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EA - Q3 2013 Electronic Arts Inc. Earnings Conference Call

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OVERVIEW:

EA reported 3Q13 GAAP net revenue of $922m and GAAP loss per share of $0.15. Expects FY13 GAAP revenue to be $3.703-3.803b and GAAP diluted EPS to be $0.18-0.38. For 4Q13, expects GAAP revenue to be $1.115-1.215b and GAAP diluted EPS to be $0.92-1.12.

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PRESENTATION

Operator

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

Now I will turn the meeting over to Mr. Rob Sison, Vice President of Investor Relations. Thank you. You may begin.

Rob Sison - *Electronic Arts Inc. - VP, IR*

Thank you. Welcome to EA's fiscal 2013 third-quarter earnings call. With me on the call today are John Riccitiello, our CEO; Blake Jorgensen, CFO; and Peter Moore, COO. Frank Gibeau, our President of Labels, will be joining us for the Q&A portion of the call.

Please note that our SEC filings and our earnings release are available at ir.ea.com. In addition, we have posted earnings slides to accompany our prepared remarks.

Lastly, after the call, we will post our prepared remarks, an audio replay of this call, and a transcript.

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 actual results could differ materially from those discussed today.

Electronic Arts makes these statements as of January 30, 2013, and disclaims any duty to update them.

Throughout this call, we will discuss both GAAP and non-GAAP financial measures. The comparable Q3 GAAP measures for certain non-GAAP measures to be discussed are net revenue of $922 million; digital net revenue of $321 million; gross margin of 53.5%; operating expenses of $532 million; and resulting loss per share of $0.15.

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

Now I will turn the call over to John Riccitiello. John?

John Riccitiello *- Electronic Arts Inc. - CEO*

Good afternoon. In the third quarter of fiscal year 2013, EA's non-GAAP revenue was $1.18 billion, below expectations and guidance. The revenue shortfall was a result primarily of a miss with our Medal of Honor title and stronger than expected sector headwinds for console packaged goods.

Our Q3 non-GAAP diluted earnings per share was $0.57, above the midpoint of our guidance. We managed to deliver our Q3 EPS by driving our three brands aggressively, particularly FIFA, Battlefield and Need for Speed by a good visible growth and aggressive cost controls.

The two leaders that did much to deliver the EPS and Q3 are here with me today. Peter and his team drove hard on revenues, while Blake marshalled the troops on the cost side. Blake will explain more about the cost savings shortly, while Peter will outline the hits and misses on the revenue side.

At the sector level, we continued to see strong industry growth in most digital areas -- mobile, PC, and console DLC. The console package goods market is a different story. We saw an approximate 20% decline in calendar year 2012, and consumers are behaving in a way which reflects a console transition.

Overall volumes are down. We are seeing some great unit volumes on a few winning tribals titles. The losers are getting hit hard. Console transitions are difficult, but historically they initiate periods of strong growth, and for the companies ready to step up, these transitions represent significant opportunity.

Near-term, EA will complete the fiscal year with a strong lineup of Q4 titles. These include some of my favorite franchises -- Dead Space 3; Crysis 3 from Crytek Studios; the return of an industry classic, SimCity; and finally, an incredible game for smartphones and tablets, Real Racing 3.

Beyond Q4, we see a bright light at the end of the tunnel. For EA, digital remains a winner, and our investments are generating strong growth.

We're also investing in Gen 4 console technologies and content. We've signaled that we are working on the next editions of our two biggest franchises in Battlefield and FIFA, and we look forward to discussing these programs and many others with you when we provide our fiscal 2014 guidance in May.

With that, I'll hand off to our CFO, Blake Jorgensen.

Blake Jorgensen *- Electronic Arts Inc. - CFO*

Thanks, John. First I'd like to start with some details of the gaming sector during the quarter.

We estimate that the worldwide video game market grew in the mid single-digit percentages for 2012. The digital market grew more than 25% over the prior year with the mobile business being a significant contributor. The package goods market proved to be more challenging than initially anticipated, attracting about 20% relative to 2011.

We encountered two major challenges this quarter. First, Medal of Honor performed well below our expectations. Second, the package goods market underperformed in Q3 versus going in estimates. To counter these issues, we took proactive steps to drive revenue on driving titles like FIFA, Battlefield 3, and Need for Speed.

We also reduced spending on headcount, variable compensation, contractors, marketing, advertising, and other general and administrative expenses. These actions, combined with the higher-than-anticipated gross margin resulting from strong digital sales, enabled us to hit the upper end of our non-GAAP EPS guidance range, despite generating revenue below our forecasted non-GAAP revenue range.

Total Q3 non-GAAP net revenue was $1.18 billion, which was approximately 9% below the midpoint of our guidance. Compared to the same period last year, net revenue was down 28% due to the tough comp of Battlefield 3 and the launch of Star Wars - The Old Republic. Peter will provide more detail on our Q3 revenue and title performance, but here are a few highlights.

During the quarter, we saw strong performances from FIFA and Need for Speed. Madden was up over last year, and both NCAA football and NHL were down. Hockey, we believe, driven -- or hockey's lockout drove the NHL reduction.

The package goods side of the catalog was up over 16%, driven by the continued success of FIFA and Battlefield 3, and we had strong growth on the digital side. EA's Q3 non-GAAP digital net revenue increased 8% year over year to $407 million. The underlying growth is understated because we are defining the Battlefield Premium revenue. And if we included it in this quarter's results, digital revenue growth would have been 15%. The trailing 12 months for digital net revenue was nearly $1.5 billion, representing a year-over-year growth of 37%.

