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EA - Q3 2018 Electronic Arts Inc Earnings Call

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JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

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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 Q3 2018 Earnings Call. (Operator Instructions) Thank you. Mr. Chris Evenden, VP of Investor Relations, you may begin your conference.

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

Thank you, Erica. Welcome to EA's Third 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 this call, our financial model and a transcript. With regard to our calendar, our Q4 fiscal '18 earnings call is currently scheduled for Tuesday, May 8, 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, January 30, 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 on the course of this call are against the same period in the prior year, unless otherwise stated.

On the subject of accounting standards, effective fiscal 2019, we will adopt the new ASC 606 revenue recognition standard for GAAP net revenue. We will continue to provide the GAAP measures to enable investors to derive the management reporting metrics. We do not expect a material



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

impact to net bookings. For more details, please see the brief qualitative overview of the impact of ASC 606 we have posted on our IR website. For additional information, also please see our 10-Q for the period ended December 31, 2017.

Now I'll turn the call over to Andrew.

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

Thanks, Chris. Q3 was a quarter defined by strong performances and important learnings for us in Electronic Arts. We love making games. It's a privilege to bring fun and entertainment to people all around the world. As we look across our games and services this quarter, we have a lot to be proud of. We brought hundreds of millions of hours of play to fans during the holiday quarter across console, mobile and PC.

We also appreciate that our players have high expectations of us and the games we make, and that passion drives us. As we push the boundaries with every new experience, we are continually listening, learning and taking action to serve our players.

Now let me touch on Star Wars Battlefront II. This was definitely a learning opportunity. You remember that we brought 3 of our top studios together on this project, and the result was a massive game with a new Star Wars story, space battles and huge multiplayer variety. We wanted a game that would meet the needs with our vast and passionate Star Wars fan base, so we designed it with the intent of keeping the community together and a commitment to continually add content long after launch.

Given the newness of this design, we knew that player feedback during the prelaunch testing period would be key. Having made adjustments based on sentiment and community data coming out of the beta and at early trials, we ultimately made the decision to pull in-game purchases out of the game prior to launch. We never intended to build an experience that could be seen as unfair or lacking clear progression so we removed the feature that was taking away from what fans were telling us was otherwise a great game.

We are fortunate to have such passionate players that will tell us when we get it right and when we don't. We're now working hard on more updates that will meet the needs of our players, and we hope to bring these to Battlefront II in the coming months ahead. Having made these changes before launch, Star Wars Battlefront II has been delivering fun to millions of players around the world through the holiday season and beyond. With the breadth and depth of the game, fans spent twice as much time playing Battlefront II over the previous game during the launch quarter.

The unique story of Iden Versio at the center of the game has drawn nearly 7% of players into the single-player campaign. Engagement has been strong in the first season of free post-launch content from The Last Jedi, and we're excited to bring new seasons to fans in FY '19. As we grow this game with more content, we believe that Star Wars fans will continue to have fantastic experiences over the long life of Battlefront II.

Going forward, we believe that live services that include optional digital monetization, when done right, provide a very important element of choice that can extend and enhance the experience in our games. We're committed to continually working with our players to deliver the right experience in each of our games and live services.

Across the company, our fantastic creative teams are constantly pioneering new experiences that expand our reach and add to the unmatched depth and breadth of our portfolio of games. There were many great examples of this throughout Q3, and I'll touch on a few of them here.

FIFA continues to thrive as one of the world's leading entertainment properties. On console alone, our FIFA franchise had nearly 42 million players during the calendar year, and our FIFA 18 unique player base grew 10% year-over-year from launch through Q3. FIFA Mobile added another 26 million players in the quarter to its total player base, more than any other quarter in the last 12 months, and millions more joined our FIFA experiences in Korea and China this year.

Ultimate Team is more popular than ever across our EA SPORTS titles. And in FIFA Ultimate Team, we had 12% more players year-over-year from launch through Q3. In other areas of our portfolio, Battlefield 1 now has more than 25 million unique players live to date, putting it on a similar growth trajectory as Battlefield 4's massive community.



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

The Sims 4 had another extraordinary quarter as we launched our highest-performing expansion pack to date and brought the game to consoles for the first time. Both of these contributed to player base growth in our Sims 4 community of more than 35% year-over-year in Q3. Need for Speed Payback also brought new experiences to long-time fans this quarter.

On mobile, we're bringing more players into our network from across the world through the unique breadth and depth of our IP. From deeply engaged fans in Star Wars Galaxy of Heroes to large long-term communities in our EA SPORTS titles to Sims FreePlay and mobile, our mobile games are reaching a wide and diverse audience and delivering years of high-value entertainment.

Competitive gaming continues to be a major growth opportunity for us. We are bringing some of the biggest sports franchises in the world to the esports stage. And with new league partners, sponsors and broadcasters, our Madden NFL and FIFA competitions are reaching new milestones.

The Madden Challenge special in the CW Network was the #1 esports television broadcast in the U.S. for 2017. And our Madden Challenge live finals in December drove our largest digital viewership to date for a Madden tournament.

