discount and financing costs of \$29 million associated with the extinguishment of certain term loan and senior note facilities through our refinancing activities.

Consolidated Net Revenues

The following table summarizes our consolidated net revenues and the increase/(decrease) in deferred revenues recognized (amounts in millions):

| | For the Years Ended December 31, | | | | | | |
|---|----------------------------------|----------|----------|--|--|-------------------------|-------------------------|
| | 2017 | 2016 | 2015 | Increase/ (decrease) 2017 v 2016 | Increase/ (decrease) 2016 v 2015 | % Change 2017 v 2016 | % Change 2016 v 2015 |
| Consolidated net revenues | \$ 7,017 | \$ 6,608 | \$ 4,664 | \$ 409 | \$ 1,944 | 6% | 42% |
| Net effect from recognition (deferral) of deferred net revenues | (139) | 9 | 43 | (148) | (34) | | |

Consolidated net revenues

2017 vs. 2016

The increase in consolidated net revenues for 2017, as compared to 2016, was primarily due to:

- higher revenues from King titles, as 2017 includes King revenues for the full year, while 2016 only included King revenues for the partial period following the King Closing Date, as well as higher revenues from the Candy Crush franchise, due to in-game events and features;
- higher revenues recognized from the continued strength of *Call of Duty: Black Ops III*, as compared to prior catalog releases, driven by the downloadable content pack, *Zombies Chronicles*, which was released in May 2017, and the continued strength of microtransactions;
- revenues from *Crash Bandicoot N. Sane Trilogy*, which was released in June 2017; and
- higher revenues recognized from *Call of Duty: WWII*, which was released in November 2017, as compared to *Call of Duty: Infinite Warfare*, the comparable 2016 title.

The increase was partially offset by:

- lower revenues recognized from *Call of Duty: Infinite Warfare*, as compared to the performance of *Call of Duty: Black Ops III*, the comparable 2015 title; and
- lower revenues from the Skylanders franchise, due to the release of *Skylanders Imaginators* in October 2016, with no comparable release in 2017.

2016 vs. 2015

The increase in consolidated net revenues for 2016, as compared to 2015, was primarily due to:

- new revenues from King titles following the King Closing Date, primarily driven by the Candy Crush franchise;
- revenues recognized from *Overwatch*, which was released in May 2016; and
- higher revenues recognized in 2016 from *Call of Duty: Black Ops III*, which was released in the fourth quarter of 2015 and was the third game in our successful Black Ops series, as compared to revenues recognized in 2015 from *Call of Duty: Advanced Warfare*, which was released in the fourth quarter of 2014, including, in each case, the associated digital content.

The increase was partially offset by:

- lower revenues recognized from the Destiny franchise, as *Destiny* debuted in September 2014 but had no comparable full-game release in 2015;
- lower revenues from *Skylanders Imaginators*, which was released in October 2016, as compared to *Skylanders Superchargers*, the comparable 2015 title, as well as lower revenues from standalone toys and accessories from the Skylanders franchise in 2016; and
- lower revenues recognized from the Diablo franchise due to the timing of releases.

Change in Deferred Revenues Recognized

2017 vs. 2016

The decrease in net deferred revenues recognized for 2017, as compared to 2016, was primarily due to:

- a net deferral of revenues for the Destiny franchise, primarily due to *Destiny 2*, which was released in September 2017, as compared to net deferred revenues recognized in the comparable prior period; and
- a higher net deferral of revenues from the Call of Duty franchise, primarily due to the stronger performance of *Call of Duty: WWII* in the fourth quarter of 2017, as compared to *Call of Duty: Infinite Warfare* in the fourth quarter of 2016.

The decrease was partially offset by:

- net deferred revenues recognized from *Overwatch* in 2017, as compared to a net deferral of revenues in 2016 due to the release of *Overwatch* in May 2016; and
- net deferred revenues recognized from *World of Warcraft* in 2017, as compared to a net deferral of revenues in 2016 due to the release of *World of Warcraft: Legion* in August 2016.

2016 vs. 2015

The decrease in net deferred revenues recognized for 2016, as compared to 2015, was primarily due to:

- deferrals of revenues associated with the release of *World of Warcraft: Legion* in August 2016, as compared to the recognition of deferred revenues in 2015 from the release of *World of Warcraft: Warlords of Draenor*® in November 2014; and
- deferrals of revenues associated with *Overwatch*.

The decrease was partially offset by lower deferrals of revenues associated with the Call of Duty franchise, driven by lower revenue deferrals from *Call of Duty: Infinite Warfare*, which was released in the fourth quarter of 2016, as compared to *Call of Duty: Black Ops III*, the comparable 2015 title.

Foreign Exchange Impact

Changes in foreign exchange rates had a positive impact of \$42 million, a negative impact of \$81 million, and a negative impact of \$373 million on Activision Blizzard's consolidated net revenues in 2017, 2016, and 2015, respectively, as compared to the same periods in the previous year. The changes are primarily due to changes in the value of the U.S. dollar relative to the euro and the British pound.

Operating Segment Results

Currently, we have three reportable segments. Our operating segments are consistent with the manner in which our operations are reviewed and managed by our Chief Executive Officer, who is our chief operating decision maker ("CODM"). The CODM reviews segment performance exclusive of: the impact of the change in deferred revenues and related cost of revenues with respect to certain of our online-enabled games; share-based compensation expense; amortization of intangible assets as a result of purchase price accounting; fees and other expenses (including legal fees, expenses, and accruals) related to acquisitions, associated integration activities, and financings; certain restructuring costs; and certain other non-cash charges. The CODM does not review any information regarding total assets on an operating segment basis, and accordingly, no disclosure is made with respect thereto.

Our operating segments are also consistent with our internal organization structure, the way we assess operating performance and allocate resources, and the availability of separate financial information. We do not aggregate operating segments. As discussed in the "Business Overview" above, commencing with the second quarter of 2017, we made changes to our operating segments which reflect the changes in our organization and reporting structure. Our MLG business, which was previously included in the non-reportable "Other segments," is now presented within the Blizzard reportable segment. Prior period amounts have been revised to reflect this change. This change had no impact on consolidated net revenues or operating income.

Information on the reportable segments net revenues and segment operating income are presented below (amounts in millions):

| | For the Year Ended December 31, 2017 | | | | Increase / (decrease) 2017 v 2016 | | | |
|--------------------------------------|--------------------------------------|----------|----------|----------|-----------------------------------|----------|--------|--------|
| | Activision | Blizzard | King | Total | Activision | Blizzard | King | Total |
| Segment Revenues | | | | | | | | |
| Net revenues from external customers | \$ 2,628 | \$ 2,120 | \$ 1,998 | \$ 6,746 | \$ 408 | \$ (319) | \$ 412 | \$ 501 |
| Intersegment net revenues(1) | — | 19 | — | 19 | — | 19 | — | 19 |
| Segment net revenues | \$ 2,628 | \$ 2,139 | \$ 1,998 | \$ 6,765 | \$ 408 | \$ (300) | \$ 412 | \$ 520 |
| Segment operating income | \$ 1,005 | \$ 712 | \$ 700 | \$ 2,417 | \$ 217 | \$ (283) | \$ 163 | \$ 97 |

| | For the Year Ended December 31, 2016 | | | | Increase / (decrease) 2016 v 2015 | | | |
|--------------------------------------|--------------------------------------|----------|----------|----------|-----------------------------------|----------|----------|----------|
| | Activision | Blizzard | King | Total | Activision | Blizzard | King | Total |
| Segment Revenues | | | | | | | | |
| Net revenues from external customers | \$ 2,220 | \$ 2,439 | \$ 1,586 | \$ 6,245 | \$ (480) | \$ 874 | \$ 1,586 | \$ 1,980 |
| Intersegment net revenues(1) | — | — | — | — | — | — | — | — |
| Segment net revenues | \$ 2,220 | \$ 2,439 | \$ 1,586 | \$ 6,245 | \$ (480) | \$ 874 | \$ 1,586 | \$ 1,980 |
| Segment operating income | \$ 788 | \$ 995 | \$ 537 | \$ 2,320 | \$ (80) | \$ 434 | \$ 537 | \$ 891 |

| | For the Year Ended December 31, 2015 | | | |
|--------------------------------------|--------------------------------------|----------|------|----------|
| | Activision | Blizzard | King | Total |
| Segment Revenues | | | | |
| Net revenues from external customers | \$ 2,700 | \$ 1,565 | \$ — | \$ 4,265 |
| Intersegment net revenues(1) | — | — | — | — |
| Segment net revenues | \$ 2,700 | \$ 1,565 | \$ — | \$ 4,265 |
| Segment operating income | \$ 868 | \$ 561 | \$ — | \$ 1,429 |

(1) Intersegment revenues reflect licensing and service fees charged between segments.

Reconciliations of total segment net revenues and total segment operating income to consolidated net revenues from external customers and consolidated income before income tax expense are presented in the table below (amounts in millions):

| | For the Years Ended December 31, | | |
|---|-------------------------------------|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Reconciliation to consolidated net revenues: | | | |
| Segment net revenues | \$ 6,765 | \$ 6,245 | \$ 4,265 |
| Revenues from other segments(1) | 410 | 354 | 356 |
| Net effect from recognition (deferral) of deferred net revenues(2) | (139) | 9 | 43 |
| Elimination of intersegment revenues(3) | (19) | — | — |
| Consolidated net revenues | <u>\$ 7,017</u> | <u>\$ 6,608</u> | <u>\$ 4,664</u> |
| Reconciliation to consolidated income before income tax expense: | | | |
| Segment operating income | \$ 2,417 | \$ 2,320 | \$ 1,429 |
| Operating (loss) income from other segments(1) | (19) | 14 | 37 |
| Net effect from recognition (deferral) of deferred net revenues and related cost of revenues(2) | (71) | (10) | (39) |
| Share-based compensation expense | (178) | (159) | (92) |
| Amortization of intangible assets(4) | (757) | (706) | (11) |
| Fees and other expenses related to the King Acquisition(5) | (15) | (47) | (5) |
| Restructuring costs(6) | (15) | — | — |
| Other non-cash charges(7) | (14) | — | — |
| Discrete tax-related items(8) | (39) | — | — |
| Consolidated operating income | <u>1,309</u> | <u>1,412</u> | <u>1,319</u> |
| Interest and other expense (income), net | 146 | 214 | 198 |
| Loss on extinguishment of debt | 12 | 92 | — |
| Consolidated income before income tax expense | <u>\$ 1,151</u> | <u>\$ 1,106</u> | <u>\$ 1,121</u> |

- (1) Includes other income and expenses from operating segments managed outside the reportable segments, including our Studios and Distribution businesses. Also includes unallocated corporate income and expenses.
- (2) We have determined that some of our titles' online functionality represents an essential component of gameplay and, as a result, represents a more-than-inconsequential separate deliverable. As such, we are required to recognize revenues from these titles over the estimated service periods, which are generally less than twelve months. The related cost of revenues are deferred and recognized when the related revenues are recognized. In the operating segment results table, we reflect the net effect from the deferrals of revenues and (recognition) of deferred revenues, along with the related cost of revenues, on certain of our online enabled products.
- (3) Intersegment revenues reflect licensing and service fees charged between segments.
- (4) We amortize intangible assets over their estimated useful lives based on the pattern of consumption of the underlying economic benefits. The amounts presented in the table represent the effect of the amortization of intangible assets in our consolidated statements of operations.
- (5) Reflects fees and other expenses related to the King Acquisition, inclusive of related debt financings and integration costs.
- (6) Reflects restructuring charges, primarily severance costs.
- (7) Reflects a non-cash accounting charge to reclassify certain cumulative translation gains (losses) into earnings due to the substantial liquidation of certain of our foreign entities.
- (8) Reflects the impact of other unusual or unique tax-related items and activities.

Segment Net Revenues

Activision

2017 vs. 2016

The increase in Activision's net revenues for 2017, as compared to 2016, was primarily due to:

- higher revenues from the Destiny franchise, driven by the release of *Destiny 2* in September 2017, with no comparable release in 2016;
- higher revenues from *Call of Duty: WWII*, which was released in November 2017, as compared to *Call of Duty: Infinite Warfare*, the comparable 2016 title;
- higher revenues from the continued strength of *Call of Duty: Black Ops III*, as compared to prior catalog releases, driven by the downloadable content pack, *Zombies Chronicles*, which was released in May 2017, and the continued strength of microtransactions; and
- revenues from *Crash Bandicoot N. Sane Trilogy*, which was released in June 2017.

The increase was partially offset by:

- lower revenues from *Call of Duty: Infinite Warfare* including its associated digital content, as compared to the performance of *Call of Duty: Black Ops III*, the comparable 2015 title; and
- lower revenues from the Skylanders franchise, due to the release of *Skylanders Imaginators* in October 2016, with no comparable release in 2017.

2016 vs. 2015

The decrease in Activision's net revenues for 2016, as compared to 2015, was primarily due to:

- lower revenues from *Call of Duty: Infinite Warfare*, which was released in the fourth quarter of 2016, as compared to *Call of Duty: Black Ops III*, the comparable 2015 title, which was the third game in our successful Black Ops series;
- lower revenues from the Destiny franchise, as there were two expansion packs in 2015—*House of Wolves* and *The Taken King*—but only one in 2016—*Rise of Iron*;
- lower revenues from *Skylanders Imaginators*, which was released in October 2016, as compared to *Skylanders Superchargers*, the comparable 2015 title, as well as lower revenues from standalone Skylanders toys and accessories in 2016; and
- lower revenues from *Guitar Hero Live*, which was released in 2015 with no comparable release in 2016.

The decrease was partially offset by higher revenues from digital content associated with *Call of Duty: Black Ops III*, as compared to *Call of Duty: Advanced Warfare*, the comparable 2014 title.

Blizzard

2017 vs. 2016

The decrease in Blizzard's net revenues for 2017, as compared to 2016, was primarily due to:

- lower revenues from *Overwatch*, which was released in May 2016; and
- lower revenues from *World of Warcraft*, driven by the release of *World of Warcraft: Legion* in August 2016, with no comparable release in 2017.

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The decrease was partially offset by:

- revenues recognized from franchise sales of city-based teams for the Overwatch League; and
- higher revenues from *Diablo III*, primarily due to the release of *Rise of the Necromancer*, a downloadable content pack for *Diablo III* that was released in June 2017.

2016 vs. 2015

The increase in Blizzard's net revenues for 2016, as compared to 2015, was primarily due to:

- revenues from *Overwatch*, which was released in May 2016; and
- higher revenues from *World of Warcraft*, driven by the release of *World of Warcraft: Legion* in August 2016, with no comparable release in 2015.

King

2017 vs. 2016

The increase in King's net revenues for 2017, as compared to 2016, was primarily due to:

- 2017 including King revenues for the full year, while 2016 only included King revenues for the partial period following the King Closing Date; and
- higher revenues from the Candy Crush franchise, due to in-game events and features.

2016 vs. 2015

King's 2016 net revenues represent the net revenues from the King Closing Date through December 31, 2016. The revenues were primarily driven by the Candy Crush franchise, which included the release of *Candy Crush Jelly Saga*™ in January 2016.

Segment Income from Operations

Activision

2017 vs. 2016

The increase in Activision's operating income for 2017, as compared to 2016, was primarily due to higher revenues, as discussed above, and lower costs associated with the Skylanders franchise, as there was not a new title released in 2017.

The increase was partially offset by higher sales and marketing spend on the Destiny franchise due to the release of *Destiny 2*.

2016 vs. 2015

The decrease in Activision's operating income for 2016, as compared to 2015, was primarily due to lower revenues, as discussed above. This was partially offset by:

- lower sales and marketing spend on *Guitar Hero Live* and the Destiny franchise given the timing of game launches; and
- the relative increase in revenues coming from the digital online channel, which typically has a higher profit margin.

Blizzard

2017 vs. 2016

The decrease in Blizzard's operating income for 2017, as compared to 2016, was primarily due to lower revenues, as discussed above, along with higher product development costs resulting from lower capitalization of software development costs due to the timing of game development cycles.

The decrease was partially offset by lower sales and marketing costs and software amortization for *Overwatch* and *World of Warcraft: Legion*, due to their respective launches in 2016, with no comparable releases in 2017.

2016 vs. 2015

The increase in Blizzard's operating income for 2016, as compared to 2015, was primarily due to higher revenues. This was partially offset by:

- new sales and marketing spending to support *Overwatch*; and
- higher personnel costs due to segment performance bonuses and increased headcount to support the business growth.

King

2017 vs. 2016

The increase in King's operating income for 2017, as compared to 2016, was primarily due to:

- 2017 including King's results of operations for the full year, while 2016 only included King's results of operations for the partial period following the King Closing Date; and
- higher revenues from the Candy Crush franchise, as discussed above.

2016 vs. 2015

King's operating income for the year ended December 31, 2016 represents the operating income from the King Closing Date through December 31, 2016.

Foreign Exchange Impact

Changes in foreign exchange rates had a positive impact of \$85 million, a negative impact of \$30 million, and a negative impact of \$338 million on reportable segment net revenues for 2017, 2016, and 2015, respectively, as compared to the same periods in the previous year. The changes are primarily due to changes in the value of the U.S. dollar relative to the euro and British pound.

Consolidated Results

Net Revenues by Distribution Channel

The following table details our consolidated net revenues by distribution channel (amounts in millions):

| | For the Years Ended December 31, | | | | | | |
|--------------------------------------|----------------------------------|----------|----------|--|--|-------------------------|-------------------------|
| | 2017 | 2016 | 2015 | Increase/ (decrease) 2017 v 2016 | Increase/ (decrease) 2016 v 2015 | % Change 2017 v 2016 | % Change 2016 v 2015 |
| Net revenues by distribution channel | | | | | | | |
| Digital online channels(1) | \$ 5,479 | \$ 4,865 | \$ 2,502 | \$ 614 | \$ 2,363 | 13% | 94% |
| Retail channels | 1,033 | 1,386 | 1,806 | (353) | (420) | (25) | (23) |
| Other(2) | 505 | 357 | 356 | 148 | 1 | 41 | — |
| Total consolidated net revenues | \$ 7,017 | \$ 6,608 | \$ 4,664 | \$ 409 | \$ 1,944 | 6% | 42% |

- (1) Net revenues from "Digital online channels" include revenues from digitally-distributed subscriptions, licensing royalties, value-added services, downloadable content, microtransactions, and products.
- (2) Net revenues from "Other" include revenues from our Studios and Distribution businesses, as well as revenues from MLG and the Overwatch League.

Digital Online Channel Net Revenues

2017 vs. 2016

The increase in net revenues from digital online channels for 2017, as compared to 2016, was primarily due to:

- higher revenues from King titles, as 2017 includes King revenues for the full year, while 2016 only included King revenues for the partial period following the King Closing Date, as well as higher revenues from the Candy Crush franchise due to in-game events and features; and
- higher revenues recognized from the continued strength of *Call of Duty: Black Ops III*, as compared to prior catalog releases, driven by the downloadable content pack, *Zombies Chronicles*, which was released in May 2017, and the continued strength of microtransactions.

The increase was partially offset by lower revenues recognized from *Call of Duty: Infinite Warfare*, which was released in November 2016, as compared to the performance of *Call of Duty: Black Ops III*, the comparable 2015 title.

2016 vs. 2015

The increase in net revenues from digital online channels for 2016, as compared to 2015, was primarily due to:

- new revenues from King titles following the King Closing Date, primarily driven by the Candy Crush franchise;
- revenues recognized from *Overwatch*, which was released in May 2016; and
- higher revenues recognized in 2016 from digital content associated with *Call of Duty: Black Ops III*, as compared to revenues recognized in 2015 from digital content associated with *Call of Duty: Advanced Warfare*, the comparable 2015 title.

Retail Channel Net Revenues

2017 vs. 2016

The decrease in net revenues from retail channels for 2017, as compared to 2016, was primarily due to:

- lower revenues recognized from *Call of Duty: Infinite Warfare*, which was released in November 2016, as compared to the performance of *Call of Duty: Black Ops III*, the comparable 2015 title; and
- lower revenues from the Skylanders franchise, due to the release of *Skylanders Imaginators* in October 2016, with no comparable release in 2017.

The decrease was partially offset by:

- revenues from *Crash Bandicoot N. Sane Trilogy*, which was released in June 2017; and
- higher revenues recognized from *Call of Duty: WWII*, which was released in November 2017, as compared to *Call of Duty: Infinite Warfare*, the comparable 2016 title.

2016 vs. 2015

The decrease in net revenues from retail channels for 2016, as compared to 2015, was primarily due to:

- lower revenues recognized from the Destiny franchise, as *Destiny* debuted in September 2014 but had no comparable full-game release in 2015;
- lower revenues from *Skylanders Imaginators*, which was released in October 2016, as compared to *Skylanders Superchargers*, the comparable 2015 title, as well as lower revenues from standalone Skylanders toys and accessories in 2016; and
- lower revenues recognized from *Call of Duty: Infinite Warfare*, which was released in the fourth quarter of 2016, as compared to *Call of Duty: Black Ops III*, which was released in the fourth quarter of 2015.

The decrease was partially offset by:

- revenues recognized from *Overwatch*, which was released in May 2016; and
- higher revenues recognized in 2016 from *Call of Duty: Black Ops III*, which was released in the fourth quarter of 2015, as compared to revenues recognized in 2015 from *Call of Duty: Advanced Warfare*, which was released in the fourth quarter of 2014.

Net Revenues by Geographic Region

The following table details our consolidated net revenues by geographic region (amounts in millions):

| | For the Years Ended December 31, | | | | | | |
|---------------------------------|----------------------------------|-----------------|-----------------|--|--|-------------------------|-------------------------|
| | 2017 | 2016 | 2015 | Increase/ (decrease) 2017 v 2016 | Increase/ (decrease) 2016 v 2015 | % Change 2017 v 2016 | % Change 2016 v 2015 |
| Geographic region net revenues: | | | | | | | |
| Americas | \$ 3,607 | \$ 3,423 | \$ 2,409 | \$ 184 | \$ 1,014 | 5% | 42% |
| EMEA(1) | 2,464 | 2,221 | 1,741 | 243 | 480 | 11 | 28 |
| Asia Pacific | 946 | 964 | 514 | (18) | 450 | (2) | 88 |
| Consolidated net revenues | <u>\$ 7,017</u> | <u>\$ 6,608</u> | <u>\$ 4,664</u> | <u>\$ 409</u> | <u>\$ 1,944</u> | 6 | 42 |

(1) Consists of the Europe, Middle East, and Africa geographic regions.

*Americas*2017 vs. 2016

The increase in net revenues in the Americas region for 2017, as compared to 2016, was primarily due to:

- higher revenues from King titles, as 2017 includes King's revenues for the full year, while 2016 only included King's revenues for the partial period following the King Closing Date, as well as higher revenues from the Candy Crush franchise due to in-game events and features;
- higher revenues recognized from the continued strength of *Call of Duty: Black Ops III*, as compared to prior catalog releases, driven by the downloadable content pack, *Zombies Chronicles*, which was released in May 2017, and the continued strength of microtransactions; and
- revenues from *Crash Bandicoot N. Sane Trilogy*, which was released in June 2017.

The increase was partially offset by lower revenues recognized from *Call of Duty: Infinite Warfare*, which was released in November 2016, as compared to the performance of *Call of Duty: Black Ops III*, the comparable 2015 title.

2016 vs. 2015

The increase in net revenues in the Americas region for 2016, as compared to 2015, was primarily due to:

- new revenues from King titles following the King Closing Date, primarily driven by the Candy Crush franchise;
- revenues recognized from *Overwatch*, which was released in May 2016; and
- higher revenues recognized in 2016 from *Call of Duty: Black Ops III*, which was released in the fourth quarter of 2015, as compared to revenues recognized in 2015 from *Call of Duty: Advanced Warfare*, which was released in the fourth quarter of 2014, including, in each case, the associated digital content.

The increase was partially offset by:

- lower revenues recognized from the Destiny franchise, as *Destiny* debuted in September 2014 but had no comparable full-game release in 2015; and
- lower revenues from *Skylanders Imaginators* , which was released in October 2016, as compared to *Skylanders Superchargers* , the comparable 2015 title, as well as lower revenues from standalone toys and accessories from the Skylanders franchise in 2016.

EMEA

2017 vs. 2016

The increase in net revenues in the EMEA region for 2017, as compared to 2016, was primarily due to the same drivers and partially offsetting factors as those for the Americas region discussed above, as well as higher revenues from our Distribution business, primarily due to higher sales during the holiday season.

2016 vs. 2015

The increase in net revenues in the EMEA region for 2016, as compared to 2015, was primarily due to the same drivers and partially offsetting factors as the Americas region, as discussed above.

Asia Pacific

2017 vs. 2016

The slight decrease in net revenues in the Asia Pacific region for 2017, as compared 2016, was primarily due to slightly lower revenues recognized from *Overwatch* and *Hearthstone* , mostly offset by higher revenues from King titles and *Crash Bandicoot N. Sane Trilogy*.

2016 vs. 2015

The increase in net revenues in the Asia Pacific region for 2016, as compared to 2015, was primarily due to:

- new revenues from King titles following the King Closing Date, primarily driven by the Candy Crush franchise;
- revenues recognized from *Overwatch* , which was released in May 2016; and
- higher revenues recognized from *Hearthstone*.

The increase was partially offset by lower revenues recognized from the Diablo franchise due to the timing of releases.

Net Revenues by Platform

The following tables detail our net revenues by platform and as a percentage of total consolidated net revenues (amounts in millions):

| | Year Ended December 31, 2017 | % of total(3) consolidated net revenues | Year Ended December 31, 2016 | % of total(3) consolidated net revenues | Year Ended December 31, 2015 | % of total(3) consolidated net revenues | Increase/ (Decrease) 2017 v 2016 | Increase/ (Decrease) 2016 v 2015 |
|---------------------------------|------------------------------------|--|------------------------------------|--|------------------------------------|--|--|--|
| Platform net revenues: | | | | | | | | |
| Console | \$ 2,389 | 34% | \$ 2,453 | 37% | \$ 2,391 | 51% | \$ (64) | \$ 62 |
| PC | 2,042 | 29 | 2,124 | 32 | 1,499 | 32 | (82) | 625 |
| Mobile and ancillary(1) | 2,081 | 30 | 1,674 | 25 | 418 | 9 | 407 | 1,256 |
| Other(2) | 505 | 7 | 357 | 5 | 356 | 8 | 148 | 1 |
| Total consolidated net revenues | \$ 7,017 | 100% | \$ 6,608 | 100% | \$ 4,664 | 100% | \$ 409 | \$ 1,944 |

- (1) Net revenues from "Mobile and ancillary" include revenues from mobile devices, as well as non-platform-specific game-related revenues, such as standalone sales of toys and accessories from our Skylanders franchise and other physical merchandise and accessories.
- (2) Net revenues from "Other" include revenues from our Studios and Distribution businesses, as well as revenues from MLG and the Overwatch League.
- (3) The percentages of total are presented as calculated. Therefore, the sum of these percentages, as presented, may differ due to the impact of rounding.

Console Net Revenues

2017 vs. 2016

The decrease in net revenues from console for 2017, as compared to 2016, was primarily due to lower revenues recognized from *Call of Duty: Infinite Warfare*, which was released November 2016, as compared to the performance of *Call of Duty: Black Ops III*, the comparable 2015 title. The decrease is partially offset by:

- higher revenues recognized from the continued strength of *Call of Duty: Black Ops III*, as compared to prior catalog releases, driven by the downloadable content pack, *Zombies Chronicles*, which was released in May 2017, and the continued strength of microtransactions;
- revenues from *Crash Bandicoot N. Sane Trilogy*, which was released in June 2017; and
- higher revenues recognized from *Call of Duty: WWII*, which was released in November 2017, as compared to *Call of Duty: Infinite Warfare*, the comparable 2016 title.

2016 vs. 2015

The increase in net revenues from console for 2016, as compared to 2015, was primarily due to:

- higher revenues recognized in 2016 from *Call of Duty: Black Ops III*, which was released in the fourth quarter of 2015, as compared to revenues recognized in 2015 from *Call of Duty: Advanced Warfare*, which was released in the fourth quarter of 2014, including, in each case, the associated digital content; and
- revenues recognized from *Overwatch*, which was released in May 2016.

The increase was partially offset by lower revenues recognized from the *Destiny* franchise, as *Destiny* debuted in September 2014 but had no comparable full-game release in 2015.

PC Net Revenues

2017 vs. 2016

The decrease in net revenues from PC for 2017, as compared to 2016, was primarily due to:

- lower revenues recognized from the World of Warcraft franchise; and
- lower revenues recognized from *Overwatch* , which was released in May 2016.

2016 vs. 2015

The increase in net revenues from PC for 2016, as compared to 2015, was primarily due to:

- revenues recognized from *Overwatch* , which was released in May 2016; and
- revenues from King titles following the King Closing Date.

Mobile and Ancillary Net Revenues

2017 vs. 2016

The increase in net revenues from mobile and ancillary for 2017, as compared to 2016, was primarily due to higher revenues from King titles, as 2017 includes King's revenues for the full year, while 2016 only included King's revenues for the partial period following the King Closing Date, as well as higher revenues from the Candy Crush franchise due to in-game events and features.

The increase was partially offset by lower revenues from sales of standalone toys and accessories from the Skylanders franchise.

2016 vs. 2015

The increase in net revenues from mobile and ancillary for 2016, as compared to 2015, was primarily due to:

- new revenues from King titles following the King Closing Date, which were primarily driven by the Candy Crush franchise; and
- higher revenues recognized from *Hearthstone* , which was released on iPhone and Android smartphones in April 2015.

The increase was partially offset by lower revenues from sales of standalone toys and accessories from the Skylanders franchise.

