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EA - Q2 2017 Electronic Arts Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 01, 2016 / 9:00PM GMT

OVERVIEW:

EA reported 2Q17 GAAP net revenues of \$898m and loss per share of \$0.13. Expects FY17 net revenues to be \$4.775b and EPS to be \$2.69. Expects 3Q17 net revenues to be \$1.125b and diluted loss per share to be \$0.17.



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PRESENTATION

Operator

Good afternoon. My name is Jennifer, and I will be your conference operator today. At this time, I would like to welcome everyone to the Electronic Arts Second Quarter 2017 earnings call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

(Operator Instructions)

Thank you. I would like to turn the call over to Chris Evenden, Vice President of Investor Relations. Sir, you may begin.

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

Thank you, Jennifer. Welcome to EA's second quarter FY17 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.

We have a few events coming up. Blake will be speaking at the UBS conference in San Francisco on Tuesday, November 15. Peter Moore will be speaking at the Credit Suisse conference in Phoenix on Tuesday, November 29. Blake will also be at the NASDAQ conference in London on Wednesday, November 30, and back in San Francisco for the Barclays conference on Wednesday, December 7. Finally, our Q3 earnings call is scheduled for Tuesday, January 31, 2017.



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, November 1, 2016, and disclaims any duty to update them.

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

Andrew Wilson - *Electronic Arts, Inc. - CEO*

Thanks, Chris. Electronic Arts delivered excellent results for the second quarter of FY17, powered by a slate of the most advanced and innovative new EA Sports titles that we have ever delivered. We're thrilled with the quality and player excitement for the new games we launched in Q2, and even more excited for the exceptional titles we've launched in Q3. As a result, we're raising our full-year guidance for FY17.

More than 43 million players engaged in our breakthrough EA Sports games across consoles and mobile devices during Q2. On console, FIFA 17 has given soccer fans around the world a revolutionary new experience powered by our Frostbite engine. We introduced The Journey, FIFA's first-ever story mode, which helped bring 20% more players into FIFA 17 in the first week over last year's game. To date, nearly 2/3 of all FIFA 17 players, spanning 183 countries, have engaged in this critically acclaimed new addition to the game.

The FIFA Ultimate Team experience is more robust than ever in FIFA 17, and engagement continues to grow through new modes and global competitions. Players in the Champions mode are now competing to advance to our live tournament event, the FIFA 17 Ultimate Team Championship Series.

Madden NFL 17 players spent more time in the game in Q2 than any previous Madden title in the last five years, logging 44 million game play hours during the quarter. Ultimate Team also continues to grow in Madden NFL, with engaged players in MUT up nearly 20% year over year in Q2.

Our Madden NFL competitive gaming season also kicked off in Q2, with The Madden Classic, the first of four EA major live events in the Madden NFL championship series. 1.5 million fans played 5.8 million ranked games in the online qualifying rounds, and the top 16 players will compete for the Madden Classic Championship in Los Angeles in early December. The holidays are always a great season for football, and we're looking forward to more passion and engagement from our Madden NFL community in the months ahead.

EA Sports has been a leader in high quality and emerging sports games across multiple platforms. Now we're delivering on that promise for mobile players, as well. We now have top-performing mobile titles across three of our major sports franchises. Madden NFL Mobile continues to grow year over year in both unique players and sessions per day. NBA Live Mobile has brought in more players than Madden NFL Mobile did during its launch period. FIFA Mobile hit number one in the App Store free games chart in 138 countries just after its early Q3 launch.

Each of these experiences are long-term live services that will continue to grow and be tuned with the expanding player base in this high-growth genre. Strength in our mobile portfolio reaches across other key genres. Our action RPG Star Wars Galaxy of Heroes continues to drive strong levels of engagement, with average game play per player holding at 2.5 hours per day in Q2, one of the highest totals we've seen in a mobile game. Our deep roster of live services on mobile, including The Sims free play, Sim City Builder, and Real Racing 3 continue to deliver long-lasting entertainment.

Mobile players today expect increasing levels of creativity, depth, and polish in the games they play. As a result, only a few titles will break out. With decades of rich experience building high quality and immersive games, our portfolio of leading titles and a strong pipeline of new projects, we are well positioned for this evolution in mobile.

Throughout Q2, the energy around our two ground-breaking first-person shooter games, Battlefield 1 and Titanfall 2, continue to build in anticipation of their Q3 launches. Battlefield 1 has impressed at every turn, from the debut trailer to subsequent looks at game play, features and single-player stories, our Battlefield 1 content has over 100 million video views on YouTube, a record level for any EA game.

Community influences shared hundreds of hours of game play captured from play sessions around the world, bringing the world of Battlefield 1 to life in unprecedented depth. DICE has redefined the shooter genre with Battlefield 1, which now stands as the most highly rated battlefield game of this generation. Player engagement since launch on October 21 has been phenomenal. Battlefield 1's total player base for the first week was nearly double that of Battlefield 4.

Respawn has cemented Titanfall's position as one of the most exciting new IPs in the industry, with a bold vision and accelerating action of Titanfall 2. This is a game that feels incredibly fluid and fulfilling to play. Critics agree that Titanfall 2 is a fantastic game, with more than 40 top outlets from around the world, rating at 90 and above in reviews.

The thrill of multi-player in Titanfall 2 has the community buzzing, and rave reviews are also coming for the campaign that adds purpose and depth to the experience. Titanfall 2 is being called one of the year's must-play titles, and we're excited to see more fans across the world getting their hands on this extraordinary game.

