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Conference Call Transcript

ERTS - Electronic Arts Inc at UBS AG Best of America's Conference

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CORPORATE PARTICIPANTS

Eric Brown

Electronic Arts Inc. - EVP & CFO

PRESENTATION

Unidentified Participant

I'd like to introduce Eric Brown who is the CFO of Electronic Arts, as probably most of you all know, obviously a leading global video game publisher. Obviously an interesting time for him to be here talking as we go through the whole sort of videogame transition to some more digital downloads away from sort of the traditional retail model. Covered by UBS by analyst Brian Pitz, he's got (inaudible) and a \$29.50 target price. Eric, the floor is yours.

Eric Brown - Electronic Arts Inc. - EVP & CFO

Thank you very much. What I'd like to do is to lead off with the Safe Harbor statement. During the course of this presentation EA may make forward-looking statements regarding future events and the future financial performance of the Company. We caution you that actual events and results may differ materially.

We refer you to EA's most recent forms 10-K and 10-Q for a discussion of risk factors that could cause actual results to differ materially from those discussed today. EA makes these statements as of September 9, 2011 and disclaims any duty to update them.

Okay, in terms of the agenda today, I'd like to cover some of the sector trends with a focus on the digital transformation. I'd then like to talk about what EA is doing specifically through FY'11 and looking forward to the balance of FY'12 and our major strategic initiatives.

EA participates in about a \$50 billion market of worldwide interactive entertainment. And as you can see here, the growth in the sector has been about 7% over the last several years. There are really two things going on in the overall video game market.

We have on the one hand high growth in digital. As you can see here, we've seen and anticipate about a 20% CAGR in digital overall in video games reaching approximately \$29 billion in calendar year '12. Underpinning that is kind of the core packaged goods market; i.e. games that are physically delivered on a disc, typically a DVD disk or a Blu-ray disc in the case of the PlayStation3 which is sold at retail. That market has been in decline over the last several years at minus 5%. So blended between the two you see about a 7% growth rate overall.

Now within digital there's been some really interesting trends. Number one, there's been strong growth; number two, there's been growth across all the different areas within digital. The platform of choice within digital obviously has been helped by the advent of Smartphones, (technical difficulty) and others, but the PC platform, as you can see here in the blue and the red data set, occupies about two-thirds of the overall digital marketplace.

Game modes such as MMOs, which stands for massively multi-player online games, typically subscription-based games where people pay a \$10 to \$15 per month access fee are played on the PC platform. Free-to-play games or micro-transaction based games are also a feature of the PC market overall. That's experienced the strongest growth, about 25% CAGR over the last several years. We estimate that the digital sector for the first time will surpass packaged goods video games in the upcoming year.

Demographics are also playing into the sector. If we go back five to six years, there were about 200 million, perhaps 225 million core video game players in the marketplace. They played video games and purchased contents principally for consumption on dedicated consoles, consoles from Sony, Nintendo and Microsoft.

If you look at some of the platforms that have emerged in the last five to six years -- Smartphones, social networks and in general Internet access which allows for browser based (technical difficulty) for you to play games. We basically have about 1 billion gamers worldwide consuming content across multiple devices.

One of the things that we've seen is not just a growth in the number of users, but a growth in the number of platforms that people are playing video games on. In just about a year and a half period a survey based on North American data indicates that the average person was playing video games on two platforms, to typically that would be the home PC plus one console.

What they've done is they've added 0.6 game devices on average. And that 0.6 game device addition can be thought of as, for example, a Smartphone. It could be typically an Apple iOS powered device or an Android powered device.

And so, in summary what we're seeing in the video game market is an explosion in terms of the addressable market due to the proliferation of new game capable devices. And we're seeing an increase in play rates among consumers as they play games on different devices to suit the window of opportunity that they have for entertainment.

Within mobile we've seen some interesting trends. A couple years ago the Smartphone market was about two-thirds of overall video gaming. Here it was about \$1 billion over \$1.5 billion. We anticipate that by calendar '13 the majority of the marketplace will be Smartphone-based video gaming. Featurephones will be in decline, as you can see here. Overall the mobile video game market is about a 10% CAGR industry, but it's 20% top-line due to Apple iOS devices, Android devices and other Blackberry devices, etc.