On the FIFA side, we just kicked off The Road to the eWorld Cup with the Champions Cup in Barcelona last weekend. Digital viewership was massive with more than 17 million total views. That's half of last season's total views in just our first tournament of the year. We're also a partner in leagues like the MLS, Bundesliga and more to bring competitive FIFA deep into their fan bases, expanding our global opportunity.

Next, we're bringing competition to Battlefield with online qualifiers set to begin in Q1 FY '19. Across FIFA, Madden and Battlefield, this is going to be our biggest competitive season yet for players and spectators.

Looking to the quarter ahead, we're set to deliver a mix of amazing new games that will add to the breadth of our portfolio. First, later this week, we will launch UFC 3. We have a great partnership with the UFC and have worked hard over a 2-year development cycle to bring innovation across the entire game. With major UFC events coming in the months ahead, we're delivering UFC 3 at a very exciting time for the sport and its fans.

During the fourth quarter, we will also launch the first 2 games for our EA Originals program, Fe and A Way Out. As you remember, we started the EA Originals with a commitment to help independent developers bring unique and memorable games to the world. We can't wait to see fans come out and support these deeply talented creators and the ideas they have brought to life in these games.

Also in Q4, The Sims Mobile will launch worldwide on iOS and Android. This game is a major leap forward for the franchise, combining unique Sims magic with new dimensions of social play. Sims players are some of our most diverse and committed fans, and with games like The Sims 4 and The Sims FreePlay, we've shown how we build and deliver for these communities over many years.

In FY '19, we will push the boundaries even further for our players with new experiences and constant innovation. It's a World Cup year. And with the largest sporting event on the planet set to reach billions of soccer fans, our EA SPORTS development teams are packing excitement into our next FIFA. Madden NFL, NHL and NBA Live will all bring new dimensions of gameplay, self-expression and social connection.

The Battlefield universe will grow this year with our next Battlefield title, captivating long-time fans and new players alike and adding to our Battlefield service where players can move seamlessly with their friends.

Our new IP, Anthem, is a stunning project from BioWare that will blend genres with a shared world experience that evolves around its players. Excitement for Anthem is building, and we're deeply invested in delivering a great new experience with this game when it launches in Q4 FY '19.

In addition, we plan to launch 2 new mobile games built around fan favorite IP. We'll grow in esports with competitions and broadcast content reaching more players and viewers, and we'll continue to deliver for players through our live services, including Star Wars Battlefront II, with more great content for the games they love.

This collection of amazing games and content across more platforms wrapped in live services is at the core of the network we are building for our players. With competition and subscription offerings that we will expand in new and innovative ways, we are reaching new audiences.



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

Our amazing creative teams, including the addition of the talented group at Respawn Entertainment, our Frostbite engine, our central technology platform and our labs groups are putting us in position to be disruptive and deliver the unexpected. We're excited to bring many more great experiences to our global network in this quarter and beyond.

Now I'll hand the call over to Blake.

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

Thanks, Andrew. Electronic Arts delivered earnings above our guidance absent a one-time impact from tax reform. Sales of Star Wars Battlefront II underperformed our expectations but event-driven live services significantly exceeded them. This speaks to the stability of a business as diverse as ours with its broad portfolio of titles and mix of business models.

Our reported 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 \$1.160 billion compared to \$1.149 billion a year ago. Operating expenses were \$680 million compared to \$637 million a year ago, with the year-over-year increase primarily due to continued investments in existing and new genres and in live services.

GAAP operating loss was \$21 million compared to an operating loss of \$4 million a year ago and, together with the charge from tax reform, resulted in a loss per share of \$0.60 compared with \$0.00 a year ago. Almost all of the year-on-year change, approximately \$0.57, was due to the tax charge. Note that given our GAAP results for the loss, our share count was 308 million shares. Had we reported a profit, the diluted share count would have been 311 million shares.

Operating cash flow for the quarter was \$849 million, down \$288 million from last year. The decrease was driven by the timing of collections and by lower net bookings. Capital expenditures for the quarter were \$24 million, resulting in a free cash flow of \$825 million. Operating cash flow for the trailing 12 months was \$1.514 billion. We remain on track to deliver operating cash flow of \$1.6 billion for the fiscal year, which would be a new record. See our earnings slides for further cash flow information.

During the quarter, we repurchased 1.4 million shares at a cost of \$150 million, leaving \$778 million in our 2-year \$1.2 billion buyback program we began in May. We also paid \$151 million in cash to acquire Respawn Entertainment. Our cash and short-term investments at the end of the quarter were \$4.9 billion, with 36% of this balance held onshore.

Now I'd like to turn to the key drivers of our business in the quarter. Net bookings for the quarter were \$1.971 billion, down \$99 million on the prior year, which benefited from a strong Battlefield 1 launch. Net bookings for the quarter were \$29 million below our guidance, driven by lower-than-expected sales of Star Wars Battlefront II.

For Q3, we had expected to sell about 8 million units, but we fell short of that by less than 1 million units. However, this shortfall was significantly offset by excellent performance from our live services. The impact of FX was immaterial on the quarter.

Digital net bookings were \$1.23 billion, up 12% on a year-ago period and a new record for the third quarter. The main driver of this increase was live services, offset by lower sales of Star Wars Battlefront II compared to Battlefield 1. Digital net bookings now represents 67% of our business on a trailing 12-month basis compared to 60% in the prior year.