Heading into the holiday season that will include updated consoles and more mobile devices, Electronic Arts is in an outstanding position. With Battlefield 1 and Titanfall 2, we now have two of the top-rated shooter games of this console generation engaging a broad audience of players. Our EA Sports titles are delivering excitement for fans, with thrilling new game play, challenges in Ultimate Team, and dozens of new competitive gaming tournaments, from the community level to the global stage.

Our mobile portfolio has a game for every player, with Star Wars Galaxy of Heroes, Plants Vs. Zombies Heroes, and more. We will also deliver our first virtual reality experiences this holiday with the Star Wars Battlefront Rogue 1 X-Wing VR mission for PlayStation VR, and Need For Speed No Limits on DayDream, Google's VR platform. We're looking forward to another strong quarter ahead. Now I'll turn the call over to Blake.

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

Thanks, Andrew. Before I talk about the quarter, I'd like to describe the steps we are taking to improve transparency in our new GAAP-only reporting environment. As we mentioned on our Q1 earnings call, we are no longer reporting non-GAAP metrics, but we'll provide you with all the GAAP data you need to derive metrics comparable to our historical reported non-GAAP financials.

In addition, to give more visibility into the performance of our business, we have decided to add a new operating performance metric, net sales. We define net sales as the net amount of products and services sold digitally, or sold in physically in the period. Historical net sales have been added to our downloadable model posted on our website. In addition, please reference the tables in our press release as we discuss GAAP results and the GAAP adjustments that may be applied to compare them with our historical non-GAAP results.

I'll start by reporting our results on a GAAP basis, and then use our new operational measure to discuss the dynamics of our business. We are very pleased with the strong second quarter, in particular, the great reception for FIFA 17 and the strength of our mobile portfolio.

EA's GAAP net revenue was \$898 million, compared to \$815 million last year. Net revenue was below our guidance by \$17 million; however, the change in deferred net revenue was \$40 million above our guidance, at \$200 million. If you wish to compare our current results to our historical non-GAAP revenue, you will need to add GAAP revenue of \$898 million to the change in deferred net revenue of \$200 million.

Thus, although underlying sales were above our expectations because GAAP revenue is subject to the sales timing within the quarter, a larger portion of the total sales were deferred into future quarters. The increase over last year's net revenue was primarily driven by the success of Star Wars Battlefront in Q3 FY16, compared to smaller launches in Q3 FY15. See the document we posted on our Investor Relations website on July 19 for details on how to compare these results to historically reported non-GAAP results.

Our cost of revenue was \$401 million, including acquisition-related expenses of \$12 million, and \$1 million worth of stock-based compensation. Gross margin for the quarter was 55.3%, up 5.5 percentage points over last year. This reflects the strength of Star Wars Battlefront three quarters ago in FY16.

As I just mentioned, revenue deferred from Star Wars Battlefront drove higher GAAP revenues in Q2 FY17, compared to the revenue deferrals from smaller titles launched in Q3 FY15. However, the cost of revenue this Q2 and last year's Q2 were approximately the same, given that the respective launch slates were similar. Thus, GAAP gross margin was up year on year.

Operating expenses were \$546 million, up \$21 million or 4% year on year, driven by increased investment in R&D, particularly in new franchises and in our new player network infrastructure. The \$20 million improvement on guidance was driven by timing of marketing activities. The \$546 million includes \$47 million in stock-based compensation, and \$1 million in acquisition-related expenses. The resulting loss per share was \$0.13, which is \$0.04 better than our guidance due to lower costs. It is \$0.32 better than last year.

GAAP adjustments to derive a measure comparable to our historical non-GAAP EPS include the \$200 million change in deferred net revenue, \$13 million in acquisition-related expenses, \$48 million of stock-based compensation attributable to operating expenses and the cost of revenue, and a Management reporting tax rate of 21%.

Note that given our GAAP result was a loss, our share count was 301 million shares, as GAAP requires us to exclude the estimated 13 million shares that might be issued in the future, such as the shares expected to be issued this quarter for the settlement of the warrants. Those shares would be included in the diluted share count had we reported a profit.

Net cash generated by operating activities for the quarter was \$109 million, up \$100 million on last year. For the trailing 12 months, it was \$1.1 billion. With capital expenditures of \$120 million, free cash flow was \$1 billion in the same period. See our earnings slides for further cash-flow information.

During Q2, we settled the remaining \$136 million of our convertible notes. As a reminder, the warrants issued with our convertible notes are still outstanding, and starting on October 17, began to exercise automatically over 60 trading days. We have posted a document on our website that explains the impact on our share count. The most important take-away remains that our diluted share count already includes the potential dilution at the current share price.

During the quarter, we also re-purchased 1.6 million shares at a cost of \$127 million, leaving \$282 million in our two-year, \$1 billion buy-back program we began in May 2015. The current rate of re-purchases keeps us on track to complete the full \$1 billion in that time.

Our cash and short-term investments at the end of the quarter were \$3.27 billion. 43% of this balance is held on-shore. This is down from 48% last quarter, the difference driven primarily by the share repurchase and convertible note settlement.

Now I'd like to turn to the key drivers of our business this quarter. Net sales for the quarter were \$1.1 billion better than our expectations. Sales were driven by successful sports launches and growth in mobile.

As discussed in our last call, FIFA 17 launched only four days from the end of the quarter, so almost no digital sales, whether downloads or Ultimate Team, were captured in the quarter. FIFA 16 launched 11 days before the end of Q2 FY16, allowing a whole week of digital sales to be captured. Using the first four weeks of sales to make a true like-for-like comparison shows that FIFA sell-through is up 13% year on year. This speaks to how The Journey story mode has grown the market for our biggest franchise.

