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# EDITED TRANSCRIPT

EA - Q1 2018 Electronic Arts Inc Earnings Call

EVENT DATE/TIME: JULY 27, 2017 / 9:00PM GMT

## OVERVIEW:

Co. reported 1Q18 net revenues of \$1.45b and diluted EPS of \$2.06. Expects 2Q18 net revenues to be \$955m and loss per share to be \$0.18.



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## CORPORATE PARTICIPANTS

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**Blake J. Jorgensen** *Electronic Arts Inc. - Executive VP & CFO*

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

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## PRESENTATION

### Operator

Good afternoon. My name is Jennifer, and I will be your conference operator today. At this time, I would like to welcome everyone to the Electronic Arts First Quarter 2018 Earnings Conference Call. (Operator Instructions) Thank you.

And I would like to turn the call over to Mr. Chris Evenden. Sir, please go ahead.

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

Thanks, Jennifer. Welcome to EA's First Quarter Fiscal 2018 Earnings Call. With me on the call today are Andrew Wilson, our CEO; and Blake Jorgensen, our CFO.

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 this call, we will post our prepared remarks, an audio replay of this call, our financial model and a transcript.

With regard to our calendar, our Annual Shareholder Meeting will be on Thursday, August 3, here in Redwood Shores.

This presentation and our comments include forward-looking statements regarding future events and the future financial performance of the company. Actual events and results may differ materially from our expectations. We refer you to our most recent Form 10-K for a discussion of risks



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that could cause actual results to differ materially from those discussed today. Electronic Arts makes these statements as of today, July 27, 2017, and disclaims any duty to update them.

During this call, the financial metrics, with the exception of free cash flow, will be presented on a GAAP basis. 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 & Director*

Thanks, Chris. Our first quarter of FY '18 was an outstanding start to an exciting year for Electronic Arts. Engagement in our live services across console, PC and mobile was exceptional, demonstrating the strength of our digital business that evolves daily to meet the needs of our players. Revenue and EPS for the quarter were above our guidance, and we had our highest Q1 operating cash flow in EA history.

Our live services today continue to grow with more passionate players connecting with their friends through our network and having more fun with the games they love. Our EA SPORTS live services were thriving through Q1, engaging more players on multiple platforms. Unique players in Ultimate Team grew 11% year-over-year through Q1. In our mobile businesses, FIFA Mobile expanded to more than 95 million unique players, and NBA Live Mobile grew to more than 70 million unique players. Our Sims community continues to be strong: monthly active players in The Sims 4 increased more than 20% year-over-year in Q1, and we're excited to have a new Sims Mobile game in soft launch. And in Battlefield 1, our community has grown to 21 million unique players experiencing an extensive live service, with monthly updates, in-game events and missions and the largest expansion packs in franchise history.

As we continue to strengthen player relationships through our live services, we are also innovating with how we reach players outside of our games. Through EA PLAY in June, we engaged a global audience from our event in Hollywood. First, we gave fans the most comprehensive look to date at our FY '18 titles, including Star Wars Battlefront II, FIFA 18, Need for Speed Payback, Madden NFL 18, NBA LIVE 18, and a new EA Originals title in A Way Out, and our stunning new IP, Anthem. The trailers and videos we launched for our games at EA PLAY have together generated more than 115 million views on social channels, twice as many as last year's content. We welcomed nearly 20,000 players to our venue for a celebration of play, and opportunities to go hands-on with our biggest games. Among those attendees were 300 community leaders and content creators, who captured and streamed 1,000 hours of gameplay for our upcoming titles. That content is now being shared among a combined 250 million subscribers worldwide, bringing them closer to the new experiences and excitement we will deliver this year.

Q1 set the foundation for FY '18, and there is much more ahead of us -- new games, more content and pioneering for the future of play.

At Electronic Arts, we're committed to innovation -- for our players and the industry. We are pushing the limit forward. Our focus manifests in 3 key areas that uniquely position EA to lead and drive growth: a core technology base that is unparalleled in our industry, amazing new titles being developed by extraordinary teams, and new models to expand our reach and help more people discover, engage and enjoy the fun of games.

EA's investments in engine technology, analytics, infrastructure and research continue to fuel advancements in our games, our services and our Player Network. Our industry-leading Frostbite engine is now powering development of a dozen new titles across our portfolio. It is continually engineered alongside our world-class technology platform for games and services, enabling our creative teams to leverage sophisticated data and insights to conceptualize and build the most incredible new experiences for our players. A digital platform provides the scalable infrastructure that powers our multiplayer experiences, connects players to their friends, and updates our games based on player inputs. And across the company, research teams like SEED are working in areas like neural networks derived from our data sets, cloud infrastructure to deliver streaming experiences, virtual humans and AI. These concepts will dramatically shape how players interact and experience games over the next 5 years and beyond.

Competitive gaming will also continue to fuel growth and evolution in EA's portfolio. Players in titles like FIFA and Madden NFL are up to 3x more engaged when they are playing competitively, and fan feedback from our tournaments has been highly positive. This year, new competitive structures and new mode -- modes are set to expand engagement and drive growth in the digital ecosystem, broadcast and sponsorship. Launching first is Madden NFL, where the size and scope of our competitions in FY '18 will increase substantially from a strong foundation as we deepen our



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partnership with the NFL and bring esports even closer to the real-world sport. At Gamescom, we'll debut a new way to play Battlefield 1 built for competition, and designed with direct input from our Battlefield community. Through a growing portfolio of digital and traditional broadcast deals, our spectator reach will continue to expand, with major brands set to engage this high-value audience through global sponsorships.

