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EA - Q4 2015 Electronic Arts Inc Earnings Call

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OVERVIEW:

Co. reported 4Q15 non-GAAP net revenues of \$896m and non-GAAP diluted EPS of \$0.39. Expects FY16 GAAP net revenues to be \$4.25b and GAAP EPS to be \$1.90. Also expects 1Q16 GAAP revenues to be \$1.14b and GAAP diluted EPS to be \$1.14.



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PRESENTATION

Operator

Welcome, and thank you for standing by. At this time, all participants are in a listen-only mode. (Operator Instructions) Today's conference is being recorded. If you have any objections, please disconnect at this time.

Now I will turn the meeting over to Mr. Chris Evenden, Vice President of Investor Relations. You may begin.

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

Thank you, Jen. Welcome to EA's fiscal 2015 fourth-quarter earnings call. With me on the call today are Andrew Wilson, our CEO; Blake Jorgensen, our CFO. Frank Gibeau, our EVP of Mobile, and Peter Moore, our COO, will be joining us for the Q&A portion of the call.

Please note that our SEC filings and our earnings release are available at IR.EA.com. In addition, we have posted earnings slides to accompany our prepared remarks. After the call, we will post our prepared remarks, an audio replay of this call, and a transcript.

A couple of quick notes on our calendar. The date of our next earnings report will be Thursday, July the 30th, and our E3 press conference is at 1 p.m. Pacific Time on Monday, June the 15th.

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 May the 5th, 2015, and disclaims any duty to update them.

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

Now I'll turn the call over to Andrew.

Andrew Wilson - *Electronic Arts Inc. - CEO*

Thanks, Chris. And thanks, everyone, for joining us today. FY15 was an exceptional year for Electronic Arts. With a clear focus on putting our players first, we delivered new experiences that were award winners, global bestsellers, and breakout hits.

Our live services for franchises like Battlefield, FIFA, Madden NFL and the Sims are thriving. The communities in our mobile titles continue to grow. And through constant dialogue, we are forging deeper relationships with our players. We broadened our portfolio on key platforms, introduced new service models, and delivered quality through stable, scalable and innovative experiences. All of this contributed to outstanding player engagement and EA experiences across console, PC, and mobile in FY15.

Our financial results were consistently strong throughout the year. Revenue and EPS were above our guidance for the full fiscal year, and we have reached an all-time high in operating cash flow. EA today is performing with focus and efficiency, and we're leaning into our strength to deliver great experiences to a growing and diverse audience of players around the world.

Dragon Age: Inquisition and Battlefield Hardline are both terrific examples of the focus we have today. Moving launch dates is never easy, but we are committed to making the hard decisions that will benefit our players. With Dragon Age: Inquisition, those extra few weeks of polish allowed BioWare to deliver a truly epic new experience. Not only did it win dozens of Game of the Year awards, more importantly, our players gave it the highest form of praise with nearly 200 million hours of Dragon Age: Inquisition played live to date.

Our Visceral team opened up to player feedback earlier and more than ever before while developing Battlefield Hardline. And the input from our community was a catalyst for great innovation. With the added development time, Battlefield Hardline delivered a complete package for different types of play -- core strategy-based Battlefield gameplay that our fans love, fast and fun new multiplayer modes like hotwire, as well as a deep story-driven single-player campaign. We are very happy with how well the game has sold to date, and more importantly, that we've brought many new fans into the Battlefield universe.

Meanwhile, EA Sports had one of its best performances ever. Nearly six months after launch, FIFA 15 remains a top five title in the Western world, with more than 18 million matches played on average every day in Q4. Gameplay hours of Madden NFL 15 were up nearly 30% for the quarter over last year, and the hours played in Madden NFL Ultimate Team in the quarter increased a massive 97% year-over-year.

Passionate sports fans are spending more time in our games today and engaging in our Ultimate Team mode to extend the fun long after the season is over. We continue to see major growth in player engagement with our live services and digital offerings across all platforms. Our investment in Battlefield 4 brought greater stability to the experience, and allowed us to apply our learnings to ensure that Battlefield Hardline was stable and scalable at launch and beyond.

We now have two Battlefield experiences with large, highly engaged audiences. And both will receive new expansion packs in the coming months. Other services are showing strong momentum with players as well. Monthly engagement levels on Origin were up significantly over the previous year. And the subscriber base for EA Access continues to grow as we learn more about the innovative new delivery models on console.



For players on smartphones and tablets, we've built a strong foundation of key titles and now we're adding to it. Players are going deeper into SimCity BuildIt, logging more than 2.4 billion game sessions in Q4. And Madden NFL mobile continues to capture more sports gamers, with gameplay up 25% over the previous quarter. But perhaps the greatest example of our core strength in mobile designing experiences that will provide news of entertainment is The Simpsons - Tapped Out.

Nearly three years after launch, The Simpsons - Tapped Out averaged more than 16 million monthly players throughout FY15. We are building some excellent momentum in our mobile business, and we are excited to launch new Minions and Star Wars experiences later this year.

In FY15, we captured hundreds of millions of players with new RPG, sports, shooter, simulation, and casual experiences across console, PC, and mobile devices. Now as we look at the opportunities ahead of us in FY16, we are positioned to build relationships with millions more through entirely new experiences as well as new games in our major franchises.

Just three weeks ago, the world got its latest look at Star Wars Battlefront from our DICE Studio. The reaction has been powerful. Our Star Wars Battlefront trailer has been watched more than 29 million times to date across social platforms.

Brought to life through an unprecedented partnership with Disney and Lucasfilm, Star Wars Battlefront will immerse players into the Star Wars universe like never before. The power of our Frostbite engine technology enables us to deliver intricately detailed visuals and a completely authentic environment for players to live out their Star Wars fantasies.

Anticipation is now building for the launch of Star Wars Battlefront in November, and we are excited to be part of one of the biggest global pop culture events of the year with the return of Star Wars. We look forward to showing more of Star Wars Battlefront to players at E3 in just a few weeks.

