TATA MOTORS LTD/FI
Form 6-K
July 31, 2013
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

Report of Foreign Issuer

Pursuant to Rule 13a-16 or 15d-16

of the Securities Exchange Act of 1934

For the Month of July 2013

Commission File Number: 001-32294

TATA MOTORS LIMITED

(Translation of registrant s name into English)

BOMBAY HOUSE

24, HOMI MODY STREET,

MUMBAI 400 001, MAHARASHTRA, INDIA

Telephone # 91 22 6665 8282 Fax # 91 22 6665 7799

(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F x Form 40-F ¨

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Yes ¨ No x

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes ¨ No x

Indicate by check mark whether by furnishing the information contained in this Form, the Registrant is also thereby furnishing theinformation to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes ¨ No x

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g 3-2(b): Not Applicable

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SIGNATURE

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

Tata Motors Limited

By: /s/ Hoshang K Sethna
Name: Hoshang K Sethna
Title: Company Secretary
Dated: July 31, 2013

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1pt;text-indent:22.5pt;">A summary of our outstanding debt is as follows (amounts in millions):

	At June 30, 2018		
	Gross Carrying Amount	Unamortized Discount and Deferred Financing Costs	Net Carrying Amount
2017 TLA	$ 990	$ (7)	$ 983
2021 Notes	650	(4)	646
2022 Notes	400	(3)	397
2023 Notes	750	(8)	742
2026 Notes	850	(9)	841
2027 Notes	400	(5)	395
2047 Notes	400	(10)	390
Total long-term debt	$ 4,440	$ (46)	$ 4,394

	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	$ 4,440	$ (50)	$ 4,390

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As of June 30, 2018, 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 (remaining six months)	$	
2019		
2020		
2021		1,640
2022		400
Thereafter (1)		2,400
Total	$	4,440

(1) Includes payment of our 2023 Notes at maturity. As discussed above, on July 17, 2018 we issued an irrevocable notice of redemption to the holders of the 2023 Notes that all of our outstanding 2023 Notes will be redeemed on August 16, 2018.

On February 1, 2018, our Board of Directors authorized repayment of up to $1.8 billion of the company s outstanding debt during 2018. As discussed above, on July 17, 2018, we issued an irrevocable notice to the holders of our 2023 Notes that all of our outstanding 2023 Notes will be redeemed on August 16, 2018. The determination as to if and when we make any such remaining repayments will be dependent on market conditions and other factors.

Using Level 2 inputs (i.e., observable market prices in less-than-active markets) at June 30, 2018, with the exception of the 2026 Notes and the 2027 Notes, the carrying values of our debt instruments approximated their fair values, as the interest rates were similar to current rates at which we could borrow funds over the selected interest periods. At June 30, 2018, based on Level 2 inputs, the fair values of the 2026 Notes and the 2027 Notes were $810 million and $379 million, respectively.

Using Level 2 inputs at December 31, 2017, with the exception of the 2023 Notes and the 2047 Notes, the carrying values of our debt instruments approximated their fair values. 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.

11. Accumulated Other Comprehensive Income (Loss)

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

	For the Six Months Ended June 30, 2018			
	Foreign currency translation adjustments	**Unrealized gain (loss) on forward contracts**	**Unrealized gain (loss) on available-for-sale securities**	**Total**

Balance at December 31, 2017	$ (623)	$ (15)	$	$ (638)
Cumulative impact from adoption of new revenue accounting standard	3			3
Other comprehensive income (loss) before reclassifications	(10)	22	4	16
Amounts reclassified from accumulated other comprehensive income (loss) into earnings		14		14
Balance at June 30, 2018	$ (630)	$ 21	$ 4	$ (605)

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	For the Six Months Ended June 30, 2017			
	Foreign currency translation adjustments	Unrealized gain (loss) on forward contracts	Unrealized gain (loss) on available-for-sale securities	Total
Balance at December 31, 2016	$ (659)	$ 29	$ 1	$ (629)
Other comprehensive income (loss) before reclassifications	11	(28)	1	(16)
Amounts reclassified from accumulated other comprehensive income (loss) into earnings	16	(9)	(2)	5
Balance at June 30, 2017	$ (632)	$ (8)	$	$ (640)

Income taxes were not previously provided for foreign currency translation items, as these were considered indefinite investments in non-U.S. subsidiaries. Due to the Tax Cuts and Jobs Act enacted on December 22, 2017 (the U.S. Tax Reform Act), we re-evaluated our indefinite reinvestment assertions and no longer consider these items to be indefinite investments. The corresponding tax impact for this change in assertion was not material.

12. 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 organizational structure, the way we assess operating performance and allocate resources, and the availability of separate financial information. We do not aggregate operating segments.

Information on reportable segment net revenues and operating income for the three months ended June 30, 2018 and 2017, are presented below (amounts in millions):

	Three Months Ended June 30, 2018			
	Activision	Blizzard	King	Total
Segment Net Revenues				
Net revenues from external customers	$ 338	$ 485	$ 502	$ 1,325
Intersegment net revenues (1)		4		4
Segment net revenues	$ 338	$ 489	$ 502	$ 1,329
Segment operating income	$ 84	$ 133	$ 169	$ 386

Three Months Ended June 30, 2017

	Activision	Blizzard	King	Total
Segment Net Revenues				
Net revenues from external customers	$ 316	$ 566	$ 480	$ 1,362
Intersegment net revenues (1)				
Segment net revenues	$ 316	$ 566	$ 480	$ 1,362
Segment operating income	$ 87	$ 225	$ 164	$ 476

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Information on reportable segment net revenues and operating income for the six months ended June 30, 2018 and 2017, are presented below (amounts in millions):

	Six Months Ended June 30, 2018			
	Activision	**Blizzard**	**King**	**Total**
Segment Net Revenues				
Net revenues from external customers	$ 651	$ 964	$ 1,036	$ 2,651
Intersegment net revenues (1)		6		6
Segment net revenues	$ 651	$ 970	$ 1,036	$ 2,657
Segment operating income	$ 175	$ 255	$ 360	$ 790

	Six Months Ended June 30, 2017			
	Activision	**Blizzard**	**King**	**Total**
Segment Net Revenues				
Net revenues from external customers	$ 532	$ 1,009	$ 954	$ 2,495
Intersegment net revenues (1)				
Segment net revenues	$ 532	$ 1,009	$ 954	$ 2,495
Segment operating income	$ 111	$ 384	$ 330	$ 825

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

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

	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Reconciliation to consolidated net revenues:				
Segment net revenues	$ 1,329	$ 1,362	$ 2,657	$ 2,495
Revenues from other segments (1)	60	56	118	119
Net effect from recognition (deferral) of deferred net revenues	256	213	838	742
Elimination of intersegment revenues (2)	(4)		(6)	
Consolidated net revenues	$ 1,641	$ 1,631	$ 3,607	$ 3,356
Reconciliation to consolidated income before income tax expense:				
Segment operating income	$ 386	$ 476	$ 790	$ 825
Operating (loss) income from other segments (1)		(5)	(11)	(3)
Net effect from recognition (deferral) of deferred net revenues and related cost of revenues	182	105	557	501
Share-based compensation expense	(57)	(39)	(111)	(73)
Amortization of intangible assets	(77)	(194)	(196)	(384)
Fees and other expenses related to the acquisition of King (3)		(5)		(9)
Restructuring costs (4)				(11)
Other non-cash charges (5)		1		(15)
Consolidated operating income	434	339	1,029	831
Interest and other expense (income), net	26	46	54	85
Consolidated income before income tax expense	$ 408	$ 293	$ 975	$ 746

(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.

(3) Reflects fees and other expenses, such as legal, banking, and professional services fees, related to the acquisition of King 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.

Due to requirements from our adoption of the new revenue accounting standard as discussed in Note 2, net revenues by distribution channel for the three and six months ended June 30, 2018, include a reconciliation to our segment revenues as disclosed for each of our reportable segments above. Net revenues by distribution channel were as follows (amounts in millions):

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	Three Months Ended June 30, 2018					
	Activision	Blizzard	King	Non-reportable segments	Elimination of intersegment revenues (3)	Total
Net revenues by distribution channel:						
Digital online channels (1)	$ 333	$ 420	$ 510	$	$ (4)	$ 1,259
Retail channels	259	19				278
Other (2)		49		55		104
Total consolidated net revenues	$ 592	$ 488	$ 510	$ 55	$ (4)	$ 1,641
Change in deferred revenues:						
Digital online channels (1)	$ (58)	$ 4	$ (8)	$	$	$ (62)
Retail channels	(196)	(6)				(202)
Other (2)		3		5		8
Total change in deferred revenues	$ (254)	$ 1	$ (8)	$ 5	$	$ (256)
Segment net revenues:						
Digital online channels (1)	$ 275	$ 424	$ 502	$	$ (4)	$ 1,197
Retail channels	63	13				76
Other (2)		52		60		112
Total segment net revenues	$ 338	$ 489	$ 502	$ 60	$ (4)	$ 1,385

	Six Months Ended June 30, 2018					
	Activision	Blizzard	King	Non-reportable segments	Elimination of intersegment revenues (3)	Total
Net revenues by distribution channel:						
Digital online channels (1)	$ 809	$ 875	$ 1,042	$	$ (6)	$ 2,720
Retail channels	656	33	1			690
Other (2)		89		108		197
Total consolidated net revenues	$ 1,465	$ 997	$ 1,043	$ 108	$ (6)	$ 3,607
Change in deferred revenues:						
Digital online channels (1)	$ (290)	$ (23)	$ (6)	$	$	$ (319)
Retail channels	(524)	(8)	(1)			(533)
Other (2)		4		10		14
Total change in deferred revenues	$ (814)	$ (27)	$ (7)	$ 10	$	$ (838)
Segment net revenues:						
Digital online channels (1)	$ 519	$ 852	$ 1,036	$	$ (6)	$ 2,401
Retail channels	132	25				157
Other (2)		93		118		211
Total segment net revenues	$ 651	$ 970	$ 1,036	$ 118	$ (6)	$ 2,769

Net revenues by distribution channel for the three and six months ended June 30, 2017, were as follows (amounts in millions):

	Three Months Ended June 30, 2017	Six Months Ended June 30, 2017
Net revenues by distribution channel:		
Digital online channels (1)	$ 1,309	$ 2,694
Retail channels	260	529
Other (2)	62	133
Total consolidated net revenues	$ 1,631	$ 3,356

(1) Net revenues from Digital online channels include revenues from digitally-distributed subscriptions, downloadable content, microtransactions, and products, as well as licensing royalties.