Looking to our FY '18 slate of new titles and live services, we are delivering unprecedented levels of innovation. Starting in Q2: FIFA 18 delivers a generational leap forward for the franchise. Frostbite is now enhancing every aspect of the game from visual fidelity to gameplay. The Journey 2 brings a deeper and more personalized story experience, and FIFA Ultimate Team is expanding with the addition of FUT Icons. FIFA's global appeal also continue to grow: FIFA Online in China is one of our fastest-growing sports businesses over the past year.

Madden NFL will break new ground for the franchise when it launches in August, powered by Frostbite, delivering a unique take on story mode with Longshot and introducing MUT Champions to power our global esports competitions.

NHL 18 will have the most ways to team up and compete with friends in franchise history -- 60 combinations of co-op and online multiplayer, including a brand-new NHL THREES mode.

And Battlefield 1 will continue to evolve as a content-rich live service, with monthly game updates, and our next expansion pack, In The Name of the Tsar, launching in full in September. In addition, at Gamescom, we will detail our plans for a new offering that will bring the richest Battlefield 1 experience yet -- including the all-out warfare, epic multiplayer battles and War Stories campaign that have defined the game, plus new maps, deeper progression and additional fan-favorite game modes, all in a single package.

In Q3, we'll deliver new games in some of our most popular global IP: Need for Speed Payback will excite fans with its adrenaline-fueled, action-driving experience, signature car customization, new story and new characters.

Yesterday, we announced that The Sims 4 is coming to Xbox One and PlayStation 4 players this November, bringing the same unique gameplay and self-expression from the PC game to console players. Much of the content added post-launch on PC will be included, with more game modes and updates to come.

Finally, Star Wars Battlefront II will bring the unforgettable Star Wars experience that fans want: a game 3x the size of the previous title, with a new single-player story, iconic space battles, deeper multiplayer and a new, event-driven live service model that will keep the community together long after launch. Anticipation and excitement for this game continues to grow: our trailers and user-generated content for Battlefront II have received more than 117 million views to date, up more than 1/3 from our previous game.

We are also focused on growing our reach and encouraging more players around the world. Our live services are continually evolving to connect more players with new experiences, like our unique model for Star Wars Battlefront II post-launch content, and event-based modes like FUT Champions. As we continue to expand our competitive gaming program across more IP, we are delivering highly engaging broadcast content for esports spectators, one of the fastest-growing audiences in entertainment. And as a publisher, we have pioneered the multi-title subscription service at the platform level with EA Access and Origin Access, enabling players to discover and enjoy more games at tremendous value. Only EA spans this breadth of engagement models today, helping us to reach more players and continually grow our network.

There is a lot to be excited about in the quarters to come. We are innovating for our players, for our business and for the industry. Now I'll hand the call over to Blake.

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**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Thanks, Andrew. We had a great start to the fiscal year, powered by our event-driven live services, particularly FIFA Ultimate Team and our mobile titles. Our operating cash flow was the highest ever for a first quarter and underlines how our growing live services have fundamentally changed our business model, resulting in a more stable and predictable cash flow all year round.



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I'll report our results on a GAAP basis, then use our operational measure of net sales to discuss the dynamics of our business. To compare this quarter results to historically reported non-GAAP measures, please refer to the relevant tabs in our downloadable financial model.

EA's net revenue was \$1.45 billion compared to \$1.27 billion a year ago and above our guidance by \$24 million. Operating expenses were \$552 million, \$6 million above our guidance due to phasing. The increase over last year was primarily driven by new product development as we invest in new genres. Operating income was \$743 million, and diluted earnings per share was \$2.06, \$0.13 above our guidance.

Operating cash flow for the quarter was a record \$176 million, up \$294 million from last year. Remember that the FASB rules regarding the treatment of stock-based compensation have changed, and this affects how we classify our cash flow. Under the old rules, operating cash flow for the first fiscal quarter in 2018 would have been \$42 million, up \$290 million year-on-year. Under both accounting treatments, operating cash flow was an all-time record for the first quarter. Capital expenditures for the quarter were 300 -- \$33 million, resulting in a free cash flow of \$143 million. Operating cash flow for the last 12 months was \$1.87 billion, our strongest-ever 12 months. See our earnings slide for further cash flow information.

During the quarter, we also repurchased 1.4 million shares at a cost of \$100 million -- \$150 million, leaving \$1.08 billion in our 2-year \$1.2 billion buyback program we began in May.

Our cash and short-term investments at the end of the quarter were \$4.47 billion, with 37% of this balance held onshore.

Now I'd like to turn to the key drivers of our business this quarter.

Net sales for the quarter were \$775 million, up \$93 million on the prior year and \$25 million above our guidance. There was an FX headwind of approximately \$16 million compared to the prior year. The outperformance relative to guidance was driven by Ultimate Team, The Sims 4 and FIFA Online 3. Year-on-year growth was driven by the Mass Effect: Andromeda sales captured in the quarter and by FIFA.

Digital net sales were \$681 million, a new record for the first quarter and up \$113 million on the year-ago period. The increase reflects strength in live services, together with our Mobile business. In addition, Mass Effect: Andromeda was a significant contributor. Digital sales now represent 63% of our business on a trailing 12-month basis compared to 56% in the prior year.

Looking at each of the components of this quarter's digital sales in turn: Live services net sales were up 22% year-on-year to \$420 million. The growth was broad-based, driven by FIFA Ultimate Team, Battlefield 1 and The Sims 4. The esports mode in FIFA Ultimate Team continues to attract new players and drive engagement. Notably, Sims 4 expansion packs continue to perform extremely well, and the last 12 months have been the best in the title's history. Both EA Access and Origin Access are up year-on-year. Remember, we have merged extra content and subscriptions, ads and other into this new live services category.

