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EA - Q4 2018 Electronic Arts Inc Earnings Call

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OVERVIEW:

Co. reported 4Q18 GAAP net revenues of \$1.6b and diluted EPS of \$1.95. Expects FY19 GAAP net revenues to be \$5.6b and GAAP EPS to be \$3.55. Expects 1Q19 GAAP net revenues to be \$1.1b and GAAP EPS to be \$0.64.



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PRESENTATION

Operator

Good afternoon. My name is Erica, and I will be your conference operator today. At this time, I would like to welcome everyone to the Electronic Arts Q4 2018 Earnings Call. (Operator Instructions) Thank you. Mr. Chris Evenden, Vice President of Investor Relations, you may begin.

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

Thank you, Erica. Welcome to EA's Fourth Quarter Fiscal 2018 Earnings Call. With me on the call today are Andrew Wilson, our CEO; and Blake Jorgensen, our CFO and COO.

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 this call, our financial model, a transcript and an updated accounting Q&A. With regard to our calendar, our Q1 fiscal '19 earnings call is scheduled for Thursday, July 26, 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 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, May 8, 2018, and disclaims any duty to update them.

During this call, the financial metrics, with the exception of free cash flow, will be presented on a GAAP basis. All comparisons made in the course of this call are against the same period in the prior year, unless otherwise stated.

And with that, I'll turn the call over to Andrew.



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

Thanks, Chris. FY '18 was a year of growth and continued transformation for Electronic Arts and a year where our commitment to putting players first grew even stronger. We expanded our global player base; grew engagement in our leading games, live services and subscriptions; and continued our focus on listening and learning from our communities.

Our revenue and earnings for Q4 and the fiscal year 2018 were above our guidance given in January, and we are well positioned for continued growth in FY '19.

Our strategy is to deliver a collection of amazing games and content wrapped in services with new and innovative ways to reach an expanding global audience. Here are a few of our achievements in the year just completed.

Our EA SPORTS franchises: FIFA, Madden NFL, NBA Live, NHL and UFC continue to be some of the most powerful sports brands in the world. In FY '18, our EA SPORTS player base grew to nearly 90 million players life to date on current generation consoles and many tens of millions more across mobile and PC.

Our sports games are also powerful platforms for competitive gaming. Nearly 18 million players engage in competition across FIFA 18 and Madden NFL 18 this season, up more than 75% year-over-year, and viewership of our top level competitions continues to break records on networks and digital channels.

We are growing our reach across all platforms. Our Battlefield ecosystem of games has more than 54 million players life to date across current generation consoles and PC, as fans continue to play their favorite Battlefield titles for years after launch.

Our Sims community spans across generations and platforms, with more than 80 million active Sims players across PC and mobile in FY '18. Our Sims 4 community continues to grow nearly 4 years after launch, we have a great deal more content coming to our PC players this year.

Alongside the ongoing success of the Sims FreePlay, we've had strong early growth in the player base for the Sims mobile, giving us 2 games on mobile delivering the breadth of experiences that Sims fans are looking for.

FY '18 was our strongest year ever for the EA mobile portfolio. Star Wars: Galaxy of Heroes continues to have one of our most committed and deeply engaged fan bases, driving player satisfaction scores to an all-time high in Q4.

Our EA SPORTS titles, SimCity BuildIt, Real Racing 3 and more continue to entertain global communities on a daily basis, and we will add more breadth and depth to our portfolio in FY '19.

We also help players experience more games, including innovative new IP. Our EA Access and Origin Access subscriber titles continue to grow, and we've expanded Origin Access to include dozens of third-party titles in addition to EA's PC portfolio. And with our EA Originals program, we saw outstanding success with A Way Out, the innovative card game from Hazelight that engage nearly 2 million players in the first 4 weeks after launch.

Through all of these examples and many more, we hold an unfaltering commitment to our communities. We will also always push forward to innovate and create new experiences. That's in our DNA. We also continue to listen, learn and act in service to our players.

We have a deep appreciation and commitment to our Star Wars fans. And as promised, we delivered a major redesign of the progression in Star Wars Battlefront II in Q4, updating into a more linear system that our players wanted. We've also brought new content modes and fan-requested updates to the game, and we have much more coming to the launch of the new movie, Solo: A Star Wars Story.

As we begin FY '19, EA is uniquely positioned to lead. Through our investments in IP, technology, competition and new ways to play, our talented teams continue to live a new experiences that will disrupt and expand the future of play. There is no bigger event in sports than the World Cup,

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and we're excited to kick off an unprecedented year of new experiences across our FIFA franchise with our new World Cup content in FIFA 18. As we announced last week, we are bringing all the teams, matchups and so much more of the World Cup experience and making it all free for FIFA 18 players. Building on the momentum of World Cup, we then have some very exciting plans for FIFA 19, which we'll speak to at EA PLAY in June. This is a major year for EA SPORTS across all platforms with more innovation coming to Madden NFL, NBA Live and NHL as well as our EA SPORTS titles on mobile and FIFA Online 4 going live soon in China and Korea.

This year, we also plan to deliver 2 massive new games: Our next Battlefield title and our new IP, Anthem. Both of these experiences are introducing new dynamics that begin to change the way fans interact with their games and with each other.

