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EA - Q2 2018 Electronic Arts Inc Earnings Call

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OVERVIEW:

EA reported 2Q18 net revenues of \$959m and loss per share of \$0.07. Expects FY18 revenues to be \$5.075b and EPS to be \$3.63. Expects 3Q18 net revenues to be \$1.135b and loss per share to be \$0.21.



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CORPORATE PARTICIPANTS

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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 Second Quarter 2018 Earnings Call. (Operator Instructions)

Thank you. Mr. Chris Evenden, Vice President of Investor Relations, you may begin your conference.

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

Thank you, Jennifer. Welcome to EA's Second 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. In addition, we have posted earnings slides to accompany our prepared remarks. Lastly, after the call, we will post our prepared remarks, an audio replay of the call, our financial model and a transcript.

With regard to our calendar. Blake will be speaking at the UBS conference in San Francisco on Monday, November 13; the Credit Suisse conference in Scottsdale on Tuesday, November 28; and the NASDAQ conference in London on Tuesday, December 5. Our Q3 fiscal '18 earnings call is scheduled for Thursday, January 25, 2018.

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 today, October 31, 2017, and disclaims any duty to update them.



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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.

We have changed the name of our net sales operating metric to net bookings. This came up in a recent discussion with the SEC as part of their ordinary cost periodic review of our filings. We also believe that this change will enable our industry to better align on terminology. We have not changed how it is calculated.

Now I'll turn the call over to Andrew.

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

Thanks, Chris.

It was a strong second quarter for Electronic Arts. Excellent launches for our EA SPORTS titles and growth in our event-driven live services across all major platforms continued our momentum for the fiscal year to date. Revenue and earnings were above our guidance, highlighted by continuing digital growth and strong ongoing execution to deliver for our players around the world. The impact of the digital transformation is accelerating across the interactive entertainment industry. Players today are looking for more choice, more content and more fun in experiences that continually evolve with the way they want to play.

Capturing these opportunities is at the core of EA's strategy: creating extraordinary new games, content and experiences, wrapped in services, access through more platforms and more business models, and powered by innovative technologies. These are the key growth drivers that uniquely position EA to lead this industry.

EA's Q2 results reflected our focus on these growth areas. Our new EA SPORTS titles drove more downloads and deep engagement, our mobile portfolio continues to strengthen and our venture and live services continued to deliver the experiences our players want.

Beginning with EA SPORTS and Madden NFL 18, players are loving the combination of an emotional story mode, greater depth and more competition. We had 25% more players engaged in Madden Ultimate Team through Q2 year-over-year, and our competitive gaming player base has grown by over 30% in the same period. FIFA 18 launched in late September, reaching players across more than 50 countries and igniting the global soccer community.

The depth and precision of the Frostbite-driven gameplay are just the beginning for FIFA 18, with much more to come as programs like Squad Battles, FUT ICONS and Ones To Watch are already driving strong FIFA Ultimate Team engagement.

NBA LIVE 18 was a strong reentry into the market and continues to captivate a growing base of NBA fans. And with NHL 18, the new NHL THREES mode helped us reach an entirely new audience, with 60% more first-time EA players joined through Q2 over the previous game.

This quarter was an outstanding demonstration of the ongoing opportunity for our EA SPORTS franchises to drive growth through expanded reach, new experiences and more competition.

On mobile, our portfolio of deep, high-quality and long-term experiences continues to strengthen in an increasingly competitive market. In Q2, Madden NFL mobile saw unique players grow significantly year-over-year as we kicked off a new season in the game. In-game events in Star Wars: Galaxy of Heroes throughout the quarter continued to drive high levels of engagement across the community. Most of these games charted in the top 10 grossing games on the App Store and Google Play dozens of times throughout the quarter. In addition, FIFA Mobile topped 113 million players life to date, and fans are anticipating our annual update to that game that comes in Q3.

Our communities are expanding, our players are deeply engaged, and our strategy to deliver our portfolio of mobile games that players love to spend time is showing its strength.



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Across our portfolio, event-driven live services are enhancing the experience for players, keeping them together with friends, extending the fun and giving them choice in how they want to play. The global Battlefield community has tens of millions of unique players continuing to connect and play with their friends across different games in the franchise.

In The Sims 4, monthly average players are up more than 40% year-over-year, and anticipation is high for the console game launching in Q3. As these communities and many others in our top franchises continue to thrive, our subscription services like EA Access and Origin Access are bringing more players from across our network to join in.

Our subscription player base continues to grow, and you should expect us to continue driving this model to more platforms going forward.

We are now well positioned for the holiday quarter. We will add momentum with 2 massive new experiences, a new event-driven live service and more competition.

First, is Need for Speed Payback, launching on November 10. An all-new story drives this experience with a narrative, characters and explosive moments that will excite a broad audience of players. Combined with deep customization, a huge open world and a rich multiplayer experience, this is one of the biggest Need for Speed games ever created. Trailer views are up more than 100% over the previous title, and the community is excited to jump into this new Need for Speed.

On November 17, Star Wars Battlefront II will launch worldwide. This is a game that is nearly 3x the size of the previous Battlefront, delivering an untold Star Wars story in our single-player campaign; multiplayer battles; and dozens of ships, settings and heroes from all 3 Star Wars eras. As you will remember, there is no season pass for Star Wars Battlefront II. Instead, our event-driven live service will be free for all players, delivering new environments, new heroes, in-game events and more to everyone in the community. This new ecosystem's post-launch content is built around player choice and designed to keep the community together and extending experience for many years to come.

As we run the live service, we will continually work with our player community to ensure the player experience remains rich and balanced. This began with the beta in early October where millions of players got their first taste of 20 v 20 multiplayer, enabling us to learn a great deal and make some key adjustments to balance and progression. Now our sights are set on launch and delivering a Star Wars game like none other in scale, depth and service to fans around the world.

