





Table of Contents

ELECTRONIC ARTS INC.  
 FORM 10-Q  
 FOR THE PERIOD ENDED SEPTEMBER 30, 2015  
 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 September 30, 2015 and March 31, 2015</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended September 30, 2015 and 2014</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Six Months Ended September 30, 2015 and 2014</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended September 30, 2015 and 2014</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>31</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>32</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>66</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>66</u>
Item 6. <u>Exhibits</u>	<u>66</u>
<u>Signature</u>	<u>67</u>
<u>Exhibit Index</u>	<u>68</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) (In millions, except par value data)	September 30, 2015	March 31, 2015 (a)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,598	\$ 2,068
Short-term investments	990	953
Receivables, net of allowances of \$116 and \$140, respectively	737	362
Inventories	62	36
Deferred income taxes, net	46	54
Other current assets	213	247
Total current assets	3,646	3,720
Property and equipment, net	430	459
Goodwill	1,709	1,713
Acquisition-related intangibles, net	84	111
Deferred income taxes, net	14	13
Other assets	117	131
<b>TOTAL ASSETS</b>	<b>\$6,000</b>	<b>\$6,147</b>

## LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	\$ 188	\$ 68
Accrued and other current liabilities	802	794
Deferred net revenue (online-enabled games)	1,113	1,283
0.75% convertible senior notes due 2016, net	422	602
Total current liabilities	2,525	2,747
Income tax obligations	66	70
Deferred income taxes, net	75	80
Other liabilities	175	183
Total liabilities	2,841	3,080
Commitments and contingencies (See Note 11)		
0.75% convertible senior notes due 2016 (See Note 10)	13	31
Stockholders' equity:		
Preferred stock, \$0.01 par value. 10 shares authorized	—	—
Common stock, \$0.01 par value. 1,000 shares authorized; 311 and 310 shares issued and outstanding, respectively	3	3
Additional paid-in capital	1,981	2,127
Retained earnings	1,206	904
Accumulated other comprehensive income (loss)	(44	) 2
Total stockholders' equity	3,146	3,036
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$6,000</b>	<b>\$6,147</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		Six Months Ended		
	September 30,		September 30,		
(In millions, except per share data)	2015	2014	2015	2014	
Net revenue:					
Product	\$434	\$536	\$1,177	\$1,293	
Service and other	381	454	841	911	
Total net revenue	815	990	2,018	2,204	
Cost of revenue:					
Product	335	347	429	599	
Service and other	74	80	153	195	
Total cost of revenue	409	427	582	794	
Gross profit	406	563	1,436	1,410	
Operating expenses:					
Research and development	265	261	561	526	
Marketing and sales	156	183	279	313	
General and administrative	101	92	199	180	
Acquisition-related contingent consideration	—	(1	) —	(2	)
Amortization of intangibles	3	4	4	7	
Total operating expenses	525	539	1,043	1,024	
Operating income (loss)	(119	) 24	393	386	
Interest and other income (expense), net	(9	) (6	) (12	) (14	)
Income (loss) before provision for income taxes	(128	) 18	381	372	
Provision for income taxes	12	15	79	34	
Net income (loss)	\$(140	) \$3	\$302	\$338	
Earnings (loss) per share:					
Basic	\$(0.45	) \$0.01	\$0.97	\$1.08	
Diluted	\$(0.45	) \$0.01	\$0.90	\$1.05	
Number of shares used in computation:					
Basic	312	313	311	312	
Diluted	312	322	334	322	

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

Table of ContentsELECTRONIC ARTS INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited) (In millions)	Three Months Ended September 30,		Six Months Ended September 30,	
	2015	2014	2015	2014
Net income (loss)	\$(140	) \$3	\$302	\$338
Other comprehensive income (loss), net of tax:				
Change in unrealized net gains and losses on available-for-sale securities	2	—	1	—
Reclassification adjustment for net realized gains and losses on available-for-sale securities	(1	) —	(1	) —
Change in unrealized net gains and losses on derivative instruments	5	11	(8	) 10
Reclassification adjustment for net realized gains and losses on derivative instruments	(4	) 2	(7	) 7
Foreign currency translation adjustments	(32	) (21	) (31	) (1
Total other comprehensive income (loss), net of tax	(30	) (8	) (46	) 16
Total comprehensive income (loss)	\$(170	) \$(5	) \$256	\$354

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

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

(Unaudited)	Six Months Ended	
(In millions)	September 30,	
	2015	2014
<b>OPERATING ACTIVITIES</b>		
Net income	\$302	\$338
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation, amortization and accretion	99	112
Loss on conversion of senior notes	6	—
Stock-based compensation	89	69
Acquisition-related contingent consideration	—	(2)
Change in assets and liabilities:		
Receivables, net	(379)	(508)
Inventories	(26)	(11)
Other assets	39	138
Accounts payable	126	83
Accrued and other liabilities	(149)	173
Deferred income taxes, net	1	4
Deferred net revenue (online-enabled games)	(170)	(209)
Net cash provided by (used in) operating activities	(62)	187
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(42)	(48)
Proceeds from maturities and sales of short-term investments	513	352
Purchase of short-term investments	(551)	(537)
Net cash used in investing activities	(80)	(233)
<b>FINANCING ACTIVITIES</b>		
Payment of senior notes	(198)	—
Proceeds from issuance of common stock	84	26
Excess tax benefit from stock-based compensation	65	14
Repurchase and retirement of common stock	(258)	(145)
Net cash used in financing activities	(307)	(105)
Effect of foreign exchange on cash and cash equivalents	(21)	(7)
Decrease in cash and cash equivalents	(470)	(158)
Beginning cash and cash equivalents	2,068	1,782
Ending cash and cash equivalents	\$1,598	\$1,624
Supplemental cash flow information:		
Cash paid (refunded) during the period for income taxes, net	\$26	\$(11)
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 the PlayStation 3 and 4 from Sony, and the Xbox 360 and Xbox One from Microsoft), PCs, mobile phones and tablets. We deliver our games and services to our players across multiple platforms, through multiple distribution channels, and directly (online and wirelessly). Some of our games are based on our wholly-owned intellectual property (e.g., Battlefield, Mass Effect, Need for Speed, Dragon Age, The Sims, SimCity, 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 develop 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, providers of free-to-download PC games played on the Internet, mobile carriers via streaming and digital downloads, and directly through Origin, our own digital distribution platform.

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 year ending March 31, 2016 contains 53 weeks and ends on April 2, 2016. Our results of operations for the fiscal year ended March 31, 2015 contained 52 weeks and ended on March 28, 2015. Our results of operations for the three months ended September 30, 2015 and 2014 contained 13 weeks each and ended on October 3, 2015 and September 27, 2014, respectively. Our results of operations for the six months ended September 30, 2015 and 2014 contained 27 and 26 weeks, respectively, and ended on October 3, 2015 and September 27, 2014, 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, 2015, as filed with the United States Securities and Exchange Commission (“SEC”) on May 21, 2015.

Impact of Recently Issued Accounting Standards

In April 2015, the FASB issued ASU 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Topic 350-40). The amendments of this ASU will help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement by providing guidance as to whether an arrangement includes the sale or license of software. The requirements will be effective for annual periods (and interim periods within those annual periods) beginning after December 15, 2015. The amendment may be adopted either prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. Early adoption is permitted. We expect to adopt this new standard in the first quarter of fiscal year 2017. We do not expect the adoption to have a material impact on our Consolidated Financial Statements.

In April 2015, the FASB issued ASU 2015-03, Interest - Imputation of Interest (Topic 835-30), which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. In August 2015, the FASB issued ASU 2015-15, which clarified that debt issuance costs related to line-of-credit arrangements could continue to be presented as an asset and be subsequently amortized over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the arrangement. The disclosure requirements will be effective for annual periods (and

interim periods within those annual periods) beginning after December 15, 2015, and will require retrospective application. Early adoption is permitted. We do not expect the adoption to have a material impact on our Consolidated Financial Statements.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330), which requires entities to measure inventory at the lower of cost or net realizable value. Current guidance requires inventory to be measured at the lower of cost or market, with market defined as replacement cost, net realizable value, or net realizable value less a normal profit margin. This ASU simplifies the subsequent measurement of inventory by replacing the lower of cost or market test with a lower of cost or net realizable value

Table of Contents

test. The requirements will be effective for annual periods (and interim periods within those annual periods) beginning after December 15, 2016, and will require prospective application. Early adoption is permitted. We are currently evaluating the timing of adoption and impact of this new standard on our Consolidated Financial Statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), 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 standard permits the use of either the retrospective or cumulative effect transition method. The original effective date for ASU 2014-09 would have required the Company to adopt beginning in its first quarter of fiscal year 2018. In August 2015, the FASB issued ASU 2015-14, which deferred the effective date of ASU 2014-09 by one year and also provides the option to early adopt on the original effective date. We are currently evaluating the timing and method of adoption and the impact of the new revenue standard on our Consolidated Financial Statements and related disclosures.