Looking at each of the components of this quarter's digital net bookings in turn. Live services' net bookings were 39% year-on-year to \$787 million. The increase was driven by Ultimate Team and The Sims 4. This was a record for the third quarter. Mobile delivered net bookings of \$183 million, up 5% year-on-year, also a record for the third quarter. Year-on-year growth was driven by FIFA Mobile.



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

Full game PC and console downloads generated net bookings of \$260 million, 27% lower than last year, driven by Star Wars Battlefront II compared to Battlefield 1 last year. This was partially offset by the underlying growth in digital downloads. Star Wars Battlefront II units on console were 28% digital, up 12 percentage points over Battlefield I 2 years ago.

Across the portfolio, 37% of our full game unit sales were digital, measured on Xbox and PlayStation 4 over the last 12 months. This compares to 32% a year ago.

Before turning to guidance, a brief note on tax reform. The enactment of the Tax Cuts and Jobs Act in December 2017 resulted in a charge of \$176 million in the third quarter. The charge is preliminary and includes a tax on accumulated overseas profits and the revaluation of deferred tax assets and liabilities.

Also, while we are not changing our management reporting tax rate for fiscal 2018, we're still analyzing whether the new legislation will reduce this rate for fiscal '19. In addition, because the new tax legislation, the tax treatment for cash earned outside the United States, it provides an opportunity for us to repatriate most of our foreign earnings. During the coming months, we'll reevaluate our capital return and investment strategy, including our stock repurchase program and whether we should consider a dividend. We would like to expect -- we would expect to announce any changes on our next earnings call.

On the guidance, we are raising our full year GAAP revenue guidance from \$5.075 billion to \$5.1 billion on the strength of our live services. Our guidance for full year EPS becomes \$3.25. Excluding the impact of \$0.48 from tax reform, this represents a \$0.10 increase on our previous guidance. We are reaffirming our operating cash flow guidance of \$1.6 billion.

We continue to anticipate capital expenditures of around \$120 million, which would deliver free cash flow of about \$1.48 billion. We are reaffirming our guidance for net bookings at \$5.15 billion but, owing to the strength of our live services, we expect this to skew more digital than originally anticipated, increasing our profitability.

For the fourth quarter, we expect net revenue of \$1.532 billion, cost of revenue to be \$234 million and operating expenses of \$619 million. Q4 OpEx is up slightly from our previous expectations, driven by phasing of investments from Q3 and stock-based compensation expenses related to the Respawn acquisition. It is up year-on-year primarily due to continued investment in existing and new genres and in live services. This results in an earnings per share of \$1.86 for the fourth quarter, using the diluted share count of 311 million shares.

We anticipate net bookings for the quarter to be \$1.225 billion. This is a raise on our previous expectations and up 12% year-on-year, driven by strength in live services. We continue to be excited about our opportunities for the future. Though the fourth quarter and fiscal -- through the fourth quarter of fiscal '19, we'll be launching games across 5 different genres: sports, action, shooter, real-time strategy and sim. We will launch them across 3 platforms, PC, console and mobile, and we'll reach players in all corners of the world.

We expect full game downloads to continue to grow, and we see growth in subscriptions, extra content and in our mobile business. We expect esports will continue to drive growth in Ultimate Team as well as Battlefield and other titles. This will also grow our broadcast, sponsorship and advertising deals associated with our esports activities. This revenue -- or this diversity in portfolio, platforms, geographies and business models is the foundation of a robust business that enables us to deliver dependable cash flow.

Now I'll turn the call back to Andrew.

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

Thanks, Blake. Across the world, more people are playing more games in more geographies through more devices and more ways to connect. It's a vast and growing audience in the billions, with increasingly diverse interests and high expectations. Reaching players with the fun and meaningful experiences they seek requires the best games and content available across multiple platforms. It requires more ways to engage with that content, including competition, and it requires a strong connection to the community, the openness and dialogue that make this industry so unique and powerful in the entertainment world.



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

Today, EA has one of the most wide-reaching portfolios of top games and franchises in the industry. Through FY '19 and beyond, we are planning stunning new additions that will continue to grow the depth, breadth and quality of experiences we bring to fans around the world. Our DICE Studio would deliver the next Battlefield with innovation at every level, incredible stories at the core, astonishing visuals and gameplay that will captivate every Battlefield fan.

Building on one of the strongest years ever for EA SPORTS, we're setting our sights to excite even more players and deliver even more advanced experiences with our next slate of games. Anthem will bring a rich and dramatic new world to players built from the ground up by BioWare as a new IP that we believe will reach a wide audience and foster our long-term community. We'll take major leaps in our mobile portfolio with 2 new titles set for this year and more to follow as we continue to focus on high-quality long-lasting games.

And there is so much more to come in the years ahead with new projects in development at Motive, Respawn and our other studios, as well from all games from the indie developers in our EA Originals program.

We're also creating more ways to connect with our franchises, including competitive gaming that reaches tens of millions of players and spectators. With FIFA and Madden, we've broken new ground, bringing global competition to some of the most passionate fan bases in all of sports. Now with league partnerships, broadcast partners and sponsors on board, we're driving even larger audiences with thrilling high-stakes competition.