Competitive gaming will continue to grow in our portfolio in Q3, with more ways to play and watch. As you may have seen, the Madden NFL Club Championship is the first esports competition to feature a full roster of teams and players from a U.S. professional sports league, and tournaments to represent all 32 NFL teams are already underway. We have also launched the Madden Ultimate League for elite players, further expanding the Madden NFL competitive footprint for players, sponsors and broadcasters.

On the FIFA side, we just announced the EA SPORTS FIFA Global Series that kicks off in November, a landmark ecosystem of online tournaments, official league competitions and all-star events on the road to the FIFA eWorld Cup 2018. And this spring, we'll kick off competitions in our third major franchise with Battlefield 1 Incursions, a bespoke competitive gaming environment designed in partnership with our community.

We're excited for the holiday quarter and to continue a strong year of innovation and leadership for our players and for Electronic Arts.

Now I'll hand the call over to Blake.

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

Thanks, Andrew.

We're pleased with the performance of our business through the second quarter, which added strong digital growth to the dependable results we expect from our sports titles. In particular, we saw a notable shift to digital purchases in our sports titles and strong growth in our Ultimate Team of event-driven live services.

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

EA's net revenue was \$959 million compared to \$898 million a year ago and above our guidance by \$4 million. Operating expenses were \$611 million, \$27 million lower than our guidance, driven by the phasing of our marketing investment. GAAP operating loss was \$41 million compared to an operating loss of \$49 million a year ago and resulted in a loss per share of \$0.07, \$0.11 better than our guidance. Note that given our GAAP share results were a loss, our share count was 309 million shares. Had we reported a profit, the diluted share count would have been 312 million shares.

Operating cash flow for the quarter was \$52 million, down \$70 million from last year. The decrease was driven by timing of collections. In contrast, operating cash flow for the trailing 12 months was \$1.082 billion (sic) [\$1.802 billion], our strongest-ever performance measured at the end of the second quarter, and \$479 million above last year's. Capital expenditures for the quarter were \$30 million, resulting in a free cash flow of \$22 million.

Remember that the FASB rules associated regarding the treatment of stock-based comp have changed and this affects how our -- we classify our cash flow. However, all of these comparisons are made on a like-for-like basis. See our earnings slides for further cash flow information.

During the quarter, we also repurchased 1.3 million shares at a cost of \$153 million, leaving \$928 million 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 \$4.4 billion, with 35% of this balance held onshore.

Now I'd like to turn to the key drivers of our business this quarter. Net bookings for the quarter were \$1.179 billion, up \$81 million on the prior year and \$19 million above our guidance. Exchange rates have improved over the last 12 months, but this tailwind is offset by the effect of our hedging program, resulting in a net FX headwind of \$10 million compared with the year ago quarter.

Performance over guidance was primarily driven by our mobile live services, The Sims 4 and by Ultimate Team.

Digital net bookings were \$579 million, up 19% on the year ago period and a new record for the second quarter. The main drivers of the increase were Battlefield 1, Ultimate Team and Madden NFL 18 full game downloads.

Digital net bookings now represent 63% of our business on a trailing 12-month basis compared to 57% in the prior year.

Looking at each of the components of this quarter's digital net bookings in turn. First, live service net bookings were up 22% year-on-year to \$310 million. This increase was driven by strong growth in FIFA and Madden Ultimate Team and in Battlefield 1, FIFA Online 3 in Asia, and The Sims 4. In addition, our EA Access and Origin Access services continue to see rapid growth.

Mobile delivered net bookings of \$150 million, up 9% year-on-year. This was a Q2 record and also drove the trailing 12 months net bookings to a new high. Growth was primarily from Star Wars: Galaxy of Heroes and Madden Mobile.

Full-game PC and console downloads generated net bookings of \$119 million, 28% higher than last year, driven by Madden NFL and Battlefield 1. 36% of our unit sales were digital rather than physical, measured on Xbox One and PlayStation 4 over the last 12 months. This compares to just 30% a year ago. FIFA 18 launched just days before the end of the quarter, but based on the first 3 weeks of sales, it was about 25% digital, up from 16% in the comparable period to FIFA 17. The digital portion of Madden sales also increased 9 percentage points year-on-year to 34%.

Turning to guidance. Our expectations for full year GAAP revenue remains \$5.075 billion. However, we're raising our earnings per share guidance for the full year to \$3.63. We're raising our operating cash flow guidance from \$1.575 billion to \$1.6 billion. We continue to anticipate capital expenditures of around \$120 million, which would deliver free cash flow of about \$1.48 billion. Although our expectations for net revenue are unchanged, we are raising our guidance for net bookings from \$5.1 billion to \$5.15 billion, driven by the strength in Ultimate Team. The difference between GAAP net revenue and net bookings guidance is driven by revenue and deferrals.



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For the third quarter, we expect net revenue of \$1.135 billion, cost of revenue to be \$521 million, and operating expenses to be \$690 million. OpEx is up year-on-year, primarily due to continued investments in existing and new genres and in existing and new live services. This results in a loss per share of \$0.21 for the third quarter. Note that this is calculated using the basic share count of 309 million. Should we report a profit, the diluted share count of 313 million would be used.

We anticipate net bookings for the quarter to be \$2 billion. This is down 3% year-on-year, with growth in live services offset by the effect of different product launches.

Looking further ahead, our growth priorities continue to be the expansion of our live services, including the integration of our esports business across many other titles; the addition of new genres such as action; new business models like our subscription business; and to continue to deliver profitable growth in our mobile business.

