FINAL TRANSCRIPT

Thomson StreetEvents℠

Conference Call Transcript

ERTS - Q2 2011 Electronic Arts Earnings Conference Call

Event Date/Time: Nov 02, 2010 / 09:00PM GMT

CORPORATE PARTICIPANTS

Peter Ausnit
Electronic Arts - VP of IR

John Riccitiello
Electronic Arts - CEO and Executive Director

Eric Brown
Electronic Arts - CFO and EVP

John Schappert
Electronic Arts - COO

CONFERENCE CALL PARTICIPANTS

Brian Pitz
UBS - Analyst

Edward Williams
BMO Capital Markets - Analyst

Mike Hickey
Janco Partners - Analyst

Jess Lubert
Wells Fargo Securities - Analyst

Colin Sebastian
Lazard Capital Markets - Analyst

Eric Handler
MKM Partners - Analyst

Tony Gikas
Piper Jaffray - Analyst

Justin Post
BofA Merrill Lynch - Analyst

Atul Bagga
ThinkEquity - Analyst

Andrey Glukhov
Brean Murray, Carret & Co. - Analyst

Arvind Bhatia
Sterne, Agee & Leach - Analyst

PRESENTATION

Operator

At this time I would like to welcome everyone to the second quarter fiscal year 2011 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

(Operator Instructions)

I will now turn today's call over to Peter Ausnit, Vice President of Investor Relations.

Peter Ausnit *- Electronic Arts - VP of IR*

Thank you.

Welcome to EA's fiscal 2011 second quarter earnings call. Today on the call we have John Riccitiello, our Chief Executive Officer, Eric Brown, our Chief Financial Officer, and John Schappert, our Chief Operating Officer.

Please note that our SEC filings and our earnings release are available at investor.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 November 2, 2010 and disclaims any duty to update them.

Throughout this call, we will discuss both GAAP and non-GAAP financial measures. Our earnings release and the earnings slides provide a reconciliation of our GAAP to non-GAAP measures. These non-GAAP measures are not intended to be considered in isolation from, as a substitute for, or superior to our GAAP results. We encourage investors to consider all measures before making an investment decision. All comparisons made in the course of this call are against the same period in the prior year unless otherwise stated.

Now, I'll turn the call over to John Riccitiello. John?

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

Thanks, Peter. We are pleased to report a strong Q2 with revenues and EPS above expectations. This completes a strong first half of FY '11. EA continues to focus on three strategic objectives to drive shareholder value - producing fewer, bigger, better packaged goods games; driving growth in digital; controlling costs and creating operating efficiencies. In Q2, we delivered against all three objectives.

A great example of fewer, bigger, better games is FIFA 11. This title owes its success in the marketplace to our ability to deliver top quality games, on time, with effective marketing support. FIFA sales are up 20% versus last year on a comparable basis, with sell-in approaching 8 million units. We grew digital revenue by 35% year-over-year in the first half of FY '11 through a combination of paid downloadable content, social games, and our success on the iPad and iPhone.

We are also making excellent progress on digital revenue derived from our core packaged goods titles. DLC revenue on packaged goods is up 200% year-over-year. In Q2, we also implemented EA SPORTS Online Pass, which creates yet another digital revenue stream from games that start with a disk.

We remain on track to reduce annualized operating expenses by $100 million this year thanks to a better leveraged product portfolio, more efficient marketing, global sourcing, and shared technologies. EA is focused on cost containment, and Eric will discuss our restructuring plan to reduce key licensing and development costs further starting in FY '12.

While we are ahead of our plan at the mid-year point, we still have most of the year ahead of us in terms of revenue and earnings. We are maintaining full year guidance, top and bottom line.

Now let me step back and offer a take on the industry. The game industry is growing; digital is growing by 25% to 30%, and we're seeing solid double-digit growth in the high-definition packaged goods segments. Packaged software sales for PC and High Definition Consoles are expected to be up in the mid-teens in the current calendar year, whereas standard definition software for the Wii and dedicated handhelds are expected to be down sharply. What we are seeing is three distinct market segments- strong growth in digital, strong growth in high definition packaged, and declines for Wii and handheld software. This distinction is highly relevant for investors, but often lost in broader headlines about packaged goods trends as reported by NPD.

Before I turn it over to Eric, I want to thank our studio and publishing teams for great execution in Q2. Eric?

Eric Brown - ***Electronic Arts - CFO and EVP***

Thank you, John.

Q2 results exceeded our expectations for both non-GAAP revenue and non-GAAP EPS. Non-GAAP revenue of $884 million reflects our efforts to build digital revenue and drive packaged goods hits, with notable contributions from the worldwide launch of FIFA 11 and strong catalogue sales. Combined with higher gross margins and delayed expense phasing, Q2 revenue upside translated to non-GAAP EPS of $0.10, which was better than our expectations of a non-GAAP loss of $0.15 to $0.10 per share for the quarter. Q2 non-GAAP net revenue was $884 million, down 23% year-over-year, as expected, on fewer titles. On a GAAP basis, net revenue was $631 million. Non-GAAP revenue was down, on a lighter title schedule compared to Q2 last year, which had nine titles including The Beatles Rock Band and Need for Speed Shift in its launch schedule. Q2 GAAP net revenue of $631 million was down by 20% year-over-year.

The effect of foreign exchange rates on non-GAAP revenue year-over-year was an adverse impact of $23 million this quarter. Q2 non-GAAP gross profit margin was 59.2% compared to 48.4% a year ago due to lower distribution revenues, a higher mix of EA-owned catalogue titles, and a greater percentage of digital revenues at higher margins. On a GAAP basis, gross profit margin was 42.5% versus 24.7% a year ago.

Q2 non-GAAP operating income was $39 million versus non-GAAP operating income of $19 million a year ago. On a GAAP basis, operating loss was $252 million versus an operating loss of $417 million a year ago. Non-GAAP earnings per share was $0.10 versus $0.06 a year ago. GAAP diluted loss per share was $0.61 versus a diluted loss per share of $1.21 a year ago.