Breaking the digital revenues down by type for Q3 shows the following. First, full game downloads contributed $44 million, down 57% compared to the same period last year. Full game downloads have typically been driven by PC products such as Battlefield and Star Wars, and this quarter we did not have any PC-centric titles. The majority of our Q3 digital revenue full-game downloads came from FIFA, Medal of Honor, and Need for Speed. We believe that full-game downloads will grow in the future.

Extra content and free to play contributed $185 million, up 50%, led by FIFA and Madden Ultimate Teams and Star Wars - The Old Republic. These revenues relate to businesses on PCs or consoles where consumers pay for additional digital content, including virtual characters, map packs and microtransactions associated with browser-based games or MMOs like Star Wars.

As a reminder, on November 15, we launched our free to play option for Star Wars - The Old Republic. Very early indications have been positive, and we are pleased with the initial results. But it's still too early to know how successful this will be in the long-term.

Our mobile business, including handhelds, generated close to $100 million for the quarter and was up 18% over the prior year. The major portion of this revenue was driven by smartphones and tablets, which accounted for $79 million of the $100 million, growing 36% year over year. Some of this growth was due to the success of The Simpsons - Tapped Out on the iOS platform. We are actively developing Android applications for our key brands to address that growing market, as well.

Based on industry estimates, there is over 1 billion smartphones and over 200 million tablets being used currently. We continue to focus on this segment due to the evolution and the sharp growth in the smartphone and tablet markets.

And last, subscriptions, advertising, and other digital revenue contributed $79 million growing 18% over the same period last year. The current year includes a full quarter of Star Wars subscription, but it was offset by a decline in other licensing digital revenue.

As a reminder, the non-GAAP revenue continues to exclude our Battlefield 3 Premium subscription service. For the third quarter, Battlefield 3 Premium generated $28 million in sales, bringing the total premium revenue for the first three quarters to approximately $108 million. We will recognize these sales as revenue in the fourth quarter when we release the fifth expansion pack entitled End Game. And as another reminder, all of the development and delivery costs have been recognized in the previous quarters.

I'd like to point out that all these digital revenue types have no physical goods, costs and there are no associated price protections. Eliminating these expenses provides greater savings resulting in higher margins.

Also, consumers tend to purchase digital content over the course of their gameplay, extending the life of our brands.

Lastly, these transactions are direct to consumers, helping us develop and foster our relationship with our gamers. This digital momentum continues to build, and we see this as the future.

Moving on to gross margin. Our non-GAAP gross margin was up almost 2% over our guidance, driven by the growth of our digital revenue. In our continued drive to improve gross margins over time, we are implementing our own digital distribution business, replacing third-party vendors. Taking full control of this process combined with shipping fewer physical discs has contributed to improved gross margin. We believe this trend will continue into 2014 and beyond.

Operating expenses for the quarter came in approximately $70 million lower than expectations due to concentrated efforts to reduce spending as discussed earlier. We are being more critical with regard to expenses, concentrating our efforts on the highest value opportunities.

In addition, we are focused on greater efficiencies in marketing and leveraging the power of our brands to reduce the need for incremental spend. We continue to reevaluate expenses and cut back where it makes sense.

The resulting non-GAAP diluted EPS was $0.57 for the quarter, in line with our guidance and market consensus.

Our cash, short-term investments and marketable securities at the end of the quarter were $1.5 billion or approximately $5 per share. Roughly 60% of this cash is held outside of the US.

Net cash provided by operating activities for the quarter was $363 million. And on a trailing 12-month basis, operating cash flow was $378 million. Obviously, cash flow was impacted by the lower revenues in the quarter.

During Q3 we repurchased 12.2 million shares at a cost of $157 million, bringing the total share repurchased under our current program to 20.6 million shares at a total cost of $265 million.

As a reminder, the $500 million share repurchase program was initiated in August, and we continue to repurchase shares under this program.

In summary, for Q3 we delivered non-GAAP EPS in line with our guidance, despite the revenue challenges. We were able to achieve this through favorable gross margin and focused efforts on reducing operating expenses.

Now turning to guidance for Q4. Q4 has some encouraging elements that we can see. First, we will finally get to recognize a full year of the Battlefield Premium. Second, we have strong momentum on the digital side of the business with FIFA Ultimate Team and mobile leading the way. And finally, our biggest three titles shipping in the quarter -- Dead Space 3, Crysis 3 and SimCity -- are all finishing strong.

However, there's a high level of uncertainty and challenges surrounding the upcoming quarter because of the softness we just experienced in the holiday quarter.

Additionally, we are also anticipating significant volatility that accompanies a perceived console transition.

Also, our first key launch for the quarter won't be until next week with Dead Space 3, and there have been no other major releases since December that could reveal any specific trends or developments in the market.

And last, we have decided to move the launch of Fuse to Q1 of fiscal 2014. These factors are causing us to be more conservative, and therefore, we are widening and adjusting down our guidance for the quarter and consequently for the year.

GAAP revenue for the fourth quarter is expected to be between $1.115 billion and $1.215 billion as compared to $1.368 billion in the prior year. GAAP diluted EPS for the fourth quarter is expected to be between $0.92 and $1.12 per share as compared to $1.20 per share in the prior year. Non-GAAP revenue for the quarter is expected to be between $1.025 billion and $1.125 billion, an increase over last year's $977 million. Gross margin for the quarter will benefit from the very high margin Battlefield Premium revenue that has been deferred.

Regarding operating expenses, we expect our total non-GAAP operating expenses to be less than $525 million for the quarter.

