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EA - Q1 2017 Electronic Arts Inc Earnings Call

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PRESENTATION

Operator

Good afternoon. My name is Jennifer and I will be your conference operator today. At this time, I would like to welcome everyone to the Electronic Arts first-quarter 2017 earnings call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions).

Thank you. And now I'd like to turn the call over to Chris Evenden, Vice President of Investor Relations. Sir, you may begin.

Chris Evenden - *Electronic Arts Inc. - VP of IR*

Thank you, Jennifer. Welcome to EA's fiscal 2017 first-quarter earnings call. With me on the call today are Andrew Wilson, our CEO; Blake Jorgensen, our CFO; and Ken Barker, our Chief Accounting Officer.

Please note that our SEC filings and our earnings release are available at IR.EA.com. In addition, we have posted earnings slides to accompany our prepared remarks. Lastly, after the call, we will post our prepared remarks, an audio replay of this call, and a transcript.

One quick note on upcoming events. Our Q2 earnings call is scheduled for Tuesday, November the 1st. This presentation (technical difficulty) include forward-looking statements regarding future events and the future financial performance of the Company. Actual events and results may differ materially from our expectations. We refer you to our most recent Form 10-K for a discussion of risks that could cause actual results to differ



materially from those discussed today. Electronic Arts makes these statements as of today, August the 2nd, 2016, and disclaims any duty to update them.

We will present both GAAP and non-GAAP financial metrics during this call. However, as discussed on our July 19 conference call, in light of the new interpretations issued by the SEC on May 17, this will be the last call in which we disclose any non-GAAP measures that adjust for deferred revenue. Our earnings release and the earnings slides provide a reconciliation of our GAAP to non-GAAP measures. These non-GAAP measures are not intended to be considered in isolation from, as a substitute for, or superior to, our GAAP results.

We encourage investors to consider all measures before making an investment decision. All comparisons made in the course of this call are against the same period in the prior year unless otherwise stated.

Now, I'll turn the call over to Andrew.

Andrew Wilson - *Electronic Arts Inc. - CEO*

Thanks, Chris. Our first quarter was an excellent start to fiscal year 2017, demonstrating how our digital transformation continues to strengthen and drive growth for Electronic Arts. Revenue and earnings exceeded our guidance as players engaged deeply with their favorite games and connected with each other across our global network of life services.

On HD platforms, we have thriving communities in our major franchises, and these will continue to grow as we introduce great new experiences this year. More than 11.5 million people played our Battlefield titles during Q1, and more than 6.6 million played Star Wars Battlefront, two examples that illustrate how great games continue to engage players over time.

Looking ahead, there is tremendous excitement for both Battlefield 1 and Titanfall 2, a combination that we believe will bring vitality and innovation to the huge first-person shooter audience. The community has been electrified by Battlefield 1's modern take on World War I, delivering strategy, team play, and epic scale in a completely new setting.

Titanfall 2 is bringing the game's signature pilot and Titan combat to a new single player campaign, and its fast and fluid multiplayer led it to win The Best Online Multiplayer award from the E3 Game Critics. These two titles are driving the variety, progression, and fresh new experiences that players want, and we believe they will be an unstoppable pairing during the holiday quarter.

Our EA SPORTS titles on console are also seeing massive engagement and players will be thrilled with the new ways to play in this year's games. Unique players in Madden NFL grew 20% in Q1 over last year's game, and current and new fans alike will love Madden NFL 17's redesigned franchise mode and new competitive tournament, the Madden NFL 17 Championship Series.

In our FIFA franchise, millions of soccer fans continue to engage daily with FIFA Ultimate Team, and this year, we will deliver our first-ever story mode in FIFA 17. Powered by our Frostbite engine, Story Mode adds an entirely new dimension to the FIFA experience that has fans incredibly excited. And perennial fan favorite NHL 17 will let hockey fans show their national pride through the all-new World Cup of Hockey mode.

In our mobile business, we are seeing growth across multiple genres. Star Wars: Galaxy of Heroes players spent nearly 2 1/2 hours per day on average in the game, reflecting how much players continue to enjoy the RPG style combat and in-game community events. In the sports genre, our EA SPORTS Mobile titles continue to gain momentum and connect with even more passionate fans.

Madden NFL Mobile had 25% more monthly active players in Q1 year-over-year and 37 more game sessions in the same period. We are continuing to invest in great experiences for sports fans across the globe. A new Madden NFL Mobile season is coming soon. NBA LIVE Mobile just launched on iOS and Android and hit number one on the US App Store free download charts, and we have a new FIFA mobile game coming later this year.

With our focus on groundbreaking new games, dynamic digital experiences, and deeper play relationships, EA is innovating to lead our industry. A new EA play event in June was built on these same principles, inviting our players in and going beyond the typical format to drive a global conversation. Nearly 9,000 fans joined us in Los Angeles and London, and millions more connected online to dive deeper into our upcoming games.

We live-streamed more than 20 hours of gameplay and competitive gaming events, and more importantly, hundreds of community influencers captured more than 1,400 hours of content from our games to share with the community.

Feedback from players that got hands-on at EA PLAY was very positive. And more than ever, we are fulfilling the needs of our players and content creators that connect by sharing great experiences in the games they love to play. We're off to a strong start for Q1, and the year ahead is going to be an exciting one for our players, for Electronic Arts, and for our industry.

Now I will turn the call over to Blake.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

Thanks, Andrew. As we discussed on our July 19 call, the SEC has issued new interpretations that no longer permit the use of non-GAAP measures that adjust for revenue deferrals into and out of the quarter. As well as revenue, we have historically adjusted many non-GAAP financial measures for the effect of revenue deferrals, including gross margin and EPS.

This is the last call in which we will report these non-GAAP measures. However, since our Board and management team will continue to use these measures internally to manage the business, we will continue to provide the financial data that will allow you to compare our results to our historically reported non-GAAP financials. For more information on this, please see the documents we posted on our Investor Relations website following our July 19 call.