Digital net sales were \$486 million, up \$6 million on the year-ago quarter. The increase reflects strong growth in mobile and in digital downloads, offset by the FIFA timing I just mentioned. The long-term trend towards digital is clear in net sales for the last 12 months, which were \$2.6 billion, or 57% of the total.

Looking at each of the components of this quarter's digital net sales in turn, extra content and freemium net sales were down nearly 12% year on year to \$172 million, driven by the fact almost all of the first week of FIFA digital sales will be captured in Q3 of this year. Using the first four weeks of Ultimate Team sales for FIFA 17 and FIFA 16 reveals year-on-year growth of 23%, even in the face of ongoing currency headwinds.



Mobile net sales were \$138 million in the quarter, up 22% year on year, with growth led by Star Wars Galaxy of Heroes. We launched NBA Live mobile in July, and FIFA Mobile after the quarter end. Early indications from both titles are promising.

Net sales for full game PC and console downloads were \$93 million, up 4.5% over last year, and in line with our expectations. Subscription, advertising, and other digital purchases contributed \$83 million to net sales, flat year on year. Strong growth in EA Access and Origin Access were offset by declining revenue from some older titles.

Now turning to guidance. We are raising our full-year guidance to \$4.775 billion in net revenue, and \$150 million increase in deferred net revenue. We anticipate cost of revenue to be \$1.387 billion, including \$31 million of acquisition-related costs and \$2 million of stock-based compensation.

Operating expenses are expected to be \$2.304 billion, including \$198 million in stock-based compensation, and \$6 million in acquisition-related costs. This results in an earnings per share of \$2.69 for the year, also an increase from prior guidance.

GAAP adjustments to derive a measure comparable to our historical non-GAAP EPS include the \$150 million change in deferred net revenue, \$200 million of stock-based compensation attributable to operating expenses and cost of revenue, \$37 million in acquisition-related costs, \$2 million in debt-related expenses, and a reduction of 1 million shares from the convertible bond hedge.

Regarding cash flow for the full fiscal year, we are reaffirming our operating cash flow guidance of approximately \$1.3 billion. Our capital expense forecast remains approximately \$110 million, resulting in a free cash flow forecast of \$1.2 billion.

We expect Q3 FY17 to be our biggest cash flow quarter ever. We anticipate net sales for the year to be approximately \$4.925 billion. This reflects a modest increase in our expectations for the underlying business, primarily based on the early successes of FIFA 17.

We're delighted with the way players are reacting to Battlefield 1 and Titanfall 2. Both are reviewing very well, and we expect them to sell strongly for a long time. However, we're only a week into Battlefield and just a handful of days into Titanfall, so it's too early to update sales forecasts for either.

Guidance for the third quarter is for net revenue of \$1.125 billion, including \$910 million in deferred net revenue. We anticipate cost of revenue to be \$532 million, including \$3 million of acquisition-related expenses. Operating expenses are expected to be \$652 million, including \$50 million in stock-based compensation, and \$2 million in acquisition-related expenses.

Excluding the effect of stock-based compensation, expenses are up year on year, chiefly driven by increased investment in new franchises and our player network. This results in a diluted loss per share of \$0.17 for the quarter.

GAAP adjustments to derive measures comparable to our historical non-GAAP EPS include the \$910 million change in deferred net revenue, \$50 million of stock-based compensation attributed to operating expenses, and \$5 million in acquisition-related expenses. We anticipate net sales for the quarter to be \$2.035 billion. This is up 13% year on year, driven by a combination of Battlefield 1 and Titanfall 2. As you build models and make year-on-year comparison, remember that the same timing issue that pushed FIFA digital sales into fiscal Q3 will also push some holiday sales into our fiscal Q4.

In conclusion, with the new innovations in FIFA, we've increased the market size. In Battlefield 1 and Titanfall 2, we have two extremely high quality games in place for the holiday season, and we're continuing to grow our portfolio of successful mobile titles. Together, we expect them to deliver a record holiday quarter. Now I'll turn the call back to Andrew.

Andrew Wilson - *Electronic Arts, Inc. - CEO*

Thanks, Blake. EA is leading across multiple growth vectors that are shaping our industry. The audience for high quality games on HD consoles and PC continues to expand. We believe the new console options will add depth to the hardware cycle, grow the in-store base, and add to the player value proposition.

The power of our frost bite engage enables us to scale with platform capabilities to deliver the experiences our players want. From the groundbreaking game play in Battlefield 1 and FIFA 17 to Mass Effect Andromeda in stunning 4k, to extraordinary new VR experiences from our labs teams across the spectrum of high-end and lower-end devices, we are pushing the boundaries in a multi-platform world.

The evolution of mobile games is another growth vector where the tenets of great mobile experiences and great HD games continue to converge, and open new high-growth opportunities. In this increasingly competitive world where the number of players and the number of games grows on a daily basis, players are looking to major brands as markers for quality.

The expectations for creativity, innovation, polish, and depth play directly to our strengths. Our EA sports titles are strong demonstrations of social play, blended with strategy and action that have proven to deeply engage mobile players over time. We will continue to infuse this same approach throughout our pipeline of new mobile experiences in development for the quarters ahead.

Players today also have more ways to connect and engage with the games they love. Millions of fans are competing in our global Madden NFL 17 and FIFA 17 competitions, beginning with in-game qualifications and leaderboards that will ultimately feed championship events on a world stage.

