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EA - Q1 2016 Electronic Arts Inc Earnings Call

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## OVERVIEW:

EA reported 1Q16 non-GAAP net revenue of \$693m and non-GAAP diluted EPS of \$0.15. Co. expects FY16 GAAP revenue to be \$4.3b and GAAP fully-diluted EPS to be \$1.98.



## CORPORATE PARTICIPANTS

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

**Andrew Wilson** *Electronic Arts Inc. - CEO*

**Blake Jorgensen** *Electronic Arts Inc. - EVP, CFO*

**Peter Moore** *Electronic Arts Inc. - COO*

## CONFERENCE CALL PARTICIPANTS

**Chris Merwin** *Barclays Capital - Analyst*

**Ryan Gee** *BofA Merrill Lynch - Analyst*

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

**Stephen Ju** *Credit Suisse - Analyst*

**Brian Pitz** *Jefferies LLC - Analyst*

**Drew Crum** *Stifel Nicolaus - Analyst*

**Ben Schachter** *Macquarie Research - Analyst*

**Mike Hickey** *The Benchmark Company - Analyst*

**Eric Handler** *MKM Partners - Analyst*

**Doug Creutz** *Cowen and Company - Analyst*

## PRESENTATION

### Operator

Welcome and thank you all for standing by. (Operator Instructions). Today's conference is being recorded. If you have any objections, you may disconnect at this time.

Now I will turn the meeting over to your host, Mr. Chris Evenden. Sir, you may begin.

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

Thank you, Kat. Welcome to EA's fiscal 2016 first-quarter earnings call. With me on the call today are Andrew Wilson, our CEO, and Blake Jorgensen, our CFO. Peter Moore, our COO, will be joining us for the Q&A portion of the call.

Please note that our SEC filings and our earnings release are available at [ir.EA.com](http://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.

A quick calendar note, our Q2 earnings call is scheduled for Thursday, October 29.

This presentation and our comments 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 statement as of today, July 30, 2015, and disclaims any duty to update them.



During this call, unless otherwise stated, the financial metrics will be presented on a non-GAAP basis. 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 will turn the call over to Andrew.

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**Andrew Wilson** - *Electronic Arts Inc. - CEO*

Thanks, Chris.

Q1 was a great start to fiscal-year 2016 and we continue our journey to put our players first and deliver amazing entertainment experiences for them. We are building deeper connections with players in our games and large services. There is tremendous excitement for our upcoming titles and we see profound new energy in our industry.

Our Q1 results were excellent, with revenue, margins, and earnings above our guidance. Our top games and large services, including EA SPORTS FIFA 15, Battlefield Hardline, The Sims 4, are engaging players around the world with fresh new experiences. We see continued strength in our mobile titles, with new games coming later this year.

EA is executing well against our plans for FY16, and with ongoing strength in our digital business and growing anticipation for our upcoming titles, we are raising our full-year guidance today to reflect momentum across the portfolio.

Our industry is hitting a powerful stride as we advance further into the new global era for games. The Xbox One and PlayStation 4 installed base continues to grow and show great strength, driving well beyond adoption rates of previous-generation devices.

The opportunities in mobile, as well as new service and delivery models, are opening up more ways to bring players into our games than ever before.

At the E3 conference in June, the appetite for great new games was clear. Players on all platforms are ready for new experiences that capture their imagination with creativity, innovation, and breakthrough game play. EA is in a strong position to deliver.

We had an outstanding E3 this year, showcasing 15 new games to our players, media, and partners. Throughout the event, our partnership with Disney and Lucasfilm was in full view. Star Wars Battlefront stunned audiences with the magnitude and realism of its game play. We revealed new expansion -- a new expansion for Star Wars - The Old Republic and announced a new Star Wars mobile game. We unveiled new experiences for original IP with Mass Effect Andromeda, Plants vs. Zombies Garden Warfare 2, and surprised with the unexpected charm of Unravel.

We celebrated the return of Need for Speed, captivated players with the authenticity of our upcoming sports games, and detailed the game play innovation in Mirrors Edge Catalyst. Attendees were able to go hands-on with all of this year's titles that our E3 booth.

Most importantly, through content and social conversation we brought the E3 experience to players around the world. Millions of viewers joined the stream of our live event and our titles were mentioned more than 500 times per minute on social media during the week of E3. Trailers, game play, and large streams of our games were viewed over 53 million times throughout E3 and Star Wars Battlefront alone generated 22 million views on social platforms, our most popular content ever at E3.

It was tremendous to see such positive reaction from players and feel the excitement level for our games continuing to build. We are looking forward to sharing more at Gamescom in just a few days.



In addition to our upcoming games, our large service today are ecosystems of ever-changing content for our players. Battlefield 4 and Battlefield Hardline players logged a combined 170 million online game play hours in Q1. And we will be bringing new expansion packs to both experiences in the coming months.

The Sims 4 play community continues to grow and engage deeply with the game as we deliver more update and new content, and we saw game play hours in our mobile hit, The Sims FreePlay, increase 85% year over year. In addition, our EA Sports ultimate team modes averaged over 2 million players per day in Q1, up nearly 20% year over year.

Amazing and creative new experiences, dynamic live services, and deeply engaged communities built on strong and meaningful relationships with our players, these are the building blocks of our long-term strategy for Electronic Arts. Through our key franchises, as well as experiences with new and original IP, we have the ability to reach more players than ever.

EA Access, Origin, and our new XFINITY Games beta are bringing more players in to compete, connect, and fuel their passion for games, and with our digital infrastructure, analytics, and large services, we are evolving and personalizing the experience for each player and exploring how cross-game services can create additional value for everyone.

