

ELECTRONIC ARTS INC  
Form 10-K  
May 30, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-K**

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

**For the fiscal year ended March 31, 2007**

**OR**

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

**For the transition period from to**

**Commission File No. 0-17948**

**ELECTRONIC ARTS INC.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**94-2838567**

*(I.R.S. Employer  
Identification No.)*

**209 Redwood Shores Parkway  
Redwood City, California**

*(Address of principal executive offices)*

**94065**

*(Zip Code)*

**Registrant's telephone number, including area code:**

**(650) 628-1500**

**Securities registered pursuant to Section 12(b) of the Act:**

**Title of Each Class**

**Name of Each Exchange on Which Registered**

Common Stock, \$0.01 par value

The NASDAQ Stock Market LLC

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☐

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐

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

The aggregate market value of the registrant's common stock, \$0.01 par value, held by non-affiliates of the registrant as of September 29, 2006, the last business day of the second fiscal quarter, was \$17,149,452,000.

As of May 24, 2007 there were 311,473,084 shares of the registrant's common stock, \$0.01 par value, outstanding.

**Documents Incorporated by Reference**

Portions of the registrant's definitive proxy statement for its 2007 Annual Meeting of Stockholders are incorporated by reference into Part III hereof.

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**ELECTRONIC ARTS INC.  
2007 FORM 10-K ANNUAL REPORT**

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**PART I**

**This 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, including statements regarding industry prospects and future results of operations or financial position, made in this Report are forward looking. 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. 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 under the heading Risk Factors , beginning on page 13.**

**Item 1: *Business***

**Overview**

Electronic Arts develops, markets, publishes and distributes interactive software games and content that are playable by consumers on the following devices:

Video game consoles such as the Sony PlayStation® 2 and PLAYSTATION® 3, Microsoft Xbox® and Xbox 360™ and Nintendo Wii™,

Personal computers (PCs),

Mobile platforms including cellular handsets and handheld game players such as the PlayStation® Portable ( PSP™ ), Nintendo DS® and Game Boy® Advance and iPod®, and

Online (over the Internet and other proprietary online networks).

We also sell advertising in many of our games and on our websites.

We refer to consoles, PCs, mobile platforms and online collectively as platforms . In fiscal 2007, we developed or published products for 13 different platforms. Since our inception, we have published games for over 50 different platforms. This platform diversification continues to be a cornerstone of our product strategy.

The interactive software games that we develop and publish are broken down into two major categories: (1) games developed by our EA Studios, and (2) games that we co-publish with, or distribute on behalf of, another company through our EA Partners group. Our EA Studios games are either developed internally at our development and production studios located in the United States, Canada, England, Sweden, Germany, Singapore, China, Romania and India, or by third parties whom we engage to develop games on our behalf at their own development and production studios. We market, publish and distribute games in over 30 countries throughout the world.

We market the products produced by our studios under the EA™, EA SPORTS™, EA SPORTS BIG™, and POGO™ brands.

We were initially incorporated in California in 1982. In September 1991, we reincorporated under the laws of Delaware. Our principal executive offices are located at 209 Redwood Shores Parkway, Redwood City, California 94065 and our telephone number is (650) 628-1500.

### **Development of Our Games**

The console, handheld, PC and online games we publish are developed primarily by our EA Studios, while the games we offer for cellular handsets are developed primarily by third parties. In addition, through our EA Partners group, we team with other game development companies to assist them with the development of games on our behalf. For the fiscal years ended March 31, 2007, 2006 and 2005, research and development expenses were \$1,041 million, \$758 million and \$633 million, respectively.

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### ***EA Studios***

We develop packaged goods games internally at our development and production studios located in the United States, Canada, England, Sweden, Germany, Singapore and China. We invest in the creation of software tools to more efficiently develop games for multiple platforms. We also make investments in facilities and equipment that allow us to create and edit video and audio recordings that are used in our games. Employees whom we call executive producers are responsible for overseeing the development of one or more products or franchises (a series of sequels or related products). We also engage third parties to develop games on our behalf at their own development and production studios.

Following our acquisition of JAMDAT Mobile Inc. in February 2006, we merged our existing cellular handset software game development and publishing business into JAMDAT to establish our EA Mobile business. We engage third parties to develop games for cellular handsets on our behalf at their own development and production studios and, to a lesser extent, we develop cellular handset games internally at our development and production studios located in the United States, Canada, England, Romania and India.

We develop online games and content internally at our development and production studios located in the United States, Canada and Singapore. In fiscal 2007, we acquired Mythic Entertainment, Inc., a developer and publisher of massively multiplayer online role-playing games. We also engage third parties to develop online games on our behalf at their own development and production studios.

In fiscal 2007, we generated approximately 65 percent of our net revenue from games developed by our EA Studios that were initially released during the year, as compared to approximately 73 percent in fiscal 2006. Excluding titles developed for cellular handsets, during fiscal 2007 we released 32 EA Studio titles compared to 31 EA Studio titles in fiscal 2006. In fiscal 2007, we released over 190,000 stock keeping units, or SKUs (a version of a title designed for play on a particular platform), for cellular handsets.

### ***Co-publishing, Distribution and Third Party Development***

Through our EA Partners group, we team with other game development companies to assist with the development of their own interactive software games, which we then publish, market and distribute. We refer to these types of arrangements as co-publishing. For example, in fiscal 2007, we signed a co-publishing agreement with NAMCO BANDAI Games America for *Hellgate: London*<sup>™</sup>, which is being developed by Flagship Studios.

We also distribute interactive software games that are developed and published by other companies. An example of one of our recent distribution products is *Half-Life*<sup>®</sup> 2: *Episode One*, which was developed and published by Valve and distributed worldwide by us.

We also engage third parties to develop games on our behalf.

### **Publishing Our Games   Marketing, Market Segments and Distribution**

We market our products under four major brand names:

EA we publish a variety of games under our EA brand. Some of our products published under the EA brand include *Need for Speed*<sup>™</sup> *Carbon*, *The Sims*<sup>™</sup> 2 and *The Godfather*<sup>™</sup> *The Game*;

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EA SPORTS sports simulation games. Some of our products published under the EA SPORTS brand include *Madden NFL 07*, *FIFA Soccer 07* and *Tiger Woods PGA TOUR® 07*;

EA SPORTS BIG arcade-style extreme sports and modified traditional sports games. Some of our products published under the EA SPORTS BIG brand include *Def Jam: Icon™*, *NBA STREET Homecourt* and *FIFA Street 2*; and

POGO Online casual games and downloadable casual games.



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In addition, our EA Partners group operates under a variety of deal types and structures with the intent of making available our publishing marketing and distribution services to game developers who may not have the scale of our resources.

In fiscal 2007, we had two titles, *Need for Speed Carbon* and *Madden NFL 07*, published on 10 different platforms, each of which represented approximately 11 percent of our total net revenue. In fiscal 2006, we had one title, *Need for Speed Most Wanted*, published on eight different platforms, which represented approximately 10 percent of our total net revenue. In fiscal 2005, we had one title, *Need for Speed Underground 2*, published on five different platforms, which represented approximately 11 percent of our total net revenue.

## ***Packaged Goods***

The console, PC and handheld games that we publish are made available to consumers as packaged goods (usually Blu-ray Disc, CD, DVD, cartridge or Universal Media Disc format) that are typically sold in retail stores and through online stores (including our own online store). In North America and Europe, our largest markets, we sell these packaged goods products primarily to retailers, including mass market retailers (such as Wal-Mart), electronics specialty stores (such as Best Buy) or game software specialty stores (such as GameStop). Many of our PC products can also be purchased over the Internet through digital download.

We generated approximately 95 percent of our North American packaged goods net revenue from direct sales to retailers, with the remaining net revenue being generated through a limited number of specialized and regional distributors and rack jobbers in markets where we believe direct sales would not be economical. Outside of North America, we derive packaged goods revenue primarily from direct sales to retailers. In a few of our smaller markets, we sell our packaged goods products through distributors with whom we have written agreements or informal arrangements, depending on the business customs of the territories. We also distribute products of other companies through our rack jobbing business in Switzerland. We had direct sales to Wal-Mart Stores, Inc. which represented approximately 13 percent of total net revenue in both fiscal 2007 and 2006, and approximately 14 percent of total net revenue in fiscal 2005. We also had direct sales to GameStop Corp. which represented approximately 12 percent of total net revenue in fiscal 2007.

*Video Games Consoles, Handhelds and PCs.* Historically, there have been multiple video game consoles and handheld game players available to consumers, and there has been vigorous competition among manufacturers. While Sony's PlayStation® and PlayStation 2 consoles have significantly outsold their competitors in the past, the PLAYSTATION 3 faces very strong competition from new platforms such as Microsoft's Xbox 360 and the Nintendo Wii. The PC also continues to be a strong interactive game platform. Similarly, while Nintendo's Game Boy® Advance and Nintendo DS are current and historic leaders in the handheld game player market, Sony's PlayStation Portable is also a competitor in this segment.

Video game consoles have historically had a life cycle of four to six years, which causes the video game software market to be cyclical as well. With the release of Microsoft's Xbox 360 in 2005 and the releases of Sony's PLAYSTATION 3 and Nintendo's Wii in 2006, our industry is at the beginning of a new cycle. As such, in fiscal 2008, we expect to release fewer titles for the PlayStation 2 than in fiscal 2007, a very small number of titles for the Xbox, and no titles for the Nintendo GameCube™. The following table details select information on some of the console platforms for which we have published titles:

**Number of EA  
Titles**

| <b>Manufacturer</b> | <b>Video Game Console/Platform Name</b> | <b>Year Introduced</b> | <b>Published in Fiscal 2007</b> |
|---------------------|---|------------------------|---------------------------------|
| Sony                | PlayStation 2                           | 2000                   | 22                              |
| Nintendo            | Nintendo GameCube                       | 2001                   | 5                               |
| Microsoft           | Xbox                                    | 2001                   | 11                              |
| Microsoft           | Xbox 360                                | 2005                   | 18                              |
| Sony                | PLAYSTATION 3                           | 2006                   | 7                               |
| Nintendo            | Wii                                     | 2006                   | 6                               |

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The following table details select information on some of the handheld video game players for which we have published titles:

| <b>Manufacturer</b> | <b>Mobile Game Machine/Platform Name</b> | <b>Year Introduced</b> | <b>Number of EA Titles Published in Fiscal 2007</b> |
|---------------------|--|------------------------|---|
| Nintendo            | Game Boy Advance                         | 2001                   | 6   |
| Nintendo            | Nintendo DS                              | 2004                   | 8   |
| Sony                | PSP                                      | 2005                   | 18  |

In fiscal 2007, we published 26 EA titles for the PC.

***Cellular Handsets***

Through EA Mobile, we are a leading global publisher of interactive entertainment software playable on cellular handsets, including games, ring tones, images and other content. Our customers typically purchase and download our games through a wireless carrier's branded e-commerce service accessed directly from their cellular handsets. These wireless carrier services include, among others, Verizon Wireless *Get It Now*, Sprint PCS *Vision*, Cingular *MEdia* and Vodafone *live!*. Our customers are charged either a one-time or a monthly subscription fee on their cellular service invoice for the game. The wireless carriers generally retain a percentage of the fee and pay the remainder to us. The wireless distribution of our games eliminates traditional publishing complexities, including physical production, packaging, shipping, inventory management and return processing. Our customers may also purchase and download games directly from our website.

Many of our games are designed to take advantage of multimedia enhancements in the latest generation of cellular handsets, including high-resolution color displays, increased processing power, improved audio capabilities and increased memory capabilities. We publish games in multiple categories designed to appeal to a broad range of wireless subscribers. Our portfolio is primarily based on intellectual properties that we create and own, and well-established brands and content that we license from third parties.

***Online***

We publish four types of games that are played online by consumers: online casual games, massively multiplayer online games, mid-session games, and online-enabled packaged goods. We derive revenue from these games primarily through paid subscriptions, advertising and sales of digital content.

*Online Casual Games.* We offer online casual games such as card games, puzzle games and word games on our website, pogo.com, and on certain online services provided by third parties. We had over 1.5 million paying Club Pogo subscribers as of March 31, 2007, up from 1.2 million paying subscribers as of March 31, 2006.

*Massively Multiplayer Online Games.* Players experience online-only massively multiplayer online games (sometimes called "persistent state world games" or "MMOs") as interactive virtual worlds where thousands of other players can interact with one another. After installing the software on their PCs, players are able to subscribe and interact with other players online. We currently offer three MMO games: *Ultima Online*<sup>™</sup>, *Dark Age of Camelot*<sup>®</sup> and *The Sims Online*<sup>™</sup>, and we are in the process of developing *Warhammer*<sup>®</sup> *Online*.

*Mid-session games.* Players experience mid-session games as interactive virtual worlds where players form small groups and interact with one another. We currently offer one mid-session game, *EA Sports™ FIFA Online*, but anticipate offering more in future years. Although we offer *EA Sports FIFA Online* for free, players may purchase additional in-game content from us through micro-transactions.

*Online-Enabled Packaged Goods.* We include online functionality in certain of our PC, PLAYSTATION 3, PlayStation 2, Xbox 360, Xbox and PSP products, which enable consumers to participate in online communities and play against one another via the Internet.

*Digital Content.* We offer full-game downloads and additional content (such as booster packs, expansion packs and smaller pieces of game content referred to as micro-transactions) for our PC and console-based games through our EA.com website and online interfaces within game consoles. In addition, our POGO games are offered through third-party websites.

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*Advertising.* We derive revenue from advertising in our games and on our websites.

### **Competition**

We compete in the entertainment industry for the leisure time and discretionary spending of consumers with other forms of media, such as motion pictures, television, social networking and music. Our competitors vary in size and cost structure from very small companies with limited resources to very large, diversified corporations with greater financial and marketing resources than ours. For example, we compete with venture capital funded start-ups, traditional independent video game publishers, hardware and software manufacturers, casual entertainment websites, social networking websites, mobile games developers, foreign games developers and large media companies. We also compete with satellite radio, traditional radio and all other forms of entertainment.

Our business is characterized by the continuous introduction of innovative new titles and the development of new technologies. Competition is also based on product quality and features, timing of product releases, brand-name recognition, quality of in-game content, access to distribution channels, effectiveness of marketing and price.

In addition to competing for product sales, we face heavy competition from other software game companies and large media companies to obtain license agreements granting us the right to use intellectual property included in our products. Some of these content licenses are controlled by the diversified media companies, which, in some cases, have decided to publish their own games based on popular entertainment properties that they control, rather than licensing the content to a software game company such as us. See *Intellectual Property* below.

### ***Sales of Packaged Goods***

The market for our packaged goods products is also characterized by significant price competition and we regularly face pricing pressures from our competitors. These pressures have, from time to time, required us to reduce our prices on certain products. Our experience has been that software game prices tend to decline once a generation of consoles has been in the market for a significant period of time due to the increasing number of software titles competing for acceptance by consumers and the introduction of new consoles. As our industry has transitioned to a new generation of consoles over the past two years, we have experienced this kind of price erosion with respect to games for the prior generation of consoles (e.g., PlayStation 2, Xbox and Nintendo GameCube).

For sales of packaged goods, we compete directly with Sony, Microsoft and Nintendo, each of which develop and publish software for their respective console platforms. We also compete with numerous companies which, like us, develop and publish software games that operate on their consoles. These competitors include Activision, Atari, Capcom, Koei, Konami, LucasArts, Midway, Namco, Sega, Take-Two Interactive, THQ and Ubisoft, among others. As discussed above, diversified media companies such as Fox, Disney, Time Warner, Viacom and Vivendi are also expanding their software game publishing efforts.

### ***Sales for Cellular Handsets***

The wireless entertainment applications market segment, for which we develop and publish games, ring tones and wallpapers for cellular handsets, is highly competitive and characterized by frequent product introductions, evolving wireless platforms and new technologies. As demand for applications continues to increase, we expect new competitors to enter the market and existing competitors to allocate more resources to develop and market applications. As a result, we expect competition in the wireless entertainment market segment to intensify.

The current and potential competition in the wireless entertainment applications market segment includes major media companies, traditional video game publishing companies, wireless carriers, wireless software providers and other companies that specialize in wireless entertainment applications. We also compete with wireless content aggregators, who pool applications from multiple developers (and sometimes publishers) and

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offer them to carriers or through other sales channels. In addition, new and existing competitors are beginning to offer wireless entertainment applications on an ad-supported basis. Currently, we consider our primary competitors in the wireless entertainment applications market segment to be Disney, Fox Mobile Entertainment, Gameloft, Glu Mobile, Hands-On Mobile, Namco, Sony Pictures and THQ Wireless.

### ***Online Sales***

The online games market segment is also highly competitive and characterized by frequent product introductions, new business models and new platforms. As the proportion of households with a broadband connection increases, we expect new competitors to enter the market and existing competitors to allocate more resources toward developing online games. As a result, we expect competition in the online games market segment to intensify.

Our current and potential competitors in the online games market segment include major media companies, traditional video game publishing companies, and companies that specialize in online games. Our competitors in the casual games segment include MSN, Popcap, Real, AOL and Yahoo!. In the massively multiplayer online game segment our competitors include Atari, Midway, NC Soft, Sony and Vivendi Games. In the mid-session game segment our competitors include Nexon.

### **Intellectual Property**

Like other entertainment companies, our business is significantly based on the creation, acquisition, exploitation and protection of intellectual property. Some of this intellectual property is in the form of software code, patented technology, and other technology and trade secrets that we use to develop our games and to make them run properly on the platforms. Other intellectual property is in the form of audio-visual elements that consumers can see, hear and interact with when they are playing our games we call this form of intellectual property content .

Each of our products embodies a number of separate forms of intellectual property protection: the software and the content of our products are copyrighted; our products may use patented inventions or trade secrets; our product brands and names may be trademarks of ours or others; our products may contain voices and likenesses of actors, athletes and/or commentators (which may be protected by personal publicity rights) and often contain musical compositions and recordings that are also copyrighted. Our products also may contain content licensed from others, such as trademarks, fictional characters, storylines and software code.

We acquire the rights to include wholly-owned intellectual property in our products by creating the intellectual property within our EA Studios. We also acquire the rights to include proprietary intellectual property in our products through acquisitions. We also enter into content license agreements such as those with sports leagues and player associations, movie studios and performing talent, music labels, music publishers and musicians. These licenses are typically limited to use of the licensed rights in products for specific time periods. In addition, our products that play on game consoles, handhelds and cellular handsets include technology that is owned by the console manufacturer and licensed non-exclusively to us for use. While we may have renewal rights for some licenses, our business and the justification for the development of many of our products is dependent on our ability to continue to obtain the intellectual property rights from the owners of these rights at reasonable rates.

Our products are susceptible to unauthorized copying. We typically distribute our PC products using copy protection technology that we license from other companies. In addition, console manufacturers, such as Sony, typically incorporate security devices in their consoles in an effort to prevent the use of unlicensed products. Our primary protection against unauthorized use, duplication and distribution of our products is enforcement of our copyright and trademark interests. We typically own the copyright to the software code as well as the brand or title name trademark under which our products are marketed. We register our copyrights and trademarks in the United States and other

countries.



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### **Significant Relationships**

#### ***Hardware Platform Companies***

*Sony.* Under the terms of agreements we have entered into with Sony Computer Entertainment Inc. and its affiliates, we are authorized to develop and distribute disk-based software products and online content compatible with the PlayStation 2, PLAYSTATION 3 and PSP. Pursuant to these agreements, we engage Sony to supply PlayStation 2, PLAYSTATION 3 and PSP disks for our products.

*Microsoft.* Under the terms of agreements we have entered into with Microsoft Corporation and its affiliates, we are authorized to develop and distribute DVD-based software products and online content compatible with the Xbox and Xbox 360.

*Nintendo.* Under the terms of agreements we have entered into with Nintendo Co., Ltd. and its affiliates, we are authorized to develop and distribute proprietary optical format disk products and cartridges compatible with the Nintendo GameCube, the Wii, the Nintendo DS and Game Boy Advance. Pursuant to these agreements, we engage Nintendo to supply Wii proprietary optical format disk products and Nintendo DS cartridges for our products.

#### ***Cellular Handsets***

We have agreements to distribute our wireless applications through more than 110 carriers in over 40 countries. Our customers download our applications to their cellular handsets and their wireless carrier invoices them a one-time fee or monthly subscription fee. Our carrier distribution agreements establish the fees to be retained by the carrier for distributing our applications. These arrangements are typically terminable on short notice. The agreements generally do not obligate the carriers to market or distribute any of our applications.

#### ***Content Licensors***

Many of our products are based on or incorporate content and trademarks owned by others. For example, our EA, EA SPORTS and EA SPORTS BIG products include rights licensed from third parties, including major studios, publishers, artists, authors, celebrities, athletes and the major sports leagues and players associations.

### **Inventory, Working Capital, Backlog, Manufacturing and Suppliers**

We manage inventory by communicating with our customers prior to the release of our products, and then using our industry experience to forecast demand on a product-by-product and territory-by-territory basis. Historically, we have experienced high turnover of our products, and the lead times on re-orders of our products are generally short, approximately two to three weeks. Further, as discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations, we have practices in place with our customers (such as stock balancing and price protection) that reduce product returns.

We typically ship orders immediately upon receipt. To the extent that any backlog may or may not exist at the end of a reporting period, it would be both coincidental and an unreliable indicator of future results of any period.

The suppliers we use to manufacture our games and related materials include independent third parties, Sony and Nintendo.

In many instances, we are able to acquire materials on a volume-discount basis. We have multiple potential sources of supply for most materials, except for the disk component of our PLAYSTATION 3, PlayStation 2, PSP and Wii and Nintendo DS cartridges.

Our online games and cellular handset applications are delivered digitally, and therefore, are not manufactured.

### **International Operations**

We conduct business and have wholly-owned subsidiaries throughout the world, including offices in Europe, Australia, Asia and Latin America. International net revenue increased by 4 percent to \$1.425 billion, or

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46 percent of total net revenue in fiscal 2007, compared to \$1.367 billion, or 46 percent of total net revenue in fiscal 2006.

The amounts of net revenue and long-lived assets attributable to each of our geographic regions for each of the last three fiscal years are set forth in Note 18 of the Notes to Consolidated Financial Statements, included in Item 8 of this report.

**Seasonality**

Our business is highly seasonal. We typically experience our highest sales volume in the holiday season quarter ending in December and a seasonal low in sales volume in the quarter ending in June. Starting in fiscal 2008, we expect to defer the recognition of a significant amount of net revenue related to our online-enabled packaged goods over an extended period of time (which we currently estimate to be six months). As a result, the quarter in which we generate the highest sales volume may be different than the quarter in which we recognize the highest net revenue. Our results can also vary based on a number of factors, including title release dates, consumer demand for our products, shipment schedules and our revenue recognition policies.

**Employees**

As of March 31, 2007, we employed approximately 7,900 people, of whom over 4,500 were outside the United States. We believe that our ability to attract and retain qualified employees is a critical factor in the successful development of our products and that our future success will depend, in large measure, on our ability to continue to attract and retain qualified employees. Less than 3 percent of our employees, all of whom work for our Swedish development subsidiary, are represented by a union, guild or other collective bargaining organization.

**Executive Officers**

The following table sets forth information regarding our executive officers, who are appointed by and serve at the discretion of the Board of Directors as of May 29, 2007:

| <b>Name</b>         | <b>Age</b> | <b>Position</b>  |
|---------------------|------------|--|
| John S. Riccitiello | 47         | Chief Executive Officer  |
| V. Paul Lee         | 42         | President, Worldwide Studios   |
| Gerhard Florin      | 48         | Executive Vice President, General Manager, International Publishing  |
| Frank D. Gibeau     | 38         | Executive Vice President, General Manager, North America Publishing  |
| Warren C. Jenson    | 50         | Executive Vice President, Chief Financial and Administrative Officer |
| Joel Linzner        | 55         | Executive Vice President, Business and Legal Affairs                 |
| Nancy L. Smith      | 54         | Executive Vice President, General Manager, The Sims Franchise        |
| Gabrielle Toledano  | 40         | Executive Vice President, Human Resources                            |
| Kenneth A. Barker   | 40         | Senior Vice President, Chief Accounting Officer                      |
| Stephen G. Bené     | 43         | Senior Vice President, General Counsel and Corporate Secretary       |
| Michael Marchetti   | 38         | Senior Vice President and General Manager, EA Mobile                 |

John Schappert

36 Senior Vice President, Chief Operating Officer, Worldwide Studios

**Mr. Riccitiello** has served as Chief Executive Officer and a Director of Electronic Arts since April 2007. Prior to re-joining Electronic Arts, he was a co-founder and Managing Partner at Elevation Partners, a private equity fund. From October 1997 to April 2004, he served as President and Chief Operating Officer of Electronic Arts. Prior to joining Electronic Arts, Mr. Riccitiello served as President and Chief Executive Officer of the

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worldwide bakery division at Sara Lee Corporation. Before joining Sara Lee, he served as President and CEO of Wilson Sporting Goods Co. and has also held executive management positions at Haagen-Dazs, PepsiCo, Inc. and The Clorox Company. Mr. Riccitiello holds a B.S. degree from the University of California, Berkeley.

**Mr. Lee** was named President, Worldwide Studios, in September 2005. He served as Executive Vice President and Chief Operating Officer, Worldwide Studios from August 2002 to September 2005. From 1998 to August 2002, he was Senior Vice President and Chief Operating Officer, Worldwide Studios. Prior to this, he served as General Manager of EA Canada, Chief Operating Officer of EA Canada, Chief Financial Officer of EA Sports and Vice President, Finance and Administration of EA Canada. Mr. Lee was a principal of Distinctive Software Inc. until it was acquired by Electronic Arts in 1991. Mr. Lee holds a Bachelor of Commerce degree from the University of British Columbia and is a Chartered Financial Analyst.

**Dr. Florin** has served as Executive Vice President, General Manager, International Publishing since September 2005. Previously he was Senior Vice President and Managing Director, European Publishing since April 2003. Prior to this, he served as Vice President, Managing Director for European countries since 2001. From the time he joined Electronic Arts in 1996 to 2001, he was the Managing Director for German speaking countries. Prior to joining Electronic Arts, Dr. Florin held various positions at BMG, the global music division of Bertelsmann AG, and worked as a consultant with McKinsey. Dr. Florin holds Masters and Ph.D. degrees in Economics from the University of Augsburg, Germany.

**Mr. Gibeau** has served as Executive Vice President, General Manager, North America Publishing since September 2005. Previously he was Senior Vice President of North American Marketing, a position he held since 2002. Mr. Gibeau has held various publishing positions since joining the company in 1991. Mr. Gibeau holds a B.S. degree from the University of Southern California and an M.B.A. from Santa Clara University.

**Mr. Jenson** joined Electronic Arts in June 2002 as Executive Vice President, Chief Financial and Administrative Officer. Before joining Electronic Arts, he was the Senior Vice President and Chief Financial Officer for Amazon.com from 1999 to 2002. From 1998 to 1999, he was the Chief Financial Officer and Executive Vice President for Delta Air Lines. Prior to that, he worked in several positions as part of the General Electric Company. Most notably, he served as Chief Financial Officer and Senior Vice President for the National Broadcasting Company, a subsidiary of General Electric. Mr. Jenson earned his Masters of Accountancy-Business Taxation, and B.S. in Accounting from Brigham Young University.

**Mr. Linzner** has served as Executive Vice President, Business and Legal Affairs since March 2005. From April 2004 to March 2005, he served as Senior Vice President, Business and Legal Affairs. From October 2002 to April 2004, Mr. Linzner held the position of Senior Vice President of Worldwide Business Affairs and from July 1999 to October 2002, he held the position of Vice President of Worldwide Business Affairs. Prior to joining Electronic Arts in July 1999, Mr. Linzner served as outside litigation counsel to Electronic Arts and several other companies in the video game industry. Mr. Linzner earned his J.D. from Boalt Hall at the University of California, Berkeley, after graduating from Brandeis University. He is a member of the Bar of the State of California and is admitted to practice in the United States Supreme Court, the Ninth Circuit Court of Appeals and several United States District Courts.

**Ms. Smith** was named Executive Vice President, General Manager, The Sims Franchise in September 2005. Prior to this position, she served as Executive Vice President and General Manager, North American Publishing since March 1998. From October 1996 to March 1998, Ms. Smith served as Executive Vice President, North American Sales. She previously held the position of Senior Vice President of North American Sales and Distribution from July 1993 to October 1996 and as Vice President of Sales from 1988 to 1993. Ms. Smith has also served as Western Regional Sales Manager and National Sales Manager since she joined Electronic Arts in 1984. Ms. Smith holds a B.S. degree in management and organizational behavior from the University of San Francisco.

**Ms. Toledano** has served as Executive Vice President, Human Resources since April 2007. From February 2006 to April 2007, Ms. Toledano held the position of Senior Vice President, Human Resources. Prior to joining Electronic Arts, Ms. Toledano worked at Siebel Systems, Inc. from July 2002 to February 2006 where she held a number of positions, including Senior Vice President of Human Resources. From September 2000

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to June 2002, she served as Senior Director of Human Resources for Microsoft Corporation, and from September 1998 until September 2000, she served as Director of Human Resources and Recruiting for Microsoft. Ms. Toledano earned both her undergraduate degree in Humanities and her graduate degree in Education from Stanford University.

**Mr. Barker** has served as Senior Vice President, Chief Accounting Officer since April 2006. From June 2003 to April 2006, Mr. Barker held the position of Vice President, Chief Accounting Officer. Prior to joining Electronic Arts, Mr. Barker was employed at Sun Microsystems, Inc., as Vice President and Corporate Controller from October 2002 to June 2003 and Assistant Corporate Controller from April 2000 to September 2002. Prior to that, he was an audit partner at Deloitte. Mr. Barker graduated from the University of Notre Dame with a B.A. degree in Accounting.

**Mr. Bené** has served as Senior Vice President, General Counsel and Corporate Secretary since October 2004. From April 2004 to October 2004, Mr. Bené held the position of Vice President, Acting General Counsel and Corporate Secretary, and from June 2003 to April 2004, he held the position of Vice President and Associate General Counsel. Prior to June 2003, Mr. Bené had served as internal legal counsel since joining the Company in March 1995. Mr. Bené earned his J.D. from Stanford Law School, and received his B.S. in Mechanical Engineering from Rice University. Mr. Bené is a member of the Bar of the State of California.

**Mr. Marchetti** was named Senior Vice President and General Manager of EA Mobile in April 2007. He joined Electronic Arts in February 2006 as Vice President and Chief Operating Officer of EA Mobile. From December 2000 to February 2006, he served as Chief Financial Officer of JAMDAT Mobile Inc. Prior to this, Mr. Marchetti served as Vice President Finance for eCompanies LLC from April 2000 to December 2000. Mr. Marchetti served as a Vice President in the Emerging Telecommunications and the Global Leveraged Finance groups of Merrill Lynch, where he worked from July 1996 to April 2000. Prior to Merrill Lynch, Mr. Marchetti practiced law at Cahill Gordon & Reindel from 1994 to 1996. Mr. Marchetti earned a J.D. from Brooklyn Law School, cum laude, and received his B.A. degree from Brooklyn College City University, magna cum laude.

**Mr. Schappert** was named Senior Vice President, Chief Operating Officer, Worldwide Studios in November 2006. Prior to being named to this position, from January 2003 to October 2006, Mr. Schappert served as Senior Vice President, Group General Manager, Worldwide Studios. Mr. Schappert served as Vice President, General Manager of EA Canada from July 2002 to January 2003, and Vice President, General Manager of EA Tiburon from April 1998 to July 2002. Mr. Schappert founded Tiburon Entertainment in 1994, which was acquired by Electronic Arts in 1998.

## **Investor Information**

We file various reports with, or furnish them to, the Securities and Exchange Commission (the SEC), including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports. These reports are available free of charge on the Investor Relations section of our website, <http://investor.ea.com>, as soon as reasonably practicable after we electronically file the reports with, or furnish them to, the SEC.

The charters of our Audit, Compensation, and Nominating and Governance committees of our Board of Directors, as well as our Global Code of Conduct (which includes code of ethics provisions applicable to our directors, principal executive officer, principal financial officer, principal accounting officer, and other senior financial officers), are available in the Investor Relations section of our website at <http://investor.ea.com>. We will post amendments to our Global Code of Conduct in the Investor Relations section of our website. Copies of our charters and Global Code of Conduct are available without charge by contacting our Investor Relations department at (650) 628-1500.

Stockholders of record may hold their shares of our common stock in book-entry form. This eliminates costs related to safekeeping or replacing paper stock certificates. In addition, stockholders of record may request electronic movement

of book-entry shares between their account with our stock transfer agent and their broker.



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Stock certificates may be converted to book-entry shares at any time. Questions regarding this service may be directed to our stock transfer agent, Wells Fargo Bank, N.A., at 1-800-468-9716.

**Item 1A: *Risk Factors***

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

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

We derive most of our revenue from the sale of products for play on video game hardware systems (which we also refer to as platforms) manufactured by third parties, such as Sony's PlayStation 2 and PLAYSTATION 3, Microsoft's Xbox 360 and Nintendo's Wii. The success of our business is driven in large part by the commercial success and adequate supply of these video game hardware systems, our ability to accurately predict which systems will be successful in the marketplace, and our ability to develop commercially successful products for these systems. We must make product development decisions and commit significant resources well in advance of anticipated product ship dates. A platform for which we are developing products may not succeed or may have a shorter life cycle than anticipated. If consumer demand for the systems for which we are developing products are lower than our expectations, our revenue will suffer, we may be unable to fully recover the investments we have made in developing our products, and our financial performance will be harmed. Alternatively, a system for which we have not devoted significant resources could be more successful than we had initially anticipated, causing us to miss out on meaningful revenue opportunities.

**Our industry is cyclical and is beginning its next cycle. During the transition, consumers may be slower to adopt new video game systems than we anticipate, and our operating results may suffer and become more difficult to predict.**

Video game hardware systems have historically had a life cycle of four to six years, which causes the video game software market to be cyclical as well. Microsoft launched the Xbox 360 in November 2005, while Sony and Nintendo launched the PLAYSTATION 3 and the Wii, respectively, in November 2006. We have continued to develop and market new titles for prior-generation video game systems such as the PlayStation 2 while also making significant investments in products for the new systems. As the prior-generation systems reach the end of their life cycle and the installed base of the new systems continues to grow, our sales of video games for prior-generation systems will continue to decline as (1) we produce fewer titles for prior-generation systems, (2) consumers replace their prior-generation systems with the new systems, and/or (3) consumers defer game software purchases until they are able to purchase a new video game hardware system. This decline in prior-generation product sales may be greater than we anticipate, and sales of products for the new platforms may be lower than we anticipate. Moreover, we expect development costs for the new video game systems to be greater on a per-title basis than development costs for prior-generation video game systems. As a result of these factors, during the next several quarters, we expect our operating results to be more volatile and difficult to predict, which could cause our stock price to fluctuate significantly.

**If we do not consistently meet our product development schedules, our operating results will be adversely affected.**

Our business is highly seasonal, with the highest levels of consumer demand and a significant percentage of our sales occurring in the December quarter. In addition, we seek to release many of our products in conjunction with specific events, such as the release of a related movie or the beginning of a sports season or major sporting event. If we miss these key selling periods for any reason, including product delays or delayed introduction of a new platform for which we have developed products, our sales will suffer disproportionately.

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Likewise, if a key event to which our product release schedule is tied were to be delayed or cancelled, our sales would also suffer disproportionately. Our ability to meet product development schedules is affected by a number of factors, including the creative processes involved, the coordination of large and sometimes geographically dispersed development teams required by the increasing complexity of our products and the platforms for which they are developed, and the need to fine-tune our products prior to their release. We have experienced development delays for our products in the past, which caused us to push back release dates. In the future, any failure to meet anticipated production or release schedules would likely result in a delay of revenue and/or possibly a significant shortfall in our revenue, harm our profitability, and cause our operating results to be materially different than anticipated.

**Our business is intensely competitive and hit driven. If we do not continue to 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 and we expect new competitors to continue to emerge in the United States and abroad. While many new products and services are regularly introduced, only a relatively small number of hit titles accounts for a significant portion of total revenue in our industry. Hit products or services offered by our competitors may take a larger share of consumer spending than we anticipate, which could cause revenue generated from our products and services to fall below expectations. If our competitors develop 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 (such as pay-for-play or subscription-based models), or if we do not continue to develop consistently high-quality and well-received products and services, our revenue, margins, and profitability will decline.

**Technology changes rapidly in our business and if we fail to anticipate or successfully implement new technologies or the manner in which people play our games, the quality, timeliness and competitiveness of our products and services will suffer.**

Rapid technology changes in our industry require us to anticipate, sometimes years in advance, which technologies we must implement and take advantage of in order to make our products and services competitive in the market. Therefore, we usually start our product development with a range of technical development goals that we hope to be able to achieve. We may not be able to achieve these goals, or our competition may be able to achieve them more quickly and effectively than we can. In either case, our products and services may be technologically inferior to our competitors, less appealing to consumers, or both. If we cannot achieve our technology goals within the original development schedule of our products and services, then we may delay their release until these technology goals can be achieved, which may delay or reduce revenue and increase our development expenses. Alternatively, we may increase the resources employed in research and development in an attempt to accelerate our development of new technologies, either to preserve our product or service launch schedule or to keep up with our competition, which would increase our development expenses.

**The video game hardware manufacturers set the royalty rates and other fees that we must pay to publish games for their platforms, and therefore have significant influence on our costs. If one or more of these manufacturers adopt a different fee structure for future game consoles, our profitability will be materially impacted.**

In order to publish products for a video game system such as the Xbox 360, PLAYSTATION 3 or Wii, we must take a license from the manufacturer, which gives it the opportunity to set the fee structure that we must pay in order to publish games for that platform. Similarly, certain manufacturers have retained the flexibility to change their fee structures, or adopt different fee structures for online gameplay and other new features for their consoles. The control that hardware manufacturers have over the fee structures for their platforms and online access makes it difficult for us to predict our costs, profitability and impact on margins. Because publishing products for video game systems is the largest portion of our business, any increase in fee structures would significantly harm our ability to generate revenues

and/or profits.

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**The video game hardware manufacturers are among our chief competitors and frequently control the manufacturing of and/or access to our video game products. If they do not approve our products, we will be unable to ship to our customers.**

Our agreements with hardware licensors (such as Sony for the PLAYSTATION 3, Microsoft for the Xbox 360, and Nintendo for the Wii) typically give significant control to the licensor over the approval and manufacturing of our products, which could, in certain circumstances, leave us unable to get our products approved, manufactured and shipped to customers. These hardware licensors are also among our chief competitors. Generally, control of the approval and manufacturing process by the hardware licensors increases both our manufacturing lead times and costs as compared to those we can achieve independently. While we believe that our relationships with our hardware licensors are currently good, the potential for these licensors to delay or refuse to approve or manufacture our products exists. Such occurrences would harm our business and our financial performance.

We also require compatibility code and the consent of Microsoft, Sony and Nintendo in order to include online capabilities in our products for their respective platforms. As online capabilities for video game systems become more significant, Microsoft, Sony and Nintendo could restrict the manner in which we provide online capabilities for our products. If Microsoft, Sony or Nintendo refused to approve our products with online capabilities or significantly impacted the financial terms on which these services are offered to our customers, our business could be harmed.