EA mobile business, as you can see, is shown on the right. Last year it was about a \$234 million business. We have yet to hit the 50-50 point, last year we were at about 40% in Smartphone. We anticipate actually hitting 50-50 Smartphone-Featurephone in terms of our distribution of sales and from that point forward we expect to be primarily dominated by Smartphone revenue.

One of the questions we've received is with the advent of these new online platforms and these free-to-play business models, what happens in terms of our revenue. If we have a game offered on a free-to-play basis and a game offered on a paid basis, \$50 or \$60 up front, what happens? Is there substitution, is there cannibalization, is there a degradation of the ASPs?

What we found, and I've illustrated four specific game franchises here, is that the provisioning online or free-to-play games is actually additive in terms of bringing new users into the franchises. Let's take a couple of examples here.

Battlefield Play4Free is a browser-based first person shooter game and what we saw is that we had about 500,000 people who were playing both the browser free-to-play game and the underlying paid traditional console game. Fully 1.6 million new users came into the franchise for the first time because they had available to them a free-to-play experience.

Similarly we see with games like Dragon Age Legends, what's interesting here is Dragon Age Legends is one of these Facebook or social network games. And here we brought in 0.6 million additional new users to the core Dragon Age franchises.

As we move further to the right we're actually moving closer to recent releases, Need For Speed World, one of our preeminent driving franchises, fully 7 million new customers came into the franchise for the first time by playing the lightweight, again free-to-play, browser game providing a funnel effect, as it were, to bring them into the packaged goods world.

Now having touched upon some of the key trends in specifically digital, I'd like to now delve a bit deeper into what EA is doing specifically. For fiscal '11 our strategy was fewer, better and bigger packaged goods titles, i.e. rationalization of the portfolio. Secondly, building digital, driving the digital revenue streams because, again, digital is the area where we're seeing the greatest new demand. And driving cost efficiencies, i.e., bottom line non-GAAP operating margin and operating cash flow leverage.

If you look at our report card going back to fiscal '09, we can see that we had about 67 packaged goods titles and we basically refocused the business, we reduced the title count by about two-thirds. This fiscal year we expect about approximately 22 primary title releases, so a third of what we had before. And so doing what we've done is we increased the average revenue per franchise from about \$55 million to an anticipated \$131 million in fiscal '12.

In the area of quality we've really focused our talented studio teams in terms of building the highest possible quality games because quality is indeed highly correlated to unit sales outcomes. Using the third party rating service called Metacritic, Metacritic rates, amongst other things, movies as well as video games, it's a composite score of dozens of reviewers.

In fiscal '09 we had about 22% of our titles that received a Metacritic rating of 80 or better. In fiscal '11 we had about twice the hit rate of 80 or better Metacritic, we had 42% of our overall titles with a Metacritic of 80 or better. Fiscal '12 still to be determined since we still have titles to come into the marketplace. We're expecting to do a bit better in terms of our quality rating.

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In summary what we've done over the past several years is we decreased our title count as you've seen, we've increased quality on average per title, increased revenue per title exactly as we said we would do several years ago and that leverage is starting to flow to the bottom line of our P&L.

In digital as well the growth is for the industry overall. Again 20% plus CAGR expected. EA has grown its digital business at a CAGR of about 38% over the last several years. So we started out in fiscal '09, we recorded on a non-GAAP basis approximately \$429 million of digital revenue. We achieved \$833 million of digital revenue actual for this past fiscal year. And at the midpoint of our guidance for fiscal '12 we're expecting \$1.125 billion in digital.

We're building a \$1 billion plus digital business not just through one or two franchises but really through a multitude of ways. We're introducing the Star Wars MMO, we're driving downloadable content, digital content for Xbox and PS3 related games. We're driving our free-to-play micro-transaction games and we're driving revenue in the all-important Facebook social games platform as well.

One of the things we like about digital is that the revenues tend to be more ratable. In the case of a subscription-based game it's a predictable revenue stream, we typically have the subscriber's method of payment, credit card, on file with permission to bill \$10, \$15, \$20 per month on a recurring basis. That's one of the reasons that we continue to really emphasize digital revenue within our P&L.

We're also driving digital revenue on our core packaged goods. Our single largest packaged goods game franchise is FIFA Soccer. And this past year FIFA 11 generated well in excess of 10 million units of sales through the traditional retail channel.

One of the other things that we've done with FIFA is that we've, again, taken into the digital area. In fiscal '11 we had \$110 million of non-GAAP digital revenue with the FIFA franchise. And what we did is we've adapted and modified the game so that people can procure micro-transaction content a variety of different ways.

