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# EDITED TRANSCRIPT

EA - Electronic Arts Inc at Nasdaq OMX Investor Program

EVENT DATE/TIME: DECEMBER 02, 2015 / 8:30AM GMT



## CONFERENCE CALL PARTICIPANTS

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

## PRESENTATION

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

Good morning, everyone. Thank you very much for coming.

I am going to try to give you a few prepared remarks and then take questions and answers as much as possible. Without our research analyst here I thought I would just go ahead and play the role of the research analyst. So if you don't want to ask questions I will ask them to myself over time.

First off, thank you to the NASDAQ for having us. It's really an honor to be here at what is a great conference and a great introduction to many institutional investors here in Europe.

For those who love the safe Harbor statement I will refuse to read it all out loud because I know you all know it by heart. And I wanted to just introduce Electronic Arts for those who may not know the Company very well. We are an entertainment Company making electronic entertainment in the form of games for the masses around the world.

We've been around since 1982 and we have one of the largest networks of gamers in the world. We have over 300 million registered users. Compare that to many of the networks, you know you realize that's one of the largest networks in the world.

We have some of the best well-known, well-loved IP: FIFA, Madden, Battlefield, most recently Battlefield, the Star Wars game we just released. Some of the best games in console, PC and mobile, all three venues, both free-to-play and paid premium games.

In our fiscal 2015 which ended last March, we had \$4.3 billion in revenue and about 58% of that comes from international. We've guided this year to \$4.5 billion in revenue and as a note that \$4.5 billion includes about \$300 million in FX headwind this year, particularly because of that international exposure.

Our games, content, live services and councils are across all platforms. We're primarily dominated by Microsoft and Sony with Xbox One and PlayStation and with Apple and Google on their iOS and Android platforms for mobile. We also have partnerships with Nexon in Korea and Tencent in China for free-to-play PC games and mobile games.

There have been over 2 billion downloads of our mobile games and we've only been in the mobile business for about five or six years. We're the fourth-largest mobile Company in the West and around the 10th largest or 12th largest in the world.

And obviously we have a healthy profile of free cash flow generation. This is a great business for cash flow. And we had a 25% operating margin last year and roughly \$1 billion in free cash flow. And we've guided this year to a 28% operating margin, \$1.2 billion of operating cash flow, \$1.1 billion of free cash flow.

Now, the story hasn't always been so good. This is a company that over the last decade lost its way; had fantastic brands and amazing passion internally around the products, but had lost some of its financial discipline.

A quick snapshot, I joined the Company a little more than three years ago and when I joined the Company's revenue was about \$4.1 billion, \$4.2 billion. So not all that different than where we are today. But we had gross margins of 63% and OpEx of \$2.2 billion, leading an operating margin of single-digits 9% and free cash flow just barely above \$100 million.

Stock price at the time was \$11 and the market cap was around \$4 billion. Fast-forward to the end of last year, our revenue grew slightly but the digital component of our revenue, meaning the products that we delivered digitally, grew from 29% to 52%. An amazing driver and profitability



as you can see it shows up in the gross margin of 71% and a lot more control around OpEx, yielding an operating margin of 25% and a free cash flow number that now is close to \$1 billion and will most likely be over \$1 billion this year. A dramatically different business all through the push of digital and financial discipline.

Historically it was a hits driven business. It was all about if your game was one of the top games and if it wasn't you usually had a financial disaster on your hands.

Low user engagement. People moved from game to game and they didn't play games for very long. They typically played games for six to eight weeks and then moved on.

A sole focus on the console, no real exposure to PC free-to-play and the mobile business and a very siloed organization. We were built historically by acquisitions and we had a whole series of studios that did very little to interact with each other and had very little focus on the consumer at the end of the day.

Today with the help of our new CEO Andrew Wilson and the management team we have focused the business on large digital recurring revenue streams. I will give you some examples in a moment.

Super-high user engagement. People now play games on our platforms from anywhere from six to 12 months where they typically before were doing it six to 12 weeks at the most.