Headcount, we ended the quarter with 7,820 employees versus 8,829 a year ago and 7,758 in Q1 FY '11. 22% of our employees are now in low cost locations.

Cash flow from operations this quarter totaled negative $134 million versus positive $6 million a year ago. Our trailing 12-month operating cash flow has increased significantly, growing from $105 million in the twelve months ended Q2 last year to $192 million in the twelve months ended Q2 FY '11. At the same time, capital expenditures have declined, excluding the purchase of our headquarters facilities. This has led to an increase in free cash flow from $19 million to $131 million in the twelve months just ended. EA remains on track to generate $250 million to $300 million in operating cash flow this year. EA has approximately $5.00 per share in cash, short-term investments, and marketable securities.

Inventory levels were well managed in the quarter, and fell from $155 million -- to $155 million from $250 million in the prior year. We are carrying significantly less distribution-related inventory compared to last year. Reserves for Sales Returns and Allowances, as a percentage of trailing six month non-GAAP net revenue, were 11%, up from 10% a year ago, and are down on a nine-month basis to 7% from 8% last year. Overall, the worldwide interactive entertainment segment, inclusive of packaged goods and digital, is flat to up 5% on a calendar year-to-date basis. Consumers are moving towards high definition platforms and touch-enabled smart phones and tablets, built on Apple iOS, Google Android, and Windows Phone 7.

The digital segment continues to perform well. We estimate that the total digital sector worldwide is growing at 25% to 30% year-over-year on an annualized basis, and that the September quarter was also strong. In packaged goods, we continue to see strength in the high definition console plus PC software market, which we estimate is up 25% year-over-year in the Western World for the quarter, and is up approximately 15% calendar year-to-date. This trend plays into our strength, given our share position on high definition consoles and our market leadership on the PC.

Packaged software sales for standard definition and handheld platforms, including the Wii, PS2, PSP, and Nintendo DS, are down, we estimate, by approximately 32% in the quarter and calendar year-to-date. Particular areas of weakness are the Nintendo Wii and the music category, where EA has less exposure. In the Western World, Wii software is down 34% and music is down by 60% year-over-year for the quarter. We estimate that the total Western World packaged goods software market is down 2% year-over-year for the September quarter, and down 4% on a calendar year-to-date basis. We see Europe performing better than North America, with Europe packaged goods software remaining flat compared to a decrease of 8% for North America. For the September quarter, Europe was up 2% year-over-year, while North America was down 6%.

Turning to market share, EA was the number 1 publisher for the quarter and calendar year to date. Our share in Q2 FY '11 was 21% overall, with 23% in North America and 20% in Europe. Our calendar year-to-date share was 18% overall, with 19% in North America and 17% in Europe. On a trailing twelve-month basis, EA's Western World packaged goods share is stable at 18%, with 16% share coming from EA published titles excluding distribution, versus 15% a year ago.

In Q2, our key frontline packaged goods titles were FIFA 11 and Madden NFL 11, which sold in over six and three million units in the quarter, respectively; Tiger Woods PGA TOUR 11, Battlefield -- Bad Company 2, The Sims 3 and FIFA 10 were strong catalogue titles. Our mix of catalogue revenue was 16% for Q2. We attribute this continued strength in catalogue sales to higher quality, and the fact that almost of our games now have digital content extensions and feature online multi-player modes.

Q2 non-GAAP digital revenue increased by 20% from $138 million to $166 million year-over-year, comprising 19% of total revenue this quarter. This is the result of increases in PC digital distribution and console downloadable content. Mobile revenue was down slightly year-over-year at $49 million, with growth in smart phone-related revenue approximately compensating for a reduction in feature phone related revenue.

We now have over 80 million registered users in our Nucleus consumer registration system, up from 41 million a year ago. Titles like FIFA, Battlefield -- Bad Company 2 and Madden NFL 11 drove registrations in Q2. Approximately 20% of registered users are active on a monthly basis. EA has 49 million monthly active social game users, or MAUs, and 8.5 million daily active users, or DAUs. Playfish experienced improved monetization on the continued strength of Pet Society, Restaurant City, FIFA Superstars and Madden Superstars.

For the twelve months ended Q2 FY '11, non-GAAP gross profit margins improved by over seven points, from 50.5% to 57.8% on an improved mix of EA published titles and higher digital revenue. Trailing 12-month non-GAAP operating margins improved from 1.8% to 3.3%.

Before moving into guidance, I would like to comment on two Q3 items. First, EA purchased Chillingo, a leading publisher of iPhone and iPad games. Chillingo publishes two of the top grossing mobile games, Angry Birds and Cut the Rope. The total purchase price was $17 million upfront, with up to another $12 million in earnout over the next three years. Chillingo has the industry-leading mobile publishing platform, which we intend to leverage across EAi.

Second, we announced a plan to restructure key licensing and development agreements to improve the long-term profitability of our packaged goods business. Consequently, we expect to incur one-time GAAP charges of up to approximately $180 million in the second half of FY '11. Benefits of the restructuring are expected starting in fiscal 2012 and beyond.

I'd like to highlight a few points about this restructuring. First, with these actions, there is no significant overall change in the total payments for licenses and contracts. We are, in large part, setting aside rights we won't be using. Net, there is an incremental cash outlay of only $10 million versus existing contractual amounts.

Second, there are other contracts that are also being negotiated that do not qualify as part of this restructuring. While we won't discuss the details of any one deal, we are addressing structural issues on contracts that were signed years ago, under significantly different market conditions.

Third, while some employees are impacted by this restructuring, it is a relatively small number. This is not a major personnel reorganization. We are continuing to hire in selected franchise teams and our digital businesses. Once restructured, we expect that these deals will improve our long-term profitability, provide higher rates of return under current market conditions and provide us with downside protection should there be a league lockout.

For full year guidance, we are reaffirming our non-GAAP revenue and EPS ranges for FY '11. The first topic I would like to address is why we are keeping full year revenue and EPS guidance unchanged, despite $0.20 of non GAAP EPS over-performance in Q2 versus prior guidance. The answer is straightforward. First, we were able to bring the original Q3 launch of FIFA 11 in North America forward into Q2 for a simultaneous release with Europe; this is approximately $0.05 worth of EPS phased from the second half of the year into Q2.