In addition to Star Wars Battlefront, we will leverage the breadth of our IP to reach a wider audience of players across multiple genres and platforms in FY16. EA Sports will excite fans throughout the summer and fall with the latest releases of Rory McIlroy PGA TOUR, Madden NFL, FIFA, NHL, and NBA Live, including industry-leading gameplay, compelling new features, and fresh Ultimate Team experiences. FY16 will see the return of Need for Speed, as we introduce a new console experience as well as a new mobile game.

Maxis will continue to deliver great new content for the Sims 4, including another expansion pack, multiple game packs, and additional game updates for the growing Sims 4 community. After Plants vs. Zombies Garden Warfare became a sensation last year with console players young and old. We will be returning to the Plants vs. Zombies universe with a bigger and bolder new console experience in FY16 that we'll share more about at E3.

Minions Paradise, our first game with a popular franchising partnership with Illumination Entertainment, will be one of at least five new EA mobile titles this year. In spring 2016, Mirror's Edge is set to revolutionize the action-adventure genre with its stunning first-person gameplay. And, of course, we'll continue to bring new content to our communities in Battlefield Hardline, Battlefield 4, Dragon Age: Inquisition, Star Wars The Old Republic, our EA sports titles, and EA mobile games.

Our live services will continue to keep these experiences fresh and fun for players throughout the year. Across the world today, more people are playing games and spend more time playing games than ever before. The audience is wider and more diverse than we have ever known. Games are truly becoming the best form of entertainment, and EA is well-positioned to benefit.

Building relationships with new players and strengthening existing ones through meaningful engagement is at the core of our objectives as a company. We are continuing to invest in our digital platform, infrastructure, security, live service systems, and community engagement teams to scale the needs of a growing global player base that hold games as a vital and intrinsic part of their lives.

FY15 was a transformative year for EA, as we put our players first, delivered amazing high-quality games and services, and drove greater speed and efficiency into our business. I'll now turn the call over to Blake for a deeper look at our Q4 financial performance and a view into the year ahead.



Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

Thanks, Andrew. As Andrew mentioned, we had another great quarter and a phenomenal 12 months. Before going into details, I'd like to step back and consider the journey we've been on for the last couple of years.

When we first started talking about improving the performance of Electronic Arts, I suggested it would take three years to double our non-GAAP operating margins from 10% to 20%. We've exceeded that in two years. In fact, at nearly 25%, our fiscal 2015 operating margin is over 500 basis points above our guidance at the beginning of the year, and at its highest point in over a decade.

We've dramatically increased our efficiency. Non-GAAP operating expenses are down a full 10 percentage points from 56% of net revenue in fiscal 2013 to just 46% in fiscal 2015. And we've done so without adversely impacting our revenue or the effectiveness of our R&D or marketing. This year, we delivered the best Dragon Age of all time, grew our sports franchises, expanded a core franchise with Battlefield Hardline, and announced new IP, including Star Wars Battlefront.

In addition, we've continued to grow our digital live services and leveraged our IP portfolio to establish a strong position on mobile platforms. Our core product catalog and digital live services are helping the Company deliver more consistent, repeatable revenue and cash flow each year. These improvements have more than quadrupled our free cash flow over the same period from \$218 million in fiscal 2013 to \$972 million in fiscal 2015, and driven a three-fold increase in non-GAAP diluted EPS from \$0.84 a share to \$2.51 a share.

But there's plenty of road at left to travel on our journey to build both great games and shareholder value. Most significantly, the digital transformation sweeping the whole industry is still in its infancy. This transformation presents opportunity to continue to grow margins by increasing the proportion of full game downloads by providing extra content for games and by taking our IP to mobile platforms.

Downloads of our games for current generation consoles continue to increase. Meanwhile, our extra content and subscription strategy generated \$1.3 billion in net revenue in fiscal 2015 and continues to grow strongly.

Finally, our mobile business at \$524 million is now the third largest in Western markets and the eighth largest worldwide. And we anticipate continued healthy growth going forward. As well as driving gross margin improvement, we continue to look for opportunities to better leverage our investments.

For example, our digital platform strategy will help us better understand and engage with gamers for more efficiently -- efficiency. And standardizing on one game engine across studios amortizes core technology development across all our titles and accelerates our innovation. Bottom line, we believe we can continue to grow non-GAAP EPS into the future.

Moving to the fourth-quarter results, EA's non-GAAP net revenue was \$896 million, which was \$66 million above our guidance and \$18 million below last year. The quarter's outperformance was driven by sales of Battlefield Hardline and the ongoing strength of our catalog titles. In addition, our mobile business continued to grow, led by SimCity BuildIt, Madden NFL mobile, the Sims FreePlay and The Simpsons - Tapped Out.

One note -- because FIFA Online 3 was launched in China in April, we did not recognize any revenue in Q4. We expect to start recognizing revenue for this service in Q1 fiscal 2016.

EA's Q4 non-GAAP digital net revenue was \$602 million. This resulted in a fiscal-year digital revenue of more than \$2.2 billion, about 52% of total revenue.

Breaking down Q4 digital revenue into its key components highlights the performance of each business. First, extra content and PC free-to-play contributed \$247 million, up 2% over the prior year. The growth of extra content slowed this quarter due to FX headwinds resulting from the fact that most of the FIFA Ultimate Team business is in Europe, and from changes we made to reduce illegitimate coin selling in FIFA Ultimate Team.

Nevertheless, for the year, FIFA Ultimate Team expanded over 40%, and Madden NFL Ultimate Team more than doubled. Overall, Ultimate Team grew 53% on top of the prior year's 62% growth.

We took steps during the quarter to reduce the trading of illegitimate FIFA Ultimate Team coins, which had distorted the economy and made it difficult for many players to build the team they wanted. We've made changes to limit the game exploits and automated processes that used to generate those coins, and taken steps to rebalance the game economy. However, some risks remain and we've factored those into our Q1 and full-year guidance.