After a strong first quarter, the stage is now set for us to go with our slate of groundbreaking and stunning new games through the remainder of FY16.

I will now turn the call over to Blake for a deeper look at our financials.

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

Thanks, Andrew.

EA's non-GAAP net revenue was \$693 million, which was \$53 million, or more than 8%, above our guidance. The quarter's revenue was 11% lower than prior years because we had no console title launches this quarter. And the year-ago quarter included the launches of Titanfall for Xbox 360, EA Sports FIFA World Cup 2014, and EA Sports UFC.

Our core business was strong, and at constant currency, this quarter's revenue would have been within 4% of last year's. As I discuss the results for the quarter, bear in mind that FX changes have had a dramatic impact on year-on-year comparisons. The euro, for example, fell nearly 20% against the dollar from the first quarter last year to this year's first quarter.

In the first quarter, EA Sports FIFA 15, Battlefield Hardline, and The Sims 4 drove solid revenue and delivered excellent margins. This demonstrates the power of our deep catalog of popular IP, which delivers a base of stable revenue throughout the year. The revenue and margin beat versus guidance were driven by better-than-expected performance from FIFA Ultimate Team and The Sims 4.

Our non-GAAP digital net revenue for the quarter increased 10% year over year to \$532 million, 77% of this quarter's revenue. The trailing 12-month digital net revenue was up 20% to \$2.28 billion.

Breaking down our digital revenue into its key components highlights the performance of each of these businesses this quarter. Extra content and freemium contributed \$255 million, up 21% over the prior year. The principal driver of this growth was FIFA Online 3 in China. \$31 million of the FIFA Online 3 revenue was deferred from previous quarters, as noted in our last earnings call. Total Ultimate Team was down 6% year on year, but up 3% on a constant-currency basis, even with the World Cup boosting FIFA Ultimate Team engagement levels last year.

Mobile generated \$122 million in the quarter. Digital extra content and advertising was up 11% versus the prior year to \$115 million, while premium mobile full-game download revenue was just \$7 million, down 56% compared to the prior year. We expect premium full-game download revenue to remain at this minimal level for the foreseeable future.



Full-game PC and console downloads generated \$84 million of revenue, up 18% over the prior year. We continue to see the digital downloads increased as a percentage of full-game sales, although this quarter was particularly high since our catalog titles typically skew more towards digital download than do newly launched games.

Subscriptions, advertising, and other digital revenue contributed \$71 million, down 11% from last year, due to the natural decline in Battlefield 4 premium revenues. EA Access is delivering strong sustained growth and we continue to build this value to gamers as we add more games to the vault. Titanfall is now in the vault and Dragon Age: Inquisition will join it at the end of the summer, bringing the total titles to 13.

Moving on to gross margin, our non-GAAP gross margin for the quarter was 76.8%, an increase from last year's 70.2% and better than our guidance of 74.5%. Growth over the prior year was driven by product mix, the shift to digital, and FIFA Online 3 in China. We exceeded guidance largely through better-than-expected performance from FIFA Ultimate Team and the continued success of The Sims 4, which delivers very high margins by virtue of being a PC title based on wholly-owned IP.

Non-GAAP operating expenses for the quarter were \$472 million, up \$13 million, or 3%, year on year. The increase over last year was driven by R&D; payroll tax expenses related to stock-based compensation, which have risen with the stock price; and by the extra week in the quarter. This was offset by FX and lower marketing costs as a result of no major launches this quarter.

The resulting non-GAAP EPS was \$0.15 a share, which is \$0.15 better than guidance, due to strong revenue and higher gross margin. As a reminder, this is calculated at our new tax rate of 22%.

Our cash and short-term investments at the end of the quarter were \$2.88 billion or approximately \$9.23 per share. 64% of this cash and short-term investment balance is held onshore.

Net cash used by operating activities for the quarter was \$71 million. On a trailing 12-month basis, operating cash flow was \$992 million, a record for this period.

During Q1, we repurchased 2.2 million shares at a cost of \$132 million. Our \$1 billion stock buyback program was initiated partway through Q1, in May 2015, and has a two-year time frame. As of the end of the first quarter, there was \$925 million left on the \$1 billion plan, as some of the stock repurchased during the quarter was bought under the old plan.

Due to the strength of our business, we are increasing our full-year guidance. For fiscal 2016, our non-GAAP guidance for revenue is up by \$50 million to \$4.45 billion and our non-GAAP EPS increases \$0.10 to \$2.85 per share.

This results in an expected operating margin of 27%. It is still early in the year and with Q1 representing less than 16% of expected full-year revenues, we believe some continued conservatism is appropriate. The GAAP guidance becomes \$4.3 billion in revenue and \$1.98 of fully diluted EPS.

Regarding cash flow for the year, we are reiterating our operating cash flow guidance of approximately \$1.15 billion. Our capital expense forecast remains approximately \$100 million, resulting in a free cash flow forecast of approximately \$1.05 billion.

Guidance for our second quarter is for non-GAAP net revenue to be \$1.075 billion, 12% lower than last year's \$1.22 billion. In this quarter, we are launching Madden NFL, FIFA, Rory McIlroy PGA TOUR, NHL, and NBA LIVE. While last year's Q2 saw the launches of our major sports titles, it also included The Sims 4.

In addition, FX presents a year-on-year impact of around \$100 million to Q2 revenues.

Non-GAAP gross margin is forecasted to be 63%. Again, the main difference between this quarter and a year-ago quarter is the launch of The Sims 4. We expect our Q2 non-GAAP operating expenses to be \$510 million, up slightly year on year, driven by an increased investment in R&D and offset by FX and savings in marketing. This results in a non-GAAP diluted EPS of \$0.40 per share, as compared to \$0.73 per share last year.