Now, on to the quarter. Q1 beat our expectations, driven by outperformance from Ultimate Team and our mobile game Star Wars: Galaxy of Heroes. EA's GAAP net revenue was \$1.271 billion. This benefited from a change in deferred net revenue of \$589 million, resulting in a non-GAAP net revenue of \$682 million, well above our guidance of \$640 million.

As a reminder, non-GAAP net revenue is always the sum of GAAP net revenue and the change in deferred net revenue. The change this quarter is negative; thus non-GAAP net revenue is smaller than GAAP net revenue this quarter. See our earnings documents and July 19 information -- or for more information.

GAAP revenue is up year-on-year, driven by deferrals of Star Wars Battlefront revenue from Q3 fiscal 2016. The underlying business is down slightly year-on-year, but remember, the year-ago quarter benefited from strong catalog sales of Battlefield Hardline, which launched two weeks before the beginning of the quarter. Last year's quarter also included an extra week and a one-off revenue recognition of the \$31 million for FIFA Online 3 in China.

A note here on quarterly comparisons in a GAAP-only reporting environment. Because GAAP revenue is built from a portion of the sales from the quarter plus some of the sales from each of the previous three quarters, a simple year-on-year comparison doesn't reveal much about the dynamics of the underlying business.

Because of this, we will restrict ourselves to qualitative comparisons. We will continue to report all the financial data we use internally to adjust our GAAP financials, so you may derive comparable measures for yourself. We are also considering adding other metrics that might be used to quantify business trends.

We will continue to focus on our most important financial metric, operating cash flow. Our trailing 12 months operating cash flow was \$1.05 billion, a record for the period. Capital expenditures for the 12 months were \$109 million, delivering a trailing 12-month free cash flow of \$937 million.



Our GAAP digital net revenue for the quarter was \$689 million, benefiting from a change in deferred revenues of \$121 million, resulting in \$568 million on a non-GAAP basis. Digital continues to grow as a percentage of the business, and this quarter marked a new high.

Breaking down our digital revenue into its key components highlights the performance of each of these businesses this quarter. Extra content and free to play contributed \$300 million to GAAP net revenue, benefiting from a change in deferred net revenue of \$42 million; thus, non-GAAP net revenue was \$258 million.

As mentioned earlier, the year-ago quarter had a one-off benefit of \$31 million from FIFA Online 3 in China. Underlying growth was strong, as FIFA Ultimate Team benefited from the heightened interest in soccer, driven by the Euros and Copa America. FIFA Online 3 continues to perform well and is tracking to our expectations.

Mobile was up strongly year-on-year, driven by the strength of Star Wars: Galaxy of Heroes. Mobile generated \$165 million in GAAP net revenue in the quarter, benefiting from a change in deferred net revenue of \$24 million. Thus, non-GAAP net revenue was \$141 million. Note that under GAAP rules, online-enabled content for mobile games, including in-game currencies, is also recognized ratably over a service period.

Full game PC and console downloads generated \$137 million of GAAP net revenue, benefiting from a change in deferred revenue of \$53 million. Thus, non-GAAP net revenue was \$84 million. Digital downloads were high in the quarter, as expected for a period dominated by catalog sales. Sales growth year-on-year was flat, due to the strength of Battlefield Hardline in Q1 last year.

We continue to anticipate that the proportion of games bought digitally will increase by about 5 percentage points this year. Subscriptions, advertising, and other digital revenue contributed \$87 million to GAAP net revenue. Non-GAAP was \$85 million. The underlying business was up, supported by the growth in subscriptions for EA Access and Origin Access.

Moving on to gross profit, our GAAP gross profit for the quarter was \$1.1 billion, a gross margin of 85.9%. Remember that GAAP revenue, particularly in Q1, is driven by revenue deferred from prior quarters, whereas cost of goods sold is driven by the volume of sales actually in Q1. You can therefore expect to see some volatility in the quarterly GAAP gross margin as we move through the year.

GAAP cost of goods sold was \$179 million, which included \$13 million of amortization of intangibles and \$1 million of stock-based compensation. Therefore, non-GAAP COGS was \$165 million and non-GAAP gross profit was \$517 million, resulting in a non-GAAP gross margin of 75.8%. This was down 1 percentage point year-on-year because of the extra FIFA Online 3 revenue recognized in Q1 fiscal 2016.

GAAP operating expenses for the quarter were \$532 million, including \$47 million of stock-based compensation and \$2 million of amortization of intangibles. Thus, non-GAAP operating expenses for the quarter were \$483 million.

Currency movements actually added to expenses this quarter, as rates were higher for most of the quarter than when we gave guidance, although the British pound, in particular, fell at the end of the period. Despite the unexpected currency headwinds, underlying expenses were down year-on-year.

The resulting GAAP diluted EPS was \$1.40 per share. Adjustments required to derive the non-GAAP EPS include the \$589 million change in deferred net revenue, \$15 million of amortization of intangibles, \$48 million of stock-based compensation attributed to operating expenses and Cost Of Goods Sold, debt-related expenses of \$2 million, a non-GAAP tax rate of 21%, and a reduction of 2 million shares for the convertible bond hedge, which is not included in the GAAP share count.

See the example we posted for Q4 fiscal 2016 following our July 19 call for details on how to apply these to derive the non-GAAP EPS. Non-GAAP EPS was a positive \$0.07 and \$0.12 better than our guidance. Outperformance in our digital business drove both top line and profitability higher than we had anticipated this quarter.



Our cash and short-term investments at the end of the quarter were \$3.427 billion. 48% of this cash and short-term investment balance is held onshore. During Q1, we settled \$27 million in early conversions of our convertible notes. We completed repayment of the remaining notes in July. We have posted a document on our website that explains the impact on our share count.