Second, we just announced the cancellation of NBA Elite 11. This is a loss of approximately $0.05 of EPS in the second half of FY '11. Third, we were able to delay expenses for marketing, contracted services and other items out of Q2 into the second half of the year; this is approximately negative $0.05 worth of EPS moved from Q2 into the second half. That adds to $0.15, and we carry the remaining $0.05 of Q2 EPS upside into the second half of the year as additional buffer against title level performance in the key peak season.

Currency exchange rates remain volatile and rate changes impact our reported revenue more than non-GAAP EPS thanks to natural hedges in our business. For the first half of FY '11, we did not experience any FX variance for non-GAAP EPS versus our original cross rate assumptions. On a full year basis, our earnings are mostly hedged versus the euro. Our R&D costs will increase if the Canadian dollar strengthens, and we have both revenue and earnings exposure should the British pound weaken.

Our updated guidance assumes the following FX rates for the balance of the fiscal year -- $1.36 USD to the euro, $0.97 USD to the Canadian dollar, and $1.58 USD to the British pound. If spot rates as of October 29, 2010 persist during the fiscal year, we anticipate no impact to non-GAAP EPS, and a zero to $10 million benefit to non-GAAP revenue for the year. On a non-GAAP basis, we continue to expect a total of $3.65

billion to $3.90 billion in FY '11 revenue. Our packaged goods expectations call for publishing revenue ranging from $2.725 billion to $2.975 billion; our distribution revenue expectations are for at least $175 million, and we expect approximately $750 million in digital revenue.

The year-over-year dollar growth of $180 million in digital is divided roughly as follows -- approximately 30% from Console Full Games and DLC, approximately 40% from PC and Browser Full Games and DLC, and approximately 30% from Mobile, Games Services, Subscriptions and Advertising. We expect the worldwide market, inclusive of packaged goods and digital, to grow 7% year-over-year in calendar 2010, based on the assumption that total worldwide packaged goods will be down 5% and will be more than offset by digital growth of approximately 25% to 30%.

Analysts and investors should carefully examine the CY10 Western Packaged Goods software segment to understand our trends. High level NPD data does not provide a complete picture of the games industry. Based on our data and industry reports, we expect software for high definition platforms -- the Xbox 360 and PS3 consoles and the PC -- to be up mid-teens for calendar 2010. We expect this growth will be offset by weak sales of packaged goods software for the Wii, PS2, PSP and NDS. Netting these subsegments results in an overall packaged goods decline of 5%, which is more than offset by growth on the digital side. On a full year basis, our packaged goods business, excluding distribution, is expected to be approximately 85% on high-definition platforms, and approximately 15% on standard-definition and handheld platforms.

Our title schedule now assumes 35 titles in the fiscal year, versus 36 titles in our original plan. EA plans to release 14 titles in Q3 and 8 titles in Q4. Our top 20 titles for FY '11 are expected to generate approximately 77% of total non-distribution packaged goods revenue; this compares to 76% in FY '10. In regards to full year non-GAAP operating expenses, of the approximately $2 billion we expect 26% to 28% R&D, 18% to 19% Marketing and Sales, and 7% G&A for the year, as a percent of total revenue. EA is incurring significant development costs for a major new massively multiplayer online game. This game is not expected to ship in FY '11.

We expect to end FY '11 with total headcount of less than 8,000, and continue to move resources from high-cost to low-cost locations. Total low-cost location headcount is expected to increase to 24% by the end of FY '11. In terms of non-GAAP EPS, we are maintaining guidance for the full year at $0.50 to $0.70 per share on 334 million diluted shares. This corresponds to a non-GAAP operating income margin of approximately 6% to 8%, with approximately $5 million in Other Income and Expense. We are maintaining the EPS range taking into account FIFA 11 North American Q2 launch timing, the cancellation of NBA Elite 11 in Q3, and second half expense phasing.

On a GAAP basis, we are reaffirming our GAAP net revenue guidance of $3.35 to $3.60 billion, and updating our GAAP EPS guidance to a loss of $0.85 to a loss of $0.55 per share. The GAAP guidance excludes second half restructuring charges, which we are finalizing. For Q3 FY '11, we expect Q3 non-GAAP revenue between $1.375 billion and $1.5 billion and non-GAAP EPS of $0.50 to $0.60. This reflects a shift of FIFA 11 North American units from Q3 to Q2, and the cancellation of NBA Elite 11. Non-GAAP gross profit margin is expected to be approximately 58%, operating expense is expected to be approximately $575 million to $590 million, and share count is an estimated 334 million.

For Q4 FY '11, we expect non-GAAP revenue between $850 million and $975 million and a non-GAAP EPS of $0.13 to $0.23, based on potential schedule risk at the end of the quarter. Non-GAAP gross profit margin is expected to be approximately 63% to 64%, operating expense is expected to be approximately $480 million to $500 million, and share count is an estimated 335 million.

This concludes our outlook and guidance. Now, I'd like to turn the call over to John Schappert.

John Schappert - ***Electronic Arts - COO***

Thanks, Eric.

I'm going to offer some perspective on the sector, then outline EA's retail performance. I'll finish with an update on our progress in mobile and online games and services.

The segments of our industry where EA is investing are strong. As Eric mentioned, we expect the total software sector to be up 7% worldwide this year driven by growth in digital and high definition and PC packaged goods. Total packaged goods have declined 4% in the calendar year to date. However, the high-definition platforms- the PlayStation 3 and XBox 360 have grown by 23% in the same period. EA's portfolio strongly favors these growth platforms, and we now command a 25% segment share on HD consoles.

Another positive for HD consoles is the introduction of new motion control technology from both Sony and Microsoft. We are encouraged by the early data we're seeing on Move and the pre-launch data on Kinect. EA is launching two titles for Kinect- EA SPORTS Active 2, and Harry

Potter and the Deathly Hallows Part 1. For the Move, we have Dead Space Extraction,Tiger Woods PGA Tour 11, and Create. We believe these innovations will grow the HD console market.