**If we are unable to maintain or acquire licenses to intellectual property, we will publish fewer hit titles and our revenue, profitability and cash flows will decline. Competition for these licenses may make them more expensive and increase our costs.**

Many of our products are based on or incorporate intellectual property owned by others. For example, our EA SPORTS products include rights licensed from major sports leagues and players' associations. Similarly, many of our other hit franchises, such as The Godfather, Harry Potter and Lord of the Rings, are based on key film and literary licenses. Competition for these licenses is intense. If we are unable to maintain these licenses or obtain additional licenses with significant commercial value, our revenues and profitability will decline significantly. Competition for these licenses may also drive up the advances, guarantees and royalties that we must pay to the licensor, which could significantly increase our costs.

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

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

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

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

**If patent claims continue to be asserted against us, we may be unable to sustain our current business models or profits, or we may be precluded from pursuing new business opportunities in the future.**

Many patents have been issued that may apply to widely-used game technologies, or to potential new modes of delivering, playing or monetizing game software products. For example, infringement claims under many issued patents are now being asserted against interactive software or online game sites. Several such claims

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have been asserted against us. We incur substantial expenses in evaluating and defending against such claims, regardless of the merits of the claims. In the event that there is a determination that we have infringed a third-party patent, we could incur significant monetary liability and be prevented from using the rights in the future, which could negatively impact our operating results. We may also discover that future opportunities to provide new and innovative modes of game play and game delivery to consumers may be precluded by existing patents that we are unable to license on reasonable terms.

### **Other intellectual property claims may increase our product costs or require us to cease selling affected products.**

Many of our products include extremely realistic graphical images, and we expect that as technology continues to advance, images will become even more realistic. Some of the images and other content are based on real-world examples that may inadvertently infringe upon the intellectual property rights of others. Although we believe that we make reasonable efforts to ensure that our products do not violate the intellectual property rights of others, it is possible that third parties still may claim infringement. From time to time, we receive communications from third parties regarding such claims. Existing or future infringement claims against us, whether valid or not, may be time consuming and expensive to defend. Such claims or litigations could require us to stop selling the affected products, redesign those products to avoid infringement, or obtain a license, all of which would be costly and harm our business.

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

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

### **Our business, our products and our distribution are subject to increasing regulation of content, consumer privacy, distribution and online hosting and delivery in the key territories in which we conduct business. If we do not successfully respond to these regulations, our business may suffer.**

Legislation is continually being introduced that may affect both the content of our products and their distribution. For example, data and consumer protection laws in the United States and Europe impose various restrictions on our web sites. Those rules vary by territory although the Internet recognizes no geographical boundaries. Other countries, such as Germany, have adopted laws regulating content both in packaged games and those transmitted over the Internet that are stricter than current United States laws. In the United States, the federal and several state governments are continually considering content restrictions on products such as ours, as well as restrictions on distribution of such products. For example, recent legislation has been adopted in several states, and could be proposed at the federal level, that prohibits the sale of certain games (e.g., violent games or those with M (Mature) or AO (Adults Only) ratings) to minors. Any one or more of these factors could harm our business by limiting the products we are able to offer to our customers, by limiting the size of the potential market for our products, and by requiring costly additional differentiation between products for different territories to address varying regulations.

### **If one or more of our titles were found to contain hidden, objectionable content, our business could suffer.**

Throughout the history of our industry, many video games have been designed to include certain hidden content and gameplay features that are accessible through the use of in-game cheat codes or other technological means that are intended to enhance the gameplay experience. However, in several recent cases, hidden content or features have been found to be included in other publishers' products by an employee who was not authorized to do so or by an outside

developer without the knowledge of the publisher. From time to time, some hidden content and features have contained profanity, graphic violence and sexually explicit or otherwise objectionable material. In a few cases, the Entertainment Software Ratings Board ( ESRB ) has reacted to discoveries of hidden content and features by reviewing the rating that was originally assigned to the product, requiring the publisher to change the game packaging and/or fining the publisher. Retailers have



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on occasion reacted to the discovery of such hidden content by removing these games from their shelves, refusing to sell them, and demanding that their publishers accept them as product returns. Likewise, consumers have reacted to the revelation of hidden content by refusing to purchase such games, demanding refunds for games they've already purchased, and refraining from buying other games published by the company whose game contained the objectionable material.

We have implemented preventative measures designed to reduce the possibility of hidden, objectionable content from appearing in the video games we publish. Nonetheless, these preventative measures are subject to human error, circumvention, overriding, and reasonable resource constraints. If a video game we published were found to contain hidden, objectionable content, the ESRB could demand that we recall a game and change its packaging to reflect a revised rating, retailers could refuse to sell it and demand we accept the return of any unsold copies or returns from customers, and consumers could refuse to buy it or demand that we refund their money. This could have a material negative impact on our operating results and financial condition. In addition, our reputation could be harmed, which could impact sales of other video games we sell. If any of these consequences were to occur, our business and financial performance could be significantly harmed.

### **If we ship defective products, our operating results could suffer.**

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

### **Our international net revenue is subject to currency fluctuations.**

For the fiscal year ended March 31, 2007, international net revenue comprised 46 percent of our total net revenue. We expect foreign sales to continue to account for a significant portion of our total net revenue. Such sales may be subject to unexpected regulatory requirements, tariffs and other barriers. Additionally, foreign sales are primarily made in local currencies, which may fluctuate against the U.S. dollar. While we utilize foreign exchange forward contracts to mitigate some foreign currency risk associated with foreign currency denominated assets and liabilities (primarily certain intercompany receivables and payables) and, from time to time, foreign currency option contracts to hedge foreign currency forecasted transactions (primarily related to a portion of the revenue and expenses denominated in foreign currency generated by our operational subsidiaries), our results of operations, including our reported net revenue and net income, and financial condition would be adversely affected by unfavorable foreign currency fluctuations, particularly the Euro, British pound sterling and Canadian dollar.

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

We are subject to income taxes in the United States and in various foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes, and, in the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain.

We are also required to estimate what our taxes will be in the future. Although we believe our tax estimates are reasonable, the estimation process and applicable laws are inherently uncertain, and our estimates are not binding on tax authorities. Our effective tax rate could be adversely affected by our profit level, by changes in our business,

including the mix of earnings in countries with differing statutory tax rates, changes in the elections we make, changes in applicable tax laws as well as other factors. Further, our tax determinations are regularly subject to audit by tax authorities and developments in those audits could adversely affect our income tax provision. Should our ultimate tax liability exceed our estimates, our income tax provision and net income or loss could be materially affected.

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We incur certain tax expenses that do not decline proportionately with declines in our consolidated pre-tax income or loss. As a result, in absolute dollar terms, our tax expense will have a greater influence on our effective tax rate at lower levels of pre-tax income or loss than higher levels. In addition, at lower levels of pre-tax income or loss, our effective tax rate will be more volatile.

In addition, the rules for tax accounting have recently been changed. In July 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation ( FIN ) No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* , which provides new rules for the accounting for uncertainty in income taxes recognized in financial statements in accordance with Statement of Financial Accounting Standard ( SFAS ) No. 109, *Accounting for Income Taxes* (see Note 10 of the Notes to Consolidated Financial Statements). We are evaluating what impact the adoption of FIN No. 48 will have on our Consolidated Financial Statements as it becomes effective in the first quarter of fiscal 2008. This impact could be material and our future effective tax rates could be more volatile.

We are also required to pay taxes other than income taxes, such as payroll, sales, use, value-added, net worth, property and goods and services taxes, in both the United States and various foreign jurisdictions. We are regularly under examination by tax authorities with respect to these non-income taxes. There can be no assurance that the outcomes from these examinations, changes in our business or changes in applicable tax rules will not have an adverse effect on our earnings and financial condition.

### **Our reported financial results could be adversely affected by changes in financial accounting standards or by the application of existing or future accounting standards to our business as it evolves.**

As a result of the enactment of the Sarbanes-Oxley Act and the review of accounting policies by the SEC and national and international accounting standards bodies, the frequency of accounting policy changes may accelerate. For example, as discussed above, FIN No. 48 will affect the way we account for income taxes and could have a material impact on our financial results. Similarly, changes in accounting standards relating to stock-based compensation require us to recognize significantly greater expense than we had been recognizing prior to the adoption of the new standard. Likewise, policies affecting software revenue recognition have and could further significantly affect the way we account for revenue related to our products and services. For example, as our industry transitions to new video game hardware systems, we expect a more significant portion of our console and PC games will be online-enabled and, as a result, we will be required to recognize the related revenue over an extended period of time rather than at the time of sale. As we enhance, expand and diversify our business and product offerings, the application of existing or future financial accounting standards, particularly those relating to the way we account for revenue and taxes, could have a significant adverse effect on our reported results although not necessarily on our cash flows.

### **We have begun the implementation of a new set of financial information systems in anticipation of a significant increase in deferred net revenue, which, if not completed in a successful and timely manner, could impede our ability to accurately process, prepare and analyze important financial data.**

We have begun to implement a new set of financial information systems and processes designed to help us accurately process, prepare and analyze the significant amount of net revenue from online-enabled packaged goods we expect to recognize on a deferred basis beginning in fiscal 2008. The successful implementation of these systems and processes entails a number of risks due to the complexity of the systems, the number of people affected company-wide, and the implementation process itself. While testing of these new systems and processes and training of employees are done in advance of implementation, there are inherent limitations in our ability to simulate a full-scale operating environment in advance of implementation. There can be no assurance that the implementation of these financial information systems and processes will not impede our ability to accurately and timely process, prepare and analyze the financial

data we use in making operating decisions and which form the basis of the financial information we include in the periodic reports we file with the SEC.

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**Changes in our worldwide operating structure or the adoption of new products and distribution models could have adverse tax consequences.**

As we expand our international operations, adopt new products and new distribution models, implement changes to our operating structure or undertake intercompany transactions in light of changing tax laws, expiring rulings, acquisitions and our current and anticipated business and operational requirements, our tax expense could increase. For example, in the fourth quarter of fiscal 2006, we repatriated \$375 million under the America Jobs Creation Act of 2004. As a result, we recognized an additional one-time tax expense in fiscal 2006 of \$17 million.

**The majority of our sales are made to a relatively small number of key customers. If these customers reduce their purchases of our products or become unable to pay for them, our business could be harmed.**

In our fiscal year ended March 31, 2007, over 70 percent of our U.S. sales were made to seven key customers. In Europe, our top ten customers accounted for approximately 31 percent of our sales in that territory during the year ended March 31, 2007. Worldwide, we had direct sales to two customers, Wal-Mart Stores and GameStop Corp., Inc., which represented approximately 13 percent and 12 percent, respectively, of total net revenue in the year ended March 31, 2007. Though our products are available to consumers through a variety of retailers, the concentration of our sales in one, or a few, large customers could lead to a short-term disruption in our sales if one or more of these customers significantly reduced their purchases or ceased to carry our products, and could make us more vulnerable to collection risk if one or more of these large customers became unable to pay for our products. Additionally, our receivables from these large customers increase significantly in the December quarter as they stock up for the holiday selling season. Also, having such a large portion of our total net revenue concentrated in a few customers could reduce our negotiating leverage with these customers.

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

We have engaged in, evaluated, and expect to continue to engage in and evaluate, a wide array of potential strategic transactions, including (i) acquisitions of companies, businesses, intellectual properties, and other assets, (ii) minority investments in strategic partners, and (iii) investments in new interactive entertainment businesses (for example, online and mobile games). Any of these strategic transactions could be material to our financial condition and results of operations. Although we regularly search for opportunities to engage in strategic transactions, we may not be successful in identifying suitable opportunities. We may not be able to consummate potential acquisitions or investments or an acquisition or investment may not enhance our business or may decrease rather than increase our earnings. In addition, the process of integrating an acquired company or business, or successfully exploiting acquired intellectual property or other assets, could divert a significant amount of our management's time and focus and may create unforeseen operating difficulties and expenditures. Additional risks we face include:

The need to implement or remediate controls, procedures and policies appropriate for a public company in an acquired company that, prior to the acquisition, lacked these controls, procedures and policies,

Cultural challenges associated with integrating employees from an acquired company or business into our organization,

Retaining key employees from the businesses we acquire,

The need to integrate an acquired company's accounting, management information, human resource and other administrative systems to permit effective management, and

To the extent that we engage in strategic transactions outside of the United States, we face additional risks, including risks related to integration of operations across different cultures and languages, currency risks and the particular economic, political and regulatory risks associated with specific countries.

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Future acquisitions and investments could involve the issuance of our equity securities, potentially diluting our existing stockholders, the incurrence of debt, contingent liabilities or amortization expenses, write-offs of goodwill, intangibles, or acquired in-process technology, or other increased expenses, any of which could harm our financial condition. Our stockholders may not have the opportunity to review, vote on or evaluate future acquisitions or investments.

**Our products are subject to the threat of piracy by a variety of organizations and individuals. If we are not successful in combating and preventing piracy, our sales and profitability could be harmed significantly.**

In many countries around the world, more pirated copies of our products are sold than legitimate copies. Though we believe piracy has not had a material impact on our operating results to date, highly organized pirate operations have been expanding globally. In addition, the proliferation of technology designed to circumvent the protection measures we use in our products, the availability of broadband access to the Internet, the ability to download pirated copies of our games from various Internet sites, and the widespread proliferation of Internet cafes using pirated copies of our products, all have contributed to ongoing and expanding piracy. Though we take steps to make the unauthorized copying and distribution of our products more difficult, as do the manufacturers of consoles on which our games are played, these efforts may not be successful in controlling the piracy of our products. This could have a negative effect on our growth and profitability in the future.

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

The market price of our common stock historically has been, and we expect will continue to be, subject to significant fluctuations. These fluctuations may be due to factors specific to us (including those discussed in the risk factors above as well as others not currently known to us or that we currently do not believe are material), to changes in securities analysts' earnings estimates or ratings, to our results or future financial guidance falling below our expectations and analysts' and investors' expectations, to factors affecting the computer, software, Internet, entertainment, media or electronics industries, or to national or international economic conditions.

**Item 1B: *Unresolved Staff Comments***

None.

**Item 2: *Properties***

The following diagram depicts the locations of our most significant facilities throughout the world:

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We currently own a 418,000-square-foot product development studio facility in Burnaby, British Columbia, Canada and a 122,000-square-foot administrative, sales and development facility in Chertsey, England. In addition to the properties we own, we lease approximately 2.7 million square feet of facilities, including significant leases for our headquarters in Redwood City, California, our studios in Los Angeles, California and Orlando, Florida, and our distribution center in Louisville, Kentucky. Our leased space is summarized as follows (in square feet):

| <b>Purpose</b>              | <b>North<br/>America</b> | <b>Europe</b> | <b>Asia</b> | <b>Total</b> |
|-----------------------------|--------------------------|---------------|-------------|--------------|
| Distribution                | 250,000                  | 86,735        |             | 336,735      |
| Sales & Administrative      | 730,563                  | 235,001       | 100,221     | 1,065,785    |
| Studio Development          | 1,119,127                | 191,190       | 36,338      | 1,346,655    |
| Total Leased Square Footage | 2,099,690                | 512,926       | 136,559     | 2,749,175    |

***Redwood City Headquarters***

In February 1995, we entered into a build-to-suit lease ( Phase One Lease ) with a third-party lessor for our headquarters facilities in Redwood City, California ( Phase One Facilities ). The Phase One Facilities comprise a total of approximately 350,000 square feet and provide space for sales, marketing, administration and research and development functions. In July 2001, the lessor refinanced the Phase One Lease with Keybank National Association through July 2006. The Phase One Lease expires in January 2039, subject to early termination in the event the underlying financing between the lessor and its lenders is not extended. Subject to certain terms and conditions, we may purchase the Phase One Facilities or arrange for the sale of the Phase One Facilities to a third party.

Pursuant to the terms of the Phase One Lease, we have an option to purchase the Phase One Facilities at any time for a purchase price of \$132 million. In the event of a sale to a third party, if the sale price is less than \$132 million, we will be obligated to reimburse the difference between the actual sale price and \$132 million, up to a maximum of \$117 million, subject to certain provisions of the Phase One Lease, as amended.

On May 26, 2006, the lessor extended its loan financing underlying the Phase One Lease with its lenders through July 2007, and on May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor's loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009; otherwise the lease will terminate. We account for the Phase One Lease arrangement as an operating lease in accordance with SFAS No. 13, *Accounting for Leases*, as amended.

In December 2000, we entered into a second build-to-suit lease ( Phase Two Lease ) with Keybank National Association for a five and one-half year term beginning in December 2000 to expand our Redwood City, California headquarters facilities and develop adjacent property ( Phase Two Facilities ). Construction of the Phase Two Facilities was completed in June 2002. The Phase Two Facilities comprise a total of approximately 310,000 square feet and provide space for sales, marketing, administration and research and development functions. Subject to certain terms and conditions, we may purchase the Phase Two Facilities or arrange for the sale of the Phase Two Facilities to a third party.



Pursuant to the terms of the Phase Two Lease, we have an option to purchase the Phase Two Facilities at any time for a purchase price of \$115 million. In the event of a sale to a third party, if the sale price is less than \$115 million, we will be obligated to reimburse the difference between the actual sale price and \$115 million, up to a maximum of \$105 million, subject to certain provisions of the Phase Two Lease, as amended.

On May 26, 2006, the lessor extended the Phase Two Lease through July 2009 subject to early termination in the event the underlying loan financing between the lessor and its lenders is not extended. Concurrently with the extension of the lease, the lessor extended the loan financing underlying the Phase Two Lease with its

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lenders through July 2007. On May 14, 2007 the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor's loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009, otherwise the lease will terminate. We account for the Phase Two Lease arrangement as an operating lease in accordance with SFAS No. 13, as amended.

We believe that, as of March 31, 2007, the estimated fair values of both properties under these operating leases exceeded their respective guaranteed residual values.

### ***Guildford, Orlando, Los Angeles and Vancouver Studios; Louisville Distribution Center***

In February 2006, we entered into an agreement with an independent third party to lease a studio facility in Guildford, Surrey, United Kingdom, which commenced in June 2006 and will expire in May 2016. The facility comprises a total of approximately 95,000 square feet, which we use for research and development functions. Our rental obligation under this agreement is approximately \$33 million over the initial ten-year term of the lease.

In June 2004, we entered into a lease agreement, amended in December 2005, with an independent third party for a studio facility in Orlando, Florida. The lease commenced in January 2005 and expires in June 2010, with one five-year option to extend the lease term. The campus facilities comprise a total of 140,000 square feet and provide space for research and development functions. Our rental obligation over the initial five-and-a-half year term of the lease is \$15 million.

In July 2003, we entered into a lease agreement with an independent third party (the Landlord) for a studio facility in Los Angeles, California, which commenced in October 2003 and expires in September 2013 with two five-year options to extend the lease term. Additionally, we have options to purchase the property after five and ten years based on the fair market value of the property at the date of sale, a right of first offer to purchase the property upon terms offered by the Landlord, and a right to share in the profits from a sale of the property. Existing campus facilities comprise a total of 243,000 square feet and provide space for research and development functions. Our rental obligation under this agreement is \$50 million over the initial ten-year term of the lease. This commitment is offset by expected sublease income of \$6 million for a sublease to an affiliate of the Landlord of 18,000 square feet of the Los Angeles facility, which commenced in October 2003 and expires in September 2013, with options of early termination by the affiliate after five years and by us after four and five years.

In October 2002, we entered into a lease agreement, with an independent third party for a studio facility in Vancouver, British Columbia, Canada, which commenced in May 2003 and expires in April 2013. We amended the lease in October 2003. The facility comprises a total of approximately 65,000 square feet and provides space for research and development functions. Our rental obligation under this agreement is approximately \$16 million over the initial ten-year term of the lease.

Our North American distribution is supported by a centralized warehouse facility that we lease in Louisville, Kentucky, occupying 250,000 square feet.

In addition to the properties discussed above, we have other properties under lease which have been included in our restructuring costs as discussed in Note 6 of the Notes to Consolidated Financial Statements included in Item 8 of this report. While we continually evaluate our facility requirements, we believe that suitable additional or substitute space will be available as needed to accommodate our future needs.



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**Item 3: *Legal Proceedings***

On September 14, 2006, we received an informal inquiry from the Securities and Exchange Commission requesting certain documents and information relating to our stock option grant practices from January 1, 1997 through the date of the letter. We have cooperated to date with all matters related to this request. We most recently provided the SEC with information in December 2006. The SEC has not asked for any further information since that time.

We are also subject to claims and litigation arising in the ordinary course of business. We believe that any liability from any reasonably foreseeable disposition of such claims and litigation, individually or in the aggregate, would not have a material adverse effect on our consolidated financial position or results of operations.

**Item 4: *Submission of Matters to a Vote of Security Holders***

There were no matters submitted to a vote of our security holders during the quarter ended March 31, 2007.

**Table of Contents****PART II****Item 5: *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*****Market Information**

Our common stock is traded on the NASDAQ Global Select Market under the symbol ERTS. The following table sets forth the quarterly high and low sales price per share of our common stock from April 1, 2005 through March 31, 2007.

|                                   | <b>Prices</b> |            |
|-----------------------------------|---------------|------------|
|                                   | <b>High</b>   | <b>Low</b> |
| Fiscal Year Ended March 31, 2006: |               |            |
| First Quarter                     | \$ 59.83      | \$ 47.45   |
| Second Quarter                    | 63.12         | 55.22      |
| Third Quarter                     | 61.97         | 51.04      |
| Fourth Quarter                    | 58.59         | 50.14      |
| Fiscal Year Ended March 31, 2007: |               |            |
| First Quarter                     | \$ 57.80      | \$ 39.99   |
| Second Quarter                    | 57.74         | 41.37      |
| Third Quarter                     | 59.85         | 50.21      |
| Fourth Quarter                    | 54.43         | 47.96      |

**Holders**

There were approximately 1,722 holders of record of our common stock as of May 24, 2007. In addition, we believe that a significant number of beneficial owners of our common stock hold their shares in street name.

**Dividends**

We have not paid any cash dividends and do not anticipate paying cash dividends in the foreseeable future.

**Table of Contents****Stock Performance Graph**

The following information shall not be deemed to be filed with the Securities and Exchange Commission nor shall this information be incorporated by reference into any future filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that we specifically incorporate it by reference into a filing.

The following graph shows a five-year comparison of cumulative total returns during the period from March 31, 2002 through March 31, 2007, for our common stock, the NASDAQ Market Composite Index, the S&P 500 Index (to which EA was added in July 2002) and the RDG Technology Index, each of which assumes an initial value of \$100. Each measurement point is as of the end of each fiscal year ended March 31. The performance of our stock depicted in the following graph is not necessarily indicative of the future performance of our stock.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***

Among Electronic Arts Inc., The NASDAQ Composite Index,  
The S&P 500 Index and The RDG Technology Composite Index

\* \$100 invested on 3/31/02 in stock or index-including reinvestment of dividends. Fiscal year ending March 31.

|                          | <b>March 31,</b> |             |             |             |             |             |
|--------------------------|------------------|-------------|-------------|-------------|-------------|-------------|
|                          | <b>2002</b>      | <b>2003</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> |
| Electronic Arts Inc.     | \$ 100           | \$ 96       | \$ 177      | \$ 170      | \$ 180      | \$ 166      |
| NASDAQ Composite         | 100              | 72          | 110         | 111         | 133         | 140         |
| S&P 500                  | 100              | 75          | 102         | 108         | 121         | 136         |
| RDG Technology Composite | 100              | 67          | 99          | 96          | 113         | 117         |

**Table of Contents****Item 6: Selected Financial Data****ELECTRONIC ARTS INC. AND SUBSIDIARIES****SELECTED FIVE-YEAR CONSOLIDATED FINANCIAL DATA**

(In millions, except per share data)

| STATEMENTS OF OPERATIONS DATA                                  | Year Ended March 31, |          |          |          |          |
|--|----------------------|----------|----------|----------|----------|
|  | 2007 <sup>(a)</sup>  | 2006     | 2005     | 2004     | 2003     |
| Net revenue  | \$ 3,091             | \$ 2,951 | \$ 3,129 | \$ 2,957 | \$ 2,482 |
| Cost of goods sold   | 1,212                | 1,181    | 1,197    | 1,103    | 1,073    |
| Gross profit   | 1,879                | 1,770    | 1,932    | 1,854    | 1,409    |
| Operating expenses:  |                      |          |          |          |          |
| Marketing and sales  | 466                  | 431      | 391      | 370      | 332      |
| General and administrative                                     | 288                  | 215      | 221      | 185      | 131      |
| Research and development                                       | 1,041                | 758      | 633      | 511      | 401      |
| Amortization of intangibles                                    | 27                   | 7        | 3        | 3        | 8        |
| Acquired in-process technology                                 | 3                    | 8        | 13       |          |          |
| Restructuring charges  | 15                   | 26       | 2        | 9        | 15       |
| Asset impairment charges                                       |                      |          |          |          | 66       |
| Total operating expenses                                       | 1,840                | 1,445    | 1,263    | 1,078    | 953      |
| Operating income   | 39                   | 325      | 669      | 776      | 456      |
| Interest and other income, net                                 | 99                   | 64       | 56       | 21       | 5        |
| Income before provision for income taxes and minority interest | 138                  | 389      | 725      | 797      | 461      |
| Provision for income taxes                                     | 66                   | 147      | 221      | 220      | 143      |
| Income before minority interest                                | 72                   | 242      | 504      | 577      | 318      |
| Minority interest  | 4                    | (6)      |          |          | (1)      |
| Net income   | \$ 76                | \$ 236   | \$ 504   | \$ 577   | \$ 317   |
| Net income (loss) per share:                                   |                      |          |          |          |          |
| Common stock:  |                      |          |          |          |          |
| Net income:  |                      |          |          |          |          |
| Basic  | \$ 76                | \$ 236   | \$ 504   | \$ 577   | \$ 329   |
| Diluted  | \$ 76                | \$ 236   | \$ 504   | \$ 577   | \$ 317   |
| Net income per share:  |                      |          |          |          |          |

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|  |         |         |         |         |           |
|--|---------|---------|---------|---------|-----------|
| Basic  | \$ 0.25 | \$ 0.78 | \$ 1.65 | \$ 1.95 | \$ 1.17   |
| Diluted                                      | \$ 0.24 | \$ 0.75 | \$ 1.59 | \$ 1.87 | \$ 1.08   |
| Number of shares used in computation:        |         |         |         |         |           |
| Basic  | 308     | 304     | 305     | 295     | 282       |
| Diluted                                      | 317     | 314     | 318     | 308     | 293       |
| Class B common stock:                        |         |         |         |         |           |
| Net loss, net of retained interest in EA.com | N/A     | N/A     | N/A     | N/A     | \$ (12)   |
| Net loss per share:                          |         |         |         |         |           |
| Basic  | N/A     | N/A     | N/A     | N/A     | \$ (2.77) |
| Diluted                                      | N/A     | N/A     | N/A     | N/A     | \$ (2.77) |
| Number of shares used in computation:        |         |         |         |         |           |
| Basic  | N/A     | N/A     | N/A     | N/A     | 4         |
| Diluted                                      | N/A     | N/A     | N/A     | N/A     | 4         |



**Table of Contents****ELECTRONIC ARTS INC. AND SUBSIDIARIES****SELECTED FIVE-YEAR CONSOLIDATED FINANCIAL DATA (Continued)**

(In millions)

| <b>BALANCE SHEET DATA</b>    | <b>2007<sup>(a)</sup></b> | <b>Year Ended March 31,</b> |             |             | <b>2003</b> |
|------------------------------|---------------------------|-----------------------------|-------------|-------------|-------------|
|                              |                           | <b>2006</b>                 | <b>2005</b> | <b>2004</b> |             |
| Cash and cash equivalents    | \$ 1,371                  | \$ 1,242                    | \$ 1,270    | \$ 2,150    | \$ 950      |
| Short-term investments       | 1,264                     | 1,030                       | 1,688       | 264         | 638         |
| Marketable equity securities | 341                       | 160                         | 140         | 1           | 1           |
| Working capital              | 2,571                     | 2,143                       | 2,899       | 2,185       | 1,334       |
| Total assets                 | 5,146                     | 4,386                       | 4,370       | 3,464       | 2,429       |
| Long-term liabilities        | 88                        | 97                          | 54          | 42          | 54          |
| Total liabilities            | 1,114                     | 966                         | 861         | 786         | 640         |
| Minority interest            |                           | 12                          | 11          |             | 4           |
| Total stockholders' equity   | 4,032                     | 3,408                       | 3,498       | 2,678       | 1,785       |

- (a) Beginning in fiscal 2007, we adopted Statement of Financial Accounting Standard No. 123 (revised 2004) (SFAS No. 123(R)), *Share-Based Payment*. Accordingly, in fiscal 2007, we recognized stock-based compensation expense of \$133 million, pre-tax, and \$107 million, net of tax. See Note 12 of the Notes to Consolidated Financial Statements for a detailed functional line-item breakdown of our stock-based compensation expense.

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### **Item 7: *Management's Discussion and Analysis of Financial Condition and Results of Operations***

#### **OVERVIEW**

The following overview is a top-level discussion of our operating results as well as some of the trends and drivers that affect our business. Management believes that an understanding of these trends and drivers is important in order to understand our results for the fiscal year ended March 31, 2007, 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-K, including in the **Business** section and the **Risk Factors** above, the remainder of **Management's Discussion and Analysis of Financial Condition and Results of Operations**, or the Consolidated Financial Statements and related notes.

#### ***About Electronic Arts***

We develop, market, publish and distribute interactive software games that are playable by consumers on video game consoles (such as the Sony PlayStation 2 and PLAYSTATION 3, Microsoft Xbox 360 and Nintendo Wii), personal computers, mobile platforms (including cellular handsets and handheld game players such as the PlayStation Portable (PSP) and the Nintendo DS) and online (over the Internet and other proprietary online networks). Some of our games are based on content that we license from others (e.g., Madden NFL Football, The Godfather and FIFA Soccer), and some of our games are based on our own wholly-owned intellectual property (e.g., The Sims and Need for Speed). Our goal is to publish titles with mass-market appeal, which often means translating and localizing them for sale in non-English speaking countries. In addition, we also attempt to create software game franchises that allow us to publish new titles on a recurring basis that are based on the same property. Examples of this franchise approach are the annual iterations of our sports-based products (e.g., Madden NFL Football, NCAA® Football and FIFA Soccer), wholly-owned properties that can be successfully sequenced (e.g., The Sims, Need for Speed and Battlefield) and titles based on long-lived literary and/or movie properties (e.g., Lord of the Rings and Harry Potter).

#### ***Overview of Financial Results***

Total net revenue for the fiscal year ended March 31, 2007 was \$3.091 billion, up 5 percent as compared to the fiscal year ended March 31, 2006. Total net revenue for the fiscal year ended March 31, 2007 was driven by sales of *Madden NFL 07*, *Need for Speed Carbon*, *FIFA 07*, *The Sims 2 Pets*, and *NCAA® Football 07*. Four titles sold more than five million units in the fiscal year ended March 31, 2007: *Madden NFL 07*, *Need for Speed Carbon*, *FIFA 07*, and *The Sims 2 Pets*.

Net income for the fiscal year ended March 31, 2007 was \$76 million as compared to \$236 million for the fiscal year ended March 31, 2006. Diluted net income per share for the fiscal year ended March 31, 2007 was \$0.24 as compared to \$0.75 for the fiscal year ended March 31, 2006. Although net revenue increased in fiscal 2007 as compared to fiscal 2006, net income decreased due to an increase in our operating expenses as a result of our adoption of SFAS No. 123 (revised 2004) (SFAS No. 123(R)), *Share Based Payment*, an increase in our annual bonus expense and an increase in additional personnel-related costs due to an increase in headcount. These increases were further mitigated by a decrease in our income tax provision.

We generated \$397 million of cash from operating activities during the year ended March 31, 2007, as compared to \$596 million for fiscal 2006. The decrease in cash generated from operating activities was primarily due to the timing of the collection of our receivables as a result of collecting a greater amount of our receivables during fiscal 2006 as compared to fiscal 2007.

*Stock-Based Compensation.* Beginning in fiscal 2007, we adopted SFAS No. 123(R) which requires us to recognize the cost resulting from all share-based payment transactions in our financial statements using a fair-value-based method. See Note 12 of the Notes to Consolidated Financial Statements. The following table summarizes our stock-based compensation expense resulting from stock options, restricted stock, restricted

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stock units and our employee stock purchase plan included in our Consolidated Statements of Operations for the fiscal years ended March 31, 2007, 2006 and 2005 (in millions):

|  | <b>Year Ended March 31,</b> |             |             |
|--|-----------------------------|-------------|-------------|
|  | <b>2007</b>                 | <b>2006</b> | <b>2005</b> |
| Cost of goods sold                           | \$ 2                        | \$          | \$          |
| Marketing and sales                          | 17                          |             |             |
| General and administrative                   | 37                          | 1           |             |
| Research and development                     | 77                          | 2           | 6           |
| Stock-based compensation expense             | 133                         | 3           | 6           |
| Benefit from income taxes                    | (26)                        | (1)         | (2)         |
| Stock-based compensation expense, net of tax | \$ 107                      | \$ 2        | \$ 4        |

As of March 31, 2007, our total unrecognized compensation cost related to stock options was \$153 million and is expected to be recognized over a weighted-average service period of 1.6 years. As of March 31, 2007, our total unrecognized compensation cost related to restricted stock and restricted stock units (collectively referred to as restricted stock rights ) was \$82 million and is expected to be recognized over a weighted-average service period of 2.3 years.

***Management's Overview of Historical and Prospective Business Trends***

*Transition to A New Generation of Consoles.* Video game hardware systems have historically had a life cycle of four to six years, which causes the video game software market to be cyclical as well. Microsoft launched the Xbox 360 in November 2005, while Sony and Nintendo launched the PLAYSTATION 3 and the Wii, respectively, in November 2006. We have continued to develop and market new titles for prior-generation video game systems such as the PlayStation 2 while also making significant investments in products for the new systems. As the prior-generation systems reach the end of their life cycle and the installed base of the new systems continues to grow, our sales of video games for prior-generation systems will continue to decline as (1) we produce fewer titles for prior-generation systems, (2) consumers replace their prior-generation systems with the new systems, and/or (3) consumers reduce game software purchases for certain prior-generation consoles generally, for example, until they are able to purchase a new video game hardware system. This decline in prior-generation product sales could ultimately be greater than we anticipate, and sales of products for the new platforms may be lower than we anticipate. Moreover, we expect development costs for the new video game systems to be greater on a per-title basis than development costs for prior-generation video game systems.

We have incurred increased costs during this transition as we have continued to develop and market new titles for certain prior-generation video game platforms while also making significant investments in products for the new generation platforms. As we move through the life cycle of prior-generation consoles, we will continue to devote significant resources to the development of prior-generation titles while at the same time spending more for the new generation of platforms and technology. As a result of these factors, we expect research and development expenses to increase in fiscal 2008.

*Investment in Online.* Today, we generate net revenue from a variety of online products and services, including casual games and downloadable content marketed under our Pogo brand, persistent state world games such as *Ultima Online*

and *Dark Age of Camelot*, PC-based downloadable content and online-enabled packaged goods. As the nature of online game offerings expands and evolves, we anticipate long-term opportunities for growth in this area. For example, we expect that consumers will take advantage of the online connectivity of the new generation of consoles at a much higher rate than they have on prior-generation consoles, allowing more consumers to enhance their gameplay experience through multiplayer activity, community-building and downloading content. We plan to increase the amount of content available for download on the PC, consoles and cell phones, increase the number of games with dynamic in-game advertising and to increase the number of PC-based games that can be downloaded digitally. In addition, we plan to expand our casual game offerings internationally and to invest in growing genres such as mid-session

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games. To further enhance our online offerings, we acquired Mythic, a developer and publisher of massively multiplayer online role-playing games, in July 2006. We intend to make significant investments in online products, infrastructure and services and believe that online gameplay will become an increasingly important part of our business in the long term.

*Significantly Increased Deferred Revenue for Online-Enabled Games.* The ubiquity of high-speed Internet access and the integration of network connectivity into new generation game consoles are expected to increase demand for games with online-enabled features. To address this demand, many of our software products are developed with the ability to be connected to and played via the Internet. In order for consumers to participate in online communities and play against one another via the Internet, we (or through outsourced arrangements with third parties) have servers which support the various online services we provide to consumers such as matchmaking, roster updates, tournaments and player rankings. In situations where we do not separately sell these online services, we consider the sale of the software product as a bundle sale or multiple element arrangement in which we sell both the software product and the online service for one combined price.

Through fiscal 2007, for accounting purposes, vendor specific objective evidence of fair value existed for the online service. Accordingly, we allocated the revenue collected from the sale of the software product between the online service and the software product and recognized the amounts allocated to each element separately. However, starting in fiscal 2008, for accounting purposes, the required vendor specific objective evidence of fair value will not exist for the online services. This will prevent us from allocating and recognizing revenue related to the software product and the online services separately. Accordingly, we will begin to recognize all of the revenue from the sale of our online-enabled software products related to the PC, PlayStation 2, PLAYSTATION 3 and the PSP platforms over the estimated online service period (currently expected to be recognized over six months after the month of sale). We anticipate that, in fiscal 2008, we will likely defer approximately \$400 to \$500 million in net revenue from the sale of these online-enabled software products into fiscal 2009. On a quarterly basis, this amount will vary significantly depending upon the timing of the release of the online-enabled software product and the sales volume of such products. In addition, we will expense the cost of goods sold related to these transactions when delivered. As of March 31, 2007, deferred net revenue related to packaged goods and digital content (i.e., content delivered to the consumer via the Internet including (1) digital downloads and (2) certain incremental content related to our core subscription services payable only online, which are types of micro-transactions ) was \$23 million.

*Expansion of Mobile Platforms.* Advances in mobile technology have resulted in a variety of new and evolving platforms for on-the-go interactive entertainment that appeal to a broader demographic of consumers. Our efforts to capitalize on the growth in mobile interactive entertainment are focused in two broad areas packaged goods games for handheld game systems and downloadable games for cellular handsets.

We have developed and published games for a variety of handheld platforms, including the Nintendo Game Boy and Game Boy Advance, for several years. The introductions of the Sony PSP and the Nintendo DS, with their enhanced graphics, deeper gameplay, and online functionality, provide a richer mobile gaming experience for consumers.

We expect sales of games for cellular handsets to continue to be an increasingly important part of our business worldwide. To accelerate our position in this growing segment, in February 2006, we acquired JAMDAT Mobile Inc., a global publisher of wireless games and other wireless entertainment applications. As a result of this acquisition, our net revenue from games for cellular handsets increased significantly in fiscal 2007 as compared to prior years. Likewise, the acquisition, along with the additional investment required to grow this portion of our business globally, resulted in increased license royalties, development and operating expenses in fiscal 2007.

As mobile technology continues to evolve and the installed base of both handheld game systems and game-enabled cellular phones continues to expand, we anticipate that sales of our titles for mobile platforms for both handhelds and

cellular handsets will become an increasingly important part of our business.