Our Q2 GAAP net revenue is expected to be \$815 million, as compared to \$990 million in prior year. GAAP loss per share is expected to be \$0.58, as compared to \$0.01 per-share profit in the prior year.

We are very pleased with our first-quarter results. Our ability to reliably generate earnings even in the absence of major launches is a testament to the value of our broad IP portfolio, our catalog, and our robust live services. Digital extra content and mobile continue to provide additional layers of consistent revenue. On top of this, player reaction to our marquee titles at E3 gives us great confidence in our competitive position as we look forward into this year and beyond.

Now I will turn the call back to Andrew.

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**Andrew Wilson** - *Electronic Arts Inc. - CEO*

Thanks, Blake.

We have a great deal ahead of us over the next three quarters as we prepare to deliver a range of new titles from our key franchises and original IP, as well as more new content for players in our large services. We will have four more EA Sports experiences launching through the summer and fall, Madden NFL 16, NHL 16, FIFA 16, and NBA LIVE 16, all featuring engaging new modes and groundbreaking game play for our players.

Need for Speed will arrive in November and fans are loving the authentic car culture and deep customization that we have shown so far. And, of course, Star Wars Battlefront will launch on November 17. The excitement for this game continues to build. It took home 45 awards from E3, including Game of the Show from IGN and Best Online Multiplayer from the E3 game critics. We look forward to unveiling new dimensions of Star Wars Battlefront and letting players go hands-on next week at Gamescom.

We have more new experiences coming throughout the year. Our large services will continue to evolve with new content, we will have some great new mobile games, and we're excited to have three new and original IP titles launching in Q4.

Looking further ahead, we are preparing more new games for our players. The reaction to a first look at Mass Effect: Andromeda at E3 was incredibly positive. We have a new Battlefield experience coming in Q3 FY17 and another new Star Wars project being led by the dynamic creative team of Jade Raymond and Amy Hennig.

These are just a few of the new experiences in development across our studios today. From the creativity of our teams to the technologies we are building, to the passion for play that we share with our players, we are pushing the boundaries for games in an effort to deliver the next amazing experience. Through our games and live services, we will immerse players in new worlds, introduce engaging new characters, and transport them into adventures that capture the imagination.

In a new global age for games when more time is spent playing than ever before, we are also building a future with relationships at the core. Through our network, we're connecting players with each other and delivering experiences that are meaningful every time they play. I look forward to sharing more updates on our progress in the quarters ahead.

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

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

We are ready for questions now. Thank you.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Chris Merwin, Barclays.

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### Chris Merwin - Barclays Capital - Analyst

I just had one on gross margin. I think, Blake, you touched on some of this, but it was a very impressive margin that you posted, and I was just hoping you could provide a little bit more detail on what in particular drove that through a combination of, I guess, digital downloads, FIFA online in China, and then whatever else?

And then just, secondly, in terms of Ultimate Team, I think you commented that it was up slightly on a constant-currency basis, but down on a reported basis. I know last quarter there was an illegal coin sell issue and I know you're working to resolve that. So just curious where you stand as it relates to that, and then how we should be thinking about growth for Ultimate Team for the rest of the year in the context of your extra content revenue? Thanks.

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### Blake Jorgensen - Electronic Arts Inc. - EVP, CFO

Sure, so first on gross margin, the gross margin -- a couple things to remember in just year-over-year comparisons. One, last year, both Titanfall and UFC are royalty-bearing titles, so they have dampened last year's gross margin a little bit.

But the real driver for us was the strength, as you noted, FIFA Online 3. Obviously, some of that deferred revenue, so coming in at very nice gross margins.

But second, and probably more importantly, the strength of The Sims 4. And I'd just give people a reminder. Last year, The Sims started a little slow relative to our thinking. We talked about that in our Q2 earnings, but the strength of The Sims franchise is the layering in of expansion packs that really fuel not just the expansion pack revenue, but bring people into the core game.

And we were in a situation where many consumers were comparing the original Sims 4 game to The Sims 3 game with a long series of expansion packs. And as we now start to bring out expansion packs, they are starting to see the power of The Sims 4 game play and the excitement around it. And we sold more Sims 4 this quarter than we thought, and we think that trend will continue and we are very excited about it, not just because of the franchise, but because of the power that drives to the gross margin.

And then last, but not least, as you saw, the digital business as a whole was 77% of our total revenue, and that included a large amount of full-game downloads, which obviously enhances margin, as well as all the other components of the digital business which enhanced our gross margin, and that really helped the overdelivery relative to plan.

Now in terms of FIFA Ultimate Team, and I encourage Peter or Andrew to jump in on this if they would like, first, we saw as you said Ultimate Team down slightly, but up on a constant-currency basis. And a key reminder there is the comparison year over year was that FIFA Ultimate Team did extremely well in the first quarter last year because of the World Cup and all the people playing associated with the World Cup and the World Cup modes that we had in the game.

We did see better performance of FIFA Ultimate Team than we expected. As you remember in Q1 -- or last call before Q4, excuse me, we gave some warning that because of the illegitimate coin selling, we thought that we would see some slowdown in FIFA Ultimate Team, mainly because of the actions we had taken to do price banding. Much of that will be corrected in the new version of FIFA Ultimate Team that comes out with FIFA 16 and we're excited about that. We don't see any change to our outlook for the overall extra content and Ultimate Team business in the future.

And as you can see, we were surprised that we did better than expected on Ultimate Team in the quarter, which also helped drive margin.