The next point I want to make about the sector is that the impressive growth of the digital online business is largely invisible in the industry's retail tracking data. Today, we estimate that digital sales represent roughly 30% of revenue in Western markets, yet none of this is captured in retail tracking data. EA has the leading share on the high-growth digital portable platforms- iPad and iPhone and a comparatively small exposure on traditional handhelds. So our overall take on the sector is that contrary to the headlines, there is a solid growth story for publishers that have invested in platforms where millions of consumers are choosing to play -- HD consoles and online digital platforms.

With that, I'll now go over some highlights of EA's retail performance. By now, you're familiar with our mantra, Fewer, Bigger, Better. We've dramatically reduced our SKU plan, improved our overall product quality, and focused on hits we can take to the top of the charts. This strategy is working. In the spring, we released Battlefield -- Bad Company 2 with a Metacritic index of 89. Today, Bad Company 2 has sold through almost six million units more than double the sales of the original. Congratulations to the team at our DICE Studio in Stockholm for turning Battlefield -- Bad Company into a new, stand-alone franchise for EA.

Medal of Honor was released just two weeks ago, and has already sold-through more than two million units. This is a game we are proud of, and the sales speak for themselves. Built with a superior multi-player experience, Medal of Honor is a key element in our strategy to capture shooter-category leadership along with blockbusters like Battlefield -- Vietnam, Bulletstorm, Crysis 2, and the much-anticipated Battlefield 3.

Last week, we brought our flagship PC franchise, The Sims 3, to High-Definition consoles for the first time ever. The early read on sales looks good.

EA SPORTS launched two new franchises -- NBA JAM and MMA. NBA JAM is a great title for the Wii, and will soon be available on Playstation 3 and Xbox 360. MMA, our mixed martial arts game, launched with a great roster of fighters and innovative online features. It's off to a slow start, but we are optimistic that this one will find an audience of fight fans over the holidays. Also, as Eric mentioned, we have elected to cancel NBA ELITE 11. Future development of that franchise will be handled at EA Tiburon in Orlando.

Our soccer game, FIFA 11, is breaking worldwide sales records. The game has sold in -- almost eight million units to date, up more than 20% over last year's great performance. FIFA 11 has captured a worldwide segment share of more than 80%. It remains the number one title in Europe, and has sold almost twice as many units as the number two game in Europe. This is amazing growth from our largest franchise, which has sold, life-to-date, over 100 million units. Congratulations to the developers at EA Canada and the European publishing team, who drove it to the top of the charts.

Looking ahead, we are preparing for the launch of more holiday blockbusters, including EA SPORTS Active 2 and Harry Potter and the Deathly Hallows Part 1. Our biggest release for Q3 is Need for Speed Hot Pursuit. This is one of EA's greatest franchises, and is back with action, cops, high-speed chases, crashes, and a hugely new innovative online feature, Autolog, a suite of connected features that allows friends and competitors to set up match races, compare times, and share their experiences. This one looks like a true holiday blockbuster.

Our message on packaged goods is simple -- our strategy is working. EA is delivering fewer titles, Better quality and Bigger hits. In Q2, we had six of the top 20 titles in the Western World, and were the number one publisher with a 21% share. On HD consoles and PC our share was 28% in Q2. We lead on the largest, most attractive platforms.

Now I'll turn to our digital and online business; digital extensions to packaged goods software and a division we call EAi, which includes mobile, Pogo online games for the PC and Facebook, and the Playfish social gaming network. As Eric mentioned, we are on track to hit $750 million in total digital revenue this fiscal year, and we're very excited about this side of our business.

I'll start with the proliferation of smart phones, tablets, and mobile operating systems. In recent weeks, we've seen great new products for Apple's iOS, Google's Android platform, and Microsoft's Windows Phone 7. We've also seen a strong launch of commercial games for Amazon's Kindle. At EA, we're particularly proud of our leadership in this space. We are the number one publisher across the entire Apple App store. Our recent acquisition, Chillingo, is the number three publisher, further strengthening our reach on this key platform. Chillingo adds another dimension to our mobile leadership. EA Mobile has nailed this market with established brands like FIFA, Madden, The Sims and Tetris. Chillingo works with independent developers to bring their innovative, original creations to market. They provide the technology and expertise to turn a good indie game into a great big hit. And, they've proved it with great games like Angry Birds and Cut the Rope. Another asset they bring to EA is Chillingo's social gaming platform, which allows friends to challenge each other, earn achievements, compete on leaderboards, and share their experiences on Facebook and Twitter.

Other opportunities for growth in mobile include Android and Windows Phone 7. Android is growing incredibly fast. And then there is the Kindle, where the Scrabble game we publish in partnership with Hasbro outsold all other Kindle books to secure the number one position in the Kindle store. Yes, an EA game was the number one selling product, more than any book, on the Kindle store, for almost two straight weeks. Scrabble was knocked out of first place by another EA gam, Solitaire for the Kindle. Each of these, Android, Windows Phone 7, and the Kindle, represent new platforms and opportunities for our games.

Next, some big news from our casual online division, Pogo. Pogo has launched an initiative to grow beyond its strong PC base, and reach millions of new players on new platforms. To start, a beta version of Pogo is now available on Facebook with about 20 of Pogo's favorite games including Poppit!, Word Whomp, Turbo 21, and First Class Solitaire. Also on Pogo for Facebook are popular Hasbro titles such as Scrabble, Monopoly, Boggle, Yahtzee Party!, and Trivial Pursuit. Watch for more Pogo news, games and exciting new platforms in the weeks ahead.

Facebook continues to grow rapidly, with an estimated 250 million gamers, each playing an average of 3.5 hours per month. In Q2, Playfish saw improved monetization thanks to the launch of Madden NFL Superstars, and continued success of their top franchises. And today we announced a five-year agreement with Facebook, a strategic partnership to establish a simplified experience for consumer transactions. Going forward, we will use Facebook credits as the exclusive payment method for our transactions on that platform.

Now, I'll turn the call back to John Riccitiello.

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

Thanks, John.