The most important takeaway is that our diluted share count, whether expressed as GAAP or non-GAAP, already includes the potential dilution at the current share price. We also repurchased 1.9 million shares at a cost of \$129 million, leaving \$410 million in our two-year \$1 billion buyback program we began in May 2015. The current rate of repurchases keeps us on track to complete the full \$1 billion in that time.

Net cash used by operating activities for the quarter was \$248 million. This is typical for a first quarter. The year-ago quarter was atypical in that it had substantial collections from Battlefield Hardline sales. The trailing 12-month operating cash flow was \$1.05 billion.

I wanted to take a moment away from our quarterly results to discuss our FX hedging program in a broader context. We run a global business, with roughly half our revenue coming from outside the US. Volatility in exchange rates is still very high by historical standards, and macroeconomic events, like the UK's vote to leave the European Union, are injecting even more uncertainty into the system. A comprehensive hedging program is important in ordinary times, but the extraordinary events of the last year or so made it critical.

Our hedging program has two components: one to reduce volatility in the P&L and a second that does the same for the balance sheet. The first is designed to hedge anticipated revenue and expenses across seven of EA's largest foreign currency exposures. Combined, these seven currencies represent approximately 70% of our non-US dollar operating income. We hedge with forward contracts up to 18 months out.

The second covers FX exposure to net monetary assets and liabilities, including third-party accounts receivable and payables as well as intercompany balances. This program aims for 100% coverage of 17 currencies, which account for about 90% of EA's non-US dollar net monetary exposure. We hedge with swaps and forward contracts that generally have a maturity of three months or less. Together, these programs are designed to minimize the impact of currency fluctuations on our business.

Turning to guidance, we are excited about the Expanded Franchise mode in Madden NFL 17 and by the FIFA Story Mode powered by Frostbite. We expect our second quarter of GAAP net revenue to be \$915 million. This includes a headwind from the anticipated change in deferred net revenue of \$160 million.

Note that this is an increase in deferred net revenue. Thus, we expect the non-GAAP measures we would have reported under our previous approach to be higher than the GAAP net revenue in Q2. In other words, you need to add GAAP revenue of \$915 million to deferred net revenue of \$160 million to arrive at the comparable non-GAAP numbers in your model.

With regards to year-on-year comparison, remember FIFA 17 will launch four days before the end of the quarter, as opposed to the 11 days FIFA 16 had in the quarter last year. This means very little of the digital revenue associated with FIFA 17 for full game downloads and FIFA Ultimate Team can be recognized in the quarter. We estimate that, absent changes in deferred revenue, about \$75 million of high-margin, mostly digital sales, are pushed into Q3.

We anticipate a currency headwind to a year-on-year comparisons -- to add to the year-on-year comparisons. And this is factored into our outlook for revenue and change in deferred revenue. Our expectations of currency impact on the whole year have not changed.

Cost Of Goods Sold during the quarter is expected to be \$405 million, including \$13 million of amortization of intangibles. Rather than guide GAAP gross margins, which can be highly volatile from quarter to quarter due to revenue deferrals, we believe that guiding COGS will give you a better insight into our business.

With GAAP net revenue, the change in deferred net revenue in COGS, you can calculate both GAAP gross margins and a gross margin comparable to the non-GAAP measures we have given in the past. We expect our Q2 GAAP operating expenses to be \$566 million, including about \$50 million in stock-based compensation and \$1 million in amortization of intangibles. Excluding the effect of stock-based compensation, expenses are up year-on-year, driven by increased investment in R&D.



This results in a GAAP diluted loss per share of \$0.17. As mentioned earlier, this is driven by costs associated with the major sports launches being recognized within the quarter, but much of the revenue being deferred out of the quarter.

Adjustments required to derive the non-GAAP EPS include the \$160 million change in deferred net revenue, \$50 million of stock-based compensation attributed to operating expenses and COGS, \$14 million in amortization of intangibles, and a reduction of 2 million shares from the convertible bond hedge. Debt-related expenses are expected to be below \$1 million in this quarter.

With regards to the underlying business, we would expect it to be down slightly year-on-year, driven by the roughly \$75 million of FIFA sales that has moved to Q3. We are not changing our annual outlook for revenue and net income at this time. EA PLAY and the response at E3 was very positive, but it's too early to attempt to extrapolate from that to full-year results, particularly on a fiscal year that is expected to be so backend-loaded.

We are updating our GAAP diluted share count for the year to 316 million, primarily based on the repurchase activity in the first quarter. This increases the GAAP EPS guidance by \$0.03 to \$2.56 for the year. It remains our practice to not factor in potential repurchases into our forecasted share count for the full year.

Regarding cash flow for the full year, we are maintaining our operating cash flow guidance at approximately \$1.3 billion and a free cash flow guidance of approximately \$1.2 billion. The ongoing strength of our live services and the reception to our upcoming launches bodes well for the rest of the year.

Now I will turn the call back to Andrew.

Andrew Wilson - *Electronic Arts Inc. - CEO*

Thanks, Blake. Our industry has never been more vibrant and full of opportunity. Games are a global phenomenon. Digital is unlocking more growth and reducing barriers for the next 1 billion players who experience games through new platforms, new ways to play, and new business models.

In this world, discovery and connection are critical. We are building out EA PLAY network to connect more players through games and deliver fresh, engaging experiences every time they play. From single cross-platform identity profiles to more intuitive user interfaces and recommendation engines that help you find friends and get into the action faster, the player network will enable new ways to engage in game and beyond.

In our crowded, competitive, and multiplatform world, EA is working to connect more players with each other through the games they want to play. Games should be extraordinary. With each game we make, we work to push the boundaries with creativity, technology, and new ways to play. Our Frostbite engine is powering more of our biggest games and becoming a true differentiator, scaling across FIFA, Battlefield, Mass Effect, and more, to deliver stunning gameplay, incredible depth, and entirely new modes.

And mobile games from EA SPORTS to The Sims to Star Wars are tapping into the passion of our players and offering captivating ways to engage no matter where you are. Across our studios and labs teams, we are developing new types of games and breakthrough capabilities. From immersive and authentic VR experiences to new technologies that transform how we connect, we are constantly in pursuit of the next amazing thing for our players.