Mobile delivered net sales of \$150 million, up 6% year-on-year, with the growth primarily from FIFA Mobile, Galaxy -- Star Wars: Galaxy of Heroes and NBA Mobile. FIFA Mobile is continuing along its growth trajectory and beat our expectations by delivering its strongest quarter since launch. June was the strongest month so far for FIFA Mobile, a testament to the ability of the team to create compelling live services for players. In Q1 alone, they released 2 major client upgrades and delivered 10 major content programs.

Full game PC and console downloads generated net sales of \$111 million, 32% higher than last year. This was driven by Mass Effect: Andromeda sales captured in the quarter. 34% of our unit sales are now digital rather than physical, measured on Xbox One and PlayStation 4 over the last 12 months. This compares to just 27% a year ago.

Turning to guidance: we are reiterating our guidance for the full year.

For the second quarter, we expect net revenue of \$955 million, cost of revenue to be \$389 million and operating expenses of \$638 million. OpEx is up year-on-year, primarily due to 2 factors: continued investment in new genres and live services and the phasing of marketing expenses. Phasing will be different as we start campaigns earlier for new games and live services. This results in a loss per share of \$0.18 for the second quarter. Note



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that this is calculated using the basic share count of 310 million shares. Should EA report a profit, the diluted share count of 314 million will be used.

We anticipate net sales for the quarter to be \$1.16 billion. This is up 5.6% year-on-year, primarily driven by growth in our sports franchises, offset by an FX headwind of around \$18 million. With regard to sports, Madden NFL 18 is a significant step up from last year's game. It's the first Madden on Frostbite, it's the first with a story mode, and we've significantly refined the competitive gaming features in Madden Ultimate Team. FIFA 18 continues to be -- continues the pattern of innovation with the addition of Real Player Motion Technology and Player Personalities, and the second season of the Journey. Also contributing to our excitement around FIFA is the addition of the Nintendo Switch. We will launch FIFA 18 for all 3 console platforms on September 19 -- or 29, excuse me.

In conclusion, we are delighted with the performance of our business in the first quarter, driven by the growing revenue streams generated by our live services. We've applied our teams to developing competitive or compelling live service events, and this has fundamentally transformed our business model. Our live services continue to grow our profitability and enable us to generate cash all year round.

Now I'll turn the call back to Andrew.

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### **Andrew Wilson** - *Electronic Arts Inc. - CEO & Director*

Thanks, Blake. The future of games is changing. Over 2.5 billion people are estimated to play video games today, and we expect that number will continue to grow. At that scale, the way we connect to, access and play games will continue to evolve. EA is at the leading edge of that transformation.

Our creative teams are applying advanced technologies and data intelligence to craft new experiences, like our Longshot mode in Madden NFL 18 and the massive, dynamic environments in Star Wars Battlefront II. But this is just the beginning as we combine the power of our Frostbite engine with our digital platform. With increased processing power on devices and in the cloud, the new frontiers for innovation become deeper forms of personalization, immersive and self-generating worlds, artificial intelligence and deep learning.

As we continue to pioneer for our players, our portfolio will expand in FY '19 and beyond. We will deliver stories that you're able to play, like the Star Wars action-adventure game being developed by the Visceral Games team. Anthem, our new IP from BioWare, will introduce a contiguous open world that is ever-changing and influenced by players, as they band together and support each other in their journeys. Next year will also be a World Cup year in soccer, an added opportunity for us to innovate and engage our massive FIFA audience around the world. We will continue delivering for our Battlefield fans, including the next great game in the franchise. Across our top franchises and new IP, our ongoing focus will be on advancing the state of the art in games for players on every platform.

Delivering new and compelling ways to discover, engage and enjoy games will enable us to reach more players and grow our network. Our live services will continue to expand, hosting thousands of daily, weekly and seasonal in-game events that brings players in deeper. Our competitive gaming programs, from online tournaments to global championship spectacles, will engage more players and spectators in our franchises as the massive esports audience continues to grow. And through our subscriptions and Origin platform, players will be able to seamlessly connect to new experiences from EA's portfolio and beyond.

We are entering a new era for innovation in the games industry. We believe interactive entertainment will change more in the next 5 years than it has in the last 45, and we are excited to lead that evolution at Electronic Arts.

Now Blake and I are here for your questions.



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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And our first question comes from the line of Tim O'Shea with Jefferies.

### Timothy Larkin O'Shea - Jefferies LLC, Research Division - Equity Analyst

So one of the big announcements at E3 was this new Ultimate Team style mode for Star Wars Battlefront II where gamers can purchase Star Cards to unlock the special in-game abilities. That you guys are doing over \$800 million in Ultimate Team revenues. So my question is, how much incremental Ultimate Team style revenue could be generated by Star Wars? And then how much is implicitly included in your outlook, your full year outlook?

### Blake J. Jorgensen - Electronic Arts Inc. - Executive VP & CFO

Yes. So thanks, Tim. Good question. I remind everybody, it took us 8 to 9 years to get Ultimate Team where it is today. Our first year of Ultimate Team was \$8 million for FIFA. I think there's a huge possibility for the extra content, live service, event-driven model in nonsports games, but we're also very conscious that it will take time to develop. We have a relatively small amount of that built into this year's forecast. I think if it's successful, we'll start to see the benefits at the tail end of this year and really see the benefits next year. But it's hard for us to really predict at this time exactly how that might play out. Our biggest focus, though, to remember is, we want to just engage all of our users, all of our players, deeply in the game and provide them more ongoing activities, content, events for them to keep coming back and playing. And if that's successful, we think the economics will follow, but more to come as we release that game into the market in November.

### Operator

Your next question comes from the line of Stephen Ju with Cr dit Suisse.