While we are very proud of our first half performance, we recognize that a big part of the upside came from bringing all of FIFA into Q2. As a result, we are maintaining our full year guidance. Our Q3 slate is ready to go; Medal of Honor and The Sims 3 Console are tracking well. Between now and the holidays, we have a great slate highlighted by Need for Speed Hot Pursuit.

EA is executing against our three strategic objectives. We are outpacing the industry in terms of digital growth, and we are creating meaningful digital revenue streams in our well-positioned packaged goods business. And we are proving that our IP is working well, not only on the growing high-definition platforms, but also on casual platforms from social networks to mobile, helping drive our 35% growth rate on the digital side. We continue to lead in the most attractive segments of a growing game industry.

In closing, I'd like to mention one of our most important franchises, Need for Speed. Need for Speed is back in a huge way, so take the day off on November 16 and play Need for Speed Hot Pursuit with Autolog. You're going to love it.

With that, we would be happy to take your questions.

QUESTION AND ANSWER

Operator

(Operator Instructions)

Our first question will come from Brian Pitz with UBS.

Brian Pitz - ***UBS - Analyst***

Great, thanks. Couple questions for John. Would you talk about your views on the independent ratings for Medal of Honor? What do you think went wrong there, given that the reviews were so low, and how have these ratings impacted your guidance on title into the quarter? And just separately, a quick question on the Facebook announcement today, what do you believe is the size of the market opportunity for social-based games on Facebook and other social platforms? Thanks.

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

John Schappert and I will split that. I'll take the MOH one, Medal of Honor. First off, the game is rated mid-70s; almost 20 ratings rated 90 or above. So as an observation, mid-70s is generally perceived to be pretty good. I think ultimately what happened there, and pretty much as we had expected, the game appeals really well to a mass market, your average gamer. There's a small minority of folks, sometimes well represented by core gamer reviewers, or game magazine reviewers, where best I can tell they spend 80 or 90 hours a week playing first-person shooters. They are very core to that segment, and some of them didn't like the title; again, not unexpected. So far the title has outperformed our sales expectations, continues to outperform our expectations through to the week three, which we didn't include in the numbers we just gave you, so it feels very good.

As an aside, one of the things that we track very carefully is input to our customer service call-in lines, and web question and answer from our service personnel. And it's interesting that Medal of Honor is getting some of the strongest positive reviews on fun to play and other positive attributes, more so than other shooters we've shipped in the past.

So by and large, it feels like the ding that we got on this one is from an exceptionally narrow demographic of reviewers that gave it a negative review, offset by a more overwhelming majority of people that are buying it and enjoying it.

I will let John pick up on Facebook.

John Schappert - ***Electronic Arts - COO***

On the Facebook, we actually are bullish on this market. Obviously we've seen DAUs and MAUs drop as Facebook made some changes to their platform; we think for the most part, that is kind of leveling out. We also think with the on-boarding of EA and Playfish with Facebook credits, and giving people a unified currency, we think we'll see more guests turn into purchasers on this platform, so we think that there's upside from that. Maybe some near-term hiccups as people kind of transition their currency to Facebook credits, but we think long-term that's a win. And with a half a billion people there and 250 million of them playing games, we think it's a real market, and are happy with our performance, and certainly with the monetization that our teams worked on in the past quarter.

Brian Pitz - ***UBS - Analyst***

Great, thanks.

Operator

Our next question will come from Arvind Bhatia of Sterne Agee.

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

Thanks guys, good quarter. I wanted to talk about the $180 million restructuring charge one more time, Eric. I didn't quite get the details there. I think you said about $10 million of actual cash outlay. Did I catch that right? Then maybe just talk about the benefits, how soon we will start to see some benefits in FY '12, and just maybe talk about the magnitude?

Eric Brown - ***Electronic Arts - CFO and EVP***

First of all, the restructuring itself is oriented around license agreements and developer contracts, so 95% of the charge that we estimated, $180 million or so pertains to those various contracts. This is not major personnel related restructuring. The cash cost of the restructuring is essentially the same as what we otherwise would have paid out over time under existing commitments on license contracts and development agreements. There's essentially a $10 million Delta versus the baseline commitments, and that's why we call that out as being nominal.

Other than that, I would say that the benefits of the restructuring are expected to begin in FY '12. They're designed to improve the long-term profitability of our business, and give us the flexibility to manage our franchises as we see fit under current market conditions.

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

Thank you.

Operator

Our next question will come from Edward Williams from BMO Capital Markets.

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

Good afternoon. Just a couple questions on the downloadable -- or the digital business for a moment. Can you talk a little bit on the PC sales, how much of your PC sales are now occurring via download versus packaged goods? Also if you can give us a little color as to what the amount of incremental revenue is on your console packaged goods sales that you're getting, if it's reasonably consistent at this point?

Eric Brown - ***Electronic Arts - CFO and EVP***

This is Eric. I think that -- I'll take the second question first. The console DLC attach rate, it varies by franchise. I can tell you that the Ultimate Team modes that we introduced for FIFA, and have now extended across other sports products, is very popular. We've seen gross revenues in excess of $30 million at FIFA 10 for the Ultimate Team mode. Ultimate Team for FIFA 11 has just recently been announced, and we expect that's going to track well in the future.

In regards to the PC business, packaged sales versus full game PC digital downloads, we're seeing that increase over time. So it's not yet at the 50/50 mark, but what we're finding is that certainly in certain genres, like Battlefield -- Bad Company 2, first-person kind of core game shooter, the uptake rate on pure digital downloads of PC has exceeded our expectations, and that's part of what's been driving the upside across the Battlefield -- Bad Company 2 franchise overall.

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

This is John. Just to add a little color, a couple years ago we really didn't focus on either of those revenue streams, which are frankly high profit margin ARPU drivers for our business. We focused on both of them, and we're seeing great results on both fronts. It's very pleasing to see that there are really -- an interesting way to think about it, our digital business is really two very related businesses. One of them is pure digital; what we do on social network, what we do in mobile, what we do on Pogo. But then there's also a sizable business that starts with a disk and is pure digital ARPU-driving, revenue-driving, margin-driving. We're seeing success in both sides of the fronts.