Games also bring us together. Each day, millions of players connect through our live services, and this year will bring even more ways to engage, including competitions accessible to all our players. In two weeks, tens of thousands of players will join us at Gamescom to play our upcoming titles like Battlefield 1, Titanfall 2, and FIFA 17.

Many more will watch the content streamed online from Cologne, joining the excitement and conversation about the games they love that are launching in the weeks and months ahead. With every game session, every social conversation, and every connection between our players, we are building a powerful, global community. We have outstanding new titles for launch in Q2 and much more to come through the rest of the year.

Now, Blake, Ken and I are here for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Stephen Ju, Credit Suisse.

Stephen Ju - Credit Suisse - Analyst

Just wondering if you can share anything about NBA this year and what will change reverses years passed, and whether you think launching off-calendar will meaningfully impact its prospects?

And secondarily, I mean, is the Q4 launch of NBA -- I mean, is that going to be the rule of thumb on a go-forward basis? Or will you look to get this back on the calendar? Thanks.

Andrew Wilson - Electronic Arts Inc. - CEO

So, first off, as we think about NBA, we think about captivating a global fan base NBA. We're very, very excited about what we've just launched with NBA LIVE on Mobile. As we said in the prepared remarks, it quickly went to number one in the free downloads and has been performing extremely well. Engagement is high and better, in terms of metrics, across the board than we could have expected, and better in terms of metrics than many of our other sports games so far. So that leads us to believe that we have an exciting opportunity with NBA, and an exciting opportunity with sports on mobile altogether.

Now the broader NBA plans, we don't have anything more to announce right now, other than the team continues to work diligently on ensuring that we are delivering great NBA experiences on any mobile devices that fans want to play on. And we believe that, as we are able to announce more around our plans, it will be very exciting for fans across all devices.

Stephen Ju - Credit Suisse - Analyst

Thank you.

Blake Jorgensen - Electronic Arts Inc. - CFO

Next question?

Operator

Justin Post, Merrill Lynch.

Justin Post - BofA Merrill Lynch - Analyst

Can you help us at all with your Battlefield expectations in your guidance, and whether you've changed those at all post-E3?

And then, you are buying back quite a bit of stock, but you have a lot of SBC. Now that you are going to GAAP, do you think you can lower SBC? And as you do buybacks, do you think you can really lower that share count over time? Thank you.



Blake Jorgensen - *Electronic Arts Inc. - CFO*

Yes, let me hit both of those, Justin. First, we were very pleased at the reaction of players at our EA PLAY. I think you got a chance to play it yourself. But it's been very, very popular and the feedback has been an extremely strong.

We tend not to try to raise guidance too early in the year. We would like to see a little more demand metrics on all of our products, particularly Battlefield and Titanfall, before we make that decision. Gamescom is a very important beat that's coming up in a couple of weeks in Europe. And then, obviously, the potential for betas around those products will help us derive better demand metrics.

Last year, if you remember, we did raise guidance coming out of the first quarter, because our initial forecast on Battlefield, the Star Wars title, was relatively low, and we moved that up. We've got a fairly normal forecast for Battlefield and Titanfall, so we're not moving those yet, but we're still super optimistic about the titles and very excited. So more to come in the future. But we felt it was just too early in the year to try to move guidance on any of the titles going forward.

On the share count piece, we have been, over time, bringing down stock-based compensation. It's an important part of the overall compensation. We feel it's important as part of our employees and executives to bear some of the risks of the stockholders, and making -- having your compensation as part of that is critical.

But we also recognize that we need to bring all compensation down over time to continue to be profitable as a company. We balance that with the requirements of attracting the greatest people that we can in the industry, and we feel like that mix is a pretty good mix today. But we will obviously be trying to drive down the share count between a combination of managing aggressive buybacks as well as prudent management of our overall compensation pool.

Justin Post - *BofA Merrill Lynch - Analyst*

Okay, thank you.

Operator

Colin Sebastian, Robert W. Baird.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

I wonder if you could just describing overall trends you see in the attach rates (technical difficulty)--?

Blake Jorgensen - *Electronic Arts Inc. - CFO*

Hey, Colin?

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

Yes.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

Colin, we're having a hard time hearing you.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

Can you hear me now? The first question was describing trends you're seeing in the attach rates for catalog titles. And that's just as a measure of the progress that [caused] the cycle.

And then secondly, I was hoping for just a clarification or update on the multiyear framework for revenue growth that you laid out at the Analyst Day. I believe you initially indicated an incremental \$1 billion in revenue over two to three years. I wonder if you look through the pipeline and the progress you're making, how much potential there could be to that framework. Thank you.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

Sure. So, on attach rates, we are continuing to be excited about the growth of the overall console business. And I think the plans that were announced at E3 around both Xbox and PlayStation were viewed in the industry as very positive.

I think moving beyond the notion of -- or jumping into the compatibility issue head-on and trying to stop the notion of having consoles that are not compatible, will help the software side of the equation dramatically over time. And I think that's a big plus.

We continue to believe that we will see upside in the number of consoles sold this year. And the software attach rates stayed pretty consistent with what we've seen up through the cycle so far. And so all that, I think, bodes well for the overall cycle, and should continue to help us drive upside.

Now, on the revenue growth, the numbers I laid out at the Analyst Day were basically, if you take our year-end fiscal 2016 results, and you look out over the 2020 to 2022 time frame, we believe that we could add another \$1.5 billion of revenue from areas such as genre growth moving into the action genre; continuing to grow our mobile business; continuing to grow our business in Asia and other parts of the emerging markets around the world.

And we believe that could then continue to drive free cash flow growth and earnings growth. And \$1.5 billion of additional revenue should be able to drive \$1 billion in operating income and just under \$1 billion in free cash flow growth during that time. Obviously, those are all non-GAAP numbers. So -- and we feel confident about the progress that we're making there.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

Great. Thank you.

