

ELECTRONIC ARTS INC.  
Form 10-Q  
February 04, 2015  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934

For the Quarterly Period Ended December 31, 2014  
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934

For the Transition Period from                      to  
Commission File No. 000-17948  
ELECTRONIC ARTS INC.  
(Exact name of registrant as specified in its charter)

Delaware	94-2838567
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

209 Redwood Shores Parkway Redwood City, California (Address of principal executive offices)	94065
(650) 628-1500	(Zip Code)

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/> Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> Smaller reporting company	<input type="checkbox"/>

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

As of January 30, 2015, there were 310,035,894 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.



Table of Contents

ELECTRONIC ARTS INC.  
FORM 10-Q  
FOR THE PERIOD ENDED DECEMBER 31, 2014  
Table of Contents

	Page
<u>Part I - FINANCIAL INFORMATION</u>	
Item 1. <u>Condensed Consolidated Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of December 31, 2014 and March 31, 2014</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended December 31, 2014 and 2013</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended December 31, 2014 and 2013</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended December 31, 2014 and 2013</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
<u>Report of Independent Registered Public Accounting Firm</u>	<u>32</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>33</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>53</u>
Item 4. <u>Controls and Procedures</u>	<u>55</u>
<u>Part II - OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	<u>56</u>
Item 1A. <u>Risk Factors</u>	<u>56</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>65</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>65</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>65</u>
Item 6. <u>Exhibits</u>	<u>65</u>
<u>Signature</u>	<u>66</u>
<u>Exhibit Index</u>	<u>67</u>

Table of Contents

## PART I – FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements (Unaudited)

## ELECTRONIC ARTS INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)	December 31, 2014	March 31, 2014 <sup>(a)</sup>
(In millions, except par value data)		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$2,166	\$1,782
Short-term investments	774	583
Receivables, net of allowances of \$189 and \$186, respectively	488	327
Inventories	39	56
Deferred income taxes, net	57	74
Other current assets	230	316
Total current assets	3,754	3,138
Property and equipment, net	461	510
Goodwill	1,718	1,723
Acquisition-related intangibles, net	127	177
Deferred income taxes, net	6	28
Other assets	101	140
<b>TOTAL ASSETS</b>	<b>\$6,167</b>	<b>\$5,716</b>

## LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	\$77	\$119
Accrued and other current liabilities	813	781
Deferred net revenue (online-enabled games)	1,583	1,490
0.75% convertible senior notes due 2016, net	596	—
Total current liabilities	3,069	2,390
0.75% convertible senior notes due 2016, net	—	580
Income tax obligations	88	189
Deferred income taxes, net	85	18
Other liabilities	201	117
Total liabilities	3,443	3,294
Commitments and contingencies (See Note 13)		
0.75% convertible senior notes due 2016 (See Note 12)	37	—
Stockholders' equity:		
Preferred stock, \$0.01 par value. 10 shares authorized	—	—
Common stock, \$0.01 par value. 1,000 shares authorized; 310 and 311 shares issued and outstanding, respectively	3	3
Paid-in capital	2,152	2,353
Retained earnings	509	29
Accumulated other comprehensive income	23	37
Total stockholders' equity	2,687	2,422
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$6,167</b>	<b>\$5,716</b>

See accompanying Notes to Condensed Consolidated Financial Statements (unaudited).

(a) Derived from audited consolidated financial statements.



Table of ContentsELECTRONIC ARTS INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)	Three Months Ended December 31,		Nine Months Ended December 31,	
(In millions, except per share data)	2014	2013	2014	2013
Net revenue:				
Product	\$606	\$485	\$1,899	\$1,378
Service and other	520	323	1,431	1,074
Total net revenue	1,126	808	3,330	2,452
Cost of revenue:				
Product	300	438	899	909
Service and other	101	79	296	215
Total cost of revenue	401	517	1,195	1,124
Gross profit	725	291	2,135	1,328
Operating expenses:				
Research and development	283	275	809	836
Marketing and sales	169	214	482	525
General and administrative	107	91	287	305
Acquisition-related contingent consideration	—	—	(2	) (37
Amortization of intangibles	4	4	11	12
Restructuring and other charges	—	(1	) —	(2
Total operating expenses	563	583	1,587	1,639
Operating income (loss)	162	(292	) 548	(311
Interest and other income (expense), net	(6	) (6	) (20	) (19
Income (loss) before provision for income taxes	156	(298	) 528	(330
Provision for income taxes	14	10	48	29
Net income (loss)	\$142	\$(308	) \$480	\$(359
Net income (loss) per share:				
Basic	\$0.46	\$(1.00	) \$1.54	\$(1.17
Diluted	\$0.44	\$(1.00	) \$1.49	\$(1.17
Number of shares used in computation:				
Basic	311	309	312	307
Diluted	323	309	322	307
See accompanying Notes to Condensed Consolidated Financial Statements (unaudited).				

See accompanying Notes to Condensed Consolidated Financial Statements (unaudited).

Table of Contents

## ELECTRONIC ARTS INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)	Three Months Ended		Nine Months Ended	
(In millions)	December 31,		December 31,	
	2014	2013	2014	2013
Net income (loss)	\$ 142	\$(308 )	\$ 480	\$(359 )
Other comprehensive income (loss), net of tax:				
Change in unrealized net gains and losses on available-for-sale securities	(1 )	—	(1 )	—
Reclassification adjustment for net realized gains on available-for-sale securities	(1 )	—	(1 )	—
Change in unrealized net gains and losses on derivative instruments	1	(4 )	11	(15 )
Reclassification adjustment for net realized losses on derivative instruments	1	3	8	5
Foreign currency translation adjustments	(30 )	(9 )	(31 )	(7 )
Total other comprehensive loss, net of tax	(30 )	(10 )	(14 )	(17 )
Total comprehensive income (loss)	\$ 112	\$(318 )	\$ 466	\$(376 )

See accompanying Notes to Condensed Consolidated Financial Statements (unaudited).

Table of ContentsELECTRONIC ARTS INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)	Nine Months Ended	
	December 31,	
(In millions)	2014	2013
<b>OPERATING ACTIVITIES</b>		
Net income (loss)	\$480	\$(359)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization and accretion	165	170
Stock-based compensation	108	111
Acquisition-related contingent consideration	(2)	(37)
Net loss on investments	—	1
Change in assets and liabilities:		
Receivables, net	(176)	(210)
Inventories	16	(12)
Other assets	137	17
Accounts payable	(29)	13
Accrued and other liabilities	68	75
Deferred income taxes, net	9	7
Deferred net revenue (online-enabled games)	93	655
Net cash provided by operating activities	869	431
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(63)	(81)
Proceeds from maturities and sales of short-term investments	520	331
Purchase of short-term investments	(717)	(270)
Acquisition of subsidiaries, net of cash acquired	—	(5)
Net cash used in investing activities	(260)	(25)
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of common stock	31	51
Excess tax benefit from stock-based compensation	16	—
Repurchase and retirement of common stock	(242)	—
Acquisition-related contingent consideration payment	—	(1)
Net cash provided by (used in) financing activities	(195)	50
Effect of foreign exchange on cash and cash equivalents	(30)	(2)
Increase in cash and cash equivalents	384	454
Beginning cash and cash equivalents	1,782	1,292
Ending cash and cash equivalents	\$2,166	\$1,746
<b>Supplemental cash flow information:</b>		
Cash paid (refunded) during the period for income taxes, net	\$(8)	\$21
Cash paid during the period for interest	\$3	\$3

See accompanying Notes to Condensed Consolidated Financial Statements (unaudited).



## Table of Contents

### ELECTRONIC ARTS INC. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

#### (1) DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

We develop, market, publish and distribute game software content and services that can be played by consumers on a variety of platforms, including video game consoles (such as PlayStation 3 and 4 from Sony and Xbox 360 and Xbox One from Microsoft), personal computers ("PCs"), mobile phones and tablets. Our ability to deliver games and services across multiple platforms, through multiple distribution channels, and directly to consumers (online and wirelessly) has been, and will continue to be, a cornerstone of our product strategy. We have adopted new business models and alternative revenue streams (such as subscription, micro-transactions, and advertising) in connection with our online and wireless product and service offerings. Some of our games are based on our wholly-owned intellectual property (e.g., Battlefield, Mass Effect, Need for Speed, Dragon Age, The Sims, Bejeweled, and Plants vs. Zombies), and some of our games leverage content that we license from others (e.g., FIFA, Madden NFL and Star Wars). We also publish and distribute games developed by third parties (e.g., Titanfall). Our goal is to turn our intellectual properties into year-round businesses available on a range of platforms. Our products and services may be purchased through physical and online retailers, platform providers such as console manufacturers and mobile carriers via digital downloads, as well as directly through our own distribution platform, including online portals such as Origin. Our fiscal year is reported on a 52- or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ending or ended, as the case may be, March 31, 2015 and 2014 contain 52 weeks each, and ends or ended, as the case may be, on March 28, 2015 and March 29, 2014, respectively. Our results of operations for the three and nine months ended December 31, 2014 and 2013 contained 13 and 39 weeks each and ended on December 27, 2014 and December 28, 2013, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

The Condensed Consolidated Financial Statements are unaudited and reflect all adjustments (consisting only of normal recurring accruals unless otherwise indicated) that, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. The preparation of these Condensed Consolidated Financial Statements requires management to make estimates and assumptions that affect the amounts reported in these Condensed Consolidated Financial Statements and accompanying notes. Actual results could differ materially from those estimates. The results of operations for the current interim periods are not necessarily indicative of results to be expected for the current year or any other period.

These Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014, as filed with the United States Securities and Exchange Commission ("SEC") on May 21, 2014.

#### Change in Estimated Offering Period

Prior to July 1, 2013, for most sales, we estimated the offering period to be six months and recognized revenue over this period in the month after delivery. During the three months ended September 30, 2013, we completed our fiscal 2014 annual evaluation of the estimated offering period and noted that generally, consumers were playing our games online over a longer period of time. Based on this, we concluded that for physical software sales made after June 30, 2013, the estimated offering period should be increased to nine months, resulting in revenue being recognized over a longer period of time. This change in estimate resulted in an estimated decrease to net revenue and net income of \$474 million and a decrease of \$1.50 of diluted earnings per share for fiscal year 2014. During the three months ended December 31, 2014, this change in estimate resulted in an estimated increase to net revenue and net income of \$180 million and an increase of \$0.56 of diluted earnings per share. During the nine months ended December 31, 2014, this change in estimate resulted in an estimated increase to net revenue and net income of \$466 million and an increase of \$1.45 of diluted earnings per share. The estimated offering period for digitally distributed software games did not change and is six months. We completed our fiscal 2015 annual evaluation during the second quarter and determined that the estimated offering period for physical software sales and digital sales continues to be nine months and six months, respectively.



## Table of Contents

### Recently Adopted Accounting Standards

On April 1, 2014, we adopted ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. Under the new accounting standard, an unrecognized tax benefit is required to be presented as a reduction to a deferred tax asset if the disallowance of the uncertain tax position would reduce an available tax loss or tax credit carryforward instead of resulting in a cash tax liability. The ASU applies prospectively to all unrecognized tax benefits that exist as of the adoption date. As a result of the adoption, we reduced: (a) noncurrent income tax obligations by \$96 million; (b) current deferred income tax assets by \$18 million; and (c) noncurrent deferred income tax assets by \$11 million. We increased noncurrent deferred income tax liabilities by \$67 million. As the new accounting standard only impacted presentation, it did not have an impact on the Company's net financial position, results of operations, or cash flows.

### Impact of Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for annual reporting periods beginning after December 15, 2016. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its Condensed Consolidated Financial Statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting. We expect to adopt this new standard in the first quarter of fiscal year 2018.

## (2) FAIR VALUE MEASUREMENTS

There are various valuation techniques used to estimate fair value, the primary one being the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining fair value, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use when pricing the asset or liability. We measure certain financial and nonfinancial assets and liabilities at fair value on a recurring and nonrecurring basis.

### Fair Value Hierarchy

The three levels of inputs that may be used to measure fair value are as follows:

Level 1. Quoted prices in active markets for identical assets or liabilities.

Level 2. Observable inputs other than quoted prices included within Level 1, such as quoted prices for similar assets or liabilities, quoted prices in markets with insufficient volume or infrequent transactions (less active markets), or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data for substantially the full term of the assets or liabilities.

Level 3. Unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of assets or liabilities.

Table of Contents

## Assets and Liabilities Measured at Fair Value on a Recurring Basis

As of December 31, 2014 and March 31, 2014, our assets and liabilities that were measured and recorded at fair value on a recurring basis were as follows (in millions):

	As of December 31, 2014	Fair Value Measurements at Reporting Date Using			Balance Sheet Classification
		Quoted Prices in Active Markets for Identical Financial Instruments	Significant Other Observable Inputs	Significant Unobservable Inputs	
		(Level 1)	(Level 2)	(Level 3)	
<b>Assets</b>					
Bank and time deposits	\$98	\$ 98	\$ —	\$ —	Cash equivalents
Money market funds	2	2	—	—	Cash equivalents
Available-for-sale securities:					
Corporate bonds	398	—	398	—	Short-term investments
U.S. Treasury securities	170	170	—	—	Short-term investments and cash equivalents
U.S. agency securities	126	—	126	—	Short-term investments
Commercial paper	108	—	108	—	Short-term investments and cash equivalents
Foreign currency derivatives	15	—	15	—	Other current assets
Deferred compensation plan assets <sup>(a)</sup>	10	10	—	—	Other assets
Total assets at fair value	\$927	\$ 280	\$ 647	\$ —	
<b>Liabilities</b>					
Contingent consideration <sup>(b)</sup>	\$—	\$—	\$—	\$—	Accrued and other current liabilities
Foreign currency derivatives	9	—	9	—	Accrued and other current liabilities
Deferred compensation plan liabilities	10	10	—	—	Other liabilities
Total liabilities at fair value	\$19	\$ 10	\$ 9	\$ —	

## Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

	Contingent Consideration
Balance as of March 31, 2014	\$4
Change in fair value <sup>(c)</sup>	(2 )
Payments <sup>(d)</sup>	(2 )
Balance as of December 31, 2014 <sup>(b)</sup>	\$—

Table of Contents

		Fair Value Measurements at Reporting Date Using			Balance Sheet Classification
		Quoted Prices in Active Markets for Identical Financial Instruments	Significant Other Observable Inputs	Significant Unobservable Inputs	
	As of March 31, 2014	(Level 1)	(Level 2)	(Level 3)	
<b>Assets</b>					
Money market funds	\$588	\$ 588	\$ —	\$ —	Cash equivalents
Available-for-sale securities:					
Corporate bonds	279	—	279	—	Short-term investments
Commercial paper	146	—	146	—	Short-term investments and cash equivalents
U.S. Treasury securities	118	118	—	—	Short-term investments and cash equivalents
U.S. agency securities	89	—	89	—	Short-term investments and cash equivalents
Deferred compensation plan assets <sup>(a)</sup>	9	9	—	—	Other assets
Total assets at fair value	\$ 1,229	\$ 715	\$ 514	\$ —	
<b>Liabilities</b>					
Contingent consideration <sup>(b)</sup>	\$4	\$ —	\$ —	\$ 4	Accrued and other current liabilities and other liabilities
Foreign currency derivatives	6	—	6	—	Accrued and other current liabilities
Deferred compensation plan liabilities	9	9	—	—	Other liabilities
Total liabilities at fair value	\$ 19	\$ 9	\$ 6	\$ 4	

		Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
			Contingent Consideration
Balance as of March 31, 2013			\$43
Change in fair value <sup>(c)</sup>			(35 )
Payment <sup>(d)</sup>			(4 )
Balance as of March 31, 2014 <sup>(b)</sup>			\$4

The Deferred Compensation Plan assets consist of various mutual funds. See Note 15 in our Annual Report on (a) Form 10-K for the fiscal year ended March 31, 2014, for additional information regarding our Deferred Compensation Plan.

(b) The immaterial contingent consideration as of December 31, 2014 represents the estimated fair value of the additional variable cash consideration payable in connection with our acquisition of KlickNation Corporation (“KlickNation”) that is contingent upon the achievement of certain performance milestones. The \$4 million

contingent consideration as of March 31, 2014 represents the estimated fair value of the additional variable cash consideration payable in connection with our acquisitions of KlickNation and Chillingo Limited (“Chillingo”) that are contingent upon the achievement of certain performance milestones. We estimated the fair value of the acquisition-related contingent consideration payable using probability-weighted discounted cash flow models, and applied a discount rate that appropriately captures the risk associated with the obligation. The weighted average of the discount rates used during the nine months ended December 31, 2014 was 17 percent. The weighted average of the discount rates used during the fiscal year 2014 was 18 percent. The significant unobservable input used in the fair value measurement of the contingent consideration payable are forecasted earnings. Significant changes in forecasted earnings would result in a significantly higher or lower fair value measurement. At December 31, 2014 and March 31, 2014, the fair market value of acquisition-related contingent consideration was immaterial and \$4 million, respectively, compared to a maximum potential payout of \$3 million and \$10 million, respectively.

Table of Contents

- (c) The change in fair value is reported as acquisition-related contingent consideration in our Condensed Consolidated Statements of Operations.

- (d) During the nine months ended December 31, 2014, we made payments totaling \$2 million to settle certain performance milestones achieved in connection with one of our acquisitions. During fiscal year 2014, we made payments of \$4 million to settle certain performance milestones achieved in connection with two of our acquisitions.

**(3) FINANCIAL INSTRUMENTS****Cash and Cash Equivalents**

As of December 31, 2014 and March 31, 2014, our cash and cash equivalents were \$2,166 million and \$1,782 million, respectively. Cash equivalents were valued at their carrying amounts as they approximate fair value due to the short maturities of these financial instruments.

**Short-Term Investments**

Short-term investments consisted of the following as of December 31, 2014 and March 31, 2014 (in millions):

	As of December 31, 2014				As of March 31, 2014			
	Cost or Amortized Cost	Gross Gains	Unrealized Losses	Fair Value	Cost or Amortized Cost	Gross Gains	Unrealized Losses	Fair Value
Corporate bonds	\$399	\$—	\$(1 )	\$398	\$279	\$—	\$—	\$279
U.S. Treasury securities	168	—	—	168	114	—	—	114
U.S. agency securities	126	—	—	126	80	—	—	80
Commercial paper	82	—	—	82	110	—	—	110
Short-term investments	\$775	\$—	\$(1 )	\$774	\$583	\$—	\$—	\$583

We evaluate our investments for impairment quarterly. Factors considered in the review of investments with an unrealized loss include the credit quality of the issuer, the duration that the fair value has been less than the adjusted cost basis, the severity of the impairment, the reason for the decline in value and potential recovery period, the financial condition and near-term prospects of the investees, our intent to sell and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value, and any contractual terms impacting the prepayment or settlement process. Based on our review, we did not consider these investments to be other-than-temporarily impaired as of December 31, 2014 and March 31, 2014.

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of December 31, 2014 and March 31, 2014 (in millions):

	As of December 31, 2014		As of March 31, 2014	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Short-term investments				
Due in 1 year or less	\$363	\$363	\$318	\$318
Due in 1-2 years	208	208	156	156
Due in 2-3 years	201	200	104	104
Due in 3-4 years	3	3	5	5
Short-term investments	\$775	\$774	\$583	\$583

**(4) DERIVATIVE FINANCIAL INSTRUMENTS**

The assets or liabilities associated with our derivative instruments and hedging activities are recorded at fair value in other current assets or accrued and other current liabilities, respectively, on our Condensed Consolidated Balance Sheets. As discussed below, the accounting for gains and losses resulting from changes in fair value depends on the use of the derivative instrument and whether it is designated and qualifies for hedge accounting.

We transact business in various foreign currencies and have significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. We purchase foreign currency forward contracts, generally with maturities of



Table of Contents

15 months or less, to reduce the volatility of cash flows primarily related to forecasted revenue and expenses denominated in certain foreign currencies. Our cash flow risks are primarily related to fluctuations in the Euro, British pound sterling, Canadian dollar, and Swedish krona. In addition, we utilize foreign currency forward contracts to mitigate foreign exchange rate risk associated with foreign-currency-denominated monetary assets and liabilities, primarily intercompany receivables and payables. The foreign currency forward contracts not designated as hedging instruments generally have a contractual term of approximately 3 months or less and are transacted near month-end. We do not use foreign currency forward contracts for speculative or trading purposes.

Cash Flow Hedging Activities

Certain of our forward contracts are designated and qualify as cash flow hedges. The effectiveness of the cash flow hedge contracts, including time value, is assessed monthly using regression analysis, as well as other timing and probability criteria. To qualify for hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedges and must be highly effective in offsetting changes to future cash flows on hedged transactions. The derivative assets or liabilities associated with our hedging activities are recorded at fair value in other current assets or accrued and other liabilities on our Condensed Consolidated Balance Sheets. The effective portion of gains or losses resulting from changes in the fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income in stockholders' equity. The gross amount of the effective portion of gains or losses resulting from changes in the fair value of these hedges is subsequently reclassified into net revenue or research and development expenses, as appropriate, in the period when the forecasted transaction is recognized in our Condensed Consolidated Statements of Operations. In the event that the gains or losses in accumulated other comprehensive income are deemed to be ineffective, the ineffective portion of gains or losses resulting from changes in fair value, if any, is reclassified to interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. In the event that the underlying forecasted transactions do not occur, or it becomes remote that they will occur, within the defined hedge period, the gains or losses on the related cash flow hedges are reclassified from accumulated other comprehensive income to interest and other income (expense), net, in our Condensed Consolidated Statements of Operations.

Total gross notional amounts and fair values for currency derivatives with cash flow hedge accounting designation are as follows:

	As of December 31, 2014			As of March 31, 2014		
	Notional	Fair Value		Notional	Fair Value	
	Amount	Asset	Liability	Amount	Asset	Liability
Forward contracts to purchase	\$132	\$—	\$9	\$179	\$—	\$3
Forward contracts to sell	\$164	\$11	\$—	\$363	\$—	\$2

The net impact of the effective portion of gains and losses from our cash flow hedging activities in our Condensed Consolidated Statements of Operations for three months ended December 31, 2014 and 2013 was immaterial.