Competitive Battlefield will open up a brand-new dimension of our esports programs beginning next fiscal year. And by the end of FY '19, we will launch competition in a fourth title as well. esports is also fueling opportunities for us in growth regions of the world, driving excitement with our players across China, Korea, the Middle East and more.

In all of this, we are leading in service of our players and strengthening the connections at the heart of our global network. We are constantly listening, learning and working to make every player experience better. With our subscription services, we're removing friction so players can enjoy more of the games they love. And in FY '19, we'll be doubling down with new offerings.

By leveraging the cloud, we're exploring ways at streaming, and other technologies will enable those experiences to be even more seamless. And through our Frostbite technology, we are pushing the boundaries in every aspect of games today.

With an amazing collection of games and content, thrilling competitions for our global audience and a network built on the strength of our player connections, EA is uniquely positioned to lead in the expansion and evolution of this industry that we love.

Now Blake and I are here for your questions.

QUESTIONS AND ANSWERS

Operator

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

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

So you called out live service revenue growth of 39% in the quarter, and I don't think we've seen that level of growth, quarterly growth since fiscal '15. So I was wondering if you could help us understand the components of that a bit better, in particular, what drove such a strong acceleration in growth for Ultimate Team. And then just a second question, when it comes to live services, you mentioned the learning experience that you have with Star Wars. So now when you think about how to build the digital economy for your nonsports titles, can you maybe talk a bit about how your philosophy has changed there, if at all? And are you now more focused on cosmetic items? Or do you still think [collection] mechanic can work well for a shooter or an action title?



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

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

Thanks, Chris. Let me -- this is Blake. I'll start with the digital question, and I'll let Andrew answer the second one. So we were very pleased with the live service growth and the strength of it across all of the franchises. I think first and foremost, FIFA and Madden had fabulous Ultimate Team experiences during the quarter, great events driving continued deep engagement. The opportunity that we did with last year with FIFA to bring a single-player story mode into the game helped drive Ultimate Team last year and FIFA and continued that this year. The same thing occurred in Madden, as it brought more people into Madden and it brought them into Ultimate Team. That, in combination with the esports business that we've been building around Ultimate Team in those 2 properties has proven to be extremely exciting for the consumer and driving a huge level of interest in Ultimate Team and participation in Ultimate Team. Beyond those 2 properties as well as hockey, which continues to do well, and UFC is starting to grow and basketball's starting to grow around Ultimate Team. The Sims 4 added a substantial amount to extra content live services. The continuation of our successful content packages that we shipped with The Sims 4 was very strong during the quarter. And then as we brought The Sims 4 out on console, that also started that process for the console side of the equation. So we're excited about the continued future of The Sims 4 and, clearly, that in mobile down the road. Battlefield 1 continued to help monetize live services in their extra content program. And the combination of all of that really drove the massive growth in extra content during the quarter and helped balance out the business model. So -- and as I mentioned just a moment ago, competitive gaming, we believe, continues to be a big driver there going forward. We'll see that in the Battlefield franchise, I think, as Andrew mentioned. So that's the extra content piece, I'm going to let -- the live services piece. I'm going to let Andrew address the other question.

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

Thank you, and a great question. We were making it into a long-term strategy of building amazing games that offer compelling event-driven in live services and believe that digital economies can have a place in those live services as we see that accepted across the industry in our games and in other games. But I think the greatest learning is there's no single model. And it's more about how we can deliver the most engaging experience to players with new content and game updates. So for some games like The Sims, we continue to find that DLC packs do really well with the community, and that works well in that construct. We also know that when larger games like Battlefield and Star Wars Battlefront, premium content after launch is valued by the community but only where we can offer it in a world where we don't bifurcate the community. And so it comes to us being really careful and considerate in designing models for post-launch content that will be authentic and engaging but, most importantly, offer player choice. And as you see us continue to work on Star Wars Battlefront II, as you see us continue to evolve this in the broader event-driven live services across our portfolio, at the very center, really, we want to offer is choice, player choice in a world that keeps the communities together.

Operator

And your next question comes from Justin Post from BAML.

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

I guess my questions will be on future titles, given some of the recent controversies. First, maybe talk about Anthem. It seems to be -- have pushed out to the fourth quarter. What's your confidence in that build, in that game? How do you think it's coming along and maybe a little bit why it was maybe delayed a little bit? And then with Star Wars having some issues versus your guidance, how do you think about that as a franchise? Can that come back in 2 years and be really strong again? And how are you thinking about that franchise?

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

The first thing about Anthem is regardless of kind of how it's being portrayed, we're not looking at that as a delay in the game. We've chosen to launch Anthem in Q4. And the date is really determined by portfolio-balancing considerations, not for product readiness reasons. It's tracking well on its development milestones. We're really confident of its ship date. We're really excited by the way the next Battlefield is shaping up. And it makes sense -- it probably doesn't make sense to launch Anthem right up next to it. And when you think about Anthem as a brand-new IP, we also



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

believe it makes sense to give it its own launch window so that we can give it the focus and attention it deserves and give it some free air. In terms of Star Wars ongoing, again, we remain committed to the franchise. We think that Star Wars Battlefront II at its very core is an amazing game. The team is working diligently on updates and extra content for the live services around Star Wars Battlefront II. We expect to be -- the response, as I said in the prepared remarks, has been really strong with the content we've released so far. We expect the response to continue to be strong as we bring that content forward. And we're going to really look after that community and support and sustain that community and fulfill the commitment we made to them for a long time to come.

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

Yes, Justin, just as a reminder, we have not obviously announced products for our fiscal '20 yet but remember that we have a Star Wars action game that the team at Respawn has been working on for the last couple of years and, most likely, that would drop in fiscal '20 versus another Battlefront. We haven't decided exactly the timing for another Battlefront yet. But clearly, the next big Star Wars game would be the action game in fiscal '20.

Operator

And your next question comes from Stephen Ju from Crédit Suisse.

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

So Andrew or Blake, it seems like to me FIFA Mobile presents one of the largest incremental opportunities for you, given the installed base of devices and the global popularity of soccer. So I'm wondering what drove the 26 million-player increase to the base and what you may be doing in the background to improve the game's performance. I think the dialogue today has been you guys were looking to optimize the game. I'm just wondering if you guys have turned the corner here.

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

Well, I don't know if I would say -- ever say turn the corner because it's a huge long-term plan, but we're seeing incredible improvement in the game. We're very excited about what we're seeing. But it's been on the road map that we've been talking about, the similar roadmap that Madden followed of 2- to 3-year improvement cycle in the game where we're constantly updating and then building better and better events around for the players, and that's the same approach that we're taking with FIFA. It is now trending to be our #2 or #3 game, depending on where Madden is, behind Galaxy of Heroes. But it's really moving in the right direction. We're very excited, and we're continuing to tune it almost daily. The team's incredibly committed to making this one of the largest mobile games in the world, and we think it certainly has potential. And as you can imagine, World Cup will be part of that road map going forward and some exciting things coming there as well.

Operator

And your next question comes from Brian Nowak for Morgan Stanley.

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

I have 2. Just the first one on the strength of the FIFA and the Madden Ultimate Team, another very good quarter. I was wondering, could you talk to the composition of that Ultimate Team live service growth between bringing new payers into the ecosystem versus ARPU? And maybe just some of the key that you see to bringing more payers into the ecosystem going forward? And the second one, kind of a bigger picture. Over the last couple of years, you've talked a lot about diversifying away from nonsports titles. And unfortunately, some of the nonsports titles have performed below expectation. As a postmortem, I guess, can you give us some examples of areas you see for opportunity to improve your ability to execute and consistently kind of deliver the titles and really drive nonsports franchises through the company?



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

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

Sure. I'll start on the Ultimate Team, and then I'll let Andrew address the second one, with the caveat of saying, the last I checked, last year's Battlefield was one of the largest Battlefields -- or was the largest Battlefield of all time. So I would probably say that might put a little question in how you phased our success rate in nonsports. So -- but to your point on live services around Ultimate Team, the biggest driver has been to continue to bring new people into the franchise. We grew the FIFA franchise this year in the low double-digits, which is, on the largest game in the world, probably one of the most amazing feats that we continue to do year in, year out through amazing innovation in the game and incredible improvement around the consumer experience, the gamer experience with the game. That, plus bringing more people into Ultimate Team, has really been the major driver. It is the single most popular way to play the game. People start to think about FIFA as really Ultimate Team more than they do the underlying game itself. It's so exciting for people because it's constantly changing, and it has new and exciting events every single week to bring people back. So it is truly a live service that's being driven every day and every week versus a single game. Madden follows that same trail as well as hockey, UFC and basketball. And all of those efforts have been on how do you bring more and more people into the Ultimate Team world versus how do you try to increase the ARPU on the people that are already there. We find that the ARPU increase happens naturally as people spend more time playing. But at the end of the day, our effort is primarily on bringing more people into the franchise through making sure they understand it, making sure they find ways to play it and enjoy it. For example, this year, we've addressed an issue where people who didn't want to play online, they still wanted to play Ultimate Team, we created a mode so they could do that. So it's ways to continue to bring people into the franchise overall as well as into Ultimate Team versus ARPU. So...

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

Yes. And on to the second part the question, I echo Blake's sentiment a little bit. As I look back over the last few years and we think about The Sims, which has continued to perform year-over-year; Battlefield 1, which in its year, I think, was either -- it's certainly the biggest Battlefield and maybe the biggest shooter of that year; Plants vs. Zombies Garden Warfare, which is a new IP that has done well across 2 iterations; Dragon Age: Inquisition which, in that year, was game of the year; even if you look at Mass Effect, and while there was some polarizing sentiment in that franchise, it's actually performed really well, and player engagement is really strong; and then of course, across mobile, SimCity BuildIt, The Sims FreePlay and Star Wars: Galaxy of Heroes, all highly successful in their own markets. So as I take a 50,000-foot view and look at the breadth and depth of our portfolio across all of the games we make, and even you look at last -- in 2017 in aggregate, we were the highest reviewed publisher across our entire portfolio. So there's a lot of real goodness there. With all of that said, that doesn't mean we are perfect, and there are always learning opportunities for us. And we are a learning company. And as you look through our history over the last 3 or 4 years, there have been times we didn't quite get it right. And we have put our player-first commitment at the forefront of everything we do, and we have worked tirelessly to ensure that we're able to support and sustain them with the kinds of experiences they expect from us. And so that has meant we have changed some beta processes, we have changed some testing processes, we've changed some of the ways we've designed, and we've changed some of the ways we go to market. And as a company, we will always be learning and always evolving and always making the right changes in service of our players. But on balance, I think we've had a really, really strong run on sports and nonsports.