Operator

Drew Crum, Stifel.

Drew Crum - *Stifel Nicolaus - Analyst*

Wondered if you guys could comment on the timing of FIFA Mobile, what your expectations are? And I believe your guidance for mobile for the year was 15%. I know that's on a non-GAAP basis, but it looks like you are off to a very good start for fiscal 2017. Any update on expectations for mobile as a whole? Thanks.



Andrew Wilson - *Electronic Arts Inc. - CEO*

I'll take that. Thanks, Drew. So a couple of things. One is mobile is going strong for us. We're seeing growth in the mobile market that is outpacing some of our early expectations for the broader industry. Star Wars: Galaxy of Heroes continues to perform well.

Madden NFL continues to perform well, even in the off-season. And with the football season just around the corner, we expect that that will once again ramp. Our broader catalog of SimCity and The Sims and Need For Speed and Real Racing also continue to perform very well.

As I said earlier, we've just launched NBA LIVE Mobile. We launched that well in advance of the season to ensure a good and strong ramp both of the game design, the architecture and infrastructure, and with a lot of basketball happening still with the summer season, and a certain competitive sports event going on in Rio over the next couple of weeks, we believe it's a great opportunity to start to ramp our NBA business on mobile.

And it's performing extremely well, and follows a similar design and modality of play to what we have learned engages fans to the highest degree around Madden. As we talked about before, we're also looking to do that with FIFA.

And as with all our sports games, we typically launch them at the outset or early in the season, and right now we're on track to launch our FIFA Mobile property early in the European football season, which would align perfectly with kind of the ramp of the fan base at that time.

Drew Crum - *Stifel Nicolaus - Analyst*

Okay. Thanks, guys.

Operator

Brian Pitz, Jefferies.

Brian Pitz - *Jefferies LLC - Analyst*

Thanks for the questions. On Madden, with the unique players up 20% and mobile players up 25%, can you discuss what is driving this user growth, and what role Ultimate Team is actually playing here?

And then on mobile with Star Wars: Galaxy of Heroes at the top of the charts, just wondering if you could comment on monetization on a per-user basis relative to other EA mobile titles. And looking at that average 2.5 hours per day of playtime, what is -- what's the durability of a game like that? Thanks.

Andrew Wilson - *Electronic Arts Inc. - CEO*

So, I will grab the first half of that and I'll let Blake take the second half. As it relates to our broader Madden community, again, the fan base of the NFL continues to grow. It's a great league. It's a sport that's very, very important to the population of North America, and even growing internationally right now in Europe and Mexico and other parts of the world.

Our Madden development teams have been very, very focused on a couple of vectors over the last couple of years. And you've seen this kind of manifest in both console and mobile as we have come forward.

The first is about how do we bring on new players? And then how do we keep players engaged over time? And of course quality is at the very core of that, but onboarding, user interface, tutorials, training, things that really ignite the passion for new players and get them into the Madden community, and playing and competing for the love of the sport, as well as providing ongoing innovation and live services, and ongoing community-based events that keeps our long-term fans and our long-time fans more deeply engaged.

You're going to continue to see this across both Madden and our sports games, and our broader portfolio. The global player community continues to grow. Mobile brings players in. Many of those players choose other modalities of play like console. We see it as our objective to continue to deliver great experiences to new fans, as well as meaningful and long-term in engaging live services to our long-time fans.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

Yes, I think on Galaxy of Heroes, what makes a great game is a deep engagement model -- some reason for people to come back to enjoy something each day or each week. And we have cracked that code, we believe, inside of the console base Ultimate Team, as you are all well aware of, it's a deeply engaging way to enjoy the sports you love as well as the video game you love. That same mechanic can work well inside of a mobile game, not just in sports, but also in games that we're proving with Star Wars: Galaxy of Heroes.

It's event-driven -- activities, new things, new characters, new ways to play that are constantly brought into the game, that keeps people coming back and keeps the level of that engagement at the height that you're seeing. We think that's very sustainable, because you are able to continue to add activities.

In the sports world, it works well because you are dealing with a real world sport all the time; but in the fantasy world, it's even better, because you don't have the limits that you have in the real world. And so, our goal is to continue to add new, exciting context, ways to play, characters, enjoyment in the games that will keep them alive for many years to come, and I think obviously keep them monetizing over time.

Brian Pitz - *Jefferies LLC - Analyst*

Great. Thanks.

Operator

Chris Merwin, Barclays.

Chris Merwin - *Barclays Capital - Analyst*

I just had a couple, and apologies if this was covered. Just in terms of the player network, I was just trying to get a sense of where you are in rolling that out. And to what extent we actually saw the benefit of that in the Ultimate Team result that you delivered this quarter?

And then should we see maybe even more of an impact later in the year as it relates to kind of your marketing costs as you roll out the big first-person shooters?

And then just a second question on the mobile business. Just wondering if there was any impact that you saw from Pokemon Go in the quarter.? Augmented Reality turned out to be this huge mass-market sort of feature that people really like, so do you have any plans to integrate Augmented Reality into your mobile games? Thanks.

Andrew Wilson - *Electronic Arts Inc. - CEO*

Okay. So, on the player network, I mean, you're going to hear a lot more about this from us. As we look to the future -- as we think about where games are going, we see some fundamental problems arising if you are a gamer.

So in a world where gamers are playing more games across more devices through more business models in more geographies than ever before, the concept as a player of always being able to stay connected to your friends and always being able to stay connected to the games you love, irrespective of what device you play on, is going to be an important problem to solve.



We believe that the investment that we've been making in our core digital platform with an ID that travels with you across devices, with a single data infrastructure that allows us to always understand a full 360 degree of you as a player, and all the services that are built on top of that that allow you to connect with your friends across devices, is going to be an imperative part of our future.