### Stephen D. Ju - Cr dit Suisse AG, Research Division - Director

So Andrew and Blake, I think we talked about this topic before, but I thought I would bring it up again, given all of the different development efforts at Motive, BioWare, at DICE and Visceral, you're kind of now in a position where it looks like you might have too much product. So does this open up the opportunity for you guys to space out some of the nonsports franchises to maybe every 2 years or maybe even 3 years as opposed to every other year?

### Blake J. Jorgensen - Electronic Arts Inc. - Executive VP & CFO

Never too much product. I think we like a regular cadence. I think we've found a good cadence, obviously, with Battlefield and with Star Wars Battlefront. We're trying to make sure that we're leveraging our relationship with Disney on the Star Wars property, so aligning those where possible with their theatrical release schedules. So right now our plan is not to change our cadence schedule. Clearly, we don't yet know how the cadence of new properties like Anthem or anything coming out of Motive will be. That's still to be determined. But I think we're pretty comfortable. We believe it creates a nice top line growth that's all organic from our teams. And we're very focused on making sure that it's very profitable along the way. So we want to continue to drive both the top line and the bottom line through new IP, existing IP, new live services and margin expansion across all of those.

### Operator

Your next question comes from the line of Justin Post with Bank of America.



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**Justin Post** - *BofA Merrill Lynch, Research Division - MD*

Two questions. First, obviously, you're excited about the improvements in Madden. How have you factored that into your guidance for both the upcoming quarter and maybe in the holiday season? And then second, Battlefield 1, looks like you're pretty excited about some changes there. Can you keep monetizing the digital after the year anniversary? Meaning, can you still see some pretty good digital revenues in fiscal '19 for that game?

**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Yes. So we are planning for Madden to be up year-over-year, but I would say that it's not up dramatically, i.e., creating a risk in any way. You know Justin our approach to guidance. We try to be pretty rational and conservative. We think there's some upside to our guidance number there, but I wouldn't expect that it's up dramatically, creating any risk. Based on what we've seen of the game and the excitement around the esports mode is very, very positive. And so we're looking forward to a great Madden year ahead. In terms of Battlefield 1, we've had such great engagement there that we're continuing to feed new content into that community to try to continue to drive the game. We're constantly reminded that people are still playing Battlefield 4, for example. And that's a game that was -- it's almost 4 years old. And so to try to be able to continue to add things for people to stay engaged and to build off that economically is a big positive for us, and we see that as one of the efforts as to why we're pushing Battlefield 1. And then as a reminder, Andrew mentioned that at Gamescom in a few weeks, we're going to introduce a new esports mode to Battlefield. People have used Battlefield as an esports product for many years outside of EA. It's a fun, fast-paced game, but with a 64-player multiplayer, it's a bit hectic and chaotic for esports. And so you'll see some new modes coming out that will benefit a more rational esports approach and pretty exciting for us for this year and really powering next year and the year after off of that title.

**Operator**

Your next question comes from the line of Brian Nowak with Morgan Stanley.

**Jonathan Paul Lanterman** - *Morgan Stanley, Research Division - Research Associate*

This is Jon Lanterman on for Brian. In the past, you guys had stated a goal of getting the percentage of games bought via digital download to 40%, 45%. And more recently, you've kind of updated this to 50% to 60-plus percent. Last year, we saw the traditional kind of 5% annual mix shift accelerate closer to 10%. So looking ahead, kind of what are some of the barriers that you guys see, the main barriers in getting to that 60-plus percent of games being downloaded?

**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Yes, I think for us, the first and most important thing to remember is, we're very global. And so while there's high bandwidth speeds in the United States and in key major countries like the U.K. or France or Germany, that's not consistent all through Europe or Eastern Europe or Asia. And so that's probably still the biggest impediment to full game downloads. And the second piece is, while we in the U.S. and I think it's the same in Northern Europe and in some parts of Europe, the cashless credit or cashless transaction methods are fairly well-developed. I would say they're not as well developed in other places in the world. So the use of credit cards, PayPal, any type of e-pay approach has still got a long ways to go. And I would say those 2 things are the biggest impediments to full game downloads. We know that the consumer, once they do a full game download, realizes how easy it is and how effective it is for managing their games. And so we don't see consumer resistance. It's really the resistance around bandwidth speed and ability to pay with a cashless method.

**Jonathan Paul Lanterman** - *Morgan Stanley, Research Division - Research Associate*

And then would you say a consumer who downloads the game is also more likely to do MTX and DLC and things like that?





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**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Yes. In fact, I would say it's probably the opposite, which is, many consumers are doing, for example, Ultimate Team, but were still buying the game physically. And they're realizing how effective and easy it is to pay through a credit card method and thus they'll transition into a full game download. We'll continue to do things to help the consumer see the opportunity there and find a way to buy our products digitally. And at the same time, we'll continue to make sure that we have a strong presence in all of our retail partners so -- because we know it will be a mixed model for a long period of time.

**Operator**

Your next question comes from the line of Colin Sebastian with Robert W. Baird.

**Colin Alan Sebastian** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

First on competitive gaming. I wonder if you could comment on expectations for monetization of competitions, in particular for Madden and FIFA. Or whether you still view these experiences as more about driving loyalty and community? And then maybe a bigger picture question on Frostbite, which I think, Andrew, you said is powering 12 titles in development and is often highlighted as a key factor in game quality. My question is whether this version of the engine remains cutting-edge, is being refreshed sort of on an ongoing basis or given some more frequent console platform refreshes now? Should we expect a new version of Frostbite on the horizon?