For the quarter, we expect non-GAAP diluted EPS to be between $0.57 and $0.72 per share as compared to $0.17 last year. So for the full year, GAAP revenue for the fiscal is expected to be between $3.703 billion and $3.803 billion, and GAAP diluted EPS is expected to be between $0.18 per share and $0.38 per share. Non-GAAP revenue for the fiscal year is expected to be between $3.778 billion and $3.878 billion. And non-GAAP EPS is expected to be between $0.86 per share and $1.00 a share.

On cash flow for the fiscal year, we reconfirm our fiscal 2013 capital expense projections of approximately $100 million, but we are adjusting our operating cash flow estimates to $350 million, reflective of our lower guidance. This implies an expected free cash flow generation of $250 million, more than double what we generated in fiscal 2012.

Regarding next fiscal year, our plan is to provide fiscal guidance for 2014 during our Q4 earnings call when we will be in a better position to share our insights.

With that, I will now turn the call over to Peter.

Peter Moore - ***Electronic Arts Inc. - COO***

Thanks, Blake. Today I'm going to offer an overview on the sector, some color on EA's Q3 performance and an update on the games and services we are offering in the current quarter. I'll start with a sector overview.

The most obvious trend is the distinction between the performance of high definition consoles, the PS3 and the Xbox 360 versus standard definition consoles. That is earlier generations and the Nintendo Wii. Both are trending down, but standard definition is down 46% year over year in 2012 versus a 13% decline in our HD titles. That is an important distinction as EA's console titles are singularly focused on that HD audience.

The next trend is the concentration of consumer dollars behind chart-topping hits in the package goods sector. In the holiday quarter of 2011, the top 10 titles accounted for approximately 40% of Western world industry revenue. In 2012 the top 10 captured nearly 50%. EA had two of the top five in 2012, FIFA 13 and Madden NFL 13. We also had more top 20 hits, six in 2012 versus four for the prior year.

But as John mentioned a moment ago, this market dynamic results in a clear distinction between winners and losers, and in Q3 EA had both.

The digital trends are extremely positive. We estimate that the global revenue from digital games and services grew by more than 25% year over year. Multiple game revenues on iOS and Android doubled in size in 2012. Digital revenue related to PC games, including full-game downloads, PDLC, social gaming and subscriptions grew at approximately 20% as did the digital revenue related to console games.

Now turning to EA in the holiday quarter, we struggled with two challenges, the slowdown that impacted the entire sector and poor critical and commercial reception for Medal of Honor Warfighter. Medal of Honor was an obvious miss. The game was solid, but the focus on combat authenticity did not resonate with consumers. Critics were polarized and gave the game scores, which were, frankly, lower than it deserved. This one is behind us now. We are taking Medal of Honor out of the rotation and have a plan to bring year-over-year continuity to our shooter offerings.

To address the revenue gap, our global publishing organization moved quickly to align behind blockbuster brands with solid revenue streams, namely FIFA, Battlefield, Need for Speed and Madden.

I will start with FIFA, an EA franchise that has emerged as one of the world's top two or three games. The EA sports team in Vancouver is absolutely crushing it on every format and in every market. Since FIFA 13 launched in September, we've sold through more than 12 million units. And in Europe, FIFA 13 was the number one title in 2012, outselling all other games, including Call of Duty.

The digital performance for this franchise is particularly impressive. The number of gamers that actually play FIFA Ultimate Team grew 61% over last year's offering.

Additionally, the average revenue per paying user increased by approximately 30%. Both of these increases contributed to FIFA Ultimate Team revenue being up 136% year over year, and the holiday delivered the largest revenue day in the history of the service.

Moving to Asia, FIFA World Class Soccer in Japan has delivered lifetime revenue of $80 million. We are extremely optimistic about the early read on FIFA Online 3, which we have debuted in Korea in partnership with Nexon. After two successful closed trials, we went to open beta on December 17 and registered more than 2.4 million players in the first four weeks, a record for Nexon. Average daily users reached 440,000, which is 10% above our target. This one is tracking really well.

Another Q3 success story was Need for Speed Most Wanted. Sell-through was up over 30% year over year and outperformed the industry's other AAA racing titles. In this market, consumers are concentrating their choices. They don't buy two driving titles, but they will buy the best one. Need for Speed is back in position as an annualized blockbuster.

Next up, Battlefield 3. The core game launched 15 months ago and has captured more than 20 million players. Following the release of Aftermath in December, our fourth expansion pack, the Battlefield Premium service added over 0.5 million subscribers to exit Q3 with total subs of 2.7 million. This is a shooter franchise with unmatched ability to engage consumers -- millions of fans who want more missions, more maps, and more fun.

Battlefield, along with FIFA, is now in position to become one of the top two or three game franchises in the industry.

And no review of our blockbusters would be complete without mentioning Madden NFL. This year's game performed well this quarter with year-over-year increases in both unit sales and revenue. This year's key innovation is real physics that drive incredibly fluid animations and fundamentally improve the game experience in Madden NFL 13.

Beyond the AAA blockbusters, our mobile titles continue to perform well. The Simpsons - Tapped Out hit number one top grossing app in the US during the holiday period, climbing to 3.2 million daily active users. Both The Simpsons and Bejeweled Blitz have been charting well in the Apple app store for several months. Both will debut on Android later this quarter.

In December, EA was once again the number one iOS publisher worldwide, and December was the highest revenue-generating month of 2012 for the App Store.

Now turning to Q4. We have three top titles and one highly-anticipated mobile game to finish out our fiscal year.

First, Dead Space 3, a proven sci-fi horror franchise with a strong consumer base will launch in the first week of February. This is our biggest and best Dead Space in the series with a terrifying single player campaign and an entirely new to this series co-op gameplay mode. 30 media outlets listed Dead Space 3 on their Best of 2013 lists. The Dead Space 3 demo released earlier this month on Xbox 360 has generated 44% more downloads than the demo for Dead Space 2 and the PlayStation 3 demo launch last week. We are feeling really good about this one.