(2) Net revenues from Other include revenues from our Studios and Distribution businesses, as well as revenues from MLG and the Overwatch LeagueTM.

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

Geographic information presented below is based on the location of the paying customer. Net revenues by geographic region, including a reconciliation to each of our reportable segment s net revenues, for the three and six months ended June 30, 2018, were as follows (amounts in millions):

	Three Months Ended June 30, 2018					
	Activision	Blizzard	King	Non-reportable segments	Elimination of intersegment revenues (2)	Total
Net revenues by geographic region:						
Americas	$ 349	$ 239	$ 315	$	$ (3)	$ 900
EMEA (1)	199	155	144	55	(1)	552
Asia Pacific	44	94	51			189
Total consolidated net revenues	$ 592	$ 488	$ 510	$ 55	$ (4)	$ 1,641
Change in deferred revenues:						
Americas	$ (143)	$ 7	$ (5)	$	$	$ (141)
EMEA (1)	(97)	(6)	(2)	5		(100)
Asia Pacific	(14)		(1)			(15)
Total change in deferred revenues	$ (254)	$ 1	$ (8)	$ 5	$	$ (256)
Segment net revenues:						

Americas	$	206	$	246	$	310	$		$	(3)	$	759
EMEA (1)		102		149		142		60		(1)		452
Asia Pacific		30		94		50						174
Total segment net revenues	$	338	$	489	$	502	$	60	$	(4)	$	1,385

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	Six Months Ended June 30, 2018					
	Activision	Blizzard	King	Non-reportable segments	Elimination of intersegment revenues (2)	Total
Net revenues by geographic region:						
Americas	$ 859	$ 473	$ 637	$	$ (3)	$ 1,966
EMEA (1)	504	325	305	108	(3)	1,239
Asia Pacific	102	199	101			402
Total consolidated net revenues	$ 1,465	$ 997	$ 1,043	$ 108	$ (6)	$ 3,607
Change in deferred revenues:						
Americas	$ (471)	$	$ (3)	$	$	$ (474)
EMEA (1)	(295)	(14)	(4)	10	1	(302)
Asia Pacific	(48)	(13)			(1)	(62)
Total change in deferred revenues	$ (814)	$ (27)	$ (7)	$ 10	$	$ (838)
Segment net revenues:						
Americas	$ 388	$ 473	$ 634	$	$ (3)	$ 1,492
EMEA (1)	209	311	301	118	(2)	937
Asia Pacific	54	186	101		(1)	340
Total segment net revenues	$ 651	$ 970	$ 1,036	$ 118	$ (6)	$ 2,769

Net revenues by geographic region for the three and six months ended June 30, 2017, were as follows (amounts in millions):

	Three Months Ended June 30, 2017	Six Months Ended June 30, 2017
Net revenues by geographic region:		
Americas	$ 858	$ 1,787
EMEA (1)	538	1,092
Asia Pacific	235	477
Total consolidated net revenues	$ 1,631	$ 3,356

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

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

The Company s net revenues in the U.S. were 49% and 46% of consolidated net revenues for the three months ended June 30, 2018 and 2017, respectively. The Company s net revenues in the U.K. were 10% of consolidated net revenues for both the three months ended June 30, 2018 and 2017. No other country s net revenues exceeded 10% of consolidated net revenues for either the three months ended June 30, 2018 or 2017.

The Company s net revenues in the U.S. were 48% and 47% of consolidated net revenues for the six months ended June 30, 2018 and 2017, respectively. The Company s net revenues in the U.K. were 10% of consolidated net revenues for both the six months ended June 30, 2018 and 2017. No other country s net revenues exceeded 10% of consolidated net revenues for either the six months ended June 30, 2018 or 2017.

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Net revenues by platform, including a reconciliation to each of our reportable segment s net revenues, for the three and six months ended June 30, 2018, were as follows (amounts in millions):

	Three Months Ended June 30, 2018					
	Activision	**Blizzard**	**King**	**Non-reportable segments**	**Elimination of intersegment revenues (3)**	**Total**
Net revenues by platform:						
Console	$ 520	$ 45	$	$	$	$ 565
PC	69	347	39		(4)	451
Mobile and ancillary (1)	3	47	471			521
Other (2)		49		55		104
Total consolidated net revenues	$ 592	$ 488	$ 510	$ 55	$ (4)	$ 1,641
Change in deferred revenues:						
Console	$ (233)	$ 1	$	$	$	$ (232)
PC	(21)	(6)	(1)			(28)
Mobile and ancillary (1)		3	(7)			(4)
Other (2)		3		5		8
Total change in deferred revenues	$ (254)	$ 1	$ (8)	$ 5	$	$ (256)
Segment net revenues:						
Console	$ 287	$ 46	$	$	$	$ 333
PC	48	341	38		(4)	423
Mobile and ancillary (1)	3	50	464			517
Other (2)		52		60		112
Total segment net revenues	$ 338	$ 489	$ 502	$ 60	$ (4)	$ 1,385

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	Six Months Ended June 30, 2018					
	Activision	Blizzard	King	Non-reportable segments	Elimination of intersegment revenues (3)	Total
Net revenues by platform:						
Console	$ 1,289	$ 93	$	$	$	$ 1,382
PC	169	726	82		(6)	971
Mobile and ancillary (1)	7	89	961			1,057
Other (2)		89		108		197
Total consolidated net revenues	$ 1,465	$ 997	$ 1,043	$ 108	$ (6)	$ 3,607
Change in deferred revenues:						
Console	$ (723)	$ (17)	$	$	$	$ (740)
PC	(91)	(6)				(97)
Mobile and ancillary (1)		(8)	(7)			(15)
Other (2)		4		10		14
Total change in deferred revenues	$ (814)	$ (27)	$ (7)	$ 10	$	$ (838)
Segment net revenues:						
Console	$ 566	$ 76	$	$	$	$ 642
PC	78	720	82		(6)	874
Mobile and ancillary (1)	7	81	954			1,042
Other (2)		93		118		211
Total segment net revenues	$ 651	$ 970	$ 1,036	$ 118	$ (6)	$ 2,769

Net revenues by platform for the three and six months ended June 30, 2017, were as follows (amounts in millions):

	Three Months Ended June 30, 2017	Six Months Ended June 30, 2017
Net revenues by platform:		
Console	$ 568	$ 1,182
PC	508	1,072
Mobile and ancillary (1)	493	969
Other (2)	62	133
Total consolidated net revenues	$ 1,631	$ 3,356

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

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

	At June 30, 2018	At December 31, 2017
Long-lived assets (1) by geographic region:		
Americas	$ 199	$ 197
EMEA	64	75
Asia Pacific	18	22
Total long-lived assets by geographic region	$ 281	$ 294

(1) 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.

13. Income Taxes

We account for our provision for income taxes in accordance with Accounting Standards Codification (ASC) 740, *Income Taxes*, which requires an estimate of the annual effective tax rate for the full year to be applied to the interim period, taking into account year-to-date amounts and projected results for the full year. The provision for income taxes represents federal, foreign, state, and local income taxes. Our effective tax rate differs from the statutory U.S. income tax rate due to the effect of state and local income taxes, tax rates that apply to our foreign income (including U.S. tax on foreign income), research and development credits, and certain nondeductible expenses. Our effective tax rate could fluctuate significantly from quarter to quarter based on recurring and nonrecurring factors including, but not limited to: variations in the estimated and actual level of pre-tax income or loss by jurisdiction (including changes in the mix of income by tax jurisdiction); changes in enacted tax laws and regulations, and interpretations thereof, including with respect to tax credits and state and local income taxes; developments in tax audits and other matters; recognition of excess tax benefits and tax deficiencies from share-based payments; and certain nondeductible expenses. Changes in judgment from the evaluation of new information resulting in the recognition, derecognition, or remeasurement of a tax position taken in a prior annual period are recognized separately in the quarter of the change.

On June 27, 2018, the Company entered into a closing agreement with the Internal Revenue Service (IRS) to resolve certain intercompany transfer pricing arrangements for tax periods starting in 2009 (the Closing Agreement). The primary adjustments recognized in the second quarter of 2018 related to the Closing Agreement were a tax expense of $70 million and a reduction in unrecognized tax benefits of $437 million. In addition, we recognized $185 million of tax benefits related to other tax adjustments resulting from the changes in U.S. tax attributes and taxable income caused by the primary adjustments. We expect the Closing Agreement to result in federal and state cash tax payments of approximately $345 million, which we expect to be made mostly before December 31, 2018.

We evaluate deferred tax assets each period for recoverability. We record a valuation allowance for assets that do not meet the threshold of more likely than not to be realized in the future. To make that determination, the Company evaluates the likelihood of realization based on the weight of all positive and negative evidence available. As of December 31, 2017, the Company had a deferred tax asset for California research and development credit carryforwards (CA R&D Credits), which can be carried forward indefinitely. The Closing Agreement impacts historical and prospective filings in certain states, including California, and after considering the impact of the Closing Agreement on its prospective California taxable income, the Company determined that its remaining CA R&D Credits no longer met the threshold of more likely than not being realized in the future. Accordingly, during the three months ended June 30, 2018, we recorded a full valuation allowance of $57 million. Additionally, the Company has not recognized a tax benefit for current-year CA R&D Credits in its year-to-date tax expense. We will reassess this determination quarterly and record a tax benefit if future evidence allows for a partial or full release of this valuation allowance.