(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 September 30, 2015 and March 31, 2015, our assets and liabilities that were measured and recorded at fair value on a recurring basis were as follows (in millions):

	As of September 30, 2015	Fair Value Measurements at Reporting Date Using			Balance Sheet Classification
		Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets</b>					
Bank and time deposits	\$200	\$200	\$—	\$—	Cash equivalents
Money market funds	5	5	—	—	Cash equivalents
Available-for-sale securities:					
Corporate bonds	593	—	593	—	Short-term investments and cash equivalents
U.S. Treasury securities	200	200	—	—	Short-term investments
U.S. agency securities	148	—	148	—	Short-term investments
Commercial paper	66	—	66	—	Short-term investments and cash equivalents
Foreign currency derivatives	10	—	10	—	Other current assets and other assets
Deferred compensation plan assets <sup>(a)</sup>	8	8	—	—	Other assets
<b>Total assets at fair value</b>	<b>\$1,230</b>	<b>\$413</b>	<b>\$817</b>	<b>\$—</b>	
<b>Liabilities</b>					
Foreign currency derivatives	8	—	8	—	Accrued and other current liabilities and other liabilities
Deferred compensation plan liabilities <sup>(a)</sup>	9	9	—	—	Other liabilities
<b>Total liabilities at fair value</b>	<b>\$17</b>	<b>\$9</b>	<b>\$8</b>	<b>\$—</b>	

Table of Contents

	As of March 31, 2015	Fair Value Measurements at Reporting Date Using			Balance Sheet Classification
		Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets</b>					
Bank and time deposits	\$ 175	\$ 175	\$ —	\$ —	Cash equivalents
Money market funds	7	7	—	—	Cash equivalents
Available-for-sale securities:					
Corporate bonds	468	—	468	—	Short-term investments and cash equivalents
U.S. Treasury securities	214	214	—	—	Short-term investments
U.S. agency securities	180	—	180	—	Short-term investments and cash equivalents
Commercial paper	140	—	140	—	Short-term investments and cash equivalents
Foreign currency derivatives	18	—	18	—	Other current assets
Deferred compensation plan assets <sup>(a)</sup>	9	9	—	—	Other assets
Total assets at fair value	\$ 1,211	\$ 405	\$ 806	\$ —	
<b>Liabilities</b>					
Foreign currency derivatives	9	—	9	—	Accrued and other current liabilities
Deferred compensation plan liabilities <sup>(a)</sup>	9	9	—	—	Other liabilities
Total liabilities at fair value	\$ 18	\$ 9	\$ 9	\$ —	

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, 2015, for additional information regarding our Deferred Compensation Plan.

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

As of September 30, 2015 and March 31, 2015, our cash and cash equivalents were \$1,598 million and \$2,068 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 September 30, 2015 and March 31, 2015 (in millions):

As of September 30, 2015			As of March 31, 2015		
Cost or	Gross Unrealized	Fair	Cost or	Gross Unrealized	Fair

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

	Amortized Cost	Gains	Losses	Value	Amortized Cost	Gains	Losses	Value
Corporate bonds	\$588	\$—	\$—	\$588	\$467	\$—	\$—	\$467
U.S. Treasury securities	199	1	—	200	214	—	—	214
U.S. agency securities	147	1	—	148	161	1	—	162
Commercial paper	54	—	—	54	110	—	—	110
Short-term investments	\$988	\$2	\$—	\$990	\$952	\$1	\$—	\$953

We evaluate our investments for impairment quarterly. Factors considered in the review of investments 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

Table of Contents

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 September 30, 2015 and March 31, 2015.

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of September 30, 2015 and March 31, 2015 (in millions):

	As of September 30, 2015		As of March 31, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Short-term investments				
Due in 1 year or less	\$441	\$441	\$417	\$417
Due in 1-2 years	332	333	281	281
Due in 2-3 years	214	215	244	245
Due in 3-4 years	1	1	10	10
Short-term investments	\$988	\$990	\$952	\$953

**(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/other assets, or accrued and other current liabilities/other 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 18 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, Swedish krona, Australian dollar, Chinese yuan and South Korean won. 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 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/other assets, or accrued and other current liabilities/other liabilities, respectively, 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.

11

---



Table of Contents

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

	As of September 30, 2015			As of March 31, 2015		
	Notional	Fair Value		Notional	Fair Value	
	Amount	Asset	Liability	Amount	Asset	Liability
Forward contracts to purchase	\$127	\$1	\$5	\$108	\$—	\$8
Forward contracts to sell	\$655	\$9	\$3	\$508	\$18	\$1

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 gain of \$4 million for the three months ended September 30, 2015 and immaterial for the three months ended September 30, 2014.

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 the six months ended September 30, 2015 was a gain of \$7 million and a loss of \$7 million for the six months ended September 30, 2014.

During the three and six months ended September 30, 2015 and 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. 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 (in millions):

	As of September 30, 2015			As of March 31, 2015		
	Notional	Fair Value		Notional	Fair Value	
	Amount	Asset	Liability	Amount	Asset	Liability
Forward contracts to purchase	\$84	\$—	\$—	\$99	\$—	\$—
Forward contracts to sell	\$406	\$—	\$—	\$173	\$—	\$—

The effect of foreign currency forward contracts not designated as hedging instruments in our Condensed Consolidated Statements of Operations for the three and six months ended September 30, 2015 and 2014, was as follows (in millions):

	Location of Gain (Loss) Recognized in Income on Derivative	Amount of Gain (Loss) Recognized in Income on Derivative			
		Three Months Ended		Six Months Ended	
		September 30, 2015	2014	September 30, 2015	2014
Foreign currency forward contracts not designated as hedging instruments	Interest and other income (expense), net	\$4	\$18	\$2	\$19

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 September 30, 2015 and 2014 are as follows (in millions):

	Unrealized Net Gains (Losses) on Available-for-Sale Securities	Unrealized Net Gains (Losses) on Derivative Instruments	Foreign Currency Translation Adjustments	Total
Balances as of June 30, 2015	\$ (4 )	\$5	\$(15 )	\$(14 )
Other comprehensive income (loss) before reclassifications	2	5	(32 )	(25 )
Amounts reclassified from accumulated other comprehensive income (loss)	(1 )	(4 )	—	(5 )
Total other comprehensive income (loss), net of tax	1	1	(32 )	(30 )
Balance as of September 30, 2015	\$ (3 )	\$6	\$(47 )	\$(44 )
	Unrealized Net Gains (Losses) on Available-for-Sale Securities	Unrealized Net Gains (Losses) on Derivative Instruments	Foreign Currency Translation Adjustments	Total
Balances as of June 30, 2014	\$ (4 )	\$(6 )	\$71	\$61
Other comprehensive income (loss) before reclassifications	—	11	(21 )	(10 )
Amounts reclassified from accumulated other comprehensive income (loss)	—	2	—	2
Total other comprehensive income (loss), net of tax	—	13	(21 )	(8 )
Balance as of September 30, 2014	\$ (4 )	\$7	\$50	\$53

The changes in accumulated other comprehensive income (loss) by component, net of tax, for the six months ended September 30, 2015 and 2014 are as follows (in millions):

	Unrealized Net Gains (Losses) on Available-for-Sale Securities	Unrealized Net Gains (Losses) on Derivative Instruments	Foreign Currency Translation Adjustments	Total
Balances as of March 31, 2015	\$ (3 )	\$21	\$(16 )	\$2
Other comprehensive income (loss) before reclassifications	1	(8 )	(31 )	(38 )
Amounts reclassified from accumulated other comprehensive income (loss)	(1 )	(7 )	—	(8 )
Total other comprehensive income (loss), net of tax	—	(15 )	(31 )	(46 )
Balance as of September 30, 2015	\$ (3 )	\$6	\$(47 )	\$(44 )

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

	Unrealized Net Gains (Losses) on Available-for-Sale Securities	Unrealized Net 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	—	10	(1 )	9
Amounts reclassified from accumulated other comprehensive income (loss)	—	7	—	7
Total other comprehensive income (loss), net of tax	—	17	(1 )	16
Balance as of September 30, 2014	\$ (4 )	\$7	\$50	\$53

Table of Contents

The effects on net income of amounts reclassified from accumulated other comprehensive income (loss) for the three and six months ended September 30, 2015 were as follows (in millions):

Statement of Operations Classification	Amount Reclassified From Accumulated Other Comprehensive Income (Loss)	
	Three Months Ended September 30, 2015	Six Months Ended September 30, 2015
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	\$(6	) \$(14
Research and development	2	7
Net of tax	(4	) (7
Total amount reclassified, net of tax	\$(5	) \$(8

The net impact from our available-for-sale securities and cash flow hedging activities in our Condensed Consolidated Statements of Operations for the three and six months ended September 30, 2015 was a gain of \$5 million and \$8 million, respectively.

The effects on net income of amounts reclassified from accumulated other comprehensive income (loss) for the three and six months ended September 30, 2014 were as follows (in millions):

Statement of Operations Classification	Amount Reclassified From Accumulated Other Comprehensive Income (Loss)	
	Three Months Ended September 30, 2014	Six Months Ended September 30, 2014
Gains and losses on cash flow hedges from forward contracts		
Net revenue	\$2	\$5
Research and development	—	2
Total amount reclassified, net of tax	\$2	\$7

The net impact from our cash flow hedging activities in our Condensed Consolidated Statements of Operations for the three and six months ended September 30, 2014 was a loss of \$2 million and \$7 million, respectively.

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

The changes in the carrying amount of goodwill for the six months ended September 30, 2015 are as follows (in millions):

	As of March 31, 2015	Activity	Effects of Foreign Currency Translation	As of September 30, 2015
Goodwill	\$2,081	\$—	\$(4	) \$2,077
Accumulated impairment	(368	) —	—	(368
Total	\$1,713	\$—	\$(4	) \$1,709

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 September 30, 2015			As of March 31, 2015		
	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net
Developed and core technology	\$531	\$ (463 )	\$ 68	\$531	\$ (439 )	\$ 92
Trade names and trademarks	130	(114 )	16	130	(111 )	19
Registered user base and other intangibles	87	(87 )	—	87	(87 )	—
Carrier contracts and related	85	(85 )	—	85	(85 )	—
Total	\$833	\$ (749 )	\$ 84	\$833	\$ (722 )	\$ 111

Amortization of intangibles for the three and six months ended September 30, 2015 and 2014 are classified in the Condensed Consolidated Statement of Operations as follows (in millions):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2015	2014	2015	2014
Cost of service and other	\$8	\$9	\$16	\$19
Cost of product	3	3	7	7
Operating expenses	3	4	4	7
Total	\$14	\$16	\$27	\$33

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 September 30, 2015 and March 31, 2015, the weighted-average remaining useful life for acquisition-related intangible assets was approximately 2.5 years and 2.8 years, respectively.

As of September 30, 2015, 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,	
2016 (remaining six months)	\$26
2017	32
2018	12
2019	8
2020	6
2021	—
Total	\$84

**(7) 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.

Table of Contents

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. Prepaid royalties are classified as current assets to the extent that such amounts will be recognized in our Condensed Consolidated Statements of Operations within the next 12 months. 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 and service 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 using undiscounted cash flows when impairment indicators exist. If impairment exists, then the assets are written down to fair value. 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 and six months ended September 30, 2015, we did not recognize any losses or impairment charges on royalty-based commitments. During the three months ended September 30, 2014, we did not recognize any losses or impairment charges on royalty-based commitments. During the six months ended September 30, 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 \$25 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.