On the right you see FIFA 11 ultimate team. Now what this is, it's a mode of play where people who buy the PlayStation3 disc or the 360 disc have an opportunity to purchase digital card packs, as it were, of players. They assemble the best possible team, they put them into the ultimate team mode, they play online, they compete head-to-head with their friends. The more of the ultimate team content packs they purchase the higher the likelihood that they get the all-star players. And so it's really a game that (inaudible) cycles upon itself.

FIFA 10 generated also a fair amount of digital revenue, but, as you can see, FIFA 11 was a step function above and beyond that. We also have FIFA Online for the PC, this is a game that we released in Asia, principally in South Korea. It's a game where you download the (inaudible), about a gigabyte or so of a download, and then you pay nothing upfront, but then you micro-transact thereafter. We also have FIFA on mobile platforms, as you can see here. We have FIFA on the Facebook platform as well.

So in summary, what you see here is an example of a packaged goods franchise in EA that's been a perennial top seller. We've now successfully extended into the digital realm \$110 million of non-GAAP digital revenue that you see represented here is a very high net margin, typically 40% to 50% or better depending upon whether it's mobile or ultimate team downloadable content.

Some one of the other things that digital content for our packaged goods products does is that it establishes a real connection, it has ongoing engagement. And so here it looks like the data is a bit busy, but we have on the left FIFA Ultimate Team 10 compared on the right to FIFA Ultimate Team 11. So it's the exact same core FIFA franchise as the -- pretty much the exact same digital revenue mode.

But as you can see here, what we're doing is we're tracking by week, it's an apples-to-apples comparison, the amount of non-GAAP digital net revenue accruing to the P&L. And what we've been able to do is actually come up the learning curve a bit and figure out how to more effectively market on an ongoing basis the FIFA consumer base.

Some of the things that we do as we deployed the FIFA ultimate team is we register every single user, we have in our backend systems a user ID management system, we refer to it as Nucleus, it has in excess of 130 million registered users. We typically have their e-mail, first name, last name and we know a fair amount about their game play, purchase patterns, etc. So we use that back end connectivity to merchandise and message to them.

So we can see here in the example of FIFA 11 versus FIFA 10, we're able to compound that revenue and drive engagement throughout the year. We can keep the customer connected, tied into the community, they're going to be happier and they're going to be spending more revenue, as you can see here, across the data set.

This is also a business model, Ultimate Team, that we've extended not just from soccer, we've deployed Ultimate Team IV, American Football and Madden; we have a similar Ultimate Team mode in our NHL sports franchise as well.

Another key franchise that EA markets is Battlefield. Battlefield falls under the genre of first person shooter, it's a moderate combat head-to-head. It's a wholly-owned franchise that we've now built and turned into a year-round business.

So Battlefield Bad Company 2 on the upper left-hand corner is a packaged good that we launched well over a year ago, it was in March of our past fiscal year. Over a year subsequent to the release we'd been releasing additional downloadable content. This past holiday season we released an expansion pack known as Battlefield Vietnam, again that was an additional piece of content that people could purchase on the Xbox or Sony PlayStation network, download to the console and then combine with a pre-existing disc-based purchase.

The lower right-hand corner you can see Battlefield Heroes and Battlefield Play4Free. Again, these are games modes where you can go online, you can start playing for free initially, but then if you want to improve your squad or the performance of your individual combatant you would purchase micro-transaction items and level up.

And finally, Battlefield is also in the lower left-hand corner, it's also in the mobile space. You can get, for example, an iPad version of Battlefield as well. So net, this is an example of EA taking a core franchise cross-platform and really creating a year-round business and trying to get out of the typical peaks that we've seen in the December holiday quarter.

Overall we've had a fair amount of success creating a digital business for the Battlefield franchise. The numbers aren't quite as high for the leading FIFA franchise, but we can report that across fiscal '10 and fiscal '11 combined we generated \$83 million in net non-GAAP digital revenue for the Battlefield franchise. And on the right hand side you can see it's broken down by mode.

So, for example, Battlefield Bad Company 2 full game downloads, so not only can you purchase this game for the Xbox 360 or the PlayStation3, you can also go online and download the PC version. Now admittedly it's a pretty large download, it's over 5 gigabytes, you need a bit of patience depending upon your broadband connection.