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 imposed a one-time tax on deemed repatriated earnings of foreign subsidiaries (the Transition Tax).

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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 enabled 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. During the fourth quarter of 2017, we recorded provisional amounts for the effects of the U.S. Tax Reform Act in accordance with SAB 118. In addition, as of December 31. 2017, we no longer considered the available cash balances related to undistributed earnings held outside of the U.S. by our foreign subsidiaries to be indefinitely reinvested. We continue to analyze the effects of the U.S. Tax Reform Act on our condensed consolidated financial statements. 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.

During the three months ended June 30, 2018, the Company obtained additional information, including adjustments related to the Closing Agreement, and the evaluation of the impact of changing our indefinite reinvestment assertion, which affected the provisional amount initially recorded for the U.S. Tax Reform Act in the fourth quarter of 2017. As a result, the Company recorded an additional tax expense of $34 million in the three months ended June 30, 2018 for the effects of the U.S. Tax Reform Act.

We continue to evaluate the ongoing impacts of the U.S. Tax Reform Act, including provisions impacting certain foreign income, such as a tax on global intangible low-taxed income of foreign subsidiaries (GILTI) and a deduction for foreign derived intangible income. These provisions are complex and subject to continuing regulatory interpretation by the IRS. While we have included an estimate of GILTI in our estimated effective tax rate for 2018, we may make adjustments as we 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.

The income tax expense of $6 million for the three months ended June 30, 2018, reflects an effective tax rate of 1%, which is lower than the effective tax rate of 17% for the three months ended June 30, 2017. The decrease is due to a discrete net tax benefit resulting from the Closing Agreement and the benefit from the lower U.S. corporate income tax rate in the current year, net of the impact of GILTI. This decrease was partially offset by the valuation allowance recorded with regard to CA R&D Credits and the additional income tax expense related to the change in the provisional amount described above.

The income tax expense of $73 million for the six months ended June 30, 2018, reflects an effective tax rate of 7%, which is lower than the effective tax rate of 10% for the six months ended June 30, 2017. The decrease is due to a discrete net tax benefit resulting from the Closing Agreement and the benefit from the lower U.S. corporate income tax rate in the current year, net of the impact of GILTI. This decrease was partially offset by the valuation allowance recorded with regard to CA R&D Credits, lower excess tax benefits from share-based payments, and the additional income tax expense related to the change in the provisional amount described above.

The effective tax rate of 1% and 7% for the three and six months ended June 30, 2018, respectively, is lower than the U.S. statutory rate of 21%, primarily due to a discrete net tax benefit resulting from the Closing Agreement, foreign earnings taxed at relatively lower statutory rates, the recognition of excess tax benefits from share-based payments, and recognition of federal research and development credits, partially offset by the valuation allowance recorded with regard to CA R&D Credits and the additional income tax expense related to the change in the provisional amount described above.

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 also be subject to examination. The Company also has several state and non-U.S. audits pending, including the French audit discussed below. In addition, as part of purchase price accounting for our 2016 acquisition of King, the Company assumed $74 million of uncertain tax positions primarily related to pre-acquisition transfer pricing matters. 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.

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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 ($660 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, if necessary, judicial remedies. While we believe our tax provisions at June 30, 2018 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 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.

We regularly assess the likelihood of adverse outcomes resulting from these examinations and monitor the progress of ongoing discussions with tax authorities in determining the appropriateness of our tax provisions. 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.

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14. 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 Three Months Ended June 30, 2018	2017	For the Six Months Ended June 30, 2018	2017
Numerator:				
Consolidated net income	$ 402	$ 243	$ 902	$ 669
Denominator:				
Denominator for basic earnings per common share weighted-average common shares outstanding	761	754	760	752
Effect of potential dilutive common shares under the treasury stock method employee stock options and awards	9	10	10	11
Denominator for basic earnings per common share weighted-average dilutive common shares outstanding	770	764	770	763
Basic earnings per common share	$ 0.53	$ 0.32	$ 1.19	$ 0.89
Diluted earnings per common share	$ 0.52	$ 0.32	$ 1.17	$ 0.88

The vesting of certain of our employee-related restricted stock units and options is 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 6 million shares are not included in the computation of diluted earnings per share for both the three and six months ended June 30, 2018, as their underlying performance measures had not yet been met. Approximately 9 million shares are not included in the computation of diluted earnings per share for both the three and six months ended June 30, 2017, as their underlying 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, approximately 2 million options to purchase shares of common stock were not included in the calculation of diluted earnings per common share for both the three and six months ended June 30, 2018, and 1 million and 5 million options to purchase shares of common stock were not included in the calculation of diluted earnings per common share for the three and six months ended June 30, 2017, respectively, as the effect of their inclusion would be anti-dilutive.

15. Capital Transactions

Repurchase Program

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 June 30, 2018, we have not repurchased any shares under this program.

Dividends

On February 1, 2018, our Board of Directors approved a cash dividend of $0.34 per common share. On May 9, 2018, we made an aggregate cash dividend payment of $259 million 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.

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16. Commitments and Contingencies

Legal Proceedings

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 2. 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, personal computers (PC), and mobile devices. We also operate esports events and leagues and create film and television content based on our intellectual property. The terms Activision Blizzard, the Company, we, us, and our are used t 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., then 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.

Our Segments

Based on 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.

(ii) Blizzard Entertainment, Inc.

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. Blizzard also includes the activities of our Major League Gaming (MLG) business, which is responsible for various esports events, and serves as a multi-platform network for Activision Blizzard esports content.

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Blizzard s key product franchises include: World of Warcraft®, a subscription-based massive multi-player online role-playing game for the PC platform; StarCraft®, a real-time strategy franchise for the PC platform; 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 the PC platform; 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. King s games are free to play, however, players can acquire in-game items, either with virtual currency 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.

Business Results and Highlights

Financial Results

The Company s financial results for 2018 are presented in accordance with a new revenue accounting standard that was adopted in the first quarter of 2018. Prior period results have not been restated to reflect this change in accounting standards. Further information about our adoption of the new standard is provided in Notes 2 and 3 of the notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q.

During the three months ended June 30, 2018:

- consolidated net revenues increased 1% to $1.64 billion, while consolidated operating income increased 28% to $434 million, as compared to consolidated net revenues of $1.63 billion and consolidated operating income of $339 million for the three months ended June 30, 2017;

- revenues from digital online channels were $1.26 billion, or 77% of consolidated net revenues, as compared to $1.31 billion, or 80% of consolidated net revenues, for the three months ended June 30, 2017;

- operating margin was 26.4%, as compared to 20.8% for the three months ended June 30, 2017;

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- consolidated net income increased 65% to $402 million, as compared to $243 million for the three months ended June 30, 2017; the current period included $25 million of net tax benefits from several discrete tax items, primarily related to the settlement with the Internal Revenue Service (IRS) with respect to intercompany transfer pricing arrangements, the establishment of a valuation allowance on California research and development credit carryforwards, and updates to our accounting for the Tax Cuts and Jobs Act (U.S. Tax Reform Act) (see Consolidated Results discussion below for additional details); and

- diluted earnings per common share increased 63% to $0.52, as compared to $0.32 for the three months ended June 30, 2017.

During the six months ended June 30, 2018:

- consolidated net revenues increased 7% to $3.61 billion, while consolidated operating income increased 24% to $1.0 billion, as compared to consolidated net revenues of $3.36 billion and consolidated operating income of $831 million for the six months ended June 30, 2017;

- revenues from digital online channels were $2.72 billion, or 75% of consolidated net revenues, as compared to $2.69 billion, or 80% of consolidated net revenues, for the six months ended June 30, 2017;

- operating margin was 28.5%, as compared to 24.8% for the six months ended June 30, 2017;

- cash flows from operating activities were $538 million, a decrease of 20%, as compared to $676 million for the six months ended June 30, 2017;

- consolidated net income increased 35% to $902 million, as compared to $669 million for the six months ended June 30, 2017; the current period included $25 million of net tax benefits from several discrete tax items, primarily related to the settlement with the IRS with respect to intercompany transfer pricing arrangements, the establishment of a valuation allowance on California research and development credit carryforwards, and updates to our accounting for the U.S. Tax Reform Act (see Consolidated Results discussion below for additional details); and

- diluted earnings per common share increased 33% to $1.17, as compared to $0.88 for the six months ended June 30, 2017.

Since certain of our games are hosted online or include significant online functionality that represents a separate performance obligation, we defer the transaction price allocable to the online functionality 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 three months ended June 30, 2018, include a net effect of $256 million and $182 million, respectively, from the recognition of deferred net revenues and related cost of revenues. Net revenues and operating income for the six months ended June 30, 2018, include a net effect of $838 million and $557 million, respectively, from the recognition of deferred net revenues and related cost of revenues.

Content Release and Event Highlights

Games and downloadable content that were released during the three months ended June 30, 2018, include:

- Activision s *Warmind*, the second expansion to *Destiny 2*;
- Activision s *The War Machine*, the second downloadable content pack for *Call of Duty: WWII*;
- Activision s *United Front*, the third downloadable content pack for *Call of Duty: WWII,* on PlayStation 4*;*
- Activision s *Crash Bandicoot N. Sane Trilogy*, a remastered version of the first three Crash Bandicoot games, on the Xbox One, PC, and Nintendo Switch; and
- Blizzard s latest expansion to *Hearthstone The Witchwood* .