Costs and Expenses

Cost of Revenues

The following tables detail the components of cost of revenues in dollars and as a percentage of associated net revenues (amounts in millions):

| | Year Ended December 31, 2017 | % of associated net revenues | Year Ended December 31, 2016 | % of associated net revenues | Year Ended December 31, 2015 | % of associated net revenues | Increase (Decrease) 2017 v 2016 | Increase (Decrease) 2016 v 2015 |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|---------------------------------------|---------------------------------------|
| Cost of revenues | | | | | | | | |
| —product sales: | | | | | | | | |
| Product costs | \$ 733 | 35% | \$ 741 | 34% | \$ 872 | 36% | \$ (8) | \$ (131) |
| Software royalties, amortization, intellectual property licenses | 300 | 14 | 331 | 15 | 370 | 15 | (31) | (39) |
| Cost of revenues —subscription, licensing, and other revenues: | | | | | | | | |
| Game operations and distribution costs | 984 | 20 | 851 | 19 | 274 | 12 | 133 | 577 |
| Software royalties, amortization, intellectual property licenses | 484 | 10 | 471 | 11 | 69 | 3 | 13 | 402 |
| Total cost of revenues | \$ 2,501 | 36% | \$ 2,394 | 36% | \$ 1,585 | 34% | \$ 107 | \$ 809 |

Cost of Revenues—Product Sales:

2017 vs. 2016

Product costs for 2017, were comparable to 2016, primarily due to lower product costs from the Skylanders franchise as there was no new release in 2017, offset by higher product costs resulting from the increased revenues of our relatively lower-margin Distribution business.

The decrease in software royalties, amortization, and intellectual property licenses related to product sales for 2017, as compared to 2016, was primarily due to:

- lower software amortization associated with *Guitar Hero Live*, which was released in October 2015;
- lower software amortization from *Overwatch*, which was released in May 2016; and
- lower software amortization from the Skylanders franchise as there was no new release in 2017.

The decrease was partially offset by higher software amortization associated with the Destiny franchise, primarily due to the release of *Destiny 2* in September 2017.

2016 vs. 2015

The decrease in product costs for 2016, as compared to 2015, was primarily due to:

- lower product costs associated with the Skylanders franchise; and
- the relative increase in revenues coming from the digital online channel, which typically have relatively lower product costs.

The decrease in software royalties, amortization, and intellectual property licenses related to product sales for 2016, as compared to 2015, was primarily due to lower software amortization from the Destiny franchise, as *Destiny* was released in the third quarter of 2014, but had no comparable full-game release in 2015.

This decrease was partially offset by:

- software amortization from *Overwatch*, which was released in May 2016 with no comparable 2015 title; and
- higher software amortization associated with *Call of Duty: Black Ops III*, which was released in the fourth quarter of 2015, as compared to *Call of Duty: Advanced Warfare*, which was released in the fourth quarter of 2014.

Cost of Revenues—Subscription, Licensing, and Other Revenues:

2017 vs. 2016

The increase in game operations and distribution costs for 2017, as compared to 2016, was primarily due to platform provider fees associated with the increase in revenues from King.

Software royalties, amortization, and intellectual property licenses related to subscription, licensing, and other revenues for 2017 were comparable to 2016.

2016 vs. 2015

The increase in game operations and distribution costs for 2016, as compared to 2015, was primarily due to:

- increased online costs and platform provider fees associated with revenues from King titles included following the King Closing Date; and
- increased expenditures to support our growing online activity across our existing and new titles.

The increase in software royalties, amortization, and intellectual property licenses related to subscription, licensing, and other revenues for 2016, as compared to 2015, was primarily due to a full year-to-date period amortization of internally-developed franchise intangible assets acquired in the King Acquisition, while the comparable prior period only included the partial period of amortization of internally-developed franchise intangible assets following the King Closing Date.

Product Development (amounts in millions)

| | <u>Year Ended December 31, 2017</u> | <u>% of consolidated net revenues</u> | <u>Year Ended December 31, 2016</u> | <u>% of consolidated net revenues</u> | <u>Year Ended December 31, 2015</u> | <u>% of consolidated net revenues</u> | <u>Increase (Decrease) 2017 v 2016</u> | <u>Increase (Decrease) 2016 v 2015</u> |
|---------------------|---|---|---|---|---|---|--|--|
| Product development | \$ 1,069 | 15% | \$ 958 | 14% | \$ 646 | 14% | \$ 111 | \$ 312 |

2017 vs 2016

The increase in product development costs for 2017, as compared to 2016, was primarily due to:

- higher Blizzard product development costs resulting from lower capitalization of software development costs due to the timing of game development cycles; and
- increased product development costs for King, as 2017 includes King's costs for a full year, while 2016 only included King's costs for the partial period following the King Closing Date.

2016 vs 2015

The increase in product development costs for 2016, as compared to 2015, was primarily due to:

- product development costs associated with King's titles for the period following the King Closing Date; and

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- increased product development costs for Activision and Blizzard's current and upcoming releases.

Sales and Marketing (amounts in millions)

| | Year Ended December 31, 2017 | % of consolidated net revenues | Year Ended December 31, 2016 | % of consolidated net revenues | Year Ended December 31, 2015 | % of consolidated net revenues | Increase (Decrease) 2017 v 2016 | Increase (Decrease) 2016 v 2015 |
|------------------------|------------------------------------|--------------------------------------|------------------------------------|--------------------------------------|------------------------------------|--------------------------------------|---------------------------------------|---------------------------------------|
| Sales and marketing | \$ 1,378 | 20% | \$ 1,210 | 18% | \$ 734 | 16% | \$ 168 | \$ 476 |

2017 vs. 2016

The increase in sales and marketing expenses for 2017, as compared to 2016, was primarily due to:

- higher sales and marketing costs for the Destiny franchise, given the release of *Destiny 2* in September 2017; and
- increased amortization of the customer base intangible assets acquired in the King Acquisition and increased sales and marketing costs to support King's titles, as 2017 includes a full year of costs, while 2016 only included King's costs for the partial period following the King Closing Date.

The increase was partially offset by lower sales and marketing costs for the Skylanders franchise as there was no new title release in 2017.

2016 vs. 2015

The increase in sales and marketing expenses for 2016, as compared to 2015, was primarily due to:

- amortization of the customer base intangible assets acquired in the King Acquisition;
- sales and marketing spending to support King's titles and new launches, including *Candy Crush Jelly Saga* and *Farm Heroes Super Saga*TM; and
- sales and marketing spending to support Blizzard's new title, *Overwatch*.

The increase was partially offset by lower sales and marketing expenditures on *Guitar Hero Live* and the Destiny franchise given the timing of game launches.

General and Administrative (amounts in millions)

| | Year Ended December 31, 2017 | % of consolidated net revenues | Year Ended December 31, 2016 | % of consolidated net revenues | Year Ended December 31, 2015 | % of consolidated net revenues | Increase (Decrease) 2017 v 2016 | Increase (Decrease) 2016 v 2015 |
|-------------------------------|------------------------------------|--------------------------------------|------------------------------------|--------------------------------------|------------------------------------|--------------------------------------|---------------------------------------|---------------------------------------|
| General and administrative | \$ 760 | 11% | \$ 634 | 10% | \$ 380 | 8% | \$ 126 | \$ 254 |

2017 vs. 2016

The increase in general and administrative expenses for 2017, as compared to 2016, was primarily due to:

- increased personnel costs, including stock compensation expenses, to support the growth in our business and adjacent areas of opportunity;
- the inclusion of a non-cash accounting charge to reclassify certain losses included in our cumulative translation adjustments into earnings due to the substantial liquidation of certain of our foreign entities, with no comparable activity in 2016;

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- restructuring charges, primarily severance costs, incurred in 2017 with no comparable activity in 2016; and
- higher foreign currency transaction losses.

The increase is partially offset by lower transaction costs as 2016 included the King Acquisition.

2016 vs. 2015

The increase in general and administrative expenses for 2016, as compared to 2015, was primarily due to:

- King's general and administrative costs, which are included from the King Closing Date;
- higher Blizzard personnel costs due to segment performance bonuses and increased headcount to support the growth of the Blizzard business;
- higher professional and transaction-related fees due to the King Acquisition, which closed on February 23, 2016; and
- lower foreign currency transaction and derivative contract gains.

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

| | Year Ended December 31, 2017 | % of consolidated net revenues | Year Ended December 31, 2016 | % of consolidated net revenues | Year Ended December 31, 2015 | % of consolidated net revenues | Increase (Decrease) 2017 v 2016 | Increase (Decrease) 2016 v 2015 |
|--|------------------------------------|--------------------------------------|------------------------------------|--------------------------------------|------------------------------------|--------------------------------------|---------------------------------------|---------------------------------------|
| Interest and other expense (income), net | \$ 146 | 2% | \$ 214 | 3% | \$ 198 | 4% | (\$ 68) | \$ 16 |

2017 vs. 2016

The decrease in interest and other expense, net, for 2017, as compared to 2016, was primarily due to our lower total outstanding debt and lower interest rates on our current debt instruments as a result of our refinancing activities in 2016 and 2017. See further discussion below under "Liquidity and Capital Resources."

2016 vs. 2015

The increase in interest and other expense, net, for 2016, as compared to 2015, was primarily due to interest expense associated with the new \$2.3 billion tranche of term loans "A" that were incurred in connection with the King Acquisition. This increase was partially offset by lower interest expense related to our prior term loan because of voluntary prepayments on the principal we made throughout 2016, with the prior term loan being fully extinguished in September 2016. See further discussion below under "Liquidity and Capital Resources."

Income Tax Expense (Benefit) (amounts in millions)

| | Year Ended December 31, 2017 | % of Pretax income | Year Ended December 31, 2016 | % of Pretax income | Year Ended December 31, 2015 | % of Pretax income | Increase (Decrease) 2017 v 2016 | Increase (Decrease) 2016 v 2015 |
|--------------------|------------------------------------|--------------------------|------------------------------------|--------------------------|------------------------------------|--------------------------|---------------------------------------|---------------------------------------|
| Income tax expense | \$ 878 | 76% | \$ 140 | 13% | \$ 229 | 20% | \$ 738 | \$ (89) |

For the years ended December 31, 2017, 2016, and 2015, the Company's income before income tax expense was \$1.15 billion, \$1.11 billion, and \$1.12 billion, respectively, and our income tax expense was \$878 million (or a 76% effective tax rate), \$140 million (or a 13% effective tax rate), and \$229 million (or a 20% effective tax rate), respectively. Our full year 2017 effective tax rate of 76% is higher than

the U.S. statutory rate of 35% primarily due to the one-time tax expense related to the U.S. Tax Reform Act (discussed further below) and changes in the Company's liability for uncertain tax positions, partially offset by earnings taxed at relatively lower rates in foreign jurisdictions, recognition of excess tax benefits from shared-based payments, and research and development ("R&D") credits.

On December 22, 2017, the U.S. Tax Reform Act was enacted. The U.S. Tax Reform Act, among other things, reduced the U.S. corporate income tax rate from 35% to 21% beginning in 2018 and implemented a modified territorial tax system that imposes a one-time tax on deemed repatriated earnings of foreign subsidiaries ("Transition Tax").

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 ("SAB 118"), which provides guidance on how to account for the effects of the U.S. Tax Reform Act under ASC 740. SAB 118 enables companies to record a provisional amount for the effects of the U.S. Tax Reform Act based on a reasonable estimate, subject to adjustment during a measurement period of up to one year, until accounting is complete.

We recorded a provisional amount for the effects of the U.S. Tax Reform Act based on a reasonable estimate in the fourth quarter of 2017 resulting in a charge of \$636 million. This includes current tax expense of \$555 million related to the Transition Tax, which is payable over eight years, and deferred tax expense of \$81 million related to the remeasurement of deferred taxes resulting from the U.S. corporate income tax rate reduction. Accounting for the income tax effects of the U.S. Tax Reform Act requires complex new calculations to be performed and significant judgments in interpreting the legislation. Additional guidance may be issued on how the provisions of the U.S. Tax Reform Act will be applied or otherwise administered that is different from our interpretation. We may make adjustments to the provisional amounts as we collect and prepare the data necessary to finalize our calculations, interpret the U.S. Tax Reform Act and any additional guidance issued, and consider the effects of any additional actions we may take as a result of the U.S. Tax Reform Act.

We continue to analyze the prospective effects of the U.S. Tax Reform Act, including new provisions impacting certain foreign income, such as global intangible low-taxed income ("GILTI") of foreign subsidiaries, base erosion anti-abuse tax ("BEAT"), and foreign-derived intangible income ("FDII"), potential limitations on interest expense deductions, and changes to the provisions of Section 162(m) of the Internal Revenue Code, among other provisions of the U.S. Tax Reform Act.

In 2017 and 2016, our U.S. income before income tax expense was \$185 million and \$228 million, respectively, and comprised 16% and 21%, respectively, of our consolidated income before income tax expense. In 2017 and 2016, our foreign income before income tax expense was \$966 million and \$878 million, respectively, and comprised 84% and 79%, respectively, of our consolidated income before income tax expense.

In 2017, 2016 and 2015, earnings taxed at lower rates in foreign jurisdictions, as compared to domestic earnings taxed at the U.S. federal statutory tax rate, lowered our effective tax rate by 24 percentage points, 22 percentage points, and 20 percentage points, respectively. The increase in the foreign rate differential is due to the overall increase in foreign income, which is taxed at relatively lower rates in proportion to U.S. income.

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

On December 28, 2017, we received a Notice of Reassessment from the FTA related to transfer pricing concerning intercompany transactions involving one of our French subsidiaries for the 2011 through 2013 tax years. The total assessment, including penalties and interest, was approximately €571 million (\$680 million). We disagree with the proposed assessment and intend to vigorously contest it. We plan to pursue all remedies available to us to successfully resolve this matter, including administrative remedies with the FTA, and judicial remedies, if necessary. While we believe our tax provisions at December 31, 2017 are appropriate, until such time as this matter is ultimately resolved we could be subject to significant additional tax liabilities. In addition to the risk of additional tax for years 2011 through 2013, if litigation regarding this matter were adversely determined and/or if the FTA were to seek adjustments of a similar nature for subsequent years, we could be subject to significant additional tax liabilities.

Further analysis of the differences between the U.S. federal statutory rate and the consolidated effective tax rate, as well as other information about our income taxes, is provided in Note 15 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

Foreign Exchange Impact

Changes in foreign exchange rates had a positive impact of \$27 million, a positive impact of \$10 million, and a negative impact of \$242 million on Activision Blizzard's consolidated operating income in 2017, 2016 and 2015, respectively. The changes are primarily due to changes in the value of the U.S. dollar relative to the euro and British pound and its impact on our foreign operating income.

Liquidity and Capital Resources

We believe our ability to generate cash flows from operating activities is one of our fundamental financial strengths. In the near term, we expect our business and financial condition to remain strong and to continue to generate significant operating cash flows, which, in combination with our existing balance of cash and cash equivalents and short-term investments of \$4.8 billion, our access to capital, and the availability of our \$250 million revolving credit facility, we believe will be sufficient to finance our operational and financing requirements for the next 12 months. Our primary sources of liquidity, which are available to us to fund cash outflows such as our anticipated dividend payments, share repurchases, and scheduled debt maturities, include our cash and cash equivalents, short-term investments, and cash flows provided by operating activities.

As of December 31, 2017, the amount of cash and cash equivalents held outside of the U.S. by our foreign subsidiaries was \$3.0 billion, as compared to \$1.9 billion as of December 31, 2016. Following the enactment of the U.S. Tax Reform Act and the current period expense on unrepatriated earnings, we no longer consider these available cash balances, which primarily relate to undistributed earnings of our most significant foreign subsidiaries, to be indefinitely reinvested.

Our cash provided from operating activities is somewhat impacted by seasonality. Working capital needs are impacted by weekly sales, which are generally highest in the fourth quarter due to seasonal and holiday-related sales patterns. On a continuing basis, we consider various transactions to increase shareholder value and enhance our business results, including acquisitions, divestitures, joint ventures, share repurchases, and other structural changes. These transactions may result in future cash proceeds or payments.

Sources of Liquidity (amounts in millions)

| | For the Years Ended December 31, | | |
|----------------------------|-------------------------------------|-----------------|---------------------------------------|
| | 2017 | 2016 | Increase (Decrease) 2017 v 2016 |
| Cash and cash equivalents | \$ 4,713 | \$ 3,245 | \$ 1,468 |
| Short-term investments | 62 | 13 | 49 |
| | <u>\$ 4,775</u> | <u>\$ 3,258</u> | <u>\$ 1,517</u> |
| Percentage of total assets | 26% | 19% | |

| | For the Years Ended December 31, | | | | |
|--|----------------------------------|-----------------|-------------------|---------------------------------------|---------------------------------------|
| | 2017 | 2016 | 2015 | Increase (Decrease) 2017 v 2016 | Increase (Decrease) 2016 v 2015 |
| Net cash provided by operating activities | \$ 2,213 | \$ 2,155 | \$ 1,259 | \$ 58 | \$ 896 |
| Net cash used in investing activities | (197) | (1,177) | (3,716) | 980 | 2,539 |
| Net cash (used in) provided by financing activities | (624) | 500 | (202) | (1,124) | 702 |
| Effect of foreign exchange rate changes | 76 | (56) | (366) | 132 | 310 |
| Net increase (decrease) in cash and cash equivalents | <u>\$ 1,468</u> | <u>\$ 1,422</u> | <u>\$ (3,025)</u> | <u>\$ 46</u> | <u>\$ 4,447</u> |

Net Cash Provided by Operating Activities

The primary driver of net cash flows associated with our operating activities is the collection of customer receivables generated from the sale of our products and services. These collections are typically partially offset by: payments to vendors for the manufacturing, distribution, and marketing of our products; payments for customer service support for our consumers; payments to third-party developers and intellectual property holders; payments for interest on our debt; payments for software development; payments for tax liabilities; and payments to our workforce.

2017 vs 2016

Net cash provided by operating activities for 2017 was \$2.21 billion, as compared to \$2.16 billion for 2016. The increase was primarily due to:

- increased earnings after excluding the effects of charges due to impacts from the U.S. Tax Reform Act, which did not result in current year cash outflows, and other non-cash charges for depreciation and amortization and share-based compensation expenses;
- a full year of King operating cash flows; and
- changes in our working capital due to the timing of collections and payments.

Net cash provided by operating activities for 2017 included \$145 million of interest paid on our outstanding debt, as compared to \$209 million paid in 2016.

2016 vs 2015

Net cash provided by operating activities for 2016 was \$2.2 billion, as compared to \$1.3 billion for 2015. The increase was primarily due to:

- new operating cash flows contributed by King following the King Closing Date; and

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- higher net income in 2016, as compared to 2015, along with larger adjustments to net income for non-cash charges, primarily associated with the amortization of the acquired intangibles in the King Acquisition, higher stock compensation expense due to converted equity awards for King personnel in the King Acquisition, and other non-cash or non-operating costs associated with our debt-related activities during the year.

Net cash provided by operating activities for 2016 included \$209 million of interest paid on our outstanding debt, as compared to \$193 million paid in 2015.

Net Cash Used in Investing Activities

The primary drivers of net cash flows associated with investing activities typically include capital expenditures, purchases and sales of investments, changes in restricted cash balances, and cash used for acquisitions.

2017 vs 2016

Net cash used in investing activities for 2017 was \$197 million, as compared to \$1.2 billion for 2016. The decrease in the cash used was primarily due to cash used for the King Acquisition in 2016, with no comparable transaction in 2017. The decrease was partially offset by purchases of available-for-sale investments, net of proceeds from maturities, of \$55 million in 2017, with no comparable transaction in 2016.

2016 vs 2015

Net cash used in investing activities for 2016 was \$1.2 billion, as compared to \$3.7 billion for 2015. The lower amount of cash used in investing activities in 2016 was primarily due to a 2015 cash outflow of \$3.6 billion for cash placed into escrow to facilitate the King Acquisition. In 2016, when we acquired King, the cash in escrow became a cash inflow. As a result, in 2016 we had a \$2.2 billion cash outflow for the King Acquisition in excess of the cash already in escrow, net of \$1.15 billion of cash acquired from King.

Net Cash Provided by (Used in) Financing Activities

The primary drivers of net cash flows associated with financing activities typically include the proceeds from, and repayments of, our long-term debt and transactions involving our common stock, including the issuance of shares of common stock to employees upon the exercise of stock options, as well as the payment of dividends.

2017 vs 2016

Net cash used in financing activities for 2017 was \$624 million, as compared to net cash provided by financing activities of \$500 million for 2016. The changes were primarily attributed to our debt financing activities. For 2017, we had net debt repayments of \$500 million, as compared to approximately \$700 million of net debt proceeds, inclusive of a premium payment, for 2016. The cash flows used in financing activities for 2017, were partially offset by:

- higher proceeds from stock option exercises in 2017 of \$178 million, as compared to \$106 million for 2016; and
- lower tax payments made for net share settlements on restricted stock units in 2017 of \$56 million, as compared to \$115 million in 2016.

2016 vs 2015

Net cash provided by financing activities for 2016 was \$500 million, as compared to cash flows used in financing activities of \$202 million for 2015. The difference was primarily due to \$6.9 billion of proceeds received from the following debt issuances in 2016:

- issuance of a \$2.3 billion tranche of term loans "A" on February 23, 2016 to fund the King Acquisition;
- issuance of an additional \$250 million tranche of term loans "A" on March 31, 2016;
- issuance of a new unsecured \$2.9 billion tranche of term loans "A" in connection with the fifth amendment to our credit agreement on August 23, 2016;
- issuance of \$650 million of 2.3% unsecured senior notes due September 2021 on September 19, 2016; and
- issuance of \$850 million of 3.4% unsecured senior notes due September 2026 on September 19, 2016.

These issuances were partially offset by:

- repayments of \$1.9 billion to extinguish our term loan outstanding at December 31, 2015 (the "Original Term Loan");
- repayments of \$2.5 billion in connection with the refinancing of our tranche of term loans "A" that were provided in the first quarter of 2016;
- repayments of \$185 million on our new tranche of term loans "A" that were provided on August 23, 2016, which included \$167 million of voluntary prepayments, as compared to the \$250 million partial repayment of our Original Term Loan in 2015;
- a cash payment to redeem all \$1.5 billion of our outstanding 5.625% unsecured senior notes due September 2021, as well as the associated \$63 million premium; and
- higher cash dividend payments made during 2016, as compared to 2015.

Net cash used in financing activities for 2015 also included proceeds of \$202 million received in the settlement of the litigation related to the October 11, 2013 repurchase of approximately 429 million shares of our common stock (the "Purchase Transaction"). There were no such proceeds received in 2016.

Effect of Foreign Exchange Rate Changes

Changes in foreign exchange rates had a positive impact of \$76 million, a negative impact of \$56 million, and a negative impact of \$366 million on our cash and cash equivalents for the years ended December 31, 2017, 2016, and 2015, respectively. The change is primarily due to changes in the value of the U.S. dollar relative to the Euro and British pound.

Debt

As of December 31, 2016, our total outstanding debt was \$4.9 billion, bearing interest at a weighted average rate of 2.92%. As a result of the activities described below, our total outstanding debt as of December 31, 2017, was \$4.4 billion, bearing interest at a weighted average rate of 3.58%.

On February 3, 2017, we entered into a sixth amendment (the "Sixth Amendment") to our credit agreement, which was originally executed on October 11, 2013 (as amended thereafter and from time to time, the "Credit Agreement"). The Sixth Amendment: (1) provided for a new tranche of term loans "A" in an aggregate principal amount of \$2.55 billion (the "2017 TLA") and (2) released each of

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our subsidiary guarantors from their respective guarantees provided under the Credit Agreement. All proceeds of the 2017 TLA, together with additional cash on hand of \$139 million, were used to fully retire the term loans then outstanding (the "2016 TLA") under the Credit Agreement, including all accrued and unpaid interest thereon. The terms of the 2017 TLA, other than the absence of the subsidiary guarantees, are generally the same as the terms of the 2016 TLA. The fees incurred as a result of the Sixth Amendment were not material. The 2017 TLA will mature on August 23, 2021.

On May 26, 2017, in a public underwritten offering, we issued three series of unsecured senior notes—\$400 million of 2.6% unsecured senior notes due June 2022, \$400 million of 3.4% unsecured senior notes due June 2027, and \$400 million of 4.5% unsecured senior notes due June 2047. The proceeds from these unsecured senior notes, together with cash on hand, were used to make a prepayment of \$1.2 billion on our 2017 TLA.

During the year ended December 31, 2017, we reduced our total outstanding long-term debt by \$500 million. This included \$139 million of cash used to retire the 2016 TLA, as discussed above, along with a prepayment on the 2017 TLA of \$361 million. The prepayment made on our 2017 TLA satisfied the remaining required quarterly principal repayments for the entire term of the Credit Agreement.

A summary of our outstanding debt as of December 31, 2017, is as follows (amounts in millions):

| | December 31, 2017 | | |
|------------|-----------------------|---|---------------------|
| | Gross Carrying Amount | Unamortized Discount and Deferred Financing Costs | Net Carrying Amount |
| 2017 TLA | \$ 990 | \$ (8) | \$ 982 |
| 2021 Notes | 650 | (4) | 646 |
| 2022 Notes | 400 | (4) | 396 |
| 2023 Notes | 750 | (9) | 741 |
| 2026 Notes | 850 | (9) | 841 |
| 2027 Notes | 400 | (6) | 394 |
| 2047 Notes | 400 | (10) | 390 |
| Total debt | <u>\$ 4,440</u> | <u>\$ (50)</u> | <u>\$ 4,390</u> |

A summary of our outstanding debt as of December 31, 2016, is as follows (amounts in millions):

| | December 31, 2016 | | |
|----------------------|-----------------------|---|---------------------|
| | Gross Carrying Amount | Unamortized Discount and Deferred Financing Costs | Net Carrying Amount |
| 2016 TLA | \$ 2,690 | \$ (27) | \$ 2,663 |
| 2021 Notes | 650 | (5) | 645 |
| 2023 Notes | 750 | (11) | 739 |
| 2026 Notes | 850 | (10) | 840 |
| Total long-term debt | <u>\$ 4,940</u> | <u>\$ (53)</u> | <u>\$ 4,887</u> |

On February 1, 2018, our Board of Directors authorized repayments of up to \$1.8 billion of the company's outstanding debt during 2018. As of the date hereof, we have not made any additional repayments on our outstanding debt and the determination as to if and when we make any such repayment will be dependent on market conditions and other factors.

Refer to Note 11 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K for disclosures regarding terms and activities associated with our debt obligations.

Dividends

On February 1, 2018, our Board of Directors approved a cash dividend of \$0.34 per common share, payable on May 9, 2018, to shareholders of record at the close of business on March 30, 2018.

On February 2, 2017, our Board of Directors approved a cash dividend of \$0.30 per common share and we made an aggregate cash dividend payment on May 10, 2017 of \$226 million to shareholders.

Capital Expenditures

We made capital expenditures of \$155 million in 2017, as compared to \$136 million in 2016. In 2018, we anticipate total capital expenditures of approximately \$155 million, primarily for leasehold improvements, computer hardware, and software purchases.

Commitments

Refer to Note 19 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K for disclosures regarding our commitments.

Off-balance Sheet Arrangements

At December 31, 2017 and 2016, Activision Blizzard had no significant relationships with unconsolidated entities or financial parties, often referred to as "structured finance" or "special purpose" entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes, that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions. The impact and any associated risks related to these policies on our business operations are discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. The policies, estimates, and assumptions discussed below are considered by management to be critical because they are both important to the portrayal of our financial condition and results of operations and because their application places the most significant demands on management's judgment, with financial reporting results relying on estimates and assumptions about the effect of matters that are inherently uncertain. Specific risks for these critical accounting policies, estimates, and assumptions are described in the following paragraphs.

Revenue Recognition

We recognize revenues when there is persuasive evidence of an arrangement, the product or service has been provided to the customer, the collection of our fees is reasonably assured, and the amount of fees to be paid by the customer is fixed or determinable. Certain products are sold to customers with a "street date" (which is the earliest date these products may be sold by retailers). For these products, we recognize revenues on the later of the street date or the date the product is sold to the customer.

Revenue Arrangements with Multiple Deliverables

Certain of our revenue arrangements have multiple deliverables, which we account for in accordance with Accounting Standards Codification ("ASC") Topic 605. These revenue arrangements include product sales consisting of both software, service (such as ongoing hosting arrangements), and hardware deliverables (such as peripherals or other ancillary collectors' items sold together with physical "boxed" software).

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. Further, 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 did not have significant revenue arrangements that required using BESP for the years ended December 31, 2017, 2016, and 2015. The inputs we use to determine the selling price of our significant deliverables include the actual price charged by the Company for deliverables that the Company sells separately (which represents VSOE) and the wholesale prices of the same or similar products for deliverables not sold separately (which represents TPE).

Product Sales

Product sales consists of sales of our games, including physical products and digital full-game downloads. We recognize revenues from the sale of our products after both (1) title and risk of loss have been transferred to our customers and (2) all performance obligations have been completed. With respect to digital full-game downloads, this is when the product is available for download or is activated for gameplay. Revenues from product sales are recognized after deducting the estimated allowance for returns and price protection.