But we've sold hundreds of thousands of full game versions of Battlefield downloaded directly to the PC. And this is extremely high margin to EA because we bypass the retailer and actually pick up the margin that would otherwise go to the retail channel.

Battlefield Bad Company 2 downloadable content, again, as with FIFA, this is additional content available to the player on the PlayStation3 or the connected Microsoft 360 console. Battlefield 1943 was an industry first, it was a game for the 360 and PlayStation3 that was never released in physical disk format, it was only made available for digital download directly to the hard drive. And that racked up a fair amount of revenue as well. And the Play4Free versions, Battlefield Heroes, also contributed to the overall \$83 million of net revenue for this particular franchise.

One of the most exciting platforms in digital is Facebook and the Facebook connect platform. And so, amongst other activities that users (inaudible) Facebook, gaming has session become a really important way for people to stay connected.

Now EA and just about four weeks ago launched The Sims Social Facebook game. And this was based on the pre-existing Sims franchise that life to date has sold approximately 140 million units of full game downloads, [stuff] packs, expansion packs, etc. And so one of the things that's actually demonstrated here is that on a brand-new platform, i.e. social network gaming, what EA has been able to do is the following.

Number one, we purchased a company called Playfish about two years ago which specialized in social games and we acquired not just a talented (inaudible) team, but an existing platform technology, which allows you to take content, publish it on the Facebook platform and then interact and monitor telemetry across the game to drive very tactical promotions and also place advertising and measure in near real time ROI on advertising.

The core Sims team that invented the franchise over a decade ago partnered with Playfish to reimagine the franchise specifically for a social game (inaudible). What's really important here is creating connections between users.

And so when you play The Sims Social you can download it for free if you have a Facebook account; what you'll find is that you reach certain levels and achievements, you can broadcast your attainment to your friends, you can invite them to play, you can buy them digital gifts, etc, and so it creates that connection.

Now another fascinating thing about the social network gaming as in Sims Social in particular is we launched it, as you can see, about four weeks ago, we launched it with zero advertising. We have yet to turn on acquisition advertising, all the growth in user count and the typical metric used for user count in social network games is DAU, which stands for daily active user, i.e., someone that logs into their Facebook account, plays their game at least once per day.

So we've gone from zero to -- in this chart it says 7.4 million DAUs. The actual number as of today, it changes pretty rapidly, is just over 7.9 million daily average users. What we've done is we've created from scratch in about a month with no marketing the number three game on Facebook overall. And so we're looking forward to actually turning on acquisition marketing for the Sims Social franchise and driving even more revenue.

Again, the revenue here is digital by definition, the free-to-play game, people purchase micro-transaction content to include within their free game play. The engagement level for the franchise is high, people are logging in on average not one or two times per day but three times per day and spending 15 to 20 minutes per session. So the DAU metric looks good and the engagement factor is extremely high for this successful product launch.

Bringing this all together, what we've done is also focused on operating expenses. In fiscal '09 we, like many other businesses, had to reimagine our product portfolio. We restructured the business, we brought down the number of titles, we reduced headcount, we brought down operating expenses by about 10%, as you can see here.

One of the things that we've done is move more of our full-time headcount to lower-cost locations. We have, for example, about 1,000 people in our EA Hyderabad office working principally on mobile titles. And what we're focused on is delivering operating margin leverage.

So out of a deficit operating margin position -- again this is all on a non-GAAP basis -- is minus 4% and we delivered 5% in fiscal '10, about 7% in fiscal '11. And depending upon where you are in our guidance range for fiscal '12, 8% to 10% expected for fiscal '12.

So as we look to fiscal '12, and we're about halfway through the fiscal year, we're a March fiscal year end company, we're focused on key intellectual property or game franchises. We'll be launching the third iteration of Battlefield, Battlefield 3 October 25 is when it launches in both North America and European markets.

Star Wars the Old Republic is a highly anticipated online subscription-based game, the intellectual property is licensed from LUCAS Arts, the revenue model will be a monthly paid subscription coupled with an upfront purchase of the actual game client. Our signature driving franchise, Need For Speed, The Run, is also coming out this holiday period. And then towards the end of the fiscal year in our fourth fiscal quarter, we're also releasing version of three of the highly acclaimed Mass Effect 3 franchise.

In terms of platforms, I've talked about Sims Social, again an area where EA is pushing very hard. We also have a new platform technology called Origin, which I'll touch on in just a moment.