Second, Crysis 3 from our partners at Crytek Studios, will ship on PC and consoles February 19 in North America and February 22 in Europe. Pre-orders are tracking roughly 40% ahead of Crysis 2. We opened the multiplayer beta last weekend, and we are getting a great response from gamers.

Third, SimCity, a completely new version of the treasured classic includes deep online features. More than 100,000 people played the SimCity beta last weekend, giving us a nice bump in pre-orders, and the critical reception is shaping up well. Watch for SimCity on March 5 in North America and March 8 in Europe.

And finally, Real Racing 3 is a stunning driving game for iPhone, iPad and Android devices. Our Firemonkeys studio did an awesome job with this one, bringing console-quality graphics and fluidity to a mobile title. Real Racing 3 will ramp up to a full launch in North America on February 28.

Three more shoutouts for games scheduled for release this spring. First, Tiger Woods PGA Tour 14 will be released on consoles on March 26 in the US and on the 28 worldwide.

Secondly, Army of TWO - The Devil's Cartel will be available on consoles on March 26 in the US and in Europe on March 29.

And finally, Ted Price and the Insomniac studio are putting a lot of polish in their new game, Fuse. The extra work delivers a big payout for players, and Fuse will be released in Q1 of spring quarter.

I will finish with a note on Origin. Our online portal for digital games and services continues to scale. Origin now boasts more than 39 million registered users with over 2 million new registrations in January alone, and the team is preparing to launch Origin for the Mac next month extending Origin to tens of millions of new gamers.

Now back to John.

John Riccitiello *- Electronic Arts Inc. - CEO*

Thanks, Peter. Here's a quick summary of what we've told you today. First, Q3 was a disappointment on the revenue side. Medal of Honor didn't deliver, and we underestimated the overall softness of the console package goods sector.

Helping to offset these challenges was the stellar performance on our two biggest brands. FIFA delivered on package goods and digital in Western markets and in Asia, and Battlefield 3 contributed strong package goods sales in Q1 through Q3, and Battlefield 3 Premium is providing a big digital revenue positive in Q4.

Second, our Q3 EPS performance was solid and at the upper end of our guidance. Looking forward, we feel we are in a position to capture and lead the next period of industry growth. We think we are perfectly positioned to take advantage of the trend we see coming in digital and mobile, as well as on the console side of the business. In each of these growth opportunities, we are investing in the next generation of technology and content.

We have the biggest brands. FIFA and Battlefield are proven blockbusters. They just keep growing and getting better. I believe that in the next four years both will be among the top franchises that define the industry across all platforms and geographies, and we have several more blockbuster franchises right behind Battlefield and FIFA.

We are building a digital platform for servicing our global network of more than 275 million users. The platform enables profitable growth in digital with efficient cost structure, and we've got the best talent in the industry. EA is the rare company that can build global brands, we can nail it on console, nail it on mobile, and we built a team that can turn the complexity of a digital platform into a competitive advantage for Electronic Arts.

We believe fiscal 2014 to be a point of departure, the starting point for a new area of gaming and a growth period for the best game companies. We are confident that EA brands, platforms and talent will separate us from our competition and allow us to lead in this new era.

With that, Blake, Peter, Frank, and I will take your questions.

QUESTION AND ANSWER

Operator

(Operator Instructions). Edward Williams, BMO Capital Markets.

Edward Williams *- BMO Capital Markets - Analyst*

Just a quick question, first of all, on Medal of Honor. Can you you talk a little bit about what you think drove the performance of Medal of Honor and what steps you can take from that to prevent that from going forward?

And then maybe you can provide a little bit of clarity, Peter, on your comments on year-over year continuity with first-person shooters?

John Riccitiello *- Electronic Arts Inc. - CEO*

I think Frank will take this one.

Frank Gibeau *- Electronic Arts Inc. - President, EA Labels*

Sure. Let me start with Medal of Honor. Look, we are in a hit-driven business where it's about what you can build in a certain period time and really deliver for the marketplace. And frankly, we missed on Medal of Honor, and we take responsibility for that.

I would be remiss if I didn't point out that the rest of our studios have performed pretty well. We released 11 games and scored over 80 in the year, more than any other third-party developer, and we also deliver about 94% of our titles on time. And Medal of Honor definitely overshadows these achievements, but we are proud of our team overall.

Now if you look at Medal of Honor as a specific case, it was really about a hit missing. But the rest of the studios are really performing and delivered on their goals.

As it relates to the comment that Peter talked about in shooters, we've already talked a little bit about it, that we have a Battlefield title coming next year. But we are not in a position right now to talk about our development plans and our SKU plan long-term. That will come in about 90 days when we get to show you some Battlefield stuff.

Edward Williams *- BMO Capital Markets - Analyst*

Okay. Great. Thank you.

Operator

Bryant Karimzad, Goldman Sachs.

Brian Karimzad *- Goldman Sachs - Analyst*

A couple of questions relating to cost. So the first one was somewhat refreshing to see the absolute marketing expense came down about 20% year on year in the quarter. It had been tracking flattish prior to that. So, Blake, is it your sense this is something that is sustainable as we think about things going forward, and maybe do we go back to the situation where three, four years ago you were able to get away with a $600 million marketing expense base on a similar revenue base? And then I have a follow-up.

Blake Jorgensen *- Electronic Arts Inc. - CFO*

I hesitate to say it's a trend because it's really driven more by the titles and the activity in the quarter. But we are spending a substantial amount of time both with our core marketing teams, as well as our digital teams here, trying to determine how best to spend each marketing dollar. A lot of work is being done on how to get more out of each dollar, and we are being conscious in a difficult market as to when we spend, and if we think volumes are coming down, we will correspondingly wind back some of our marketing spend associated with some of those volumes.