Product with Online Functionality or Online Hosted Arrangements

For our software products with online functionality or that are part of an online hosted arrangement, we evaluate whether that online functionality constitutes a more-than-inconsequential separate deliverable in addition to the software product. This evaluation is performed for each software product or product add-on (including downloadable content), when it is released. Determining whether the online functionality for a particular product constitutes a more-than-inconsequential deliverable is subjective and requires management's judgment. When we determine that the online functionality constitutes a more-than-inconsequential separate service deliverable in addition to the product, which is principally because of the online functionality's importance to gameplay, we consider our performance obligation for this title to extend beyond the sale of the game. In addition, VSOE of fair value does not exist for the online functionality of some products, as we do not separately charge for this component. As a result, we initially defer all of the software-related revenues from the sale of any such title (including downloadable content) and recognize the revenues ratably over the estimated service period. In addition, we initially defer the cost of revenues for the title and recognize the cost of revenues as the related revenues are recognized. The cost of revenues that are initially deferred include

product and distribution costs, software royalties and amortization, and intellectual property licenses and exclude intangible asset amortization.

For our software products with online functionality that are considered to be incidental to the overall product offering and are inconsequential deliverables, we recognize the related revenues when the revenue recognition criteria described above have been met.

For our *World of Warcraft* boxed products, expansion packs and value-added services, we recognize revenues in each case with the related subscription service revenues ratably over the estimated service period, beginning upon the activation of the software and delivery of the related services. For revenues associated with the sales of subscriptions, the revenues are deferred until the subscription service is activated by the consumer and are then recognized ratably over the subscription period. Revenues attributed to the sale of *World of Warcraft* boxed software and related expansion packs are classified as "Product sales," whereas revenues attributable to subscriptions and other value-added services are classified as "Subscription, licensing, and other revenues."

Microtransaction Revenues

Microtransaction revenues are derived from the sale of virtual goods and currencies to our players to enhance their gameplay experience. Proceeds from the sales of virtual goods and currencies are initially recorded in deferred revenues. Proceeds from the sales of virtual currencies are recognized as revenues when a player uses the virtual goods purchased with the virtual currency. Proceeds from the sales of virtual goods directly are also recognized as revenues when a player uses the virtual goods. We categorize our virtual goods as either consumable or durable. Consumable virtual goods represent goods that can be consumed by a specific player action; accordingly, we recognize revenues from the sale of consumable virtual goods as the goods are consumed. Durable virtual goods represent goods that are accessible to the player over an extended period of time; accordingly, we recognize revenues from the sale of durable virtual goods ratably over the period of time the goods are available to the player, which is generally the estimated service period.

Estimated Service Period

We determine the estimated service period for players of our games with consideration of various data points, including the weighted-average number of days between players' first and last date played online, the average total hours played, the average number of days in which player activity stabilizes, and the weighted-average number of days between players' first purchase date and last date played online. We also consider known online trends, the service periods of our previously released games, and the service periods of our competitors' games that are similar in nature to ours, to the extent they are publicly available. Determining the estimated service period is subjective and requires management's judgment. Future usage patterns may differ from historical usage patterns and therefore the estimated service period may change in the future. The estimated service periods for players of our current games are generally less than twelve months.

Principal Agent Considerations

We evaluate sales of our products and content via third party digital storefronts, such as Microsoft's Xbox Games Store, Sony's PSN, the Apple App Store, and the Google Play Store, to determine whether revenues should be reported gross or net of fees retained by the storefront. Key indicators that we evaluate in determining gross versus net treatment include, but are not limited to, the following:

- the party responsible for delivery/fulfillment of the product or service to the consumer;
- the party responsible for consumer billing, fee collection, and refunds;

- the storefront and terms of sale that govern the consumer's purchase of the product or service; and
- the party that sets the pricing with the consumer and has credit risk.

Based on evaluation of the above indicators, we report revenues on a gross basis for sales arrangements via Apple App Store and Google Play Store, and we report revenues on a net basis (i.e., net of fees retained by the storefront) for sales arrangements via Microsoft's Xbox Games Store and Sony PSN.

Allowances for Returns and Price Protection

We closely monitor and analyze the historical performance of our various titles, the performance of products released by other publishers, market conditions, and the anticipated timing of other releases to assess future demand of current and upcoming titles. Initial volumes shipped upon title launch and subsequent reorders are evaluated with the goal of ensuring that quantities are sufficient to meet the demand from the retail markets, but at the same time are controlled to prevent excess inventory in the channel. We benchmark units to be shipped to our customers using historical and industry data.

We may permit product returns from, or grant price protection to, our customers under certain conditions. In general, price protection refers to the circumstances in which we elect to decrease, on a short- or longer-term basis, the wholesale price of a product by a certain amount and, when granted and applicable, allow customers a credit against amounts owed by such customers to us with respect to open and/or future invoices. The conditions our customers must meet to be granted the right to return products or receive price protection credits include, among other things, compliance with applicable trading and payment terms and consistent return of inventory and delivery of sell-through reports to us. We may also consider other factors, including achievement of sell-through performance targets in certain instances, the facilitation of slow-moving inventory, and other market factors.

Significant management judgments and estimates with respect to potential future product returns and price protection related to current period product revenues must be made and used when establishing the allowance for returns and price protection in any accounting period. We estimate the amount of future returns and price protection for current period product revenues utilizing historical experience and information regarding inventory levels and the demand and acceptance of our products by the end consumer. The following factors are used to estimate the amount of future returns and price protection for a particular title: historical performance of titles in similar genres; historical performance of the hardware platform; historical performance of the franchise; console hardware life cycle; sales force and retail customer feedback; industry pricing; future pricing assumptions; weeks of on-hand retail channel inventory; absolute quantity of on-hand retail channel inventory; our warehouse on-hand inventory levels; the title's recent sell-through history (if available); marketing trade programs; and the performance of competing titles. The relative importance of these factors varies among titles depending upon, among other things, genre, platform, seasonality, and sales strategy.

Based upon historical experience, we believe that our estimates are reasonable. However, actual returns and price protection could vary materially from our allowance estimates due to a number of reasons, including, among others: a lack of consumer acceptance of a title, the release in the same period of a similarly themed title by a competitor, or technological obsolescence due to the emergence of new hardware platforms. There may be material differences in the amount and timing of our revenues for any period if factors or market conditions change or if matters resolve in a manner that is inconsistent with management's assumptions utilized in determining the allowances for returns and price protection. For example, a 1% change in our December 31, 2017 allowance for sales returns, price protection, and other allowances would have impacted net revenues by approximately \$3 million.

Software Development Costs

Software development costs include payments made to independent software developers under development agreements, as well as direct costs incurred for internally developed products. Software development costs are capitalized once the technological feasibility of a product is established and such costs are determined to be recoverable. Technological feasibility of a product requires both technical design documentation and game design documentation, or the completed and tested product design and a working model. Significant management judgments and estimates are utilized in the assessment of when technological feasibility is established and the evaluation is performed on a product-by-product basis. For products where proven technology exists, this may occur early in the development cycle. Software development costs related to online hosted revenue arrangements are capitalized after the preliminary project phase is complete and it is probable that the project will be completed and the software will be used to perform the function intended. Prior to a product's release, if and when we believe capitalized costs are not recoverable, we expense the amounts as part of "Cost of revenues—software royalties, amortization, and intellectual property licenses." Capitalized costs for products that are cancelled or are expected to be abandoned are charged to "Product development" in the period of cancellation. Amounts related to software development which are not capitalized are charged immediately to "Product development."

Commencing upon a product's release, capitalized software development costs are amortized to "Cost of revenues—software royalties, amortization, and intellectual property licenses" based on the ratio of current revenues to total projected revenues for the specific product, generally resulting in an amortization period of six months to approximately two years.

We evaluate the future recoverability of capitalized software development costs on a quarterly basis. For products that have been released in prior periods, the primary evaluation criterion is the actual performance of the title to which the costs relate. For products that are scheduled to be released in future periods, recoverability is evaluated based on the expected performance of the specific products to which the costs relate. Criteria used to evaluate expected product performance include: historical performance of comparable products developed with comparable technology; market performance of comparable titles; orders for the product prior to its release; general market conditions; and, for any sequel product, estimated performance based on the performance of the product on which the sequel is based.

Significant management judgments and estimates are utilized in assessing the recoverability of capitalized costs. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional costs to be incurred. If revised forecasted or actual product sales are less than the originally forecasted amounts utilized in the initial recoverability analysis, the net realizable value may be lower than originally estimated in any given quarter, which could result in an impairment charge. Material differences may result in the amount and timing of expenses for any period if matters resolve in a manner that is inconsistent with management's expectations.

Income Taxes

We record a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with 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. The effect on deferred tax assets and liabilities due to a change in tax rates is

recognized in income in the period that includes the enactment date. We evaluate deferred tax assets each period for recoverability. For those assets that do not meet the threshold of "more likely than not" that they will be realized in the future, a valuation allowance is recorded.

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 tax expenses 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 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.

Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Although we believe our reserves are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest and penalties.

Our provision for income taxes is subject to volatility and could be adversely impacted by: (1) earnings being lower than anticipated in foreign regions where taxes are levied at relatively lower statutory rates and/or higher than anticipated in the United States where taxes are levied at relatively higher statutory rates; (2) changes in the valuation of our deferred tax assets and liabilities; (3) tax effects of nondeductible compensation; (4) tax costs related to intercompany realignments; (5) differences between amounts included in our tax filings and the estimate of such amounts included in our tax expenses; (6) changes in accounting principles; or (7) changes in tax laws, regulations, administrative practices, principles or interpretations, including fundamental changes to the tax laws applicable to multinational corporations. Significant judgment is required to determine the recognition and measurement attributes prescribed in the accounting guidance for uncertainty in income taxes. The accounting guidance for uncertainty in income taxes applies to all income tax positions, including the potential recovery of previously paid taxes, which if settled unfavorably could adversely impact our provision for income taxes. In addition, we are subject to the continuous examination of our income tax returns by the IRS and are regularly subject to audit by other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse impact on our operating results and financial condition.

As further described in "Consolidated Results" above, on December 22, 2017, the U.S. Tax Reform Act was enacted. The U.S. Tax Reform Act, among other things, reduced the U.S. corporate income tax rate from 35% to 21% beginning in 2018 and implemented a modified territorial tax system that imposes a one-time tax on deemed repatriated earnings of foreign subsidiaries.

On December 22, 2017, the SEC staff issued SAB 118, which provides guidance on how to account for the effects of the U.S. Tax Reform Act under ASC 740. SAB 118 enables companies to record a provisional amount for the effects of the U.S. Tax Reform Act based on a reasonable estimate, subject to adjustment during a measurement period of up to one year, until accounting is complete.

We continue to analyze the prospective effects of the U.S. Tax Reform Act, including new provisions impacting certain foreign income, such as GILTI, BEAT, and FDII, potential limitations on

interest expense deductions, and changes to the provisions of Section 162(m) of the Internal Revenue Code, among other provisions of the U.S. Tax Reform Act. The Company has elected to account for the U.S. Tax Reform Act provisions related to GILTI as period costs if and when incurred pursuant to the FASB Staff Q&A guidance issued in January 2018.

Fair Value Estimates

The preparation of financial statements often requires us to determine the fair value of a particular item to fairly present in our consolidated financial statements. Without an independent market or another representative transaction, determining the fair value of a particular item requires us to make several assumptions that are inherently difficult to predict and can have a material impact on the conclusion of the appropriate accounting.

There are various valuation techniques used to estimate fair value. These include: (1) the market approach, where market transactions for identical or comparable assets or liabilities are used to determine the fair value; (2) the income approach, which uses valuation techniques to convert future amounts (for example, future cash flows or future earnings) to a single present amount; and (3) the cost approach, which is based on the amount that would be required to replace an asset. For many of our fair value estimates, including our estimates of the fair value of acquired intangible assets, we use the income approach. Using the income approach requires the use of financial models, which require us to make various estimates including, but not limited to: (1) the potential future cash flows for the asset, liability or equity instrument being measured; (2) the timing of receipt or payment of those future cash flows; (3) the time value of money associated with the delayed receipt or payment of such cash flows; and (4) the inherent risk associated with the cash flows (that is, the risk premium). Determining these cash flow estimates is inherently difficult and subjective, and, if any of the estimates used to determine the fair value using the income approach turns out to be inaccurate, our financial results may be negatively impacted. Furthermore, relatively small changes in many of these estimates can have a significant impact on the estimated fair value resulting from the financial models or the related accounting conclusion reached. For example, a relatively small change in the estimated fair value of an asset may change a conclusion as to whether an asset is impaired. While we are required to make certain fair value assessments associated with the accounting for several types of transactions, the following areas are the most sensitive to the assessments:

Business Combinations. Assets acquired and liabilities assumed in a business combination are recorded based on their estimated fair value. Our assessment of the estimated fair value of each of these can have a material effect on our reported results as intangible assets are amortized over various estimated useful lives. Furthermore, a change in the estimated fair value of an asset or liability often has a direct impact on the amount we recognize as goodwill, which is an asset that is not amortized. Often determining the fair value of these assets and liabilities assumed requires an assessment of the expected use of the asset, the expected cost to extinguish the liability or our expectations related to the timing and the successful completion of development of an acquired in-process technology. Such estimates are inherently difficult and subjective and can have a material impact on our financial statements.

Assessment of Impairment of Definite-lived Intangible and Other Long-lived Assets. We evaluate the recoverability of our identifiable amortizable intangible assets and other long-lived assets in accordance with ASC Subtopic 360-10, which generally requires the assessment of these assets for recoverability when events or circumstances (referred to as a "triggering event") indicate a potential impairment exists. We consider certain events and circumstances in determining whether a triggering event has occurred that could indicate the carrying value of identifiable definite-lived intangible assets and other long-lived assets, may not be recoverable, including, but not limited to: (1) significant changes in performance relative to expected operating results; (2) significant changes in the use of the assets; (3) significant negative industry or economic trends; (4) a significant decline in our stock price for a

sustained period of time; and (5) changes in our business strategy. If it is determined that a triggering event has occurred, we determine if an impairment exists based on an estimate of the undiscounted cash flows to be generated from the use and ultimate disposition of the asset group. If the undiscounted cash flows are lower than the carrying values of the related asset group, an impairment exists and the impairment loss is measured as the amount by which the carrying amount of the group's assets exceeds the fair value of the asset group. We did not record an impairment charge to any of our definite-lived intangible assets as of December 31, 2017, 2016, and 2015.

Assessment of Impairment of Goodwill and Indefinite-lived Intangible Assets. We are required to test goodwill and other indefinite-lived intangible assets for impairment on an annual basis and, if current events or circumstances require, on an interim basis. ASC Topic 350 provides companies an 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 value before performing a quantitative two-step approach to testing goodwill for impairment. We perform our impairment test for each reporting unit as part of our annual impairment test performed as of December 31. Our reporting units are determined based on the guidance within ASC Subtopic 350-20. The first step of the quantitative test measures for impairment by applying fair value-based tests at the reporting unit level. The second step (if necessary) measures the amount of impairment by applying fair value-based tests to the individual assets and liabilities within each reporting unit.

To determine the fair values of the reporting units used in the first step, we use a discounted cash flow approach. Each step requires us to make judgments and involves the use of significant estimates and assumptions. These estimates and assumptions include long-term growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates based on our weighted average cost of capital, and future economic and market conditions. These estimates and assumptions must be made for each reporting unit evaluated for impairment. Our estimates for market growth, our market share and costs are based on historical data, various internal estimates and certain external sources, and are based on assumptions that are consistent with the plans and estimates we are using to manage the underlying business. If future forecasts are revised, they may indicate or require future impairment charges. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates.

In determining the fair value of our significant reporting units—namely Activision, Blizzard, and King—we assumed discount rates ranging from 8.5% to 11.5% and terminal growth rates of 0.0% to 4.0%, depending on the reporting unit and its specific characteristics and risk profiles. Based on our quantitative evaluation, we determined the estimated fair value of all of the reporting units exceeded their carrying values as of December 31, 2017. Changes in our assumptions underlying our estimates of fair value, which will be a function of our future financial performance and changes in economic conditions, could result in future impairment charges.

We test our acquired trade names for possible impairment by using a discounted cash flow model to estimate fair value. At December 31, 2017 and 2016, we concluded that no impairment had occurred and that no impairment was reasonably likely to occur. In determining the fair value of these trade names, we assumed a discount rate of 8.5%, and royalty saving rates of approximately 1.5%. Changes in our assumptions underlying our estimates of fair value, which will be a function of our future financial performance and changes in economic conditions, could result in future impairment charges.

Share-Based Payments

We account for share-based payments in accordance with ASC Subtopic 718-10 and ASC Subtopic 505-50. Share-based compensation expense for a given grant is recognized over the requisite service period (that is, the period for which the employee is being compensated) and is based on the

value of share-based payment awards after a reduction for estimated forfeitures. Forfeitures are estimated at the time of grant and are revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

We generally estimate the value of stock options using a binomial-lattice model. This estimate is affected by our stock price, as well as assumptions regarding a number of highly complex and subjective variables, including our expected stock price volatility over the term of the awards and actual and projected employee stock option exercise behaviors.

We generally determine the fair value of restricted stock units based on the closing market price of the Company's common stock on the date of grant, reduced by the present value of the estimated future dividends during the vesting period in which the restricted stock units holder will not participate. Certain restricted stock units granted to our employees and senior management vest based on the achievement of pre-established performance or market conditions. For performance-based restricted stock units, each quarter we update our assessment of the probability that the specified performance criteria will be achieved. We amortize the fair values of performance-based restricted stock units over the requisite service period, adjusting for estimated forfeitures for each separately vesting tranche of the award. For market-based restricted stock units, we estimate the fair value at the date of grant using a Monte Carlo valuation methodology and amortize those fair values over the requisite service period, adjusting for estimated forfeitures for each separately vesting tranche of the award. The Monte Carlo methodology that we use to estimate the fair value of market-based restricted stock units at the date of grant incorporates into the valuation the possibility that the market condition may not be satisfied. Provided that the requisite service is rendered, the total fair value of the market-based restricted stock units at the date of grant must be recognized as compensation expense even if the market condition is not achieved. However, the number of shares that ultimately vest can vary significantly with the performance of the specified market criteria.

For a detailed discussion of the application of these and other accounting policies, see Note 2 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

Recently Issued Accounting Pronouncements

Below are the recently issued accounting pronouncements that were most significant to our accounting policy activities for fiscal 2017. For a detailed discussion of recently issued accounting pronouncements, see Note 21 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

Recently adopted accounting pronouncements

Inventory

In July 2015, the Financial Accounting Standards Board ("FASB") issued new guidance related to the measurement of inventory which requires inventory within the scope of the guidance to be measured at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. We adopted this new standard as of January 1, 2017, and applied it prospectively. The adoption of this guidance did not have a material impact on our financial statements.

Recent accounting pronouncements not yet adopted

Revenue recognition

In May 2014, the FASB issued new accounting guidance related to revenue recognition. The new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific

guidance, providing a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue upon the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This guidance is effective for us beginning with the first quarter of 2018. We are adopting the accounting standard using the modified retrospective method, which recognizes the cumulative effect upon adoption as an adjustment to retained earnings at the adoption date. We will report our adoption in our Form 10-Q for the first quarter of 2018.

The most significant impacts of the new revenue recognition standard are expected to be:

- *The accounting for our sales of our games with significant online functionality for which we do not have VSOE for unspecified future updates and ongoing online services provided.* Under the current accounting standards, VSOE for undelivered elements is required. This requirement will be eliminated under the new standard. Accordingly, we will be required to recognize as revenue a portion of the sales price upon delivery of the software, as compared to the current requirement of recognizing the entire sales price ratably over an estimated service period. We expect this difference to primarily impact revenues from our Call of Duty franchise, where we expect that approximately 20% of the sales price will be recognized as revenue upon delivery of the games to our customers. Many of our other franchises, such as Destiny, Overwatch, World of Warcraft, and Candy Crush, are online hosted arrangements, and we do not expect any significant impact on the accounting for our sales of these games; and
- *The accounting for certain of our software licensing arrangements.* While the impacts of the new standard may differ on a contract-by-contract basis (the actual revenue recognition treatment required under the standard will depend on contract-specific terms), we generally expect earlier revenue recognition for these arrangements under the new revenue standard.

We estimate that the cumulative effect of adopting this standard will result in an adjustment to retained earnings at the adoption date of approximately \$60 million to \$100 million, inclusive of the associated tax impacts. Additionally, we expect that the new disclosure requirements will require us to design and implement additional internal controls over financial reporting, and we are in process of adjusting our processes and internal controls in preparation for adopting the new standard.

Leases

In February 2016, the FASB issued new guidance related to the accounting for leases. The new standard will replace all current U.S. GAAP guidance on this topic. The new standard, among other things, requires a lessee to classify a lease as either an operating or financing lease, and lessees will need to recognize a lease liability and a right-of-use asset for their leases. The liability will be equal to the present value of lease payments. The asset will be based on the liability, subject to adjustment for initial direct costs, lease incentives received, and any prepaid lease payments. Operating leases will result in a straight-line expense pattern, while finance leases will result in a front-loaded expense pattern. Classification will be based on criteria that are largely similar to those applied in current lease accounting. The standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition and will require application of the new guidance at the beginning of the earliest comparative period presented, with certain transition practical expedients available to provide relief in adopting the new standard. We are evaluating the impact of this new accounting guidance on our financial statements. Currently, we do not plan to early adopt this new standard but we do expect to elect and apply the available transition practical expedients upon adoption.

Statement of Cash Flows-Restricted Cash

In November 2016, the FASB issued new guidance related to the classification of restricted cash in the statement of cash flows. The new standard requires that a statement of cash flows explain any change during the period in total cash, cash equivalents, and restricted cash. Therefore, restricted cash will be included with "Cash and cash equivalents" when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The new standard is effective for fiscal years beginning after December 15, 2018, and should be applied retrospectively. Early adoption is permitted.

We are evaluating the impact, if any, of adopting this new accounting guidance on our financial statements. We expect there will be a significant impact to the consolidated statements of cash flows for 2016, as this period includes, as an investing activity, the \$3.6 billion movement in restricted cash resulting from the transfer of cash into escrow at December 31, 2015, to facilitate the King Acquisition and the subsequent release of that cash in 2016 in connection with the King Acquisition. Under this new standard, the restricted cash balance will be included in the beginning and ending total cash, cash equivalents, and restricted cash balances and, hence, would not be included as an investing activity in the statement of cash flows.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Foreign Currency Exchange Rate Risk

We transact business in many different foreign currencies and may be exposed to financial market risk resulting from fluctuations in foreign currency exchange rates. Revenues and related expenses generated from our international operations are generally denominated in their respective local currencies. Primary currencies include Euros, British pounds, Australian dollars, South Korean won, Chinese yuan, and Swedish krona. To the extent the U.S. dollar strengthens against foreign currencies, the translation of these foreign currency-denominated transactions will result in reduced revenues, operating expenses, net income, and cash flows from our international operations. Similarly, our revenues, operating expenses, net income, and cash flows will increase for our international operations if the U.S. dollar weakens against foreign currencies. Since we have significant international sales, but incur the majority of our costs in the United States, the impact of foreign currency fluctuations, particularly the strengthening of the U.S. dollar, may have an asymmetric and disproportional impact on our business. We monitor currency volatility throughout the year.

To mitigate our foreign currency risk resulting from our foreign currency-denominated monetary assets, liabilities, and earnings and our foreign currency risk related to functional currency-equivalent cash flows resulting from our intercompany transactions, we periodically enter into currency derivative contracts, principally forward contracts. These forward contracts generally have a maturity of less than one year. The counterparties for our currency derivative contracts are large and reputable commercial or investment banks.

The fair value of foreign currency contracts are estimated based on the prevailing exchange rates of the various hedged currencies as of the end of the period.

We do not hold or purchase any foreign currency forward contracts for trading or speculative purposes.

For a detailed discussion of our accounting policies for our foreign currency forward contracts, see Note 2 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K.

Foreign Currency Forward Contracts Designated as Hedges ("Cash Flow Hedges")

At December 31, 2017, the gross notional amount of outstanding Cash Flow Hedges was approximately \$521 million. The fair value of these contracts, all of which have remaining maturities of 12 months or less, was \$5 million of net unrealized losses. Additionally, at December 31, 2017, we had approximately \$10 million of net realized but unrecognized losses recorded within "Accumulated other comprehensive income (loss)" associated with contracts that had settled but were deferred and will be amortized into earnings, along with the associated hedged revenues. Such amounts will be reclassified into earnings within the next 12 months.

At December 31, 2016, the gross notional amount of outstanding Cash Flow Hedges was approximately \$346 million. The fair value of these contracts was \$22 million of net unrealized gains.

During the years ended December 31, 2017 and 2016, there was no ineffectiveness relating to our Cash Flow Hedges. During the years ended December 31, 2017 and 2016, the amount of pre-tax net realized gains associated with these contracts that were reclassified out of "Accumulated other comprehensive loss" and into earnings was not material.

In the absence of hedging activities for the year ended December 31, 2017, a hypothetical adverse foreign currency exchange rate movement of 10% would have resulted in potential declines of our net income of approximately \$134 million. This sensitivity analysis assumes a parallel adverse shift of all foreign currency exchange rates against the U.S. dollar; however, all foreign currency exchange rates do not always move in such manner and actual results may differ materially.

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio and variable rate debt under our credit agreement. We do not currently use derivative financial instruments to manage interest rate risk. As of December 31, 2017 and 2016, a hypothetical interest rate change on our variable rate debt of one percent (100 basis points) would have changed interest expense on an annual basis by approximately \$10 million and \$27 million, respectively. This estimate does not include a change in interest income from our investment portfolio that may result from such a hypothetical interest rate change nor does it include the effects of other actions that we may take in the future to mitigate this risk or any changes in our financial structure. Refer to Note 11 of the notes to consolidated financial statements included in Item 8 of this Annual Report on Form 10-K for disclosures regarding terms and interest rates associated with our debt obligations.

Our investment portfolio consists primarily of money market funds and government securities with high credit quality and short average maturities. Because short-term securities mature relatively quickly and must be reinvested at the then-current market rates, interest income on a portfolio consisting of cash, cash equivalents, or short-term securities is more subject to market fluctuations than a portfolio of longer-term securities. Conversely, the fair value of such a portfolio is less sensitive to market fluctuations than a portfolio of longer-term securities. At December 31, 2017, our \$4.7 billion of cash and cash equivalents was comprised primarily of money market funds.

The Company has determined that, based on the composition of our investment portfolio as of December 31, 2017, there was no material interest rate risk exposure to the Company's consolidated financial condition, results of operations, or liquidity as of that date.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

| | |
|--|----------------------|
| Report of Independent Registered Public Accounting Firm | F-1 |
| Consolidated Balance Sheets at December 31, 2017 and 2016 | F-3 |
| Consolidated Statements of Operations for the Years Ended December 31, 2017, 2016, and 2015 | F-4 |
| Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2017, 2016, and 2015 | F-5 |
| Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2017, 2016, and 2015 | F-6 |
| Consolidated Statements of Cash Flows for the Years Ended December 31, 2017, 2016, and 2015 | F-7 |
| Notes to Consolidated Financial Statements | F-8 |
| Schedule II—Valuation and Qualifying Accounts at December 31, 2017, 2016, and 2015 | F-60 |

Other financial statement schedules are omitted because the information called for is not applicable or is shown either in the Consolidated Financial Statements or the Notes thereto.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. 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: (1) recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and (2) accumulated and communicated to our 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 December 31, 2017, the end of the period covered by this report. Based on this evaluation, the principal executive officer and principal financial officer concluded that, at December 31, 2017, 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 (1) recorded, processed, summarized, and reported on a timely basis, and (2) accumulated and communicated to our

management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Management's Report on Internal Control Over Financial Reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Our management, with the participation of our principal executive officer and principal financial officer, conducted an evaluation of the effectiveness, as of December 31, 2017, of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework (2013)*. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2017.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

The effectiveness of our internal control over financial reporting as of December 31, 2017 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report included in this Annual Report on Form 10-K.

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.

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information required by this Item, other than the information regarding executive officers, which is included in Item 1 of this report, is incorporated by reference to the sections of our definitive Proxy Statement for our 2018 Annual Meeting of Shareholders entitled "Proposal 1—Election of Directors," "Beneficial Ownership Matters—Section 16(a) Beneficial Ownership Reporting Compliance," "Corporate Governance Matters—Code of Conduct," and "Corporate Governance Matters—Board of Directors and Committees—Board Committees" to be filed with the SEC.

Item 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2018 Annual Meeting of Shareholders entitled "Executive Compensation" and "Proposal 2—Director Compensation" to be filed with the SEC.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2018 Annual Meeting of Shareholders entitled "Equity Compensation Plan Information" and "Beneficial Ownership Matters" to be filed with the SEC.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2018 Annual Meeting of Shareholders entitled "Certain Relationships and Related Transactions" and "Corporate Governance Matters—Board of Directors and Committees" to be filed with the SEC.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is incorporated by reference to the sections of our definitive Proxy Statement for our 2018 Annual Meeting of Shareholders entitled "Audit-Related Matters" to be filed with the SEC.

PART IV

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULE

- (a) 1 *Financial Statements* See Item 8.—Consolidated Financial Statements and Supplementary Data for index to Financial Statements and Financial Statement Schedule on page 81 herein.
- 2 *Financial Statement Schedule* The following financial statement schedule of Activision Blizzard for the years ended December 31, 2017, 2016, and 2015 is filed as part of this report on page F-60 and should be read in conjunction with the consolidated financial statements of Activision Blizzard:

Schedule II—Valuation and Qualifying Accounts

Other financial statement schedules are omitted because the information called for is not applicable or is shown either in the Consolidated Financial Statements or the Notes thereto.

- 3 The exhibits listed on the accompanying index to exhibits immediately following the financial statements are filed as part of, or hereby incorporated by reference into, this Annual Report on Form 10-K.

Item 16. FORM 10-K SUMMARY

Not applicable.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Activision Blizzard, Inc.:

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Activision Blizzard, Inc. and its subsidiaries as of December 31, 2017 and 2016, and the related consolidated statements of operations, of comprehensive income, of changes in shareholders' equity and of cash flows for each of the three years in the period ended December 31, 2017, including the related notes and financial statement schedule listed in the accompanying index appearing under Item 15(a)(2), (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control—Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control—Integrated Framework* (2013) issued by the COSO.

