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# EDITED TRANSCRIPT

EA - Q1 2015 Electronic Arts Inc Earnings Call

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## OVERVIEW:

EA reported 1Q15 non-GAAP net revenue of \$775m and non-GAAP EPS of \$0.19.  
Expects FY15 GAAP revenue to be \$4.3b and fully diluted GAAP EPS to be \$1.78.  
Expects 2Q15 GAAP net revenue to be \$965m and GAAP loss per share to be \$0.12.



## CORPORATE PARTICIPANTS

**Rob Sison** *Electronic Arts Inc. - VP of IR*

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

**Blake Jorgensen** *Electronic Arts Inc - CFO*

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

**Frank Gibeau** *Electronic Arts Inc. - EVP of Mobile*

**Patrick Sutherland** *Electronic Arts Inc. - EVP of EA Studios*

## CONFERENCE CALL PARTICIPANTS

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

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**Sean McGowan** *Needham & Company - Analyst*

## PRESENTATION

### Operator

Welcome and thank you for standing by.

(Operator Instructions)

Today's conference is being recorded. If you have any objections, you may disconnect at this time. Now I'll turn the meeting over to Mr. Rob Sison, Vice President of Investor Relations. You may begin.

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### Rob Sison - *Electronic Arts Inc. - VP of IR*

Thank you, Holly. Welcome to EA's FY15 first-quarter earnings call. With me on the call today are Andrew Wilson, our CEO and Blake Jorgensen, our CFO. Frank Gibeau, our EVP of Mobile, Peter Moore, our COO, and Patrick Sutherland, 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](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 and audio replay of this call in 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 10K for a discussion of risks that could cause actual results to differ materially from those discussed today. Electronic Arts makes these statement as of July 22, 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 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.

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

Thanks, Rob. Earlier this afternoon we released our Q1 earnings report detailing a strong start to FY15 for Electronic Arts. At EA we have a commitment to put our players first, holding at our core that every game, every live service, every EA experience, will deliver the entertainment, innovation, creativity and value that our players want. With a strong slate of exciting new titles and fresh content served to players in our live services, we are well positioned to deliver on that commitment in FY15.

Around the world, more than 300 million registered players are engaging with the long-lasting entertainment provided by EA's games and services today. In the last quarter, gamers played more than 13.6 billion online sessions of EA games for a total of nearly 2.4 billion hours played across console, mobile, and PC experiences. To put that in context, that's more than 3,000 years of game play every single day. On screens from 6 inches to 60 inches, for sessions of 2 minutes to 2 hours or more, EA continues to deliver outstanding entertainment to players.

Our global fee for soccer franchise had a standout quarter as the World Cup drama began to unfold on the [pitches] in Brazil. More than 53 million matches were played in FIFA Ultimate Team World Cup mode alone during the quarter. That's the equivalent of more than 830,000 World Cup tournaments. The World Cup update to FIFA 14 on mobile drove engagement to a franchise record high and in Korea, FIFA Online 3 had the highest peak in current play levels ever for FIFA Online since it was launched in 2006.

Fight fans drove sales of EA Sports UFC to exceed our expectations for the quarter and the in-game action has been intense. More than 65 million fights have been played since the game launched. With EA Sports UFC joining our other great games for the new consoles, EA continues to hold the number one segment share on PlayStation 4 and XBOX 1 calendar year to date.

Our live services and digital content are reshaping the game experience today, helping players enjoy the games they love for longer. During the quarter, Naval Strike, the third expansion pack for Battlefield 4 launched to players in April, while Titanfall's first content pack, Expedition, was released to players in May. Our EA sports Ultimate Team modes continue to feed players' appetite for their favorite sports with live updates, new content and competitions daily. Players also continue to get a new and fresh experiences in live services for our top EA Mobile games where we drew more than 140 million monthly active players in Q1.

Titles like the Simpsons Tapped Out, Real Racing 3, the Sims Freeplay and FIFA 14 demonstrate the success in the approach of our mobile development teams build top quality experiences around fun and entertaining IP that can grow over years of play. With innovative new content like the Real Racing 3 Le Mans update, which drew 2 million entrants, players keep coming back to their favorite games. All of these factors contributed to a strong fiscal first quarter for EA, as we delivered revenue and EPS above our non-GAAP guidance. Our focus is now on the work ahead for us for FY15 as we prepare to launch a slate of new games and live services to our players.

As I said at the top, our commitment to players and the quality of our games is paramount with every game we make. We have some amazing new experiences coming this year, games that will connect, inspire, challenge, and entertain players. Games that are packed with creativity, innovation and emotion. Games with vibrant communities giving us feedback to make them even better.

Dragon Age Inquisition is the biggest RPG that BioWare has ever created in its rich history. It will deliver an epic open world experience powered by Frostbite 3 and combining combat, compelling characters and rich storytelling. The game was a huge hit with fans and critics at E3, taking home 25 awards including best RPG from the E3 Game Critics.

The team has crafted an absolutely amazing game for players. They want this to be the best Dragon Age experience ever delivered, so they are taking a little more time to put the final touches on the game. Dragon Age Inquisition now launches on November 18.

The live multi player beta for Battlefield Hardline that launched to E3 was a powerful opportunity to bring our players into the game earlier than ever before, with 1.7 million players joining the beta on PlayStation 4 and PC and logging more than 4.2 million sessions over two weeks -- 4.2 million session hours over two weeks, the beta delivered a very stable experience that also helped the visceral games team get a valuable player feedback.