I'd say hold off on putting too much of a trend in your models going forward, but know that we are going to try to keep pushing that down. But it's really going to be driven by the slate of titles going forward.

Brian Karimzad *- Goldman Sachs - Analyst*

Okay. And I guess leading off of that, you generally talk about having eight, 10 recurring franchises. I guess we officially got rid of one with Medal of Honor going away, and I know you guys don't like to talk about individual game profitability, but I think we can all back into the fact that FIFA and Battlefield probably represent substantially all, if not more, of the profit of the Company at least over the last year or two. So, as you move into next generation here with the console cycle, what has changed in your thinking about your approach to rationalization?

Blake Jorgensen *- Electronic Arts Inc. - CFO*

I think we are going to continue to try to maintain a smaller slate of titles than we had historically. Does that go up or down one title or two a year? It depends. I will let Frank or John comment to that.

But at the end of the day, we are trying to build around franchises. So Battlefield and FIFA are great examples, but Madden and others are also examples on that.

And the franchise build is try to build the profitability by not just having a big title, but by having a long digital life associated with that title.

Battlefield is a great example. If you look at the Battlefield Premium service that has come along with that, we are now over a year and a half outside of when that title was released. And as we've said, we will book at least $108 million in the fourth quarter on revenue associated with that Battlefield Premium service.

FIFA Ultimate Team is another great example. We are trying to create a world in which people are playing FIFA on many different devices and many places during the day. So the team may play at night on a console with their friends. They may then next morning update the scores in their Ultimate Team on their smartphone or their tablet while they are going to work. They may play at work on their tablet or smartphone. They may arrange for a game late in the evening or for that coming evening and then get back together with their friends on the console. And all of that can be monetized through different methods of digital, which help drive that profitability versus having one single package goods title that is really driving it.

John Riccitiello *- Electronic Arts Inc. - CEO*

This is John. Let me add a little bit to that. So two thoughts. 10 franchises -- Madden, FIFA, Sims, SimCity, Battlefield, FIFA -- that is twice on FIFA, sorry -- NHL, Mass Effect, Need for Speed -- 10 titles, all profitable. So let me start by dispelling the notion that it's only Battlefield and FIFA that contributed to our profitability. We have a deep bench of highly profitable, great franchises.

The second point that I would make is you are correct that titles at the scale of FIFA and Battlefield are what drive the profitability inside of EA, and they are doing so increasingly for precisely the reasons Blake just outlined.

And my view is that the top five franchises globally in the industry probably define half the industry's profitability or something close to that. I could be exaggerating a little bit, because I haven't calculated it that way, but I will ensure you that we believe that FIFA and Battlefield have a shot at certainly remaining in the top five, quite possibly, being one in two if we are successful as we move through the next technology transitions we see it coming.

We do recognize as we move into what we determine or call Gen 3, i.e. or PlayStation 3, Wii, Xbox 360, we started weak and we have climbed forward and improved, but we lost marketshare coming into this transition, and we've climbed back. We think Battlefield and FIFA are going to help us lead as we move into the next set of technology opportunities and platform opportunities and continue to get bigger.

So you are right to believe that FIFA and Battlefield are vitally important to us. I think it is too simple to believe that is all that is important to us. I am proud of the breadth of the titles we have in that, say, 10 or so titles because it's through that that we can be sure to have from this point, you know, 10 great years, 15 great years -- not one generation of great years defined by one or two franchises that may falter toward the end of an individual cycle.

Brian Karimzad - ***Goldman Sachs - Analyst***

That's helpful. Thank you.

Operator

Colin Sebastian, Robert W. Baird.

Greg Rashara - ***Robert W. Baird & Co. Inc. - Analyst***

This is [Greg Rashara]. I am filling in for Colin. He's on another call at the moment. And I guess maybe a bit of a tough question, but as you guys have mentioned, one of the biggest issues you guys are facing are the secular headwinds as a result of the late stage of the console cycle. So to a certain extent it seems that a lot is not in your control at the moment. And I guess everyone is anticipating hopefully a positive and a well-selling new console. But in the event that the new consoles are not that competitive, what is Plan B in that scenario? And I guess that scenario could potentially involve the other platforms that are gaining penetration in the TV rooms -- maybe evolving as console platforms. How do you -- is that something you can do a lot in terms of preparation for, or what do you --?

John Riccitiello - ***Electronic Arts Inc. - CEO***

This is John. Let me take that for you. Just a little bit.

So as a starting point, the data on game usage and game revenue is exceptionally clear. So we have added gamers to the universe of paying game customers in a dramatic way each year over the last several years, and there's absolutely nothing that I see that suggests that's going to slow down.

The second thing is that has been driving very substantial growth in what we refer to as digital. In the last 12 months, we've generated 37% growth to get us to a $1.5 billion digital business over the last 12 months. I mean I could make a reasonable argument that absent all of our package goods business, that $1.05 billion digital business growing at 37% might well be more valuable than the entirety of our current market cap, if I were to venture a guess. You guys value us; I don't.

But so I think that is a vital, fast-growing, massive opportunity business for us that is spinning on some pretty sound fundamentals -- great brands, strong consumer franchises, great technology, and compelling entertainment content. So I think we've got that.

What drives that is a talent base that I think no one else in our industry has. Some folks in some of the social game companies are good at data; some companies that make simple console games are great at entertainment, not so great at monetization. I think we've got both here in that team.