With our next Battlefield game, the team at DICE is bringing the intensity of combat to life in new and unexpected ways. Every battle is unique, and every mode brings its own challenges, from the way you interact with the environment around you to compelling single player story to the next level of large-scale multiplayer that spans across multiple maps and modes. This will be a deep and fully featured shooter, an ongoing service that will evolve with major new experiences for our community beginning right from launch.

Building on the success of Battlefield 1 and taking inspiration from DICE's core DNA, the new game will advance the state-of-the-art for the franchise, while still delivering a signature gameplay and Battlefield moments that have captivated and grown our global community.

Later in the fiscal year, we will launch our stunning and ambitious new IP, Anthem. Every dimension of this game will offer something entirely new for a wide audience of players, from a new universe with unique stories that BioWare's creating, to the cooperative gameplay, to the epic and beautiful environment that constantly evolves around players. Anthem is a fundamentally social experience and will open new ways for fans to join the community and play early, enabling us to shape and refine the game with their input and feedback. We're deeply excited to launch this brand-new franchise and equally excited to work with our players to make Anthem a game they can't wait to play and share with their friends for years to come.

EA's mobile portfolio will continue to grow in FY '19. In recent years, our mobile games had been some of the most engaging new games to enter the marketplace. We are doubling down in FY '19 with 2 new titles: Star Wars: Rise to Power and another game we'll reveal at EA PLAY, both unlike anything else in our mobile lineup today. Each game crosses into the new genres with social ways designed to bring together global communities.

In competitive gaming, we continue to expand our global esports audience and viewers and players that are experiencing the thrill of high-stakes competition through FIFA and Madden NFL. This year, we will grow our competitive footprint with more franchises, events, broadcast content and sponsorship.

We'll hold our first Battlefield competition in FY '19, and we're set to bring competition to another new title later this year.

In FY '19, we will also continue to lead with innovation in our subscriptions and new technologies. We will introduce a new offering to one of our industry-leading subscription programs, delivering unprecedented access and value. Our advance technology development, including cloud gaming, AI and Frostbite, will enable us to create and deliver next-generation experiences at scale. All of these and more continue to fuel the future of our player network that will connect players across games and devices.

There has never been a more exciting time to be making games. Our industry is dynamic, evolving and full of new opportunities. With the updates to our organization and structure that we announced last month, EA's positioned for continued growth and leadership. We'll push the boundaries of entertainment in a world where change is accelerating. We will strive to be disruptors, shaping the future of play.

Now I'll turn the call over to Blake.

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Thanks, Andrew. Fiscal 2018 was a record year for Electronic Arts as measured against almost every major financial metric from revenue to operating income to cash flow. Our success is driven by the way we have changed and continue to change our relationship with players. They want more



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depth in their favorite games and fresh content that can hold their attention year round. As a result, we've gone from one-off interactions at a moment in time to ongoing engagements with consistently changing dynamic worlds. It's a situation analogous to the transition we've seen in the software-as-a-service industry.

Consequently, our business already looks very SaaS-like with live services and subscription making up a greater and greater portion of our revenue. This has made our business much more stable and enabled us to deliver a dependable and growing cash flow to investors.

Now I'll provide our results on a GAAP basis before using our operational metric of net bookings to discuss the dynamics of the business.

EA had a record year with net revenue of \$5.2 billion, cost of revenue of \$1.3 billion and operating income of \$1.4 billion. These results enabled us to deliver record operating cash flow of almost \$1.7 billion. We also returned over \$600 million to shareholders through our share repurchase program.

Total net bookings for the year were \$5.2 billion, a record. Digital net bookings accounted for 68% of this, up 7 percentage points year-on-year. Live services net bookings were a record \$2.2 billion. Net of hedges, FX was immaterial to net bookings and a slight headwind to underlying profitability.

Now moving on to the details of our fourth quarter. GAAP net revenue was \$1.6 billion, \$50 million above our guidance and \$55 million above our year-ago period. Cost of revenue was \$233 million, in line with our guidance of \$234 million and up from \$202 million last year. Operating expenses were \$596 million, \$23 million below our expectations and \$12 million less year-over-year. This drove diluted earnings per share of \$1.95 or \$0.09 higher than guidance and \$0.14 higher than last year.

Net cash provided by operating activities was \$615 million. Operating cash flow for the full fiscal year was a record \$1.69 billion, beating our guidance of \$1.6 billion and up 7% over last year's. Fiscal year 2018 capital expenditures were \$107 million, resulting in free cash flow of \$1.59 billion. See our earnings slides for further cash flow information.

At the end of the quarter, we held \$5.33 billion in cash and short-term investments. During the quarter, we repurchased 1.2 million shares at a cost of \$148 million. Today, we announced that we have replaced our old share repurchase program with a new \$2.4 billion 2-year stock repurchase program. We returned about 38% of our free cash flow to investors in fiscal 2018. This new program aims to return approximately 3/4 of our annual free cash flow. We believe this is an appropriate target based on our current cash needs, our ability to access international cash and our desire to maintain flexibility for future growth investments.

Now I'd like to turn to the key drivers of our business this quarter. Net bookings were \$1.26 billion, above our guidance of \$1.23 billion and up from \$1.09 billion last year. Digital net bookings delivered \$1.05 billion of the \$1.26 billion total, up from \$885 million last year. This increase was driven by our ongoing success with our live -- event-driven live services.