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 September 30, 2015	As of March 31, 2015
Other current assets	\$63	\$70
Other assets	50	59
Royalty-related assets	\$113	\$129

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 September 30, 2015	As of March 31, 2015
Accrued royalties	\$166	\$119
Other liabilities	128	131
Royalty-related liabilities	\$294	\$250

As of September 30, 2015, we were committed to pay approximately \$1,433 million to content licensors, independent software developers, and co-publishing and/or distribution affiliates, but because performance remained with the counterparty (i.e., delivery of the product or content or other factors), such commitments were not recorded in our Condensed Consolidated Financial Statements. See Note 11 for further information on our developer and licensor commitments.





Table of Contents

## (8) BALANCE SHEET DETAILS

## Inventories

Inventories as of September 30, 2015 and March 31, 2015 consisted of (in millions):

	As of September 30, 2015	As of March 31, 2015
Finished goods	\$60	\$35
Raw materials and work in process	2	1
Inventories	\$62	\$36

## Property and Equipment, Net

Property and equipment, net, as of September 30, 2015 and March 31, 2015 consisted of (in millions):

	As of September 30, 2015	As of March 31, 2015
Computer, equipment and software	\$658	\$655
Buildings	307	315
Leasehold improvements	129	126
Equipment, furniture and fixtures, and other	73	73
Land	61	62
Construction in progress	9	7
	1,237	1,238
Less: accumulated depreciation	(807	) (779
Property and equipment, net	\$430	\$459

During the three and six months ended September 30, 2015, depreciation expense associated with property and equipment was \$30 million and \$60 million, respectively. During the three and six months ended September 30, 2014, depreciation expense associated with property and equipment was \$33 million and \$64 million, respectively.

## Accrued and Other Current Liabilities

Accrued and other current liabilities as of September 30, 2015 and March 31, 2015 consisted of (in millions):

	As of September 30, 2015	As of March 31, 2015
Other accrued expenses	\$315	\$298
Accrued compensation and benefits	157	263
Accrued royalties	166	119
Deferred net revenue (other)	164	114
Accrued and other current liabilities	\$802	\$794

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 \$1,113 million and \$1,283 million as of September 30, 2015 and March 31, 2015, 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).



Table of Contents

(9) 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 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. 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.

In fiscal year 2015, we reported U.S. pre-tax income, compared to U.S. pre-tax losses in each of the last seven fiscal years. We have not yet been able to establish a sustained level of profitability in the U.S. or other sufficient significant positive evidence to conclude that our U.S. deferred tax assets are more likely than not to be realized. Therefore, we continue to maintain a valuation allowance against most of our U.S. deferred tax assets. It is reasonably possible that in fiscal year 2016 we will establish a sustained level of profitability in the U.S. As a result, it is possible that a significant portion of the \$539 million valuation allowance recorded against our U.S. deferred tax assets at March 31, 2015 could be reversed by the end of fiscal year 2016.

The provision for income taxes reported for the three and six months ended September 30, 2015 is based on our projected annual effective tax rate for fiscal year 2016, and also includes certain discrete items recorded during the period. Our effective tax rate for the three and six months ended September 30, 2015 was a tax expense of 9.4 percent and 20.7 percent, respectively, as compared to 83.3 percent and 9.1 percent, respectively, for the same period of fiscal year 2015. The effective tax rate for the three and six months ended September 30, 2015 and 2014 was reduced, when compared to the statutory rate of 35.0 percent, by 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. Conversely, the effective tax rate was increased due to a discrete expense of \$25 million and \$65 million recorded in the three and six months ended September 30, 2015, respectively, for excess tax benefits from stock-based compensation deductions allocated directly to contributed capital. The effective tax rate for the three months ended September 30, 2015 differs from the same period in fiscal year 2015 primarily due to the difference in pre-tax income. The effective tax rate for the six months ended September 30, 2015 is higher compared to the same period in fiscal 2015 primarily due to the increase in the discrete expense for excess tax benefits from stock-based compensation deductions.

During the three and six months ended September 30, 2015, we recorded a net increase of \$11 million and \$17 million, respectively, in gross unrecognized tax benefits. The total gross unrecognized tax benefits as of September 30, 2015 is \$271 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 September 30, 2015, if recognized,

approximately \$53 million of the unrecognized tax benefits would affect our effective tax rate and approximately \$218 million would result in adjustments to deferred tax assets with corresponding adjustments to the valuation allowance.

During the three and six months ended September 30, 2015, there was no material change in accrued interest and penalties related to tax positions taken on our tax returns. As of September 30, 2015, 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 \$16 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

Table of Contents

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 through 2013. We remain subject to income tax examination for several other jurisdictions including in France for fiscal years after 2011, in Germany for fiscal years after 2012, in the United Kingdom for fiscal years after 2013, and in Canada and 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 \$4 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.

On July 27, 2015, the Tax Court issued an opinion (*Altera Corp. et al. v. Commissioner*) regarding the treatment of stock-based compensation expense in related-party cost-sharing arrangements. A final decision has yet to be issued by the Tax Court. At this time, the U.S. Department of the Treasury has not withdrawn its regulations that require the inclusion of stock-based compensation expense in such arrangements. We will continue to monitor developments related to this opinion and the potential impact of these developments on our Condensed Consolidated Financial Statements.

(10) FINANCING ARRANGEMENT

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.

Following certain corporate events described in the indenture governing the notes (the "Indenture") that occur prior to the maturity date, the conversion rate as discussed below 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.

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.

Table of Contents

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 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.

During the fiscal quarter ended September 30, 2015, the Sales Price Condition was met. As a result, the Notes are convertible at the option of the holder through January 2, 2016, and the carrying value of the Notes continued to be classified as a current liability and the excess of the principal amount over the carrying value of the Notes continued to be classified in temporary equity in the Consolidated Balance Sheets as of September 30, 2015. The determination of whether or not the Notes are convertible is performed on a quarterly basis.

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. During the six months ended September 30, 2015, approximately \$245 million principal value of the Notes were converted by holders thereof. The majority of these conversions were settled during the three months ended September 30, 2015. During the three months ended September 30, 2015, we repaid \$198 million of the principal balance of the Notes and issued approximately 3.4 million shares of common stock to noteholders with a fair value of \$226 million, resulting in a loss on conversion of senior notes of \$6 million. We also received and cancelled approximately 3.4 million shares of common stock from the exercise of the Convertible Note Hedge. Based on the closing price of our common stock of \$66.49 at the end of the quarter ended September 30, 2015, the if-converted value of our Notes in aggregate exceeded their principal amount by \$476 million.

The remaining \$47 million of conversion requests received prior to September 30, 2015 will be settled in the quarter ending December 31, 2015. Subsequent to the quarter ended September 30, 2015 and through November 6, 2015, we received conversion requests for an additional \$48 million principal value of the Notes. During the quarter ending December 31, 2015, we expect to settle conversion requests with at least \$95 million in cash and a number of shares of our common stock equal in value to the excess conversion value. Based on the closing stock price of our common stock of \$66.49 at the end of the quarter ended September 30, 2015, approximately 2 million shares of our common stock would be issuable to converting holders. The actual amount of shares issuable upon conversion will be determined based upon the market price of our common stock during an observation period following any conversion.

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

	As of September 30, 2015	As of March 31, 2015
Principal amount of Notes	\$435	\$633
Unamortized debt discount of the liability component	(13)	(31)
Net carrying value of Notes	\$422	\$602
Fair value of Notes	\$916	\$1,158

The fair value of the Notes is classified as Level 2 within the fair value hierarchy. As of September 30, 2015, the remaining life of the Notes is approximately 9.5 months.

**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. We paid \$107 million for the Convertible Note Hedge, which was recorded as an equity transaction. The Convertible Note Hedge,



Table of Contents

subject to customary anti-dilution adjustments, provides us with the option to acquire, on a net settlement basis, approximately 19.9 million shares of our common stock equal to the number of shares of our common stock that notionally underlie the Notes at a strike price of \$31.74, which corresponds to the conversion price of the Notes. As of September 30, 2015, we received 3.4 million shares of our common stock under the Convertible Note Hedge. Subsequent to September 30, 2015, we expect to receive a number of shares under the Convertible Note Hedge substantially equal to the number of shares of common stock to be issued in connection with any conversions of the Notes.

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 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. Based on the closing stock price of our common stock of \$66.49 at the end of the quarter ended September 30, 2015, approximately 8 million shares would be issuable under the Warrants. The Warrants are exercisable for a period of 60 trading days commencing on October 17, 2016. 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 for periods where the average quarterly price of our common stock is below 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 13 for additional information related to our EPS.

Credit Facility

On March 19, 2015, we entered into a \$500 million senior unsecured revolving credit facility (“Credit Facility”) with a syndicate of banks. The credit facility terminates on March 19, 2020, 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 March 19, 2020.

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.

The credit agreement contains customary events of default, including among others, non-payment defaults, covenant defaults, cross-defaults to material indebtedness, bankruptcy and insolvency defaults, material judgment of 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 facility, an obligation by any guarantors to repay the obligations in full and an increase in the applicable interest rate.

As of September 30, 2015, 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 5-year term of the Credit Facility.