Change in Accounting Principle

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for income taxes related to share-based payments in 2016.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company's consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and

evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Los Angeles, California

February 27, 2018

We have served as the Company's auditor since 2008.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in millions, except share data)

| | At December 31, 2017 | At December 31, 2016 |
|---|-------------------------|-------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 4,713 | \$ 3,245 |
| Accounts receivable, net of allowances of \$279 and \$261, at December 31, 2017 and December 31, 2016, respectively | 918 | 732 |
| Inventories, net | 46 | 49 |
| Software development | 367 | 412 |
| Other current assets | 476 | 392 |
| Total current assets | 6,520 | 4,830 |
| Software development | 86 | 54 |
| Property and equipment, net | 294 | 258 |
| Deferred income taxes, net | 459 | 283 |
| Other assets | 440 | 401 |
| Intangible assets, net | 1,106 | 1,858 |
| Goodwill | 9,763 | 9,768 |
| Total assets | <u>\$ 18,668</u> | <u>\$ 17,452</u> |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 323 | \$ 222 |
| Deferred revenues | 1,929 | 1,628 |
| Accrued expenses and other liabilities | 1,411 | 806 |
| Total current liabilities | 3,663 | 2,656 |
| Long-term debt, net | 4,390 | 4,887 |
| Deferred income taxes, net | 21 | 44 |
| Other liabilities | 1,132 | 746 |
| Total liabilities | 9,206 | 8,333 |
| Commitments and contingencies (Note 19) | | |
| Shareholders' equity: | | |
| Common stock, \$0.000001 par value, 2,400,000,000 shares authorized, 1,186,181,666 and 1,174,163,069 shares issued at December 31, 2017 and December 31, 2016, respectively | — | — |
| Additional paid-in capital | 10,747 | 10,442 |
| Less: Treasury stock, at cost, 428,676,471 shares at December 31, 2017 and December 31, 2016 | (5,563) | (5,563) |
| Retained earnings | 4,916 | 4,869 |
| Accumulated other comprehensive loss | (638) | (629) |
| Total shareholders' equity | 9,462 | 9,119 |
| Total liabilities and shareholders' equity | <u>\$ 18,668</u> | <u>\$ 17,452</u> |

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

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in millions, except per share data)

| | For the Years Ended | | |
|--|---------------------|----------|----------|
| | December 31, | | |
| | 2017 | 2016 | 2015 |
| Net revenues | | | |
| Product sales | \$ 2,110 | \$ 2,196 | \$ 2,447 |
| Subscription, licensing, and other revenues | 4,907 | 4,412 | 2,217 |
| Total net revenues | 7,017 | 6,608 | 4,664 |
| Costs and expenses | | | |
| Cost of revenues—product sales: | | | |
| Product costs | 733 | 741 | 872 |
| Software royalties, amortization, and intellectual property licenses | 300 | 331 | 370 |
| Cost of revenues—subscription, licensing, and other revenues: | | | |
| Game operations and distribution costs | 984 | 851 | 274 |
| Software royalties, amortization, and intellectual property licenses | 484 | 471 | 69 |
| Product development | 1,069 | 958 | 646 |
| Sales and marketing | 1,378 | 1,210 | 734 |
| General and administrative | 760 | 634 | 380 |
| Total costs and expenses | 5,708 | 5,196 | 3,345 |
| Operating income | 1,309 | 1,412 | 1,319 |
| Interest and other expense (income), net | 146 | 214 | 198 |
| Loss on extinguishment of debt | 12 | 92 | — |
| Income before income tax expense | 1,151 | 1,106 | 1,121 |
| Income tax expense | 878 | 140 | 229 |
| Net income | \$ 273 | \$ 966 | \$ 892 |
| Earnings per common share | | | |
| Basic | \$ 0.36 | \$ 1.30 | \$ 1.21 |
| Diluted | \$ 0.36 | \$ 1.28 | \$ 1.19 |
| Weighted-average number of shares outstanding | | | |
| Basic | 754 | 740 | 728 |
| Diluted | 766 | 754 | 739 |
| Dividends per common share | \$ 0.30 | \$ 0.26 | \$ 0.23 |

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

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

(Amounts in millions)

| | For the Years Ended | | |
|---|---------------------|---------------|---------------|
| | December 31, | | |
| | 2017 | 2016 | 2015 |
| Net income | \$ 273 | \$ 966 | \$ 892 |
| Other comprehensive income (loss): | | | |
| Foreign currency translation adjustments | 36 | (29) | (326) |
| Unrealized gains (losses) on forward contracts designated as hedges, net of tax | (44) | 33 | (4) |
| Unrealized gains (losses) on investments, net of tax | (1) | — | — |
| Total other comprehensive income (loss) | \$ (9) | \$ 4 | \$ (330) |
| Comprehensive income | <u>\$ 264</u> | <u>\$ 970</u> | <u>\$ 562</u> |

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

| | | | | | | | | |
|---|--------------|-------------|--------------|-------------------|------------------|-----------------|-----------------|-----------------|
| common share) | — | — | — | — | — | (193) | — | (193) |
| Indemnity on tax attributes assumed in connection with the Purchase Transaction (see Note 15) | — | — | — | 74 | — | — | — | 74 |
| Balance at | | | | | | | | |
| December 31, 2016 | 1,174 | \$ — | (429) | \$ (5,563) | \$ 10,442 | \$ 4,869 | \$ (629) | \$ 9,119 |
| Components of comprehensive income: | | | | | | | | |
| Net income | — | — | — | — | — | 273 | — | 273 |
| Other comprehensive income (loss) | — | — | — | — | — | — | (9) | (9) |
| Issuance of common stock pursuant to employee stock options | 11 | — | — | — | 178 | — | — | 178 |
| Issuance of common stock pursuant to restricted stock units | 2 | — | — | — | — | — | — | — |
| Restricted stock surrendered for employees' tax liability | (1) | — | — | — | (54) | — | — | (54) |
| Share-based compensation expense related to employee stock options and restricted stock units | — | — | — | — | 181 | — | — | 181 |
| Dividends (\$0.30 per common share) | — | — | — | — | — | (226) | — | (226) |
| Balance at | | | | | | | | |
| December 31, 2017 | 1,186 | \$ — | (429) | \$ (5,563) | \$ 10,747 | \$ 4,916 | \$ (638) | \$ 9,462 |

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

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in millions)

| | For the Years Ended December 31, | | |
|---|-------------------------------------|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Cash flows from operating activities: | | | |
| Net income | \$ 273 | \$ 966 | \$ 892 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Deferred income taxes | (181) | (9) | (27) |
| Provision for inventories | 33 | 42 | 43 |
| Depreciation and amortization | 888 | 829 | 95 |
| Amortization of capitalized software development costs and intellectual property licenses(1) | 311 | 321 | 399 |
| Premium payment for early redemption of note | — | 63 | — |
| Amortization of debt discount, financing costs, and non-cash write-off due to extinguishment of debts | 24 | 50 | 7 |
| Share-based compensation expense(2) | 176 | 147 | 92 |
| Other | 28 | 4 | — |
| Changes in operating assets and liabilities, net of effect from business acquisitions: | | | |
| Accounts receivable, net | (165) | 84 | (40) |
| Inventories | (26) | 32 | (54) |
| Software development and intellectual property licenses | (301) | (362) | (350) |
| Other assets | (97) | (10) | 21 |
| Deferred revenues | 220 | (35) | (27) |
| Accounts payable | 85 | (50) | (25) |
| Accrued expenses and other liabilities | 945 | 83 | 233 |
| Net cash provided by operating activities | <u>2,213</u> | <u>2,155</u> | <u>1,259</u> |
| Cash flows from investing activities: | | | |
| Proceeds from maturities of available-for-sale investments | 80 | — | 145 |
| Purchases of available-for-sale investments | (135) | — | (145) |
| Acquisition of business, net of cash acquired (see Note 20) | — | (4,588) | (46) |
| Release (deposit) of cash in escrow | — | 3,561 | (3,561) |
| Capital expenditures | (155) | (136) | (111) |
| Other investing activities | 13 | (14) | 2 |
| Net cash used in investing activities | <u>(197)</u> | <u>(1,177)</u> | <u>(3,716)</u> |
| Cash flows from financing activities: | | | |
| Proceeds from issuance of common stock to employees | 178 | 106 | 106 |
| Tax payment related to net share settlements on restricted stock units | (56) | (115) | (83) |
| Dividends paid | (226) | (195) | (170) |
| Proceeds from debt issuances, net of discounts | 3,741 | 6,878 | — |
| Repayment of long-term debt | (4,251) | (6,104) | (250) |
| Premium payment for early redemption of note | — | (63) | — |
| Proceeds received from shareholder settlement (see Note 19) | — | — | 202 |
| Other financing activities | (10) | (7) | (7) |
| Net cash (used in) provided by financing activities | <u>(624)</u> | <u>500</u> | <u>(202)</u> |
| Effect of foreign exchange rate changes on cash and cash equivalents | 76 | (56) | (366) |
| Net increase (decrease) in cash and cash equivalents | 1,468 | 1,422 | (3,025) |
| Cash and cash equivalents at beginning of period | 3,245 | 1,823 | 4,848 |
| Cash and cash equivalents at end of period | <u>\$ 4,713</u> | <u>\$ 3,245</u> | <u>\$ 1,823</u> |

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

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

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

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. Description of Business

Activision Blizzard, Inc. is a leading global developer and publisher of interactive entertainment content and services. We develop and distribute content and services on video game consoles, personal computers ("PC"), and mobile devices. We also operate esports events and leagues and create film and television content based on our games. The terms "Activision Blizzard," the "Company," "we," "us," and "our" are used to refer collectively to Activision Blizzard, Inc. and its subsidiaries.

The Company was originally incorporated in California in 1979 and was reincorporated in Delaware in December 1992. In connection with the 2008 business combination by and among the Company (then known as Activision, Inc.), Vivendi S.A. ("Vivendi"), and Vivendi Games, Inc., an indirect wholly-owned subsidiary of Vivendi, we were renamed Activision Blizzard, Inc.

The common stock of Activision Blizzard is traded on The Nasdaq Stock Market under the ticker symbol "ATVI."

The King Acquisition

On February 23, 2016 (the "King Closing Date"), we acquired King Digital Entertainment, a leading interactive mobile entertainment company ("King"), by purchasing all of its outstanding shares (the "King Acquisition"), as further described in Note 20. Our consolidated financial statements include the operations of King commencing on the King Closing Date.

Our Segments

As part of the continued implementation of our esports strategy, we instituted changes to our internal organization and reporting structure such that the Major League Gaming ("MLG") business now operates as a division of Blizzard Entertainment, Inc. ("Blizzard"). As such, commencing with the second quarter of 2017, MLG, which was previously a separate operating segment, is now a component of the Blizzard operating segment. MLG is responsible for the operations of the Overwatch League™, along with other esports events, and will also continue to serve as a multi-platform network for other Activision Blizzard esports content.

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

(i) Activision Publishing, Inc.

Activision Publishing, Inc. ("Activision") is a leading global developer and publisher of interactive software products and entertainment content, particularly for the console platform. Activision primarily delivers content through retail and digital channels, including full-game and in-game sales, as well as by licensing software to third-party or related-party companies that distribute Activision products. Activision develops, markets, and sells products based on our internally developed intellectual properties, as well as some licensed properties. We have also established a long-term alliance with Bungie to publish its game universe, Destiny.

Activision's key product franchises include: Call of Duty®, a first-person shooter for the console and PC platforms, and Destiny, an online universe of first-person action gameplay (which we call a "shared-world shooter") for the console and PC platforms.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

1. Description of Business (Continued)

(ii) Blizzard Entertainment, Inc.

Blizzard is a leading global developer and publisher of interactive software products and entertainment content, particularly for the PC platform. Blizzard primarily delivers content through retail and digital channels, including subscriptions, full-game, and in-game sales, as well as by licensing software to third-party or related-party companies that distribute Blizzard products. Blizzard also maintains a proprietary online gaming service, Blizzard Battle.net®, which facilitates digital distribution of Blizzard content, along with Activision's *Destiny 2* PC content, online social connectivity, and the creation of user-generated content. As noted above, Blizzard also includes the activities of our MLG business, which is responsible for the operations of the Overwatch League, along with other esports events, and will also continue to serve as a multi-platform network for other Activision Blizzard esports content.

Blizzard's key product franchises include: World of Warcraft®, a subscription-based massive multi-player online role-playing game for PC; StarCraft®, a real-time strategy PC franchise; Diablo®, an action role-playing franchise for the PC and console platforms; Hearthstone®, an online collectible card franchise for the PC and mobile platforms; Heroes of the Storm®, a free-to-play team brawler for PC; and Overwatch®, a team-based first-person shooter for the PC and console platforms.

(iii) King Digital Entertainment

King Digital Entertainment ("King") is a leading global developer and publisher of interactive entertainment content and services, particularly on mobile platforms, such as Google Inc.'s ("Google") Android and Apple Inc.'s ("Apple") iOS. King also distributes its content and services on the PC platform, primarily via Facebook, Inc. ("Facebook"). King's games are free to play, however, players can acquire in-game items, either with virtual currency the players purchase or directly using real currency.

King's key product franchises, all of which are for the mobile and PC platforms, include: Candy Crush™, which features "match three" games; Farm Heroes™, which also features "match three" games; and Bubble Witch™, which features "bubble shooter" games.

Other

We also engage in other businesses that do not represent reportable segments, including:

- the Activision Blizzard Studios ("Studios") business, which is devoted to creating original film and television content based on our library of globally recognized intellectual properties, and which, in October 2017, released the second season of the animated TV series *Skylanders™ Academy* on Netflix; and
- the Activision Blizzard Distribution ("Distribution") business, which consists of operations in Europe that provide warehousing, logistics, and sales distribution services to third-party publishers of interactive entertainment software, our own publishing operations, and manufacturers of interactive entertainment hardware.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies

Basis of Consolidation and Presentation

The accompanying consolidated financial statements include the accounts and operations of the Company. All intercompany accounts and transactions have been eliminated. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates and assumptions.

Certain reclassifications have been made to prior-year 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.

Cash and Cash Equivalents

We consider all money market funds and highly liquid investments with original maturities of three months or less at the time of purchase to be "Cash and cash equivalents."

Investment Securities

Investments designated as available-for-sale securities are carried at fair value, which is based on quoted market prices for such securities, if available, or is estimated on the basis of quoted market prices of financial instruments with similar characteristics. Unrealized gains and losses of the Company's available-for-sale securities are excluded from earnings and are reported as a component of "Other comprehensive income (loss)."

Investments with original maturities greater than 90 days and remaining maturities of less than one year are normally classified within "Other current assets." In addition, investments with maturities beyond one year may be classified within "Other current assets" if they are highly liquid in nature and represent the investment of cash that is available for current operations.

The specific identification method is used to determine the cost of securities disposed of, with realized gains and losses reflected in "Interest and other expense (income), net" in our consolidated statements of operations.

Cash in Escrow

As part of the King Acquisition, we were required to deposit \$3.56 billion in cash to be held in an escrow account until the earlier of (1) the completion of the King Acquisition, or (2) the termination of the transaction agreement. The cash was not accessible to the Company for operating cash needs as its use had been administratively restricted for use in the consummation of the King Acquisition.

Financial Instruments

The carrying amounts of "Cash and cash equivalents," "Accounts receivable, net of allowances," "Accounts payable," and "Accrued expenses and other liabilities" approximate fair value due to the

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

short-term nature of these accounts. Our investments in U.S. treasuries, government agency securities, and corporate bonds, if any, are carried at fair value, which is based on quoted market prices for such securities, if available, or is estimated on the basis of quoted market prices of financial instruments with similar characteristics.

The Company transacts business in various foreign currencies and has significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. To mitigate our foreign currency risk resulting from our foreign currency-denominated monetary assets, liabilities and earnings and our foreign currency risk related to functional currency-equivalent cash flows resulting from our intercompany transactions, we periodically enter into currency derivative contracts, principally forward contracts. These forward contracts generally have a maturity of less than one year. The counterparties for our currency derivative contracts are large and reputable commercial or investment banks.

We assess the nature of these derivatives under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 815 to determine whether such derivatives should be designated as hedging instruments. The fair value of foreign currency contracts are estimated based on the prevailing exchange rates of the various hedged currencies as of the end of the period. We report the fair value of these contracts within "Other current assets," "Accrued expense and other liabilities," "Other assets," or "Other liabilities," as applicable, in our consolidated balance sheets based on the prevailing exchange rates of the various hedged currencies as of the end of the relevant period.

We do not hold or purchase any foreign currency forward contracts for trading or speculative purposes.

For foreign currency forward contracts which are not designated as hedging instruments under ASC 815, changes in the estimated fair value of these derivatives are recorded within "General and administrative expenses" and "Interest and other expense, net" in our consolidated statements of operations, consistent with the nature of the underlying transactions.

For foreign currency forward contracts which have been designated as cash flow hedges in accordance with ASC 815, we assess the effectiveness of these cash flow hedges at inception and on an ongoing basis and determine if the hedges are effective at providing offsetting changes in cash flows of the hedged items. The Company records the effective portion of changes in the estimated fair value of these derivatives in "Accumulated other comprehensive loss" and subsequently reclassifies the related amount of accumulated other comprehensive income (loss) to earnings within "General and administrative" or "Net revenues" when the hedged item impacts earnings, consistent with the nature and timing of the underlying transactions. Cash flows from these foreign currency forward contracts are classified in the same category as the cash flows associated with the hedged item in the consolidated statements of cash flows. We measure hedge ineffectiveness, if any, and if it is determined that a derivative has ceased to be a highly effective hedge, the Company will discontinue hedge accounting for the derivative.

Concentration of Credit Risk

Our concentration of credit risk relates to depositors holding the Company's cash and cash equivalents and customers with significant accounts receivable balances.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

Our cash and cash equivalents are invested primarily in money market funds consisting of short-term, high-quality debt instruments issued by governments and governmental organizations, financial institutions and industrial companies.

Our customer base includes retailers and distributors, including mass-market retailers, first party digital storefronts, consumer electronics stores, discount warehouses, and game specialty stores in the U.S. and other countries worldwide. We perform ongoing credit evaluations of our customers and maintain allowances for potential credit losses. We generally do not require collateral or other security from our customers.

For the year ended December 31, 2017, we had three customers—Apple, Sony Interactive Entertainment, Inc. ("Sony"), and Google—who accounted for 16%, 14%, and 10%, respectively, of net revenues. For the year ended December 31, 2016, we had two customers—Sony and Apple—who each accounted for 13% of net revenues. For the year ended December 31, 2015, we had two customers—Sony and Microsoft Corporation ("Microsoft")—who accounted for 12% and 10%, respectively, of net revenues.

We had three customers—Sony, Microsoft, and Apple—who accounted for 17%, 14%, and 10%, respectively, of consolidated gross receivables at December 31, 2017. We had three customers—Sony, Microsoft, and Wal-Mart Stores, Inc.—who accounted for 17%, 10%, and 10%, respectively, of consolidated gross receivables at December 31, 2016.

Software Development Costs and Intellectual Property Licenses

Software development costs include payments made to independent software developers under development agreements, as well as direct costs incurred for internally developed products. Software development costs are capitalized once technological feasibility of a product is established and such costs are determined to be recoverable. Technological feasibility of a product requires both technical design documentation and game design documentation, or the completed and tested product design and a working model. Significant management judgments and estimates are utilized in the assessment of when technological feasibility is established and the evaluation is performed on a product-by-product basis. For products where proven technology exists, this may occur early in the development cycle. Software development costs related to online hosted revenue arrangements are capitalized after the preliminary project phase is complete and it is probable that the project will be completed and the software will be used to perform the function intended. Prior to a product's release, if and when we believe capitalized costs are not recoverable, we expense the amounts as part of "Cost of revenues—software royalties, amortization, and intellectual property licenses." Capitalized costs for products that are canceled or are expected to be abandoned are charged to "Product development" in the period of cancellation. Amounts related to software development which are not capitalized are charged immediately to "Product development."

Commencing upon a product's release, capitalized software development costs are amortized to "Cost of revenues—software royalties, amortization, and intellectual property licenses" based on the ratio of current revenues to total projected revenues for the specific product, generally resulting in an amortization period of six months to approximately two years.

Intellectual property license costs represent license fees paid to intellectual property rights holders for use of their trademarks, copyrights, software, technology, music or other intellectual property or proprietary rights in the development of our products. Depending upon the agreement with the rights

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

holder, we may obtain the right to use the intellectual property in multiple products over a number of years, or alternatively, for a single product. Prior to a product's release, if and when we believe capitalized costs are not recoverable, we expense the amounts as part of "Cost of revenues—software royalties, amortization, and intellectual property licenses." Capitalized intellectual property costs for products that are canceled or are expected to be abandoned are charged to "Product development" in the period of cancellation.

Commencing upon a product's release, capitalized intellectual property license costs are amortized to "Cost of revenues—software royalties, amortization, and intellectual property licenses" based on the ratio of current revenues for the specific product to total projected revenues for all products in which the licensed property will be utilized. As intellectual property license contracts may extend for multiple years and can be used in multiple products to be released over a period beyond one year, the amortization of capitalized intellectual property license costs relating to such contracts may extend beyond one year.

We evaluate the future recoverability of capitalized software development costs and intellectual property licenses on a quarterly basis. For products that have been released in prior periods, the primary evaluation criterion is the actual performance of the title to which the costs relate. For products that are scheduled to be released in future periods, recoverability is evaluated based on the expected performance of the specific products to which the costs relate or in which the licensed trademark or copyright is to be used. Criteria used to evaluate expected product performance include: historical performance of comparable products developed with comparable technology; market performance of comparable titles; orders for the product prior to its release; general market conditions; and, for any sequel product, estimated performance based on the performance of the product on which the sequel is based. Further, as many of our capitalized intellectual property licenses extend for multiple products over multiple years, we also assess the recoverability of capitalized intellectual property license costs based on certain qualitative factors, such as the success of other products and/or entertainment vehicles utilizing the intellectual property, whether there are any future planned theatrical releases or television series based on the intellectual property, and the rights holder's continued promotion and exploitation of the intellectual property.

Significant management judgments and estimates are utilized in assessing the recoverability of capitalized costs. In evaluating the recoverability of capitalized costs, the assessment of expected product performance utilizes forecasted sales amounts and estimates of additional costs to be incurred. If revised forecasted or actual product sales are less than the originally forecasted amounts utilized in the initial recoverability analysis, the net realizable value may be lower than originally estimated in any given quarter, which could result in an impairment charge. Material differences may result in the amount and timing of expenses for any period if matters resolve in a manner that is inconsistent with management's expectations.

Inventories

Inventories consist of materials (including manufacturing royalties paid to console manufacturers), labor, and freight-in and are stated at the lower of cost (weighted-average method) or net realizable value. Inventories are relieved on a weighted-average cost method.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

Allowance for Inventory Obsolescence

We regularly review inventory quantities on-hand and in the retail channels. We write down inventory based on excess or obsolete inventories determined primarily by future anticipated demand for our products. Inventory write-downs are measured as the difference between the cost of the inventory and net realizable value, based upon assumptions about future demand, which are inherently difficult to assess and dependent on market conditions. At the point of a loss recognition, a new, lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established basis.

Long-Lived Assets

Property and Equipment. Property and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful life (i.e., 25 to 33 years for buildings, and 2 to 5 years for computer equipment, office furniture and other equipment) of the asset. When assets are retired or disposed of, the cost and accumulated depreciation thereon are removed and any resulting gains or losses are included in the consolidated statements of operations. Leasehold improvements are amortized using the straight-line method over the estimated life of the asset, not to exceed the length of the lease. Repair and maintenance costs are expensed as incurred.

Goodwill and Other Indefinite-Lived Assets. We account for goodwill in accordance with ASC Topic 350. Under ASC Topic 350, goodwill is considered to have an indefinite life, and is carried at cost. Acquired trade names are assessed as indefinite lived assets if there is no foreseeable limits on the periods of time over which they are expected to contribute cash flows. Goodwill and indefinite-lived assets are not amortized, but are subject to an annual impairment test, as well as between annual tests when events or circumstances indicate that the carrying value may not be recoverable. We perform our annual impairment testing at December 31.

Our annual goodwill impairment test is performed at the reporting unit level. We have determined our reporting units based on the guidance within ASC Subtopic 350-20. As of December 31, 2017 and 2016, our reporting units are the same as our operating segments. We test goodwill for possible impairment by first determining the fair value of the related reporting unit and comparing this value to the recorded net assets of the reporting unit, including goodwill. The fair value of our reporting units is determined using an income approach based on discounted cash flow models. In the event the recorded net assets of the reporting unit exceed the estimated fair value of such assets, we perform a second step to measure the amount of the impairment, which is equal to the amount by which the recorded goodwill exceeds the implied fair value of the goodwill after assessing the fair value of each of the assets and liabilities within the reporting unit. We have determined that no impairment has occurred at December 31, 2017, 2016 and 2015 based upon a set of assumptions regarding discounted future cash flows, which represent our best estimate of future performance at this time.

We test indefinite-lived acquired trade names for possible impairment by using a discounted cash flow model to estimate fair value. We have determined that no impairment has occurred at December 31, 2017, 2016 and 2015 based upon a set of assumptions regarding discounted future cash flows, which represent our best estimate of future performance at this time.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

Changes in our assumptions underlying our estimates of fair value, which will be a function of our future financial performance and changes in economic conditions, could result in future impairment charges.

Amortizable Intangible and Other Long-lived Assets. Intangible assets subject to amortization are carried at cost less accumulated amortization, and amortized over the estimated useful life in proportion to the economic benefits received.

We evaluate the recoverability of our definite-lived intangible assets and other long-lived assets in accordance with ASC Subtopic 360-10, which generally requires the assessment of these assets for recoverability when events or circumstances indicate a potential impairment exists. We considered certain events and circumstances in determining whether the carrying value of identifiable intangible assets and other long-lived assets, other than indefinite-lived intangible assets, may not be recoverable including, but not limited to: significant changes in performance relative to expected operating results; significant changes in the use of the assets; significant negative industry or economic trends; a significant decline in our stock price for a sustained period of time; and changes in our business strategy. If we determine that the carrying value may not be recoverable, we estimate the undiscounted cash flows to be generated from the use and ultimate disposition of the asset group to determine whether an impairment exists. If an impairment is indicated based on a comparison of the asset groups' carrying values and the undiscounted cash flows, the impairment loss is measured as the amount by which the carrying amount of the asset group exceeds its fair value. We did not record an impairment charge to our definite-lived intangible assets as of December 31, 2017, 2016, and 2015.

Revenue Recognition

We recognize revenues when there is persuasive evidence of an arrangement, the product or service has been provided to the customer, the collection of our fees is reasonably assured and the amount of fees to be paid by the customer is fixed or determinable. Certain products are sold to customers with a "street date" (which is the earliest date these products may be sold by retailers). For these products, we recognize revenues on the later of the street date or the date the product is sold to the customer. Revenues are recorded net of taxes assessed by governmental authorities that are both imposed on and concurrent with the specific revenue-producing transaction between us and our customer, such as sales and value-added taxes.

Revenue Arrangements with Multiple Deliverables

Certain of our revenue arrangements have multiple deliverables, which we account for in accordance with ASC Topic 605. These revenue arrangements include product sales consisting of both software, service (such as ongoing hosting arrangements), and hardware deliverables (such as peripherals or other ancillary collectors' items sold together with physical "boxed" software).

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

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy. Further, 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 did not have significant revenue arrangements that required using BESP for the years ended December 31, 2017, 2016, and 2015. The inputs we use to determine the selling price of our significant deliverables include the actual price charged by the Company for deliverables that the Company sells separately (which represents VSOE) and the wholesale prices of the same or similar products for deliverables not sold separately (which represents TPE).

Product Sales

Product sales consist of sales of our games, including physical products and digital full-game downloads. We recognize revenues from the sale of our products after both (1) title and risk of loss have been transferred to our customers and (2) all performance obligations have been completed. With respect to digital full-game downloads, this is when the product is available for download or is activated for gameplay. Revenues from product sales are recognized after deducting the estimated allowance for returns and price protection. 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 revenues. 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.

Products with Online Functionality or Online Hosted Arrangements

For our software products with online functionality or that are part of an online hosted arrangement, we evaluate whether that online functionality constitutes a more-than-inconsequential separate deliverable in addition to the software product. This evaluation is performed for each software product or product add-on (including downloadable content), when it is released. Determining whether the online functionality for a particular product constitutes a more-than-inconsequential deliverable is subjective and requires management's judgment. When we determine that the online functionality constitutes a more-than-inconsequential separate service deliverable in addition to the product, which is principally because of the online functionality's importance to gameplay, we consider our performance obligation for this title to extend beyond the sale of the game. In addition, VSOE of fair value does not exist for the online functionality of some products, as we do not separately charge for this component. As a result, we initially defer all of the software-related revenues from the sale of any such title (including downloadable content) and recognize the revenues ratably over the estimated service period. In addition, we initially defer the cost of revenues for the title and recognize the costs of sales as the related revenues are recognized. The cost of revenues that are initially deferred include product and distribution costs, software royalties and amortization, and intellectual property licenses and exclude intangible asset amortization.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

For our software products with online functionality that we consider to be incidental to the overall product offering and are inconsequential deliverables, we recognize the related revenues when the revenue recognition criteria described above have been met.

For our *World of Warcraft* boxed products, expansion packs and value-added services, we recognize revenues in each case with the related subscription service revenues ratably over the estimated service period, beginning upon the 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," whereas revenues attributable to subscriptions and other value-added services are classified as "Subscription, licensing, and other revenues."