Second, our mobile business generated \$150 million for the quarter, up 22% over prior-year. Premium mobile only accounted for \$9 million of the mobile revenue this quarter. Excluding premium, our ongoing mobile business grew 38% year-on-year.

Third, full game downloads added \$114 million to the quarter, flat year-on-year, with strong sales of Battlefield Hardline, Dragon Age: Inquisition, and the Sims 4 offsetting the falloff in Battlefield 4 and Titanfall sales. Our Origin service for PC gamers increased its monthly player engagement levels by two-thirds over the previous year, and continues to strongly grow revenues and users.

And finally, subscriptions, advertising and other digital revenue totaled \$91 million, up \$22 million or 32% over the same period last year, driven largely by Battlefield 4 Premium. EA Access again outperformed, and we expect its contribution to accelerate this year, as we start to promote the service with Microsoft and continue to add titles to the EA Access vault.

Moving on to gross margin, our non-GAAP gross margin for the quarter was 75.4%, 140 basis points above our guidance, due to the strength of Battlefield Hardline. It was down from 77.4% in Q4 fiscal 2014, primarily due to the strength of our sports titles.

Operating expenses for the quarter were \$513 million, up \$10 million from last year, and \$2 million lower than our guidance. The year-on-year increase is primarily due to marketing expenses for Battlefield Hardline. The resulting non-GAAP diluted EPS for the quarter was \$0.39 per share, \$0.17 above our guidance.

Net cash provided by operating activities for the quarter was \$198 million compared to \$281 million in the prior year, primarily due to the timing of titles. Operating cash flow for the full fiscal year hit its highest level in Company history at \$1.07 billion, a very significant increase over last year's cash flow of \$712 million, and above our twice-revised guidance.

Fiscal year 2015 capital expenditures were \$95 million, resulting in a free cash flow of \$972 million. Our cash and short-term investments at the end of the quarter were \$3.02 billion or \$9.75 per share. Approximately 62% of this was held in the US. During the quarter, we repurchased 1.8 million shares of common stock at an average price of \$53.44 per share.

We far surpassed our expectations for the full fiscal year. On a non-GAAP basis, we exceeded our original revenue guidance by \$219 million, gross margin by 250 basis points, operating cash flow by \$267 million, and EPS by \$0.66 a share. The new EA is delivering more consistent revenue, increasing the proportion of high-margin digital revenue, and growing operating margins, earnings, and cash flow.

This has given the Board confidence to authorize a new \$1 billion stock repurchase program. This new program has a two-year timeframe and replaces the remaining \$356 million portion of our previous \$750 million buyback program. It represents an expected return to shareholders of approximately 50% of forecasted free cash flow.

Onto fiscal 2016 guidance. With regards to the market, we expect the console transition to continue at a rapid pace and another 22 million units to be sold this calendar year, adding to the 27 million units in place at the end of calendar 2014. This is a much faster growth than in previous generations. Illustrating how far the transition has already come, approximately four out of every five copies of Battlefield Hardline sold for consoles that were either Xbox One or PlayStation 4.

In addition to the console growth, we are expecting our mobile franchise to benefit from the continued expansion of iOS and Android. We are anticipating the installed base to grow by over 600 million to nearly 3 billion devices by the end of calendar 2015.



On a constant currency basis, we expect non-GAAP revenue to increase approximately 8% to \$4.65 billion. The anticipated strength is broad-based and driven by the launch of Star Wars Battlefront, the continued growth of our core sports titles and associated live services, the expansion of our mobile business, and the addition of Need for Speed, Mirror's Edge, and Plants vs. Zombies titles, as well as some other unannounced games.

We expect foreign exchange rates will have an impact on our forecasted results. At our FY16 guided exchange rates, we anticipate an FX headwind of approximately \$250 million, leading to our expectation for non-GAAP revenue of \$4.4 billion. Volatility in exchange rates during the year may cause us to reconsider these assumptions and we'll update you on a quarterly basis.

Non-GAAP gross margin is expected to rise about 50 basis points to 71.5%, driven by the increase in digital revenue. This forecast reflects gross margin pressure for product mix, since one of our major launches this year is Star Wars Battlefront, a royalty-bearing title. As a reminder, the major nonsports titles last year were Battlefield Hardline, Dragon Age: Inquisition, and the Sims 4, all of which are wholly-owned IP.

Although the dollar's rise had a negative impact on revenue, it has a positive impact on expenses, since about 46% of our R&D expense is outside the US. This natural hedge is worth approximately \$100 million in FY16 and offsets the increased investment we are planning for new IP and our digital platform. As a result, we expect non-GAAP operating expenses of \$1.98 billion, marginally down compared to fiscal 2015.

This would deliver an operating margin of approximately 26.5% and non-GAAP EPS of \$2.75, up 10% year-on-year. This includes an adverse impact of \$0.21 from FX and a benefit of \$0.11 due to a change in tax rate. The strong growth of our business outside of the United States is having a long-term benefit to our corporate tax rate such that we now view our long-term non-GAAP tax rate to be 22% instead of 25%. Our non-GAAP EPS guidance does not factor in any share repurchases that may take place during the year.

The earnings presentation on our Investor website contains more information about our exchange rate assumptions for the year. On a GAAP basis, guidance is for net revenue of \$4.25 billion, gross margin of 69.4%, and EPS of \$1.90. Segmenting the sales provides further insights into our key drivers of our full-year non-GAAP revenue guidance. As a note, all of these revenue numbers assumed guidance exchange rates.

Packaged goods and other revenue was forecasted to be approximately \$1.85 billion, down 11%, driven by the continued shift to digital delivery. Digital revenue was forecasted to be nearly \$2.55 billion, up 14%.

Breaking down our digital revenue into its four primary categories, we see the contributions from each group. Our mobile business is expected to grow approximately 25%, as we broaden our revenue base through the launch of more free-to-download games based on our own IP, such as Need for Speed, and licensed IPs such as Star Wars and Minions, while continue to generate income from existing titles.