The net impact of the effective portion of gains and losses from our cash flow hedging activities in our Condensed Consolidated Statements of Operations was a loss of \$8 million for the nine months ended December 31, 2014 and a loss of \$5 million for the nine months ended December 31, 2013.

During the three and nine months ended December 31, 2014, we reclassified an immaterial amount of the ineffective portion of gains or losses resulting from changes in fair value into interest and other income (expense), net.

Table of Contents

## Balance Sheet Hedging Activities

Our foreign currency forward contracts that are not designated as hedging instruments are accounted for as derivatives whereby the fair value of the contracts are reported as other current assets or accrued and other current liabilities on our Condensed Consolidated Balance Sheets, and gains and losses resulting from changes in the fair value are reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. The gains and losses on these foreign currency forward contracts generally offset the gains and losses in the underlying foreign-currency-denominated monetary assets and liabilities, which are also reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. The fair value of our foreign currency forward contracts was measured using Level 2 inputs. Total gross notional amounts and fair values for currency derivatives that are not designated as hedging instruments are accounted for as follows:

	As of December 31, 2014			As of March 31, 2014		
	Notional Amount	Fair Value Asset	Liability	Notional Amount	Fair Value Asset	Liability
Forward contracts to purchase	\$58	\$—	\$—	\$140	\$—	\$1
Forward contracts to sell	\$361	\$4	\$—	\$232	\$—	\$—

The effect of foreign currency forward contracts not designated as hedging instruments in our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2014 and 2013, was as follows (in millions):

	Location of Gain (Loss) Recognized in Income on Derivatives	Amount of Gain (Loss) Recognized in Income on Derivatives			
		Three Months Ended		Nine Months Ended	
		December 31, 2014	2013	December 31, 2014	2013
Foreign currency forward contracts not designated as hedging instruments	Interest and other income (expense), net	\$19	\$1	\$38	\$(4 )

Table of Contents

## (5) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The changes in accumulated other comprehensive income (loss) by component, net of tax, for the three months ended December 31, 2014 and 2013 are as follows (in millions):

	Unrealized Gains (Losses) on Available-for-Sale Securities	Unrealized Gains (Losses) on Derivative Instruments	Foreign Currency Translation Adjustments	Total
Balances as of September 30, 2014	\$ (4 )	\$7	\$50	\$53
Other comprehensive income (loss) before reclassifications	(1 )	1	(30 )	(30 )
Amounts reclassified from accumulated other comprehensive income	(1 )	1	—	—
Net current-period other comprehensive income (loss)	(2 )	2	(30 )	(30 )
Balance as of December 31, 2014	\$ (6 )	\$9	\$20	\$23
	Unrealized Gains (Losses) on Available-for-Sale Securities	Unrealized Gains (Losses) on Derivative Instruments	Foreign Currency Translation Adjustments	Total
Balances as of September 30, 2013	\$ (4 )	\$ (9 )	\$75	\$62
Other comprehensive loss before reclassifications	—	(4 )	(9 )	(13 )
Amounts reclassified from accumulated other comprehensive income	—	3	—	3
Net current-period other comprehensive loss	—	(1 )	(9 )	(10 )
Balance as of December 31, 2013	\$ (4 )	\$ (10 )	\$66	\$52

The changes in accumulated other comprehensive income (loss) by component, net of tax, for the nine months ended December 31, 2014 and 2013 are as follows (in millions):

	Unrealized Gains (Losses) on Available-for-Sale Securities	Unrealized Gains (Losses) on Derivative Instruments	Foreign Currency Translation Adjustments	Total
Balances as of March 31, 2014	\$ (4 )	\$ (10 )	\$51	\$37
Other comprehensive income (loss) before reclassifications	(1 )	11	(31 )	(21 )
Amounts reclassified from accumulated other comprehensive income	(1 )	8	—	7
Net current-period other comprehensive income (loss)	(2 )	19	(31 )	(14 )
Balances as of December 31, 2014	\$ (6 )	\$9	\$20	\$23
	Unrealized Gains (Losses) on Available-for-Sale Securities	Unrealized Gains (Losses) on Derivative Instruments	Foreign Currency Translation Adjustments	Total
Balances as of March 31, 2013	\$ (4 )	\$—	\$73	\$69
Other comprehensive loss before reclassifications	—	(15 )	(7 )	(22 )
Amounts reclassified from accumulated other comprehensive income	—	5	—	5

Edgar Filing: ELECTRONIC ARTS INC. - Form 10-Q

Net current-period other comprehensive loss	—	(10	) (7	) (17	)
Balances as of December 31, 2013	\$ (4	) \$(10	) \$66	\$52	

Table of Contents

The effects on net income of amounts reclassified from accumulated other comprehensive income (loss) for the three and nine months ended December 31, 2014 were as follows (in millions):

Statement of Operations Classification	Amount Reclassified From Accumulated Other Comprehensive Income (loss)	
	Three Months Ended December 31, 2014	Nine Months Ended December 30, 2014
Gains and losses on available-for-sale securities		
Interest and other income (expense), net	(1	) (1
Net of tax	\$(1	) \$(1
Gains and losses on cash flow hedges from forward contracts		
Net revenue	\$(2	) \$3
Research and development	3	5
Net of tax	\$1	\$8
Total amount reclassified, net of tax	\$—	\$7

The effects on net income of amounts reclassified from accumulated other comprehensive income (loss) for the three and nine months ended December 31, 2013 were as follows (in millions):

Statement of Operations Classification	Amount Reclassified From Accumulated Other Comprehensive Income (loss)	
	Three Months Ended December 31, 2013	Nine Months Ended December 30, 2013
Gains and losses on cash flow hedges from forward contracts		
Net revenue	2	4
Research and development	1	1
Total amount reclassified, net of tax	\$3	\$5

**(6) BUSINESS COMBINATIONS**

During the nine months ended December 31, 2014, there were no acquisitions. During the nine months ended December 31, 2013, we completed one acquisition that did not have a significant impact on our Condensed Consolidated Financial Statements.

**(7) GOODWILL AND ACQUISITION-RELATED INTANGIBLES, NET**

The changes in the carrying amount of goodwill for the nine months ended December 31, 2014 are as follows (in millions):

	As of March 31, 2014	Activity	Effects of Foreign Currency Translation	As of December 31, 2014
Goodwill	\$2,091	\$—	\$(5	) \$2,086
Accumulated impairment	(368	) —	—	(368
Total	\$1,723	\$—	\$(5	) \$1,718

Goodwill represents the excess of the purchase price over the fair value of the underlying acquired net tangible and intangible assets. Goodwill is not amortized, but rather subject to at least an annual assessment for impairment by applying a fair value-based test.

Table of Contents

Acquisition-related intangibles consisted of the following (in millions):

	As of December 31, 2014			As of March 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net
Developed and core technology	\$531	\$ (426 )	\$ 105	\$531	\$ (385 )	\$ 146
Trade names and trademarks	130	(110 )	20	130	(105 )	25
Registered user base and other intangibles	87	(87 )	—	87	(87 )	—
Carrier contracts and related	85	(83 )	2	85	(79 )	6
Total	\$833	\$ (706 )	\$ 127	\$833	\$ (656 )	\$ 177

Amortization of intangibles for the three and nine months ended December 31, 2014 and 2013 are classified in the Condensed Consolidated Statement of Operations as follows (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Cost of service and other	\$8	\$6	27	18
Cost of product	4	10	11	27
Operating expenses	4	4	11	12
Total	\$16	\$20	\$49	\$57

Acquisition-related intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the agreement terms, typically from 2 to 14 years. As of December 31, 2014 and March 31, 2014, the weighted-average remaining useful life for acquisition-related intangible assets was approximately 2.9 years and 3.4 years, respectively.

As of December 31, 2014, future amortization of acquisition-related intangibles that will be recorded in the Condensed Consolidated Statement of Operations is estimated as follows (in millions):

Fiscal Year Ending March 31,	
2015 (remaining three months)	\$16
2016	53
2017	32
2018	12
2019	8
2020	6
Thereafter	—
Total	\$127

**(8) RESTRUCTURING AND OTHER CHARGES**

Restructuring and other restructuring plan-related information as of December 31, 2014 was as follows (in millions):

	Fiscal 2011	Other Restructurings and Reorganization		
	Other	Facilities-related	Other	Total
Balances as of March 31, 2013	\$57	\$4	\$1	\$62
Charges to operations	(2 )	1	—	(1 )
Charges settled in cash	(8 )	(3 )	—	(11 )
Balances as of March 31, 2014	47	2	1	50
Charges to operations	—	—	—	—
Charges settled in cash	(22 )	—	(1 )	(23 )
Balances as of December 31, 2014	\$25	\$2	\$—	\$27



## Table of Contents

### Fiscal 2011 Restructuring

In fiscal year 2011, we announced a plan focused on the restructuring of certain licensing and developer agreements in an effort to improve the long-term profitability of our packaged goods business. Under this plan, we amended certain licensing and developer agreements. To a much lesser extent, as part of this restructuring we had workforce reductions and facilities closures through March 31, 2011. Substantially all of these exit activities were completed by March 31, 2011.

Since the inception of the fiscal 2011 restructuring plan through December 31, 2014, we have incurred charges of \$172 million, consisting of (1) \$129 million related to the amendment of certain licensing agreements and other intangible asset impairment costs, (2) \$31 million related to the amendment of certain developer agreements, and (3) \$12 million in employee-related expenses. The \$25 million restructuring accrual as of December 31, 2014 is expected to be settled by December 2015. We do not expect to incur any additional restructuring charges under this plan.

### Other Restructurings and Reorganization

We also engaged in various other restructurings and a reorganization based on management decisions made in fiscal years 2013 and 2009. We do not expect to incur any additional restructuring charges under these plans. The \$2 million restructuring accrual as of December 31, 2014 related to our other restructuring plans is expected to be settled by April 2020.

## (9) ROYALTIES AND LICENSES

Our royalty expenses consist of payments to (1) content licensors, (2) independent software developers, and (3) co-publishing and distribution affiliates. License royalties consist of payments made to celebrities, professional sports organizations, movie studios and other organizations for our use of their trademarks, copyrights, personal publicity rights, content and/or other intellectual property. Royalty payments to independent software developers are payments for the development of intellectual property related to our games. Co-publishing and distribution royalties are payments made to third parties for the delivery of products.

Royalty-based obligations with content licensors and distribution affiliates are either paid in advance and capitalized as prepaid royalties or are accrued as incurred and subsequently paid. These royalty-based obligations are generally expensed to cost of revenue at the greater of the contractual rate or an effective royalty rate based on the total projected net revenue for contracts with guaranteed minimums. Prepayments made to thinly capitalized independent software developers and co-publishing affiliates are generally made in connection with the development of a particular product, and therefore, we are generally subject to development risk prior to the release of the product. Accordingly, payments that are due prior to completion of a product are generally expensed to research and development over the development period as the services are incurred. Payments due after completion of the product (primarily royalty-based in nature) are generally expensed as cost of revenue.

Our contracts with some licensors include minimum guaranteed royalty payments, which are initially recorded as an asset and as a liability at the contractual amount when no performance remains with the licensor. When performance remains with the licensor, we record guarantee payments as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract. Royalty liabilities are classified as current liabilities to the extent such royalty payments are contractually due within the next 12 months.

Each quarter, we also evaluate the expected future realization of our royalty-based assets, as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are generally charged to research and development expense. Impairments or losses determined post-launch are charged to cost of revenue. We evaluate long-lived royalty-based assets for impairment generally using undiscounted cash flows when impairment indicators exist. Unrecognized minimum royalty-based commitments are accounted for as executory contracts, and therefore, any losses on these commitments are recognized when the underlying intellectual property is abandoned (i.e., cease use) or the contractual rights to use the intellectual property are terminated.



During the three months ended December 31, 2014, we did not recognize any losses or impairment charges on royalty-based commitments. During the nine months ended December 31, 2014, we recognized a loss of \$122 million on a previously unrecognized licensed intellectual property commitment. The \$122 million loss relates to the termination of certain rights we previously had to use a licensor's intellectual property. In addition, because the loss will be paid in installments through March 2022, our accrued loss was computed using the effective interest method. We currently estimate recognizing in future periods through March 2022, approximately \$31 million for the accretion of interest expense related to this obligation. This interest expense will be included in cost of revenue in our Condensed Consolidated Statement of Operations. During the three months ended December 31, 2013, we did not recognize any losses or impairment charges on previously unrecognized royalty-based

Table of Contents

commitments. During the nine months ended December 31, 2013, we recognized total losses of \$27 million, inclusive of impairment charges of \$17 million on royalty-based assets recognized during the three months ended June 30, 2013.

The current and long-term portions of prepaid royalties and minimum guaranteed royalty-related assets, included in other current assets and other assets, consisted of (in millions):

	As of December 31, 2014	As of March 31, 2014
Other current assets	\$53	\$97
Other assets	16	58
Royalty-related assets	\$69	\$155

At any given time, depending on the timing of our payments to our co-publishing and/or distribution affiliates, content licensors, and/or independent software developers, we classify any recognized unpaid royalty amounts due to these parties as accrued liabilities. The current and long-term portions of accrued royalties, included in accrued and other current liabilities and other liabilities, consisted of (in millions):

	As of December 31, 2014	As of March 31, 2014
Accrued royalties	\$162	\$73
Other accrued expenses	—	7
Other liabilities	143	53
Royalty-related liabilities	\$305	\$133

In addition, as of December 31, 2014, we were committed to pay approximately \$973 million to content licensors, independent software developers, and co-publishing and/or distribution affiliates, but performance remained with the counterparty (i.e., delivery of the product or content or other factors) and such commitments were therefore not recorded in our Condensed Consolidated Financial Statements. See Note 13 for further information on our developer and licensor commitments.

**(10) BALANCE SHEET DETAILS****Inventories**

Inventories as of December 31, 2014 and March 31, 2014 consisted of (in millions):

	As of December 31, 2014	As of March 31, 2014
Finished goods	\$38	\$55
Raw materials and work in process	1	1
Inventories	\$39	\$56

**Property and Equipment, Net**

Property and equipment, net, as of December 31, 2014 and March 31, 2014 consisted of (in millions):

	As of December 31, 2014	As of March 31, 2014
Computer, equipment and software	\$699	\$718
Buildings	321	327
Leasehold improvements	127	129
Office equipment, furniture and fixtures	64	67
Land	62	63
Warehouse, equipment and other	9	10
Construction in progress	7	5

Edgar Filing: ELECTRONIC ARTS INC. - Form 10-Q

	1,289	1,319	
Less: accumulated depreciation	(828	) (809	)
Property and equipment, net	\$461	\$510	

18

---

Table of Contents

During the three and nine months ended December 31, 2014, depreciation expense associated with property and equipment was \$32 million and \$96 million, respectively. During the three and nine months ended December 31, 2013, depreciation expense associated with property and equipment was \$33 million and \$95 million, respectively.

**Accrued and Other Current Liabilities**

Accrued and other current liabilities as of December 31, 2014 and March 31, 2014 consisted of (in millions):

	As of December 31, 2014	As of March 31, 2014
Other accrued expenses	\$304	\$328
Accrued compensation and benefits	226	259
Accrued royalties	162	73
Deferred net revenue (other)	121	121
Accrued and other current liabilities	\$813	\$781

Deferred net revenue (other) includes the deferral of subscription revenue, deferrals related to our Switzerland distribution business, advertising revenue, licensing arrangements, and other revenue for which revenue recognition criteria has not been met.

**Deferred Net Revenue (Online-Enabled Games)**

Deferred net revenue (online-enabled games) was \$1,583 million and \$1,490 million as of December 31, 2014 and March 31, 2014, respectively. Deferred net revenue (online-enabled games) generally includes the unrecognized revenue from bundled sales of online-enabled games for which we do not have vendor-specific objective evidence of fair value ("VSOE") for the obligation to provide unspecified updates. We recognize revenue from the sale of online-enabled games for which we do not have VSOE for the unspecified updates on a straight-line basis, generally over an estimated nine-month period beginning in the month after shipment for physical games sold through retail and an estimated six-month period for digitally-distributed games. However, we expense the cost of revenue related to these transactions during the period in which the product is delivered (rather than on a deferred basis).

**(11) INCOME TAXES**

We estimate our annual effective tax rate at the end of each quarterly period, and we record the tax effect of certain discrete items, which are unusual or occur infrequently, in the interim period in which they occur, including changes in judgment about deferred tax valuation allowances. In addition, jurisdictions with a projected loss for the year, jurisdictions with a year-to-date loss where no tax benefit can be recognized, and jurisdictions where we are unable to estimate an annual effective tax rate are excluded from the estimated annual effective tax rate. The impact of such an exclusion could result in a higher or lower effective tax rate during a particular quarter depending on the mix and timing of actual earnings versus annual projections.

We recognize deferred tax assets and liabilities for both the expected impact of differences between the financial statement amount and the tax basis of assets and liabilities and for the expected future tax benefit to be derived from tax losses and tax credit carry forwards. We record a valuation allowance against deferred tax assets when it is considered more likely than not that all or a portion of our deferred tax assets will not be realized. In making this determination, we are required to give significant weight to evidence that can be objectively verified. It is generally difficult to conclude that a valuation allowance is not needed when there is significant negative evidence, such as cumulative losses in recent years. Forecasts of future taxable income are considered to be less objective than past results, particularly in light of the previous years' economic environment. Therefore, cumulative losses weigh heavily in the overall assessment. Based on the assumptions and requirements noted above, we have recorded a valuation allowance against most of our U.S. deferred tax assets. In addition, we expect to provide a valuation allowance on future U.S. tax benefits until we can sustain a level of profitability in the U.S. or until other significant positive evidence arises that suggest that these benefits are more likely than not to be realized.

The provision for income taxes reported for the three and nine months ended December 31, 2014 is based on our projected annual effective tax rate for fiscal year 2015, and also includes certain discrete items recorded during the

period. Our effective tax rate for the three and nine months ended December 31, 2014 was a tax expense of 9.0 percent and 9.1 percent, respectively, as compared to a tax expense of 3.4 percent and 8.8 percent, respectively, for the same period of fiscal year 2014. The effective tax rate for the three and nine months ended December 31, 2014 and 2013 differs from the statutory rate of 35.0 percent primarily due to the utilization of U.S. deferred tax assets which were subject to a valuation allowance and non-U.S. profits subject to a reduced or zero tax rate. The effective tax rate for the three and nine months ended December 31, 2014 differs from

## Table of Contents

the same period in fiscal year 2014 primarily due to differences in the pre-tax income or loss. In addition, the effective tax rate for the nine months ended December 31, 2014 differs from the same period in fiscal year 2014 primarily due to a discrete expense of \$16 million recorded in the nine months ended December 31, 2014 for excess tax benefits from stock-based compensation deductions allocated directly to contributed capital.

During the three and nine months ended December 31, 2014, we recorded a net increase of \$1 million and decrease of \$1 million in gross unrecognized tax benefits. The total gross unrecognized tax benefits as of December 31, 2014 is \$231 million. A portion of our unrecognized tax benefits will affect our effective tax rate if they are recognized upon favorable resolution of the uncertain tax positions. As of December 31, 2014, if recognized, approximately \$71 million of the unrecognized tax benefits would affect our effective tax rate and approximately \$160 million would result in adjustments to deferred tax assets with corresponding adjustments to the valuation allowance.

During the three and nine months ended December 31, 2014, we recorded a net increase of \$1 million for accrued interest and penalties related to tax positions taken on our tax returns. As of December 31, 2014, the combined amount of accrued interest and penalties related to uncertain tax positions included in income tax obligations on our Condensed Consolidated Balance Sheet was approximately \$17 million.

We file income tax returns in the United States, including various state and local jurisdictions. Our subsidiaries file tax returns in various foreign jurisdictions, including Canada, France, Germany, Switzerland and the United Kingdom. The IRS is currently examining our returns for fiscal years 2009 through 2011, and we remain subject to income tax examination by the IRS for fiscal years after 2011. We are also currently under income tax examination in the United Kingdom for fiscal years 2010 and 2012, in Germany for fiscal years 2008 through 2012, and in Spain for fiscal years 2010 through 2013. We remain subject to income tax examination for several other jurisdictions including in Canada for fiscal years after 2005, in France for fiscal years after 2011, in Germany for fiscal years after 2012, in the United Kingdom for fiscal years 2011 and after 2012, and in Switzerland for fiscal years after 2007.

The timing of the resolution of income tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued for each year. Although potential resolution of uncertain tax positions involve multiple tax periods and jurisdictions, it is reasonably possible that a reduction of up to \$8 million of unrecognized tax benefits may occur within the next 12 months, some of which, depending on the nature of the settlement or expiration of statutes of limitations, may affect the Company's income tax provision and therefore benefit the resulting effective tax rate. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements.

## (12) FINANCING ARRANGEMENTS

### 0.75% Convertible Senior Notes Due 2016

In July 2011, we issued \$632.5 million aggregate principal amount of 0.75% Convertible Senior Notes due 2016 (the "Notes"). The Notes are senior unsecured obligations which pay interest semiannually in arrears at a rate of 0.75% per annum on January 15 and July 15 of each year, beginning on January 15, 2012 and will mature on July 15, 2016, unless purchased earlier or converted in accordance with their terms prior to such date. The Notes are senior in right of payment to any unsecured indebtedness that is expressly subordinated in right of payment to the Notes.

The Notes are convertible into cash and shares of our common stock based on an initial conversion value of 31.5075 shares of our common stock per \$1,000 principal amount of Notes (equivalent to an initial conversion price of approximately \$31.74 per share). Upon conversion of the Notes, holders will receive cash up to the principal amount of each Note, and any excess conversion value will be delivered in shares of our common stock. Prior to April 15, 2016, the Notes are convertible only if (1) the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130 percent of the conversion price (\$41.26 per share) on each applicable trading day (the "Sales Price Condition"); (2) during the five business day period after any ten

consecutive trading day period in which the trading price per \$1,000 principal amount of notes falls below 98 percent of the last reported sale price of our common stock multiplied by the conversion rate on each trading day; or (3) specified corporate transactions, including a change in control, occur. On or after April 15, 2016, a holder may convert any of its Notes at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date. The conversion rate is subject to customary anti-dilution adjustments (for example, certain dividend distributions or tender or exchange offer of our common stock), but will not be adjusted for any

Table of Contents

accrued and unpaid interest. The Notes are not redeemable prior to maturity except for specified corporate transactions and events of default, and no sinking fund is provided for the Notes. The Notes do not contain any financial covenants.