What you are starting to see now is this line-up inside of our -- across our console games, across our mobile games. We're making tremendous headway that means no matter where you play, you can remain connected to your friends. If you move from iOS to Android, and you are using our ID system, you do not lose your game progress.

As you start to think about the communities that we build and connecting with those communities, particularly in things like Ultimate Team, we are seeing tremendous engagement where we are able to deliver you by virtue of this player network, experiences that are personal, contextual, and meaningful to you and your friends.

We're seeing that the engagement improved dramatically, and we're seeing that players are opting into more and more of our games because we are finding a way to present them with opportunities that are meaningful and personal for them. You are going to see more and more of this in the future. We expect that it will continue to become a powerful tool in how we engage with players, but as importantly, how players engage with each other.

And in the broader network world that we now live in, the power of our network will be directly proportionate to the number of players inside the network and the strength of connections between the players inside that network. And a lot of what we are doing as it relates to our core digital platform development, our single-engine development, and our broader portfolio of game development, is all in service of manifesting the strength in that network.

As it relates to Pokemon GO, great question. First, as a comment, I think that what that team has done is very, very strong. It's a great blend of an IP that we have known and loved for the best part of 20 years, and a new technology that introduces that to a new audience through mobile devices.

What you've heard from us is that we have been working on both VR and AR for some time. We have made some announcements around VR in mobile and on console with PlayStation VR, and we're going to continue to invest there.

As you can imagine, we are energized by the success of Pokemon GO. We have tremendously strong brands that are unbelievably social in nature, where we believe that the participation at a community level through AR will just heighten that experience. And we have been working on some things for some time and we will continue working on those, and we will be ready to launch them at a time where we think we can better engage communities through AR.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

Chris, Pokemon really came out after our quarter ended, and in a broader sense in global rollout. But if we look at the daily revenue trends even after it's come out, we haven't seen much impact. I think it has brought in a lot of new game players and a lot of people have been involved with it, but it hasn't really distracted from -- or detracted from any revenue that we're seeing in our regular mobile games.

Chris Merwin - *Barclays Capital - Analyst*

All right, great. Thank you.

Operator

Eric Sheridan, UBS.



Eric Sheridan - UBS - Analyst

Thanks for taking the questions. Maybe one big picture and one on the Star Wars franchise. Big picture question, Andrew.

So would love your thoughts on how we should be thinking about the publisher community and how it's going to approach the console upgrade or midcycle console upgrade cycle, however you'd like to frame it, that we're going to see from Sony and Microsoft and Nintendo over the next sort of 12 months, plus or minus, how you are preparing for that, what that might mean in terms of going to market, making consumers aware of your titles and sort of managing through that transition?

And then on Star Wars, we saw the announcement a Star Wars Celebration. It looks as if the expansion pack this year is going to be more tightly intertwined with the actual movie content that comes out in December. What that mean for sort of the breadth of the platform going forward as well as maybe even marketing efficiencies, since the content could be so tied closely with the movie? Thanks, guys.

Andrew Wilson - Electronic Arts Inc. - CEO

So, on the first question, at a macro level, we're excited about what Sony and Microsoft have announced. The reality for us is, again, in a networked world, liquidity of play is really, really important. And what we've seen over the last decade or more with respect to PC gamers, is that community has continued to grow. And it's growing in a world where the hardware refresh cycle has been disconnected from the software refresh cycle.

And what that's meant is that, irrespective of what kind of device you have within kind of a 7 to 10 year time frame, you are able to play with a much, much bigger global community. What we see now with the things being talked about, with the midcycle refresh, is that only going to enhance the size and engagement levels inside the communities.

For us as a publisher we are in a very strong place. We have been building a cross-platform, a cross-console, and the scalable architectures like PC for some time. So the notion that we would build once an experience that can scale up and down across an entire spectrum of consoles, whether the first phase, the second phase, or the third phase over time, is not something that's foreign to us and something that we're very energized about.

Because again, I think we have strength in a networked world, and we have strength where there is a requirement to build these scale experiences that keep players connected. So on balance, we think this is great for the industry.

It will almost certainly extend the console cycle almost to an infinite level if we get to a point where there's just constant hardware upgrades and constant software upgrades, but we are able, through the scaling of our games, to keep the community always together.

More broadly thinking about the Star Wars franchise, again, this is a long-term play for us. We're very excited. We were overjoyed with the performance of Star Wars Battlefront. We're overjoyed with the 6.6 million players that played the game through Q1. We are continuing to support that.

As each movie comes out over the time of our relationship, we expect that the Star Wars community will continue to grow, and we will be doing more best to align, in some cases, the content and experiences, and in some cases, just a passion for Star Wars, but certainly aligning what we're doing around the Star Wars universe with what is more broadly happening with Star Wars pop culture. And we think that's a win as we continue to deliver for the fans long-term.

Blake Jorgensen - Electronic Arts Inc. - CFO

Next question?



Operator

Mike Olson, Piper Jaffray.

Mike Olson - Piper Jaffray & Co. - Analyst

I had two questions. You mentioned earlier that you haven't changed your assumptions that are built into guidance for Battlefield 1 and Titanfall 2. I don't recall if you provided what kind of unit expectations you have for those titles. Is that something that you would be willing to share, or share again if you have already talked about it?

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And then secondly, do you anticipate any Olympics-related distraction that could impact player engagement over the next month or so? Have you ever seen anything from Olympics in the past? Thanks.

Blake Jorgensen - Electronic Arts Inc. - CFO

So, on the guidance, we talked rough numbers with people. We told people that typically a Battlefield title is about [15 million] in a year. Our guidance is slightly under that. And we hope that that excitement builds and it will clearly go through that number, but for right now, it's slightly under that number.

And Titanfall did a little more than 7 million units last time. It was early in the cycle and one of the few titles out there. We think it will do more than that, but it's probably closer to 10 million than it is to 15 million is built into our guidance. So closer to 9 million to 10 million on Titanfall and just under 15 million on Battlefield 1.