The core of our fiscal 2019 is in a full slate of sports titles and their associated live services, plus new live services from Star Wars Battlefront II. We will add the next Battlefield game and move into the action genre with Anthem. We expect our subscriber base to continue to grow and our new mobile titles to benefit from players looking for deeper experiences with higher production values.

As you start to build your fiscal 2019 models, remember that our event-driven live services continue to be the bedrock of our business. Live services, including mobile live services, were nearly 1/2 of our net bookings over the last 12 months. Including our recurring sports titles and catalog sales in the calculation takes us to our total of over 75% of our annual net bookings, leaving less than 1/4 of net bookings delivered to the sale of our remaining frontline titles.

In addition, our live services are growing strongly. We forecast 10% to 15% growth in fiscal 2018, and we're tracking well ahead of that. We're excited by the progress we're making and the impact we'll have on fiscal 2019, particularly given the success we are already seeing in esports driving Ultimate Team revenues and next year's FIFA World Cup in Russia, which is sure to drive interest in soccer around the globe.

In conclusion, our sports titles have once again shown their value in delivering a stable and dependable performance. In addition, this quarter demonstrates how they can also drive the digital transformation within our business, both with regard to downloads and highly enjoyable event-driven live services. As such, they offer a window into how all our games will evolve over the months and years to come.

Now I'll turn the call back to Andrew.

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

Thanks, Blake.

Today, we reach a global connected community of more than 350 million players worldwide. In the future, we envision a global network that engages more than 1 billion people in play. Our part to achieve this is clear: continue to deliver amazing games and content across more platforms; offer dynamic services that enhance the experience; engage a global audience through competition and more content; and drive disruptive new opportunities to expand how the world plays and watches games.

In each of these growth vectors, EA is uniquely positioned with a talented team, creativity and technology to lead our industry. Creating groundbreaking experiences for our players across more platforms and more geographies continues to be at our core. From visually stunning, deeply immersive gameplay Star Wars Battlefield II and our next Battlefield to our ongoing innovation in our EA SPORTS titles, we are advancing the state-of-the-art. We'll continue to expand our mobile portfolio with more high-quality experiences and games that can reach a larger audience of players around the world. We're also producing experiences that will blur the lines of how people play like our shared-world action title Anthem, and our new IP in development at Motive. Through these growing portfolio of games that push the boundaries forward, we are positioned to offer some of the most captivating experiences in all of entertainment.



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Surrounding these games are services that power the choice, connection and community that our players seek. Adventure and live services like Ultimate Team, Star Wars Battlefront II seasons and our EA SPORTS mobile titles continue to enhance and expand our games for many years of play.

Our global communities for The Sims and other franchises thrive on the connections, interactions and creations shared between players. And for players seeking new communities and the next great experience, our subscription services will continue to expand and remove friction in a crowded, digital world.

Competitive gaming and esports then introduce more communities for the world to engage with our games and content. Today, our Madden NFL and FIFA tournaments are elevating competitive sports gaming to the world stage with the energy and drama of high-stakes competition.

Next, official competitions will ignite our Battlefield community. Competitive gaming will integrate into more of our experiences and more of our franchises in the future, continuing our focus to make stars of all our players and expanding our ecosystem of content to engage a massive esports audience.

We're also building for the future, continuing to invest in our technology platform, our Frostbite engine and our Player Network to deliver this growing collection of content, wrapped in services. Our labs and central technology teams are also exploring disruptive new concepts to advance the way we play, including supergames, the notion of a metaverse and how the cloud can deliver dynamic experiences to players on every platform.

At EA, we believe that entertainment is a fundamental human need. We also believe that games, by their ability to drive social connection, self-actualization and competition, are the single best form of entertainment.

With amazing games that reach across more platforms, more geographies and more business models; with live services that provide many years of fun; with competitions that engage a global audience; and disruptive innovations that will continue to evolve the way we play, we believe EA is well positioned to be the entertainment platform of the future.

Now Blake and I will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Chris Merwin with Goldman Sachs.

Christopher David Merwin - Goldman Sachs Group Inc., Research Division - Research Analyst

I just had a couple. So for digital downloads, I think you called out year-on-year changes for FIFA and Madden in excess of 5 points year-on-year, which I think has been the long-term guidance for mix shift and console revenue. Do you feel like we're reaching any sort of inflection in digital downloads? And is 5 points per year still the right way to think about that shift over time? And then just secondly, for Star Wars Battlefront, I was hoping if you could maybe talk a little bit more about how the beta went and what type of feedback you got from the community during that process, and maybe any changes that you've made to the end game modernization mechanics since the beta.

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

Hey, Chris, this is Blake. I'll address the digital download piece, and then I'll have Andrew do the Star Wars piece. We were very pleased and a bit surprised at the strength of digital downloads, both for FIFA and Madden. FIFA, in particular, since it's such a global game and sold in many markets where digital is not as strong as it is in some of the more mature markets. And so it's great to see the movement towards digital. And we attribute

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that to some digital-only promotions that we did, special digital packages as well as the continued involvement of everyone with Ultimate Team, which is 100% digital. And I think that's driving the adoption. Overall, we're continuing to see our -- the 5% number look conservative. It did last year, and it's on track to look conservative again this year. So to us, that signals that we're certainly not slowing in digital, and we might be needing inflection point where our consumers are just starting to pick up that pace. So we're very optimistic about where it's going. You clearly can see that in the gross margin differences as you look at our business year-over-year, and we'll continue to do everything we can to push the digital business.