Additional player testing has shown great excitement for this new world of cops and criminals inside the Battlefield franchise. It also showed us how, with more time, we could go deeper and innovate more. Visceral is testing and implementing several new features that will help to make Battlefield Hardline a game that players can enjoy for many years to come. We are moving the release of Battlefield Hardline out to Q4 FY15 and the team will keep players regularly updated on progress. We'll also have an all new beta opportunity in the months ahead for players to experience more of Battlefield Hardline.

Of course, Battlefield fans don't need to wait until then as Battlefield 4 continues to provide a dynamic live service today. Many more hours of new Battlefield 4 content and game play are yet to come, including the expansion packs Dragon's Teeth, launching worldwide on July 29, and Final Stand, coming in Q3. The [dos] team continues to deliver new updates and features for Battlefield 4 players and recently introduced a community test environment for players to provide feedback on new additions to the game before they launch.

With breathtaking game play innovation, stunning visuals, and immersive depth and detail, this year's EA Sports lineup will capture an unprecedented level of excitement and emotion. Madden NFL 15, FIFA 15 and NBA Live 15 are all making big strides in the second year of the new console generation, while the NHL and PGA tour franchises will make their next-gen debuts this year. NHL 15 took home Best Sports Game from the E3 Game Critics and EA Sports PGA tour takes golf to places it has never been as the first sports game to be powered by Frostbite 3.

[Mackus] will launch the Sims 4 in early September to an eager fan base ready to get their hands on this rich new Sims experience. Everything about the Sims 4 is exciting, from the massive technical innovation that gives these new Sims emotions and unique personalities to the beautiful and vibrant new neighborhoods in which they live to the weird and fun stories that players will tell. For both veteran fans and newcomers alike, the Sims 4 will open up a whole new world of game play possibilities. Players can preload the Sims 4 in Origin and be the first to play.

We will deliver entertaining new experiences from some of EA's biggest brands to players on mobile devices. New FIFA and Madden NFL experiences are set to launch during Q2, as well as a big and really fun new update to the Simpsons Tapped Out. A much anticipated new PayLo game from PopCat is moving through a test period in preparation for launch and our EA Mobile studios have four more exciting new experiences from other major franchises in development. We're excited to share more about all of these new titles for IOS and Android players in the coming months.

EA entered our second quarter in a strong position. We are committed to delivering top quality games and services to our players throughout the year.

I'll now hand the call over to Blake for a deeper look at our Q1 financial performance and FY15 outlook.

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**Blake Jorgensen - Electronic Arts Inc - CFO**

Thanks, Andrew. Starting with our Q1 results, EA's non-GAAP net revenue was \$775 million, which was 57% higher than prior year's results and 11% above our guidance. Digital continues to be a major contributor, but this quarter also saw three new launches, EA Sports UFC, FIFA World Cup 2014 and the XBOX360 version of Titanfall. In addition, FIFA 2014 Battlefield 4, Madden NFL 25 and the rest of our catalog titles had solid performances.

Our non-GAAP digital net revenue for the quarter increased by 28% year over year to \$482 million and accounted for more than 60% of this quarter's revenue. The trailing 12-month digital revenue was up 10% to a record \$1.9 billion.

Breaking down our digital revenues into its key components highlights the performances of each of these businesses. Extra content and free-to-play contributed \$211 million, up 19% over the prior year, lead by sustained momentum and approaching 90% growth in our Ultimate Team businesses.

We saw NFL Ultimate Team grow 50%, FIFA Ultimate Team grow nearly 80%, and Madden Ultimate Team grow over 350% year over year. Star Wars the Old Republic and FIFA Online 3 also continue to be significant contributors. As a reminder, this revenue relates to businesses on PC or consoles where consumers can enhance or extend their gaming experience by buying additional digital content.

Mobile generated \$120 million for the quarter, up 18% over the prior year. Smartphones and tablets continue to represent the majority of the revenue, accounting for \$109 million, or 90%, of our total mobile revenue. Going into a little more detail, we break out our mobile revenue into two streams. First, digital extra content and advertising revenues, which is also known as freemium, and second, full-game or one-time download revenues also known as premium.

In the quarter, \$105 million, or 87%, of our mobile revenues were comprised of the digital extra content and advertising revenue, reflecting the shift to the freemium business model. This freemium business was up 39% versus the prior year, more than offsetting the decline in the premium business. Premium full game downloads were \$15 million, down 43% compared with the prior year. We attribute our freemium growth to the strength of our portfolio of live services games. We continue to view mobile as a business with tremendous opportunity as the market is experiencing significant global growth in Smartphones and tablets, and as this market base expands we continue to release new content in our live service games and execute against our launch road map.

Full game PC and console downloads represented \$71 million, up nearly 90% over the prior year. Historically, full-game downloads were primarily driven by PC-centric products; however, we continue to see full-game download growth on the new consoles. Titanfall, Battlefield 4 and FIFA14 were key PC and console titles that contributed to the increase in full-game downloads in addition to other catalog titles.

Subscriptions, advertising and other digital revenue contributed \$80 million, up 31% over the same period last year. The ratable recognition of Battlefield 4 Premium is a key contributor to the increase in our subscription revenue this quarter.

Moving on to gross margin, our non-GAAP gross margin for the quarter was 70%, an increase from last year's 64% and better than our guidance of 67%. The increase was primarily due to solid results from our digital revenue offerings and a continued focus on reducing online processing fees and support costs. Operating expenses for the quarter were \$459 million, \$18 million below prior year and \$26 million below our guidance.