Following certain corporate events described in the indenture governing the notes (the “Indenture”) that occur prior to the maturity date, the conversion rate will be increased for a holder who elects to convert its Notes in connection with such corporate event in certain circumstances. If we undergo a “fundamental change,” as defined in the Indenture, subject to certain conditions, holders may require us to purchase for cash all or any portion of their Notes. The fundamental change purchase price will be 100 percent of the principal amount of the Notes to be purchased plus any accrued and unpaid interest up to but excluding the fundamental change purchase date.

The Indenture contains customary terms and covenants, including that upon certain events of default occurring and continuing, either the trustee or the holders of at least 25 percent in principal amount of the outstanding Notes may declare 100 percent of the principal and accrued and unpaid interest on all the Notes to be due and payable.

During the quarter ended December 31, 2014, the Sales Price Condition was met. As a result, the Notes are convertible at the option of the holder through March 27, 2015, and the carrying value of the Notes was reclassified as a current liability and the excess of the principal amount over the carrying value of the Notes was reclassified from permanent equity to temporary equity in the Condensed Consolidated Balance Sheets as of December 31, 2014. The determination of whether or not the Notes are convertible is performed on a quarterly basis. If this threshold is not met next quarter, the Notes will be reclassified back to long-term debt and the temporary equity will be reclassified back to permanent equity.

Upon conversion of any Notes, we will deliver cash up to the principal amount of the Notes and any excess conversion value will be delivered in shares of our common stock. As of December 31, 2014, there were no shares issued related to the Notes. Based on the closing price of our common stock of \$48.33 at the end of the quarter ended December 31, 2014, the if-converted value of our Notes exceeded their principal amount by \$331 million.

We separately account for the liability and equity components of the Notes. The initial carrying amount of the equity component representing the conversion option is equal to the fair value of the Convertible Note Hedge, as described below, which is a substantially identical instrument and was purchased on the same day as the Notes. The initial carrying amount of the liability component was determined by deducting the fair value of the equity component from the par value of the Notes as a whole, and represents the fair value of a similar liability that does not have an associated convertible feature. A liability of \$525 million as of the initial date of issuance was recognized for the principal amount of the Notes representing the present value of the Notes’ cash flows using a discount rate of 4.54 percent. The excess of the principal amount of the liability component over its carrying amount is amortized to interest expense over the term of the Notes using the effective interest method. The equity component on the date of issuance was \$107 million.

In accounting for \$15 million of issuance costs paid in July 2011 related to the Notes issuance, we allocated \$13 million to the liability component and \$2 million to the equity component. Debt issuance costs attributable to the liability component are being amortized to interest expense over the term of the Notes, and issuance costs attributable to the equity component were netted with the equity component in additional paid-in capital.

The carrying and fair values of the Notes are as follows (in millions):

	As of December 31, 2014	As of March 31, 2014
Principal amount of Notes	\$633	\$633
Unamortized debt discount of the liability component	(37)	(53)
Net carrying value of Notes	\$596	\$580
Fair value of Notes	\$972	731



The fair value of the 0.75% Convertible Senior Notes due 2016 is classified as Level 2 within the fair value hierarchy. As of December 31, 2014, the remaining life of the Notes is approximately 1.5 years.

Convertible Note Hedge and Warrants Issuance

In July 2011, we entered into privately negotiated convertible note hedge transactions (the “Convertible Note Hedge”) with certain counterparties to reduce the potential dilution with respect to our common stock upon conversion of the Notes. The Convertible Note Hedge, subject to customary anti-dilution adjustments, provides us with the option to acquire, on a net

## Table of Contents

settlement basis, approximately 19.9 million shares of our common stock at a strike price of \$31.74, which corresponds to the conversion price of the Notes and is equal to the number of shares of our common stock that notionally underlie the Notes. As of December 31, 2014, we have not purchased any shares under the Convertible Note Hedge. We paid \$107 million for the Convertible Note Hedge, which was recorded as an equity transaction. Separately, in July 2011 we also entered into privately negotiated warrant transactions with certain counterparties whereby we sold to independent third parties warrants (the “Warrants”) to acquire, subject to customary anti-dilution adjustments that are substantially the same as the anti-dilution provisions contained in the Notes, up to 19.9 million shares of our common stock (which is also equal to the number of shares of our common stock that notionally underlie the Notes), with a strike price of \$41.14. The Warrants could have a dilutive effect with respect to our common stock to the extent that the market price per share of our common stock exceeds \$41.14 on or prior to the expiration date of the Warrants. We received proceeds of \$65 million from the sale of the Warrants.

### Effect of conversion on earning per share (“EPS”)

The Notes have no impact on diluted EPS until the average quarterly price of our common stock exceeds the conversion price of \$31.74 per share. Prior to conversion, we will include the effect of the additional shares that may be issued if our common stock price exceeds \$31.74 per share using the treasury stock method. If the average price of our common stock exceeds \$41.14 per share for a quarterly period, we will also include the effect of the additional potential shares that may be issued related to the Warrants using the treasury stock method. Prior to conversion, the Convertible Note Hedge is not considered for purposes of the EPS calculation, as its effect would be anti-dilutive. Upon conversion, the Convertible Note Hedge is expected to offset the dilutive effect of the Notes when the stock price is above \$31.74 per share. See Note 15 for additional information related to our EPS.

### Credit Facility

On August 30, 2012, we entered into a \$500 million senior unsecured revolving credit facility with a syndicate of banks. The credit facility terminates on February 29, 2016 and contains an option to arrange with existing lenders and/or new lenders for them to provide up to an aggregate of \$250 million in additional commitments for revolving loans. Proceeds of loans made under the credit facility may be used for general corporate purposes.

The loans bear interest, at our option, at the base rate plus an applicable spread or an adjusted LIBOR rate plus an applicable spread, in each case with such spread being determined based on our consolidated leverage ratio for the preceding fiscal quarter. We are also obligated to pay other customary fees for a credit facility of this size and type. Interest is due and payable in arrears quarterly for loans bearing interest at the base rate and at the end of an interest period (or at each three month interval in the case of loans with interest periods greater than three months) in the case of loans bearing interest at the adjusted LIBOR rate. Principal, together with all accrued and unpaid interest, is due and payable on February 29, 2016.

The credit agreement contains customary affirmative and negative covenants, including covenants that limit or restrict our ability to, among other things, incur subsidiary indebtedness, grant liens, dispose of all or substantially all assets and pay dividends or make distributions, in each case subject to customary exceptions for a credit facility of this size and type. We are also required to maintain compliance with a capitalization ratio and maintain a minimum level of total liquidity and a minimum level of domestic liquidity.

The credit agreement contains customary events of default, including among others, non-payment defaults, covenant defaults, bankruptcy and insolvency defaults and a change of control default, in each case, subject to customary exceptions for a credit facility of this size and type. The occurrence of an event of default could result in the acceleration of the obligations under the credit agreement, an obligation by any guarantors to repay the obligations in full and an increase in the applicable interest rate.

As of December 31, 2014, no amounts were outstanding under the credit facility. \$2 million of debt issuance costs that were paid in connection with obtaining this credit facility are being amortized to interest expense over the 3.5 years term of the credit facility.



Table of Contents

The following table summarizes our interest expense recognized for the three and nine months ended December 31, 2014 and 2013 that is included in interest and other income (expense), net on our Condensed Consolidated Statements of Operations (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Amortization of debt discount	\$ (5)	) \$ (6)	) \$ (16)	) \$ (16)
Amortization of debt issuance costs	—	(1)	(2)	(3)
Coupon interest expense	(2)	(1)	(4)	(3)
Other interest expense	(1)	—	(2)	(1)
Total interest expense	\$ (8)	) \$ (8)	) \$ (24)	) \$ (23)

**(13) COMMITMENTS AND CONTINGENCIES****Lease Commitments**

As of December 31, 2014, we leased certain facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.

**Development, Celebrity, League and Content Licenses: Payments and Commitments**

The products we produce in our studios are designed and created by our employee designers, artists, software programmers and by non-employee software developers (“independent artists” or “third-party developers”). We typically advance development funds to the independent artists and third-party developers during development of our games, usually in installment payments made upon the completion of specified development milestones. Contractually, these payments are generally considered advances against subsequent royalties on the sales of the products. These terms are set forth in written agreements entered into with the independent artists and third-party developers.

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include, but are not limited to: FIFA (Fédération Internationale de Football Association), FIFPRO Foundation, FAPL (Football Association Premier League Limited), and DFL Deutsche Fußball Liga GmbH (German Soccer League) (professional soccer); Dr. Ing. h.c. F. Porsche AG, Ferrari S.p.A. (Need For Speed and Real Racing games); National Basketball Association (professional basketball); PGA TOUR (professional golf); National Hockey League and NHL Players’ Association (professional hockey); National Football League Properties, PLAYERS Inc., and Red Bear Inc. (professional football); Zuffa, LLC (Ultimate Fighting Championship); ESPN (content in EA SPORTS games); Hasbro, Inc. (certain of Hasbro’s board game intellectual properties); Disney Interactive (Star Wars); Fox Digital Entertainment, Inc. (The Simpsons); and Universal Studios Inc. These developer and content license commitments represent the sum of (1) the cash payments due under non-royalty-bearing licenses and services agreements and (2) the minimum guaranteed payments and advances against royalties due under royalty-bearing licenses and services agreements, the majority of which are conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.

Table of Contents

The following table summarizes our minimum contractual obligations as of December 31, 2014 (in millions):

		Fiscal Years Ending March 31, 2015 (Remaining three mos.)	2016	2017	2018	2019	2020	Thereafter
Unrecognized commitments	Total							
Developer/licensor commitments	\$973	\$18	\$221	\$259	\$154	\$102	\$76	\$143
Marketing commitments	214	3	39	64	21	21	21	45
Operating leases	195	10	45	33	25	20	14	48
0.75% Convertible Senior Notes due 2016 interest <sup>(a)</sup>	9	2	5	2	—	—	—	—
Other purchase obligations	47	13	23	10	1	—	—	—
Total unrecognized commitments	1,438	46	333	368	201	143	111	236
Recognized commitments								
0.75% Convertible Senior Notes due 2016 principal <sup>(a)</sup>	633	633	—	—	—	—	—	—
Licensing and lease obligations <sup>(b)</sup>	175	5	22	22	24	24	25	53
Total recognized commitments	808	638	22	22	24	24	25	53
Total commitments	\$2,246	\$684	\$355	\$390	\$225	\$167	\$136	\$289

Included in the \$9 million coupon interest on the 0.75% Convertible Senior Notes due 2016 is \$2 million of accrued interest recognized as of December 31, 2014. We will be obligated to pay the \$632.5 million principal amount of the 0.75% Convertible Senior Notes due 2016 in cash and any excess conversion value in shares of our (a) common stock upon redemption of the Notes at maturity on July 15, 2016, or upon earlier conversion. During the quarter ended December 31, 2014, the Sales Price Condition was met and as a result, the Notes are currently convertible at the option of the holder through March 27, 2015. See Note 12 for additional information regarding our 0.75% Convertible Senior Notes due 2016.

See Note 8 for additional information regarding recognized commitments resulting from our restructuring plans.

(b) Lease commitments have not been reduced for approximately \$5 million due in the future from third parties under non-cancelable sub-leases. See Note 9 for additional information regarding recognized obligations from our licensing-related commitments.

The unrecognized amounts represented in the table above reflect our minimum cash obligations for the respective fiscal years, but do not necessarily represent the periods in which they will be recognized and expensed in our Condensed Consolidated Financial Statements. In addition, the amounts in the table above are presented based on the dates the amounts are contractually due as of December 31, 2014; however, certain payment obligations may be accelerated depending on the performance of our operating results.

In addition to what is included in the table above, as of December 31, 2014, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$87 million, of which we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

Also, in addition to what is included in the table above, as of December 31, 2014, in connection with our KlickNation acquisition, we may be required to pay an additional \$3 million of cash consideration based upon the achievement of certain performance milestones through March 31, 2015. As of December 31, 2014, the accrued contingent consideration on our Condensed Consolidated Balance Sheet representing the estimated fair value of the contingent

consideration was immaterial.

Subsequent to December 31, 2014, we entered into various licensor agreements with third parties which contingently commits us to pay an additional approximately \$780 million at various dates through fiscal year 2022.

## Table of Contents

### Legal Proceedings

We are a defendant in several actions that allege we misappropriated the likenesses of various college athletes in certain of our college-themed sports games. In September 2013, we reached an agreement to settle all actions brought by college athletes against us. We recognized a \$30 million accrual during the three months ended September 30, 2013 associated with the anticipated settlement. On September 3, 2014, the United States District Court for the Northern District of California granted preliminary approval of the settlement and set a hearing for May 14, 2015, to determine whether to grant its final approval of the settlement.

On December 17, 2013, a purported shareholder class action lawsuit was filed in the United States District Court for the Northern District of California against the Company and certain of its officers by an individual purporting to represent a class of purchasers of EA common stock. A second purported shareholder class action lawsuit alleging substantially similar claims was subsequently filed in the same court. These lawsuits have been consolidated into one action. The lawsuits, which assert claims under Section 10(b) and 20(a) of the Securities Exchange Act of 1934, allege, among other things, that the Company and certain of its officers issued materially false and misleading statements regarding the rollout of the Company's Battlefield 4 game. On October 20, 2014, the court granted our motion to dismiss all claims with leave for the plaintiffs to amend their complaint. On November 18, 2014, the plaintiffs filed an amended complaint, and we filed a motion seeking dismissal of all claims on January 15, 2015. The court has not yet ruled on our motion.

On July 29, 2010, Michael Davis, a former NFL running back, filed a putative class action in the United States District Court for the Northern District of California against the Company, alleging that certain past versions of Madden NFL included the images of certain retired NFL players without their permission. In March 2012, the trial court denied the Company's request to dismiss the complaint on First Amendment grounds. In January 2015, that trial court decision was affirmed by the Ninth Circuit Court of Appeals and the case was remanded back to the district court. The Company intends to seek further court review.

We are also subject to claims and litigation arising in the ordinary course of business. We do not believe that any liability from any reasonably foreseeable disposition of such claims and litigation, individually or in the aggregate, would have a material adverse effect on our Condensed Consolidated Financial Statements.

### (14) STOCK-BASED COMPENSATION

#### Valuation Assumptions

We estimate the fair value of share-based payment awards on the date of grant. We recognize compensation costs for stock-based payment awards to employees based on the grant-date fair value using a straight-line approach over the service period for which such awards are expected to vest. For awards with only service conditions that have a graded vesting schedule, we recognize compensation costs on a straight-line basis over the requisite service period for the entire award.

We determine the fair value of our share-based payment awards as follows:

**Restricted Stock Units, Restricted Stock, and Performance-Based Restricted Stock Units.** The fair value of restricted stock units, restricted stock, and performance-based restricted stock units (other than market-based restricted stock units) is determined based on the quoted market price of our common stock on the date of grant. Performance-based restricted stock units include grants made in connection with certain acquisitions.

**Market-Based Restricted Stock Units.** Market-based restricted stock units consist of grants of performance-based restricted stock units to certain members of executive management that vest contingent upon the achievement of pre-determined market and service conditions (referred to herein as "market-based restricted stock units"). The fair value of our market-based restricted stock units is determined using a Monte-Carlo simulation model. Key assumptions for the Monte-Carlo simulation model are the risk-free interest rate, expected volatility, expected dividends and correlation coefficient.

**Stock Options and Employee Stock Purchase Plan.** The fair value of stock options and stock purchase rights granted pursuant to our equity incentive plans and our 2000 Employee Stock Purchase Plan ("ESPP"), respectively, is

determined using the Black-Scholes valuation model based on the multiple-award valuation method. Key assumptions of the Black-Scholes valuation model are the risk-free interest rate, expected volatility, expected term and expected dividends.



Table of Contents

The determination of the fair value of market-based restricted stock units, stock options and ESPP is affected by assumptions regarding subjective and complex variables. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. There were an insignificant number of stock options granted during the three months ended December 31, 2014. The estimated assumptions used in the Black-Scholes valuation model to value our stock option grants and ESPP were as follows:

	Stock Option Grants			ESPP		
	Three Months Ended December 31, 2013	Nine Months Ended December 31, 2014		Nine Months Ended December 31, 2014		2013
Risk-free interest rate	1.6%	1.1 - 1.9%	1.6%	0.04 - 0.1%	0.1	%
Expected volatility	37 - 42%	36 - 40%	37 - 42%	34 - 35%	36 - 37%	
Weighted-average volatility	37	% 38	% 37	% 35	% 37	%
Expected term	4.5 years	4.5 years	4.5 years	6 - 12 months	6 - 12 months	
Expected dividends	None	None	None	None	None	

There were no market-based restricted stock units granted during the three months ended December 31, 2014 and 2013.

**Stock-Based Compensation Expense**

Employee stock-based compensation expense recognized during the three and nine months ended December 31, 2014 and 2013 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. In subsequent periods, if actual forfeitures differ from those estimates, an adjustment to stock-based compensation expense will be recognized at that time.

The following table summarizes stock-based compensation expense resulting from stock options, restricted stock, restricted stock units, performance-based restricted stock units, market-based restricted stock units, and the ESPP included in our Condensed Consolidated Statements of Operations (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Cost of revenue	\$1	\$—	\$2	\$1
Research and development	22	25	61	68
Marketing and sales	6	7	16	20
General and administrative	10	8	29	22
Stock-based compensation expense	\$39	\$40	\$108	\$111

We did not recognize any benefit from income taxes related to our stock-based compensation expense recognized during the three and nine months ended December 31, 2014 and 2013.

As of December 31, 2014, our total unrecognized compensation cost related to stock options was \$19 million and is expected to be recognized over a weighted-average service period of 2.5 years. As of December 31, 2014, our total unrecognized compensation cost related to restricted stock and restricted stock units (collectively referred to as “restricted stock rights”) was \$249 million and is expected to be recognized over a weighted-average service period of 1.4 years. Of the \$249 million of unrecognized compensation cost, \$15 million relates to market-based restricted stock units.

During the three and nine months ended December 31, 2014, we recognized \$2 million and \$16 million, respectively, of tax expense for the excess tax benefits resulting from stock-based compensation deductions; this amount is allocated directly to contributed capital and reported in the financing activities on our Condensed Consolidated Statement of Cash Flows.



Table of Contents

## Stock Options

The following table summarizes our stock option activity for the nine months ended December 31, 2014:

	Options (in thousands)	Weighted- Average Exercise Prices	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding as of March 31, 2014	5,311	\$ 37.43		
Granted	1,246	35.76		
Exercised	(575 )	19.22		
Forfeited, cancelled or expired	(259 )	48.28		
Outstanding as of December 31, 2014	5,723	\$ 38.41	5.11	\$ 69
Vested and expected to vest	5,438	\$ 38.72	4.89	\$ 65
Exercisable as of December 31, 2014	3,718	\$ 42.01	2.94	\$ 36

The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price as of December 31, 2014, which would have been received by the option holders had all the option holders exercised their options as of that date. We issue new common stock from our authorized shares upon the exercise of stock options.

## Restricted Stock Rights

The following table summarizes our restricted stock rights activity, excluding performance-based restricted stock unit activity which is discussed below, for the nine months ended December 31, 2014:

	Restricted Stock Rights (in thousands)	Weighted- Average Grant Date Fair Values
Balance as of March 31, 2014	13,536	\$19.70
Granted	4,169	35.93
Vested	(5,405 )	19.85
Forfeited or cancelled	(1,191 )	23.18
Balance as of December 31, 2014	11,109	\$25.34

The weighted-average grant date fair values of restricted stock rights granted during the three and nine months ended December 31, 2014 were \$39.16 and \$35.93 respectively.

## Performance-Based Restricted Stock Units

The following table summarizes our performance-based restricted stock unit activity for the nine months ended December 31, 2014:

	Performance- Based Restricted Stock Units (in thousands)	Weighted- Average Grant Date Fair Values
Balance as of March 31, 2014	54	\$15.39
Vested	(49 )	15.39
Forfeited or cancelled	(5 )	15.39
Balance as of December 31, 2014	—	\$—

Table of Contents**Market-Based Restricted Stock Units**

Our market-based restricted stock units vest contingent upon the achievement of pre-determined market and service conditions. If these market conditions are not met but service conditions are met, the restricted stock units will not vest; however, any compensation expense we have recognized to date will not be reversed. The number of shares of common stock to be received at vesting will range from zero percent to 200 percent of the target number of stock units based on our total stockholder return (“TSR”) relative to the performance of companies in the NASDAQ-100 Index for each measurement period, generally over a three year period. In the table below, we present shares granted at 100 percent of target of the number of stock units that may potentially vest. The maximum number of common shares that could vest is approximately 0.4 million for market-based restricted stock units granted during the nine months ended December 31, 2014. As of December 31, 2014, the maximum number of shares that could vest is approximately 1.3 million for market-based restricted stock units outstanding.

The following table summarizes our market-based restricted stock unit activity for the nine months ended December 31, 2014:

	Market-Based Restricted Stock Units (in thousands)	Weighted- Average Grant Date Fair Value
Balance as of March 31, 2014	978	\$24.83
Granted	193	46.96
Vested	(671)	) 21.45
Vested above target	192	16.80
Forfeited or cancelled	(29)	) 33.70
Balance as of December 31, 2014	663	\$31.97
<b>Stock Repurchase Program</b>		

In May 2014, a special committee of our Board of Directors, on behalf of the full Board of Directors, authorized a new program to repurchase up to \$750 million of our common stock. This new stock repurchase program, which expires on May 31, 2016, supersedes and replaces the stock repurchase authorization approved by our Board of Directors in July 2012. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase any specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and nine months ended December 31, 2014, we repurchased approximately 2.5 million and 6.5 million shares of our common stock for approximately \$97 million and \$242 million, respectively. We continue to actively repurchase shares under this program. During the three and nine months ended December 31, 2013, we did not repurchase any shares of our common stock.