Multiplatform business across both consoles, PCs and mobile. And a big focus on One EA, one Company and one focus ultimately on the consumer. How do we deliver the greatest products for the consumer.

The industry has gone through a big transition as well. There is a massive movement towards digital. People just like in books, music, records, TV, consumption of products digitally versus going to a retail store to pick them up.

Live services are a critical component of the business. And when I say live services I will give you a simple example of our largest live service, it's called Ultimate Team. Essentially for three of our sports games the football game FIFA, the American football game Madden and our hockey game NHL we have what's called an Ultimate Team mode in which you can play for free.

You buy the base game and then you engage in Ultimate Team. And it's essentially a collection of players, a trading of players to build your ultimate fantasy team. And unlike regular fantasy sports where you have to wait to find out if people, how the team does in their actual matches you can take that team and put it back in the videogame and play against your friends.

So it works off of some basic principles of human nature. People like to collect, they like to compete, they like to beat their friends and they are usually willing to pay for that. And our goal is to try to build an engagement model which allows people to engage in a much longer interaction with something that they love.

And in sports it works perfectly because people love sports, they love building fantasy teams and they love proving to their friends that their fantasy team is better. No better way to do it but to actually play it out in a videogame.

So for example we sell approximately \$1 billion of FIFA every year as a core game. On top of that we have roughly \$400 million of Ultimate Team, fantasy football where people are buying and trading players and engaging for a much longer period of time.

The key to that business, though, is the fact that they no longer play FIFA for just a few months, they play it for the entire season all the way up until we ship the next FIFA. So not only are they heavily engaged, we monetize them over time, they are also incredibly easy to re-attract again for the next year's FIFA. We don't have to reacquire them as if they were a brand-new customer. It's a critical component of our business model which is engagement through Ultimate Team.



There's also a critical importance of franchises these days. The big have gotten bigger.

So the large sports franchises are very important in the industry. The large first-person shooter franchises and action franchises are incredibly important as the business has developed.

A quick snapshot of how the business breaks out around the world and the industry. It is primarily a PC, mobile and console business and as you can see console is really the smallest slice of that business.

But in the West console is much larger. Xbox and PlayStation have very strong shares in both Europe and the Americas but very little share in Asia-Pacific.

Consoles have been forbidden for many years in China for example. They are just now starting to come on. But it's really been a mobile and PC free-to-play business in that marketplace.

The most important piece of the story has been this expansion of the business model. The old days this was primarily a console, PC software market. You bought a title, you played a title and then you moved on and bought another title.

Today all of these digital live services add to the engagement of the title. And those include extra content, subscription, free-to-play games and micro-transactions within games along the way. And critical as well is the chance now to do full game downloads where you didn't do that before.

So the in the old days you went to the store, you bought the disk, you came home and played. Today you can go on Xbox Live or PlayStation Now and download the game onto your console. You don't need to go to the store anymore and it's a major driver for profitability in the business.

If you look directly at our business and this is two snapshots, this is the second quarter over the last three years and that's the trailing 12 months over the last three years. These are the four key slices of our digital business.

As I said earlier our total business is about \$4.5 billion, we're roughly 52% digital now. And the components of that digital business are at the bottom full game downloads. And as you can see \$420 million of full game downloads, still a small fraction of the overall industry's products are done as full game downloads.

Only about 20% of the products today are downloaded full game. And we believe that will continue to grow as consumers default towards much more simplicity and ease of use.

Extra content, that's where the Ultimate Team revenue is I spoke of, is roughly \$1 billion which is growing rapidly 20%-plus over the last few years and a huge driver for us. Essentially it's incremental profitability on the core products.

Subscription businesses like our EA Access business with Microsoft where you can subscribe to a vault of games or a subscription business, we have a subscription Star Wars product where you can subscribe to play are still a small business but we believe there's overall growth in that subscription consumption model over time. And last but not least our mobile business is about \$500 million but continuing to grow rapidly and we think there's a huge opportunity in the future there.

