July 19th Call on Changes to External Financial Reporting

CHRIS:

Thank you.

Welcome. With me on the call today are Blake Jorgensen, our CFO, and Ken Barker, our Chief Accounting Officer. We are hosting this call to help you understand the changes we will be making in our external financial reporting in response to the SEC staff's recent interpretations on the use of non-GAAP financial measures. We will not be making any statements about our business or financial performance on this call.

After the call, we will post our prepared remarks, an audio replay of this call, a transcript, a FAQ document and a spreadsheet that illustrates the GAAP to non-GAAP adjustments for Q4 Fiscal 2016.

These materials and our comments may include forward-looking statements regarding future events with respect to the Company, including the ways in which the Company may modify its external financial reporting and the ways in which our Board and management will assess the Company's performance. Actual events may differ materially from our expectations. Important factors that could cause actual events to differ materially from those in the forward-looking statements include additional guidance or rules from the Securities and Exchange Commission, refinement of our analysis with respect to the subject matter of the forward-looking statements and any of the risks discussed in our most recent Form 10-K. Electronic Arts makes these statements as of today, July 19, 2016 and disclaims any duty to update them.

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

BLAKE:

Thanks, Chris.

The SEC issued new interpretations on the use of non-GAAP financial measures on May 17, 2016. These new interpretations no longer permit the use of our historical non-GAAP revenue measures. After reviewing these interpretations, we have decided to modify the way in which we report our financial results by no longer externally reporting many non-GAAP financial measures, including net revenue, gross margin and EPS. We will continue to provide guidance and report financial measures on a GAAP basis. In addition, we will separately provide guidance and report the financial data that we historically used to calculate our non-GAAP financial measures so that you may calculate comparable measures yourself if you wish to do so.

These interpretations apply to all U.S. public companies that report non-GAAP measures, particularly those that make adjustments for revenue recognition, such as many of our video game peers. Because the new interpretations are effective immediately, we will use the earnings call for our fiscal first quarter, which is scheduled for August 2, as a transition to our new external reporting structure. That call will be the last one in which we will report our financial results on a non-GAAP basis. On that call, we will use the results for our first fiscal quarter to describe the ways in which EA's external reporting is changing and explain how to bridge from our GAAP results to non-GAAP results should you choose to perform similar calculations in the future. Also on that call and in future earnings calls we will only provide guidance on our GAAP financial measures and the financial data that we have historically used to compute non-GAAP guidance.

It's important to note that this is only a change in external financial reporting on a prospective basis. We are not restating any of our prior financial results. It has no effect on our business, nor how we manage our business nor the way our Board of Directors evaluates management and company performance. It has no impact on the key valuation measure for our business – cash flow. But it will change how we present our business results externally. We remain fully committed to maintaining the highest level of transparency into our business operations and results.

Let me provide some background on the issue. We have been externally reporting both GAAP and non-GAAP financial measures using a consistent methodology since Fiscal 2008, along with the required reconciliation between the two measures. Our management and Board have utilized these non-GAAP financial measures internally to assess the Company's operating results as well as to forecast and analyze future periods. Our management team is compensated, in part, based on our non-GAAP financial measures. In addition, these non-GAAP measures align more accurately with cash flow.

Our non-GAAP measures included an adjustment for revenue recognition due to the delayed revenue recognition for software with online capabilities. As you know, many of the games that we sell can be played online and often include the right to receive unspecified future updates. Because we do not separately sell these services, we do not have “Vendor Specific Objective Evidence” of their fair value. Therefore, GAAP rules require us to recognize the revenue ratably over the period we expect people to play the games. Today, for most of our online-enabled games, this period is between six and nine months.

However, we do not defer any of our costs. We expense our costs when they actually occur. As a result, given the seasonality of our business and the period of time upon which we recognize revenue, our profitability under GAAP is subject to significant variability depending upon when our products are sold. For example, two of our largest franchises, Madden and FIFA are released toward the end of our second quarter which ends in September. This means the September quarter includes a majority of the costs associated with releasing these games but very little of the revenue, often resulting in a significant GAAP loss in that quarter.

In order to better match the revenue with our costs, we have historically provided non-GAAP measures that adjusted our GAAP revenue for the impact of this revenue deferral. This adjustment was made only for online-enabled games and was not adjusted for other revenue recognition issues such as subscriptions or extended payment terms.

However, the new SEC interpretations no longer permit us to externally report non-GAAP financial measures that adjust for revenue to be recognized upon delivery of the game. Rather than develop new non-GAAP measures that are not used internally and risk confusion when comparing with historical data, we will report many financial measures on a GAAP-only basis, including net revenue. Therefore, going forward you will need to add our GAAP revenue to the change in deferred revenue in order to calculate a revenue number that can be compared to our historically reported non-GAAP revenue.

We will also report the financial data that is used to adjust for our internal management and Board reporting. With this data and our long-term tax rate of 21% that management and the Board of Directors use to evaluate financial performance, you will be able to calculate all of the financial measures comparable to our historical non-GAAP financial measures. We intend to provide this information for all of the various cuts of revenue we currently provide, whether it is based on geography, platform or composition.

We will take the same approach to guidance, providing GAAP guidance across a number of measures, together with the GAAP adjustments we make for our internal reporting. We will be providing a new financial model on our Investor Relations website to help you with these calculations. Today, we've posted a model that illustrates how we applied the adjustments for the last quarter of Fiscal 16.

We understand that this change will require some extra steps for each of you to compare our results to prior periods. We'll review the translation between GAAP and non-GAAP again on August 2 when we report non-GAAP numbers for the final time.

Thank you for your time and patience on this issue, one that is impacting everyone in our industry.

Now Ken and I are happy to take your questions.

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