Table of Contents**(15) NET INCOME (LOSS) PER SHARE**

The following table summarizes the computations of basic earnings per share ("Basic EPS") and diluted earnings per share ("Diluted EPS"). Basic EPS is computed as net income divided by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock-based compensation plans including stock options, restricted stock, restricted stock units, common stock through our ESPP, warrants, and other convertible securities using the treasury stock method.

(In millions, except per share amounts)	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Net income (loss)	\$ 142	\$(308 )	\$ 480	\$(359 )
Shares used to compute net income (loss) per share:				
Weighted-average common stock outstanding — basic	311	309	312	307
Dilutive potential common shares related to stock award plans and from assumed exercise of stock options	8	—	8	—
Dilutive potential common shares related to the Notes	4	—	2	—
Weighted-average common stock outstanding — diluted	323	309	322	307
Net income (loss) per share:				
Basic	\$0.46	\$(1.00 )	\$1.54	\$(1.17 )
Diluted	\$0.44	\$(1.00 )	\$1.49	\$(1.17 )

For the three and nine months ended December 31, 2014, options to purchase, restricted stock units and restricted stock to be released in the amount of 4 million shares were excluded from the treasury stock method computation of diluted shares as their inclusion would have had an antidilutive effect.

As a result of our net loss for the three and nine months ended December 31, 2013, we have excluded all outstanding equity-based instruments from the diluted loss per share ("Diluted EPS") calculation as their inclusion would have had an antidilutive effect. Had we reported net income for these periods, an additional 8 million shares of common stock would have been included in the number of shares used to calculate Diluted EPS for both the three and nine months ended December 31, 2013.

For the three and nine months ended December 31, 2013, potentially dilutive shares of common stock related to our 0.75% Convertible Senior Notes due 2016 issued during fiscal year 2012, which have a conversion price of \$31.74 per share and the associated Warrants, which have a conversion price of \$41.14 per share, were excluded from the computation of Diluted EPS as their inclusion would have had an antidilutive effect resulting from the conversion price. The associated Convertible Note Hedge was excluded from the computation of diluted shares as the impact is always considered antidilutive. See Note 12 for additional information related to our 0.75% Convertible Senior Notes due 2016 and related Convertible Note Hedge and Warrants.

**(16) SEGMENT INFORMATION**

Our reporting segment is based upon: our internal organizational structure; the manner in which our operations are managed; the criteria used by our Chief Executive Officer, our Chief Operating Decision Maker ("CODM"), to evaluate segment performance; the availability of separate financial information; and overall materiality considerations. Our CODM currently reviews total company operating results to assess overall performance and allocate resources.

Table of Contents

The following table summarizes the financial performance of our current segment operating profit and a reconciliation to our consolidated operating income (loss) for the three and nine months ended December 31, 2014 and 2013.

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Segment:				
Net revenue before revenue deferral	\$1,428	\$1,572	\$3,423	\$3,107
Depreciation	(32)	(33)	(96)	(95)
Other expenses	(877)	(1,008)	(2,414)	(2,499)
Segment operating profit	519	531	913	513
Reconciliation to consolidated operating income:				
Other:				
Revenue deferral	(1,171)	(1,388)	(2,829)	(2,622)
Recognition of revenue deferral	869	624	2,736	1,967
Amortization of intangibles	(16)	(20)	(49)	(57)
Acquisition-related contingent consideration	—	—	2	37
Restructuring and other charges	—	1	—	2
Stock-based compensation	(39)	(40)	(108)	(111)
Loss on licensed intellectual property commitment	—	—	(122)	—
Other expenses	—	—	5	(40)
Consolidated operating income (loss)	\$162	\$(292)	\$548	\$(311)

Our segment profit differs from consolidated operating income (loss) primarily due to the exclusion of (1) the deferral of net revenue related to online-enabled games (see Note 10 for additional information regarding deferred net revenue (online-enabled games)), (2) certain non-cash costs such as stock-based compensation, (3) acquisition-related expenses such as amortization of intangibles and acquisition-related contingent consideration, and (4) other significant non-recurring costs that may not be indicative of the company's core business, operating results or future outlook. Our CODM reviews assets on a consolidated basis and not on a segment basis.

Information about our total net revenue by revenue composition and by platform for the three and nine months ended December 31, 2014 and 2013 is presented below (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Packaged goods and other	\$585	\$398	\$1,745	\$1,110
Digital	541	410	1,585	1,342
Net revenue	\$1,126	\$808	\$3,330	\$2,452
	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Platform net revenue				
Xbox One, PlayStation 4	\$427	\$24	\$1,037	\$24
Xbox 360, PlayStation 3	306	425	1,157	1,217
Other consoles	9	10	18	25
Total consoles	742	459	2,212	1,266
PC / Browser	218	210	657	782
Mobile	122	97	368	285
Other	44	42	93	119
Net revenue	\$1,126	\$808	\$3,330	\$2,452



Table of Contents

Information about our operations in North America and internationally as of and for the three and nine months ended December 31, 2014 and 2013 is presented below (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Net revenue from unaffiliated customers				
North America	\$473	\$338	\$1,428	\$1,036
International	653	470	1,902	1,416
Net revenue	\$1,126	\$808	\$3,330	\$2,452

	As of December 31,	
	2014	2013
Long-lived assets		
North America	\$1,831	\$1,949
International	475	490
Total	\$2,306	\$2,439

We attribute net revenue from external customers to individual countries based on the location of the legal entity that sells the products and/or services. Note that revenue attributed to the legal entity that makes the sale is often not the country where the consumer resides. For example, revenue generated by our Swiss legal entities includes digital revenue from consumers who reside outside of Switzerland, including consumers who reside outside of Europe. Revenue generated by our Swiss legal entities during the three and nine months ended December 31, 2014 represented \$377 million and \$1,012 million, or 33 percent and 30 percent, of our total net revenue, respectively. Revenue generated by our Swiss legal entities during the three and nine months ended December 31, 2013 represented \$194 million and \$733 million, or 24 percent and 30 percent, of our total net revenue, respectively. Revenue generated in the United States represents over 99 percent of our total North America net revenue. There were no other countries with net revenue greater than 10 percent.

Our direct sales to Sony and Microsoft represented approximately 11 percent and 10 percent of total net revenue, respectively, during the three months ended December 31, 2014. Our direct sales to GameStop Corp. represented approximately 12 percent of total net revenue for the nine months ended December 31, 2014. Our direct sales to GameStop Corp. represented approximately 15 percent and 14 percent of total net revenue during the three and nine months ended December 31, 2013, respectively.



Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Electronic Arts Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Electronic Arts Inc. and subsidiaries (the Company) as of December 27, 2014, and the related condensed consolidated statements of operations and comprehensive income (loss), for the three-month and nine-month periods ended December 27, 2014 and December 28, 2013, and the related condensed consolidated statements of cash flows for the nine-month periods ended December 27, 2014 and December 28, 2013. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Electronic Arts Inc. and subsidiaries as of March 29, 2014, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated May 21, 2014, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of March 29, 2014, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Santa Clara, California

February 4, 2015

## Table of Contents

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, made in this Quarterly Report are forward looking. Examples of forward-looking statements include statements related to industry prospects, our future economic performance including anticipated revenues and expenditures, results of operations or financial position, and other financial items, our business plans and objectives, including our intended product releases, and may include certain assumptions that underlie the forward-looking statements. We use words such as "anticipate," "believe," "expect," "intend," "estimate" (and the negative of any of these terms), "future" and similar expressions to help identify forward-looking statements. These forward-looking statements are subject to business and economic risk and reflect management's current expectations, and involve subjects that are inherently uncertain and difficult to predict. Our actual results could differ materially from those in the forward-looking statements. We will not necessarily update information if any forward-looking statement later turns out to be inaccurate. Risks and uncertainties that may affect our future results include, but are not limited to, those discussed in this report under the heading "Risk Factors" in Part II, Item 1A, as well as in our Annual Report on Form 10-K for the fiscal year ended March 31, 2014 as filed with the Securities and Exchange Commission ("SEC") on May 21, 2014 and in other documents we have filed with the SEC.

#### OVERVIEW

The following overview is a high-level discussion of our operating results, as well as some of the trends and drivers that affect our business. Management believes that an understanding of these trends and drivers is important in order to understand our results for the three and nine months ended December 31, 2014, as well as our future prospects. This summary is not intended to be exhaustive, nor is it intended to be a substitute for the detailed discussion and analysis provided elsewhere in this Form 10-Q, including in the remainder of "Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")," "Risk Factors," and the Condensed Consolidated Financial Statements and related Notes. Additional information can be found in the "Business" section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2014 as filed with the SEC on May 21, 2014 and in other documents we have filed with the SEC.

#### About Electronic Arts

We develop, market, publish and distribute game software content and services that can be played by consumers on a variety of platforms, including video game consoles (such as PlayStation 3 and 4 from Sony and Xbox 360 and Xbox One from Microsoft), personal computers, mobile phones and tablets. Our ability to deliver games and services across multiple platforms, through multiple distribution channels, and directly to consumers (online and wirelessly) has been, and will continue to be, a cornerstone of our product strategy. We have adopted new business models and alternative revenue streams (such as subscription, micro-transactions, and advertising) in connection with our online and wireless product and service offerings. Some of our games are based on our wholly-owned intellectual property (e.g., Battlefield, Mass Effect, Need for Speed, Dragon Age, The Sims, Bejeweled, and Plants vs. Zombies), and some of our games leverage content that we license from others (e.g., FIFA, Madden NFL and Star Wars). We also publish and distribute games developed by third parties (e.g., Titanfall). Our goal is to turn our intellectual properties into year-round businesses available on a range of platforms. Our products and services may be purchased through physical and online retailers, platform providers such as console manufacturers and mobile carriers via digital downloads, as well as directly through our own distribution platform, including online portals such as Origin.

#### Financial Results

Total net revenue for the three months ended December 31, 2014 was \$1,126 million, an increase of \$318 million, or 39 percent, as compared to the three months ended December 31, 2013. Net revenue for the three months ended December 31, 2014 was driven by FIFA 15, FIFA 14, and Madden NFL 15. At December 31, 2014, deferred net revenue associated with sales of online-enabled games increased by \$302 million as compared to September 30, 2014, directly decreasing the amount of reported net revenue during the three months ended December 31, 2014. At December 31, 2013, deferred net revenue associated with sales of online-enabled games increased by \$764 million as

compared to September 30, 2013, directly decreasing the amount of reported net revenue during the three months ended December 31, 2013. Disregarding the impact of the deferred net revenue, reported net revenue would have decreased by approximately \$144 million, or 9 percent, during the three months ended December 31, 2014 as compared to the three months ended December 31, 2013.

**International Operations and Foreign Currency Exchange Impact.** International sales are a fundamental part of our business. International net revenue was \$653 million, or 58 percent of total net revenue during the three months ended December 31,

## Table of Contents

2014, compared to \$470 million, or 58 percent of total net revenue during the three months ended December 31, 2013, an increase of \$183 million, or 39 percent. We estimate that foreign exchange rates (primarily due to the Euro) decreased reported International net revenue by approximately \$16 million, or 3 percent, for the three months ended December 31, 2014 as compared to the exchange rates in effect for the three months ended December 31, 2013. Excluding the effect of foreign exchange rates from International net revenue, we estimate that International net revenue increased by approximately \$199 million, or 42 percent for the three months ended December 31, 2014 as compared to the three months ended December 31, 2013. This increase is primarily due to our FIFA and The Sims franchises, and Titanfall, partially offset by decreased revenue in our Battlefield franchise and Star Wars: The Old Republic. In addition, our international investments and our cash and cash equivalents denominated in foreign currencies are subject to fluctuations in foreign currency exchange rates. If the U.S. dollar strengthens against these currencies, then foreign exchange rates may have an unfavorable impact on our results of operations and our financial condition.

Net income for the three months ended December 31, 2014 was \$142 million as compared to a net loss of \$308 million for the three months ended December 31, 2013. Diluted earnings per share for the three months ended December 31, 2014 was \$0.44 as compared to a diluted loss per share of \$1.00 for the three months ended December 31, 2013. Net income increased for the three months ended December 31, 2014 as compared to the three months ended December 31, 2013 primarily as a result of a \$318 million increase in net revenue, a \$116 million decrease in cost of revenue, and a \$20 million decrease in operating expenses.

## Trends in Our Business

**Console System Transition.** In November 2013, the PlayStation 4 from Sony and Xbox One from Microsoft were released. EA delivered five major products for each of these new-generation console systems around the time of their launch, and we are continuing to make significant investments in products and services for these new consoles. We also expect to continue to develop and market products and services for the Microsoft Xbox 360 and the Sony PlayStation 3. Industry sales of major games for these legacy consoles declined significantly during our 2014 fiscal year. Although sales for legacy consoles were stronger than we anticipated for the three months ended December 31, 2014, we think that this sales decline trend is likely to continue. The success of our products and services for the new-generation consoles depends in part on the commercial success and adequate supply of, as well as our ability to develop commercially successful products and services for, these consoles.

**Digital Transformation.** Our business continues to transform from a traditional packaged goods business model to one in which our games and services are sold and delivered via a network connection, with digitally-delivered content, features and services helping to extend the life of the respective game offering. For example, many of our products that traditionally have been sold only as packaged goods products can now also be purchased and downloaded via a network connection. We also include digitally-delivered content, features and services as part of the product offering, either made available for free or at additional cost. Additionally, our mobile and PC free-to-download games are available solely via digital delivery and are typically monetized through a micro-transaction business model through which we sell incremental content and/or features in discrete transactions. In addition, our EA Access for the Xbox One is a subscription service that offers players access to a selection of EA games and other benefits for a monthly or annual fee.

We significantly increased the digital revenue that we derive from wireless, Internet-derived and advertising products and services from \$1,159 million in fiscal year 2012 to \$1,440 million in fiscal year 2013. During fiscal year 2014, digital revenue was \$1,833 million and was \$1,585 million for the first three fiscal quarters of fiscal 2015. We expect this portion of our business to continue to grow through the remainder of fiscal 2015 and beyond.

**Mobile and PC Free-to-Download Games.** The proliferation of mobile phones and tablets has significantly increased the consumer base for mobile games. The broad consumer acceptance of free-to-download business models, which

allow consumers to try new games with no up-front cost and pay for additional content or in-game items through micro-transactions, has led to growth in the mobile gaming industry. Likewise, the mass introduction and wide consumer acceptance of free-to-download, micro-transaction-based PC games played over the Internet has also broadened our consumer base. We expect revenue generated from mobile and PC free-to-download games to remain an important part of our business.

We track an estimate of monthly active users (“MAUs”) for our mobile business, which we believe is a useful indicator of player engagement trends. For the three months ended December 31, 2014, we had average MAUs of over 160 million. MAUs are the aggregate number of individuals who accessed a particular game on a particular device in the last 30 days as of the measurement date. Average MAUs for a particular period is the average of the MAUs at each month-end during that period. We include in this calculation data provided by our third party publishing partners for certain games that we develop but we exclude information from third party titles that we publish. Our methodology for calculating MAU may differ from the methodology used by other companies to calculate this metric.

## Table of Contents

Concentration of Sales Among the Most Popular Games. In all major segments of our industry, we see a larger portion of games sales concentrated on the most popular titles, and many of those titles are sequels of prior games. We have responded to this trend by significantly reducing the number of games that we produce to provide greater focus on our most promising intellectual properties. For example, in fiscal year 2011, we published over 30 titles for consoles and PC, while in fiscal year 2014 we published 11; in fiscal year 2015, we expect to release 9 titles for console and PC. We have similarly reduced the number of major mobile titles that we publish.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”). The preparation of these Condensed Consolidated Financial Statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, contingent assets and liabilities, and revenue and expenses during the reporting periods. The policies discussed below are considered by management to be critical because they are not only important to the portrayal of our financial condition and results of operations, but also because application and interpretation of these policies requires both management judgment and estimates of matters that are inherently uncertain and unknown. As a result, actual results may differ materially from our estimates.

### Revenue Recognition, Sales Returns and Allowances, and Bad Debt Reserves

We derive revenue principally from sales of interactive software games, and related content and services on (1) video game consoles (such as Playstation 3 and 4 from Sony and Xbox 360 and Xbox One from Microsoft) and PCs, and (2) mobile phones and tablets. We evaluate revenue recognition based on the criteria set forth in FASB Accounting Standards Codification (“ASC”) 605, Revenue Recognition and ASC 985-605, Software: Revenue Recognition. We classify our revenue as either product revenue or service and other revenue.

Product revenue. Our product revenue includes revenue associated with the sale of software games or related content, whether delivered via a physical disc (e.g., packaged goods) or delivered digitally via the Internet (e.g., full-game downloads, micro-transactions), and licensing of game software to third-parties. Product revenue also includes revenue from mobile full game downloads that do not require our hosting support (e.g., premium mobile games), and sales of tangible products such as hardware, peripherals, or collectors’ items.

Service and other revenue. Our service revenue includes revenue recognized from time-based subscriptions and games or related content that requires our hosting support in order to utilize the game or related content (i.e., can only be played with an Internet connection). This includes (1) entitlements to content that are accessed through hosting services (e.g., micro-transactions for Internet-based, social network and free-to-play mobile games), (2) massively multi-player online (“MMO”) games (both software game and subscription sales), (3) subscriptions for our Battlefield Premium and Pogo-branded online game services, and (4) allocated service revenue from sales of software games with an online service element (i.e., “matchmaking” service). Our other revenue includes advertising and non-software licensing revenue.

With respect to the allocated service revenue from sales of software games with a matchmaking service mentioned above, our allocation of proceeds between product and service revenue for presentation purposes is based on management’s best estimate of the selling price of the matchmaking service with the residual value allocated to product revenue. Our estimate of the selling price of the matchmaking service is comprised of several factors including, but not limited to, prior selling prices for the matchmaking service, prices charged separately by other third-party vendors for similar service offerings, and a cost-plus-margin approach. We review the estimated selling price of the online matchmaking service on a regular basis and use this methodology consistently to allocate revenue between product and service for software game sales with a matchmaking service.

We evaluate and recognize revenue when all four of the following criteria are met:

• Evidence of an arrangement. Evidence of an agreement with the customer that reflects the terms and conditions to deliver the related products or services must be present.

• Fixed or determinable fee. If a portion of the arrangement fee is not fixed or determinable, we recognize revenue as the amount becomes fixed or determinable.

Collection is deemed probable. Collection is deemed probable if we expect the customer to be able to pay amounts under the arrangement as those amounts become due. If we determine that collection is not probable as the amounts become due, we generally conclude that collection becomes probable upon cash collection.

## Table of Contents

Delivery. For packaged goods, delivery is considered to occur when a product is shipped and the risk of loss and rewards of ownership have transferred to the customer. For digital downloads, delivery is considered to occur when the software is made available to the customer for download. For services and other, delivery is generally considered to occur as the service is delivered, which is determined based on the underlying service obligation.

### Online-Enabled Games

The majority of our software games can be connected to the Internet whereby a consumer may be able to download unspecified content or updates on a when-and-if-available basis (“unspecified updates”) for use with the original game software. In addition, we may also offer an online matchmaking service that permits consumers to play against each other via the Internet without a separate fee. U.S. GAAP requires us to account for the consumer’s right to receive unspecified updates or the matchmaking service for no additional fee as a “bundled” sale, or multiple-element arrangement.

We have an established historical pattern of providing unspecified updates to online-enabled games (e.g., player roster updates to Madden NFL 25) at no additional charge to the consumer. We do not have vendor-specific objective evidence of fair value (“VSOE”) for these unspecified updates, and thus, as required by U.S. GAAP, we recognize revenue from the sale of these online-enabled games over the period we expect to offer the unspecified updates to the consumer (“estimated offering period”).

### Estimated Offering Period

Because the offering period is not an explicitly defined period, we must make an estimate of the offering period. Determining the estimated offering period is inherently subjective and is subject to regular revision based on historical online usage. For example, in determining the estimated offering period for unspecified updates associated with our online-enabled games, we consider the period of time consumers are online as online connectivity is required. On an annual basis, we review consumers’ online gameplay of all online-enabled games that have been released 12 to 24 months prior to the evaluation date. For example, if our evaluation date is April 1, 2014, we evaluate all online-enabled games released between April 1, 2012 and March 31, 2013. Based on this population of games, for all players that register the game online within the first six months of release of the game to the general public, we compute the weighted-average number of days for each online-enabled game, based on when a player initially registers the game online to when that player last plays the game online. We then compute the weighted-average number of days for all online-enabled games by multiplying the weighted-average number of days for each online-enabled game by its relative percentage of total units sold from these online-enabled games (i.e., a game with more units sold will have a higher weighting to the overall computation than a game with fewer units sold). Under a similar computation, we also consider the estimated period of time between the date a game unit is sold to a reseller and the date the reseller sells the game unit to an end consumer (i.e., time in channel). Based on these two calculations we then consider the method of distribution. For example, physical software games sold at retail would have a composite offering period equal to the online gameplay plus time in channel as opposed to digitally distributed software games which are delivered immediately via digital download and thus have no concept of channel. Additionally, we consider results from prior years, known online gameplay trends, as well as disclosed service periods for competitors’ games in determining the estimated offering period for future sales.

While we consistently apply this methodology, inherent assumptions used in this methodology include which online-enabled games to sample, whether to use only units that have registered online, whether to weight the number of days for each game, whether to weight the days based on the units sold of each game, determining the period of time between the date of sale to reseller and the date of sale to the consumer and assessing online gameplay trends.