In-game competitions have kicked off for Madden Bowl, our second EA major event for Madden, and season one of the FIFA 17 Ultimate Team championship series is under way, which will culminate with the FIFA interactive World Cup in August 2017.

Beyond competitive gaming, we're introducing new tools for our community to create content, and share more of the amazing experiences they have in games like Battlefield 1. Building on the continued success of EA Access and Origin Access, we're exploring ways to provide subscription choices for more of our players.

In an ever-changing world defined by more content, more devices, and an increasingly global player base, finding great games and connecting with friends becomes increasingly challenging. We are continuing to invest in our EA Player Network to reduce friction and improve discovery, purchase, and enjoyment across all of our games and player touch points.

The player experience as you enter Battlefield 1 is a good example of how this is beginning to roll out, with a new consistent interface that brings players into their personal Battlefield universe with the games they own, content recommendations, and faster ways to squad up with their friends.

The Player Network will grow and attract more players with these personalized services in game and out of game that add value and improve the experience with every minute of play. We're energized to introduce our players to new experiences, new connections, and new ways to play. Now Blake and I are here for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Chris Merwin with Barclays.

Chris Merwin - *Barclays Capital - Analyst*

Hi, how's it going?



Andrew Wilson - *Electronic Arts, Inc. - CEO*

Good.

Chris Merwin - *Barclays Capital - Analyst*

It looks like last quarter you talked about \$9 million or \$10 million for Titanfall 2 and I think under \$15 million for Battlefield 1. Basing your disclosure that the player base for Battlefield nearly doubled from Battlefield 4, can you talk about how if at all those expectations have changed in the context of your raised guidance?

Then a second question. I know it's still very early days here, but just trying to get a sense of maybe how the digital download mix of Battlefield 1 is trending relative to Star Wars. I think you gave the long-term guidance of a 5-point mix shift annually in terms of the digital download mix. Curious how that's looking in the early stages so far? Thanks.

Andrew Wilson - *Electronic Arts, Inc. - CEO*

We're not planning on updating our unit guidance for any products, including those, but we're very optimistic about obviously both Battlefield 1 and Titanfall 2. We're just early in the holiday sales cycle. While there's incredible excitement around both, we just don't want everyone to get ahead of themselves in the case of focusing on unit forecasts. Don't take that as a negative on either product.

We're very excited about both of them, and think there's a long opportunity -- not just in the quarter, but for a good one to two years to come. I remind people we had quite a few players still playing Battlefield 4 three years after the game shipped, right up until the time we shipped Battlefield 1, so deep engagement in that product.

In terms of full-game downloads, in the script we talked about growth of 4.5% in Q2. I remind everyone that none of the digital business for FIFA was in that number. You should assume we're seeing healthy growth in full-game downloads at or above our expectations. You should assume that the early data on both Battlefield and Titanfall also is strong, mainly because the skew towards PC of those games versus say Battlefront was a year ago. In general, we're very comfortable with the trend we've put in place, and we continue to see consumers defaulting to what is the easiest way to buy products.

Chris Merwin - *Barclays Capital - Analyst*

All right, great. Thanks, Blake.

Operator

Your next question comes from the line of Brian Nowak with Morgan Stanley.

Brian Nowak - *Morgan Stanley - Analyst*

Great, thanks for taking my questions. I have two. Appreciating some of the color on FIFA on a like-for-like basis, I'd be curious if you can talk about Ultimate Team paying and playing penetration now versus a year ago. What do you see as the main drivers to take Ultimate Team penetration higher over the next couple years? Secondly, can you just talk about early learnings on FIFA Mobile relative to what you saw in Madden Mobile when you made the changes a couple years ago? Thanks so much.

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

Yes, why don't I start on the Ultimate Team piece, and then I'll have Andrew talk about the mobile piece. The Ultimate Team data is as I mentioned strong growth when you just look at the first four weeks. Because of the calendar differences this year versus last, we use that first-four-week stack, because I think it gives a good sense that Ultimate Team is growing, along with the growth of the FIFA portfolio of users.

The Ultimate Team growth is greater than the underlying FIFA unit growth, so that's a good sign. It's too early for us to be able to say does that mean more people are in the funnel or more people spending more. It's just early in the season to be able to say that. But we're very confident that people continue to enjoy the game mode, and found that to be a very highly engaging way to continue to come back and play FIFA every day or every week. We're optimistic about where that's going, but yet unable to know exactly what the stats are driving the underlying business.

Andrew Wilson - *Electronic Arts, Inc. - CEO*

On the mobile question, we're very happy with both NBA Live and FIFA on mobile. As we think about the future of that and we think about a benchmark in terms of Ultimate Team on console, what we have seen with Ultimate Team on console across FIFA, Madden, and hockey, for example, is the underlying mechanic is fairly consistent. There are some nuances based on the game play of each particular sport and the markets where those sports are strongest, and the consumer spending habits in those markets.

We're seeing similar nuances between Madden Mobile, NBA Live Mobile, and FIFA Mobile. We're very comfortable and confident with the underlying mechanic, and very excited that both NBA and FIFA are ahead of where Madden was at this point in its life cycle. We would expect to continue to grow and tune those experiences for the core game and their core markets over the coming months and years.

Brian Nowak - *Morgan Stanley - Analyst*

Great, thanks.

Operator

Your next question comes from the line of Justin Post with Bank of America Merrill Lynch.