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

Two really good questions. On esports, as we think about esports and we think about the monetization of esports, we think about it along some core vectors. The first vector to esports is you need a global community of players who are engaged in the game. And if we look at FIFA and we look at Battlefield and we look at Madden, we have many tens of millions of players in each of those franchises who are continually and consistently engaged. Then next, you need a competitive game structure. And what you've seen from us over the last 12 months is a real focus on ensuring that we have a strong, competitive game structure all the way from the very, very amateur leagues, through to kind of elite championships. The next thing you need is a way to kind of monetize the increased engagement that you get out of that structure that you've put into place. And what you heard from me earlier was that we saw a significant uplift in FIFA Ultimate Team revenue over the past year. And we believe a strong contributor to that is the competitive gaming modes that we've built into FIFA, which again were the precursor to many of the new competitive gaming modes we've built into Madden this year. And so we are hopeful to see ongoing growth and monetization in and around Madden Ultimate Team as well. And then, of course, once you've got these global communities engaged at a higher rate in a digital ecosystem and a competitive game structure, then that's a very compelling community when it comes to broadcast deals and sponsorship deals. And we're seeing that also accelerate at a faster rate than we had expected and are very pleasantly surprised by that. In all honesty, our focus isn't about generating huge numbers out of broadcast deals yet. It's really about increasing viewership and building a truly entertainment -- entertaining experience for our global audience, but we see opportunities for strong returns on those 2 vectors as well, broadcast and sponsorship over the coming years.

**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Before Andrew answers the question on Frostbite, what I would say is, we talk about our business in general around engagement because that's what we're focused on. But let me be really direct, you don't get 22% year-on-year growth in live services without the esports power that we've seen in our Ultimate Team business. And I challenge any other console player to demonstrate where they've seen revenue growth of that level driving -- coming from esports. It is very powerful for us and it will continue to be very powerful.



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

On Frostbite, again, we have a very large team across a number of different locations who are constantly and continually investing and innovating in that engine in terms of visual fidelity, in terms of physics, in terms of animation, in terms of AI, every aspect that a game team needs to develop the most innovative and creative experiences. And when you look at what we've been able to do with Real Player Technology in FIFA this year, when you look at what we've been able to do with Madden visual fidelity and Madden cinematics and Longshot, the story mode, when you look at the expansive, dynamic worlds that we're showing in Star Wars Battlefront II, that is really demonstrative of the level of innovation and advancement we continue to make in that engine. And at some level, because we have a dozen teams building on top of the platform and a core team feeding all of that development back into the mainline of code, that engine is actually making leaps and bounds faster than many engines would, which is 1 or 2 games working on them. And so we are very, very happy with our core strategy of moving to a single engine. We're starting to see real leverage in the engine, not just in terms of our ability to build wonderfully large and creative and entertaining new games efficiently, but because we're able to do things that are far more innovative than things we're seeing anywhere else in the industry.

**Operator**

Your next question comes from the line of Drew Crum with Stifel.

**Andrew E. Crum** - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP*

So you have a very large installed base it seems for FIFA Mobile. Can you comment on the monetization trends that you're seeing? I think you mentioned, Blake, that June was your best month thus far. What changes have been made to drive the improved performance? And maybe comment on how it's performing relative to Madden NFL Mobile.

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

So a great question. Again, when we launched FIFA, we were using the blueprint that we had used and developed over a 3-year period for Madden NFL in mobile that had really started to gain traction and continues to be a very engaging property for us. And when we did launch that, we said that even though we're using the blueprint for Madden, we expect that given the nature of the global community and the different geographic and cultural differences around both engagement and monetization in the soccer audience versus the North American-focused Madden audience, that we believed there would be some tuning time required. What the team has been doing on a day-to-day, week-to-week, month-to-month basis since launch is really better understanding through the great deal of data that we are able to get every day from play what cultural needs are, what engagement needs are, and ultimately, what the overall monetization needs are of each player base in each community. What we're seeing now, again, is the ongoing commitment to live services, events that are relevant to each of those communities around the globe starting to generate the kind of engagement and monetization growth that we would expect and continue to expect. I think that we are ahead of where we were with Madden. I don't have the exact data. We're ahead of where we were with Madden. And again, when you think about Madden as in a \$50 million to \$100 million range being primarily North American-focused, we continue to believe that FIFA on mobile can be substantially greater than that on a global basis.

**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Yes. And Drew, a couple of examples that just occurred during the quarter is, as I mentioned, they had 10 major new content updates. One, for example, is called VS Attack Mode, where players compete for leaderboard status and can unlock or upgrade items based on the division that they're in. It's proven to be very popular with the community and highly engaging. And think about this as, when we started FIFA Ultimate Team years ago, it was really one mode. And over time, it's developed into many different modes and many ways to play, and with many different types of players. And the journey of Madden Mobile followed that. FIFA Mobile will follow a similar journey over time. The quarter did really well, but it's a strong -- it wasn't a strong quarter for American football, but it's a strong quarter for international soccer. And so you tend to see strength in both FIFA and NBA in that quarter, but also you're seeing just the potential as we continue to add and work with the game. It's a game unlike most



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mobile games. It's more like our Madden or our FIFA or Madden Ultimate Team, where we've tinkered, we've played with it, and we've added to it over many years. And that's how we'll continue to grow both FIFA and NBA and Madden over time, and we're pretty excited about that.

### Operator

And your next question comes from the line of Andrew Uerkwitz with Oppenheimer.

### Andrew Paul Uerkwitz - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

I just have 2 kind of higher-level questions. The first one is Battlefield 1, Titanfall 2 and a couple other games were added recently to EA Access. It feels a little bit like they were added a little bit earlier. Could you talk a little bit about the strategy around EA Access and potentially eventually an over-the-top gaming service? And then secondly and shifting gears on Frostbite, as that becomes more and more powerful, do you see opportunities beyond -- to use that game engine beyond traditional gaming?