Operator

Your next question comes from Eric Sheridan from UBS.

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

Maybe 2. One on EA Originals, how should we think about the sizing of the opportunities for those sorts of games as well as maybe the marketing support that's needed for those games versus more traditional titles that you've seen that might have had bigger budgets on both the development side and the marketing side? Second question, obviously, the World Cup in the calendar 2018, how do you think about a framing of the World Cup? What it means for FIFA broadly as a franchise, both in mobile and in nonmobile, broadly as you look out over the next 12 months?



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

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

Let me take the first one, I'll let Blake take the second part. Again, a reminder, EA Originals for us is really built on a philosophical belief that we need to encourage all forms of game development to keep the industry healthy over time. We see this in the indie music business, we see it in the indie movie business. And in a world where, today, to compete with the likes of us and some of the other players in our development publishing space, you need hundreds of millions of dollars. And that probably means that some of the really interesting, different quirky ideas never get to make it into players' hands. And we believe that as a company with the kind of leadership position that we have that it's actually our responsibility to help those games get into the players' hands. And through the process, that probably means they're not going to be giant games in the first part of it, and we don't look at it that way. But we do believe it's our responsibility. And we think there is the chance, as we work with these great, creative developers, who are doing new and interesting and innovative things, that we may find some great new IP for the future. And as we build those relationships with those kind of indie developers, we think it's an opportunity for us to continue to push the entire industry forward and give us access to some ideas that we may not otherwise see, both inside the company or inside the industry.

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

And just one final point on that from a financial standpoint, and you should assume that the financial impact is negligible. We would love these titles to become big breakout hits, and we're not saying they won't. But right now, in our guidance for the fourth quarter, we're not planning on big revenue component of it, and we provide the profitability back to the developers, so it's not really a profit issue. It's -- there's some revenue generated, but it won't be very large for the quarter. But we do think there'll be great games that live on for a long, long period of time on multiple platforms. In terms of World Cup and how we think about that, as you know, the World Cup doesn't start until the summer, so it really will fall into next year's fiscal. We'll give you some details when we give guidance around what we think the impact of that will be. But as we have in the past, we've had a long tradition of celebrating the World Cup inside of FIFA and bringing it to life for our fans. That goes all the way back, I think, to World Cup '98 where we really started it going. And we've got some exciting and fun things to announce that will come on later this spring before, obviously, the World Cup gets going. And since I'm on next year, I might as well talk a little bit about Q1, just to make sure everyone remembers a few facts from last year. We expect '19 to be a growth year for EA. We've talked about World Cup; continued strength in all of our sports titles; the emergence of the next Battlefield, which is extremely exciting, as Andrew mentioned; as well as our new IP, Anthem. All of that should turn out to be a fabulous year for EA. The one thing I'd want to remind people is all of that stuff comes past Q1. So as you're looking at Q1, remember, last year, we benefited from a \$53 million deferral of Mass Effect revenue into the quarter. We shipped Mass Effect at the end of Q4, but there was a deferral on the premium revenue, which shipped fairly high profitability revenue into Q1. And we benefited as well from some one-time adjustments when we shut down our distribution center in Switzerland. And so the combination of those 2 is probably worth somewhere between \$0.15 and \$0.20 of EPS, so just remember that as you're thinking about the quarters. We'll, obviously, give everyone quarterly data, the type of data that we give every year when we give guidance. But I just want to keep people aware of that as you think about next year's quarter. But we're extremely excited for FIFA, for World Cup and for the year to come. It looks like it's going to be another great year for EA.

Operator

Your next question comes from Ben Schachter from Macquarie Research.

Benjamin Ari Schachter - *Macquarie Research - Head of TMET Research*

A few high-level questions. One, can you just talk about how your view of esports has evolved really over the past couple of years? You used to talk about it as much more of a sort of marketing driver, and then now it has -- so that changed. Second question is just how do you think the success of PUBG has impacted your development? And why do you think it's been so successful? And then finally, Blake, any update on potential new streaming models or expectations for new platforms?

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

So why don't I let Andrew talk about esports and PUBG, and then I'll talk about the last question.