Looking at each component of this quarter's digital net bookings in turn. Live services net bookings were up 31% year-on-year to \$679 million. The increase was driven by Ultimate Team, The Sims 4 and Battlefield 1. By adding features to broaden Ultimate Team's appeal, layering in a packed calendar of events and building esports on top of that, the team is continuing to grow fun and engaging games that players want to come back to time-after-time.

Mobile delivered net bookings of \$176 million, roughly flat year-on-year. Strength in Star Wars: Galaxy of Heroes and FIFA Mobile was offset by anticipated decline in some of our older games. Full game PC and console downloads generated \$193 million, roughly flat year-on-year, driven by Star Wars Battlefront II and strength in FIFA 18, offset by the success of Battlefield 1 in the prior year. The long-term trend towards downloading games continues. And across the portfolio, 39% of our full game unit sales were digital, measured on Xbox One and PlayStation 4 over the last 12 months. This compares to 33% a year ago.

Turning to our expectations for fiscal 2019. We expect sales of current generation consoles from Microsoft and Sony to continue to be strong, with the installed base growing to 130 million consoles by the end of calendar 2018, from 103 million at the end of calendar 2017.



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Nintendo Switch is expected to have built an installed base over 30 million by the end of the calendar year. In dollar terms, we expect the PC gaming software market to be approximately flat and the mobile market to grow in the mid-teens in the calendar year.

A note on accounting for fiscal 2019. As mentioned, we have adopted ASC 606 going forward. This does not materially impact our net bookings metric, but it does change our GAAP reporting in several ways. Most significantly, more of our GAAP revenue will be recognized upfront, bringing GAAP reported numbers closer to our historical non-GAAP reporting.

Also as a result of the introduction of ASC 606, we will now be reporting most of our mobile GAAP revenue on a gross, not net basis. We will continue to report the metrics that enable you to bring back to -- measures comparable to our historically reported numbers, including mobile net bookings. These and other issues are discussed in more detail in the expanded accounting fact we posted on our IR website today.

Primarily as a result of the changes in the U.S. tax law, we are reducing our management tax rate from 21% to 18%. Guidance for fiscal 2019 is for GAAP net revenue of \$5.6 billion; cost of revenue of \$1.6 billion; and GAAP EPS of \$3.55. This outlook was prepared in accordance with the new ASC 606 standard and includes approximately \$300 million of additional mobile revenue resulting from the accounting change to reporting mobile revenue on a gross, not net basis.

With regard to cash flow. For fiscal 2019, we expect operating cash flow to be approximately \$1.825 billion. We anticipate capital expenditures of around \$125 million, which would deliver free cash flow of \$1.7 billion. CapEx is up year-on-year as we invest in IT infrastructure for our player network and upgrade facilities, including the Respawn offices in Los Angeles.

Turning to business drivers. We anticipate net bookings for the year to be \$5.55 billion, up 7% year-on-year. This is driven by growth in live services, mobile and Battlefield. We have disclosed the phasing of net bookings through the year on our slide deck. As a result of the timing of launches, we expect this year to be more back-end loaded than fiscal 2018. We're excited about how both Anthem and Battlefield are shaping up, and we look forward to sharing more with you about -- or more about them soon.

Our projections assume a benefit from FX to net bookings of over \$100 million and an extra \$30 million in OpEx relative to last year's rates. Both of these numbers are net of hedges. Our currency assumptions are disclosed in our earnings presentation on our website.

Drilling down further into the key drivers of our full year net bookings guidance. Net bookings for packaged goods and other are forecasted to be approximately \$1.5 billion, down 9% year-on-year, driven by the shift to digital. Digital net bookings are expected to contribute \$4.1 billion, up 14% year-on-year.

Further breaking down digital net bookings. We expect live services to grow 10% to 15%, led by Ultimate Team, The Sims 4 expansion packs for PC and console versions of the game and by growth in our subscription business. The World Cup will have a positive effect on FIFA Ultimate Team engagement, but remember, it's only a 4-week event split across Q1 and Q2. And we have modeled that accordingly in our revenue forecast.

With regards to our mobile business, The Sims Mobile launched just before the year end, and we have 2 games coming in the second half of the year. Thus, we expect our mobile business to grow strongly of the order around 15% to 20%, led by the Sims Mobile, FIFA Mobile, Star Wars: Rise to Power and the unannounced title. Note that this growth forecast is based off our net bookings metric, not gross revenue or gross bookings.

Net bookings for full game downloads are expected to grow 10% to 15%, driven by product mix and the ongoing change of consumer behavior. We continue to model an underlying shift of around 5 percentage points a year to digital.

Focusing on Q1. We're expecting GAAP net revenue of \$1.1 billion; GAAP cost of revenue of \$226 million; and GAAP EPS of \$0.64. We expect Q1 net bookings to be \$720 million, slightly down year-on-year. As discussed on our last call, Q1 fiscal 2018 benefited from the deferral of over \$50 million of net booking for Mass Effect: Andromeda and some other onetime events.

On a management reporting basis, OpEx will grow year-on-year as we continue to invest in our growth drivers. As we look ahead to Q2, we see growth in FIFA and mobile, particularly offset by declines in other areas, including a difficult comp against Battlefield 1's performance in fiscal 2018.