Now, I think we have got a great story, absent console. But as you might well expect, we know more about the roadmap and more about what is coming to consumer electronics in terms of the specific devices that will play games than you might otherwise be exposed to. The information we have, we remain bullish. It's why we have outlined our plan to invest this past fiscal year, the current fiscal year, $80 million in that opportunity.

So I think Plan A is explode along with the opportunities we see on digital and console, and Plan B is console writ a little smaller, but we have high confidence in what we see coming.

Greg Rashara - ***Robert W. Baird & Co. Inc. - Analyst***

Okay. Thank you.

Operator

Justin Post, Bank of America.

Ryan Gee - ***BofA Merrill Lynch - Analyst***

This is Ryan Gee calling in for Justin. First, going back to the digital, it has accelerated substantially quarter over quarter, and even if you go back and factor in the Battlefield 3, 15% growth, what else is driving that deceleration? If we see that FIFA digital was pretty much doubled year over year, what else is driving down that growth? And then is there any sign that comps get better moving into next quarter outside of the Battlefield 3 Digital?

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

This is Blake. The reminder is that full-game downloads are really PC-centric. And so when you have a title like Battlefield, which was a substantially bigger title than anything we had in this quarter, and you have a title like Star Wars that starts up -- so we had the startup of Star Wars in Q3 last year -- those two combined are primarily PC-based businesses, and that drove a huge amount of extra content -- excuse me, full-game downloads during the quarter.

So if you look at the slides that we distributed with our earnings package, on page nine can see it pretty clearly -- $103 million in Q3 full-game downloads versus $44 million in this quarter. Almost all of that is driven by Battlefield and Star Wars startups in that quarter.

The other is just pure math, right? We are now north of $400 million a quarter in digital business. The law of averages -- you can't keep growing that at high percentage rates that we have been growing them at. Year-over-year growth, 37%. We're fairly confident we are going to continue to see growth because all components of that business, absent the product-driven growth in full-game downloads, you're going to see a lot more growth coming out of that going forward.

Ryan Gee - ***BofA Merrill Lynch - Analyst***

Okay. Great. And then another question, I know you guys didn't ever really quantify it, but it sounds like you are more optimistic on Battlefield 3 Digital. It had some good sales in the quarter. And then SimCity, it looks like that's tracking well for next quarter. Should we assume that maybe that Q4 benefit next quarter is maybe a little bit bigger? Again, I know you never really quantified it, but should we expect maybe a bigger benefit for next quarter than maybe we were modeling going into this quarter?

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

Well, if you take Battlefield Premium, we know -- we disclosed today that $108 million will drop into the fourth quarter at a minimum, right? Because that is everything that has been up through the third quarter.

In the third quarter, we had $28 million generated from Battlefield 3 Premium. Obviously, we are down to the last expansion pack in that series in the quarter, so you might see that trend down a little bit, but you've probably, if you did your math and you are probably somewhere in the $120 million to $130 million in the fourth quarter, you probably see that.

I think the one thing to keep in mind is that, as we mentioned, most of the costs for developing or delivering that product were incurred as the quarters went along. And so that revenue when it comes into the fourth quarter will be at a very high gross margin.

And so when you're looking at the guidance, you might be asking the question, your gross margins must be relatively high compared to, say, third quarter, and that is, indeed, true, driven by both that Battlefield Premium, as well as the owned IP from titles like SimCity or Dead Space 3, which run at higher margins than some of our other titles. So that is going to help give you your boost in gross margin, which I will pencil out on the guidance that we just gave you guys.

Ryan Gee *- BofA Merrill Lynch - Analyst*

Okay, great. And then just one last big-picture question, maybe for John. I know Nintendo came out today and was a little bit more cautious on its outlook for Wii U sales. Doesn't sound like this is a platform you guys are really pursuing aggressively early on. What does this really say about consumer's willingness to adopt the NextGen consoles? We should have something new from Sony or Microsoft, so what does that say just with Nintendo going through the struggles early on on the Wii U?

John Riccitiello *- Electronic Arts Inc. - CEO*

So a couple of things. I first say you never count Nintendo out. They've got some of the best IP found in the game industry. When their marque titles show up, that's when you usually see the bounce. I'm deeply respectful of the achievement they've had over the last several years. And as I said, you never really count them out.

Having said that, I wouldn't say that we see much correlation between the results that Nintendo has shown with their console debut of the Wii U and what we see coming. We see a pretty sharp distinction. And unfortunately, I'm unable to go any further than that.

Ours is an industry where a lot of devices come in and represent themselves as the next generation and the next generation after that. In many ways we would argue that the -- what we are describing as Gen 4 is yet to come, and it is that we are excited about, and that is what we are investing in. And, frankly, we've been quite consistent with that for some time, recognizing the frustration and our inability to articulate precisely why cause is for you.

Ryan Gee *- BofA Merrill Lynch - Analyst*

Okay. Great. Thanks, guys.

Operator

Brian Fitzgerald, Jefferies.

Brian Fitzgerald *- Jefferies & Company - Analyst*

A couple of questions, guys. First one, with the recent events that happened, any softness around first-person shooters or more mature-rated games impact that you are seeing or potentially expect to see around Gun Club?

And then just to follow on, what's your view of the media and political focus and how it pans out maybe historically looking back at other incidents that have happened? Thanks.

John Riccitiello *- Electronic Arts Inc. - CEO*

All right. So I was hoping we weren't going to do this question, but thanks for asking. So, first off, no, we are not seeing softness on the FPS sector.

Secondly, I would say, I have got a somewhat unique advantage point here working at EA and also sharing the ESRB and the ESA. Some reasonable exposure to the goings-on in Washington.

I want to underline the first point. The game industry is a very mature, responsible industry, moreso than you might otherwise imagine. First off, we are very confident in the quality of our content and the lack of an actual factual linkage to any of the actual violence that takes place in America or markets around the world.