There is a lot of excitement about soccer in the world. The women's World Cup in Canada really drove a huge amount of excitement in North America. We are seeing a great amount of excitement across Asia and we think that will continue to help drive both the FIFA product and the Ultimate Team product over time.

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**Chris Merwin** - *Barclays Capital - Analyst*

Thank you.

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**Operator**

Ryan Gee, Bank of America.

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**Ryan Gee** - *BofA Merrill Lynch - Analyst*

This is Ryan calling in for Justin. The first question is on OpEx. You have done a good job of managing those expenses the past several years, and 2Q guidance shows some sequential growth there. Any color you can give on just where you are in terms of investing for the cycle and OpEx growth going forward?

Second, Blake, can you just confirm whether or not Unravel was included in your prior outlook and just whether any of the guidance increase this quarter was due to unannounced or new titles or products? Thanks.

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

Sure, sure. So let me hit OpEx first. OpEx, the OpEx that we gave guidance on at the start of the year obviously hasn't changed in terms of the guidance. We have built into that OpEx R&D investment in both console and mobile products, and that's why you're seeing a slight uptick.

The OpEx this quarter was driven primarily by the options or RSU exercises and the tax expenses associated with those. We didn't forecast the stock price to be as high as it has turned out to be, and thus it was a little bit higher than we had expected. Still, obviously, within our guidance and we are comfortable with our full-year guidance on OpEx.

We are continuing to try to be extremely efficient in R&D and continue to try to build benefits in to drive marketing expenses around the great digital connection we have with our users, our gamers, and consumers out there. And you will hopefully see a continued benefit to that over time.

In terms of the guidance and products, Unravel was in the original guidance. I don't think the expectations around the love for Yarny himself was quite built into our guidance and we were pleasantly surprised at E3 about how popular he was. But it is still a fairly small product and it is built into our guidance.

We haven't added any products to our guidance; that was not the reason that we raised the number. The number was raised primarily due to the positive reception we saw across all of our products and the strength of the industry, as Andrew mentioned, the excitement we have seen around console gaming and the continued popularity of both Xbox and PlayStation and the strength of that going forward. So that was really the driver to our raise of guidance.

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**Ryan Gee** - *BofA Merrill Lynch - Analyst*

Okay, and then one quick follow-up, if I could. On digital and the mobile, it was a pretty sharp fall-off, but it looks like the smartphone portion of that mobile is doing well. Can you help us with the phasing of mobile throughout the year or any products that we should be aware of that are coming out on mobile in the near term? Thanks.



**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

We have talked about a couple of key products that are coming out in the back half of the year. I can't give you exact dates. We test our mobile products extensively, and so it is often hard to be able to get exactly when the launch date is going to be.

Clearly, we have the Minions as a key product. We have a Star Wars product coming out. We have updates to some of our sports titles, which you'll see, and a lot of exciting expansions or additions to products, like The Simpsons or SimCity BuildIt, which have continued to build off of the strength of our platform there.

In terms of the actual phasing, hard to say, and I don't think it changes our overall phasing that we have put in our new guidance. But we will update you as that comes along.

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**Ryan Gee** - *BofA Merrill Lynch - Analyst*

Great, thank you.

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**Operator**

Colin Sebastian, Robert Baird.

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

Nice quarter, guys. I have a couple of questions. First off, a lot of anticipation around Star Wars, obviously, and it looked really great at E3. Just considering the release date is fairly fixed, I wonder how comfortable or confident you are, Andrew, around the studio's ability to launch a fully finished product by the time November rolls around. And then, are you sticking with your original 9 million to 10 million unit guidance for the game?

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**Andrew Wilson** - *Electronic Arts Inc. - CEO*

Thanks, Colin, and thanks for the congrats. We're feeling very good about the game right now.

Again, as a reminder, this is a tried-and-true development team building on a Frostbite engine that has now launched a number of products on this platform generation. And we are coming to the third phase of development on this generation of products, so we feel like we have put all of the things in place that we need to to deliver a great product.

We had thousands of people play it at E3 in one of the more robust setups we have had for a shooter in our E3 booth in recent years, and we're looking at having literally tens or hundreds of thousands of people play it on over 200 units at Gamescom next week. So, the code is all very playable, the quality is high, and the feedback so far from the player base has been very positive.

On the 9 million to 10 million, I will let Blake take that one.

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

Okay. Just to clarify, there is no change, obviously, on ship date on that whatsoever. We are very confident that we should be able to hit that date, based on what Andrew just told you.

On the guidance, look, we are normally -- we normally do not raise guidance coming out of the first quarter. I think all of you know we have a fairly conservative mindset around guidance. This was the first time we have raised guidance in probably 10 or 15 years coming out of the first quarter, because only 16% of our business is really booked in the first quarter.

We are really excited about Battlefront, but we're also really excited about all of our products, and that excitement drove us to increase our guidance in the quarter.

We haven't yet started to think about or talk about publicly what that means in terms of units, partially because it's still early. We want to see how the reaction is at Gamescom to all of our products, including Battlefront, as well as how the fall plays out. So I would assume we will have that discussion in October before we ship those products, and more to come on that. But right now, think about the raise in guidance on revenue as strength across all of our products, including strength in the response around Battlefront.

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

Okay, Blake, thanks. And just one quick one on the second-quarter outlook versus a year ago. You mentioned the FX headwinds in Sims 4, the comp there, but you also have the higher console installed base and digital growth, and I think NBA is incremental. So it would appear that topline growth is still a possibility on the strength of the franchises, but are there any other moving parts I'm missing that might have impacted your initial outlook?

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

No, and in fact, it looks like a lot of people on the Street got ahead in terms of revenue and I think that is because maybe people forgot that The Sims was in last year's quarter, along with the sports titles.