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Operating Metrics

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

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 is equal to net revenues excluding the impact from deferrals. Net bookings were as follows (amounts in millions):

	June 30, 2018	June 30, 2017	Increase (Decrease)
Net bookings			
Three Months Ended	$ 1,385	$ 1,418	$ (33)
Six Months Ended	$ 2,769	$ 2,614	$ 155

Q2 2018 vs. Q2 2017

The decrease in net bookings for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to:

- lower net bookings in the current quarter from *Call of Duty: Infinite Warfare*™ (which, when referred to herein, is inclusive of *Call of Duty: Modern Warfare® Remastered*), which was released in November 2016, as compared to net bookings in the comparable prior year quarter from *Call of Duty: Black Ops III*, the comparable 2015 title, primarily since the prior-year quarter included the May 2017 release of *Zombies Chronicles*, a downloadable content pack for *Call of Duty: Black Ops III,* with no comparable content release in the current quarter; and

- lower net bookings from *Overwatch*, which was released in May 2016.

The decrease was partially offset by:

- higher net bookings from *Call of Duty: WWII*, which was released in November 2017, as compared to *Call of Duty: Infinite Warfare*, the comparable 2016 title;

- higher net bookings from the Destiny franchise, driven by *Destiny 2*, which was released in September 2017, and its associated in-game content, with no comparable release in 2016; and

- higher net bookings from the Candy Crush franchise due to increased monetization, primarily through in-game events and features.

YTD Q2 2018 vs. YTD Q2 2017

The increase in net bookings for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to:

- higher net bookings from *Call of Duty: WWII*, as compared to *Call of Duty: Infinite Warfare*; and

- higher net bookings from the Candy Crush franchise due to increased monetization, primarily through in-game events and features.

The increase was partially offset by:

- lower net bookings from *Call of Duty: Infinite Warfare*, as compared to *Call of Duty: Black Ops III;* and

- lower net bookings from *Overwatch*.

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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.

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):

	June 30, 2018	**March 31, 2018**	**December 31, 2017**	**September 30, 2017**	**June 30, 2017**	**March 31, 2017**
Activision	45	51	55	49	47	48
Blizzard	37	38	40	42	46	41
King	270	285	290	293	314	342
Total	352	374	385	384	407	431

Average MAUs decreased by 22 million, or 6%, for the three months ended June 30, 2018, as compared to the three months ended March 31, 2018. The sequential decrease in King s average MAUs is due to decreases across franchises and less engaged users leaving the network. The sequential decrease in Activision s average MAUs is due primarily to lower MAUs for the Call of Duty franchise.

Average MAUs decreased by 55 million, or 14%, for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017. The year-over-year decrease in King s average MAUs is due to decreases across King s franchises due to less engaged users leaving the network. The year-over-year decrease in Blizzard s average MAUs is due to lower MAUs for *Heroes of the Storm* and *Overwatch*.

MAUs at King for the three months ended June 30, 2018, were also negatively impacted as a result of technical system changes made by some third-party partners in response to data initiatives, which inadvertently impacted some users ability to play and spend money in King games.

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 grew, on average, 18% from 2014 to 2017. The industry continues to benefit from additional players entering the market as interactive entertainment becomes more commonplace across age groups and as more developing regions gain access to this form of entertainment.

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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 estimated to be larger than both 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 LeagueTM, the first major global professional esports league with city-based teams, and we are nearing completion of the league s inaugural season.

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. The top 10 console franchises in 2017 were all 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 franchises, 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, in 2016 we acquired King.

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

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.

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Consolidated Statements of Operations Data

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

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2018		2017		2018		2017	
Net revenues								
Product sales	$ 464	28%	$ 481	29%	$ 1,184	33%	$ 989	29%
Subscription, licensing, and other revenues	1,177	72	1,150	71	2,423	67	2,367	71
Total net revenues	1,641	100	1,631	100	3,607	100	3,356	100
Costs and expenses:								
Cost of revenues product sales:								
Product costs	126	27	130	27	289	24	273	28
Software royalties, amortization, and intellectual property licenses	49	11	75	16	194	16	163	16
Cost of revenues subscription, licensing, and other revenues:								
Game operations and distribution costs	250	21	236	21	521	22	468	20
Software royalties, amortization, and intellectual property licenses	85	7	120	10	169	7	242	10
Product development	255	16	252	15	513	14	478	14
Sales and marketing	226	14	308	19	477	13	554	17
General and administrative	216	13	171	10	415	12	347	10
Total costs and expenses	1,207	74	1,292	79	2,578	71	2,525	75
Operating income	434	26	339	21	1,029	29	831	25
Interest and other expense (income), net	26	2	46	3	54	1	85	3
Income before income tax expense	408	25	293	18	975	27	746	22
Income tax expense	6		50	3	73	2	77	2
Net income	$ 402	24%	$ 243	15%	$ 902	25%	$ 669	20%

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Consolidated Net Revenues

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

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2018	2017	Increase (decrease)	% Change	2018	2017	Increase (decrease)	% Change
Consolidated net revenues	$ 1,641	$ 1,631	$ 10	1%	$ 3,607	$ 3,356	$ 251	7%
Net effect from recognition (deferral) of deferred net revenues	256	213	43		838	742	96	

Consolidated Net Revenues

Q2 2018 vs. Q2 2017

The slight increase in consolidated net revenues for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to:

- higher revenues recognized from Activision of $68 million, primarily due to 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 and higher revenues recognized from the Destiny franchise, driven by *Destiny 2*, which was released in September 2017, and its associated in-game content, with no comparable release in 2016, partially offset by lower revenues recognized 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; and

- higher revenues from King of $32 million, driven by the Candy Crush franchise s increased monetization, primarily through in-game events and features.

The increase was partially offset by lower revenues recognized from Blizzard of $81 million, primarily due to lower revenues recognized from *Overwatch*, which was released in May 2016.

YTD Q2 2018 vs. YTD Q2 2017

The increase in consolidated net revenues for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to:

- higher revenues recognized from Activision of $358 million, primarily due to higher revenues recognized from the Destiny franchise, driven by *Destiny 2* and higher revenues recognized from *Call of Duty: WWII*, as compared to *Call of Duty: Infinite Warfare*, partially offset by lower revenues recognized from *Call of Duty: Infinite Warfare*, as compared to *Call of Duty: Black Ops III*; and

- higher revenues from King of $101 million, primarily driven by the Candy Crush franchise s increased monetization, primarily through in-game events and features.

The increase was partially offset by lower revenues recognized from Blizzard of $184 million, primarily due to lower revenues recognized from *Overwatch*.

Change in Deferred Revenues Recognized

Q2 2018 vs. Q2 2017

The increase in net deferred revenues recognized for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to higher net deferred revenues recognized for Activision of $46 million, primarily due to net deferred revenues recognized from *Call of Duty: Infinite Warfare*, which was released in November 2016, as compared to a net deferral of revenues in the prior period for *Call of Duty: Black Ops III*, which was released in November 2015, driven by the release its downloadable content pack, *Zombies Chronicles,* in May 2017.

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YTD Q2 2018 vs. YTD Q2 2017

The increase in net deferred revenues recognized for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to higher net deferred revenues recognized for Activision of $239 million, primarily due to higher net deferred revenues recognized from the Destiny franchise, driven by *Destiny 2,* which was released in September 2017, and its associated in-game content, with no comparable release in 2016.

The increase was partially offset by lower net deferred revenues recognized from Blizzard of $145 million, primarily due to a net deferral of revenues for *World of Warcraft*, primarily driven by revenues associated with in-game content and the timing of expansion releases, as compared to net deferred revenues recognized in the prior-year period from *World of Warcraft: Legion*TM, which was released in August 2016.

Foreign Exchange Impact

Changes in foreign exchange rates had a positive impact of $51 million and $161 million on our consolidated net revenues for the three and six months ended June 30, 2018, 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 organizational structure, the way we assess operating performance and allocate resources, and the availability of separate financial information. We do not aggregate operating segments.

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Information on reportable segment net revenues and operating income for the three months ended June 30, 2018 and 2017, are presented below (amounts in millions):

	Three Months Ended June 30, 2018				$ Increase / (Decrease)			
	Activision	**Blizzard**	**King**	**Total**	**Activision**	**Blizzard**	**King**	**Total**
Segment Net Revenues								
Net revenues from external customers	$ 338	$ 485	$ 502	$ 1,325	$ 22	$ (81)	$ 22	$ (37)
Intersegment net revenues (1)		4		4		4		4
Segment net revenues	$ 338	$ 489	$ 502	$ 1,329	$ 22	$ (77)	$ 22	$ (33)
Segment operating income	$ 84	$ 133	$ 169	$ 386	$ (3)	$ (92)	$ 5	$ (90)

	Three Months Ended June 30, 2017			
	Activision	**Blizzard**	**King**	**Total**
Segment Net Revenues				
Net revenues from external customers	$ 316	$ 566	$ 480	$ 1,362
Intersegment net revenues (1)				
Segment net revenues	$ 316	$ 566	$ 480	$ 1,362
Segment operating income	$ 87	$ 225	$ 164	$ 476

Information on reportable segment net revenues and operating income for the six months ended June 30, 2018 and 2017, are presented below (amounts in millions):

	Six Months Ended June 30, 2018				$ Increase / (Decrease)			
	Activision	**Blizzard**	**King**	**Total**	**Activision**	**Blizzard**	**King**	**Total**
Segment Net Revenues								
Net revenues from external customers	$ 651	$ 964	$ 1,036	$ 2,651	$ 119	$ (45)	$ 82	$ 156
Intersegment net revenues (1)		6		6		6		6
Segment net revenues	$ 651	$ 970	$ 1,036	$ 2,657	$ 119	$ (39)	$ 82	$ 162
Segment operating income	$ 175	$ 255	$ 360	$ 790	$ 64	$ (129)	$ 30	$ (35)