Prior to July 1, 2013, for most sales, we estimated the offering period to be six months and recognized revenue over this period in the month after delivery. During the three months ended September 30, 2013, we completed our fiscal 2014 annual evaluation of the estimated offering period and noted that generally, consumers were playing our games online over a longer period of time. Based on this, we concluded that for physical software sales made after June 30, 2013, the estimated offering period should be increased to nine months, resulting in revenue being recognized over a longer period of time. This change in estimate resulted in an estimated decrease to net revenue and net income of \$474 million and a decrease of \$1.50 of diluted earnings per share for fiscal year 2014. During the three months ended December 31, 2014, this change in estimate resulted in an estimated increase to net revenue and net income of \$180 million and an increase of \$0.56 of diluted earnings per share. During the nine months ended December 31, 2014, this change in estimate resulted in an estimated increase to net revenue and net income of \$466 million and an increase of \$1.45 of diluted earnings per share. The estimated offering period for digitally distributed games did not change and is six months. We completed our fiscal 2015 annual evaluation during the second quarter and determined that the estimated offering period for physical software sales and digital sales continues to be nine months and six months, respectively.

## Table of Contents

### Other Multiple-Element Arrangements

In some of our multiple-element arrangements, we sell tangible products with software and/or software-related offerings. These tangible products are generally either peripherals or ancillary collectors' items, such as figurines and comic books. Revenue for these arrangements is allocated to each separate unit of accounting for each deliverable using the relative selling prices of each deliverable in the arrangement based on the selling price hierarchy described below. If the arrangement contains more than one software deliverable, the arrangement consideration is allocated to the software deliverables as a group and then allocated to each software deliverable in accordance with ASC 985-605.

We determine the selling price for a tangible product deliverable based on the following selling price hierarchy: VSOE (i.e., the price we charge when the tangible product is sold separately) if available, third-party evidence ("TPE") of fair value (i.e., the price charged by others for similar tangible products) if VSOE is not available, or our best estimate of selling price ("BESP") if neither VSOE nor TPE is available. Determining the BESP is a subjective process that is based on multiple factors including, but not limited to, recent selling prices and related discounts, market conditions, customer classes, sales channels and other factors. In accordance with ASC 605, provided the other three revenue recognition criteria other than delivery have been met, we recognize revenue upon delivery to the customer as we have no further obligations.

We must make assumptions and judgments in order to (1) determine whether and when each element is delivered, (2) determine whether VSOE exists for each undelivered element, and (3) allocate the total price among the various elements, as applicable. Changes to any of these assumptions and judgments, or changes to the elements in the arrangement, could cause a material increase or decrease in the amount of revenue that we report in a particular period.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for annual reporting periods beginning after December 15, 2016. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its Condensed Consolidated Financial Statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting. We expect to adopt this new standard in the first quarter of fiscal year 2018.

### Principal Agent Considerations

In accordance with ASC 605-45, Revenue Recognition: Principal Agent Considerations, we evaluate sales of our interactive software games via third party storefronts, including digital storefronts such as Xbox Live Marketplace, Sony PSN, Apple AppStore, Google Play, in order to determine whether or not we are acting as the principal or as an agent, which we consider in determining if revenue should be reported gross or net of fees retained by the storefront. Key indicators that we evaluate in determining gross versus net treatment include but are not limited to the following:

- ☐ The party responsible for delivery/fulfillment of the product or service to the end consumer
- ☐ The party responsible for the billing, collection of fees and refunds to the consumer
- ☐ The storefront and Terms of Sale that govern the consumer's purchase of the product or service
- ☐ The party that sets the pricing with the consumer and has credit risk

Based on the evaluation of the above indicators, we have determined that we are generally acting as an agent and are not considered the primary obligor to consumers for our interactive software games distributed through third party digital storefronts. We therefore recognize revenue related to these arrangements on a net basis.

### Sales Returns and Allowances and Bad Debt Reserves

We reduce revenue primarily for estimated future returns and price protection which may occur with our distributors and retailers (“channel partners”). Price protection represents our practice to provide our channel partners with a credit allowance to lower their wholesale price on a particular product in the channel. The amount of the price protection is generally the difference between the old wholesale price and the new reduced wholesale price. In certain countries for our PC and console packaged goods software products, we also have a practice of allowing channel partners to return older software products in the channel in exchange for a credit allowance. As a general practice, we do not give cash refunds.

When evaluating the adequacy of sales returns and price protection allowances, we analyze the following: historical credit allowances, current sell-through of our channel partners’ inventory of our software products, current trends in retail and the

## Table of Contents

video game industry, changes in customer demand, acceptance of our software products, and other related factors. In addition, we monitor the volume of sales to our channel partners and their inventories, as substantial overstocking in the distribution channel could result in high returns or higher price protection in subsequent periods.

In the future, actual returns and price protections may materially exceed our estimates as unsold software products in the distribution channels are exposed to rapid changes in consumer preferences, market conditions or technological obsolescence due to new platforms, product updates or competing software products. While we believe we can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, if our estimates change, our returns and price protection allowances would change and would impact the total net revenue, accounts receivable and deferred net revenue that we report.

We determine our allowance for doubtful accounts by evaluating the following: customer creditworthiness, current economic trends, historical experience, age of current accounts receivable balances, changes in financial condition or payment terms of our customers. Significant management judgment is required to estimate our allowance for doubtful accounts in any accounting period. The amount and timing of our bad debt expense and cash collection could change significantly as a result of a change in any of the evaluation factors mentioned above.

### Fair Value Estimates

The preparation of financial statements in conformity with U.S. GAAP often requires us to determine the fair value of a particular item in order to fairly present our financial statements. Without an independent market or another representative transaction, determining the fair value of a particular item requires us to make several assumptions that are inherently difficult to predict and can have a material impact on the accounting.

There are various valuation techniques used to estimate fair value. These include (1) the market approach where market transactions for identical or comparable assets or liabilities are used to determine the fair value, (2) the income approach, which uses valuation techniques to convert future amounts (for example, future cash flows or future earnings) to a single present value amount, and (3) the cost approach, which is based on the amount that would be required to replace an asset. For many of our fair value estimates, including our estimates of the fair value of acquired intangible assets, we use the income approach. Using the income approach requires the use of financial models, which require us to make various estimates including, but not limited to (1) the potential future cash flows for the asset or liability being measured, (2) the timing of receipt or payment of those future cash flows, (3) the time value of money associated with the expected receipt or payment of such cash flows, and (4) the inherent risk associated with the cash flows (risk premium). Making these cash flow estimates is inherently difficult and subjective, and if any of the estimates used to determine the fair value using the income approach turns out to be inaccurate, our financial results may be negatively impacted. Furthermore, relatively small changes in many of these estimates can have a significant impact to the estimated fair value resulting from the financial models or the related accounting conclusion reached. For example, a relatively small change in the estimated fair value of an asset may change a conclusion as to whether an asset is impaired.

While we are required to make certain fair value assessments associated with the accounting for several types of transactions, the following areas are the most sensitive to these assessments:

**Business Combinations.** We must estimate the fair value of assets acquired, liabilities and contingencies assumed, acquired in-process technology, and contingent consideration issued in a business combination. Our assessment of the estimated fair value of each of these can have a material effect on our reported results as intangible assets are amortized over various estimated useful lives. Furthermore, the estimated fair value assigned to an acquired asset or liability has a direct impact on the amount we recognize as goodwill, which is an asset that is not amortized.

Determining the fair value of assets acquired requires an assessment of the highest and best use or the expected price to sell the asset and the related expected future cash flows. Determining the fair value of acquired in-process technology also requires an assessment of our expectations related to the use of that technology. Determining the fair

value of an assumed liability requires an assessment of the expected cost to transfer the liability. Determining the fair value of contingent consideration requires an assessment of the probability-weighted expected future cash flows over the period in which the obligation is expected to be settled, and applying a discount rate that appropriately captures the risk associated with the obligation. The significant unobservable inputs used in the fair value measurement of the contingent consideration payable are forecasted earnings. Significant changes in forecasted earnings would result in significantly higher or lower fair value measurement. This fair value assessment is also required in periods subsequent to a business combination. Such estimates are inherently difficult and subjective and can have a material impact on our Condensed Consolidated Financial Statements.

## Table of Contents

Assessment of Impairment of Goodwill, Intangibles, and Other Long-Lived Assets. Current accounting standards require that we assess the recoverability of our finite lived acquisition-related intangible assets and other long-lived assets whenever events or changes in circumstances indicate the remaining value of the assets recorded on our Condensed Consolidated Balance Sheets is potentially impaired. In order to determine if a potential impairment has occurred, management must make various assumptions about the estimated fair value of the asset by evaluating future business prospects and estimated future cash flows. For some assets, our estimated fair value is dependent upon predicting which of our products will be successful. This success is dependent upon several factors, such as which operating platforms will be successful in the marketplace. Also, our revenue and earnings are dependent on our ability to meet our product release schedules. Judgments and assumptions about future cash flows and remaining useful lives are complex and often subjective. They can be affected by a variety of factors, including but not limited to, significant negative industry or economic trends, significant changes in the manner of our use of the assets or the strategy of our overall business and significant under-performance relative to projected future operating results. When we consider such assets to be impaired, the amount of impairment we recognize is measured by the amount by which the carrying amount of the asset exceeds its fair value.

In assessing impairment on our goodwill, we first analyze qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The qualitative factors we assess include long-term prospects of our performance, share price trends and market capitalization, and Company specific events. If we conclude it is more likely than not that the fair value of a reporting unit exceeds its carrying amount, we do not need to perform the two-step impairment test. If based on that assessment, we believe it is more likely than not that the fair value of the reporting unit is less than its carrying value, a two-step goodwill impairment test will be performed. The first step measures for impairment by applying fair value-based tests at the reporting unit level. The second step (if necessary) measures the amount of impairment by applying fair value-based tests to the individual assets and liabilities within each reporting unit. Reporting units are determined by the components of operating segments that constitute a business for which (1) discrete financial information is available, (2) segment management regularly reviews the operating results of that component, and (3) whether the component has dissimilar economic characteristics to other components.

As of our last annual assessment of goodwill in the fourth quarter of fiscal year 2014, we determined that it was more likely than not that the fair value of our reporting unit exceeded its carrying amount and, as such, we did not need to perform the two-step impairment test. We have not identified any indicators of impairment since that assessment.

Our business consists of developing, marketing and distributing video game software content and services using both established and emerging intellectual properties and our forecasts for emerging intellectual properties are based upon internal estimates and external sources rather than historical information and have an inherently higher risk of inaccuracy. If future forecasts are revised, they may indicate or require future impairment charges. We base our fair value estimates on assumptions we believe to be reasonable, but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates.

## Royalties and Licenses

Our royalty expenses consist of payments to (1) content licensors, (2) independent software developers, and (3) co-publishing and distribution affiliates. License royalties consist of payments made to celebrities, professional sports organizations, movie studios and other organizations for our use of their trademarks, copyrights, personal publicity rights, content and/or other intellectual property. Royalty payments to independent software developers are payments for the development of intellectual property related to our games. Co-publishing and distribution royalties are payments made to third parties for the delivery of products.

Royalty-based obligations with content licensors and distribution affiliates are either paid in advance and capitalized as prepaid royalties or are accrued as incurred and subsequently paid. These royalty-based obligations are generally expensed to cost of revenue generally at the greater of the contractual rate or an effective royalty rate based on the total projected net revenue for contracts with guaranteed minimums. Significant judgment is required to estimate the effective royalty rate for a particular contract. Because the computation of effective royalty rates requires us to project future revenue, it is inherently subjective as our future revenue projections must anticipate a number of factors, including (1) the total number of titles subject to the contract, (2) the timing of the release of these titles, (3) the number of software units we expect to sell, which can be impacted by a number of variables, including product quality, number of platforms we release on, the timing of the title's release and competition, and (4) future pricing. Determining the effective royalty rate for our titles is particularly challenging due to the inherent difficulty in predicting the popularity of entertainment products. Furthermore, if we conclude that we are unable to make a reasonably reliable forecast of projected net revenue, we recognize royalty expense at the greater of contract rate or on a

## Table of Contents

straight-line basis over the term of the contract. Accordingly, if our future revenue projections change, our effective royalty rates would change, which could impact the amount and timing of royalty expense we recognize.

Prepayments made to thinly capitalized independent software developers and co-publishing affiliates are generally made in connection with the development of a particular product, and therefore, we are generally subject to development risk prior to the release of the product. Accordingly, payments that are due prior to completion of a product are generally expensed to research and development over the development period as the services are incurred. Payments due after completion of the product (primarily royalty-based in nature) are generally expensed as cost of revenue.

Our contracts with some licensors include minimum guaranteed royalty payments, which are initially recorded as an asset and as a liability at the contractual amount when no performance remains with the licensor. When performance remains with the licensor, we record guarantee payments as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract. Royalty liabilities are classified as current liabilities to the extent such royalty payments are contractually due within the next 12 months.

Each quarter, we also evaluate the expected future realization of our royalty-based assets, as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are generally charged to research and development expense. Impairments or losses determined post-launch are charged to cost of revenue. We evaluate long-lived royalty-based assets for impairment generally using undiscounted cash flows when impairment indicators exist. Unrecognized minimum royalty-based commitments are accounted for as executory contracts, and therefore, any losses on these commitments are recognized when the underlying intellectual property is abandoned (i.e., cease use) or the contractual rights to use the intellectual property are terminated.

### Income Taxes

We recognize deferred tax assets and liabilities for both the expected impact of differences between the financial statement amount and the tax basis of assets and liabilities and for the expected future tax benefit to be derived from tax losses and tax credit carryforwards. We record a valuation allowance against deferred tax assets when it is considered more likely than not that all or a portion of our deferred tax assets will not be realized. In making this determination, we are required to give significant weight to evidence that can be objectively verified. It is generally difficult to conclude that a valuation allowance is not needed when there is significant negative evidence, such as cumulative losses in recent years. Forecasts of future taxable income are considered to be less objective than past results, particularly in light of the previous years' economic environment. Therefore, cumulative losses weigh heavily in the overall assessment.

In addition to considering forecasts of future taxable income, we are also required to evaluate and quantify other possible sources of taxable income in order to assess the realization of our deferred tax assets, namely the reversal of existing deferred tax liabilities, the carry back of losses and credits as allowed under current tax law, and the implementation of tax planning strategies. Evaluating and quantifying these amounts involves significant judgments. Each source of income must be evaluated based on all positive and negative evidence; this evaluation involves assumptions about future activity. Certain taxable temporary differences that are not expected to reverse during the carry forward periods permitted by tax law cannot be considered as a source of future taxable income that may be available to realize the benefit of deferred tax assets.

Based on the assumptions and requirements noted above, we have recorded a valuation allowance against most of our U.S. deferred tax assets. In addition, we expect to provide a valuation allowance on future U.S. tax benefits until we can sustain a level of profitability in the U.S., or until other significant positive evidence arises that suggest that these benefits are more likely than not to be realized.

In the ordinary course of our business, there are many transactions and calculations where the tax law and ultimate tax determination is uncertain. As part of the process of preparing our Condensed Consolidated Financial Statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate prior to the completion and



filing of tax returns for such periods. This process requires estimating both our geographic mix of income and our uncertain tax positions in each jurisdiction where we operate. These estimates involve complex issues and require us to make judgments about the likely application of the tax law to our situation, as well as with respect to other matters, such as anticipating the positions that we will take on tax returns prior to our actually preparing the returns and the outcomes of disputes with tax authorities. The ultimate resolution of these issues may take extended periods of time due to examinations by tax authorities and statutes of limitations. In addition, changes in our business, including acquisitions, changes in our international corporate structure, changes in the geographic location of business functions or assets, changes in the geographic mix and amount of income, as well as changes in our agreements with tax authorities, valuation allowances, applicable accounting rules, applicable tax laws and regulations,

## Table of Contents

rulings and interpretations thereof, developments in tax audit and other matters, and variations in the estimated and actual level of annual pre-tax income can affect the overall effective income tax rate.

### RESULTS OF OPERATIONS

Our fiscal year is reported on a 52- or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ending or ended, as the case may be, March 31, 2015 and 2014 contain 52 weeks each and ends or ended, as the case may be, on March 28, 2015 and March 29, 2014, respectively. Our results of operations for the three months ended December 31, 2014 and 2013 contained 13 weeks each and ended on December 27, 2014 and December 28, 2013, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

#### Net Revenue

Net revenue consists of sales generated from (1) video games sold as packaged goods or as digital downloads and designed for play on video game consoles (such as the PlayStation 3 and 4 from Sony and Xbox 360 and One from Microsoft) and PCs, (2) video games for mobile phones and tablets, (3) separate software products and content and online game services associated with these products, (4) licensing our game software to third parties, (5) allowing other companies to manufacture and sell our products in conjunction with other products, and (6) advertisements on our online web pages and in our games.

We provide two different measures of our Net Revenue. One of these measures is presented in accordance with U.S. GAAP - Net Revenue by Product revenue and Service and other revenue. The second measure is a non-GAAP financial measure - Net Revenue before Revenue Deferral by Revenue Composition, which is primarily based on method of distribution. We use this second non-GAAP financial measure internally to evaluate our operating performance, when planning, forecasting and analyzing future periods, and when assessing the performance of our management team.

Management places a greater emphasis and focus on assessing our business through a review of the Net Revenue before Revenue Deferral by Revenue Composition than by Net Revenue by Product revenue and Service and other revenue. These two measures differ as (1) Net Revenue by Product revenue and Service and other revenue reflects the deferral and recognition of revenue in periods subsequent to the date of sale due to U.S. GAAP while Net Revenue before Revenue Deferral by Revenue Composition does not, and (2) both measures contain a different aggregation of sales from one another. For instance, Service and other revenue does not include a portion of our full-game digital download and mobile sales that are fully included in our Digital revenue. Further, Service and other revenue includes all of our revenue associated with MMO games while software sales associated with our MMOs are included in either Digital revenue or Packaged goods and other revenue depending on whether the sale was a full-game digital download or a packaged goods sale.

#### Net Revenue Quarterly Analysis

##### Net Revenue

For the three months ended December 31, 2014, net revenue was \$1,126 million and increased \$318 million, or 39 percent, as compared to the three months ended December 31, 2013. This increase was driven by a \$408 million increase in revenue primarily from the FIFA and Madden franchises, and Titanfall. This increase was partially offset by a \$90 million decrease in revenue primarily from the NCAA Football, Battlefield, and SimCity franchises, Star Wars: The Old Republic, and Pogo-branded online game services.

##### Net Revenue by Product Revenue and Service and Other Revenue

Edgar Filing: ELECTRONIC ARTS INC. - Form 10-Q

Our total net revenue by product revenue and service and other revenue for the three months ended December 31, 2014 and 2013 was as follows (in millions):

	Three Months Ended December 31,			
	2014	2013	\$ Change	% Change
Net revenue:				
Product	\$606	\$485	\$121	25%
Service and other	520	323	197	61%
Total net revenue	\$1,126	\$808	\$318	39%

## Table of Contents

### Product Revenue

For the three months ended December 31, 2014, product revenue was \$606 million, primarily driven by FIFA 15, Madden NFL 15, and FIFA 14. Product revenue for the three months ended December 31, 2014 increased \$121 million, or 25 percent, as compared to the three months ended December 31, 2013, and was driven by a \$203 million increase primarily from the FIFA, The Sims, and Dragon Age franchises. This increase was partially offset by a \$82 million decrease primarily from the Battlefield, NCAA Football, and SimCity franchises.

### Service and Other Revenue

For the three months ended December 31, 2014, service and other revenue was \$520 million, primarily driven by FIFA Ultimate Team, Titanfall, and Battlefield 4 Premium. Service and other revenue for the three months ended December 31, 2014 increased \$197 million, or 61 percent, as compared to the three months ended December 31, 2013, and was driven by a \$239 million increase primarily from Titanfall and the FIFA and Plants vs Zombies franchises. This increase was partially offset by a \$42 million decrease primarily from Star Wars: The Old Republic, Need for Speed World, and Pogo-branded online game services.

### Supplemental Non-GAAP Net Revenue by Revenue Composition

As we continue to evolve our business and more of our products are delivered to consumers digitally via the Internet, we place a greater emphasis and focus on assessing our business through a review of net revenue by revenue composition.

Net Revenue before Revenue Deferral, a non-GAAP financial measure that excludes the impact of Revenue Deferral and the Recognition of Revenue Deferral on Net Revenue related to sales of online-enabled games and content, is provided in this section of MD&A, including a discussion of the components of this measure: (1) packaged goods and other and (2) the components that comprise our digital revenue. A reconciliation to the corresponding measure calculated in accordance with U.S. GAAP is provided in the discussion below.

“Revenue Deferral” in this “Net Revenue” section generally relates to sales of online-enabled games and content for which we do not have VSOE for unspecified updates to be delivered after the initial sale or for which we have a continuing service obligation. Fluctuations in the Revenue Deferral are largely dependent upon the amounts of products that we sell with the online features and services previously discussed, while the Recognition of Revenue Deferral for a period is also dependent upon (1) the amount deferred, (2) the period of time the software-related offerings and service obligations are to be provided, and (3) the timing of the sale.

Our sales are generally deferred and recognized over an estimated nine-month period beginning in the month after shipment for physical games sold through retail and an estimated six-month period for digitally delivered games and content, and therefore, the related revenue recognized during the fiscal quarter ended December 31 is primarily due to sales that occurred during the preceding six-month period for digitally delivered games and content, and the preceding nine-month period for physical games sold through retail. Consequently, most Revenue Deferrals incurred in the first quarter of a fiscal year are recognized within the same fiscal year; however, substantially all of the Revenue Deferrals incurred in the last month of a fiscal year will be recognized in the subsequent fiscal year.

We believe that excluding the impact of Revenue Deferral and the Recognition of Revenue Deferral related to online-enabled games and content from our operating results is important to facilitate comparisons between periods in understanding our underlying sales performance for the period, and understanding our operations because all related costs of revenues are expensed as incurred instead of deferred and recognized ratably. We use this non-GAAP financial measure internally to evaluate our operating performance, when planning, forecasting and analyzing future periods, and when assessing the performance of our management team. While we believe that this non-GAAP financial measure is useful in evaluating our business, this information should be considered as supplemental in nature and is not meant to be considered in isolation from or as a substitute for the related financial information prepared in accordance with GAAP. In addition, this non-GAAP financial measure may not be the same as non-GAAP financial

measures presented by other companies.