So that's a very quick snapshot of our business. Massive transformation with a huge continuing transformation to come as the industry continues to shift to digital. The top publisher in the Western world, strong digital consumption driving our margin profile and great, strong, dependable EPS and cash flow generation based on minimizing the volatility of hit-driven titles and driving digital through the business.

So with that I will take questions. And apologize if I can't see very well in the back of the room.

## QUESTIONS AND ANSWERS

### Unidentified Audience Member

Could you talk about micro-transactions, their volume, the quantum of them, what the trends are, when you might break that out as an independent revenue source if ever?

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### Blake Jorgensen - *Electronic Arts Inc. - EVP & CFO*

Yes, so the question is can I talk about micro-transactions, the trend, how large those are? Today of this \$1 billion in extra content micro-transactions are less than a couple hundred million dollars. And micro-transactions just for those who might not know is you have the opportunity inside of a game to buy certain things, to enhance your gameplay.

So if you're playing a first-person shooter game you could buy a weapon or a vehicle that was not available to everyone which would put you in a position to be more competitive than others in the game. These have been around for some period of time. We think it's an important part of the business model but we're extremely careful that we don't ruin the consumer experience.

We want the consumers to feel like they can earn their way to better gameplay but we don't want them to feel like their nickel and dimes all the time and only can get things if they buy them. So it's balancing that ability to earn extra content versus only being able to play or pay for it quickly. But it is an important part of the business and it is a part of the business that's continued to grow and we will see continued growth on it.

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### Unidentified Audience Member

(inaudible) and on both Battlefront and also their view that digital downloads aren't increasing in terms of share? And then secondly over the next three to five years a full game download penetration I think your base case is kind of high 30s, maybe 40%, you are always fairly conservative. Where could it get to if we were to get over excited and how much flex does that really give on the operating margin side?

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### Blake Jorgensen - *Electronic Arts Inc. - EVP & CFO*

Good, so the first part of the question was around the comments that Game Stop made a week ago about their disappointment, early disappointment in how the Battlefront Star Wars game sold relative to some of the other games. And it was relative to their expectations to be clear.

I guess I would remind everybody of a couple of things. The Star Wars movie doesn't come out until December 18 and there's a lot of Star Wars hype and will continue to be a lot of hype. Star Wars Battlefront is a first-person shooter but it is the only teen rated first-person shooter.

We had designed it to be a much more accessible product to a wide age group. So an eight-year-old could play with his father on the couch as well as a teenager or a 20-year-old play the game and enjoy it.

It is more accessible and for the hard-core it may not have the depth that they wanted in the game. We're very confident in our forecast of 13 million units and in our full-year forecast for the Company. And it's a title that will sell well all through the holiday seasons.

After the second part of the question was on full game downloads. We've seen on the new console, so Xbox One and PlayStation 4 we've seen the jump of full game downloads from roughly 5% on the old consoles to 20% to 25% on the new consoles. And the big drivers of that change are a couple of things.

First, the consoles have more storage capacity. And most users want to keep their games on their console. Even if they lose those games they still own them, they are on our servers, they can download them again but they like to keep them on their consoles.

Bandwidth speed is another issue, around the world there's varying levels of bandwidth speed. These are large pieces of software and it oftentimes takes anywhere between two and eight hours to download a game. So people are in some cases afraid of that download time.

Another big driver is many of our consumers do not have a cashless transaction methodology. They don't have a credit card, a debit card, a PayPal account. And so they're finding going to the store with cash is an important part of that transaction.

And then last but not least there's a perceived value that they can trade that game in at some point. There's very few people that actually do trade it in but there's a perception of that value that they can trade it in.

And all those things have held down full game downloads over time. But clearly if we went from 5% to 20% as the platforms changed and the storage changed on those that's been a huge driver. And we've seen that Microsoft has already added a new 1 terabyte box or console to the marketplace and that will continue to expand and help people get over that storage issue.