*Acquisitions, Investments and Strategic Transactions.* We have engaged in, evaluated, and expect to continue to engage in and evaluate, a wide array of potential strategic transactions, including (1) acquisitions of

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companies, businesses, intellectual properties, and other assets, and (2) investments in new interactive entertainment businesses, such as online and mobile games. In May 2007, we announced that we entered into a licensing agreement with and expect to make a strategic equity investment in The9 Limited, a leading online game operator in China, on or around May 29, 2007. The licensing agreement gives The9 exclusive publishing rights for *EA SPORTS FIFA Online* in mainland China. In April 2007, we expanded our commercial agreements with and made strategic equity investments in Neowiz Corporation and its online gaming subsidiary, Neowiz Games. Based in Korea, Neowiz is an online media and gaming company with which we partnered in 2006 to launch *EA Sports FIFA Online* in Korea. In October 2006, the remaining outstanding shares of Digital Illusions C.E. ( DICE ) were purchased, thereby completing the acquisition of the remaining minority interest of DICE. In July 2006, we acquired Mythic as part of our efforts to accelerate our growth in the massively multiplayer online role-playing market. In fiscal 2007, we also acquired SingShot Media, a San Francisco-based online karaoke community, as well as substantially all of the assets of Headgate Studios, a Utah-based developer with which we had partnered since 2000 to develop certain EA franchises, and Phenomic Game Development, a developer of Real Time Strategy games based in Germany. In fiscal 2006, we acquired JAMDAT as part of our efforts to accelerate our growth in mobile gaming.

*International Expansion.* We expect international sales to remain a fundamental part of our business. As part of our international expansion strategy, we may seek to partner with established local companies through acquisitions, joint ventures, minority investments or other similar arrangements. We are planning to expand our development and business activities internationally. We believe that in order to succeed internationally, it is important to locally develop content that is specifically directed toward local cultures and consumers. As such, we expect to continue to devote resources to hiring local development talent and expanding our infrastructure.

*Sales of Hit Titles.* Sales of hit titles, several of which were top sellers in a number of countries, contributed significantly to our net revenue in fiscal 2007. Our top-selling titles across all platforms worldwide during the year ended March 31, 2007 were *Madden NFL 07*, *Need for Speed Carbon*, *FIFA 07*, *The Sims 2 Pets* and *NCAA Football 07*. Hit titles are important to our financial performance because they benefit from overall economies of scale. We have developed, and it is our objective to continue to develop, many of our hit titles to become franchise titles that can be regularly iterated.

*Increasing Licensing Costs.* We generate a significant portion of our net revenue and operating income from games based on licensed content, such as FIFA Soccer. We have recently entered into new licenses and renewed older licenses, some of which may contain higher royalty rates or guarantees than similar license agreements we have entered into in the past. We believe these licenses, and the product franchises they support, will continue to be important to our future operations, but the higher costs of these licenses will negatively impact our gross margins.

*Foreign Currency Exchange Impact.* Net revenue from international sales accounted for approximately 46 percent of our total net revenue during both fiscal 2007 and 2006. Our international net revenue was primarily driven by sales in Europe and, to a much lesser extent, in Asia. Year-over-year, foreign exchange rates had a favorable impact on our net revenue of \$53 million, or 2 percent, for the year ended March 31, 2007.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these 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 judgment and estimates of matters that are inherently uncertain and unknown. As a result, actual results may differ materially from our estimates.





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

We principally derive revenue from sales of interactive software games designed for play on video game consoles (such as the PLAYSTATION 3, Xbox 360 and Wii), PCs and mobile platforms including handheld game players (such as the Sony PSP, Nintendo DS and Nintendo Game Boy Advance) and cellular handsets. We evaluate the recognition of revenue based on the criteria set forth in Statement of Position ( SOP ) 97-2, *Software Revenue Recognition* , as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions* and Staff Accounting Bulletin ( SAB ) No. 104, *Revenue Recognition* . We evaluate revenue recognition using the following basic criteria 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 products must be present in order to recognize revenue.

*Delivery.* Delivery is considered to occur when a product is shipped and the risk of loss and rewards of ownership have been transferred to the customer. For online game services, delivery is considered to occur as the service is provided.

*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.* We conduct a credit review of each customer involved in a significant transaction to determine the creditworthiness of the customer. 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, we recognize revenue when collection becomes probable (generally upon cash collection).

Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue we report. For example, for multiple element arrangements, we must make assumptions and judgments in order to: (1) determine whether and when each element has been delivered; (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services; (3) determine whether vendor-specific objective evidence of fair value ( VSOE ) exists for each undelivered element; and (4) allocate the total price among the various elements we must deliver. Changes to any of these assumptions or judgments, or changes to the elements in a software arrangement, could cause a material increase or decrease in the amount of revenue that we report in a particular period. For example, some of our packaged goods products are sold with online services. Prior to, and through fiscal 2007, we had been able to determine VSOE for the online services to be delivered; therefore, we have been able to allocate the total price received from the combined product and online service sale between these two elements and recognize the related revenue separately. However, starting in fiscal 2008, VSOE will not exist for the online services to be delivered for certain platforms and all revenue from these transactions will be recognized over the estimated online service period. More specifically, we will begin to recognize the revenue from sales of certain online-enabled packaged goods on a straight-line basis over six months after the month of sale. Accordingly, this relatively small change (from having VSOE for online hosting services to no longer having VSOE) will have a significant effect on our reported results.

Determining whether a transaction constitutes an online game service transaction or a download of a product requires judgment and can be difficult. The accounting for these transactions is significantly different. Revenue from product downloads is recognized when the download occurs (assuming all other recognition criteria are met). Revenue from online game services is recognized as the services are rendered. If the service period is not defined, we recognize the revenue over the estimated service period. Determining the estimated service period is inherently subjective and is

subject to regular revision based on historical online usage.

Product revenue, including sales to resellers and distributors ( channel partners ), is recognized when the above criteria are met. We reduce product revenue for estimated future returns, price protection, and other offerings, which may occur with our customers and channel partners. In certain countries, we have stock-balancing programs for our PC and video game system products, which allow for the exchange of these

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products by resellers under certain circumstances. It is our general practice to exchange products or give credits rather than to give cash refunds.

In certain countries, from time to time, we decide to provide price protection for both our PC and video game system products. When evaluating the adequacy of sales returns and price protection allowances, we analyze historical returns, current sell-through of distributor and retailer inventory of our products, current trends in retail and the video game segment, changes in customer demand and acceptance of our 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 costs in subsequent periods.

In the future, actual returns and price protections may materially exceed our estimates as unsold 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 products. For example, the risk of product returns and/or price protection for our products may continue to increase as the PlayStation 2 console moves through its lifecycle. While we believe we can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, if our estimates changed, our returns and price protection reserves would change, which would impact the total net revenue we report. For example, if actual returns and/or price protection were significantly greater than the reserves we have established, our actual results would decrease our reported total net revenue. Conversely, if actual returns and/or price protection were significantly less than our reserves, this would increase our reported total net revenue.

Significant judgment is required to estimate our allowance for doubtful accounts in any accounting period. We determine our allowance for doubtful accounts by evaluating customer creditworthiness in the context of current economic trends and historical experience. Depending upon the overall economic climate and the financial condition of our customers, the amount and timing of our bad debt expense and cash collection could change significantly.

## ***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 product.

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 goods sold generally at the greater of the contractual rate or an effective royalty rate based on expected net product sales. Significant judgment is required to estimate the effective royalty rate for a particular contract. Because the computation of effective royalty rates requires us to project future revenue, it is inherently subjective as our future revenue projections must anticipate a number of factors, including (1) the total number of titles subject to the contract, (2) the timing of the release of these titles, (3) the number of software units we expect to sell which can be impacted by a number of variables, including product quality 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. Accordingly, if our future revenue projections change, our effective royalty rates would change, which could impact the 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 amortized 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 goods sold.

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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. Minimum royalty payment obligations are classified as current liabilities to the extent such royalty payments are contractually due within the next twelve months. As of March 31, 2007 and 2006, approximately \$9 million of minimum guaranteed royalty obligations had been recognized in each period.

Each quarter, we also evaluate the future realization of our royalty-based assets as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments determined before the launch of a product are charged to research and development expense. Impairments determined post-launch are charged to cost of goods sold. In either case, we rely on estimated revenue to evaluate the future realization of prepaid royalties and commitments. If actual sales or revised revenue estimates fall below the initial revenue estimate, then the actual charge taken may be greater in any given quarter than anticipated. We had no impairments during fiscal 2007. During fiscal 2006 and 2005, we recorded impairment charges of \$16 million and \$8 million, respectively.

### ***Valuation of Long-Lived Assets, including goodwill and other intangible assets***

We evaluate both purchased intangible assets and other long-lived assets in order to determine if events or changes in circumstances indicate a potential impairment in value exists. This evaluation requires us to estimate, among other things, the remaining useful lives of the assets and future cash flows of the business. These evaluations and estimates require the use of judgment. Our actual results could differ materially from our current estimates.

Under current accounting standards, we make judgments about the recoverability of purchased intangible assets and other long-lived assets whenever events or changes in circumstances indicate a potential impairment in the remaining value of the assets recorded on our Consolidated Balance Sheets. In order to determine if a potential impairment has occurred, management makes various assumptions about the future value of the asset by evaluating future business prospects and estimated cash flows. Our future net cash flows are primarily dependent on the sale of products for play on proprietary video game consoles, handheld game players, PCs, and cellular handsets ( platforms ). The sales of our products are affected by our ability to accurately predict which platforms and which products we develop will be successful. Also, our revenue and earnings are dependent on our ability to meet our product release schedules. Due to product sales shortfalls, we may not realize the future net cash flows necessary to recover our long-lived assets, which may result in an impairment charge being recorded in the future. We recognized an insignificant amount of impairment in fiscal 2007, 2006 and 2005.

SFAS No. 142, *Goodwill and Other Intangible Assets* requires at least an annual assessment for impairment of goodwill by applying a fair-value-based test. A two-step approach is required to test goodwill for impairment for each reporting unit. The first step tests 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 individual assets and liabilities within each reporting unit. Application of the goodwill impairment test requires judgment, including identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated using a discounted cash flow methodology which requires significant judgment to estimate the future cash flows, determine the appropriate discount rates, growth rates and other assumptions. The determination of fair value for each reporting unit could be materially affected by changes in these estimates and assumptions which could trigger impairment. In fiscal 2007, we completed the first step of the annual goodwill impairment testing as of January 1, 2007 and found no indicators of impairment of our recorded goodwill. We did not recognize an impairment loss on

goodwill in fiscal 2007, 2006 or 2005. Future impairment tests may result in a charge to earnings and there is a potential for a write-down of goodwill in connection with the annual impairment test.

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### ***Stock-Based Compensation***

On April 1, 2006, we adopted SFAS No. 123(R) and applied the provisions of SAB No. 107, *Share-Based Payment*, on our adoption of SFAS No. 123(R). SFAS No. 123(R) requires that the cost resulting from all share-based payment transactions be recognized in the financial statements using a fair-value-based method. We elected to use the modified prospective transition method of adoption. SFAS No. 123(R) requires us to measure compensation cost for all outstanding unvested stock-based awards made to our employees and directors based on estimated fair values and recognize compensation over the service period for awards expected to vest. We recognized \$133 million of stock-based compensation related to employee stock options, restricted stock units, restricted stock awards and our employee stock purchase plan ( ESPP ) during the fiscal year ended March 31, 2007. We recognized \$3 million of stock-based compensation related to employee restricted stock units, stock options assumed in connection with our acquisition of JAMDAT and non-employee stock options during the fiscal year ended March 31, 2006. We recognized \$6 million of stock-based compensation related to stock options assumed in connection with our acquisition of Criterion Software Group Ltd. and non-employee stock options and warrants during the fiscal year ended March 31, 2005.

For options and ESPP, we use the Black-Scholes option valuation model to determine the grant date fair value. The Black-Scholes option valuation model requires us to make certain assumptions about the future. The determination of fair value is affected by our stock price as well as assumptions regarding subjective and complex variables such as expected employee exercise behavior and our expected stock price volatility over the term of the award. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. We estimated the following key assumptions for the Black-Scholes valuation calculation:

*Risk-free interest rate.* 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.* We use our historical stock price volatility and consider the implied volatility computed based on the price of short-term options publicly traded on our common stock for our expected volatility assumption.

*Expected term.* The expected term represents the weighted-average period the stock options are expected to remain outstanding. The expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.

*Expected dividends.*

As required by SFAS No. 123(R), employee stock-based compensation expense recognized in fiscal 2007 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. Forfeitures are revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates and an adjustment will be recognized at that time.

Changes to our underlying stock price, our assumptions used in the Black-Scholes option valuation calculation and our forfeiture rate as well as future grants of equity could significantly impact compensation expense to be recognized in fiscal 2008 and future periods.

### ***Income Taxes***



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 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 current tax exposures in each jurisdiction where we operate. These estimates involve complex issues, require extended periods of time to resolve, and require us to make judgments, 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. We are also required to make determinations of the need to record deferred tax liabilities and the recoverability of deferred tax assets. A valuation allowance is

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established to the extent recovery of deferred tax assets is not likely based on our estimation of future taxable income in each jurisdiction.

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. As with fiscal 2007, we expect our effective tax rate to be unusually volatile and subject to significant fluctuation.

**RESULTS OF OPERATIONS**

Our fiscal year is reported on a 52 or 53-week period that, historically, ended on the final Saturday of March in each year. Beginning with the fiscal year ended March 31, 2006, our fiscal year ends on the Saturday nearest March 31. As a result, fiscal 2006 contained 53 weeks with the first quarter containing 14 weeks. Our results of operations for the fiscal years ended March 31, 2008, 2007, 2006 and 2005 contain the following number of weeks:

| <b>Fiscal Year Ended</b> | <b>Number of Weeks</b> | <b>Fiscal Period End Date</b> |
|--------------------------|------------------------|-------------------------------|
| March 31, 2008           | 52 weeks               | March 29, 2008                |
| March 31, 2007           | 52 weeks               | March 31, 2007                |
| March 31, 2006           | 53 weeks               | April 1, 2006                 |
| March 31, 2005           | 52 weeks               | March 26, 2005                |

For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

Beginning in fiscal 2007, we adopted SFAS No. 123(R) and applied the provisions of SAB No. 107 to our adoption of SFAS No. 123(R). We elected to use the modified prospective transition method of adoption which requires that compensation expense be recognized in the financial statements for all awards granted after the date of adoption as well as for existing awards for which the requisite service has not been rendered as of the date of adoption. Accordingly, prior periods are not restated for the effect of SFAS No. 123(R). Prior to our adoption of SFAS No. 123(R), we valued our stock options based on the multiple-award valuation method and recognized the expense using the accelerated approach over the requisite service period. In conjunction with our adoption of SFAS No. 123(R), we changed our method of recognizing our stock-based compensation expense to the straight-line approach over the requisite service period; however, we continue to value our stock options based on the multiple-award valuation method.

Prior to fiscal 2007, we accounted for stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board No. 25, *Accounting for Stock Issued to Employees* and adopted the disclosure-only provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended. Also, as required by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, we provided pro forma net income and net income per common share disclosures for stock-based awards as if the fair-value-based method defined in SFAS No. 123 had been applied. As a result, prior periods are not restated for the effect of SFAS No. 123(R). Pre-tax stock-based compensation expense for the fiscal years ended March 31, 2007, 2006 and 2005 was \$133 million, \$3 million and \$6 million, respectively.

**Comparison of Fiscal 2007 to Fiscal 2006**

**Net Revenue**

We derive net revenue principally from sales of interactive software games designed for play on video game consoles (such as the PlayStation 2, PLAYSTATION 3, Xbox 360 and Wii), PCs and handheld game players (such as the Sony PSP, Nintendo DS and Nintendo Game Boy Advance) and cellular handsets. We also derive net revenue from selling services in connection with some of our online games, programming third-party web

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sites with our game content, allowing other companies to manufacture and sell our products in conjunction with other products, and selling advertisements on our online web pages and in our games.

From a geographical perspective, our total net revenue for fiscal years ended March 31, 2007 and 2006 was as follows (in millions):

|                   | Year Ended March 31, |      | Year Ended March 31, |      | Increase<br>/<br>(Decrease) | %<br>Change |
|-------------------|----------------------|------|----------------------|------|-----------------------------|-------------|
|                   | 2007                 |      | 2006                 |      |                             |             |
| North America     | \$ 1,666             | 54%  | \$ 1,584             | 54%  | \$ 82                       | 5%          |
| Europe            | 1,261                | 41%  | 1,174                | 40%  | 87                          | 7%          |
| Asia              | 164                  | 5%   | 193                  | 6%   | (29)                        | (15%)       |
| International     | 1,425                | 46%  | 1,367                | 46%  | 58                          | 4%          |
| Total Net Revenue | \$ 3,091             | 100% | \$ 2,951             | 100% | \$ 140                      | 5%          |

***North America***

For fiscal 2007, net revenue in North America was \$1,666 million, driven primarily by (1) our packaged goods business led by sales of *Madden NFL 07*, *Need for Speed Carbon*, and *NCAA Football 07*, and (2) to a lesser extent, growth in our cellular handset games business resulting from our February 2006 acquisition of JAMDAT. Overall, net revenue increased \$82 million, or 5 percent, as compared to fiscal 2006.

The increase in net revenue for fiscal 2007, as compared to fiscal 2006 was driven primarily by (1) a \$95 million increase in cellular handset net revenue, and (2) a \$43 million increase in catalog<sup>(a)</sup> net revenue. These increases were partially offset by a \$79 million decrease in frontline<sup>(b)</sup> net revenue.

(a) We refer to catalog net revenue as net revenue derived from an EA Studio SKU (a version of a title designed for play on a particular platform) for consoles, PC, PSP, Nintendo DS, and Game Boy Advance subsequent to the fiscal period presented in which the SKU was initially launched.

(b) We refer to frontline net revenue as net revenue derived from an EA Studio SKU for consoles, PC, PSP, Nintendo DS, and Game Boy Advance during the same fiscal period presented as the SKU was launched.

***Europe***

For fiscal 2007, net revenue in Europe was \$1,261 million, driven primarily by sales of *FIFA 07* and *Need for Speed Carbon*. Overall, net revenue increased \$87 million, or 7 percent, as compared to fiscal 2006. We estimate that foreign exchange rates (primarily the Euro and the British pound sterling) increased reported European net revenue by approximately \$57 million, or 5 percent, for fiscal 2007 as compared to fiscal 2006. Excluding the effect of foreign exchange rates, we estimate that European net revenue increased by approximately \$30 million, or 2 percent, for fiscal 2007.

The increase in net revenue for fiscal 2007, as compared to fiscal 2006 was driven primarily by (1) a \$64 million increase in catalog net revenue, and (2) a \$25 million increase in cellular handset net revenue. These increases were partially offset by a \$7 million decrease in frontline net revenue.

### *Asia*

For fiscal 2007, net revenue in Asia was \$164 million, driven primarily by sales of *Need for Speed Carbon*. Overall, net revenue decreased by \$29 million, or 15 percent, as compared to fiscal 2006. The decrease in net revenue for fiscal 2007 was driven primarily by (1) a \$21 million decrease in co-publishing and distribution net revenue, and (2) a \$20 million decrease in frontline net revenue. These decreases were partially offset by a \$13 million increase in catalog net revenue. We estimate that changes in foreign exchange rates decreased reported net revenue in Asia by approximately \$4 million, or 2 percent, for fiscal 2007. Excluding the effect

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of foreign exchange rates, we estimate that Asia net revenue decreased by approximately \$25 million, or 13 percent, for fiscal 2007 as compared to fiscal 2006.

Our total net revenue by platform for fiscal years 2007 and 2006 was as follows (in millions):

|  | <b>Year Ended March 31,</b> |      |             |      | <b>Increase/</b>  | <b>%</b>      |
|--|-----------------------------|------|-------------|------|-------------------|---------------|
|  | <b>2007</b>                 |      | <b>2006</b> |      | <b>(Decrease)</b> | <b>Change</b> |
| Consoles                                     |                             |      |             |      |                   |               |
| PlayStation 2                                | \$ 886                      | 29%  | \$ 1,127    | 38%  | \$ (241)          | (21%)         |
| Xbox 360                                     | 480                         | 15%  | 140         | 5%   | 340               | 243%          |
| Xbox   | 157                         | 5%   | 400         | 13%  | (243)             | (61%)         |
| PLAYSTATION 3                                | 94                          | 3%   |             |      | 94                | N/M           |
| Wii  | 65                          | 2%   |             |      | 65                | N/M           |
| Nintendo GameCube                            | 60                          | 2%   | 135         | 5%   | (75)              | (56%)         |
| Other Consoles                               |                             |      | 1           |      | (1)               | (100%)        |
| Total Consoles                               | 1,742                       | 56%  | 1,803       | 61%  | (61)              | (3%)          |
| PC   | 498                         | 16%  | 418         | 14%  | 80                | 19%           |
| Mobility                                     |                             |      |             |      |                   |               |
| PSP  | 258                         | 8%   | 252         | 9%   | 6                 | 2%            |
| Cellular Handsets                            | 140                         | 6%   | 19          | 1%   | 121               | 637%          |
| Nintendo DS                                  | 104                         | 3%   | 67          | 2%   | 37                | 55%           |
| Game Boy Advance                             | 38                          | 1%   | 55          | 2%   | (17)              | (31%)         |
| Total Mobility                               | 540                         | 18%  | 393         | 14%  | 147               | 37%           |
| Co-publishing and Distribution               | 175                         | 6%   | 213         | 7%   | (38)              | (18%)         |
| Internet Services, Licensing and Other       |                             |      |             |      |                   |               |
| Subscription Services                        | 79                          | 2%   | 61          | 2%   | 18                | 30%           |
| Licensing, Advertising and Other             | 57                          | 2%   | 63          | 2%   | (6)               | (10%)         |
| Total Internet Services, Licensing and Other | 136                         | 4%   | 124         | 4%   | 12                | 10%           |
| Total Net Revenue                            | \$ 3,091                    | 100% | \$ 2,951    | 100% | \$ 140            | 5%            |

***PlayStation 2***

For fiscal 2007, net revenue from sales of titles for the PlayStation 2 was \$886 million, driven primarily by sales of *Madden NFL 07*, *Need for Speed Carbon*, and *FIFA 07*. Overall, PlayStation 2 net revenue decreased \$241 million, or 21 percent, compared to fiscal 2006. Although we are unable to specifically quantify the impact, we believe the decrease was primarily due to the transition to new generation consoles.

We expect PlayStation 2-related net revenue to continue to decline in fiscal 2008 as consumers increasingly migrate to new platforms, we publish fewer titles (as compared to fiscal 2007) and we defer a greater percentage of our net revenue due to the change in our online-enabled packaged goods business model.

***Xbox 360***

The Xbox 360 was launched in North America, Europe and Japan during the three months ended December 31, 2005 and in the rest of Asia during the three months ended March 31, 2006. For fiscal 2007, net revenue from sales of titles for the Xbox 360 was \$480 million driven primarily by sales of *Madden NFL 07*, *Need for Speed Carbon*, and *FIFA 07*.

We expect net revenue from sales of titles for the Xbox 360 to increase as the installed base grows and we release more titles.

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***Xbox***

For fiscal 2007, net revenue from sales of titles for the Xbox was \$157 million, driven primarily by sales of *Madden NFL 07*, *Need for Speed Carbon*, and *NCAA Football 07*. Overall, Xbox net revenue decreased \$243 million, or 61 percent, as compared to fiscal 2006. Although we are unable to specifically quantify the impact, we believe the decrease was primarily due to the transition to new generation consoles.

We expect Xbox-related net revenue to continue to decline as consumers increasingly migrate to new platforms and we publish significantly fewer titles (as compared to fiscal 2007).

***PLAYSTATION 3***

The PLAYSTATION 3 launched in North America and Japan during the three months ended December 31, 2006 and Europe and the rest of Asia during the three months ended March 31, 2007. Net revenue from sales of titles for the PLAYSTATION 3 was \$94 million for fiscal 2007, driven by sales of *Need for Speed Carbon*, *Madden NFL 07*, and *EA SPORTS™ Fight Night Round 3*.

We expect net revenue from sales of titles for the PLAYSTATION 3 to increase as the installed base grows and we release more titles. The increase will be partially offset by our deferral of net revenue resulting from certain online-enabled PLAYSTATION 3 games.

***Wii***

The Wii launched in North America, Europe and parts of Asia during the three months ended December 31, 2006. Net revenue from sales of titles for the Wii was \$65 million for fiscal 2007, driven by sales of *Need for Speed Carbon*, *Madden NFL 07*, and *Tiger Woods PGA® TOUR 07*.

We expect net revenue from sales of titles for the Wii to increase as the installed base grows and we release more titles.

***Nintendo GameCube***

For fiscal 2007, net revenue from sales of titles for the Nintendo GameCube was \$60 million, driven primarily by sales of *Madden NFL 07*, *Need for Speed Carbon*, and *FIFA 07*. Overall, Nintendo GameCube net revenue decreased \$75 million, or 56 percent, as compared to fiscal 2006. Although we are unable to specifically quantify the impact, we believe the decrease was primarily due to the transition to new generation consoles.

We expect Nintendo GameCube-related net revenue to continue to decline as consumers increasingly migrate to new platforms. We will no longer release titles for the Nintendo GameCube, which will also contribute to our expected net revenue decline from this platform.

***PC***

For fiscal 2007, net revenue from sales of titles for the PC was \$498 million driven primarily by sales of titles from The Sims, Battlefield, and Command and Conquer franchises. Overall, PC net revenue increased \$80 million, or 19 percent, as compared to fiscal 2006. The increase was due to a \$62 million increase in frontline net revenue and an \$18 million increase in catalog net revenue.



***Mobile Platforms***

Net revenue from mobile products, which consist of packaged goods games for handheld systems and downloadable games for cellular handsets, increased from \$393 million in fiscal 2006 to \$540 million in fiscal 2007. The increase was primarily due to a \$121 million year-over-year growth in our cellular handset games business resulting from our acquisition of JAMDAT and an increase of \$37 million in net revenue from sales of titles for the Nintendo DS.

We expect sales of games for cellular handsets to continue to be an increasingly important part of our business worldwide.

**Table of Contents*****Co-Publishing and Distribution***

Net revenue from co-publishing and distribution products, which consists of packaged goods games we co-develop and co-publish with as well as distribute on behalf of other companies and revenue generated from our Switzerland distribution business, decreased from \$213 million in fiscal 2006 to \$175 million in fiscal 2007. The decrease was primarily due to a decline in sales from two titles which were released in fiscal 2006 but had no corresponding releases in fiscal 2007: (1) *Half-Life 2*, sales of which decreased by \$19 million and (2) *Black & White 2<sup>™</sup>*, sales of which decreased by \$15 million.

We expect sales of titles for co-publishing products to increase in fiscal 2008.

**Cost of Goods Sold**

Cost of goods sold for our packaged-goods business consists of (1) product costs, (2) certain royalty expenses for celebrities, professional sports and other organizations and independent software developers, (3) manufacturing royalties, net of volume discounts and other vendor reimbursements, (4) expenses for defective products, (5) write-offs of post-launch prepaid royalty costs, (6) amortization of certain intangible assets, and (7) operational expenses. 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 goods sold for our online products consists primarily of data center and bandwidth costs associated with hosting our web sites, credit card fees and royalties for use of third-party properties. Cost of goods sold for our web site advertising business primarily consists of ad-serving costs.

Cost of goods sold for fiscal years 2007 and 2006 were as follows (in millions):

| <b>March 31,<br/>2007</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>% Change</b> | <b>Change as a<br/>% of Net<br/>Revenue</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|-----------------|---|
| \$1,212                   | 39.2%                       | \$1,181                   | 40.0%                       | 2.6%            | (0.8%)                                      |

In fiscal 2007, cost of goods sold decreased by 0.8 percentage points as a percentage of total net revenue as compared to fiscal 2006. This decrease was primarily due to lower average product costs as a percentage of total net revenue primarily driven by (1) fewer returns and lower pricing actions taken, or expected to be taken, in fiscal 2007 as compared to fiscal 2006 and (2) improved inventory management. As a result, we estimate average product costs as a percentage of total net revenue decreased by approximately 2 percent in fiscal 2007 as compared to fiscal 2006.

As a percentage of total net revenue, the decrease in average product costs was partially offset by an estimated 1 percent increase in license royalties during fiscal 2007 as compared to fiscal 2006 primarily due to (1) license agreements associated with our EA SPORTS titles and (2) from our acquisition of JAMDAT. This was partially offset by lower license royalties from movie-based titles in fiscal 2007.

Although there can be no assurance, and our actual results could differ materially, in the short-term we expect our gross margin to decline as a result of (1) increased deferred net revenue related to certain online-enabled packaged goods (we will expense the cost of goods sold related to these transactions when delivered), (2) a higher mix of co-publishing and distribution net revenue that has a lower gross margin, and (3) higher license royalty rates.

**Marketing and Sales**

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

Marketing and sales expenses for fiscal years 2007 and 2006 were as follows (in millions):

| <b>March 31,<br/>2007</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$466                     | 15%                         | \$431                     | 15%                         | \$35             | 8%              |

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Marketing and sales expenses increased by \$35 million, or 8 percent, in fiscal 2007 as compared to fiscal 2006. The increase was primarily due to (1) an increase of \$17 million in stock-based compensation expense recognized as a result of our adoption of SFAS No. 123(R), (2) an increase of \$10 million in our annual bonus expense, and (3) \$10 million in additional personnel-related costs primarily resulting from an increase in headcount. These increases were partially offset by a decrease of \$9 million in our marketing, advertising, promotional and related services as a result of higher advertising in the prior year to support our product releases, primarily from our Harry Potter and BLACK franchises.

Marketing and sales expenses included vendor reimbursements for advertising expenses of \$28 million and \$41 million in fiscal 2007 and 2006, respectively.

We expect marketing and sales expenses to increase in absolute dollars in fiscal 2008 primarily to support our titles.

**General and Administrative**

General and administrative expenses consist of personnel and related expenses of executive and administrative staff, fees for professional services such as legal and accounting, and allowances for doubtful accounts.

General and administrative expenses for fiscal years 2007 and 2006 were as follows (in millions):

| <b>March 31,<br/>2007</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$288                     | 9%                          | \$215                     | 7%                          | \$73             | 34%             |

General and administrative expenses increased by \$73 million, or 34 percent, in fiscal 2007 as compared to fiscal 2006 primarily due to (1) an increase of \$36 million in stock-based compensation expense recognized as a result of our adoption of SFAS No. 123(R), (2) a \$14 million increase in our annual bonus expense, (3) an \$11 million increase in additional personnel-related costs to help support our administrative functions worldwide, and (4) an increase of \$11 million in professional and contracted services in support of our technology infrastructure.

We expect general and administrative expenses to increase in absolute dollars in fiscal 2008 primarily due to an increase in personnel-related costs.

**Research and Development**

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

Research and development expenses for fiscal years 2007 and 2006 were as follows (in millions):

| <b>March 31,</b> | <b>% of Net</b> | <b>March 31,</b> | <b>% of Net</b> |
|------------------|-----------------|------------------|-----------------|
|------------------|-----------------|------------------|-----------------|

| <b>2007</b> | <b>Revenue</b> | <b>2006</b> | <b>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|-------------|----------------|-------------|----------------|------------------|-----------------|
| \$1,041     | 34%            | \$758       | 26%            | \$283            | 37%             |

Research and development expenses increased by \$283 million, or 37 percent, in fiscal 2007 as compared to fiscal 2006. The increase was primarily due to (1) an increase of \$75 million in stock-based compensation expense recognized as a result of our adoption of SFAS No. 123(R), (2) a \$59 million increase in our annual bonus expense, (3) \$54 million in additional personnel-related costs, primarily due to a 14 percent increase in headcount related in part to our acquisitions of JAMDAT and Mythic, and partially to support development of games for the new generation of consoles, (4) an increase of \$50 million in external development expenses primarily due to a greater number of projects in development as compared to the prior year as well as

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expenses in our cellular handset business resulting from our acquisition of JAMDAT, and (5) an increase of \$45 million in facilities-related expenses in support of our research and development functions worldwide.

We expect research and development expenses to increase in absolute dollars in fiscal 2008 primarily to support our development of titles for the new generation of consoles.

**Amortization of Intangibles**

Amortization of intangibles for fiscal years 2007 and 2006 were as follows (in millions):

| <b>March 31,<br/>2007</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$27                      | 1%                          | \$7                       |                             | \$20             | 286%            |

For fiscal 2007, amortization of intangibles resulted from our acquisitions of JAMDAT, Mythic and others. For fiscal 2006, amortization of intangibles resulted from our acquisitions of JAMDAT, Criterion and others. Amortization of intangibles increased by \$20 million, or 286 percent, in fiscal 2007 as compared to fiscal 2006 primarily due to the amortization of intangibles related to our acquisitions of JAMDAT and Mythic. See Note 4 of the Notes to Consolidated Financial Statements included in Item 8 of this report.

We expect amortization of intangible expenses to increase slightly in fiscal 2008 primarily due to the amortization of intangibles related to our acquisition of Mythic, which will be included in our results for a full year in fiscal 2008.

**Acquired In-process Technology**

Acquired in-process technology charges for fiscal years 2007 and 2006 were as follows (in millions):

| <b>March 31,<br/>2007</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$3                       |                             | \$8                       |                             | \$(5)            | (63%)           |

The acquired in-process technology charge we incurred in fiscal 2007 resulted from our acquisitions of Mythic and the remaining minority interest in DICE. The acquired in-process technology charge we incurred in fiscal 2006 resulted primarily from our acquisition of JAMDAT. Acquired in-process technology includes the value of products in the development stage that are not considered to have reached technological feasibility or have an alternative future use. Accordingly, upon consummation of these acquisitions, we incurred a charge for the acquired in-process technology, as reflected in our Consolidated Statement of Operations. See Note 4 of the Notes to Consolidated Financial Statements included in Item 8 of this report.

**Restructuring Charges**

Restructuring charges for fiscal years 2007 and 2006 were as follows (in millions):

| <b>March 31,</b> | <b>% of Net</b> | <b>March 31,</b> | <b>% of Net</b> |
|------------------|-----------------|------------------|-----------------|
|------------------|-----------------|------------------|-----------------|

| <b>2007</b> | <b>Revenue</b> | <b>2006</b> | <b>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|-------------|----------------|-------------|----------------|------------------|-----------------|
|             | \$15           | \$26        | 1%             | \$(11)           | (42%)           |

During the fourth quarter of fiscal 2006, we recorded a total pre-tax restructuring charge of \$10 million, consisting entirely of one-time benefits related to headcount reductions, which is included in restructuring charges in our Consolidated Statement of Operations. These headcount reductions related to our decision in the fourth quarter of fiscal 2006 to realign our resources with our product plan for fiscal 2007 and strategic opportunities for the new generation of consoles, online and mobile platforms.

During fiscal 2006, restructuring charges related to the establishment of our international publishing headquarters in Geneva, Switzerland were approximately \$14 million, of which \$8 million was for the closure of certain United Kingdom facilities. During fiscal 2007, restructuring charges related to the establishment of our international publishing headquarters in Geneva, Switzerland were approximately \$15 million, of which \$10 million was for employee-related expenses.

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In connection with our fiscal 2006 international publishing reorganization, in fiscal 2008, we expect to incur between \$5 million and \$10 million of restructuring costs. Overall, including charges incurred through March 31, 2007, we expect to incur between \$50 million and \$55 million of restructuring costs in connection with our fiscal 2006 international publishing reorganization, substantially all of which will result in cash expenditures by 2017. These restructuring costs will consist primarily of employee-related relocation assistance (approximately \$30 million), facility exit costs (approximately \$15 million), as well as other reorganization costs (approximately \$7 million).

**Interest and Other Income, Net**

Interest and other income, net, for fiscal years 2007 and 2006 was as follows (in millions):

| <b>March 31,<br/>2007</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$99                      | 3%                          | \$64                      | 2%                          | \$35             | 55%             |

For fiscal 2007, interest and other income, net, increased by \$35 million, or 55 percent, as compared to fiscal 2006 primarily due to an increase of \$30 million in interest income as a result of higher yields on our cash, cash equivalent and short-term investment balances and a \$7 million decrease in realized net losses recognized on investments.

**Income Taxes**

Income taxes for fiscal years 2007 and 2006 were as follows (in millions):

| <b>March 31,<br/>2007</b> | <b>Effective<br/>Tax Rate</b> | <b>March 31,<br/>2006</b> | <b>Effective<br/>Tax Rate</b> | <b>% Change</b> |
|---------------------------|-------------------------------|---------------------------|-------------------------------|-----------------|
| \$66                      | 48.2%                         | \$147                     | 37.6%                         | (55%)           |

Our effective income tax rates were 48.2 percent and 37.6 percent for fiscal 2007 and fiscal 2006, respectively. For fiscal 2007, our effective income tax rate was higher than the U.S. statutory rate of 35.0 percent due to a number of factors, including certain non-deductible stock based compensation expenses related to SFAS No. 123(R) and additional charges resulting from certain non-deductible acquisition-related costs during the fourth quarter of fiscal 2007. For fiscal 2006, our effective income tax rate is higher than the U.S. statutory rate of 35.0 percent for fiscal 2006 due to a number of factors, including the repatriation of foreign earnings in connection with the American Jobs Creation Act of 2004 (the Jobs Act), as discussed below, and additional charges resulting from certain non-deductible acquisition-related costs during the second and fourth quarters of fiscal 2006, which were partially offset by other items.

Our effective income tax rates for fiscal 2008 and future periods will depend on a variety of factors. For example, changes in our business such as acquisitions and intercompany transactions (for example, the acquisition of and intercompany transactions related to Mythic and DICE), changes in our international structure, changes in the geographic location of business functions or assets, changes in the geographic mix of income, as well as changes in, or termination of, 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. Also, variations in the estimated and actual level of annual pre-tax income can affect the overall effective income tax rate for future



fiscal years. We incur certain tax expenses that do not decline proportionately with declines in our consolidated income or increase in consolidated loss. As a result, in absolute dollar terms, our tax expense will have a greater influence on our effective tax rate at lower levels of pre-tax income than higher levels. In addition, at lower levels of pre-tax income, our effective tax rate will be more volatile.

We historically have considered undistributed earnings of our foreign subsidiaries to be indefinitely reinvested and, accordingly, no U.S. taxes have been provided thereon. With the exception of taking advantage of the one-time opportunity afforded to us by the Jobs Act, we currently intend to continue to indefinitely reinvest the undistributed earnings of our foreign subsidiaries.

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In July 2006, FASB issued FIN No. 48 which clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under FIN No. 48, the evaluation of a tax position is a two-step process. The first step is a recognition process where we are required to determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, it is presumed that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is a measurement process whereby a tax position that meets the more-likely-than-not recognition threshold is calculated to determine the amount of benefit to recognize in the financial statements. FIN No. 48 also requires new tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the reporting period. The provisions of FIN No. 48 are effective for fiscal years beginning after December 15, 2006. As such, we are required to adopt it in our first quarter of fiscal year 2008. Any changes to our income taxes due to the adoption of FIN No. 48 are treated as the cumulative effect of a change in accounting principle. We are evaluating what impact the adoption of FIN No. 48 will have on our Consolidated Financial Statements. This impact could be material and our future effective tax rates could be more volatile.

**Net Income**

Net income for fiscal years 2007 and 2006 was as follows (in millions):

| <b>March 31,<br/>2007</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$76                      | 2%                          | \$236                     | 8%                          | \$(160)          | (68%)           |

Net income decreased by \$160 million, or 68 percent, in fiscal 2007 as compared to fiscal 2006. The decrease was due to a \$395 million increase in our operating expenses primarily due to (1) an increase of \$128 million in stock-based compensation expense recognized as a result of our adoption of SFAS No. 123(R), (2) an \$83 million increase in our annual bonus expense, and (3) a \$75 million increase in additional personnel-related costs due to an increase in headcount (related in part to our acquisitions and growth in our EA Mobile business). These increases in operating expenses were mitigated by (1) a \$140 million increase in net revenue and (2) an \$81 million decrease in our income tax provision.