Our lower operating expenses are due to continued cost discipline, but some portion of the reduction is due to quarterly phasing of key expenses in marketing and contracted services and we expect these costs to be incurred in future quarters. The resulting non-GAAP EPS was \$0.19 per share, exceeding our guidance in prior year due to strong revenues, higher gross margins and lower operating expenses.

Our cash and short-term investments at the end of the quarter were \$2.32 billion, or approximately \$7.40 per share. Roughly 68% of this cash and short-term investment balance is held onshore. Net cash provided by operating activities for the quarter was \$4 million versus last year's use of \$248 million for operating activities. Year over year, this is a \$252 million improvement in cash flows. On a trailing 12-month basis, operating cash flow hit a Company record high of \$964 million, demonstrating our ability to generate higher cash flows. During Q1 we repurchased 1.4 million shares at a cost of \$50 million. As a reminder, our \$750 million stock buyback program was initiated in May and has a two-year time frame.

Before we discuss guidance, we want to address a couple of items. First, we recently completed a review of our portfolio of licenses and agreements and we decided not to use, on a going-forward basis, certain licensed intellectual property. This decision resulted in a GAAP-only charge of \$122 million to cost of goods sold due to the loss on the corresponding royalty commitment. Going forward, our non-GAAP P & L will benefit from this decision not to use the IP. It should also be noted that this decision will not impact any of our core licensed products.



Second, with regard to our share count, for the first time since the issuance of our convertible notes in 2011, our stock price for the quarter was above the \$31.74 exercise price of the notes. However, at the time of issuance of the notes, EA also entered bond hedge and warrant transactions to effectively raise the exercise price to \$41.14. Under GAAP, we are required to include only the dilutive effect of the convertible notes and warrants in determining our diluted share count. However, on a non-GAAP basis, we also included the effect of the offsetting bond hedge transactions in order to provide a complete view of the economic dilution to earnings. On our website we have posted a table that illustrates the potential share count dilution on both a GAAP and a non-GAAP basis.

Turning to Q2 guidance, GAAP net revenue is expected to be \$965 million as compared to \$695 million in the prior year. GAAP loss per share is expected to be \$0.12 as compared to \$0.89 loss per share in the prior year. Our non-GAAP net revenue for the quarter is expected to be \$1.14 billion, a 10% increase over last year's \$1.04 billion. This quarter we will launch the Sims 4, which we expect to more than offset last year's college football game. In addition, we will launch FIFA 15, Madden NFL 15 and NHL 15. Non-GAAP gross margin is forecasted to be 65.5%, better than prior year's 62%, driven by the positive impact of the Sims 4, a PC-centric, wholly owned IP.

Operating expenses will be impacted by the phasing of some of our operating expenses from Q1. We expect our total non-GAAP operating expenses to be \$530 million. This results in a non-GAAP diluted EPS of \$0.50 per share as compared to \$0.33 last year. For FY15, we are reiterating our non-GAAP guidance announced at the beginning of the year, net revenue of \$4.1 billion and \$1.85 of fully diluted EPS. We expect our positive Q1 results to offset any impact of delaying Battlefield Hardline to the fourth quarter. The GAAP guidance is \$4.3 billion in revenue and \$1.78 of fully diluted EPS. The updated GAAP estimate reflects the impact of the \$122 million GAAP charge I mentioned as well as the delayed launch of Battlefield Hardline.

Regarding cash flow for the year, we continue to forecast operating cash flows of approximately \$800 million and capital expenses of approximately \$100 million, resulting in free cash flow of approximately \$700 million. We remain very positive about the trends in our industry and business -- growth of the new generation consoles, trends toward greater digital business and growth in mobile and PC free-to-play. With that, I'll turn the call back to Andrew.

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

Thanks, Blake. We have an exciting year ahead of us. We raised the curtain at E3 on rich new experiences in development at EA today, providing a view into our future and the breadth of games and services from favorite brands and new IP. Now we head to Games Con in Cologne, an event that is all about giving millions of gamers worldwide the next view into our games coming this year. For more than 300,000 gamers attending in Cologne, it will also be an opportunity to get up close with our biggest titles including FIFA 15, the Sims 4, Dragon Age Inquisition and Battlefield Hardline.

We look forward to hearing more of their passionate feedback. We greatly value that open-end direction and dialogue with our players. It's what drives us to lead with innovation, to explore new ideas and pursue creative new experiences with every one of our games. The opportunity in front of us is to build entertainment on a truly epic scale, to captivate with amazing experiences that hundreds of millions of players want to play. There's a lot more to come from Electronic Arts in FY15 and I look forward to sharing more updates in the months ahead.

For now, Blake, Patrick, Peter, Frank and I are here for your questions.

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## QUESTIONS AND ANSWERS

### Operator

Thank you.

(Operator Instructions)



Our first question comes from Colin Sebastian with Robert Baird and Company.

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

Congratulations on a nice quarter. Thanks for taking my questions.

Firstly, on the Battlefield and Dragon Age news certainly sounds like the extra time is justified. I wonder if that should also change our assumptions at all about the release of next year's sequels such as Battlefield?

And then secondly, what are you guys seeing in terms of the mix between physical and digital sales on next-gen, particularly full-game downloads? And as a related point, how are you managing the transition to digital with your retail partners in mind? Thank you.

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

So let me start. Collin, this is Blake, and then I'll turn it to Peter for the second part of the question.

On the first, we're going to refrain from giving 2016 guidance already or even talking about timing on Battlefield for next year. We're committed to continuing to build a great Battlefield franchise. I think that's the reason why we're really focused on a fabulous Hardline product and you'll hear more as the year goes on about what might occur in the future year.