Table of Contents

Our total non-GAAP net revenue by revenue composition and the reconciliation to net revenue for the three months ended December 31, 2014 and 2013 was as follows (in millions):

	Three Months Ended December 31,			
	2014	2013	\$ Change	% Change
Packaged goods and other	\$735	\$1,055	\$(320)	(30)%
Full game downloads	140	115	25	22%
Extra content	314	213	101	47%
Subscriptions, advertising, and other	100	66	34	52%
Mobile	139	123	16	13%
Total Digital	693	517	176	34%
Net Revenue before Revenue Deferral (Non-GAAP Net Revenue)	\$1,428	\$1,572	\$(144)	(9)%
Revenue Deferral	(1,171)	(1,388)	217	16%
Recognition of Revenue Deferral	869	624	245	39%
Change in deferred net revenue (online-enabled games)	(302)	(764)	462	(60)%
Total net revenue	\$1,126	\$808	\$318	39%

## Net Revenue before Revenue Deferral

## Packaged Goods and Other

Packaged goods revenue (previously disclosed as “publishing revenue”) includes sales of software that is distributed physically. This includes (1) sales of our internally-developed and co-published game software distributed physically through traditional channels such as brick and mortar retailers, (2) our software licensing revenue from third parties (for example, makers of personal computers or computer accessories) who include certain of our products for sale with their products (“OEM bundles”), and (3) sales through our Switzerland distribution business. Other revenue includes our non-software licensing revenue.

For the three months ended December 31, 2014, packaged goods and other was \$735 million, primarily driven by FIFA 15, Dragon Age: Inquisition and Madden NFL 15. Packaged goods and other for the three months ended December 31, 2014 decreased \$320 million, or 30 percent, as compared to the three months ended December 31, 2013. This decrease was driven by a \$584 million decrease in sales primarily from the Battlefield, Need for Speed and NCAA Football franchises. This decrease was partially offset by a \$264 million increase in sales primarily from the Dragon Age, NHL, and FIFA franchises.

## Digital

Digital revenue (previously disclosed as “wireless, Internet-derived, and advertising (digital) revenue”) includes sales of software distributed through direct download via the Internet. This includes full-game downloads, extra content, subscriptions, advertising and other, and mobile revenue. Digital revenue includes internally-developed and co-published game software distributed through our direct-to-consumer platform Origin, distributed wirelessly through mobile carriers, or licensed to our third-party publishing partners who distribute our games digitally. Full-game downloads are generally classified as product revenue with the exception of our MMO and full game downloads related to games that require our hosting support in order to utilize the game or related content (i.e. Titanfall and Plants vs. Zombies: Garden Warfare), which are classified as service revenue. Subscriptions, advertising and other revenue and free-to-download mobile games are each generally classified as service and other revenue.

For the three months ended December 31, 2014, digital was \$693 million, an increase of \$176 million, or 34 percent, as compared to the three months ended December 31, 2013. This increase is due to (1) a \$25 million or 22 percent increase in full-game download sales primarily driven by Dragon Age Inquisition, FIFA 15 and The Sims 4, (2) a \$101 million or 47 percent increase in extra content and free-to-download sales primarily driven by FIFA Ultimate Team and Madden Ultimate Team, (3) a \$34 million or 52 percent increase in subscription sales primarily driven by Battlefield 4 Premium, and (4) a \$16 million or 13 percent increase in mobile revenue primarily driven by FIFA 15 Mobile, Madden NFL Mobile, and FIFA Online 3.

Table of Contents

## Revenue Deferral

Revenue Deferral for the three months ended December 31, 2014 decreased \$217 million, or 16 percent, as compared to the three months ended December 31, 2013. This decrease was primarily due to a \$144 million decrease in Net Revenue before Revenue Deferral related to our packaged goods and other and digital sales during the three months ended December 31, 2014 as compared to three months ended December 31, 2013.

## Recognition of Revenue Deferral

Our sales are generally deferred and recognized over an estimated nine-month period beginning in the month after shipment for physical games sold through retail and an estimated six-month period for digitally delivered games and content, and therefore, the related revenue recognized during the fiscal quarter ended December 31 is primarily due to sales that occurred during the preceding six-month period for digitally delivered games and content, and the preceding nine-month period for physical games sold through retail. The Recognition of Revenue Deferral for the three months ended December 31, 2014 increased \$245 million, or 39 percent, as compared to the three months ended December 31, 2013. This increase was primarily due to (1) an increase in digital and physical games sold through retail during the preceding six and nine-month period, and (2) the increase in our estimated offering period, which was implemented during the second quarter of fiscal 2014 for physical games sold through retail from six to nine months. This change in estimate resulted in an estimated increase to net revenue and net income of \$180 million and an increase of \$0.56 of diluted earnings per share for the three months ended December 31, 2014.

## Net Revenue Year-to-Date Analysis

## Net Revenue

For the nine months ended December 31, 2014, Net Revenue was \$3,330 million and increased \$878 million, or 36 percent, as compared to the nine months ended December 31, 2013. This increase was driven by a \$1,340 million increase in revenue primarily from the FIFA and Battlefield franchises, and Titanfall. This increase was partially offset by a \$462 million decrease in revenue primarily from the SimCity, Crysis, Dead Space, and Mass Effect franchises, and Star Wars: The Old Republic.

## Net Revenue by Product Revenue and Service and Other Revenue

Our total net revenue by product revenue and service and other revenue for the nine months ended December 31, 2014 and 2013 was as follows (in millions):

	Nine Months Ended December 31,				
	2014	2013	\$ Change	% Change	
Net revenue:					
Product	\$1,899	\$1,378	\$521	38	%
Service and other	1,431	1,074	357	33	%
Total net revenue	\$3,330	\$2,452	\$878	36	%

## Product Revenue

For the nine months ended December 31, 2014, product revenue was \$1,899 million, primarily driven by FIFA 14, Battlefield 4, and FIFA 15. Product revenue for the nine months ended December 31, 2014 increased \$521 million, or 38 percent, as compared to the nine months ended December 31, 2013, and was driven by an \$876 million increase



primarily from the FIFA, Battlefield, and Madden NFL franchises. This increase was partially offset by a \$355 million decrease primarily from the Crysis, Dead Space, Army of Two, and Mass Effect franchises.

Table of Contents

## Service and Other Revenue

For the nine months ended December 31, 2014, service and other revenue was \$1,431 million, primarily driven by FIFA Ultimate Team, Titanfall, and Battlefield 4 Premium. Service and other revenue for the nine months ended December 31, 2014 increased \$357 million, or 33 percent, as compared to the nine months ended December 31, 2013, and was driven by a \$519 million increase primarily from Titanfall and the FIFA and Plants vs Zombies franchises. This increase was partially offset by a \$162 million decrease primarily from the SimCity franchise, Star Wars: The Old Republic, and Pogo-branded online games services.

## Supplemental Non-GAAP Net Revenue by Revenue Composition

Our total non-GAAP net revenue by revenue composition and the reconciliation to net revenue for the nine months ended December 31, 2014 and 2013 was as follows (in millions):

	Nine Months Ended December 31,				
	2014	2013	\$ Change	% Change	
Packaged goods and other	\$1,795	\$1,864	\$(69)	(4)	%
Full game downloads	305	208	97	47	%
Extra content	678	517	161	31	%
Subscriptions, advertising, and other	271	189	82	43	%
Mobile	374	329	45	14	%
Total Digital	1,628	1,243	385	31	%
Net Revenue before Revenue Deferral (Non-GAAP Net Revenue)	\$3,423	\$3,107	\$316	10	%
Revenue Deferral	(2,829)	(2,622)	(207)	(8)	%
Recognition of Revenue Deferral	2,736	1,967	769	39	%
Change in deferred net revenue (online-enabled games)	(93)	(655)	562	(86)	%
Total net revenue	\$3,330	\$2,452	\$878	36	%

## Net Revenue before Revenue Deferral

## Packaged Goods and Other

For the nine months ended December 31, 2014, packaged goods and other was \$1,795 million, primarily driven by FIFA 15, Madden NFL 15, and Dragon Age: Inquisition. Packaged goods and other for the nine months ended December 31, 2014 decreased \$69 million, or 4 percent, as compared to the nine months ended December 31, 2013. This decrease was driven by a \$654 million decrease in sales primarily from the Battlefield, Need for Speed, and NCAA Football franchises. This decrease was partially offset by a \$585 million increase in sales primarily from the Dragon Age, FIFA, and FIFA World Cup franchises, and Titanfall.

## Digital

For the nine months ended December 31, 2014, digital was \$1,628 million, an increase of \$385 million, or 31 percent, as compared to the nine months ended December 31, 2013. This increase is due to (1) a \$97 million or 47 percent increase in full-game download sales primarily driven by FIFA 15, Dragon Age: Inquisition, The Sims 4, and Titanfall, (2) a \$161 million or 31 percent increase in extra content and free-to-download sales primarily driven by FIFA Ultimate Team and Madden Ultimate Team, (3) an \$82 million or 43 percent increase in subscription sales primarily driven by Battlefield 4 Premium, and (4) a \$45 million or 14 percent increase in mobile revenue primarily driven by FIFA Online 3, FIFA 15 Mobile, The Sims Free Play, and Madden NFL Mobile.



Table of Contents

## Revenue Deferral

Revenue Deferral for the nine months ended December 31, 2014 increased \$207 million, or 8 percent, as compared to the nine months ended December 31, 2013. This increase was primarily due to a \$316 million increase in Net Revenue before Revenue Deferral related to our packaged goods and other and digital sales during the nine months ended December 31, 2014 as compared to the nine months ended December 31, 2013.

## Recognition of Revenue Deferral

The Recognition of Revenue Deferral for the nine months ended December 31, 2014 increased \$769 million, or 39 percent, as compared to the nine months ended December 31, 2013. This increase was primarily due to (1) an increase in digital and packaged goods sold through retail during the preceding six and nine-month period, and (2) the increase in our estimated offering period, which was implemented during the second quarter of fiscal 2014 for packaged goods sold through retail from six to nine months. This change in estimate resulted in an estimated increase to net revenue and net income of \$466 million and an increase of \$1.45 of diluted earnings per share for the nine months ended December 31, 2014.

## Cost of Revenue

## Cost of Revenue Quarterly Analysis

Total cost of revenue for the three months ended December 31, 2014 and 2013 was as follows (in millions):

	December 31, 2014	% of Related Net Revenue	December 31, 2013	% of Related Net Revenue	% Change	Change as a % of Related Net Revenue
Cost of revenue:						
Product	\$ 300	49.5	% \$ 438	90.3	% (31.5)	)% (40.8)
Service and other	101	19.4	% 79	24.5	% 27.8	% (5.1)
Total cost of revenue	\$ 401	35.6	% \$ 517	64.0	% (22.4)	)% (28.4)

## Cost of Product Revenue

Cost of product revenue consists of (1) product costs, (2) certain royalty expenses for celebrities, professional sports and other organizations, and independent software developers, (3) manufacturing royalties, net of volume discounts and other vendor reimbursements, (4) expenses for defective products, (5) write-offs of post launch prepaid royalty costs and losses on previously unrecognized licensed intellectual property commitments, (6) amortization of certain intangible assets, (7) personnel-related costs, and (8) warehousing and distribution costs. We generally recognize volume discounts when they are earned from the manufacturer (typically in connection with the achievement of unit-based milestones); whereas other vendor reimbursements are generally recognized as the related revenue is recognized.

Cost of product revenue decreased by \$138 million, or 31.5 percent in the three months ended December 31, 2014, as compared to the three months ended December 31, 2013. Cost of product revenue decreased primarily due to volume, as Net Revenue before Revenue Deferral from our product sales decreased during the three months ended December 31, 2014, as compared to the three months ended December 31, 2013.

## Cost of Service and Other Revenue

Cost of service and other revenue consists primarily of (1) data center and bandwidth costs associated with hosting our online games and websites, (2) associated royalty costs, (3) credit card fees associated with our service revenue, (4) server costs related to our website advertising business, and (5) platform processing fees from operating our

website-based games on third party platforms.

Cost of service and other revenue increased by \$22 million, or 27.8 percent in the three months ended December 31, 2014, as compared to the three months ended December 31, 2013. The increase was due to an increase in royalty-related costs primarily driven by FIFA Ultimate Team and Madden Ultimate Team.

**Total Cost of Revenue as a Percentage of Total Net Revenue**

During the three months ended December 31, 2014, total cost of revenue as a percentage of total net revenue decreased by 28.4 percent as compared to the three months ended December 31, 2013. This decrease as a percentage of net revenue was primarily

Table of Contents

due to a 34 percent increase in net revenue from our digital products and services that generally have lower costs than our packaged goods and other products.

## Cost of Revenue Year-to-Date Analysis

Total cost of revenue for the nine months ended December 31, 2014 and 2013 was as follows (in millions):

	December 31, 2014	% of Related Net Revenue	December 31, 2013	% of Related Net Revenue	% Change	Change as a % of Related Net Revenue
Cost of revenue:						
Product	\$ 899	47.3	% \$ 909	66.0	% (1.1)	)% (18.7)
Service and other	296	20.7	% 215	20.0	% 37.7	% 0.7
Total cost of revenue	\$ 1,195	35.9	% \$ 1,124	45.8	% 6.3	% (9.9)

## Cost of Product Revenue

Cost of product revenue decreased by \$10 million, or 1.1 percent in the nine months ended December 31, 2014, as compared to the nine months ended December 31, 2013. Cost of product revenue decreased primarily due to an increase in net revenue before revenue deferral from our digital product sales that generally have lower costs than our packaged goods and other product sales in the three months ended December 31, 2014, as compared to the three months ended December 31, 2013, partially offset by a loss of \$122 million on a previously unrecognized licensed intellectual property commitment during the three months ended June 30, 2014.

## Cost of Service and Other Revenue

Cost of service and other revenue increased by \$81 million, or 37.7 percent in the nine months ended December 31, 2014, as compared to the nine months ended December 31, 2013. The increase was primarily due to an increase in product and royalty-related costs due to Titanfall, which launched in the fourth quarter of fiscal year 2014.

## Total Cost of Revenue as a Percentage of Total Net Revenue

During the nine months ended December 31, 2014, total cost of revenue as a percentage of total net revenue decreased by 9.9 percent as compared to the nine months ended December 31, 2013. Excluding the loss of \$122 million on previously unrecognized license intellectual property, total cost of revenue as a percentage of total net revenue decreased 13.6 percent as a result of an increase in our digital products and services that generally have a lower cost than our packaged goods and other products.

## Research and Development

Research and development expenses consist of expenses incurred by our production studios for personnel-related costs, related overhead costs, contracted services, depreciation and any impairment of prepaid royalties for pre-launch products. Research and development expenses for our online products include expenses incurred by our studios consisting of direct development and related overhead costs in connection with the development and production of our online games. Research and development expenses also include expenses associated with the development of network infrastructure, software licenses and maintenance, and management overhead.

Research and development expenses for the three and nine months ended December 31, 2014 and 2013 were as follows (in millions):

	December 31, 2014	% of Net Revenue	December 31, 2013	% of Net Revenue	\$ Change	% Change
Three months ended	\$283	25	% \$275	34	% \$8	3
Nine months ended	\$809	24	% \$836	34	% \$(27)	(3)

Research and development expenses increased by \$8 million, or 3 percent, during the three months ended December 31, 2014, as compared to the three months ended December 31, 2013, primarily due to an \$8 million increase in incentive-based compensation and a loss of \$3 million primarily from our cash flow hedging activities during the three months ended December 31, 2014. This was partially offset by a \$7 million decrease in contracted services as a result of higher development contracted services in fiscal year 2014 due to Titanfall, as compared to the current fiscal year.

Table of Contents

Research and development expenses decreased by \$27 million or 3 percent, during the nine months ended December 31, 2014, as compared to the nine months ended December 31, 2013, primarily due to a \$17 million decrease in personnel-related costs resulting from a decrease in headcount and a \$25 million decrease in contracted services as a result of higher development contracted services in fiscal year 2014 due to Titanfall, Battlefield 4, and EA Sports UFC as compared to the current fiscal year. This was partially offset by a \$10 million increase in facility-related costs related to higher rent and a loss of \$5 million primarily from our cash flow hedging activities incurred during the nine months ended December 31, 2014.

**Marketing and Sales**

Marketing and sales expenses consist of personnel-related costs, related overhead costs, advertising, marketing and promotional expenses, net of qualified advertising cost reimbursements from third parties.

Marketing and sales expenses for the three and nine months ended December 31, 2014 and 2013 were as follows (in millions):

	December 31, 2014	% of Net Revenue	December 31, 2013	% of Net Revenue	\$ Change	% Change
Three months ended	\$169	15	% \$214	26	% \$(45)	(21)%
Nine months ended	\$482	14	% \$525	21	% \$(43)	(8)%

Marketing and sales expenses decreased by \$45 million, or 21 percent, during the three months ended December 31, 2014, as compared to the three months ended December 31, 2013, primarily due to a \$42 million decrease in advertising and promotional spending on our franchises due to fewer frontline title releases as compared to the prior year, and changes in the way we advertise.

Marketing and sales expenses decreased by \$43 million, or 8 percent, during the nine months ended December 31, 2014, as compared to the nine months ended December 31, 2013, primarily due to (1) a \$17 million decrease in advertising and promotional spending on our franchises and (2) a \$7 million decrease in contracted services due to fewer frontline title releases in the current year as compared to the prior year, (3) an \$11 million decrease in personnel-related costs resulting from a decrease in headcount, (4) an \$8 million decrease in facility-related costs, during the nine months ended December 31, 2014.

**General and Administrative**

General and administrative expenses consist of personnel and related expenses of executive and administrative staff, corporate functions such as finance and human resources, related overhead costs, fees for professional services such as legal and accounting, and allowances for doubtful accounts.

General and administrative expenses for the three and nine months ended December 31, 2014 and 2013 were as follows (in millions):

	December 31, 2014	% of Net Revenue	December 31, 2013	% of Net Revenue	\$ Change	% Change
Three months ended	\$107	10	% \$91	11	% \$16	18%
Nine months ended	\$287	9	% \$305	12	% \$(18)	(6)%

General and administrative expenses increased \$16 million, or 18 percent, primarily due to an \$8 million increase in personnel-related costs and incentive-based compensation and a \$9 million increase primarily related to litigation matters during the three months ended December 31, 2014.

General and administrative expenses decreased \$18 million, or 6 percent, primarily due to a \$30 million accrual related to the anticipated settlement of a litigation matter and a \$10 million loss on a license, both related to our college football franchise, incurred during the nine months ended December 31, 2013. This was partially offset by a \$16 million increase in personnel-related costs and incentive-based compensation and a \$9 million increase primarily



related to litigation matters during the nine months ended December 31, 2014.

Table of Contents

## Acquisition-Related Contingent Consideration

Acquisition-related contingent consideration for the three and nine months ended December 31, 2014 and 2013 were as follows (in millions):

	December 31, 2014	% of Net Revenue	December 31, 2013	% of Net Revenue	\$ Change	% Change
Three months ended	\$—	—	% \$—	—	% \$—	—
Nine months ended	\$(2	) —	% \$(37	) (2	)% \$35	95

During the three months ended December 31, 2014, acquisition-related contingent consideration remained consistent, as compared to the three months ended December 31, 2013.

During the nine months ended December 31, 2014, acquisition-related contingent consideration decreased by \$35 million, or 95 percent, respectively, as compared to the nine months ended December 31, 2013, primarily resulting from changes in the fair market value of the acquisition-related contingent consideration of our PopCap acquisition during the prior year. The PopCap earn-out expired on December 31, 2013. No payments were made under this earn-out.

## Interest and Other Income (Expense), Net

Interest and other income (expense), net, for the three and nine months ended December 31, 2014 and 2013 were as follows (in millions):

	December 31, 2014	% of Net Revenue	December 31, 2013	% of Net Revenue	\$ Change	% Change
Three months ended	\$(6	) (1	)% \$(6	) (1	)% \$—	—
Nine months ended	\$(20	) (1	)% \$(19	) (1	)% \$(1	) (5

During the three and nine months ended December 31, 2014, interest and other expense, net, remained relatively consistent, as compared to the three and nine months ended December 31, 2013.

## Income Taxes

Provision for income taxes for the three and nine months ended December 31, 2014 and 2013 were as follows (in millions):

	December 31, 2014	Effective Tax Rate	December 31, 2013	Effective Tax Rate
Three months ended	14	9.0	% 10	3.4
Nine months ended	48	9.1	% 29	8.8

Our effective tax rate for the three and nine months ended December 31, 2014 was 9.0 percent and 9.1 percent, respectively, as compared to 3.4 percent and 8.8 percent, respectively, for the same periods of fiscal year 2014. The effective tax rate for the three and nine months ended December 31, 2014 and 2013 differs from the statutory rate of 35.0 percent primarily due to the utilization of U.S. deferred tax assets, which were subject to a valuation allowance and non-U.S. profits subject to a reduced or zero tax rate. The effective tax rate for the three and nine months ended December 31, 2014 differs from the same period in fiscal year 2014 primarily due to differences in the pre-tax income or loss. In addition, the effective tax rate for the nine months ended December 31, 2014 differs from the same period in fiscal year 2014 primarily due to a discrete expense of \$16 million recorded in the nine months ended December 31, 2014 for excess tax benefits from stock-based compensation deductions allocated directly to contributed capital. Historically, we have considered undistributed earnings of our foreign subsidiaries to be indefinitely reinvested outside of the United States and, accordingly, no U.S. taxes have been provided thereon. We currently intend to continue to indefinitely reinvest the undistributed earnings of our foreign subsidiaries outside of the United States.