We expect net earnings to decrease in fiscal 2008 primarily as a result of (1) the fact that during fiscal 2008, we expect to recognize the cost of goods sold and direct marketing and selling costs related to certain online-enabled packaged goods for which a portion of the corresponding net revenue will be deferred and not recognized until fiscal 2009, and (2) an increase in our research and development expense.

**Comparison of Fiscal 2006 to Fiscal 2005****Net Revenue**

From a geographical perspective, our total net revenue for the fiscal years ended March 31, 2006 and 2005 was as follows (in millions):

|                   | <b>Year Ended March 31,</b> |      |             |      | <b>Increase/</b>  | <b>%</b>      |
|-------------------|-----------------------------|------|-------------|------|-------------------|---------------|
|                   | <b>2006</b>                 |      | <b>2005</b> |      | <b>(Decrease)</b> | <b>Change</b> |
| North America     | \$ 1,584                    | 54%  | \$ 1,665    | 53%  | \$ (81)           | (5%)          |
| Europe            | 1,174                       | 40%  | 1,284       | 41%  | (110)             | (9%)          |
| Asia              | 193                         | 6%   | 180         | 6%   | 13                | 7%            |
| International     | 1,367                       | 46%  | 1,464       | 47%  | (97)              | (7%)          |
| Total Net Revenue | \$ 2,951                    | 100% | \$ 3,129    | 100% | \$ (178)          | (6%)          |

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### ***North America***

For fiscal 2006, net revenue in North America was \$1,584 million, driven primarily by sales of (1) *Madden NFL 06*, *Need for Speed Most Wanted*, *NBA LIVE 06*, *NCAA® Football 06* and *The Sims 2*, (2) titles for the PSP, which was launched in North America in March 2005, and (3) titles for the Xbox 360, which launched in November 2005. Overall, net revenue decreased \$81 million, or 5 percent, as compared to fiscal 2005. Our net revenue was adversely impacted by the transition to next-generation consoles in fiscal 2006 as overall net revenue from sales of our titles for the PlayStation 2, Xbox and Nintendo GameCube decreased. While sales of titles for the PSP and the Xbox 360 helped to mitigate the impact of the transition in fiscal 2006, they were not enough to offset the overall decrease in net revenue in North America.

From a title and franchise perspective, the decrease in net revenue was primarily due to (1) lower sales from our NFL Street, NBA Street, Def Jam and The Urbz™ franchises as there were no corresponding titles released during fiscal 2006, and (2) lower sales from our Lord of the Rings franchise which was released on multiple platforms during fiscal 2005 as compared to two platforms, the PSP and PC, during fiscal 2006. The overall decrease in net revenue was mitigated by (1) sales of *Battlefield 2™* on the PC which was released during the first quarter of fiscal 2006 and *Battlefield 2: Modern Combat™* on the PlayStation 2 and Xbox released during the third quarter of fiscal 2006, (2) increased net revenue from our Madden franchise primarily resulting from the release of *Madden NFL 06* on the Xbox 360 and PSP in fiscal 2006, and (3) increased net revenue from our Burnout franchise primarily resulting from the release of *Burnout™ Revenge* on the Xbox 360 and *Burnout™ Legends* on the PSP in fiscal 2006.

### ***Europe***

For fiscal 2006, net revenue in Europe was \$1,174 million, driven primarily by sales of *Need for Speed Most Wanted*, *FIFA 06*, *The Sims 2*, *Harry Potter and the Goblet of Fire*, as well as sales of titles for the PSP and Xbox 360 which were both introduced in Europe during fiscal 2006. Overall, net revenue declined \$110 million, or 9 percent, as compared to fiscal 2005. We estimate that foreign exchange rates (primarily the Euro and the British pound sterling) decreased reported European net revenue by approximately \$36 million, or 3 percent, net of realized gains from hedging activities, for the fiscal 2006 as compared to fiscal 2005. Excluding the effect of foreign exchange rates, we estimate that European net revenue decreased by approximately \$74 million, or 6 percent, for fiscal 2006. Our net revenue in Europe was adversely impacted by the transition to next-generation consoles in fiscal 2006 as overall net revenue from sales of our titles for the PlayStation 2, Xbox and Nintendo GameCube decreased. Sales of titles for the PSP, Nintendo DS, and the Xbox 360, however, were enough to offset the overall decrease in net revenue from sales of titles for current-generation consoles.

From a title and franchise perspective, the overall decrease in net revenue was primarily due to (1) lower sales from our Lord of the Rings and The Sims franchises, (2) the release of *The Urbz™: Sims in the City™* during the three months ended December 31, 2004 as there was no corresponding title released during fiscal 2006, and (3) higher fiscal 2005 sales of *UEFA Euro 2004™*, which was released in the three months ended June 30, 2004 in conjunction with the UEFA Euro 2004 football tournament held in Europe. The overall decrease in net revenue was mitigated by increased net revenue from our Battlefield franchise due to the release of multiple titles during fiscal 2006 and our FIFA Street franchise due to the initial release of *FIFA Street* late in the fourth quarter of fiscal 2005 which benefited fiscal 2006 and the release of *FIFA Street 2* earlier in the fourth quarter of fiscal 2006.

### ***Asia***

For fiscal 2006, net revenue in Asia increased by \$13 million, or 7 percent, as compared to fiscal 2005. The increase in net revenue for fiscal 2006 was driven primarily by sales of titles for the PSP, which launched in the fourth quarter of fiscal 2005. We estimate that the foreign exchange rate impact on Asia net revenue was not material for fiscal 2006.

as compared to fiscal 2005.

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Our total net revenue by product line for fiscal years 2006 and 2005 was as follows (in millions):

|  | Year Ended March 31, |      |          |      | Increase/<br>(Decrease) | %<br>Change |
|--|----------------------|------|----------|------|-------------------------|-------------|
|  | 2006                 |      | 2005     |      |                         |             |
| Consoles                                     |                      |      |          |      |                         |             |
| PlayStation 2                                | \$ 1,127             | 38%  | \$ 1,330 | 43%  | \$ (203)                | (15%)       |
| Xbox   | 400                  | 13%  | 516      | 16%  | (116)                   | (22%)       |
| Xbox 360                                     | 140                  | 5%   |          |      | 140                     | N/M         |
| Nintendo GameCube                            | 135                  | 5%   | 212      | 7%   | (77)                    | (36%)       |
| Other consoles                               | 1                    |      | 10       |      | (9)                     | (90%)       |
| Total Consoles                               | 1,803                | 61%  | 2,068    | 66%  | (265)                   | (13%)       |
| PC   | 418                  | 14%  | 531      | 17%  | (113)                   | (21%)       |
| Mobility                                     |                      |      |          |      |                         |             |
| PSP  | 252                  | 9%   | 18       | 1%   | 234                     | 1,300%      |
| Nintendo DS                                  | 67                   | 2%   | 23       | 1%   | 44                      | 191%        |
| Game Boy Advance and Game Boy Color          | 55                   | 2%   | 77       | 2%   | (22)                    | (29%)       |
| Cellular Handsets                            | 19                   | 1%   |          |      | 19                      | N/M         |
| Total Mobility                               | 393                  | 14%  | 118      | 4%   | 275                     | 233%        |
| Co-publishing and Distribution               | 213                  | 7%   | 283      | 9%   | (70)                    | (25%)       |
| Internet Services, Licensing and Other       |                      |      |          |      |                         |             |
| Subscription Services                        | 61                   | 2%   | 55       | 2%   | 6                       | 11%         |
| Licensing, Advertising and Other             | 63                   | 2%   | 74       | 2%   | (11)                    | (15%)       |
| Total Internet Services, Licensing and Other | 124                  | 4%   | 129      | 4%   | (5)                     | (4%)        |
| Total Net Revenue                            | \$ 2,951             | 100% | \$ 3,129 | 100% | \$ (178)                | (6%)        |

***PlayStation 2***

For fiscal 2006, net revenue from sales of titles for the PlayStation 2 was \$1,127 million, driven primarily by sales of *Need for Speed Most Wanted*, *Madden NFL 06*, *FIFA 06*, *NCAA Football 06* and *NBA LIVE 06*. We released 28 titles for the PlayStation 2 during fiscal 2006, as compared to 27 titles in fiscal 2005. Overall, PlayStation 2 net revenue decreased \$203 million, or 15 percent, as compared to fiscal 2005. We believe the transition to next-generation consoles adversely impacted our net revenue from sales of titles for the PlayStation 2 in fiscal 2006. From a title and franchise perspective, the decrease in net revenue was primarily due to (1) lower sales from our Lord of the Rings, The Urbz, Def Jam, NFL Street and NBA Street franchises, none of which had fiscal 2006 releases, and (2) lower sales of fiscal 2006 releases from our Need for Speed and Bond franchises as well as lower sales of our Fight Night franchise from which two titles were released in fiscal 2005 as compared to one title in fiscal 2006. The overall decrease in net revenue was mitigated by the releases of *The Godfather™ The Game*, *BLACK™*, *Medal of Honor European Assault™*, and *Battlefield 2: Modern Combat* none of which had a corresponding release in fiscal 2005.

***Xbox***

For fiscal 2006, net revenue from sales of titles for the Xbox was \$400 million, driven primarily by sales of *Madden NFL 06*, *Need for Speed Most Wanted*, *NCAA Football 06* and *Burnout Revenge*. We released 28 titles for the Xbox during fiscal 2006, as compared to 26 titles in fiscal 2005. Overall, Xbox net revenue decreased \$116 million, or 22 percent, as compared to fiscal 2005. We believe the transition to next-generation consoles, particularly the launch of the Xbox 360 during the last half of fiscal 2006, adversely impacted our net revenue from sales of titles for the Xbox in fiscal 2006. From a title and franchise perspective, the decrease in net revenue was primarily due to (1) lower sales from our Lord of the Rings, NFL Street, Def Jam, NBA Street

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and The Urbz franchises, none of which had fiscal 2006 releases, and (2) lower sales of fiscal 2006 releases from our Need for Speed and Bond franchises as well as lower sales of our Fight Night franchise from which two titles were released in fiscal 2005 as compared to one title in fiscal 2006. The overall decrease in net revenue was mitigated by the release of *Battlefield 2: Modern Combat*, *BLACK* and *The Godfather The Game*, none of which had a corresponding release in fiscal 2005.

### ***Xbox 360***

The Xbox 360 was launched in North America, Europe and Japan during the three months ended December 31, 2005, and in the rest of Asia during the three months ended March 31, 2006. As of March 31 2006, the installed base of the Xbox 360 continued to be small compared to the installed base of the Xbox. Net revenue from sales of titles for the Xbox 360 was \$140 million for fiscal 2006, driven by sales of *Need for Speed Most Wanted*, *Madden NFL 06* and *EA SPORTS Fight Night Round 3*. We released seven titles for the Xbox 360 in fiscal 2006.

### ***Nintendo GameCube***

For fiscal 2006, net revenue from sales of titles for the Nintendo GameCube was \$135 million, driven primarily by sales of *Need for Speed Most Wanted*, *Harry Potter and the Goblet of Fire* and *Madden NFL 06*. We released 14 titles for the Nintendo GameCube during fiscal 2006, as compared to 20 titles in fiscal 2005. Overall, Nintendo GameCube net revenue decreased \$77 million, or 36 percent, as compared to fiscal 2005, consistent with the percentage decline in the number of titles we released for this platform. We believe the transition to next-generation consoles adversely impacted our net revenue from sales of titles for the Nintendo GameCube in fiscal 2006. From a title and franchise perspective, the decrease in net revenue in fiscal 2006 was primarily due to (1) lower sales from our Lord of the Rings, The Urbz, NBA Street, NFL Street and Def Jam franchises, none of which had fiscal 2006 releases, and (2) lower sales of fiscal 2006 releases from our Need for Speed and Bond franchises.

### ***PC***

For fiscal 2006, net revenue from sales of titles for the PC was \$418 million, driven primarily by sales of titles from The Sims franchise and *Battlefield 2*. We released 22 titles for the PC during fiscal 2006, as compared to 21 titles in fiscal 2005. Overall, PC net revenue decreased \$113 million, or 21 percent, as compared to fiscal 2005. The decrease was primarily due to (1) significantly higher fiscal 2005 sales of *The Sims 2*, (2) lower sales from our Medal of Honor<sup>™</sup> franchise as there were no corresponding titles released during fiscal 2006, and (3) lower sales from our Lord of the Rings franchise. The overall decrease in net revenue was mitigated by sales of products from our Battlefield franchise in fiscal 2006. On January 27, 2005, we began consolidating the financial results of DICE into our financial statements, and, therefore, have characterized *Battlefield 2* PC-based revenue as part of our PC product line. Prior to consolidating DICE's financial results, we classified revenue from the Battlefield franchise as co-publishing and distribution revenue.

### ***Mobile Platforms***

Net revenue from mobile products consisting of packaged goods games for handheld systems and downloadable games for cellular handsets increased from \$118 million in fiscal 2005 to \$393 million in fiscal 2006. The increase was primarily due to sales of titles released in fiscal 2006 for the PSP, and the Nintendo DS, both of which were launched in fiscal 2005 in certain countries. We released 16 titles for the PSP during fiscal 2006, as compared to three titles in fiscal 2005. Overall, PSP net revenue increased \$234 million, driven primarily by sales of titles from our Need for Speed, FIFA, Burnout and Madden franchises. We released ten titles for the Nintendo DS during fiscal 2006, as compared to three titles in fiscal 2005. Nintendo DS net revenue increased \$44 million, driven primarily by sales of titles from our Need for Speed, The Sims and Madden franchises. The increase in PSP and Nintendo DS net revenue



was partially offset by lower sales of titles for the Game Boy Advance.

**Table of Contents*****Co-Publishing and Distribution***

Net revenue from co-publishing and distribution products decreased from \$283 million in fiscal 2005 to \$213 million in fiscal 2006. The decrease was primarily due to (1) the change in our classification of sales of products from our Battlefield franchise, which, as discussed above, we no longer classify as co-publishing and distribution revenue, and (2) overall higher fiscal 2005 sales of various co-publishing and distribution titles. The overall decrease in net revenue was mitigated by sales of *Half-Life 2* in fiscal 2006.

***Subscription Services***

Net revenue from subscription services increased from \$55 million in fiscal 2005 to \$61 million in fiscal 2006. The increase in net revenue was primarily due to an increase in the number of paying subscribers to Club Pogo™, partially offset by a decrease in net revenue from *Ultima Online*.

***Licensing, Advertising and Other***

Net revenue from licensing, advertising and other decreased from \$74 million in fiscal 2005 to \$63 million in fiscal 2006. The decrease in net revenue was primarily due to Nokia N-Gage license revenue in fiscal 2005.

**Cost of Goods Sold**

Cost of goods sold for fiscal years 2006 and 2005 were as follows (in millions):

| <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2005</b> | <b>% of Net<br/>Revenue</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|-----------------|
| \$1,181                   | 40.0%                       | \$1,197                   | 38.2%                       | (1.3%)          |

In fiscal 2006, cost of goods sold as a percentage of total net revenue increased 1.8 percent from 38.2 percent to 40.0 percent. As a percentage of total net revenue, the increase was primarily due to an increase in our license royalties associated with new license agreements for our football titles.

**Marketing and Sales**

Marketing and sales expenses for fiscal years 2006 and 2005 were as follows (in millions):

| <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2005</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$431                     | 15%                         | \$391                     | 13%                         | \$40             | 10%             |

Marketing and sales expenses increased by \$40 million, or 10 percent, in fiscal 2006 as compared to fiscal 2005. The increase was primarily due to (1) an increase of \$30 million in our marketing and advertising, promotional and related contracted service expenses as a result of increased advertising to support our titles, and (2) an increase of \$11 million in personnel-related costs resulting from an increase in facilities and headcount-related expenses in support of our marketing and sales functions worldwide.

Marketing and sales expenses included vendor reimbursements for advertising expenses of \$41 million and \$42 million in fiscal 2006 and 2005, respectively.

**General and Administrative**

General and administrative expenses for fiscal years 2006 and 2005 were as follows (in millions):

| <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2005</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$215                     | 7%                          | \$221                     | 7%                          | \$(6)            | (3%)            |

General and administrative expenses decreased by \$6 million, or 3 percent, in fiscal 2006 as compared to fiscal 2005 primarily due to a decrease in employee-related costs resulting from charges taken in connection with certain employee-related litigation matters in fiscal 2005. This decrease was partially offset by an

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increase in personnel-related expenses due to an increase in headcount costs as well as an increase in professional and contracted services to support our business.

**Research and Development**

Research and development expenses for fiscal years 2006 and 2005 were as follows (in millions):

| <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2005</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$758                     | 26%                         | \$633                     | 20%                         | \$125            | 20%             |

Research and development expenses increased by \$125 million, or 20 percent, in fiscal 2006 as compared to fiscal 2005. The increase is primarily due to an increase of \$124 million in personnel-related costs resulting from an increase in employee headcount in our Canadian and European studios as we increased our internal development efforts and invested in next-generation tools, technologies and titles, as well as consolidation of DICE. To a lesser extent, these increases were also due to higher facilities-related costs offset by lower third-party development costs.

**Amortization of Intangibles**

Amortization of intangibles for fiscal years 2006 and 2005 were as follows (in millions):

| <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2005</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$7                       |                             | \$3                       |                             | \$4              | 133%            |

For fiscal 2006, amortization of intangibles resulted from our acquisitions of JAMDAT, Criterion and others. For fiscal 2005, amortization of intangibles resulted from our acquisition of Criterion and others. See Note 5 of the Notes to Consolidated Financial Statements included in Item 8 of this report.

**Acquired In-process Technology**

Acquired in-process technology charges for fiscal years 2006 and 2005 were as follows (in millions):

| <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2005</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$8                       |                             | \$13                      | 1%                          | \$(5)            | (38%)           |

The acquired in-process technology charge we incurred in fiscal 2006 was primarily the result of our acquisition of JAMDAT. The acquired in-process technology charge we incurred in fiscal 2005 was the result of our acquisitions of Criterion and a majority stake of the outstanding shares of DICE. Acquired in-process technology includes the value of products in the development stage that are not considered to have reached technological feasibility or have an alternative future use. Accordingly, upon consummation of these acquisitions, we incurred a charge for the acquired in-process technology, as reflected in our Consolidated Statement of Operations. See Note 4 of the Notes to

Consolidated Financial Statements included in Item 8 of this report.

**Restructuring Charges**

Restructuring charges for fiscal years 2006 and 2005 were as follows (in millions):

| <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2005</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$26                      | 1%                          | \$2                       |                             | \$24             | 1,200%          |

In November 2005, we announced plans to establish an international publishing headquarters in Geneva, Switzerland. Through our quarter ended September 30, 2006, we relocated certain employees to our new facility in Geneva, closed certain facilities in the United Kingdom, and made other related changes in our international publishing business.

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During fiscal 2006, restructuring charges were approximately \$14 million, of which \$8 million was for the closure of certain United Kingdom facilities, \$3 million for employee-related expenses, and \$3 million in other costs relating to our international publishing reorganization.

During the fourth quarter of fiscal 2006, we aligned our resources with our product plan for fiscal 2007 and strategic opportunities relating to next-generation consoles, online and mobile platforms. As part of this alignment we recorded a total pre-tax restructuring charge of \$10 million, consisting entirely of one-time benefits related to headcount reductions, which is included in restructuring charges in our Consolidated Statement of Operations.

**Interest and Other Income, Net**

Interest and other income, net, for fiscal years 2006 and 2005 was as follows (in millions):

| <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2005</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
| \$64                      | 2%                          | \$56                      | 2%                          | \$8              | 14%             |

For fiscal 2006, interest and other income, net, increased by \$8 million, or 14 percent, as compared to fiscal 2005 primarily due to an increase of \$31 million in interest income as a result of higher yields on our cash, cash equivalent and short-term investment balances, partially offset by a net loss of \$22 million in investments and foreign currency activities.

**Income Taxes**

Income taxes for fiscal years 2006 and 2005 were as follows (in millions):

| <b>March 31,<br/>2006</b> | <b>Effective<br/>Tax Rate</b> | <b>March 31,<br/>2005</b> | <b>Effective<br/>Tax Rate</b> | <b>% Change</b> |
|---------------------------|-------------------------------|---------------------------|-------------------------------|-----------------|
| \$147                     | 37.6%                         | \$221                     | 30.5%                         | (33%)           |

Our effective income tax rates were 37.6 percent and 30.5 percent for fiscal 2006 and fiscal 2005, respectively. For fiscal 2006, our effective income tax rate was higher than the U.S. statutory rate of 35.0 percent for fiscal 2006 due to a number of factors, including the repatriation of foreign earnings in connection with the American Jobs Creation Act of 2004, and additional charges resulting from certain non-deductible acquisition-related costs during the second and fourth quarters of fiscal 2006, which were partially offset by other items.

**Net Income**

Net income for fiscal years 2006 and 2005 was as follows (in millions):

| <b>March 31,<br/>2006</b> | <b>% of Net<br/>Revenue</b> | <b>March 31,<br/>2005</b> | <b>% of Net<br/>Revenue</b> | <b>\$ Change</b> | <b>% Change</b> |
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|
|---------------------------|-----------------------------|---------------------------|-----------------------------|------------------|-----------------|

|       |    |       |     |         |       |
|-------|----|-------|-----|---------|-------|
| \$236 | 8% | \$504 | 16% | \$(268) | (53%) |
|-------|----|-------|-----|---------|-------|

Net income decreased by \$268 million, or 53 percent, in fiscal 2006 as compared to fiscal 2005. The decrease was primarily due to a decrease in our net revenue and growth in our operating expenses. The growth in our operating expenses was primarily driven by an increase in research and development expenses as we increased our internal development efforts and invested in next-generation tools, technologies and titles, while at the same time we continued to support current-generation product development.

### **Impact of Recently Issued Accounting Standards**

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments – An Amendment of FASB Statements No. 133 and 140*. SFAS No. 155 (1) permits fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (2) clarifies that interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, (3) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (4) clarifies that

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concentrations of credit risk in the form of subordination are not embedded derivatives, and (5) amends SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* A Replacement of FASB Statement No. 125 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. In December 2006, the FASB cleared guidance in Derivatives Implementation Group Statement 133 Implementation Issue No. B40, *Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets*. FASB concluded that a securitized interest in prepayable financial assets is not subject to the conditions in paragraph 13(b) of SFAS No. 133 if it meets the two criteria outlined in the Statement 133 Implementation Issue No. B40. SFAS No. 155 is effective for all financial instruments acquired or issued for fiscal years beginning after September 15, 2006. The guidance in the Statement 133 Implementation Issue No. B40 is applicable upon adoption of SFAS No. 155, although the FASB provides certain exceptions as described in the Statement 133 Implementation Issue No. B40. We do not expect the adoption of SFAS No. 155 or Statement 133 Implementation Issue No. B40 to have a material impact on our Consolidated Financial Statements.

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes* An Interpretation of FASB Statement No. 109. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under FIN No. 48, the evaluation of a tax position is a two-step process. The first step is a recognition process where we are required to determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, it is presumed that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is a measurement process whereby a tax position that meets the more-likely-than-not recognition threshold is calculated to determine the amount of benefit to recognize in the financial statements. FIN No. 48 also requires new tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the reporting period. The provisions of FIN No. 48 are effective for fiscal years beginning after December 15, 2006. As such, we are required to adopt it in our first quarter of fiscal year 2008. Any changes to our income taxes due to the adoption of FIN No. 48 are treated as the cumulative effect of a change in accounting principle. We are evaluating what impact the adoption of FIN No. 48 will have on our Consolidated Financial Statements. This impact could be material and our future effective tax rates could be more volatile.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. Fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Fair value measurements would be separately disclosed by level within the fair value hierarchy. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of SFAS No. 157 to have a material impact on our Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. It also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The provisions of



SFAS No. 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007. This Statement should not be applied retrospectively to fiscal years

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beginning prior to the effective date, except as permitted with early adoption. We are evaluating if we will adopt SFAS No. 159 and what impact the adoption will have on our Consolidated Financial Statements if we adopt. If we adopt SFAS No. 159, it may have a material impact on our Consolidated Financial Statements.

In March 2007, the Emerging Issues Task Force ( EITF ) issued a tentative conclusion on EITF 07-03, *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development* and the FASB ratified the tentative conclusion. The FASB exposed the EITF tentative conclusion for public comment. The comment period was expected to end in May 2007. EITF 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under this tentative conclusion, an entity would defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. If a final consensus is reached on this tentative conclusion, EITF 07-03 would be effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007. We do not expect the adoption of EITF 07-03 to have a material impact on our Consolidated Financial Statements if ratified by the FASB as currently proposed.

**LIQUIDITY AND CAPITAL RESOURCES**

| (In millions)                | <b>March 31,<br/>2007</b> | <b>Year Ended<br/>March 31,<br/>2006</b> | <b>Increase</b> |
|------------------------------|---------------------------|--|-----------------|
| Cash and cash equivalents    | \$ 1,371                  | \$ 1,242                                 | \$ 129          |
| Short-term investments       | 1,264                     | 1,030                                    | 234             |
| Marketable equity securities | 341                       | 160                                      | 181             |
| Total                        | \$ 2,976                  | \$ 2,432                                 | \$ 544          |
| Percentage of total assets   | 58%                       | 55%                                      |                 |

| (In millions)   | <b>March 31,<br/>2007</b> | <b>Year Ended<br/>March 31,<br/>2006</b> | <b>Increase /<br/>(Decrease)</b> |
|---|---------------------------|--|----------------------------------|
| Cash provided by operating activities                   | \$ 397                    | \$ 596                                   | \$ (199)                         |
| Cash used in investing activities                       | (487)                     | (108)                                    | (379)                            |
| Cash provided by (used in) financing activities         | 190                       | (503)                                    | 693                              |
| Effect of foreign exchange on cash and cash equivalents | 29                        | (13)                                     | 42                               |
| Net increase (decrease) in cash and cash equivalents    | \$ 129                    | \$ (28)                                  | \$ 157                           |

***Changes in Cash Flow***

During fiscal 2007, we generated \$397 million of cash from operating activities as compared to \$596 million for fiscal 2006. The decrease in cash generated from operating activities was primarily due to the timing of the collection of our

receivables as a result of collecting a greater amount of our receivables during fiscal 2006 as compared to fiscal 2007. We expect cash from operating activities to increase in fiscal 2008.

For fiscal 2007, we generated \$1,315 million of cash proceeds from maturities and sales of short-term investments and \$168 million in proceeds from sales of common stock through our stock-based compensation plans. Our primary use of cash in non-operating activities consisted of (1) \$1,522 million used to purchase short-term investments, (2) \$178 million in capital expenditures primarily related to investments in our worldwide development tools, technologies and equipment and expansions of our Vancouver and United Kingdom studios, as well as (3) \$103 million primarily for the acquisitions of Mythic and the remaining minority interest in DICE. During fiscal 2008, we anticipate making continued capital investments in our studios, investments in the new generation of consoles, online infrastructure and mobile platforms. In addition,

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we have engaged in, evaluated, and expect to continue to engage in and evaluate, a wide array of potential strategic transactions.

In April 2007, we expanded our commercial agreements with and made strategic equity investments in Neowiz Corporation and its online gaming subsidiary, Neowiz Games. We purchased stock representing in aggregate approximately 19 percent of each of Neowiz and Neowiz Games for approximately \$108 million. Based in Korea, Neowiz is an online media and gaming company with which we partnered in 2006 to launch *EA Sports FIFA Online* in Korea.

***Short-term investments and marketable equity securities***

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 March 31, 2007, 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 approximately \$1 million, or less than 1 percent of the total in short-term investments. From time to time, we may liquidate some or all of our short-term investments to fund operational needs or other activities, such as capital expenditures, business acquisitions or stock repurchase programs. Depending on which short-term investments we liquidate to fund these activities, we could recognize a portion, or all, of the gross unrealized gains or losses.

Marketable equity securities increased to \$341 million as of March 31, 2007, from \$160 million as of March 31, 2006, due to an increase in the fair value of our investment in Ubisoft Entertainment.

***Receivables, net***

Our gross accounts receivable balances were \$470 million and \$431 million as of March 31, 2007 and 2006, respectively. The increase in our accounts receivable balance was primarily due to a higher percentage of net revenue recognized in the last month of our fourth quarter of fiscal 2007 as compared to the fourth quarter of fiscal 2006. Reserves for sales returns, pricing allowances and doubtful accounts decreased in absolute dollars from \$232 million as of March 31, 2006 to \$214 million as of March 31, 2007. As a percentage of trailing nine month net revenue, reserves decreased from 9 percent as of March 31, 2006, to 8 percent as of March 31, 2007. We believe these reserves are adequate based on historical experience and our current estimate of potential returns, pricing allowances and doubtful accounts.

***Inventories***

Inventories increased slightly to \$62 million as of March 31, 2007 from \$61 million as of March 31, 2006. Other than *Need for Speed Carbon*, no single title represented more than \$3 million of inventory as of March 31, 2007.

***Other current assets***

Other current assets decreased to \$219 million as of March 31, 2007, from \$234 million as of March 31, 2006, primarily due to the timing of the collection of advertising credits owed to us by our vendors that were earned in fiscal 2007, partially offset by an increase in value added taxes receivable.

***Accounts payable***

Accounts payable increased to \$180 million as of March 31, 2007, from \$163 million as of March 31, 2006, primarily due to higher inventory purchases to support our business in the fourth quarter of fiscal 2007 as compared to the fourth quarter of fiscal 2006.

***Accrued and other current liabilities***

Our accrued and other liabilities increased to \$823 million as of March 31, 2007 from \$697 million as of March 31, 2006. The increase was primarily due to an increase of (1) \$84 million in accrued compensation and benefits and (2) \$50 million in income taxes payable.

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### ***Deferred income taxes, net***

Our long-term position of deferred income taxes changed by \$46 million, from a liability position as of March 31, 2006 to a net asset position as of March 31, 2007 primarily due to the addition of assets related to our adoption of SFAS No. 123(R) and the reduction of liabilities due to the amortization of purchased intangibles.

### ***Financial Condition***

We believe that existing cash, cash equivalents, short-term investments, marketable equity securities and cash generated from operations will be sufficient to meet our operating requirements for at least the next twelve months, including working capital requirements, capital expenditures, and potential future acquisitions or strategic investments. We may choose at any time to raise additional capital to strengthen our financial position, facilitate expansion, pursue strategic acquisitions and investments 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.

The loan financing arrangements supporting our Redwood City headquarters leases with Keybank National Association, described in the Off-Balance Sheet Commitments section below, are scheduled to expire in July 2008. Upon expiration of the financing, we may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor's loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009, otherwise the leases will terminate. Upon expiration of the leases, we may purchase the facilities for \$247 million, or arrange for a sale of the facilities to a third party. In the event of a sale to a third party, if the sale price is less than \$247 million, we will be obligated to reimburse the difference between the actual sale price and \$247 million, up to maximum of \$222 million, subject to certain provisions of the leases.

As of March 31, 2007, approximately \$1,108 million of our cash, cash equivalents, short-term investments and marketable equity securities that was generated from operations was 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 would accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided. During the fourth quarter of fiscal 2006, we repatriated \$375 million of foreign earnings in fiscal 2006 under the Jobs Act. We completed the repatriation in fiscal 2006 which resulted in a tax expense of \$17 million.

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 up to a total amount of \$2 billion. Unless otherwise specified in a prospectus supplement accompanying the base prospectus, we would use the net proceeds from the sale of any securities offered pursuant to the shelf registration statement for general corporate purposes, including for working capital, financing capital expenditures, research and development, marketing and distribution efforts and, if opportunities arise, for acquisitions or strategic alliances. Pending such uses, we may invest the net proceeds in interest-bearing securities. In addition, we may conduct concurrent or other financings at any time.

Our ability to maintain sufficient liquidity could be affected by various risks and uncertainties including, but not limited to, those related to customer demand and acceptance of our products on new platforms and new versions of our products on existing platforms, 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 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 I, Item 1A of this report.

**Table of Contents****Contractual Obligations and Commercial Commitments*****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: FIFA, FIFPRO Foundation, UEFA and FAPL (Football Association Premier League Limited) (professional soccer); NASCAR (stock car racing); National Basketball Association (professional basketball); PGA TOUR and Tiger Woods (professional golf); National Hockey League and NHL Players Association (professional hockey); Warner Bros. (Harry Potter, Batman and Superman); New Line Productions and Saul Zaentz Company (The Lord of the Rings); Red Bear Inc. (John Madden); National Football League Properties and PLAYERS Inc. (professional football); Collegiate Licensing Company (collegiate football, basketball and baseball); SimcoH (Def Jam); Viacom Consumer Products (The Godfather); ESPN (content in EA SPORTS™ games); Twentieth Century Fox Licensing and Merchandising (The Simpsons); and Marvel Entertainment, Inc. (Marvel character fighting games). 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.

The following table summarizes our minimum contractual obligations and commercial commitments as of March 31, 2007, and the effect we expect them to have on our liquidity and cash flow in future periods (in millions):

| Fiscal Year Ending March 31, | Contractual Obligations |                            |           | Commercial Commitments                         | Total    |
|------------------------------|-------------------------|----------------------------|-----------|--|----------|
|                              | Leases <sup>(1)</sup>   | Developer/<br>Licensor     | Marketing | Letter of Credit,<br>Bank and Other Guarantees |          |
|                              |                         | Commitments <sup>(2)</sup> |           |  |          |
| 2008                         | \$ 56                   | \$ 200                     | \$ 58     | \$ 7   | \$ 321   |
| 2009                         | 54                      | 202                        | 31        |  | 287      |
| 2010                         | 39                      | 166                        | 31        |  | 236      |
| 2011                         | 27                      | 263                        | 31        |  | 321      |
| 2012                         | 23                      | 27                         | 17        |  | 67       |
| Thereafter                   | 46                      | 697                        | 169       |  | 912      |
| Total                        | \$ 245                  | \$ 1,555                   | \$ 337    | \$ 7   | \$ 2,144 |



- (1) See discussion on operating leases in the Off-Balance Sheet Commitments section below for additional information.
- (2) Developer/licensor commitments include \$9 million of commitments to developers or licensors that have been recorded in current and long-term liabilities and a corresponding amount in current and long-term assets in our Consolidated Balance Sheets as of March 31, 2007 because payment is not contingent upon performance by the developer or licensor.

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The amounts represented in the table above reflect our minimal cash obligations for the respective fiscal years, but do not necessarily represent the periods in which they will be expensed in our Consolidated Financial Statements.

Lease commitments include contractual rental commitments of \$15 million under real estate leases for unutilized office space resulting from our restructuring activities. These amounts, net of estimated future sub-lease income, were expensed in the periods of the related restructuring and are included in our accrued and other current liabilities reported on our Consolidated Balance Sheets as of March 31, 2007. See Note 6 of the Notes to Consolidated Financial Statements.

## **Related Person Transaction**

On June 24, 2002, we hired Warren C. Jenson as our Executive Vice President, Chief Financial and Administrative Officer and agreed to loan him \$4 million to be forgiven over four years based on his continuing employment. The loan did not bear interest. On June 24, 2004, pursuant to the terms of the loan agreement, we forgave \$2 million of the loan and provided Mr. Jenson approximately \$1.6 million to offset the tax implications of the forgiveness. On June 24, 2006, pursuant to the terms of the loan agreement, we forgave the remaining outstanding loan balance of \$2 million. No additional funds were provided to offset the tax implications of the forgiveness of the \$2 million balance.

## **OFF-BALANCE SHEET COMMITMENTS**

In February 1995, we entered into a build-to-suit lease ( Phase One Lease ) with a third-party lessor for our headquarters facilities in Redwood City, California ( Phase One Facilities ). The Phase One Facilities comprise a total of approximately 350,000 square feet and provide space for sales, marketing, administration and research and development functions. In July 2001, the lessor refinanced the Phase One Lease with Keybank National Association through July 2006. The Phase One Lease expires in January 2039, subject to early termination in the event the underlying financing between the lessor and its lenders is not extended. Subject to certain terms and conditions, we may purchase the Phase One Facilities or arrange for the sale of the Phase One Facilities to a third party.

Pursuant to the terms of the Phase One Lease, we have an option to purchase the Phase One Facilities at any time for a purchase price of \$132 million. In the event of a sale to a third party, if the sale price is less than \$132 million, we will be obligated to reimburse the difference between the actual sale price and \$132 million, up to a maximum of \$117 million, subject to certain provisions of the Phase One Lease, as amended.

On May 26, 2006, the lessor extended its loan financing underlying the Phase One Lease with its lenders through July 2007, and on May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor's loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009; otherwise the lease will terminate. We account for the Phase One Lease arrangement as an operating lease in accordance with SFAS No. 13, *Accounting for Leases*, as amended.

In December 2000, we entered into a second build-to-suit lease ( Phase Two Lease ) with Keybank National Association for a five and one-half year term beginning in December 2000 to expand our Redwood City, California headquarters facilities and develop adjacent property ( Phase Two Facilities ). Construction of the Phase Two Facilities was completed in June 2002. The Phase Two Facilities comprise a total of approximately 310,000 square feet and provide space for sales, marketing, administration and research and development functions. Subject to certain terms and conditions, we may purchase the Phase Two Facilities or arrange for the sale of the Phase Two Facilities to a third party.

Pursuant to the terms of the Phase Two Lease, we have an option to purchase the Phase Two Facilities at any time for a purchase price of \$115 million. In the event of a sale to a third party, if the sale price is less than

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\$115 million, we will be obligated to reimburse the difference between the actual sale price and \$115 million, up to a maximum of \$105 million, subject to certain provisions of the Phase Two Lease, as amended.

On May 26, 2006, the lessor extended the Phase Two Lease through July 2009 subject to early termination in the event the underlying loan financing between the lessor and its lenders is not extended. Concurrently with the extension of the lease, the lessor extended the loan financing underlying the Phase Two Lease with its lenders through July 2007. On May 14, 2007 the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor's loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009, otherwise the lease will terminate. We account for the Phase Two Lease arrangement as an operating lease in accordance with SFAS No. 13, as amended.

We believe that, as of March 31, 2007, the estimated fair values of both properties under these operating leases exceeded their respective guaranteed residual values.

The two lease agreements with Keybank National Association described above require us to maintain certain financial covenants as shown below, all of which we were in compliance with as of March 31, 2007.

| <b>Financial Covenants</b>           | <b>Requirement</b>       | <b>Actual as of<br/>March 1,<br/>2007</b> |
|--------------------------------------|--------------------------|---|
| Consolidated Net Worth (in millions) | equal to or greater than | \$ 2,430                                  |
| Fixed Charge Coverage Ratio          | equal to or greater than | 3.00                                      |
| Total Consolidated Debt to Capital   | equal to or less than    | 60%                                       |
| Quick Ratio Q1 & Q2                  | equal to or greater than | 1.00                                      |
| Q3 & Q4                              | equal to or greater than | 1.75                                      |
|                                      |                          | \$ 4,032                                  |
|                                      |                          | 4.41                                      |
|                                      |                          | 5.8%                                      |
|                                      |                          | N/A                                       |
|                                      |                          | 8.92                                      |

In February 2006, we entered into an agreement with an independent third party to lease a studio facility in Guildford, Surrey, United Kingdom, which commenced in June 2006 and will expire in May 2016. The facility comprises a total of approximately 95,000 square feet, which we use for research and development functions. Our rental obligation under this agreement is approximately \$33 million over the initial ten-year term of the lease.