Subscription Revenues

Subscription revenues are mostly derived from *World of Warcraft*. *World of Warcraft* is a game that is playable through Blizzard's servers and is generally sold on a subscription-only basis.

For *World of Warcraft*, 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 sales 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 are then recognized ratably over the subscription period. Value-added service revenues associated with subscriptions are recognized ratably over the estimated service periods.

Licensing Revenues

In certain countries, we utilize third-party licensees to distribute and host our games in accordance with license agreements, for which the licensees pay the Company a royalty. We recognize these royalties as revenues based on usage by the end user and over the estimated service period when we have continuing service obligations. We recognize any upfront licensing fees received over the term of the agreements.

With respect to license agreements that provide customers the right to make multiple copies in exchange for guaranteed amounts, revenues are generally recognized upon delivery of a master copy if all other performance obligations have been completed or over the estimated service period when we have continuing service obligations. 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.

Other Revenues

Other revenues primarily include revenues from digital downloadable content (e.g., multi-player content packs), microtransactions and the licensing of intellectual property other than software to third-parties.

Microtransaction revenues are derived from the sale of virtual goods and currencies to our players to enhance their gameplay experience. Proceeds from the sales of virtual goods and currencies are initially recorded in deferred revenues. Proceeds from the sales of virtual currencies are recognized as revenues when a player uses the virtual goods purchased with the virtual currency. Proceeds from the

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

sales of virtual goods directly are also recognized as revenues when a player uses the virtual goods. We categorize our virtual goods as either consumable or durable. Consumable virtual goods represent goods that can be consumed by a specific player action; accordingly, we recognize revenues from the sale of consumable virtual goods as the goods are consumed. Durable virtual goods represent goods that are accessible to the player over an extended period of time; accordingly, we recognize revenues from the sale of durable virtual goods ratably over the period of time the goods are available to the player, which is generally the estimated service period.

Revenues from the licensing of intellectual property other than software to third-parties are recorded upon the receipt of licensee statements, or upon the receipt of cash, provided the license period has begun and all performance obligations have been completed.

Estimated Service Period

We determine the estimated service period for players of our games with consideration of various data points, including the weighted average number of days between players' first and last days played online, the average total hours played, the average number of days in which player activity stabilizes, and the weighted-average number of days between players' first purchase date and last date played online. We also consider known online trends, the service periods of our previously released games, and the service periods of our competitors' games that are similar in nature to ours, to the extent they are publicly available. Determining the estimated service period is subjective and requires management's judgment. Future usage patterns may differ from historical usage patterns and therefore the estimated service period may change in the future. The estimated service periods for players of our current games are generally less than 12 months.

Principal Agent Considerations

We evaluate sales of our products and content via third party digital storefronts, such as Microsoft's Xbox Games Store, Sony's PSN, the Apple App Store, and the Google Play Store, to determine whether revenues should be reported gross or net of fees retained by the storefront. Key indicators that we evaluate in determining gross versus net treatment include but are not limited to the following:

- the party responsible for delivery/fulfillment of the product or service to the consumer;
- the party responsible for consumer billing, fee collection, and refunds;
- the storefront and terms of sale that govern the consumer's purchase of the product or service; and
- the party that sets the pricing with the consumer and has credit risk.

Based on evaluation of the above indicators, we report revenues on a gross basis for sales arrangements via Apple App Store and Google Play Store, and we report revenues on a net basis (i.e. net of fees retained by the storefront) for sales arrangements via Microsoft's Xbox Games Store and Sony PSN.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

Allowances for Returns, Price Protection, and Doubtful Accounts

We closely monitor and analyze the historical performance of our various titles, the performance of products released by other publishers, market conditions, and the anticipated timing of other releases to assess future demand of current and upcoming titles. Initial volumes shipped upon title launch and subsequent reorders are evaluated with the goal of ensuring that quantities are sufficient to meet the demand from the retail markets, but at the same time are controlled to prevent excess inventory in the channel. We benchmark units to be shipped to our customers using historical and industry data.

We may permit product returns from, or grant price protection to, our customers under certain conditions. In general, price protection refers to the circumstances in which we elect to decrease, on a short- or longer-term basis, the wholesale price of a product by a certain amount and, when granted and applicable, allow customers a credit against amounts owed by such customers to us with respect to open and/or future invoices. The conditions our customers must meet to be granted the right to return products or receive price protection credits include, among other things, compliance with applicable trading and payment terms and consistent return of inventory and delivery of sell-through reports to us. We may also consider other factors, including achievement of sell-through performance targets in certain instances, the facilitation of slow-moving inventory, and other market factors.

Significant management judgments and estimates with respect to potential future product returns and price protection related to current period product revenues must be made and used when establishing the allowance for returns and price protection in any accounting period. We estimate the amount of future returns and price protection for current period product revenues utilizing historical experience and information regarding inventory levels and the demand and acceptance of our products by the end consumer. The following factors are used to estimate the amount of future returns and price protection for a particular title: historical performance of titles in similar genres; historical performance of the hardware platform; historical performance of the franchise; console hardware life cycle; sales force and retail customer feedback; industry pricing; future pricing assumptions; weeks of on-hand retail channel inventory; absolute quantity of on-hand retail channel inventory; our warehouse on-hand inventory levels; the title's recent sell-through history (if available); marketing trade programs; and the performance of competing titles. The relative importance of these factors varies among titles depending upon, among other things, genre, platform, seasonality, and sales strategy.

Based upon historical experience, we believe that our estimates are reasonable. However, actual returns and price protection could vary materially from our allowance estimates due to a number of reasons, including, among others: a lack of consumer acceptance of a title, the release in the same period of a similarly themed title by a competitor, or technological obsolescence due to the emergence of new hardware platforms. There may be material differences in the amount and timing of our revenues for any period if factors or market conditions change or if matters resolve in a manner that is inconsistent with management's assumptions utilized in determining the allowances for returns and price protection.

Similarly, management must make estimates as to the collectability of our accounts receivable. In estimating the allowance for doubtful accounts, we analyze the age of current outstanding account balances, historical bad debts, customer concentrations, customer creditworthiness, current economic trends, and changes in our customers' payment terms and their economic condition, as well as whether

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

we can obtain sufficient credit insurance. Any significant changes in any of these criteria would affect management's estimates in establishing our allowance for doubtful accounts.

Shipping and Handling

Shipping and handling costs, which consist primarily of packaging and transportation charges incurred to move finished goods to customers, are included in "Cost of revenues—product costs."

Cost of Revenues

Our cost of revenues consist of the following:

Cost of revenues—product sales:

- (1) "Product costs"—includes the manufacturing costs of goods produced and sold. These generally include product costs, manufacturing royalties, net of volume discounts, personnel-related costs, warehousing, and distribution costs. We generally recognize volume discounts when they are earned (typically in connection with the achievement of unit-based milestones).
- (2) "Software royalties, amortization, and intellectual property licenses"—includes the amortization of capitalized software costs and royalties attributable to product sales revenues. These are costs capitalized on the balance sheet until the respective games are released, at which time the capitalized costs are amortized. Also included is amortization of intangible assets recognized in purchase accounting attributable to product sales revenues.

Cost of revenues—subscription, licensing, and other revenues:

- (1) "Game operations and distribution costs"—includes costs to operate our games, such as customer service, internet bandwidth and server costs, platform provider fee, and payment provider fees.
- (2) "Software royalties, amortization, and intellectual property licenses"—includes the amortization of capitalized software costs and royalties attributable to subscription, licensing and other revenues. These are costs capitalized on the balance sheet until the respective games are released, at which time the capitalized costs are amortized. Also included is amortization of intangible assets recognized in purchase accounting attributable to subscription, licensing and other revenues.

Advertising Expenses

We expense advertising as incurred, except for production costs associated with media advertising, which are deferred and charged to expense when the related advertisement is run for the first time. Advertising expenses for the years ended December 31, 2017, 2016, and 2015 were \$708 million, \$641 million, and \$523 million, respectively, and are included in "Sales and marketing" in the consolidated statements of operations.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

Income Taxes

We record a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with 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. The effect on deferred tax assets and liabilities due to a change in tax rates is recognized in income in the period that includes the enactment date. We evaluate deferred tax assets each period for recoverability. For those assets that do not meet the threshold of "more likely than not" that they will be realized in the future, a valuation allowance is recorded.

We report a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. We recognize interest and penalties, if any, related to unrecognized tax benefits in "Income tax expense."

On December 22, 2017, tax reform legislation known as the Tax Cuts and Jobs Act (the "U.S. Tax Reform Act") was enacted in the United States. The U.S. Tax Reform Act, among other things, reduced the U.S. corporate income tax rate from 35% to 21% beginning in 2018 and implemented a modified territorial tax system that imposes a one-time tax on deemed repatriated earnings of foreign subsidiaries ("Transition Tax").

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 ("SAB 118"), which provides guidance on how to account for the effects of the U.S. Tax Reform Act under ASC 740. SAB 118 enables companies to record a provisional amount for the effects of the U.S. Tax Reform Act based on a reasonable estimate, subject to adjustment during a measurement period of up to one year, until accounting is complete.

We continue to analyze the prospective effects of the U.S. Tax Reform Act, including new provisions impacting certain foreign income, such as global intangible low-taxed income ("GILTI") of foreign subsidiaries, base erosion anti-abuse tax ("BEAT"), and foreign-derived intangible income ("FDII"), potential limitations on interest expense deductions, and changes to the provisions of Section 162(m) of the Internal Revenue Code, among other provisions of the U.S. Tax Reform Act. The Company has elected to account for the U.S. Tax Reform Act provisions related to GILTI as period costs if and when incurred pursuant to the FASB Staff Q&A guidance issued in January 2018.

In March 2016, the FASB issued new guidance to simplify accounting for share-based payments. The new standard, amongst other things:

- requires that all excess tax benefits and tax deficiencies be recorded as an income tax expense or benefit in the consolidated statement of operations and that the tax effects of exercised or vested awards be treated as discrete items in the reporting period in which they occur;
- requires excess tax benefits from share-based payments to be reported as operating activities on the statement of cash flows; and

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

- permits an accounting policy election to either estimate the number of awards that are expected to vest using an estimated forfeiture rate, as currently required, or account for forfeitures when they occur.

We elected to early adopt this new standard in the third quarter of 2016, which required us to reflect any adjustments as of January 1, 2016. As part of the adoption, we made certain elections, including the following:

- to apply the presentation requirements for our consolidated statement of cash flows related to excess tax benefits retrospectively to all periods presented; and
- to continue to estimate the number of awards that are expected to vest using an estimated forfeiture rate.

As a result of the adoption, we recognized excess tax benefits of \$113 million and \$81 million as a reduction to income tax expense in our consolidated statement of operations for the years ended December 31, 2017 and 2016, respectively. For periods prior to 2016, such excess tax benefits were recorded to shareholders equity.

Foreign Currency Translation

All assets and liabilities of our foreign subsidiaries who have a functional currency other than U.S. dollars are translated into U.S. dollars at the exchange rate in effect at the balance sheet date, and revenue and expenses are translated at average exchange rates during the period. The resulting translation adjustments are reflected as a component of "Accumulated other comprehensive loss" in shareholders' equity.

Earnings (Loss) Per Common Share

"Basic (loss) earnings per common share" is computed by dividing income (loss) available to common shareholders by the weighted-average number of common shares outstanding for the periods presented. "Diluted earnings (loss) per common share" is computed by dividing income (loss) available to common shareholders by the weighted-average number of common shares outstanding, increased by the weighted-average number of common stock equivalents. Common stock equivalents are calculated using the treasury stock method and represent incremental shares issuable upon exercise of our outstanding options. However, potential common shares are not included in the denominator of the diluted earnings (loss) per common share calculation when inclusion of such shares would be anti-dilutive, such as in a period in which a net loss is recorded.

When we determine whether instruments granted in share-based payment transactions are participating securities, unvested share-based awards which include the right to receive non-forfeitable dividends or dividend equivalents are considered to participate with common stock in undistributed earnings. With participating securities, we are required to calculate basic and diluted earnings (loss) per common share amounts under the two-class method. The two-class method excludes from the earnings (loss) per common share calculation any dividends paid or owed to participating securities and any undistributed earnings considered to be attributable to participating securities.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

2. Summary of Significant Accounting Policies (Continued)

Share-Based Payments

We account for share-based payments in accordance with ASC Subtopic 718-10 and ASC Subtopic 505-50. Share-based compensation expense for a given grant is recognized over the requisite service period (that is, the period for which the employee is being compensated) and is based on the value of share-based payment awards after a reduction for estimated forfeitures. Forfeitures are estimated at the time of grant and are revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

We generally estimate the value of stock options using a binomial-lattice model. This estimate is affected by our stock price, as well as assumptions regarding a number of highly complex and subjective variables, including our expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

We generally determine the fair value of restricted stock units based on the closing market price of the Company's common stock on the date of grant, reduced by the present value of the estimated future dividends during the vesting period in which the restricted stock units holder will not participate. Certain restricted stock units granted to our employees and senior management vest based on the achievement of pre-established performance or market conditions. For performance-based restricted stock units, each quarter we update our assessment of the probability that the specified performance criteria will be achieved. We amortize the fair values of performance-based restricted stock units over the requisite service period, adjusting for estimated forfeitures for each separately vesting tranche of the award. For market-based restricted stock units, we estimate the fair value at the date of grant using a Monte Carlo valuation methodology and amortize those fair values over the requisite service period, adjusting for estimated forfeitures for each separately vesting tranche of the award. The Monte Carlo methodology that we use to estimate the fair value of market-based restricted stock units at the date of grant incorporates into the valuation the possibility that the market condition may not be satisfied. Provided that the requisite service is rendered, the total fair value of the market-based restricted stock units at the date of grant must be recognized as compensation expense even if the market condition is not achieved. However, the number of shares that ultimately vest can vary significantly with the performance of the specified market criteria.

For share-based compensation grants that are liability classified, we update our grant date valuation at each reporting period and recognize a cumulative catch-up adjustment for changes in the value related to the requisite service already rendered.

Loss Contingencies

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

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

3. Cash and Cash Equivalents

The following table summarizes the components of our cash and cash equivalents (amounts in millions):

| | At December 31, | |
|-----------------------------------|-----------------|-----------------|
| | 2017 | 2016 |
| Cash | \$ 269 | \$ 286 |
| Foreign government treasury bills | 39 | 38 |
| Money market funds | 4,405 | 2,921 |
| Cash and cash equivalents | <u>\$ 4,713</u> | <u>\$ 3,245</u> |

4. Inventories, Net

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

| | At December 31, | |
|--------------------------------|--------------------|--------------|
| | 2017 | 2016 |
| Finished goods | \$ 45 | \$ 40 |
| Purchased parts and components | 1 | 9 |
| Inventories, net | <u>\$ 46</u> | <u>\$ 49</u> |

At December 31, 2017 and 2016, inventory reserves were \$36 million and \$45 million, respectively.

5. Software Development and Intellectual Property Licenses

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

| | At December 31, | |
|--|--------------------|---------------|
| | 2017 | 2016 |
| Internally-developed software costs | \$ 270 | \$ 277 |
| Payments made to third-party software developers | 183 | 189 |
| Total software development costs | <u>\$ 453</u> | <u>\$ 466</u> |

As of December 31, 2017 and December 31, 2016, capitalized intellectual property licenses were not material.

Amortization of capitalized software development costs and intellectual property was the following (amounts in millions):

| | For the Years Ended December 31, | | |
|---|-------------------------------------|--------|--------|
| | 2017 | 2016 | 2015 |
| Amortization of capitalized software development costs and intellectual property licenses | \$ 314 | \$ 335 | \$ 410 |

Write-offs and impairments of capitalized software development costs and intellectual property licenses were not material for the years ended December 31, 2017, 2016, and 2015.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

6. Property and Equipment, Net

Property and equipment, net was comprised of the following (amounts in millions):

| | At December 31, | |
|--------------------------------------|-----------------|--------|
| | 2017 | 2016 |
| Land | \$ 1 | \$ 1 |
| Buildings | 4 | 4 |
| Leasehold improvements | 224 | 162 |
| Computer equipment | 658 | 560 |
| Office furniture and other equipment | 92 | 78 |
| Total cost of property and equipment | 979 | 805 |
| Less accumulated depreciation | (685) | (547) |
| Property and equipment, net | \$ 294 | \$ 258 |

Depreciation expense for the years ended December 31, 2017, 2016, and 2015 was \$130 million, \$121 million, and \$82 million, respectively.

Rental expense was \$71 million, \$65 million and \$39 million for the years ended December 31, 2017, 2016, and 2015, respectively.

7. Intangible Assets, Net

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

| | Estimated useful lives | At December 31, 2017 | | |
|--|------------------------|-----------------------|--------------------------|---------------------|
| | | Gross carrying amount | Accumulated amortization | Net carrying amount |
| Acquired definite-lived intangible assets: | | | | |
| Internally-developed franchises | 3 - 11 years | \$ 1,154 | \$ (869) | \$ 285 |
| Developed software | 2 - 5 years | 601 | (301) | 300 |
| Customer base | 2 years | 617 | (573) | 44 |
| Trade names | 7 - 10 years | 54 | (16) | 38 |
| Other | 1 - 15 years | 19 | (13) | 6 |
| Total definite-lived intangible assets | | \$ 2,445 | \$ (1,772) | \$ 673 |
| Acquired indefinite-lived intangible assets: | | | | |
| Activision trademark | Indefinite | | | 386 |
| Acquired trade names | Indefinite | | | 47 |
| Total indefinite-lived intangible assets | | | | \$ 433 |
| Total intangible assets, net | | | | \$ 1,106 |

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

7. Intangible Assets, Net (Continued)

| | At December 31, 2016 | | | |
|--|------------------------|-----------------------|--------------------------|---------------------|
| | Estimated useful lives | Gross carrying amount | Accumulated amortization | Net carrying amount |
| Acquired definite-lived intangible assets: | | | | |
| Internally-developed franchises | 3 - 11 years | 1,154 | (583) | 571 |
| Developed software | 3 - 5 years | 595 | (145) | 450 |
| Customer base | 2 years | 617 | (266) | 351 |
| Trade names | 7 - 10 years | 54 | (8) | 46 |
| Other | 1 - 8 years | 18 | (11) | 7 |
| Total definite-lived intangible assets | | <u>\$ 2,438</u> | <u>\$ (1,013)</u> | <u>\$ 1,425</u> |
| Acquired indefinite-lived intangible assets: | | | | |
| Activision trademark | Indefinite | | | 386 |
| Acquired trade names | Indefinite | | | 47 |
| Total indefinite-lived intangible assets | | | | <u>\$ 433</u> |
| Total intangible assets, net | | | | <u>\$ 1,858</u> |

Amortization expense of intangible assets was \$759 million, \$708 million, and \$13 million for the years ended December 31, 2017, 2016, and 2015, respectively.

At December 31, 2017, future amortization of definite-lived intangible assets is estimated as follows (amounts in millions):

| | |
|------------|---------------|
| 2018 | \$ 369 |
| 2019 | 209 |
| 2020 | 72 |
| 2021 | 12 |
| 2022 | 7 |
| Thereafter | 4 |
| Total | <u>\$ 673</u> |

We did not record any impairment charges against our intangible assets for the years ended December 31, 2017, 2016, and 2015.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**Notes to Consolidated Financial Statements (Continued)****8. Goodwill**

The changes in the carrying amount of goodwill by operating segment are as follows (amounts in millions):

| | <u>Activision</u> | <u>Blizzard(1)</u> | <u>King</u> | <u>Total</u> |
|-------------------------------|-------------------|--------------------|-----------------|-----------------|
| Balance at December 31, 2015 | \$ 6,905 | \$ 190 | \$ — | \$ 7,095 |
| Additions through acquisition | — | — | 2,675 | 2,675 |
| Other | (2) | — | — | (2) |
| Balance at December 31, 2016 | <u>\$ 6,903</u> | <u>\$ 190</u> | <u>\$ 2,675</u> | <u>\$ 9,768</u> |
| Other | (5) | — | — | (5) |
| Balance at December 31, 2017 | <u>\$ 6,898</u> | <u>\$ 190</u> | <u>\$ 2,675</u> | <u>\$ 9,763</u> |

- (1) As a result of the change in our operating segments discussed in Note 1, goodwill of \$12 million previously reported within the "Other segments" is now included in the "Blizzard" reportable segment. The prior period balance has been revised to reflect this change.

For 2016, the addition to goodwill through acquisition is attributed to the King Acquisition (see Note 20). At December 31, 2017, 2016, and 2015, there were no accumulated impairment losses.

9. Other Assets and Liabilities

Included in "Accrued expenses and other liabilities" of our consolidated balance sheets are accrued payroll-related costs of \$441 million and \$393 million at December 31, 2017 and 2016, respectively.

Included in "Other liabilities" of our consolidated balance sheets are income tax payable of \$473 million and \$49 million at December 31, 2017 and 2016, respectively.

10. Fair Value Measurements

FASB literature regarding fair value measurements for certain assets and liabilities establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of "observable inputs" and minimize the use of "unobservable inputs." The three levels of inputs used to measure fair value are as follows:

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

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

10. Fair Value Measurements (Continued)

Fair Value Measurements on a Recurring Basis

The table below segregates all of our financial assets and liabilities that are measured at fair value on a recurring basis into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the measurement date, generally including money market funds, treasury bills, available-for-sale and derivative financial instruments, and other investments (amounts in millions):

| | Fair Value Measurements at December 31, 2017 Using | | | | Balance Sheet Classification |
|---|---|--|---|--|--|
| | As of December 31, 2017 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Financial Assets: | | | | | |
| Recurring fair value measurements: | | | | | |
| Money market funds | \$ 4,405 | \$ 4,405 | \$ — | \$ — | Cash and cash equivalents |
| Foreign government treasury bills | 39 | 39 | — | — | Cash and cash equivalents |
| U.S. treasuries and government agency securities | 55 | 55 | — | — | Other current assets |
| Total recurring fair value measurements | <u>\$ 4,499</u> | <u>\$ 4,499</u> | <u>\$ —</u> | <u>\$ —</u> | |
| Financial Liabilities: | | | | | |
| Foreign currency forward contracts designated as hedges | \$ (5) | \$ — | \$ (5) | \$ — | Accrued expenses and other liabilities |

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

10. Fair Value Measurements (Continued)

| | Fair Value Measurements at December 31, 2016 Using | | | | Balance Sheet Classification |
|--|---|--|---|--|---------------------------------|
| | As of December 31, 2016 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Financial Assets: | | | | | |
| Recurring fair value measurements: | | | | | |
| Money market funds | \$ 2,921 | \$ 2,921 | \$ — | \$ — | Cash and cash equivalents |
| Foreign government treasury bills | 38 | 38 | — | — | Cash and cash equivalents |
| Foreign currency forward contracts designated as hedges | 22 | — | 22 | — | Other current assets |
| Auction rate securities | 9 | — | — | 9 | Other assets |
| Total recurring fair value measurements | \$ 2,990 | \$ 2,959 | \$ 22 | \$ 9 | |

Foreign Currency Forward Contracts

Foreign Currency Forward Contracts Designated as Hedges ("Cash Flow Hedges")

At December 31, 2017, the gross notional amount of outstanding Cash Flow Hedges was approximately \$521 million. The fair value of these contracts, all of which have remaining maturities of 12 months or less, was \$5 million of net unrealized losses. Additionally, at December 31, 2017, we had approximately \$10 million of net realized but unrecognized losses recorded within "Accumulated other comprehensive income (loss)" associated with contracts that had settled but were deferred and will be amortized into earnings, along with the associated hedged revenues. Such amounts will be reclassified into earnings within the next 12 months.

At December 31, 2016, the gross notional amount of outstanding Cash Flow Hedges was approximately \$346 million. The fair value of these contracts was \$22 million of net unrealized gains.

During the years ended December 31, 2017 and 2016, there was no ineffectiveness relating to our Cash Flow Hedges. During the years ended December 31, 2017 and 2016, the amount of pre-tax net realized gains associated with these contracts that were reclassified out of "Accumulated other comprehensive income (loss)" and into earnings was not material.

Fair Value Measurements on a Non-Recurring Basis

We measure the fair value of certain assets on a non-recurring basis, generally annually or when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

10. Fair Value Measurements (Continued)

For the years ended December 31, 2017, 2016, and 2015, there were no impairment charges related to assets that are measured on a non-recurring basis.

11. Debt

Credit Facilities

At December 31, 2016, we had outstanding term loans "A" of approximately \$2.7 billion (the "2016 TLA") and \$250 million available under a revolving credit facility (the "Revolver") pursuant to a credit agreement executed on October 11, 2013 (as amended thereafter and from time to time, the "Credit Agreement").

On February 3, 2017, we entered into a sixth amendment (the "Sixth Amendment") to the Credit Agreement. The Sixth Amendment: (1) provided for a new tranche of term loans "A" in an aggregate principal amount of \$2.55 billion (the "2017 TLA" and, together with the Revolver, the "Credit Facilities") and (2) released each of our subsidiary guarantors from their respective guarantees provided under the Credit Agreement. All proceeds of the 2017 TLA, together with additional cash on hand of \$139 million, were used to fully retire the 2016 TLA, including all accrued and unpaid interest thereon. The terms of the 2017 TLA, other than the absence of the subsidiary guarantees, are generally the same as the terms of the 2016 TLA. The 2017 TLA will mature on August 23, 2021.

Borrowings under the 2017 TLA and the Revolver will bear interest, at the Company's option, at either (1) a base rate equal to the highest of (i) the federal funds rate, plus 0.5%, (ii) the prime commercial lending rate of Bank of America, N.A. and (iii) the London Interbank Offered Rate ("LIBOR") for an interest period of one month beginning on such day plus 1.00%, or (2) LIBOR, in each case, plus an applicable interest margin. LIBOR will be subject to a floor of 0% and the base rate will be subject to an effective floor of 1.00%. The applicable interest margin for borrowings under the 2017 TLA and Revolver will range from 1.125% to 2.00% for LIBOR borrowings and from 0.125% to 1.00% for base rate borrowings and will be determined by reference to a pricing grid based on the Company's credit ratings. At December 31, 2017, the 2017 TLA bore interest at 2.73%.

Borrowings under the Revolver may be borrowed, repaid, and re-borrowed by the Company, and are available for working capital and other general corporate purposes. Up to \$50 million of the Revolver may be used for letters of credit. To date, we have not drawn on the Revolver.

During the year ended December 31, 2017, we reduced our total outstanding term loan balances by \$1.7 billion. This included \$139 million of cash used to retire the 2016 TLA, as discussed above, along with prepayments on the 2017 TLA of \$361 million made on February 15, 2017, and \$1.2 billion made on May 26, 2017. The May prepayment was made using proceeds from a concurrent issuance of \$1.2 billion in notes, as discussed further below. As part of that refinancing, we wrote-off unamortized discount and deferred financing costs of \$12 million, which is included in "Loss on extinguishment of debt" in the consolidated statement of operations. The prepayments made on our 2017 TLA have satisfied the remaining required quarterly principal repayments for the entire term of the Credit Agreement. As a result of these prepayments, at December 31, 2017, the outstanding balance of our 2017 TLA was \$990 million.

The Company is subject to a financial covenant requiring the Company's Consolidated Total Net Debt Ratio (as defined in the Credit Agreement) not to exceed 3.50:1.00. The Credit Agreement contains other covenants that are customary for issuers with similar credit ratings. A violation of any of

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

11. Debt (Continued)

these covenants could result in an event of default under the Credit Agreement. Upon the occurrence of an event of default, payment of any outstanding amounts under the Credit Agreement may be accelerated, and the lenders' commitments to extend credit under the Credit Agreement may be terminated. In addition, an event of default under the Credit Agreement could, under certain circumstances, permit the holders of other outstanding unsecured debt, including the debt holders described below, to accelerate the repayment of such obligations. The Company was in compliance with the terms of the Credit Facilities as of December 31, 2017.

On February 1, 2018, our Board of Directors authorized repayments of up to \$1.8 billion of the company's outstanding debt during 2018. As of the date hereof, we have not made any additional repayments on our outstanding debt and the determination as to if and when we make any such repayment will be dependent on market conditions and other factors.

Unsecured Senior Notes

At December 31, 2016, we had the following unsecured senior notes outstanding:

- \$750 million of 6.125% unsecured senior notes due September 2023 that we issued on September 19, 2013 (the "2023 Notes"), in a private offering made in accordance with Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"); and
- \$650 million of 2.3% unsecured senior notes due September 2021 (the "Unregistered 2021 Notes") and \$850 million of 3.4% unsecured senior notes due September 2026 (the "Unregistered 2026 Notes") that we issued on September 19, 2016, in a private offering made in accordance with Rule 144A and Regulation S under the Securities Act.

In connection with the issuance of the Unregistered 2021 Notes and the Unregistered 2026 Notes, we entered into a registration rights agreement (the "Registration Rights Agreement"), among the Company, and the representatives of the initial purchasers of the Unregistered 2021 Notes and the Unregistered 2026 Notes. Under the Registration Rights Agreement, we were required to use commercially reasonable efforts to, within one year of the issue date of the Unregistered 2021 Notes and the Unregistered 2026 Notes, among other things, (1) file a registration statement with respect to an offer to exchange each series of the Unregistered 2021 Notes and the Unregistered 2026 Notes for new notes that were substantially identical in all material respects (except for the provisions relating to the transfer restrictions and payment of additional interest) (the "Exchange Offer"), and (2) cause that registration statement (the "Exchange Offer Registration Statement") to be declared effective by the SEC under the Securities Act. The Exchange Offer Registration Statement was declared effective by the SEC on April 28, 2017, and we completed the Exchange Offer on June 1, 2017, such that all the Unregistered 2021 Notes and Unregistered 2026 Notes were exchanged for registered 2021 notes (the "2021 Notes") and registered 2026 notes (the "2026 Notes"), respectively.