In terms of the Olympics, Andrew can probably jump in here, but I think oftentimes if there are sports going on that we have games associated with, there's a lot of positive. As you see with the FIFA Ultimate Team numbers relative to the Euro and the Copa America, we didn't have programs directly linked to those, but people engage in those because their favorite players are playing on new teams or in new tournaments. And that drives them in.

So I think, in general, athletics -- bringing people back to athletics. If they're watching on TV, they're oftentimes going to try to imitate that somewhere else, and that may benefit some of our games.

Mike Olson - Piper Jaffray & Co. - Analyst

Thank you.

Operator

Eric Handler, MKM Partners.

Eric Handler - MKM Partners - Analyst

Thanks a lot for taking my question. Just looking at your extra content free to play line in digital, obviously your biggest segment within the digital, growth in 1Q was just a little more than 1%. That's your slowest growth quarter I think ever since you started putting out those metrics.



Was there anything specific that was a timing of just the releases that drove that number so below average? Or was there something unique there? And how do you see that playing out over the rest of the year?

Blake Jorgensen - *Electronic Arts Inc. - CFO*

Yes. So you are referring to growth in extra content, is that what you're saying?

Eric Handler - *MKM Partners - Analyst*

Yes, Blake.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

Yes. So, growth in extra content is really masked by the fact that we, last year in the quarter, had a \$30 million deferral of FIFA Online 3 revenues that popped all in Q3. So, if you take that out, you saw a strong growth in extra content. Clearly, if you look at the underlying growth of Ultimate Team, you are continuing to see extremely strong growth in Ultimate Team, led by FIFA across the full Ultimate Team spectrum.

And so we are pretty confident that our guidance for the full year of 10% growth of extra content will be on track, and we should easily be able to beat that over time.

It's a similar dynamic in full game downloads. It was flat year-over-year, but almost all of that flat was driven by the fact that in Q1 last year, we had a huge amount of sales on Battlefield Hardline, a very large title. We didn't have a similar large title. Obviously, we had one title in the quarter, Mirror's Edge, but a much smaller title than in comparison as Battlefield Hardline last year.

So we're very confident that the digital growth is continuing, and just talking to people to always make sure they look at the drivers of the underlying -- to understand the underlying component.

Eric Handler - *MKM Partners - Analyst*

Much appreciated, Blake. Thanks.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

Thanks.

Operator

Ben Schachter, Macquarie.

Ben Schachter - *Macquarie Research - Analyst*

A few questions. First, just broadly on retail, as you move to more digital full game downloads, can you just broadly discuss how it's impacting relationships with the key retailers, how that will evolve over time?



And then secondly, PlayStation VR, likely to source more mass-market VR product to come to market? How -- what is that going to mean for the industry overall? Obviously, it's going to be pretty small numbers this year, likely supply constrained, but does the interest in that mean anything for the industry broadly?

And then finally, on the UK, historically, first-person shooters have actually been geared very much to the UK and US. With all the issues that are going on in the UK, do you think that's going to impact anything at all for Titanfall and Battlefield and potentially FIFA? Thanks.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

So, why don't I just hit the FIFA on the UK real quick. So, we're hedged through -- out 18 months. Those hedges are not 100% each quarter, as they decline over time. But we are well-hedged for the rest of this year. So we don't see any more FX headwind that would impact the sales of FIFA or Battlefield or Titanfall. We also don't see any changes in the Brexit driving -- changing people's desire to play video games, so we don't see an impact there.

Do you want to touch on the VR piece?

Andrew Wilson - *Electronic Arts Inc. - CEO*

Yes, so on PlayStation VR, again, we're very excited about this. I think to your point, given its price point and modality of play, it's one of the more accessible forms of virtually reality play right now. We've got a great experience coming later in the year that I played, and it's super fun and super exciting.

I think that part of the reason people play games is to kind of immerse themselves in a fantasy and escape and fulfill these fantasies with their friends. Now, typically, when we design games, we design them on a big screen TV and we have to overcome, as designers, this spatial disconnect between us and the television.

Of course, virtual reality, we don't have to overcome that spatial disconnect. So the more that we can introduce people to low-barrier-to-entry virtual reality, I think the faster it's going to take off as an industry. And so us as a company, we're looking at how we can invest across all elements of the spectrum, from kind of the mobile element right up to the high-end elements. And PlayStation VR I think is going to be a great step in the evolution of our industry and the evolution of how people play games. And we're going to continue to invest there.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

And then on the retail question, we have, we believe, strong relationships with a whole set of global retailers around the world, some large, some small. We try to maintain those and we try to build a dual strategy where we're pushing digital, but we're also using the retailers for what the retailers are really good about, which is marketing and really pushing out the information about the games and the excitement around the games.

We are always going to have that as a dual strategy. We believe the retailers will be around for a long period of time and are important in our system, and we try to have a fine balance there. We try to help the retailers be involved in some of the digital business where they can, and just maintain a strong business for them as well as continuing to grow our business both digitally and physically.

Next question?

Operator

Mike Hickey, The Benchmark Company.

Mike Hickey - *The Benchmark Company - Analyst*

Andrew and Blake, great quarter, guys. Thanks for squeezing me in the question-and-answer here. The -- curious -- two questions. One on FIFA 17 on the Story Mode, who the incremental player is there that you think will show up? And do you fear at all there could be any sort of pressure on Ultimate Team to sort of, I guess, Story Mode cannibalizing ultimate team to some level?

And second question, any visibility on fiscal 2018, at least on the surface. Obviously, we're in Q1 2017, but it's quite a ways away, but on the surface it looks like the environment could be a bit challenging, at least in driving sales growth. And how you think about maybe M&A as a potential driver for fiscal 2018 growth? Thanks, guys.

Andrew Wilson - *Electronic Arts Inc. - CEO*

So let me touch on the FIFA piece, and then I'll let Blake take on Ultimate Team. As we think about our global community of gamers, again, FIFA is one of the biggest games on the planet. It attracts a very diverse playing population -- old, young, male, female, East, West. And we are always looking at delivering new and innovative experiences for our FIFA players.