There's no doubt, we like you, were stunned and horrified by the violence in Connecticut or Colorado or many other places over the years. But there has been an enormous amount of research done in the entertainment field about looking for linkages between entertainment content and actual violence, and they haven't found any. And I could give you long stories about how people in Denmark or the UK or Ireland or Canada consume as much or more violent games and violent media as they do in the United States, and yet they have an infinitely smaller incidence of gun violence.

But that's not really the point. The point is that direct studies have been done, hundreds of millions of dollars of research have been done, has been unable to find a linkage because there isn't one.

And that went all the way up to the Supreme Court this past summer. A number of folks had summarized the available data provided at the Supreme Court, and the Supreme Court came out in favor of effectively stating that we deserve all the First Amendment right freedoms that are accorded to any media. And a key part of that is I think they were swayed by the evidence that was presented to them of all these studies.

Now having said all of that, and with all -- if you will, humility, about the world we live in, we understand that while there may not be an actual problem, given all the finger-pointing going on in the press, there appears to be the perception of a problem, and we do have to wrestle with that.

Ours is an industry with an association that has risen to that call many times before and will as we move forward. We are responsible, we are mature, and we intend to be part of the solution. Our media reaches literally every American, and that can be used as a voice for good. And I think you'll hear more from Mike Gallagher, the head of the ESA, and other industry participants, including ourselves, over how we can be part of the solution to this perception problem as opposed to, if you will, the butt of the joke.

So a quick summary. We are horrified, like you. It's not about games. There is a perception issue. We can be part of that solution, and we are ready to step up to do that.

Brian Fitzgerald - ***Jefferies & Company - Analyst***

Thanks, John. I really appreciate your candid and thorough and sincere comments there.

Operator

Doug Creutz, Cowen.

Doug Creutz - ***Cowen and Company - Analyst***

Thanks. We've seen in the past year some smaller companies have some real success in mobile and somewhat social in the midcore zone. And I was just wondering where you guys are with respect to that genre and what your plans are do you view as an opportunity? Thanks.

Frank Gibeau - ***Electronic Arts Inc. - President, EA Labels***

Yes, this is Frank. Absolutely, we are looking at the midcore segment for mobile. Real Racing is a good example of a game that appeals to a core gamer that is going to be coming out shortly on Android and iOS, and we have a number of titles planned going forward that will start to reach that audience. We are big believers in it.

Doug Creutz - ***Cowen and Company - Analyst***

Any update on plans for Zombies 2?

John Riccitiello - ***Electronic Arts Inc. - CEO***

We have nothing to announce at this time. The PopCap business is doing really well on mobile, Plants vs. Zombies being a key title in that mix. And we are looking at a great plan going forward from PopCap to grow the Plants vs. Zombies franchise.

Doug Creutz *- Cowen and Company - Analyst*

Okay. Thanks.

Operator

Mike Hickey, National Alliance Security.

Mike Hickey *- National Alliance Securities - Analyst*

Valve at CES this year created, I think, some noise with their official introduction of Steam Box as Nintendo fazed a bit maybe from this cycle, and there's uncertainty around Sony and Microsoft, and certainly some excitement. Do you think Valve could be a competitor within the home console market moving forward?

John Riccitiello *- Electronic Arts Inc. - CEO*

This is John. First off, let me admit that I am squarely in the Gabe Newell fan club. Really enjoy my conversations with him; certainly have enjoyed a whole lot of content they've produced. And at one time and certainly even today, I would say Portal represents one of my all-time favorites bits of game software that has ever been produced.

Having said that, Valve really hasn't put enough information out there to suggest whether or not they've got the wherewithal to compete in console. There are lots and lots of issues. But large-scale success in game console, usually goes with multiple billions of dollars of investment both in content development, investment that is made across a blend of developers and publishers, retail relationships, online relationships, consumer marketing, chip fabrication, manufacturing, supply pipeline and the rest. So based on what they've said so far, it could be anything from a cool niche product that appeals to Gabe and his friends and people like me to a product that actually has the shoulders to give help -- lift our industry forward into what we're describing as Gen 4. They need to give us -- put a few more breadcrumbs on the ground to tell us what path we are on.

Good people, smart people, technologically-innovative people, and right now there's just not enough information out there to really answer.

Mike Hickey *- National Alliance Securities - Analyst*

Okay. Thanks, guys.

Operator

Sean McGowan, Needham & Company.

Sean McGowan *- Needham & Company - Analyst*

A couple of questions, if I can. First, probably quicker, what do you think you could take away as learnings from your success with Simpsons for the mobile market? What is either in that title or monetization techniques that you think you can apply to other titles?

John Riccitiello *- Electronic Arts Inc. - CEO*

Look, the Simpsons brand was a great opportunity for us to bring a bunch of new thinking and new ideas related to episodic content to the market. So one of the things that really stood out for the Simpsons then as a key growth driver was the release of Treehouse of Horror's packet at Halloween. We have a commitment to ongoing episodic theme-based content releases for The Simpsons.

So at its core, it's a hilarious game, working directly with the writers at Gracie really gave the game an edge and an attitude and an authenticity that resonated with fans. And the fact that we are committed to releasing and continuing to release high quality episodic content has really proven to be the growth driver there.

Sean McGowan - ***Needham & Company - Analyst***

Okay. Thanks. And then maybe for John or anyone, could you give us a little more specifics on what is driving the guidance for the fourth quarter? Is it just -- you don't like what you generally see out there, or is there something more specific that says, here's something we were expecting, and we know we are going to see a lot less of it.