In addition, on May 26, 2017, in a public underwritten offering, we issued \$400 million of 2.6% unsecured senior notes due June 2022 (the "2022 Notes"), \$400 million of 3.4% unsecured senior notes due June 2027 (the "2027 Notes"), and \$400 million of 4.5% unsecured senior notes due June 2047 (the "2047 Notes", and together with the 2021 Notes, the 2022 Notes, the 2023 Notes, the 2026 Notes, and the 2027 Notes, the "Notes"), which were outstanding at December 31, 2017.

We may redeem the 2023 Notes on or after September 15, 2018, in whole or in part on any one or more occasions, at specified redemption prices, plus accrued and unpaid interest. In addition, we may

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

11. Debt (Continued)

redeem some or all of the 2023 Notes prior to September 15, 2018, at a price equal to 100% of the aggregate principal amount thereof plus a "make-whole premium" and accrued and unpaid interest. Further, upon the occurrence of one or more qualified equity offerings, we may also redeem up to 35% of the aggregate principal amount of the 2023 Notes outstanding with the net cash proceeds from such offerings.

We may redeem some or all of the 2021 Notes, the 2022 Notes, the 2026 Notes, the 2027 Notes, and the 2047 Notes prior to August 15, 2021, May 15, 2022, June 15, 2026, March 15, 2027, and December 15, 2046, respectively, and in each case at a price equal to 100% of the aggregate principal amount thereof plus a "make-whole" premium and accrued and unpaid interest. Any redemption of all or a portion of the applicable class of note after the applicable date would be at 100% of aggregate principal amount plus accrued and unpaid interest.

Upon the occurrence of certain change of control events, we will be required to offer to repurchase the Notes at a purchase price equal to 101% of the principal amount thereof, plus accrued and unpaid interest. These repurchase requirements are considered clearly and closely related to the Notes and are not accounted for separately upon issuance.

The Notes are general senior obligations of the Company and rank *pari passu* in right of payment to all of the Company's existing and future senior indebtedness, including the Credit Facilities described above. The Notes are not secured and are effectively subordinated to any of the Company's existing or future indebtedness that is secured.

The 2023 Notes contain customary covenants that place restrictions in certain circumstances on, among other things, the incurrence of debt, granting of liens, payment of dividends, sales of assets, and certain merger and consolidation transactions. The Notes, with the exception of the 2023 Notes, contain customary covenants that place restrictions in certain circumstances on, among other things, the incurrence of secured debt, entry into sale or leaseback transactions, and certain merger or consolidation transactions. The Company was in compliance with the terms of the Notes as of December 31, 2017.

Interest is payable semi-annually in arrears on March 15 and September 15 of each year for the 2021 Notes, the 2023 Notes, and 2026 Notes, and payable semi-annually in arrears on June 15 and December 15 of each year for the 2022 Notes, the 2027 Notes, and 2047 Notes. Accrued interest payable is recorded within "Accrued expenses and other liabilities" in our consolidated balance sheets. As of December 31, 2017 and December 31, 2016, we had accrued interest payable of \$28 million and \$25 million, respectively, related to the Notes.

Interest expense and financing costs

Fees and discounts associated with the issuance of our debt instruments are recorded as debt discount, which reduces their respective carrying values, and is amortized over their respective terms. Amortization expense is recorded within "Interest and other expense (income), net" in our condensed consolidated statement of operations.

In connection with the May 2017 note issuances, we incurred approximately \$20 million of discounts and financing costs that were capitalized and recorded within "Long-term debt, net" in our consolidated balance sheet.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

11. Debt (Continued)

For the years ended December 31, 2017, 2016, and 2015: interest expense was \$150 million, \$197 million, and \$193 million, respectively; amortization of the debt discount and deferred financing costs was \$12 million, \$20 million, and \$7 million, respectively; and commitment fees for the Revolver were not material.

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

| | At December 31, 2017 | | |
|----------------------|--------------------------|--|------------------------|
| | Gross Carrying Amount | Unamortized Discount and Deferred Financing Costs | Net Carrying Amount |
| 2017 TLA | \$ 990 | \$ (8) | \$ 982 |
| 2021 Notes | 650 | (4) | 646 |
| 2022 Notes | 400 | (4) | 396 |
| 2023 Notes | 750 | (9) | 741 |
| 2026 Notes | 850 | (9) | 841 |
| 2027 Notes | 400 | (6) | 394 |
| 2047 Notes | 400 | (10) | 390 |
| Total long-term debt | <u>\$ 4,440</u> | <u>\$ (50)</u> | <u>\$ 4,390</u> |

| | At December 31, 2016 | | |
|----------------------|--------------------------|--|------------------------|
| | Gross Carrying Amount | Unamortized Discount and Deferred Financing Costs | Net Carrying Amount |
| 2016 TLA | \$ 2,690 | \$ (27) | \$ 2,663 |
| 2021 Notes | 650 | (5) | 645 |
| 2023 Notes | 750 | (11) | 739 |
| 2026 Notes | 850 | (10) | 840 |
| Total long-term debt | <u>\$ 4,940</u> | <u>\$ (53)</u> | <u>\$ 4,887</u> |

As of December 31, 2017 the scheduled maturities and contractual principal repayments of our debt for each of the five succeeding years are as follows (amounts in millions):

| For the year ending December 31, | | |
|----------------------------------|--|-----------------|
| 2018 | | \$ — |
| 2019 | | — |
| 2020 | | — |
| 2021 | | 1,640 |
| 2022 | | 400 |
| Thereafter | | <u>2,400</u> |
| Total | | <u>\$ 4,440</u> |

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

11. Debt (Continued)

With the exception of the 2023 Notes and the 2047 Notes, using Level 2 inputs (i.e., observable market prices in less-than-active markets), the carrying values of our debt instruments approximated their fair values as of December 31, 2017, as the interest rates are similar to current rates at which we can borrow funds over the selected interest periods. At December 31, 2017, based on Level 2 inputs, the fair values of the 2023 Notes and the 2047 Notes were \$795 million and \$421 million, respectively.

At December 31, 2016, the carrying value of the 2016 TLA approximated its fair value, based on Level 2 inputs. At December 31, 2016, based on Level 2 inputs, the fair values of the 2021 Notes, 2023 Notes, and 2026 Notes were \$635 million, \$818 million, and \$808 million, respectively.

12. Accumulated Other Comprehensive Income (Loss)

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

| | For the Year Ended December 31, 2017 | | | |
|---|--|---|---|----------|
| | Foreign currency translation adjustments | Unrealized gain (loss) on available-for-sale securities | Unrealized gain (loss) on forward contracts | Total |
| Balance at December 31, 2016 | \$ (659) | \$ 1 | \$ 29 | \$ (629) |
| Other comprehensive income (loss) before reclassifications | 20 | (1) | (45) | (26) |
| Amounts reclassified from accumulated other comprehensive income (loss) into earnings | 16 | — | 1 | 17 |
| Balance at December 31, 2017 | \$ (623) | \$ — | \$ (15) | \$ (638) |

| | For the Year Ended December 31, 2016 | | | |
|---|--|---|---|----------|
| | Foreign currency translation adjustments | Unrealized gain (loss) on available-for-sale securities | Unrealized gain (loss) on forward contracts | Total |
| Balance at December 31, 2015 | \$ (630) | \$ 1 | \$ (4) | \$ (633) |
| Other comprehensive income (loss) before reclassifications | (29) | — | 37 | 8 |
| Amounts reclassified from accumulated other comprehensive income (loss) into earnings | — | — | (4) | (4) |
| Balance at December 31, 2016 | \$ (659) | \$ 1 | \$ 29 | \$ (629) |

Income taxes were not provided for foreign currency translation items, as these are considered indefinite investments in non-U.S. subsidiaries. Due to the U.S. Tax Reform Act, we are re-evaluating our indefinite reinvestment assertions, but we have not yet completed this evaluation. In accordance with SAB 118, we intend to complete this evaluation during the measurement period of up to one year and will record adjustments, if any, during those respective periods.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

13. Operating Segments and Geographic Region

Currently, we have three reportable segments. Our operating segments are consistent with the manner in which our operations are reviewed and managed by our Chief Executive Officer, who is our chief operating decision maker ("CODM"). The CODM reviews segment performance exclusive of: the impact of the change in deferred revenues and related cost of revenues with respect to certain of our online-enabled games; share-based compensation expense; amortization of intangible assets as a result of purchase price accounting; fees and other expenses (including legal fees, expenses, and accruals) related to acquisitions, associated integration activities, and financings; certain restructuring costs; and certain other non-cash charges. The CODM does not review any information regarding total assets on an operating segment basis, and accordingly, no disclosure is made with respect thereto.

Our operating segments are also consistent with our internal organization structure, the way we assess operating performance and allocate resources, and the availability of separate financial information. We do not aggregate operating segments. As discussed in Note 1, commencing with the second quarter of 2017, we made changes to our operating segments which reflect the changes in our organization and reporting structure. Our MLG business, which was previously included in the non-reportable "Other segments," is now presented within the "Blizzard" reportable segment. Prior period amounts have been revised to reflect this change. The change had no impact on consolidated net revenues or operating income.

Information on the reportable segments net revenues and segment operating income are presented below (amounts in millions):

| | Year Ended December 31, 2017 | | | |
|--------------------------------------|------------------------------|----------|----------|----------|
| | Activision | Blizzard | King | Total |
| Segment Revenues | | | | |
| Net revenues from external customers | \$ 2,628 | \$ 2,120 | \$ 1,998 | \$ 6,746 |
| Intersegment net revenues(1) | — | 19 | — | 19 |
| Segment net revenues | \$ 2,628 | \$ 2,139 | \$ 1,998 | \$ 6,765 |
| Segment operating income | \$ 1,005 | \$ 712 | \$ 700 | \$ 2,417 |

| | Year Ended December 31, 2016 | | | |
|--------------------------------------|------------------------------|----------|----------|----------|
| | Activision | Blizzard | King | Total |
| Segment Revenues | | | | |
| Net revenues from external customers | \$ 2,220 | \$ 2,439 | \$ 1,586 | \$ 6,245 |
| Intersegment net revenues(1) | — | — | — | — |
| Segment net revenues | \$ 2,220 | \$ 2,439 | \$ 1,586 | \$ 6,245 |
| Segment operating income | \$ 788 | \$ 995 | \$ 537 | \$ 2,320 |

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

13. Operating Segments and Geographic Region (Continued)

| | Year Ended December 31, 2015 | | | |
|--------------------------------------|------------------------------|-----------------|-------------|-----------------|
| | Activision | Blizzard | King | Total |
| Segment Revenues | | | | |
| Net revenues from external customers | \$ 2,700 | \$ 1,565 | \$ — | \$ 4,265 |
| Intersegment net revenues(1) | — | — | — | — |
| Segment net revenues | <u>\$ 2,700</u> | <u>\$ 1,565</u> | <u>\$ —</u> | <u>\$ 4,265</u> |
| Segment operating income | <u>\$ 868</u> | <u>\$ 561</u> | <u>\$ —</u> | <u>\$ 1,429</u> |

(1) Intersegment revenues reflect licensing and service fees charged between segments.

Reconciliations of total segment net revenues and total segment operating income to consolidated net revenues from external customers and consolidated income before income tax expense are presented in the table below (amounts in millions):

| | Years Ended December 31, | | |
|--|--------------------------|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Reconciliation to consolidated net revenues: | | | |
| Segment net revenues | \$ 6,765 | \$ 6,245 | \$ 4,265 |
| Revenues from other segments(1) | 410 | 354 | 356 |
| Net effect from recognition (deferral) of deferred net revenues | (139) | 9 | 43 |
| Elimination of intersegment revenues(2) | (19) | — | — |
| Consolidated net revenues | <u>\$ 7,017</u> | <u>\$ 6,608</u> | <u>\$ 4,664</u> |
| Reconciliation to consolidated income before income tax expense: | | | |
| Segment operating income | \$ 2,417 | \$ 2,320 | \$ 1,429 |
| Operating (loss) income from other segments(1) | (19) | 14 | 37 |
| Net effect from recognition (deferral) of deferred net revenues and related cost of revenues | (71) | (10) | (39) |
| Share-based compensation expense | (178) | (159) | (92) |
| Amortization of intangible assets | (757) | (706) | (11) |
| Fees and other expenses related to the King Acquisition(3) | (15) | (47) | (5) |
| Restructuring costs(4) | (15) | — | — |
| Other non-cash charges(5) | (14) | — | — |
| Discrete tax-related items(6) | (39) | — | — |
| Consolidated operating income | 1,309 | 1,412 | 1,319 |
| Interest and other expense (income), net | 146 | 214 | 198 |
| Loss on extinguishment of debt | 12 | 92 | — |
| Consolidated income before income tax expense | <u>\$ 1,151</u> | <u>\$ 1,106</u> | <u>\$ 1,121</u> |

(1) Includes other income and expenses from operating segments managed outside the reportable segments, including our Studios and Distribution businesses. Also includes unallocated corporate income and expenses.

(2) Intersegment revenues reflect licensing and service fees charged between segments.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

13. Operating Segments and Geographic Region (Continued)

- (3) Reflects fees and other expenses, such as legal, banking, and professional services fees, related to the King Acquisition and associated integration activities, inclusive of related debt financings.
- (4) Reflects restructuring charges, primarily severance costs.
- (5) Reflects a non-cash accounting charge to reclassify certain cumulative translation gains (losses) into earnings due to the substantial liquidation of certain of our foreign entities.
- (6) Reflects the impact of other unusual or unique tax-related items and activities.

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

| | Years Ended December 31, | | |
|--|--------------------------|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Net revenues by distribution channel: | | | |
| Digital online channels(1) | \$ 5,479 | \$ 4,865 | \$ 2,502 |
| Retail channels | 1,033 | 1,386 | 1,806 |
| Other(2) | 505 | 357 | 356 |
| Total consolidated net revenues | \$ 7,017 | \$ 6,608 | \$ 4,664 |

- (1) Include revenues from digitally-distributed subscriptions, licensing royalties, value-added services, downloadable content, microtransactions, and products.
- (2) Include revenues from our Studios and Distribution businesses, as well as revenues from MLG and the Overwatch League.

Geographic information presented below is based on the location of the paying customer. Net revenues by geographic region were as follows (amounts in millions):

| | Years Ended December 31, | | |
|--|--------------------------|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Net revenues by geographic region: | | | |
| Americas | \$ 3,607 | \$ 3,423 | \$ 2,409 |
| EMEA(1) | 2,464 | 2,221 | 1,741 |
| Asia Pacific | 946 | 964 | 514 |
| Total consolidated net revenues | \$ 7,017 | \$ 6,608 | \$ 4,664 |

- (1) Consists of the Europe, Middle East, and Africa geographic regions.

The Company's net revenues in the U.S. were 45%, 45%, and 48% of consolidated net revenues for the years ended December 31, 2017, 2016, and 2015, respectively. The Company's net revenues in the United Kingdom ("U.K.") were 12%, 11%, and 14% of consolidated net revenues for the years ended December 31, 2017, 2016, and 2015, respectively. No other country's net revenues exceeded 10% of consolidated net revenues for the years ended December 31, 2017, 2016, or 2015.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

13. Operating Segments and Geographic Region (Continued)

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

| | Years Ended December 31, | | |
|---------------------------------|--------------------------|-----------------|-----------------|
| | 2017 | 2016 | 2015 |
| Net revenues by platform: | | | |
| Console | \$ 2,389 | \$ 2,453 | \$ 2,391 |
| PC | 2,042 | 2,124 | 1,499 |
| Mobile and ancillary(1) | 2,081 | 1,674 | 418 |
| Other(2) | 505 | 357 | 356 |
| Total consolidated net revenues | <u>\$ 7,017</u> | <u>\$ 6,608</u> | <u>\$ 4,664</u> |

- (1) Net revenues from "Mobile and ancillary" include revenues from mobile devices, as well as non-platform specific game-related revenues, such as standalone sales of toys and accessories from our Skylanders[®] franchise and other physical merchandise and accessories.
- (2) Net revenues from "Other" include revenues from our Studios and Distribution businesses, as well as revenues from MLG and the Overwatch League.

Long-lived assets by geographic region were as follows (amounts in millions):

| | At December 31, | | |
|--|-----------------|---------------|---------------|
| | 2017 | 2016 | 2015 |
| Long-lived assets* by geographic region: | | | |
| Americas | \$ 197 | \$ 154 | \$ 138 |
| EMEA | 75 | 87 | 42 |
| Asia Pacific | 22 | 17 | 9 |
| Total long-lived assets by geographic region | <u>\$ 294</u> | <u>\$ 258</u> | <u>\$ 189</u> |

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

For information regarding significant customers, see "Concentration of Credit Risk" in Note 2.

14. Share-Based Payments

Activision Blizzard Equity Incentive Plans

On June 5, 2014, the Activision Blizzard, Inc. 2014 Incentive Plan (the "2014 Plan") became effective. Under the 2014 Plan, the Compensation Committee of our Board of Directors is authorized to provide share-based compensation in the form of stock options, share appreciation rights, restricted stock, restricted stock units, performance shares, and other performance- or value-based awards structured by the Compensation Committee within parameters set forth in the 2014 Plan. Upon the effective date of the 2014 Plan, we ceased making awards under our prior equity incentive plans

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Share-Based Payments (Continued)

(collectively, the "Prior Plans"), although such plans will remain in effect and continue to govern outstanding awards.

While the Compensation Committee has broad discretion to create equity incentives, our share-based compensation program currently utilizes a combination of options and restricted stock units. The majority of our options have time-based vesting schedules, generally vesting annually over a period of three to five years, and expire ten years from the grant date. In addition, under the terms of the 2014 Plan, the exercise price for the options must be equal to or greater than the closing price per share of our common stock on the date the award is granted, as reported on Nasdaq. Restricted stock units have time-based vesting schedules, generally vesting in their entirety on an anniversary of the date of grant, or vest annually over a period of three to five years, and may also be contingent on the achievement of specified performance measures.

As of the date it was approved by our shareholders, there were 46 million shares available for issuance under the 2014 Plan. The number of shares of our common stock reserved for issuance under the 2014 Plan has been, and may be further, increased from time to time by: (1) the number of shares relating to awards outstanding under any Prior Plan that: (i) expire, or are forfeited, terminated or canceled, without the issuance of shares; (ii) are settled in cash in lieu of shares; or (iii) are exchanged, prior to the issuance of shares of our common stock, for awards not involving our common stock; (2) if the exercise price of any option outstanding under any Prior Plans is, or the tax withholding requirements with respect to any award outstanding under any Prior Plans are, satisfied by withholding shares otherwise then deliverable in respect of the award or the actual or constructive transfer to the Company of shares already owned, the number of shares equal to the withheld or transferred shares; and (3) if a share appreciation right is exercised and settled in shares, a number of shares equal to the difference between the total number of shares with respect to which the award is exercised and the number of shares actually issued or transferred. As of December 31, 2017, we had approximately 30 million shares of our common stock reserved for future issuance under the 2014 Plan. Shares issued in connection with awards made under the 2014 Plan are generally issued as new stock issuances.

Additionally, in connection with the King Acquisition, a majority of the outstanding options and awards with respect to King shares that were unvested as of the King Closing Date were converted into equivalent options and awards with respect to shares of the Company's common stock (see Note 20 for further discussion). As part of the conversion, we assumed King's equity incentive plan (the "King Plan") and amended the King Plan to convert it to a plan with respect to shares of the Company's common stock for the King shares assumed. No future shares can be granted from the King Plan, but it continues to govern outstanding awards.

Fair Value Valuation Assumptions

Valuation of Stock Options

The fair value of stock options granted are principally estimated using a binomial-lattice model. The inputs in our binomial-lattice model include expected stock price volatility, risk-free interest rate, dividend yield, contractual term, and vesting schedule, as well as measures of employees' cancellations, exercise, and post-vesting termination behavior. Statistical methods are used to estimate employee rank-specific termination rates.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Share-Based Payments (Continued)

The following table presents the weighted-average assumptions, weighted average grant date fair value, and the range of expected stock price volatilities:

| | Employee and Director Options | | |
|--|-------------------------------------|----------|---------|
| | For the Years Ended December 31, | | |
| | 2017 | 2016 | 2015 |
| Expected life (in years) | 7.01 | 6.86 | 6.26 |
| Volatility | 35.00% | 35.31% | 36.13% |
| Risk free interest rate | 2.14% | 1.56% | 1.90% |
| Dividend yield | 0.50% | 0.67% | 0.72% |
| Weighted-average grant date fair value | \$ 21.11 | \$ 12.83 | \$ 9.87 |
| Stock price volatility range: | | | |
| Low | 28.19% | 29.20% | 26.96% |
| High | 35.00% | 36.00% | 37.00% |

Expected life

The expected life of employee stock options is a derived output of the binomial-lattice model and represents the weighted-average period the stock options are expected to remain outstanding. A binomial-lattice model can be viewed as assuming that employees will exercise their options when the stock price equals or exceeds an exercise multiple, of which the multiple is based on historical employee exercise behaviors.

Volatility

To estimate volatility for the binomial-lattice model, we consider the implied volatility of exchange-traded options on our stock to estimate short-term volatility, the historical volatility of our common shares during the option's contractual term to estimate long-term volatility, and a statistical model to estimate the transition from short-term volatility to long-term volatility.

Risk-free interest rate

As is the case for volatility, the risk-free interest rate is assumed to change during the option's contractual term. The risk-free interest rate, which is based on U.S. Treasury yield curves, reflects the expected movement in the interest rate from one time period to the next ("forward rate").

Dividend yield

The expected dividend yield assumption is based on our historical and expected future amount of dividend payouts.

Share-based compensation expense recognized is based on awards ultimately expected to vest and therefore has been reduced for estimated forfeitures in the consolidated statement of operations for the years ended December 31, 2017, 2016, and 2015. Forfeitures are estimated at the time of grant based on historical experience and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Share-Based Payments (Continued)

Valuation of Restricted Stock Units ("RSUs")

The fair value of the Company's RSU awards granted is principally based upon the closing price of the Company's stock price on the date of grant reduced by the present value of dividends expected to be paid on our common stock prior to vesting.

Accuracy of Fair Value Estimates

We developed the assumptions used in the models above, including model inputs and measures of employees' exercise and post-vesting termination behavior. Our ability to accurately estimate the fair value of share-based payment awards at the grant date depends upon the accuracy of the model and our ability to accurately forecast model inputs as long as 10 years into the future. These inputs include, but are not limited to, expected stock price volatility, risk-free rate, dividend yield, and employee termination rates. Although the fair value of employee stock options is determined using an option-pricing model, the estimates that are produced by this model may not be indicative of the fair value observed between a willing buyer and a willing seller. Unfortunately, it is difficult to determine if this is the case, as markets do not currently exist that permit the active trading of employee stock option and other share-based instruments.

Stock Option Activity

Stock option activity is as follows:

| | Number of Shares (in thousands) | Weighted- average exercise price | Weighted- average remaining contractual term (in years) | Aggregate intrinsic value (in millions) |
|--|---------------------------------------|--|---|---|
| Outstanding stock options at December 31, 2016 | 31,485 | \$ 26.79 | | |
| Granted | 2,579 | 59.89 | | |
| Exercised | (10,861) | 16.44 | | |
| Forfeited | (2,650) | 41.32 | | |
| Expired | (9) | 16.41 | | |
| Outstanding stock options at December 31, 2017 | <u>20,544</u> | \$ 34.54 | 7.07 | \$ 591 |
| Vested and expected to vest at December 31, 2017 | <u>16,077</u> | \$ 31.79 | 7.26 | \$ 507 |
| Exercisable at December 31, 2017 | 6,747 | \$ 21.36 | 5.79 | \$ 283 |

For options assumed in the King Acquisition, 0.4 million of the options are based on performance conditions which do not have an accounting grant date as of December 31, 2017, as there is not a mutual understanding between the Company and the employee of the performance terms.

The aggregate intrinsic values in the table above represents the total pretax intrinsic value (i.e. the difference between our closing stock price on the last trading day of the period and the exercise price, times the number of shares for options where the closing stock price is greater than the exercise price) that would have been received by the option holders had all option holders exercised their options on

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Share-Based Payments (Continued)

that date. This amount changes based on the market value of our stock. The total intrinsic value of options actually exercised was \$372 million, \$161 million, and \$125 million for the years ended December 31, 2017, 2016, and 2015, respectively. The total grant date fair value of options vested was \$47 million, \$40 million, and \$19 million for the years ended December 31, 2017, 2016, and 2015, respectively.

At December 31, 2017, \$80 million of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted-average period of 1.27 years.

RSU Activity

We grant RSUs, which represent the right to receive shares of our common stock. Vesting for RSUs is contingent upon the holders' continued employment with us and may be subject to other conditions (which may include the satisfaction of a performance measure). Also, certain of our performance-based RSUs include a range of shares that may be released at vesting which are above or below the targeted number of RSUs based on actual performance relative to the grant date performance measure. If the vesting conditions are not met, unvested RSUs will be forfeited. Upon vesting of the RSUs, we may withhold shares otherwise deliverable to satisfy tax withholding requirements.

The following table summarizes our RSU activity with performance-based RSUs presented at the maximum potential shares that could be earned and issued at vesting (amounts in thousands except per share amounts):

| | <u>Number of shares</u> | <u>Weighted- Average Grant Date Fair Value</u> |
|------------------------------------|-----------------------------|--|
| Unvested RSUs at December 31, 2016 | 11,977 | \$ 17.44 |
| Granted | 3,298 | 63.75 |
| Vested | (2,233) | 29.50 |
| Forfeited | (1,221) | 26.41 |
| Unvested RSUs at December 31, 2017 | <u>11,821</u> | <u>\$ 27.20</u> |

Certain of our performance-based RSUs did not have an accounting grant date as of December 31, 2017, as there is not a mutual understanding between the Company and the employee of the performance terms. Generally, these performance terms relate to operating income performance for future years where the performance goals have not yet been set. As of December 31, 2017, there were 4.4 million performance-based RSUs outstanding for which the accounting grant date has not been set, of which 1.9 million were 2017 grants. Accordingly, no grant date fair value was established and the weighted average grant date fair value calculated above for 2017 grants excludes these RSUs.

At December 31, 2017, approximately \$111 million of total unrecognized compensation cost was related to RSUs and is expected to be recognized over a weighted-average period of 1.44 years. Of the total unrecognized compensation cost, \$102 million was related to performance-based RSUs, which is expected to be recognized over a weighted-average period of 1.54 years. The total grant date fair value of vested RSUs was \$64 million, \$123 million and \$93 million for the years ended December 31, 2017, 2016 and 2015, respectively.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

14. Share-Based Payments (Continued)

The income tax benefit from stock option exercises and RSU vestings was \$160 million, \$134 million, and \$109 million for the years ended December 31, 2017, 2016, and 2015, respectively.

Share-Based Compensation Expense

The following table sets forth the total share-based compensation expense included in our consolidated statements of operations (amounts in millions):

| | For the Years Ended | | |
|--|---------------------|---------------|--------------|
| | December 31, | | |
| | 2017 | 2016 | 2015 |
| Cost of revenues—product sales: Software royalties, amortization, and intellectual property licenses | \$ 10 | \$ 20 | \$ 12 |
| Cost of revenues—subscription, licensing, and other revenues: Game Operations and Distribution | | | |
| Costs | 1 | 2 | — |
| Cost of revenues—subscription, licensing, and other revenues: Software royalties, amortization, and intellectual property licenses | 3 | 2 | 3 |
| Product development | 57 | 47 | 25 |
| Sales and marketing | 15 | 15 | 9 |
| General and administrative | 92 | 73 | 43 |
| Share-based compensation expense before income taxes | 178 | 159 | 92 |
| Income tax benefit | (34) | (42) | (27) |
| Total share-based compensation expense, net of income tax benefit | <u>\$ 144</u> | <u>\$ 117</u> | <u>\$ 65</u> |

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

15. Income Taxes

Domestic and foreign income (loss) before income taxes and details of the income tax expense (benefit) are as follows (amounts in millions):

| | For the Years Ended | | |
|-----------------------------------|---------------------|-----------------|-----------------|
| | December 31, | | |
| | 2017 | 2016 | 2015 |
| Income before income tax expense: | | | |
| Domestic | \$ 185 | \$ 228 | \$ 355 |
| Foreign | 966 | 878 | 766 |
| | <u>\$ 1,151</u> | <u>\$ 1,106</u> | <u>\$ 1,121</u> |
| Income tax expense (benefit): | | | |
| Current: | | | |
| Federal | \$ 696 | \$ (15) | \$ 169 |
| State | 26 | 16 | 31 |
| Foreign | 335 | 150 | 40 |
| Total current | <u>1,057</u> | <u>151</u> | <u>240</u> |
| Deferred: | | | |
| Federal | (111) | 40 | 1 |
| State | (32) | (13) | (21) |
| Foreign | (36) | (38) | 9 |
| Total deferred | <u>(179)</u> | <u>(11)</u> | <u>(11)</u> |
| Income tax expense | <u>\$ 878</u> | <u>\$ 140</u> | <u>\$ 229</u> |

For the year ended December 31, 2017 and 2016, excess tax benefits attributable to share-based compensation transactions are recognized to the extent that tax deduction on share-based compensation exceeds the corresponding compensation cost recorded on the financial statement. For the years ended December 31, 2017 and 2016, we recognized \$113 million and \$81 million, respectively, of excess tax benefits from share-based payments as a reduction to income tax expense due to our adoption of a new accounting standard in 2016. For periods prior to 2016, such excess tax benefits were recorded to shareholders' equity.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

15. Income Taxes (Continued)

The items accounting for the difference between income taxes computed at the U.S. federal statutory income tax rate and the income tax expense (benefit) at the effective tax rate for each of the years are as follows (amounts in millions):

| | For the Years Ended December 31, | | | | | |
|--|----------------------------------|------------|---------------|------------|---------------|------------|
| | 2017 | | 2016 | | 2015 | |
| Federal income tax provision at statutory rate | \$ 403 | 35% | \$ 387 | 35% | \$ 392 | 35% |
| State taxes, net of federal benefit | 4 | — | 9 | 1 | 5 | — |
| Research and development credits | (26) | (2) | (36) | (3) | (26) | (2) |
| Foreign rate differential | (271) | (24) | (239) | (22) | (228) | (20) |
| Change in tax reserves | 291 | 25 | 210 | 19 | 136 | 12 |
| Net operating loss tax attribute assumed from the Purchase Transaction | (36) | (3) | (114) | (10) | (63) | (6) |
| Excess tax benefits related to share-based payments | (113) | (10) | (81) | (7) | — | — |
| U.S. Tax Reform Act | 636 | 55 | — | — | — | — |
| Other | (10) | — | 4 | — | 13 | 1 |
| Income tax expense | <u>\$ 878</u> | <u>76%</u> | <u>\$ 140</u> | <u>13%</u> | <u>\$ 229</u> | <u>20%</u> |

The Company's tax rate is affected by the tax rates in the jurisdictions in which the Company operates, the relative amount of income earned by jurisdiction, and the jurisdictions with a statutory tax rate less than the U.S. rate of 35%.