In terms of talent, the industry is heating up and a lot of publishers are going out and looking to take their franchises into the digital space given the 20% CAGR that we see overall.

And so EA, the creative teams are taking on the challenge to take their existing core packaged goods franchises, again FIFA and Battlefield, great examples where you have teams that have produced award-winning titles for the PlayStation and the 360 and the Wii and are now taking that into the digital free-to-play space. So our teams are adapting, recruiting and training for the digital era.

Key titles for fiscal '12 I've touched upon -- Battlefield 3, Madden, just launched about a week or so ago. One of the things I can report today, Madden is a pretty signature video game launch. The industry comped down year over year in August because Madden was three days outside the reporting period for NPD.

But Madden is up about 10% year over year and this is with the backdrop of labor negotiations, etc. So that's our core franchise. We're off to a pretty good start as we head into the holiday period as well.

PopCap, the logo depicted here, is a company that EA purchased about a month ago. PopCap was a private company, the leading developer of a genre of games known as casual games. It was about a \$100 million business with a 16% EBIT margin with a top-line revenue CAGR of in excess of 35%. We're now in the process of taking the highly regarded PopCap intellectual property across multiple platforms, social, digital, mobile type of transactions, etc.

Origin, I touched upon this earlier. This is something that EA launched just in June and it's a connected direct-to-consumer gaming platform. So what this means is you can go to EA.com, download Origin and what it is is a client application that sits on top of your PC desktop, it provides for highly available digital downloads of games and has an embedded e-commerce store.

But more importantly than just being an e-commerce conduit, it provides for connectivity with the user base. So you can create a friends list, you can go online, you can chat, you can figure out who has had what level of success in a particular game, you can issue challenges, etc. And so, EA is the world leader in terms of traditional packaged goods PC games. Origin is a client owned and operated by EA, again bypassing traditional retailer margin, which allows people to buy content directly for EA.

Initially Origin is set up to deliver EA games, but very soon we'll be delivering third-party content to Origin where we leverage, again, our back-end infrastructure, the \$130 million plus registered users that we have, a multitude of digital payment methods, etc.

So we're fairly excited about Origin, we have about 4 million installs of the client, we expect that number to climb substantially as we enter the specific holiday season because all our PC games are now by default installed to the Origin wrapper even if the game itself is purchased in physical format at traditional retail.

I touched upon PopCap, again we're very excited about this acquisition. We acquired a business which was predominately digital, they have social network games, they have mobile games, they have free-to-play micro-transaction games, DirecPC downloads. It helps accelerate our growth towards our now \$1.1 billion digital revenue target for fiscal '12.

Casual gaming is the industry's fastest growing segment. If you step back and you think about this, again many new consumers are coming into video gaming because they're carrying around in their pocket a Smartphone, an iOS device, an Android device. And frequently the first video game experience is across those devices and purchased through the app store.

PopCap has five signature franchises all of which are available on mobile. And so that helps us lever into this fast-growing new consumer segment. We expect the transaction to be at least \$0.10 accretive to our non-GAAP earnings per share in fiscal 2013 and I'm pleased to report that the integration on the transaction closed about a month ago, the integration of core EA operations is going very well thus far and we're so excited to have the PopCap team as a part of the EA family.

Okay, we pull this together and what we see is the following. Number one on the left here, the EA revenue on a non-GAAP basis has actually remained fairly flat over the last several years, it's about \$4 billion top-line. But if you drill down what you find is that we've significantly transformed the nature of the P&L.

Starting in fiscal '09 we had about 46% of our overall non-GAAP revenue on the negative growth platforms, standard definition platforms. So again, the overall video game packaged goods market is bifurcated. You have growth in high definition, which is the Xbox 360, the PlayStation3 and the PC. And you have about a minus 15% to a minus 20% decline in standard definition video gaming, i.e. the Nintendo Wii and the dedicated hand-held; the NDS, the hand-held from Nintendo; and the PlayStation portable.

EA recognizes changing trends and as part of the rationalization of the SKU plan emphasized really two things. Number one, digital, which is depicted as the blue data set here. We've almost tripled digital revenue over the time frame. I would also emphasize high definition video gaming, i.e. the 360 platform, the PlayStation3 and the PC. That is the green data set here.