### Andrew Wilson - *Electronic Arts Inc. - CEO & Director*

Two great questions. As we think about subscription and less about the timing of adding of those particular titles to our EA Access subscription, but as we think about media consumption over the last 5 years, the greatest disruptor has been the combination of streaming and subscription. It's changed the way we watch television. It's changed the way we listen to music. It's changed how we think about ownership versus access. And we believe that ultimately, the combination of streaming plus subscription will also be a great disruptor to our business. And you've seen us investing there for a number of years. It's some years ago that we started our first streaming test. We continue those tests. We continue to work with other key large-scale partners on how we think streaming might work for our business in the future. You saw us launch EA Access and Origin Access. You should expect us to continue to push in growing the opportunities in and around subscription and delivering more value for our players on both of those vectors. As it relates to Frostbite, again, we had this wonderfully powerful engine that can do things that no other engine can do. And as you might imagine in our strategic planning meetings, often, we are sitting down and saying, okay, we have a great many strengths as a company, whether that's our nearly half -- people in our network, whether that's our social reach, whether that's the depth and breadth of our portfolio, whether that's our engine or our core digital platform with ID, infrastructure security, data, scalability. And we're always looking at how we might apply those to adjacent businesses or other areas that might deliver value, both to our players and to our shareholders. And Frostbite absolutely is front and center in those conversations.

### Blake J. Jorgensen - *Electronic Arts Inc. - Executive VP & CFO*

And just one clarification. We've announced that we will release Titanfall and Battlefield 1 in September. And that's about the normal cadence. We're typically somewhere between 7 and 9 months after initial -- of putting the title out. And so those really aren't any earlier than what we would normally see. But what we do see is, the more titles we have, the greater interest there is in the subscription. I think that makes common sense. But the more exciting titles like a Titanfall or a Battlefield 1, it also drives a huge amount of interest in the subscription service, and we tend to see nice pops around those announcements.

### Operator

Your next question comes from the line of Eric Handler with MKM Partners.

### Eric Owen Handler - *MKM Partners LLC, Research Division - MD, Sector Head, & Senior Analyst*

I'm just curious with -- we'll keep on the FIFA theme. You're now about 11 months away from the 2018 World Cup. How are you thinking about live services as you sort of get the lead-up to that event with -- you've got qualifying events. You've got the actual event itself. How you can sort of



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parlay that to sort of a side-by-side type of situation? And then secondly for Blake. So it looks like on your operating expense number guidance for 2Q, it looks like the non-GAAP, if we're allowed to say non-GAAP, number looks to be about \$575 million. Should that be the peak of the year for operating expenses?

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### **Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Well, why don't I hit that one first, then I'll let Andrew hit the FIFA one. It's a very nice way of trying to get me -- have me give you third quarter and fourth quarter guidance early. But I can't say that, other than to say that if you've been using historical patterns for marketing spend, you should start to think about those differently over time. Because as we said, as we live in a live service world and as we have a bigger and bigger mobile business, we're driving and managing our business daily, not by title specifically or title launch specifically. And so what you're going to see is our marketing spend smooth out more across the year, but still be dominated by Q2 and Q3 because that's when our biggest properties come out. But we started spending on FIFA months ago or on Madden months ago. We're starting spending on Star Wars, for example, that doesn't come out until November versus the old model where the bulk of your spending came 3 weeks before you or 4 weeks before you ship the product, more like a movie. And we're moving to a much more ROI-driven marketing structure, where when we see something that works, we continue to fuel it. And we're driving more and more of our marketing in nontraditional ways, away from traditional media and into the more influencers of the world to try to drive the message home. And because of that, you're going to see different patterns in marketing spend. But I do -- I reiterate to everybody, our total marketing budget for the full year has not changed. And the targets that we've talked about relative to marketing have not changed. It's simply the spend patterns are slightly higher in this quarter than they have been historically, and that's probably why most people's models were off.

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### **Andrew Wilson** - *Electronic Arts Inc. - CEO & Director*

On World Cup, again, as you can imagine, we -- there's always a great deal of excitement around the World Cup. It's the world's largest sporting event. And typically, represents a great opportunity for us and our FIFA player community. We got a long history of bringing that event to life for our fan base, dating all the way back to World Cup '98. So no new announcements on that yet. But as the event gets closer in 2018, we're going to detail a lot more of how we're thinking about bringing the event to life for our global FIFA community.

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### **Operator**

Your next question comes from the line of San Phan with Mizuho.

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### **San Q. Phan** - *Mizuho Securities USA LLC, Research Division - Director of Americas Equity Research*

I was wondering, can you tease out what you mentioned earlier on the step-up in OpEx maybe on the R&D side with the new genres. And perhaps how much of the increase is more a timing issue versus a higher run rate for R&D?

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### **Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

So we will have a slightly higher run rate for R&D. We're building out a new studio in Montréal, as we've told everyone. And we've hired over 100 people into that studio that are brand-new to EA. This is to build the new IP around Jade Raymond's team that she's been building. I was in that studio last month. And it's a wonderful new addition to our team. And we brought our BioWare Montréal team into that same facility. So they now all sit in one new studio together. We're obviously investing in Anthem, which everyone got a chance to see at E3. That's out of the BioWare Edmonton team and are very excited -- they're very excited. We'll see some increases around that in terms of spending. And then we're continuing to invest across all of our network and platform activities. I don't see any of those going beyond the targets that we've talked about, trying to keep R&D expense in the 21% to 22% of revenue range, but it is -- the goal is to drive new revenue. And if for some reason we weren't able to drive new revenue, clearly, that would be overspending, but we're very confident that we can drive new revenue around the action genre and continuing live service build-out across all of our products.