I would say, though, that since we'll be shipping in fourth quarter, you'll tend to see more Hardline business next year than we would have originally had if we shipped it in the third quarter. And that bodes well for our 2016 as well as our 2015. With that let me turn it to Peter.

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

Yes, Collin, as Blake mentioned in his remarks, we saw about \$71 million in full game downloads which excludes mobile, and that was split about 50/50 PC versus console. If -- and I've mentioned on the last call that we were seeing somewhere in excess of 10% now for full-game downloads on the XBOX live and play stage network.

We're seeing that continue to grow. Now it's between 10% and 15% of the initial sales that is going digitally full-game downloads on those platforms. If we take UFC as an example, which only shipped with two weeks of the quarter left, we saw it as the high range of that 10% to 15% band. So we're continuing to see a progressive move towards gamers being able to download because they can now on the next-gen consoles, full games on day one and week one of the ship.

I will also add that the transition, though, is working well with our retail partners. Progressive retailers such as GameStop are pre-selling well our sports titles that are the Ultimate addition SKUs which give \$40 of digital content for only an incremental \$10, so our retail partners are able to play in that digital space as well.

I think we're balancing out this transformation between physical packaged goods and digital well and our retailers are able to play in that space.

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

Great. Thanks very much.

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**Operator**

Comes from Edward Williams with BMO Capital.



**Edward Williams** - *BMO Capital Markets - Analyst*

Good afternoon. Just a couple of quick questions.

First of all, can you talk a little bit about what your thought is on the next-gen adoption trends, what we're seeing with regards to hardware pick up and what its impact is on the legacy console systems and what we might see in terms of the mix between the two as we progress through the year?

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

Edward, this is Peter again. So when we look at the eight months since launch of the PlayStation 4 and the XBOX1 and then look back at the same period of time of XBOX360 and PlayStation 3 and the previous generation, we are seeing 90% increase here in the US of actual hardware sales. And we're seeing no drop off in attach rate whatsoever.

We are keeping a very close eye on the current gen of XBOX360 and PS3, but as we continue to ship games and as competitors and colleagues in the industry continue to ship games, we're seeing a still pretty vibrant ecosystem there and we have reassurances from Sony and Microsoft they are going to support the long tail of both platforms. So very strong start for XBOX1 and PlayStation 4 respectively.

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**Edward Williams** - *BMO Capital Markets - Analyst*

Okay, great. And then can you just comment a little bit about now that you're eight months into post release of these consoles, what you're seeing with regards to developing a software for those systems? Any challenges that you've run into, or is the learning curve already been mostly scaled at this point?

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

Let me jump in there. Great question. I think what we're seeing right now is, any time you go into a new platform transition, the benefit, to use that term loosely, of going through three or four major transitions in my career so far, they are never easy.

What you do find is you come into the second phase is that the software, the operating software and the platforms itself starts to stabilize and the first part as Microsoft and Sony start to find additional processing and GP bandwidth on those platforms that we are able to benefit from. Also, our teams get a better understanding of how our engine's pipelines work with respect to those new platforms and we start to see an optimization of our development process and we start to see greater output in terms of CPU, GPU, and ultimate quality of games as a result.

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**Edward Williams** - *BMO Capital Markets - Analyst*

Okay, great. Thank you.

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**Operator**

Next question is from Doug Creutz with Cowen & Company. Your line is open.

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

Thank you. Just kind of want to touch on the mobile gaming business. It feels like we're kind of rapidly morphing to a situation where the hits in that business are getting bigger much rapidly but potentially beginning to suck some of the air out of the room for lesser titles, much like we saw happen in the console space over the last 5 to 10 years.

Just curious if you agree with that? And also, how -- if and how are you changing your approach to the mobile business to try and ensure that you get some of those top 10 and top 20 hits that could really be material events for you? Thank you.

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**Frank Gibeau** - *Electronic Arts Inc. - EVP of Mobile*

This is Frank. Let me point out that you are correct in that there is a greater concentration of revenue in the top of the charts in mobile, so the dynamic that we've seen in the PC or in the consoles over the years is happening in mobile. It's happening at a fairly normal rate if not any faster or any slower than we anticipated. But you're definitely seeing more revenue, more audience in the top 5, top 10, top 20. It is a very large market and the charts do differ by region, so Asia is very different than the West, so there's still a lot of room to maneuver in terms of the types of titles and types of genres that can be successful and that are growing.

The mobile business also has a lot of growth in front of it and so we anticipate that the overall pie will continue to grow while the concentration occurs at the same time, so it's a lot positives in terms of how you look at the overall market.

When we look at our opportunity in mobile, EA, we really looked at what are we really good at and what do we need to get better at and what we think we really have is a core competitive advantage and unbelievable portfolio of IPs and brands. If you look at some of the more recent releases in mobile, like Farmville or even the Kim Kardashian game, it's really pointing to the fact that brands are becoming more and more important in mobile and if you look at the charts the concentration of the revenue is happening in brands.

That's definitely moving into our direction, where we have a strong portfolio of proven brands like the Sims, FIFA, Madden, Need for Speed and so on, as well as the Simpsons Real Racing, so we feel really good about how the market is moving our direction on the IP front.

We also have great production values, we've got great technology, so we know we can nail the art side of the business. What we need to do a better job of is mastering the live services piece, and that's where we've been spending a lot of time reconfiguring the mobile teams at Electronic Arts from premium to premium teams. As you heard in the remarks from Blake, the mobile premium side of our business is growing at about 39%, 40% year over year, which is a healthy number. We think we can be even better than that.