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

So Star Wars Battlefront II, feedback from the beta and the added assets that we put in the marketplace have been very strong. Feedback on gameplay was very positive, the beta was very robust and probably one of the most stable betas that we've had. And again, the core reason why we put betas into the marketplace is really to test the robustness of the infrastructure and systems on which a game of this size and magnitude will run on. As we've looked at the feedback on the graphical quality, the overall gameplay and the assets around single play that we've launched since then, everything is very, very positive. There was, of course, the conversation around loot boxes which is not a Star Wars Battlefront II-specific conversation, but more one that the industry is having with players across the global community. And we are engaged in that conversation, engaging with our players on a daily basis as we think about that. There's really 2 conversations going on there. One is about value and -- in a world where a player pays \$60 for a game, will there also be value in the ongoing digital ecosystem that comes for many years. When we think about value, we look at Star Wars Battlefront II and we say we start with a game that's nearly 3x the size of the last game, we take what much of the content that would've been gated behind a Season Pass, and we offer that to the community for free. So we feel very good about the overall value proposition focused on keeping the player community together. Then as we think about players that are playing the game for many years post-launch and the digital ecosystem in the event-driven live services that they participate in, it comes down to the second conversation, which is does the digital ecosystem offer the opportunity for an individual player in the community to pay to win. And balance and fairness inside of gameplay is very important to our community, and it's very important to us. And it's kind of a benchmark by which DICE builds games. And we have seen that in the many DICE games -- multi-play games we've built over the years. When we think about this, it really comes down to what are the things that you can earn, what are the things that you can buy, and how do we manage progression through that process? And while we will be making adjustments based on feedback from the beta, which is great, we'll continue a daily dialogue with our players to make ongoing adjustments for many years to come as this event-driven live services continues, we feel very good about the fact that you can earn almost everything in the game. And more importantly, key elements that drive progression can only be earned in the game. But there will be an opportunity for players who come in to also enhance and extend their experience through the ongoing digital economy. And we believe that what we've got with a core base game of 3x the size, what would have previously been gated behind Season Pass is now free for all users, with a focus on keeping the community together, and an event-driven live service that we expect will continue for many years to come that is built around player choice and focuses around a world where players can earn everything they need to progress through the game is the right way to balance this. And so we feel very good about that, and we'll continue to stay connected with our community as we move through the coming weeks, months and years.

Operator

Your next question comes from Brian Nowak with Morgan Stanley.

Brian Thomas Nowak - *Morgan Stanley, Research Division - Research Analyst*

I have 2. Appreciate the commentary around the number of Ultimate Team players in Madden. I was curious to hear about increases in payer penetration across FIFA Ultimate Team and Madden. Kind of what has worked to bring on more players and start paying? And what do you think are the biggest hurdles or points of friction you still need to overcome? And secondly, does any -- any comments or commentary on what went on around Visceral Games and the state of the live-action creation portfolio right now?



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

This is Blake again. I'll start on the Ultimate Team one, and Andrew can address Visceral. Ultimate Team, the #1 driver continues to be bringing more people into the base game. And we believe the single player added to Madden this year as well as the single player last year and this year in FIFA were big drivers in bringing people in, and introducing them to how to play the game as well as how to play Ultimate Team. And we found the flow of people starting to play Ultimate Team has continue to grow, and then people who realize that spending some money in Ultimate Team is actually a lot of fun, and that's continued to grow. And overall, that's been across all of the Ultimate Team sports, but it's been most prevalent in both FIFA and Madden. The other thing to remember is we're getting better and better each year at the live events that we design and run, and those events are more and more fun and bring in more people. And that, plus the fact that we build all of our esports around Ultimate Team has allowed us to continue to drive the business as everyone who's interested in esports, have played in an esports tournament, either online or in person, have to practice as well and build their Ultimate Team for the esports business, and that's what's helped drive it as well.

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

So on Visceral, again, anytime you close a studio, it's a very, very tough decision and something that we take very seriously, and we spend a lot of time working through before we make such a decision. But it does happen from time to time as part of the creative process. And during a development process of the game that they were working on, we've been testing the game constantly with players, listening to the feedback in terms of what and how they wanted to play and really tracking that closely with fundamental shifts in the marketplace. And we are seeing an evolution in the marketplace. And it became clear to us that to deliver the experience that players wanted to come back and enjoy for a long time that we needed to pivot the design. You may have heard the conversation around single player versus multiplayer or single player versus live service, and this wasn't about that conversation. It wasn't about this was just a single-player game or needed to be a live service. It was more about how do we get to a point where the overall gameplay experience was right for players? We still believe strongly in a Star Wars IP. Star Wars Battlefront II, as you will have heard, we're very excited about. We're also very happy with some of the assets and content that was created as part of that game development. And we'll be looking at how we can better utilize that in line with fan and player expectations in the future.

Operator

Your next question comes from Stephen Ju with Credit Suisse.

Stephen D. Ju - *Crédit Suisse AG, Research Division - Director*

So I think, Blake, you previously talked about the cross-currents in your mobile business and how your older games like The Simpsons are no longer really growing as rapidly but the newer games like Galaxy of Heroes are. So can you talk about where we are in terms of that mix shift between old and new? It seems like your mobile revenue growth has accelerated for the second quarter in a row, which makes me think that the older games must now be less than 50% of the total and shrinking in terms of the overall contribution. And also, Andrew, can you update us on what the plans are for the launch of the new mobile version of The Sims?

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

Yes, so I'll talk about the first part, and then I'll let Andrew get The Sims piece. Yes, clearly, The Sims is the exciting addition to the mobile business and -- for us, and we'll see that sometime in the coming spring. We also have some unannounced titles that we're working on, and so you'll see those. I think all of those will help drive the growth over the next few years, if not longer. We're -- a couple of things have been -- yes, the drag from some of the older titles have slowed, but the reality is some of those titles will just stay around for a long time because they still do great business for us. The key to our mobile business, and I think different than some other people in the industry, is we drive our business just like our console and PC business to be profitable. So we hold up high standards on profitability, we invest around marketing expenses, around a profitable model, so we don't simply try to build the mobile business in an unprofitable way like we've seen some of the people do in this market. And that's something that's not going to change. We're not going to try to drive topline growth simply with 0 profitability. That doesn't do anything for the shareholders.