Justin Post - *BofA Merrill Lynch - Analyst*

Great, thanks. Blake, maybe you could help us a little bit and frame the FIFA Mobile opportunity as you see it relative to Madden. I think it's important. Then it looks like Mass Effect is still scheduled for the year. Maybe talk a little bit about the flexibility around that title, and how you see the timing there? Thank you.

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

On the FIFA Mobile opportunity, obviously soccer is a much larger sport globally than American football. That's a huge positive for FIFA. I think you could do lots of stats as to the size of the audience base for those two sports. I don't know those numbers off the top of my head, but clearly global football is a lot larger than American football.

The counter to that is that mobile games tend to monetize very well in the West, and in particular monetize well in the US. That's driven by economics in the country. That means that there are places around the world where we do not expect FIFA to monetize anywhere near at the level that it does -- Madden does here in the US.

I think for us, the long-term play is how do we build an engaging mechanic in mobile that provides access to the number one sport in the world, to allow people to engage like they do in Ultimate Team on console, in places all around the world where they may not have access to a console or they may not be a console player. That means large potential in all of Europe, both western and eastern; large potential in Latin America, where soccer is very strong; and obviously large potential in China. Our goal is to go after all of those markets with a very compelling service.

The beauty of mobile, as well, as Andrew just mentioned, is it can be tuned and change the engagement models over time without having to build a whole new product. You don't have, like in the console business, the need to build a product every year. You're constantly updating mobile, and that provides us the ability to tailor the offering as we find what plays well in each local market.

On the Mass Effect question, really our focus -- the way to think about it is our focus is on building great games. Right now, Mass Effect is tracking extremely well. The game looks beautiful, and we're really pleased with its progress. However, as you've seen, we are willing to make moves in launch dates if we feel it's necessary to deliver the right player experience.

Our guidance assumes that Mass Effect continues to be in this year; but it gives us some flexibility that we might choose to move it either a week or three or four or five months if we have to, based on what we want to make sure in terms of delivering the right experience for the player. No news on Mass Effect, other than we continue to have it in our guidance. The moment that changes, we'll certainly let everyone know.

Justin Post - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Your next question comes from the line of Stephen Ju from Credit Suisse.

Stephen Ju - *Credit Suisse - Analyst*

Thanks. Andrew, any perspective you can give us on how much of a head wind you might be seeing outside the US for full-game downloads, as well as for downloadable content due to payments friction? Also, one more question on FIFA Mobile, if I may. Now that you shipped the game, can you talk about the extent of the resources that you have prepared for live ops and I guess follow-up content to keep up user engagement? Is there any seasonality data you can share with us in terms of the global user base, especially as it regards to the EPL Champion's League or World Cup qualifying activity? Thanks.

Andrew Wilson - *Electronic Arts, Inc. - CEO*

Wow, that was a lot. I will endeavor to get all three there. On digital download data, again what we have talked about many times is we see that growing by about 5 percentage points a year. That accounts for some more aggressive growth in certain markets over others. We do typically see markets in Europe where this is progressing more slowly. But again, I think by the time we get back to you next quarter, we'll have more data on both Battlefield 1 and Titanfall 2 that we'll be able to share. That will be a good measuring stick for us as we think about where digital downloads are going.

They're absolutely moving in the growth trajectory direction in all markets; but bigger markets like North America, UK, and markets that typically have more access to digital payment methods are growing at a faster rate, as you might imagine.

FIFA Mobile, as we think about that, we have built what we believe is a very strong EA Sports mobile organization. As many of you know, I had the great fortune of leading that organization, the EA Sports organization for a number of years. We take great pride in really driving great broad sport

experiences on every platform that people want to access interactive sports on. We see it as a real opportunity for us to grow sports in the mobile space, as we have done on almost every other platform up to this point.

We also believe that the live service orientation of sport is growing rapidly, as we have seen with Ultimate Team on our console business, and have built a very strong and robust organization around our sports mobile business that we believe is very well-resourced to deal with the live service opportunity that we think those games will bring on mobile.

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

I think to add to that, one of the keys to remember is it's not just running a live service. It's driving events. You mentioned events associated with the Premier League or with actions that are going on in the sporting world like World Cup, or in the case of American football, the Super Bowl or playoffs. Our strength is to drive those live ops, and we believe that works in both the success -- that's proven in the success we've had in Ultimate Team. It's proven early on in the success we've had with Madden, and we think we can do that.

I think it will prove ultimately that it will help us in the competitive sports world in how we design the tournaments that we're doing, and how we partner with people during those tournaments. We're very excited about that potential to drive our skills around live ops across all of the platforms in which we are doing business today.

Andrew Wilson - *Electronic Arts, Inc. - CEO*

Just to add a little context on that for your last point, which was seasonality in the global user base, particularly around European football. One of the great things about our FIFA property is the many licenses and relationships we have across domestic leagues and international teams and tournaments.

The beauty of soccer on a global basis is the season when combining domestic leagues with international tournaments is very long. Part of the reason why we're seeing such deep engagement in FIFA Ultimate Team month-in, month-out from launch through to the launch of the next version of the title is driven by this ongoing global soccer season. We would expect that to also deliver benefit to us in the mobile space.

Stephen Ju - *Credit Suisse - Analyst*

Thank you.

Operator

Your next question comes from the line of Brian Fitzgerald with Jefferies.

Brian Fitzgerald - *Jefferies, LLC - Analyst*

Thanks, guys, a couple questions. One, any sense Titanfall is being cannibalized by other games like Battlefield 1? Any notable -- anything notable to call out in terms of player overlaps or player dynamics, maybe, between the two titles? We know it's still early, but any thoughts on launch windows being so close? Do you like it this close? You don't mind it, or would you rather spread them out a little bit in the future?