Table of Contents

The following table summarizes our interest expense recognized for the three and six months ended September 30, 2015 and 2014 that is included in interest and other income (expense), net on our Condensed Consolidated Statements of Operations (in millions):

	Three Months Ended		Six Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Loss on conversion of senior notes	\$(6	) \$—	\$(6	) \$—
Amortization of debt discount	(5	) (6	) (11	) (11
Amortization of debt issuance costs	—	(1	) (1	) (2
Coupon interest expense	(1	) (1	) (2	) (2
Other interest expense	—	—	—	(1
Total interest expense	\$(12	) \$(8	) \$(20	) \$(16

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

As of September 30, 2015, 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. (Minions). 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 September 30, 2015 (in millions):

	Total	Fiscal Years Ending March 31, 2016 (Remaining six mos.)	2017	2018	2019	2020	2021	Thereafter
Unrecognized commitments								
Developer/licensor commitments	\$1,433	\$97	\$208	\$252	\$241	\$209	\$185	\$241
Marketing commitments	339	27	66	52	50	48	48	48
Operating leases	203	19	34	26	23	21	19	61
0.75% Convertible Senior Notes due 2016 interest <sup>(a)</sup>	2	1	1	—	—	—	—	—
Other purchase obligations	35	18	13	2	1	1	—	—
Total unrecognized commitments	2,012	162	322	332	315	279	252	350
Recognized commitments								
0.75% Convertible Senior Notes due 2016 principal <sup>(a)</sup>	435	435	—	—	—	—	—	—
Licensing and lease obligations <sup>(b)</sup>	157	10	22	23	24	25	26	27
Total recognized commitments	592	445	22	23	24	25	26	27
Total commitments	\$2,604	\$607	\$344	\$355	\$339	\$304	\$278	\$377

We will be obligated to pay the \$434.6 million principal amount of the Notes in cash and any excess conversion value in shares of our common stock upon redemption of the Notes at maturity on July 15, 2016, or upon earlier conversion. During the quarter ended September 30, 2015, the Sales Price Condition was met and as a result, the Notes are currently convertible at the option of the holder through January 2, 2016. Subsequent to the quarter ended <sup>(a)</sup>September 30, 2015 and through November 6, 2015, we received conversion requests for an additional \$48 million principal value of the Notes. During the quarter ending December 31, 2015, we expect to settle at least \$95 million in cash and a number of shares of our common stock equal in value to the excess conversion value. See Note 10 for additional information regarding our Notes.

Lease commitments exclude the impact of sub-lease income due from third parties totaling approximately \$2 <sup>(b)</sup>million. See Note 7 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 September 30, 2015; however, certain payment obligations may be accelerated depending on the performance of our operating results. Up to \$32 million of the unrecognized amounts in the table above may be payable, at the licensor's election, in shares of our common stock, subject to a \$10 million maximum during any fiscal year. The number of shares to be issued will be based on fair market value at the time of issuance.

In addition to what is included in the table above, as of September 30, 2015, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$64 million, of which we are unable to make a reasonably reliable estimate of when cash settlement with the taxing authority will occur.

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. On August 19, 2015, the United States District Court for the Northern District of California granted final approval of the settlement, and during the six months ended September 30, 2015, we paid \$29.5 million pursuant to the terms of the settlement.

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

Table of Contents

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. On October 5, 2015, the Company filed a petition for a writ of certiorari to the United States Supreme Court.

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.

(12) STOCK-BASED COMPENSATION

Valuation Assumptions

We estimate the fair value of stock-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 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.

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. We determine the fair value of our stock-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. The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option. Expected volatility is based on a combination of historical stock price volatility and implied volatility of publicly-traded options on our common stock. Expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.

There were an insignificant number of stock options granted during the three and six months ended September 30, 2015.

Table of Contents

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 September 30, 2014	Six Months Ended September 30, 2014	Three Months Ended September 30, 2015	
Risk-free interest rate	1.2 - 1.9%	1.1 - 1.9%	0.3 - 0.4%	0.04 - 0.1%
Expected volatility	36 - 38%	36 - 40%	32	% 34 - 35%
Weighted-average volatility	37	% 38	% 32	% 35
Expected term	4.5 years	4.5 years	6 - 11.5 months	6 - 12 months
Expected dividends	None	None	None	None

There were no market-based restricted stock units granted during the three months ended September 30, 2015 and 2014.

Stock-Based Compensation Expense

Employee stock-based compensation expense recognized during the three months ended September 30, 2015 and 2014 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 is 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 September 30,		Six Months Ended September 30,	
	2015	2014	2015	2014
Cost of revenue	\$1	\$1	\$1	\$1
Research and development	25	\$23	51	39
Marketing and sales	7	6	12	10
General and administrative	11	10	25	19
Stock-based compensation expense	\$44	\$40	\$89	\$69

During the three and six months ended September 30, 2015 and 2014, we did not recognize any benefit from income taxes related to our stock-based compensation expense.

As of September 30, 2015, our total unrecognized compensation cost related to stock options was \$12 million and is expected to be recognized over a weighted-average service period of 1.9 years. As of September 30, 2015, our total unrecognized compensation cost related to restricted stock and restricted stock units (collectively referred to as "restricted stock rights") was \$305 million and is expected to be recognized over a weighted-average service period of 1.6 years. Of the \$305 million of unrecognized compensation cost, \$35 million relates to market-based restricted stock units.

During the three and six months ended September 30, 2015, we recognized \$25 million and \$65 million, respectively, of excess tax benefit from stock-based compensation deductions; this amount is 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 six months ended September 30, 2015:

	Options (in thousands)	Weighted- Average Exercise Prices	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding as of March 31, 2015	4,920	\$ 37.44		
Granted	3	64.43		
Exercised	(1,406 )	44.65		
Forfeited, cancelled or expired	(51 )	35.70		
Outstanding as of September 30, 2015	3,466	\$ 34.56	6.00	\$ 111
Vested and expected to vest	3,269	\$ 34.74	5.85	\$ 104
Exercisable as of September 30, 2015	2,267	\$ 36.23	4.71	\$ 69

The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price as of September 30, 2015, which would have been received by the option holders had all the option holders exercised their options as of that date. The weighted-average grant date fair values of stock options granted during three and six months ended September 30, 2014 was \$12.06 and \$12.01, respectively. 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 six months ended September 30, 2015:

	Restricted Stock Rights (in thousands)	Weighted- Average Grant Date Fair Values
Balance as of March 31, 2015	10,855	\$26.20
Granted	2,463	63.76
Vested	(5,182 )	21.27
Forfeited or cancelled	(622 )	32.93
Balance as of September 30, 2015	7,514	\$41.35

The weighted-average grant date fair values of restricted stock rights granted during the three and six months ended September 30, 2015 were \$72.24 and \$63.76, respectively.



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 market-based 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 market-based restricted 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 one-year, two-year cumulative and three-year cumulative period. In the table below, we present shares granted at 100 percent of target of the number of market-based restricted stock units that may potentially vest. The maximum number of common shares that could vest is approximately 0.8 million for market-based restricted stock units granted during the six months ended September 30, 2015. As of September 30, 2015, 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 three months ended September 30, 2015:

	Market-Based Restricted Stock Units (in thousands)	Weighted- Average Grant Date Fair Value
Balance as of March 31, 2015	663	\$31.82
Granted	395	79.81
Vested	(742)	) 25.77
Vested above target	371	25.77
Forfeited or cancelled	(53)	) 41.16
Balance as of September 30, 2015	634	\$62.00

## Stock Repurchase Program

In May 2014, a special committee of our Board of Directors, on behalf of the full Board of Directors, authorized a two-year program to repurchase up to \$750 million of our common stock. Since inception, we repurchased approximately 9.2 million shares for approximately \$394 million under this program.

In May 2015, our Board of Directors authorized a new program to repurchase up to \$1 billion of our common stock. This new stock repurchase program, which expires on May 31, 2017, supersedes and replaces the stock repurchase authorization approved in May 2014. 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 six months ended September 30, 2015, we repurchased approximately 1.8 million and 4.0 million shares for approximately \$126 million and \$258 million respectively. We continue to actively repurchase shares.

The following table summarizes total shares repurchased during the three and six months ended September 30, 2015 and 2014:

(in millions)	May 2014 Program		May 2015 Program		Total	
	Shares	Amount	Shares	Amount	Shares	Amount
Three months ended September 30, 2015—		\$—	1.8	\$126	1.8	\$126
Six months ended September 30, 2015	1.0	\$57	3.0	\$201	4.0	\$258
Three months ended September 30, 2014	2.6	\$95	—	\$—	2.6	\$95
Six months ended September 30, 2014	4.0	\$145	—	\$—	4.0	\$145



Table of Contents

## (13) EARNINGS (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		Six Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income (loss)	\$ (140 )	\$ 3	\$ 302	\$ 338
Shares used to compute earnings (loss) per share:				
Weighted-average common stock outstanding — basic	312	313	311	312
Dilutive potential common shares related to stock award plans and from assumed exercise of stock options	—	6	7	8
Dilutive potential common shares related to the Notes	—	3	9	2
Dilutive potential common shares related to the Warrants	—	—	7	—
Weighted-average common stock outstanding — diluted	312	322	334	322
Earnings (loss) per share:				
Basic	\$ (0.45 )	\$ 0.01	\$ 0.97	\$ 1.08
Diluted	\$ (0.45 )	\$ 0.01	\$ 0.90	\$ 1.05

As a result of our net loss for the three months ended September 30, 2015, we have excluded all potentially dilutive common shares from the diluted loss per share calculation as their inclusion would have had an antidilutive effect. Had we reported net income for this period, an additional 6 million shares of common stock related to our outstanding equity-based instruments, an additional 7.0 million shares of common stock related to the Notes, and an additional 8.0 million shares related to the Warrants would have been included in the number of shares used to calculate Diluted EPS for the three months ended September 30, 2015.

For the six months ended September 30, 2015, an immaterial amount of options to purchase, restricted stock units and restricted stock to be released were excluded from the treasury stock method computation of diluted shares as their inclusion would have had an antidilutive effect.

For the three and six months ended September 30, 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.

For the three and six months ended September 30, 2014, potentially dilutive shares of common stock related to 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 10 for additional information related to our 0.75% Convertible Senior Notes due 2016 and related Convertible Note Hedge and Warrants.