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

Thank you.

Operator

Our next question will come from Mike Hickey from Janco Partners.

Mike Hickey - ***Janco Partners - Analyst***

Hello, congrats on the quarter. Eric, just a couple housekeeping, the R&D, headcount quarter end, and catalogue sales for the period?

Eric Brown - ***Electronic Arts - CFO and EVP***

Catalogue sales were 16% for the quarter, and of the total headcount of 7,820, the R&D headcount was 5,640.

Mike Hickey - ***Janco Partners - Analyst***

Okay. And then John, I was curious if could you share with us how you see the Internet TV game market taking shape over the next several years?

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

The next several years for Internet TV, we'll get the crystal ball out. But, look, I think that there's absolutely no question that Internet TV is here to stay. It's a big story. And with CPU prices reasonable as they are for powerful CPUs, and hard drive prices as cheap as they are, you are going to see the equivalent of a mini computer under the TV in the form of a device from Apple or Google or Samsung built in. I think the long term opportunity there is significant. I think it will ultimately be more than just casual games, and I think it bodes well as we go from a world where, if you think about, a minority of consumers around the world have have got a game-ready device connected to their plasma or otherwise high-definition television, to that being sort a universal standard.

What I like about EA is I think it's going to really present itself to the consumer in two ways. One is stuff that looks a lot like what we do in EAi with our more casual offerings, and I think a big part of is it going to feel more traditional, and I think we can participate in both. It's likely to promote more direct to consumer digital models, which as we've indicated up until now leave more of the money in our pockets as a business than they do various folks taking a piece out of the middle.

So I think it's a long-term positive. I think it supports both core and more casual offerings. I think it's a growth driver, and I think navigating the specifics is going to be tricky and interesting to watch.

Mike Hickey - ***Janco Partners - Analyst***

Thank you.

Operator

Our next question will come from Jess Lubert from Wells Fargo Securities.

Jess Lubert - ***Wells Fargo Securities - Analyst***

Two questions. First, can you provide some incremental color regarding what's driving the shift of expenses into the second half of the year? I didn't catch your comments there.

Eric Brown - ***Electronic Arts - CFO and EVP***

Certainly. This is Eric. The expense shift that we were able to do pertained to marketing and personnel and contract-related expenses out of Q2 into the second half.

Jess Lubert - ***Wells Fargo Securities - Analyst***

Okay. Another question on Medal of Honor. Looks like it sold through a little less than Battlefield did than it did in its first few weeks; can you update us on how Medal of Honor through week three relative to Battlefield, and expect how you expect the game to track relative to Battlefield going forward?

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

Yes, this is John again. One observation, and a comment I should have made earlier with respect to Medal of Honor, the game has exceeded our plan and expectations sell-through and sell-in, and those expectations were -- they went up as we went from plan to forecast and as we updated our forecast through the year. So at every possible gate of opportunity to increase the forecast we did, and then we exceeded those forecasts based on strong sell-in numbers. So it's absolutely a clear success as a business for us; and consumer feedback has been strong, to suggest that we've got a franchise now once again that we can successfully and effectively sequel in the future.

I think it's the first step with this franchise, sort of back into the marketplace, where Battlefield -- Bad Company is essentially on its 5th edition, alternating between Battlefield 1 and Battlefield 2 and a couple of additions of various expansions in the Bad Company franchise, but we had expected and we realize greater sales on Battlefield -- Bad Company 2 than Medal of Honor, but just slightly based on the first few weeks of sell-in. Battlefield -- Bad Company 2 in its third week as I recall, I don't have the numbers in front of me, spiked up in week three more than we thought. It decayed less in week three than we thought, and that was really strong word of mouth among gamer press. We started to see sort of a quality-driven rise, where Medal of Honor is following a slightly more traditional decay curve, as is what we would have expected this time of year.

Jess Lubert - ***Wells Fargo Securities - Analyst***

Thanks, guys.

Operator

Our next question will come from Colin Sebastian from Lazard Capital Markets.

Colin Sebastian - ***Lazard Capital Markets - Analyst***

Thanks. Just wanted to first follow up on the digital segments, given the doubling in the core registered user count over the past year, but overall digital revenue growth decelerated a bit, presumably on the mobile and social segments. If you could address that maybe in a little more detail, and then what gives you visibility that the digital segment will rebound in terms of growth over the remaining part of the year?

Eric Brown - ***Electronic Arts - CFO and EVP***

Thanks, Colin. This is Eric. I think that it's important to recall what we said last quarter in regards to our digital results. We reported about $188 million, $189 million of digital revenue, and we specifically called out approximately $20 million of that as being very favorable in terms of timing, phasing, and being nonrecurring, and so please keep that in mind as you look at at the current quarter Q2 results. We had revenue in Q1 that could possibly have fallen in Q2 per se.

So the relevant comparison, or I think an important comparison, is what does the first half look like this year versus last year? The first half digital all-in is up 35%, and we're seeing particularly strong growth in disk-related console DLC, and that number in the quarter doubled year-over-year in terms of digital revenue.

Colin Sebastian - ***Lazard Capital Markets - Analyst***

Okay, thank you. And where did Madden end up for the quarter versus last year on a unit sales basis, is the last question.

John Schappert - ***Electronic Arts - COO***

Madden is actually roughly flat with last year, but Madden is seeing great growth in the digital side. So we launched Madden Ultimate Team about a month ago, and to date Madden Ultimate Team has done almost as much in revenue as last year's Madden Ultimate Team has done; not to mention we launched Madden NFL Superstars on Facebook, and Madden also launched on iPad and iPhone Day and Date with the Madden console title, and it's the first title on the App Store to be number one top grossing in both the iPhone and iPad. So Madden has great upside on the digital side, and is doing well on consoles.