We believe that convenience will ultimately win out and the consumer will like they have in other mediums move toward more and more digital downloads. And that will mean that over time it will most likely go from the low 20s to probably as you mentioned our comments in the past around 40%. And we believe that will happen over the next three to five years.

There is an argument that says it could go faster. Our PC game business is at about 75% full game downloads. But most people have been used to doing downloading onto their PC for many years, storage, software has all been downloaded over time and people are comfortable with that.

We may not see that same level of penetration with full game downloads. Our business model and our ability to continue to grow gross margin is directly linked to the continued growth of our digital business. And any of the trends that grow the digital business will continue to help us there.

The one caution I would have as you look at our numbers quarter over quarter is it's highly driven by titles that might be shipped in the quarter. And for example, FIFA here in the UK is a title that many of the mass-market retailers like to discount to drive traffic into their stores. And they like to have a physical copy to do that.

They don't have the capabilities of selling a digital copy. And so you tend to see a depression of full game downloads when we first ship FIFA into particularly the UK and Europe in general.

Where last year for example we shipped The Sims which was a PC title you tend to see high digital downloads of that. So be careful that you read any one quarter-to-quarter data around a trend. We think the trend continues to be positive and we benefit from that.

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**Unidentified Audience Member**

Could you please elaborate a little more the partnership with Tencent in China? And also do you see any big difference between players in China and those in the US or in Europe? Thank you.

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

Good question. Our partnership with Tencent in China just started about six months ago. We've found that the key to our global growth is our focus on our football product FIFA.

And we have that product in the US and in Europe primarily as a console product. So we would refer to that as a premium product. You pay for it up front.

And what that means is that you're essentially buying the product up front and then you might transact over time an Ultimate Team and add additional revenue to that product. In Asia the market is primarily a free-to-play market. There isn't a console business per se except really in Japan.

And so Korea and China which are the two biggest gaming markets in Asia have always traditionally been a free-to-play market. That's a free-to-play market either on a PC or on a mobile device.

Historically we've built a business in Korea through various partnerships, the partnership now is with Nexon, to have a free-to-play version of FIFA. And essentially it's a combination of the base game and an Ultimate Team style gameplay which you pay as you go to engage in the game.

Today we do about \$100 million with that game through our partnership with Nexon. We just recently late last year started a similar business in China to do a free-to-play PC version with Tencent. And we selected Tencent because they have an amazing network of free-to-play games and getting into that network is very powerful.

They also didn't have any sports or very few sports games in their network and so we wanted to take advantage of that potential. The real driver for growth in that business we believe long term will be the popularity of football as it grows in the marketplace. And we see that is a huge opportunity for us longer term and Tencent sees that as well and so we're looking forward to a long, successful relationship there growing that football product in China.

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**Unidentified Audience Member**

Do you have any statistics on churn for your digital, either your digital products or your digital subscribers i.e., the people that download content? Are they less likely to churn than people that buy content in a shop?

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

Yes, that's a good question. The best data we have and it's a little spotty but I think the best thing to think about is we find that people who engage longer have a higher propensity to buy the next year's product and continue to engage.

So the reason they are engaging longer is they are engaging on additional content. They are either buying additional content or playing in a free-to-play method. So if they are in our Ultimate Team, if they just play FIFA they typically don't play it is long but if they engage in Ultimate Team they typically engage at a much longer level and have a much lower churn as the next year's FIFA comes along.

Same thing with our Battlefield game. If they engage in our Battlefield premium which gives you extra content over various quarters after the game they are much more liable to continue to engage in Battlefield.

We have a simple mantra internally which is build a very strong engagement model. We tend not to think even about the economic side of it. We're trying to think about what it engages our consumers for as long as possible and if we do that we know there's a higher probability of monetizing them over time.

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**Unidentified Audience Member**

Can you talk a little bit about E Sports and live game spectating, what is EA's direct and indirect exposure? What's the growing importance?