In addition, the headwind remaining from the winding down of our premium mobile business is now very small. Revenue from full game downloads is anticipated to grow in line with last year's growth. Full game downloads on a current generation -- on current generation consoles are now over 20% for a newly launched game. And we are seeing higher percentages for our catalog titles.

As a reminder, we count bundled games as physical sales, regardless of whether it's a disk or a downloaded code in a box with the console. We've seen a dramatic increase in PC downloads since 2010, and we believe the same forces that drove this on PC are at play in the latest generation of consoles.

Extra content and free-to-download is expected to grow approximately 10% this year, driven by FIFA Online 3 and Ultimate Team. Our strongest market for Ultimate Team are overseas, so this forecast bakes in a significant FX headwind, as well as the changes we've made to improve the FIFA Ultimate Team experience.

Lastly, subscription revenue is expected to decline approximately 15% to 20% this year, driven by a fall-off in Battlefield 4 premium revenue, partially offset by the growth in EA Access, and by Battlefield Hardline premium revenue. GAAP operating expenses for the fiscal year are expected to be around \$2.17 billion.



Finally, cash flow will continue to be a key metric for us going forward. In fiscal 2016, we are forecasting operating cash flow of approximately \$1.15 billion, and capital expenses to be approximately \$100 million, resulting in a free cash flow of \$1.05 billion versus \$972 million in fiscal 2015.

Focusing on Q1, our Q1 is seasonally the quietest of our fiscal year. And although we have no major launches this quarter, we do anticipate strong catalog sales, particularly of FIFA 15 and Battlefield Hardline, which launched at the very end of Q4. GAAP revenue is expected to be \$1.14 billion as compared to \$1.2 billion in the prior year. GAAP diluted EPS is expected to be \$1.14 as compared to \$1.04 per share in the prior year.

Non-GAAP revenue for the quarter is expected to be \$640 million, a 17% decrease compared to last year's \$775 million. The year-ago quarter benefited from more favorable exchange rates, Titanfall, the launch of 2014 FIFA World Cup and UFC, and from Battlefield 4 catalog. The decline is offset by Battlefield Hardline catalog, but we are not planning any HD launches this quarter.

Our revenue phasing for FY16 is different to the prior year, with a much larger proportion in the back half due to our launch schedule. The expected phasing of our revenue is in the earnings presentation posted to our website.

Non-GAAP gross margin is forecasted to be approximately 74.5%. Non-GAAP operating expenses are expected to be \$475 million, \$16 million higher compared to last year, driven by the extra week in the quarter, offset somewhat by more favorable exchange rates for overseas expenses. For the quarter, we expect non-GAAP diluted EPS to be \$0.00 per share as compared to \$0.19 per share last year.

Looking further into the future, we remain focused on driving our business model and improving profitability. We will continue to leverage one of the core strengths of our business, the recurring revenue generated by our annualized titles, live services, and ongoing mobile businesses. While not guaranteed, this revenue is highly dependable and accounts for 60% to 70% of our total revenue.

For the next few years, we expect further improvements in gross margin on the order of 100 basis points a year through growing our digital business. In addition, we will continue to invest in new and existing IP, and in new technology infrastructure to support our growing live services business. In marketing, we will continue to increase personalization and customization, and leverage our player network to further improve efficiency and impact. These efforts will help us move operating margins from the mid-20s to the high-20s, and continue to grow our earnings and cash flow power.

In conclusion, fiscal 2015, we made some considerable progress on our journey. We were able to massively grow our earnings and cash generation. And we have built a solid and consistent business with a strong operational foundation that enables us to capitalize on the shift to digital content, the console cycle, and the growth in mobile.

Now I'll turn the call back to Andrew.

Andrew Wilson - *Electronic Arts Inc. - CEO*

Thanks, Blake. We are entering a new global age for games with a growing audience that spends more time playing games across more platforms than ever before. New consoles are being adopted faster than the last generation. Mobile continues its global expansion. New delivery and business models are poised to break through on consoles and PC, and there's huge innovation happening in game experiences across every platform.

Players are at the center of this new era. And our focus is on building long-lasting relationships. As humans, we all need entertainment. For our players, we're delivering the best form of entertainment through amazing new games, dynamic and enduring live services, vibrant communities and meaningful dialogue. We are enabling their passion for inspiration, immersion, competition, social connection, and fun. The passion we have for that opportunity to lead this new age of gaming built around our global audience of players is what will drive us in fiscal year 2016 and beyond.

With that, Blake, Peter, Frank, and I are here for your questions.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Colin Sebastian, Robert Baird.

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

Congrats to each of you. I guess first off maybe for Blake, with all the progress and the success to date on managing expenses, I can only imagine that there's some pressure to invest more, given all the growth opportunity. Can you talk a little bit about the ability to keep expenses roughly flat, adjusting for the FX impact? And if that's a realistic expectation in future years?

And then, secondly, maybe Peter can add some color on the specific impact you are seeing on Ultimate Team from the FIFA -- on FIFA with the pricing changes and the transfer market restriction.

Blake Jorgensen - Electronic Arts Inc. - EVP and CFO

Yes. So, thanks, Colin. The first question on our guidance for our OpEx, we are actually saying, as we said in the script, roughly \$100 million of investments that we are making. It's flat because of the -- obviously the FX impact on our international base investments.

I think we're making substantial investments in new IP, in mobile IP, in our game engine, to drive to continue to expand Frostbite across multiple products and in our underlying infrastructure. We're continuing to focus on making marketing more efficient and effective by leveraging our digital connection with our consumers. And that will benefit us in our marketing expenses, but I guarantee we'll continue to support our brands in a fairly healthy way. I think we're making the right investments going forward, and it will continue to help drive the top line of the business and the effectiveness of our products.