But what is important to us is that we have been going through this transition from premium to freemium and it's pretty much over at this point. It's freemium from this way forward and we're adding a lot of new technology and talent to allow us to operate premium services at scale. So it's a combination of proven brands that install organically at an amazing rate, combined with great freemium services that engage customers over a very long period of time and provide them great value. So we feel really good about that combination of audience, brands and freemium services.

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

Terrific, thank you.

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**Operator**

From Justin Post with Merrill Lynch.

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**Justin Post** - *BofA Merrill Lynch - Analyst*

Great, thank you. A couple questions.

First, maybe just give us a little more color on the Battlefield data. Obviously you're pushing it out. What areas maybe are you trying to address and make better?

And then secondly, great job with the expense controls. Are you kind of through that and kind of more level expense growth from here with revenues or how are you thinking about that and making sure you're investing in the future? Thank you.

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**Patrick Sutherland** - *Electronic Arts Inc. - EVP of EA Studios*

This is Patrick. I'll take the first one related to Battlefield Hardline.

So we launched the beta at E3 and we saw a tremendous pick up of players. We had over 1.7 million players in the beta and what made me happy was the fact that we had a stable environment, people got to play the game and it functioned really well, which is kind of a first thing we're looking at when we look at a beta. Then we allowed people to play for a little bit longer maybe than we planned because we found a lot of feedback from players in there, providing us valid information and feedback around features of the game and how the game felt, et cetera, and things like the cops and robbers fiction maybe wasn't shining through properly, is it playing like a military game but it should be a cops and robbers games.

We saw ideas around an asymmetric game play. A bunch of really strong, good, well thought ideas that we decided to listen to. And having a long discussion with the team and looking at where we were, we felt like the best thing for us was to give the development team a little bit of extra time and get the game to where we think it needs to be in order to be successful.

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

Justin, let me address the OpEx question.

I think we're never done reviewing our OpEx and looking for opportunities to bring OpEx down. The question is, do we use that savings to invest back in the business or do we drop it to the bottom line? I think we're pleased with the level that we're currently running at but we also know that we've got future products that we need to invest in, as well as marketing that we want to invest in.

If you look at the trend from 2013 to 2014, just for Q2 as an example, Q2 OpEx in 2013 was \$580 million and it dropped to \$499 million in last year's trend. We've guided obviously above that, but some of that guidance, or most of that guidance, is driven by marketing spend increases to support the Sims, which was not obviously in last year and a very profitable product for us, as well as some of our continuing fueling the mobile growth in our Ultimate Team and Sports property growth.

But the reality is, we'll probably continue to keep focused on that. I think the organization and the key message I think for shareholders is the organization is very aligned on making sure we manage OpEx effectively and balance that against investment for the future and we're very excited about what we're seeing and the level we've been able to maintain.

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**Justin Post** - *BofA Merrill Lynch - Analyst*

Great. Nice job with the cash flow.

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**Rob Sison** - *Electronic Arts Inc. - VP of IR*

Next question?



**Operator**

From Stephen Ju with Credit Suisse.

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**Stephen Ju - Credit Suisse - Analyst**

Thanks. Peter or Andrew I think I just heard Blake talk about \$105 million in net mobile revenues that were not advertising I guess from premium content. This suggests about \$150 million in gross bookings for the quarter and about, say, about \$600 million for the year. So this makes you already one of the larger mobile game companies on the planet, yet it seems like you're monetizing on a paying user base that's about half the rate of some of your developer peers.

So is there yet a concerted effort inside the Company to bring up the monetization rate at all or will your confidence be to try to grow your active user base for now? Additionally, you're disclosing you have 140 million monthly active users as of the latest quarter. What was that number a year ago? Thanks.

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**Blake Jorgensen - Electronic Arts Inc - CFO**

Steve, let me start -- it's Blake -- and I'll turn it to Frank. Just a clarification. We had \$109 million of mobile revenue associated with Smartphones and tablets and of the freemium revenue, which is most of that, roughly that was primarily the \$105 million number I mentioned. So freemium is \$105 million of the \$120 million overall mobile.

I'd be careful about drawing a line between that number and our ability or inability to monetize. It's hard to assess that based on just a pure revenue number. Now, having said that, I'll have Frank address we are obviously focusing on now we can monetize more and build great games around that.

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**Frank Gibeau - Electronic Arts Inc. - EVP of Mobile**

The key to monetization is value and engagement, and that's where we're focused on, is building live services for our products that deliver the maximum value to customers over the long term in a highly engaged way. That's where you'll start to see our conversion percentages improve, our DARPs, all of the KPI that go into what monetization looks like. That's where our focus is right now. We're building great games with great brands.

We organically install very well. Last year we had about 635 million installs across the business, so we generate very large audiences. We don't have a problem with audience size. Our issue is really is engaging them and giving a maximum value over the longest period possible. What we're doing right now is investing in technology and teams and talent to get us into position to be amongst the best in the world at freemium long services. That's our long-term goal.

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**Operator**

Next question comes from Arvind Bhatia with Sterne Agee.

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**Arvind Bhatia - Sterne, Agee & Leach, Inc. - Analyst**

Thank you guys, and my congratulations as well on a great quarter.



I wanted see if I could focus a little bit on the FIFA franchise. I know you guys talked a little bit about the momentum you had. The World Cup product was only on the old gen, and I'm just wondering how that resulted in the performance of this title versus the one four years ago, and also if you can shed some light on FIFA 15 pre-order activity at this point?

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

Hey, Arvind, it's Peter.