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We discussed the idea of recurring revenues at our Analyst Day 2 years ago. At the time, about 75% of our net bookings fit into this category. Since then, we've continued to push our business in that direction. And our guidance implies that 85% of our net bookings in fiscal 2019 are expected to be recurring. Our drive to greater recurring revenues and cash flow will be fueled by our investments in subscriptions, live services, esports, broadcasting and cloud gaming. These are all components of our player network strategy, and we look forward to updating you on our progress as we continue to pioneer their adoption.

Now I'll turn the call back to Andrew.

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

Thanks, Blake. We're excited to begin another year in our journey at Electronic Arts, at a time when there is so much passion for games around the world. As an industry, we are reaching an amazing nexus where the creative energy in game-making is intensifying and converging with technology innovation that is unlocking gateways to access delivery and sharing of gaming experiences on a global scale. Games are becoming a truly ubiquitous form of entertainment. We believe the best form of entertainment and through the evolutions to come, we are seeking to connect more players to amazing games and to each other.

Creativity is the central strand of everything we do at EA. Every experience begins with creating something new and unexpected. That's what you'll see new dynamics in gameplay, new social layers and new ways to interact with the worlds we create in games like Anthem, our next Battlefield and our new mobile titles. It's powering new projects in development at Respawn, Motive, EA Vancouver, Criterion and more. It's behind our EA Originals program and our commitment to support Indie developers with amazing ideas. It drives us to continually evolve and update our games through live services because the creative cycle in service of our player never ends.

This isn't just a creative revolution. It's also a revolution of access and choice. New forms of content, new consumption models and advanced technology investments are accelerating how we will reach more players in a network world and satisfy their unique needs. Whether you're a player or a viewer, our competitive gaming experiences for games like FIFA, Madden NFL and more are becoming must-see programming for fans around the world. With more games and content available to players today, subscription services like EA Access and Origin Access are continuing to build momentum. And we are pioneering new offerings that will expand how players can experience more of the best games.

Looking further ahead, the culmination of subscriptions and cloud gaming capabilities, combined with our Frostbite engine and digital platform, will power the growth of our player network that scales across games, devices and geographies.

At the center of this are our players and our global communities. Everything we do is in service of our players, and we grow stronger in this commitment every day. This year, we will continue to expand how we connect with our players early and often from thousands of hours with our studio teams and play testing to large-scale soft launches and early-play opportunities.

One month from now, we'll open up our annual EA PLAY event and what has been a cultural moment for games and our communities. We'll welcome tens of thousands of players to join us in Hollywood to go hands-on and millions more that join us online around the world to hear more about our games and services, our commitments and our plans for the future. At every touch point with our players in our games, in our network, in our communities and beyond, we are constantly working to bring them closer to the games they love.

In FY 19, we are set to take major steps forward towards our vision of a network future and our opportunity to connect 1 billion people in play. We look forward to sharing more updates with you in the months to come.

Now Blake and I are here for your questions.



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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from Eric Handler with MKM Partners.

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

Just looking quickly, Blake, and I don't want to quibble about the size of your buyback, but you've got free cash flow this year of \$1.7 billion and you're going to do a buyback. Assuming you do it on an even pace of \$1.2 billion, so you've already -- you're already sitting on cash of about \$5.3 billion or \$17 a share and you'll add another \$500 million or so to that. I'm assuming you're going to repatriate a lot, so you'll definitely have a lot more cash flow to pay with -- to play with. Wondered what are your other opportunities or what you're thinking about with your excess cash.

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Well, the call is only 30 minutes gone by. And I'm already being criticized for doubling the buyback. It's amazing. It's a high-quality problem. I appreciate the question. It's a good question. Our view is, in today's world, financial flexibility has huge power to it. And we want to return as much to shareholders. We've consistently, over the last 4 years, grown that buyback fairly dramatically, and we'll continue to do that as we continue to build. But we also want to maintain flexibility should something happen that we either want to deeper invest in or want to purchase something. I'm not signaling that anything's happening. I think you guys know we've been consistent in how we grow the buyback, but also try to be prudent and safe with our capital to prepare for potential opportunities down the road.

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

All right. And then just one follow-up question. The new Star Wars mobile game, would you still be supporting Galaxy of Heroes for the complementary -- are they complementary games? And can you market between those 2 games?

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Yes, without a doubt. I mean, the perfect example of that is if you look at our Sims FreePlay game, which has been around for 4, 5 years, has done -- has not gone down at all with the introduction of the new Sims mobile game. Mobile games have -- there are so many audience members out there. There's so many opportunities, and game styles are very different. The game style between the new Star Wars game and Galaxy of Heroes is going to be very, very different, different style audience. And we think both will remain extremely successful for a long period of time.

Operator

Your next question comes from Drew Crum with Stifel, Nicolaus.

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

Blake, just want to ask about the guidance, net bookings growth of mid-single digits and low double-digit non-GAAP earnings growth. Can you talk about the lack of leverage there? Last time, you guys grew top line in the comparable rate. You achieved 25% earnings growth. That was back in fiscal '16. Your book tax rate is 300 basis points lower, and you're buying back more stock, which I would assume is accretive. So I just want to understand the puts and takes behind the earnings growth that you're forecasting.