Andrew Wilson - *Electronic Arts, Inc. - CEO*

Great question. Again, as we talked about coming into this, the first-person shooter category's a very large category, one of the largest. I think this year it's forecast to be the largest in the absence of some action adventure titles. It actually breaks down into a number of key categories. We believe that Battlefield 1 and Titanfall 2, while they have some overlap, fulfill very different motivations in what a player is looking for.

We think there's really three types of players -- people that really love Battlefield and that type of big strategic game play that will orient in that direction; the player that loves the fast, fluid kinetic game play of Titanfall 2, and really orient in that direction; and the player that just has to play the two greatest shooters this year, and will buy both.

Again, we're very excited about the quality in both titles. We believe they both will have a long sale cycle, both this quarter through the festive season, and deep into the years to come. As we think about the long game on this, we couldn't be in a better position for what we think is delivering great games to a very big player base.

Brian Fitzgerald - *Jefferies, LLC - Analyst*

Great. Thanks, Andrew.

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

Next question?

Operator

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

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

Thank you, and congratulations on another strong quarter and launch of Battlefield. First off, I was hoping for an update on Peter's e-sports initiatives, in particular with Battlefield. Then secondly, I was wondering if you saw any noticeable impact on sell-through of software from launch of new hardware SKUs? Thank you.

Andrew Wilson - *Electronic Arts, Inc. - CEO*

Let me jump on. Peter and the competitive gaming group inside Electronic Arts have been doing amazing work. Again, we've been doing competitive gaming for a number of years, but the energy that Peter and his team have brought to it has really taken it to the next level.

What you heard in the prepared remarks is how strong we are going into both FIFA and Madden seasons, not -- focused on all aspects of the player journey, from the grassroots level in qualifying tournaments through to elite leagues and elite championships on a global stage. We're very excited about what that is doing for engagement, and how that is bringing new people into play both our Madden and FIFA franchises.

With the launch of Battlefield 1, as you can imagine, we are also looking deep into Battlefield 1 tournaments. We have run a lot of great tournaments with partners in Europe and in North America with Battlefield in the past. With the launch now in place, and the quality of the games so high, the team is working on some very specific game modes and features that will further enhance the competitive player in Battlefield 1 over the coming months and years.

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

On the console question, it's a little early for us to know what the big impact will be of the new PlayStation and Xbox models. We're extremely excited about them. The game play quality is obviously fantastic. We think the consumer experience is going to be great on both of those consoles, but it's early because the selling season is really as we go between now and the end of the calendar year.

Our internal estimate is still roughly 80 million units by the end of calendar year and 100 million units by the end of next year, calendar year. As a note, the install base right now is 33% higher than the previous-generation consoles for the first 35 months in the West. All of that bodes extremely well for the overall business. That, combined with the fact that I think you'll continue to see fantastic deals around bundling associated with the new consoles, the consumer's really going to get a great opportunity to increase or enter the best level of the gaming business that we've seen in a long time.

Colin Sebastian - *Robert W. Baird & Company, Inc. - Analyst*

Thank you.

Operator

The next question comes from the line of Eric Sheridan with UBS.

Eric Sheridan - *UBS - Analyst*

Thanks for taking the questions. Maybe two more on the cost side of the equation. One, as you see the competitive environment playing out through the holiday period, how's that competitive intensity comparing with what you were thinking in terms of spending on marketing, or combating the competitive intensity during the holiday period? That's number one.

Number two, Blake, in your prepared remarks you talked a little bit about R&D. Obviously you have some titles you haven't unveiled yet as we look out towards FY18. Any way you can size for us what the R&D scope against numbers might be as we look out either this quarter or in future periods, versus things that haven't yet been announced on the revenue side, but could be impacting us on margins and free cash flow? Thanks, guys.

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

On the competitive nature, I think we've built into our guidance appropriate marketing spending. We do tend to see, as you saw this quarter, there tends to be phasing from Q2 into Q3. Certain programs we decided on timing at the last minute; but in general, I think the core marketing focus, including traditional holiday promotions, and all of the activities around everything from Black Friday through the end of the calendar year, I think are pretty well baked in, and are reflected in our guidance. I don't think you should see something different than that relative to our overall marketing spend.

In terms of R&D, we've talked I think publicly about roughly 25% of our R&D is for new products. Those new products could be brand-new IPs, such as we're building obviously a new studio in Montreal around Jade Raymond and the team she's building there, so we're hiring people for that studio. They'll be building a new action title for us. That's not next year or the following year. That will be three or four years out; but obviously we're spending money on that.

We're spending money on building out around key sports properties that we have, adding things like The Journey into FIFA, for example. You'll see more of that type of work on existing products over time. We're obviously building out on the Star Wars franchise that has proven to be very successful for us. You'll see a new Star Wars product coming out in the future, as well.



Much of our core increases in R&D expenses have been all around those new opportunities, as well as some new technologies -- obviously investing in VR, investing and streaming technologies, investing in mobile. We're trying to make sure we are very focused on where the future is going, and be able to be there when any new platforms develop, or any shifts in platforms happen.

We think it's the prudent way to run the business. We try to make our biggest franchises as cost efficient as possible. But at the same time, we're constantly investing in innovation around those two as new and exciting ways to play the games.

Operator

Your next question comes from the line of Mike Olson with Piper Jaffrey.