So I think it's a radically different world today with the World Cup in Brazil than it was in 2010 in South Africa. When we look at our FIFA franchise and the offerings we have on a global basis across the platforms that we bring it on the different business models and our ability to be able to engage our consumers globally versus when we were in 2010, which is simply put out an event-based game. Our FIFA Ultimate Team mode, as Andrew mentioned, in World Cup mode alone drove over what was it, 53 million games. We had a 800,000 World Cups played almost every single day. The engagement levels we're seeing at a digital level are far greater than we're seeing from a standalone event-based game.

Not to say that game didn't do well and it did, but I think what we're seeing now is our FIFA consumer, regardless of the event, is engage 365 days a year. And really it was the World Cup Modern FIFA Ultimate Team combined with great catalog sales of FIFA 14, as well as the event game itself that will give us tremendous impetus and motivation to go into FIFA 15 now. To your question, the pre orders are very strong on that title. I think it showed extremely well at E3 and we continue to release assets. It's a gorgeous looking title and you saw earlier this week the release of the emotion-based engine the team is working on now.

I think it's a very different world and it's a very strong part of our franchise offerings. And obviously now I think we've moved away from having individual beef-like big events and having a 365 day a year offering called football, and it's as simple as that.

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**Arvind Bhatia** - *Sterne, Agee & Leach, Inc. - Analyst*

One last one for me. On digital up 28% in the quarter, guidance for the year is, I think, 17%. Just maybe help us reconcile is there any timing issue here or is it just being conservative in your full-year number?

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

Well, we're always tend to drift towards the conservative side. I think you also, though, have some areas that are fairly consistent quarter over quarter like extra content, but full-game downloads will bounce around depending on the product.

PC-centric product like a Battlefield or a Sims tend to do really well in full-game downloads and will tend to see higher quarters then and, while mobile is growing very well, we still want to continue to see that grow. So I'd say we're still in line with our guidance and unless we start to see complete outside trends around something like full-game downloads, we're probably not going to start changing that yet. But more to come.

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**Arvind Bhatia** - *Sterne, Agee & Leach, Inc. - Analyst*

All right. Thank you, guys.

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**Operator**

Next question is from Mike Olson with Piper Jaffrey.

**Mike Olson** - *Piper Jaffray & Co. - Analyst*

Hey, good afternoon. Couple quick ones here.

How do you feel the new Hardline timing sets a game up competitively compared to the prior October launch timing that I guess was arguably a more crowded competitive launch period?

And then secondly, this is way out there, but regarding Star Wars Battlefront. I'll try to avoid asking about specific timing of the game, but maybe more relative to the movie. If the timing of the movie changes, is that something that could impact the timing of the game or is the timing of Battlefront not tied to the theatrical release of the film in any way? Thanks.

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

Yes, Mike, this is Peter. So the timing -- it's a great question on Battlefield Hardline and as I think we all know on this call, we're coming into a very competitive holiday period. Notwithstanding Patrick's comment, which is the real reason we've moved it just to create a better game based on the feedback we've got from the beta coming out of E3 and of course another beta to come as well. We actually like the window that Q4 offers us. It's a cleaner window.

We look at Q4 fiscal which is Q1 calendar year 2015, and when you take the primary reason, which is to have a better game and you think about the ability for us to deliver in a cleaner window, it actually sets us up well. Not only for the quarter, but also take in mind how that will set us up for FY16 coming off what should be a strong game that gives us a longer tail with strong catalog.

I'll throw it to Patrick to talk about Star Wars.

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**Patrick Sutherland** - *Electronic Arts Inc. - EVP of EA Studios*

As it relates to Star Wars, we've shown parts from the game today, so you know what we're building is more rooted in the traditional Star Wars universe and not so much necessarily linked to the movie. And that's being made and that's just because we wanted to make a game that celebrated the history of Star Wars.

Obviously, there will be things that are somewhat tied to the new movie. I wouldn't say that we have a particular tie to the movie. Now obviously, we would prefer to be close to the movie, but I wouldn't say we're directly tied to it.

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**Mike Olson** - *Piper Jaffray & Co. - Analyst*

Thank you.

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**Rob Sison** - *Electronic Arts Inc. - VP of IR*

Next question.

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**Operator**

Comes from Brian Pitz with Jefferies.

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**Brian Pitz** - *Jefferies & Co. - Analyst*

Great, thanks for the question. Just a quick one on Battlefield.

How are you thinking about annualizing this franchise? Basically, what are the metrics that you'll drive to go green light this franchise as an annual release? And then separately, can you give us some color on the \$122 million loss on licensed IP commitment? Specifically, is this Star Wars Knights of the Republic or maybe college football IP or is it something else? Thanks.

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**Patrick Sutherland** - *Electronic Arts Inc. - EVP of EA Studios*

I'll start with the Battlefield question. I wouldn't say that it's -- for Battlefield, I think it's important that we have the right products at the right time. We need to make sure that we that continue to drive innovation, we continue to drive quality and that we get the best possible hands -- games in the hands of our gamers.

Now, does that mean that we need to ship a Battlefield game every year? In some years that may be the case. In others it may not be the case, but it doesn't mean that we want or need a Battlefield game every year. I think this year we've shown that we are willing to put quality first and I think that's ultimately how we are going to be successful.

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

On the GAAP write-off, I think about it as follows. When Andrew became CEO, we looked at a lot of things about the business that we had questions on and one of them was a review of all of our licensed properties that we have. And as you can imagine, we've been in the business a long time. We have a long stable of licensed properties, much the same way a movie studio might have with options on properties that they may or may not make movies on.