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**Operator**

Your next question comes from the line of Mike Hickey with Benchmark Company.

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**Michael Joseph Hickey** - *The Benchmark Company, LLC, Research Division - Research Analyst*

Just a quick one, I guess, on Battlefield II. Obviously, you guys have done a lot of work with the first version. I think, Andrew, you said that for the YouTube videos your views was up over the original, but do you have any specific data at this point that would suggest that this game could outsell Battlefield I? And then just to confirm, I think you have said before you're looking for 14 million units within your guidance. I don't know if that's correct or not. Any thoughts there would be helpful.

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**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Mike, just -- I'll let Andrew answer, but you broke in and out a little bit on the last. I think were you saying, are you changing your 14 million unit number for guidance? Is that what you asked?

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**Michael Joseph Hickey** - *The Benchmark Company, LLC, Research Division - Research Analyst*

No, I wasn't getting there yet. I may have gotten there, but I just wanted to clarify that was the number, Blake?

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**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Yes, that was and still is the number, but I'll let Andrew talk a little bit about the demand generation and how the product is shaping up.

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

Yes, thanks, Mike. If anyone got to see the title in and around EA PLAY or at E3 in Sony's booth, the title is coming together really, really strong. The sentiment is really strong. The single-player campaign is resonating really, really well with the community as well as the depth and breadth expansion in multiplayer. The video views are up significantly, as I talked about in the prepared notes. We have not changed our unit expectation on that at this point, but we're very, very happy with the progress in the game and very energized by the positive feedback we're receiving from the community.

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**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Yes, and Disney has been a great partner for us. They had our lead protagonist on the stage with characters from the Star Wars movie at their D23 celebration last month. And we're very excited about continuing to leverage the upcoming movie as well as the buzz that's generated around Star Wars. And so more to come. I think we're trying to be careful that we don't get ahead of ourselves on unit forecast. And as I said earlier, it's still really early in the year so.

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**Michael Joseph Hickey** - *The Benchmark Company, LLC, Research Division - Research Analyst*

That's fair enough. Just one quick one, another one for me. I was hopeful that you could sort of walk us through the competitive setup. This holiday, obviously, not a holiday release, but Destiny is coming out fairly soon in September. And then you have Call of Duty that's sort of a boots on the ground similar to play experience you had with Battlefield 1. I have Battlegrounds on Xbox, which obviously is catching a lot of buzz and all those boots on the ground. So just curious how you think all these 4 titles will play out and maybe the opportunity or threat they could create for you.



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**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Well, you have Assassin's as well, don't you just throw more fuel on your fire. I guess the difference is, we've got boots in space versus boots on the ground. So what we found historically, we've had many times where we've gone into quarters that are -- look daunting because of the competition. Think back to GTA when it came out. And what we've actually found is it grows the overall market. It drives console sales. Oftentimes, many of those titles get bundled to help drive or reduce the price of a console for the consumer and it drives excitement in the marketplace. And we like that. It benefits the consumer and it benefits us because it generates a lot of buzz around games. We've always competed against most of those titles you mentioned or all those titles you mentioned. And so I don't think it bothers us, but it excites us, I'd say, instead. And remember, no Red Dead that was originally in the plans for the fourth -- or the third -- our third quarter, fourth quarter in the calendar year. So that does open up a little bit of opportunity, I think, for everybody.

**Operator**

Your next question comes from the line of Laura Martin with Needham.

**Laura Anne Martin** - *Needham & Company, LLC, Research Division - Senior Analyst*

So I guess I have 3 like little ones. So I'm wondering if you've seen player engagement fall on Madden as a reflection of the weakness in NFL TV ratings or have you seen those things be disconnected? That's my first one. My second one is, so philosophically, marketing, I would have guessed that marketing expense in your mind was more of a substitute for your license fees because to your point, you do have soccer starting or football starting or you're going to have Star Wars released. To me, those feel like marketing, I don't know, marketing turnaround that should cut your marketing fees -- expenses. So I'm wondering how you think about license fees as a substitute for marketing or do you not think of it that way. And then I'd love your update on VR/AR and where do you think its place is in future games.

**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Why don't I have Andrew hit the first and the last question on VR and then the first question on the NFL.

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

So I'll start with VR and AR. Not a lot of new news on VR for us. And as you said, there's not a lot of new news for VR in the industry. People seem to have come to terms with the fact that VR, while an unbelievably wonderful innovation for how you consume interactive entertainment and all forms of entertainment for that matter, is going to take a couple of years at least to kind of get to a point where it is truly a mass-market consumer opportunity. We still are in the same position we were in which we have enabled core VR capability in our Frostbite engine. We have delivered a console experience, in the process of delivering a mobile experience. And we'll continue to push on the boundaries of, what's a sports game look like inside of VR, what's a first-person shooter look like in VR, what's an action-adventure game look like in VR. And that's really at a design level and something that will start to manifest in the marketplace in the years to come. AR, I think, is more interesting. I think the notion of a data overlay into your mobile, console, PC games, something that takes things that are important and interesting about you, whether that's geo data or whether that's gameplay data or friends data that you are able to allow the game to utilize to enhance and extend your experience. I think we're likely to see more of that sooner. And certainly, our creative teams are really thinking about what kind of data would a player want to use from their real-world to augment their virtual. And you should expect to see more of that from us also in the coming months and years. As it relates to Madden, again, what you might also recall as well, there was a lot of articles in the early part of the season around slower TV ratings around football. Post-November, the ratings were actually very strong and ultimately end up with one of the most exciting Super Bowls in recent history. And again, Tom Brady, who was the chief architect of that excitement, is on the cover of our Madden game this year. So we're very happy to have him. In terms of engagement for us, what we actually saw was more engagement in our Madden game and more engagement in Madden Ultimate Team. And so we feel very good about that. We believe we are introducing, engaging and onboarding a new and young audience to football fandom and are



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excited by what we're going to do this year with Madden on Frostbite, with Longshot and the many developments and innovations that come with it.