Peter Moore - Electronic Arts Inc. - COO

Yes, Colin, it's Peter. And just on Ultimate Team, as Blake said in his commentary, FIFA Ultimate Team expanded 40%, and Madden NFL Ultimate Team more than doubled. So, overall, Ultimate Team grew 53%, and that's on top of the previous year when it grew 62%.

As you know, and you are aware, and you track it, that we did put some measures in place, outlined by both Andrew and Blake, to look at some of the more nefarious actions that were going on. We continue to monitor that, keep a very close eye on what's going on, trying to balance the economy, keep some of the coin sellers out. But we have great optimism that our growth in Ultimate Team will continue going forward in FY16 and beyond.

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

Okay, thanks very much.

Peter Moore - Electronic Arts Inc. - COO

Thanks, Colin.

Chris Evenden - Electronic Arts Inc. - VP of IR

Next question?



Operator

Justin Post, Merrill Lynch.

Justin Post - BofA Merrill Lynch - Analyst

Obviously a lot of anticipation into Star Wars. Can you give us any thoughts on how you've incorporated that into your guidance? How it might affect gross profit? And kind of -- is there going to be a marketing benefit from that title, given all the hype around the movie? Thank you.

Blake Jorgensen - Electronic Arts Inc. - EVP and CFO

Yes, we certainly hope that we can leverage a lot of the hype. We certainly have done that so far. And we've got a great partner in Disney and Lucasfilm on that. They are very excited for our title as well.

You know for us, we are thinking about it with kind of two bookends, right? One book in the historical Battlefront, which did roughly 9 million units. The other bookend is our core first-person shooter franchise of Battlefield, which typically does around 15 million units. So I think in our guidance, we've roughly put in there roughly 9 million to 10 million units for the title, with, we believe, some upside, obviously, if things go well.

It is Gen4 only in PC, and so that needs to get factored into people's thinking. But it is a very exciting title. It will put, as we said, in the script some pressure on gross margin in the quarter. We've been trying to target 100 basis points of gross margin improvement. And this year, we are forecasting roughly 50 basis points. And much of that is due to the fact that there is a royalty on that to Disney. And at a level of 10 million units, that's a fairly large pressure on gross.

So that's -- we are very optimistic and excited about the title. And obviously, the market has been the same way, as the feedback we've seen from, recently, the Disney celebration where we showed the title for the first time. We'll obviously show more at E3, and so, everyone will get a chance to start to appreciate the depth and the excitement around it.

Justin Post - BofA Merrill Lynch - Analyst

Great. Thank you and congrats on the execution last year.

Blake Jorgensen - Electronic Arts Inc. - EVP and CFO

Thanks.

Operator

Stephen Ju, Credit Suisse.

Stephen Ju - Credit Suisse - Analyst

Andrew or Peter, some of your competitors showed off what I thought was a pretty interesting piece of technology which allows streaming of game content from either the smartphone or the tablet onto the TV. So I mean this obviously creates some interesting opportunities for you as a publisher to take stuff off the console.

So, is this an area of focus for you right now? Or should we expect some of your less graphics-intensive titles to ship them currently with the console releases at some point in the future?

And, secondarily, how much data are you collecting from all of your users, just broadly? And where do you think you are in terms of using that data to influence your content development? Thanks.

Andrew Wilson - *Electronic Arts Inc. - CEO*

Okay. I'll take that. Two great questions. One, as it relates to streaming, streaming as a technology is still in its infancy, I would say. Certainly, we have a few incubation efforts going on around the Company to see how best we can benefit from that. But as you think of that, our core objective, which is to build more relationships with more players across more platforms around the world, streaming certainly represents an opportunity for us. Lots of work to go there in order to deliver the kind of experiences we believe our players want to play, but certainly we have efforts going on.

As it relates to data collection, we are collecting -- I heard one stat once that we collect more data on a daily basis than the combined US Library of Congress, which, as you can imagine, is a lot of data. At a more core level, what we are starting to understand better about our players is how engagement works -- how engagement works, where a player engages on more than one platform; how engagement works where a player plays more than one franchise. And the effective engagement over the long-term as it relates to the likelihood that a player will continue and buy the next version of a title, provided we can keep them playing over time.

So, there is a lot in our data right now as it relates to our players. We are using that data, one, to build better games, and two, deliver more enhanced and extended and engaging experiences over time that keep them playing and entertained for longer.

Stephen Ju - *Credit Suisse - Analyst*

Thank you.

Operator

Chris Merwin, Barclays.

Chris Merwin - *Barclays Capital - Analyst*

So just in the context of your guidance for 2016, Blake, I think you talked about 10% growth for the extra content business. And I think a lot of that might've been coming from FIFA online in China.

Can you quantify at all what you are expecting in terms of dollars for FIFA online in China? Or maybe asked another way, do you think this could be bigger than FIFA online in Korea?

And then secondly, on the mobile business, I don't know if you can give out a margin for that business, but are you seeing stability in that margin or even improvement, as you are allowed to more branded IP? I imagine that relative to competitors, you might even have lower sales and marketing costs for mobile, given that you are leveraging branded IP that has a built-in audience, and I imagine would lower the cost of customer acquisition. Thanks.

Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

Yes. So, let me start on FIFA Online 3 China, and then I'll have Frank address the mobile economics.

On FIFA Online 3 China, as we said, we did not recognize any revenue in Q4 for that. We will start recognizing revenue in Q1 this quarter, which will include the revenue that we generated in last year for that title. It will roughly be around \$40 million this quarter.

I think going forward for your models, I'd probably focus on \$10 million to \$15 million a quarter. And as that business grows, we'll keep you updated. We are very optimistic about it. Tencent has been very public around their optimism. But we remind people it's taken us three to four years to grow Korea to where it is today. And Korea is a more affluent market than China right now, and so it's probably going to take some time.

Also, soccer is much more prevalent in Korea than it is in China. But it's growing fast in China, so we hope to follow that. It's a longer story for us, we think, but I think there's a lot of potential and everything is going very well.