Table of Contents

## LIQUIDITY AND CAPITAL RESOURCES

(In millions)	As of December 31, 2014	As of March 31, 2014	Increase/(Decrease)
Cash and cash equivalents	\$2,166	\$1,782	\$384
Short-term investments	774	583	191
Total	\$2,940	\$2,365	\$575
Percentage of total assets	48	% 41	%
(In millions)	Nine Months Ended December 31, 2014	2013	Change
Cash provided by operating activities	\$869	\$431	\$438
Cash used in investing activities	(260	) (25	) (235
Cash provided by (used in) financing activities	(195	) 50	(245
Effect of foreign exchange on cash and cash equivalents	(30	) (2	) (28
Net increase in cash and cash equivalents	\$384	\$454	\$(70

## Changes in Cash Flow

Operating Activities. Cash provided by operating activities increased \$438 million during the nine months ended December 31, 2014 as compared to the nine months ended December 31, 2013. The change is primarily due to a \$316 million increase in Net Revenue before Revenue Deferral and a \$88 million decrease in research and development, marketing and sales, and general and administrative expenses during the nine months ended December 31, 2014 as compared to the nine months ended December 31, 2013.

Investing Activities. Cash used in investing activities increased \$235 million during the nine months ended December 31, 2014 as compared to the nine months ended December 31, 2013 primarily driven by a \$447 million increase in purchases of short-term investments. This was partially offset by a \$189 million increase in proceeds from the sales and maturities of short-term investments and an \$18 million decrease in capital expenditures during the nine months ended December 31, 2014 as compared to the nine months ended December 31, 2013.

Financing Activities. Cash used in financing activities increased \$245 million during the nine months ended December 31, 2014 as compared to the nine months ended December 31, 2013 primarily due to (1) \$242 million used to repurchase and retire common stock during the nine months ended December 31, 2014 as compared to no stock repurchases during the nine months ended December 31, 2013, and (2) a decrease of \$20 million in proceeds received from the exercise of stock options during the nine months ended December 31, 2014 as compared to the nine months ended December 31, 2013. This was offset by a \$16 million excess tax benefit from stock compensation recognized during the nine months ended December 31, 2014 compared to no benefit recognized during the nine months ended December 31, 2013.

## Short-term Investments

Due to our mix of fixed and variable rate securities, our short-term investment portfolio is susceptible to changes in short-term interest rates. As of December 31, 2014, our short-term investments had gross unrealized gains of less than \$1 million, or less than 1 percent of the total in short-term investments, and gross unrealized losses of \$1 million, or less than 1 percent of the total in short-term investments. From time to time, we may liquidate some or all of our short-term investments to fund operational needs or other activities, such as capital expenditures, business acquisitions or stock repurchase programs. Depending on which short-term investments we liquidate to fund these activities, we could recognize a portion, or all, of the gross unrealized gains or losses.

## Fiscal 2011 Restructuring

In connection with our fiscal 2011 restructuring plan, we expect to incur cash expenditures through March 2015 of approximately \$7 million during the remainder of fiscal year 2015 and \$18 million in fiscal year 2016.



## Table of Contents

### Financing Arrangement

In July 2011, we issued \$632.5 million aggregate principal amount of 0.75% Convertible Senior Notes due 2016 (the “Notes”). We used the net proceeds of the Notes to finance the cash consideration of our acquisition of PopCap, which closed in August 2011.

During the quarter ended December 31, 2014, the Sales Price Condition was met.

Note 12 - Financing Arrangements to the Condensed Consolidated Financial Statements as it relates to the Notes, the convertibility of the Notes, and the Convertible Note Hedge and Warrants is incorporated by reference into this Item 2.

### Credit Facility

On August 30, 2012, we entered into a \$500 million senior unsecured revolving credit facility with a syndicate of banks. As of December 31, 2014, no amounts were outstanding under the credit facility. Note 12 - Financing Arrangements to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our credit facility is incorporated by reference into this Item 2.

### Financial Condition

We believe that our cash, cash equivalents, short-term investments, cash generated from operations and available financing facilities will be sufficient to meet our operating requirements for at least the next 12 months, including working capital requirements, capital expenditures, and potentially, future acquisitions, stock repurchases, or strategic investments. We may choose at any time to raise additional capital to strengthen our financial position, facilitate expansion, repurchase our stock, pursue strategic acquisitions and investments, and/or to take advantage of business opportunities as they arise. There can be no assurance, however, that such additional capital will be available to us on favorable terms, if at all, or that it will not result in substantial dilution to our existing stockholders.

As of December 31, 2014, approximately \$999 million of our cash, cash equivalents, and short-term investments were domiciled in foreign tax jurisdictions. While we have no plans to repatriate these funds to the United States in the short term, if we choose to do so, we may be required to accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided. We made a one-time repatriation of \$700 million from certain of our wholly-owned subsidiaries during the three months ended March 31, 2014. This repatriation did not have a material impact on our effective tax rate for fiscal year 2014 due to the deferred tax valuation allowance.

In May 2014, a special committee of our Board of Directors, on behalf of the full Board of Directors, authorized a new program to repurchase up to \$750 million of our common stock. This new stock repurchase program, which expires on May 31, 2016, supersedes and replaces the stock repurchase authorization approved by our Board of Directors in July 2012. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase any specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and nine months ended December 31, 2014, we repurchased approximately 2.5 million and 6.5 million shares of our common stock for approximately \$97 million and \$242 million, respectively.

We have a “shelf” registration statement on Form S-3 on file with the SEC. This shelf registration statement, which includes a base prospectus, allows us at any time to offer any combination of securities described in the prospectus in one or more offerings. Unless otherwise specified in a prospectus supplement accompanying the base prospectus, we would use the net proceeds from the sale of any securities offered pursuant to the shelf registration statement for general corporate purposes, including for working capital, financing capital expenditures, research and development, marketing and distribution efforts, and if opportunities arise, for acquisitions or strategic alliances. Pending such uses, we may invest the net proceeds in interest-bearing securities. In addition, we may conduct concurrent or other financings at any time.

Our ability to maintain sufficient liquidity could be affected by various risks and uncertainties including, but not limited to, those related to customer demand and acceptance of our products, our ability to collect our accounts receivable as they become due, successfully achieving our product release schedules and attaining our forecasted sales

objectives, the impact of acquisitions and other strategic transactions in which we may engage, the impact of competition, economic conditions in the United States and abroad, the seasonal and cyclical nature of our business and operating results, risks of product returns and the other risks described in the “Risk Factors” section, included in Part II, Item 1A of this report.

Table of Contents

Contractual Obligations and Commercial Commitments

Note 13 - Commitments and Contingencies to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our contractual obligations and commercial commitments is incorporated by reference into this Item 2.

OFF-BALANCE SHEET COMMITMENTS

Lease Commitments

As of December 31, 2014, we leased certain facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.

Director Indemnity Agreements

We entered into indemnification agreements with each of the members of our Board of Directors at the time they joined the Board to indemnify them to the extent permitted by law against any and all liabilities, costs, expenses, amounts paid in settlement and damages incurred by the directors as a result of any lawsuit, or any judicial, administrative or investigative proceeding in which the directors are sued or charged as a result of their service as members of our Board of Directors.



Table of Contents

## Item 3: Quantitative and Qualitative Disclosures About Market Risk

**MARKET RISK**

We are exposed to various market risks, including changes in foreign currency exchange rates, interest rates and market prices, which have experienced significant volatility in light of the global economic downturn. Market risk is the potential loss arising from changes in market rates and market prices. We employ established policies and practices to manage these risks. Foreign currency forward contracts are used to hedge anticipated exposures or mitigate some existing exposures subject to foreign exchange risk as discussed below. While we do not hedge our short-term investment portfolio, we protect our short-term investment portfolio against different market risks, including interest rate risk as discussed below. Our cash and cash equivalents portfolio consists of highly liquid investments with insignificant interest rate risk and original or remaining maturities of three months or less at the time of purchase. We do not enter into derivatives or other financial instruments for trading or speculative purposes and do not hedge our market price risk relating to marketable equity securities, if any.

**Foreign Currency Exchange Rate Risk**

**Cash Flow Hedging Activities.** From time to time, we hedge a portion of our foreign currency risk related to forecasted foreign-currency-denominated sales and expense transactions by purchasing foreign currency forward contracts that generally have maturities of 15 months or less. These transactions are designated and qualify as cash flow hedges. Our hedging programs are designed to reduce, but do not entirely eliminate, the impact of currency exchange rate movements in net revenue and research and development expenses.

**Balance Sheet Hedging Activities.** We use foreign currency forward contracts to mitigate foreign currency risk associated with foreign-currency-denominated monetary assets and liabilities, primarily intercompany receivables and payables. The foreign currency forward contracts generally have a contractual term of three months or less and are transacted near month-end.

We believe the counterparties to our foreign currency forward contracts are creditworthy multinational commercial banks. While we believe the risk of counterparty nonperformance is not material, a sustained decline in the financial stability of financial institutions as a result of disruption in the financial markets could affect our ability to secure credit-worthy counterparties for our foreign currency hedging programs.

Notwithstanding our efforts to mitigate some foreign currency exchange rate risks, there can be no assurance that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations. As of December 31, 2014, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 20 percent would have resulted in potential declines in the fair value on our foreign currency forward contracts used in cash flow hedging of \$28 million and \$55 million, respectively. As of December 31, 2014, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 20 percent would have resulted in potential losses on our foreign currency forward contracts used in balance sheet hedging of \$35 million and \$70 million, respectively. This sensitivity analysis assumes an adverse shift of all foreign currency exchange rates; however, all foreign currency exchange rates do not always move in such manner and actual results may differ materially. Note 4 - Derivative Financial Instruments to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our derivative financial instruments is incorporated by reference into this Item 3.

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our short-term investment portfolio. We manage our interest rate risk by maintaining an investment portfolio generally consisting of debt instruments of high credit quality and relatively short maturities. However, because short-term investments mature relatively quickly and are required to be reinvested at the then-current market rates, interest income on a portfolio consisting of short-term investments is more subject to market fluctuations than a portfolio of longer term investments. Additionally, the contractual terms of the investments do not permit the issuer to call, prepay or otherwise settle the investments at prices less than the stated par value. Our investments are held for purposes other than trading. Also, we do not use derivative financial instruments in our short-term investment portfolio.

Table of Contents

As of December 31, 2014, our short-term investments were classified as available-for-sale securities and, consequently, were recorded at fair value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive income, net of tax, in stockholders' equity.

Notwithstanding our efforts to manage interest rate risks, there can be no assurance that we will be adequately protected against risks associated with interest rate fluctuations. At any time, a sharp change in interest rates could have a significant impact on the fair value of our investment portfolio. The following table presents the hypothetical changes in the fair value of our short-term investment portfolio as of December 31, 2014, arising from potential changes in interest rates. The modeling technique estimates the change in fair value from immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points ("BPS"), 100 BPS, and 150 BPS.

(In millions)	Valuation of Securities Given an Interest Rate Decrease of X Basis Points			Fair Value as of December 31, 2014	Valuation of Securities Given an Interest Rate Increase of X Basis Points		
	(150 BPS)	(100 BPS)	(50 BPS)		50 BPS	100 BPS	150 BPS
Corporate bonds	\$404	\$402	\$400	\$ 398	\$396	\$394	\$392
U.S. treasury securities	172	170	169	168	167	166	164
U.S. agency securities	129	128	127	126	125	124	123
Commercial paper	83	83	83	82	82	82	82
Total short-term investments	\$788	\$783	\$779	\$ 774	\$770	\$766	\$761

Table of Contents

Item 4. Controls and Procedures

Definition and limitations of disclosure controls

Our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this report, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our management evaluates these controls and procedures on an ongoing basis.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. These limitations include the possibility of human error, the circumvention or overriding of the controls and procedures and reasonable resource constraints. In addition, because we have designed our system of controls based on certain assumptions, which we believe are reasonable, about the likelihood of future events, our system of controls may not achieve its desired purpose under all possible future conditions. Accordingly, our disclosure controls and procedures provide reasonable assurance, but not absolute assurance, of achieving their objectives.

Evaluation of disclosure controls and procedures

Our Chief Executive Officer and our Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures, believe that as of the end of the period covered by this report, our disclosure controls and procedures were effective in providing the requisite reasonable assurance that material information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding the required disclosure.

Changes in internal control over financial reporting

There has been no change in our internal control over financial reporting identified in connection with our evaluation that occurred during the three months ended December 31, 2014 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Table of Contents

**PART II – OTHER INFORMATION**

**Item 1. Legal Proceedings**

The information under the subheading “Legal Proceedings” in Note 13 - Commitments and Contingencies to the Condensed Consolidated Financial Statements in this Form 10-Q is incorporated by reference into this Part II.

**Item 1A. Risk Factors**

Our business is subject to many risks and uncertainties, which may affect our future financial performance. If any of the events or circumstances described below occurs, our business and financial performance could be harmed, our actual results could differ materially from our expectations and the market value of our stock could decline. The risks and uncertainties discussed below are not the only ones we face. There may be additional risks and uncertainties not currently known to us or that we currently do not believe are material that may harm our business and financial performance.

Our business is intensely competitive and “hit” driven. If we do not deliver “hit” products and services, or if consumers prefer our competitors’ products or services over our own, our operating results could suffer.

Competition in our industry is intense. Many new products and services are regularly introduced in each major industry segment (console, mobile and PC free-to-download), but only a relatively small number of “hit” titles account for a significant portion of total revenue in each segment. Our competitors range from large established companies to emerging start-ups, and we expect new competitors to continue to emerge throughout the world. If our competitors develop and market more successful products or services, offer competitive products or services at lower price points or based on payment models perceived as offering a better value proposition, or if we do not continue to develop consistently high-quality and well-received products and services, our revenue, margins, and profitability will decline.

In recent years, we have narrowed our product portfolio in an effort to focus on developing high-quality products with the potential to become “hits”. High-quality titles, even if highly-reviewed, may not turn into “hit” products. Many “hit” products within our industry are iterations of prior hit products with large established consumer bases and significant brand recognition, which makes competing in certain product categories challenging. In addition, hit products or services of our competitors may take a larger share of consumer spending than we anticipate, which could cause our products and services to underperform relative to revenue expectations. Publishing fewer major titles also concentrates risk in a smaller number of titles and means each major title has greater associated risk. The underperformance of a single major title may have a large adverse impact on our financial results.

Our operating results will be adversely affected if we do not consistently meet our product development schedules or if key events or sports seasons that we tie our product release schedules to are delayed or cancelled.

Our business is highly seasonal with the highest levels of consumer demand and a significant percentage of our sales occurring in the quarter ending in December and a seasonal low in sales volume in the quarter ending in June. While our sales generally follow this seasonal trend, there can be no assurance that this trend will continue. If we miss key selling periods for products, for any reason, including product delays, product cancellations, or delayed introduction of a new platform for which we have developed products, our sales are likely to suffer significantly. Additionally, macroeconomic conditions or the occurrence of unforeseen events that negatively impact retailer or consumer buying patterns during the quarter ending in December are likely to affect us disproportionately. Our ability to meet product development schedules is affected by a number of factors both within and outside our control, including the creative processes involved, the coordination of large and sometimes geographically dispersed development teams, the increasing complexity of our products and the platforms for which they are developed, and the need to fine-tune our products prior to their release. We have experienced development delays for our products in the past, which caused us to push back or cancel release dates. We also seek to release certain products in conjunction with key events, such as the beginning of a sports season or major sporting event, or the release of a related movie. If a key event or sports

season to which our product release schedule is tied were to be delayed or cancelled, our sales would likely suffer disproportionately. In the future, any failure to meet anticipated production or release schedules would likely result in a delay of revenue and/or possibly a significant shortfall in our revenue, increase our development and/or marketing expenses, harm our profitability, and cause our operating results to be materially different than anticipated.

The console segment of the entertainment software industry is cyclical, driven by the periodic introduction of new console systems. During the transition period to new console systems, our operating results may be more volatile.

New video game console systems have historically been developed and released every few years, which causes the video game software market to be cyclical as well. In periods of transition from legacy generation consoles to new generation consoles,

## Table of Contents

sales of software for legacy generation console systems typically slow or decline in response to the anticipated and actual introduction of new consoles, and new generation console software sales typically stabilize after new consoles are widely-established with the consumer base.

During fiscal year 2014, consumers responded to the introduction of new consoles-the PlayStation 4 from Sony and Xbox One from Microsoft-by purchasing fewer software products for the Sony PlayStation 3 and Microsoft Xbox 360 legacy generation consoles. We expect this trend to continue. This trend could also accelerate faster than anticipated and may put downward pressure on legacy generation video game software pricing, which could negatively affect our operating results. Our revenues from new generation software sales may not offset the negative effects of this trend on our operating results. In the near term, we expect to continue to develop and market products and services for the Xbox 360 and PlayStation 3, while also developing and marketing products and services for the Xbox One and PlayStation 4. We do not control the unit volumes of the new generation console systems made available for sale or the rates at which consumers purchase these consoles. As a result, our operating results during this transitional period may be more volatile and difficult to predict.

Our business is dependent on the success and availability of video game hardware systems and devices manufactured by third parties, as well as our ability to develop commercially successful products and services for these systems and devices.

The success of our business is driven in part by the commercial success and adequate supply of video game console systems, PCs, mobile phones and tablets manufactured by third parties. Our success also depends on our ability to accurately predict which platforms will be successful in the marketplace and our ability to develop commercially successful products and services for these platforms. We must make product development decisions and commit significant resources well in advance of anticipated platform release dates and may incur significant expense to adjust our product portfolio and development efforts in response to changing consumer platform preferences. Additionally, we may enter into certain exclusive licensing arrangements that affect our ability to deliver or market products or services on certain platforms. A platform for which we are developing products and services may not succeed to the extent expected or new platforms may take market share and game software consumers away from platforms for which we have devoted significant resources. If consumer demand for the platforms for which we are developing products and services is lower than our expectations, we may be unable to fully recover the investments we have made in developing our products and services, and our financial performance will be harmed. Alternatively, a platform for which we have not devoted significant resources could be more successful than we had initially anticipated, causing us to miss out on meaningful revenue opportunities.

Our adoption of new business models could fail to produce our desired financial returns.

We are actively seeking to monetize game properties through a variety of new business models, including online distribution of full games and additional content, free-to-download games supported by advertising and/or micro-transactions and subscription services. Forecasting our revenues and profitability for these new business models is inherently uncertain and volatile. Our actual revenues and profits for these businesses may be significantly greater or less than our forecasts. Additionally, these new business models could fail for one or more of our titles, resulting in the loss of our investment in the development and infrastructure needed to support these new business models, and the opportunity cost of diverting management and financial resources away from more successful businesses.

Technology changes rapidly in our business and if we fail to anticipate or successfully develop games for new platforms and services, adopt new distribution technologies or methods, or implement new technologies in our games, the quality, timeliness and competitiveness of our products and services will suffer.

Rapid technology changes in our industry require us to anticipate, sometimes years in advance, which technologies we must implement and take advantage of in order to make our products and services competitive in the market. We have invested, and in the future may invest, in new business strategies, technologies, products, and services. Such endeavors may involve significant risks and uncertainties, and no assurance can be given that the technology we choose to adopt and the platforms, products and services that we pursue will be successful and will not materially adversely affect our reputation, financial condition, and operating results.

Our product development usually starts with particular platforms and distribution methods in mind, and a range of technical development goals that we hope to be able to achieve. We may not be able to achieve these goals, or our competition may be able to achieve them more quickly and effectively than we can. In either case, our products and services may be technologically inferior to our competitors', less appealing to consumers, or both. If we cannot achieve our technology goals within the original development schedule for our products and services, then we may delay their release until these technology goals can be

## Table of Contents

achieved, which may delay or reduce revenue and increase our development expenses. Alternatively, we may increase the resources employed in research and development in an attempt to accelerate our development of new technologies, either to preserve our product or service launch schedule or to keep up with our competition, which would increase our development expenses. We may also miss opportunities to adopt technology, or develop products and services for new platforms or services that become popular with consumers, which could adversely affect our revenues. It may take significant time and resources to shift our focus to such technologies or platforms, putting us at a competitive disadvantage.

We may experience outages and disruptions of our online services that harm our business.

We expect to continue to invest in technology, hardware and software to support our portfolio of online products and services. Launching and operating online games and services, developing related technologies and implementing online business initiatives is expensive and complex. Execution of these initiatives could result in inefficiencies or operational failures, such as significant user connectivity issues. These efforts, as well as the deepening integration of online features and functionality into our products and services generally, may also result in increased vulnerability to cyber attacks that attempt to damage, disrupt or gain unauthorized access to our networks, computer systems and supporting infrastructure, many of which may be difficult to detect. Operational failures or successful cyber attacks could lead to consumers being unable to use our products and services or other negative effects upon the products, services and user experience we offer, possibly resulting in damage to our reputation, the loss of current and potential customers and harm to our business. In addition, our online products and services could be adversely impacted by outages, disruptions and failures in basic network and electrical infrastructure, as well as in the online platforms of key business partners who offer or support our products and services.

Our business could be adversely affected if our consumer protection, data privacy and security practices are not adequate, or perceived as being inadequate, to prevent data breaches, or by the application of consumer protection and data privacy laws generally.

In the course of our business, we collect, process, store and use consumer information, including personal information, passwords and credit card information. Although we take measures to protect consumer information from unauthorized access, acquisition, disclosure and misuse, our security controls may not be able to prevent the improper or unauthorized access, acquisition or disclosure of such consumer information. In addition, third party vendors and business partners which in the course of our business receive access to consumer information that we collect also may not be able to prevent data security breaches with respect to the consumer information we provide them. The unauthorized access, acquisition or disclosure of consumer information could significantly harm our reputation, compel us to comply with disparate breach notification laws and otherwise subject us to substantial legal liability. A perception that we do not adequately secure consumer information could result in a loss of current or potential consumers and business partners, as well as a loss of anticipated revenues. Our key business partners also face these same risks with respect to consumer information they collect and data security breaches with respect to such information could cause reputational harm to them and negatively impact our ability to offer our products and services through their platforms.