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

And we just an added piece on Madden, one of the things I think is easy to miss is the shift in the shape of the revenue curve for Madden. Three, four years ago, which I think so many people that track the business are used to, Madden used to do the dominant portion of its business in the month of August and early September. Basically it was a get out immediately and buy the franchise. As the franchise grew, and went from a couple million units to four, five, and six million units, one of the things that's happened is we've picked up a more sizable holiday business with Madden, which was part of the growth. One of the comparison points that I think we suffered from last year, and I don't think we pointed it out as well, is that folks were looking for that same portion of the business in August, September, when it was in fact delivered August through -- actually last year through January. So we're looking forward to a Madden holiday.

Colin Sebastian - ***Lazard Capital Markets - Analyst***

A Madden holiday, as we say. Thank you.

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

Next question.

Operator

Our next question will come from Eric Handler from MKM Partners.

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

Thanks for taking my question. Two things I should ask. First, what are you seeing in terms of digital attach rates for digital content? And also what kind of price point tends to work best for you there? Secondly, the M&A landscape right now, where do you see you may need to -- or may want to do some type of tuck-in acquisitions, and what's sort of out there right now?

Eric Brown - ***Electronic Arts - CFO and EVP***

So I'll take the first half of it. The digital attach rate for console DLC, it varies by franchises. We noted earlier that the Ultimate Team mode initiated by the FIFA team has been quite successful; on FIFA 10, we're north of $30 million gross revenue on that. Battlefield -- Bad Company 2 had good attach rates as well. And so at this point, it's kind of mid single digits, in some cases getting a bit over double digits. It depends on the franchise, and the depth of the DLC content plan. But overall, whatever we seem to produce in terms of DLC for console games, we're seeing uptake rates that consistently meet or exceed our own internal expectations, so we're pretty happy about that.

John Schappert - ***Electronic Arts - COO***

And I will just add a little bit more color, too. We launched -- we talked about launching Madden Ultimate Team. We just launched FIFA Ultimate team today. We've launched NFL Ultimate Team. All of those get a fairly robust user base, and they're pretty active users once they go on board. Once they spend some money, they stay pretty attached to that

With respect to your second part about any tuck-in acquisitions, we are still tucking in Chillingo as we speak, and are very happy with that acquisition, and welcome Joe and Chris to the team. And of course, we are going to always be looking out for the right companies that can fit into the fold, and fit in nicely with EA, but we have nothing to announce right now.

Peter Ausnit - ***Electronic Arts - VP of IR***

Next question.

Operator

Our next question will come from Tony Gikas with Piper Jaffray.

Tony Gikas - ***Piper Jaffray - Analyst***

A couple questions. Can you talk a little bit about the margins on some of these new digital revenue streams? Maybe you can update --

---

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

Tony, it sounds like you're on a cell phone, and a long distance from a tower out there. We got most of the question, which we'll try to answer, which is margins on new digital revenue streams. I'll let Eric go a little bit deeper on this, but in general we see significantly better margin structure, and across the board on digital; whether that digital starts with a disk or it doesn't.

Eric Brown - ***Electronic Arts - CFO and EVP***

What we've been doing again, the core franchise team has been doing a great job creating digital extensions, whether it's Ultimate Team in sports or DLC in the games label, and so on. The marginal cost to market and sell another $10, $15, or $20 piece of DLC to an incremental customer is effectively zero, and so we find ourselves recouping the debt costs quite quickly on DLC, and then going at 90%-plus margins thereafter on the incremental sales. This is of course net of the fee that we had paid to the first party to transmit the DLC. So the console DLC is very high incremental margin, we've been very encouraged by it, and again year-over-year we've seen that business double.

Tony Gikas - ***Piper Jaffray - Analyst***

Second part of my question then was, do you know what the growth rate of social gaming will be this year and potentially next year? And then the last question, just any thoughts on 3-D? When does that become a real material or meaningful business? How big can that be, and what platforms will that be on?

John Schappert - ***Electronic Arts - COO***

This is John Schappert. I can take the social gaming. I don't think we're going to provide any predictions for what we think the growth rate will be, although we are seeing nice growth in that business, and I think there were some changes that happened earlier in the year, hopefully we are hopefully seeing that kind of stabilize, and with the addition of Facebook credits we actually hope that we will see some good growth there. And of course Facebook continues to on-board new users too, so you've got growth happening hopefully twofold, both from new users and from making it easier to purchase content on that site. And Facebook still seems to be moving along pretty strong, so we're happy with our agreement with them. With respect to 3-D, John, did you --

---

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

Just one thought on Facebook or social. John is appropriately not giving you a specific forecast for social, since we haven't put that out there and we're very careful about guiding specific sectors. I would say not inconsistent with what we see across the board with digital, so it's definitely a growth story.

John Schappert - ***Electronic Arts - COO***

With respect to 3-D. We think 3-D is interesting. We think it's still kind of early. People are buying their televisions now this holiday that feature 3-D. We think it is something that will continue to grow and mature, but probably a little early right now. A little bit more interesting next year.

Certainly very interesting on the 3-DS, which has 3-D built into it. And what's nice for us is our content is all 3-D ready, so it's relatively easy for us to flip that 3-D switch on and make our content 3-D, as opposed to having to remaster it or reshoot all of the content to make it 3-D. We have 3-D content, so when the market is there, we're ready.

John Riccitiello *- Electronic Arts - CEO and Executive Director*

And as regards 3-D, just one additional thing, there was a question earlier about IPTV. If I had to pick between IPTV and 3-D and which one would be more important for gaming, not necessarily for installed base for homes, because I'm sure people are definitely going to want to watch Shrek in 3-D at home, but for us I think there's probably more potential in terms of new revenue and business models for us in what derives from the IPTV side; we're watching that very carefully. So as priority, that sits high for us.

Tony Gikas *- Piper Jaffray - Analyst*

Thank you.

Operator

Our next question will come from Justin Post with Banc of America.

Justin Post *- BofA Merrill Lynch - Analyst*

Great. John, sports franchises has really been a real strength of the Company and a real source of competitive advantage. When you think about that business, and including the digital piece, and maybe some of these contract negotiations, do you see in two to three years a top-line growth story, or a margin improvement story? And then also, any help with maybe what percent of profits the sports business contributes? I know you last updated that on the analyst day, but I don't know if you have any update you want to provide on that? Thanks.