Frank, on the mobile?

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

Yes, the questions on mobile, I'll take. When we look at how Electronic Arts is constructing its mobile business, there's a couple of key competitive advantages that we are trying to harness. And the first is we have the broadest and most diverse and powerful portfolio of brands in the business. And that translates into very strong organic acquisition advantages.

So, pound for pound, people have heard of SimCity, the Sims, the products like FIFA, Madden. And organically, they install at very high rates. If you looked at how SimCity did over the break, we were generating tens of millions of installs without really spending any money in paid acquisition.

That's also combined with a really powerful network that we are designing. So it allows us to cross-promote and understand, based on telemetry and data, what our gamers are doing at any given time, and what's the right message at the right time, and what are the right games that we can put in front of them that might interest them?

So the combination of a profound organic acquisition advantage coming from brand power, and a network effect, we believe, will allow us to, from a long-term standpoint, keep marketing and sales as a percentage of revenue very low. Very low certainly relative to other mobile game companies. And as we look to grow the business, we'll continue to harness those advantages.

Chris Merwin - *Barclays Capital - Analyst*

All right, thank you.

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

Next question?

Operator

Arvind Bhatia, Sterne, Agee CRT.

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

Thank you, and I'd like to add my congratulations, guys. A couple of quick ones. Just going back to the FIFA Online 3 China question, we've got the revenue guidance. I would assume that most of that revenue comes in at pretty full margin. Wondering if you could maybe comment on that?



And then you touched on EA access, so wondering if you could maybe elaborate a little bit more how we should think about the adoption rates right now? What are some of the puts and takes there?

And then lastly, Andrew, would love to get your views on the overall market, the console market in particular, over the next couple of years. We see your breakdown of the physical versus digital revenue. Just wondering how you think about the progression over the next couple of years? Thank you.

Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

So, thanks, Arvind. On FIFA Online 3, we don't disclose, obviously, the profitability of the individual lines of business. But what you should assume there is Tencent is essentially delivering the product and doing much of the marketing in the local market. We are doing the product development and helping Tencent on any issues around hosting and delivering the product.

So, we obviously have product development costs. We don't have some of the marketing costs that you'd see in our normal business. So, you should assume that it's good profit margins, but that's about as far as I can go on that.

On the EA Access, we are extremely pleased with the growth of EA Access. As I said on the call, we haven't really started to promote that with Microsoft. We will this summer. We've now added -- we've got 12 titles in the vault. And that's why we feel like it's a great time to start to promote it, because much of the value is around those titles in the vault.

The subscriber base continues to grow. It's still not a meaningful part of our financials, and thus, we're not calling out the actual numbers or the stats. But we will consider that in the future as we see how it grows. But overall, we are very interested in it, and we are learning a great deal from the service around players' interest in subscription models, and where they get the most value out of the service.

I want Andrew catch the last one on consoles.

Andrew Wilson - *Electronic Arts Inc. - CEO*

Yes. Overall, we are very happy with the speed at which this console generation has been taken up by players. You know, as we talked about in our prepared notes, it's much faster than the last generation. And we would expect close to 50 million consoles by the end of the year.

And that's a meaningful installed base for us to build games for. And the level of engagement we are seeing on a per-game basis is also very, very high, with people engaging in the live services that we are building around our games for much, much longer than before.

As we think about retail versus full game downloads, certainly we've seen growth in that area. It varies from geography to platform. But on a Gen4 game like Battlefield Hardline in the West, we are seeing nearly 20% numbers. And we would expect that growth to continue.

We've seen a dramatic increase in PC downloads in 2010. And we believe the same forces that drove this in PC are at play on this latest generation of consoles. And so, as bandwidth increases, lower-cost storage increases, we would expect continued growth in this area.

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

Great.



Andrew Wilson - *Electronic Arts Inc. - CEO*

And, Arvind, we always give this stat on every call -- we're up 51% over the same period in Gen4 versus Gen3. So 17 months since launch, the installed base of Gen4 consoles is now up 51% versus the same period for Gen3.

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

Great. Thanks, Peter. Thank you, guys.

Peter Moore - *Electronic Arts Inc. - COO*

Thank you.

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

Next question?

Operator

Mike Olson, Piper Jaffray.

Mike Olson - *Piper Jaffray - Analyst*

Just a follow-on regarding the full game download. So you mentioned 20% on games like Battlefield. Are you trying to kind of accelerate that as fast as you can because it's better margin? Or are there reasons to kind of take it slowly? I guess, in other words, are there risks to a rapid transition to full game downloads? Are you just putting the pedal down on kind of pushing that as fast as you can?

And then secondly, regarding the pipeline, we noticed Titanfall is not in your announced title slate as of now. Does that mean that it won't ship in fiscal 2016? Or does that mean that it may or may not ship in the year, but would currently be an unannounced title if it were a fiscal 2016 launch?

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

So, first on full game downloads, we are essentially allowing the consumer to vote. We would like the consumer to consume games where they want to consume them. And if that's in full game downloads or if that's through retail, we'll want to be there.

We've got great partners in retail -- GameStop, Target, Walmart Game and others are very powerful and helpful to us. And so we want to make sure we are delivering the experience in the way the consumers would like it.

Obviously, it's better economically for us longer-term to do digital. And we are focused on all the digital content, not just full games. And we see that that's the direction the industry is going. But we are not trying to do something unnatural to push it one way or the other.

In terms of Titanfall, you should assume that that's not in fiscal 2016. It's more likely in fiscal 2017. And the title of that size we'd want to be pretty clear as to when it's falling in the title slate. And so, your assumption should be 2017.

Mike Olson - *Piper Jaffray - Analyst*

All right, thanks a lot.



Operator

Drew Crum, Stifel.