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And so you'll see us continue to have steady growth. We've got great products coming down the path in the future. We're very excited about The Sims. I'll let Andrew talk about that.

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

So The Sims is going really well. It is still in soft launch, and we're receiving valuable feedback on the game and incorporating adjustments both in terms of kind of a core engagement profile in the game as well as how the game monetizes over time. The Sims is a very valuable brand for us, a very valuable IP. And it's a genre in which we are essentially unchallenged on any platform for that matter. And so we want to make sure that we get it right with our community, and we're seeing very strong uptick in the kind of metrics that we need. And we expect to launch it in the spring. And the good news for us, given the strength of The Sims brand, we still have The Sims free play, which is doing really well for us on mobile.

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

And I just -- since we're on The Sims, I'll just throw in one more, that, as you can see or hear from the prepared text, we've mentioned The Sims a couple of times, The Sims 4 as a major driver in the growth in the quarter. We're -- continue to be very pleased with how The Sims 4 and all the extra content has performed. And we're very excited about The Sims 4 console version that will be out later this quarter. And I think that bodes well for the overall Sims franchise, both in console, PC -- for all console, PC and mobile.

Operator

Your next question comes from Ryan Gee with Barclays.

Ryan Gee - *Barclays PLC, Research Division - Research Analyst*

The first one is on mobile. The acceleration and the pickup in mobile revenues that you saw this quarter, it's a nice positive. I'm glad to see that it's driven by in-app purchases. Have you guys considered the potential for mobile advertising in any of your games whether it is The Sims or other sports titles? And then if that is a meaningful contributor to your business today, could you help us quantify or think about that opportunity going forward? And then the second question is for Blake on guidance. It sounds like with the sports full-game downloads doing much better and the mobile business accelerating, then as you guys said, live services are certainly tracking ahead of your outlook, you should really see some strong digital revenue mix benefiting margins going forward. And I'm not sure that, that is really as apparent in the guidance. So it makes sense that Star Wars is a gross margin headwind for next quarter, but is there anything specific or unique about fiscal 3Q this year that's going to drive any sort of op margin deleverage that we should keep in mind?

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

Okay, so first on mobile. We've been doing advertising in our mobile -- in some of our mobile games for a long time, many years. And that total advertising number's under \$100 million. It is a good business. We operate on a simple principle which we will not do other mobile game advertising outside of our own games. That is different than what other companies do. Our goal is to keep people inside our network of mobile games. And so if we're going to do mobile game advertising, we would do that simply to steer people to other games inside our network. And that's not going to be advertising dollars for us. It just minimizes our outside marketing costs. But we do, do some mobile games. We have some games that we don't do advertising in. And we're continuing to look at opportunities to grow that. But the biggest challenge is most people play mobile games anonymously, and anonymous advertising is at very low CPMs versus very structured advertising that you might see out of a Google or a Facebook, where they have strong intent information on the consumer. There may be some day that we can build that. We're thinking about it in a lot of ways, but right now, it's still at a fairly base level. On the guidance, a couple of things to just look at. One is, I encourage people to go back and look over the last 5 years. I think coming out of Q2, we've always been fairly conservative on our guidance going into our largest quarter of the year, Q3. And I don't think we've had any different behavior in how we've given guidance over those last periods of time. And so I don't think there's any messaging whatsoever. I think raising our guidance by \$0.10 on the bottom line is a pretty powerful raise and \$50 million on the top line. And



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I think it's consistent with how we've operated historically and signals the positive view we have on the back half of the year. And the split between Q2 and Q3, I challenge you guys on the phone to start doing your models a little more finely and listening to us a little closer on what we tell people. We phase our revenue for you every quarter. And I think we're getting much more -- we have a much better ability to predict our revenue because of the large component of live services, and so we're probably going to be better at our guidance over time. So I'd just keep that challenge there to you.

Operator

Your next question is from Justin Post with Merrill Lynch.

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

First, for Blake. Q3, can you go through the puts and takes on the 3% decline in revenues? I know you had 2 big titles last year, 1 big one and 1 maybe medium one this year. Talk about maybe your expectations for Battlefield versus Battlefield? And then, Andrew, World Cup is obviously next year. You've launched FIFA. Are you thinking about that as a live services event? And how will you capture incremental users and maybe dollars around the World Cup?

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

Yes, Justin. I think most people know that Battlefield -- excuse me, Battlefield 1 last year was a mass success for us, and we had a huge Q3 because of that. We also had Titanfall, which, while it didn't meet our original expectations, still sold very well. And so with Star Wars Battlefield II and Need for Speed, you just can't -- and Sims 4 console, you just can't comp against the strength of Battlefield 1 last year. We're looking -- it's obviously a big quarter for us. Guiding net bookings to \$2 billion is huge. And the fact that it's only down 3% year-on-year, with the strength of Battlefield 1 last year, I think is a huge positive. And live services obviously continued to grow. We're seeing strength across the board there, but we still have some unknowns. We don't yet know how the Battlefield II live service will monetize. We'll find that out over the next quarter. We'll be able to give people a better sense of that in Q4 -- Q3 when we talk, but that's part of the unknown. And The Sims 4 on console, while people are very excited about it, we'll just need to see how the well that sells. So those are probably the unknowns in the mix versus last year as well as the scale differences.