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Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Yes, let me hit this real quick on the buyback. We don't build the buyback into our forecast because we don't like to forecast what stock price is going to be. But assuming that the buyback -- assuming the stock price is where it is today, you'd probably see 4 to 5 points of -- cents of earnings accretion going forward. You'd probably see share count down to around 308 million by year end, in other words, if you do the math that way. I'd say the other issue is back in fiscal '16, we were not investing as much in the future. I think we were still coming through the tail end of the transformation. We are now investing much more heavily in the future, and you see that in our OpEx growth. And that's trimmed some of the earnings growth power, at least in our guidance. Remember, this is guidance, not actual results. And I think if you went back a couple of years, you'd see the same pattern as we've given annual guidance. But I do think what you heard from Andrew earlier is continued investment in both new IP as well as way people will play games in the future and the way games will be delivered in the future. Investing in our network, investing in subscriptions, investing in cloud gaming, you're going to continue to hear and see those investments from us over time because we believe that's the way this business will be transformed. But at the same time, we're going to always look to get earnings leverage, and we think that, that model's pretty consistent with how it's been in the past.

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

Okay. One more for me. Just any update on the release window for Battlefield? Historically, you guys have targeted October. Looks like a very crowded window this year. Any opportunity to push that out later in the December quarter?

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Yes. Well, you'll hear more around E3 time frame on Battlefield. You'll hear quite a bit coming up about the game and the plans for it. We're very excited. But you should assume -- back to your guidance question, you should assume that we built in the guidance some conservatism because of -- and caution because we know it's going to be a crowded third quarter for us, fourth quarter calendar year. And we'll -- but the benefit that we have, I think, that we've always had is we have a very strong Battlefield community. And we think they're going to be extremely excited about this new Battlefield game. And we've been able to compete against others like Call of Duty in that same time frame in the past, and we will work hard to try to do that going forward. But more to come on the exact timing and a lot more about the game, which is pretty exciting.

Operator

And your next question comes from Chris Merwin with Goldman Sachs.

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

I just have a couple. First, for Blake. Even with the backdrop of Fortnite, yet another very strong quarter on live service, up about 30% year-on-year, and was it FIFA Ultimate Team and competitive gaming that were the main driving force behind that? Or was there anything else that you would call out, like Star Wars MTX, which I think you brought back late in the quarter? And then just a second question for Andrew. There've been some reports in the press about a couple of countries labeling loot boxes as illegal gambling and calling for the removal from games. You and I know, at FIFA, you've made some efforts to ensure that in-game currency can't be redeemed for real currency in any sort of illicit market. So maybe, can you update us on where talks stand with regulators on this topic and how we should think about any changes to the Ultimate Team mechanic in the affected countries?

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

So on the live service piece, it was Ultimate Team across FIFA, Madden and Hockey and, to a smaller extent, NBA. But really, Ultimate Team #1 driver. Sims 4, #2 driver, and that's been consistent through the year. It's been extremely strong as we continue to add extra content to that game. In Battlefield 1, we're at the tail end of extra content along Battlefield 1. Battlefront was not a major addition since, as you mentioned, the MTX came



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in very late in the quarter. But the other thing to remember is the breadth of our extra content subscription, advertising, all the other components continue to add up and help us build that base that we've been able to build, now over \$2.2 billion, is what's so great about that live service business because it continues to maintain a fairly large consistency year-over-year. I'll let Andrew hit the loot box piece now.

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

Yes, and good question and certainly timely. And as you might imagine, we're working with all of the industry associations globally and with regulators in various jurisdictions and territories, many of whom we've been working with for some time and has evaluated and established that programs like FIFA Ultimate Team are not gambling. And we don't believe at FIFA Ultimate Team, all loot boxes are gambling. Firstly, players always receive a specified number of items in each pack. And secondly, we don't provide or authorize any way to cash out or sell items of virtual currency for real-world money. And there is no way we can make value assigned to fight items in game currency. And while we forbid the transfer of items of in-game currency outside, we also actively seek to eliminate that where it's going on in a legal environment, and we work with regulators in various jurisdictions to achieve that. And so net-net, we're going to continue to push forward. We're always thinking about our players. We're always thinking about how to deliver these types of experiences in a transparent, fun, fair and balanced way for our players. And we'll continue to work with regulators around the world on it.

Operator

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

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

First off for me, without creating a separate SKU for World Cup this time around, I wonder if you could talk a little more detail about the monetization strategy within the core game. And then secondly, looking at the phasing of the year in terms of revenues, it looks like the fourth quarter is expected to be similar to this past year, and I wonder what that means in terms of your expectations for Anthem given that you also have the Battlefield content in Q1 -- in Q4 as well.

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

Yes, I'll take the first, I'll let Blake take the second one. As it relates to FIFA, what we've come to understand over the years, and many of you might remember I've worked on this franchise for a long time and I built both FIFA and World Cup games, and as each year passed and digital became a more prevalent way for our players to access games and connect with each other through games, liquidity in the player base became really, really important. And players are -- weren't wanting to opt out of one experience to play another soccer experience. So a part of why we brought the 2 experiences together in our core FIFA experience and what is the biggest sporting event in the world, the World Cup, is really deliver on the needs and requests and motivations of our players to stay connected in a global soccer community. And as we've announced, we're releasing all of the content, all the teams and things around the World Cup to allow people to play offline and online. But you should expect that, for all of our players in FIFA Ultimate Team, there'll be very, very specific and interesting and entertaining and enjoying and engaging live service events in and around the World Cup.