Drew Crum - Stifel Nicolaus - Analyst

So just want to go back to FIFA. You guys talked about a lot of the puts and takes that will contribute to results in fiscal 2016. If you take a step back, you're comping against the World Cup last year. What are your expectations for the franchise maybe on a constant currency basis or a headline number? And then separately, as it relates to Star Wars, you mentioned that you are going to be publishing on Gen4 only. Is that a strategy you intend to employ across other franchises going forward? Thanks.

Blake Jorgensen - Electronic Arts Inc. - EVP and CFO

Yes. So, Drew, on FIFA, well, we expect continued growth in that franchise, obviously, at the size that franchise is now. The law of large numbers makes big growth numbers difficult. But we have continually, year in and year out, been able to grow FIFA by improving the quality of the game, by adding extra additional services around the game like Ultimate Team, and driving it into continued new geographies around the world.

The popularity of football in America continues to grow, and that's been fueling the growth of the product here in the US, even though it's always been very strong internationally. And we think we'll continue to see that. So we are very optimistic about FIFA. And we hope to see that continue to see upside growth, and that's what's built into our forecast.

Your second question was --?

Drew Crum - Stifel Nicolaus - Analyst

So, as far as Star Wars is concerned --

Blake Jorgensen - Electronic Arts Inc. - EVP and CFO

Oh, yes, thanks. So, yes, we will see a slow movement away from Gen3. As a reminder, we've been making Gen2 console games up until the last year or so. For some of our bigger franchises, like our sports franchises, we'll continue to make Gen3. But we're making some decisions on new franchises and titles to focus on Gen4, partially because the power of the platform allows for exceptional gameplay and incredible graphics.

And for something like Star Wars, we wanted to make sure that we provided the highest level of quality for the game experience. And you can do that only on Gen4 PC.

Drew Crum - Stifel Nicolaus - Analyst

Okay, thanks, guys.

Operator

Ben Schachter, Macquarie.

Ben Schachter - *Macquarie Research - Analyst*

Hey, guys, congratulations again on the execution. A few questions for you. First, some very large companies seem to be focusing more and more on virtual reality. Can you talk a little bit about how EA is working in that space? And are there any meaningful investments there yet? Or is it just still too early?

And then, if you could also just describe how FIFA is actually monetized in China? And remind us how the revenue recognition works?

And then, finally Blake, I think you said the new \$1 billion buyback anticipates returning about 50% of free cash. And then you guided FY16 to \$1 billion. So does that mean that FY17 free cash should be flat with 2016? Thanks.

Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

Oh, Ben, I love how you do your math. I was not implying at all that 2017 free cash flow was going to be down. Simply trying to help people understand how we are thinking about return of capital.

The goal would be if we were to continue to be able to increase cash flow over time, we would continue to increase our buybacks over time. And we are thinking about that as sort of a two-year program. And you can see we started a two-year program a year ago, and we replaced that with a new two-year program this year.

I'm not predicting what that's going to be for the future, but think about it more like a progression over time versus any guidance around fiscal 2017. I'm very optimistic about 2016 and 2017. So that's that piece.

The FIFA Online 3 is it's a free-to-play PC game, which means much like in Ultimate Team, you monetize based on collecting and trading players, and playing with those players. You don't have to monetize. You can play the game for free. But like all free-to-play games, to build a better team, to get further ahead in the game, to win against your friends, you will possibly monetize to build that team. The revenue recognition issue was simply a one-time issue for us.

And that was, we were waiting for the formal rollout of the game in China with our partner Tencent. And that occurred in early April. And thus, the ability to start to recognize revenue. We did not want to recognize revenue until the game was fully functional, fully rolled out, moved from soft beta to hard beta to full rollout, and had all of the features available for gameplay. And that's why we now start to recognize. But we shouldn't have a recognition issue going forward on that.

Ben Schachter - *Macquarie Research - Analyst*

I'm sorry, I meant recognition. If a player spends a dollar in China, are you booking only the piece that you're getting from Tencent? Or are you booking the full dollar?

Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

Yes, good question. Yes, we are. Much like we do with mobile, we only book net.

Andrew Wilson - *Electronic Arts Inc. - CEO*

On virtual reality, again I would say that this is a technology that has the potential for family impact our industry over time. I think the notion of immersion as a key motivation that our players are looking to fulfill when they play our games is something that could certainly be well fulfilled through the notion of virtual reality technology.

As a company with creativity and innovation as one of its core pillars, it's very important that we stay ahead of this. And, as a result, we have some clear and focused investments in the space. As you all know, if you follow this, there's a number of different potential providers and manifestations of virtual reality right now that go everywhere, from wearing a pair of goggles to a holographic type experience, or to a room overall that you step into.

We are looking at any and all of these things, and have a few kind of incubation efforts going on around the Company. So that as this begins to manifest itself, we are, as a creative and innovative company, able to lead from the front.

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

Next questions?

Operator

Mike Hickey, The Benchmark Company.

Mike Hickey - *The Benchmark Company - Analyst*

Hey, guys, congrats on a great quarter and year. Enjoy it. You guys have definitely deserved it here. A couple of questions. I was kind of curious on your capital allocation strategy as it relates to share repurchases, and intensifying your effort there when your Company's valuation is near all-time high versus potentially accretive M&A opportunities, particularly as you begin to increase investment in new IP, as you outlined today. And I have a follow-up.

Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

Yes. So, we look at a couple of components when we think about return of capital to shareholders. We first and foremost believe that that's a critical goal of the Company is to continue to return capital to shareholders.

We balance that with two things. One, our need for capital internally; and two, our onshore versus offshore balance of capital. Right now we have about 60% of our capital onshore. Our need for capital in terms of CapEx is roughly \$100 million a year, as we've talked to. We have obviously our outstanding convert that we will either refinance or pay off over time that's due next summer.

And we believe even after that, we have plenty of capital to respond to any opportunities that come our way, either on acquisitions or internal investment. We've got substantial debt capacity based on our performance, and substantial onshore cash to be able to address -- or offshore cash for international acquisitions, to be able to address anything that comes along.