In June 2004, we entered into a lease agreement, amended in December 2005, with an independent third party for a studio facility in Orlando, Florida. The lease commenced in January 2005 and expires in June 2010, with one five-year option to extend the lease term. The campus facilities comprise a total of 140,000 square feet and provide space for research and development functions. Our rental obligation over the initial five-and-a-half year term of the lease is \$15 million.

In July 2003, we entered into a lease agreement with an independent third party (the Landlord) for a studio facility in Los Angeles, California, which commenced in October 2003 and expires in September 2013 with two five-year options to extend the lease term. Additionally, we have options to purchase the property after five and ten years based on the fair market value of the property at the date of sale, a right of first offer to purchase the property upon terms offered by the Landlord, and a right to share in the profits from a sale of the property. Existing campus facilities comprise a total of 243,000 square feet and provide space for research and development functions. Our rental obligation under this agreement is \$50 million over the initial ten-year term of the lease. This commitment is offset by expected sublease income of \$6 million for a sublease to an affiliate of the Landlord of 18,000 square feet of the Los

Angeles facility, which commenced in October 2003 and expires in September 2013, with options of early termination by the affiliate after five years and by us after four and five years.

In October 2002, we entered into a lease agreement, with an independent third party for a studio facility in Vancouver, British Columbia, Canada, which commenced in May 2003 and expires in April 2013. We amended the lease in October 2003. The facility comprises a total of approximately 65,000 square feet and provides space for research and development functions. Our rental obligation under this agreement is approximately \$16 million over the initial ten-year term of the lease.

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### ***Neowiz Investment***

In April 2007, we expanded our commercial agreements with and made strategic equity investments in Neowiz Corporation and its online gaming subsidiary, Neowiz Games. We purchased stock representing in aggregate approximately 19 percent of each of Neowiz and Neowiz Games for approximately \$108 million. Based in Korea, Neowiz is an online media and gaming company with which we partnered in 2006 to launch *EA Sports FIFA Online* in Korea.

### ***Legal Proceedings***

On September 14, 2006, we received an informal inquiry from the Securities and Exchange Commission requesting certain documents and information relating to our stock option grant practices from January 1, 1997 through the date of the letter. We have cooperated to date with all matters related to this request. We most recently provided the SEC with information in December 2006. The SEC has not asked for further information since that time.

We are also subject to claims and litigation arising in the ordinary course of business. We believe that any liability from any reasonably foreseeable disposition of such claims and litigation, individually or in the aggregate, would not have a material adverse effect on our consolidated financial position or results of operations.

### ***Director Indemnity Agreements***

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

## **INFLATION**

We believe the impact of inflation on our results of operations has not been significant in any of the past three fiscal years.

### ***Item 7A: 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. 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 exchange option and forward contracts are used to hedge anticipated exposures or mitigate some existing exposures subject to foreign exchange risk as discussed below. We have not historically, nor do we currently, hedge our short-term investment portfolio. We do not consider our cash and cash equivalents to be exposed to significant interest rate risk because our cash and cash equivalent portfolio consists of highly liquid investments with original maturities of three months or less (see Note 2 to the Consolidated Financial Statements included in Item 8 of this report). We also do not currently hedge our market price risk relating to our equity investments. Further, we do not enter into derivatives or other financial instruments for trading or speculative purposes (see Note 3 to the Consolidated Financial Statements included in Item 8 of this report).

#### ***Foreign Currency Exchange Rate Risk***

*Cash Flow Hedging Activities.* From time to time, we hedge a portion of our foreign currency risk related to forecasted foreign-currency-denominated sales and expense transactions by purchasing option contracts that generally have maturities of 15 months or less. These transactions are designated and qualify as cash flow hedges. The derivative assets associated with our hedging activities are recorded at fair value in other current assets in our Consolidated Balance Sheets. The effective portion of gains or losses resulting from changes in fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive

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income in stockholders' equity and subsequently reclassified into net revenue or operating expenses, as appropriate in the period when the forecasted transaction is recorded. The ineffective portion of gains or losses resulting from changes in fair value, if any, is reported in each period in interest and other income, net, in our Consolidated Statements of Operations. Our hedging programs reduce, but do not entirely eliminate, the impact of currency exchange rate movements in revenue and operating expenses. As of March 31, 2007, we had foreign currency option contracts to purchase approximately \$28 million in foreign currencies and to sell approximately \$72 million of foreign currencies. As of March 31, 2007, these foreign currency option contracts outstanding had a total fair value of less than \$1 million, included in other current assets. As of March 31, 2006, we had no foreign currency option contracts outstanding.

*Balance Sheet Hedging Activities.* We utilize foreign exchange forward contracts to mitigate foreign currency risk associated with foreign-currency-denominated assets and liabilities, primarily intercompany receivables and payables. The forward contracts generally have a contractual term of approximately one month and are transacted near month-end. Therefore, the fair value of the forward contracts generally is not significant at each month-end. Our foreign exchange forward contracts are not designated as hedging instruments under SFAS No. 133 and are accounted for as derivatives whereby the fair value of the contracts are reported as other current assets or other current liabilities in our Consolidated Balance Sheets, and gains and losses from changes in fair value are reported in interest and other income, net. The gains and losses on these forward contracts generally offset the gains and losses on the underlying foreign-currency-denominated assets and liabilities, which are also reported in interest and other income, net, in our Consolidated Statements of Operations. As of March 31, 2007, we had forward foreign exchange contracts to purchase and sell approximately \$104 million in foreign currencies. Of this amount, \$73 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$8 million to sell foreign currencies in exchange for British pound sterling and \$23 million to purchase foreign currencies in exchange for U.S. dollars. As of March 31, 2006, we had forward foreign exchange contracts to purchase and sell approximately \$161 million in foreign currencies. Of this amount, \$132 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$14 million to sell foreign currencies in exchange for British pound sterling and \$15 million to purchase foreign currencies in exchange for U.S. dollars. The fair value of our forward contracts was immaterial as of March 31, 2007 and March 31, 2006.

The counterparties to these forward and option contracts are creditworthy multinational commercial banks; therefore, the risk of counterparty nonperformance is not considered to be material.

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 March 31, 2007, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 15 percent would result in a potential loss in fair value of our option contracts of \$1 million in both scenarios. As of March 31, 2006, we had no foreign currency option contracts outstanding. A hypothetical adverse foreign currency exchange rate movement of 10 percent or 15 percent would result in potential losses on our forward contracts of \$9 million and \$14 million, respectively, as of March 31, 2007, and \$16 million and \$23 million, respectively, as of March 31, 2006. This sensitivity analysis assumes a parallel adverse shift in foreign currency exchange rates, which do not always move in the same direction. Actual results may differ materially.

### ***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. Additionally, the contractual terms of the securities do not permit the issuer to call, prepay or otherwise settle the securities at prices less than the stated par value of the securities. Our investments are held for purposes other than trading. Also, we do not use derivative financial instruments in our short-term investment portfolio.



As of March 31, 2007 and 2006, our short-term investments were classified as available-for-sale and, consequently, recorded at fair market value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive income, net of any tax effects, in

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stockholders' equity. Our portfolio of short-term investments consisted of the following investment categories, summarized by fair value as of March 31, 2007 and 2006 (in millions):

|                              | <b>As of March 31,</b> |             |
|------------------------------|------------------------|-------------|
|                              | <b>2007</b>            | <b>2006</b> |
| Commercial paper             | \$ 574                 | \$ 25       |
| U.S. agency securities       | 264                    | 575         |
| Corporate bonds              | 226                    | 178         |
| Asset-backed securities      | 108                    | 40          |
| U.S. Treasury securities     | 92                     | 212         |
| Total short-term investments | \$ 1,264               | \$ 1,030    |

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 fair value in our short-term investment portfolio as of March 31, 2007, arising from potential changes in interest rates. The modeling technique estimates the change in fair value from immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points ( 50 BPS ), 100 BPS, and 150 BPS.

| (In millions)                | <b>Valuation of Securities<br/>Given an Interest Rate<br/>Decrease of X Basis Points</b> |                      |                     | <b>Fair<br/>Value<br/>as of<br/>March 31,<br/>2007</b> | <b>Valuation of Securities<br/>Given an Interest Rate<br/>Increase of X Basis Points</b> |                |                |
|------------------------------|--|----------------------|---------------------|--|--|----------------|----------------|
|                              | <b>(150<br/>BPS)</b>   | <b>(100<br/>BPS)</b> | <b>(50<br/>BPS)</b> |  | <b>50 BPS</b>  | <b>100 BPS</b> | <b>150 BPS</b> |
| Commercial paper             | \$ 575   | \$ 575               | \$ 574              | \$ 574   | \$ 573   | \$ 573         | \$ 572         |
| U.S. agency securities       | 271  | 269                  | 267                 | 264  | 262  | 259            | 257            |
| Corporate bonds              | 231  | 230                  | 228                 | 226  | 225  | 223            | 222            |
| Asset-backed securities      | 110  | 109                  | 108                 | 108  | 107  | 106            | 105            |
| U.S. Treasury securities     | 95   | 94                   | 94                  | 92   | 92   | 91             | 90             |
| Total short-term investments | \$ 1,282   | \$ 1,277             | \$ 1,271            | \$ 1,264   | \$ 1,259   | \$ 1,252       | \$ 1,246       |

The following table presents the hypothetical changes in fair value in our short-term investment portfolio as of March 31, 2006, arising from selected potential changes in interest rates.

| (In millions) | <b>Valuation of Securities<br/>Given an Interest Rate<br/>Decrease of X Basis Points</b> |  |  | <b>Fair<br/>Value<br/>as of<br/>March 31,<br/>2006</b> | <b>Valuation of Securities<br/>Given an Interest Rate<br/>Increase of X Basis Points</b> |                |                |
|---------------|--|--|--|--|--|----------------|----------------|
|               |  |  |  |  | <b>50 BPS</b>  | <b>100 BPS</b> | <b>150 BPS</b> |

|  | (150<br>BPS) | (100<br>BPS) | (50<br>BPS) |          |          |          |          |  |  |
|--|--------------|--------------|-------------|----------|----------|----------|----------|--|--|
| U.S. agency securities                 | \$ 581       | \$ 579       | \$ 577      | \$ 575   | \$ 573   | \$ 571   | \$ 570   |  |  |
| U.S. Treasury securities               | 218          | 216          | 214         | 212      | 210      | 208      | 205      |  |  |
| Corporate bonds                        | 182          | 181          | 179         | 178      | 176      | 175      | 173      |  |  |
| Asset-backed and other debt securities | 66           | 66           | 66          | 65       | 65       | 65       | 65       |  |  |
| Total short-term investments           | \$ 1,047     | \$ 1,042     | \$ 1,036    | \$ 1,030 | \$ 1,024 | \$ 1,019 | \$ 1,013 |  |  |

***Market Price Risk***

The value of our equity investments in publicly traded companies are subject to market price volatility. As of March 31, 2007 and 2006, our marketable equity securities were classified as available-for-sale and, consequently, were recorded in our Consolidated Balance Sheets at fair market value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of any tax effects, in

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stockholders' equity. The fair value of our marketable equity securities was \$341 million and \$160 million as of March 31, 2007 and 2006, respectively.

At any time, a sharp change in market prices in our investments in marketable equity securities could have a significant impact on the fair value of our investments. The following table presents the hypothetical changes in fair value in our marketable equity securities as of March 31, 2007, arising from changes in market prices plus or minus 25 percent, 50 percent and 75 percent.

| (In millions)                | Valuation of Securities   |        |        |   | Fair<br>Value<br>as of<br>March 31,<br>2007 | Valuation of Securities |        |  |
|------------------------------|---|--------|--------|---|---|-------------------------|--------|--|
|                              | Given an X Percentage<br>Decrease in Each<br>Stock's Market Price |        |        | Given an X Percentage<br>Increase in Each<br>Stock's Market Price |   |                         |        |  |
|                              | (75%)   | (50%)  | (25%)  | 25%   |   | 50%                     | 75%    |  |
|                              |   |        |        |   |   |                         |        |  |
|                              |   |        |        |   |   |                         |        |  |
| Marketable equity securities | \$ 85   | \$ 171 | \$ 256 | \$ 341  | \$ 426                                      | \$ 512                  | \$ 597 |  |

The following table presents the hypothetical changes in fair value in our marketable equity securities as of March 31, 2006, arising from changes in market prices plus or minus 25 percent, 50 percent and 75 percent.

| (In millions)                | Valuation of Securities   |       |        |   | Fair<br>Value<br>as of<br>March 31,<br>2006 | Valuation of Securities |        |  |
|------------------------------|---|-------|--------|---|---|-------------------------|--------|--|
|                              | Given an X Percentage<br>Decrease in Each<br>Stock's Market Price |       |        | Given an X Percentage<br>Increase in Each<br>Stock's Market Price |   |                         |        |  |
|                              | (75%)   | (50%) | (25%)  | 25%   |   | 50%                     | 75%    |  |
|                              |   |       |        |   |   |                         |        |  |
|                              |   |       |        |   |   |                         |        |  |
| Marketable equity securities | \$ 40   | \$ 80 | \$ 120 | \$ 160  | \$ 200                                      | \$ 240                  | \$ 280 |  |

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**Item 8: *Financial Statements and Supplementary Data***

**Index to Consolidated Financial Statements**

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| Consolidated Financial Statements of Electronic Arts Inc. and Subsidiaries:  |             |
| <u>Consolidated Balance Sheets as of March 31, 2007 and 2006</u>   | 63          |
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| <u>Reports of Independent Registered Public Accounting Firm</u>  | 106         |
| Financial Statement Schedule:  |             |
| The following financial statement schedule of Electronic Arts Inc. and Subsidiaries for the years ended March 31, 2007, 2006 and 2005 is filed as part of this report and should be read in conjunction with the Consolidated Financial Statements of Electronic Arts Inc. and Subsidiaries: |             |
| <u>Schedule II Valuation and Qualifying Accounts</u>   | 116         |

Other financial statement schedules have been omitted because the information called for in them is not required or has already been included in either the Consolidated Financial Statements or the notes thereto.

**Table of Contents****ELECTRONIC ARTS INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

| (In millions, except par value data)                            | <b>March 31,<br/>2007</b> | <b>March 31,<br/>2006</b> |
|---|---------------------------|---------------------------|
| <b>ASSETS</b>   |                           |                           |
| Current assets:   |                           |                           |
| Cash and cash equivalents                                       | \$ 1,371                  | \$ 1,242                  |
| Short-term investments  | 1,264                     | 1,030                     |
| Marketable equity securities                                    | 341                       | 160                       |
| Receivables, net of allowances of \$214 and \$232, respectively | 256                       | 199                       |
| Inventories   | 62                        | 61                        |
| Deferred income taxes, net                                      | 84                        | 86                        |
| Other current assets  | 219                       | 234                       |
| Total current assets  | 3,597                     | 3,012                     |
| Property and equipment, net                                     | 484                       | 392                       |
| Investments in affiliates                                       | 6                         | 11                        |
| Goodwill  | 734                       | 647                       |
| Other intangibles, net  | 210                       | 232                       |
| Deferred income taxes, net                                      | 25                        |                           |
| Other assets  | 90                        | 92                        |
| <b>TOTAL ASSETS</b>   | <b>\$ 5,146</b>           | <b>\$ 4,386</b>           |

**LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS' EQUITY**

|   |        |        |
|---|--------|--------|
| Current liabilities:                                      |        |        |
| Accounts payable  | \$ 180 | \$ 163 |
| Accrued and other current liabilities                     | 823    | 697    |
| Deferred net revenue — packaged goods and digital content | 23     | 9      |
| Total current liabilities                                 | 1,026  | 869    |
| Deferred income taxes, net                                | 8      | 29     |
| Other liabilities   | 80     | 68     |
| Total liabilities   | 1,114  | 966    |
| Commitments and contingencies (See Note 9)                |        |        |
| Minority interest   |        | 12     |

Stockholders' equity:

Preferred stock, \$0.01 par value. 10 shares authorized

Common stock, \$0.01 par value. 1,000 shares authorized; 311 and 305 shares issued and outstanding, respectively

|  |       |       |
|--|-------|-------|
|  | 3     | 3     |
| Paid-in capital                        | 1,412 | 1,081 |
| Retained earnings                      | 2,323 | 2,241 |
| Accumulated other comprehensive income | 294   | 83    |

|                            |       |       |
|----------------------------|-------|-------|
| Total stockholders' equity | 4,032 | 3,408 |
|----------------------------|-------|-------|

**TOTAL LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS  
EQUITY**

|    |       |    |       |
|----|-------|----|-------|
| \$ | 5,146 | \$ | 4,386 |
|----|-------|----|-------|

See accompanying Notes to Consolidated Financial Statements.

**Table of Contents****ELECTRONIC ARTS INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

| (In millions, except per share data)                           | Year Ended March 31, |          |          |
|--|----------------------|----------|----------|
|  | 2007                 | 2006     | 2005     |
| Net revenue  | \$ 3,091             | \$ 2,951 | \$ 3,129 |
| Cost of goods sold   | 1,212                | 1,181    | 1,197    |
| Gross profit   | 1,879                | 1,770    | 1,932    |
| Operating expenses:  |                      |          |          |
| Marketing and sales  | 466                  | 431      | 391      |
| General and administrative                                     | 288                  | 215      | 221      |
| Research and development                                       | 1,041                | 758      | 633      |
| Amortization of intangibles                                    | 27                   | 7        | 3        |
| Acquired in-process technology                                 | 3                    | 8        | 13       |
| Restructuring charges  | 15                   | 26       | 2        |
| Total operating expenses                                       | 1,840                | 1,445    | 1,263    |
| Operating income   | 39                   | 325      | 669      |
| Interest and other income, net                                 | 99                   | 64       | 56       |
| Income before provision for income taxes and minority interest | 138                  | 389      | 725      |
| Provision for income taxes                                     | 66                   | 147      | 221      |
| Income before minority interest                                | 72                   | 242      | 504      |
| Minority interest  | 4                    | (6)      |          |



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|                                       |    |      |    |      |    |      |
|---------------------------------------|----|------|----|------|----|------|
| Net income                            | \$ | 76   | \$ | 236  | \$ | 504  |
| Net income per share:                 |    |      |    |      |    |      |
| Basic                                 | \$ | 0.25 | \$ | 0.78 | \$ | 1.65 |
| Diluted                               | \$ | 0.24 | \$ | 0.75 | \$ | 1.59 |
| Number of shares used in computation: |    |      |    |      |    |      |
| Basic                                 |    | 308  |    | 304  |    | 305  |
| Diluted                               |    | 317  |    | 314  |    | 318  |

See accompanying Notes to Consolidated Financial Statements.

**Table of Contents****ELECTRONIC ARTS INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME**

(In millions, share data in thousands)

|  |          |      |  | Class B<br>Common<br>Stock<br>Shares <sup>(a)</sup> | Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Total<br>Stockholders'<br>Equity |
|--|----------|------|--|---|--------------------|----------------------|---|----------------------------------|
| Balances as of March 31, 2004  | 301,333  | \$ 3 |  | 200   | \$ 1,154           | \$ 1,501             | \$ 20   | \$ 2,678                         |
| Net income   |          |      |  |   |                    | 504                  |   | 504                              |
| Change in unrealized gains<br>(losses) on investments, net   |          |      |  |   |                    |                      | 27  | 27                               |
| Reclassification adjustment for<br>(gains) losses realized, net  |          |      |  |   |                    |                      | (1)   | (1)                              |
| Translation adjustment   |          |      |  |   |                    |                      | 10  | 10                               |
| Comprehensive income   |          |      |  |   |                    |                      |   | \$ 540                           |
| Issuance of common stock   | 9,914    |      |  |   | 241                |                      |   | 241                              |
| Repurchase and retirement of<br>common stock   | (806)    |      |  |   | (41)               |                      |   | (41)                             |
| Conversion of Class B shares to<br>common stock  |          |      |  | (200)   |                    |                      |   |                                  |
| Stock-based compensation   |          |      |  |   | 5                  |                      |   | 5                                |
| Tax benefit from exercise of<br>stock options  |          |      |  |   | 75                 |                      |   | 75                               |
| Balances as of March 31, 2005  | 310,441  | \$ 3 |  |   | \$ 1,434           | \$ 2,005             | \$ 56   | \$ 3,498                         |
| Net income   |          |      |  |   |                    | 236                  |   | 236                              |
| Change in unrealized gains<br>(losses) on investments and<br>derivative instruments, net                         |          |      |  |   |                    |                      | 33  | 33                               |
| Reclassification adjustment for<br>(gains) losses, realized on<br>investments and derivative<br>instruments, net |          |      |  |   |                    |                      | 4   | 4                                |
| Translation adjustment   |          |      |  |   |                    |                      | (10)  | (10)                             |
| Comprehensive income   |          |      |  |   |                    |                      |   | \$ 263                           |
| Issuance of common stock   | 7,174    |      |  |   | 206                |                      |   | 206                              |
| Repurchase and retirement of<br>common stock   | (12,621) |      |  |   | (709)              |                      |   | (709)                            |

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|   |         |      |          |          |        |    |       |
|---|---------|------|----------|----------|--------|----|-------|
| Stock-based compensation  |         |      | 3        |          |        |    | 3     |
| Tax benefit from exercise of stock options  |         |      | 133      |          |        |    | 133   |
| Assumption of stock options in connection with acquisition  |         |      | 14       |          |        |    | 14    |
| Balances as of March 31, 2006   | 304,994 | \$ 3 | \$ 1,081 | \$ 2,241 | \$ 83  | \$ | 3,408 |
| Cumulative effect of adjustments resulting from the adoption of SAB No. 108, net of tax                 |         |      |          | 6        |        |    | 6     |
| Adjusted balance as of March 31, 2006   | 304,994 | \$ 3 | \$ 1,081 | \$ 2,247 | \$ 83  | \$ | 3,414 |
| Net income  |         |      |          | 76       |        |    | 76    |
| Change in unrealized gains (losses) on investments and derivative instruments, net                      |         |      |          |          | 183    |    | 183   |
| Reclassification adjustment for (gains) losses, realized on investments and derivative instruments, net |         |      |          |          | 5      |    | 5     |
| Translation adjustment  |         |      |          |          | 23     |    | 23    |
| Comprehensive income  |         |      |          |          |        | \$ | 287   |
| Issuance of common stock  | 6,044   |      | 164      |          |        |    | 164   |
| Stock-based compensation  |         |      | 133      |          |        |    | 133   |
| Tax benefit from exercise of stock options  |         |      | 34       |          |        |    | 34    |
| Balances as of March 31, 2007   | 311,038 | \$ 3 | \$ 1,412 | \$ 2,323 | \$ 294 | \$ | 4,032 |

(a) The ending balance of our Class B Common Stock was \$0 as of March 31, 2007, 2006, and 2005.

See accompanying Notes to Consolidated Financial Statements.

**Table of Contents****ELECTRONIC ARTS INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

| (In millions)   | Year Ended March 31, |        |         |
|---|----------------------|--------|---------|
|   | 2007                 | 2006   | 2005    |
| <b>OPERATING ACTIVITIES</b>   |                      |        |         |
| Net income  | \$ 76                | \$ 236 | \$ 504  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                      |        |         |
| Depreciation, amortization and accretion  | 147                  | 95     | 75      |
| Stock-based compensation  | 133                  | 3      | 6       |
| Minority interest   | (4)                  | 6      |         |
| Realized (gains) losses on investments and sale of property and equipment         | 1                    | 7      | (8)     |
| Tax benefit from exercise of stock options  |                      | 133    | 75      |
| Acquired in-process technology  | 3                    | 8      | 13      |
| Change in assets and liabilities:   |                      |        |         |
| Receivables, net  | (18)                 | 104    | (80)    |
| Inventories   | 12                   | (3)    | (14)    |
| Other assets  | 46                   | (71)   | (35)    |
| Accounts payable  | (2)                  | 31     | 28      |
| Accrued and other liabilities   | 43                   | 30     | 46      |
| Deferred income taxes, net  | (54)                 | 8      | 24      |
| Deferred net revenue packaged goods and digital content                           | 14                   | 9      |         |
| Net cash provided by operating activities   | 397                  | 596    | 634     |
| <b>INVESTING ACTIVITIES</b>   |                      |        |         |
| Capital expenditures  | (178)                | (123)  | (126)   |
| Proceeds from sale of property and equipment                                      | 2                    | 2      | 16      |
| Purchase of marketable equity securities  |                      |        | (90)    |
| Proceeds from sale of marketable equity securities                                |                      | 4      | 4       |
| Purchase of investments in affiliates   | (1)                  | (2)    | (2)     |
| Proceeds from sale of investments in affiliates                                   |                      | 2      |         |
| Proceeds from maturities and sales of short-term investments                      | 1,315                | 1,427  | 996     |
| Purchase of short-term investments  | (1,522)              | (755)  | (2,442) |
| Acquisition of subsidiaries, net of cash acquired                                 | (103)                | (661)  | (81)    |
| Other investing activities  |                      | (2)    | (1)     |
| Net cash used in investing activities   | (487)                | (108)  | (1,726) |
| <b>FINANCING ACTIVITIES</b>   |                      |        |         |
| Proceeds from issuance of common stock  | 168                  | 206    | 241     |
| Excess tax benefit from stock-based compensation                                  | 36                   |        |         |
| Repayment of note assumed in connection with acquisition                          | (14)                 |        |         |
| Repurchase and retirement of common stock   |                      | (709)  | (41)    |

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|  |          |          |          |
|--|----------|----------|----------|
| Net cash provided by (used in) financing activities        | 190      | (503)    | 200      |
| Effect of foreign exchange on cash and cash equivalents    | 29       | (13)     | 12       |
| Increase (decrease) in cash and cash equivalents           | 129      | (28)     | (880)    |
| Beginning cash and cash equivalents                        | 1,242    | 1,270    | 2,150    |
| Ending cash and cash equivalents                           | 1,371    | 1,242    | 1,270    |
| Short-term investments                                     | 1,264    | 1,030    | 1,688    |
| Ending cash, cash equivalents and short-term investments   | \$ 2,635 | \$ 2,272 | \$ 2,958 |
| <b>Supplemental cash flow information:</b>                 |          |          |          |
| Cash paid during the year for income taxes                 | \$ 55    | \$ 24    | \$ 101   |
| <b>Non-cash investing activities:</b>                      |          |          |          |
| Change in unrealized gains (losses) on investments, net    | \$ 188   | \$ 37    | \$ 26    |
| Assumption of stock options in connection with acquisition | \$       | \$ 14    | \$       |

See accompanying Notes to Consolidated Financial Statements.

**Table of Contents****ELECTRONIC ARTS INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(1) DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

We develop, market, publish and distribute interactive software games that are playable by consumers on video game consoles (such as the Sony PlayStation® 2 and PLAYSTATION® 3, Microsoft Xbox 360™ and Nintendo Wii™), personal computers, mobile platforms (including cellular handsets and handheld game players such as the PlayStation® Portable ( PSP™ ) and the Nintendo DS™) and online (over the Internet and other proprietary online networks). Some of our games are based on content that we license from others (e.g., Madden NFL Football, The Godfather and FIFA Soccer), and some of our games are based on our own wholly-owned intellectual property (e.g., The Sims™ and Need for Speed™). Our goal is to publish titles with mass-market appeal, which often means translating and localizing them for sale in non-English speaking countries. In addition, we also attempt to create software game franchises that allow us to publish new titles on a recurring basis that are based on the same property. Examples of this franchise approach are the annual iterations of our sports-based products (e.g., Madden NFL Football, NCAA® Football and FIFA Soccer), wholly-owned properties that can be successfully sequeled (e.g., The Sims, Need for Speed and Battlefield) and titles based on long-lived literary and/or movie properties (e.g., Lord of the Rings and Harry Potter).

A summary of our significant accounting policies applied in the preparation of our Consolidated Financial Statements follows:

***(a) Consolidation***

The accompanying Consolidated Financial Statements include the accounts of Electronic Arts Inc. and its wholly- and majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

***(b) Fiscal Year***

Our fiscal year is reported on a 52 or 53-week period that, historically, ended on the final Saturday of March in each year. Beginning with the fiscal year ended March 31, 2006, our fiscal year ends on the Saturday nearest March 31. As a result, fiscal 2006 contained 53 weeks with the first quarter containing 14 weeks. Our results of operations for the fiscal years ended March 31, 2007, 2006 and 2005 contain the following number of weeks:

| <b>Fiscal Year Ended</b> | <b>Number of Weeks</b> | <b>Fiscal Period End Date</b> |
|--------------------------|------------------------|-------------------------------|
| March 31, 2007           | 52 weeks               | March 31, 2007                |
| March 31, 2006           | 53 weeks               | April 1, 2006                 |
| March 31, 2005           | 52 weeks               | March 26, 2005                |

For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

***(c) Reclassifications***

Certain prior-year amounts have been reclassified to conform to the fiscal 2007 presentation.

***(d) Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us 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 period. Such estimates include sales returns and allowances, provisions for doubtful accounts, accrued liabilities, income taxes, estimates regarding the recoverability of prepaid royalties and royalty commitments, inventories, long-lived assets, certain estimates related to the measurement and recognition of costs resulting from our share-based payment transactions, deferred income tax assets as well as estimates used in our goodwill impairment

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test. These estimates generally involve complex issues and require us to make judgments, involve analysis of historical and future trends, can require extended periods of time to resolve, and are subject to change from period to period. In all cases, actual results could differ materially from our estimates.

### ***(e) Cash, Cash Equivalents, Short-Term Investments, Marketable Equity Securities and Other Investments***

Cash equivalents consist of highly liquid investments with insignificant interest rate risk and original or remaining maturities of three months or less at the time of purchase.

Short-term investments consist of securities with original or remaining maturities of greater than three months at the time of purchase. The short-term investments are available for use in current operations or other activities such as capital expenditures and business acquisitions.

As of March 31, 2007 and March 31, 2006, short-term investments and marketable equity securities were classified as available-for-sale and stated at fair value based upon quoted market prices for the securities. Unrealized gains and losses are included as a separate component of accumulated other comprehensive income, net of any related tax effect, in stockholders' equity. Realized gains and losses are calculated based on the specific identification method. We recognize an impairment charge when we determine that a decline in the fair value of a security below its cost basis is other-than-temporary.

Investments in affiliates consist of investments in equity securities accounted for under either the cost method or the equity method in accordance with Accounting Principles Board Opinion ( APB ) No. 18, *The Equity Method Of Accounting For Investments In Common Stock* . Our share of earnings or losses of investments in affiliates accounted for under the equity method is included in interest and other income, net, in our Consolidated Statement of Operations, except for investments where we are not able to exercise significant influence over the operating and financing decisions of the investee, in which case the cost method of accounting is used. We evaluate the investment in affiliates to determine if events or changes in circumstances indicate an other-than-temporary impairment in value. We recognize an impairment charge when we determine an other-than-temporary impairment in value exists.

### ***(f) Inventories***

Inventories consist of materials (including manufacturing royalties paid to console manufacturers), labor and freight-in. Inventories are stated at the lower of cost (first-in, first-out method) or market.

### ***(g) Property and Equipment, Net***

Property and equipment, net, are stated at cost. Depreciation is calculated using the straight-line method over the following useful lives:

|                                 |   |
|---------------------------------|---|
| Buildings                       | 20 to 25 years  |
| Computer equipment and software | 3 to 5 years  |
| Furniture and equipment         | 3 to 5 years  |
| Leasehold improvements          | Lesser of the lease term or the estimated useful lives of the improvements, generally 1 to 10 years |

Under the provisions of American Institute of Certified Public Accountants Statement of Position ( SOP ) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* , we capitalize costs associated with customized internal-use software systems that have reached the application development stage and



meet recoverability tests. Such capitalized costs include external direct costs utilized in developing or obtaining the applications and payroll and payroll-related expenses for employees who are directly associated with the applications. Capitalization of such costs begins when the preliminary project stage is complete and ceases at the point in which the project is substantially complete and ready for its intended purpose. The net book value of capitalized costs associated with internal-use software amounted to \$18 million and \$23 million as of March 31, 2007 and 2006, respectively, and are being depreciated on a straight-line basis over each asset's estimated useful life that ranges from three to five years.

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### ***(h) Long-Lived Assets***

We evaluate long-lived assets and certain identifiable intangibles for impairment, in accordance with Statement of Financial Accounting Standard ( SFAS ) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* , whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. This may include assumptions about future prospects for the business that the asset relates to and typically involves computations of the estimated future cash flows to be generated by these businesses. Based on these judgments and assumptions, we determine whether we need to take an impairment charge to reduce the value of the asset stated on our Consolidated Balance Sheet to reflect its actual fair value. Judgments and assumptions about future values 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 acquired assets or the strategy of our overall business and significant under-performance relative to expected historical or projected future operating results. If we were to consider such assets to be impaired, the amount of impairment we would recognize would be measured by the amount by which the carrying amount of the asset exceeds its fair value which is estimated by discounted cash flows. We recognized an insignificant amount of impairment in fiscal 2007, 2006 and 2005.

### ***(i) Taxes Collected from Customers and Remitted to Governmental Authorities***

Taxes assessed by a government authority that are both imposed on and concurrent with specific revenue transactions between us and our customers is presented on a net basis in our Consolidated Statements of Operations.

### ***(j) Concentration of Credit Risk***

We extend credit to various companies in the retail and mass merchandising industries. Collection of trade receivables may be affected by changes in economic or other industry conditions and may, accordingly, impact our overall credit risk. Although we generally do not require collateral, we perform ongoing credit evaluations of our customers and maintain reserves for potential credit losses. As of March 31, 2007 and 2006, we had 10 percent and 11 percent, respectively, of our gross accounts receivable outstanding with Wal-Mart Stores, Inc. As of March 31, 2007, we had 11 percent of our gross accounts receivable outstanding with GameStop Corp.

Short-term investments are placed with high quality financial institutions or in short-duration, investment-grade securities. We limit the amount of credit exposure in any one financial institution or type of investment instrument.

### ***(k) Revenue Recognition***

We evaluate the recognition of revenue based on the criteria set forth in SOP 97-2, *Software Revenue Recognition* , as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions* and Staff Accounting Bulletin ( SAB ) No. 101, *Revenue Recognition in Financial Statements* , as revised by SAB No. 104, *Revenue Recognition* . We evaluate revenue recognition using the following basic criteria 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 products must be present in order to recognize revenue.

Delivery. Delivery is considered to occur when a product is shipped and the risk of loss and rewards of ownership have been transferred to the customer. For online game services, delivery is considered to occur as

the service is provided. For online services associated with our packaged goods products (other than massively multiplayer online games) such as matchmaking, roster updates, tournaments and player rankings, we estimate the service period to be six months after the month of sale.

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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. We conduct a credit review of each customer involved in a significant transaction to determine the creditworthiness of the customer. 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, we recognize revenue when collection becomes probable (generally upon cash collection).

Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue we report. For example, for multiple element arrangements, we must make assumptions and judgments in order to: (1) determine whether and when each element has been delivered; (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services; (3) determine whether vendor-specific objective evidence of fair value ( VSOE ) exists for each undelivered element; and (4) allocate the total price among the various elements we must deliver. Changes to any of these assumptions or judgments, or changes to the elements in a software arrangement, could cause a material increase or decrease in the amount of revenue that we report in a particular period.

*Product Revenue:* Product revenue, including sales to resellers and distributors ( channel partners ), is recognized when the above criteria are met. We reduce product revenue for estimated future returns, price protection, and other offerings, which may occur with our customers and channel partners.

*Shipping and Handling:* In accordance with Emerging Issues Task Force ( EITF ) Issue No. 00-10, *Accounting for Shipping and Handling Fees and Costs* , we recognize amounts billed to customers for shipping and handling as revenue. Additionally, shipping and handling costs incurred by us are included in cost of goods sold.

*Online Subscription Revenue:* Online subscription revenue is derived principally from subscription revenue collected from customers for online play related to our massively multiplayer online games and Pogo-branded online games services. These customers generally pay on an annual basis or a month-to-month basis and prepaid subscription revenue, including revenue collected from credit card sales, is recognized ratably over the period for which the services are provided.

*Software Licenses:* We license software rights to manufacturers of products in related industries (for example, makers of personal computers or computer accessories) to include certain of our products with the manufacturer's product, or offer our products to consumers who have purchased the manufacturer's product. We call these combined products OEM bundles . These OEM bundles generally require the customer to pay us an upfront nonrefundable fee, which represents the guaranteed minimum royalty amount. Revenue is generally recognized upon delivery of the product master or the first copy. Per-copy royalties on sales that exceed the minimum guarantee are recognized as earned.

### ***(I) Sales Returns and Allowances and Bad Debt Reserves***

We estimate potential future product returns, price protection and stock-balancing programs related to current-period product revenue. We analyze historical returns, current sell-through of distributor and retailer inventory of our products, current trends in retail and the video game segment, changes in customer demand and acceptance of our products and other related factors when evaluating the adequacy of our sales returns and price protection allowances. 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 costs in subsequent periods.

Similarly, significant judgment is required to estimate our allowance for doubtful accounts in any accounting period. We analyze customer concentrations, customer credit-worthiness, current economic trends, and historical experience when evaluating the adequacy of the allowance for doubtful accounts.

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### ***(m) Advertising Costs***

We generally expense advertising costs as incurred, except for production costs associated with media campaigns which are recognized as prepaid assets (to the extent paid in advance) and expensed at the first run of the advertisement. Cooperative advertising with our channel partners is accrued when revenue is recognized and such amounts are included in marketing and sales expense if there is a separate identifiable benefit for which we can reasonably estimate the fair value of the benefit identified. Otherwise, they are recognized as a reduction of net revenue. We then reimburse the channel partner when qualifying claims are submitted. We sometimes receive reimbursements for advertising costs from our vendors, and such amounts are recognized as a reduction of marketing and sales expense if the advertising (1) is specific to the vendor, (2) represents an identifiable benefit to us and (3) represents an incremental cost to us. Otherwise, vendor reimbursements are recognized as a reduction of cost of goods sold as the related revenue is recognized. Vendor reimbursements of advertising costs of \$28 million, \$41 million and \$42 million reduced marketing and sales expense for the fiscal years ended March 31, 2007, 2006 and 2005, respectively. For the fiscal years ended March 31, 2007, 2006 and 2005, advertising expenses, net of vendor reimbursements, totaled approximately \$163 million, \$180 million and \$174 million, respectively.

### ***(n) Software Development Costs***

Research and development costs, which consist primarily of software development costs, are expensed as incurred. SFAS No. 86, *Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed*, provides for the capitalization of certain software development costs incurred after technological feasibility of the software is established or for development costs that have alternative future uses. Under our current practice of developing new products, the technological feasibility of the underlying software is not established until substantially all product development is complete, which generally includes the development of a working model. The software development costs that have been capitalized to date have been insignificant.

### ***(o) Stock-based Compensation***

On April 1, 2006, we adopted SFAS No. 123 (revised 2004) ( SFAS No. 123(R) ), *Share-Based Payment*, and applied the provisions of SAB No. 107, *Share-Based Payment*, on our adoption of SFAS No. 123(R). SFAS No. 123(R) requires that the cost resulting from all share-based payment transactions be recognized in the financial statements using a fair-value-based method. We elected to use the modified prospective transition method of adoption. SFAS No. 123(R) requires us to measure compensation cost for all outstanding unvested stock-based awards made to our employees and directors based on estimated fair values and recognize compensation over the service period for awards expected to vest.