On December 22, 2017, the U.S. Tax Reform Act was enacted. The U.S. Tax Reform Act, among other things, reduced the U.S. corporate income tax rate from 35% to 21% beginning in 2018 and implemented a modified territorial tax system that imposes a one-time tax on deemed repatriated earnings of foreign subsidiaries ("Transition Tax").

On December 22, 2017, the SEC staff issued SAB 118, which provides guidance on how to account for the effects of the U.S. Tax Reform Act under ASC 740. SAB 118 enables companies to record a provisional amount for the effects of the U.S. Tax Reform Act based on a reasonable estimate, subject to adjustment during a measurement period of up to one year, until accounting is complete.

We recorded a provisional amount for the effects of the U.S. Tax Reform Act based on a reasonable estimate in the fourth quarter of 2017 resulting in a charge of \$636 million. This includes current tax expense of \$555 million related to the Transition Tax, which is payable over eight years, and deferred tax expense of \$81 million related to the remeasurement of deferred taxes resulting from the U.S. corporate income tax rate reduction. Accounting for the income tax effects of the U.S. Tax Reform Act requires complex new calculations to be performed and significant judgments in interpreting the legislation. Additional guidance may be issued on how the provisions of the U.S. Tax Reform Act will be applied or otherwise administered that is different from our interpretation. We may make adjustments to the provisional amounts as we collect and prepare the data necessary to finalize our calculations, interpret the U.S. Tax Reform Act and any additional guidance issued, and consider the effects of any additional actions we may take as a result of the U.S. Tax Reform Act.

We continue to analyze the prospective effects of the U.S. Tax Reform Act, including new provisions impacting certain foreign income, such as GILTI, BEAT, and FDII, potential limitations on interest expense deductions, and changes to the provisions of Section 162(m) of the Internal Revenue Code, among other provisions of the U.S. Tax Reform Act.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

15. Income Taxes (Continued)

In 2013, in connection with the October 11, 2013 repurchase of approximately 429 million shares of our common stock ("Purchase Transaction"), we assumed certain tax attributes, generally consisting of net operating loss ("NOL") carryforwards of approximately \$760 million, which represent a potential tax benefit of approximately \$266 million. The Company also obtained indemnification from Vivendi against losses attributable to the disallowance of claimed utilization of such NOL carryforwards of up to \$200 million in unrealized tax benefits in the aggregate, limited to taxable years ending on or prior to December 31, 2016. No benefit for these tax attributes or indemnification was recorded upon the close of the Purchase Transaction. As of December 31, 2017, we had utilized approximately \$760 million of the original NOL and had recorded an indemnification asset of \$200 million in "Other assets." Correspondingly, the same amount was recorded as a reduction to the consideration paid for the shares repurchased in "Treasury stock." In each of the years ended December 31, 2017, 2016, and 2015, we utilized \$103 million, \$326 million, and \$180 million of the NOL and recognized a corresponding reserve of \$36 million, \$114 million, and \$63 million in each of those years ended, respectively.

Deferred income taxes reflect the net tax effects of temporary differences between the amounts of assets and liabilities for accounting purposes and the amounts used for income tax purposes. The components of the net deferred tax assets (liabilities) are as follows (amounts in millions):

| | <u>As of December 31,</u> | |
|--|---------------------------|---------------|
| | <u>2017</u> | <u>2016</u> |
| Deferred tax assets: | | |
| Allowance for sales returns and price protection | \$ 47 | \$ 64 |
| Inventory reserve | 5 | 9 |
| Accrued expenses | 26 | 25 |
| Deferred revenue | 245 | 233 |
| Tax credit carryforwards | 60 | 48 |
| Net operating loss carryforwards | 11 | 10 |
| Share-based compensation | 59 | 61 |
| Acquired intangibles | 149 | 111 |
| State taxes | 22 | 24 |
| Other | 39 | 28 |
| Deferred tax assets | <u>663</u> | <u>613</u> |
| Valuation allowance | — | — |
| Deferred tax assets, net of valuation allowance | <u>663</u> | <u>613</u> |
| Deferred tax liabilities: | | |
| Acquired intangibles | (146) | (219) |
| Prepaid royalties | (19) | (60) |
| Capitalized software development expenses | (55) | (91) |
| Other | (5) | (4) |
| Deferred tax liabilities | <u>(225)</u> | <u>(374)</u> |
| Net deferred tax assets | <u>\$ 438</u> | <u>\$ 239</u> |

As of December 31, 2017, we had gross tax credit carryforwards of \$152 million for state purposes. The tax credit carryforwards are presented in "Deferred tax assets" net of unrealized tax benefits that

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

15. Income Taxes (Continued)

would apply upon the realization of uncertain tax positions. In addition, we had foreign NOL carryforwards of \$33 million at December 31, 2017, attributed mainly to losses in France which can be carried forward indefinitely.

We evaluate our deferred tax assets, including net operating losses and tax credits, to determine if a valuation allowance is required. We assess whether a valuation allowance should be established or released based on the consideration of all available evidence using a "more-likely-than-not" standard. Realization of the U.S. deferred tax assets is dependent upon the continued generation of sufficient taxable income. In making such judgments, significant weight is given to evidence that can be objectively verified. Although realization is not assured, management believes it is more likely than not that the net carrying value of the U.S. deferred tax assets will be realized. At December 31, 2017 and 2016, there are no valuation allowances on deferred tax assets.

As of December 31, 2017, we no longer consider the available cash balances related to undistributed earnings of our most significant foreign subsidiaries to be indefinitely reinvested. As a result of the U.S. Tax Reform Act, we continue to assess and may change our intentions related to the indefinite reinvestment assertion. Any impact resulting from such a change in this assertion during the SAB 118 measurement period will be recorded as an adjustment to the provisional amount recorded for the effects of the U.S. Tax Reform Act in the period in which such determination is made.

Activision Blizzard's tax years 2009 through 2016 remain open to examination by the major taxing jurisdictions to which we are subject. The IRS is currently examining the Company's federal tax returns for the 2009 through 2011 tax years, and during February 2018, the Company was notified that our tax returns for 2012 through 2016 tax years will be subject to examination. The Company also has several state and non-U.S. audits pending. In addition, as part of purchase price accounting for the King Acquisition, the Company assumed \$74 million of uncertain tax positions primarily related to the transfer pricing on King tax years occurring prior to the King Acquisition. The Company is currently in negotiations with the relevant jurisdictions and taxing authorities with respect to King's transfer pricing, which could result in a different allocation of profits and losses between the relevant jurisdictions.

On December 28, 2017, we received a Notice of Reassessment from the French Tax Authority ("FTA") related to transfer pricing concerning intercompany transactions involving one of our French subsidiaries for the 2011 through 2013 tax years. The total assessment, including penalties and interest, was approximately €571 million (\$680 million). We disagree with the proposed assessment and intend to vigorously contest it. We plan to pursue all remedies available to us to successfully resolve this matter, including administrative remedies with the FTA, and judicial remedies, if necessary. While we believe our tax provisions at December 31, 2017 are appropriate, until such time as this matter is ultimately resolved we could be subject to significant additional tax liabilities. In addition to the risk of additional tax for years 2011 through 2013, if litigation regarding this matter were adversely determined and/or if the FTA were to seek adjustments of a similar nature for subsequent years, we could be subject to significant additional tax liabilities.

In addition, certain of our subsidiaries are under examination or investigation or may be subject to examination or investigation by tax authorities in various jurisdictions. These proceedings may lead to adjustments or proposed adjustments to our taxes or provisions for uncertain tax positions. Such proceedings may have a material adverse effect on the Company's consolidated financial position, liquidity or results of operations in the period or periods in which the matters are resolved or in which appropriate tax provisions are taken into account in our financial statements. If we were to receive a

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

15. Income Taxes (Continued)

materially adverse assessment from a taxing jurisdiction, we would plan to vigorously contest it and consider all of our options, including the pursuit of judicial remedies.

As of December 31, 2017, we had approximately \$1,138 million of gross unrecognized tax benefits, of which \$1,114 million would affect our effective tax rate, if recognized. A reconciliation of total gross unrecognized tax benefits is as follows (amounts in millions):

| | For the Years Ended | | |
|--|---------------------|---------------|---------------|
| | December 31, | | |
| | 2017 | 2016 | 2015 |
| Unrecognized tax benefits balance at January 1 | \$ 846 | \$ 552 | \$ 419 |
| Gross increase for tax positions of prior-years | 66 | 89 | 8 |
| Gross decrease for tax positions of prior-years | — | (17) | (11) |
| Gross increase for tax positions of current year | 229 | 240 | 136 |
| Settlement with taxing authorities | (1) | (18) | — |
| Lapse of statute of limitations | (2) | — | — |
| Unrecognized tax benefits balance at December 31 | <u>\$ 1,138</u> | <u>\$ 846</u> | <u>\$ 552</u> |

As of December 31, 2017 and 2016, we had approximately \$121 million and \$71 million, respectively, of accrued interest and penalties related to uncertain tax positions. For the year ended December 31, 2017, 2016, and 2015, we recorded \$28 million, \$17 million, and \$10 million, respectively, of interest expense related to uncertain tax positions.

The final resolution of the Company's global tax disputes is uncertain. There is significant judgment required in the analysis of disputes, including the probability determination and estimation of the potential exposure. Based on current information, in the opinion of the Company's management, the ultimate resolution of these matters is not expected to have a material adverse effect on the Company's consolidated financial position, liquidity or results of operations, except as noted above.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

16. 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):

| | For the Years Ended | | |
|--|---------------------|---------|---------|
| | December 31, | | |
| | 2017 | 2016 | 2015 |
| Numerator: | | | |
| Consolidated net income | \$ 273 | \$ 966 | \$ 892 |
| Less: Distributed earnings to unvested share-based awards that participate in earnings | — | (2) | (4) |
| Less: Undistributed earnings allocated to unvested share-based awards that participate in earnings | — | (2) | (7) |
| Numerator for basic and diluted earnings per common share—income available to common shareholders | \$ 273 | \$ 962 | \$ 881 |
| Denominator: | | | |
| Denominator for basic earnings per common share—weighted-average common shares outstanding | 754 | 740 | 728 |
| Effect of dilutive stock options and awards under the treasury stock method | 12 | 14 | 11 |
| Denominator for diluted earnings per common share—weighted-average common shares outstanding plus dilutive common shares under the treasury stock method | 766 | 754 | 739 |
| Basic earnings per common share | \$ 0.36 | \$ 1.30 | \$ 1.21 |
| Diluted earnings per common share | \$ 0.36 | \$ 1.28 | \$ 1.19 |

Certain of our unvested restricted stock units meet the definition of participating securities as they participate in earnings based on their rights to dividends or dividend equivalents. Therefore, we are required to use the two-class method in our computation of basic and diluted earnings per common share. For the years ended December 31, 2017, 2016, and 2015, on a weighted-average basis, we had outstanding unvested restricted stock units of less than 1 million, 3 million, and 8 million shares of common stock, respectively, that are participating in earnings.

The vesting of certain of our employee-related restricted stock units and options are contingent upon the satisfaction of pre-defined performance measures. The shares underlying these equity awards are included in the weighted-average dilutive common shares only if the performance measures are met as of the end of the reporting period. Approximately 7 million, 8 million, and 3 million shares are not included in the computation of diluted earnings per common share for the years ended December 31, 2017, 2016, and 2015, respectively, as their respective performance measures had not yet been met.

Potential common shares are not included in the denominator of the diluted earnings per common share calculation when the inclusion of such shares would be anti-dilutive. Therefore, options to acquire 1 million, 5 million, and 1 million shares of common stock were not included in the calculation of diluted earnings per common share for the years ended December 31, 2017, 2016, and 2015, respectively, as the effect of their inclusion would be anti-dilutive.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**Notes to Consolidated Financial Statements (Continued)****17. Capital Transactions*****Repurchase Programs***

On February 2, 2017, our Board of Directors authorized a stock repurchase program under which we are authorized to repurchase up to \$1 billion of our common stock during the two-year period from February 13, 2017 through February 12, 2019. As of the date hereof, we have not repurchased any shares under this program and the determination as to if and when we make any such stock repurchases will be dependent on market conditions and other factors.

Dividends

On February 1, 2018, our Board of Director approved a cash dividend of \$0.34 per common share. Such dividend is payable on May 9, 2018, to shareholders of record at the close of business on March 30, 2018.

On February 2, 2017, our Board of Directors approved a cash dividend of \$0.30 per common share. On May 10, 2017, we made an aggregate cash dividend payment of \$226 million to shareholders of record at the close of business on March 30, 2017. On May 26, 2017, we made related dividend equivalent payments of less than \$1 million to certain holders of restricted stock units.

On February 2, 2016, our Board of Directors approved a cash dividend of \$0.26 per common share. On May 11, 2016, we made an aggregate cash dividend payment of \$192 million to shareholders of record at the close of business on March 30, 2016. On May 27, 2016, we made related dividend equivalent payments of \$3 million to certain holders of restricted stock units.

On February 3, 2015, our Board of Directors approved a cash dividend of \$0.23 per common share. On May 13, 2015, we made an aggregate cash dividend payment of \$167 million to shareholders of record at the close of business on March 30, 2015. On May 29, 2015, we made related dividend equivalent payments of \$3 million to certain holders of restricted stock units.

18. Supplemental Cash Flow Information

Supplemental cash flow information is as follows (amounts in millions):

| | For the Years Ended December 31, | | |
|--|-------------------------------------|--------|-------|
| | 2017 | 2016 | 2015 |
| Supplemental cash flow information: | | | |
| Cash paid for income taxes, net of refunds | \$ 176 | \$ 121 | \$ 20 |
| Cash paid for interest | 145 | 209 | 193 |

For the year ended December 31, 2016, we had non-cash purchase price consideration of \$89 million related to vested and unvested stock options and awards that were assumed and replaced with Activision Blizzard equity or deferred cash awards in the King Acquisition. Refer to Note 20 for further discussion.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

19. Commitments and Contingencies

Commitments and Obligations

In the normal course of business, we enter into contractual arrangements with third parties for non-cancelable operating lease agreements for our offices, for the development of products and for the rights to intellectual property. Under these agreements, we commit to provide specified payments to a lessor, developer or intellectual property holder, as the case may be, based upon contractual arrangements. The payments to third-party developers are generally conditioned upon the achievement by the developers of contractually specified development milestones. Further, these payments to third-party developers and intellectual property holders typically are deemed to be advances and, as such, are recoupable against future royalties earned by the developer or intellectual property holder based on sales of the related game. Additionally, in connection with certain intellectual property rights, acquisitions and development agreements, we commit to spend specified amounts for marketing support for the game(s) which is (are) to be developed or in which the intellectual property will be utilized. Assuming all contractual provisions are met, the total future minimum commitments for these and other contractual arrangements in place at December 31, 2017 are scheduled to be paid as follows (amounts in millions):

| | Contractual Obligations(1) | | | | Total |
|-----------------------------------|-------------------------------|---------------------------------------|--------------|-------------------------------|-----------------|
| | Facility and Equipment Leases | Developer and Intellectual Properties | Marketing | Long-Term Debt Obligations(2) | |
| For the years ending December 31, | | | | | |
| 2018 | \$ 81 | \$ 202 | \$ 19 | \$ 159 | \$ 461 |
| 2019 | 70 | 2 | — | 159 | 231 |
| 2020 | 61 | 1 | — | 159 | 221 |
| 2021 | 48 | — | — | 1,790 | 1,838 |
| 2022 | 41 | — | — | 512 | 553 |
| Thereafter | 88 | — | — | 3,064 | 3,152 |
| Total | <u>\$ 389</u> | <u>\$ 205</u> | <u>\$ 19</u> | <u>\$ 5,843</u> | <u>\$ 6,456</u> |

- (1) We have omitted uncertain income tax liabilities from this table due to the inherent uncertainty regarding the timing of the potential issue resolution of the underlying matters. Specifically, either (a) the underlying positions have not been fully developed under audit to quantify at this time or, (b) the years relating to the matters for certain jurisdictions are not currently under audit. At December 31, 2017, we had \$455 million and \$495 million of net unrecognized tax benefits included in "Accrued expenses and other liabilities" and "Other liabilities," respectively, in our consolidated balance sheet.

Additionally, as a result of the U.S. Tax Reform Act, we recorded a liability at December 31, 2017, of \$467 million which reflects our estimated Transition Tax net payments. This provisional amount is subject to change as we collect and prepare the data necessary to finalize our calculations, interpret the U.S. Tax Reform Act and any additional guidance issued. The Transition Tax liability is payable over up to eight years and is not reflected in our Contractual Obligations table above. We expect to pay \$77 million of the Transition Tax during 2018.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

19. Commitments and Contingencies (Continued)

- (2) Long-term debt obligations represent our obligations related to the contractual principal repayments and interest payments under the 2017 TLA and the Notes as of December 31, 2017. There was no outstanding balance under our Revolver as of December 31, 2017. The Notes are subject to fixed interest rates and we have calculated the interest obligation based on the applicable rates and payment dates. The 2017 TLA bears a variable interest rate and interest is payable at least quarterly. We have calculated the expected interest obligation based on the outstanding principal balance and interest rate applicable at December 31, 2017. Refer to Note 11 for additional information on our debt obligations.

Legal Proceedings

As described in Note 15, on December 28, 2017, we received a Notice of Reassessment from the FTA related to transfer pricing concerning intercompany transactions involving one of our French subsidiaries for the 2011 through 2013 tax years. The total assessment, including penalties and interest, was approximately €571 million (\$680 million). We disagree with the proposed assessment and intend to vigorously contest it. We plan to pursue all remedies available to us to successfully resolve this matter, including administrative remedies with the FTA, and judicial remedies, if necessary. While we believe our tax provisions at December 31, 2017 are appropriate, until such time as this matter is ultimately resolved we could be subject to significant additional tax liabilities. In addition to the risk of additional tax for years 2011 through 2013, if litigation regarding this matter were adversely determined and/or if the FTA were to seek adjustments of a similar nature for subsequent years, we could be subject to significant additional tax liabilities.

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

Purchase Transaction Matters

In prior periods, the Company reported on litigation related to the Purchase Transaction. During the period ended June 30, 2015, the cases were resolved and dismissed with prejudice. As part of the resolution of the claims, we received a settlement payment of \$202 million in July 2015 from Vivendi, ASAC LP, and our insurers. We recorded the settlement within "Shareholders' equity" in our consolidated balance sheet as of December 31, 2015.

Letters of Credit

As described in Note 11, a portion of our Revolver can be used to issue letters of credit of up to \$50 million, subject to the availability of the Revolver. At December 31, 2017, we did not have any letters of credit issued or outstanding under the Revolver.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

20. Acquisitions

King Digital Entertainment

On February 23, 2016, we completed the King Acquisition, purchasing all of its outstanding shares. As a result, King became a wholly-owned subsidiary of Activision Blizzard. King is a leading global developer and publisher of interactive entertainment content and services, particularly on mobile platforms, such as Android and iOS, and on online and social platforms, such as Facebook and the king.com websites. King's results of operations since the King Closing Date are included in our consolidated financial statements.

We made this acquisition because we believed that the addition of King's highly-complementary mobile business positioned the Company as a global leader in interactive entertainment across console, PC, and mobile platforms, and aligned us for future growth.

The aggregate purchase price of the King Acquisition was approximately \$5.8 billion, which was paid on the King Closing Date and funded primarily with \$3.6 billion of existing cash and \$2.2 billion of cash from new debt issued by the Company. We identified and recorded assets acquired and liabilities assumed at their estimated fair values at the King Closing Date, and allocated the remaining value of approximately \$2.7 billion to goodwill.

The final purchase price allocation was as follows (in millions):

| | February 23, 2016 | Estimated useful lives |
|--|----------------------|---------------------------|
| Tangible assets and liabilities assumed: | | |
| Cash and cash equivalents | \$ 1,151 | |
| Accounts receivable | 162 | |
| Other current assets | 72 | |
| Property and equipment | 57 | 2 - 7 years |
| Deferred income tax assets, net | 27 | |
| Other assets | 47 | |
| Accounts payable | (9) | |
| Accrued expenses and other liabilities | (272) | |
| Other liabilities | (110) | |
| Deferred income tax liabilities, net | (52) | |
| Intangible assets | | |
| Internally-developed franchises | 845 | 3 - 5 years |
| Customer base | 609 | 2 years |
| Developed software | 580 | 3 - 4 years |
| Trade name | 46 | 7 years |
| Goodwill | 2,675 | |
| Total purchase price | <u>\$ 5,828</u> | |

During the year ended December 31, 2016, the Company incurred \$38 million of expenses related to the King Acquisition, which are included within "General and administrative" in the consolidated statements of operations. In connection with the debt financing that occurred on the King Closing Date, we incurred \$38 million of discounts and financing costs that were capitalized and recorded within "Long-term debt, net" on our consolidated balance sheet. The amortization of these capitalized

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

20. Acquisitions (Continued)

costs was not material to our consolidated statement of operations for the year ended December 31, 2016.

Share-Based Compensation

In connection with the King Acquisition, a majority of the outstanding King options and other equity awards that were unvested as of the King Closing Date were converted into equivalent options and awards with respect to shares of the Company's common stock, using an equity award exchange ratio calculated in accordance with the transaction agreement. As a result, replacement options and other equity awards of 10 million and 3 million, respectively, were issued. The portion of the fair value related to pre-combination services of \$76 million was included in the purchase price, while the remaining fair value will be recognized over the remaining service periods. As of December 31, 2016, the future expense for the converted King unvested stock options and equity awards was approximately \$40 million, which will be recognized over a weighted average service period of approximately 1.6 years.

The remaining portion of outstanding unvested awards that were assumed were replaced with deferred cash awards. The cash proceeds were placed in an escrow-like account with the cash releases to occur based on the awards' original vesting schedule upon future service being rendered. The cash associated with these awards is recorded in "Other current assets" and "Other assets" in our consolidated balance sheet. The portion of the fair value related to pre-combination services of \$22 million was included in the purchase price while the remaining fair value of approximately \$9 million will be recognized over the remaining service periods.

Identifiable Intangible Assets Acquired and Goodwill

The internally-developed franchises, customer base, developed software, and trade name intangible assets from the acquisition of King will be amortized to "Cost of revenues—subscription, licensing, and other revenues—Software royalties, amortization, and intellectual property licenses," "Sales and marketing," "Cost of revenues—subscription, licensing, and other revenues—Software royalties, amortization, and intellectual property licenses," and "General and administrative," respectively. The intangible assets will be amortized over their estimated useful lives in proportion to the economic benefits received.

The \$2.7 billion of goodwill recognized is primarily attributable to the benefits the Company expects to derive from accelerated expansion as an interactive entertainment provider in the mobile sector, future franchises, and technology, as well as the management team's proven ability to create future games and franchises. Approximately \$620 million of the goodwill is expected to be deductible for tax purposes in the U.S.

King Net Revenue and Earnings

The amount of net revenue and earnings attributable to King in the Company's consolidated statement of operations during the year ended December 31, 2016, the period of the King Acquisition, are included in the table below. The amounts presented represent the net revenues and earnings after

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

20. Acquisitions (Continued)

adjustments for purchase price accounting, inclusive of amortization of intangible assets, share-based payments, and deferrals of revenues and related cost of revenues.

| (in millions) | For the Year Ended December 31, 2016 | |
|---------------|--|-------|
| | | |
| Net revenues | \$ | 1,523 |
| Net loss | \$ | (230) |

Pro Forma Financial Information

The unaudited financial information in the table below summarizes the combined results of operations of the Company and King, on a pro forma basis, as though the acquisition had occurred on January 1, 2015. The 2016 pro forma financial information presented includes the effects of adjustments related to amortization charges from acquired intangible assets, employee compensation from replacement equity awards issued in the King Acquisition and the profit sharing bonus plan established as part of the King Acquisition, and interest expense from the new debt issued in connection with the King Acquisition, among other adjustments. We also adjusted for Activision Blizzard and King non-recurring acquisition-related costs of approximately \$74 million incurred for the year ended December 31, 2016. The 2015 pro forma financial information for the year ended December 31, 2015 were adjusted to include these charges.

The unaudited pro forma financial information as presented below is for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved if the King Acquisition, and any borrowings undertaken to finance the King Acquisition, had taken place at the beginning of the earliest period presented, nor does it intend to be a projection of future results.

| (in millions) | For the Year Ended December 31, | |
|-----------------------------------|---------------------------------------|----------|
| | 2016 | 2015 |
| Net revenues | \$ 6,888 | \$ 6,677 |
| Net income | \$ 1,005 | \$ 639 |
| Basic earnings per common share | \$ 1.35 | \$ 0.87 |
| Diluted earnings per common share | \$ 1.32 | \$ 0.85 |

21. Recently Issued Accounting Pronouncements*Recently adopted accounting pronouncements**Inventory*

In July 2015, the FASB issued new guidance related to the measurement of inventory which requires inventory within the scope of the guidance to be measured at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. We adopted this new standard as of January 1, 2017, and applied it prospectively. The adoption of this guidance did not have a material impact on our financial statements.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

21. Recently Issued Accounting Pronouncements (Continued)

Recent accounting pronouncements not yet adopted

Revenue recognition

In May 2014, the FASB issued new accounting guidance related to revenue recognition. The new standard will replace all current U.S. GAAP guidance on this topic and eliminate all industry-specific guidance, providing a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue upon the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This guidance is effective for us beginning with the first quarter of 2018. We are adopting the accounting standard using the modified retrospective method, which recognizes the cumulative effect upon adoption as an adjustment to retained earnings at the adoption date. We will report our adoption in our Form 10-Q for the first quarter of 2018.

The most significant impacts of the new revenue recognition standard are expected to be:

- *The accounting for our sales of our games with significant online functionality for which we do not have VSOE for unspecified future updates and ongoing online services provided* . Under the current accounting standards, VSOE for undelivered elements is required. This requirement will be eliminated under the new standard. Accordingly, we will be required to recognize as revenue a portion of the sales price upon delivery of the software, as compared to the current requirement of recognizing the entire sales price ratably over an estimated service period. We expect this difference to primarily impact revenues from our Call of Duty franchise, where we expect that approximately 20% of the sales price will be recognized as revenue upon delivery of the games to our customers. Many of our other franchises, such as Destiny, Overwatch, World of Warcraft, and Candy Crush, are online hosted arrangements, and we do not expect any significant impact on the accounting for our sales of these games; and
- *The accounting for certain of our software licensing arrangements* . While the impacts of the new standard may differ on a contract-by-contract basis (the actual revenue recognition treatment required under the standard will depend on contract-specific terms), we generally expect earlier revenue recognition for these arrangements under the new revenue standard.

We estimate that the cumulative effect of adopting this standard will result in an adjustment to retained earnings at the adoption date of approximately \$60 million to \$100 million, inclusive of the associated tax impacts. Additionally, we expect that the new disclosure requirements will require us to design and implement additional internal controls over financial reporting, and we are in process of adjusting our processes and internal controls in preparation for adopting the new standard.

Leases

In February 2016, the FASB issued new guidance related to the accounting for leases. The new standard will replace all current U.S. GAAP guidance on this topic. The new standard, among other things, requires a lessee to classify a lease as either an operating or financing lease, and lessees will need to recognize a lease liability and a right-of-use asset for their leases. The liability will be equal to the present value of lease payments. The asset will be based on the liability, subject to adjustment for initial direct costs, lease incentives received, and any prepaid lease payments. Operating leases will result in a straight-line expense pattern, while finance leases will result in a front-loaded expense pattern. Classification will be based on criteria that are largely similar to those applied in current lease

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

21. Recently Issued Accounting Pronouncements (Continued)

accounting. The standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition and will require application of the new guidance at the beginning of the earliest comparative period presented, with certain transition practical expedients available to provide relief in adopting the new standard. We are evaluating the impact of this new accounting guidance on our financial statements. Currently, we do not plan to early adopt this new standard but we do expect to elect and apply the available transition practical expedients upon adoption.