But we are really focused on driving the business out of our existing IP or licensed IP. We see a huge future for the Company with what we have today. And we feel like we want to make sure we are focused on that first and foremost before we run and chase other acquisitions. Doesn't mean we wouldn't do something, but we are very focused on the opportunities that we have today.

Mike Hickey - *The Benchmark Company - Analyst*

All right. Fair enough, Blake. Thank you. Last question. You had a few game delays last year and obviously that happens. And ultimately, you seem to have crafted an advantage from the delay of providing a higher quality product.

But curious on Star Wars, how confident you feel today on the development of this game? And the anticipated quality is sort of pacing within that desired launch window. We've seen that the timing of this drop is perhaps more important, given the launch of the movie in December, and as

you noted, related marketing benefit, hopefully, from that. I'm also curious if you plan to have a beta or early release within your EA access program? Thanks, guys.

Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

So I'll let Andrew touch on the Star Wars question.

Andrew Wilson - *Electronic Arts Inc. - CEO*

So again, as someone who grew up making games in this Company, making games is hard, building fun is hard, and getting that right on a day is even harder. And what you saw over the past year was our commitment to players and building great properties, and the willingness to make hard decisions around that.

With that said, there are any number of things that might contribute to a miss or a need to move a date. As it relates to Star Wars Battlefront, I would say, as it stands right now, we feel very, very good about the trajectory and the velocity of the development team. They are building on platforms now that have been in the marketplace for a number of years.

They are building on the core engine that has launched a number of products, including Battlefield 4, Battlefield Hardline, Dragon Age: Inquisition, all of which have been great properties. And their tried and tested development team have a very, very clear focus and understanding of the type of game they are making.

The game is fully playable. We released a gameplay trailer a couple of weeks ago at Celebration, but some of the inside community also got to see a fairly lengthy full gameplay demo, which is very, very exciting. And we look forward to showing more of that at E3. But as it stands right now, we feel good about the trajectory and the velocity, and our ability to ship that game at the appropriate time this year.

Mike Hickey - *The Benchmark Company - Analyst*

Thanks, guys. Best of luck.

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

Thank you. Next question?

Operator

Sean McGowan, Needham.

Sean McGowan - *Needham & Company - Analyst*

Just wanted to circle back on a couple of things mentioned before for clarification. When you were talking about the estimated unit sales of Star Wars, I think you said 9 to 10. Are you talking about in the fiscal year or over the life of the product?

Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

In the fiscal year and our guidance.

Sean McGowan - *Needham & Company - Analyst*

Thanks. And I don't know if this would be for Peter or Andrew or Blake, anybody. When you said you count a bundle as a physical sale and you are still getting 20% full game downloads, what would that number look like if you counted that as a digital sale?

Peter Moore - *Electronic Arts Inc. - COO*

Sean, it's Peter. That varies from quarter-to-quarter, year-to-year depending on the bundles. But I want to make it very clear that whether it's a code or a physical disk that goes into a bundle that is primarily put together by our first party platform partners, that is physical media to us. And that's how it's accounted for.

Our full game downloads that you are seeing, they do vary from title and by geography, but the latest data we've got shows us at 20%-plus for Battlefield Hardline. And that's up from about 13% to 15% this time last year for our AAA title releases. So we are seeing the growth. And as Andrew said, if we stay on a path that's analogous to PC, that will continue to grow over the coming fiscal years.

Sean McGowan - *Needham & Company - Analyst*

Okay, thanks. And then my last question was on the -- any variability around the June quarter? Considering that there are no major launches, it seems like this might be a quarter where there's not a lot of variance off of your -- off of the guidance. Is that a fair way to look at it?

Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

I'll let you guys look at history and decide that.

Sean McGowan - *Needham & Company - Analyst*

(laughter) Okay. Got to try. Thanks.

Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

We try our best, guys, to give the best guidance as we can at the moment that we are giving it. So, one last question.

Operator

Our last question comes from Brian Pitz of Jefferies. Go ahead, sir. Your line is open.

Brian Pitz - *Jefferies LLC - Analyst*

Thanks for the question. Just a quick Star Wars follow-on. Just curious how DICE is really prepping to ensure the smooth launch of Battlefront, including not only gameplay but also things like connectivity and even various types of IP protection that might be in the works? Basically, are there any out-of-the-ordinary aspects of the game that could cause an unforeseen delay? I know someone else was asking about a delayed timeframe. Just any additional color on out-of-the-ordinary stuff would be great. Thanks.

Andrew Wilson - *Electronic Arts Inc. - CEO*

I don't think there's anything out of the ordinary. I think we treat every game launch with security, stability and scalability of paramount importance. Certainly, as we talked about in the prepared comments, we learned a lot coming out of Battlefield 4. We've launched a number of very, very large-scale titles on our infrastructure since then, and have performed very, very well by market standards.

Dragon Age: Inquisition launched; Battlefield Hardline launched. You know, so we've been making significant investments into our core infrastructure around security, stability and scalability. Game teams have been making significant investments in terms of development process and QA around that. So, while we can never foresee everything, we have demonstrated now that we've learned from some of the things that we've gone through over the past. And we don't expect anything unforeseen or different with respect to Star Wars than we have around our other joint titles.

Brian Pitz - *Jefferies LLC - Analyst*

Yes. And the reason I ask is just going back to Spore with the DRM limitations back in the past, that kind of backfired. With a bigger IP title like this, that's the only reason I'm asking.

Andrew Wilson - *Electronic Arts Inc. - CEO*

No, it's a good question. But we don't see anything at this time.

Brian Pitz - *Jefferies LLC - Analyst*

Thanks.

Blake Jorgensen - *Electronic Arts Inc. - EVP and CFO*

Great. Thank you, everyone.

Andrew Wilson - *Electronic Arts Inc. - CEO*

Thank you.

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

Thanks, everyone.

Operator

And this concludes today's conference. Thank you for your participation. You may now disconnect.



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