Now look at our product portfolio and the business is about 90% high-definition digital, the actual number is about 88%, and we've rounded here for convenience. So we've actually significantly transformed the P&L and positioned our products so that they're all in growth areas, 20-plus-percent CAGR for digital and 5% to 10% CAGR expected for high definition video gaming.

The result in terms of non-GAAP EPS, as you can see, we had a loss in fiscal '09; EA was severely impacted by the fall of calendar '08, the consumer led recession. We started to recover in fiscal '10 with \$0.44 of non-GAAP EPS, we reported \$0.70 on fiscal '11. It's important to note here that we started out fiscal '11 with guidance of \$0.50 to \$0.70, so we hit the upper end of that guidance range of 12 months in advance of actually delivering.

In fiscal '12 our estimate is for non-GAAP EPS of \$0.70 to \$0.90. And so this number here at the midpoint, \$0.80, is about 10% to 12% growth. What's important to note here is that as we move through fiscal 2012 we launch a game which is fairly important in terms of our P&L, Star Wars,

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the Old Republic. It's a game where we enter fiscal '12 expensing tens of millions of dollars in terms of R&D, EA expenses, not capitalizes but expenses all of its R&D. And when we exit fiscal '12 we expect a substantial paid subscriber user base.

We've talked about exiting the last day of fiscal '12 with a non-GAAP EPS run rate of about \$1, we add on top of that PopCap, we expect about \$0.10 of non-GAAP EPS accretion going into the next fiscal year overall. And so the midpoint here in fiscal '12 doesn't really fully reflect the actual trajectory that EA is on at this point.

So that's a quick overview of the industry and what EA has been up to in fiscal '11 looking out to fiscal '12. With that I'd be very happy to take questions from the audience.

QUESTION AND ANSWER

Unidentified Audience Member

Two questions, firstly, can you, if you're able to, give us any indication of the health of the consumer in terms of their purchase of electronic games? At the moment obviously (inaudible) consumer spending in the US.

And then secondly, if you take something like the iPad, where do you port that game from? Does it come from the mobile device, does it come from the PC or the other platforms? And how expensive is it to port across?

Eric Brown - *Electronic Arts Inc. - EVP & CFO*

Okay, I'll take the second question first. So the iPad games are more often than not derived or based upon the iPhone games, so they're a similar operating system. The iPad, what you need to do is you need to scale up the experience. There's more graphic intensity across the big screen compared to the Apple device versus porting it from a 360 version. That's a pretty large and complex product in terms of code base.

Development costs, as you would expect, are a bit -- quite a bit lower for an iPad or in iOS device in general compared to a traditional 360 or PlayStation3 game. And one of the things that, again, EA tends to do is leverage existing brands and brands themselves more often than not like FIFA is a great example, they're established on the 360 or the PS3, people have their first experience there.

And we leverage the brand into the iPad but the code base, the actual product itself, is quite a bit different from what we started out with on the 360. It's less complex, less costly to build, it's hundreds of thousands of dollars versus \$10-million-plus for development of the 360 game.

In terms of the consumer overall, spending patterns -- I wouldn't say that we feel like there's a strong consumer led recovery. So that's not what we're seeing thus far. But on the other hand we're starting to see some encouraging data points as we enter the all-important holiday season or December quarter.

So the first major game that we released was NCAA football, so it's college football in the US, and that game did well in the early portion of August. We just launched Madden and as of August 30, just comparing that game for the first week of sales this year versus the same week of sales last year, net revenue was up about 10%. So this is a very similar product. I think this is the 20 plus years into the franchise. So it's a good apples-to-apples comparison.

We're seeing strong demand in digital. Sims Social, which I just touched upon, with no advertising has gone from zero users to nearly 8 million users per day, it's the number three ranking game in terms of Facebook games right now. So I guess we're having some modest success so far into the fiscal year.

But it's really important to note that, again, packaged goods sales of video games are highly seasonal. The most important quarter is the December quarter or the holiday quarter. And we really can't get a clean read on our fiscal year until we actually go through the end of December, early January and tabulate the result. There's just that much loading of overall revenue into the December quarter.

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But based on the data we have thus far the trends are positive. The forward demand indicators that we have for titles that we're launching in the holiday quarter, Battlefield 3 is a signature release, we're now up to nearly 1.5 million pre-orders on the title. So this -- a pre-order is an example where someone has actually gone to a retailer, put down some amount of money and reserved in advance a copy of the game before its release.