For stock options and purchases through our employee stock purchase plan, we use the Black-Scholes option valuation model to determine the grant date fair value. The Black-Scholes option valuation model requires us to make certain assumptions about the future. The determination of fair value is affected by our stock price as well as assumptions regarding subjective and complex variables such as expected employee exercise behaviors and our expected stock price volatility over the term of the award. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes.

As required by SFAS No. 123(R), employee stock-based compensation expense is calculated based on awards ultimately expected to vest and is reduced for estimated forfeitures. Forfeitures are revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates and an adjustment is recognized at that time.

Changes to our underlying stock price, our assumptions used in the Black-Scholes option valuation calculation and our forfeiture rate, as well as future grants of equity, could significantly impact compensation expense to be recognized in fiscal 2008 and future periods.

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***(p) Foreign Currency Translation***

For each of our foreign operating subsidiaries, the functional currency is generally its local currency. Assets and liabilities of foreign operations are translated into U.S. dollars using month-end exchange rates, and revenue and expenses are translated into U.S. dollars using average exchange rates. The effects of foreign currency translation adjustments are included as a component of accumulated other comprehensive income in stockholders' equity.

Foreign currency transaction gains and losses are a result of the effect of exchange rate changes on transactions denominated in currencies other than the functional currency. Foreign currency transaction gains (losses) of \$10 million, \$(1) million and \$25 million for the fiscal years ended March 31, 2007, 2006 and 2005, respectively, are included in interest and other income, net, in our Consolidated Statements of Operations.

***(q) Impact of Recently Issued Accounting Standards***

In February 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments - An Amendment of FASB Statements No. 133 and 140* . SFAS No. 155 (1) permits fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (2) clarifies that interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* , (3) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (4) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (5) amends SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - A Replacement of FASB Statement No. 125* to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. In December 2006, the FASB cleared guidance in Derivatives Implementation Group Statement 133 Implementation Issue No. B40, *Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets* . FASB concluded that a securitized interest in prepayable financial assets is not subject to the conditions in paragraph 13(b) of SFAS No. 133 if it meets the two criteria outlined in the Statement 133 Implementation Issue No. B40. SFAS No. 155 is effective for all financial instruments acquired or issued for fiscal years beginning after September 15, 2006. The guidance in the Statement 133 Implementation Issue No. B40 is applicable upon adoption of SFAS No. 155, although the FASB provides certain exceptions as described in the Statement 133 Implementation Issue No. B40. We do not expect the adoption of SFAS No. 155 or Statement 133 Implementation Issue No. B40 to have a material impact on our Consolidated Financial Statements.

In July 2006, the FASB issued FASB Interpretation ( FIN ) No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* . FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes* . FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under FIN No. 48, the evaluation of a tax position is a two-step process. The first step is a recognition process where we are required to determine whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, it is presumed that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is a measurement process whereby a tax position that meets the more-likely-than-not recognition threshold is calculated to determine the amount of benefit to recognize in the financial statements. FIN No. 48 also requires new tabular reconciliation of the



total amounts of unrecognized tax benefits at the beginning and end of the reporting period. The provisions of FIN No. 48 are effective for fiscal years beginning after December 15, 2006. As such, we are required to adopt it in our first quarter of fiscal year 2008. Any changes to our income taxes due to the adoption of

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FIN No. 48 are treated as the cumulative effect of a change in accounting principle. We are evaluating what impact the adoption of FIN No. 48 will have on our Consolidated Financial Statements. This impact could be material and our future effective tax rates could be more volatile.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. Fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Fair value measurements would be separately disclosed by level within the fair value hierarchy. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of SFAS No. 157 to have a material impact on our Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. It also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The provisions of SFAS No. 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007. This Statement should not be applied retrospectively to fiscal years beginning prior to the effective date, except as permitted with early adoption. We are evaluating if we will adopt SFAS No. 159 and what impact the adoption will have on our Consolidated Financial Statements if we adopt. If we adopt SFAS No. 159, it may have a material impact on our Consolidated Financial Statements.

In March 2007, the EITF issued a tentative conclusion on EITF 07-03, *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development* and the FASB ratified the tentative conclusion. The FASB exposed the EITF tentative conclusion for public comment. The comment period was expected to end in May 2007. EITF 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under this tentative conclusion, an entity would defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. If a final consensus is reached on this tentative conclusion, EITF 07-03 would be effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007. We do not expect the adoption of EITF 07-03 to have a material impact on our Consolidated Financial Statements if ratified by the FASB as currently proposed.

## **(2) FINANCIAL INSTRUMENTS**

### ***(a) Fair Value of Financial Instruments***

Cash, cash equivalents, receivables, accounts payable and accrued and other liabilities are valued at their carrying amounts as they approximate their fair value due to the short maturity of these financial instruments.

**Table of Contents*****(b) Cash, Cash Equivalents and Short-term Investments***

Cash, cash equivalents and short-term investments consisted of the following as of March 31, 2007 and 2006 (in millions):

|   | <b>As of March 31, 2007</b>           |                                       |  |                       |
|---|---------------------------------------|---------------------------------------|--|-----------------------|
|   | <b>Cost or<br/>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| Cash and cash equivalents:                        |                                       |                                       |  |                       |
| Cash  | \$ 194                                | \$                                    | \$                                     | \$ 194                |
| Money market funds                                | 989                                   |                                       |  | 989                   |
| Commercial paper                                  | 188                                   |                                       |  | 188                   |
| Cash and cash equivalents                         | 1,371                                 |                                       |  | 1,371                 |
| Short-term investments:                           |                                       |                                       |  |                       |
| Commercial paper                                  | 574                                   |                                       |  | 574                   |
| U.S. agency securities                            | 263                                   | 1                                     |  | 264                   |
| Corporate bonds                                   | 227                                   |                                       | (1)                                    | 226                   |
| Asset-backed securities                           | 107                                   | 1                                     |  | 108                   |
| U.S. Treasury securities                          | 92                                    |                                       |  | 92                    |
| Short-term investments                            | 1,263                                 | 2                                     | (1)                                    | 1,264                 |
| Cash, cash equivalents and short-term investments | \$ 2,634                              | \$ 2                                  | \$ (1)                                 | \$ 2,635              |

|                            | <b>As of March 31, 2006</b>           |                                       |  |                       |
|----------------------------|---------------------------------------|---------------------------------------|--|-----------------------|
|                            | <b>Cost or<br/>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
| Cash and cash equivalents: |                                       |                                       |  |                       |
| Cash                       | \$ 260                                | \$                                    | \$                                     | \$ 260                |
| Money market funds         | 819                                   |                                       |  | 819                   |
| Commercial paper           | 145                                   |                                       |  | 145                   |
| U.S. agency securities     | 14                                    |                                       |  | 14                    |
| Asset-backed securities    | 4                                     |                                       |  | 4                     |
| Cash and cash equivalents  | 1,242                                 |                                       |  | 1,242                 |
| Short-term investments:    |                                       |                                       |  |                       |
| U.S. agency securities     | 579                                   |                                       | (4)                                    | 575                   |
| U.S. Treasury securities   | 213                                   |                                       | (1)                                    | 212                   |
| Corporate bonds            | 180                                   |                                       | (2)                                    | 178                   |
| Asset-backed securities    | 40                                    |                                       |  | 40                    |

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|   |          |    |        |          |
|---|----------|----|--------|----------|
| Commercial paper                                  | 25       |    |        | 25       |
| Short-term investments                            | 1,037    |    | (7)    | 1,030    |
| Cash, cash equivalents and short-term investments | \$ 2,279 | \$ | \$ (7) | \$ 2,272 |

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The following table summarizes the fair value and gross unrealized losses for investments that were in an unrealized loss position as of March 31, 2007 and 2006 (in millions):

|                          | <b>Unrealized Losses<br/>For Less Than<br/>12 Months<br/>Gross<br/>Fair Value      Unrealized<br/>Losses</b> |        | <b>Unrealized Losses<br/>For 12 Months or<br/>Greater<br/>Gross<br/>Fair Value      Unrealized<br/>Losses</b> |        | <b>Total<br/>Fair Value      Gross<br/>Unrealized<br/>Losses</b> |        |
|--------------------------|--|--------|---|--------|--|--------|
| As of March 31, 2007     |  |        |   |        |  |        |
| Corporate bonds          | \$   | \$     | \$ 92   | \$ (1) | \$ 92  | \$ (1) |
| Total                    | \$   | \$     | \$ 92   | \$ (1) | \$ 92  | \$ (1) |
| As of March 31, 2006     |  |        |   |        |  |        |
| U.S. agency securities   | \$ 133   | \$ (1) | \$ 388  | \$ (3) | \$ 521   | \$ (4) |
| U.S. Treasury securities | 202  | (1)    |   |        | 202  | (1)    |
| Corporate bonds          | 104  | (1)    | 72  | (1)    | 176  | (2)    |
| Total                    | \$ 439   | \$ (3) | \$ 460  | \$ (4) | \$ 899   | \$ (7) |

We periodically evaluate our securities for impairment. Factors considered in the review of securities with an unrealized loss include the credit quality of the issuer, the magnitude of the unrealized loss position, the length of time that the security has been in a loss position, our intentions with respect to the selling or holding of such security as well as any contractual terms impacting the prepayment or settlement process. Based on our review, we do not consider the investments listed above to be other-than-temporarily impaired as of March 31, 2007.

Gross realized losses of \$1 million and gross realized gains of less than \$1 million were recognized from the sale of short-term investments for the year ended March 31, 2007. Gross realized losses of \$9 million and gross realized gains of less than \$1 million were recognized from the sale of short-term investments for the year ended March 31, 2006. No material gains or losses were recognized from the sale of short-term investments for the year ended March 31, 2005.

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of March 31, 2007 (in millions):

|                         | <b>Amortized<br/>Cost</b> | <b>Fair<br/>Value</b> |
|-------------------------|---------------------------|-----------------------|
| Due in 1 year or less   | \$ 662                    | \$ 661                |
| Due in 1-2 years        | 241                       | 241                   |
| Due in 2-3 years        | 253                       | 254                   |
| Asset-backed securities | 107                       | 108                   |
| Short-term investments  | \$ 1,263                  | \$ 1,264              |

Asset-backed securities are separately disclosed as they are not due at a single maturity date. Our portfolio only includes asset-backed securities that have weighted-average maturities of three years or less. As of March 31, 2007, the amortized cost and fair value of asset-backed securities with a weighted average maturity of 2 to 3 years was \$102 million and \$103 million, respectively, while the amortized cost and fair value of asset-backed securities with a weighted average maturity of 1 to 2 years was \$5 million. There were no asset-backed securities with a weighted average maturity of less than one year.

**Table of Contents*****(c) Marketable Equity Securities***

Marketable equity securities consisted of the following (in millions):

|                      | <b>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b> |
|----------------------|-------------|---------------------------------------|--|-----------------------|
| As of March 31, 2007 | \$ 91       | \$ 250                                | \$                                     | \$ 341                |
| As of March 31, 2006 | \$ 91       | \$ 69                                 | \$                                     | \$ 160                |

Our investments in marketable equity securities consist of investments in common stock of publicly traded companies. On February 3, 2005, we purchased approximately 19.9 percent of the then outstanding ordinary shares (representing 18.4 percent of the voting rights at the time) of Ubisoft Entertainment ( "Ubisoft" ) for \$91 million. At March 31, 2007, we owned approximately 15.4 percent of the outstanding shares of Ubisoft (representing 14.4 percent of the voting rights). As the fair value of our marketable equity securities exceeds the cost basis of those investments as of March 31, 2007, we do not consider these investments to be other-than-temporarily impaired. During fiscal 2006 and 2005, no other-than-temporary impairment charges were recognized.

We did not have any realized gains or losses from the sale of marketable equity securities for the year ended March 31, 2007. Realized gains from the sale of marketable equity securities were \$1 million and \$2 million for the years ended March 31, 2006 and 2005, respectively.

***(d) Investments in Affiliates***

As of March 31, 2007 and 2006, the total investment in affiliates reflected on our Consolidated Balance Sheets was \$6 million and \$11 million, respectively.

Prior to the acquisition of the remaining minority interest in Digital Illusions, C.E. ( "DICE" ), our investments in affiliates included a warrant to acquire 2,327,602 additional shares of DICE common stock. Prior to April 2005, the warrant was accounted for as a derivative under SFAS No. 133. The warrant was amended in April 2005, such that only subscriptions of 500,000 or more shares could be exercised. Due to the limited trading volume of DICE's common stock, there was no market mechanism for settlement and the warrant was not readily convertible to cash and was therefore accounted for under the cost method as prescribed by APB No. 18. As of March 31, 2006, the cost basis of the warrant was \$5 million. In connection with the acquisition of the remaining minority interest of DICE in October 2006, the warrant was reclassified to goodwill for this wholly owned subsidiary. See Note 4 of the Notes to Consolidated Financial Statements.

For cost method investments, we estimate that the fair value exceeds the cost basis of those investments. Accordingly, we do not consider these investments to be other-than-temporarily impaired as of March 31, 2007. During fiscal 2007, 2006 and 2005, no other-than-temporary impairments in investments in affiliates were recognized.

**(3) DERIVATIVE FINANCIAL INSTRUMENTS**

We account for our derivative and hedging activities under SFAS No. 133. The assets or liabilities associated with our derivative instruments and hedging activities are recorded at fair value in other current assets or other current liabilities, respectively, in our 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 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 option contracts, generally with maturities of 15 months or less, to reduce the volatility of cash flows primarily related to forecasted revenue and expenses denominated in certain foreign currencies. In addition, we utilize foreign exchange forward contracts to mitigate foreign currency exchange rate risk associated with foreign-currency-denominated assets and liabilities, primarily intercompany receivables and payables. The forward contracts generally have a contractual term of approximately one month and are transacted near month-end;



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therefore, the fair value of the forward contracts generally is not significant at each month-end. We do not use foreign currency option or foreign exchange forward contracts for speculative or trading purposes.

***Cash Flow Hedging Activities***

Our foreign currency option contracts are designated and qualify as cash flow hedges under SFAS No. 133. The effectiveness of the cash flow hedge contracts, including time value, is assessed monthly using regression as well as other timing and probability criteria required by SFAS No. 133. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. The effective portion of gains or losses resulting from changes in 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 fair value of these hedges was subsequently reclassified into net revenue or operating expenses, as appropriate, in the period when the forecasted transaction was recognized in the Consolidated Statements of Operations. The ineffective portion of gains or losses resulting from changes in fair value, if any, is reported in each period in interest and other income, net in our Consolidated Statements of Operations. The effective portion of hedges recognized in accumulated other comprehensive income at the end of each year will be reclassified to earnings within 12 months.

The following table summarizes the activity in accumulated other comprehensive income, net of related taxes, with regard to the changes in fair value of derivative instruments, for fiscal 2007 and 2006 (in millions):

|  | <b>Year Ended<br/>March 31,</b> |             |
|--|---------------------------------|-------------|
|  | <b>2007</b>                     | <b>2006</b> |
| Beginning balance of unrealized gains (losses), net, on derivative instruments                         | \$                              | \$          |
| Change in unrealized gains (losses), net, on derivative instruments                                    | (4)                             | 4           |
| Reclassification adjustment for (gains) losses, realized on derivative instruments to net income, net: |                                 |             |
| Net revenue  | 3                               | (4)         |
| Operating expenses   | 1                               |             |
| Ending balance of unrealized gains (losses), net, on derivative instruments                            | \$                              | \$          |

Hedging ineffectiveness for the years ended March 31, 2007 and 2006 was not significant. The amount of hedging ineffectiveness recognized in interest and other income, net, was a loss of \$1 million for the year ended March 31, 2005.

***Balance Sheet Hedging Activities***

Our foreign exchange forward contracts are not designated as hedging instruments under SFAS No. 133. Accordingly, any gains or losses resulting from changes in the fair value of the forward contracts are reported in interest and other income, net. The gains and losses on these forward contracts generally offset the gains and losses associated with the underlying foreign-currency-denominated assets and liabilities, which are also reported in interest and other income, net, in our Consolidated Statements of Operations.



**Table of Contents****(4) BUSINESS COMBINATIONS*****Digital Illusions C.E.***

The following table summarizes the estimated fair values of the remaining minority interest acquired for the fiscal year ended March 31, 2007 and the fair values of assets acquired and liabilities assumed for the fiscal years ended March 31, 2006 and 2005, in connection with the acquisition of DICE (in millions):

|                                | <b>Year Ended March 31,</b> |             |             |              |
|--------------------------------|-----------------------------|-------------|-------------|--------------|
|                                | <b>2007</b>                 | <b>2006</b> | <b>2005</b> | <b>Total</b> |
| Current assets                 | \$                          | \$          | \$ 35       | \$ 35        |
| Property and equipment, net    |                             | 1           | 1           | 2            |
| Acquired in-process technology | 1                           |             | 4           | 5            |
| Goodwill                       | 19                          | 5           | 31          | 55           |
| Finite-lived intangibles       | 3                           | 1           | 1           | 5            |
| Liabilities                    |                             |             | (9)         | (9)          |
| Minority interest              | 8                           | 3           | (11)        |              |
| Total consideration            | \$ 31                       | \$ 10       | \$ 52       | \$ 93        |

Based in Sweden, DICE develops games for PCs and video game consoles. In 2003 we acquired (1) approximately 1,911,403 shares of Class B common stock representing a 19 percent equity interest in DICE, and (2) a warrant to acquire an additional 2,327,602 shares of to-be-issued Class A common stock at an exercise price of SEK 43.23. Prior to our tender offer in the fourth quarter of fiscal 2005, we accounted for our Class B common stock investment in DICE under the equity method of accounting, as prescribed by APB No. 18, *The Equity Method of Accounting for Investments in Common Stock*. Separately, the warrant was recognized at a cost of \$5 million as of March 31, 2006 and was included in investments in affiliates in our Consolidated Balance Sheets.

On January 27, 2005, we completed a tender offer by acquiring 3,235,053 shares of Class A common stock at a price of SEK 61 per share, representing 32 percent of the outstanding Class A common stock of DICE. During the tender offer period and through the end of fiscal 2005, we acquired, through open market purchases at an average price of SEK 60.33, an additional 1,190,658 shares of Class A common stock, representing approximately 12 percent of the outstanding Class A common stock of DICE. During the first three months and last two weeks of fiscal 2006, we acquired, through open market purchases at an average price of SEK 63.07, an additional 1,071,152 shares of Class A common stock, representing approximately 10 percent of the outstanding Class A common stock of DICE. Accordingly, on a cumulative basis as of March 31, 2006, we owned approximately 73 percent of DICE on an undiluted basis (excluding the warrant discussed above). As a result, we have included the assets, liabilities and results of operations of DICE in our Consolidated Financial Statements since January 27, 2005. The percent of DICE stock that we did not own was reflected as minority interest on our Consolidated Financial Statements from January 27, 2005 until the acquisition date of the remaining minority interest in October 2006. DICE's products were primarily sold through co-publishing agreements with us and our transactions with DICE were recorded on an arm's-length basis.

In October 2006, the remaining minority interest in DICE was acquired for a total of \$27 million in cash, including transaction costs. In connection with the acquisition of the remaining minority interest of DICE, the warrant was

reclassified to goodwill for this wholly owned subsidiary.

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Except for acquired in-process technology, which is discussed below, the acquired finite-lived intangible assets are being amortized on a straight-line basis over estimated lives ranging from one to four years. The intangible assets that make up that amount include:

|                                | <b>Gross<br/>Carrying<br/>Amount<br/>(in millions)</b> | <b>Weighted-Average<br/>Useful Life<br/>(in years)</b> |
|--------------------------------|--|--|
| Developed and Core Technology  | \$ 3   | 2  |
| Trade Name                     | 2  | 4  |
| Total Finite-Lived Intangibles | \$ 5   | 3  |

During fiscal 2007, we recorded \$19 million of goodwill, none of which is tax deductible.

The acquired in-process technology was expensed in our Consolidated Statements of Operations upon consummation of the acquisition, and in each period we increased our ownership percentage. Acquired in-process technology includes the value of products in the development stage that are not considered to have reached technological feasibility or have alternative future use.

***Mythic Entertainment, Inc.***

On July 24, 2006, we acquired all outstanding shares of Mythic Entertainment, Inc. for an aggregate purchase price of \$76 million in cash, including transaction costs. Based in Fairfax, Virginia, Mythic is a developer and publisher of massively multiplayer online role-playing games. The results of operations of Mythic and the estimated fair market values of the acquired assets and assumed liabilities have been included in our Consolidated Financial Statements since the date of acquisition. The following table summarizes the estimated fair values of assets acquired and liabilities assumed in connection with our acquisition of Mythic for the fiscal year ended March 31, 2007 (in millions):

|                                |       |
|--------------------------------|-------|
| Current assets                 | \$ 15 |
| Other long-term assets         | 2     |
| Acquired in-process technology | 2     |
| Goodwill                       | 62    |
| Finite-lived intangibles       | 22    |
| Liabilities                    | (27)  |
| Total consideration            | \$ 76 |

Except for acquired in-process technology, which is discussed below, the acquired finite-lived intangible assets are being amortized on a straight-line basis over estimated lives ranging from three to five years. The intangible assets that make up that amount as of the date of the acquisition include:

|                                   | <b>Gross<br/>Carrying<br/>Amount<br/>(in millions)</b> | <b>Weighted-Average<br/>Useful Life<br/>(in years)</b> |
|-----------------------------------|--|--|
| Developed and Core Technology     | \$ 15  | 4  |
| Trade Name                        | 6  | 5  |
| Subscribers and Other Intangibles | 1  | 5  |
| Total Finite-Lived Intangibles    | \$ 22  | 4  |

We recorded \$62 million of goodwill, none of which is tax deductible, and we expensed \$2 million of acquired in-process technology in our Consolidated Statements of Operations upon consummation of the acquisition.

**Table of Contents*****JAMDAT Mobile Inc.***

On February 15, 2006, we acquired all of the outstanding shares of JAMDAT Mobile Inc. Based in Los Angeles, California, JAMDAT was a global publisher of wireless games and other wireless entertainment applications. We paid \$27 per share in cash in exchange for each share of JAMDAT common stock and assumed outstanding stock options and restricted stock units under certain JAMDAT equity plans for an aggregate purchase price of \$684 million, including transaction costs. The following table summarizes the estimated fair values of assets acquired and liabilities assumed in connection with our acquisition of JAMDAT for the fiscal year ended March 31, 2006 and the subsequent adjustment to the purchase price allocation for the fiscal year ended March 31, 2007 (in millions):

|                                 |            |
|---------------------------------|------------|
| Current assets                  | \$ 52      |
| Property and equipment, net     | 2          |
| Acquired in-process technology  | 7          |
| Goodwill                        | 491        |
| Finite-lived intangibles        | 212        |
| Deferred income tax liabilities | (45)       |
| Other liabilities               | (35)       |
| <br>Total consideration         | <br>\$ 684 |

Prior to our acquisition of JAMDAT, on April 20, 2005, JAMDAT entered into a purchase agreement with the shareholders of Blue Lava Wireless, LLC ( "Blue Lava" ). In connection with JAMDAT's acquisition of Blue Lava, JAMDAT stock was placed in escrow to satisfy certain indemnification provisions under the Blue Lava purchase agreement. Upon completion of our acquisition of JAMDAT, we assumed JAMDAT's contingent liability and replaced the JAMDAT stock in escrow with \$27 million in cash, also placed in escrow. The \$27 million is included in our purchase price of JAMDAT as a pre-acquisition contingency. We are required to pay \$9 million on each of the three anniversaries of the Blue Lava acquisition, beginning on April 20, 2006, less any claims we may have pursuant to the indemnification provisions of the Blue Lava purchase agreement. In April 2007 and 2006, we made the first two payments of approximately \$9 million in each period.

In fiscal 2007, we adjusted the purchase price allocation, including the allocation of goodwill, related to our acquisition of JAMDAT. As a result, we reduced goodwill and the liability balance assumed from JAMDAT by \$4 million.

The results of operations of JAMDAT and the estimated fair market values of the acquired assets and assumed liabilities have been included in our Consolidated Financial Statements since the date of acquisition.

Except for acquired in-process technology, which is discussed below, the acquired finite-lived intangible assets are being amortized on a straight-line basis over estimated lives ranging from two to twelve years. The intangible assets that make up that amount as of the date of the acquisition include:

| Gross<br>Carrying<br>Amount<br>(in millions) | Weighted-Average<br>Useful Life<br>(Years) |
|--|--|
|--|--|

|                                |    |     |    |
|--------------------------------|----|-----|----|
| Developed and Core Technology  | \$ | 122 | 10 |
| Carrier Contracts and Related  |    | 85  | 5  |
| Other Intangibles              |    | 5   | 3  |
| Total Finite-Lived Intangibles | \$ | 212 | 8  |

We recorded \$491 million of goodwill, substantially none of which is tax deductible.

Acquired in-process technology includes the value of products in the development stage that are not considered to have reached technological feasibility or have alternative future use. Accordingly, we expensed acquired in-process technology in our Consolidated Statement of Operations upon consummation of the acquisition.



**Table of Contents*****Criterion Software Group Ltd.***

On October 19, 2004, we acquired all outstanding shares of Criterion Software Group Ltd. for an aggregate purchase price of approximately \$68 million, including transaction costs and the assumption of outstanding stock options under certain Criterion stock option plans. Based in England, Criterion was a developer of video games and a provider of middleware solutions for the game development and publishing industry. The results of operations of Criterion and the estimated fair market values of the acquired assets and assumed liabilities have been included in our Consolidated Financial Statements since the date of acquisition. The following table summarizes the estimated fair values of assets acquired and liabilities assumed in connection with our acquisition of Criterion for the fiscal year ended March 31, 2005 and the subsequent adjustment to the purchase price allocation for the fiscal year ended March 31, 2006 (in millions):

|                                   |       |
|-----------------------------------|-------|
| Current assets                    | \$ 21 |
| Property and equipment, net       | 1     |
| Long-term deferred tax asset      | 3     |
| Acquired in-process technology    | 9     |
| Stock-based employee compensation | 6     |
| Goodwill                          | 23    |
| Finite-lived intangibles          | 21    |
| Liabilities                       | (16)  |
| Total consideration               | \$ 68 |

Except for acquired in-process technology which was expensed in our Consolidated Statement of Operations upon consummation of the acquisition, the acquired finite-lived intangible assets are being amortized on a straight-line basis over estimated lives ranging from two to four years.

Stock-based employee compensation represents the intrinsic value of certain unvested employee stock options that were assumed as part of the transaction. The stock options were considered modified for accounting purposes and were fully amortized over the remaining vesting period in our Consolidated Statement of Operations for the year ended March 31, 2005.

**(5) GOODWILL AND OTHER INTANGIBLE ASSETS**

Goodwill information is as follows (in millions):

|  | <b>Year Ended<br/>March 31,</b> |             |
|--|---------------------------------|-------------|
|  | <b>2007</b>                     | <b>2006</b> |
| Goodwill beginning of year                     | \$ 647                          | \$ 153      |
| Acquired                                       | 87                              | 496         |
| Purchase Accounting Adjustments <sup>(1)</sup> | (4)                             |             |
| Effects of Foreign Currency Translation        | 4                               | (2)         |

|          |             |        |        |
|----------|-------------|--------|--------|
| Goodwill | end of year | \$ 734 | \$ 647 |
|----------|-------------|--------|--------|

- (1) During fiscal 2007, we adjusted the purchase price allocation including the allocation of goodwill related to our acquisition of JAMDAT. As a result, we reduced goodwill and the liability balance assumed from JAMDAT by \$4 million.

SFAS No. 142, *Goodwill and Other Intangible Assets* requires that purchased goodwill and indefinite-lived intangibles not be amortized. Rather, goodwill and indefinite-lived intangible assets are subject to at least an annual assessment for impairment by applying a fair-value-based test.

SFAS No. 142 requires a two-step approach to testing goodwill for impairment for each reporting unit. Our reporting units are determined by the components that constitute a business for which both (1) discreet

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financial information is available and (2) management of the reporting unit regularly reviews the operating results of that component. The first step tests 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 individual assets and liabilities within each reporting unit. We completed the first step of the annual goodwill impairment testing in the fourth quarter of fiscal 2007 and found no indicators of impairment of our recorded goodwill. We did not recognize an impairment loss on goodwill in fiscal 2007, 2006 or 2005.

Finite-lived intangible assets, net of accumulated amortization, as of March 31, 2007 and 2006, were \$210 million and \$232 million, respectively, and include costs for obtaining (1) developed technologies, (2) carrier contracts and related, (3) trade names, and (4) subscribers and other intangibles. Amortization of intangibles for fiscal 2007, 2006 and 2005 was \$54 million (of which \$27 million was recognized in cost of goods sold), \$16 million (of which \$9 million was recognized in cost of goods sold) and \$6 million (of which \$3 million was recognized in cost of goods sold), respectively. Finite-lived intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the agreement terms, typically from two to twelve years. As of March 31, 2007 and 2006, the weighted-average remaining useful life for finite-lived intangible assets was approximately 6.3 years and 7.2 years, respectively.

Finite-lived intangibles consisted of the following (in millions):

|                                   | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Other</b> | <b>Other<br/>Intangibles,<br/>Net</b> |
|-----------------------------------|--------------------------------------|-------------------------------------|--------------|---------------------------------------|
| As of March 31, 2007              |                                      |                                     |              |                                       |
| Developed and Core Technology     | \$ 183                               | \$ (62)                             | \$           | \$ 121                                |
| Carrier Contracts and Related     | 85                                   | (19)                                |              | 66                                    |
| Trade Name                        | 44                                   | (24)                                |              | 20                                    |
| Subscribers and Other Intangibles | 16                                   | (12)                                | (1)          | 3                                     |
| Total                             | \$ 328                               | \$ (117)                            | \$ (1)       | \$ 210                                |
| As of March 31, 2006              |                                      |                                     |              |                                       |
| Developed and Core Technology     | \$ 160                               | \$ (31)                             | \$           | \$ 129                                |
| Carrier Contracts and Related     | 85                                   | (2)                                 |              | 83                                    |
| Trade Name                        | 36                                   | (21)                                |              | 15                                    |
| Subscribers and Other Intangibles | 15                                   | (9)                                 | (1)          | 5                                     |
| Total                             | \$ 296                               | \$ (63)                             | \$ (1)       | \$ 232                                |

As of March 31, 2007, future amortization of finite-lived intangibles that will be recorded in cost of goods sold and operating expenses is estimated as follows (in millions):

|                                      |       |
|--------------------------------------|-------|
| Fiscal Year Ending March 31,<br>2008 | \$ 52 |
|--------------------------------------|-------|

|            |        |
|------------|--------|
| 2009       | 41     |
| 2010       | 34     |
| 2011       | 29     |
| 2012       | 9      |
| Thereafter | 45     |
| Total      | \$ 210 |

**Table of Contents****(6) RESTRUCTURING CHARGES**

Restructuring information as of March 31, 2007 was as follows (in millions):

|                               | Fiscal 2006 International<br>Publishing Reorganization<br>Facilities-<br>Workforce related Other |    |     | Fiscal 2006<br>Restructuring<br>Workforce | Fiscal 2004, 2003<br>and<br>2002 Restructurings<br>Workforce Facilities-<br>related |     |    | Total |       |
|-------------------------------|--|----|-----|---|---|-----|----|-------|-------|
| Balances as of March 31, 2004 | \$   | \$ | \$  | \$  | \$  | 2   | \$ | 12    | \$ 14 |
| Charges utilized in cash      |  |    |     |   |   | (2) |    | (4)   | (6)   |
| Adjustments to operations     |  |    |     |   |   |     |    | 2     | 2     |
| Balances as of March 31, 2005 |  |    |     |   |   |     |    | 10    | 10    |
| Charges to operations         | 3  | 8  | 3   | 10  |   |     |    |       | 24    |
| Charges utilized in cash      | (2)  |    | (1) | (7)                                       |   |     |    | (5)   | (15)  |
| Adjustments to operations     |  |    |     |   |   |     |    | 2     | 2     |
| Balances as of March 31, 2006 | 1  | 8  | 2   | 3   |   |     |    | 7     | 21    |
| Charges to operations         | 10   | 1  | 4   |   |   |     |    |       | 15    |
| Charges utilized in cash      | (11)   |    | (5) | (3)                                       |   |     |    | (7)   | (26)  |
| Balances as of March 31, 2007 | \$   | \$ | 9   | \$ 1                                      | \$  |     | \$ |       | \$ 10 |

***Fiscal 2006 International Publishing Reorganization***

In November 2005, we announced plans to establish an international publishing headquarters in Geneva, Switzerland. Through the quarter ended September 30, 2006, we relocated certain employees to our new facility in Geneva, closed certain facilities in the United Kingdom, and made other related changes in our international publishing business.

Since the inception of the restructuring plan, through March 31, 2007, we have incurred restructuring charges of approximately \$29 million, of which \$13 million was for employee-related expenses, \$9 million for the closure of certain United Kingdom facilities, and \$7 million in other costs in connection with our international publishing reorganization. The restructuring accrual of \$10 million as of March 31, 2007 is expected to be utilized by March 2017. This accrual is included in other accrued expenses presented in Note 8 of the Notes to Consolidated Financial Statements.

In connection with our fiscal 2006 international publishing reorganization, in fiscal 2008, we expect to incur between \$5 million and \$10 million of restructuring costs. Overall, including charges incurred through March 31, 2007, we expect to incur between \$50 million and \$55 million of restructuring costs in connection with our fiscal 2006 international publishing reorganization, substantially all of which will result in cash expenditures by 2017. These restructuring costs will consist primarily of employee-related relocation assistance (approximately \$30 million), facility exit costs (approximately \$15 million), as well as other reorganization costs (approximately \$7 million).

***Fiscal 2006 Restructuring***

During the fourth quarter of fiscal 2006, we recorded a total pre-tax restructuring charge of \$10 million consisting entirely of one-time costs related to headcount reductions which are included in restructuring charges in our Consolidated Statements of Operations. These headcount reductions related to our decision in the fourth quarter of fiscal 2006 to realign our resources with our product plan for fiscal 2007 and strategic opportunities with next-generation consoles, online and mobile platforms. As of March 31, 2006, this accrual was included in other accrued expenses presented in Note 8 of the Notes to Consolidated Financial Statements. As of March 31, 2007, all \$10 million had been paid out in cash under the restructuring plan.

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### ***Fiscal 2004, 2003 and 2002 Restructurings***

In fiscal 2004, 2003 and 2002, we engaged in various restructurings based on management decisions. As of March 31, 2007, all \$34 million in cash had been paid out under these restructuring plans. As of March 31, 2006, the restructuring accrual was included in other accrued expenses presented in Note 8 of the Notes to Consolidated Financial Statements.

## **(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 product.

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 goods sold generally at the greater of the contractual rate or an effective royalty rate based on expected net product sales. Prepayments made to thinly capitalized independent software developers and co-publishing affiliates are generally 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 amortized 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 goods sold.

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. Minimum royalty payment obligations are classified as current liabilities to the extent such royalty payments are contractually due within the next twelve months. As of March 31, 2007 and 2006, approximately \$9 million of minimum guaranteed royalty obligations had been recognized in each period and are included in the royalty-related assets and liabilities tables below.

Each quarter, we also evaluate the future realization of our royalty-based assets as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments determined before the launch of a product are charged to research and development expense. Impairments determined post-launch are charged to cost of goods sold. In either case, we rely on estimated revenue to evaluate the future realization of prepaid royalties and commitments. If actual sales or revised revenue estimates fall below the initial revenue estimate, then the actual charge taken may be greater in any given quarter than anticipated. We had no impairments during fiscal 2007. During fiscal 2006 and 2005, we recorded impairment charges of \$16 million and \$8 million, respectively.

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 March 31,**

|                        | <b>2007</b> | <b>2006</b> |
|------------------------|-------------|-------------|
| Other current assets   | \$ 69       | \$ 76       |
| Other assets           | 40          | 55          |
| Royalty-related assets | \$ 109      | \$ 131      |

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 recognize unpaid royalty amounts owed to these



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parties as either accounts payable or accrued liabilities. The current and long-term portions of accrued royalties, included in accrued and other current liabilities as well as other liabilities, consisted of (in millions):

|                                       | <b>As of March 31,</b> |             |
|---------------------------------------|------------------------|-------------|
|                                       | <b>2007</b>            | <b>2006</b> |
| Accrued and other current liabilities | \$ 91                  | \$ 82       |
| Other liabilities                     | 3                      | 7           |
| Royalty-related liabilities           | \$ 94                  | \$ 89       |

In addition, as of March 31, 2007, we were committed to pay approximately \$1,546 million to content licensors and co-publishing and/or distribution affiliates, but performance remained with the counterparty (i.e., delivery of the product or content or other factors) and such commitments were therefore not recorded in our Consolidated Financial Statements. See Note 9 of the Notes to Consolidated Financial Statements.

**(8) BALANCE SHEET DETAILS*****(a) Inventories***

Inventories as of March 31, 2007 and 2006 consisted of (in millions):

|  | <b>As of March 31,</b> |             |
|--|------------------------|-------------|
|  | <b>2007</b>            | <b>2006</b> |
| Raw materials and work in process                  | \$ 1                   | \$ 1        |
| Finished goods (including manufacturing royalties) | 61                     | 60          |
| Inventories  | \$ 62                  | \$ 61       |

A significant amount of our inventory balance relates to our distribution business in Switzerland.

***(b) Property and Equipment, Net***

Property and equipment, net, as of March 31, 2007 and 2006 consisted of (in millions):

|  | <b>As of March 31,</b> |             |
|--|------------------------|-------------|
|  | <b>2007</b>            | <b>2006</b> |
| Computer equipment and software          | \$ 555                 | \$ 418      |
| Buildings                                | 194                    | 127         |
| Leasehold improvements                   | 110                    | 78          |
| Office equipment, furniture and fixtures | 70                     | 57          |
| Land                                     | 65                     | 57          |

|                               |        |        |
|-------------------------------|--------|--------|
| Warehouse equipment and other | 10     | 11     |
| Construction in progress      | 10     | 59     |
|                               | 1,014  | 807    |
| Less accumulated depreciation | (530)  | (415)  |
| Property and equipment, net   | \$ 484 | \$ 392 |

Depreciation expense associated with property and equipment amounted to \$113 million, \$79 million and \$69 million for the fiscal years ended March 31, 2007, 2006 and 2005, respectively.

**Table of Contents*****(c) Accrued and Other Current Liabilities***

Accrued and other current liabilities as of March 31, 2007 and 2006 consisted of (in millions):

|                                       | <b>As of March 31,</b> |             |
|---------------------------------------|------------------------|-------------|
|                                       | <b>2007</b>            | <b>2006</b> |
| Accrued income taxes                  | \$ 284                 | \$ 234      |
| Accrued compensation and benefits     | 206                    | 122         |
| Other accrued expenses                | 152                    | 202         |
| Accrued royalties                     | 91                     | 82          |
| Deferred net revenue other            | 67                     | 43          |
| Accrued value added taxes             | 23                     | 14          |
| Accrued and other current liabilities | \$ 823                 | \$ 697      |

***(d) Deferred Net Revenue***

Deferred net revenue consisted of the following (in millions):

|   | <b>As of</b>     |             |
|---|------------------|-------------|
|   | <b>March 31,</b> |             |
|   | <b>2007</b>      | <b>2006</b> |
| Deferred net revenue packaged goods and digital content | \$ 23            | \$ 9        |
| Deferred net revenue other                              | 67               | 43          |
|   | \$ 90            | \$ 52       |

Deferred net revenue, packaged goods and digital content, includes the deferral of the fair value of the online service related to sales of certain online-enabled packaged goods and PC digital downloads and revenue from sales of certain incremental content related to our core subscription services playable only online, which are types of micro-transactions .