## (14) 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 six months ended September 30, 2015 and 2014 (in millions):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2015	2014	2015	2014
Segment:				
Net revenue before revenue deferral	\$1,146	\$1,220	\$1,839	\$1,995
Depreciation	(30 )	(33 )	(60 )	(64 )
Other expenses	(846 )	(878 )	(1,449 )	(1,537 )
Segment operating profit	270	309	330	394
Reconciliation to consolidated operating income (loss):				
Other:				
Revenue deferral	(977 )	(1,035 )	(1,472 )	(1,658 )
Recognition of revenue deferral	646	805	1,651	1,867
Amortization of intangibles	(14 )	(16 )	(27 )	(33 )
Acquisition-related contingent consideration	—	1	—	2
Stock-based compensation	(44 )	(40 )	(89 )	(69 )
Loss on licensed intellectual property commitment	—	—	—	(122 )
Other expenses	—	—	—	5
Consolidated operating income (loss)	\$(119 )	\$24	\$393	\$386

Our segment profit differs from consolidated operating income primarily due to the exclusion of (1) the deferral of net revenue related to online-enabled games (see Note 8 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 six months ended September 30, 2015 and 2014 is presented below (in millions):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2015	2014	2015	2014
Packaged goods and other	\$313	\$482	\$893	\$1,160
Digital	502	508	1,125	1,044
Net revenue	\$815	\$990	\$2,018	\$2,204
	Three Months Ended September 30,		Six Months Ended September 30,	
	2015	2014	2015	2014
Platform net revenue				
Xbox One, PlayStation 4	\$332	\$317	\$819	\$610
Xbox 360, PlayStation 3	155	308	448	851
Other consoles	1	6	3	9
Total consoles	488	631	1,270	1,470
PC / Browser	184	208	437	439
Mobile	124	123	269	246
Other	19	28	42	49
Net revenue	\$815	\$990	\$2,018	\$2,204



Table of Contents

Net revenue from unaffiliated customers in North America and internationally for the three and six months ended September 30, 2015 and 2014 is presented below (in millions):

	Three Months Ended		Six Months Ended	
	September 30, 2015	2014	September 30, 2015	2014
Net revenue from unaffiliated customers				
North America	\$381	\$433	\$887	\$955
International	434	557	1,131	1,249
Net revenue	\$815	\$990	\$2,018	\$2,204

Long-lived assets in North America and internationally as of September 30, 2015 and March 31, 2015 is presented below (in millions):

	As of September 30, 2015	As of March 31, 2015
Long-lived assets		
North America	\$1,753	\$1,809
International	470	474
Total	\$2,223	\$2,283

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 six months ended September 30, 2015 represented \$189 million and \$721 million, or 23 percent and 36 percent, of our total net revenue, respectively. Revenue generated by our Swiss legal entities during the three and six months ended September 30, 2014 represented \$195 million and \$635 million, or 20 percent and 29 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.

During the three months ended September 30, 2015, we estimate that our direct sales to Microsoft, GameStop and Sony represented approximately 13 percent, 12 percent and 11 percent of total net revenue, respectively. During the six months ended September 30, 2015, we estimate that our direct sales to Microsoft and Sony represented approximately 14 percent and 12 percent of total net revenue, respectively.

During the three and six months ended September 30, 2014, we estimate that our direct sales to GameStop Corp. represented approximately 16 percent and 14 percent of total net revenue, 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 October 3, 2015, and the related condensed consolidated statements of operations, and comprehensive income (loss), for the three-month and six-month periods ended October 3, 2015 and September 27, 2014, and the related condensed consolidated statements of cash flows for the six-month periods ended October 3, 2015 and September 27, 2014. 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 28, 2015, 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, 2015, 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 28, 2015, 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  
November 10, 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, 2015 as filed with the Securities and Exchange Commission ("SEC") on May 21, 2015 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 provides important context for our results for the three and six months ended September 30, 2015, 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, 2015 as filed with the SEC on May 21, 2015 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 the PlayStation 3 and 4 from Sony and the Xbox 360 and Xbox One from Microsoft), PCs, mobile phones and tablets. We deliver our games and services to our players across multiple platforms, through multiple distribution channels, and directly (online and wirelessly). Some of our games are based on our wholly-owned intellectual property (e.g., Battlefield, Mass Effect, Need for Speed, Dragon Age, The Sims, SimCity, 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 develop 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, providers of free-to-download PC games played on the Internet, mobile carriers via streaming and digital downloads and directly through Origin, our own digital distribution platform.

Financial Results

Total net revenue for the three months ended September 30, 2015 was \$815 million, a decrease of \$175 million, or 18 percent, as compared to the three months ended September 30, 2014. Net revenue for the three months ended September 30, 2015 was driven by FIFA 15, Battlefield Hardline, and Dragon Age: Inquisition. At September 30, 2015, deferred net revenue associated with sales of online-enabled games increased by \$338 million as compared to June 30, 2015, directly decreasing the amount of reported net revenue during the three months ended September 30, 2015. At September 30, 2014, deferred net revenue associated with sales of online-enabled games increased by \$230 million as compared to June 30, 2014, directly decreasing the amount of reported net revenue during the three months ended September 30, 2014. Disregarding the impact of the deferred net revenue and the \$7 million decrease in

unrecognized cash flow hedging net gains, reported net revenue would have decreased by approximately \$74 million, or 6 percent, during the three months ended September 30, 2015 as compared to the three months ended September 30, 2014.

Net loss for the three months ended September 30, 2015 was \$140 million as compared to net income of \$3 million for the three months ended September 30, 2014. Diluted loss per share for the three months ended September 30, 2015 was \$0.45 as compared to a diluted earnings per share of \$0.01 for the three months ended September 30, 2014. Net income decreased for

## Table of Contents

the three months ended September 30, 2015 as compared to the three months ended September 30, 2014 primarily as a result of a \$157 million decrease in gross profit, partially offset by a \$14 million decrease in operating expenses.

**International Operations and Foreign Currency Exchange Impact.** International net revenue was \$434 million, or 53 percent of total net revenue during the three months ended September 30, 2015, compared to \$557 million, or 56 percent of total net revenue during the three months ended September 30, 2014, a decrease of \$123 million, or 22 percent. We estimate that the negative impact of foreign currency exchange rates during the three months ended September 30, 2015 (primarily the U.S. Dollar strengthening against the Euro), decreased reported International net revenue by approximately \$58 million, or 10 percent, for the three months ended September 30, 2015 as compared to the three months ended September 30, 2014. This was partially offset by our related cash flow hedging gains of \$8 million. Excluding the \$50 million net negative impact of foreign currency exchange rates and related cash flow hedging activities, we estimate that International net revenue would have decreased by approximately \$73 million, or 13 percent for the three months ended September 30, 2015 as compared to the three months ended September 30, 2014. This decrease is primarily due to our Battlefield, FIFA and Need for Speed franchises, and Titanfall, partially offset by increased revenue in Dragon Age: Inquisition and our SimCity franchise. In addition, our international investments and our cash and cash equivalents denominated in foreign currencies are subject to fluctuations in foreign currency exchange rates and decline in value when the U.S. dollar strengthens against the currencies in which our international investments are denominated.

## Trends in Our Business

**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 were 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. For example, the Ultimate Team mode incorporated into recent iterations of our FIFA, Madden NFL, NHL and NBA franchises and expansion packs available digitally for our Battlefield and Sims franchises have kept many of our players engaged with those games for longer periods of time. Additionally, our mobile and PC free-to-download games are available solely via digital delivery and are typically monetized through a business model through which we sell incremental content and/or features in discrete transactions. We also provide our EA Access service for the Xbox One which offers players access to a selection of EA games and other benefits for a monthly or annual fee.

We significantly increased our digital net revenue from \$1,440 million in fiscal year 2013 to \$1,833 million in fiscal year 2014 and \$2,199 million during fiscal year 2015. We expect this portion of our business to continue to grow through fiscal year 2016 and beyond.

**Console System Transition.** We have made and will continue to make significant investments in products and services for the PlayStation 4 from Sony and Xbox One from Microsoft, and 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 2015 fiscal year and we think that this sales decline trend will 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.

**Foreign Currency Exchange Rates.** International sales are a fundamental part of our business, and the significant strengthening of the U.S. Dollar during the second half of fiscal year 2015 (particularly relative to the Euro, British pound sterling, Swedish krona and Canadian dollar) had a negative impact on our reported international net revenues,

but a positive impact on our reported international operating expenses because these amounts were translated at lower rates in fiscal year 2015 than in fiscal year 2014. This trend has continued during the first half of fiscal year 2016. While we use foreign currency hedging contracts to mitigate some foreign currency exchange risk, these activities are limited in the protection that they provide us and can themselves result in losses. We currently anticipate foreign currency exchange rates to continue to have a negative impact on our expected reported net revenue in the second half of fiscal year 2016 as compared to the same period of fiscal year 2015, but the strengthening of the U.S. dollar is expected to have a positive impact on our reported operating expenses as a significant portion of those expenses are incurred outside the United States.

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, has led to growth in the mobile gaming industry. Likewise, the mass introduction and wide consumer acceptance of free-to-download, micro-

## Table of Contents

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 that business. For the three months ended September 30, 2015, we had average MAUs of over 150 million as compared to over 155 million average MAUs for the three months ended September 30, 2014. 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. For our calculation, an individual who either plays two of our games on a single device, or the same game on two devices in the relevant period, would be counted as two users. Average MAUs for a particular period is the average of the MAUs at each month-end during that period. MAUs are calculated using internal company data based on tracking the activity of user accounts. We also 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. From time to time, we adjust the calculation for user activity that is inconsistent with our methodology. We believe that the numbers are reasonable estimates of our user base for the applicable period of measurement; however, factors relating to user activity may impact these numbers. Our methodology for calculating MAUs may differ from the methodology used by other companies to calculate this metric.

**Concentration of Sales Among the Most Popular Games.** In all major segments of our industry, we see a large portion of games sales concentrated on the most popular titles, and many of those titles are sequels of prior games. A significant portion of our revenue has historically been derived from games and services based on a few popular franchises. For example, in fiscal year 2015, net revenue generated from the sale of products and services associated with our three largest franchises accounted for approximately 54% of our net revenue. We expect this trend to continue in fiscal year 2016.

### Recent Developments

**Stock Repurchase Program.** In May 2015, our Board of Directors authorized a new program to repurchase up to \$1 billion of our common stock. This new stock repurchase program, which expires on May 31, 2017, supersedes and replaces the stock repurchase authorization approved in May 2014. Under the new 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 months ended September 30, 2015, we repurchased approximately 1.8 million shares for approximately \$126 million under this new program. During the six months ended September 30, 2015, we repurchased approximately 4.0 million shares for approximately \$258 million. Of these repurchases, approximately 3.0 million shares were repurchased under the May 2015 program for approximately \$201 million. We continue to actively repurchase shares.