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

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

So I think what you're seeing right now is actually our strategy around esports coming to life. I don't believe there's been a material shift for us. We always believe, at its very core, esports is going to drive tremendous engagement in our community and allow us to reach broader communities of viewers who maybe have never played our games before. And in doing so, we would see growth in the core digital businesses of the games that we'll feature in esports. And so you're seeing that right now in FIFA and Madden, and we expect to see that in Battlefield also. What's actually happening is we're getting to our milestones quicker than we had planned. And we had always believed that, over time, as we've built greater engagement, as we've built greater viewership and as we added more titles to our portfolio of competitive games, that new opportunities around media rights, broadcast rights, sponsorship rights, would also come into play for us. And we're overjoyed with the performance so far. Our Competitive Gaming group is doing spectacular work, the global player bases in FIFA and Madden, and we expect Battlefield and future titles continue to engage and play these spectacular games and put an amazing entertainment for viewers. And that just means that we're accelerating in terms of where we think other growth vectors and profitable revenue might come from over time. In terms of PUBG, again, I think what you discover in this industry is there's a lot of great vectors that drive player engagement. And one of those is just innovation in the core gameplay mechanic. And what the team, with PUBG, have done is really deliver a new level of innovation that change the way people were playing first-person shooter games. And we're very respectful and complimentary on what they've been able to do. We've seen that continue with Fortnite again, so it's clearly a mode of play that the global FPS population are interested in. And given that we have some of the best shooters in the marketplace, you might expect that we're also thinking about new and innovative ways to play. And that doesn't mean just kind of PUBG replicas inside of the Battlefield universe, but it does mean that our Battlefield teams, and I've talked a little bit about this in the prepared remarks, are looking at how they innovate in every aspect of the game, including core gameplay and map design.

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

On the streaming question, I think as we've talked about before, we see -- as we look at the media industry, we've seen one of the greatest disruptions has been the combination of streaming plus subscriptions. We think that combination is critical. And we see the ability to have live services, which allows you to monetize on top of subscriptions, is also incredibly important. And obviously, that plays to our strength. We've built a long history already in the subscription business, and we have a long history in live services. And we think the combination of that experience, plus delivering through streaming, may be very important in this industry going forward. We've been doing some consumer streaming trials. We've done them over both cable and -- traditional streaming over cable as well as now through the use of local clients to help with streaming through data centers. We're obviously having a very successful subscription experience both on EA Access as well as Origin Access. And with it building actively, as part of the investments that we've been making, our player network through a technology infrastructure internally any that helps players transition and connect with friends, experiences -- experiencing more content across multiple platforms. We think that's important and also very important in the streaming world. And we've been working with some of the largest partners out there on potential business models for streaming. We'll continue that work, and we'll continue work on the technology side ourselves. And I'd say that between -- in the next 2 to 5 years, you'll see some major movements there with probably some testing that occurs versus the shorter side of that versus the longer side, maybe even earlier. More to come, but it's obviously something we've been trying to invest in across many different vectors, and we're extremely excited about it.

Operator

Your next question comes from Ryan Gee from Barclays.

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

So we really appreciate the color on the unit sales for Star Wars. I was hoping you guys could just clarify what you're doing to restructure the MTX portion of Star Wars. And assuming that are still committed to delivering content for sale, how we should think about the time line there and maybe how meaningful Star Wars could be, the top and bottom line in year 2 of its life.



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

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

Yes. So I think as we talked about in the prepared remarks, we believe that digital economies have a place in event-driven live services. And our plan is absolutely to continue to drive and focus and deliver on that. And the teams are working on how to -- how that will fit in the context of the Star Wars Battlefront II universe. And we expect, over the next coming months, we'll have more to share on that front.

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

Yes. And in terms of financials, Ryan, I think, as you know, we're inherently conservative in how we try to forecast. And we did not build very much revenue at all into this year's forecast for Star Wars. And while we haven't given guidance yet, as we're doing our budgets for next year internally, we're assuming that until we have a proven model that we are confident of, we're probably not going to build a lot into our budgets either, i.e. then into our guidance. More to come when we give our guidance. But don't take that as a negative in any way. It's simply conservatism around how we're trying to drive the business. As Andrew said, it's very important to us long-term because we think it's very important to how fun the games are and how people will enjoy the games. We just need to make sure we get the model exactly right.

Operator

Your next question comes from Andrew Uerkwitz from Oppenheimer.

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

If we remove World Cup out of the equation for a second and just starting about FIFA maybe longer term, where is the opportunity in growing that franchise? Is it kind of increasing the player base, increasing ARPU? And on the gaming side, you've added a lot of new features over the past couple of years. Do you still see room for more features?

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

Great question. And as we think about FIFA, the beauty of FIFA and the greatness of FIFA is that soccer or football in many parts of the world is the world's game and just goes from strength to strength across the globe. And so really, the opportunity with FIFA is really, really strong. And we think about it on a few key vectors. And they all involve, at first level, growing the total addressable market. So right now, we have tremendous geographic expansion opportunities. And we've talked a little bit about our China presence and how well it's doing there; the Middle East is opening up as a tremendous opportunity for FIFA; the U.S. continues to grow; Southeast Asia continues to grow; and the passion, quite frankly, across Europe continues to grow. Next, we think about this in terms of platform expansion. And as consoles continue to grow, and again, there were more consoles sold this generation than any generation before on PlayStation and Xbox. PC is kind of -- is making a resurgence for gamers, and FIFA has a very strong PC presence. We talked in our prepared remarks around mobile. And Blake talked a little bit about how we think about streaming long-term to really remove the barriers to entry to bring in more people. And then 2 of the most powerful motivators of human behavior on the planet, competition and social interaction. And so as you think about the types of games and features that we'll continue to build inside the FIFA universe, as we bring this multibillion global community of football fans together, are features that actually drive greater social interaction. As a sports fan, the thing I want to do most is interact with the sports fans. And as a competitor, the thing I want to do most is compete. And you're seeing this now around our competitive moat. But you should also expect, as we branch out in geographies and platforms and new access models like streaming and subscription, that features around social interaction and competition continue to be at the very core of what we do, and we think there's still tremendous opportunity there.