Obviously, no Sims this year. We're expecting strong revenue out of FIFA, Madden, NHL, and NBA, but those are obviously -- they were there last year as well.

I think the biggest and really only headwind comes out of FX, and based on where we are today and FX rates today, we think that is relatively -- roughly \$100 million relative to last year.

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

Okay, great. Thanks a lot.

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**Operator**

Stephen Ju, Credit Suisse.

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**Stephen Ju** - *Credit Suisse - Analyst*

So Peter, Andrew, are you able to share some of the underlying user data for FIFA Online 3 in China? You know, monthly active users, paying users, et cetera? If not, at least a directional indicator on how this is ramping?

And separately, if you are able to look at your user base for FIFA in the US and compare that versus western Europe or even versus Korea, where do you think you are?

And Blake, I think at E3 you talked about the possibility for an annual release of a Star Wars game as you take advantage of your license here. So, where are you in terms of deploying development talent to make that possible? Thanks.



**Andrew Wilson** - *Electronic Arts Inc. - CEO*

So the first question, Stephen, on FIFA Online 3, as regards to -- this is, of course, published with our partners in Tencent there, so it's a little early. As you recall, we waited to soft launch. We are now in full commercial launch. We can probably share a lot more of that data in the next earnings call.

As regard to your question in comparison to the West, obviously they are very different experiences. This is a free-to-play game. It is built on the Ultimate Team format, but is not a twitch-type game, which regular FIFA game obviously is.

So from that perspective, I think the overriding similarities of soccer fans around the world, and Blake touched on this, we are riding high on soccer currently right now, coming off the women's World Cup and with the new domestic leagues all about to start within the last two weeks. So, obviously having that FIFA license for us and being able to deploy it across multiple geographies with multiple partners, and in particular in the biggest geography in the world with a very strong partner in Tencent, gives us great opportunity.

We brought forward the \$31 million from the previous quarter into this quarter here, and as Blake has mentioned on the previous call, we are looking at somewhere in the region of about \$10 million to \$15 million per quarter as net revenue from our Tencent relationship.

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

And in terms of Star Wars, I don't think we have actually said that there is an annual Star Wars plan in place, but we do have a long-term contract with Disney and we know Disney has plans for many Star Wars movies, and we're going to try to take advantage of the IP that is coming out of those movies.

I do think what we have said is that our intention is to try over the next couple of years to have a first-person shooter as one of the core titles. This year, obviously, Star Wars Battlefront; next year, another Battlefield title.

And as Andrew said, we're working on some other Star Wars titles. Jade Raymond and Amy Hennig are working on a core title right now. We don't have the timetable yet to announce those, but trust that you will see multiple Star Wars titles both on console and PC, as well as on mobile. We have at least one mobile title that is going to come out this year and we have more in the process as well, so a lot of to come on Star Wars and you'll hear about that as we discuss our future guidance. We are very excited about the franchise and about our partnership.

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**Stephen Ju** - *Credit Suisse - Analyst*

Thank you.

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**Operator**

Brian Pitz, Jefferies.

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**Brian Pitz** - *Jefferies LLC - Analyst*

Thanks for the question. Just a follow-up on Star Wars, curious what you are seeing out of preorders. I know you have had 20 million views on the trailer and a lot of marketing around it, but any comment on this translating into preorders on the title, and maybe how those preorders could compare to the last Battlefield at this point?

And then, separately, an update on your console growth expectations. I know Sony just raised its expectations today for the year. I believe you were around 48 million to 49 million next-gen boxes by year-end. Any changes or updates? Thanks.

**Peter Moore** - *Electronic Arts Inc. - COO*

So on the preorders, we are seeing extremely strong preorders coming out of E3, as you might imagine.

I will remind everybody on the call that more and more as we see digital start to take a hold with our consumers that preorders become less of a key indicator, key leading indicator as how we predict our business here. But as we came out of E3, and more importantly, as Andrew mentioned, as we come out for what I think will be a pivotal moment for Star Wars next week in Cologne, Germany, when 265,000 consumers will descend on the Cologne convention center on Thursday, all of whom will be trying desperately to get their hands on this title, we expect to see tremendous response from that.

I have seen the build and the game looks very, very solid. And we are excited to be able to share that.

As regards to the question regarding installed base, yes, 49 million at the end of the calendar year. Just some data on that, we are now 20 months in, and if we go like for like on the previous generation, we are up 44% installed base hardware versus where we were with Xbox 360, PS3, et al, and our attach rate for software is slightly ahead as well. When correcting for full-game downloads, digital full-game downloads in hardware bundles, we are at 6.1 right now versus 5.9 in the same period in the previous generation.

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

And Brian, we haven't fully digested the Sony announcement, other than to say that it is hugely positive. Every time either Sony or Microsoft brings out information, it has been on the positive surprise upside. I think the NPV data showing the success of the Microsoft 1 terabyte console, as well as the continued strength in both Sony and Microsoft's product mix, have been really strong.

And a piece of that puzzle is if you -- if you were at E3, you saw the quality of software, not just ours, but the whole industry, and that bodes extremely well for generating interest in, if you are sitting on the fence today, getting out and buying a new console. And we think that's going to do well over the next couple of years.

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**Brian Pitz** - *Jefferies LLC - Analyst*

Great. Thanks, guys.

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**Operator**

Drew Crum, Stifel.

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**Drew Crum** - *Stifel Nicolaus - Analyst*

So you guys hit a pretty sizable beat on gross margin in the first quarter, but it does not seem to be flowing to your fiscal-year guidance and I wondered what the rationale behind that was.

And then, separately, as it relates to your sports titles, obviously a lot of moving parts there. Any updated view in terms of directionally how those businesses or how those franchises will perform in aggregate in your fiscal 2016? Thanks.