Financial Instruments

In January 2016, the FASB issued new guidance related to the recognition and measurement of financial assets and financial liabilities. The new standard, among other things, generally requires companies to measure investments in other entities, except those accounted for under the equity method, at fair value and recognize any changes in fair value in net income. The new standard also simplifies the impairment assessment of equity investments without readily determinable fair values. The new standard is effective for fiscal years beginning after December 15, 2017, and the guidance should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity investments without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption. Based on our current financial instruments held, we do not anticipate this new guidance will have a material impact on our financial statements.

Statement of Cash Flows—Restricted Cash

In November 2016, the FASB issued new guidance related to the classification of restricted cash in the statement of cash flows. The new standard requires that a statement of cash flows explain any change during the period in total cash, cash equivalents, and restricted cash. Therefore, restricted cash will be included with "Cash and cash equivalents" when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The new standard is effective for fiscal years beginning after December 15, 2018, and should be applied retrospectively. Early adoption is permitted.

We are evaluating the impact, if any, of adopting this new accounting guidance on our financial statements. We expect there will be a significant impact to the consolidated statements of cash flows for the years ended December 31, 2015 and 2016, as those years include, as an investing activity, the \$3.6 billion movement in restricted cash as a result of transferring cash into escrow at December 31, 2015 to facilitate the King Acquisition and the subsequent release of that cash in 2016 in connection with the King Acquisition. Under this new standard, the restricted cash balance will be included in the beginning and ending total cash, cash equivalents, and restricted cash balances and hence would not be included as an investing activity in the statement of cash flows.

Goodwill

In January 2017, the FASB issued new guidance which eliminates Step 2 from the goodwill impairment test. Instead, if any entity forgoes a Step 0 test, an entity will be required to perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit, as

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES**Notes to Consolidated Financial Statements (Continued)****21. Recently Issued Accounting Pronouncements (Continued)**

determined in Step 1 from the goodwill impairment test, with its carrying amount and recognize an impairment charge, if any, for the amount by which the carrying amount exceeds the reporting unit's fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new standard is effective for fiscal years beginning after December 15, 2019 and should be applied prospectively. Early adoption is permitted. The effect of adoption should be reflected as of the beginning of the fiscal year of adoption. We are evaluating the impact, if any, of adopting this new accounting guidance on our consolidated financial statements.

Derivatives and Hedging

In August 2017, the FASB issued new guidance related to the accounting for derivatives and hedging. The new guidance expands and refines hedge accounting for both financial and non-financial risk components, aligns the recognition and presentation of the effects of hedging instruments and hedged items in the financial statements, and includes certain targeted improvements to ease the application of current guidance related to the assessment of a hedge's effectiveness. The new standard is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. If early adopted, the new standard must generally be applied as of the beginning of the fiscal year of adoption. We are evaluating the impact of this new accounting guidance on our financial statements and related disclosures. We expect, based on our current outstanding derivative instruments, the new guidance will not have a material impact on our financial statements.

22. Quarterly Financial Information (Unaudited)

| | For the Quarters Ended | | | |
|--|--|-----------------------|------------------|-------------------|
| | December 31, 2017 | September 30, 2017 | June 30, 2017 | March 31, 2017 |
| | (Amounts in millions, except per share data) | | | |
| Net revenues | \$ 2,043 | \$ 1,618 | \$ 1,631 | \$ 1,726 |
| Cost of revenues | 803 | 552 | 561 | 585 |
| Operating income | 221 | 257 | 339 | 493 |
| Net income (loss) | (584) | 188 | 243 | 426 |
| Basic earnings (loss) per common share | (0.77) | 0.25 | 0.32 | 0.57 |
| Diluted earnings (loss) per common share | (0.77) | 0.25 | 0.32 | 0.56 |

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Continued)

22. Quarterly Financial Information (Unaudited) (Continued)

| | For the Quarters Ended | | | |
|--------------------------------------|--|-----------------------|------------------|-------------------|
| | December 31, 2016 | September 30, 2016 | June 30, 2016 | March 31, 2016 |
| | (Amounts in millions, except per share data) | | | |
| Net revenues | \$ 2,014 | \$ 1,568 | \$ 1,570 | \$ 1,455 |
| Cost of revenues | 776 | 529 | 598 | 491 |
| Operating income | 425 | 294 | 232 | 461 |
| Net income(1) | 254 | 199 | 151 | 363 |
| Basic earnings per common share(1) | 0.34 | 0.27 | 0.20 | 0.49 |
| Diluted earnings per common share(1) | 0.33 | 0.26 | 0.20 | 0.48 |

- (1) During the third quarter of 2016, we early adopted an accounting standard which simplifies the accounting for share-based payments. The standard, among other things, requires all excess tax benefits and tax deficiencies to be recorded as an income tax expense or benefit in the consolidated statement of operations. The adoption of the standard impacted our previously reported results for the quarters ended June 30, 2016 and March 31, 2016. As a result of the adoption of this standard, our net income, basic earnings per common share, and diluted earnings per common share increased by \$24 million, \$0.03, and \$0.03, respectively, for the quarter ended June 30, 2016, and \$27 million, \$0.04, and \$0.03, respectively, for the quarter ended March 31, 2016.

ACTIVISION BLIZZARD, INC. AND SUBSIDIARIES

VALUATION AND QUALIFYING ACCOUNTS

(Amounts in millions)

| <u>Col. A Description</u> | <u>Col. B Balance at Beginning of Period</u> | <u>Col. C Additions(A)</u> | <u>Col. D Deductions(B)</u> | <u>Col. E Balance at End of Period</u> |
|--|--|--------------------------------|---------------------------------|--|
| At December 31, 2017 | | | | |
| Allowances for sales returns and price protection and other allowances | \$ 257 | \$ 83 | \$ (66) | \$ 274 |
| Allowance for doubtful accounts | 4 | 1 | — | 5 |
| At December 31, 2016 | | | | |
| Allowances for sales returns and price protection and other allowances | \$ 339 | \$ 119 | \$ (201) | \$ 257 |
| Allowance for doubtful accounts | 4 | 2 | (2) | 4 |
| At December 31, 2015 | | | | |
| Allowances for sales returns and price protection and other allowances | \$ 379 | \$ 114 | \$ (154) | \$ 339 |
| Allowance for doubtful accounts | 4 | 1 | (1) | 4 |

- (A) Includes increases and reversals of allowances for sales returns, price protection, and doubtful accounts due to normal reserving terms.
- (B) Includes actual write-offs and utilization of allowances for sales returns, price protection and uncollectible accounts receivable, net of recoveries, and foreign currency translation and other adjustments.

EXHIBIT INDEX

Pursuant to the rules and regulations of the SEC, the Company has filed certain agreements as exhibits to this Annual Report on Form 10-K. These agreements may contain representations and warranties by the parties. These representations and warranties have been made solely for the benefit of the other party or parties to such agreements and (i) may have been qualified by disclosures made to such other party or parties, (ii) were made only as of the date of such agreements or such other date(s) as may be specified in such agreements and are subject to more recent developments, which may not be fully reflected in the Company's public disclosure, (iii) may reflect the allocation of risk among the parties to such agreements and (iv) may apply materiality standards different from what may be viewed as material to investors. Accordingly, these representations and warranties may not describe the Company's actual state of affairs at the date hereof and should not be relied upon.

| Exhibit Number | Exhibit |
|-----------------------|---|
| 3.1 | Third Amended and Restated Certificate of Incorporation of Activision Blizzard, Inc., dated June 5, 2014 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed June 6, 2014). |
| 3.2 | Fourth Amended and Restated Bylaws of Activision Blizzard, Inc., adopted as of February 1, 2018 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K, filed February 7, 2018). |
| 4.1 | Indenture, dated as of September 19, 2013, among Activision Blizzard, Inc., the guarantors named therein and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 of the Company's Form 8-K, filed September 19, 2013). |
| 4.2 | Indenture, dated as of September 19, 2016, among Activision Blizzard, Inc., the guarantors named therein and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 of the Company's Form 8-K, filed September 19, 2016). |
| 4.3 | Indenture, dated as of May 26, 2017, between Activision Blizzard, Inc. and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.1 of the Company's Form 8-K, filed May 26, 2017). |
| 4.4 | Supplemental Indenture, dated as of May 26, 2017, between Activision Blizzard, Inc. and Wells Fargo Bank, National Association, as trustee (incorporated by reference to Exhibit 4.2 of the Company's Form 8-K, filed May 26, 2017). |
| 4.5 | Form of certificate for the Company's 2.600% Notes due 2022 (incorporated by reference to Exhibit 4.3 of the Company's Form 8-K, filed May 26, 2017). |
| 4.6 | Form of certificate for the Company's 3.400% Notes due 2027 (incorporated by reference to Exhibit 4.4 of the Company's Form 8-K, filed May 26, 2017). |
| 4.7 | Form of certificate for the Company's 4.500% Notes due 2047 (incorporated by reference to Exhibit 4.5 of the Company's Form 8-K, filed May 26, 2017). |
| 10.1* | Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 99.1 of the Company's Registration Statement on Form S-8, Registration No. 333-146431, filed October 1, 2007). |
| 10.2* | Activision Blizzard, Inc. Amended and Restated 2008 Incentive Plan, as amended and restated (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K filed June 12, 2012). |

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| <u>Exhibit Number</u> | <u>Exhibit</u> |
|-----------------------|--|
| 10.3* | Activision Blizzard, Inc. 2014 Incentive Plan, amended and restated as of March 2, 2017 (incorporated by reference to Exhibit 10.1 of the Company's Form 10-Q filed May 4, 2017). |
| 10.4* | Activision Blizzard, Inc. KDE Equity Incentive Plan, amended as of November 1, 2016 (incorporated by reference to Exhibit 10.14 of the Company's Form 10-K for the year ended December 31, 2016). |
| 10.5* | Form of Notice of Stock Option Award for grants to non-employee directors pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.1 of the Company's Form 10-Q for the quarter ended September 30, 2008). |
| 10.6* | Form of Notice of Stock Option Award for grants to persons other than non-employee directors pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.2 of the Company's Form 10-Q for the quarter ended September 30, 2008). |
| 10.7* | Form of Notice of Restricted Share Unit Award for grants to officers pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.4 of the Company's Form 10-Q for the quarter ended September 30, 2008). |
| 10.8* | Form of Notice of Restricted Share Unit Award for grants to persons other than officers or directors pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.8 of the Company's Form 10-Q for the quarter ended September 30, 2008). |
| 10.9* | Form of Notice of Restricted Share Award for grants to persons other than non-employee directors pursuant to the Activision, Inc. 2007 Incentive Plan (incorporated by reference to Exhibit 10.3 of the Company's Form 10-Q for the quarter ended September 30, 2008). |
| 10.10* | Form of Notice of Stock Option Award for grants to unaffiliated directors pursuant to the Activision Blizzard, Inc. 2008 Incentive Plan (effective as of November 12, 2008) (incorporated by reference to Exhibit 10.44 of the Company's Form 10-K for the year ended December 31, 2008). |
| 10.11* | Form of Notice of Stock Option Award for grants to persons other than directors pursuant to the Activision Blizzard, Inc. 2008 Incentive Plan (effective as of November 12, 2008) (incorporated by reference to Exhibit 10.45 of the Company's Form 10-K for the year ended December 31, 2008). |
| 10.12* | Form of Notice of Restricted Share Unit Award for grants to persons other than directors pursuant to the Activision Blizzard, Inc. 2008 Incentive Plan (effective as of November 12, 2008) (incorporated by reference to Exhibit 10.49 of the Company's Form 10-K for the year ended December 31, 2008). |
| 10.13* | Form of Notice of Restricted Share Award for grants to persons other than directors pursuant to the Activision Blizzard, Inc. 2008 Incentive Plan (effective as of November 12, 2008) (incorporated by reference to Exhibit 10.50 of the Company's Form 10-K for the year ended December 31, 2008). |
| 10.14* | Form of Notice of Restricted Share Unit Award for grants under the Company's 2008 Incentive Plan (effective as of November 12, 2008) (incorporated by reference to Exhibit 10.12 of the Company's Form 10-Q for the quarter ended March 31, 2012). |

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| <u>Exhibit Number</u> | <u>Exhibit</u> |
|-----------------------|---|
| 10.15* | Form of Notice of Performance Share Award for grants under the Company's 2008 Incentive Plan (incorporated by reference to Exhibit 10.13 of the Company's Form 10-Q for the quarter ended March 31, 2012). |
| 10.16* | Form of Notice of Stock Option Award for grants to unaffiliated directors pursuant to the Activision Blizzard, Inc. 2008 Incentive Plan (effective as of March 6, 2013) (incorporated by reference to Exhibit 10.5 of the Company's Form 10-Q for the quarter ended March 31, 2013). |
| 10.17* | Form of Notice of Stock Option Award for grants to persons other than directors pursuant to the Activision Blizzard, Inc. 2008 Incentive Plan (effective as of March 6, 2013) (incorporated by reference to Exhibit 10.6 of the Company's Form 10-Q for the quarter ended March 31, 2013). |
| 10.18* | Form of Notice of Restricted Share Unit Award for grants to affiliated non-employee directors and to unaffiliated directors upon their re-election to the board (other than in connection with 10 years of continuous service) pursuant to the Activision Blizzard, Inc. 2008 Incentive Plan (effective as of November 12, 2008) (incorporated by reference to Exhibit 10.8 of the Company's Form 10-Q for the quarter ended March 31, 2013). |
| 10.19* | Form of Notice of Restricted Share Unit Award for grants to persons other than directors pursuant to the Activision Blizzard, Inc. 2008 Incentive Plan (effective as of March 6, 2013) (incorporated by reference to Exhibit 10.9 of the Company's Form 10-Q for the quarter ended March 31, 2013). |
| 10.20* | Form of Notice of Restricted Share Award for grants to persons other than directors pursuant to the Activision Blizzard, Inc. 2008 Incentive Plan (effective as of March 6, 2013) (incorporated by reference to Exhibit 10.10 of the Company's Form 10-Q for the quarter ended March 31, 2013). |
| 10.21* | Form of Notice of Stock Option Award for grants pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of June 5, 2013) (incorporated by reference to Exhibit 10.1 of the Company's Form 10-Q for the quarter ended June 30, 2014). |
| 10.22* | Form of Notice of Restricted Share Unit Award for grants to persons other than non-affiliated directors pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of June 5, 2014) (incorporated by reference to Exhibit 10.2 of the Company's Form 10-Q for the quarter ended June 30, 2014). |
| 10.23* | Form of Notice of Performance-Vesting Restricted Share Unit Award for grants pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of June 5, 2014) (incorporated by reference to Exhibit 10.4 of the Company's Form 10-Q for the quarter ended June 30, 2014). |
| 10.24* | Form of Notice of Restricted Share Award for grants pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of June 5, 2014) (incorporated by reference to Exhibit 10.5 of the Company's Form 10-Q for the quarter ended June 30, 2014). |
| 10.25* | Form of Notice of Restricted Share Unit Award for grants to persons other than non-affiliated directors pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of July 29, 2014) (incorporated by reference to Exhibit 10.1 of the Company's Form 10-Q for the quarter ended September 30, 2014). |

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| <u>Exhibit Number</u> | <u>Exhibit</u> |
|-----------------------|---|
| 10.26* | Form of Notice of Restricted Share Unit Award for grants to non-affiliated directors pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of July 29, 2014) (incorporated by reference to Exhibit 10.2 of the Company's Form 10-Q for the quarter ended September 30, 2014). |
| 10.27* | Form of Notice of Performance-Vesting Restricted Share Unit Award for grants pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of July 29, 2014) (incorporated by reference to Exhibit 10.3 of the Company's Form 10-Q for the quarter ended September 30, 2014). |
| 10.28* | Form of Notice of Stock Option Award for grants to U.S. employees pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of November 1, 2016) (incorporated by reference to Exhibit 10.44 of the Company's Form 10-K for the year ended December 31, 2016). |
| 10.29* | Form of Notice of Stock Option Award for grants to non-U.S. employees pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of November 1, 2016) (incorporated by reference to Exhibit 10.45 of the Company's Form 10-K for the year ended December 31, 2016). |
| 10.30* | Form of Notice of Restricted Share Unit Award for grants to non-U.S. employees pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of November 1, 2016) (incorporated by reference to Exhibit 10.46 of the Company's Form 10-K for the year ended December 31, 2016). |
| 10.31* | Form of Notice of Stock Option Award for grants pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of March 2, 2017) (incorporated by reference to Exhibit 10.2 of the Company's Form 10-Q for the quarter ended March 31, 2017). |
| 10.32* | Form of Notice of Performance-Vesting Restricted Share Unit Award for grants pursuant to the Activision Blizzard, Inc. 2014 Incentive Plan (effective as of March 2, 2017) (incorporated by reference to Exhibit 10.3 of the Company's Form 10-Q for the quarter ended March 31, 2017). |
| 10.33* | Amended and Restated CEO Recognition Program (incorporated by reference to Exhibit 10.6 of the Company's Form 10-Q for the quarter ended June 30, 2014). |
| 10.34* | Activision Blizzard, Inc. Corporate Annual Incentive Plan (incorporated by reference to Exhibit 10.1 of the Company's Form 10-Q for the quarter ended September 30, 2015). |
| 10.35* | Employment Agreement, dated May 5, 2017, between Activision Blizzard, Inc. and Thomas Tippl (incorporated by reference to Exhibit 10.3 of the Company's Form 8-K, filed May 11, 2017). |
| 10.36* | Transition Agreement, dated November 22, 2016, between the Company and Brian G. Kelly (incorporated by reference to Exhibit 10.56 of the Company's Form 10-K for the year ended December 31, 2016). |
| 10.37* | Employment Agreement, dated May 10, 2017, between Activision Blizzard, Inc. and Dennis Durkin (incorporated by reference to Exhibit 10.4 of the Company's Form 8-K, filed May 11, 2017). |
| 10.38* | Employment Agreement, dated as of November 22, 2016, between Robert A. Kotick and the Company (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, filed November 25, 2016). |

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| <u>Exhibit Number</u> | <u>Exhibit</u> |
|-----------------------|---|
| 10.39* | Form of Notice of Performance Share Unit Award to Robert A. Kotick (incorporated by reference to Exhibit 10.2 of the Company's Form 8-K, filed November 25, 2016). |
| 10.40* | Notice of Stock Option Award, dated as of August 7, 2017, to Robert A. Kotick (incorporated by reference to Exhibit 10.1 of the Company's Form 10-Q for the quarter ended September 30, 2017). |
| 10.41* | Form of Notice of Performance Share Unit Award Regarding Operating Income to Robert A. Kotick (incorporated by reference to Exhibit 10.2 of the Company's Form 10-Q for the quarter ended September 30, 2017). |
| 10.42* | Form of Notice of Performance Share Unit Award Regarding Relative Total Shareholder Return to Robert A. Kotick (incorporated by reference to Exhibit 10.3 of the Company's Form 10-Q for the quarter ended September 30, 2017). |
| 10.43* | Service Agreement, dated November 2, 2015, between Riccardo Zacconi and the Company (incorporated by reference to Exhibit 10.4 of the Company's Form 10-Q for the quarter ended March 31, 2017). |
| 10.44* | Individual Option and Subscription Agreement, dated as of January 31, 2014 (incorporated by reference to Exhibit 10.5 of the Company's Form 10-Q for the quarter ended March 31, 2017). |
| 10.45* | Option Exchange/Supplemental Subscription Agreement, dated as of March 21, 2014 (incorporated by reference to Exhibit 10.6 of the Company's Form 10-Q for the quarter ended March 31, 2017). |
| 10.46* | Notice of Share Option Grant, dated as of February 16, 2015, to Riccardo Zacconi (incorporated by reference to Exhibit 10.7 of the Company's Form 10-Q for the quarter ended March 31, 2017). |
| 10.47* | Notice of Restricted Stock Unit Award, dated as of February 16, 2015, to Riccardo Zacconi (incorporated by reference to Exhibit 10.8 of the Company's Form 10-Q for the quarter ended March 31, 2017). |
| 10.48* | Notice of Restricted Stock Unit Award, dated as of November 10, 2015, to Riccardo Zacconi (incorporated by reference to Exhibit 10.9 of the Company's Form 10-Q for the quarter ended March 31, 2017). |
| 10.49* | Employment Agreement, dated May 10, 2017, between Activision Blizzard, Inc. and Collister Johnson (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, filed May 11, 2017). |
| 10.50* | Employment Agreement, dated May 5, 2017, between Activision Blizzard, Inc. and Spencer Neumann (incorporated by reference to Exhibit 10.2 of the Company's Form 8-K, filed May 11, 2017). |
| 10.51*† | King Profit Sharing Plan, effective as of February 23, 2016 (incorporated by reference to Exhibit 10.10 of the Company's Form 10-Q for the quarter ended March 31, 2017). |

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| <u>Exhibit Number</u> | <u>Exhibit</u> |
|-----------------------|---|
| 10.52 | <u>Credit Agreement, dated as of October 11, 2013, among the Company, as borrower, certain subsidiaries of the Company, as guarantors, a group of lenders, Bank of America, N.A., as administrative agent and collateral agent for the lenders, J.P. Morgan Securities LLC, as syndication agent, Bank of America Merrill Lynch and J.P. Morgan Securities LLC, as joint lead arrangers and joint bookrunners, and Goldman Sachs & Co., HSBC Securities (USA) Inc., Mitsubishi UFJ Securities (USA), Inc., Mizuho Securities USA Inc., RBC Capital Markets, SunTrust Bank and U.S. Bank National Association, as co-documentation agents (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, filed October 18, 2013).</u> |
| 10.53 | <u>First Amendment to the Credit Agreement, dated as of October 11, 2013, by and among Activision Blizzard, Inc., the guarantors from time to time party thereto, the lenders from time to time party thereto, Bank of America, N.A., as administrative agent and collateral agent, and the several other agents party thereto (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, filed November 3, 2015).</u> |
| 10.54 | <u>Second Amendment to the Credit Agreement, dated as of October 11, 2013, by and among Activision Blizzard, Inc., the guarantors from time to time party thereto, the lenders from time to time party thereto, Bank of America, N.A., as administrative agent and collateral agent, and the several other agents party thereto (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, filed November 17, 2015).</u> |
| 10.55 | <u>Third Amendment to the Credit Agreement, dated as of October 11, 2013, by and among Activision Blizzard, Inc., the guarantors from time to time party thereto, the lenders from time to time party thereto, Bank of America, N.A., as administrative agent and collateral agent, and the several other agents party thereto (incorporated by reference to Exhibit 10.1 of the Company's form 8-K, filed December 14, 2015).</u> |
| 10.56 | <u>Fourth Amendment to the Credit Agreement, dated as of October 11, 2013, by and among Activision Blizzard, Inc., the guarantors from time to time party thereto, the lenders from time to time party thereto, Bank of America, N.A., as administrative agent and collateral agent, and the several other agents party thereto (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, filed April 1, 2016).</u> |
| 10.57 | <u>Fifth Amendment to the Credit Agreement, dated as of October 11, 2013, by and among Activision Blizzard, Inc., the guarantors from time to time party thereto, the lenders from time to time party thereto, Bank of America, N.A., as administrative agent and collateral agent, and the several other agents party thereto (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, filed August 24, 2016).</u> |
| 10.58 | <u>Sixth Amendment to the Credit Agreement, dated as of October 11, 2013, by and among Activision Blizzard, Inc., the guarantors from time to time party thereto, the lenders from time to time party thereto, Bank of America, N.A., as administrative agent and collateral agent, and the several other agents party thereto (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, filed February 6, 2017).</u> |
| 10.59 | <u>Registration Rights Agreement, dated as of September 19, 2016, among Activision Blizzard, Inc., the guarantors named therein and the representatives of the initial purchasers of the Notes (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, filed September 19, 2016).</u> |
| 10.60* | <u>Non-Affiliated Director Compensation Program and Stock Ownership Guidelines, as amended and restated as of November 22, 2016 (incorporated by reference to Exhibit 10.90 of the Company's Form 10-K for the year ended December 31, 2016).</u> |

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| <u>Exhibit Number</u> | <u>Exhibit</u> |
|-----------------------|---|
| 21.1 | Subsidiaries of the Company. |
| 23.1 | Consent of Independent Registered Public Accounting Firm (PricewaterhouseCoopers LLP). |
| 24.1 | Power of Attorney of each Executive Officer and Director signing this report (included in the signature page hereto). |
| 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 Spencer Neumann 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 Spencer Neumann pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema Document. |
| 101.CAL | XBRL Taxonomy Calculation Linkbase Document. |
| 101.LAB | XBRL Taxonomy Label Linkbase Document. |
| 101.PRE | XBRL Taxonomy Presentation Linkbase Document. |
| 101.DEF | XBRL Taxonomy Extension Definition Document. |

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

† Confidential treatment requested as to portions of the exhibit. Confidential materials omitted and filed separately with the Securities and Exchange Commission.

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Activision Blizzard, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: February 27, 2018

ACTIVISION BLIZZARD, INC.

By: /s/ ROBERT A. KOTICK
Robert A. Kotick
Director and Chief Executive Officer of Activision
Blizzard, Inc.
(Principal Executive Officer)

POWER OF ATTORNEY

Each individual whose signature appears below constitutes and appoints Robert A. Kotick, and Spencer Neumann and each of them, his or her true and lawful attorneys-in-fact and agents with full power of substitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto and all documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or his, her or their substitute or substitutes, may lawfully do or cause to be done or by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| | | | |
|-----|---|--|-------------------|
| By: | <u> /s/ ROBERT A. KOTICK </u> (Robert A. Kotick) | Director, Chief Executive Officer, and Principal Executive Officer | February 27, 2018 |
| By: | <u> /s/ SPENCER NEUMANN </u> (Spencer Neumann) | Chief Financial Officer and Principal Financial Officer | February 27, 2018 |
| By: | <u> /s/ STEPHEN WEREB </u> (Stephen Wereb) | Deputy Chief Financial Officer, Chief Accounting Officer, and Principal Accounting Officer | February 27, 2018 |
| By: | <u> /s/ REVETA BOWERS </u> (Reveta Bowers) | Director | February 27, 2018 |

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| | | | |
|-----|---|-----------------------|-------------------|
| By: | <u> /s/ ROBERT J. CORTI</u> | Director | February 27, 2018 |
| | (Robert J. Corti) | | |
| By: | <u> /s/ BRIAN G. KELLY</u> | Chairman and Director | February 27, 2018 |
| | (Brian G. Kelly) | | |
| By: | <u> /s/ HENDRIK J. HARTONG III</u> | Director | February 27, 2018 |
| | (Hendrik J. Hartong III) | | |
| By: | <u> /s/ BARRY MEYER</u> | Director | February 27, 2018 |
| | (Barry Meyer) | | |
| By: | <u> /s/ ROBERT J. MORGADO</u> | Director | February 27, 2018 |
| | (Robert J. Morgado) | | |
| By: | <u> /s/ PETER NOLAN</u> | Director | February 27, 2018 |
| | (Peter Nolan) | | |
| By: | <u> /s/ CASEY WASSERMAN</u> | Director | February 27, 2018 |
| | (Casey Wasserman) | | |
| By: | <u> /s/ ELAINE P. WYNN</u> | Director | February 27, 2018 |
| | (Elaine P. Wynn) | | |

MAJOR SUBSIDIARIES OF THE REGISTRANT AT DECEMBER 31, 2017

| Name of Subsidiary | State or Other Jurisdiction of Incorporation or Organization |
|---|---|
| Activision Blizzard International BV | Netherlands |
| Activision Blizzard UK Limited | U.K. |
| Activision Publishing, Inc. | U.S.-Delaware |
| ATVI C.V. | Netherlands |
| Blizzard Entertainment (Hong Kong), Limited | Hong Kong |
| Blizzard Entertainment, Inc. | U.S.-Delaware |
| ATVI International SRL | Barbados |
| Blizzard Entertainment SAS | France |
| CDH Consolidated | U.K. |
| Infinity Ward [®] , Inc. | U.S.-Delaware |
| King.com (US) LLC | U.S.-Delaware |
| King.com Limited | Malta |
| Midasplayer AB | Sweden |
| Midasplayer.com Limited | U.K. |
| Treyarch [®] Corporation | U.S.-Delaware |

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Forms S-3 (Nos. 333-211836 and 333-213520) and Forms S-8 (333-146431, 333-153661, 333-165123, 333-167428, 333-196956, 333-209825 and 333-209864) of Activision Blizzard, Inc. of our report dated February 27, 2018 relating to the financial statements, financial statement schedule and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

Los Angeles, California

February 27, 2018

CERTIFICATION

I, Robert A. Kotick, certify that:

1. I have reviewed this Annual Report on Form 10-K of Activision Blizzard, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 27, 2018

/s/ ROBERT A. KOTICK

Robert A. Kotick
*Chief Executive Officer and
Principal Executive Officer of
Activision Blizzard, Inc.*

CERTIFICATION

I, Spencer Neumann, certify that:

1. I have reviewed this Annual Report on Form 10-K of Activision Blizzard, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 27, 2018

/s/ SPENCER NEUMANN

Spencer Neumann
*Chief Financial Officer and
Principal Financial Officer of
Activision Blizzard, Inc.*

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Activision Blizzard, Inc. (the "Company") on Form 10-K for the year ended December 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert A. Kotick, Chief Executive Officer and Principal Executive Officer of the Company, certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 27, 2018

/s/ ROBERT A. KOTICK

Robert A. Kotick
*Chief Executive Officer and
Principal Executive Officer of
Activision Blizzard, Inc.*

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Activision Blizzard, Inc. (the "Company") on Form 10-K for the year ended December 31, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Spencer Neumann, Chief Financial Officer and Principal Financial Officer of the Company, certify, to my knowledge, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 27, 2018

/s/ SPENCER NEUMANN

Spencer Neumann
*Chief Financial Officer and
Principal Financial Officer of
Activision Blizzard, Inc.*

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.