Deferred net revenue, other, includes the deferral of subscription revenue, deferrals related to our Switzerland distribution business, advertising revenue, revenue from licensing arrangements and other revenue for which revenue recognition criteria has not been met. The deferred net revenue, other, balance is included in accrued and other current liabilities in our Consolidated Balance Sheets.

**(9) COMMITMENTS AND CONTINGENCIES*****Lease Commitments and Residual Value Guarantees***

We lease certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We are required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and will be required to pay any increases over the base year of these expenses on the remainder of our facilities.

In February 1995, we entered into a build-to-suit lease ( Phase One Lease ) with a third-party lessor for our headquarters facilities in Redwood City, California ( Phase One Facilities ). The Phase One Facilities comprise a total of approximately 350,000 square feet and provide space for sales, marketing, administration and research and development functions. In July 2001, the lessor refinanced the Phase One Lease with Keybank National Association through July 2006. The Phase One Lease expires in January 2039, subject to early termination in the event the underlying financing between the lessor and its lenders is not extended. Subject to certain terms and conditions, we may purchase the Phase One Facilities or arrange for the sale of the Phase One Facilities to a third party.

Pursuant to the terms of the Phase One Lease, we have an option to purchase the Phase One Facilities at any time for a purchase price of \$132 million. In the event of a sale to a third party, if the sale price is less than

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\$132 million, we will be obligated to reimburse the difference between the actual sale price and \$132 million, up to a maximum of \$117 million, subject to certain provisions of the Phase One Lease, as amended.

On May 26, 2006, the lessor extended its loan financing underlying the Phase One Lease with its lenders through July 2007, and on May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor's loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009; otherwise the lease will terminate. We account for the Phase One Lease arrangement as an operating lease in accordance with SFAS No. 13, *Accounting for Leases*, as amended.

In December 2000, we entered into a second build-to-suit lease ( Phase Two Lease ) with Keybank National Association for a five and one-half year term beginning in December 2000 to expand our Redwood City, California headquarters facilities and develop adjacent property ( Phase Two Facilities ). Construction of the Phase Two Facilities was completed in June 2002. The Phase Two Facilities comprise a total of approximately 310,000 square feet and provide space for sales, marketing, administration and research and development functions. Subject to certain terms and conditions, we may purchase the Phase Two Facilities or arrange for the sale of the Phase Two Facilities to a third party.

Pursuant to the terms of the Phase Two Lease, we have an option to purchase the Phase Two Facilities at any time for a purchase price of \$115 million. In the event of a sale to a third party, if the sale price is less than \$115 million, we will be obligated to reimburse the difference between the actual sale price and \$115 million, up to a maximum of \$105 million, subject to certain provisions of the Phase Two Lease, as amended.

On May 26, 2006, the lessor extended the Phase Two Lease through July 2009 subject to early termination in the event the underlying loan financing between the lessor and its lenders is not extended. Concurrently with the extension of the lease, the lessor extended the loan financing underlying the Phase Two Lease with its lenders through July 2007. On May 14, 2007 the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor's loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009, otherwise the lease will terminate. We account for the Phase Two Lease arrangement as an operating lease in accordance with SFAS No. 13, as amended.

We believe that, as of March 31, 2007, the estimated fair values of both properties under these operating leases exceeded their respective guaranteed residual values.

The two lease agreements with Keybank National Association described above require us to maintain certain financial covenants as shown below, all of which we were in compliance with as of March 31, 2007.

| <b>Financial Covenants</b>           | <b>Requirement</b>       | <b>Actual as of<br/>March 31,<br/>2007</b> |
|--------------------------------------|--------------------------|--|
| Consolidated Net Worth (in millions) | equal to or greater than | \$ 2,430      \$ 4,032                     |
| Fixed Charge Coverage Ratio          | equal to or greater than | 3.00      4.41                             |
| Total Consolidated Debt to Capital   | equal to or less than    | 60%      5.8%                              |
| Quick Ratio    Q1 & Q2               | equal to or greater than | 1.00      N/A                              |

|         |                          |      |      |
|---------|--------------------------|------|------|
| Q3 & Q4 | equal to or greater than | 1.75 | 8.92 |
|---------|--------------------------|------|------|

In February 2006, we entered into an agreement with an independent third party to lease a studio facility in Guildford, Surrey, United Kingdom, which commenced in June 2006 and will expire in May 2016. The facility comprises a total of approximately 95,000 square feet, which we use for research and development functions. Our rental obligation under this agreement is approximately \$33 million over the initial ten-year term of the lease.

In June 2004, we entered into a lease agreement, amended in December 2005, with an independent third party for a studio facility in Orlando, Florida. The lease commenced in January 2005 and expires in June 2010, with

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one five-year option to extend the lease term. The campus facilities comprise a total of 140,000 square feet and provide space for research and development functions. Our rental obligation over the initial five-and-a-half year term of the lease is \$15 million.

In July 2003, we entered into a lease agreement with an independent third party (the Landlord) for a studio facility in Los Angeles, California, which commenced in October 2003 and expires in September 2013 with two five-year options to extend the lease term. Additionally, we have options to purchase the property after five and ten years based on the fair market value of the property at the date of sale, a right of first offer to purchase the property upon terms offered by the Landlord, and a right to share in the profits from a sale of the property. Existing campus facilities comprise a total of 243,000 square feet and provide space for research and development functions. Our rental obligation under this agreement is \$50 million over the initial ten-year term of the lease. This commitment is offset by expected sublease income of \$6 million for a sublease to an affiliate of the Landlord of 18,000 square feet of the Los Angeles facility, which commenced in October 2003 and expires in September 2013, with options of early termination by the affiliate after five years and by us after four and five years.

In October 2002, we entered into a lease agreement, with an independent third party for a studio facility in Vancouver, British Columbia, Canada, which commenced in May 2003 and expires in April 2013. We amended the lease in October 2003. The facility comprises a total of approximately 65,000 square feet and provides space for research and development functions. Our rental obligation under this agreement is approximately \$16 million over the initial ten-year term of the lease.

### ***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: FIFA, FIFPRO Foundation, UEFA and FAPL (Football Association Premier League Limited) (professional soccer); NASCAR (stock car racing); National Basketball Association (professional basketball); PGA TOUR and Tiger Woods (professional golf); National Hockey League and NHL Players Association (professional hockey); Warner Bros. (Harry Potter, Batman and Superman); New Line Productions and Saul Zaentz Company (The Lord of the Rings); Red Bear Inc. (John Madden); National Football League Properties and PLAYERS Inc. (professional football); Collegiate Licensing Company (collegiate football, basketball and baseball); Simco (Def Jam); Viacom Consumer Products (The Godfather); ESPN (content in EA SPORTS™ games); Twentieth Century Fox Licensing and Merchandising (The Simpsons); and Marvel Entertainment, Inc. (Marvel character fighting games). 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.

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The following table summarizes our minimum contractual obligations and commercial commitments as of March 31, 2007 (in millions):

| Fiscal Year Ending March 31, | Contractual Obligations |  |           | Commercial Commitments                                  |          |
|------------------------------|-------------------------|--|-----------|---|----------|
|                              | Leases <sup>(1)</sup>   | Developer/<br>Licensor<br>Commitments <sup>(2)</sup> | Marketing | Letter of<br>Credit,<br>Bank and<br>Other<br>Guarantees | Total    |
| 2008                         | \$ 56                   | \$ 200   | \$ 58     | \$ 7  | \$ 321   |
| 2009                         | 54                      | 202  | 31        |   | 287      |
| 2010                         | 39                      | 166  | 31        |   | 236      |
| 2011                         | 27                      | 263  | 31        |   | 321      |
| 2012                         | 23                      | 27   | 17        |   | 67       |
| Thereafter                   | 46                      | 697  | 169       |   | 912      |
| Total                        | \$ 245                  | \$ 1,555   | \$ 337    | \$ 7  | \$ 2,144 |

(1) Lease commitments include contractual rental commitments of \$15 million under real estate leases for unutilized office space resulting from our restructuring activities. These amounts, net of estimated future sub-lease income, were expensed in the periods of the related restructuring and are included in our accrued and other current liabilities reported on our Consolidated Balance Sheets as of March 31, 2007. See Note 6 of the Notes to Consolidated Financial Statements.

(2) Developer/licensor commitments include \$9 million of commitments to developers or licensors that have been recorded in current and long-term liabilities and a corresponding amount in current and long-term assets in our Consolidated Balance Sheets as of March 31, 2007 because payment is not contingent upon performance by the developer or licensor.

The amounts represented in the table above reflect our minimal cash obligations for the respective fiscal years, but do not necessarily represent the periods in which they will be expensed in our Consolidated Financial Statements.

Total rent expense for all operating leases was \$88 million, \$59 million and \$41 million, for the fiscal years ended March 31, 2007, 2006 and 2005, respectively.

***Neowiz Investment***

In April 2007, we expanded our commercial agreements with and made strategic equity investments in Neowiz Corporation and its online gaming subsidiary, Neowiz Games. We purchased stock representing in aggregate approximately 19 percent of each of Neowiz and Neowiz Games for approximately \$108 million. Based in Korea, Neowiz is an online media and gaming company with which we partnered in 2006 to launch *EA Sports FIFA Online*



in Korea.

***Legal proceedings***

On September 14, 2006, we received an informal inquiry from the Securities and Exchange Commission requesting certain documents and information relating to our stock option grant practices from January 1, 1997 through the date of the letter. We have cooperated to date with all matters related to this request. We most recently provided the SEC with information in December 2006. The SEC has not asked for any further information since that time.

We are also subject to claims and litigation arising in the ordinary course of business. We believe that any liability from any reasonably foreseeable disposition of such claims and litigation, individually or in the aggregate, would not have a material adverse effect on our consolidated financial position or results of operations.

**Table of Contents*****Director Indemnity Agreements***

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

**(10) INCOME TAXES**

Our pretax income from operations for the fiscal years ended March 31, 2007, 2006 and 2005 consisted of the following components (in millions):

|  | <b>Year Ended March 31,</b> |             |             |
|--|-----------------------------|-------------|-------------|
|  | <b>2007</b>                 | <b>2006</b> | <b>2005</b> |
| Domestic   | \$ 31                       | \$ 200      | \$ 386      |
| Foreign  | 107                         | 189         | 339         |
| Income before provision for income taxes and minority interest | \$ 138                      | \$ 389      | \$ 725      |

Income tax expense (benefit) for the fiscal years ended March 31, 2007, 2006 and 2005 consisted of (in millions):

|                                  | <b>Current</b> | <b>Deferred</b> | <b>Total</b> |
|----------------------------------|----------------|-----------------|--------------|
| <b>Year Ended March 31, 2007</b> |                |                 |              |
| Federal                          | \$ 98          | \$ (31)         | \$ 67        |
| State                            | 4              | (22)            | (18)         |
| Foreign                          | 14             | 3               | 17           |
|                                  | \$ 116         | \$ (50)         | \$ 66        |
| <b>Year Ended March 31, 2006</b> |                |                 |              |
| Federal                          | \$ 91          | \$ 17           | \$ 108       |
| State                            | 13             | 2               | 15           |
| Foreign                          | 32             | (8)             | 24           |
|                                  | \$ 136         | \$ 11           | \$ 147       |
| <b>Year Ended March 31, 2005</b> |                |                 |              |
| Federal                          | \$ 184         | \$ 4            | \$ 188       |
| State                            | 10             | 11              | 21           |
| Foreign                          | 9              | 3               | 12           |
|                                  | \$ 203         | \$ 18           | \$ 221       |

During fiscal 2006 we recognized a \$73 million reduction in income taxes payable following a U.S. Tax Court ruling regarding the proper allocation of the tax deduction for stock options between U.S. and foreign entities. Although the Tax Court ruling remains subject to appeal, as a precedent, it is relevant to our situation. Accordingly, we released a reserve of \$73 million during fiscal 2006, whereby, we recorded a reduction to our income tax payable and an increase to additional paid-in capital with no impact to net income.

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The differences between the statutory income tax rate and our effective tax rate, expressed as a percentage of income before provision for income taxes and minority interest, for the years ended March 31, 2007, 2006 and 2005 were as follows:

|  | <b>Year Ended March 31,</b> |             |             |
|--|-----------------------------|-------------|-------------|
|  | <b>2007</b>                 | <b>2006</b> | <b>2005</b> |
| Statutory federal tax rate   | 35.0%                       | 35.0%       | 35.0%       |
| State taxes, net of federal benefit  | (0.7%)                      | 0.8%        | 1.4%        |
| Differences between statutory rate and foreign effective tax rate                        | (8.6%)                      | (4.9%)      | (7.3%)      |
| Research and development credits   | (3.0%)                      | (0.2%)      | (0.5%)      |
| Resolution of tax-related matters with tax authorities                                   | (0.2%)                      | (6.1%)      |             |
| Non-deductible acquisition related costs and tax expense from integration restructurings | 7.2%                        | 8.7%        | 0.8%        |
| Change in valuation allowance  | 0.7%                        | 0.4%        | 0.5%        |
| Jobs Act, including state taxes  |                             | 4.3%        |             |
| Non-deductible stock based compensation  | 15.5%                       |             |             |
| Other  | 2.3%                        | (0.4%)      | 0.6%        |
| Effective tax rate   | 48.2%                       | 37.6%       | 30.5%       |

For fiscal 2007, our effective income tax rate was higher than the U.S. statutory rate of 35.0 percent due to a number of factors, including certain non-deductible acquisition-related costs, tax expense from integration restructurings, and certain non-deductible stock based compensation related to SFAS No. 123(R).

Undistributed earnings of our foreign subsidiaries amounted to approximately \$1 billion as of March 31, 2007. Those earnings are considered to be indefinitely reinvested and, accordingly, no U.S. income taxes have been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, we would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to various foreign countries. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

The IRS has examined our U.S. income tax returns for fiscal years 1997 through 2003 and has proposed certain adjustments. We do not agree with these adjustments and are planning to contest them. In addition, during the second quarter of fiscal 2006, we recorded various adjustments for the resolution of certain tax-related matters with foreign tax authorities that resulted in a 6.1 percent rate reduction. While the ultimate resolution of tax audits is uncertain, we expect that the aggregate tax accruals which have been provided should be adequate for the aggregate adjustments that are likely to result for these years.

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The components of the deferred tax assets, net, as of March 31, 2007 and 2006 consisted of (in millions):

|   | <b>As of March 31,</b> |             |
|---|------------------------|-------------|
|   | <b>2007</b>            | <b>2006</b> |
| Deferred tax assets:                            |                        |             |
| Accruals, reserves and other expenses           | \$ 101                 | \$ 103      |
| Tax credit carryforwards                        | 60                     | 40          |
| Unrealized loss on marketable equity securities |                        | 3           |
| Equity compensation                             | 25                     |             |
| Net operating loss & capital loss carryforwards | 8                      | 4           |
| Total   | 194                    | 150         |
| Valuation allowance                             | (5)                    | (6)         |
| Deferred tax asset net of valuation allowance   | 189                    | 144         |
| Deferred tax liabilities:                       |                        |             |
| Depreciation                                    | (41)                   | (40)        |
| Amortization                                    | (21)                   | (27)        |
| State effect on federal taxes                   | (23)                   | (14)        |
| Prepays and other liabilities                   | (3)                    | (6)         |
| Total   | (88)                   | (87)        |
| Deferred tax asset, net                         | \$ 101                 | \$ 57       |

As of March 31, 2007, deferred tax assets, net, of \$84 million were classified as current assets, \$25 million were classified as long-term assets and deferred tax liabilities, net, of \$8 million were classified as long-term liabilities. As of March 31, 2006, deferred tax assets, net, of \$86 million were classified as current assets and deferred tax liabilities, net, of \$29 million were classified as long-term liabilities.

Of the tax credit carryforwards as of March 31, 2007, we have research and development tax credit carryforwards of approximately \$54 million for California purposes, which can be carried forward indefinitely.

In the fourth quarter of fiscal 2006, we repatriated \$375 million of foreign earnings to take advantage of the favorable provisions of the American Jobs Creation Act (the Jobs Act). Under the Jobs Act, the qualifying portion of this repatriation was eligible for a temporary 85 percent dividends received deduction on certain foreign earnings. Accordingly, we recorded tax expense in fiscal 2006 of \$17 million related to this repatriation.

**(11) STOCKHOLDERS EQUITY****(a) Preferred Stock**

As of March 31, 2007 and 2006, we had 10,000,000 shares of preferred stock authorized but unissued. The rights, preferences, and restrictions of the preferred stock may be designated by our Board of Directors without further action by our stockholders.

***(b) Common Stock***

On March 22, 2000, our stockholders authorized the issuance of a new series of common stock, designated as Class B common stock ( Tracking Stock ). The Tracking Stock was intended to reflect the performance of the EA.com online games business segment. As a result of the approval of the Tracking Stock proposal, our existing common stock was re-classified as Class A common stock and was intended to reflect the performance of our core console and PC business segment. With the authorization of the Class B common

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stock, we transferred a portion of our consolidated assets, liabilities, revenue, expenses and cash flows to EA.com Inc., a wholly-owned subsidiary of Electronic Arts.

In March 2003, we consolidated the operations of EA.com back into our core operations in order to increase efficiency, simplify our reporting structure and more directly integrate our online activities into our core console and PC business. As a result, we eliminated dual class reporting starting in fiscal 2004. The majority of outstanding Class B options and warrants not directly held by us were acquired or converted to common stock and warrants.

At our Annual Meeting of Stockholders, held on July 29, 2004, our stockholders approved an amendment and restatement of our Certificate of Incorporation to (1) consolidate our Class A and Class B common stock into a single class of common stock by reclassifying each outstanding share of Class A common stock as one share of common stock and converting each outstanding share of Class B common stock into 0.001 share of common stock, and (2) increase the authorized common stock from 500 million total shares of Class A and Class B common stock combined to 1 billion shares of the newly consolidated single class of common stock.

***(c) Share Repurchase Program***

On October 18, 2004, our Board of Directors authorized a program to repurchase up to an aggregate of \$750 million of our common stock. We completed the repurchase program in September 2005. We repurchased and retired the following (in millions):

|  | <b>Number of<br/>Shares<br/>Repurchased<br/>and Retired</b> | <b>Amount</b> |
|--|---|---------------|
| From the inception of the program through March 31, 2005     | 0.8   | \$ 41         |
| Six months ended September 30, 2005                          | 12.6  | 709           |
| From the inception of the program through September 30, 2005 | 13.4  | \$ 750        |

**(12) STOCK-BASED COMPENSATION AND EMPLOYEE BENEFIT PLANS*****Adoption of SFAS No. 123(R)***

In December 2004, the FASB issued SFAS No. 123 (revised 2004) ( SFAS No. 123(R) ), *Share-Based Payment* . SFAS No. 123(R) requires that the cost resulting from all share-based payment transactions be recognized in the financial statements using a fair-value-based method. In March 2005, the Securities and Exchange Commission ( SEC ) released SAB No. 107, *Share-Based Payment* , which provides the views of the SEC regarding the interaction between SFAS No. 123(R) and certain SEC rules and regulations for public companies. SFAS No. 123(R) replaces SFAS No. 123, *Accounting for Stock-Based Compensation* , as amended, supersedes APB No. 25, *Accounting for Stock Issued to Employees* , and amends SFAS No. 95, *Statement of Cash Flows* .

We adopted SFAS No. 123(R) as of April 1, 2006 and have applied the provisions of SAB No. 107 to our adoption of SFAS No. 123(R). SFAS No. 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. We elected to use the modified prospective transition method of adoption which requires that compensation expense be recognized in the financial statements for all awards granted

after the date of adoption as well as for existing awards for which the requisite service has not been rendered as of the date of adoption. Accordingly, prior periods are not restated for the effect of SFAS No. 123(R).

Prior to April 1, 2006, we accounted for stock-based awards to employees using the intrinsic value method in accordance with APB No. 25 and adopted the disclosure-only provisions of SFAS No. 123, as amended. Also, as required by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, we provided pro forma net income (loss) and net income (loss) per share disclosures for stock-based awards as if the fair-value-based method defined in SFAS No. 123 had been applied.



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*Valuation and Expense Recognition.* Upon adoption of SFAS No. 123(R), we began to recognize compensation costs for stock-based payment transactions to employees based on their grant-date fair value over the service period for which such awards are expected to vest. The fair value of restricted stock units is determined based on the quoted price of our common stock on the date of grant. The fair value of stock options and stock purchase rights granted pursuant to our employee stock purchase plan is determined using the Black-Scholes valuation model, which was the same model we previously used for the pro forma information required under SFAS No. 123. The determination of fair value is affected by our stock price as well as assumptions regarding subjective and complex variables such as expected employee exercise behavior and our expected stock price volatility over the expected term of the award. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. The Black-Scholes valuation model requires us to estimate the following key assumptions:

*Risk-free interest rate.* 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.* We use our historical stock price volatility and consider the implied volatility computed based on the price of short-term options publicly traded on our common stock for our expected volatility assumption.

*Expected term.* The expected term represents the weighted-average period the stock options are expected to remain outstanding. The expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.

*Expected dividends.*

The assumptions used in the Black-Scholes valuation model to value our option grants and employee stock purchase plan during the fiscal year ended March 31, 2007 were as follows:

|                             | <b>Stock Option<br/>Grants</b> | <b>Employee Stock Purchase<br/>Plan</b> |
|-----------------------------|--------------------------------|---|
| Risk-free interest rate     | 4.5 - 5.1%                     | 3.7 - 5.1%                              |
| Expected volatility         | 31 - 46%                       | 28 - 36%                                |
| Weighted-average volatility | 35%                            | 33%                                     |
| Expected term               | 4.2 years                      | 6 - 12 months                           |
| Expected dividends          | None                           | None                                    |

Prior to our adoption of SFAS No. 123(R), we valued our stock options based on the multiple-award valuation method and recognized the expense using the accelerated approach over the requisite service period. In conjunction with our adoption of SFAS No. 123(R), we changed our method of recognizing our stock-based compensation expense for post-adoption grants to the straight-line approach over the requisite service period; however, we continue to value our stock options based on the multiple-award valuation method.

As required by SFAS No. 123(R), employee stock-based compensation expense recognized during the fiscal year ended March 31, 2007 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. In subsequent periods, if actual forfeitures differ from those estimates, an adjustment to stock-based compensation expense will be recognized at that time.



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The following table summarizes stock-based compensation expense resulting from stock options, restricted stock, restricted stock units and our employee stock purchase plan included in our Consolidated Statements of Operations (in millions):

|  | <b>Year Ended March 31,</b> |             |             |
|--|-----------------------------|-------------|-------------|
|  | <b>2007</b>                 | <b>2006</b> | <b>2005</b> |
| Cost of goods sold                           | \$ 2                        | \$          | \$          |
| Marketing and sales                          | 17                          |             |             |
| General and administrative                   | 37                          | 1           |             |
| Research and development                     | 77                          | 2           | 6           |
| Stock-based compensation expense             | 133                         | 3           | 6           |
| Benefit from income taxes                    | (26)                        | (1)         | (2)         |
| Stock-based compensation expense, net of tax | \$ 107                      | \$ 2        | \$ 4        |

As of March 31, 2007, our total unrecognized compensation cost related to stock options was \$153 million and is expected to be recognized over a weighted-average service period of 1.6 years. As of March 31, 2007, our total unrecognized compensation cost related to restricted stock and restricted stock units was \$82 million and is expected to be recognized over a weighted-average service period of 2.3 years.

The adoption of SFAS No. 123(R), using the fair value method, had the following adverse impact on our pre-tax income, net income, and basic and diluted net income per share as compared to what would have been reported under APB No. 25 using the intrinsic value method, which was the method used prior to our adoption for the year ended March 31, 2007 (in millions, except per share data):

|  | <b>Fair Value<br/>Method<br/>(As<br/>Reported)</b> | <b>Intrinsic<br/>Value<br/>Method</b> | <b>Adverse<br/>Impact<br/>of Change</b> |
|--|--|---------------------------------------|---|
| Income before provision for income taxes and minority interest | \$ 138   | \$ 237                                | \$ (99)                                 |
| Net income   | \$ 76  | \$ 153                                | \$ (77)                                 |
| Net income per share:  |  |                                       |   |
| Basic  | \$ 0.25  | \$ 0.50                               | \$ (0.25)                               |
| Diluted  | \$ 0.24  | \$ 0.48                               | \$ (0.24)                               |

*APIC Pool.* In November 2005, the FASB issued FASB Staff Position ( FSP ) No. Financial Accounting Standard ( FAS ) 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* . The FASB allows for a practical exception in calculating the additional paid-in capital pool ( APIC pool ) of excess tax benefits upon adoption that is available to absorb tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R). For employee stock-based compensation awards that are outstanding upon adoption of SFAS No. 123(R), the alternative transition method provides a simplified method to establish the beginning balance of the APIC pool related to the tax effects of employee stock-based compensation. It also provides a simplified method

to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows for the tax effects of employee stock-based compensation awards. We elected to adopt the alternative transition method provided in FSP No. FAS 123(R)-3 for calculating the tax effects of stock-based compensation pursuant to SFAS No. 123(R).

*Cash Flow Impact.* Prior to our adoption of SFAS No. 123(R), cash retained as a result of tax deductions relating to stock-based compensation was presented in operating cash flows along with other tax cash flows. SFAS No. 123(R) requires a classification change in the statement of cash flows. As a result, tax benefits relating to excess stock-based compensation deductions, which had been included in operating cash flow activities, are now presented as financing cash flow activities (total cash flows remain unchanged). For the fiscal year ended March 31, 2007, we recognized \$34 million of tax benefit from the exercise of stock options; of this amount, \$36 million of excess tax benefit related to stock-based compensation reported in financing activities. For the fiscal year ended March 31, 2006, we recognized \$133 million of tax benefit from exercise of stock options reported in operating activities.

**Table of Contents*****Summary of Plans and Plan Activity*****Stock Option Plans**

Our 2000 Equity Incentive Plan (the "Equity Plan") allows us to grant options to purchase our common stock, restricted stock, restricted stock units and stock appreciation rights to our employees, officers and directors. Pursuant to the Equity Plan, incentive stock options may be granted to employees and officers and non-qualified options may be granted to employees, officers and directors, at not less than 100 percent of the fair market value on the date of grant.

We also have options outstanding that were granted under (1) the Criterion Software Limited Approved Share Option Scheme (the "Criterion Plan"), which we assumed in connection with our acquisition of Criterion, and (2) the JAMDAT Mobile Inc. Amended and Restated 2000 Stock Incentive Plan and the JAMDAT Mobile Inc. 2004 Equity Incentive Plan (collectively, the "JAMDAT Plans"), which we assumed in connection with our acquisition of JAMDAT.

Options granted under the Equity Plan generally expire ten years from the date of grant and are generally exercisable as to 24 percent of the shares after 12 months, and then ratably over the following 38 months. All options granted under the Criterion Plan were exercisable as of March 31, 2005 and expire in January 2012. Certain assumed options granted under the JAMDAT Plans have acceleration rights upon the occurrence of various triggering events. Otherwise, the terms of the JAMDAT Plans are similar to our Equity Plan.

The following table summarizes our stock option activity for the fiscal year ended March 31, 2007:

|  | <b>Options<br/>(in<br/>thousands)</b> | <b>Weighted-<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term (in<br/>years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(in<br/>millions)</b> |
|--|---------------------------------------|---|--|--|
| Outstanding as of March 31, 2006                   | 40,882                                | \$ 40.02  |  |  |
| Activity for the fiscal year ended March 31, 2007: |                                       |   |  |  |
| Granted  | 4,373                                 | 51.11   |  |  |
| Exercised  | (4,881)                               | 28.14   |  |  |
| Forfeited, cancelled or expired                    | (2,731)                               | 53.20   |  |  |
| Exchange Program (cancelled)                       | (1,779)                               | 64.92   |  |  |
| Outstanding as of March 31, 2007                   | 35,864                                | \$ 40.75  | 6.2  | \$ 422   |

Additional stock option-related information as of March 31, 2007:

| <b>Options</b> | <b>Weighted-<br/>Average</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual</b> | <b>Aggregate</b> |
|----------------|------------------------------|--|------------------|
|----------------|------------------------------|--|------------------|

|                             | (in<br>thousands) | Exercise<br>Price | Term (in<br>years) | Intrinsic<br>Value<br>(in millions) |
|-----------------------------|-------------------|-------------------|--------------------|-------------------------------------|
| Vested and expected to vest | 33,463            | \$ 39.82          | 6.0                | \$ 421                              |
| Exercisable                 | 23,479            | \$ 33.99          | 5.1                | \$ 411                              |

A total of 15 million shares were available for grant under our Equity Plan as of March 31, 2007, of which no more than 13 million shares were eligible for grant in the form of restricted stock or restricted stock units.

The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price as of March 31, 2007 which would have been received by the option holders had all option holders exercised their options as of that date. We issue new common stock from our authorized shares upon the exercise of stock options.

The weighted-average grant-date fair value of stock options granted during fiscal years 2007, 2006 and 2005 was \$17.75, \$15.19 and \$17.70, respectively. The total intrinsic value of options exercised during fiscal years 2007, 2006 and 2005 was \$120 million, \$199 million and \$307 million, respectively. The total fair value

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(determined at the grant date) of shares vested during fiscal years 2007, 2006 and 2005 was \$105 million, \$150 million and \$130 million, respectively.

The following table summarizes outstanding and exercisable options as of March 31, 2007:

| Range of<br>Exercise Prices | Number<br>of Shares<br>(in<br>thousands) | Options Outstanding  |   | Potential<br>Dilution | Options Exercisable                      |   |                       |
|-----------------------------|--|--|---|-----------------------|--|---|-----------------------|
|                             |  | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (in<br>years) | Weighted-<br>Average<br>Exercise<br>Price |                       | Number<br>of Shares<br>(in<br>thousands) | Weighted-<br>Average<br>Exercise<br>Price | Potential<br>Dilution |
| \$ 0.53-\$19.99             | 3,681                                    | 1.72   | \$ 12.42                                  | 1.2%                  | 3,675                                    | \$ 12.44                                  | 1.2%                  |
| 20.00-29.99                 | 6,427                                    | 4.26   | 25.37                                     | 2.1%                  | 6,422                                    | 25.37                                     | 2.0%                  |
| 30.00-39.99                 | 5,487                                    | 5.35   | 31.83                                     | 1.8%                  | 5,293                                    | 31.73                                     | 1.7%                  |
| 40.00-49.99                 | 5,768                                    | 6.87   | 46.88                                     | 1.8%                  | 4,024                                    | 47.19                                     | 1.3%                  |
| 50.00-59.99                 | 11,641                                   | 8.37   | 53.62                                     | 3.7%                  | 2,903                                    | 54.02                                     | 0.9%                  |
| 60.00-65.93                 | 2,860                                    | 7.82   | 64.17                                     | 0.9%                  | 1,162                                    | 64.37                                     | 0.4%                  |
| \$ 0.53-\$65.93             | 35,864                                   | 6.20   | \$ 40.75                                  | 11.5%                 | 23,479                                   | \$ 33.99                                  | 7.5%                  |

Potential dilution is computed by dividing the options in the related range of exercise prices by the shares of common stock issued and outstanding as of March 31, 2007 (311 million shares).

**Restricted Stock Units and Restricted Stock**

We grant restricted stock units and restricted stock (collectively referred to as "restricted stock rights") under our Equity Plan to employees worldwide. Restricted stock units entitle holders to receive shares of common stock at the end of a specified period of time. Upon vesting, the equivalent number of common shares are typically issued net of tax withholdings. Restricted stock is issued and outstanding upon grant; however, restricted stock award holders are restricted from selling the shares until they vest. Upon vesting, we will typically withhold shares to satisfy tax withholding requirements. Restricted stock rights are subject to forfeiture and transfer restrictions. Vesting for restricted stock rights is based on the holders' continued employment with us. If the vesting conditions are not met, unvested restricted stock rights will be forfeited. Generally, our restricted stock rights vest according to one of the following vesting schedules:

100 percent after one year;

Three-year vesting with 25 percent cliff vesting at the end of each of the first and second years, and 50 percent cliff vesting at the end of the third year; or

Four-year vesting with 25 percent cliff vesting at the end of each year.

The following table summarizes our restricted stock rights activity for the fiscal year ended March 31, 2007:

|  | <b>Restricted<br/>Stock<br/>Rights<br/>(In thousands)</b> | <b>Weighted-<br/>Average Grant<br/>Date Fair Value</b> |
|--|---|--|
| Balance as of March 31, 2006                       | 655   | \$ 52.21   |
| Activity for the fiscal year ended March 31, 2007: |   |  |
| Granted  | 1,362   | 52.31  |
| Exchange Program (granted)                         | 445   | 54.22  |
| Vested   | (189)   | 52.60  |
| Forfeited  | (139)   | 52.74  |
| Balance as of March 31, 2007                       | 2,134   | \$ 52.62   |

The weighted-average grant date fair value of restricted stock rights is based on the quoted market value of our common stock on the date of grant. The weighted-average fair value of restricted stock rights granted during fiscal years 2007 and 2006 was \$52.31 and \$52.21, respectively. There were no restricted stock rights



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granted during fiscal year 2005. The total grant date fair value of restricted stock rights that vested during fiscal year 2007 was \$10 million. There were no restricted stock rights that vested during fiscal years 2006 and 2005.

At our Annual Meeting of Stockholders, held on July 27, 2006, our stockholders approved amendments to the Equity Plan to (1) increase by 11 million shares the limit on the total number of shares underlying awards of restricted stock and restricted stock units that may be granted under the Equity Plan from 4 million to 15 million shares, and (2) to limit the number of shares subject to options surrendered and cancelled in the Exchange Program that will again become available for issuance under the Equity Plan to 7 million plus the number of shares necessary for the issuance of the restricted stock rights to be granted in connection with the Exchange Program.

## **Exchange Program**

At our Annual Meeting of Stockholders, held on July 27, 2006, our stockholders approved a voluntary program (the Exchange Program) to permit our eligible employees to exchange certain outstanding stock options that were significantly underwater (that is, the exercise price is greater than the trading price of our common stock) for a lesser number of shares of restricted stock rights to be granted under the Equity Plan. The Exchange Program commenced on August 16, 2006 and ended on September 15, 2006.

The Exchange Program was open to all of our employees who were employed by us on August 16, 2006 and were still employed on the date on which the tendered options were cancelled and restricted stock rights were granted except (1) our named executive officers identified in our 2006 Annual Proxy Statement, (2) members of our Board of Directors, and (3) employees who resided in China, Belgium and Denmark, due to restrictions arising under the local laws of those countries.

Option grants that had an exercise price per share equal to or greater than the threshold price were considered eligible options. The threshold price was \$61.66, which represented 125 percent of the five-business day average closing price of our common stock prior to August 16, 2006, as reported on the NASDAQ Global Select Market, which was \$49.324. Due to local tax law restrictions, certain options granted to United Kingdom employees were not eligible for exchange. Excluded from the offer were any option grants for fewer than five shares.

Eligible options exchanged under the program were cancelled in exchange for restricted stock rights following the expiration of the offer. For restricted stock rights issued in exchange for unvested options, compensation expense is recorded based on the grant-date fair value of the options tendered over their remaining original vesting period of those options. Restricted stock rights issued in connection with the Exchange Program vest over a period of up to three years.

The Exchange Program resulted in options to purchase approximately 1,779,000 shares of our common stock being exchanged for approximately 445,000 shares of restricted stock rights. In connection with the Exchange Program, a net total of 1,334,000 shares of common stock were returned to the Equity Plan for future issuance.

## **Employee Stock Purchase Plan**

Since September 1991, we have offered our employees the ability to participate in an employee stock purchase plan. Pursuant to our current plan, the 2000 Employee Stock Purchase Plan (ESPP), eligible employees may authorize payroll deductions of up to 10 percent of their compensation to purchase shares at 85 percent of the lower of the fair market value of the common stock on the date of commencement of the offering or on the last day of each six-month purchase period.

At our Annual Meeting of Stockholders, held on July 27, 2006, our stockholders approved an amendment to the ESPP to increase the number of shares authorized under the ESPP by 1.5 million. As of March 31, 2007, we had 3 million shares of common stock reserved for future issuance under the ESPP.

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Information related to stock issuances under the ESPP are as follows:

|  | 2007                | Year Ended March 31,<br>2006 | 2005                |
|--|---------------------|------------------------------|---------------------|
| Number of shares issued (in thousands)                   | 705                 | 625                          | 624                 |
| Exercise prices for purchase rights                      | \$ 43.04 to \$43.10 | \$ 42.31 to \$47.95          | \$ 38.14 to \$51.35 |
| Estimated weighted-average fair value of purchase rights | \$16.51             | \$15.42                      | \$13.96             |

We issue new common stock out of the ESPP's pool of authorized shares. The fair value above was estimated on the date of grant using the Black-Scholes option-pricing model assumptions described in this note under the headings Adoption of SFAS No. 123(R) and Pre-SFAS No. 123(R) Pro Forma Accounting Disclosures.

***Pre-SFAS No. 123(R) Pro Forma Accounting Disclosures***

Prior to the adoption of SFAS No. 123(R), we accounted for stock-based awards to employees using the intrinsic value method in accordance with APB No. 25 and adopted the disclosure-only provisions of SFAS No. 123, as amended.

Had compensation cost for our stock-based compensation plans been measured based on the estimated fair value at the grant dates in accordance with the provisions of SFAS No. 123, as amended, we estimate that our reported net income and net income per share would have been the pro forma amounts indicated below. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following weighted-average assumptions were used for grants made under our stock-based compensation plans in fiscal 2006 and 2005:

|   | Year Ended<br>March 31, |      |
|---|-------------------------|------|
|   | 2006                    | 2005 |
| Risk-free interest rate                                   | 4.3%                    | 3.5% |
| Expected volatility                                       | 33%                     | 36%  |
| Expected term of stock options (in years)                 | 3.2                     | 3.3  |
| Expected term of employee stock purchase plan (in months) | 6                       | 6    |
| Expected dividends  | None                    | None |

Our calculations were based on a multiple-award valuation method and forfeitures were recognized when they occurred.

|                                      | Year Ended<br>March 31, |        |
|--------------------------------------|-------------------------|--------|
| (In millions, except per share data) | 2006                    | 2005   |
| Net income:                          |                         |        |
| As reported                          | \$ 236                  | \$ 504 |

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|   |         |         |
|---|---------|---------|
| Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects | (85)    | (83)    |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects                                  | 2       | 4       |
| Pro forma   | \$ 153  | \$ 425  |
| Net income per share:   |         |         |
| As reported basic   | \$ 0.78 | \$ 1.65 |
| Pro forma basic   | \$ 0.50 | \$ 1.39 |
| As reported diluted   | \$ 0.75 | \$ 1.59 |
| Pro forma diluted   | \$ 0.49 | \$ 1.35 |

**Table of Contents*****401(k) Plan and Registered Retirement Savings Plan***

We have a 401(k) plan covering substantially all of our U.S. employees, and a Registered Retirement Savings Plan covering substantially all of our Canadian employees. These plans permit us to make discretionary contributions to employees' accounts based on our financial performance. We contributed \$3 million, \$2 million and \$4 million to these plans in fiscal 2007, 2006 and 2005, respectively.