### 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 (e.g., micro-transactions) and services on (1) video game consoles (such as the PlayStation 3 and 4 from Sony and the 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, extra-content), and licensing of game software to third-parties. Product revenue also includes revenue from mobile full game

## Table of Contents

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-download mobile games), (2) massively multi-player online ("MMO") games (both software game and subscription sales), (3) subscriptions for our Battlefield Premium, EA Access, 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.

**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. If there is significant uncertainty of acceptance, revenue is recognized once acceptance is reasonably assured.

### Online-Enabled Games

The majority of our software games and related content 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 (e.g., player roster updates to Madden NFL 16) to online-enabled games and related content 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 and related content 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,



## Table of Contents

if our evaluation date is April 1, 2015, we evaluate all online-enabled games released between April 1, 2013 and March 31, 2014. 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 analyses, known and expected 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.

### 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.

### 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 App Store, and 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.

## Table of Contents

### 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 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, and 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:

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

37

---

## Table of Contents

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 2015, 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 and amount of extra content that 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 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

## Table of Contents

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 and service 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 using undiscounted cash flows when impairment indicators exist. If impairment exists, then the assets are written down to fair value. 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. 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.

In fiscal year 2015, we reported U.S. pre-tax income, compared to U.S. pre-tax losses in each of the last seven fiscal years. We have not yet been able to establish a sustained level of profitability in the U.S. or other sufficient significant positive evidence to conclude that our U.S. deferred tax assets are more likely than not to be realized. Therefore, we continue to maintain a valuation allowance against most of our U.S. deferred tax assets. It is reasonably possible that in fiscal year 2016 we will establish a sustained level of profitability in the U.S. As a result, it is possible that a significant portion of the \$539 million valuation allowance recorded against our U.S. deferred tax assets at March 31, 2015 could be reversed by the end of fiscal year 2016.

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, 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.



Table of Contents

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 year ending March 31, 2016 contains 53 weeks and ends on April 2, 2016. Our results of operations for the fiscal year ended March 31, 2015 contained 52 weeks and ended on March 28, 2015. Our results of operations for the three months ended September 30, 2015 and 2014 contained 13 weeks each and ended on October 3, 2015 and September 27, 2014, respectively. Our results of operations for the six months ended September 30, 2015 and 2014 contained 27 and 26 weeks, respectively, and ended on October 3, 2015 and September 27, 2014, 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 the 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 September 30, 2015, net revenue was \$815 million and decreased \$175 million, or 18 percent, as compared to the three months ended September 30, 2014. This decrease was driven by a \$322 million decrease in revenue primarily from Titanfall, and the Battlefield and Need for Speed franchises. This decrease was partially offset by a \$147 million increase in revenue primarily from Dragon Age: Inquisition, and the Madden NFL and The Sims franchises.

Net Revenue by Product Revenue and Service and Other Revenue

Our net revenue by product revenue and service and other revenue for the three months ended September 30, 2015 and 2014 was as follows (in millions):

Three Months Ended September 30,

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

	2015	2014	\$ Change	% Change
Net revenue:				
Product	\$434	\$536	\$(102 )	(19 )%
Service and other	381	454	(73 )	(16 )%
Total net revenue	\$815	\$990	\$(175 )	(18 )%

40

---

## Table of Contents

### Product Revenue

For the three months ended September 30, 2015, product revenue was \$434 million, primarily driven by FIFA 15, Battlefield Hardline, and Dragon Age: Inquisition. Product revenue decreased \$102 million, or 19 percent, as compared to the three months ended September 30, 2014. This decrease was driven by a \$187 million decrease primarily from the Battlefield, Need for Speed, and FIFA franchises. This decrease was partially offset by an \$85 million increase primarily from Dragon Age: Inquisition and The Sims franchise.

### Service and Other Revenue

For the three months ended September 30, 2015, service and other revenue was \$381 million, primarily driven by FIFA Ultimate Team, Star Wars: The Old Republic, and Madden Ultimate Team. Service and other revenue for the three months ended September 30, 2015 decreased \$73 million, or 16 percent, as compared to the three months ended September 30, 2014. This decrease was driven by a \$144 million decrease primarily from Titanfall and Battlefield 4 Premium. This decrease was partially offset by a \$71 million increase primarily from the Madden NFL and SimCity franchises.

### 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 September 30 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.

41

---

Table of Contents

Our non-GAAP net revenue by revenue composition and the reconciliation to net revenue for the three months ended September 30, 2015 and 2014 was as follows (in millions):

	Three Months Ended September 30,			
	2015	2014	\$ Change	% Change
Packaged goods and other	\$666	\$767	\$(101)	(13)%
Full game downloads	89	94	(5)	(5)%
Extra content	195	153	42	27%
Subscriptions, advertising, and other	83	91	(8)	(9)%
Mobile	113	115	(2)	(2)%
Total Digital	480	453	27	6%
Net Revenue before Revenue Deferral (Non-GAAP Net Revenue)	\$1,146	\$1,220	\$(74)	(6)%
Revenue Deferral	(977)	(1,035)	58	6%
Recognition of Revenue Deferral	646	805	(159)	(20)%
Change in deferred net revenue (online-enabled games)	(331)	(230)	(101)	44%
Total net revenue	\$815	\$990	\$(175)	(18)%

## Net Revenue before Revenue Deferral

## Packaged goods and other

Packaged goods 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 September 30, 2015, packaged goods and other Net Revenue before Revenue Deferral was \$666 million, primarily driven by FIFA 16, Madden NFL 16, and NHL 16. Packaged goods and other Net Revenue before Revenue Deferral for the three months ended September 30, 2015 decreased \$101 million, or 13 percent, as compared to the three months ended September 30, 2014. Excluding the \$71 million net negative impact of foreign currency exchange rates, we estimate that packaged goods and other Net Revenue before Revenue Deferral would have decreased by \$30 million. This decrease was driven primarily by the strong launch of The Sims 4 in the prior year.

## Digital

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 (e.g. 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 September 30, 2015, digital Net Revenue before Revenue Deferral was \$480 million, an increase of \$27 million, or 6 percent, as compared to the three months ended September 30, 2014. Excluding the \$38 million net negative impact of foreign currency exchange rates, we estimate that digital Net Revenue before Revenue Deferral would have increased by \$65 million. This increase on a constant currency basis is due to (1) a \$55 million or 36 percent increase in extra content and free-to-download sales primarily driven by FIFA Ultimate Team, which benefited from an extra week of FIFA 16 sales in the quarter compared to last year, (2) a \$6 million or 6 percent increase in full-game download sales primarily driven by FIFA 16,

Table of Contents

and (3) a \$6 million or 5 percent increase in mobile revenue primarily driven by Simcity Buildit. This increase was partially offset by a \$2 million or 2 percent decrease in subscription sales primarily driven by Battlefield 4 Premium.

## Revenue Deferral

Revenue Deferral for the three months ended September 30, 2015 decreased \$58 million, or 6 percent, as compared to the three months ended September 30, 2014. This decrease was due to a \$74 million decrease in Net Revenue before Revenue Deferral related to our packaged goods and other and digital sales during the three months ended September 30, 2015 as compared to three months ended September 30, 2014.

## Recognition of Revenue Deferral

The Recognition of Revenue Deferral for the three months ended September 30, 2015 decreased \$159 million, or 20 percent, as compared to the three months ended September 30, 2014. This decrease was primarily due to a decrease in packaged goods sales during the preceding nine-month period.

## Net Revenue Year-to-Date Analysis

## Net Revenue

For the six months ended September 30, 2015, net revenue was \$2,018 million and decreased \$186 million, or 8 percent, as compared to the six months ended September 30, 2014. This decrease was driven by a \$571 million decrease in revenue primarily from the Battlefield and Need for Speed franchises, and Titanfall. This decrease was partially offset by a \$385 million increase in revenue primarily from Dragon Age: Inquisition, and the Madden NFL and The Sims franchises.

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

Our net revenue by product revenue and service and other revenue for the six months ended September 30, 2015 and 2014 was as follows (in millions):

	Six Months Ended September 30,			
	2015	2014	\$ Change	% Change
Net revenue:				
Product	\$1,177	\$1,293	\$(116)	(9)%
Service and other	841	911	(70)	(8)%
Total net revenue	\$2,018	\$2,204	\$(186)	(8)%

## Product Revenue

For the six months ended September 30, 2015, product revenue was \$1,177 million, primarily driven by FIFA 15, Battlefield Hardline, and Dragon Age: Inquisition. Product revenue decreased \$116 million, or 9 percent, as compared to the six months ended September 30, 2014. This decrease was driven by a \$367 million decrease primarily from the Battlefield and Need for Speed franchises. This decrease was partially offset by a \$251 million increase primarily from Dragon Age: Inquisition and The Sims franchise.

## Service and Other Revenue

For the six months ended September 30, 2015, service and other revenue was \$841 million, primarily driven by FIFA Ultimate Team, Madden Ultimate Team, and Star Wars: The Old Republic. Service and other revenue for the six months ended September 30, 2015 decreased \$70 million, or 8 percent, as compared to the six months ended September 30, 2014. This decrease was driven by a \$221 million decrease primarily from Titanfall and Battlefield 4

Premium. This decrease was partially offset by a \$151 million increase primarily from the Madden NFL and SimCity franchises.