We then went through and decided which properties made sense to maintain, and we decided that this property did not. It's not a property that you would -- neither of the ones you mentioned, Star Wars or NCAA, and it's property that most people wouldn't know that we actually had a license around. But when we decide to abandon a certain licensed property, accounting rules require us to recognize the loss from the decision, much like a loss is recognized maybe when you exit a lease in a facility, for example. So that charge reflects the loss we will no longer use as part of that IP.

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**Brian Pitz** - *Jefferies & Co. - Analyst*

Great. Very helpful, thanks.

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**Operator**

Next question comes from Drew Crum with Stifel.

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

Thanks. Good afternoon, everyone. So I want to stick on the gross margin topic.

70% in the first quarter feels like a milestone for the Company. In taking consideration that the write off you just mentioned, Blake, have you reset expectations for gross margin? Can you talk about how you're thinking about gross margin longer term?



And then separately, can you comment on -- and I think there was a comment made on FIFA pre-sales. Can you comment on pre-sales for Sports titles generally relative to what we were seeing last year at this time? Thanks.

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

So I'll start with the gross margin and then I'll turn it to Peter on the pre-sales. So remember the charge we've discussed is a GAAP-only charge and you'll see in our guidance that we've made some changes to our GAAP guidance but not to our non-GAAP guidance.

So in our GAAP guidance, you'd see a reduction, and this is in the GAAP to non-GAAP tables in our website, you'll see there's a reduction of gross profit, or of cost of revenue, of \$122 million. That impacts our GAAP-only results and not our non-GAAP results. On a non-GAAP basis, we're pretty confident of our continued growth in digital business, which will continue to drive our gross margins. You saw that in the quarter and you'll continue to see that as a year goes through.

Obviously, as a reminder, Q2 tends to be a lower gross margin title because of all of the Sports titles that we ship in the quarter and the royalties associated with those. But we're fairly confident as we've reiterated our longer term full-year guidance to stay the same on a non-GAAP basis and we're very focused on driving value through continuing to drive our digital business, which we think will impact our gross margin over time. Peter?

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

Drew, this is Peter.

On your question on pre-sales and Sports titles, as I mentioned, coming out of E3 we saw a strong pick up across the board for all EA Sports titles, but maybe I can take this opportunity to reset some expectations of the importance of pre-sales as a key indicator to the strength of the title. Here at EA we not only track pre-sales, and, yes, they are important and have been for decades, but also look on a daily if not hourly basis at the NPS, the net promoter score, what gamers are thinking about our title at any given time.

The AD awareness, the definite purchase intake, the rating amongst [aware]. We're in a digital age now and this -- again, as important as pre-sales are and particularly to our key retailers, we're also looking at the importance of the sentiment that gamers have about what they're seeing every single day through social media and the assets that we're pushing out from our games team. So yes, they are important, yes they continue to improve, but they are just one single data point in a myriad of data points we now use to measure our success going into launches.

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

Very helpful. Thanks, guys.

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**Rob Sison** - *Electronic Arts Inc. - VP of IR*

Next question?

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**Operator**

Comes from Ben Schachter with Macquarie.

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**John Merrick** - *Macquarie Research Equities - Analyst*

Hi, it's John Merrick on for Ben.



I wanted to follow-up on a couple of the questions on mobile that were asked earlier on the call, maybe from a little bit different angle. It seems clear that you've had a lot of success with the Ultimate Team so far and I was wondering if you could talk about how you translate this success to drive more growth for the Sports titles on mobile, specifically?

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

Yes, the teams that are working on Ultimate Team on console and on PC are the same teams that are building the mobile products, so there's a lot of crossover and institutional learning going into the designs on mobile. In Q2 you'll see two new designs from us on FIFA and Madden that will incorporate a lot of the learnings that we've accrued over the last several years as we've grown the Ultimate Team business in both Madden and in FIFA.

Again, it really comes down to what I pointed out earlier, which is engaging the customer, giving the maximum value over maximum time, and that's something the console teams on FIFA have done so well over the years and they're bringing that to bear on mobile starting in Q2.

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

I guess the one thing to remember, though, is that local games tend to be played in shorter bursts of time and they are typically played with one finger, or one or two fingers, and different twitch mechanics than on a console. So as we develop mobile games associated with things like FIFA or Madden, it will take different forms than our current games or our current Ultimate Team franchise.

But we're in full alignment with where you're heading, which is we think there's a great opportunity to continue to expand on the fantastic Sports partnerships we have with people like NBA, NHL, NFL, and FIFA to really drive mobile around the globe, particularly around the globe in places like Asia where mobile games are so popular.

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**Operator**

James Hardiman with Longbow Research.

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**James Hardiman** - *Longbow Research - Analyst*

Hi, good afternoon. Thanks for taking my call.

Can you talk a little bit about retailers, both digital and physical, that are willing to pay a little bit more exclusive content? I think GameStop recently said that they're going -- or they would at least look into putting a little bit more capital to work. That's not a completely new trend, but I guess at the end of the day is that another lever that you can pull that will allow you to extract more of the economics of a game, and how do you balance that with consumer preferences?

And I guess sort of a related question, as Sony moves further and further ahead of Microsoft with respect to the next-gen, remind us how long the XBOX1 exclusivity is for Titanfall, and is it safe to say the sequel will be on both platforms? Thanks.

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

Well, let me -- that's a great question. Let me also point you to a clarification that Paul Raines of GameStop had with this paying for exclusive content. He clarified that the next day. This wasn't going into developers and publishers and giving them money to get content specifically for GameStop.





GameStop is a very progressive retailer. We work very closely with them around the world in providing them and other retailers with content that drives pre-sales, to my original point, but also drives interest in the game itself. And I think, again, that's just one thing that drives demand generation, combined obviously with great marketing and a great game itself.