John Riccitiello - ***Electronic Arts Inc. - CEO***

I think it is less specific than that. And Blake has actually provided a detailed explanation and as Peter did on the prepared comments, but I'll give you some color.

I think most industry analysts were looking at the holiday quarter, the December quarter, expecting a raft of really good titles, headlined by things like a very rich and positive game coming out of Moviesoft with Assassin's Creed, Microsoft entry with Halo, obviously Cod, which is a stalwart of the industry and one of the biggest games in history, together with strong increases like Need for Speed from EA and the continued strength on FIFA and Madden, and expected that that title slate would have resulted in much stronger performance than we had seen in the first half of the year, which was not supported by the same richness on the content side.

Despite great games, well marketed, the December quarter was weaker than we had anticipated going in, and that often happens when the consumer carries the expectation of a console transition.

And another hallmark of consumers behaving as if there is a transition afoot or coming is when you start to see certain titles overperform and other titles underperforming in relatively dramatic ways. And that is something else we saw in the December quarter.

So when we look at that, it's both down and erratic. And now we are down and erratic and it's the end of January, and with the exception of a small title that was released from Capcom, there are no industry examples thus far this year in January that we could point to to say, is the market up, down, or sideways? Is it performing consistently with the December quarter, or is it going to trend down or up? We just don't have that information.

And we are about to launch the first of three major package goods titles that will define our quarter. So we know we've got a fast boat, we just don't know how deep the water is right now. So we don't know precisely what to do with that. That is why we have widened the range a bit to give us room to be sure we have the right answer.

Look, we think the content is great. We're anxious a little bit about the sector. And if the sector ends up a little bit smaller and more volatile, that gets us closer to the bottom end of the range, and if the sector performs better, our titles will go with it, and we will be at the upper end of the range.

Sean McGowan - ***Needham & Company - Analyst***

Great. Thank you very much.

Rob Sison - ***Electronic Arts Inc. - VP, IR***

One last question.

Operator

Todd Mitchell, Brean Capital.

Todd Mitchell - ***Brean Murray, Carret & Co. - Analyst***

Just two quick questions and then a follow-up. Just to clarify on the Battlefield, can I assume from the comments that you are dropping Medal of Honor that you are going to annualize Battlefield?

And the second question is related to the guidance for Q4. It seems to me is there some kind of backend text loading in the non-GAAP number versus what you were thinking before?

Frank Gibeau - ***Electronic Arts Inc. - President, EA Labels***

I will take the first question. This is Frank. We are not announcing an annualization of Battlefield today. What we've said is that we will be launching a Battlefield game next year, and we are very excited to show you guys more detail on that coming soon. But we are not announcing an annualization of Battlefield at this time.

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

And on the guidance, I think what you are asking is there is some tax benefit that is in our non-GAAP numbers. And no, you are pursuing the same --

Todd Mitchell - ***Brean Murray, Carret & Co. - Analyst***

No, no, quite the opposite. Versus what you were thinking with your prior non-GAAP guidance for the full year, has the tax bill gone up?

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

No, we are assuming the same tax rate through the full year.

John Riccitiello - ***Electronic Arts Inc. - CEO***

28%, right?

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

Yes, 28%.

Todd Mitchell - ***Brean Murray, Carret & Co. - Analyst***

Okay. All right. And then one last question, if you don't mind. In terms of your digital initiatives, there was a lot of acquisition, a lot of internal organic building. Could you just briefly discuss in terms of what is working and what is not working? Is there areas where you intend to -- in sort of re-thinking it, re-trench in some of your investments in new digital revenue streams?

John Riccitiello - ***Electronic Arts Inc. - CEO***

This is John. I will take that question to close out today's call.

First off, what is working for us is mobile. Digital downloads of full games, although that's obviously very confident with the success of individual titles. And our PDLC business and things like FIFA Ultimate Team, Madden Ultimate Team, and that is both for PC and console.

So we feel very, very good about -- if you will, it's really console, PC, and mobile. It's both the premium business on a download, and it is a whole bunch of free-to-play models that are working really, really well for us. So that would capture individual examples like FIFA Ultimate Team doing really well. That is a micro-transaction-based business mostly related to console.

A big part of Battlefield Premium is related to PC. And when I say free-to-play, titles like FIFA in Korea and Japan are both free-to-play, but generating very substantial revenues or The Simpsons - Tapped Out is a free-to-play micro-transaction game. If you want to try to draw up a grid, it would be premium and free-to-play titles, again both mobile, PC and console and most of the console being addon to core titles. So that is what is working well for us.

Absent from that list is social. Social hasn't done as well for us, and the overall sector is significantly softer than we had anticipated it going forward.

I think another question you were getting at and one that I think is worth answering is yes, we have made some M&A. We've acquired a number of companies. I would argue at this point in time we have the IP we need and the channel access we need. We feel very good about the portfolio of digital assets we have. We think we are in a position to lead digital in the West and perhaps with great execution over time take that lead into Asia because we are now seeing our titles resonate there.

We didn't have the strength on smartphones. We did some acquisition to get there. We had good IP. We wanted the added strength of the PvZ brand and the Bejeweled brand, and we feel great about the PopCap acquisition. But net, net, we have got, if you will, a full house with the things that are working, PCs, consoles, mobile, free-to-play, premium. That's a great deck of cards or a great hand. And at this point, we are not going to trade anything. We like what we've got, and we're not looking to draw.

Todd Mitchell - ***Brean Murray, Carret & Co. - Analyst***

Okay. Thank you very much.

Rob Sison - ***Electronic Arts Inc. - VP, IR***

And with that, we will wrap it up now.

Operator

Thank you. That does conclude today's conference. Thank you for your participation. You may now disconnect from the audio portion.