Table of Contents

## Supplemental Non-GAAP Net Revenue by Revenue Composition

Our non-GAAP net revenue by revenue composition and the reconciliation to net revenue for the six months ended September 30, 2015 and 2014 was as follows (in millions):

	Six Months Ended September 30,			
	2015	2014	\$ Change	% Change
Packaged goods and other	\$827	\$1,060	\$(233 )	(22 )%
Full game downloads	173	165	8	5 %
Extra content	450	364	86	24 %
Subscriptions, advertising, and other	154	171	(17 )	(10 )%
Mobile	235	235	—	— %
Total Digital	1,012	935	77	8 %
Net Revenue before Revenue Deferral (Non-GAAP Net Revenue)	\$1,839	\$1,995	\$(156 )	(8 )%
Revenue Deferral	(1,472 )	(1,658 )	186	11 %
Recognition of Revenue Deferral	1,651	1,867	(216 )	(12 )%
Change in deferred net revenue (online-enabled games)	179	209	(30 )	(14 )%
Total net revenue	\$2,018	\$2,204	\$(186 )	(8 )%

## Net Revenue before Revenue Deferral

## Packaged goods and other

For the six months ended September 30, 2015, packaged goods and other Net Revenue before Revenue Deferral was \$827 million, primarily driven by FIFA 16, Madden NFL 16, and FIFA 15. Packaged goods and other Net Revenue before Revenue Deferral for the six months ended September 30, 2015 decreased \$233 million, or 22 percent, as compared to the six months ended September 30, 2014. Excluding the \$87 million net negative impact of foreign currency exchange rates, we estimate that packaged goods and other Net Revenue before Revenue Deferral would have decreased by \$146 million. This decrease was driven by a decrease in sales primarily from Titanfall and the FIFA World Cup franchise.

## Digital

For the six months ended September 30, 2015, digital Net Revenue before Revenue Deferral was \$1,012 million, an increase of \$77 million, or 8 percent, as compared to the six months ended September 30, 2014. Excluding the \$80 million net negative impact of foreign currency exchange rates, we estimate that digital Net Revenue before Revenue Deferral would have increased by \$157 million. This increase on a constant currency basis is due to (1) a \$117 million or 32 percent increase in extra content and free-to-download sales primarily driven by FIFA Ultimate Team and FIFA Online 3 in China, (2) a \$28 million or 17 percent increase in full-game download sales primarily driven by FIFA 16 and Battlefield Hardline, and (3) a \$17 million or 7 percent increase in mobile sales primarily driven by Simcity Buildit. These increases were partially offset by a \$5 million or 3 percent decrease in subscription sales primarily driven by Battlefield 4 Premium.

## Revenue Deferral

Revenue Deferral for the six months ended September 30, 2015 decreased \$186 million, or 11 percent, as compared to the six months ended September 30, 2014. This decrease was primarily due to a \$156 million decrease in Net Revenue

before Revenue Deferral related to our packaged goods and other and digital sales during the six months ended September 30, 2015 as compared to six months ended September 30, 2014.

Table of Contents

## Recognition of Revenue Deferral

The Recognition of Revenue Deferral for the six months ended September 30, 2015 decreased \$216 million, or 12 percent, as compared to the six months ended September 30, 2014. This decrease was primarily due to a decrease in packaged goods sales during the preceding nine-month period.

## Cost of Revenue

## Cost of Revenue Quarterly Analysis

Cost of revenue for the three months ended September 30, 2015 and 2014 was as follows (in millions):

	September 30, 2015	% of Related Net Revenue	September 30, 2014	% of Related Net Revenue	% Change	Change as a % of Related Net Revenue
Cost of revenue:						
Product	\$ 335	77.2	% \$ 347	64.7	% (3.5)	% 12.5
Service and other	74	19.4	% 80	17.6	% (7.5)	% 1.8
Total cost of revenue	\$ 409	50.2	% \$ 427	43.1	% (4.2)	% 7.1

## Cost of Product Revenue

Cost of product revenue consists of (1) inventory 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 \$12 million, or 3.5 percent in the three months ended September 30, 2015, as compared to the three months ended September 30, 2014. Cost of product revenue decreased primarily due to a decrease in inventory costs as a result of product mix. Overall sales for our top three launches, FIFA 16, Madden NFL 16 and NHL 16, during the second quarter were higher as compared to the three months ended September 30, 2014. However, a higher percentage of these sales were for digital downloads versus packaged goods. This resulted in a corresponding decrease in inventory costs as our digital products have a lower cost than our packaged goods and other products.

## Cost of Service and Other Revenue

Cost of service and other revenue consists primarily of (1) royalty costs, (2) data center, bandwidth and server costs associated with hosting our online games and websites, (3) inventory costs, (4) platform processing fees from operating our website-based games on third party platforms, and (5) credit card fees associated with our service revenue.

Cost of service and other revenue decreased by \$6 million, or 7.5 percent in the three months ended September 30, 2015, as compared to the three months ended September 30, 2014. The decrease was primarily due to a decrease in inventory costs primarily driven by Plants vs. Zombies: Garden Warfare, which was released for the PlayStation 3 and 4 in the second quarter of the prior year.

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

During the three months ended September 30, 2015, total cost of revenue as a percentage of total net revenue increased by 7.1 percent as compared to the three months ended September 30, 2014. This increase was primarily due to a decline in our packaged goods and other sales (i.e. Net Revenue before Revenue Deferral) during the three months ended September 30, 2015.

Table of Contents

## Cost of Revenue Year-to-Date Analysis

Cost of revenue for the six months ended September 30, 2015 and 2014 was as follows (in millions):

	September 30, 2015	% of Related Net Revenue	September 30, 2014	% of Related Net Revenue	% Change	Change as a % of Related Net Revenue
Cost of revenue:						
Product	\$ 429	36.4	% \$ 599	46.3	% (28.4)	)% (9.9)
Service and other	153	18.2	% 195	21.4	% (21.5)	)% (3.2)
Total cost of revenue	\$ 582	28.8	% \$ 794	36.0	% (26.7)	)% (7.2)

## Cost of Product Revenue

Cost of product revenue decreased by \$170 million, or 28.4 percent in the six months ended September 30, 2015, as compared to the six months ended September 30, 2014. Cost of product revenue decreased primarily due to a loss of \$122 million on previously unrecognized licensed intellectual property commitment recognized during the three months ended June 30, 2014. Excluding the impact of the \$122 million loss, cost of product revenue decreased \$48 million, or 10 percent, primarily due to a decline in our packaged goods sales (i.e. Net Revenue before Revenue Deferral) during the six months ended September 30, 2015, as compared to the six months ended September 30, 2014.

## Cost of Service and Other Revenue

Cost of service and other revenue decreased by \$42 million, or 22 percent in the six months ended September 30, 2015, as compared to the six months ended September 30, 2014. The decrease was primarily due to a decrease in royalty and inventory costs due to Titanfall for the Xbox 360, which launched in the first quarter of fiscal year 2015, and Plants vs. Zombies: Garden Warfare, which was released for the PlayStation 3 and 4 in the second quarter of the prior year, and we had no console service game launches during the six months ended September 30, 2015.

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

During the six months ended September 30, 2015, total cost of revenue as a percentage of total net revenue decreased by 7.2 percent as compared to the six months ended September 30, 2014. Excluding the loss of \$122 million on previously unrecognized licensed intellectual property recognized during the three months ended June 30, 2014, total cost of revenue as a percentage of total net revenue remained relatively consistent.

## 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 our digital platform, software licenses and maintenance, and management overhead.

Research and development expenses for the three and six months ended September 30, 2015 and 2014 were as follows (in millions):

	September 30, 2015	% of Net Revenue	September 30, 2014	% of Net Revenue	\$ Change	% Change
Three months ended	\$265	32.5	% \$261	26.4	% \$4	1.5
Six months ended	\$561	27.8	% \$526	23.9	% \$35	6.7

Research and development expenses increased by \$4 million, or 1.5 percent, during the three months ended September 30, 2015, as compared to the three months ended September 30, 2014. Excluding the \$21 million positive impact of foreign currency exchange rates, we estimate that research and development would have increased by \$25 million. This \$25 million increase was primarily due to (1) a \$15 million increase in personnel-related costs, (2) a \$9 million increase in contracted

Table of Contents

services as a result of higher development contracted services during the three months ended September 30, 2015 as compared to the same period in the prior fiscal year, and (3) a \$2 million increase in stock-based compensation.

Research and development expenses increased by \$35 million, or 6.7 percent, during the six months ended September 30, 2015, as compared to the six months ended September 30, 2014. Excluding the \$40 million positive impact of foreign currency exchange rates, we estimate that research and development would have increased by \$75 million. This \$75 million increase was primarily due to (1) a \$36 million increase in personnel-related costs primarily resulting from higher payroll taxes as well as the quarter ended June 30, 2015 containing 14 weeks as compared to 13 weeks in the prior fiscal year, (2) a \$17 million increase in contracted services as a result of higher development contracted services during the six months ended September 30, 2015 as compared to the same period in the prior fiscal year, (3) a \$12 million increase in stock-based compensation, and (4) a \$5 million increase due to losses from our cash flow hedging activities incurred during the six months ended September 30, 2015.

**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 six months ended September 30, 2015 and 2014 were as follows (in millions):

	September 30, 2015	% of Net Revenue	September 30, 2014	% of Net Revenue	\$ Change	% Change
Three months ended	\$ 156	19.1	% \$ 183	18.5	% \$(27 )	(14.8 )%
Six months ended	\$ 279	13.8	% \$ 313	14.2	% \$(34 )	(10.9 )%

Marketing and sales expenses decreased by \$27 million, or 14.8 percent, during the three months ended September 30, 2015, as compared to the three months ended September 30, 2014. Excluding the \$8 million positive impact of foreign currency exchange rates, we estimate that marketing and sales expenses would have decreased by \$19 million. This \$19 million decrease was primarily due to advertising and promotional spending primarily related to The Sims 4 during the three months ended September 30, 2014.

Marketing and sales expenses decreased by \$34 million, or 10.9 percent, during the six months ended September 30, 2015, as compared to the six months ended September 30, 2014. Excluding the \$13 million positive impact of foreign currency exchange rates, we estimate that marketing and sales expenses would have decreased by \$21 million. This \$21 million decrease was primarily due to a \$25 million decrease in advertising and promotional spending on our franchises primarily due to fewer frontline title releases during the six months ended September 30, 2015 as compared to the same period in the prior year.