John Riccitiello *- Electronic Arts - CEO and Executive Director*

First off, sports has been a strong growth story for us this year. We've gotten it off the World Cup, we've gotten it on FIFA, we've built an exercise business in EA Sports Active, we've added nice flanker products in the form of martial arts and boxing, and we've been growing digital.

I would say that one of the things that is true is we've been focused very much on making sure that they're not just a representation of what we are on the front of the magazine but they're also -- or the front of the annual report, but they're a big contributor in the back of the annual report, relative to the profit contribution. Without getting into specifics, it's a substantially profitable business comparable to our other businesses. It can do better over the years to come, which is why we've addressed some of the structural issues. This is not our first cut at some of those structural issues; we took some steps a few years ago to allow these businesses to be as profitable as the best of any packaged goods in digital business for us.

I particularly see an opportunity in sports in the EA sports brand as it's been casual and social and mobile continues to grow. It might be a stretch for imagining some franchises whether they'd be core [RPG or RTF] sort of reaching 30 or 40 million people in the US, but sports is interesting to almost everybody. You know, I live in San Francisco and last night you could frankly hear the cheer rising out of the city at about 8.20 or 8.30, or whatever the time was. There's very little that unites consumers the way sports does. We are the leading proponent, and I think advocate, and ultimately beneficiary, of all these platforms as they go forward, and that speaks to profit growth.

Justin Post *- BofA Merrill Lynch - Analyst*

Thank you.

Operator

Our next question --

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

By the way, if you were in Texas you probably didn't hear that cheer.

Operator

Our next question will come from Atul Bagga with ThinkEquity.

Atul Bagga - ***ThinkEquity - Analyst***

Congratulations on a great quarter. Couple of questions for you. I was wondering if you could share any update on the Star Wars development? Is it still on track for launch Spring of 2011? Second, on Facebook, with this agreement I understand there are two dynamics, one you're expecting better retention, higher acquisition of customers and better conversion, but at that time same time you are also going to share 30% revenue with Facebook. So all in all, in the near term what kind of impact do you see on Facebook games because of the Facebook Credit agreement you signed today?

Eric Brown - ***Electronic Arts - CFO and EVP***

This is Eric. I will take the first half of the question. In regards to Star Wars, we're not providing any update in regards to timing. The only thing that we're here to confirm today is that it is not shipping in FY '11, and that we continue to incur development costs. Second half of the question, John?

John Schappert - ***Electronic Arts - COO***

Second half of the question was Facebook and margins, and you are right, there is a margin share with -- a revenue share with Facebook as we transition to Facebook credits. The thing to keep in mind though is, there is a margin share now with our current payment provider. So we're going from one vendor to another vendor. In fact, we're going to a vendor where everyone on Facebook now actually can have Facebook credits, and they can be used to purchase virtual items on all of their games.

So what we think will happen is rather than pay a one vendor, we're going to pay Facebook and we are going to see a lot more of the 250 million gamers that actually Facebook credits in their account; in fact, I think they may have credits in their account now, as Facebook seeded them with Facebook credits to turn them into spenders. So we actually think it's going to be a benefit for us, but you are right there is a share of revenue, but frankly we that had before.

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

So just a couple thoughts before we take your last question. First, with regard to our -- the big MMO we've been talking a lot about, we're not trying to avoid your question on the call, but the fact is when we make our announcements for a consumer franchise like that, we'll make a consumer announcement as opposed to a release through a financial review as we are doing today.

Secondly, in my prepared comments, just one thing I wanted to highlight for you, I finished by encouraging you to take a look at Need for Speed; there was a reason I encouraged that. I think Autolog can do for driving and/or for Need for Speed what superior forms of multiplayer game play did for shooters a few short years ago. It's the first truly compelling on-line feature set for a driving game. I think it's worth paying attention to. If you are looking for innovation driving outcomes, it's a place to look for innovation. As we're nigh on 3.00, we'll take one last question.

Operator

our next question will come from Andrey Glukhov from Brean Murray.

THOMSON REUTERS

Andrey Glukhov - ***Brean Murray, Carret & Co. - Analyst***

Thank for taking the question. So to follow up on the last comment. As you think about the racing genre worldwide, in light of the new platforms that are available for you, do you think that the racing genre is structurally still a growth genre, or is it going to be stable? How do you think about the growth outlook there?

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

I think without doubt, the racing genre is a growth genre, but I think what's really going to prove it out is comping Q3 -- calendar Q4, but our Q3 FY '11 with Q3 FY '10. You know, we have the same product on the marketplace, and let's see how we do. What bodes well, I think, for both the sector and the franchise is innovation and quality. The innovation is going drive on-line play like we haven't seen in driving if it catches on; that's still to be proven, but I'm pretty confident that it should work.

I think the second thing to remember is this holiday is fairly crowded with products that appeal quite richly to a very core audience. With the exception of The Sims, and what we have with Need for Speed, there's precious little that appeals outside of folks that probably get their first name and their gamer tag confused. So against that more broad audience, I think we've got the right offering.

Andrey Glukhov - ***Brean Murray, Carret & Co. - Analyst***

And then the second question, if I can ask one on Star Wars, as we get a little bit closer to the launch, are you guys in a position to, over time, trend the development expenses? And on a related note, as you get closer to the launch do you need to ramp up expenses related to kind of game operation, and what that impact might be?

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

Eric is probably tempted on this one. I don't think you should expect any significant ramp-up as we get towards launch. Secondly, of course we will disclose all that is appropriate around that franchise as we gets towards it. I would offer this. I've had a chance to get a close look at it, quite recently in fact. The game development is going very well. We're very pleased with it. And we're looking forward to an opportunity to introduce the franchise more formally to the consumer, and when we do so we'll certainly talk to all the folks that track the stock.

Andrey Glukhov - ***Brean Murray, Carret & Co. - Analyst***

Thank you.

John Riccitiello - ***Electronic Arts - CEO and Executive Director***

Thanks, everybody. With that, we'll close the call.

Operator

Ladies and gentlemen, that does conclude today's conference call. Thank you for your participation. You may now disconnect.