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

So on the guidance piece, a couple things I think you'll note. We didn't use unit sales metrics for any of our titles. And as you've heard in the past, we're trying to move away from that. This is an example of how our business model has changed. Unit sales are much less indicative of long-term franchise health due to the significant power of our event-driven live services now. Live services component is really the bedrock of our business. And while units sold to grow that are important, they become misleading in many ways to the street. And so we'll stay away from unit predictions for any titles going forward, unless there's some unique reason for it. With -- in the case of Anthem, the real issue is the game will be shipped in the last quarter of the year and in the last month of that quarter. Meaning, we'll probably have limited restocking of the title even if it's extremely



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successful. Since it is new IP, we're being conservative in how we're thinking about it. We're very excited about the game. It's extremely unique, and I think players are going to really enjoy playing it. But we're careful not to put too large of a forecast in there. And clearly, it will impact this year as well as next year as we not only continue to sell more into the next year but start rolling out the live services associated with that game.

Operator

Your next question comes from Eric Sheridan with UBS.

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

Maybe 2, if I can. Andrew, you talked a lot about extending gameplay as you look out for the future of gaming. Wonder if you can give us your perspective on the title mixes and what you see at some of the key titles, especially with respect to mobile, where you can extend gameplay beyond console and PC into a mobile first world and how you think about the pace and cadence of that going forward. And then following up on, I think it was, Drew's question from before for Blake, anything you want to call out in terms of the pace or cadence of R&D and marketing as we go through the year quarter-by-quarter, given the way that you laid out, sort of, revenue and bookings? Just so maybe we have some guideposts to think about margin evolution as you go through the year.

Andrew Wilson - Electronic Arts Inc. - CEO & Director

Yes. So let me grab the first one. I mean, at this very call, you've heard us talk a lot about subscription plus cloud gaming and the opportunity for those 2 things to fundamentally disrupt the way people access and enjoy games like nothing before, in much in the same way as disrupted enjoyment and engagement in movies and music. And so we've talked about, in a 3- to 5-year time horizon, we believe that cloud gaming is going to have a -- make a meaningful contribution to the way players engage with games. And of course what that does mean is it really doesn't matter what device you're accessing it by. The experience that you have is governed by the size of the screen and the amount of time you have to play. And so everything we're building right now, we are thinking about a world where we will not be bound by device, we will not be bound by local compute or memory, but much of these experiences will exist in the cloud. And you'll access them based on whatever device you have access to at the time. And we think about that at a core technology level. We think about that at a game design level. We also think about that as kind of how we think -- how we interact with our players and how they interact with the games. And you should expect to see us, between now and that time, start to push more of our experiences, particularly ones with really large global communities to be able to interact with the experiences across devices. And you've already seen this from us with FIFA and the ability to access Ultimate Team and do a great deal of interactions with Ultimate Team through fought mobile and on PC and on your console experience. And we look forward to driving more of that in the future.

Blake J. Jorgensen - Electronic Arts Inc. - COO & CFO

So on the second question. You should assume that we'll see some phasing of R&D as -- over the year as we start to build out our games, new games. We get better leverage, obviously, as the revenue grows in the third and fourth quarter on that number. But you should see, in real terms, you'd see some slow growth of that during the year. We do tend to use more part-time employees during the third quarter as we have large -- as we're gleaning into large layout -- or large new titles. You can see that in the past P&Ls in terms of the phasing. G&A is pretty consistent year-on-year. And marketing, as you know, we're targeting around 12%. And so that's really dependent on titles and the marketing that we're doing ahead of a quarter around the title. But obviously, our bigger quarters, you're going to see larger marketing spend both at the tail end of the second quarter and all through the third quarter and into the fourth quarter.

Operator

And your next question comes from Tim O'Shea with Jefferies.



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

So Andrew has talked about the future of play and how the industry will evolve over the next few years, and Blake spoke about how the revenue stream is already looking more SaaS-like. So my question is as we start to think about cloud gaming, what does the business model look like? Is it subscription add, full price, is it microtransactions or DLC? And with this cloud gaming offering, is that a standalone EA offering? Or would you offer your games in the third-party platform, maybe something analogous to the current console paradigm? I'd just love to hear your thoughts as we think about how this industry is evolving.