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

Yes, why don't -- let me take the gross margin question and let Andrew hit the sports question.

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I think the reality is -- it's a little bit of a law of math, right? We are able to raise our full-year guidance on the bottom line and the topline, with a slight improvement in gross margin, but, remember, third-quarter gross margin gets somewhat impacted by the royalty-bearing nature of Star Wars Battlefront.

So, net net, we are seeing a positive trend in gross margin, but with only 16% of the year gone, math just doesn't drive the gross margin number that much, even though we have got a 10% -- or \$0.10 increase in EPS.

I think the good news there is a slight improvement in gross margin, nowhere near what we saw in the first quarter, but just a slight improvement going forward, bodes well for the earnings and the cash flow power in the business model. And that's why we're so focused on driving the digital side of our business because it is a huge value creator for us.

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**Andrew Wilson** - *Electronic Arts Inc. - CEO*

As we think about our sports portfolio coming into Q2, again, as we have got more and more data on our player base, one of the greatest things that demonstrates a propensity to upgrade to the next version is continued engagement in the current version.

We are seeing very, very strong engagement across the portfolio right now and that combined with a great feature set across our sports portfolio and the evolution and growing player base as a result of growing console cycle and increased followship of sports like soccer around the world, we are very encouraged and excited by what our sports portfolio can do through this quarter, but not just that; as a result of the live services that we now build around our sports games, what it can do through this fiscal year and beyond.

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**Drew Crum** - *Stifel Nicolaus - Analyst*

Got it. Okay, and just one last one. Blake, can you remind us what you are assuming in terms of FX detriment to topline in fiscal 2016?

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

Yes, so it's a good question. Thanks, Drew, for asking.

As a reminder, we said at the start of last quarter, and it pretty much holds, that our revenue forecast on a like-for-like basis last year's FX rate was \$4.65 billion. We thought FX would impact that by \$250 million and that led to the \$4.4 billion revenue guide.

So obviously under the new guidance, we're assuming \$4.7 billion in revenue, the same FX impact, \$250 million, less the \$4.45 billion in adjusted post FX revenue. And we present in our investor pack the FX rate. The reality is the euro is right about the same level as it was when we did our original guidance. We saw a little weakening in the dollar during the quarter, up to about \$1.13 from \$1.09, but that didn't last very long. It's back down around the \$1.09 level.

And the Great Britain pound, which is obviously a big driver for things like FIFA, we saw -- the original guidance was \$1.62. It is currently \$1.56, so a little bit different, but last year's full-year average was \$1.49, so we are still seeing some movement, but it pencils out to be roughly around that same \$250 million headwind.

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**Drew Crum** - *Stifel Nicolaus - Analyst*

Okay. Thanks, guys.



**Operator**

Ben Schachter, Macquarie.

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**Ben Schachter** - *Macquarie Research - Analyst*

First, congratulations on just continued positive momentum. A few questions, one, how should we be thinking about Titanfall free-to-play in China and throughout Asia?

Two, aside from FIFA in China, what are the other key drivers in China?

And then, you know I have to ask a question about virtual reality. So I know it's still very, very early for VR and it won't impact the financial model anytime soon, but should we expect you to work with some of the VR platform holders in terms of them helping fund and develop some showcase titles? And when should we expect the first VR game from EA? Thanks.

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

I thought you were going to ask when should we expect the first VR earnings release.

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**Andrew Wilson** - *Electronic Arts Inc. - CEO*

That wouldn't be pretty.

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**Peter Moore** - *Electronic Arts Inc. - COO*

It is Peter. Just on your Titan 4 question, as you saw announced a couple of days ago, yes, we have entered into a relationship with our partners at Nexon, as well, of course, as the developer Respawn.

Think of this as a classic free-to-play game there, but do not think of this as being particularly material to revenue. It is an interesting experiment in looking at that type of game and whether it plays in a free-to-play environment. We will be interested to see the results.

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**Andrew Wilson** - *Electronic Arts Inc. - CEO*

And as it relates to the, as we talked about, weird thing about this on a couple of different levels, we certainly believe that VR represents an opportunity for our industry as you think about our players' motivation to immerse themselves in cool new worlds and explore new characters.

It is less for us about any one particular device or piece of technology and more about how we abstract beyond that and ensure our core technology layer, our digital platform, and our core engine in Frostbite can facilitate virtual reality experiences irrespective of which device a consumer wants to use.

Right now, we have a number of different incubation projects across the Company where we are looking at best-in-class new and innovative and creative ways for players to experience our games in a virtual reality environment. It's still very early days, but we feel we are investing appropriately to prepare for a time where that could provide a new and different and innovative way for our players to experience our games.

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**Ben Schachter** - *Macquarie Research - Analyst*

Great, and then if anything other than FIFA, what are the other key drivers in China that we should be watching?



**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

I think FIFA is our biggest single driver and I think there the biggest driver is continued growth and popularity of soccer, and that's a positive trend going on, obviously, around the world and particularly in places like China.

You will see additional new products come out that have similar approaches, being partner and using known IP that resonates well in the Chinese market.

More to come there, but I think our real approach is to try to stay very focused and try to build great relationships with partners there to help drive the business. That has worked for us really well in Korea with our Nexon partnership and we want to try to do the same thing with Tencent in China to really drive that business. Versus roll a lot of products into the market and hope something works, we're trying to be very, very focused.

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**Ben Schachter** - *Macquarie Research - Analyst*

I'm looking forward to the VR game.

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**Operator**

Mike Hickey, Benchmark Company.