In addition, the rate of privacy law-making is accelerating globally, and the interpretation and application of consumer protection and data privacy laws in the United States, Europe and elsewhere are often uncertain, contradictory and in flux. It is possible that these laws may be interpreted or applied in a manner that is adverse to us or otherwise inconsistent with our practices, which could result in litigation, potential legal liability or require us to change our practices in a manner adverse to our business. As a result, our reputation may be harmed, we could incur substantial costs, and we could lose both customers and revenues.



Our reputation with consumers is critical to our success as a company. Negative consumer perceptions about our brands, products, services and/or business practices may damage our business and the costs incurred in addressing consumer concerns may increase our operating expenses.

Individual consumers form our ultimate customer base, and consumer expectations regarding the quality, performance and integrity of our products and services are high. Consumers may be critical of our brands, products, services and/or business practices for a wide variety of reasons. These negative consumer reactions may not be foreseeable or within our control to manage effectively, including perceptions about gameplay fairness, negative player reactions to game content, components and services, or objections to certain of our business practices. We value our consumers and expect to take actions to address consumer concerns as appropriate, including actions that may result in additional expenditures and the loss of revenue. Negative consumer sentiment about our business practices can also result in investigations from regulatory agencies and consumer groups, as well as litigation, which, regardless of their outcome, may be damaging to our reputation and harm our business.

Table of Contents

If we release defective products or services, our operating results could suffer.

Products and services such as ours are extremely complex software programs, and are difficult to develop and distribute. We have quality controls in place to detect defects in our products and services before they are released. Nonetheless, these quality controls are subject to human error, overriding, and reasonable resource constraints. Therefore, these quality controls and preventative measures may not be effective in detecting defects in our products and services before they have been released into the marketplace. In such an event, we could be required to or may find it necessary to voluntarily recall a product or suspend the availability of the product or service, which could significantly harm our business and operating results.

Our business is subject to increasing regulation and the adoption of proposed legislation we oppose could negatively impact our business.

Legislation is continually being introduced in the United States and other countries to mandate rating requirements or set other restrictions on the advertisement or distribution of entertainment software based on content. In the United States, most courts, including the United States Supreme Court, that have ruled on such legislation have ruled in a manner favorable to the interactive entertainment industry. Some foreign countries have adopted ratings regulations and certain countries allow government censorship of entertainment software products. Adoption of government ratings system or restrictions on distribution of entertainment software based on content could harm our business by limiting the products we are able to offer to our customers and compliance with new and possibly inconsistent regulations for different territories could be costly or delay the release of our products.

As we increase the online delivery of our products and services, we are subject to a number of foreign and domestic laws and regulations that affect companies conducting business on the Internet. In addition, laws and regulations relating to user privacy, data collection and retention, content, advertising and information security have been adopted or are being considered for adoption by many countries throughout the world. The costs of compliance with these laws may increase in the future as a result of changes in interpretation. Furthermore, any failure on our part to comply with these laws or the application of these laws in an unanticipated manner may harm our business.

If we do not continue to attract and retain key personnel, we will be unable to effectively conduct our business.

The market for technical, creative, marketing and other personnel essential to the development and marketing of our products and services and management of our businesses is extremely competitive. Our leading position within the interactive entertainment industry makes us a prime target for recruiting of executives and key creative and technical talent. If we cannot successfully recruit and retain the employees we need, or replace key employees following their departure, our ability to develop and manage our business will be impaired.

If our marketing and advertising efforts fail to resonate with our customers, our business and operating results could be adversely affected.

Our products and services are marketed worldwide through a diverse spectrum of advertising and promotional programs such as online and mobile advertising, television advertising, retail merchandising, website development, event sponsorship and direct communications with our consumers including via email. Our ability to sell our products and services is dependent in part upon the success of these programs. If the marketing for our products and services fail to resonate with our customers, particularly during the critical holiday season or during other key selling periods, or as advertising rates or other media placement costs increase, these factors could have a material adverse impact on our business and operating results.



## Table of Contents

A significant portion of our sales are made to a relatively small number of key customers. If these customers reduce their purchases of our products and services or become unable to pay for them, our business could be harmed.

During the nine months ended December 31, 2014, approximately 70 percent of our North America net revenue was derived from our top ten customers. Though our products are available to consumers through a variety of retailers and directly through us, the concentration of our sales in one, or a few, large customers could lead to a short-term disruption in our sales if one or more of these customers significantly reduced their purchases or ceased to carry our products and services, and could make us more vulnerable to collection risk if one or more of these large customers became unable to pay for our products or declared bankruptcy. Additionally, our receivables from these large customers generally increase significantly in the December quarter as they make purchases in anticipation of the holiday selling season. Having such a large portion of our total net revenue concentrated in a few customers could reduce our negotiating leverage with these customers. If one or more of our key customers experience deterioration in their business, or become unable to obtain sufficient financing to maintain their operations, our business could be harmed.

Our channel partners have significant influence over the products and services that we offer on their platforms.

Our products and services are sold to customers, primarily through retailers and online through our channel partners, including Sony, Microsoft, Apple and Google. In many cases, our channel partners set the rates that we must pay to provide our games and services through their online channels. In certain cases, our channel partners retain flexibility to change their fee structures or adopt different fee structures for their online channels, which could adversely impact our costs, profitability and margins.

Outside of the financial arrangements, our agreements with our channel partners typically give them significant control over other aspects of the distribution of the products and services that we develop for their platform. For example, our agreements with Sony and Microsoft typically give significant control to them over the approval, manufacturing and distribution of our products and services, which could, in certain circumstances, leave us unable to get our products and services approved, manufactured and distributed to customers. For the nine months ended December 31, 2014, 66 percent of our net revenue was derived from products and services for Sony's PlayStation 3 and 4 and Microsoft's Xbox 360 and One consoles (combined across all four platforms). For our digital products and services delivered direct to consumers via digital channels such as Sony's PlayStation Network, Microsoft's Xbox LIVE Marketplace, Apple's App Store and the Google Play store, the channel partner has policies and guidelines that control the promotion and distribution of these titles and the features and functionalities that we are permitted to offer through the channel.

In addition, while we have negotiated agreements in place with our channel partners - these agreements reserve the right by our channel partners to determine and change unilaterally certain key terms and conditions, including the ability to change their user and developer policies and guidelines, which can negatively impact our business. If our channel partners establish terms that restrict our offerings through their channels, or significantly impact the financial terms on which these products or services are offered to our customers, our business could be harmed.

Acquisitions, investments and other strategic transactions could result in operating difficulties, dilution to our investors and other negative consequences.

We expect to continue making acquisitions or entering into other strategic transactions including (1) acquisitions of companies, businesses, intellectual properties, and other assets, (2) minority investments in strategic partners, and (3) investments in new interactive entertainment businesses (e.g., online and mobile publishing platforms) as part of our long-term business strategy. These transactions involve significant challenges and risks including that the transaction does not advance our business strategy, that we do not realize a satisfactory return on our investment, that we acquire

unknown liabilities, or that we experience difficulty in the integration of business systems and technologies, the integration and retention of new employees, or in the maintenance of key business and customer relationships of the businesses we acquire, or diversion of management's attention from our other businesses. These events could harm our operating results or financial condition.

Future acquisitions and investments could also involve the issuance of our equity and equity-linked securities (potentially diluting our existing stockholders), the incurrence of debt, contingent liabilities or amortization expenses, write-offs of goodwill, intangibles, or acquired in-process technology, or other increased cash and non-cash expenses, such as stock-based compensation. Any of the foregoing factors could harm our financial condition or prevent us from achieving improvements in our financial condition and operating performance that could have otherwise been achieved by us on a stand-alone basis. Our stockholders may not have the opportunity to review, vote on or evaluate future acquisitions or investments.

## Table of Contents

If we are unable to maintain or acquire licenses to include intellectual property owned by others in our games, or to maintain or acquire the rights to publish or distribute games developed by others, our business may be harmed.

Many of our products and services are based on or incorporate intellectual property owned by others. For example, our EA SPORTS products include rights licensed from major sports leagues and players' associations. Similarly, other products are based on film and literary licenses and our Hasbro products are based on a license for certain of Hasbro's toy and game properties. We also publish and distribute products developed and owned by third-parties under license agreements with these parties. Competition for these licenses and rights is intense. If we are unable to maintain these licenses and rights or obtain additional licenses or rights with significant commercial value, our revenues, profitability and cash flows may decline significantly. Competition for these licenses may also drive up the advances, guarantees and royalties that we must pay to licensors and developers, which could significantly increase our costs and reduce our profitability.

Our business is subject to risks generally associated with the entertainment industry, any of which could significantly harm our operating results.

Our business is subject to risks that are generally associated with the entertainment industry, many of which are beyond our control. These risks could negatively impact our operating results and include: the popularity, price and timing of our games and the platforms on which they are played; economic conditions that adversely affect discretionary consumer spending; changes in consumer demographics; the availability and popularity of other forms of entertainment; and critical reviews and public tastes and preferences, which may change rapidly and cannot necessarily be predicted.

We rely on business partners in many areas of our business and our business may be harmed if they are unable to honor their obligations to us or their actions may put us at risk.

We rely on various business partners, including third-party service providers, vendors, licensing partners, development partners, and licensees, among others, in many areas of our business. The actions of our business partners may put our business and our reputation at risk. In many cases, these third parties are given access to sensitive and proprietary information in order to provide services and support to our teams. These third parties may misappropriate our information and engage in unauthorized use of it. The failure of these third parties to provide adequate services and technologies, or the failure of the third parties to adequately maintain or update their services and technologies, could result in a disruption to our business operations. Further, disruptions in the financial markets and economic downturns may adversely affect our business partners and they may not be able to continue honoring their obligations to us. Alternative arrangements and services may not be available to us on commercially reasonable terms or we may experience business interruptions upon a transition to an alternative partner or vendor. If we lose one or more significant business partners, our business could be harmed.

We may be subject to claims of infringement of third-party intellectual property rights, which could harm our business.

From time to time, third parties may assert claims against us relating to patents, copyrights, trademarks, personal publicity rights, or other intellectual property rights related to technologies, products, content or delivery/payment methods that are important to our business. Although we believe that we make reasonable efforts to ensure that our products do not violate the intellectual property rights of others, it is possible that third parties still may claim infringement. For example, we may be subject to intellectual property infringement claims from certain individuals and companies who have acquired patent portfolios for the sole purpose of asserting such claims against other companies. In addition, many of our products are highly realistic and feature materials that are based on real world examples, which may be the subject of intellectual property infringement claims of others. From time to time, we

receive communications from third parties regarding such claims. Existing or future infringement claims against us, whether valid or not, may be time consuming and expensive to defend. Such claims or litigations could require us to pay damages and other costs, stop selling the affected products, redesign those products to avoid infringement, or obtain a license, all of which could be costly and harm our business. In addition, many patents have been issued that may apply to potential new modes of delivering, playing or monetizing game software products and services, such as those that we produce or would like to offer in the future. We may discover that future opportunities to provide new and innovative modes of game play and game delivery to consumers may be precluded by existing patents that we are unable to license on reasonable terms.

## Table of Contents

From time to time we may become involved in other legal proceedings, which could adversely affect us.

We are currently, and from time to time in the future may become, subject to legal proceedings, claims, litigation and government investigations or inquiries, which could be expensive, lengthy, and disruptive to normal business operations. In addition, the outcome of any legal proceedings, claims, litigation, investigations or inquiries may be difficult to predict and could have a material adverse effect on our business, operating results, or financial condition.

Our products are subject to the threat of piracy and unauthorized copying.

We take measures to protect our pre-release software and other confidential information from unauthorized access. A security breach that results in the disclosure of pre-release software or other confidential assets could lead or contribute to piracy of our games or otherwise compromise our product plans.

Further, entertainment software piracy is a persistent problem in our industry. The growth in peer-to-peer networks and other channels to download pirated copies of our products, the increasing availability of broadband access to the Internet and the proliferation of technology designed to circumvent the protection measures used with our products all have contributed to an expansion in piracy. Though we take technical steps to make the unauthorized copying of our products more difficult, as do the providers of the video game systems, personal computers, mobile phones and tablets on which our games are played, these efforts may not be successful in controlling the piracy of our products.

While legal protections exist to combat piracy and other forms of unauthorized copying, preventing and curbing infringement through enforcement of our intellectual property rights may be difficult, costly and time consuming, particularly in countries where laws are less protective of intellectual property rights. Further, the scope of the legal protection of copyright and prohibitions against the circumvention of technological protection measures to protect copyrighted works are often under scrutiny by courts and governing bodies. The repeal or weakening of laws intended to combat piracy, protect intellectual property and prohibit the circumvention of technological protection measures could make it more difficult for us to adequately protect against piracy. These factors could have a negative effect on our growth and profitability in the future.

Our business is subject to currency fluctuations.

International sales are a fundamental part of our business. For the nine months ended December 31, 2014, international net revenue comprised 57 percent of our total net revenue. We expect international sales to continue to account for a significant portion of our total net revenue. Such sales may be subject to unexpected regulatory requirements, tariffs and other barriers. Additionally, foreign sales are primarily made in local currencies, which may fluctuate against the U.S. dollar. In addition, our foreign investments and our cash and cash equivalents denominated in foreign currencies are subject to currency fluctuations. We use foreign currency hedging contracts to mitigate some foreign currency risk. However, these activities are limited in the protection they provide us from foreign currency fluctuations and can themselves result in losses. In the past, the disruption in the global financial markets has impacted many of the financial institutions with which we do business, and we are subject to counterparty risk with respect to such institutions with whom we enter into hedging transactions. A sustained decline in the financial stability of financial institutions as a result of a disruption in the financial markets could negatively impact our treasury operations, including our ability to secure credit-worthy counterparties for our foreign currency hedging programs. Accordingly, our results of operations, including our reported net revenue, operating expenses and net income, and financial condition can be adversely affected by unfavorable foreign currency fluctuations, especially the Euro, British pound sterling, Canadian dollar and Swedish krona.

We utilize debt financing and such indebtedness could adversely impact our business and financial condition.



In July 2011, we issued \$632.5 million aggregate principal amount of 0.75% Convertible Senior Notes due 2016 (the “Notes”), resulting in debt service obligations on the Notes of approximately \$5 million per year. In addition, in August 2012, we entered into an unsecured committed \$500 million revolving credit facility. While the facility is currently undrawn, we may use the proceeds of any future borrowings for general corporate purposes. The credit facility contains affirmative, negative and financial covenants, including a maximum capitalization ratio and minimum liquidity requirements.

We intend to fulfill our debt service obligations from cash generated by our operations and from our existing cash and investments. We may enter into other financial instruments in the future.

Our indebtedness could have significant negative consequences. For example, it could:

• increase our vulnerability to general adverse economic and industry conditions;

Table of Contents

limit our ability to obtain additional financing;  
require the dedication of a substantial portion of any cash flow from operations to the payment of principal of, and interest on, our indebtedness, thereby reducing the availability of such cash flow to fund our growth strategy, working capital, capital expenditures and other general corporate purposes;  
limit our flexibility in planning for, or reacting to, changes in our business and our industry; and  
place us at a competitive disadvantage relative to our competitors with less debt.

We may not have enough available cash or be able to arrange for financing to pay such principal amount at the time we are required to make purchases of the Notes or convert the Notes. In addition, we may be required to use funds that are domiciled in foreign tax jurisdictions in order to make the cash payments upon any purchase or conversion of the Notes. If we were to choose to use such funds, we would be required to accrue any additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

The hedge transactions and warrant transactions entered into in connection with the Notes may affect the value of the Notes and our common stock.

In connection with the offering of the Notes, we entered into privately-negotiated convertible note hedge transactions (the "Convertible Note Hedge") with certain counterparties ("Options Counterparties") to reduce the potential dilution with respect to our common stock upon conversion of the Notes. The Convertible Note Hedge covers, subject to anti-dilution adjustments substantially similar to those applicable to the Notes, the number of shares of common stock underlying the Notes. We also entered into separate, privately-negotiated warrant transactions with the certain counterparties whereby we sold to independent third parties warrants (the "Warrants") with the Option Counterparties relating to the same number of shares of our common stock, subject to customary anti-dilution adjustments.

The effect, if any, of these activities, including the direction or magnitude, on the market price of our common stock will depend on a variety of factors, including market conditions, and cannot be ascertained at this time. Any of these activities could, however, adversely affect the market price of our common stock and the trading price of the Notes.

In addition, the Option Counterparties are financial institutions, and we will be subject to the risk that one or more of the Option Counterparties might default under the Convertible Note Hedge. Our exposure to the credit risk of the Option Counterparties will not be secured by any collateral. If any of the Option Counterparties becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings with a claim equal to our exposure at the time under the Convertible Note Hedge with such option counterparty. Our exposure will depend on many factors but, generally, the increase in our exposure will be correlated to the increase in the market price and in the volatility of our common stock.

Changes in our tax rates or exposure to additional tax liabilities could adversely affect our earnings and financial condition.

We are subject to taxes in the United States and in various foreign jurisdictions. Significant judgment is required in determining our worldwide income tax provision and accruals for other taxes, and there are many transactions and calculations where the ultimate tax determination is uncertain. Our effective income tax rate could be adversely affected by our profit levels, by changes in our business, reorganization of our business and operating structure, changes in the mix of earnings in countries with differing statutory tax rates, changes in the elections we make, changes in applicable tax laws, or changes in the valuation allowance for deferred tax assets, as well as other factors. We are also required to pay taxes other than income taxes, such as payroll, sales, use, value-added, net worth, property and goods and services taxes, in both the United States and foreign jurisdictions. Furthermore, we are regularly subject to audit by tax authorities with respect to both income and such other non-income taxes. Adverse changes in our effective income tax rate, unfavorable audit results or tax rulings, or other changes resulting in significant

additional tax liabilities could have material adverse effects upon our earnings, cash flows, and financial condition.

Table of Contents

Our reported financial results could be adversely affected by changes in financial accounting standards.

Our reported financial results are impacted by the accounting standards promulgated by the SEC and national accounting standards bodies and the methods, estimates, and judgments that we use in applying our accounting policies. For example, accounting standards affecting software revenue recognition have affected and could continue to significantly affect the way we account for revenue related to our products and services. We recognize all of the revenue from bundled sales (i.e., online-enabled games that include updates on a when-and-if-available basis or a matchmaking service) on a deferred basis over an estimated offering period. In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. While we have not yet determined the effect of the new standard on our Condensed Consolidated Financial Statements, we believe the new standard may require us to materially change the way we account for revenue by requiring us to recognize more revenue upon delivery of the primary product than we currently do under current accounting standards.

As we enhance, expand and diversify our business and product offerings, the application of existing or future financial accounting standards, particularly those relating to the way we account for revenue and taxes, could have a significant adverse effect on our reported results although not necessarily on our cash flows.

Our stock price has been volatile and may continue to fluctuate significantly.

The market price of our common stock historically has been, and we expect will continue to be, subject to significant fluctuations. These fluctuations may be due to factors specific to us (including those discussed in the risk factors above, as well as others not currently known to us or that we currently do not believe are material), to changes in securities analysts' earnings estimates or ratings, to our results or future financial guidance falling below our expectations and analysts' and investors' expectations, to factors affecting the entertainment, computer, software, Internet, media or electronics industries, to our ability to successfully integrate any acquisitions we may make, or to national or international economic conditions. In particular, economic downturns may contribute to the public stock markets experiencing extreme price and trading volume volatility. These broad market fluctuations have and could continue to adversely affect the market price of our common stock.

Table of Contents

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In May 2014, a special committee of our Board of Directors, on behalf of the full Board of Directors, authorized a new program to repurchase up to \$750 million of our common stock. This new stock repurchase program, which expires on May 31, 2016, supersedes and replaces the stock repurchase authorization approved by our Board of Directors in July 2012. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase any specific number of shares under this program and it may be modified, suspended or discontinued at any time.

During the three and nine months ended December 31, 2014, we repurchased and retired approximately 2.5 million and 6.5 million shares of our common stock for approximately \$97 million and \$242 million, respectively. We continue to actively repurchase shares under this program.

The following table summarizes the number of shares repurchased during the three months ended December 31, 2014:

Fiscal Month	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Dollar Value that May Still Be Purchased Under the Program (in millions)
September 28 - October 25, 2014	912,547	\$35.02	912,547	\$573
October 26 - November 22, 2014	804,890	\$39.67	804,890	\$541
November 23 - December 27, 2014	750,500	\$44.94	750,500	\$508
	2,467,937	\$39.55	2,467,937	

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 6. Exhibits

The exhibits listed in the accompanying index to exhibits on Page 67 are filed or incorporated by reference as part of this report.

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ELECTRONIC ARTS INC.  
(Registrant)

DATED:  
February 4, 2015

/s/ Blake Jorgensen  
Blake Jorgensen  
Executive Vice President,  
Chief Financial Officer

Table of Contents

ELECTRONIC ARTS INC.  
 FORM 10-Q  
 FOR THE PERIOD ENDED DECEMBER 31, 2014  
 EXHIBIT INDEX

Number	Exhibit Title	Incorporated by Reference			Filed Herewith
		Form	File No.	Filing Date	
15.1	Awareness Letter of KPMG LLP, Independent Registered Public Accounting Firm.				X
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
Additional exhibits furnished with this report:					
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
101.INS <sup>†</sup>	XBRL Instance Document.				X
101.SCH <sup>†</sup>	XBRL Taxonomy Extension Schema Document.				X
101.CAL <sup>†</sup>	XBRL Taxonomy Extension Calculation Linkbase Document.				X
101.DEF <sup>†</sup>	XBRL Taxonomy Extension Definition Linkbase Document.				X
101.LAB <sup>†</sup>	XBRL Taxonomy Extension Label Linkbase Document.				X
101.PRE <sup>†</sup>	XBRL Taxonomy Extension Presentation Linkbase Document.				X

Attached as Exhibit 101 to this Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2014 are the following formatted in eXtensible Business Reporting Language (“XBRL”): (1) Condensed Consolidated Balance Sheets, (2) Condensed Consolidated Statements of Operations, (3) Condensed Consolidated Statements of Comprehensive Loss, (4) Condensed Consolidated Statements of Cash Flows, and (5) Notes to Condensed Consolidated Financial Statements.