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

On World Cup, we don't have any news to announce right now. But EA SPORTS, we have a long tradition of celebrating the World Cup and bringing it to life for fans, stretching back to Road to the World Cup '98. So as it gets closer, the world's largest sporting event, we'll announce more details on how we'll continue this tradition.

Operator

Your next question is from Eric Sheridan with UBS.

Eric James Sheridan - *UBS Investment Bank, Research Division - MD and Equity Research Internet Analyst*

Maybe 2. One, going back to the digital commentary from before. I wanted to understand, normally in the December quarter, you see a little bit of a mix shift back sometimes to packaged goods with gifting around the holidays. Do you think we've seen the type of tipping point where digital penetration might power through some of the seasonality we've seen around packaged goods over the last couple of years? That's number one. And then number two, just going back to the mobile business, I wanted to understand a little bit of the mix of how you think about allocating marketing dollars there between user growth versus driving more in-game monetization just to understand a little bit of how you frame ROI on the marketing spend in the mobile business.



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

So Eric, I'll address the packaged mix, and then Andrew can address the mobile piece. So on packaged mix, obviously, Christmas or the holidays is always going to skew towards more physical. People want to have a gift to give someone. But we do know that while Star Wars Battlefront 1 skewed more heavily than we typically see, we think Battlefront II may not skew quite as much because of the breadth of the game. It addresses some of the interest that the hard-core players wanted. It's got more. It's got space battles. Many of the things that the hard-core and the traditional first-person shooter audience played were not as strong in the first Battlefront, where -- this, there's more of it. So we might see a skew that helps bring that up a little bit, but we don't know for certain yet. We do know there were a lot of people that were both hard-core and the younger audience playing in the beta, so our sense is that we could see a slight skew. We haven't assumed a big number skew difference in our guidance, but our hope is that, that could ultimately help the margins a little bit in the quarter.

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

So in terms of mobile marketing, we've got a very finely tuned model that the teams are constantly updating to ensure, as Blake talked about earlier, we maintain the level of profitability that we believe is appropriate for our mobile business and can either drive that business profitably. And so when we think about it, most of our programmatic digital spending is around acquisition, but that's done with the profitability metric in mind and done in a world where we're trying to attract the right cohort of people who ultimately will monetize and drive ongoing profitability. We work on a more conservative approach than some people in the marketplace do. Our lifetime value model operates over a shorter time span than some people in the marketplace. And we do that simply because we believe it's better balanced to drive short-term, medium-term and long-term profitable growth of our overall portfolio of titles.

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

I think the other thing to remember is we're trying to build mobile games that have deep and long engagement. If you look at Star Wars: Galaxy of Heroes, we know that people play for a long time and they play almost every day, and it's driven by the events that we put into the game each -- every few weeks. That's the key to the game model versus a model in which you have to feed the beast all the time with new people to keep the core users engaged. These are games that are really built around a much more engaging loop that people can play over a long period of time.

Operator

Your next question is from Mike Olson with Piper Jaffray.

Michael Joseph Olson - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

I had 2 questions. First, Blake, I hate to pin you down, but would you be willing to share how many units you're assuming for Star Wars Battlefront II in fiscal '18? Is that still 14 million, I think, was the previous number?

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

I would just say -- let me try to answer, and then I'll let you say or ask your next question, and even a third question, if you want. So we're giving guidance on units once a year at the start of the year to help people size things. We're finding units are becoming less and less meaningful to us because, obviously, there's a difference between a digital unit and a physical unit. Obviously, we've been surprised on the growth of digital units, and it's all about the live service at the end of the day as well. And so assume that any change in our unit guidance for any game, including Battlefront II, is built into our annual or quarterly guidance changes that we put in place. And so focus on the revenue guidance and not unit guidance. So now let me let you ask your next question. I'll just stay quiet until I hear it.



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Michael Joseph Olson - Piper Jaffray Companies, Research Division - MD and Senior Research Analyst

All right, sounds good. So you've had a lot of success with digital add-on content, but there are other areas that could have a significant impact on the business in the coming years like continued growth of full-game download mix, subscription, streaming games from the cloud. Which of those opportunities are long-term drivers that you're most focused on? Or maybe there's some others I didn't mention?

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

I would say all of the above. Clearly, all of those are important to us. We're actively working on the extra content piece. You can see that in the numbers that we've put up over the last few years. And we're -- as Andrew talked about on the call and his question-and-answer component around Star Wars, we spent a lot of time trying to build out a live service model for Star Wars Battlefront, and we'll see how that plays out. And you can imagine we're thinking and working on live service models on many of our other games. It's critical because that's how the consumer wants to play the games, and that's why we're driving them that way. Subscription obviously is very important to us. We've been doing a lot of work on Origin Access and EA Access. And as Andrew mentioned, you'll most likely see those on other platforms and you'll most likely see additional content coming into those subscriptions and some exciting things to come there, but we believe that's a very important way for more consumers to enjoy more games over time at a very reasonable price. And then streaming, ultimately, there's a lot of opportunity there. It may be a few years down the road, still, but that, plus things like subscription or live services go together very well. And you can imagine that we are spending a great amount of time, both in our technology world and in our games development on how games would operate in that kind of an environment. So more to come on all that, but I think all of those together, plus the base business that we have today, bodes extremely well for our business and in the industry in general. But we're very focused on how do we evolve this model over time to be as profitable as possible and as consistent and repeatable as possible. We think that's what investors want, and we think that delivers the best game services to the consumer.

Andrew Wilson - Electronic Arts Inc. - CEO & Director

And one addition there as we think about long-term drivers, just a little extra content -- context as we think about this. You may have heard me say before one of the greatest disruptions of the consumption of entertainment media in the last 5 years has been the combination of streaming plus subscription, and that we are thinking very seriously about that. You're seeing us do work in subscription, and you've heard us talk about the work that we're doing at a technology level around the infrastructure and services that we would need to facilitate a subscription around games. And the one thing that's often lost when we have this conversation is that unlike linear media, the subscription fee paid is not the total value of what a player might expend as they enjoy the games they play inside of subscription. Because of our live service offerings, the subscription really is about onboarding a large community globally of committed, connected players who not only play the games in a subscription, but also participate in the live services. And so we believe long term, while it might take us some years to facilitate that at the kind of scale that we expect it to evolve to, in the same way that digital music and digital movies have evolved, the upside to the interactive entertainment industry is uncut by virtue of the value of live services that are born inside of a subscription.

Operator

Your next question comes from Tim O'Shea with Jefferies.

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

So looking at FIFA Mobile, 113 million users, a very big number. Just wondering if you could talk where that game stands today in terms of monetization? And what's the time line going forward from when it could become a real contributor? I think on console, FIFA's roughly tripled the size of Madden. Would that conceivably hold true on Mobile as well? And then can you just discuss -- second, can you discuss the launch plan to support Battlefront II? Just wondering what we should expect in terms of marketing, whether you should get any boost from around the movie marketing, and then whether there's any plan to discount the game to drive unit sales? And then finally, just a quick one for Blake. It's a follow-up to Mike's question. Just wondering if you would share how much Battlefront live services revenue is embedded in guidance.



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

There was a lot there. Let me try and start. So FIFA Mobile, you started with 113 million users, how do we think about that with respect to Madden? What you heard from us in the prepared remarks is that Madden NFL, in its third season, continues to go from strength to strength. The reality is, is that we had, had a couple of false starts on Madden even before the first season in the current iteration of that franchise on Mobile. But in its current iteration, it's spent a great deal of time in the top 10 through Q2, and I think it was #1 on a number of days also. So very, very strong. And we're really starting to understand how to truly support and entertain a community of Madden players on mobile. FIFA, in a few weeks, will launch, again on Mobile, for its second season. And you might remember that when we launched FIFA last year, we knew that even though it followed a similar mechanic and a similar design construct in Madden, that given the global community and the nuances that exist around football or soccer globally, that we believe it was going to take some time to tune. This is a long-term play for us. Football, or soccer, is the biggest sport in the world. Mobile has more players than any other platform in the world, and we believe that this is truly a global opportunity as we think about this in the West and in the East. We are committed to this for the long term. We expect that we will see monetization grow in the coming year. But even if it took us 3 seasons in the same way it has with Madden, that would still be completely fine for us because we are growing it profitably and soccer is not getting any less popular on a global basis.

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

And I think to the point on triple the size, I'm not going to give you a forecast there. But what I would say is soccer is truly a global game and growing in places like China, where we may never have a console market and where PC free-to-play is not growing as fast as it once was, but mobile is continuing to grow very fast. So there's a scenario that says FIFA on mobile could be much larger than 3x Madden. And our hope is that between current FIFA on console, current FIFA on -- in the online market in Korea, Japan, and China and Southeast Asia, plus mobile could be a huge market for us.

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

So in terms of movie marketing around Battlefield II and do we hope to get a benefit from that, the answer is absolutely yes. That's part of the reason why we do a license to a great IP like Star Wars. What you may have noticed is that Disney had just released the first major trailer for The Last Jedi. It had really, really strong and positive feedback. They are marketing this title on a more compressed time line. And we're seeing the anticipation build for the movie in the same way we're seeing anticipation build for the game.

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

On discounting, let me just make it really clear right now so all you guys don't have anything to write about on Black Friday. We bring the game out right before Black Friday, so you will most likely not have discounts at Black Friday that we pay for. That doesn't mean that you might not see some stores choose to discount games on Black Friday out of their own pockets. We will most likely discount the game like we did last time around the movie launch, and maybe you'll even see some selected discounts around the holidays, either Thanksgiving or Christmas. That's the way the games business always has worked. And so if you see the title on discount, don't read anything into that other than the fact that, that's the way you sell games in the holidays. In terms of the live service, I can't break out the actual forecast, but I would say it's not large for Battlefield II, partially in the quarter because we'll just get it going in the quarter. And it will really start to drive the Live Events coming out of the quarter into the fourth quarter. So we really won't have a good sense of how well it's doing and how large it can be until probably at the tail end of the third quarter and really the tail end of the fourth quarter. But we'll keep you going, but it's not a position that it's a large component of the fiscal forecast or the quarter forecast.

Operator

Your next question comes from Laura Martin with Needham.



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

So you guys have had FIFA for about 2 decades, and I'm curious about historically when the U.S. has not been in the World Cup what the impact is on your game sales player engagement length? And then secondly, your marketing was well lower than we expected. And I'm wondering, could you give us an update? Is that a timing shift? Or should we be taking our marketing spending down next quarter as well?

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

The marketing piece is all timing shift. I think we talked about in last quarter, we're doing marketing -- a broader marketing and different types of marketing all during the year, and so it's less concentrated around launch time. I think overall, we've brought our marketing spend down. You've seen that over the last few years, but don't assume that it's going to be down across the board in the back half of the year. So some of it might not be spent, but some -- most of it is phasing. So...

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

In terms of the World Cup, again, we're disappointed. I'm Australian, but I feel American. I've been here a long time. My kids are American, so I feel for them. Although, I might say Australia really makes the World Cup. I've lived with that dream for 43 years. The reality is that the World Cup is the world's largest sporting event, and it's followed by all people around the world who love soccer, or football, depending on what they call it where they come from. And really, does it heighten their enjoyment if their national team is participating? Of course. But we don't see people stop watching the World Cup just because their team is not there. And as you think about the U.S., in particular, we are a very multicultural country. And even now, as we think about FIFA, the most played teams are from Spain and the U.K., and the most played players are also non-American players. So we don't expect a huge impact there. But for my kids and for me, I'm disappointed that the U.S. won't be there.

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

Maybe one follow-on. So I was really intrigued by the statement that you made saying that the biggest disruption is streaming plus subscription. And you were saying that onboarding a large community of committed players lets you elevate the number of players. And I'm curious, is the value driver in your mind bringing new people onboard or getting more money from super SaaS because it's an uncapped revenue stream?

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

What we've seen out of subscriptions, as we look at this, is there's really 2 types of users of subscriptions: those that do it because the friction is so low, you'd be mad not to do it; and those who do it because they are power users. In traditional linear media, you do not get the value out of a power user by virtue of the fact that subscription value is capped. We see subscription also doing the same thing in the context of games. And we see this inside of our games is we see gamers coming and participating in our existing subscriptions because the friction is low, the quality of the games is high and the opportunity to play games that they may never have played before is just too enticing for the value proposition. We also see players who come into subscription as power players, who play multiple games and, in many cases -- I think, more than 75% of cases, played games they've never played before. They also participate in the live services of those games and drive additional incremental live service revenue on top of the subscription value. And so as we think about this on a go-forward basis, we actually think about it capturing both of those categories that you mentioned: the kind of casual user, who's looking just for access without friction; and the power user, who's looking to actually play everything and really invest a great amount of their time in the entertainment value that we provide.

Operator

The next question comes from Eric Handler with MKM Partners.



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

Just curious if you could give us a little bit of a range for all your titles that come out in a given year for console. What percentage of revenue is the \$60 versus the add-on content live services dollars? And I know that could vary by game, but if you could sort of give us a range of how it plays out over a 2-year period. And then secondly, wondered if you could give a little perspective on the competitive gameplay that you're going to have coming out for Battlefield 1 in the spring.

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

So let me hit the first one really quick. It really varies. With some titles, you'd have a 10% to 25% uplift off of the core, so 60 plus 25% of that. With some titles, it can be 125% or 150%. It also varies dramatically by region or geography because you have different spend capabilities around the world. So it's kind of hard to pare it down. Obviously, Ultimate Team's at the high end of the spectrum because it's so engaging, and we're running so many events that it just keeps people coming back. So yes, it's hard to generalize. But it's really -- we think about it as really as how do we keep engaging players? And if they're engaged, they'll probably spend some money along the way. And we want to make sure we've got people who are deeply engaged in something that they love. I'll let Andrew touch the second one real quickly, and then we'll do one more question.

Andrew Wilson - Electronic Arts Inc. - CEO & Director

So for Battlefield, we don't have any new announcements for Incursions. It's currently in closed alpha, and we're got to talk a lot more about that as the year progresses. But the things we've talked about so far is it will be a 5-on-5 player focused on contained, small-scale battle. And it's unique in the fact that it will have both infantry and vehicle combat. And the feedback from the community so far has been really, really strong and positive, and we're integrating community feedback into this game. And again, it comes off a great foundation. Battlefield is one of the great multiplayer games in our industry, and Battlefield 1 was probably the greatest multiplayer game in the first-person-shooter category last year. So we're very excited about the opportunity.

Operator

And our final question comes from Mike Hickey with Benchmark.

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

Just a gas at asking you an accounting question, Blake, but revenue recognition on your FIFA sales, the digital was up. I think last year, you delayed the recognition of that into Q3. Is that similar this year?

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

Yes. I mean, we don't formally delay it. We have a digital cut off that's a few days before the end of the actual end of the quarter, and that's just the way we work with our first parties. And so most of the FIFA digital revenue will come in Q3. The bulk of the revenue would either be people who pre-ordered a digital title or purchased digitally 2 or 3 days early because they were in EA Access. But almost all the regular digital purchases, both for FIFA and for Ultimate Team, are in Q3.

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

Got it. Good. One more follow-up for me. The -- I know you have to be delicate with your retail partners, your physical partners at least. But clearly, the progression here just all seems to be picking up some speed, maybe it's in selecting. Who knows? But it looks like at least GameStop is working pretty hard to compete against new game sales by introducing a subscription plan on use. So just curious of your thoughts on if, at all, that could



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be disruptive to new game sales for you. And also curious (inaudible) feels like maybe despite themselves, maybe there's over-ordering of product over the holiday, which maybe is a catalysts to some of the promotions that we saw last year. Curious if you can do anything to manage that, and how reactive you can be to digital promotions in response.

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

Yes, I mean, we're -- we -- despite the fact that we've talked a lot about digital as an important part of our business, we still want to have great relationships with our physical retail partners out there, and we think we do around the world. I can't comment on GameStop's intentions relative to their new program. I don't even really have the details about it yet. But we're -- obviously, we're very cautious of how we ship into all retailers. We've always been that way. We don't want the channel to be overly full, which would create discounting or could ultimately create financial problems for smaller retailers. And we've always watched that closely, and we'll be careful again this year. The beauty of digital, as I think you were indicating, is we can be pretty fast and reactive. We can do 1-day sales. We can do special promos in certain regions or countries. We do a lot with digital in a short term that you can't necessarily do with long term. Most of our long-term plans for retailers are locked up 6 to 12 months ahead of time. And because you've got point-of-sale materials, you've got promotional flyers that go into newspapers, all those things have to be prepared. And so we set those up well in advance and work with the retailers very carefully on those.

So with that, I'll call it quits so everyone can enjoy their Halloween. And I appreciate everyone coming on the call this time, and we'll talk to you in late January.

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

Thank you, Jen.

Operator

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

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