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**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

On the marketing question. We do try to offset our marketing expenses where we have royalties. So in our sports titles where we're paying a royalty, we try to leverage our partners, like FIFA or the NBA or the NFL to help us market as much as possible. And in some cases, we do a good job with that offset. In some cases, it's not fully offset. I'd say the thing to remember is, in Q2, we've got FIFA, Madden, NBA, NHL and The Sims 4 all coming out on console, plus we've got -- we continue to fuel all of our mobile titles during that same time frame and PC free-to-play titles. And so just simple alone, we didn't have NBA last year, we didn't have The Sims last year, so the both of those are going to be additive to the marketing expense in the quarter. But also, as I mentioned earlier, we're doing a lot of long lead time marketing for the third quarter titles like Need for Speed or Battlefield. And despite the partnerships that we have, those still take money to market or to make sure that we're spreading the word around the quality and the excitement of the game. And so the combination of where the titles fall and how the marketing has changed over time is how you're seeing some of the differences in OpEx.

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**Operator**

Your next question comes from the line of Evan Wingren with KeyBanc Capital Markets.

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**Evan Todd Wingren** - *KeyBanc Capital Markets Inc., Research Division - Research Analyst*

You gave the Ultimate Team population was up 11% year-on-year. I wonder if you'd give us an update on the trends in terms of the number of payers and the magnitude of the payers and what the growth rates are as well there.

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**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Yes, I mean, without getting into too much numbers, what I can tell you is, the number of people that buy the game and then join Ultimate Team continues to go up. FIFA is the leader across all of our Ultimate Teams in that respect. And we believe the story mode last year helped drive much of that growth. So more people coming into Ultimate Team from the core game and more people starting to spend money realizing that it is very fun. And if they spend some money, it will even be more fun. And also the amount of dollars they spend are continuing to go up over time. As we add new ways to play and new content to play with, that gives them more things to spend money on over time. So it's a win-win across the board. It's more engagement, more enjoyment and more things to actually spend on, which is driving the success of all of the Ultimate Teams.

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**Evan Todd Wingren** - *KeyBanc Capital Markets Inc., Research Division - Research Analyst*

Got it. And it looks like, if I did my math right, the gross margin expansion in 1Q was around 700 basis points and then in the 2Q the, I guess, sequential improvement in gross margins on a year-over-year basis is down a little bit. Is that just tied to higher royalty costs? Or is there something else going on that would prohibit more margin expansion?

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**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Yes, it's mainly tied to the fact that we have 4 sports titles that all have royalties to them in the quarter. And as those titles continue to be successful, that obviously impacts the gross margin, particularly in the second quarter. We'll get some offset with The Sims, but not enough to offset all of it. We also tend to have a fairly conservative forecast on digital because it's hard for us to guess exactly how fast the consumer will move to digital. So clearly, if more digital live services occur or more full game downloads occur, there could be some upside to that gross margin number.



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**Operator**

And our final question comes from the line of Raymond Stochel with Consumer Edge Research.

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**Raymond Leonard Stochel** - *Consumer Edge Research, LLC - Analyst, Video Game Publishers*

You guys have a big bucket of initiatives in cloud, streaming, AI, virtual human. So which initiative in that bucket would most likely to be financially impactful over the next 3 to 5 years? And then overall, how much are you spending on these initiatives as you are thinking long term about your business?

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

Again, there's a lot of things that we're investing in. And again, what we talked about in the prepared notes is we do believe there's going to be more change in the next 5 years in our industry than there has been the last 45. And we want to ensure that we are on the frontline of that transformation and disruption in our business. As we think about those things, we are very focused in our investment. We don't have hundreds and hundreds of people working on these types of projects. We are very calculated and targeted in how we invest and in terms of where we think the greatest return will come. For many of those things, we actually think the time horizon is about 5 years-plus. But things like cloud and streaming, we believe it's probably in the 2- to 5-year time frame. When we think about subscription, we're already seeing return from that. And the combination of that with streaming on that 2- to 5-year time horizon could be very meaningful in terms of revenue addition for us. And so as we think about the future, we're always going to have small squads thinking about new technology. And we think about it on, what are we building for this fiscal year? What are we building for the next 24 months? What are we building for the next 24 months to 5 years? And how are we thinking about 5 years-plus? And you should expect the 5 years-plus are very, very small, targeted teams. The 2 to 5 years are slightly bigger. And much of our investment is around delivering the next 24 months.

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**Blake J. Jorgensen** - *Electronic Arts Inc. - Executive VP & CFO*

Yes, and I think 2 things to note is, we started investing on the foundation to be able to have a streaming business or a subscription business 3 or 4 years ago. And much of our investment around cloud has gone on over the last couple of years. And we feel like we're in a very good position there. So don't assume it's all going to start some time now. Much of it's already baked in. And the second thing is, part of the change that we've tried to drive at EA is we ask a simple question, if we're going to invest in this, what are we going to stop investing in? We can't do everything. And the organization is very focused around that and very much positive when we ask that question and a way of trying to constantly reprioritize what's the most important thing to do today. And we think that will also help us manage that investment so we don't show up in the future with a big surprise.

With that, we'll end the call. We'll talk to everyone next quarter. Thank you.

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

Thanks so much.

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**Operator**

Thank you for your participation. This does conclude today's conference call, and you may now disconnect.

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