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

Sure. The question is on E Sports and our participation in E Sports. It's a hot topic these days around the industry. And for those who don't know what E Sports is think about it as a tournament where people get together in large groups and actually teams play video games against each other.

They may be sports video games or they may be nonsports video games. But it is essentially a large tournament and there is money involved in terms of prize money. There is in some cases very large venues.

Madison Square Garden in New York recently hosted a giant E Sports tournament where they filled the entire place with people watching teams on large-screen TVs play against each other video games. It's the ultimate in the engagement of our product. If you really want to become good in our products and compete and have a team that wins you've got to practice, you've got to watch, you've got to observe how others play and build your skillset, just the same way you would in a regular sports event.

So we're trying to take advantage of that. Interesting, we've actually been doing it for 10-plus years. We did the FIFA Interactive World Cup tournament 10 years ago in which we created a World Cup tournament alongside the real World Cup.

We've allowed it to in our organization to be much more of a local activity versus a global activity. And in the local activities we tend to have the local salespeople set up tournaments. We're in the process of upleveling that inside our organization.

We will consolidate much of our effort to put it under a senior executive and drive a much more global view around E Sports to try to take advantage of some of these opportunities. It's clearly a great way to get people deeper engage.

At the end of the day our view is you don't make money in the E Sports tournament. The way you make money is driving greater engagement in your products and getting people to play your games more and more to become better and better and able to win at E Sports.

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**Unidentified Audience Member**

Do you have specific constraints related to your interactive platform as your number of consumers are growing and engagement is growing and interactive games are growing? What type of investment in CapEx maybe you should have to serve these clients and to give them a good experience?

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

Very good question. What are our constraints on CapEx relative to our platforms. We have run our CapEx over the last three to four years at roughly \$100 million a year and that CapEx really gets broken down into two major pieces.

One is servers and server capacity and the other is primarily offices upgrading IT equipment and support. We do not capitalize our game development software. We may capitalize some software tools but that's a small actual portion of our overall CapEx.

The biggest CapEx effort on servers we've benefited from a couple of things that are going on in the industry and many of you know this I am sure. The growth of third-party servers, AWS, Google and others have allowed us to put server capacity in many places around the world at a very economical rate. What we do is we run a mixed model where we have our own servers and third-party service.

Secondly, the ability to run servers much more efficiently than we have in the past has also helped us maintain a much lower CapEx profile on that server capacity. Typically what happens is a game goes through either Apple, Microsoft, Google and ultimately comes to our server where the actual game resides and the consumer place that game. So we do need to continually upgrade that capacity but because of the availability of low-cost server capacity out there we've been able to minimize the needs for large CapEx.

And we believe that continues to stay the same in the near future and shouldn't require a large CapEx spend for us. And thus allows us to have the great cash flow that were had. So about one minute. Anymore --

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**Unidentified Audience Member**

In order to keep the subscriber engagement at a high level, what are the marketing costs and do you feel that marketing costs could go, could explode?



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

That's a great question. Three years ago when we started to try to think about how to improve the profitability in the Company our marketing expense was running around 20% to 22% of revenue. Last year we finished the year at 14% of revenue and we believe over the next three to five years that number can get down to around 12% of revenue.

And the reason why is we are connected to all 300 million of those consumers that are in our network. So if you're playing a game, you're playing it on our server, we know who you are, how you play, who you play with, why you're playing, who your favorite teams are, we know a lot about you. And if we know that we should be able to market to you much more effectively.

Our simple view is why put up a large network TV commercial if we don't know if you're ever going to see it versus have a one-to-one communication with you about how we can give you what you want in a game and make sure you're getting and your friends are getting all the information you need about the game. That should continue to help us decrease our marketing expenses despite the trends that people might think that you go the other way. We were spending a lot on what I would call big event style marketing, movie style marketing where much of the marketing dollars you actually don't know where they ultimately go.

With that I guess we're out of time. I appreciate everybody's great questions and interest and look forward to meeting many of you one-on-one in the coming days. Thank you.

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