	Six Months Ended June 30, 2017			
	Activision	**Blizzard**	**King**	**Total**
Segment Net Revenues				

Net revenues from external customers	$ 532	$ 1,009	$ 954	$ 2,495
Intersegment net revenues (1)				
Segment net revenues	$ 532	$ 1,009	$ 954	$ 2,495
Segment operating income	$ 111	$ 384	$ 330	$ 825

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

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

	For the Three Months Ended June 30, 2018	For the Three Months Ended June 30, 2017	For the Six Months Ended June 30, 2018	For the Six Months Ended June 30, 2017
Reconciliation to consolidated net revenues:				
Segment net revenues	$ 1,329	$ 1,362	$ 2,657	$ 2,495
Revenues from other segments (1)	60	56	118	119
Net effect from recognition (deferral) of deferred net revenues	256	213	838	742
Elimination of intersegment revenues (2)	(4)		(6)	
Consolidated net revenues	$ 1,641	$ 1,631	$ 3,607	$ 3,356
Reconciliation to consolidated income before income tax expense:				
Segment operating income	$ 386	$ 476	$ 790	$ 825
Operating (loss) income from other segments (1)		(5)	(11)	(3)
Net effect from recognition (deferral) of deferred net revenues and related cost of revenues	182	105	557	501
Share-based compensation expense	(57)	(39)	(111)	(73)
Amortization of intangible assets	(77)	(194)	(196)	(384)
Fees and other expenses related to the acquisition of King		(5)		(9)
Restructuring costs				(11)
Other non-cash charges		1		(15)
Consolidated operating income	434	339	1,029	831
Interest and other expense (income), net	26	46	54	85
Consolidated income before income tax expense	$ 408	$ 293	$ 975	$ 746

(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.

Segment Net Revenues

Activision

Q2 2018 vs. Q2 2017

The increase in Activision s net revenues for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to:

- 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 Destiny franchise, driven by *Destiny 2*, which was released in September 2017, and its associated in-game content, with no comparable release in 2016; and
- revenues from the continued strength of *Call of Duty: Black Ops III*, as compared to prior catalog releases.

The increase was partially offset by lower net revenues 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.

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YTD Q2 2018 vs. YTD Q2 2017

The increase in Activision s net revenues for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to the same drivers and partially offsetting factors as for the three months ended June 30, 2018 discussed above.

Blizzard

Q2 2018 vs. Q2 2017

The decrease in Blizzard s net revenues for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to lower revenues from *Overwatch*, which was released in May 2016. The decrease was partially offset by revenues from the Overwatch League, which started its inaugural regular season in January 2018.

YTD Q2 2018 vs. YTD Q2 2017

The decrease in Blizzard s net revenues for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to lower revenues from *Overwatch.* The decrease was partially offset by:

- revenues from the Overwatch League; and

- higher revenues from *World of Warcraft*, primarily due to revenues associated with in-game content delivered to customers upon pre-purchase of *World of Warcraft: Battle for Azeroth*TM.

King

Q2 2018 vs. Q2 2017

The increase in King s net revenues for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to higher revenues from the Candy Crush franchise s increased monetization, primarily through in-game events and features.

YTD Q2 2018 vs. YTD Q2 2017

The increase in King s net revenues for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to higher revenues from the Candy Crush franchise s increased monetization, primarily through in-game events and features.

Segment Income from Operations

Activision

Q2 2018 vs. Q2 2017

Activision s operating income for the three months ended June 30, 2018, was comparable to the three months ended June 30, 2017, despite the increase in sales. This was primarily due to:

- higher software amortization and royalties associated with the Destiny franchise, primarily due to the release of *Warmind*, the second expansion to *Destiny 2,* in May 2018, with no comparable release in 2017; and

- higher developer costs to support existing and upcoming title releases.

These were offset by lower sales and marketing costs, primarily associated with the Destiny franchise.

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YTD Q2 2018 vs. YTD Q2 2017

The increase in Activision s operating income for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to:

- higher revenues, as discussed above; and
- lower sales and marketing costs, primarily associated with the Destiny franchise.

The increase was partially offset by:

- higher developer costs to support existing and upcoming title releases, partially offset by higher capitalization of software development costs; and
- higher software amortization and royalties associated with the Destiny franchise, primarily due to the release of *Warmind*, the second expansion to *Destiny 2,* in May 2018, with no comparable release in 2017.

Blizzard

Q2 2018 vs. Q2 2017

The decrease in Blizzard s operating income for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to:

- lower revenues, as discussed above; and
- higher costs to operate and support Blizzard s core business and adjacent areas of opportunity.

The decrease was partially offset by higher capitalization of software development costs due to the timing of the game development cycle.

YTD Q2 2018 vs. YTD Q2 2017

The decrease in Blizzard s operating income for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to the same drivers and partially offsetting factors as for the three months ended June 30, 2018 discussed above.

King

Q2 2018 vs. Q2 2017

The increase in King s operating income for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to the higher revenues, as discussed above.

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YTD Q2 2018 vs. YTD Q2 2017

The increase in King s operating income for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to the higher revenues, as discussed above. The increase was partially offset by:

- higher marketing and product development costs for King franchises; and

- higher digital storefront fees (e.g. fees retained by Apple and Google for our sales on their platforms), primarily associated with the increase in mobile revenues.

Foreign Exchange Impact

Changes in foreign exchange rates had a positive impact of $36 million and $108 million on reportable segment net revenues for the three and six months ended June 30, 2018, 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.

Consolidated Results

Net Revenues by Distribution Channel

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

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2018	2017	Increase (decrease)	2018	2017	Increase (decrease)
Net revenues by distribution channel:						
Digital online channels (1)	$ 1,259	$ 1,309	$ (50)	$ 2,720	$ 2,694	$ 26
Retail channels	278	260	18	690	529	161
Other (2)	104	62	42	197	133	64
Total consolidated net revenues	$ 1,641	$ 1,631	$ 10	$ 3,607	$ 3,356	$ 251

(1) Net revenues from Digital online channels include revenues from digitally-distributed subscriptions,

downloadable content, microtransactions, and products, as well as licensing royalties.

(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

Q2 2018 vs. Q2 2017

The decrease in net revenues from digital online channels for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to:

- lower revenues recognized from *Overwatch*, which was released in May 2016; and

- lower revenues recognized 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.

The decrease was partially offset by:

- higher revenues from the Candy Crush franchise due to increased monetization, primarily through in-game events and features; and

- higher revenues recognized from the Destiny franchise, driven by *Destiny 2*, which was released in September 2017, and its associated in-game content, with no comparable release in 2016.

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YTD Q2 2018 vs. YTD Q2 2017

The increase in net revenues from digital online channels for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to:

- higher revenues from the Candy Crush franchise due to increased monetization, primarily through in-game events and features; and
- higher revenues recognized from the Destiny franchise, driven by *Destiny 2*.

The increase was partially offset by:

- lower revenues recognized from *Overwatch*; and
- lower revenues recognized from *Call of Duty: Infinite Warfare*, as compared to *Call of Duty: Black Ops III.*

Retail Channel Net Revenues

Q2 2018 vs. Q2 2017

The increase in net revenues from retail channels for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to 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 *Overwatch*, which was released in May 2016.

YTD Q2 2018 vs. YTD Q2 2017

The increase in net revenues from retail channels for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to the same driver and partially offsetting factor as for the three months ended June 30, 2018 discussed above, as well as higher revenues recognized from the Destiny franchise, driven by *Destiny 2*, which was released in September 2017, with no comparable release in 2016.

Net Revenues by Geographic Region

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

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2018	2017	Increase (decrease)	2018	2017	Increase (decrease)
Net revenues by geographic region:						
Americas	$ 900	$ 858	$ 42	$ 1,966	$ 1,787	$ 179
EMEA (1)	552	538	14	1,239	1,092	147
Asia Pacific	189	235	(46)	402	477	(75)
Consolidated net revenues	$ 1,641	$ 1,631	$ 10	$ 3,607	$ 3,356	$ 251

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

Americas

Q2 2018 vs. Q2 2017

The increase in net revenues from the Americas region for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to higher revenues from the Candy Crush franchise due to increased monetization, primarily through in-game events and features.

YTD Q2 2018 vs. YTD Q2 2017

The increase in net revenues from the Americas region for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to:

- higher revenues recognized from the Destiny franchise, driven by *Destiny 2,* which was released in September 2017, and its associated in-game content, with no comparable release in 2016;
- higher revenues from the Candy Crush franchise due to increased monetization, primarily through in-game events and features; 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*, which was released in November 2016, as compared to *Call of Duty: Black Ops III,* the comparable 2015 title.

EMEA

Q2 2018 vs. Q2 2017

The increase in net revenues in the EMEA region for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to 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.

YTD Q2 2018 vs. YTD Q2 2017

The increase in net revenues in the EMEA region for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, primarily due to:

- higher revenues recognized from *Call of Duty: WWII*, as compared to *Call of Duty: Infinite Warfare;* and

- higher revenues recognized from the Destiny franchise, driven by *Destiny 2,* which was released in September 2017, and its associated in-game content, with no comparable release in 2016.

Asia Pacific

Q2 2018 vs. Q2 2017

The decrease in net revenues in the Asia Pacific region for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to lower revenues recognized from *Overwatch*, which was released in May 2016.

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YTD Q2 2018 vs. YTD Q2 2017

The decrease in net revenues in the Asia Pacific region for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to lower revenues recognized from *Overwatch*.