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

Yes, great question. I mean, we've given a lot of thought to it and plan towards. And again, if we look at other entertainment industries and other SaaS-like industries for guidance, what we discover is that multiple business models coexist. And if I think about how I consume movies right now, I have a Comcast subscription, I have a Netflix subscription. I buy things on iTunes. And I watch on a plane and I also watch a lot of free content through YouTube and other online mediums. What -- but what we're also discovering is that even while those multiple business models exist and our ideal here is to capture engagement and offer access through any business model on any device for all of our players in a growing global community, what we're seeing is a real move toward subscription as the best way to access content and the most friction-less way to access content and a way to build a relationship with a platform play who offers that collection of content wrapped in services. And so our expectations, while we will continue to offer the access to content through any known business models that our players tell us they want to utilize, we expect that consumers, much the way they have in other industries, will move towards subscription. And that will become a far more meaningful part of our business and maybe even a majority of our business in the years to come. And as we think about that, we also -- we're in a unique position to offer subscription, as we're doing today, by virtue of the breadth and depth of our content and our ability to get to a large global player base of diverse cohorts, diverse backgrounds and diverse geographies. We also understand and appreciate, however, that even with the size of the portfolio we have, there are other elements of gameplay that will be important to a broader subscriber base as we continue to grow. And what you're seeing from us now with what we're doing with our originals program is bringing new content in. What you're seeing from us with signing third parties is bringing new and interesting and different content in. You might imagine that frontline content will become an important part of that in the future, and that we might work collaboratively with other content creators and developers and publishers to ensure we have a truly robust subscription offering.

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

And a streaming approach allows, while that technology still is evolving and we know that it's -- could be 2 to 4 years away, it allows for the concept that you could play games on many different devices versus on one device typically found in your home. And we may partner with people as well as work on our own technology to help deliver that. And as Andrew said, we think that can be delivered in many different ways, and we'll still -- many years from now, we'll have gaming across consoles, PCs, possibly streaming-enabled TVs or other devices as well as mobile devices. And that's the exciting part about the business. We think that continues to help grow the market. It doesn't bifurcate the market in a negative way.

Operator

Your next question comes from Evan Wingren with KeyBanc.

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

Blake, just looking at the guidance, if I did my math right, you're actually implying that the units are down year-on-year with an initial guidance. So just trying to understand the puts and takes there given you have a favorable comp, one would think with Battlefield and Anthem obviously coming into the fray.



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Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Yes, I'm not quite sure how you're doing the math to get to units being down, but maybe you can give me the details on that offline. But we're saying a couple of things to note is you've got a whole bunch of pieces in the puzzle, that's why I don't know if you can do the math. Live service growth, remember, subscription growth is part of live services growth. And so in a subscription world, you actually may have or will have less units sold, but you'll have more consistent revenue over time. And we're expecting a few inflection points in our subscription program over this -- programs this next year, which should help drive more growth. So that's why I'd come back to my statement earlier that said we're moving away from discussing units because it's either live service revenue or subscription revenue that you're going to tend to see growing over time, which neither of those will fill up as units in any way.

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

Okay. And then just on Battlefield this year. Could you maybe just give us a sense as to how your multiplayer approach for this game might differ from historical Battlefield games?

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

Again, we've got lots to talk about in the weeks and months to come, and you should imagine that we will be talking at great length about it. The DICE team has a core DNA, maybe the strongest in the industry, around multiplayer and more importantly, innovation in multiplayer. They were the first team to get a 64-player multiplayer. They were the first team to get to kind of destruction in multiplayer. And so you should imagine that, as we talked about in prepared notes, all the things that a Battlefield fan would expect out of a multiplayer game from DICE in the Battlefield universe will be there, while additional innovations in how we're thinking about the future of multiplayer in first-person shooters will also be there, both at launch and over time as part of a large service.

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Watch closely in the hint. More things to come.

Operator

And your next question comes from Ray Stochel from Consumer Edge Research.

Raymond Leonard Stochel - *Consumer Edge Research, LLC - Analyst of Interactive Entertainment*

In thinking about the potential of your future subscription strategies, what percentage of customers repurchase titles like FIFA or Madden every year versus new customers coming in to purchase the title? And then similarly, how many people could be considered lapsed users that could come back in at a different price point or monetization strategy?

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Yes, I don't have the exact numbers, but quite a few. I mean, since Ultimate Team has gained scale, we're north of 70% with titles like FIFA and Madden. Pre-Ultimate Team, it goes back some time, it was often times less than 50% buyer every year. So you're seeing a much more consistent buying pattern because people want to reengage in Ultimate Team. People are -- 70-plus percent of the buyers are engaging in Ultimate Team so you'd expect to see that type of pattern. We do, though, spend a lot of time on how do we bring lapsed players back in and how do we maintain a consistent world with those players. And I think in that world, subscription will only help because they'll constantly be getting upgraded over time with their versions of the game. And I think that keeps people engaged and most importantly, keeps them involved in the live service components, which makes the game more fun for everybody.



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Operator

Your next question comes from Brandon Ross from BTIG.

Brandon A Ross - *BTIG, LLC, Research Division - Associate Analyst*

More on subscription. What do you think the time line is for you to immediately add your own frontline releases such as a FIFA or Battlefield or an Anthem to access an origin? And when you speak about there being an inflection point in subscription, are you alluding to that happening this year potentially? I was going to ask about capital allocation afterwards.

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Okay. So I'm going to hit the first one, then you can ask. We don't have anything to announce today, but I'd just say, assume that our subscription strategy, as Andrew said, will be evolving quickly. I think that this year and next year, you'll start to see new things in that subscription program, be it new third-party titles, potentially, at some point, frontline titles, but clearly, we'll continue to push that. We believe the platform can do all those things. We also want to add more social layers into the platform and more tools, and you'll continue to see that evolution going on as well through the origin platform. So more to come. We're pretty excited. Don't take my inflection point comment too literally, but you should see continued growth, and you'll probably see some spikes in growth as we add new and exciting things to the service. You've got a capital allocation...