**General and Administrative**

General and administrative expenses consist of personnel and related expenses of executive and administrative staff, corporate functions such as finance, legal, human resources, and information technology ("IT"), 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 six months ended September 30, 2015 and 2014 were as follows (in millions):

	September 30, 2015	% of Net Revenue	September 30, 2014	% of Net Revenue	\$ Change	% Change
Three months ended	\$ 101	12.4	% \$ 92	9.3	% \$ 9	9.8 %
Six months ended	\$ 199	9.9	% \$ 180	8.2	% \$ 19	10.6 %

General and administrative expenses increased by \$9 million, or 9.8 percent, during the three months ended September 30, 2015, as compared to the three months ended September 30, 2014. Excluding the \$6 million positive impact of foreign currency exchange rates, we estimate that general and administrative expenses would have increased

by \$15 million. This \$15 million increase was primarily due to an \$8 million increase in facilities-related expense and a \$2 million increase in contracted services.



Table of Contents

General and administrative expenses increased by \$19 million, or 10.6 percent, during the six months ended September 30, 2015, as compared to the six months ended September 30, 2014. Excluding the \$11 million positive impact of foreign currency exchange rates, we estimate that general and administrative expenses would have increased by \$30 million. This \$30 million increase was primarily due to (1) an \$11 million increase in personnel-related costs primarily due to the quarter ended June 30, 2015 containing 14 weeks as compared to 13 weeks in the prior fiscal year, (2) a \$9 million increase in facilities-related expense, and (3) a \$6 million increase in stock-based compensation.

## Income Taxes

Provision for income taxes for the three and six months ended September 30, 2015 and 2014 were as follows (in millions):

	September 30, 2015	Effective Tax Rate	September 30, 2014	Effective Tax Rate	
Three months ended	\$12	9.4	% \$15	83.3	%
Six months ended	\$79	20.7	% \$34	9.1	%

The provision for income taxes reported for the three and six months ended September 30, 2015 is based on our projected annual effective tax rate for fiscal year 2016, and also includes certain discrete items recorded during the period. Our effective tax rate for the three and six months ended September 30, 2015 was a tax expense of 9.4 percent and 20.7 percent, respectively, as compared to 83.3 percent and 9.1 percent, respectively, for the same period of fiscal year 2015. The effective tax rate for the three and six months ended September 30, 2015 and 2014 was reduced, when compared to the statutory rate of 35.0 percent, by 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. Conversely, the effective tax rate was increased due to a discrete expense of \$25 million and \$65 million recorded in the three and six months ended September 30, 2015, respectively, for excess tax benefits from stock-based compensation deductions allocated directly to contributed capital. The effective tax rate for the three months ended September 30, 2015 differs from the same period in fiscal year 2015 primarily due to the difference in pre-tax income. The effective tax rate for the six months ended September 30, 2015 is higher compared to the same period in fiscal 2015 primarily due to the increase in the discrete expense for excess tax benefits from stock-based compensation deductions.

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 September 30, 2015	As of March 31, 2015	Increase/(Decrease)
Cash and cash equivalents	\$1,598	\$2,068	\$(470)
Short-term investments	990	953	37
Total	\$2,588	\$3,021	\$(433)
Percentage of total assets	43	% 49	%

(In millions)	Six Months Ended September 30, 2015	September 30, 2014	Change
Cash provided by (used in) operating activities	\$(62)	) \$187	\$(249)
Cash used in investing activities	(80)	) (233)	) 153
Cash used in financing activities	(307)	) (105)	) (202)
Effect of foreign exchange on cash and cash equivalents	(21)	) (7)	) (14)
Net decrease in cash and cash equivalents	\$(470)	) \$(158)	) \$(312)

## Changes in Cash Flow

Operating Activities. Cash provided by operating activities decreased \$249 million during the six months ended September 30, 2015 as compared to the six months ended September 30, 2014. The change is primarily due to a \$156 million decrease in Net Revenue before Revenue Deferral due to fewer frontline title releases during the six months ended September 30, 2015 as compared to the six months ended September 30, 2014, and a \$75 million increase in research and development investments on a constant currency basis.

Investing Activities. Cash used in investing activities decreased \$153 million during the six months ended September 30, 2015 as compared to the six months ended September 30, 2014 primarily driven by a \$161 million increase in proceeds from the sales and maturities of short-term investments. This was partially offset by a \$14 million increase in purchase of short-term investments.

Financing Activities. Cash used in financing activities increased \$202 million during the six months ended September 30, 2015 as compared to the six months ended September 30, 2014 primarily due to a \$198 million repayment of our convertible senior notes during the three months ended September 30, 2015 and a \$113 million increase in repurchases and retirement of common stock. This was offset by a \$58 million increase in proceeds from the exercise of stock options and a \$51 million increase in excess tax benefit from stock compensation recognized during the six months ended September 30, 2015 as compared to the six months ended September 30, 2014.

## 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 September 30, 2015, our short-term investments had gross unrealized gains of \$2 million, or less than 1 percent of the total in short-term investments, and gross unrealized losses of less than \$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, debt repayment obligations, 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.

## 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. The Notes will mature on July 15, 2016, unless purchased earlier or converted in accordance with their terms prior to such date.

During the quarter ended September 30, 2015, the market value of our common stock exceeded the conversion trigger price of \$41.26 per share for at least 20 trading days of the 30 consecutive trading days preceding quarter end. As a

result, the Notes are convertible at the option of the holder through January 2, 2016. During the six months ended September 30, 2015,

49

---

## Table of Contents

approximately \$245 million principal value of the Notes were converted by holders thereof. The majority of these conversions were settled during the three months ended September 30, 2015. During the three months ended September 30, 2015, we repaid \$198 million of the principal balance of the Notes and issued approximately 3.4 million shares of common stock to noteholders with a fair value of \$226 million, resulting in a loss on conversion of senior notes of \$6 million. We also received and cancelled approximately 3.4 million shares of common stock from the exercise of the Convertible Note Hedge.

The remaining \$47 million of conversion requests received prior to September 30, 2015 will be settled in the quarter ending December 31, 2015. Subsequent to the quarter ended September 30, 2015 and through November 6, 2015, we received conversion requests for an additional \$48 million principal value of the Notes. During the quarter ending December 31, 2015, we will repay in cash an aggregate principal amount of at least \$95 million related to conversions of our Notes and issue the number of shares of our common stock equal in value to the excess conversion value.

Based on the closing stock price of our common stock of \$66.49 at the end of the quarter ended September 30, 2015, approximately 2 million shares of our common stock would be issuable to converting holders. The actual amount of shares issuable upon conversion will be determined based upon the market price of our common stock during an observation period following any conversion. If our stock price continues to exceed the conversion price of the Notes, we may continue to receive early conversion notices of the Notes prior to the scheduled maturity date. See Note 10 - 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, which is incorporated by reference into this Item 2.

### Credit Facility

On March 19, 2015, we entered into a new \$500 million senior unsecured revolving credit facility with a syndicate of banks. As of September 30, 2015, no amounts were outstanding under the credit facility. See Note 10 - Financing Arrangements to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our credit facility, which 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, debt repayment obligations, 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 September 30, 2015, approximately \$1.1 billion 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.

In May 2015, our Board of Directors authorized a new program to repurchase up to \$1 billion of our common stock. This new stock repurchase program, which expires on May 31, 2017, supersedes and replaces the stock repurchase authorization approved in May 2014. 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 months ended September 30, 2015, we repurchased approximately 1.8 million shares for approximately \$126 million under this new program.

During the six months ended September 30, 2015, we repurchased approximately 4.0 million shares for approximately \$258 million. Of these repurchases, approximately 3.0 million shares were repurchased under the May 2015 program for approximately \$201 million. We continue to actively repurchase shares.



Table of Contents

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, but not limited to, working capital, financing capital expenditures, research and development, marketing and distribution efforts, debt repayment obligations, stock repurchase programs, 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.

Contractual Obligations and Commercial Commitments

Note 11 - 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.

Table of Contents

OFF-BALANCE SHEET COMMITMENTS

As of September 30, 2015, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC, that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues and expenses, results of operations, liquidity, capital expenditures, or capital resources that are material to investors.

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. 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 speculative trading purposes and do not hedge our market price risk relating to marketable equity securities, if any.

**Foreign Currency Exchange Rate Risk**

**Foreign Currency Exchange Rates.** International sales are a fundamental part of our business, and we currently anticipate foreign currency exchange rates to have a negative impact on our expected reported net revenue (particularly relative to the Euro, British pound sterling, Australian dollar, Chinese yuan and South Korea won) in fiscal year 2016 as compared to fiscal year 2015, but the strengthening of the U.S. dollar is expected to have a positive impact on our reported operating expenses (particularly Swedish krona and Canadian dollar) as a significant portion of those expenses are incurred outside the United States. While we use foreign currency hedging contracts to mitigate some foreign currency exchange risk, these activities are limited in the protection that they provide us and can themselves result in losses.

**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 18 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 creditworthy 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 September 30, 2015, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 20 percent would have resulted in declines in the fair value on our foreign currency forward contracts used in cash flow hedging of \$77 million and \$155 million, respectively. As of September 30, 2015, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 20 percent would have resulted in declines in the fair value on our foreign currency forward contracts used in balance sheet hedging of \$36 million and \$73 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. See Note 4 - Derivative Financial Instruments to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our derivative financial instruments, which 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 September 30, 2015, 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 September 30, 2015, arising from hypothetical 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 September 30, 2015	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	\$597	\$594	\$591	\$588	\$585	\$582	\$579
U.S. Treasury securities	205	203	201	200	198	197	195
U.S. agency securities	151	150	149	148	147	146	145
Commercial paper	55	55	55	54	54	54	54
Total short-term investments	\$1,008	\$1,002	\$996	\$990	\$984	\$979	\$973

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 fiscal quarter ended September 30, 2015 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 11 - 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 or 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 could be material that may harm our business or 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.

We maintain a relatively limited 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 a relatively small number of major titles each year also concentrates risk in those titles and means each major title has greater associated risk. A significant portion of our revenue has historically been derived from games and services based on a few popular franchises. For example, in fiscal year 2015, net revenue generated from the sale of products and services associated with our three largest franchises accounted for approximately 54 percent of our net revenue. 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, sports seasons or movies that we tie our product release schedules to are delayed, cancelled or poorly received.

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 feedback from our players, 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 delay 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, sports season or film to which our product release schedule is tied were to be delayed, cancelled or poorly received, our sales would likely suffer disproportionately. 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.

Table of Contents

The console segment of the entertainment software industry is cyclical, driven by the periodic introductio