Net Revenues by Platform

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

	For the Three Months Ended June 30,			For the Six Months Ended June 30,		
	2018	**2017**	**Increase (Decrease)**	**2018**	**2017**	**Increase (Decrease)**
Net revenues by platform:						
Console	$ 565	$ 568	$ (3)	$ 1,382	$ 1,182	$ 200
PC	451	508	(57)	971	1,072	(101)
Mobile and ancillary (1)	521	493	28	1,057	969	88
Other (2)	104	62	42	197	133	64
Total consolidated net revenues	$ 1,641	$ 1,631	$ 10	$ 3,607	$ 3,356	$ 251

(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.

Console

Q2 2018 vs. Q2 2017

Net revenues from the console platform for the three months ended June 30, 2018, were comparable to the three months ended June 30, 2017, primarily due to:

- 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; and

- higher revenues recognized from the Destiny franchise, driven by *Destiny 2*, which was released in September 2017, and its associated in-game content, with no comparable release in 2016.

The higher revenues above were offset by:

- lower revenues recognized 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; and

- lower revenues recognized from *Overwatch*, which was released in May 2016.

<u>YTD Q2 2018 vs. YTD Q2 2017</u>

The increase in net revenues from the console platform for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to:

- higher revenues recognized from *Call of Duty: WWII*, as compared to *Call of Duty: Infinite Warfare*; and

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- higher revenues recognized from the Destiny franchise, driven by *Destiny 2*, and its associated in-game content, with no comparable release in 2016.

The higher revenues above were partially offset by lower revenues recognized 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.

PC

Q2 2018 vs. Q2 2017

The decrease in net revenues from the PC platform for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to:

- lower revenues recognized from *Overwatch*, which was released in May 2016; and

- lower revenues recognized from *World of Warcraft*, driven by the release of *World of Warcraft: Legion* in August 2016, with no comparable release in 2017.

The decrease was partially offset by revenues recognized from *Destiny 2*, which was released on the PC platform in October 2017, and its associated in-game content, with no comparable release in 2016.

YTD Q2 2018 vs. YTD Q2 2017

The decrease in net revenues from the PC platform for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to the same drivers and partially offsetting factors as for the three months ended June 30, 2018 discussed above.

Mobile and Ancillary

Q2 2018 vs. Q2 2017

The increase in net revenues from mobile and ancillary for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to higher revenues from the Candy Crush franchise s increased monetization, primarily through in-game events and features.

YTD Q2 2018 vs. YTD Q2 2017

The increase in net revenues from mobile and ancillary for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to the same driver as for the three months ended June 30, 2018 discussed above.

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Costs and Expenses

Cost of Revenues

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

	Three Months Ended June 30, 2018	% of associated net revenues	Three Months Ended June 30, 2017	% of associated net revenues	Increase (Decrease)
Cost of revenues product sales:					
Product costs	$ 126	27%	$ 130	27%	$ (4)
Software royalties, amortization, and intellectual property licenses	49	11	75	16	(26)
Cost of revenues subscription, licensing, and other revenues:					
Game operations and distribution costs	250	21	236	21	14
Software royalties, amortization, and intellectual property licenses	85	7	120	10	(35)
Total cost of revenues	$ 510	31%	$ 561	34%	$ (51)

	Six Months Ended June 30, 2018	% of associated net revenues	Six Months Ended June 30, 2017	% of associated net revenues	Increase (Decrease)
Cost of revenues product sales:					
Product costs	$ 289	24%	$ 273	28%	$ 16
Software royalties, amortization, and intellectual property licenses	194	16	163	16	31
Cost of revenues subscription, licensing, and other revenues:					
Game operations and distribution costs	521	22	468	20	53
Software royalties, amortization, and intellectual property licenses	169	7	242	10	(73)
Total cost of revenues	$ 1,173	33%	$ 1,146	34%	$ 27

Cost of Revenues Product Sales:

Q2 2018 vs. Q2 2017

The slight decrease in product costs for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was in-line with the slight decrease in product sales.

The decrease in software royalties, amortization, and intellectual property licenses related to product sales for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to:

- lower software amortization and royalties from Activision of $13 million, driven by lower software amortization and royalties from *Call of Duty: WWII* as compared to *Call of Duty: Infinite Warfare,* partially offset by higher software amortization and royalties from the Destiny franchise, primarily due to the release of *Destiny 2* in September 2017; and

- lower software amortization and royalties from Blizzard of $13 million, driven by *World of Warcraft*, for which *World of Warcraft: Legion* which was released in August 2016, with no comparable release in 2017.

<u>YTD Q2 2018 vs. YTD Q2 2017</u>

The increase in product costs for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to higher product costs from Activision of $21 million, driven by the increase in product sales associated with the Destiny and Call of Duty franchises.

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The increase in software royalties, amortization, and intellectual property licenses related to product sales for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to higher software amortization and royalties from Activision of $55 million, primarily due to the Destiny franchise, driven by the release of *Destiny 2,* which was released in September 2017, with no comparable release in 2016, partially offset by lower software amortization associated with *Call of Duty: WWII,* as compared to *Call of Duty: Infinite Warfare.* The increase from Activision was partially offset by lower software amortization and royalties from Blizzard of $24 million, driven by *World of Warcraft: Legion*.

Cost of Revenues Subscription, Licensing, and Other Revenues:

Q2 2018 vs. Q2 2017

The increase in game operations and distribution costs for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to higher personnel, facilities, and equipment costs of $15 million associated with our online games and broadcasting operations.

The decrease in software royalties, amortization, and intellectual property licenses related to subscription, licensing, and other revenues for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to a decrease of $40 million in amortization of internally-developed franchise intangible assets acquired as part of our acquisition of King.

YTD Q2 2018 vs. YTD Q2 2017

The increase in game operations and distribution costs for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to higher personnel, facilities, and equipment costs of $33 million associated with our online games and broadcasting operations.

The decrease in software royalties, amortization, and intellectual property licenses related to subscription, licensing, and other revenues for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to a decrease of $77 million in amortization of internally-developed franchise intangible assets acquired as part of our acquisition of King.

Product Development (amounts in millions)

	June 30, 2018	% of consolidated net revenues	June 30, 2017	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	$ 255	16%	$ 252	15%	$ 3

Six Months Ended	$	513	14%	$	478	14%	$	35

Q2 2018 vs. Q2 2017

Product development costs for the three months ended June 30, 2018, were comparable to the three months ended June 30, 2017, primarily due to a $30 million increase in personnel and external developer costs to support existing and upcoming title releases, offset by higher capitalization of software development costs of $23 million due the increased costs previously noted and timing of the game development cycle.

YTD Q2 2018 vs. YTD Q2 2017

The increase in product development costs for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to a $87 million increase in personnel and external developer costs to support existing and upcoming title releases. The increase was partially offset by higher capitalization of software development costs of $48 million due to the increased costs previously noted and timing of the game development cycle.

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Sales and Marketing (amounts in millions)

	June 30, 2018	% of consolidated net revenues	June 30, 2017	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	$ 226	14%	$ 308	19%	$ (82)
Six Months Ended	$ 477	13%	$ 554	17%	$ (77)

Q2 2018 vs. Q2 2017

The decrease in sales and marketing expenses for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to a decrease of $77 million in amortization of the customer base intangible asset acquired as part of our acquisition of King, as the asset was fully amortized during the first quarter of 2018.

YTD Q2 2018 vs. YTD Q2 2017

The decrease in sales and marketing expenses for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to a decrease of $111 million in amortization of the customer base intangible asset acquired as part of our acquisition of King, as the asset was fully amortized during the first quarter of 2018. The decrease was partially offset by a $34 million increase in marketing spending and personnel costs, primarily associated with the Candy Crush franchise and the Overwatch League, the latter of which started its inaugural regular season in January 2018, partially offset by reduced marketing for the Bubble Witch franchise, as *Bubble Witch 3 Saga*TM was released during the first quarter of 2017, with no comparable release in 2018.

General and Administrative (amounts in millions)

	June 30, 2018	% of consolidated net revenues	June 30, 2017	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	$ 216	13%	$ 171	10%	$ 45
Six Months Ended	$ 415	12%	$ 347	10%	$ 68

Q2 2018 vs. Q2 2017

The increase in general and administrative expenses for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to:

- a $39 million increase in personnel costs, including stock-based compensation expense, and facilities costs to support the growth of our core business and adjacent areas of opportunity; and

- a $13 million increase in charitable contributions, primarily driven by the success of a charitable campaign in *Overwatch* where all proceeds involving the sale of a special in-game item, were donated to charity.

YTD Q2 2018 vs. YTD Q2 2017

The increase in general and administrative expenses for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to a $67 million increase in personnel costs, including stock-based compensation expense, and facilities costs to support the growth of our core business and adjacent areas of opportunity.

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

	June 30, 2018	% of consolidated net revenues	June 30, 2017	% of consolidated net revenues	Increase (Decrease)
Three Months Ended	$ 26	2%	$ 46	3%	$ (20)
Six Months Ended	$ 54	1%	$ 85	3%	$ (31)

Q2 2018 vs. Q2 2017

The decrease in interest and other expense (income), net, for the three months ended June 30, 2018, as compared to the three months ended June 30, 2017, was primarily due to a $12 million increase in interest income from our cash and cash equivalents and as the prior-year quarter included $12 million from the write-offs of unamortized discount and deferred financing costs associated with debt paydown activities that are not present in 2018.

YTD Q2 2018 vs. YTD Q2 2017

The decrease in interest and other expense (income), net, for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017, was primarily due to a $23 million increase in interest income from our cash and cash equivalents and as the prior-year period included $12 million from the write-offs of unamortized discount and deferred financing costs associated with debt paydown activities that are not present in 2018.