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**Mike Hickey** - *The Benchmark Company - Analyst*

Great quarter. Nice to see the guidance going higher, too. It's awesome. Thanks for taking my question.

I think you sort of touched on this, but I am going to hit it anyway. Just curious on your hiring of Jade and the building of her new Motive studio in Montreal. As you said in your prepared remarks, it sounds like her first project is working with Amy at Visceral and it also sounds like she is overseeing that studio. Wondering if this was an original development direction you are planning, or do you feel you need additional expertise for this game's completion, Star Wars, that is rumored to be an open-world experience?

And I also wanted to confirm -- you touched on it, but confirm that this new R&D expense related to Motive was originally part of the \$100 million or so that you announced previous quarter. And I have a quick follow-up.

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**Andrew Wilson** - *Electronic Arts Inc. - CEO*

So I will let Blake cover the expense. As it relates to hiring of Jade, as an organization, as a creative organization, as an organization always looking for really strong creative leaders, we're always hoping to be able to bring in the best and greatest creative leaders.

Jade and Amy have had a relationship for a really long time. We have been working with Jade for some time about coming into our organization and doing this project and some other projects, quite frankly, and we are very, very excited by what we're going to be able to do on that front, both as it relates to the Star Wars project that you referenced, and I won't make any comment on the rumors in any way whatsoever, but we are excited to have Jade as part of our organization and really looking forward to what she and the team that she's going to be working with both here and in Motive in Montreal are going to be able to do.

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

And to your comment, Mike, on operating expenses, yes, it is contemplated in our current guidance. Our assumptions, we already have a team of people operating out of the BioWare Studios based in Montreal. It has been a great location for us, and Canada in general, obviously, has been a great development location for us across Edmonton, Montreal, and Vancouver.

We would like to continue to build more talent in that marketplace and there are some great people to be hired there, and that has always been in our expectations. The reality is it will take Jade some time to develop the IP ideas and develop the core team. That is not a lot of people up front.

So, it won't impact this year's guidance at all, and next year, we will start to build that out, but you will hear more about that in next year's guidance. I don't see it as a major driver of IP expense -- or R&D expense over the near term because we will simply reallocate where our balances around the world and where we are investing.

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**Mike Hickey** - *The Benchmark Company - Analyst*

Okay, that's very helpful. Thanks, guys.

Last question, also in your prepared remarks, and you added a little bit to it, but the 16 million matches. FIFA 15 played on average per day in Q1 obviously astonishing and it shows the ongoing engagement for a game that has been in the market now almost a year. So when you think about evolving business models, it would seem that a subscription service for a game like FIFA could be a successful future model for you and I guess for the players, too, given the consistency of their engagement.

And, so, I was just hopeful you could -- it is a little fringe of a question, I apologize, but curious if you could provide any insight on the potential for subscription game models on console in the future, and obviously not talking about EA Access?

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**Andrew Wilson** - *Electronic Arts Inc. - CEO*

Great question. I will see if I can shed some light on how we think about this.

There is really two core vectors as we think about this. The first is how do we build a live service that engages players day in, day out, week in, week out, month in, month out throughout the year? And how do we build that into a consistent and predictable engagement loop for our players and for our business? And I think what you're seeing with FIFA and our other properties, including Battlefield and Madden and NHL and others, is that we are successfully navigating that shift and really leading from the front in an industry to drive great engagement opportunities for our players.

The second vector as we think about that is then what is the appropriate business model for any given player to enjoy that experience, and I think it is insightful that you point out that it does open up subscription opportunity.

As it relates to subscription right now, we are very happy with the testing and experimentation and analysis we have got going on with EA Access, and over time we will evaluate, based on this ongoing engagement and relationship and conversation we have with our players, as to whether the extension of EA Access as a subscription or some alternate subscription would make sense for that player base. But right now, our focus is on the continuing -- continuance in driving of that large service experience.

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**Mike Hickey** - *The Benchmark Company - Analyst*

Thanks, guys. Best of luck.



**Operator**

Eric Handler, MKM Partners.

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**Eric Handler - MKM Partners - Analyst**

Thanks for taking my question; two things for you guys. First, with the news of consoles expanding in China beyond the Shanghai free trade zone, what would it take for consoles, do you think, to actually gain traction in China, changing from a massive PC environment to one that is more accepted with consoles?

Secondly, big change of thought here, the convert that you have comes due in a year. I know you have got a hedge on that convert, but can you talk a little bit about can you use cash rather than delivering shares? How does the hedge impact the P&L when that convert eventually comes due?

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**Andrew Wilson - Electronic Arts Inc. - CEO**

I will take the China piece and let Blake deal with the convert.

China, as we know, is a very interesting, diverse, and dynamic marketplace, particularly for western companies. In order for consoles to be supremely successful there, I think that we would have to account for the cultural sensibilities of the Chinese game-playing population. We would have to think about business model. We would have to think about appropriate culturalized content and the ability to fulfill the motivations that they have for social connection and competition, which differs from how we play in the West or even in other Asian markets.

I believe that both Sony and Microsoft are committed to driving the business there. I feel that we have content that, should we be able to navigate through those key elements, has appeal in China, but my sense is that it takes some time, as has the overall market in China, to really gain the traction and momentum that it has today.

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**Blake Jorgensen - Electronic Arts Inc. - EVP, CFO**

On the convert, Eric, so a couple of things to note. So, original value of the convert, roughly \$633 million. That has to be settled in cash, and then the upside component of that, obviously, settled in stock.

Right now at the average stock price for the quarter, which was \$61.61, that would equal 6.6 million shares of stock that would be used to, obviously, settle the convert. We publish a chart on our website, our IR website, that shows that at various stock levels, so I would consult that, and note there is a difference between the GAAP share count and the non-GAAP share count because GAAP accounting excludes the benefit of the bond hedge, so it shows the full dilution versus what comes in through the bond hedge, where the non-GAAP share count is obviously unaffected by it.

A couple of notes, as many people see with converts, particularly ones that are well in the money like ours, there often is really conversion requests that come in. And shortly after the last coupon payment, we saw a jump in early conversion requests. I believe people are simply making a calculation as to they take their money now or borrow money to carry it for the rest of the year, and typically the borrowing cost is offset -- not fully offset by the coupon. And so, you are seeing some early conversions.

And we have had over 165 million of early conversions that will get paid out over the next three months. There is a time lapse. And so, our assumption is we will continue to see some of that over the next year as people get closer to the conversion date next July. And our intention is to look through ways to obviously potentially refinance that in the capital structure. We have talked about a potential permanent layer of debt or another convert and/or just paying it all off, and we are looking through all those options and more to come.

But we appreciate the fact that there will be a lot of dilution and we are looking at ways to minimize that dilution going forward.

**Eric Handler** - MKM Partners - Analyst

Thank you very much. Very helpful.

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**Operator**

Ryan Gee, Bank of America.

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**Ryan Gee** - BofA Merrill Lynch - Analyst

Hi, again. Thanks for taking my question. Blake, real quick, one of the comments you made was that the increase in OpEx year over year was due to, among other things, an extra week in the quarter. Can you just explain that? It seemed like it is like for like this year and if that had any impact on revenue, not just OpEx?

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**Blake Jorgensen** - Electronic Arts Inc. - EVP, CFO

It obviously had a little bit of impact on revenue because it -- particularly catalog revenue. It didn't have a big impact because it wasn't like we were releasing a title in the quarter. But OpEx is obviously very steady, where revenue can be up and down day to day or week to week.

So I don't have the actual revenue impact, but we simply mention it because it is really our close. Our eternal accounting calendar had an extra week in the quarter versus last week, and that's why we mentioned it because it does drive a week's worth of extra OpEx. That would probably be the smaller portion. The RSU expense was obviously higher than that as part of a -- in terms of magnitude across the OpEx impact.

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**Ryan Gee** - BofA Merrill Lynch - Analyst

Okay, great. Thank you.

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**Operator**

Doug Creutz, Cowen and Company.

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**Doug Creutz** - Cowen and Company - Analyst

Follow-up on an earlier question, you mentioned that the attach rates for the cycle are slightly up and obviously that the hardware installed base is growing much faster. Can you comment on how the performance of last gen compares to the last cycle, and on net between the two where you see things?

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**Peter Moore** - Electronic Arts Inc. - COO

Doug, it's Peter. So yes, just let me say again. So when we look at this cycle, let's call this current-gen Xbox One, PS4, et al, versus last gen where we will be -- we believe the installed base of hardware at the end of 2015 will be 49 million. On a like-for-like basis of 20 months, 20 months from the launch of the Xbox 360 and PS3 to where we are today, we are up 44% in the west on installed base.

As regards the attach rate of software to the current installed base, 6.1 right now versus 5.9 of the previous generation, and that has been like-for-like indexed against the full-game downloads that we now enjoy both in the previous generation of the back end, as well as the full generation we

now have of full-game downloads, as well as hardware bundles where the software has been inserted into the hardware. So 6.1 right now versus 5.9, taking into account digital downloads and bundles.

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**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

I guess let me add to that. We saw at the tail end of the gen -- or the 360 and the PlayStation 3 cycle full-game downloads around the 5% level and that was 5% across new and catalog products.

We are seeing today, if you look at our last full line -- or frontline title that came out, Battlefield Hardline, both in last quarter and this quarter we are seeing rates north of 20% full-game downloads, and if you look at our catalogs, we are seeing some catalog titles up into the 40s that are older titles in the year versus brand-new titles.

All of those trends continue to see positive movements and we have heard similar things from our other members in our industry, and so we are very, very excited about the potential for continuing to drive that part of the business.

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**Doug Creutz** - *Cowen and Company - Analyst*

I guess maybe I didn't ask the question very well. What I was actually trying to get at is what you are seeing in terms of performance of 360 and PS3 compared to the original Xbox and PS2 at the end of the last cycle, and the net -- obviously, we have had faster growth in the new gen, but my sense is the old gen is falling off faster as well, and what does it look like on net compared to last cycle?

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**Andrew Wilson** - *Electronic Arts Inc. - CEO*

So it is how the tail is holding up, Doug, yes?

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**Doug Creutz** - *Cowen and Company - Analyst*

Yes.

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**Andrew Wilson** - *Electronic Arts Inc. - CEO*

Yes, I think it's fair to say it is hanging in there. I think when you look at EA in particular, we keep our sports titles as long as we possibly can. I will remind you that it's, gosh, only three years ago we were shipping a PS2 title for FIFA.

But I think it is fair to say as well when you look at our most recent big AAA launch, which was Battlefield Hardline, we saw four out of every five units on current gen, and as a result, you are seeing most of our new launches now being on the Xbox One and the PlayStation 4. Whilst we will still give some support in particular to sports to Xbox 360 and PS3 and hope that they continue a trend of hanging in there, our dev teams in particular are moving forward with next gen.

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**Doug Creutz** - *Cowen and Company - Analyst*

Okay, thank you.

**Blake Jorgensen** - *Electronic Arts Inc. - EVP, CFO*

So with that, I think we will call the call to a close. We appreciate everybody's time and continued support and we look forward to talking to you next quarter.

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**Operator**

And that's it for today's conference. Thank you all for participating. You may now disconnect.

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