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

Yes, and I would add to that. One of the things that's made FIFA so successful for us is the deep partnerships that we built with the leagues out there. And today, we don't have all the leagues, so we're constantly looking at what leagues are emerging, what leagues are extremely strong and



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

where can we better partner with leagues going forward. And it's been a fabulous way to help grow the business and help grow the support of football around the globe. The leagues see us as a major way that they can market their product, their players, their teams, their stadiums. And we see it obviously as a perfect business combination for us. And so part of our growth strategy going forward, particularly in new geographies, is how do you make sure you have the leagues for those geographies. But even in mature geographies where we might not be fully exposed to all the leagues, we're trying to make sure that we're driving that. It's an incredible competitive advantage for us to be able to have those deep partnerships, and we're going to continue to try to leverage those to help grow the product across all the platforms that Andrew talked about: mobile, streaming, PC and the core console business.

Operator

Your next question comes from Mike Hickey from Benchmark Company.

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

Two on loot boxes. One, sort of the ground level, curious if Disney has formulated any sort of opinion on whether they're comfortable with that sort of monetization mechanic in Battlefront or feature games. And then maybe from a higher level, how we should think about balance of risk in this sort of constrictive framework emerging around loot boxes and maybe how you think about -- if you do see that as a risk, how you think about mitigating that as a company or -- and/or as an industry?

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

So first, I would choose my words carefully. You shouldn't believe everything that you read in the press. We have a tremendous relationship with Disney. We have built some amazing games together, Battlefront, Star Wars: Galaxy of Heroes and even -- and Star Wars Battlefront II. And we have been very proactive in that relationship in service of our players. And so at a point where we make the decision that we believe we have the right model for our players and our global community, I have no doubt that we will get the support of Disney on that. And again, as we look forward, the big learning is there is no one-size-fits-all when it comes to event-driven live services. But at the very core, we must always build on a foundation of player choice. And that might be the choice of whether a player engages in a particular mode or not, that might be whether a player decides to grind for something or not. But in all things, it's around providing a fair playing field where players feel they have choice. And you should expect that we will continue to drive hard against that and ensure that -- again, we didn't set out, as I said in the prepared remarks, to build a feature set that could be perceived to be anything other than fair. It's clear that we didn't get quite that balance right, but we are doubling down now to ensure that we do.

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

Yes. And I'll just add, we do not believe that loot boxes and similar mechanics are a form of gambling. I think there are plenty of governments around the world that would agree with us on that. And it's not just us, it's the entire industry. We work very carefully and closely with all of our industry partners and the ESA, the industry body, to make sure that people understand exactly what loot boxes are, exactly why they're not gambling. And we'll continue to engage in that going forward, we think that's important. And I think there's a lot of consumers that would argue the same thing based on the great experience they've had with fun games that have associated live services with them that some may be misconstruing as a loot box or a gambling mechanism.

Operator

Your next question comes from Mike Olson from Piper Jaffray.



JANUARY 30, 2018 / 10:00PM, EA - Q3 2018 Electronic Arts Inc Earnings Call

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

Just 1 question for me. You mentioned full game downloads continue to grow, I guess not a surprise. So what did you say it was in December, high 30s as a percent of the mix, I think, or something like that. And what's your expectation for calendar '18? Will it be like 10 points of growth over the next year? Or should we expect more incentives from either console makers or publishers to push that trend? And then also, is it still the case that full game download is 15 to 20 points better gross margin-wise? Or has anything changed on that front?

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

Yes. Nothing has changed on the margin front. We finished the year around 37% -- for the calendar year, around 37%. And as you know, we're still a little below the industry. I think the industry is getting closer to 40%. We skew a little lower due to the global nature of FIFA. And then also Battlefront II, while it came up 12 points from Battlefront I, still skewed in the high 20s versus the high 30s, primarily due to gift-giving and a younger audience base. But we see all of the right trends helping that. We still have our forecast as kind of 5-plus points a year. Obviously, we've been on the low side of that for the last couple of years. But I think at a minimum, we should see 5 points of increase each year and, hopefully, it's greater than that. We don't see a cap anytime soon because we know more and more players are realizing it's a much more convenient, easy and engaging way to play. Many players have been already buying extra content and have -- thus, have a way to have digital purchases as part of their overall gameplay. And we believe the consumer will ultimately default towards convenience, however that might be. It might be they still have a store around the corner from them, or it might be they don't, and it's easy for them to buy digitally. But you'll see us continue to do things to try to encourage people to buy digitally, and we think that's still a major key as part of the future of the business.

With that, I think we're out of time. I appreciate everybody's great questions and interest. And we look forward to seeing everyone over the next few months as well as talking again at the end of our Q4 when we'll give guidance for our fiscal '19 in early May. Thank you.

Andrew Wilson - Electronic Arts Inc. - CEO & Director

Thank you so much.

Operator

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

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