Mike Olson - *Piper Jaffray & Company - Analyst*

Good afternoon. For FY17, obviously a big year for incremental titles. I was wondering if you could talk about what would be reasonable to expect as we looked into FY18? Does it make sense to assume a Star Wars Battlefront title next year that could offset Battlefield 1 this year? I think you just mentioned the new action title in the works probably won't hit next year to offset Titanfall 2. How should we think about comping Titanfall 2 -- maybe a strong digital growth or something that helps to offset? Basically, how does this good year in FY17 impact growth rates in FY18? Thanks.

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

Yes, we have talked obviously about the next Battlefront coming a year from now. We're working very hard on making sure that is an extremely deep and engaging offering. We've talked about an action title that's not yet announced, but we're very excited, and a good chance that will fall into FY18. I'm not yet giving guidance for FY18, so I want to be careful that we don't get overboard, but we're confident that we should be able to comp a strong year this year.

One thing that people tend not to remember is when you have a title like a Battlefield or a Titanfall, those tend to sell extremely well in the catalog for at least another 12 to 24 months. In the case of Battlefield in particular, you'll have all the premium services kicking in next year. We won't see any of that in this year's revenue. Exciting times for big franchises like that and huge opportunities for us to continue to monetize.

We also believe our mobile business will continue to grow, which will obviously help in the comps year over year. Our live services business is continuing to get stronger, things like our FIFA online business in Asia. Our goal is to try to grow all of those to help offset what could be a great year this year.

Mike Olson - *Piper Jaffray & Company - Analyst*

Thank you.

Operator

Your next question comes from the line of Ben Schachter with Macquarie.

Ben Schachter - *Macquarie Research Equities - Analyst*

Hi, guys, a few things. First, congratulations on the strong ratings for Titanfall and Battlefield. Following up on your point about money into next year from those titles, how does it impact your long-term thinking about the marketing investment that you would put against those games over the longer term?

Secondly, Blake you mentioned that you earned the right to look at potential acquisitions, but we haven't seen a lot. What type of deals are you focused on now? Is it mostly price that's holding those up? Finally, just a quick clarity point. Did I hear you correctly say that digital downloads are growing about 5 points a year, perhaps more in North America and UK? If yes, what was the base we're growing off of last year? Thanks.

Andrew Wilson - *Electronic Arts, Inc. - CEO*

I'll take the marketing piece, and then I'll hand over to Blake. Yes, we certainly are adjusting and evolving how we market our titles. We think about this on a few different vectors. First is we see core purchase of the title continuing for much longer, particularly of high-quality experiences with great social play dynamics like properties like Battlefield 1 and Titanfall 2. You should expect that we have planned for a longer marketing cycle around that.

The second is we are using our network and investing more deeply in our network to drive cross play of franchises within our network. You should expect to see us continue to do that using the games that we already have in the market place to help introduce new players to new games that we know they'll love based on their play patterns.

Then the third is the live services that are wrapped around games' active marketing in and of themselves, as every time we drive a new event around a particular property as part of a live service, that acts as a beat that drives conversation in social channels about the games that we play. As we think about an elongated initial marketing cycle, as we think about the power of our network and the amount of players that we have in it playing every day, and we think about the live services that we have wrapped, we are really transforming how we market our games, and believe we're getting much stronger ROI on every dollar spent.

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

Ben, on your other two questions, on full-game downloads, we finished our FY16 around 24% of all of our games. As we talked about publicly, we lagged the industry by 1 or 2 points, primarily because FIFA is such a large global product. It operates -- it has huge share in some market places where full-game downloads are, due to bandwidth or credit card capabilities, are not -- it impacts that business there.

Ben Schachter - *Macquarie Research Equities - Analyst*

Blake, are those console games or PC, also, when you say 24%?

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

This is gen-4 only consoles, sorry. Obviously PC skews it. 75% to 80% of all PC games are full-game downloads. That pulls the numbers up. We think the industries going to be probably by calendar year-end around 30%. Our internal estimates are around 29% for ourselves -- once again, slight lag with the industry. As I said, I think we're seeing positive trends on all of that, so it's good.

Then the last piece, M&A. We look at everything. As one of the large players in the industry, we have the benefit of everything gets shopped to us. We have good relationships with virtually everyone in the business, so we tend to have ongoing dialogue with everyone.

Price has been an issue on some of the big deals that have been recently completed. For us, the bigger issue is the correct fit and the right product mix. Unfortunately, there are not lots of Triple A studios out there in today's world. It's very different than it was 10 years ago in the business.

We continue to look at things. We're always trying to find ways to create value for shareholders. In the same vein, we're very careful that we don't simply try to fuel growth through acquisitions. We need to fuel value creation, not just the top line. Next question?

Operator

Your next question comes from the line of Neil Doshi with Mizuho.

Unidentified Participant - - *Analyst*

Hi, this is Sanjin for Neil. Offering free DOCs for Titanfall is pretty unique. I was wondering if you could share the feedback you're getting on that decision, and if you're expecting that to have a different sales curve on the game, versus others with Season Pass?

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

Can you repeat the first part of the question again? Sorry, we didn't hear.

Unidentified Participant - - *Analyst*

Sure. Offering a free DOC for Titanfall is pretty unique. I was wondering if you can share the feedback you're getting thus far on that decision, and if you're expecting that to have -- to impact the game with the different sales curves versus other title that traditionally would have a season pass?