Brandon A Ross - *BTIG, LLC, Research Division - Associate Analyst*

Yes, on capital allocation, a couple of things. I think you had been considering a dividend. Can you walk us through why you decided against that? And you mentioned leaving capital for potential opportunities. What are the ideal M&A opportunities for your organization at this point, is it mobile or supplementing with studios and genres for your weaker or on the technology side?

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

I'll hit that first. It's all 3 of those things. I mean, as Andrew mentioned, running a broad subscription service requires great content. And so we're always looking for great content and really great studios that can build that content. We partnered with Respawn for some time to get to know them. We believe they're a studio that can build, not just the great games they're building today but, great games for a long time to come. And so it's great studios and great partners that we can bring to the table in both mobile and console and PC, but also technology that will help us either in subscriptions or streaming. And you'll probably see some of that stuff to come. Most of it is probably more small to midsized than large because there's not that many large companies out there, but we'll look at everything. And we want to maintain that flexibility. And that was really the primary reason for not doing a dividend, is that we felt if we started a dividend it would be much harder to stop it if there was some reason to flex up to do something larger. And that's the reason we decided to stay with the buyback. We feel it's the most efficient way to do it, and it gives you the full flexibility going forward.

Operator

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

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

A couple of questions. First, your live services up 31% in what could be a big Fortnite quarter. How did you factor in that competition and then the holiday competition in your guidance? And then the second thing, Overwatch league is up and running, NBA starting this month, what have you learned from esports? And would you say you're more optimistic on the opportunity? Or about the same?



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Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Yes. So let me do the Fortnite piece, and then I'll let Andrew talk about esports. We welcome innovation in the industry. That's what makes this business so exciting and fun to operate in. If you look back over the 20 or 30 years, the innovation that one game team has done has been going through the whole industry. That's fantastic. And we welcome innovators like Fortnite or PUBG that really help push everyone's thinking, and we feel that, that's great for the business as a whole. We don't feel like any one player or any one game from FIFA to Madden to Battlefield is going to capture that 100% of the marketplace. It just doesn't happen that way. And so we haven't seen a giant impact, but that's guessing around what our forecast was. We try to be conservative. We try to anticipate as we do with either new titles coming out or existing titles or even things we don't know about. But we do think, in the case of Fortnite, it's helped grow the whole marketplace. And in particular, it's bringing younger people into the marketplace and younger people into first-person shooters, and I think that's good for the long-run health of that category for all of us in the industry, not just one player.

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

And in terms of esports, we talked about this a little bit last quarter. I mean, we saw tremendous engagement in both our Madden league and our FIFA league, up significantly year-over-year and breaking records in both broadcast television and on digital channels. We're going to continue to double down there. We've got an entire competitive gaming group that are pushing to grow that and really think about the ongoing evolution. We're excited and energized by the level of inbound queries and questions and requests for involvement that we've had. Again, we have the world's biggest game and this country's biggest game in soccer and American football. And there are a lot of people that really want to engage with that in order to get access to the audience that's really playing and watching our esports events there. Also in our prepared remarks, we talked about ongoing investment in Battlefield. Again, Battlefield has multiplayer and competition core to its DNA. And we're excited about what the DICE team is doing in innovating as it relates to a competitive play in and around Battlefield. And we've got another one that we're launching later this year, too, that we're yet to announce. So I think the macro message you're hearing from us is that we always believe this would grow engagement and grow revenue. It's happening much quicker than we anticipated, and we're doubling down to make sure that we maintain that momentum and continue to grow engagement both from players, viewers and sponsors and broadcasters in and around our events.

Operator

Your last question comes from Stephen Ju with Crédit Suisse.

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

Andrew, I think given what I think you and Blake have alluded to in the past with the expected time line for the ramp of FIFA Mobile and how long it took Madden Mobile to ramp, I was a little bit surprised to see Tencent recently announced the game for China. So I'm wondering if it's a different or the same version of the game and how your thinking may have evolved in terms of catching up to Madden Mobile monetization. And also I think you called out the launch of FIFA Online 4 with Nexon and Tencent in your prepared remarks. Can you provide us with an update on your efforts to, I guess, migrate the users from 3 to 4?

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

Well, there's a lot of questions there. So first is FIFA, in the West, you heard in the prepared remarks, continues to grow and certainly contributed to the growth in our FIFA business this year, even in the face of some of our older titles, kind of, in decline as they were expected to be at this time line. We're excited about what that team is doing and expect that, that will continue to do very well and grow this year. Particularly in a World Cup year, you should imagine that there will be a series of events and opportunities for mobile players to engage in that. We also have a game in China that we are doing with Tencent in and around FIFA Online 4 that is a China-specific execution, and we're excited about that. And then we are actively transitioning across to FIFA Online 4 in both Korea and China. And that is going as well as we plan and it's certainly getting the full support



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of Nexon in Korea and fixed our marketing support in China. And so all in all, we're very, very happy with our performance in mobile and free-to-play in Korea and China and in the West.

Blake J. Jorgensen - *Electronic Arts Inc. - COO & CFO*

Great. With that, we'll call it, and see everyone, if not at E3, in the near future. Thanks very much for your time today.

Operator

This does conclude today's conference call. You may now disconnect.

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