We see this ability to be able to spur demand 6 months, 9 months, 12 months out through digital content offerings, and I'll point you to my original comments on the Ultimate Team SKU for sports with \$40 worth of content for an extra \$10 on top of the standard SKU is one tactic in this battle. Our job is to get the attention of gamers, provide them with great value for money and work with our partners, both physical package goods retailers as well as digital retailers, to be able to drive that business and I think we do that pretty well.

The other question, Andrew?

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

So with respect to the relationship with Microsoft, we're not at liberty to discuss the terms of our exclusivity deal there in the construct of Titanfall and we are not in a position to announce anything further other than we continue to support Titanfall. The play base continues to grow and as I talked about in prepared comments, we just dropped some fantastic content for that product and it had a great showing at E3 where it was on our floor.

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**James Hardiman** - *Longbow Research - Analyst*

Great, thanks guys.

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**Operator**

Mike Hickey with The Benchmark Company.

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

Hey, guys. Great job. Great quarter.

Just curious on the first person shooter category. One of your competitors has moved to a three-year development cycle with their annual iterations of their shooter and I'm just curious, and of course the attempt there, I think, is to raise the bar on quality, so I'm curious how that reshapes your thinking, theoretically, on Battlefield, perhaps, where maybe there's the idea that you would analyze that. Thanks and a quick follow-up if I could.

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

I'll let Patrick address that one and then we'll hit the follow-up.

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**Patrick Sutherland** - *Electronic Arts Inc. - EVP of EA Studios*

I mean, we have a -- our approach is, the first thing we have to do is to get to a spectacular engine and I think engine for us in Frostbite is key. That allows us to iterate and improve our workflows and pipelines so that our teams can work as effectively as possible in our engine environment. So we have a large team working continuously on improving and updating our engine.

The second thing we need is teams. We need a couple of -- a bunch of really great development people that can get together and make spectacular games. And then the final thing we need is, obviously, time.

If you look at that as it relates to Battlefield and our shooter segment in particular, Battlefield obviously historically has been made in Stockholm by the Dice team. For the reason that you outlined, we did put Visceral on it, who is here in San Francisco and working on Hardline. Now, since Battlefield 4, we've had some people in Sweden working on expansion packs, but other people obviously doing other things.

So I think what they're doing mimics to some extent how we're thinking. Obviously, more time will -- if Madden's correct, will yield a better product. So I would say that we're similarly aligned and that we're taking a similar approach, but we haven't articulated exactly what teams are working in what, because that would imply announcing things we can't right now.

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

One thing I would just add there, and to Patrick's point, the balance of those three things, a great engine, the right teams and the appropriate amount of time, actually, and Patrick and his teams have been working for some time on changing the construct. That doesn't mean you have hundreds of people working for longer periods of time. It really means that you have the right size team at any particular point in time in development, operating in a very efficient optimized development environment, so that those teams at their appropriate size can deliver great creativity and innovation.

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

Great, thanks guys. (Multiple speakers) Blake, I don't think we've gotten a head count update for awhile. Maybe we have, I just missed it.

I was curious the total headcount for the Company and then if you could segment that between [arts] and marketing, that would be great. And then how you expect that to trend through your fiscal year end.

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

Yes, so we don't disclose, very often, headcount. We haven't recently. We don't break it out by group.

I would say that you should trust the head count is down from what it has been historically and we think it's around the right size now and we want to continue to move it around based on where the biggest opportunities are. So you might see headcount build up in one studio and down a little in another studio, but in general, we're trying to smooth out the ups and downs we've had historically around headcount because that clearly makes a better place to work but also it creates more smoother financials as well.

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

Okay. Thanks, guys. Appreciate it.

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**Rob Sison** - *Electronic Arts Inc. - VP of IR*

We will take one last question.

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**Operator**

Thank you. That comes from Sean McGowan with Needham & Company.

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**Sean McGowan** - *Needham & Company - Analyst*

Thank you. Couple of follow-ups.

Regarding the two titles that were pushed out a bit, was any of the impact that you're seeing on your guidance for the fiscal year, is any of that related to Dragon Age, or is that pretty much going to contribute whatever it would have contributed?

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

It's consistent. We haven't changed the guidance. The only thing we got changed in guidance was the GAAP guidance and that's because we recognize revenue over time based on the life of the game. So in moving Dragon Age and Battlefield forward, we'll recognize less GAAP revenue in the year, just because the deferral period gets shifted forward.

But from a non-GAAP standpoint, we've kept our guidance the same so you should assume that we're assuming similar revenue for both products.

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**Sean McGowan** - *Needham & Company - Analyst*

Okay and then clarification on that \$122 million GAAP charge. Is that entirely royalty commitments, and doesn't that imply a rather large amount of revenue that would have been associated with that? Was that over a very long period of time? Seems like a title that would have generated that kind of royalty payment would be something we would notice.

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

Don't necessarily assume it's a title. It's use of IP, so it might be either over multiple titles or might be associated with marketing long term. And assume that it's a very long term contract and thus part of the reason we made the decision, because we weren't getting the value out of it that we thought we might get, even though we get a lot of value out of the opportunities, not as much as we originally thought it might be.

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**Sean McGowan** - *Needham & Company - Analyst*

Okay, thank you.

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**Blake Jorgensen** - *Electronic Arts Inc - CFO*

With that, we'll wrap up the call. Thank you, everyone.

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

Thank you.

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

Thanks.

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**Operator**

Thank you. This does conclude the conference. You may disconnect at this time.



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