Income Tax Expense (amounts in millions)

	June 30, 2018	% of pretax income	June 30, 2017	% of pretax income	Increase (Decrease)
Three Months Ended	$ 6	1%	$ 50	17%	$ (44)
Six Months Ended	$ 73	7%	$ 77	10%	$ (4)

The income tax expense of $6 million for the three months ended June 30, 2018, reflects an effective tax rate of 1%, which is lower than the effective tax rate of 17% for the three months ended June 30, 2017. The decrease is due to a $115 million discrete net tax benefit resulting from a closing agreement the Company entered into with the IRS to resolve certain intercompany transfer pricing arrangements for tax periods starting in 2009 (the Closing Agreement) and the benefit from the lower U.S. corporate income tax rate in the current year as a result of the U.S. Tax Reform Act, net of the impact of global intangible low-taxed income of foreign subsidiaries (GILTI). This decrease was partially offset by a $57 million valuation allowance recorded with regard to California research and development credit carryforwards (CA R&D Credits) and the additional $34 million income tax expense related to the change in the provisional amount described below.

The income tax expense of $73 million for the six months ended June 30, 2018, reflects an effective tax rate of 7%, which is lower than the effective tax rate of 10% for the six months ended June 30, 2017. The decrease is due to a $115 million discrete net tax benefit resulting from the Closing Agreement and the benefit from the lower U.S. corporate income tax rate, net of the impact of GILTI. This decrease was partially offset by the $57 million valuation allowance recorded with regard to CA R&D Credits, lower excess tax benefits from share-based payments, and the additional $34 million income tax expense related to the change in the provisional amount described below.

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The effective tax rates of 1% and 7% for the three and six months ended June 30, 2018, respectively, are lower than the U.S. statutory rate of 21%, primarily due to a discrete net tax benefit resulting from the Closing Agreement, foreign earnings taxed at relatively lower statutory rates, the recognition of excess tax benefits from share-based payments, and recognition of federal research and development credits, partially offset by the valuation allowance recorded with regard to CA R&D Credits and an additional income tax expense related to the change in the provisional amount described below.

On June 27, 2018, the Company entered into the Closing Agreement. The primary adjustments recognized in the second quarter of 2018 related to the Closing Agreement were a tax expense of $70 million and a reduction in unrecognized tax benefits of $437 million. In addition, we recognized $185 million of tax benefits related to other tax adjustments resulting from the changes in U.S. tax attributes and taxable income caused by the primary adjustments. We expect the Closing Agreement to result in federal and state cash tax payments of approximately $345 million, which we expect to be made mostly before December 31, 2018.

We evaluate deferred tax assets each period for recoverability. We record a valuation allowance for assets that do not meet the threshold of more likely than not to be realized in the future. To make that determination, the Company evaluates the likelihood of realization based on the weight of all positive and negative evidence available. As of December 31, 2017, the Company had a deferred tax asset for CA R&D Credits, which can be carried forward indefinitely. The Closing Agreement impacts historical and prospective filings in certain states, including California, and after considering the impact of the Closing Agreement on its prospective California taxable income, the Company determined that its remaining CA R&D Credits no longer met the threshold of more likely than not being realized in the future. Accordingly, during the three months ended June 30, 2018, we recorded a full valuation allowance of $57 million. Additionally, the Company has not recognized a tax benefit for current-year CA R&D Credits in its year-to-date tax expense. We will reassess this determination quarterly and record a tax benefit if future evidence allows for a partial or full release of this valuation allowance.

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 imposed a one-time tax on deemed repatriated earnings of foreign subsidiaries (the Transition Tax).

On December 22, 2017, the Securities and Exchange Commission (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 Accounting Standards Codification (ASC) 740. SAB 118 enabled 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. During the fourth quarter of 2017, we recorded provisional amounts for the effects of the U.S. Tax Reform Act in accordance with SAB 118. In addition, as of December 31. 2017, we no longer considered the available cash balances related to undistributed earnings held outside of the U.S. by our foreign subsidiaries to be indefinitely reinvested. We continue to analyze the effects of the U.S. Tax Reform Act on our condensed consolidated financial statements. Accounting for the income tax effects of the U.S. Tax Reform Act requires complex new calculations 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.

During the three months ended June 30, 2018, the Company obtained additional information, including adjustments related to the Closing Agreement, and the evaluation of the impact of changing our indefinite reinvestment assertion, which affected the provisional amount initially recorded for the U.S. Tax Reform Act in the fourth quarter of 2017. As a result, the Company recorded an additional tax expense of $34 million in the three months ended June 30, 2018 for the effects of the U.S. Tax Reform Act.

We continue to evaluate the ongoing impacts of the U.S. Tax Reform Act, including provisions impacting certain foreign income, such as a tax on GILTI and a deduction for foreign derived intangible income. These provisions are complex and subject to continuing regulatory interpretation by the IRS. While we have included an estimate of GILTI in our estimated effective tax rate for 2018, we may make adjustments as we 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.

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Our effective tax rate differs from the statutory U.S. income tax rate due to the effect of state and local income taxes, tax rates that apply to our foreign income (including U.S. tax on foreign income), research and development credits, and certain nondeductible expenses. Our effective tax rate could fluctuate significantly from quarter to quarter based on recurring and nonrecurring factors including, but not limited to: variations in the estimated and actual level of pre-tax income or loss by jurisdiction (including changes in the mix of income by tax jurisdiction); changes in enacted tax laws and regulations, and interpretations thereof, including with respect to tax credits and state and local income taxes; developments in tax audits and other matters; recognition of excess tax benefits and tax deficiencies from share-based payments; and certain nondeductible expenses. Changes in judgment from the evaluation of new information resulting in the recognition, derecognition, or remeasurement of a tax position taken in a prior annual period are recognized separately in the quarter of the change.

Further information about our income taxes is provided in Note 13 of the notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q.

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, we believe, in combination with our existing balance of cash and cash equivalents and short-term investments of $5.0 billion, our access to capital, and the availability of our $250 million revolving credit facility, 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 June 30, 2018, the amount of cash and cash equivalents held outside of the U.S. by our foreign subsidiaries was $0.9 billion, as compared to $3.0 billion as of December 31, 2017. 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. We consider, on a continuing basis, 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)

	June 30, 2018	December 31, 2017	Increase (Decrease)
Cash and cash equivalents	$ 4,857	$ 4,713	$ 144
Short-term investments	124	62	62
	$ 4,981	$ 4,775	$ 206

Percentage of total assets	28%	26%

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	For the Six Months Ended June 30,					
		2018		2017		Increase (Decrease)
Net cash provided by operating activities	$	538	$	676	$	(138)
Net cash used in investing activities		(124)		(48)		(76)
Net cash used in financing activities		(250)		(652)		402
Effect of foreign exchange rate changes		(19)		50		(69)
Net increase in cash and cash equivalents and restricted cash	$	145	$	26	$	119

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.

Net cash provided by operating activities for the six months ended June 30, 2018, was $538 million, as compared to $676 million for the six months ended June 30, 2017. The decrease was primarily due to changes in our working capital resulting from timing of collections and payments. The decrease was partially offset by higher net income for the six months ended June 30, 2018, as compared to the six months ended June 30, 2017.

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.

Net cash used in investing activities for the six months ended June 30, 2018, was $124 million, as compared net cash used in investing activities of $48 million for the six months ended June 30, 2017. The increase in the cash used in investing activities was primarily due to purchases of available-for-sale investments of $59 million for the six months ended June 30, 2018, with no comparable transaction in the prior-year period.

Net Cash (Used in) Provided by 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.

Net cash used in financing activities for the six months ended June 30, 2018, was $250 million, as compared to net cash used in financing activities of $652 million for the six months ended June 30, 2017. The change was primarily attributed to our debt financing activities in the prior year. For the six months ended June 30, 2017, we had net debt repayments of $500 million, with no comparable repayment activity for the six months ended June 30, 2018. This impact was partially offset by:

- lower proceeds from stock option exercises of $77 million for the six months ended June 30, 2018, as compared to $130 million for the six months ended June 30, 2017;

- higher tax payments made for net share settlements on restricted stock units of $68 million for the six months ended June 30, 2018, as compared to $36 million for the six months ended June 30, 2017; and

- higher dividends paid of $259 million for the six months ended June 30, 2018, as compared to $226 million for the six months ended June 30, 2017.

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Effect of Foreign Exchange Rate Changes

Changes in foreign exchange rates had a negative impact of $19 million and a positive impact of $50 million on our cash and cash equivalents for the six months ended June 30, 2018 and 2017, respectively. The change was primarily due to changes in the value of the U.S. dollar relative to the euro and the British pound.

Debt

As of both June 30, 2018 and December 31, 2017, our total outstanding debt was $4.4 billion, bearing interest at a weighted average rate of 3.69% and 3.58%, respectively. During the six months ended June 30, 2018, there was no activity associated with our debt instruments except for normal recurring interest payments.

On July 17, 2018, we issued an irrevocable notice of redemption to the holders of all of our outstanding 2023 Notes. Accordingly, the 2023 Notes will be redeemed pursuant to their terms on August 16, 2018 at a redemption price equal to 100% of the principal amount of the 2023 Notes plus a make-whole premium calculated as set forth in the indenture governing the 2023 Notes. Redemption of the 2023 Notes will result in a loss on extinguishment of approximately $35 million, comprised of premium payments of approximately $27 million and a write-off of unamortized discount and financing costs of approximately $8 million. As the irrevocable notice of redemption was issued subsequent to June 30, 2018, we presented the outstanding principal balance of the 2023 Notes and its related unamortized discount and deferred financing costs as Long-term debt, net on our condensed consolidated balance sheets as of June 30, 2018.

On February 1, 2018, our Board of Directors authorized repayment of up to $1.8 billion of the company s outstanding debt during 2018. As discussed above, on July 17, 2018, we issued an irrevocable notice to the holders of our 2023 Notes that all of our outstanding 2023 Notes will be redeemed on August 16, 2018. The determination as to if and when we make any such remaining repayments will be dependent on market conditions and other factors.

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

	At June 30, 2018		
	Gross Carrying Amount	Unamortized Discount and Deferred Financing Costs	Net Carrying Amount
2017 TLA	$ 990	$ (7)	$ 983
2021 Notes	650	(4)	646
2022 Notes	400	(3)	397
2023 Notes	750	(8)	742
2026 Notes	850	(9)	841
2027 Notes	400	(5)	395
2047 Notes	400	(10)	390
Total long-term debt	$ 4,440	$ (46)	$ 4,394

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	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	$ 4,440	$ (50)	$ 4,390

Refer to Note 10 of the notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q for further disclosures regarding our debt obligations.

Dividends

On February 1, 2018, our Board of Directors approved a cash dividend of $0.34 per common share. On May 9, 2018, we made an aggregate cash dividend payment of $259 million to shareholders of record at the close of business on March 30, 2018.

Capital Expenditures

For the year ending December 31, 2018, we anticipate total capital expenditures of approximately $140 million, primarily for leasehold improvements, computer hardware, and software purchases. During the six months ended June 30, 2018, capital expenditures were $61 million.

Off-Balance Sheet Arrangements

At June 30, 2018 and December 31, 2017, 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

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

- Revenue Recognition;
- Allowances for Returns and Price Protection;

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- Software Development Costs;
- Income Taxes;
- Fair Value Estimates (including Business Combinations and Assessment of Impairment of Assets); and
- Share-Based Payments.

During the six months ended June 30, 2018, there were no significant changes to the above critical accounting policies and estimates, with the exception of our adoption of ASC 606: *Revenue from Contracts with Customers*. Refer to Note 2 of the notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q for disclosures regarding our updated revenue recognition accounting policies and see Recently Issued Accounting Pronouncements below for the financial statement impact as a result of our adoption of the new standard. Refer to Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2017, for a more complete discussion of our other critical accounting policies and estimates.

Recently Issued Accounting Pronouncements

Below are recently issued accounting pronouncements that were most significant to our accounting policy activities. For a detailed discussion of all relevant recently issued accounting pronouncements, see Note 3 of the notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q.

Recently Adopted Accounting Pronouncements

Revenue Recognition

As discussed in Note 2 of the notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q, in May 2014, the Financial Accounting Standards Board (FASB) issued new accounting guidance related to revenue recognition and on January 1, 2018, we adopted the new accounting standard and related amendments (collectively, the new revenue accounting standard), utilizing the modified retrospective method. Additionally, we elected to apply the new revenue accounting standard only to contracts not completed as of the adoption date. For contracts that were modified before the period of adoption, we elected to reflect the aggregate effect of all modifications when (1) identifying the satisfied and unsatisfied performance obligations, (2) determining the transaction price, and (3) allocating the transaction price to the satisfied and unsatisfied performance obligations. We recognized the cumulative effect of initially applying the new revenue accounting standard as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The cumulative effect adjustment recorded to our retained earnings at January 1, 2018 was $88 million.

The most significant impacts of the new revenue accounting standard for us are:

- *The accounting for our sales of our games with significant online functionality for which we do not have vendor-specific objective evidence (VSOE) for unspecified future updates and ongoing online services provided.* Under the prior accounting standards, VSOE for undelivered elements was required. This requirement was eliminated under the new revenue accounting standard. Accordingly, we are required to recognize as revenue a portion of the sales price upon delivery of this software, as compared to recognizing the entire sales price ratably over an estimated service period, as previously required. This difference in accounting primarily impacted revenues from our Call of Duty franchise, where approximately 20% of the sales price is now recognized as revenue upon delivery of the games to our customers. The amount of revenue recognized upon delivery of games to our customers is analyzed on a title-by-title basis and may change in the future. For example, we expect the entire sales price from our upcoming *Call of Duty: Black Ops 4* release to be recognized ratably over an estimated service period, as the gameplay will have an increased focus towards the online competitive and cooperative game modes with no single-player campaign mode. Many of our other franchises, such as Destiny, Overwatch, World of Warcraft, and Candy Crush, are online hosted arrangements, and the accounting for our sales of these games under the new standard is relatively unchanged; and

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- *The accounting for certain of our software licensing arrangements.* While the impact of the new revenue accounting standard may differ on a contract-by-contract basis (as the actual revenue recognition treatment required under the standard will depend on contract-specific terms), the new revenue accounting standard generally results in earlier revenue recognition for these arrangements.

For additional discussion regarding the impact of our adoption of the new revenue accounting standard, including the impacts to our condensed consolidated balance sheet and statement of operations, see Note 3 of the notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q.

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, 2017, and should be applied retrospectively. Early adoption is permitted.

We adopted the new standard during the first quarter of 2018 and applied the standard retrospectively for all periods presented. The application of this new standard did not have a material impact on our condensed consolidated statements of cash flows for the six months ended June 30, 2018 and 2017.

In our Annual Report on Form 10-K for the year ending December 31, 2018, 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 acquisition of King, and the subsequent release of that cash in 2016 to complete the 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, will not be included as an investing activity in the statement of cash flows.

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. We adopted the standard during the first quarter of 2018. The adoption of the standard did not have a material impact to our condensed consolidated financial statements.

Recent Accounting Pronouncements Not Yet Adopted

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 to recognize a lease liability and a right-of-use asset for its leases. Classification will be based on criteria that are largely similar to those applied in current lease accounting. The lease liability will be equal to the present value of lease payments. The asset will be based on the lease 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. 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, but expect it to have a significant impact to our consolidated balance sheet as a result of establishing lease liabilities and right-of-use assets for our operating leases. We do not plan to early adopt this new standard but do expect to elect and apply the available transition practical expedients upon adoption.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Foreign Currency Exchange Rate Risk

We transact business in many different foreign currencies and may be exposed to financial market risk resulting from fluctuations in foreign currency exchange rates. Revenues and related expenses generated from our international operations are generally denominated in their respective local currencies. Primary currencies include euros, British pounds, Australian dollars, South Korean won, 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 values of our 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.

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

The total gross notional amounts and fair values of our Cash Flow Hedges are as follows (amounts in millions):

	As of June 30, 2018		As of December 31, 2017	
	Notional amount	Fair value gain (loss)	Notional amount	Fair value gain (loss)
Foreign Currency:				
Buy USD, Sell Euro	$ 639	$ 21	$ 521	$ (5)

At June 30, 2018, our Cash Flow Hedges have remaining maturities of 12 months or less. Additionally, less than $1 million of net realized but unrecognized losses are recorded within Accumulated other comprehensive income (loss) at June 30, 2018 for Cash Flow Hedges 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.

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The amount of pre-tax net realized gains (losses) associated with our Cash Flow Hedges that were reclassified out of Accumulated other comprehensive income (loss) and into earnings was as follows (amounts in millions):

	For the Three Months Ended June 30, 2018	2017	For the Six Months Ended June 30, 2018	2017	Statement of Operations Classification
Cash Flow Hedges	$ (4)	$ 3	$ (14)	$ 9	Net revenues

Foreign Currency Forward Contracts Not Designated as Hedges

The total gross notional amounts and fair values of our foreign currency forward contracts not designated as hedges are as follows (amounts in millions):

	As of June 30, 2018		As of December 31, 2017	
	Notional amount	Fair value gain (loss)	Notional amount	Fair value gain (loss)
Foreign Currency:				
Buy Euro, Sell USD	$ 137	$ (6)	$	$

For the three and six months ended June 30, 2018 and 2017, pre-tax net gains associated with these forward contracts were recorded in General and administrative expenses and were not material.

In the absence of hedging activities for the six months ended June 30, 2018, a hypothetical adverse foreign currency exchange rate movement of 10% would have resulted in a theoretical decline of our net income of approximately $64 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 this 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 pursuant to the credit agreement we entered into on October 11, 2013, as amended thereafter and from time to time. We do not currently use derivative financial instruments to manage interest rate risk. As of both June 30, 2018 and December 31, 2017, 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. 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 10 of the notes to condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q for disclosures regarding 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 June 30, 2018, our $4.86 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 June 30, 2018, there was no material interest rate risk exposure to the Company s consolidated financial condition, results of operations, or liquidity as of that date.

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Item 4. Controls and Procedures

Definition and Limitations of Disclosure Controls and Procedures

Our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (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 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 June 30, 2018, the end of the period covered by this report. Based on this evaluation, the principal executive officer and principal financial officer concluded that, at June 30, 2018, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized, and reported on a timely basis, and (ii) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated any changes in our internal control over financial reporting that occurred during the fiscal quarter ended June 30, 2018. Based on this evaluation, the principal executive officer and principal financial officer concluded that, at June 30, 2018, there have not been any changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

Various risks associated with our business are described in Part I, Item 1A, Risk Factors, of our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 6. Exhibits

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

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EXHIBIT INDEX

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/A, filed March 21, 2018).
*10.1	Non Affiliated Director Compensation Program and Stock Ownership Guidelines, as amended and restated as of May 1, 2018.
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 Extension Calculation Linkbase Document.
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.

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

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) condensed consolidated balance sheets at June 30, 2018 and December 31, 2017, (ii) condensed consolidated statements of operations for the three and six months ended June 30, 2018 and June 30, 2017, (iii) condensed consolidated statements of comprehensive income (loss) for the three and six months ended June 30, 2018 and June 30, 2017, (iv) condensed consolidated statements of cash flows for the six months ended June 30, 2018 and June 30, 2017; (v) condensed consolidated statement of changes in shareholders equity for the six months ended June 30, 2018; and (vi) notes to condensed consolidated financial statements.

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SIGNATURE

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

Date: August 2, 2018

ACTIVISION BLIZZARD, INC.

/s/ SPENCER NEUMANN
Spencer Neumann
Chief Financial Officer and
Principal Financial Officer of
Activision Blizzard, Inc.

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