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

Yes, okay. I'll let Andrew --

Andrew Wilson - *Electronic Arts, Inc. - CEO*

Yes, great questions. The feedback has been really positive. If you go and look at the user -- the player conversation in the market place right now around Titanfall 2, it's very strong. Respawn, who are an amazing studio, who have built some of the greatest games over the last decade, have a real commitment to players, as do we as a Company, and are looking to support and drive and grow and nurture that community over a number of years. The whole construct of how they have put that plan together is receiving really positive feedback from that community.

As we think more broadly about how that impacts other games, again, we have a big and diverse portfolio, with a growing and diverse player base. We are always looking for the best way to offer amazing game play experiences, with tremendous value to our player base. We'll always take feedback from our player base as to how we should think about things on a go-forward basis.

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

I think one thing to remember, it gets lost I think on a big triple-A title like Titanfall is we are working with Respawn to build a franchise. This is something that we plan to be working with them on for many years to come. There is huge opportunity inside of that franchise to continue to expand it.

Part of the strategy of building us a franchise is you have the long view. You think about the business differently than you might an existing franchise like a FIFA or a Madden. What that means is we're looking for ways to not fragment the player base early, but to include everybody as possible as we can to continue to build that franchise. We think that's the right strategy for a product like Titanfall. More to come we learn more, but that's the reason we chose to go the route we went.



Unidentified Participant - - *Analyst*

Great. A second question related to that. We were actually surprised to see some retailers out of stock with physical copies of the game, both at retail and online. Anything notable to call out with the sales channel there?

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

That people bought the game, I guess, and the retailers didn't have enough stock in place. I don't know. I hope that someone, if they couldn't find it on the retail shelf went home and digitally downloaded it. I think, once again with a new franchise, there's only been -- remember, there was only one Titanfall before and it was single platform. Retailers often times have their own sales models. They try to build their own demand models. They listen to the consumer and they listen to our salespeople; but at the same time they're trying to balance how much they put on shelves. They've got to spend money to build inventory. You might have found retailers out of stock. We hope that we've gone back and got those shelves filled up for the future.

Unidentified Participant - - *Analyst*

Great, thanks a lot.

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

Thanks.

Operator

Your next question comes from the line of Eric Handler with MKM partner.

Eric Handler - *MKM Partners - Analyst*

Yes, thanks for letting me ask the question. On Madden and Madden for Mobile, I'm just curious how much overlap is there between mobile players and the console players? Are you seeing shifts in time spent? When you think about money that's being spent, is there any cannibalization from Madden for Mobile, or is it additive?

Andrew Wilson - *Electronic Arts, Inc. - CEO*

At a macro level when you look at it, it's clearly additive, because both businesses are growing. What we have seen is that mobile is adding younger players at a higher rate than console is; but we're also seeing some mobile players come across. I believe the number -- I believe about 70% or 75% of console players also play Madden Mobile. What we're seeing is when you're a football fan and you're a Madden fan, you love the experience that is high-definition on your 80-inch television, coupled with a live service like Madden Ultimate Team that connects you with your friends in that high-def experience, but you also love Madden and Madden games while you're on the go, and you're using mobile as an opportunity to do that.

As we look to the future, we think there is a world where we drive even greater connection at a design level between the console experience and the mobile experience. We believe that is going to be a strategic opportunity for us, as we think about the growing player base in any one of our franchises.

Eric Handler - MKM Partners - Analyst

Great.

Andrew Wilson - Electronic Arts, Inc. - CEO

One last question? Sorry.

Operator

I'm sorry? Our final question comes from the line of Mike Hickey with The Benchmark Company.

Mike Hickey - The Benchmark Company - Analyst

Hi guys, great quarter. Thanks for squeezing me in, Blake, appreciate it. Just two for me. Curious on how Respawn moves forward here. Normally we would think of maybe a Titanfall 3 in a couple years; but I think they're also excited to work on a Star Wars game. I'm wondering, if you're growing the studio there, or how we should think about pacing of those two games in the future?

The last one, just thinking about the comp issue for FY18. Re-mastered games have obviously been very popular. I think you've done less there than maybe some of your peers. How are you thinking about re-mastered games as an opportunity in the future? Thanks, guys.

Andrew Wilson - Electronic Arts, Inc. - CEO

On the Respawn element, again, we have announced we have a long-term relationship planned with them. We are looking at a number of different things with them. As it's related to Titanfall 2, there is still a lot of things they'll be putting into the game for the foreseeable future.

One of the lessons we have learned is that when you have a great game like Titanfall 2 or Battlefield 1, giving it enough breathing room in the market place for fans to play for many years is really important to delivering the true value of that experience to fans, as we did with Battlefield 4. Again, I think just a quarter ago, we announced we still had 11 million people playing Battlefield 4. Expectation is that Respawn will continue to support and grow the Titanfall community through Titanfall 2. Over time, we'll work out what the right cadence of the next version of Titanfall is, and/or any other titles they're working on. The second part?

Blake Jorgensen - Electronic Arts, Inc. - CFO

Re-master.

Andrew Wilson - Electronic Arts, Inc. - CEO

In terms of re-mastered, again, it's something that we look at. In all cases, we're trying to figure out what is right for the player. If there's a world where there are games we have in our catalog that players really want to play in a re-mastered variety, and we believe that we can add the kind of enhancements that make that worthwhile for a player, then we will do that -- nothing to announce today, but certainly you can imagine with a portfolio as rich and deep as ours, and with a player base as engaged as ours, that we're getting lots of requests right now.

Blake Jorgensen - Electronic Arts, Inc. - CFO

With that, I thank everyone. Look forward to seeing or talking to everybody over the next quarter, and we will see everyone back for earnings at the end of January. Thank you.



Operator

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

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