We still expect that FIFA Ultimate Team will be the most engaging mode of the game. Year-on/year-out, players tell us that it's the most exciting way to play FIFA, and the most interesting way to fulfill their fantasy of really building the ultimate team, and taking that team and competing with their friends.

But with that said, we also understand that, as a new player coming into FIFA, that may be a little daunting. And so we see Story Mode as not just a new way for existing fans to play, but actually a great onboarding mode. Again, every kid in every country around the world that follows soccer or football dreams of that opportunity to get called up to the first division in their country.

And we believe that fantasy is something that's very compelling, and we believe the mode overall will be a great onboarder for new players, and ultimately help them understand the beauty of football, the beauty of FIFA as an interactive game experience, and help move them into the broader FIFA community, where they will likely engage with the tens of millions of people every year in FIFA Ultimate Team.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

Yes, remember, still just a little bit more than 50% of all people who buy FIFA actually engage in Ultimate Team. We see that as a huge opportunity to bring more people into Ultimate Team. And there are many people that don't understand how the soccer system might work -- or works around players and development of players, which is critical to the foundation of Ultimate Team. And so, we believe this is a way to continue to bring people into that.

On the fiscal 2018, we're obviously not prepared to give guidance yet on 2018 anything more than we've already said in the past. We're excited and hard at work at the next Star Wars Battlefield title. We've got a couple of great new opportunities coming that we haven't yet announced, that we will give you more insight on. We've got some great things going on in mobile. We're excited about the continued growth of the FIFA franchise, the Madden franchise, NHL, NBA franchise, and leveraging mobile in all of those cases.

And I think the one thing that I'll remind people of that oftentimes gets forgotten is, to the extent that we have a very successful Battlefield 1 and Titanfall 2 launch, those will be a big benefit to next year's plan. Just as you are seeing now, we still have 11 million people engaging in Battlefield 4. And so, that Battlefield world is incredibly important. The Star Wars world, the same way. We will continue to leverage that as we drive through 2017 into 2018 and 2019.

Mike Hickey - *The Benchmark Company - Analyst*

Thanks, guys.

Operator

Neil Doshi, Mizuho.

Neil Doshi - *Mizuho Securities Co., Ltd. - Analyst*

Given the increasing engagement on the mobile side as well as on the console side, have you guys thought about getting more aggressive in terms of advertising as a way to get players to pay more as well as to play more?

And then on the international side, it looks like international as a percent of revenue jumped to about 59%. It's been higher than it has been in the past couple of quarters. Any color in terms of titles and/or regions that kind of drove that growth? Thanks.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

So, on mobile advertising, I mean, we do a little under \$100 million of mobile advertising. We try to steer -- we try to do a couple of things. We try to keep people in our network, so steer them to other games in our network, which is powerful. That doesn't make us money; it just keeps people in the network.

And two, the next piece is, we might tend to show people advertising if they are not monetizing in other ways. What I will tell you is, because most of mobile game use is anonymous, it's hard to collect data on your mobile users, that means the value of that advertising, or the CPMs, are fairly low.

And thus the reason it's less than \$100 million for us, even though we have a large mobile network. We will continue to experiment with that, and we will continue to look at it, but we don't see that as a giant revenue growth opportunity for us at this point in time.

On the international piece, I think some of it is simply driven by the strength of FIFA and FIFA Ultimate Team. Much of the international -- much of FIFA's marketplace is international, particularly Europe. And as that business continues to get stronger, you're going to see that skewing; particularly in a quarter where Ultimate Team is so important, where there's not as many new releases, that will skew the revenue to the international.

One last question?

Operator

And our final question is from Doug Creutz of Cowen.

Doug Creutz - *Cowen and Company - Analyst*

I'm going to get way down in the weeds here. There was a story towards the end of the quarter that your informal players weren't interacting correctly with the chemistry mechanic in FIFA Ultimate Team. It's one of those things you see on Reddit. Has that any impact on Ultimate Team monetization as you've gotten into the September quarter? And do you feel like you have your kind of arms around getting the mechanics fixed and making sure the playing base was happy with the outcome?



Andrew Wilson - *Electronic Arts Inc. - CEO*

Yes, so that is down in the weeds a little bit, but I'm happy to have a conversation about it. So, as with any live service, there are times where we find bugs in the software. We stay very, very close to the community. Again, engagement of our community, ensuring our community has the utmost and highest experience when playing our games is very, very important to us.

And so, what I'm happy to say is, the team was very close; they heard that feedback from the community. They rallied very quickly. They found a bug. They fixed the bug and deployed a fix very, very quickly, and were very transparent and open with the community throughout every step of the way.

As a result of that, we didn't see any impact to the engagement or the broader interaction with the mode. And quite the opposite, I think, what we found was the community deeply appreciated that we were connected to them, that we were listening to them, that we acted quickly, transparently, and openly, and we solve the problem going forward. As we think about our live services future, this is really how we need to operate as a business.

We won't always get the code exactly right, but it's as much about how we operate when we don't quite get it right as it is about when we do. And the commitment we make to gamers is to be very open and transparent with them, to listen to them, and always working diligently to deliver the best experience possible.

Doug Creutz - *Cowen and Company - Analyst*

Great. Thanks, Andrew.

Blake Jorgensen - *Electronic Arts Inc. - CFO*

With that, I think we'll end the call. I do appreciate everyone's patience around the GAAP to non-GAAP transition that we're making. I encourage everyone to dig in to make sure that you and your -- the rest of your investors understand what the real numbers are, because we have already started to see some disconnects between people who don't understand it. So I would appreciate everyone here on the call communicating the right numbers to people and helping us make this transition. So we will talk to everyone next quarter.

Operator

Thank you for your participation. This does conclude today's conference call, and you may now disconnect.

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