So that gives us reason for a bit of optimism looking a bit further into the December quarter. But again, packaged goods video game sales, if you're not properly positioned it's down, as I said earlier, it's down 5%. You need to have the right games in the right space of digital extensions. Thus far we seem to be faring reasonably well. Yes, sir.

Unidentified Audience Member

Are you -- in this rationalization of franchisors, is the process finished and are you down to 22 franchisors? You really talked about Madden, Battlefield, a few others; are you completely done with that process, are you done with the associated costs and studios and talent also that rationalization plan?

And then if you could talk about how you actually allocate capital every year to new franchises. Are you going to do new intellectual property, are you going to just look at new iterations, annual iterations on your existing franchises? That's question one.

And then secondly, slightly different, if you can talk about whether the emergence of casual gaming, free-to-play social gaming has had any impact at all on the market in terms of the traditional console player gaming hours or gaming users?

Eric Brown - Electric Arts Inc. - EVP & CFO

We're seeing that for the connected consoles, so the Microsoft 360, PlayStation3 console compared to the Nintendo Wii, which is less connected, there's not as well developed an e-commerce back-end system. Gameplay is up in the high-definition platforms overall. So we're not seeing cannibalization of time out of say console games into social games.

We're seeing actually more gaming and people gaming on more devices on average and back to that 2.1 devices going to 2.7 on average at least in North America. So play rate seems to be up in general, with some exceptions on the standard definition platforms.

In regards to the product portfolio are we done in terms of rationalizing the SKU plan? So we're at 22 major packaged goods titles scheduled for fiscal '12, does that mean for every year from this point forward we'll have exactly 22 packaged goods titles? No, not necessarily. But we're in about the right zone with two dozen or so.

We have a portfolio that is on the one hand a combination of games that we will sequel every year, sports titles specifically. Every year there will be a FIFA, every fourth year there will be a World Cup and every fourth year two years off cycle there will be UEFA champions variant of FIFA as well with Madden football, hockey, basketball, etc.

But then we also franchises that show up say for example every two years. Battlefield we don't produce every year, it's every other year. We alternate between that and another first person shooting game called Medal of Honor. But it feels like two dozen major packaged good SKUs is about right.

With regards to capital allocations, a great question. So how do we decide to authorize the development of these titles? Well, at EA we have what's referred to as a green light process. And so before we extend any substantial amount of development dollars and the team is allowed to put together proof of concept.

But then we have to actually come forward in partnership with our publishing organization, i.e. the team that owns the bookings number, the revenue (multiple speakers) of the Company, we have to get a forecast based on the proposed game features, the mechanic whether it's online, multi-player, how many platforms, five or six, etc., and they have to show a base case or a commit P&L.

We take a look at that P&L and we look at the bottom line, we refer to it as responsibility profit. And responsibility profit is a margin line item before our corporate overhead like G&A, etc. The profitability that the game teams are "responsible for". So it's net revenue less cost of goods, less cost to develop, less cost to market. So we include direct advertising, PR, etc.

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And that responsibility profit number in the base case commit P&L has to meet a certain level. Typically we're looking at 30% in terms of the margin targets and we're looking at gross numbers of overall dollars to be delivered. And these dollars flow through to operating income for the Company.

So that's the process that we go through and franchises like FIFA, for example, Madden, we produce them every year, they're very easily hurdled. But when we're developing a new game, that's typically where we spend a fair amount of time, because you have a new concept, it could entail a new game mechanic, slightly different technology, for example, that would affect R&D slightly different, expected marketing programs and tactics.

And so we look at that and scrutinize it. And if it doesn't pass the threshold, send the team back to the drawing board, and if they can't get it right then we won't proceed with the project. So that's how we in general undertake capital allocation decisions.

For digital games it's similar but a bit different. Digital games, good examples -- social network games, you don't see the majority of units and revenue sold at launch like you do with a traditional packaged good. The games themselves are really services, think of them as -- we're all familiar with the analogy SaaS, software as a service. Think of them as games as a service or GaaS.

We look at the P&L not just over one quarter or two quarters but over two to three years. We look at the R&D that goes into it, typically you could be 12, perhaps 15 months of development. And we look at that P&L overall and go through a similar type of calculus to decide whether we should authorize and proceed into full production of the game.

Unidentified Participant

Eric, thank you very much.

Eric Brown - *Electronic Arts Inc. - EVP & CFO*

Okay, thank you for your time today.

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