**(13) COMPREHENSIVE INCOME**

SFAS No. 130, *Reporting Comprehensive Income*, requires classifying items of other comprehensive income (loss) by their nature in a financial statement and displaying the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a balance sheet. Accumulated other comprehensive income primarily includes foreign currency translation adjustments, and the net-of-tax amounts for unrealized gains (losses) on investments and unrealized gains (losses) on derivatives designated as cash flow hedges. Foreign currency translation adjustments are not adjusted for income taxes as they relate to indefinite investments in non-U.S. subsidiaries.

The change in the components of accumulated other comprehensive income is summarized as follows (in millions):

|                                   | <b>Foreign<br/>Currency<br/>Translation<br/>Adjustment</b> | <b>Unrealized<br/>Gains<br/>(Losses) on<br/>Investments,<br/>net</b> | <b>Unrealized<br/>Gains<br/>(Losses)<br/>on<br/>Derivative<br/>Instruments,<br/>net</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income</b> |
|-----------------------------------|--|--|---|---|
| Balances as of March 31, 2004     | \$ 20  | \$   | \$  | \$ 20   |
| Other comprehensive income        | 10   | 26   |   | 36  |
| Balances as of March 31, 2005     | 30   | 26   |   | 56  |
| Other comprehensive income (loss) | (10)   | 37   |   | 27  |
| Balances as of March 31, 2006     | 20   | 63   |   | 83  |
| Other comprehensive income        | 23   | 188  |   | 211   |
| Balances as of March 31, 2007     | \$ 43  | \$ 251   | \$  | \$ 294  |

The change in unrealized gains (losses) on investments is shown net of taxes of less than \$1 million in fiscal 2007, \$0 in fiscal 2006, and \$1 million in fiscal 2005.

During fiscal 2007, we realized substantially all gains and losses outstanding from our derivative instruments. During fiscal 2006, we realized all gains and losses outstanding from our derivative instruments. In fiscal 2005, activity related to derivatives was not material. See Note 3 of the Notes to Consolidated Financial Statements.

**(14) STAFF ACCOUNTING BULLETIN No. 108**

In September 2006, the SEC issued SAB No. 108, *Financial Statements – Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB No. 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. We adopted SAB No. 108 in fiscal 2007.

In accordance with SAB No. 108, we considered both the "rollover" approach, which quantifies misstatements originating in the current year income statement and the "iron curtain" approach which quantifies

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misstatements based on the effects of correcting the misstatements existing in the balance sheet at the end of the reporting period. Prior to our application of the guidance in SAB No. 108, we used the rollover approach. We elected to recognize the cumulative effect of adoption as adjustments to assets and liabilities as of the beginning of fiscal 2007 and the offsetting adjustment to the opening balance of retained earnings for fiscal 2007.

***Property and Equipment Capitalization Adjustment***

We adjusted the beginning retained earnings balance for fiscal 2007 related to the correction of our historical accounting treatment of certain property and equipment purchases. We capitalize property and equipment purchases when certain quantitative thresholds are met; otherwise, they are expensed when purchased. Our internal review of our capitalization thresholds suggested that certain property and equipment should have been capitalized and not expensed. We believe the impact of the property and equipment capitalization errors were not material to prior years income statements under the rollover approach. However, under the iron curtain method, the cumulative property and equipment capitalization errors were material to our fiscal 2007 financial statements and, therefore, we recognized the following cumulative adjustment to our fiscal 2007 opening balance sheet (in millions):

|   |       |
|---|-------|
| Increase in property and equipment, net     | \$ 13 |
| Increase in deferred income tax liabilities | 3     |
| Increase in retained earnings               | 10    |

The impact on retained earnings is comprised of the following amounts (in millions):

|                              | <b>Fiscal 2007<br/>Beginning<br/>Balance<br/>Adjustment</b> | <b>Year Ended March 31,</b> |             |             |
|------------------------------|---|-----------------------------|-------------|-------------|
|                              |   | <b>2006</b>                 | <b>2005</b> | <b>2004</b> |
| Increase in operating income | \$ 13   | \$                          | \$ 10       | \$ 3        |
| Tax effect                   | (3)   |                             | (2)         | (1)         |
| Increase in net income       | \$ 10   | \$                          | \$ 8        | \$ 2        |

***Business Tax Expense Adjustment***

We adjusted the beginning retained earnings balance for fiscal 2007 related to the correction of our historical accounting of certain business tax expenses. Our internal review indicated that we had inadvertently not accrued for approximately \$7 million in probable business tax obligations related to prior years. We believe the impact of these adjustments were not material to prior years income statements under the rollover approach. However, under the iron curtain method, the cumulative business tax expense adjustments were material to our fiscal 2007 financial statements and, therefore, we recognized the following cumulative adjustment to our fiscal 2007 opening balance sheet (in millions):

|   |      |
|---|------|
| Increase in accrued and other liabilities   | \$ 7 |
| Decrease in deferred income tax liabilities | (3)  |
| Decrease in retained earnings               | (4)  |

The impact on retained earnings is comprised of the following amounts (in millions):

|                              | <b>Fiscal 2007<br/>Beginning<br/>Balance<br/>Adjustment</b> | <b>Year Ended March 31,</b> |             |             |             |
|------------------------------|---|-----------------------------|-------------|-------------|-------------|
|                              |   | <b>2006</b>                 | <b>2005</b> | <b>2004</b> | <b>2003</b> |
| Decrease in operating income | \$ (7)  | \$ (3)                      | \$ (2)      | \$ (1)      | \$ (1)      |
| Tax effect                   | 3   | 1                           | 1           | 1           |             |
| Decrease in net income       | \$ (4)  | \$ (2)                      | \$ (1)      | \$          | \$ (1)      |



**Table of Contents****(15) INTEREST AND OTHER INCOME, NET**

Interest and other income, net, for the years ended March 31, 2007, 2006 and 2005 consisted of (in millions):

|  | <b>Year Ended March 31,</b> |             |             |
|--|-----------------------------|-------------|-------------|
|  | <b>2007</b>                 | <b>2006</b> | <b>2005</b> |
| Interest income, net                             | \$ 104                      | \$ 75       | \$ 45       |
| Net gain (loss) on foreign currency transactions | 10                          | (1)         | 25          |
| Net loss on foreign currency forward contracts   | (13)                        | (3)         | (23)        |
| Ineffective portion of hedging                   |                             |             | (1)         |
| Other income (expense), net                      | (2)                         | (7)         | 10          |
| Interest and other income, net                   | \$ 99                       | \$ 64       | \$ 56       |

**(16) NET INCOME 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 employee stock purchase plan, warrants and other convertible securities using the treasury stock method.

|   | <b>Year Ended March 31,</b> |             |             |
|---|-----------------------------|-------------|-------------|
| (In millions, except per share amounts)           | <b>2007</b>                 | <b>2006</b> | <b>2005</b> |
| Net income  | \$ 76                       | \$ 236      | \$ 504      |
| Shares used to compute net income per share:      |                             |             |             |
| Weighted-average common stock outstanding basic   | 308                         | 304         | 305         |
| Dilutive potential common shares                  | 9                           | 10          | 13          |
| Weighted-average common stock outstanding diluted | 317                         | 314         | 318         |
| Net income per share:                             |                             |             |             |
| Basic   | \$ 0.25                     | \$ 0.78     | \$ 1.65     |
| Diluted   | \$ 0.24                     | \$ 0.75     | \$ 1.59     |

Options to purchase 16 million, 7 million and 1 million shares of common stock were excluded from the above computation of weighted-average common stock for Diluted EPS for the fiscal years ended March 31, 2007, 2006 and 2005, respectively, as their inclusion would have been antidilutive. For fiscal 2007, 2006 and 2005, the weighted-average exercise price of these options was \$55.84, \$63.34 and \$63.63 per share, respectively.

**(17) RELATED PERSON TRANSACTION**

On June 24, 2002, we hired Warren C. Jenson as our Executive Vice President, Chief Financial and Administrative Officer and agreed to loan him \$4 million to be forgiven over four years based on his continuing employment. The loan did not bear interest. On June 24, 2004, pursuant to the terms of the loan agreement, we forgave \$2 million of the loan and provided Mr. Jenson approximately \$1.6 million to offset the tax implications of the forgiveness. On June 24, 2006, pursuant to the terms of the loan agreement, we forgave the remaining outstanding loan balance of \$2 million. No additional funds were provided to offset the tax implications of the forgiveness of the \$2 million balance.

**(18) SEGMENT INFORMATION**

Our reporting segments are 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,

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to evaluate segment performance; the availability of separate financial information; and overall materiality considerations.

We manage our business primarily based on geographical performance. Accordingly, our combined global publishing organizations represent our reportable segment, our Publishing segment, due to their similar economic characteristics, products and distribution methods. Publishing refers to the manufacturing, marketing, advertising and distribution of products developed or co-developed by us, or distribution of certain third-party publishers' products through our co-publishing and distribution program.

The following table summarizes the financial performance of our Publishing segment and a reconciliation of our Publishing segment's profit to our consolidated operating income (in millions):

|  | <b>Year Ended March 31,</b> |             |             |
|--|-----------------------------|-------------|-------------|
|  | <b>2007</b>                 | <b>2006</b> | <b>2005</b> |
| Publishing segment:                              |                             |             |             |
| Net revenue                                      | \$ 2,948                    | \$ 2,927    | \$ 3,125    |
| Depreciation and amortization                    | (22)                        | (19)        | (25)        |
| Other expenses                                   | (1,685)                     | (1,690)     | (1,613)     |
| Publishing segment profit                        | 1,241                       | 1,218       | 1,487       |
| Reconciliation to consolidated operating income: |                             |             |             |
| Other:   |                             |             |             |
| Net revenue                                      | 143                         | 24          | 4           |
| Depreciation and amortization                    | (145)                       | (76)        | (50)        |
| Other expenses                                   | (1,200)                     | (841)       | (772)       |
| Consolidated operating income                    | \$ 39                       | \$ 325      | \$ 669      |

Publishing segment profit differs from consolidated operating income primarily due to the exclusion of substantially all of our research and development expense as well as certain corporate functional costs that are not allocated to the publishing organizations. Our Chief Executive Officer reviews assets on a consolidated basis and not on a segment basis.

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Information about our total net revenue by platform for the fiscal years ended March 31, 2007, 2006 and 2005 is presented below (in millions):

|  | <b>Year Ended March 31,</b> |             |             |
|--|-----------------------------|-------------|-------------|
|  | <b>2007</b>                 | <b>2006</b> | <b>2005</b> |
| Consoles                                     |                             |             |             |
| PlayStation 2                                | \$ 886                      | \$ 1,127    | \$ 1,330    |
| Xbox 360                                     | 480                         | 140         |             |
| Xbox   | 157                         | 400         | 516         |
| PLAYSTATION 3                                | 94                          |             |             |
| Wii  | 65                          |             |             |
| Nintendo GameCube                            | 60                          | 135         | 212         |
| Other Consoles                               |                             | 1           | 10          |
| Total Consoles                               | 1,742                       | 1,803       | 2,068       |
| PC   | 498                         | 418         | 531         |
| Mobility                                     |                             |             |             |
| PSP  | 258                         | 252         | 18          |
| Cellular Handsets                            | 140                         | 19          |             |
| Nintendo DS                                  | 104                         | 67          | 23          |
| Game Boy Advance and Game Boy Color          | 38                          | 55          | 77          |
| Total Mobility                               | 540                         | 393         | 118         |
| Co-publishing and Distribution               | 175                         | 213         | 283         |
| Internet Services, Licensing and Other       |                             |             |             |
| Subscription Services                        | 79                          | 61          | 55          |
| Licensing, Advertising and Other             | 57                          | 63          | 74          |
| Total Internet Services, Licensing and Other | 136                         | 124         | 129         |
| Total Net Revenue                            | \$ 3,091                    | \$ 2,951    | \$ 3,129    |

Information about our operations in North America, Europe and Asia as of and for the fiscal years ended March 31, 2007, 2006 and 2005 is presented below (in millions):

|   | <b>North<br/>America</b> | <b>Europe</b> | <b>Asia</b> | <b>Total</b> |
|---|--------------------------|---------------|-------------|--------------|
| <b><u>Year ended March 31, 2007</u></b> |                          |               |             |              |
| Net revenue from unaffiliated customers | \$ 1,666                 | \$ 1,261      | \$ 164      | \$ 3,091     |
| Long-lived assets                       | 1,150                    | 267           | 11          | 1,428        |
| <b><u>Year ended March 31, 2006</u></b> |                          |               |             |              |
| Net revenue from unaffiliated customers | \$ 1,584                 | \$ 1,174      | \$ 193      | \$ 2,951     |

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|                   |       |     |   |       |
|-------------------|-------|-----|---|-------|
| Long-lived assets | 1,061 | 203 | 7 | 1,271 |
|-------------------|-------|-----|---|-------|

Year ended March 31, 2005

|   |          |          |        |          |
|---|----------|----------|--------|----------|
| Net revenue from unaffiliated customers | \$ 1,665 | \$ 1,284 | \$ 180 | \$ 3,129 |
| Long-lived assets                       | 314      | 218      | 10     | 542      |

Substantially all of our North America net revenue is generated in the United States.

Our direct sales to Wal-Mart Stores, Inc. represented approximately 13 percent of total net revenue in both fiscal 2007 and 2006 and 14 percent of total net revenue in fiscal 2005. Our direct sales to GameStop Corp. represented approximately 12 percent of total net revenue in fiscal 2007.

**Table of Contents****(19) QUARTERLY FINANCIAL AND MARKET INFORMATION (UNAUDITED)**

| (In millions, except per share data)   |  | Quarter Ended       |                   |                    |                     | Year     |
|--|--|---------------------|-------------------|--------------------|---------------------|----------|
|  |  | June 30             | Sept. 30          | Dec. 31            | March 31            | Ended    |
| <b><u>Fiscal 2007 Consolidated</u></b> |  |                     |                   |                    |                     |          |
| Net revenue                            |  | \$ 413              | \$ 784            | \$ 1,281           | \$ 613              | \$ 3,091 |
| Gross profit                           |  | 245                 | 445               | 811                | 378                 | 1,879    |
| Operating income (loss)                |  | (119)               | 14                | 215                | (71)                | 39       |
| Net income (loss)                      |  | (81) <sup>(a)</sup> | 22 <sup>(b)</sup> | 160 <sup>(c)</sup> | (25) <sup>(d)</sup> | 76       |
| <b><u>Common Stock</u></b>             |  |                     |                   |                    |                     |          |
| Net income (loss) per share basic      |  | \$ (0.26)           | \$ 0.07           | \$ 0.52            | \$ (0.08)           | \$ 0.25  |
| Net income (loss) per share diluted    |  | \$ (0.26)           | \$ 0.07           | \$ 0.50            | \$ (0.08)           | \$ 0.24  |
| Common stock price per share           |  |                     |                   |                    |                     |          |
| High                                   |  | \$ 57.80            | \$ 57.74          | \$ 59.85           | \$ 54.43            | \$ 59.85 |
| Low                                    |  | \$ 39.99            | \$ 41.37          | \$ 50.21           | \$ 47.96            | \$ 39.99 |
| <b><u>Fiscal 2006 Consolidated</u></b> |  |                     |                   |                    |                     |          |
| Net revenue                            |  | \$ 365              | \$ 675            | \$ 1,270           | \$ 641              | \$ 2,951 |
| Gross profit                           |  | 214                 | 391               | 768                | 397                 | 1,770    |
| Operating income (loss)                |  | (96)                | 49                | 347                | 25                  | 325      |
| Net income (loss)                      |  | (58) <sup>(e)</sup> | 51 <sup>(f)</sup> | 259 <sup>(g)</sup> | (16) <sup>(h)</sup> | 236      |
| <b><u>Common Stock</u></b>             |  |                     |                   |                    |                     |          |
| Net income (loss) per share basic      |  | \$ (0.19)           | \$ 0.17           | \$ 0.86            | \$ (0.05)           | \$ 0.78  |
| Net income (loss) per share diluted    |  | \$ (0.19)           | \$ 0.16           | \$ 0.83            | \$ (0.05)           | \$ 0.75  |
| Common stock price per share           |  |                     |                   |                    |                     |          |
| High                                   |  | \$ 59.83            | \$ 63.12          | \$ 61.97           | \$ 58.59            | \$ 63.12 |
| Low                                    |  | \$ 47.45            | \$ 55.22          | \$ 51.04           | \$ 50.14            | \$ 47.45 |

(a) Net loss includes restructuring charges of \$6 million, pre-tax.

(b) Net income includes acquired in-process technology of \$2 million and restructuring charges of \$4 million, both of which are pre-tax.

(c) Net income includes acquired in-process technology of \$1 million and restructuring charges of \$2 million, both of which are pre-tax.

(d) Net loss includes restructuring charges of \$3 million, pre-tax, and net tax expense of \$7 million.

(e) Net loss includes acquired in-process technology of \$1 million, pre-tax.

(f) Net income includes certain litigation expense of \$1 million, pre-tax, and net tax credits of \$9 million.

(g) Net income includes restructuring charges of \$9 million, pre-tax.

- (h) Net loss includes acquired in-process technology of \$7 million, restructuring charges of \$17 million, a litigation expense credit of \$1 million, all pre-tax, and net tax expense of \$34 million.

Our common stock is traded on the NASDAQ Global Select Market under the symbol ERTS. The prices for the common stock in the table above represent the high and low sales prices as reported on the NASDAQ Global Select Market.

## **(20) SUBSEQUENT EVENT**

In May 2007, we announced that we entered into a licensing agreement with and expect to make a strategic equity investment in The9 Limited, a leading online game operator in China, on or around May 29, 2007. We expect to purchase approximately 15 percent of the outstanding common shares of The9 for approximately \$167 million on or around May 29, 2007. The licensing agreement gives The9 exclusive publishing rights for *EA SPORTS FIFA Online* in mainland China.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders  
Electronic Arts Inc.:

We have audited the accompanying consolidated balance sheets of Electronic Arts Inc. and subsidiaries (Electronic Arts Inc.) as of March 31, 2007 and April 1, 2006, and the related consolidated statements of operations, stockholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended March 31, 2007. In connection with our audits of the consolidated financial statements, we have also audited the accompanying financial statement schedule. These consolidated financial statements and financial statement schedule are the responsibility of Electronic Arts Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Electronic Arts Inc. as of March 31, 2007 and April 1, 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2007, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Notes 1 and 14 to the consolidated financial statements, effective April 1, 2006, Electronic Arts Inc. adopted the provision of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, and Securities and Exchange Commission Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Electronic Arts Inc.'s internal control over financial reporting as of March 31, 2007, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated May 29, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

Mountain View, California  
May 29, 2007



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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders  
Electronic Arts Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting appearing under Item 9A, that Electronic Arts Inc. and subsidiaries (Electronic Arts Inc.) maintained effective internal control over financial reporting as of March 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Electronic Arts Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the internal control over financial reporting of Electronic Arts Inc. based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Electronic Arts Inc. maintained effective internal control over financial reporting as of March 31, 2007, is fairly stated, in all material respects, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Electronic Arts Inc. maintained, in all material respects, effective internal control over financial reporting as of March 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Electronic Arts Inc. and subsidiaries as of March 31, 2007 and April 1, 2006, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended March 31, 2007, and our report dated May 29, 2007 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Mountain View, California

May 29, 2007

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**Item 9: *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not applicable.

**Item 9A: *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 and Administrative 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 and Administrative 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 and Administrative Officer, as appropriate to allow timely decisions regarding the required disclosure.

**Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act.

Our internal control over financial reporting is designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. There are inherent limitations to the effectiveness of any system of internal control over financial reporting. These limitations include the possibility of human error, the circumvention or overriding of the system and reasonable resource constraints. Because of its inherent limitations, our internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with our policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of the end of our most recently completed fiscal year. In making its assessment, management used the criteria set forth in *Internal Control-Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, our management believes that, as of the end of our most recently completed fiscal year, our internal control over financial reporting was effective.

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KPMG LLP, our independent registered public accounting firm, has issued an attestation report on management's assessment of our internal control over financial reporting. That report appears on page 107.

**Changes in Internal Controls**

In preparation for management's report on internal control over financial reporting, we documented and tested the design and operating effectiveness of our internal control over financial reporting. During fiscal 2007, there were no significant changes in our internal controls or, to our knowledge, in other factors that could significantly affect our disclosure controls and procedures.

**Item 9B: *Other Information***

None.

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**PART III**

**Item 10: *Directors, Executive Officers and Corporate Governance***

The information required by Item 10 is incorporated herein by reference to the information to be included in our definitive Proxy Statement for our 2007 Annual Meeting of Stockholders (the Proxy Statement ) other than the information regarding (a) executive officers, and (b) our Global Code of Conduct (which includes code of ethics provisions applicable to our directors, principal executive officer, principal financial officer, principal accounting officer, and other senior financial officers), which are included in Item 1 of this report. The information regarding Section 16 compliance is incorporated herein by reference to the information to be included in the Proxy Statement.

**Item 11: *Executive Compensation***

The information required by Item 11 is incorporated herein by reference to the information to be included in the Proxy Statement specifically excluding the Compensation Committee Report on Executive Compensation .

**Item 12: *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required by Item 12 is incorporated herein by reference to the information to be included in the Proxy Statement.

**Item 13: *Certain Relationships and Related Transactions, and Director Independence***

The information required by Item 13 is incorporated herein by reference to the information to be included in the Proxy Statement.

**Item 14: *Principal Accounting Fees and Services***

The information required by Item 14 is incorporated herein by reference to the information to be included in the Proxy Statement.

**PART IV**

**Item 15: *Exhibits, Financial Statement Schedules***

**(a) Documents filed as part of this report**

1. Financial Statements: See Index to Consolidated Financial Statements under Item 8 on Page 62 of this report.
2. Financial Statement Schedule: See Schedule II on Page 116 of this report.
3. Exhibits: The following exhibits (other than exhibits 32.1 and 32.2, which are furnished with this report) are filed as part of, or incorporated by reference into, this report:

| <b>Number</b> | <b>Exhibit Title</b> |
|---------------|----------------------|
|---------------|----------------------|

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- 3.01 Amended and Restated Certificate of Incorporation of Electronic Arts Inc.(1)
- 3.02 Amended and Restated Bylaws.(2)
- 4.01 Specimen Certificate of Registrant's Common Stock.(3)
- 10.01 Registrant's Directors Stock Option Plan and related documents.(\*)(4)
- 10.02 Registrant's 1991 Stock Option Plan and related documents as amended.(\*)(5)
- 10.03 Registrant's 1998 Directors' Stock Option Plan and related documents, as amended.(\*)(5)
- 10.04 Registrant's 2000 Equity Incentive Plan as amended, and related documents.(\*)(6)
- 10.05 Registrant's 2000 Employee Stock Purchase Plan as amended, and related documents.(\*)(6)

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**Number Exhibit Title**

- 10.06 Form of Indemnity Agreement with Directors.(\*)(7)
- 10.07 Electronic Arts Discretionary Bonus Program Plan Document.(\*)(8)
- 10.08 Electronic Arts Deferred Compensation Plan.(\*)(2)
- 10.09 Electronic Arts Executive Long-Term Disability Plan.(\*)(9)
- 10.10 Agreement for Lease between Flatirons Funding, LP and Electronic Arts Redwood, Inc. dated February 14, 1995.(10)
- 10.11 Guarantee from Electronic Arts Inc. to Flatirons Funding, LP dated February 14, 1995.(10)
- 10.12 Amended and Restated Guaranty from Electronic Arts Inc. to Flatirons Funding, LP dated March 7, 1997.(11)
- 10.13 Amended and Restated Agreement for Lease between Flatirons Funding, LP and Electronic Arts Redwood Inc. dated March 7, 1997.(11)
- 10.14 Amendment No. 1 to Lease Agreement between Electronic Arts Redwood Inc. and Flatirons Funding, LP dated March 7, 1997.(11)
- 10.15 Lease Agreement by and between Registrant and Louisville Commerce Realty Corporation, dated April 1, 1999.(12)
- 10.16 Option agreement, agreement of purchase and sale, and escrow instructions for Zones 2 and 4, Electronic Arts Business Park, Redwood Shores California, dated April 5, 1999.(12)
- 10.17 Licensed Publisher Agreement by and between EA and Sony Computer Entertainment America Inc. dated as of April 1, 2000.(\*)(13)
- 10.18 Master Lease and Deed of Trust by and between Registrant and Selco Service Corporation, dated December 6, 2000.(14)
- 10.19 Guaranty, dated as of December 6, 2000, by Electronic Arts Inc. in favor of Selco Service Corporation, Victory Receivables Corporation, The Bank of Tokyo-Mitsubishi, Ltd., various Liquidity Banks, and Keybank National Association.(15)
- 10.20 Participation Agreement among Electronic Arts Redwood, Inc., Electronic Arts, Inc., Selco Service Corporation, Victory Receivables Corporation, The Bank of Tokyo-Mitsubishi, Ltd., various Liquidity Banks and Keybank National Association, dated December 6, 2000.(16)
- 10.21 Amendment No. 1 to Amended and Restated Credit Agreement by and among Flatirons Funding LP and The Dai-Ichi Kangyo Bank, Limited, New York Branch, dated February 21, 2001.(17)
- 10.22 Amendment No. 2 to Lease Agreement by and between Electronic Arts Redwood, Inc. and Flatirons Funding, LP dated July 16, 2001.(18)
- 10.23 Participation Agreement among Electronic Arts Redwood, Inc., Electronic Arts Inc., Flatirons Funding, LP, Selco Service Corporation and Selco Redwood, LLC, Victory Receivables Corporation, The Bank of Tokyo-Mitsubishi, Ltd., various Liquidity Banks and Tranche B Banks and Keybank National Association dated July 16, 2001.(18)
- 10.24 Guaranty, dated as of July 16, 2001, by Electronic Arts Inc. in favor of Flatirons Funding, Limited Partnership, Victory Receivables Corporation, The Bank of Tokyo-Mitsubishi, Ltd., various Liquidity Banks and Tranche B Banks, and KeyBank National Association.(15)
- 10.25 First Amendment to Participation Agreement, dated as of May 13, 2002, by and among Electronic Arts Redwood, Inc., Electronic Arts Inc., Flatirons Funding, Limited Partnership, Victory Receivables Corporation, The Bank of Tokyo-Mitsubishi, Ltd., various Liquidity Banks, KeyBank National Association, and The Bank of Nova Scotia.(15)
- 10.26 Offer Letter for Employment at Electronic Arts Inc. to Warren Jenson, dated June 21, 2002.(\*)(19)
- 10.27 Full Recourse Promissory Note between Electronic Arts Inc. and Warren Jenson, dated July 19, 2002.(19)
- 10.28



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Full Recourse Promissory Note between Electronic Arts Inc. and Warren Jenson, dated July 19, 2002.(19)

10.29 Lease Agreement by and between Registrant and Ontrea, Inc. dated October 7, 2002.(20)

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**Number Exhibit Title**

- 10.30 Lease Agreement by and between Playa Vista-Waters Edge, LLC and Electronic Arts Inc., dated July 31, 2003.(21)
- 10.31 Agreement Re: Right of First Offer to Purchase and Option to Purchase by and between Playa Vista-Waters Edge, LLC and Electronic Arts Inc., dated July 31, 2003.(21)
- 10.32 Profit Participation Agreement by and between Playa Vista-Waters Edge, LLC and Electronic Arts Inc., dated July 31, 2003.(21)
- 10.33 Sublease Agreement by and between Electronic Arts Inc. and Playa Capital Company, LLC, dated July 31, 2003.(21)
- 10.34 Amending Agreement among Ontrea Inc. (the Landlord ), Electronic Arts (Canada), Inc. (the Tenant ), and Electronic Arts Inc. (the Indemnifier ), dated October 30, 2003.(22)
- 10.35 First Amendment of Lease by and between Louisville Commerce Realty Corporation and Electronic Arts Inc., dated February 23, 2004.(7)
- 10.36 First Amendment to lease agreement by and between Playa Vista Water s Edge, LLC and Electronic Arts Inc., entered into April 19, 2004.(2)
- 10.37 Lease agreement between ASP WT, L.L.C. ( Landlord ) and Tiburon Entertainment, Inc. ( Tenant ) for space at Summit Park I, dated June 15, 2004.(2)
- 10.38 Omnibus Amendment Agreement (2001 transaction), dated as of September 15, 2004, Electronic Arts Redwood, LLC, Electronic Arts, Inc., Selco Service Corporation, Victory Receivables Corporation, The Bank Of Tokyo-Mitsubishi, Ltd., various Liquidity Banks, and KeyBank National Association.(15)
- 10.39 Omnibus Amendment Agreement (2000 transaction), dated as of September 15, 2004, by and among Electronic Arts Redwood, LLC, Electronic Arts, Inc., Selco Service Corporation, Victory Receivables Corporation, The Bank Of Tokyo-Mitsubishi, Ltd., various Liquidity Banks, and KeyBank National Association.(15)
- 10.40 Omnibus Amendment (2000 transaction), dated as of July 11, 2005, among Electronic Arts Redwood, LLC, Electronic Arts, Inc., Selco Service Corporation, Victory Receivables Corporation, The Bank of Tokyo-Mitsubishi, Ltd., New York Branch, various Liquidity Banks, Deutsche Bank Trust Company Americas, and KeyBank National Association.(15)
- 10.41 Omnibus Amendment (2001 transaction), dated as of July 11, 2005, among Electronic Arts Redwood, LLC, Electronic Arts, Inc., Selco Service Corporation, Victory Receivables Corporation, The Bank of Tokyo-Mitsubishi, Ltd., New York Branch, various Liquidity Banks, Deutsche Bank Trust Company Americas, The Bank of Nova Scotia, and KeyBank National Association.(15)
- 10.42 First amendment to lease, dated December 13, 2005, by and between Liberty Property Limited Partnership, a Pennsylvania limited partnership and Electronic Arts Tiburon, a Florida corporation f/k/a Tiburon Entertainment, Inc.(23)
- 10.43 Agreement for Underlease relating to Onslow House, Guildford, Surrey, dated 7 February 2006, by and between The Standard Life Assurance Company and Electronic Arts Limited and Electronic Arts Inc.(23)
- 10.44 Offer Letter for Employment at Electronic Arts Inc. to Gabrielle Toledano, dated February 6, 2006.(\*)(24)
- 10.45 Second Omnibus Amendment (2001 Transaction), dated as of May 26, 2006, among Electronic Arts Redwood LLC, as Lessee, Electronic Arts Inc., as Guarantor, SELCO Service Corporation (doing business in California as Ohio SELCO Service Corporation ), as Lessor, the Various Liquidity Banks party thereto, as Liquidity Banks, The Bank of Nova Scotia, as Documentation Agent and Keybank National Association, as Agent.(25)
- 10.46 Second Omnibus Amendment (2000 Transaction), dated as of May 26, 2006, among Electronic Arts Redwood LLC, as Lessee, Electronic Arts Inc., as Guarantor, SELCO Service Corporation (doing

business in California as Ohio SELCO Service Corporation ), as Lessor, the Various Liquidity Banks party thereto, as Liquidity Banks, and KeyBank National Association, as Agent.(25)

10.47 Employment Agreement dated September 26, 2006, between EA Swiss Sàrl and Gerhard Florin.(26)

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**Number Exhibit Title**

- 10.48 Offer Letter for Employment at Electronic Arts Inc. to John Riccitiello, dated February 12, 2007.(\*)(27)
- 10.49 Third Omnibus Amendment (2001 Transaction), dated as of May 14, 2007 among Electronic Arts Redwood LLC, as Lessee, Electronic Arts Inc., as Guarantor, SELCO Service Corporation (doing business in California as Ohio SELCO Service Corporation ), as Lessor, the Various Liquidity Banks party thereto, as Liquidity Banks, The Bank of Nova Scotia, as Documentation Agent and Keybank National Association, as Agent.(28)
- 10.50 Third Omnibus Amendment (2000 Transaction), dated as of May 14, 2007 among Electronic Arts Redwood LLC, as Lessee, Electronic Arts Inc., as Guarantor, SELCO Service Corporation (doing business in California as Ohio SELCO Service Corporation ), as Lessor, the Various Liquidity Banks party thereto, as Liquidity Banks, and KeyBank National Association, as Agent.(28)
- 21.01 Subsidiaries of the Registrant.
- 23.01 Consent of KPMG LLP, Independent Registered Public Accounting Firm.
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Executive Vice President, Chief Financial and Administrative Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Additional exhibits furnished with this report:

- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Executive Vice President, Chief Financial and Administrative Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Additional exhibits furnished with this report:

\* Management contract or compensatory plan or arrangement.

\*\* Portions of this exhibit have been redacted pursuant to a confidential treatment request filed with the SEC.

- (1) Incorporated by reference to exhibits filed with Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004.
- (2) Incorporated by reference to exhibits filed with Registrant's Current Report on Form 8-K, filed November 13, 2006.
- (3) Incorporated by reference to exhibits filed with Registrant's Registration Statement on Form S-4, filed March 3, 1994 (File No. 33-75892).
- (4) Incorporated by reference to exhibits filed with Amendment No. 2 to Registrant's Registration Statement on Form S-8, filed November 6, 1991 (File No. 33-32616).
- (5) Incorporated by reference to exhibits filed with Registrant's Registration Statement on Form S-8, filed July 30, 1999 (File No. 333-84215).
- (6) Incorporated by reference to exhibits filed with Registrant's Registration Statement on Form 10-Q for the quarter ended June 30, 2006.

- (7) Incorporated by reference to exhibits filed with Registrant's Annual Report on Form 10-K for the year ended March 31, 2004.
- (8) Incorporated by reference to exhibits filed with Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005.
- (9) Incorporated by reference to exhibits filed with Registrant's Annual Report on Form 10-K for the year ended March 31, 2005.
- (10) Incorporated by reference to exhibits filed with Registrant's Annual Report on Form 10-K for the year ended March 31, 1995.

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- (11) Incorporated by reference to exhibits filed with Registrant's Annual Report on Form 10-K for the year ended March 31, 1997.
- (12) Incorporated by reference to exhibits filed with Registrant's Annual Report on Form 10-K for the year ended March 31, 1999.
- (13) Incorporated by reference to exhibits filed with Amendment No. 2 to Registrant's Registration Statement on Form S-3, filed November 21, 2003 (File No. 333-102797).
- (14) Incorporated by reference to exhibits filed with Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2000.
- (15) Incorporated by reference to exhibits filed with Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005.
- (16) Incorporated by reference to exhibits filed with Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2002.
- (17) Incorporated by reference to exhibits filed with Registrant's Annual Report on Form 10-K for the year ended March 31, 2001.
- (18) Incorporated by reference to exhibits filed with Registrant's Annual Report on Form 10-K for the year ended March 31, 2002.
- (19) Incorporated by reference to exhibits filed with Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002.
- (20) Incorporated by reference to exhibits filed with Registrant's Annual Report on Form 10-K for the year ended March 31, 2003.
- (21) Incorporated by reference to exhibits filed with Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003.
- (22) Incorporated by reference to exhibits filed with Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2003.
- (23) Incorporated by reference to exhibits filed with Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2005.
- (24) Incorporated by reference to exhibits filed with Registrant's Annual Report on Form 10-K for the year ended March 31, 2006.
- (25) Incorporated by reference to exhibits filed with Registrant's Current Report on Form 8-K, filed June 1, 2006.
- (26) Incorporated by reference to exhibits filed with Registrant's Current Report on Form 8-K, filed September 27, 2006.
- (27)

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Incorporated by reference to exhibits filed with Registrant's Current Report on Form 8-K, filed February 26, 2007.

(28) Incorporated by reference to exhibits filed with Registrant's Current Report on Form 8-K, filed May 18, 2007.

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**SIGNATURES**

Pursuant to the requirements of the Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ELECTRONIC ARTS INC.

By: /s/ John S. Riccitiello

John S. Riccitiello,  
Chief Executive Officer

Date: May 29, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons, on behalf of the Registrant in the capacities indicated and on the 29th of May 2007.

| <b>Name</b>                | <b>Title</b>   |
|----------------------------|--|
| /s/ John S. Riccitiello    | Chief Executive Officer  |
| John S. Riccitiello        |  |
| /s/ Warren C. Jenson       | Executive Vice President,<br>Chief Financial and Administrative Officer              |
| Warren C. Jenson           |  |
| /s/ Kenneth A. Barker      | Senior Vice President,<br>Chief Accounting Officer<br>(Principal Accounting Officer) |
| Kenneth A. Barker          |  |
| Directors:                 |  |
| /s/ Lawrence F. Probst III | Chairman of the Board  |
| Lawrence F. Probst III     |  |
| /s/ M. Richard Asher       | Director   |
| M. Richard Asher           |  |
| /s/ Leonard S. Coleman     | Director   |
| Leonard S. Coleman         |  |
| /s/ Gary M. Kusin          | Director   |



Gary M. Kusin

/s/ Gregory B. Maffei

Director

Gregory B. Maffei

/s/ Timothy Mott

Director

Timothy Mott

/s/ Vivek Paul

Director

Vivek Paul

/s/ John S. Riccitiello

Director

John S. Riccitiello

/s/ Richard A. Simonson

Director

Richard A. Simonson

/s/ Linda J. Srere

Director

Linda J. Srere

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**Years Ended March 31, 2007, 2006 and 2005**  
**(In millions)**

|  | <b>Balance<br/>at<br/>Beginning<br/>of Period</b> | <b>Charged<br/>to<br/>Costs<br/>and<br/>Expenses</b> | <b>Charged<br/>(credited)<br/>to Other<br/>Accounts<sup>(1)</sup></b> | <b>Deductions</b> | <b>Balance<br/>at<br/>End of<br/>Period</b> |
|--|---|--|---|-------------------|---|
| <b>Allowance for Doubtful Accounts,<br/>Price Protection and Returns</b> |   |  |   |                   |   |
| Year Ended March 31, 2007  | \$ 232  | \$ 308   | \$ 17   | \$ 343            | \$ 214                                      |
| Year Ended March 31, 2006  | \$ 162  | \$ 483   | \$ (6)  | \$ 407            | \$ 232                                      |
| Year Ended March 31, 2005  | \$ 155  | \$ 471   | \$ 7  | \$ 471            | \$ 162                                      |

<sup>(1)</sup> Primarily the translation effect of using the average exchange rate for expense items and the year-ended exchange rate for the balance sheet item (allowance account) and other reclassification adjustments.

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**ELECTRONIC ARTS INC.**

**2007 FORM 10-K ANNUAL REPORT**

**EXHIBIT INDEX**

| <b>Exhibit<br/>Number</b> | <b>Exhibit Title</b>  |
|---------------------------|---|
| 21.01                     | Subsidiaries of the Registrant.   |
| 23.01                     | Consent of KPMG LLP, Independent Registered Public Accounting Firm.   |
| 31.1                      | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2                      | Certification of Executive Vice President, Chief Financial and Administrative Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |

**ADDITIONAL EXHIBITS ACCOMPANYING THIS REPORT:**

|      |  |
|------|--|
| 32.1 | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2 | Certification of Executive Vice President, Chief Financial and Administrative Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |