

ELECTRONIC ARTS INC.  
Form 10-Q  
August 09, 2011  
Table of Contents

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

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

For the Quarterly Period Ended June 30, 2011

OR

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

For the Transition Period from            to

Commission File No. 000-17948

**ELECTRONIC ARTS INC.**

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

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

**209 Redwood Shores Parkway**

**Redwood City, California**  
*(Address of principal executive offices)*

**(650) 628-1500**

*(Registrant's telephone number, including area code)*

**94-2838567**  
*(I.R.S. Employer  
Identification No.)*

**94065**  
*(Zip Code)*

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of August 4, 2011, there were 329,937,928 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.

**Table of Contents**

**ELECTRONIC ARTS INC.**

**FORM 10-Q**

**FOR THE PERIOD ENDED JUNE 30, 2011**

**Table of Contents**

	<b>Page</b>
<b><u>Part I - FINANCIAL INFORMATION</u></b>	
Item 1. <u>Condensed Consolidated Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of June 30, 2011 and March 31, 2011</u>	3
<u>Condensed Consolidated Statements of Operations for the Three Months Ended June 30, 2011 and 2010</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended June 30, 2011 and 2010</u>	5
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	6
<u>Report of Independent Registered Public Accounting Firm</u>	28
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	49
Item 4. <u>Controls and Procedures</u>	52
<b><u>Part II - OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	53
Item 1A. <u>Risk Factors</u>	53
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	64
Item 6. <u>Exhibits</u>	64
<u>Signature</u>	65
<u>Exhibit Index</u>	66

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements (Unaudited)  
ELECTRONIC ARTS INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited)

(In millions, except par value data)	June 30, 2011	March 31, 2011 (a)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,173	\$ 1,579
Short-term investments	503	497
Marketable equity securities	172	161
Receivables, net of allowances of \$227 and \$304, respectively	30	335
Inventories	75	77
Deferred income taxes, net	58	56
Other current assets	343	327
Total current assets	2,354	3,032
Property and equipment, net	516	513
Goodwill	1,132	1,110
Acquisition-related intangibles, net	134	144
Deferred income taxes, net	49	49
Other assets	170	80
<b>TOTAL ASSETS</b>	<b>\$ 4,355</b>	<b>\$ 4,928</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 91	\$ 228
Accrued and other current liabilities	604	768
Deferred net revenue (packaged goods and digital content)	530	1,005
Total current liabilities	1,225	2,001
Income tax obligations	192	192
Deferred income taxes, net	42	37
Other liabilities	146	134
Total liabilities	1,605	2,364
Commitments and contingencies (See Note 12)		
Stockholders' equity:		
Preferred stock, \$0.01 par value. 10 shares authorized		
Common stock, \$0.01 par value. 1,000 shares authorized; 331 and 333 shares issued and outstanding, respectively	3	3
Paid-in capital	2,439	2,495
Retained earnings (accumulated deficit)	68	(153)
Accumulated other comprehensive income	240	219
Total stockholders' equity	2,750	2,564

<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	\$ 4,355	\$ 4,928
--	----------	----------

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

(a) Derived from audited consolidated financial statements.

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

(Unaudited)	Three Months Ended June 30,	
(In millions, except per share data)	2011	2010
Net revenue	\$ 999	\$ 815
Cost of goods sold	240	222
Gross profit	759	593
Operating expenses:		
Marketing and sales	140	127
General and administrative	74	74
Research and development	285	275
Restructuring and other charges	18	2
Amortization of intangibles	13	15
Acquisition-related contingent consideration	2	2
Total operating expenses	532	495
Operating income	227	98
Loss on strategic investments		(5)
Interest and other income, net	3	
Income before provision for (benefit from) income taxes	230	93
Provision for (benefit from) income taxes	9	(3)
Net income	\$ 221	\$ 96
Net income per share:		
Basic	\$ 0.67	\$ 0.29
Diluted	\$ 0.66	\$ 0.29
Number of shares used in computation:		
Basic	331	328
Diluted	337	332

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

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

(Unaudited)	Three Months Ended June 30,	
(In millions)	2011	2010
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 221	\$ 96
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation, amortization and accretion, net	43	48
Stock-based compensation	38	47
Net losses on investments and sale of property and equipment		5
Acquisition-related contingent consideration	2	2
Change in assets and liabilities:		
Receivables, net	307	97
Inventories	4	16
Other assets	(101)	(37)
Accounts payable	(133)	(40)
Accrued and other liabilities	(181)	(109)
Deferred income taxes, net	1	3
Deferred net revenue (packaged goods and digital content)	(475)	(276)
Net cash used in operating activities	(274)	(148)
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(32)	(11)
Proceeds from sale of marketable equity securities		8
Proceeds from maturities and sales of short-term investments	83	98
Purchase of short-term investments	(90)	(148)
Acquisition of subsidiaries, net of cash acquired	(25)	
Net cash used in investing activities	(64)	(53)
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of common stock	14	1
Excess tax benefit from stock-based compensation	2	
Repurchase and retirement of common stock	(91)	
Net cash provided by (used in) financing activities	(75)	1
Effect of foreign exchange on cash and cash equivalents	7	(16)
Decrease in cash and cash equivalents	(406)	(216)
Beginning cash and cash equivalents	1,579	1,273
Ending cash and cash equivalents	\$ 1,173	\$ 1,057
<b>Supplemental cash flow information:</b>		
Cash paid (refunded) during the period for income taxes, net	\$ (18)	\$ 6
<b>Non-cash investing activities:</b>		
Change in unrealized gains (losses) on available-for-sale securities, net of taxes	\$ 13	\$ (89)

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

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



---

**Table of Contents**

**ELECTRONIC ARTS INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

We develop, market, publish and distribute game software and content that can be played by consumers on a variety of platforms, including video game consoles (such as the Sony PLAYSTATION 3, Microsoft Xbox 360, and Nintendo Wii), personal computers, mobile phones (such as the Apple iPhone and Google Android compatible phones), tablets and electronic readers (such as the Apple iPad and Amazon Kindle), the Internet, and handheld game players (such as the Sony PlayStation Portable ( PSP ) and the Nintendo DS and 3DS). Some of our games are based on content that we license from others (e.g., FIFA, Madden NFL, Harry Potter, and Hasbro's toy and game intellectual properties), and some of our games are based on our own wholly-owned intellectual property (e.g., The Sims, Need for Speed, and Dead Space). Our goal is to publish titles with global 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., FIFA, Madden NFL, and NCAA Football), 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., Harry Potter).

Our fiscal year is reported on a 52- or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ending or ended, as the case may be, March 31, 2012 and 2011 contain 52 weeks each and ends or ended, as the case may be, on March 31, 2012 and April 2, 2011, respectively. Our results of operations for the three months ended June 30, 2011 and 2010 contained 13 weeks each, and ended on July 2, 2011 and July 3, 2010, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

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

These Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2011, as filed with the United States Securities and Exchange Commission ( SEC ) on May 24, 2011.

**(2) SIGNIFICANT ACCOUNTING POLICY**

***Revenue Recognition***

We evaluate revenue recognition based on the criteria set forth in Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 985-605, *Software: Revenue Recognition* and Staff Accounting Bulletin ( SAB ) No. 101, *Revenue Recognition in Financial Statements*, as revised by SAB No. 104, *Revenue Recognition*. We evaluate and recognize revenue when all four of the following criteria are met:

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

*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 digital downloads that do not have an online service component, delivery is generally considered to occur when the download is made

available.

*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.

**Table of Contents**

*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 management judgments that can have a significant impact on the timing and amount of revenue we report in each period. 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 ( 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 management 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.

Depending on the type of product, we may offer an online service that permits consumers to play against others via the Internet and/or receive additional updates or content from us. For those games that consumers can play via the Internet, we may provide a matchmaking service that permits consumers to connect with other consumers to play against each other online. In those situations where we do not require an additional fee for this online service, we account for the sale of the software product and the online service as a bundled sale, or multiple element arrangement, in which we sell both the software product and the online service for one combined price. We defer net revenue from sales of these games for which we do not have VSOE for the online service that we provided in connection with the sale, and recognize the revenue from these games over the estimated online service period, which is generally estimated to be six months beginning in the month after shipment. In addition, for some software products we also provide updates or additional content ( digital content ) to be delivered via the Internet that can be used with the original software product. In many cases we separately sell digital content for an additional fee; however, some purchased digital content can only be accessed via the Internet (*i.e.*, the consumer never takes possession of the digital content). We account for online transactions in which the consumer does not take possession of the digital content as a service transaction and, accordingly, we recognize the associated revenue over the estimated service period. In other transactions, at the date we sell the software product we have an obligation to provide incremental unspecified digital content in the future without an additional fee. In these cases, we account for the sale of the software product as a multiple element arrangement and recognize the revenue on a straight-line basis over the estimated period of game play.

Determining whether a transaction constitutes an online service transaction or a digital content download of a product requires judgment and can be difficult. The accounting for these transactions is significantly different. Revenue from product downloads is generally recognized when the download is made available (assuming all other recognition criteria are met). Revenue from an online game service is recognized as the service is 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. In addition, determining whether we have an implicit obligation to provide incremental unspecified future digital content without an additional fee can be difficult.

*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.

*Multiple Element Revenue Arrangements.* On April 3, 2011 we adopted the FASB Accounting Standards Update ( ASU ) 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* and ASU 2009-14, *Software (Topic 985): Certain Revenue Arrangements that Include Software Elements*.

ASU 2009-13 modifies the fair value requirements of ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements*, by allowing the use of the best estimate of selling price in addition to vendor-specific objective evidence and third-party evidence for determining the selling price of a deliverable for non-software arrangements. It establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (1) vendor-specific objective evidence, (2) third-party evidence, or (3) estimates. In addition, the residual method of allocating arrangement consideration is no longer permitted.

ASU 2009-14 modifies the scope of ASC subtopic 985-605, *Software-Revenue Recognition*, to exclude from its requirements non-software components of tangible products and software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product s essential functionality.

## **Table of Contents**

The adoption of ASU 2009-13 and ASU 2009-14 did not have a material impact on our Condensed Consolidated Financial Statements as substantially all of our revenue arrangements with multiple deliverables remain under ASC 985-605. As certain of our revenue arrangements include software and hardware deliverables (such as peripherals or other ancillary collectors items sold together with the physical boxed software), the new accounting principles would apply to these types of arrangements. The new accounting principles establish a selling price hierarchy for determining the selling price of a deliverable and require the application of the relative selling price method to allocate the arrangement consideration to each deliverable in a multiple element arrangement. As of the quarter ended June 30, 2011, we do not have significant revenue arrangements that require our best estimate of selling price.

*Shipping and Handling.* 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 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.

### **(3) FAIR VALUE MEASUREMENTS**

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

#### ***Fair Value Hierarchy***

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

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

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

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

**Table of Contents****Assets and Liabilities Measured at Fair Value on a Recurring Basis**

As of June 30, 2011 and March 31, 2011, our assets and liabilities that were measured and recorded at fair value on a recurring basis were as follows (in millions):

	As of June 30, 2011	Fair Value Measurements at Reporting Date Using Quoted Prices in			Balance Sheet Classification
		Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets</b>					
Money market funds	\$ 392	\$ 392	\$	\$	Cash equivalents
Available-for-sale securities:					
Corporate bonds	242		242		Short-term investments
Marketable equity securities	172	172			Marketable equity securities
U.S. agency securities	126		126		Short-term investments and cash equivalents
U.S. Treasury securities	125	125			Short-term investments and cash equivalents
Commercial paper	32		32		Short-term investments and cash equivalents
Deferred compensation plan assets <sup>(a)</sup>	12	12			Other assets
Foreign currency derivatives	1		1		Other current assets
<b>Total assets at fair value</b>	<b>\$ 1,102</b>	<b>\$ 701</b>	<b>\$ 401</b>	<b>\$</b>	
<b>Liabilities</b>					
Contingent consideration <sup>(b)</sup>	\$ 53	\$	\$	\$ 53	Accrued and other current liabilities and other liabilities
<b>Total liabilities at fair value</b>	<b>\$ 53</b>	<b>\$</b>	<b>\$</b>	<b>\$ 53</b>	

		Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
		Contingent Consideration		
Balance as of March 31, 2011		\$ 51		
Change in fair value <sup>(c)</sup>		2		
Balance as of June 30, 2011		\$ 53		

	As of March 31, 2011	Fair Value Measurements at Reporting Date Using Quoted Prices in			Balance Sheet Classification
		Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets</b>					
Money market funds	\$ 774	\$ 774	\$	\$	Cash equivalents
Available-for-sale securities:					
Corporate bonds	253		253		Short-term investments
Marketable equity securities	161	161			Marketable equity securities
U.S. Treasury securities	129	129			Short-term investments and cash equivalents
U.S. agency securities	102		102		Short-term investments
Commercial paper	31		31		

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

Deferred compensation plan assets <sup>(a)</sup>	12	12			Short-term investments and cash equivalents
					Other assets
Total assets at fair value	\$ 1,462	\$ 1,076	\$ 386	\$	
<b>Liabilities</b>					
Contingent consideration <sup>(b)</sup>	\$ 51	\$	\$	\$ 51	Accrued and other current liabilities and other liabilities
Total liabilities at fair value	\$ 51	\$	\$	\$ 51	

**Table of Contents**

	<b>Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Contingent Consideration</b>	
Balance as of March 31, 2010	\$	65
Additions		3
Change in fair value <sup>(c)</sup>		(17)
Balance as of March 31, 2011	\$	51

- (a) The deferred compensation plan assets consist of various mutual funds.
- (b) The contingent consideration represents the estimated fair value of the additional variable cash consideration payable in connection with our acquisitions of Playfish Limited ( Playfish ) and Chillingo Limited ( Chillingo ) that is contingent upon the achievement of certain performance milestones. We estimated the fair value using expected future cash flows over the period in which the obligations are expected to be settled, and applied a discount rate that appropriately captures a market participant's view of the risk associated with the obligations.
- (c) The change in fair value is reported as acquisition-related contingent consideration in our Condensed Consolidated Statements of Operations.

**Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis**

There were no material impairment charges for assets and liabilities measured at fair value on a nonrecurring basis in periods subsequent to initial recognition during the three months ended June 30, 2011 and 2010.

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

As of June 30, 2011 and March 31, 2011, our cash and cash equivalents were \$1,173 million and \$1,579 million, respectively. Cash equivalents were valued at their carrying amounts as they approximate fair value due to the short maturities of these financial instruments.

**Short-Term Investments**

Short-term investments consisted of the following as of June 30, 2011 and March 31, 2011 (in millions):

	As of June 30, 2011				As of March 31, 2011			
	Cost or Amortized Cost	Gross Gains	Unrealized Losses	Fair Value	Cost or Amortized Cost	Gross Gains	Unrealized Losses	Fair Value
Corporate bonds	\$ 241	\$ 1	\$	\$ 242	\$ 252	\$ 1	\$	\$ 253
U.S. Treasury securities	117	1		118	124			124
U.S. agency securities	117	1		118	102			102
Commercial paper	25			25	18			18
Short-term investments	\$ 500	\$ 3	\$	\$ 503	\$ 496	\$ 1	\$	\$ 497

We evaluate our investments for impairment quarterly. Factors considered in the review of investments with an unrealized loss include the credit quality of the issuer, the duration that the fair value has been less than the adjusted cost basis, severity of the impairment, reason for the decline in value and potential recovery period, the financial condition and near-term prospects of the investees, our intent to sell the investments, any contractual terms impacting the prepayment or settlement process, as well as if we would be required to sell an investment due to liquidity or

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

contractual reasons before its anticipated recovery. Based on our review, we did not consider these investments to be other-than-temporarily impaired as of June 30, 2011 and March 31, 2011.

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of June 30, 2011 and March 31, 2011 (in millions):

	As of June 30, 2011		As of March 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Short-term investments				
Due in 1 year or less	\$ 221	\$ 222	\$ 214	\$ 214
Due in 1-2 years	184	186	156	157
Due in 2-3 years	95	95	126	126
Short-term investments	\$ 500	\$ 503	\$ 496	\$ 497



**Table of Contents*****Marketable Equity Securities***

Our investments in marketable equity securities consist of investments in common stock of publicly traded companies and are accounted for as available-for-sale securities and are recorded at fair value. Unrealized gains and losses are recorded as a component of accumulated other comprehensive income in stockholders' equity, net of tax, until either the security is sold or we determine that the decline in the fair value of a security to a level below its adjusted cost basis is other-than-temporary. We evaluate these investments for impairment quarterly. If we conclude that an investment is other-than-temporarily impaired, we will recognize an impairment charge at that time in our Condensed Consolidated Statements of Operations.

Marketable equity securities consisted of the following as of June 30, 2011 and March 31, 2011 (in millions):

	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of June 30, 2011	\$ 32	\$ 140	\$	\$ 172
As of March 31, 2011	\$ 32	\$ 129	\$	\$ 161

During the three months ended June 30, 2010, we recognized an impairment charge of \$2 million on our investment in The9. We did not recognize any impairment charges during the three months ended June 30, 2011 on our marketable equity securities. Due to various factors, including but not limited to, the extent and duration during which the market price of this security had been below its adjusted cost and our intent to hold this security, we concluded the decline in value was other-than-temporary. The impairment charge for the three months ended June 30, 2010 is included in loss on strategic investments in our Condensed Consolidated Statement of Operations.

During the three months ended June 30, 2010, we received proceeds of \$8 million and realized losses of \$3 million from selling a portion of our investment in The9. We did not sell any of our marketable securities during the three months ended June 30, 2011. The realized losses for the three months ended June 30, 2010 are included in loss on strategic investments in our Condensed Consolidated Statement of Operations.

**(5) DERIVATIVE FINANCIAL INSTRUMENTS**

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

We transact business in various foreign currencies and have significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. We purchase foreign currency 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 currency forward contracts to mitigate foreign exchange rate risk associated with foreign-currency-denominated monetary assets and liabilities, primarily intercompany receivables and payables. The foreign currency forward contracts generally have a contractual term of approximately three months or less and are transacted near month-end. At each quarter-end, the fair value of the foreign currency forward contracts generally is not significant. We do not use foreign currency option or foreign currency forward contracts for speculative or trading purposes.

***Cash Flow Hedging Activities***

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

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

that they will occur, within the defined hedge period, the gains or losses on the related cash flow hedges are reclassified from accumulated other comprehensive income to interest and other income, net, in our Condensed Consolidated Statements of Operations. During the reporting periods, all forecasted transactions occurred and, therefore, there were no such gains or losses reclassified into interest and other income, net. As of June 30, 2011, we had foreign currency option contracts to purchase approximately \$14 million in foreign currency and to sell approximately \$95 million of foreign currency. All of the foreign currency option contracts outstanding as of June 30, 2011 will mature in the next 12 months. As of March 31, 2011, we had foreign currency option contracts to purchase approximately \$40 million in foreign currency and to sell approximately \$10 million of foreign currency. As of June 30, 2011 and March 31, 2011, the fair value of these outstanding foreign currency option contracts was immaterial and is included in other current assets.

**Table of Contents**

The effect of the gains and losses from our foreign currency option contracts in our Condensed Consolidated Statements of Operations for the three months ended June 30, 2011 and 2010 was immaterial.

**Balance Sheet Hedging Activities**

Our foreign currency forward contracts are not designated as hedging instruments, and are accounted for as derivatives whereby the fair value of the contracts is reported as other current assets or accrued and other current liabilities on our Condensed Consolidated Balance Sheets, and gains and losses resulting from changes in the fair value are reported in interest and other income, net, in our Condensed Consolidated Statements of Operations. The gains and losses on these foreign currency forward contracts generally offset the gains and losses in the underlying foreign-currency-denominated monetary assets and liabilities, which are also reported in interest and other income, net, in our Condensed Consolidated Statements of Operations. As of June 30, 2011, we had foreign currency forward contracts to purchase and sell approximately \$189 million in foreign currencies. Of this amount, \$117 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$51 million to purchase foreign currency in exchange for U.S. dollars and \$21 million to sell foreign currency in exchange for British pounds sterling. As of March 31, 2011, we had foreign currency forward contracts to purchase and sell approximately \$187 million in foreign currencies. Of this amount, \$140 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$31 million to purchase foreign currency in exchange for U.S. dollars and \$16 million to sell foreign currency in exchange for British pounds sterling. The fair value of our foreign currency forward contracts was immaterial as of June 30, 2011 and March 31, 2011.

The effect of foreign currency forward contracts in our Condensed Consolidated Statements of Operations for the three months ended June 30, 2011 and 2010 was immaterial.

**(6) BUSINESS COMBINATIONS**

During the three months ended June 30, 2011, we completed two acquisitions that did not have a significant impact on our Condensed Consolidated Financial Statements.

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

The changes in the carrying amount of goodwill are as follows (in millions):

	Label Segment	Other Segments	Total
As of March 31, 2011			
Goodwill	\$ 691	\$ 787	\$ 1,478
Accumulated impairment		(368)	(368)
	691	419	1,110
Goodwill acquired		21	21
Effects of foreign currency translation		1	1
As of June 30, 2011			
Goodwill	691	809	1,500
Accumulated impairment		(368)	(368)
	\$ 691	\$ 441	\$ 1,132

**Table of Contents**

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

	As of June 30, 2011			As of March 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net
Developed and core technology	\$ 265	\$ (187)	\$ 78	\$ 259	\$ (180)	\$ 79
Trade names and trademarks	90	(73)	17	90	(70)	20
Registered user base and other intangibles	86	(69)	17	86	(64)	22
Carrier contracts and related	85	(63)	22	85	(62)	23
<b>Total</b>	<b>\$ 526</b>	<b>\$ (392)</b>	<b>\$ 134</b>	<b>\$ 520</b>	<b>\$ (376)</b>	<b>\$ 144</b>

Amortization of intangibles for the three months ended June 30, 2011 and 2010 was \$16 million (of which \$3 million was recognized in cost of goods sold) and \$18 million (of which \$3 million was recognized in cost of goods sold), respectively. Acquisition-related intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the agreement terms, typically from two to fourteen years. As of June 30, 2011 and March 31, 2011, the weighted-average remaining useful life for acquisition-related intangible assets was approximately 5.1 years for each period.

As of June 30, 2011, future amortization of acquisition-related intangibles that will be recorded in cost of goods sold and operating expenses is estimated as follows (in millions):

Fiscal Year Ending March 31,	
2012 (remaining nine months)	\$ 37
2013	31
2014	20
2015	15
2016	6
Thereafter	25
<b>Total</b>	<b>\$ 134</b>

**(8) RESTRUCTURING AND OTHER CHARGES**

Restructuring and other restructuring plan-related information as of June 30, 2011 was as follows (in millions):

	Fiscal 2011 Restructuring		Fiscal 2010 Restructuring			Fiscal 2009 Restructuring	
	Workforce	Other	Workforce	Facilities-related	Other	Facilities-related	Total
Balances as of March 31, 2010	\$	\$	\$ 8	\$ 11	\$ 7	\$ 3	\$ 29
Charges to operations	13	135			13		161
Charges settled in cash	(8)	(32)	(8)	(6)	(15)	(1)	(70)
Charges settled in non-cash	(2)	(2)		1			(3)
Balances as of March 31, 2011	3	101		6	5	2	117
Charges to operations	(1)	17		1	1		18
Charges settled in cash		(9)		(2)	(3)		(14)
Balances as of June 30, 2011	\$ 2	\$ 109	\$	\$ 5	\$ 3	\$ 2	\$ 121

***Fiscal 2011 Restructuring***

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

## **Table of Contents**

As part of our fiscal 2011 restructuring plan, we amended certain license agreements to terminate certain rights we previously had to use the licensors' intellectual property. However, under these agreements we continue to be obligated to pay the contractual minimum royalty-based commitments set forth in the original agreements. Accordingly, we recognized losses and impairments of \$119 million representing (1) the net present value of the estimated payments related to terminating these rights and (2) writing down assets associated with these agreements to their approximate fair value. In addition, for one agreement, the actual amount of the loss is variable and subject to periodic adjustments as it is dependent upon the actual revenue we generate from the games. Because the loss for one agreement will be paid in installments through June 2016, our accrued loss was computed using the effective interest method. We currently estimate recognizing in future periods through June 2016, approximately \$17 million for the accretion of interest expense related to this obligation. This interest expense will be included in restructuring and other charges in our Condensed Consolidated Statement of Operations.

In addition, for the development of certain games, we previously entered into publishing agreements with independent software developers. Under these agreements, we were obligated to pay the independent software developers a predetermined amount (a Minimum Guarantee) upon delivery of a completed product. The independent software developers were thinly capitalized and they financed the development of products through bank borrowings. During fiscal year 2011, in order to more directly influence the development, product quality and product completion, we amended these agreements whereby we agreed to advance a portion of the Minimum Guarantee prior to completion of the product which were used by the independent software developers to repay their bank loans. In addition, we are now committed to advance the remaining portion of the Minimum Guarantee during the remaining development period. As a result, we have now assumed development risk of the products.

Because the independent software developers are thinly capitalized, our sole ability to recover the Minimum Guarantee is effectively through publishing the software product in development. We also have exclusive rights to exploit the software product once completed. Therefore, we concluded that the substance of the arrangement is the purchase of research and development that has no alternative future use and was expensed upon acquisition. Accordingly, we recognized a \$31 million charge in our Condensed Consolidated Statement of Operations during the fiscal year ended March 31, 2011. In addition, we will recognize the remaining portion of the Minimum Guarantee to be advanced during the development period as research and development expenses as the services are incurred.

Since the inception of the fiscal 2011 restructuring plan through June 30, 2011, we have incurred charges of \$164 million, consisting of (1) \$121 million related to the amendment of certain licensing agreements and other intangible asset impairment costs, (2) \$31 million related to the amendment of certain developer agreements, and (3) \$12 million in employee-related expenses. The \$111 million restructuring accrual as of June 30, 2011 related to the fiscal 2011 restructuring is expected to be settled by June 2016. During the remainder of fiscal year 2012, we anticipate incurring approximately \$5 million of restructuring charges related to the fiscal 2011 restructuring (primarily interest expense accretion).

Overall, including \$164 million in charges incurred through June 30, 2011, we expect to incur total cash and non-cash charges between \$180 million and \$190 million by June 2016. These charges will consist primarily of (1) charges, including accretion of interest expense, related to the amendment of certain licensing and developer agreements and other intangible asset impairment costs (approximately \$170 million) and (2) employee-related costs (approximately \$15 million).

### ***Fiscal 2010 Restructuring***

In fiscal year 2010, we announced a restructuring plan to narrow our product portfolio to provide greater focus on titles with higher margin opportunities. Under this plan, we reduced our workforce by approximately 1,100 employees and have (1) consolidated or closed various facilities, (2) eliminated certain titles, and (3) incurred IT and other costs to assist in reorganizing certain activities. The majority of these exit activities were completed by March 31, 2010.

Since the inception of the fiscal 2010 restructuring plan through June 30, 2011, we have incurred charges of \$131 million, consisting of (1) \$62 million in employee-related expenses, (2) \$46 million related to intangible asset impairment costs, abandoned rights to intellectual property, and other costs to assist in the reorganization of our business support functions, and (3) \$23 million related to the closure of certain of our facilities. The \$8 million restructuring accrual as of June 30, 2011 related to the fiscal 2010 restructuring is expected to be settled by September 2013. During the remainder of fiscal year 2012, we anticipate incurring approximately \$5 million of restructuring charges related to the fiscal 2010 restructuring (primarily costs to assist in the reorganization of our business support functions).

Overall, including charges incurred through June 30, 2011, we expect to incur total cash and non-cash charges of approximately \$135 million by March 31, 2012. These charges consist primarily of (1) employee-related costs (\$62 million), (2) intangible asset impairment costs, abandoned rights to intellectual property costs, and other costs to assist in the reorganization of our business support functions (approximately \$50 million), and (3) facilities exit costs (\$23 million).



## **Table of Contents**

### ***Fiscal 2009 Restructuring***

In fiscal year 2009, we announced a cost reduction plan as a result of our performance combined with the economic environment. This plan included a narrowing of our product portfolio, a reduction in our worldwide workforce of approximately 11 percent, or 1,100 employees, the closure of 10 facilities, and reductions in other variable costs and capital expenditures.

Since the inception of the fiscal 2009 restructuring plan through March 31, 2011, we have incurred charges of \$55 million, consisting of (1) \$33 million in employee-related expenses, (2) \$20 million related to the closure of certain of our facilities, and (3) \$2 million related to asset impairments. We do not expect to incur any additional restructuring charges under this plan. The restructuring accrual of \$2 million as of June 30, 2011 related to the fiscal 2009 restructuring is expected to be settled by September 2016.

### **(9) ROYALTIES AND LICENSES**

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

Royalty-based obligations with content licensors and distribution affiliates are either paid in advance and capitalized as prepaid royalties or are accrued as incurred and subsequently paid. These royalty-based obligations are generally expensed to cost of goods sold generally at the greater of the contractual rate for contracts with guaranteed minimums, or an effective royalty rate based on the total projected net revenue. Prepayments made to thinly capitalized independent software developers and co-publishing affiliates are generally made in connection with the development of a particular product and, therefore, we are generally subject to development risk prior to the release of the product. Accordingly, payments that are due prior to completion of a product are generally expensed to research and development over the development period as the services are incurred. Payments due after completion of the product (primarily royalty-based in nature) are generally expensed as cost of 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. Royalty liabilities are classified as current liabilities to the extent such royalty payments are contractually due within the next 12 months.

Each quarter, we also evaluate the expected future realization of our royalty-based assets, as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are charged to research and development expense. Impairments or losses determined post-launch are charged to cost of goods sold. We evaluate long-lived royalty-based assets for impairment generally using undiscounted cash flows when impairment indicators exist. Unrecognized minimum royalty-based commitments are accounted for as executory contracts and, therefore, any losses on these commitments are recognized when the underlying intellectual property is abandoned (*i.e.*, cease use) or the contractual rights to use the intellectual property are terminated. During the three months ended June 30, 2011, we recognized an additional loss of \$15 million representing an adjustment to our fiscal 2011 restructuring. During the three months ended June 30, 2010, we recognized a loss of \$10 million on previously unrecognized royalty-based commitments. We did not recognize any impairment charges during the three months ended June 30, 2011 and 2010 related to our royalty-based assets.



**Table of Contents**

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 June 30, 2011	As of March 31, 2011
Other current assets	\$ 105	\$ 89
Other assets	119	22
<b>Royalty-related assets</b>	<b>\$ 224</b>	<b>\$ 111</b>

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

	As of June 30, 2011	As of March 31, 2011
Accrued and other current liabilities	\$ 116	\$ 136
Other liabilities	71	61
<b>Royalty-related liabilities</b>	<b>\$ 187</b>	<b>\$ 197</b>

As of June 30, 2011, \$109 million of restructuring accruals related to the fiscal 2011 restructuring plan is included in royalty-related liabilities in the table above. See Note 8 for details of restructuring and other restructuring plan-related activities and Note 10 for the details of our accrued and other current liabilities.

In addition, as of June 30, 2011, we were committed to pay approximately \$1,000 million to content licensors, independent software developers and co-publishing and/or distribution affiliates, but performance remained with the counterparty (*i.e.*, delivery of the product or content or other factors) and such commitments were therefore not recorded in our Condensed Consolidated Financial Statements.

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

Inventories as of June 30, 2011 and March 31, 2011 consisted of (in millions):

	As of June 30, 2011	As of March 31, 2011
Raw materials and work in process	\$ 2	\$ 8
Finished goods	73	69
<b>Inventories</b>	<b>\$ 75</b>	<b>\$ 77</b>

**Table of Contents****Property and Equipment, Net**

Property and equipment, net, as of June 30, 2011 and March 31, 2011 consisted of (in millions):

	As of June 30, 2011	As of March 31, 2011
Computer equipment and software	\$ 496	\$ 504
Buildings	356	355
Leasehold improvements	106	105
Office equipment, furniture and fixtures	68	67
Land	66	66
Warehouse equipment and other	9	10
Construction in progress	30	20
	1,131	1,127
Less: accumulated depreciation	(615)	(614)
Property and equipment, net	\$ 516	\$ 513

Depreciation expense associated with property and equipment was \$25 million and \$28 million for the three months ended June 30, 2011 and 2010, respectively.

**Acquisition-Related Restricted Cash Included in Other Current Assets and Other Assets**

In connection with our acquisition of Playfish in fiscal year 2010, we deposited \$100 million into an escrow account to pay the former shareholders of Playfish in the event certain performance milestones through December 31, 2011 are achieved. Through the three months ended June 30, 2011, no distributions were made from the restricted cash amount. As this deposit is restricted in nature, it is excluded from cash and cash equivalents. As of June 30, 2011 and March 30, 2011 the entire amount is included in other current assets on our Condensed Consolidated Balance Sheets.

**Accrued and Other Current Liabilities**

Accrued and other current liabilities as of June 30, 2011 and March 31, 2011 consisted of (in millions):

	As of June 30, 2011	As of March 31, 2011
Other accrued expenses	\$ 303	\$ 359
Accrued compensation and benefits	149	232
Accrued royalties	78	96
Deferred net revenue (other)	74	81
Accrued and other current liabilities	\$ 604	\$ 768

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

**Deferred Net Revenue (Packaged Goods and Digital Content)**

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

Deferred net revenue (packaged goods and digital content) was \$530 million as of June 30, 2011 and \$1,005 million as of March 31, 2011. Deferred net revenue (packaged goods and digital content) includes the unrecognized revenue from (1) bundled sales of certain online-enabled packaged goods and digital content for which either we do not have vendor-specific objective evidence of fair value ( VSOE ) for the online service that we provide in connection with the sale of the software or we have an obligation to provide future incremental unspecified digital content, (2) certain packaged goods sales of massively-multiplayer online role-playing games, and (3) sales of certain incremental content associated with our core subscription services that can only be played online, which are types of micro-transactions. We recognize revenue from sales of online-enabled packaged goods and digital content for which (1) we do not have VSOE for the online service that we provided in connection with the sale and (2) we have an obligation to deliver incremental unspecified digital content in the future without an additional fee on a straight-line basis generally over an estimated six-month period beginning in the month after shipment. However, we expense the cost of goods sold related to these transactions during the period in which the product is delivered (rather than on a deferred basis).

**Table of Contents****(11) INCOME TAXES**

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

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

The tax provision reported for the three months ended June 30, 2011 is based on our projected annual effective tax rate for fiscal year 2012, and also includes certain discrete tax benefits recorded during the period. Our effective tax rates for the three months ended June 30, 2011 and June 30, 2010 were a tax provision of 3.9 percent and a tax benefit of 3.4 percent, respectively. The effective tax rate for the three months ended June 30, 2011 differs from the statutory rate of 35.0 percent primarily due to the utilization of U.S. deferred tax assets which were subject to a valuation allowance and non-U.S. profits subject to a reduced or zero tax rate. The effective tax rate for the three months ended June 30, 2011 differs from the same period in fiscal year 2011 primarily due to greater tax benefits recorded in fiscal year 2011 related to the expiration of statutes of limitations.

During the three months ended June 30, 2011, we recorded a net increase of \$5 million in gross unrecognized tax benefits. The total gross unrecognized tax benefits as of June 30, 2011 is \$278 million, of which approximately \$40 million would be offset by prior cash deposits to tax authorities for issues pending resolution. A portion of our unrecognized tax benefits will affect our effective tax rate if they are recognized upon favorable resolution of the uncertain tax positions. As of June 30, 2011, if recognized, approximately \$139 million of the unrecognized tax benefits would affect our effective tax rate and approximately \$125 million would result in adjustments to deferred tax assets with corresponding adjustments to the valuation allowance.

As of June 30, 2011, the combined amount of accrued interest and penalties related to uncertain tax positions included in income tax obligations on our Condensed Consolidated Balance Sheet was approximately \$24 million, as compared to the same amount at March 31, 2011.

The IRS has completed its examination of our federal income tax returns through fiscal year 2005, and is currently examining our fiscal years 2006, 2007 and 2008 tax returns. We are also currently under income tax examination in Canada for fiscal years 2004 and 2005, and in France for fiscal years 2006 through 2008. We remain subject to income tax examination for several other jurisdictions including Canada for fiscal years after 2001, in France for fiscal years after 2008, in Germany for fiscal years after 2007, in the United Kingdom for fiscal years after 2009, and in Switzerland for fiscal years after 2007.

On January 18, 2011, we received a Corporation Notice of Reassessment (the "Notice") from the Canada Revenue Agency ("CRA") claiming that we owe additional taxes, plus interest and penalties, for the 2004 and 2005 tax years. The incremental tax liability asserted by the CRA is \$44 million, excluding interest and penalties. The Notice primarily relates to transfer pricing in connection with the reimbursement of costs for services rendered to our U.S. parent company by one of our subsidiaries in Canada. We do not agree with the CRA's position and we have filed a Notice of Objection with the appeals department of the CRA. We do not believe the CRA's position has merit and accordingly, we have not adjusted our liability for uncertain tax positions as a result of the Notice. If, upon resolution, we are required to pay an amount in excess of our liability for uncertain tax positions for this matter, the incremental amounts due would result in additional charges to income tax expense. In determining such charges, we would consider whether any correlative relief should be included in the form of additional tax deductions in the U.S. should we decide to seek such relief.

**Table of Contents**

The timing of the resolution of income tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued for each year. Although potential resolution of uncertain tax positions involve multiple tax periods and jurisdictions, it is reasonably possible that a reduction of up to \$60 million of the reserves for unrecognized tax benefits may occur within the next 12 months, some of which, depending on the nature of the settlement or expiration of statutes of limitations, may affect our income tax provision (benefit) and therefore benefit the resulting effective tax rate. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements.

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

As of June 30, 2011, we leased certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.

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

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

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include: FIFA, FIFPRO Foundation, FAPL (Football Association Premier League Limited), and DFL Deutsche Fußball Liga GmbH (German Soccer League) (professional soccer); 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); National Football League Properties, PLAYERS Inc., and Red Bear Inc. (professional football); Collegiate Licensing Company (collegiate football); ESPN (content in EA SPORTS games); Hasbro, Inc. (most of Hasbro's toy and game intellectual properties); and LucasArts and Lucas Licensing (Star Wars: The Old Republic). These developer and content license commitments represent the sum of (1) the cash payments due under non-royalty-bearing licenses and services agreements and (2) the minimum guaranteed payments and advances against royalties due under royalty-bearing licenses and services agreements, the majority of which are conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.

The following table summarizes our unrecognized minimum contractual obligations as of June 30, 2011 (in millions):

Fiscal Year Ending March 31,	Contractual Obligations				Total
	Leases (a)	Developer/ Licensor Commitments	Marketing	Other Purchase Obligations	
2012 (remaining nine months)	\$ 35	\$ 138	\$ 98	\$ 10	\$ 281
2013	50	198	38	3	289
2014	43	126	68	3	240
2015	29	106	32	2	169
2016	20	84	33		137
Thereafter	14	348	95		457
<b>Total</b>	<b>\$ 191</b>	<b>\$ 1,000</b>	<b>\$ 364</b>	<b>\$ 18</b>	<b>\$ 1,573</b>

(a) Lease commitments have not been reduced by minimum sub-lease rentals for unutilized office space resulting from our reorganization activities of approximately \$11 million due in the future under non-cancelable sub-leases.



## **Table of Contents**

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

In addition to what is included in the table above, as of June 30, 2011, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$240 million, of which approximately \$40 million is offset by prior cash deposits to tax authorities for issues pending resolution. For the remaining liability, we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

In addition to what is included in the table above as of June 30, 2011, in connection with our acquisitions, we may be required to pay an additional \$110 million of cash consideration through March 31, 2014, that is contingent upon the achievement of certain performance milestones. As of June 30, 2011, we have accrued \$53 million of contingent consideration on our Condensed Consolidated Balance Sheet.

### ***Legal Proceedings***

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

## **(13) STOCK-BASED COMPENSATION**

### ***Valuation Assumptions***

We are required to estimate the fair value of share-based payment awards on the date of grant. We recognize compensation costs for stock-based payment awards to employees based on the grant-date fair value using a straight-line approach over the service period for which such awards are expected to vest.

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

*Restricted Stock Units, Restricted Stock, and Performance-Based Restricted Stock Units.* The fair value of restricted stock units, restricted stock, and performance-based restricted stock units (other than market-based restricted stock units) is determined based on the quoted market price of our common stock on the date of grant. Performance-based restricted stock units include grants made (1) to certain members of executive management primarily granted in fiscal year 2008 and (2) in connection with certain acquisitions.

*Market-Based Restricted Stock Units.* Market-based restricted stock units consist of grants of performance-based restricted stock units granted during the three months ended June 30, 2011 to certain members of executive management (referred to herein as market-based restricted stock units). The fair value of our market-based restricted stock units is determined using a Monte-Carlo simulation model. Key assumptions for the Monte-Carlo simulation model are the risk-free interest rate, expected volatility, expected dividends and correlation coefficient.

*Stock Options and Employee Stock Purchase Plan.* The fair value of stock options and stock purchase rights granted pursuant to our equity incentive plans and our 2000 Employee Stock Purchase Plan ( ESPP ), respectively is determined using the Black-Scholes valuation model based on the multiple-award valuation method. Key assumptions of the Black-Scholes valuation model are the risk-free interest rate, expected volatility, expected term and expected dividends.

The determination of the fair value of market-based restricted stock units, stock options and ESPP is affected by assumptions regarding subjective and complex variables. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes.





**Table of Contents**

The estimated assumptions used in the Black-Scholes valuation model to value our stock option grants were as follows:

	Three Months Ended June 30,	
	2011	2010
Risk-free interest rate	1.0 - 1.8%	1.2 - 2.4%
Expected volatility	40 - 41%	41 - 44%
Weighted-average volatility	40%	43%
Expected term	4.4 years	4.4 years
Expected dividends	None	None

The estimated assumptions used in the Monte-Carlo simulation model to value our market-based restricted stock units were as follows:

	Three Months Ended June 30, 2011	
	Risk-free interest rate	0.2 - 0.6%
Expected volatility	14 - 83%	
Weighted-average volatility	35%	
Expected dividends	None	

There were no market-based restricted stock units valued during the three months ended June 30, 2010 and no ESPP shares valued during the three months ended June 30, 2011 and 2010.

***Stock-Based Compensation Expense***

Employee stock-based compensation expense recognized during the three months ended June 30, 2011 and 2010 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. In subsequent periods, if actual forfeitures differ from those estimates, an adjustment to stock-based compensation expense will be recognized at that time.

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

	Three Months Ended June 30,	
	2011	2010
Cost of goods sold	\$ 1	\$ 1
Marketing and sales	5	4
General and administrative	9	12
Research and development	23	30
Stock-based compensation expense	\$ 38	\$ 47

During the three months ended June 30, 2011 and 2010, we did not recognize any provision for or benefit from income taxes related to our stock-based compensation expense.

As of June 30, 2011, our total unrecognized compensation cost related to stock options was \$28 million and is expected to be recognized over a weighted-average service period of 1.2 years. As of June 30, 2011, our total unrecognized compensation cost related to restricted stock, restricted stock units and notes payable in shares of common stock (collectively referred to as restricted stock rights) was \$388 million and is expected to be recognized over a weighted-average service period of 2.2 years. Of the \$388 million of unrecognized compensation cost above, \$24 million relates to performance-based restricted stock units for which we ceased recognizing stock-based compensation expense during fiscal year 2010 because we determined that the performance attainment was neither probable nor improbable of achievement.



**Table of Contents****Stock Options**

The following table summarizes our stock option activity for the three months ended June 30, 2011:

	Options (in thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding as of March 31, 2011	12,899	\$ 31.39		
Granted	105	22.19		
Exercised	(711)	19.86		
Forfeited, cancelled or expired	(698)	23.38		
Outstanding as of June 30, 2011	11,595	32.50	5.02	\$ 29
Exercisable as of June 30, 2011	8,776	35.68	4.20	\$ 15

The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price as of June 30, 2011, which would have been received by the option holders had all the option holders exercised their options as of that date. The weighted-average grant date fair values of stock options granted during the three months ended June 30, 2011 and 2010 were \$7.70 and \$6.46, respectively. We issue new common stock from our authorized shares upon the exercise of stock options.

**Restricted Stock Rights**

The following table summarizes our restricted stock rights activity, excluding performance-based and market-based restricted stock unit activity discussed below, for the three months ended June 30, 2011:

	Restricted Stock Rights (in thousands)	Weighted- Average Grant Date Fair Value
Balance as of March 31, 2011	13,971	\$ 22.01
Granted	6,995	22.35
Vested	(2,370)	22.43
Forfeited or cancelled	(664)	19.91
Balance as of June 30, 2011	17,932	22.16

The weighted-average grant date fair values of restricted stock rights granted during the three months ended June 30, 2011 and 2010 were \$22.35 and \$17.65, respectively.

**Performance-Based Restricted Stock Units**

The following table summarizes our performance-based restricted stock unit activity for the three months ended June 30, 2011:

	Performance- Based Restricted Stock Units (in thousands)	Weighted- Average Grant Date Fair Value
--	---	---

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

Balance as of March 31, 2011	1,993	\$	47.00
Forfeited or cancelled	(169)		20.01
Balance as of June 30, 2011	1,824		49.50

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

During the three months ended June 30, 2011, we granted 670,000 market-based restricted stock units to certain members of executive management with a weighted average fair value of \$34.77 per unit. Our market-based restricted stock units vest contingent upon the achievement of pre-determined market and service conditions. If these market conditions are not met but service conditions are met, the restricted stock units will not vest; however, any compensation expense we have recognized to date will not be reversed. The number of shares of common stock to be received at vesting will range from zero percent to 200 percent of the target number of stock units based on our total stockholder return (TSR) relative to the performance of companies in the NASDAQ-100 Index for each measurement period over a three year period.

***Stock Repurchase Program***

On February 1, 2011, our Board of Directors authorized a program to repurchase up to \$600 million of our common stock over the next 18 months. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase any specific number of shares under the program and the repurchase program may be modified, suspended or discontinued at any time. During three months ended June 30, 2011, we repurchased and retired approximately 4 million shares of our common stock for approximately \$91 million, net of commissions.

***Annual Meeting of Stockholders***

At our Annual Meeting of Stockholders, held on July 28, 2011, our stockholders approved (1) an amendment to our 2000 Equity Incentive Plan (the Equity Plan) to increase the number of shares authorized for issuance under the Equity Plan by 10 million shares and (2) an amendment to the ESPP to increase the number of shares authorized under the ESPP by 3.5 million shares.

**(14) COMPREHENSIVE INCOME (LOSS)**

We classify items of other comprehensive income (loss) by their nature in a financial statement and display the accumulated other comprehensive income balance separately from retained earnings (accumulated deficit) and paid-in capital in the equity section of our balance sheets. Accumulated other comprehensive income primarily includes foreign currency translation adjustments and the net of tax amounts for unrealized gains (losses) on available-for-sale securities and derivative instruments 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 comprehensive income (loss), net of related immaterial taxes, for the three months ended June 30, 2011 and 2010 is summarized as follows (in millions):

	<b>Three Months Ended</b>	
	<b>June 30,</b>	
	<b>2011</b>	<b>2010</b>
Net income	\$ 221	\$ 96
Other comprehensive income (loss):		
Change in unrealized gains (losses) on available-for-sale securities	13	(89)
Reclassification adjustment for realized losses on available-for-sale securities		5
Change in unrealized gains on derivative instruments		(1)
Reclassification adjustment for realized losses on derivative instruments	2	1
Foreign currency translation adjustments	6	(31)
Total other comprehensive income (loss)	21	(115)
Total comprehensive income (loss)	\$ 242	\$ (19)

**(15) NET INCOME PER SHARE**

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

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, and common stock through the ESPP using the treasury stock method.

**Table of Contents**

(In millions, except per share data)	Three Months Ended June 30,	
	2011	2010
Net income	\$ 221	\$ 96
Shares used to compute net income per share:		
Weighted-average common stock outstanding - basic	331	328
Dilutive potential common shares	6	4
Weighted-average common stock outstanding - diluted	337	332
Net income per share:		
Basic	\$ 0.67	\$ 0.29
Diluted	\$ 0.66	\$ 0.29

Options to purchase restricted stock units and restricted stock to be released in the amount of 12 million shares and 20 million shares of common stock were excluded from the computation of diluted shares for the three months ended June 30, 2011 and 2010, respectively, as their inclusion would have had an antidilutive effect. For the three months ended June 30, 2011 and 2010, the weighted-average exercise prices of these shares were \$29.95 and \$23.01 per share, respectively.

**(16) 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 ( CODM ), to evaluate segment performance; the availability of separate financial information; and overall materiality considerations.

Our business is currently organized around three operating labels, EA Games, EA SPORTS and EA Play, as well as EA Interactive. Our CODM regularly receives separate financial information for distinct businesses within the EA Interactive organization, including EA Mobile, the combined results of Pogo and Playfish, and Hasbro. Accordingly, in assessing performance and allocating resources, our CODM reviews the results of our three Labels, as well as the operating segments in EA Interactive, including EA Mobile, the combined results of Pogo and Playfish, and Hasbro. Due to their similar economic characteristics, products, and distribution methods, EA Games, EA SPORTS, EA Play, and Hasbro s results are aggregated into one Reportable Segment (the Label segment ) as shown below. The remaining operating segments results are not material for separate disclosure and are included in the reconciliation of Label segment profit (loss) to our consolidated operating income below. In addition to assessing performance and allocating resources based on our operating segments as described herein, to a lesser degree, our CODM also reviews results based on geographic performance.

The following table summarizes the financial performance of the Label segment and a reconciliation of the Label segment s profit (loss) to our consolidated operating income for the three months ended June 30, 2011 and 2010 (in millions):

	Three Months Ended June 30,	
	2011	2010
Label segment:		
Net revenue before revenue deferral	\$ 409	\$ 430
Depreciation and amortization	(11)	(11)
Other expenses	(445)	(416)
Label segment profit (loss)	(47)	3
Reconciliation to consolidated operating income:		
Other:		
Revenue deferral	(250)	(318)
Recognition of revenue deferral	725	594
Other net revenue	115	109
Depreciation and amortization	(30)	(35)
Other expenses	(286)	(255)

Consolidated operating income	\$ 227	\$ 98
-------------------------------	--------	-------



**Table of Contents**

Label segment profit (loss) differs from consolidated operating income primarily due to the exclusion of (1) certain corporate and other functional costs that are not allocated to the Labels, (2) the deferral of certain net revenue related to online-enabled packaged goods and digital content (see Note 10 of the Notes to Condensed Consolidated Financial Statements), and (3) the results of EA Mobile, the combined results of Pogo and Playfish, and our Switzerland distribution revenue that has not been allocated to the Labels. Our CODM reviews assets on a consolidated basis and not on a segment basis.

Information about our total net revenue by platform for the three months ended June 30, 2011 and 2010 is presented below (in millions):

	<b>Three Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Consoles</b>		
Xbox 360	\$ 345	\$ 262
PLAYSTATION 3	308	209
Wii	42	40
PlayStation 2	3	11
<b>Total consoles</b>	<b>698</b>	<b>522</b>
<b>PC</b>	<b>205</b>	<b>186</b>
<b>Mobile and handhelds</b>		
Mobile	57	52
PSP	11	19
Nintendo DS	8	11
<b>Total mobile and handhelds</b>	<b>76</b>	<b>82</b>
<b>Other</b>	<b>20</b>	<b>25</b>
<b>Total net revenue</b>	<b>\$ 999</b>	<b>\$ 815</b>

Information about our operations in North America, Europe and Asia as of and for the three months ended June 30, 2011 and 2010 is presented below (in millions):

	<b>Three Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b><u>Net revenue from unaffiliated customers</u></b>		
North America	\$ 501	\$ 451
Europe	438	317
Asia	60	47
<b>Total</b>	<b>\$ 999</b>	<b>\$ 815</b>

	<b>As of June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b><u>Long-lived assets</u></b>		
North America	\$ 1,289	\$ 1,325
Europe	440	432

Asia	53	34
<b>Total</b>	<b>\$ 1,782</b>	<b>\$ 1,791</b>

Our direct sales to GameStop Corp. represented approximately 18 percent and 14 percent of total net revenue for the three months ended June 30, 2011 and 2010, respectively. Our direct sales to Wal-Mart Stores Inc. did not exceed 10 percent of total net revenue for the three months ended June 30, 2011. Our direct sales to Wal-Mart Stores Inc. represented approximately 11 percent of total net revenue for the three months ended June 30, 2010.

#### **(17) IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS**

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments in this ASU generally represent clarification of Topic 820, but also include instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards. The amendments are effective for interim and annual periods beginning after December 15, 2011 and are to be applied prospectively. We do not expect the adoption of ASU 2011-04 to have a material impact on our Condensed Consolidated Financial Statements.

## **Table of Contents**

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. ASU 2011-05 requires one of two alternatives for presenting comprehensive income and eliminates the option to report other comprehensive income and its components as a part of the Consolidated Statements of Stockholders' Equity. ASU 2011-05 also requires presentation on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. The amendments in ASU 2011-05 do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 is effective for fiscal years and interim periods within those years beginning after December 15, 2011 and is to be applied retrospectively. We do not expect the adoption of ASU 2011-05 to have a material impact on our Condensed Consolidated Financial Statements.

### **(18) SUBSEQUENT EVENTS**

#### ***PopCap Games, Inc. Acquisition***

On July 11, 2011, we entered into an agreement to acquire all of the outstanding shares of PopCap Games, Inc. Under the terms of the agreement, we will pay (1) approximately \$650 million in cash, (2) approximately \$100 million in privately placed shares of our common stock to the founders and chief executive officer of PopCap, and (3) up to approximately \$50 million in long-term equity retention arrangements in the form of restricted stock unit awards and options to acquire our common stock to be granted over the next four years to PopCap employees joining us. PopCap is a leading provider of games for mobile phones, tablets, PCs, and social network sites. This acquisition accelerates our participation in social gaming and contributes to our digital business. The purchase price is subject to upward adjustment for the amount of unrestricted cash held by PopCap at the closing and downward adjustment for any indebtedness of PopCap and for certain transaction expenses incurred by PopCap in connection with the acquisition.

In addition, we may be required to pay additional variable cash consideration that is contingent upon the achievement of certain performance milestones through December 31, 2013. The additional consideration is limited to a maximum of \$550 million.

#### ***Offering of \$632.5 million 0.75% Convertible Senior Notes Due 2016***

On July 14, 2011, we entered into a Purchase Agreement (the "Purchase Agreement") with Morgan Stanley & Co. LLC, as representative of the initial purchasers (collectively, the "Initial Purchasers") with respect to the offer and sale of \$550 million aggregate principal amount of our 0.75% Convertible Senior Notes due 2016 (the "Firm Notes"). We also granted the Initial Purchasers an option to purchase up to an additional \$82.5 million principal amount of notes (the "Additional Notes" and together with the Firm Notes, the "Notes") solely to cover over-allotments. The Initial Purchasers exercised their option to purchase the maximum amount of the Additional Notes on July 15, 2011. The Purchase Agreement includes customary representations, warranties and covenants. Under the terms of the Purchase Agreement, we have agreed to indemnify the Initial Purchasers against certain liabilities.

## Table of Contents

Also on July 14, 2011, in connection with the pricing of the Notes, and on July 18, 2011, in connection with the Initial Purchasers' exercise of their over-allotment option, we entered into privately negotiated convertible note hedge transactions (the "Hedge Transactions") with certain option counterparties (the "Option Counterparties"). The Hedge Transactions cover, subject to customary anti-dilution adjustments, approximately 19.9 million shares of our common stock, which is equal to the number of shares of our common stock that will initially underlie the Notes. These transactions are expected to reduce the potential dilution with respect to our common stock upon conversion of the Notes. Separately, we have also entered into privately negotiated warrant transactions with the Option Counterparties to purchase, subject to customary anti-dilution adjustments, approximately 19.9 million shares of our common stock, with a strike price of \$41.14 (the "Warrant Transactions"). The Warrant Transactions will have a dilutive effect with respect to our common stock to the extent that the market price per share of its common stock exceeds the strike price of the warrants on or prior to the expiration date of the warrants. Our cost of the Hedge Transactions, after taking into account our proceeds from the Warrant Transactions, is approximately \$42.3 million.

On July 20, 2011, in connection with the issuance of the Notes, we entered into an Indenture (the "Indenture") with respect to the Notes with U.S. Bank National Association, as Trustee (the "Trustee"). Under the Indenture, the Notes will be our senior unsecured obligations and will pay interest semiannually at a rate of 0.75 percent per annum. The Notes will be convertible into shares of our common stock at an initial conversion rate of 31.5075 shares per \$1,000 principal amount of Notes (equivalent to an initial conversion price of approximately \$31.74 per share). The initial conversion price represents a premium of 35 percent to the \$23.51 per share closing price of our common stock on July 14, 2011.

Prior to April 15, 2016, the notes will be convertible only upon the occurrence of certain events and during certain periods, and thereafter, at any time until the close of business on the second scheduled trading day immediately preceding the maturity date of the notes. Interest on the notes will be payable semiannually in arrears at a rate of 0.75 percent per annum on January 15 and July 15 of each year, beginning on January 15, 2012. The notes will mature on July 15, 2016, unless previously purchased or converted in accordance with their terms prior to such date.

The conversion rate is subject to customary anti-dilution adjustments, but will not be adjusted for any accrued and unpaid interest. Following certain corporate events described in the Indenture that occur prior to the maturity date, the conversion rate will be increased for a holder who elects to convert its Notes in connection with such corporate event in certain circumstances. The notes are not redeemable prior to maturity, and no sinking fund is provided for the Notes.

Upon conversion of the Notes, holders will receive cash up to the principal amount of each Note, and any excess conversion value will be delivered in shares of our common stock.

If we undergo a fundamental change, as defined in the Indenture, subject to certain conditions, holders may require us to purchase for cash all or any portion of their Notes. The fundamental change purchase price will be 100 percent of the principal amount of the Notes to be purchased plus any accrued and unpaid interest up to but excluding the fundamental change purchase date.

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

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders

Electronic Arts Inc.:

We have reviewed the condensed consolidated balance sheets of Electronic Arts Inc. and subsidiaries (the Company) as of July 2, 2011 and July 3, 2010, the related condensed consolidated statements of operations and cash flows for the three-month periods ended July 2, 2011 and July 3, 2010. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

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

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Electronic Arts Inc. and subsidiaries as of April 2, 2011, and the related consolidated statements of operations, stockholders equity and comprehensive loss, and cash flows for the year then ended (not presented herein); and in our report dated May 24, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of April 2, 2011 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Mountain View, California

August 9, 2011

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS**

This Quarterly Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, made in this Quarterly Report are forward looking. Examples of forward-looking statements include statements related to industry prospects, our future economic performance including anticipated revenues and expenditures, results of operations or financial position, and other financial items, our business plans and objectives, including our intended product releases, and may include certain assumptions that underlie the forward-looking statements. We use words such as anticipate, believe, expect, intend, estimate (and the negative of any of these terms), future and similar expressions to identify forward-looking statements. These forward-looking statements are subject to business and economic risk and reflect management's current expectations, and involve subjects that are inherently uncertain and difficult to predict. Our actual results could differ materially from those in the forward-looking statements. We will not necessarily update information if any forward-looking statement later turns out to be inaccurate. Risks and uncertainties that may affect our future results include, but are not limited to, those discussed in this report under the heading Risk Factors in Part II, Item 1A, as well as in our Annual Report on Form 10-K for the fiscal year ended March 31, 2011 as filed with the Securities and Exchange Commission (SEC) on May 24, 2011 and in other documents we have filed with the SEC.

**OVERVIEW**

The following overview is a high-level discussion of our operating results, as well as some of the trends and drivers that affect our business. Management believes that an understanding of these trends and drivers is important in order to understand our results for the three months ended June 30, 2011, as well as our future prospects. This summary is not intended to be exhaustive, nor is it intended to be a substitute for the detailed discussion and analysis provided elsewhere in this Form 10-Q, including in the remainder of Management's Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, and the Condensed Consolidated Financial Statements and related Notes. Additional information can be found in the Business section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2011 as filed with the SEC on May 24, 2011 and in other documents we have filed with the SEC.

***About Electronic Arts***

We develop, market, publish and distribute game software and content that can be played by consumers on a variety of platforms, including video game consoles (such as the Sony PLAYSTATION 3, Microsoft Xbox 360, and Nintendo Wii), personal computers, mobile phones (such as the Apple iPhone and Google Android compatible phones), tablets and electronic readers (such as the Apple iPad and Amazon Kindle), the Internet, and handheld game players (such as the Sony PlayStation Portable (PSP) and the Nintendo DS and 3DS). Some of our games are based on content that we license from others (e.g., FIFA, Madden NFL, Harry Potter, and Hasbro's toy and game intellectual properties), and some of our games are based on our own wholly-owned intellectual property (e.g., The Sims, Need for Speed, and Dead Space). Our goal is to publish titles with global 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., FIFA, Madden NFL, and NCAA Football), 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., Harry Potter).

***Financial Results***

Total net revenue for the three months ended June 30, 2011 was \$999 million, up \$184 million as compared to the three months ended June 30, 2010. This increase was primarily the result of higher revenue from distribution products during the three months ended June 30, 2011 as compared to the three months ended June 30, 2010. At June 30, 2011, deferred net revenue associated with sales of online-enabled packaged goods and digital content decreased by \$475 million as compared to March 31, 2011, directly increasing the amount of reported net revenue during the three months ended June 30, 2011. At June 30, 2010, deferred revenue associated with sales of online-enabled packaged goods and digital content decreased by \$276 million as compared to March 31, 2010, directly increasing the amount of reported net revenue during the three months ended June 30, 2010. Without these changes in deferred net revenue, reported net revenue would have decreased by approximately \$15 million during the three months ended June 30, 2011 as compared to the three months ended June 30, 2010. Net revenue for the three months ended June 30, 2011, was driven by *Portal 2*, *FIFA 2011*, and *Need For Speed: Hot Pursuit*.

---

## **Table of Contents**

Net income for the three months ended June 30, 2011 was \$221 million as compared to a net income of \$96 million for the three months ended June 30, 2010. Diluted earnings per share for the three months ended June 30, 2011 was \$0.66 as compared to diluted earnings per share of \$0.29 for the three months ended June 30, 2010. Net income increased during the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 primarily as a result of a \$166 million increase in gross profit due to a decrease in deferred net revenue. This increase was partially offset by (1) a \$16 million increase in restructuring and other charges primarily from our fiscal 2011 restructuring, (2) a \$13 million increase in marketing and sales expenses, and (3) a \$12 million increase in our income tax provision.

Cash used in operating activities increased \$126 million during the three months ended June 30, 2011 as compared to three months ended June 30, 2010 primarily due to royalty payments.

### ***Trends in Our Business***

*Digital Content Distribution and Services.* Consumers are spending an ever-increasing portion of their money and time on interactive entertainment that is accessible online, or through mobile digital devices such as smart phones, or through social networks such as Facebook. We offer a variety of online-delivered products and services. Many of our games that are available as packaged goods products are also available through direct online download through the Internet. We also offer online-delivered content and services that are add-ons or related to our packaged goods products such as additional game content or enhancements of multiplayer services. Further, we offer other games, content and services that are available only via electronic delivery, such as Internet-only games and game services, and games for mobile devices.

Advances in mobile technology have resulted in a variety of new and evolving devices that are being used to play games by an ever-broadening base of consumers. We have responded to these advances in technology and consumer acceptance of digital distribution by offering different sales models, such as subscription services, online downloads for a one-time fee, and advertising-supported free-to-play games and game sites. In addition, we offer our consumers the ability to play a game across platforms on multiple devices. We significantly increased the revenue that we derive from wireless, Internet-derived and advertising (digital) products and services from \$176 million during the three months ended June 30, 2010 to \$232 million during the three months ended June 30, 2011 and we expect this portion of our business to continue to grow in the current fiscal year and beyond.

*Wireless and other Emerging Platforms.* Advances in technology have resulted in a variety of platforms for interactive entertainment. Examples include wireless technologies, streaming gaming services, and Internet-connected televisions. Our efforts in wireless interactive entertainment are focused in two areas – games for handheld game systems and downloadable games for mobile devices. These platforms grow the consumer base for our business while also providing competition to existing established video game platforms. We expect sales of games for wireless and other emerging platforms to continue to be an important part of our business.

*Concentration of Sales Among the Most Popular Games.* We see a larger portion of packaged goods games sales concentrated on the most popular titles, and that those titles are typically sequels of prior games. We have responded to this trend by significantly reducing the number of games that we produce from 54 primary titles in fiscal year 2010 to 36 primary titles in fiscal year 2011. In fiscal year 2012, we expect to release 22 primary titles. Consequently, we have decreased the number of third-party games that we distribute, which have lower margins.

*Catalog Sales.* The video game industry is experiencing a change in retail sales patterns, which is decreasing revenue from catalog sales (sales of games in the periods subsequent to the quarter in which the title was launched). Currently, many console games experience sales cycles that are shorter than in the past. To mitigate this trend, we offer our consumers a direct-to-consumer service (such as head-to-head play or other multiplayer options) and/or additional content available through online services to further enhance the gaming experience and extend the time that consumers play our games after their initial purchase. We anticipate that in some cases these additional online services will also generate revenue to mitigate the effect of reduced catalog sales.

*Used Games.* Some retailers sell used video games, which are generally priced lower than new video games and do not result in revenue to the publisher of the games from the sale. We have observed that the market for used video games has been growing. If retailers continue to increase their sales of used video games, it could negatively affect our sales of new video games and have an adverse impact on our operating results.

---

**Table of Contents**

***Recent Developments***

*PopCap Games, Inc. Acquisition.* On July 11, 2011, we entered into an agreement to acquire all of the outstanding shares of PopCap Games, Inc. Under the terms of the agreement, we will pay (1) approximately \$650 million in cash, (2) approximately \$100 million in privately placed shares of our common stock to the founders and chief executive officer of PopCap, and (3) up to approximately \$50 million in long-term equity retention arrangements in the form of restricted stock unit awards and options to acquire our common stock to be granted over the next four years to PopCap employees joining us. PopCap is a leading provider of games for mobile phones, tablets, PCs, and social network sites. This acquisition accelerates our participation in social gaming and contributes to our digital business. The purchase price is subject to upward adjustment for the amount of unrestricted cash held by PopCap at the closing and downward adjustment for any indebtedness of PopCap and for certain transaction expenses incurred by PopCap in connection with the acquisition.

In addition, we may be required to pay additional variable cash consideration that is contingent upon the achievement of certain performance milestones through December 31, 2013. The additional consideration is limited to a maximum of \$550 million.

*Offering of \$632.5 million 0.75% Convertible Senior Notes Due 2016.* On July 14, 2011, we entered into a Purchase Agreement (the "Purchase Agreement") with Morgan Stanley & Co. LLC, as representative of the initial purchasers (collectively, the "Initial Purchasers") with respect to the offer and sale of \$550 million aggregate principal amount of our 0.75% Convertible Senior Notes due 2016 (the "Firm Notes"). We also granted the Initial Purchasers an option to purchase up to an additional \$82.5 million principal amount of notes (the "Additional Notes" and together with the Firm Notes, the "Notes") solely to cover over-allotments. The Initial Purchasers exercised their option to purchase the maximum amount of the Additional Notes on July 15, 2011. The Purchase Agreement includes customary representations, warranties and covenants. Under the terms of the Purchase Agreement, we have agreed to indemnify the Initial Purchasers against certain liabilities.

Also on July 14, 2011, in connection with the pricing of the Notes, and on July 18, 2011, in connection with the Initial Purchasers' exercise of their over-allotment option, we entered into privately negotiated convertible note hedge transactions (the "Hedge Transactions") with certain option counterparties (the "Option Counterparties"). The Hedge Transactions cover, subject to customary anti-dilution adjustments, approximately 19.9 million shares of our common stock, which is equal to the number of shares of our common stock that will initially underlie the Notes. These transactions are expected to reduce the potential dilution with respect to our common stock upon conversion of the Notes. Separately, we have also entered into privately negotiated warrant transactions with the Option Counterparties to purchase, subject to customary anti-dilution adjustments, approximately 19.9 million shares of our common stock, with a strike price of \$41.14 (the "Warrant Transactions"). The Warrant Transactions will have a dilutive effect with respect to our common stock to the extent that the market price per share of our common stock exceeds the strike price of the warrants on or prior to the expiration date of the warrants. Our cost of the Hedge Transactions, after taking into account our proceeds from the Warrant Transactions, is approximately \$42.3 million.

On July 20, 2011, in connection with the issuance of the Notes, we entered into an Indenture (the "Indenture") with respect to the Notes with U.S. Bank National Association, as Trustee (the "Trustee"). Under the Indenture, the Notes will be our senior unsecured obligations and will pay interest semiannually at a rate of 0.75 percent per annum. The Notes will be convertible into shares of our common stock at an initial conversion rate of 31.5075 shares per \$1,000 principal amount of Notes (equivalent to an initial conversion price of approximately \$31.74 per share). The initial conversion price represents a premium of 35 percent to the \$23.51 per share closing price of our common stock on July 14, 2011.



## **Table of Contents**

Prior to April 15, 2016, the notes will be convertible only upon the occurrence of certain events and during certain periods, and thereafter, at any time until the close of business on the second scheduled trading day immediately preceding the maturity date of the notes. Interest on the notes will be payable semiannually in arrears at a rate of 0.75 percent per annum on January 15 and July 15 of each year, beginning on January 15, 2012. The notes will mature on July 15, 2016, unless previously purchased or converted in accordance with their terms prior to such date.

The conversion rate is subject to customary anti-dilution adjustments, but will not be adjusted for any accrued and unpaid interest. Following certain corporate events described in the Indenture that occur prior to the maturity date, the conversion rate will be increased for a holder who elects to convert its Notes in connection with such corporate event in certain circumstances. The notes are not redeemable prior to maturity, and no sinking fund is provided for the Notes.

Upon conversion of the Notes, holders will receive cash up to the principal amount of each Note, and any excess conversion value will be delivered in shares of our common stock.

If we undergo a fundamental change, as defined in the Indenture, subject to certain conditions, holders may require us to purchase for cash all or any portion of their Notes. The fundamental change purchase price will be 100 percent of the principal amount of the Notes to be purchased plus any accrued and unpaid interest up to but excluding the fundamental change purchase date.

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

*Stock Repurchase Program.* In February 2011, we announced that our Board of Directors authorized a program to repurchase up to \$600 million of our common stock over the next 18 months. As of June 30, 2011, we had repurchased \$149 million of our common stock, or approximately 7.1 million shares, in the open market since the commencement of the program, including pursuant to pre-arranged stock trading plans.

Under the program, we may purchase stock in the open market or through privately negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities, and other market conditions. We are not obligated to repurchase any specific number of shares under the program and the repurchase program may be modified, suspended or discontinued at any time.

*International Operations and Foreign Currency Exchange Impact.* International sales (revenue derived from countries other than Canada and the United States), are a fundamental part of our business. Net revenue from international sales accounted for approximately 50 percent of our total net revenue during the three months ended June 30, 2011 and approximately 45 percent of our total net revenue during the three months ended June 30, 2010. Our net revenue is impacted by foreign exchange rates during the reporting period associated with net revenue before revenue deferral, as well as the foreign exchange rates associated with the recognition of deferred net revenue of online-enabled packaged goods and digital content that were established at the time we recorded this deferred net revenue on our Condensed Consolidated Balance Sheets. The foreign exchange rates during the reporting period may not always move in the same direction as the foreign exchange rate impact associated with the recognition of deferred net revenue of online-enabled packaged goods and digital content. During the three months ended June 30, 2011, foreign exchange rates had an overall favorable impact on our net revenue of approximately \$20 million, or 2 percent. In addition, our international investments and our cash and cash equivalents denominated in foreign currencies are subject to fluctuations in foreign currency exchange rates. If the U.S. dollar strengthens against these currencies, then foreign exchange rates may have an unfavorable impact on our results of operations and our financial condition.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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

**Table of Contents*****Revenue Recognition, Sales Returns, Allowances and Bad Debt Reserves***

We derive revenue principally from sales of interactive software games (1) on video game consoles (such as the Sony PLAYSTATION 3, Microsoft Xbox 360, and Nintendo Wii), PCs, and handheld game players (such as the Sony PSP and Nintendo DS and 3DS), (2) on mobile devices (such as cellular and smart phones including the Apple iPhone), (3) on tablets such as the Apple iPad, and (4) from software products and content and online services associated with these products. We evaluate revenue recognition based on the criteria set forth in Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) 985-605, *Software: Revenue Recognition*, and Staff Accounting Bulletin ( SAB ) No. 101, *Revenue Recognition in Financial Statements*, as revised by SAB No. 104, *Revenue Recognition*. We evaluate and recognize revenue when all four of the following criteria are met:

*Evidence of an arrangement.* Evidence of an agreement with the customer that reflects the terms and conditions to deliver products that 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 digital downloads that do not have an online service component, delivery is generally considered to occur when the download is made available.

*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 management judgments that can have a significant impact on the timing and amount of revenue we report in each period. 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 ( 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 management 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.

Depending on the type of product, we may offer an online service that permits consumers to play against others via the Internet and/or receive additional updates or content from us. For those games that consumers can play via the Internet, we may provide a matchmaking service that permits consumers to connect with other consumers to play against each other online. In those situations where we do not require an additional fee for this online service, we account for the sale of the software product and the online service as a bundled sale, or multiple element arrangement, in which we sell both the software product and the online service for one combined price. We defer net revenue from sales of these games for which we do not have VSOE for the online service that we provided in connection with the sale, and recognize the revenue from these games over the estimated online service period, which is generally estimated to be six months beginning in the month after shipment. In addition, for some software products we also provide updates or additional content ( digital content ) to be delivered via the Internet that can be used with the original software product. In many cases we separately sell digital content for an additional fee; however, some purchased digital content can only be accessed via the Internet (*i.e.*, the consumer never takes possession of the digital content). We account for online transactions in which the consumer does not take possession of the digital content as a service transaction and, accordingly, we recognize the associated revenue over the estimated service period. In other transactions, at the date we sell the software product we have an obligation to provide incremental unspecified digital content in the future without an additional fee. In these cases, we account for the sale of the software product as a multiple element arrangement and recognize the revenue on a straight-line basis over the estimated period of game play.

## Table of Contents

Determining whether a transaction constitutes an online service transaction or a digital content download of a product requires judgment and can be difficult. The accounting for these transactions is significantly different. Revenue from product downloads is generally recognized when the download is made available (assuming all other recognition criteria are met). Revenue from an online game service is recognized as the service is 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. In addition, determining whether we have an implicit obligation to provide incremental unspecified future digital content without an additional fee can be difficult.

On April 3, 2011 we adopted the ASU 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* and ASU 2009-14, *Software (Topic 985): Certain Revenue Arrangements that Include Software Elements*.

ASU 2009-13 modifies the fair value requirements of ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements*, by allowing the use of the best estimate of selling price in addition to vendor-specific objective evidence and third-party evidence for determining the selling price of a deliverable for non-software arrangements. It establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (1) vendor-specific objective evidence, (2) third-party evidence, or (3) estimates. In addition, the residual method of allocating arrangement consideration is no longer permitted.

ASU 2009-14 modifies the scope of ASC subtopic 985-605, *Software-Revenue Recognition*, to exclude from its requirements non-software components of tangible products and software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality.

The adoption of ASU 2009-13 and ASU 2009-14 did not have a material impact on our Condensed Consolidated Financial Statements as substantially all of our revenue arrangements with multiple deliverables remain under ASC 985-605. As certain of our revenue arrangements include software and hardware deliverables (such as peripherals or other ancillary collectors items sold together with the physical boxed software), the new accounting principles would apply to these types of arrangements. The new accounting principles establish a selling price hierarchy for determining the selling price of a deliverable and require the application of the relative selling price method to allocate the arrangement consideration to each deliverable in a multiple element arrangement. As of the quarter ended June 30, 2011, we do not have significant revenue arrangements that require our best estimate of selling price.

Product revenue, including sales to resellers and distributors (channel partners), is recognized when the above four 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. Price protection represents the right to receive a credit allowance in the event we lower our wholesale price on a particular product. The amount of the price protection is generally the difference between the old price and the new price. In certain countries, we have stock-balancing programs for our PC and video game system software products, which allow for the exchange of these software products by resellers under certain circumstances. It is our general practice to exchange software products or give credits rather than to give cash refunds.

In certain countries, from time to time, we decide to provide price protection for our software 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 software products, current trends in retail and the video game industry, changes in customer demand and acceptance of our software products, and other related factors. In addition, we monitor the volume of sales to our channel partners and their inventories, as substantial overstocking in the distribution channel could result in higher returns and/or price protection costs in subsequent periods.

In the future, actual returns and price protections may materially exceed our estimates as unsold software products in the distribution channels are exposed to rapid changes in consumer preferences, market conditions or technological obsolescence due to new platforms, product updates or competing software products. While we believe we can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, if our estimates change, our returns and price protection 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, this 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. In addition, if our estimates of returns and price protection related to online-enabled packaged goods software products change, the amount of deferred net revenue we recognize in the future would change.

Significant management 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.



---

**Table of Contents*****Fair Value Estimates***

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

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

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

*Business Combinations.* We must estimate the fair value of assets acquired, liabilities and contingencies assumed, acquired in-process technology, and contingent consideration issued in a business combination. Our assessment of the estimated fair value of each of these can have a material effect on our reported results as intangible assets and acquired in-process technology are amortized over various estimated useful lives. Furthermore, a change in the estimated fair value of an asset or liability often has a direct impact on the amount we recognize as goodwill, an asset that is not amortized. Determining the fair value of assets acquired requires an assessment of the highest and best use or the expected price to sell the asset and the related expected future cash flows. Determining the fair value of acquired in-process technology also requires an assessment of our expectations related to the use of that asset. Determining the fair value of an assumed liability requires an assessment of the expected cost to transfer the liability. Determining the fair value of contingent consideration issued requires an assessment of the expected future cash flows over the period in which the obligation is expected to be settled, and applying a discount rate that appropriately captures a market participant's view of the risk associated with the obligation. This fair value assessment is also required in periods subsequent to a business combination. Such estimates are inherently difficult and subjective and can have a material impact on our Condensed Consolidated Financial Statements.

*Assessment of Impairment of Goodwill, Intangibles, and Other Long-Lived Assets.* Current accounting standards require that we assess the recoverability of our finite lived acquisition-related intangible assets and other long-lived assets whenever events or changes in circumstances indicate the remaining value of the assets recorded on our Condensed Consolidated Balance Sheets is potentially impaired. In order to determine if a potential impairment has occurred, management must make various assumptions about the estimated fair value of the asset by evaluating future business prospects and estimated future cash flows. For some assets, our estimated fair value is dependent upon predicting which of our products will be successful. This success is dependent upon several factors, which are beyond our control, such as which platforms will be successful in the marketplace. Also, our revenue and earnings are dependent on our ability to meet our product release schedules.

We are required to perform a two-step approach to testing goodwill for impairment for each reporting unit annually, or whenever events or changes in circumstances indicate the fair value of a reporting unit is below its carrying amount. Our reporting units are determined by the components of our operating segments that constitute a business for which (1) discrete financial information is available and (2) segment management regularly reviews the operating results of that component. We are required to perform the impairment test at least annually by applying a fair value-based test. The first step measures for impairment by applying fair value-based tests at the reporting unit level. The second step (if necessary) measures the amount of impairment by applying fair value-based tests to the individual assets and liabilities within each reporting unit.

---

**Table of Contents**

To determine the fair value of each reporting unit used in the first step, we use a combination of the market approach, which utilizes comparable companies' data, and/or the income approach, which utilizes discounted cash flows. Determining whether an event or change in circumstances does or does not indicate that the fair value of a reporting unit is below its carrying amount is inherently subjective. Each step requires us to make judgments and involves the use of significant estimates and assumptions. These estimates and assumptions include long-term growth rates, tax rates, and operating margins used to calculate projected future cash flows, risk-adjusted discount rates based on our weighted average cost of capital, future economic and market conditions and determination of appropriate market comparables. These estimates and assumptions have to be made for each reporting unit evaluated for impairment. As of the last annual assessment of goodwill in the fourth quarter of fiscal year 2011, we concluded that the estimated fair values of each of our reporting units adequately exceeded their carrying amounts and we have not identified any indicators of impairment since. Our estimates for market growth, our market share and costs are based on historical data, various internal estimates and certain external sources, and are based on assumptions that are consistent with the plans and estimates we are using to manage the underlying business. Our business consists of developing, marketing and distributing video game software using both established and emerging intellectual properties and our forecasts for emerging intellectual properties are based upon internal estimates and external sources rather than historical information and have an inherently higher risk of accuracy. If future forecasts are revised, they may indicate or require future impairment charges. We base our fair value estimates on assumptions we believe to be reasonable, but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates.

*Assessment of Impairment of Short-Term Investments and Marketable Equity Securities.* We periodically review our short-term investments and marketable equity securities for impairment. Our short-term investments consist of securities with remaining maturities greater than three months at the time of purchase and our marketable equity securities consist of investments in common stock of publicly traded companies, both are accounted for as available-for-sale securities. Unrealized gains and losses on our short-term investments and marketable equity securities are recorded as a component of accumulated other comprehensive income in stockholders' equity, net of tax, until either (1) the security is sold, (2) the security has matured, or (3) we determine that the fair value of the security has declined below its adjusted cost basis and the decline is other-than-temporary. Realized gains and losses on our short-term investments and marketable equity securities are calculated based on the specific identification method and are reclassified from accumulated other comprehensive income to interest and other income, net, and loss on strategic investments, respectively. Determining whether the decline in fair value is other-than-temporary requires management judgment based on the specific facts and circumstances of each security. The ultimate value realized on these securities is subject to market price volatility until they are sold. We consider various factors in determining whether we should recognize an impairment charge, including the credit quality of the issuer, the duration that the fair value has been less than the adjusted cost basis, severity of the impairment, reason for the decline in value and potential recovery period, the financial condition and near-term prospects of the investees, and our intent to sell and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value, any contractual terms impacting the prepayment or settlement process, as well as, if we would be required to sell an investment due to liquidity or contractual reasons before its anticipated recovery. Our ongoing consideration of these factors could result in impairment charges in the future, which could have a material impact on our financial results.

*Assessment of Inventory Obsolescence.* We regularly review inventory quantities on-hand. We write down inventory based on excess or obsolete inventories determined primarily by future anticipated demand for our products. Inventory write-downs are measured as the difference between the cost of the inventory and market value, based upon assumptions about future demand that are inherently difficult to assess. At the point of a loss recognition, a new, lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

***Stock-Based Compensation***

We are required to estimate the fair value of share-based payment awards on the date of grant. We recognize compensation costs for stock-based payment awards to employees based on the grant-date fair value using a straight-line approach over the service period for which such awards are expected to vest.

---

## **Table of Contents**

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

*Restricted Stock Units, Restricted Stock, and Performance-Based Restricted Stock Units.* The fair value of restricted stock units, restricted stock, and performance-based restricted stock units (other than market-based restricted stock units) is determined based on the quoted market price of our common stock on the date of grant. Performance-based restricted stock units include grants made (1) to certain members of executive management primarily granted in fiscal year 2008 and (2) in connection with certain acquisitions.

*Market-Based Restricted Stock Units.* Market-based restricted stock units consist of grants of performance-based restricted stock units granted during the three months ended June 30, 2011 to certain members of executive management (referred to herein as market-based restricted stock units). The fair value of our market-based restricted stock units is determined using a Monte-Carlo simulation model. Key assumptions for the Monte-Carlo simulation model are the risk-free interest rate, expected volatility, expected dividends and correlation coefficient.

*Stock Options and Employee Stock Purchase Plan.* The fair value of stock options and stock purchase rights granted pursuant to our equity incentive plans and our 2000 Employee Stock Purchase Plan (ESPP), respectively is determined using the Black-Scholes valuation model based on the multiple-award valuation method. Key assumptions of the Black-Scholes valuation model are the risk-free interest rate, expected volatility, expected term and expected dividends.

The determination of the fair value of market-based restricted stock units, stock options and ESPP is affected by assumptions regarding subjective and complex variables. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes.

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 to stock-based compensation expense will be recognized at that time.

Changes to our assumptions used in the Black-Scholes option valuation or the Monte-Carlo simulation model calculations and our forfeiture rate, as well as future equity granted or assumed through acquisitions could significantly impact the compensation expense we recognize.

### ***Royalties and Licenses***

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

Royalty-based obligations with content licensors and distribution affiliates are either paid in advance and capitalized as prepaid royalties or are accrued as incurred and subsequently paid. These royalty-based obligations are generally expensed to cost of goods sold generally at the greater of the contractual rate for contracts with guaranteed minimums, or an effective royalty rate based on the total projected net revenue. 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, the timing of the title's release and competition, and (4) future pricing. Determining the effective royalty rate for our titles is particularly challenging due to the inherent difficulty in predicting the popularity of entertainment products. Accordingly, if our future revenue projections change, our effective royalty rates would change, which could impact the amount and timing of royalty expense we recognize.

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

sold.



---

**Table of Contents**

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

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

***Income Taxes***

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

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

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

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

We historically have considered undistributed earnings of our foreign subsidiaries to be indefinitely reinvested outside of the United States and, accordingly, no U.S. taxes have been provided thereon. We currently intend to continue to indefinitely reinvest the undistributed earnings of our foreign subsidiaries outside of the United States.

**Table of Contents****RESULTS OF OPERATIONS**

Our fiscal year is reported on a 52- or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ending or ended, as the case may be, March 31, 2012 and 2011 contain 52 weeks each and ends or ended, as the case may be, on March 31, 2012 and April 2, 2011, respectively. Our results of operations for the three months ended June 30, 2011 and 2010 contained 13 weeks each, and ended on July 2, 2011 and July 3, 2010, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

**Net Revenue**

Net revenue consists of sales generated from (1) video games sold as packaged goods and designed for play on hardware consoles (such as the Sony PLAYSTATION 3, Microsoft Xbox 360 and Nintendo Wii), PCs, and handheld game players (such as the Sony PSP and Nintendo DS and 3DS), (2) video games for mobile devices (such as cellular and smart phones including the Apple iPhone), (3) video games for tablets such as the Apple iPad, (4) software products and content and online services associated with these products, (5) programming third-party websites with our game content, (6) allowing other companies to manufacture and sell our products in conjunction with other products, and (7) advertisements on our online web pages and in our games.

Net Revenue before Revenue Deferral, a non-GAAP financial measure, is provided in this section of Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ). See Non-GAAP Financial Measures below for an explanation of our use of this non-GAAP measure. A reconciliation to the corresponding measure calculated in accordance with accounting principles generally accepted in the United States is provided in the discussion below.

Revenue Deferral in this Net Revenue section includes the unrecognized revenue from (1) bundled sales of certain online-enabled packaged goods and PC digital downloads for which either we do not have VSOE for the online service that we provide in connection with the sale of the software or we have an obligation to provide future incremental unspecified digital content, (2) certain packaged goods sales of massively-multiplayer online role-playing games, and (3) sales of certain incremental digital content associated with our games, which are types of micro-transactions. Fluctuations in the Revenue Deferral are largely dependent upon the amounts of products that we sell with the online features and services previously discussed, while the Recognition of Revenue Deferral for a period is also dependent upon (1) the period of time the online features and services are to be provided and (2) the timing of the sale. For example, most Revenue Deferrals incurred in the first half of a fiscal year are recognized within the same fiscal year; however, substantially all of the Revenue Deferrals incurred in the last month of a fiscal year will be recognized in the subsequent fiscal year.

From a geographical perspective, our total Net Revenue for the three months ended June 30, 2011 and 2010 was as follows (in millions):

	Three Months Ended June 30,							
	2011				2010			
	North America	Europe	Asia	Total	North America	Europe	Asia	Total
Net Revenue before Revenue Deferral	\$ 261	\$ 223	\$ 40	\$ 524	\$ 267	\$ 236	\$ 36	\$ 539
Revenue Deferral	(111)	(120)	(19)	(250)	(135)	(159)	(24)	(318)
Recognition of Revenue Deferral	351	335	39	725	319	240	35	594
Net Revenue	\$ 501	\$ 438	\$ 60	\$ 999	\$ 451	\$ 317	\$ 47	\$ 815

**Worldwide**

For the three months ended June 30, 2011, Net Revenue before Revenue Deferral was \$524 million, driven by *Portal 2*, *FIFA 11*, and *Crysis 2*. Net Revenue before Revenue Deferral for the three months ended June 30, 2011 decreased \$15 million, or 3 percent, as compared to the three months ended June 30, 2010. This decrease was driven by a \$139 million decrease from FIFA World Cup and Skate franchises. This decrease was partially offset by a \$127 million increase from the Portal and FIFA franchises.

Revenue Deferral for the three months ended June 30, 2011 decreased \$68 million, or 21 percent, as compared to the three months ended June 30, 2010. This decrease was primarily due to a decrease in sales of online-enabled products with an obligation to provide future incremental unspecified digital content on a when and if available basis during the three months ended June 30, 2011 as compared to the three months ended

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

June 30, 2010. This decrease was driven by a \$153 million decrease from the FIFA World Cup, Skate, and Battlefield franchises. This decrease was partially offset by an \$88 million increase from the FIFA, Crysis, and Alice franchises.

---

**Table of Contents**

Recognition of Revenue Deferral for the three months ended June 30, 2011 increased \$131 million, or 22 percent, as compared to the three months ended June 30, 2010. This increase was primarily due to the Recognition of Revenue Deferral during the three months ended June 30, 2011 associated with the sales of online-enabled products with an obligation to provide future incremental unspecified digital content on a when and if available basis during the last half of fiscal year 2011, with less comparable recognition during the three months ended June 30, 2010. This increase was driven by a \$251 million increase from the Need for Speed, Crysis, Dead Space, and Medal of Honor franchises, as well as *Bulletstorm*. This increase was partially offset by a \$120 million decrease from the Battlefield and Mass Effect franchises.

For the three months ended June 30, 2011, Net Revenue was \$999 million, driven by *Portal 2*, *FIFA 11*, and *Need for Speed Hot Pursuit*. Net Revenue for the three months ended June 30, 2011 increased \$184 million, or 23 percent, as compared to the three months ended June 30, 2010. This increase was driven by a \$285 million increase from the Portal, Need for Speed, Crysis, and Dead Space franchises. This increase was partially offset by a \$121 million decrease from the Battlefield and Mass Effect franchises.

***North America***

For the three months ended June 30, 2011, Net Revenue before Revenue Deferral in North America was \$261 million, driven by *Portal 2*, *FIFA 11*, and *Alice: Madness Returns*. Net Revenue before Revenue Deferral for the three months ended June 30, 2011 decreased \$6 million, or 2 percent, as compared to the three months ended June 30, 2010. This decrease was driven by an \$81 million decrease from the FIFA World Cup, Skate, Rock Band, and Battlefield franchises. This decrease was partially offset by a \$72 million increase from the Portal and Alice franchises.

Revenue Deferral for the three months ended June 30, 2011 decreased \$24 million, or 18 percent, as compared to the three months ended June 30, 2010. This decrease was driven by a \$63 million decrease from the FIFA World Cup, Skate, and Battlefield franchises. This decrease was partially offset by a \$39 million increase from the Alice, Crysis, FIFA, and The Sims franchises.

Recognition of Revenue Deferral for the three months ended June 30, 2011 increased \$32 million, or 10 percent, as compared to the three months ended June 30, 2010. This increase was driven by a \$97 million increase from the Need for Speed, Crysis, and Dead Space franchises as well as *Bulletstorm*. This increase was partially offset by a \$70 million decrease from the Battlefield and Mass Effect franchises.

For the three months ended June 30, 2011, Net Revenue in North America was \$501 million, driven by *Portal 2*, *Need for Speed Hot Pursuit*, and *Madden 11*. Net Revenue for the three months ended June 30, 2011 increased \$50 million, or 11 percent, as compared to the three months ended June 30, 2010. This increase was driven by a \$117 million increase from the Portal, Need for Speed, and Crysis franchises. This increase was partially offset by a \$71 million decrease from the Battlefield and Mass Effect franchises.

***Europe***

For the three months ended June 30, 2011, Net Revenue before Revenue Deferral in Europe was \$223 million, driven by *FIFA 11*, *Portal 2*, and *Crysis 2*. Net Revenue before Revenue Deferral for the three months ended June 30, 2011 decreased \$13 million, or 6 percent, as compared to the three months ended June 30, 2010. This decrease was driven by a \$73 million decrease from the FIFA World Cup and Skate franchises. This decrease was partially offset by a \$65 million increase from the Portal, FIFA, and Crysis franchises. We estimate that foreign exchange rates (primarily the Swiss Franc and British Pound) increased reported Net Revenue before Revenue Deferral by approximately \$15 million, or 6 percent, for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010. Excluding the effect of foreign exchange rates from Net Revenue before Revenue Deferral, we estimate that Net Revenue before Revenue Deferral decreased by approximately \$28 million, or 12 percent, for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010.

Revenue Deferral for three months ended June 30, 2011 decreased by \$39 million, or 25 percent, as compared to three months ended June 30, 2010. This decrease was driven by a \$75 million decrease from the FIFA World Cup, Skate, and Battlefield franchises. This decrease was partially offset by a \$38 million increase from the FIFA and Crysis franchises.

**Table of Contents**

Recognition of Revenue Deferral for the three months ended June 30, 2011 increased \$95 million, or 40 percent, as compared to the three months ended June 30, 2010. This increase was driven by a \$125 million increase from the Need for Speed, Crysis, Dead Space, Medal of Honor and FIFA franchises. This increase was partially offset by a \$47 million decrease from the Battlefield and FIFA World Cup franchises.

For the three months ended June 30, 2011, Net Revenue in Europe was \$438 million, driven by *FIFA 11*, *Need for Speed Hot Pursuit*, and *Crysis 2*. Net Revenue for the three months ended June 30, 2011 increased \$121 million, or 38 percent, as compared to the three months ended June 30, 2010. This increase was driven by a \$141 million increase from the Need for Speed, Crysis, Portal, Dead Space, and Medal of Honor franchises. This increase was partially offset by a \$48 million decrease from the Battlefield and FIFA World Cup franchises. We estimate that foreign exchange rates (primarily the Swiss Franc and British Pound) increased reported Net Revenue by approximately \$9 million, or 3 percent, for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010. Excluding the effect of foreign exchange rates from Net Revenue, we estimate that Net Revenue increased by approximately \$112 million, or 35 percent, for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010.

***Asia***

For the three months ended June 30, 2011, Net Revenue before Revenue Deferral in Asia was \$40 million, driven by *Portal 2*, *EA SPORTS FIFA Online 2* and *Crysis 2*. Net Revenue before Revenue Deferral for the three months ended June 30, 2011 increased by \$4 million, or 11 percent, as compared to the three months ended June 30, 2010. This increase was driven by a \$17 million increase from the Portal, Crysis, FIFA, and Alice franchises. This increase was partially offset by a \$13 million decrease from the FIFA World Cup and Battlefield franchises. We estimate that foreign exchange rates (primarily the Australian Dollar) increased reported Net Revenue before Revenue Deferral by approximately \$5 million, or 14 percent, for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010. Excluding the effect of foreign exchange rates from Net Revenue before Revenue Deferral, we estimate that Net Revenue before Revenue Deferral decreased by approximately \$1 million, or 3 percent, for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010.

Revenue Deferral for the three months ended June 30, 2011 decreased \$5 million, or 21 percent, as compared to the three months ended June 30, 2010. This decrease was driven by a \$15 million decrease from the FIFA World Cup, Battlefield, and Skate franchises. This decrease was partially offset by a \$10 million increase from the Crysis, Alice, FIFA, and The Sims franchises.

Recognition of Revenue Deferral for the three months ended June 30, 2011 increased \$4 million, or 11 percent, as compared to the three months ended June 30, 2010. This increase was driven by a \$16 million increase from the Crysis, Need for Speed, Dead Space, and Medal of Honor franchises. This increase was partially offset by a \$12 million decrease from the Battlefield and FIFA World Cup franchises and *Dante s Inferno*.

For the three months ended June 30, 2011, Net Revenue in Asia was \$60 million, driven by *Portal 2*, *Crysis 2*, and *EA SPORTS FIFA Online 2*. Net Revenue for the three months ended June 30, 2011 increased by \$13 million, or 28 percent, as compared to the three months ended June 30, 2010. This increase was driven by a \$22 million increase from the Portal, Crysis, Need for Speed, Dead Space, and The Sims franchises. This increase was partially offset by a \$9 million decrease from the Battlefield and FIFA World Cup franchises. We estimate that foreign exchange rates (primarily the Australian Dollar) increased reported Net Revenue by approximately \$11 million, or 23 percent, for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010. Excluding the effect of foreign exchange rates from Net Revenue, we estimate that Net Revenue increased by approximately \$2 million, or 4 percent, for the three months ended June 30, 2011 as compared to the three months ended June 30, 2010.

**Non-GAAP Financial Measures**

Net Revenue before Revenue Deferral is a non-GAAP financial measure that excludes the impact of Revenue Deferral and the Recognition of Revenue Deferral on Net Revenue related to packaged goods games and digital content. We defer Net Revenue from sales of certain online-enabled packaged goods and digital content for which we are not able to objectively determine the fair value (as defined by accounting principles generally accepted in the United States for software sales) of the online service that we provide in connection with the sale. We recognize the revenue from these games over the estimated online service period. We also defer Net Revenue from sales of certain online-enabled packaged goods and digital content for which we had an obligation to deliver incremental unspecified digital content in the future without an additional fee. We recognize the revenue for these games on a straight-line basis over the estimated period of game play.

**Table of Contents**

We believe that excluding the impact of Revenue Deferral and the Recognition of Revenue Deferral related to packaged goods games and digital content from our operating results is important to facilitate comparisons between periods in understanding our underlying sales performance for the period. We use this non-GAAP measure internally to evaluate our operating performance, when planning, forecasting and analyzing future periods, and when assessing the performance of our management team. While we believe that this non-GAAP financial measure is useful in evaluating our business, this information should be considered as supplemental in nature and is not meant to be considered in isolation from or as a substitute for the related financial information prepared in accordance with GAAP. In addition, this non-GAAP financial measure may not be the same as non-GAAP measures presented by other companies.

**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, (7) personnel-related costs, and (8) warehousing and distribution costs. We generally recognize volume discounts when they are earned from the manufacturer (typically in connection with the achievement of unit-based milestones); whereas other vendor reimbursements are generally recognized as the related revenue is recognized. Cost of goods sold for our online products consists primarily of data center and bandwidth costs associated with hosting our websites, credit card fees and royalties for use of third-party properties. Cost of goods sold for our website advertising business primarily consists of server costs.

Cost of goods sold for the three months ended June 30, 2011 and 2010 was as follows (in millions):

June 30, 2011	% of Net Revenue	June 30, 2010	% of Net Revenue	% Change	Change as a % of Net Revenue
\$ 240	24.0%	\$ 222	27.2%	8.1%	(3.2%)

During the three months ended June 30, 2011, cost of goods sold decreased by 3.2 percent as a percentage of total net revenue as compared to the three months ended June 30, 2010. This decrease as a percentage of net revenue was primarily due to a \$199 million increase in the net amount recognized from deferred net revenue during the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 related to certain online-enabled packaged goods and digital content, which positively impacted gross profit as a percent of total net revenue by 7.8 percent. This decrease was significantly offset by a greater percentage of net revenue from co-publishing and distribution products, which have a lower margin than our EA studio and digital products, which negatively impacted gross profit as a percentage of total revenue by approximately 6.0 percent.

**Marketing and Sales**

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

Marketing and sales expenses for the three months ended June 30, 2011 and 2010 were as follows (in millions):

June 30, 2011	% of Net Revenue	June 30, 2010	% of Net Revenue	\$ Change	% Change
\$ 140	14%	\$ 127	16%	\$ 13	10%

Marketing and sales expenses increased by \$13 million, or 10 percent, during the three months ended June 30, 2011, as compared to the three months ended June 30, 2010 primarily due to a \$10 million increase in personnel-related costs resulting from an increase in headcount.

**Table of Contents****General and Administrative**

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

General and administrative expenses for the three months ended June 30, 2011 and 2010 were as follows (in millions):

June 30, 2011	% of Net Revenue	June 30, 2010	% of Net Revenue	\$ Change	% Change
\$ 74	7%	\$ 74	9%	\$	

General and administrative expenses were flat during the three months ended June 30, 2011, as compared to the three months ended June 30, 2010. Contracted services costs increased by \$5 million related to the support of business development projects offset by lower personnel- and facilities-related costs.

**Research and Development**

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

Research and development expenses for the three months ended June 30, 2011 and 2010 were as follows (in millions):

June 30, 2011	% of Net Revenue	June 30, 2010	% of Net Revenue	\$ Change	% Change
\$ 285	29%	\$ 275	34%	\$ 10	4%

Research and development expenses increase by \$10 million, or 4 percent, during the three months ended June 30, 2011, as compared to the three months ended June 30, 2010 due to a \$16 million increase in additional personnel-related costs primarily resulting from an increase in headcount in connection with recent acquisitions offset by a decrease of \$7 million in stock-based compensation expense.

**Restructuring and Other Charges**

Restructuring and other charges for the three months ended June 30, 2011 and 2010 were as follows (in millions):

June 30, 2011	% of Net Revenue	June 30, 2010	% of Net Revenue	\$ Change	% Change
\$ 18	2%	\$ 2		\$ 16	800%

***Fiscal 2011 Restructuring***

During the three months ended June 30, 2011, we incurred charges of \$16 million primarily due to adjustments to the estimated loss for the amendment of certain licensing agreements. During the remainder of fiscal year 2012, we anticipate incurring approximately \$5 million of restructuring charges related to the fiscal 2011 restructuring (primarily interest expense accretion).

Overall, including \$164 million in charges incurred through June 30, 2011, we expect to incur total cash and non-cash charges between \$180 million and \$190 million by June 2016. These charges will consist primarily of (1) charges, including accretion of interest expense, related to the amendment of certain licensing and developer agreements and other intangible asset impairment costs (approximately \$170 million) and (2) employee-related costs (approximately \$15 million).





**Table of Contents****Loss on Strategic Investments**

During the three months ended June 30, 2010, we recognized an impairment charge and realized a loss from the sale of our investment in The9 of \$5 million. We did not recognize any impairment charges or losses during the three months ended June 30, 2011 on our marketable equity securities.

**Income Taxes**

Provision for (benefit from) income taxes for the three months ended June 30, 2011 and 2010 were as follows (in millions):

June 30, 2011	Effective Tax Rate	June 30, 2010	Effective Tax Rate	% Change
\$ 9	3.9%	\$ (3)	(3.4%)	(400%)

The tax provision reported for the three months ended June 30, 2011 is based on our projected annual effective tax rate for fiscal year 2012, and also includes certain discrete tax benefits recorded during the period. Our effective tax rates for the three months ended June 30, 2011 and June 30, 2010 were a tax provision of 3.9 percent and a tax benefit of 3.4 percent, respectively. The effective tax rate for the three months ended June 30, 2011 differs from the statutory rate of 35.0 percent primarily due to the utilization of U.S. deferred tax assets which were subject to a valuation allowance and non-U.S. profits subject to a reduced or zero tax rate. The effective tax rate for the three months ended June 30, 2011 differs from the same period in fiscal year 2011 primarily due to greater tax benefits recorded in fiscal year 2011 related to the expiration of statutes of limitations.

Our effective income tax rates for fiscal year 2012 and future periods will depend on a variety of factors, including changes in the deferred tax valuation allowance, as well as changes in our business such as acquisitions and intercompany transactions, changes in our international structure, changes in the geographic location of business functions or assets, changes in the geographic mix of income, changes in or termination of our agreements with tax authorities, applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audit and other matters, and variations in our annual pre-tax income or loss. We incur certain tax expenses that do not decline proportionately with declines in our pre-tax consolidated 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 at higher levels. In addition, at lower levels of pre-tax income or loss, our effective tax rate will be more volatile.

Certain taxable temporary differences that are not expected to reverse during the carry forward periods permitted by tax law cannot be considered as a source of future taxable income that may be available to realize the benefit of deferred tax assets.

We historically have considered undistributed earnings of our foreign subsidiaries to be indefinitely reinvested outside of the United States and, accordingly, no U.S. taxes have been provided thereon. We currently intend to continue to indefinitely reinvest the undistributed earnings of our foreign subsidiaries outside of the United States.

**Impact of Recently Issued Accounting Standards**

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments in this ASU generally represent clarification of Topic 820, but also include instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards. The amendments are effective for interim and annual periods beginning after December 15, 2011 and are to be applied prospectively. We do not expect the adoption of ASU 2011-04 to have a material impact on our Condensed Consolidated Financial Statements.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. ASU 2011-05 requires one of two alternatives for presenting comprehensive income and eliminates the option to report other comprehensive income and its components as a part of the Consolidated Statements of Stockholders' Equity. ASU 2011-05 also requires presentation on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. The amendments in ASU 2011-05 do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU 2011-05 is effective for fiscal years and interim periods within those years beginning after December 15, 2011 and is to be

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

applied retrospectively. We do not expect the adoption of ASU 2011-05 to have a material impact on our Condensed Consolidated Financial Statements.

**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES**

(In millions)	As of June 30, 2011	As of March 31, 2011	Increase / (Decrease)
Cash and cash equivalents	\$ 1,173	\$ 1,579	\$ (406)
Short-term investments	503	497	6
Marketable equity securities	172	161	11
Total	\$ 1,848	\$ 2,237	\$ (389)
Percentage of total assets	42%	45%	

(In millions)	Three months Ended June 30, 2011	Three months Ended June 30, 2010	Increase / (Decrease)
Cash used in operating activities	\$ (274)	\$ (148)	\$ (126)
Cash used in investing activities	(64)	(53)	(11)
Cash provided by (used in) financing activities	(75)	1	(76)
Effect of foreign exchange on cash and cash equivalents	7	(16)	23
Net decrease in cash and cash equivalents	\$ (406)	\$ (216)	\$ (190)

**Changes in Cash Flow**

*Operating Activities.* Cash used in operating activities increased \$126 million during the three months ended June 30, 2011 as compared to three months ended June 30, 2010 primarily due to royalty payments.

*Investing Activities.* Cash used in investing activities increased \$11 million during the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 primarily due to (1) \$25 million in cash used for acquisitions during the three months ended June 30, 2011, (2) a \$21 million increase in capital expenditures, and (3) a \$15 million decrease in proceeds received from the maturities and sale of short-term investments. These items were partially offset by \$58 million decrease in purchase of short-term investments.

*Financing Activities.* Cash provided by financing activities decreased \$76 million during the three months ended June 30, 2011 as compared to the three months ended June 30, 2010 primarily due to \$91 million, net of commissions, in cash paid for the repurchase and retirement of our common stock during the three months ended June 30, 2011.

**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 June 30, 2011, our short-term investments had gross unrealized gains of \$3 million, or 1 percent of the total in short-term investments, and gross unrealized losses of less than \$1 million, or less than 1 percent of the total in short-term investments. From time to time, we may liquidate some or all of our short-term investments to fund operational needs or other activities, such as capital expenditures, business acquisitions 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.

The fair value of our marketable equity securities increased to \$172 million as of June 30, 2011 from \$161 million as of March 31, 2011 primarily due to an increase in the value of our investment in Neowiz.

**Restricted Cash and Contingent Consideration**

In connection with our acquisitions of Playfish and Chillingo, we may be required to pay an additional \$110 million of cash consideration, of which \$100 million was deposited into an escrow account. As this deposit is restricted in nature, it is excluded from cash and cash equivalents. This cash consideration is based upon the achievement of certain performance milestones through March 31, 2014. Through the three months ended June 30, 2011, no distributions were made from the restricted cash amount. As of June 30, 2011, we have accrued \$53 million of

contingent consideration on our Condensed Consolidated Balance Sheet.

---

**Table of Contents**

***Fiscal 2011 Restructuring***

In connection with our fiscal 2011 restructuring plan, we expect to incur cash expenditures through June 2016 of approximately (1) \$39 million during the remainder of fiscal year 2012, (2) \$27 million in fiscal year 2013, (3) \$26 million in fiscal year 2014, (4) \$18 million in fiscal year 2015, and (5) \$16 million thereafter. The actual cash expenditures are variable as they will be dependent upon the actual revenue we generate from certain games.

***Financing Arrangement***

On July 20, 2011, we completed the offer and sale of \$632.5 million aggregate principal amount of our 0.75% Convertible Senior Notes due 2016. Additionally, we entered into Hedge Transactions with Option Counterparties. The Hedge Transactions cover, subject to customary anti-dilution adjustments, approximately 19.9 million shares of our common stock, which is equal to the number of shares of our common stock that will initially underlie the Notes. These transactions are expected to reduce the potential dilution with respect to our common stock upon conversion of the Notes. Separately, we also has entered into Warrant Transactions with the Option Counterparties to purchase, subject to customary anti-dilution adjustments, approximately 19.9 million shares of our common stock, with a strike price of \$41.14. The Warrant Transactions will have a dilutive effect with respect to our common stock to the extent that the market price per share of its common stock exceeds the strike price of the warrants on or prior to the expiration date of the warrants. Our cost of the Hedge Transactions, after taking into account our proceeds from the Warrant Transactions, is approximately \$42.3 million. See Note 18 for additional detail regarding the financing arrangement.

***Financial Condition***

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

As of June 30, 2011, approximately \$758 million of our cash, cash equivalents, and short-term investments and \$76 million of our marketable equity securities were domiciled in foreign tax jurisdictions. While we have no plans to repatriate these funds to the United States in the short term, if we choose to do so, we would be required to accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

In February 2011, our Board of Directors authorized a program to repurchase up to \$600 million of our common stock over the next 18 months. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase any specific number of shares under the program and the repurchase program may be modified, suspended or discontinued at any time.

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

Our ability to maintain sufficient liquidity could be affected by various risks and uncertainties including, but not limited to, those related to customer demand and acceptance of our products, our ability to collect our accounts receivable as they become due, successfully achieving our product release schedules and attaining our forecasted sales objectives, the impact of acquisitions and other strategic transactions in which we may engage, the impact of competition, economic conditions in the United States and abroad, the seasonal and cyclical nature of our business and operating results, risks of product returns and the other risks described in the Risk Factors section, included in Part II, Item 1A of this report.

**Table of Contents****Contractual Obligations and Commercial Commitments*****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, FAPL (Football Association Premier League Limited), and DFL Deutsche Fußball Liga GmbH (German Soccer League) (professional soccer); 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); National Football League Properties, PLAYERS Inc., and Red Bear Inc. (professional football); Collegiate Licensing Company (collegiate football); ESPN (content in EA SPORTS games); Hasbro, Inc. (most of Hasbro's toy and game intellectual properties); and LucasArts and Lucas Licensing (Star Wars: The Old Republic). These developer and content license commitments represent the sum of (1) the cash payments due under non-royalty-bearing licenses and services agreements and (2) the minimum guaranteed payments and advances against royalties due under royalty-bearing licenses and services agreements, the majority of which are conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.

The following table summarizes our unrecognized minimum contractual obligations as of June 30, 2011, 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				Total
	Leases <sup>(a)</sup>	Developer/ Licensor Commitments	Marketing	Other Purchase Obligations	
2012 (remaining nine months)	\$ 35	\$ 138	\$ 98	\$ 10	\$ 281
2013	50	198	38	3	289
2014	43	126	68	3	240
2015	29	106	32	2	169
2016	20	84	33		137
Thereafter	14	348	95		457
<b>Total</b>	<b>\$ 191</b>	<b>\$ 1,000</b>	<b>\$ 364</b>	<b>\$ 18</b>	<b>\$ 1,573</b>

<sup>(a)</sup> See discussion on operating leases in the Off-Balance Sheet Commitments section below for additional information. Lease commitments have not been reduced by minimum sub-lease rentals for unutilized office space resulting from our reorganization activities of approximately \$11 million due in the future under non-cancelable sub-leases.

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

In addition to what is included in the table above, as of June 30, 2011, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$240 million, of which approximately \$40 million is offset by prior cash deposits to tax authorities for issues pending resolution. For the remaining liability, we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.



**Table of Contents**

**OFF-BALANCE SHEET COMMITMENTS**

***Lease Commitments***

As of June 30, 2011, we leased certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.

***Director Indemnity Agreements***

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



**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk****MARKET RISK**

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

***Foreign Currency Exchange Rate Risk***

*Cash Flow Hedging Activities.* From time to time, we hedge a portion of our foreign currency risk related to forecasted foreign-currency-denominated sales and expense transactions by purchasing foreign currency 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 on our Condensed Consolidated Balance Sheets. The effective portion of gains or losses resulting from changes in the fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income in stockholders' equity. The gross amount of the effective portion of gains or losses resulting from changes in the fair value of these hedges is subsequently reclassified into net revenue or research and development expenses, as appropriate, in the period when the forecasted transaction is recognized in our Condensed Consolidated Statements of Operations. In the event that the gains or losses in accumulated other comprehensive income are deemed to be ineffective, the ineffective portion of gains or losses resulting from changes in fair value, if any, is reclassified to interest and other income, net, in our Condensed Consolidated Statements of Operations. In the event that the underlying forecasted transactions do not occur, or it becomes remote that they will occur, within the defined hedge period, the gains or losses on the related cash flow hedges are reclassified from accumulated other comprehensive income to interest and other income, net, in our Condensed Consolidated Statements of Operations. During the reporting periods, all forecasted transactions occurred and, therefore, there were no such gains or losses reclassified into interest and other income, net. Our hedging programs are designed to reduce, but do not entirely eliminate, the impact of currency exchange rate movements in net revenue and research and development expenses. As of June 30, 2011, we had foreign currency option contracts to purchase approximately \$14 million in foreign currency and to sell approximately \$95 million of foreign currency. All of the foreign currency option contracts outstanding as of June 30, 2011 will mature in the next 12 months. As of March 31, 2011, we had foreign currency option contracts to purchase approximately \$40 million in foreign currency and to sell approximately \$10 million of foreign currency. As of June 30, 2011 and March 31, 2011, the fair value of these outstanding foreign currency option contracts was immaterial and is included in other current assets.

*Balance Sheet Hedging Activities.* We use foreign currency forward contracts to mitigate foreign currency risk associated with foreign-currency-denominated monetary assets and liabilities, primarily intercompany receivables and payables. The foreign currency forward contracts generally have a contractual term of three months or less and are transacted near month-end. Our foreign currency forward contracts are not designated as hedging instruments, and are accounted for as derivatives whereby the fair value of the contracts is reported as other current assets or accrued and other current liabilities on our Condensed Consolidated Balance Sheets, and gains and losses resulting from changes in the fair value are reported in interest and other income, net, in our Condensed Consolidated Statements of Operations. The gains and losses on these foreign currency forward contracts generally offset the gains and losses on the underlying foreign-currency-denominated monetary assets and liabilities, which are also reported in interest and other income, net, in our Condensed Consolidated Statements of Operations. In certain cases, the amount of such gains and losses will significantly differ from the amount of gains and losses recognized on the underlying foreign-currency-denominated monetary asset or liability, in which case our results will be impacted. As of June 30, 2011, we had foreign currency forward contracts to purchase and sell approximately \$189 million in foreign currencies. Of this amount, \$117 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$51 million to purchase foreign currency in exchange for U.S. dollars, and \$21 million to sell foreign currency in exchange for British pounds sterling. As of March 31, 2011, we had foreign currency forward contracts to purchase and sell approximately \$187 million in foreign currencies. Of this amount, \$140 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$31 million to purchase foreign currency in exchange for U.S. dollars and \$16 million to sell foreign currency in exchange for British pounds sterling. The fair value of our foreign currency forward contracts was immaterial as of June 30, 2011 and March 31, 2011.

**Table of Contents**

We believe the counterparties to these foreign currency forward and option contracts are creditworthy multinational commercial banks. While we believe the risk of counterparty nonperformance is not material, the disruption in the global financial markets has impacted some of the financial institutions with which we do business. A sustained decline in the financial stability of financial institutions as a result of the disruption in the financial markets could affect our ability to secure credit-worthy counterparties for our foreign currency hedging programs.

Notwithstanding our efforts to mitigate some foreign currency exchange rate risks, there can be no assurance that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations. As of June 30, 2011, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 15 percent would have resulted in potential declines in the fair value of the premiums on our foreign currency option contracts used in cash flow hedging of \$1 million in each scenario. As of June 30, 2011, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 15 percent would have resulted in potential losses on our foreign currency forward contracts used in balance sheet hedging of \$17 million and \$25 million, respectively. This sensitivity analysis assumes a parallel adverse shift of all foreign currency exchange rates against the U.S. dollar; however, all foreign currency exchange rates do not always move in such manner and 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. However, because short-term investments mature relatively quickly and are required to be reinvested at the then-current market rates, interest income on a portfolio consisting of short-term investments is more subject to market fluctuations than a portfolio of longer term investments. Additionally, the contractual terms of the investments do not permit the issuer to call, prepay or otherwise settle the investments at prices less than the stated par value. Our investments are held for purposes other than trading. Also, we do not use derivative financial instruments in our short-term investment portfolio.

As of June 30, 2011 and March 31, 2011, our short-term investments were classified as available-for-sale securities and, consequently, were recorded at fair value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive income, net of tax, in stockholders' equity. Our portfolio of short-term investments consisted of the following investment categories, summarized by fair value as of June 30, 2011 and March 31, 2011 (in millions):

	As of June 30, 2011	As of March 2011
Corporate bonds	\$ 242	\$ 253
U.S. Treasury securities	118	124
U.S. agency securities	118	102
Commercial paper	25	18
<b>Total short-term investments</b>	<b>\$ 503</b>	<b>\$ 497</b>

Notwithstanding our efforts to manage interest rate risks, there can be no assurance that we will be adequately protected against risks associated with interest rate fluctuations. At any time, a sharp change in interest rates could have a significant impact on the fair value of our investment portfolio. The following table presents the hypothetical changes in the fair value of our short-term investment portfolio as of June 30, 2011, 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.

**Table of Contents**

(In millions)	Valuation of Securities Given an Interest Rate Decrease of X Basis Points			Fair Value as of June 30, 2011	Valuation of Securities Given an Interest Rate Increase of X Basis Points		
	(150 BPS)	(100 BPS)	(50 BPS)		50 BPS	100 BPS	150 BPS
Corporate bonds	\$ 247	\$ 245	\$ 244	\$ 242	\$ 241	\$ 240	\$ 238
U.S. Treasury securities	120	118	118	118	116	115	115
U.S. agency securities	120	120	119	118	117	116	116
Commercial paper	25	25	25	25	25	25	25
Total short-term investments	\$ 512	\$ 508	\$ 506	\$ 503	\$ 499	\$ 496	\$ 494

**Market Price Risk**

The fair value of our marketable equity securities in publicly traded companies is subject to market price volatility and foreign currency risk for investments denominated in foreign currencies. As of June 30, 2011 and March 31, 2011, our marketable equity securities were classified as available-for-sale securities and, consequently, were recorded on our Condensed Consolidated Balance Sheets at fair value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive income, net of tax, in stockholders' equity. The fair value of our marketable equity securities as of June 30, 2011 and March 31, 2011 was \$172 million and \$161 million, respectively.

Our marketable equity securities have been, and may continue to be, adversely impacted by volatility in the public stock markets. 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 hypothetical changes in the fair value of our marketable equity securities as of June 30, 2011, arising from changes in market prices of plus or minus 25 percent, 50 percent, and 75 percent.

(In millions)	Valuation of Securities Given an X Percentage Decrease in Each Stock's Market Price			Fair Value as of June 30, 2011	Valuation of Securities Given an X Percentage Increase in Each Stock's Market Price		
	(75%)	(50%)	(25%)		25%	50%	75%
Marketable equity securities	\$ 43	\$ 86	\$ 129	\$ 172	\$ 215	\$ 258	\$ 301

**Table of Contents**

**Item 4. Controls and Procedures**

***Definition and limitations of disclosure controls***

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

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

***Evaluation of disclosure controls and procedures***

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

***Changes in internal control over financial reporting***

There has been no change in our internal control over financial reporting identified in connection with our evaluation that occurred during the three months ended June 30, 2011 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

---

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

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

**Item 1A. Risk Factors**

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

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

Competition in our industry is intense and we expect new competitors to continue to emerge throughout the world. Our competitors range from large established companies to emerging start-ups. In our industry, though many new products and services are regularly introduced, only a relatively small number of hit titles accounts for a significant portion of total revenue for the industry. We have significantly reduced the number of games that we develop, publish and distribute: in fiscal year 2010, we published 54 primary titles, and in fiscal year 2011, we published 36. In fiscal year 2012, we expect to release 22 primary titles, including launching our massively multiplayer online role-playing game *Star Wars: The Old Republic*. Publishing fewer titles means that we concentrate more of our development spending on each title, and driving hit titles often requires large marketing budgets and media spend. The underperformance of a title may have a large adverse impact on our financial results. Also, 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.

In addition, both the online and mobile games marketplaces are characterized by frequent product introductions, relatively low barriers to entry, and new and evolving business methods, technologies and platforms for development. We expect competition in these markets to intensify. It is also possible that consumer adoption of these new platforms for games and other technological advances in online or mobile game offerings could negatively impact our sales of console, handheld and traditional PC products before we have sufficiently developed profitable businesses in these markets. If our competitors develop and market more successful products or services, offer competitive products or services at lower price points or based on payment models perceived as offering a better value proposition (such as free-to-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.

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

Our business is highly seasonal, with the highest levels of consumer demand and a significant percentage of our sales occurring in the December quarter. If we miss these key selling periods for any reason, including product delays, product cancellations, or delayed introduction of a new platform for which we have developed products, our sales will 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 or cancel release dates. We also seek to release certain products in conjunction with specific events, such as the beginning of a sports season or major sporting event, or the release of a related movie. If a key event or sports season to which our product release schedule is tied were to be delayed or cancelled, our sales would also suffer disproportionately. In the future, any failure to meet anticipated production or release schedules would likely result in a delay of revenue and/or possibly a significant shortfall in our revenue, increase our development expense, harm our profitability, and cause our operating results to be materially different than anticipated.



## **Table of Contents**

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

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

### **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 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 is 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 adoption of new business models could fail to produce our desired financial returns.**

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

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

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

Our product development usually starts with particular platforms and distribution methods in mind, and a range of technical development goals that we hope to be able to achieve. We may not be able to achieve these goals, or our competition may be able to achieve them more quickly and effectively than we can. In either case, our products and services may be technologically inferior to our competitors', less appealing to consumers, or both. If we cannot achieve our technology goals within the original development schedule 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. We may also miss opportunities to adopt technology, or develop products and services for new platforms or services that become popular with consumers, which could adversely affect our revenues. It may take significant time and resources to shift our focus to such technologies or platforms, putting us at a competitive disadvantage.

## **Table of Contents**

### **We may experience outages and disruptions of our online services if we fail to maintain adequate operational services and supporting infrastructure.**

As we increase our online products and services, we expect to continue to invest in technology services, hardware and software including data centers, network services, storage and database technologies to support existing services and to introduce new products and services including websites, ecommerce capabilities, online game communities and online game play services. Creating the appropriate support for online business initiatives is expensive and complex, and could result in inefficiencies or operational failures, and increased vulnerability to cyber attacks, which could diminish the quality of our products, services, and user experience. Such failures could result in damage to our reputation and loss of current and potential users, subscribers, and advertisers which could harm our business. In addition, we could be adversely impacted by outages and disruptions in the online platforms of our key business partners, who offer our products and services.

### **If we release 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 or may find it necessary to voluntarily recall a product or suspend its availability, which could significantly harm our business and operating results.

### **Our business could be adversely affected if our consumer data protection measures are not seen as adequate or there are breaches of our security measures or unintended disclosures of our consumer data.**

There are several inherent risks to engaging in business online and directly with end consumers of our products. As we conduct more transactions online directly with consumers, we may be the victim of fraudulent transactions, including credit card fraud, which presents a risk to our revenues and potentially disrupts service to our consumers. In addition, we are collecting and storing more consumer information, including personal information and credit card information. We take measures to protect our consumer data from unauthorized access or disclosure. It is possible that our security controls over consumer data may not prevent the improper access or disclosure of personally identifiable information. A security breach that leads to disclosure of consumer account information (including personally identifiable information) could harm our reputation, compel us to comply with disparate breach notification laws in various jurisdictions and otherwise subject us to liability under laws that protect personal data, resulting in increased costs or loss of revenue. A resulting perception that our products or services do not adequately protect the privacy of personal information could result in a loss of current or potential consumers for our online offerings that require the collection of consumer data. Our key business partners also face these same risks and any security breaches of their system could adversely impact our ability to offer our products and services through their platforms, resulting in a loss of meaningful revenues.

In addition, the interpretation and application of consumer and data protection laws in the U.S., Europe and elsewhere are often uncertain, contradictory and in flux. It is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, this could result in government imposed fines or orders requiring that we change our data practices, which could have an adverse effect on our business. Complying with these various laws could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

### **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.**

During the three months ended June 30, 2011, approximately 70 percent of our North America sales were made to our top ten customers. In Europe, our top ten customers accounted for approximately 45 percent of our sales in that territory during the three months ended June 30, 2011. Worldwide, we had direct sales to one customer, GameStop Corp., which represented approximately 18 percent of total net revenue for the three months ended June 30, 2011. Though our products are available to consumers through a variety of retailers and directly through us, the concentration of our sales in one, or a few, large customers could lead to a short-term disruption in our sales if one or more of these customers significantly reduced their purchases or ceased to carry our products, and could make us more vulnerable to collection risk if one or more of these large customers became unable to pay for our products or declared bankruptcy. Additionally, our receivables from these large customers increase significantly in the December quarter as they make purchases in anticipation of 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. If one or more of our key customers experience deterioration in their business, or become unable to obtain sufficient financing to maintain their operations, our business could be harmed.





---

## **Table of Contents**

**Our industry is cyclical, driven by the periodic introduction of new video game hardware systems. As we continue to move through the current cycle, our industry growth may slow down and as a result, our operating results may be 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. The current cycle began with Microsoft's launch of the Xbox 360 in 2005, and continued in 2006 when Sony and Nintendo launched their next-generation systems, the PLAYSTATION 3 and the Wii, respectively. Sales of software designed for these hardware systems represent the majority of our revenue, so our growth and success is highly correlated to sales of video game hardware systems. While there are indications that this current cycle may be extended longer than prior cycles in part, due to the growth of online services and content, the greater graphic and processing power of the current generation hardware, and the introduction of new peripherals, growth in the installed base of the current generation of video game systems is likely to slow down in the coming years. This slow-down in sales of video game players may cause a corresponding slow-down in the growth of sales of video game software, which could significantly affect our operating results.

**Sales of used video game products could lower our sales of new video games.**

Certain of our retail customers sell used video games. Used video game sales have been growing in North America, and are emerging in Europe. Used video games are generally priced lower than new video games and the margins on used games sales are generally greater for retailers than the margins on new game sales. We do not receive revenue from retailers' sales of used video games. Sales of used video games may negatively impact our sales and profitability.

**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 Sony, Microsoft and Nintendo in order to include online capabilities in our products for their respective platforms and to digitally distribute our products through their proprietary networks. As online capabilities for video game systems become more significant, Sony, Microsoft and Nintendo could restrict the manner in which we provide online capabilities for our products. They may also restrict the number of products that we may distribute digitally on their networks. If Sony, Microsoft or Nintendo refuse to approve our products with online capabilities, restrict our digital download offerings on their proprietary networks, or significantly impact the financial terms on which these services are offered to our customers, our business could be harmed.

**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 change their fee structure, 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 Microsoft, Sony and Nintendo, respectively, which gives these companies the opportunity to set the fee structure that we must pay in order to publish games for that platform. Similarly, these companies have retained the flexibility to change their fee structures, or adopt different fee structures for online purchases of games, 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 could adversely impact our costs, profitability and 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 profits.

## **Table of Contents**

**If we are unable to maintain or acquire licenses to include intellectual property owned by others in our games, or to maintain or acquire the rights to publish or distribute games developed by others, we will sell fewer hit titles and our revenue, profitability and cash flows will decline. Competition for these licenses may make them more expensive and reduce our profitability.**

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 Harry Potter, are based on key film and literary licenses and our Hasbro products are based on a license for these key toy and game properties. In addition, some of our successful products in fiscal year 2011, *Bulletstorm* and *Crysis 2*, were products for which we acquired publishing rights through a license from the product's creator/owner. Competition for these licenses and rights is intense. If we are unable to maintain these licenses and rights or obtain additional licenses or rights with significant commercial value, our revenues, profitability and cash flows will decline significantly. Competition for these licenses may also drive up the advances, guarantees and royalties that we must pay to licensors and developers, which could significantly increase our costs and reduce our profitability.

**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 business will be impaired.

**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.

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

We expect to continue making acquisitions or entering into other strategic transactions including (1) acquisitions of companies, businesses, intellectual properties, and other assets, (2) minority investments in strategic partners, and (3) investments in new interactive entertainment businesses (for example, online and mobile publishing platforms) as part of our long-term business strategy. These transactions involve significant challenges and risks including that the transaction does not advance our business strategy, that we do not realize a satisfactory return on our investment, that we acquire unknown liabilities, or that we experience difficulty in the integration of business systems and technologies, the integration and retention of new employees, or in the maintenance of key business and customer relationships of the businesses we acquire, or diversion of management's attention from our other businesses. These events could harm our operating results or financial condition.

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

## **Table of Contents**

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

From time to time, third parties may assert claims against us relating to patents, copyrights, trademarks, personal publicity rights, or other intellectual property rights to technologies, products or delivery/payment methods that are important to our business. Although we believe that we make reasonable efforts to ensure that our products do not violate the intellectual property rights of others, it is possible that third parties still may claim infringement. For example, we may be subject to intellectual property infringement claims from certain individuals and companies who have acquired patent portfolios for the sole purpose of asserting such claims against other companies. In addition, many of our products are highly realistic and feature materials that are based on real world examples, which may be the subject of intellectual property infringement claims of others. From time to time, we receive communications from third parties regarding such claims. Existing or future infringement claims against us, whether valid or not, may be time consuming and expensive to defend. Such claims or litigations could require us to pay damages and other costs, stop selling the affected products, redesign those products to avoid infringement, or obtain a license, all of which could be costly and harm our business. In addition, many patents have been issued that may apply to potential new modes of delivering, playing or monetizing game software products and services, such as those that we produce or would like to offer in the future. We may discover that future opportunities to provide new and innovative modes of game play and game delivery to consumers may be precluded by existing patents that we are unable to license on reasonable terms.

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

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

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

Legislation is continually being introduced in the United States at the local, state and federal levels for the establishment of government mandated rating requirements or restrictions on distribution of entertainment software based on content. To date, most courts that have ruled on such legislation have ruled in a manner favorable to the interactive entertainment industry. Other countries have adopted or are considering laws regulating or mandating ratings requirements on entertainment software content and certain foreign countries already allow government censorship of entertainment software products. Adoption of government ratings system or restrictions on distribution of entertainment software based on content could harm our business by limiting the products we are able to offer to our customers and compliance with new and possibly inconsistent regulations for different territories could be costly or delay the release of our products.

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

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

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

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

While legal protections exist to combat piracy, preventing and curbing infringement through enforcement of our intellectual property rights may be difficult, costly and time consuming, particularly in countries where laws are less protective of intellectual property rights. Further, the scope of the legal protection of copyright and prohibitions against the circumvention of technological protection measures to protect copyrighted works are often under scrutiny by courts and governing bodies. The repeal or weakening of laws intended to combat piracy, protect intellectual

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

property and prohibit the circumvention of technological protection measures could make it more difficult for us to adequately protect against piracy. These factors could have a negative effect on our growth and profitability in the future.

## **Table of Contents**

### **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 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 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 have 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. In addition, to the extent we acquire a company without similar controls in place, the possibility of hidden, objectionable content appearing in video games developed by that company but for which we are ultimately responsible could increase. 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.

### **Our debt service obligations may adversely affect our cash flow.**

While our Notes are outstanding, we will have debt service obligations on the Notes of approximately \$5 million per year. We intend to fulfill our debt service obligations from cash generated by our operations and from our existing cash and investments. We may enter into other financial instruments in the future.

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

increase our vulnerability to general adverse economic and industry conditions;

limit our ability to obtain additional financing;

require the dedication of a substantial portion of any cash flow from operations to the payment of principal of, and interest on, our indebtedness, thereby reducing the availability of such cash flow to fund our growth strategy, working capital, capital expenditures and other general corporate purposes;

limit our flexibility in planning for, or reacting to, changes in our business and our industry; and

place us at a competitive disadvantage relative to our competitors with less debt.

Further, the Notes are subject to net share settlement, which means that we will satisfy our conversion obligation to holders by paying cash in settlement of the lesser of the principal amount and the conversion value of the Notes and by delivering shares of our common stock in settlement of any and all conversion obligations in excess of the principal amount. In addition, holders of the Notes will have the right to require us to purchase their Notes for cash upon the occurrence of a fundamental change at a purchase price equal to 100 percent of their principal amount, plus accrued and unpaid interest, if any.

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

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

---

## **Table of Contents**

In addition, our ability to purchase the Notes or to pay cash upon conversion of the Notes may be limited by law, by regulatory authority or by agreements governing our future indebtedness. Our failure to purchase the Notes at a time when the purchase is required by the indenture or to pay cash upon conversion of the Notes as required by the indenture would constitute a default under the indenture. A default under the indenture or a fundamental change itself could also lead to a default under agreements governing our future indebtedness. If the payment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and purchase the Notes or to pay cash upon conversion of the Notes.

### **The Hedge Transactions and Warrant Transactions may affect the value of the Notes and our common stock.**

In connection with the offering of the Notes, we entered into privately-negotiated Hedge Transactions with Options Counterparties. The Hedge Transactions cover, subject to anti-dilution adjustments substantially similar to those applicable to the Notes, the number of shares of common stock underlying the Notes. We also entered into separate, privately-negotiated Warrant Transactions with the Option Counterparties relating to the same number of shares of our common stock, subject to customary anti-dilution adjustments.

In connection with establishing their hedge position with respect to the Hedge Transactions and the Warrant Transactions, the Option Counterparties and/or their affiliates:

may have entered into various cash-settled over-the-counter derivative transactions with respect to our common stock and/or purchased shares of our common stock concurrently with, or shortly following, the pricing of the Notes; and

may unwind any such cash-settled over-the-counter derivative transactions and purchase shares of our common stock in open market transactions, including any observation period related to the conversion of the Notes.

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

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

### **Uncertainty and adverse changes in the economy could have a material adverse impact on our business and operating results.**

Declines in consumer spending resulting from adverse changes in the economy have in the past negatively impacted our business. Further economic distress may result in a decrease in demand for our products, particularly during key product launch windows, which could have a material adverse impact on our operating results and financial condition. Uncertainty and adverse changes in the economy could also increase the risk of material losses on our investments, increase costs associated with developing and publishing our products, increase the cost and decrease the availability of sources of financing, and increase our exposure to material losses from bad debts, any of which could have a material adverse impact on our financial condition and operating results. In addition, if we experience further deterioration in our market capitalization or our financial performance, we could be required to recognize significant impairment charges in future periods.

### **Our business is subject to currency fluctuations.**

International sales are a fundamental part of our business. For the three months ended June 30, 2011, international net revenue comprised 50 percent of our total net revenue. We expect international sales to continue to account for a significant portion of our total net revenue. Such sales may be subject to unexpected regulatory requirements, tariffs and other barriers. Additionally, foreign sales are primarily made in local currencies, which may fluctuate against the U.S. dollar. In addition, our foreign investments and our cash and cash equivalents denominated in foreign currencies are subject to currency fluctuations. We use foreign currency forward contracts to mitigate some foreign currency risk associated with foreign currency denominated monetary assets and liabilities (primarily certain intercompany receivables and payables) to a limited extent and 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). However, these activities are limited in the protection they provide us from foreign currency fluctuations and can themselves result in losses. In the past, the disruption in the global



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

financial markets has impacted many of the financial institutions with which we do business, and we are subject to counterparty risk with respect to such institutions with whom we enter into hedging transactions. A sustained decline in the financial stability of financial institutions as a result of the disruption in the financial markets could negatively impact our treasury operations, including our ability to secure credit-worthy counterparties for our foreign currency hedging programs. Accordingly, our results of operations, including our reported net revenue, operating expenses and net income, and financial condition can be adversely affected by unfavorable foreign currency fluctuations, especially the Euro, British pound sterling and Canadian dollar.

## **Table of Contents**

### **Volatility in the capital markets may adversely impact the value of our investments and could cause us to recognize significant impairment charges in our operating results.**

Our portfolio of short-term investments and marketable equity securities is subject to volatility in the capital markets and to national and international economic conditions. In particular, our international investments can be subject to fluctuations in foreign currency and our short-term investments are susceptible to changes in short-term interest rates. These investments are also impacted by declines in value attributable to the credit-worthiness of the issuer. From time to time, we may liquidate some or all of our short-term investments or marketable equity securities to fund operational needs or other activities, such as capital expenditures, strategic investments or business acquisitions, or for other purposes. If we were to liquidate these short-term investments at a time when they were worth less than what we had originally purchased them for, or if the obligor were unable to pay the full amount at maturity, we could incur a significant loss. Similarly, we hold marketable equity securities, which have been and may continue to be adversely impacted by price and trading volume volatility in the public stock markets. We could be required to recognize impairment charges on the securities held by us and/or we may realize losses on the sale of these securities, all of which could have an adverse effect on our financial condition and results of operations.

### **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 tax obligations 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. The tax laws' treatment of software and Internet-based transactions is particularly uncertain and in some cases currently applicable tax laws are ill-suited to address these kinds of transactions. Apart from an adverse resolution of these uncertainties, our effective tax rate also could be adversely affected by our profit levels, by changes in our business or changes in our structure resulting from the reorganization of our business and operating structure, changes in the mix of earnings in countries with differing statutory tax rates, changes in the elections we make, changes in applicable tax laws (in the United States or foreign jurisdictions), or changes in the valuation allowance for deferred tax assets, as well as other factors. In fiscal years 2009, 2010 and 2011, we recorded a valuation allowance against most of our U.S. deferred tax assets. We expect to provide a valuation allowance on future U.S. tax benefits until we can sustain a level of profitability or until other significant positive evidence arises that suggest that these benefits are more likely than not to be realized. 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.

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 at higher levels. In addition, at lower levels of pre-tax income or loss, our effective tax rate will 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 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.

---

## Table of Contents

Furthermore, 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.

### **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.**

Our reported financial results are impacted by the accounting policies promulgated by the SEC and national accounting standards bodies and the methods, estimates, and judgments that we use in applying our accounting policies. For example, as we have recently issued Notes which we will account for under ASC 470-20, *Debt with Conversion and Other Options*, we will be required to record a greater amount of non-cash interest expense as a result of the amortization of the discounted carrying value of the Notes to their face amount over the term of the Notes. Consequently, we will report lower net income in our financial results because ASC 470-20 will require interest to include both the current period's amortization of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the trading price of our common stock and the trading price of the Notes. Furthermore, we cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method, with respect to the calculation of diluted earnings per share when considering our Notes that may be settled entirely or partly in cash. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the Notes, then our diluted earnings per share would be adversely affected.

In addition, policies affecting software revenue recognition have and could further significantly affect the way we account for revenue related to our products and services. We recognize all of the revenue from bundled sales (*i.e.*, packaged goods video games that include an online service component) on a deferred basis over an estimated online service period, which we generally estimate to be six months beginning in the month after shipment. As we increase our downloadable content and add new features to our online service, our estimate of the online service period may change and we could be required to recognize revenue over a longer period of time. We expect that a significant portion of our games will be online-enabled in the future and we could 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 integrated financial information system to be used throughout our worldwide organization. If this implementation is not completed in a successful and timely manner or if the new system fails to perform as expected, our ability to accurately process, prepare and analyze important financial data could be impeded and our business operations may be disrupted.**

As part of our effort to improve efficiencies throughout our worldwide organization, we have begun the implementation of a new integrated financial information system. This implementation is expected to be completed by the first quarter of the fiscal year 2013. This system will integrate our order management, product shipment, cash management and financial accounting processes, among others. The successful conversion from our current multiple financial information systems to this new integrated financial information system entails a number of risks due to the complexity of the conversion and implementation process. Such risks include verifying the accuracy of the business data and information prior to conversion, the actual conversion of that data and information to the new system and then using that business data and information in the new system after the conversion. 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 conversion to, and the implementation of, the new financial information system 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. In addition, a number of important operational functions, including receiving product orders, product shipments and inventory maintenance, among others, will be reliant on the new system and therefore, any problems with the implementation or other system problems may result in a disruption to our business operations.

**Table of Contents**

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

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

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

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

In February 2011, we announced that our Board of Directors authorized a program to repurchase up to \$600 million of our common stock over the next 18 months. Our stock repurchases may be executed at market prices that may subsequently decline.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

In February 2011, we announced that our Board of Directors authorized a program to repurchase up to \$600 million of our common stock over the next 18 months. Under the program, we may purchase stock in the open market or through privately negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase any specific number of shares under the program and the repurchase program may be modified, suspended or discontinued at any time.

The following table summarizes the number of shares repurchased during the three months ended June 30, 2011:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program (in millions)
April 1-30, 2011	532,450	\$ 19.69	532,450	\$ 531
May 1-31, 2011	2,077,692	\$ 23.07	2,077,692	\$ 483
June 1-30, 2011	1,348,959	\$ 23.06	1,348,959	\$ 451

**Item 6. Exhibits**

The exhibits listed in the accompanying index to exhibits on Page 66 are filed or incorporated by reference as part of this report.

**Table of Contents**

**SIGNATURE**

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

ELECTRONIC ARTS INC.  
(Registrant)

/s/ Eric F. Brown  
Eric F. Brown  
Executive Vice President,  
Chief Financial Officer

DATED:  
August 9, 2011

**Table of Contents****ELECTRONIC ARTS INC.****FORM 10-Q****FOR THE PERIOD ENDED JUNE 30, 2011****EXHIBIT INDEX**

Number	Exhibit Title	Incorporated by Reference			Filed Herewith
		Form	File No.	Filing Date	
1.1	Purchase Agreement dated as of July 14, 2011 between EA and Morgan Stanley & Co. LLC.	8-K	000-17948	07-20-2011	
2.1	Agreement and Plan of Merger By and among EA, Plumpjack Acquisition Corporation, PopCap, David L. Roberts as earn-out representative, David L. Roberts, as shareholder representative, and with respect to Articles VII, VIII and IX only, U.S. Bank National Association, as escrow agent dated as of July 11, 2011.	8-K	000-17948	07-12-2011	
4.1	Indenture (including form of Notes) with respect to EA's 0.75 Convertible Senior Notes due 2016 dated as of July 20, 2011 by and between EA and U.S. Bank National Association.	8-K	000-17948	07-20-2011	
10.1	Letter Agreement with Relational Investors LLC.	8-K	000-17948	05-31-2011	
10.2*	Form of Performance-Based Restricted Stock Unit Agreement.	8-K	000-17948	06-01-2011	
10.3*	Electronic Arts Bonus Plan Addendum.	8-K	000-17948	06-01-2011	
10.4	Form of Stock Consideration Agreement, dated July 11, 2011 between EA and each of the founders and the chief executive officer of PopCap.	8-K	000-17948	07-12-2011	
10.5	Form of Call Option Agreement dated as of July 14, 2011 between EA and each Option Counterparty.	8-K	000-17948	07-20-2011	
10.6	Form of Warrant Agreement dated July 14, 2011 between EA and each Option Counterparty.	8-K	000-17948	07-20-2011	
10.7	Form of Additional Call Option Agreement dated July 18, 2011 between EA and each Option Counterparty.	8-K	000-17948	07-20-2011	
10.8	Form of Additional Warrant Agreement dated July 18, 2011 between EA and each Option Counterparty.	8-K	000-17948	07-20-2011	
10.9*	2000 Equity Incentive Plan, as amended, and related documents	8-K	000-17948	07-29-2011	
10.10*	2000 Employee Stock Purchase Plan, as amended	8-K	000-17948	07-29-2011	
15.1	Awareness Letter of KPMG, LLP, Independent Registered Public Accounting Firm.				X
21.1	Subsidiaries of the Registrant.				X
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X
31.2	Certification of Executive Vice President, Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				X

Additional exhibits furnished with this report:

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

32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X
32.2	Certification of Executive Vice President, Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X
101.INS	XBRL Instance Document.	X
101.SCH	XBRL Taxonomy Extension Schema Document.	X



---

**Table of Contents**

101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.	X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.	X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.	X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.	X

\* Management contract or compensatory plan or arrangement

Pursuant to Rule 406T of Regulation S-T, these interactive data files are furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended; are deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended; and otherwise are not subject to liability under these sections. We are deemed to have complied with the reporting obligation relating to the submission of interactive data files in these exhibits and are not subject to liability under the anti-fraud provisions of the Securities Act of 1933 or any other liability provision as long as we make a good faith attempt to comply with the submission requirements and promptly amend the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements.