

ELECTRONIC ARTS
Q3 FY14 PREPARED COMMENTS
January 28, 2014

ROB:

Thank you.

Welcome to EA's fiscal 2014 third quarter earnings call. With me on the call today are Andrew Wilson, our CEO, and Blake Jorgensen, our CFO. Peter Moore, our COO, and Patrick Söderlund, our EVP of EA Studios, 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. 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.

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-Q for a discussion of risks that could cause actual results to differ materially from those discussed today. Electronic Arts makes these statements as of January 28, 2014 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.

One last note: in today's remarks, PlayStation 3 and Xbox 360-related products will be referred to as current-gen or current-generation, while PlayStation 4 and Xbox One-related products will be referred to as next-gen or next-generation.

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

ANDREW:

Thanks, Rob.

In the third quarter of fiscal year 14, we had the unprecedented excitement of two new game consoles launching within weeks of each other. With that came the unique challenge of launching a full slate of EA's top titles for both next-gen and current-gen consoles.

In terms of our quarterly performance, on the top line we generated \$1.57 billion in non-GAAP revenue, which was below our guidance of \$1.65 billion. As others have noted, industry sales of major games for PlayStation 3 and Xbox 360 consoles declined in Q3 at a faster-than-anticipated rate, and that softness was the primary driver of our revenue shortfall in Q3. This shortfall will impact our full year revenue guidance, and we are now forecasting our annual revenues to be \$3.91 billion.

What's exciting for us looking forward is the uptake of next-gen consoles has been faster than we expected. The launches of the Sony PlayStation 4 and Microsoft Xbox One proved to be strong new catalysts for the console gaming market. The six titles we released with the launch of the next-generation consoles – *FIFA 14*, *Battlefield 4*, *Madden NFL 25*, *Need for Speed Rivals*, *NBA LIVE 14*, and *Peggle 2* – collectively sold above expectations and exceeded our Q3 forecasts.

As a result, we have taken an early leadership position on the next-gen consoles. Based on NPD December results in the U.S., EA achieved 40% segment share on the PlayStation 4 and 30% segment share on the Xbox One, and our estimates indicate we garnered similar shares in Europe. On average, every gamer in Europe that bought a next-gen console is playing one of EA's next-gen games. We are exceptionally proud to have been the #1 publisher on next-gen consoles in December, with millions of gamers playing EA titles on the PlayStation 4 and Xbox One across the globe.

The popularity of our next-gen games has allowed us to benefit from this early growth as illustrated by our segment share numbers. Looking forward, our goal is to keep our next-gen games fresh through live services, driving sales through Q4 and beyond as more gamers shift to

the new consoles. We also have a robust pipeline in front of us as the Xbox One and PlayStation 4 player base continues to grow.

EA's digital transition also continues at full-speed. Our non-GAAP digital net revenue, including mobile, full-game digital downloads, and live services, was up 27% year-over-year, and we are on track to exceed our guidance of \$1.7 billion in digital revenue for FY14.

Inside our digital portfolio, December was EA's biggest month ever for mobile downloads with over 71 million game downloads across the Apple App Store and Google Play – the most of any game publisher worldwide. *The Simpsons: Tapped Out* reached a record level of daily active users during the holiday quarter, and *The Sims FreePlay*, a game that launched over two years ago, delivered its largest-ever month of revenue in December. These milestones demonstrate how mobile continues to be a fantastic opportunity for EA's expansion and revenue growth.

We are further strengthened by our financial discipline during this fiscal year. We continue to manage our costs, and remain on track to lower our expenses year-over-year, an impressive achievement in a console transition cycle. However, this is not just an effort for FY14: long-term operating profit growth will continue to be an ongoing focus.

Benefiting from our position on next-gen consoles, digital growth and continued cost management, our Q3 non-GAAP EPS of \$1.26 exceeded our expectations by \$0.04 per share, and we are raising our full-year EPS guidance today by \$0.05 to \$1.30 per share on a non-GAAP basis.

Before I turn the call over to Blake to give additional details of our financial performance, a quick word on one of the most talked-about titles of Q3, *Battlefield 4*. Launching *Battlefield 4* was a complex effort, with our teams at DICE delivering a massive game packed with innovative new features for players on next-gen consoles, current-gen consoles and PC. Shortly after *Battlefield 4* went live, we began hearing from some players in the community who were experiencing issues with the game. The *Battlefield* team acted swiftly to address the issues through game updates, and they continue to make refinements as part of our live service to ensure a great game experience for all *Battlefield 4* players. *Battlefield 4* is an amazing game in size, scope and gameplay, and we're confident that gamers will be playing for a long time to come.

Q3 was an exciting start to a new generation of games, a great quarter for digital growth, and another positive step towards increasing operating profits. The stage is now properly set for the conclusion of our fiscal year, as well as the long-term opportunity in front of EA.

Over to you, Blake.

BLAKE:

Thanks, Andrew.

Turning to our Q3 results, EA's non-GAAP net revenue was \$1.57 billion, which was below our guidance, but 33% higher than last year. Our revenue growth over Q3 last year was driven by *Battlefield 4*, *FIFA 14*, *Madden NFL 25*, and *NHL 14*. And as a note, we deferred \$36 million into Q4 from programs that allowed consumers to upgrade from current-generation titles to next-generation titles. Our Q3 revenue shortfall was driven by a much sharper than anticipated decline in demand for current-generation software.

The industry showed signs of current-gen software weakness in the third quarter, and December's U.S. NPD results reflected that trend with PS3 and Xbox 360 software sales declining 35% versus the prior year. Our quarterly results were negatively impacted by this trend, and some of our key titles such as *Battlefield 4*, *FIFA 14*, and *Need for Speed Rivals* came in below our expectations for current-gen revenues.

This downward trend on current-gen software was partially offset by our positive next-gen results and fortunately this plays well for our future. Our Xbox One and PlayStation 4 software sales were well ahead of our expectations, led by *FIFA 14*, *Need for Speed Rivals*, and *Battlefield 4*. Sales of each of these titles on next-gen platforms exceeded our forecasts. Based on our estimates, EA titles represented 35% of the Western World next-gen software market in the third quarter, and EA was the #1 publisher on PS4 and Xbox One in December.

Q3 non-GAAP digital net revenue continues to grow over the prior year. Digital net revenue increased by 27% year-over-year to \$517 million. Trailing twelve-month digital net revenue was up 27% over the prior year to a record \$1.86 billion. Breaking down our digital revenue into its key components highlights the performance of each business:

- First, extra content and PC free-to-play contributed \$213 million, up 15% over the prior year, led by continued growth in *FIFA Ultimate Team*, *FIFA Online 3*, and *Star Wars: The Old Republic*. Our year-to-date results for all of our Ultimate Team services - *FIFA*, *Madden NFL*, and *NHL Hockey* continue to demonstrate revenue growth year-over-year. Extra content growth was partially offset by our decision to sunset several of our social titles.

- Second, our mobile business generated \$125 million for the quarter, up 26% over the prior year, and 19% over the prior quarter. Smartphones and tablets continue to represent a majority of the revenue, accounting for \$110 million of the \$125 million total, and growing 39% year-over-year.
- Third, full game downloads added \$113 million, up 157% over the prior year. This was largely driven by the launch of *Battlefield 4* on PC in the quarter.
- And finally, subscriptions, advertising, and other digital revenue totaled \$66 million, down 16% over the same period last year. This was driven by a decline in POGO subscription and advertising revenue, and a decline in *Star Wars: The Old Republic* subscription revenue, as the free-to-play offering continues to grow.

Moving on to gross margin: our non-GAAP gross margin for the quarter was 68.1%, up over last year's 65.7%, and in-line with our guidance. The improvement was due to our product mix shift, our growth in digital, lower transaction fees as we move away from the social business, and the benefits from our new digital platform.

Operating Expenses for the quarter were \$540 million, up \$11 million from last year, and \$60 million lower than our guidance. Operating expenses as a percentage of revenue was 34%, compared to 45% in the prior year. Our improving operating expense leverage illustrates the success of our cost control programs, as we continue to drive our operating margins above 20%, while remaining focused on investing in future growth.

The resulting non-GAAP EPS was \$1.26 per share, which exceeded our guidance of \$1.22 per share. Our EPS came in above our guidance due to our continued efforts to focus R&D investments on high return opportunities and manage our marketing expense through greater performance-based advertising strategies.

Our cash and short-term investments at the end of the quarter were \$2.07 billion, or approximately \$6.70 per share. Roughly 60% of this cash and short-term investment balance is held outside of the U.S.

Net cash provided by operating activities for the quarter was \$685 million, compared to \$363 million in the prior year. On a trailing twelve month basis, operating cash flow was \$664 million. This is the highest trailing twelve month operating cash flow for EA since 2005.

During the quarter, we did not repurchase any shares.

Now turning to guidance:

With respect to our Q4 guidance, GAAP revenue is expected to be \$1.07 billion, and **GAAP earnings per share** is expected to be \$0.72.

Non-GAAP revenue for the quarter is expected to be \$800 million. This estimate factors in the steeper-than-anticipated declines we saw in current-gen software revenues. Also, as a reminder in Q4 last year we launched five core titles and recognized the full year's *Battlefield 3 Premium* subscription revenue. This year, we will be launching two titles in the quarter and recording *Battlefield 4 Premium* subscription revenue on a ratable basis.

Our non-GAAP gross margin is forecasted to be approximately 71%, down against the prior Q4 gross margin of 74%. Our Q4 forecast includes \$36 million of revenue deferred from Q3 for promotional upgrade programs. As a reminder, last year's higher gross margin was attributable to the recognition of all of the *Battlefield 3 Premium* subscription revenue in the fourth quarter.

We expect our total non-GAAP **operating expenses** to be \$525 million. Our operating expenses will be impacted by our planned marketing and advertising for our key titles on next-gen.

This results in a non-GAAP diluted EPS of \$0.09 per share.

For the full year:

Non-GAAP revenue is now estimated to be \$3.91 billion and gross margin is expected to be 66%. Due to the favorable results of our continued cost control efforts, we are now estimating operating expenses to be reduced to approximately \$2.04 billion, and we are raising our EPS guidance by \$0.05 to \$1.30 per share.

The GAAP guidance is estimated to be \$3.52 billion in revenue, and a loss per share of (\$0.42). As we have pointed out in past quarters, our consumers are playing our games online over longer periods of time, and this longer period affects the length of time over which we are required to recognize GAAP revenue, which will drive the deferral of an incremental \$385 million of net revenue into fiscal 15. This longer service period has no impact on our non-GAAP revenue or cash flows.

Regarding Cash Flow: We are raising our estimates for fiscal 14 operating cash flow to approximately \$600 million. This implies expected free cash flow generation of approximately \$500 million dollars, which is up \$200 million from our previous guidance, and more than twice what we generated in fiscal 13.

Regarding fiscal year 15, we will provide guidance during our Q4 earnings call, when we will be in a better position to share our insights. At that time we will give you our title slate for the year and our expected financial guidance, which will be a continuation of our multi-year plan of improving operating profits and cash flow.

In summary: We were able to weather the decline in current-gen software sales by actively managing our operating expenses while still investing in the development of our next-gen products, services, future IP, earnings, and cash flow. We are encouraged by our initial software sales for PS4 and Xbox One, and going forward we remain committed to extending our leadership position in next-gen console software development, growing our digital games and services, and continuing to improve our operating profits.

With that I'll turn the call back to Andrew.

ANDREW CLOSING:

Thanks, Blake.

A few final thoughts to close:

- We're proud to have been the #1 publisher on next-gen consoles in December, with more new games on the way.
- Our digital businesses are reaching new heights across multiple platforms and geographies.
- And cost discipline measures are protecting our returns so we can invest in key IP.

We're all incredibly excited for the arrival of *Titanfall* on March 11. Our partners at Respawn Entertainment are now putting the finishing touches on this highly-anticipated title for Xbox One, Xbox 360 and PC. This is a spectacularly innovative game, a true achievement by the teams at Respawn.

Across EA's studios, development continues on plan for our future titles, and we'll share more of our FY15 slate on our next quarterly call.

We expect digital growth to continue as a defining characteristic of this fiscal year for Electronic Arts. Players are engaging deeper each year in digital live services for some of our established franchises like *FIFA Ultimate Team*, *Madden Ultimate Team* and now *Battlefield 4 Premium* – which currently has more than 1.6 million members. Digital is also accelerating our growth in new markets: *FIFA Online 3* is doing extremely well in Korea in both traffic and revenue, and we expect more fans to connect with our online free-to-play FIFA games in China and Latin America during the World Cup this year.

EA's mobile titles continue to rise up the charts and demonstrate our ability to build a portfolio of great games and grow them over time. Games like *The Simpsons: Tapped Out*, *FIFA 14*, *Real Racing 3* and *The Sims FreePlay* have highly-engaged fan bases on iOS and Android that are still growing long after launch. Our recently-launched *Heroes of Dragon Age* is another excellent example of an entirely new mobile experience designed around one of our proven IPs. Our strength in mobile is in our ability to repeat on success, and we see more strong opportunities ahead.

Throughout FY14 we've been demonstrating our ability to grow operating profits, and we expect strong returns from this increased focus on discipline across our business. This is a multi-year journey striving for both topline revenue growth and profitability improvement, and one that we are fully committed to for the long term.

By executing against our strategic priorities, we look forward to closing out FY14 in a position of strength. We are delivering exciting new experiences to our gamers every day, and we are ready to capitalize on the long-term opportunity in front of us.

With that, Blake, Peter, Patrick and I are here to take your questions.

Non-GAAP Financial Measures

To supplement the Company's unaudited condensed consolidated financial statements presented in accordance with GAAP, Electronic Arts uses certain non-GAAP measures of financial performance. The presentation of these non-GAAP financial measures is not intended to be considered in isolation from, as a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP, and may be different from non-GAAP financial measures used by other companies. In addition, these non-GAAP measures have limitations in that they do not reflect all of the amounts associated with the Company's results of operations as determined in accordance with GAAP. The non-GAAP financial measures used by Electronic Arts include: non-GAAP net revenue, non-GAAP gross profit, non-GAAP operating income (loss), non-GAAP net income (loss) and historical and estimated non-GAAP diluted earnings (loss) per share. These non-GAAP financial measures exclude the following items, as applicable in a given reporting period, from the Company's unaudited condensed consolidated statements of operations:

- Acquisition-related expenses
- Amortization of debt discount
- Certain non-recurring litigation expenses
- Change in deferred net revenue (online-enabled games)
- College football settlement expenses
- Loss (gain) on strategic investments
- Restructuring charges
- Stock-based compensation
- Income tax adjustments

Electronic Arts may consider whether other significant non-recurring items that arise in the future should also be excluded in calculating the non-GAAP financial measures it uses.

Electronic Arts believes that these non-GAAP financial measures, when taken together with the corresponding GAAP financial measures, provide meaningful supplemental information regarding the Company's performance by excluding certain items that may not be indicative of the Company's core business, operating results or future outlook. Electronic Arts' management uses, and believes that investors benefit from referring to, these non-GAAP financial measures in assessing the Company's operating results both as a consolidated entity and at the business unit level, as well as when planning, forecasting and analyzing future periods. These non-GAAP financial measures also facilitate comparisons of the Company's performance to prior periods.

In its earnings press release dated January 28, 2014, Electronic Arts has provided a reconciliation of the most comparable GAAP financial measures to the non-GAAP measures.

Forward-Looking Statements

Some statements set forth in this document, including the information relating to EA's fiscal 2014 guidance information and title slate contain forward-looking statements that are subject to change. Statements including words such as "anticipate," "believe," "estimate" or "expect" and statements in the future tense are forward looking statements. These forward-looking statements are preliminary estimates and expectations based on current information and are subject to business and economic risks and uncertainties that could cause actual events or actual future results to differ materially from the expectations set forth in the forward-looking statements.

Some of the factors which could cause the Company's results to differ materially from its expectations include the following: sales of the Company's titles; the Company's ability to manage expenses; the competition in the interactive entertainment industry; the effectiveness of the Company's sales and marketing programs; timely development and release of Electronic Arts' products; the Company's ability to realize the anticipated benefits of acquisitions; the consumer demand for, and the availability of an adequate supply of console hardware units; the Company's ability to predict consumer preferences among competing platforms; the Company's ability to service and support digital product offerings, including managing online security; general economic conditions; and other factors described in the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2013.

These forward-looking statements are current as of January 28, 2014. Electronic Arts assumes no obligation and does not intend to update these forward-looking statements. In addition, the preliminary financial results set forth in this release are estimates based on information currently available to Electronic Arts.

While Electronic Arts believes these estimates are meaningful, they could differ from the actual amounts that Electronic Arts ultimately reports in its Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2013. Electronic Arts assumes no obligation and does not intend to update these estimates prior to filing its Form 10-Q for the fiscal quarter ended December 31, 2013.