

ELECTRONIC ARTS INC.  
Form 10-Q  
November 06, 2018  
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 September 30, 2018  
OR

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 000-17948

ELECTRONIC ARTS INC.

(Exact name of registrant as specified in its charter)

Delaware 94-2838567

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

209 Redwood Shores Parkway 94065

Redwood City, California  
(Address of principal executive offices) (Zip Code)

(650) 628-1500

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). YES  NO

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 November 2, 2018, there were 302,128,696 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 SEPTEMBER 30, 2018  
 Table of Contents

|  | Page |
|--|------|
| <u>Part I - FINANCIAL INFORMATION</u>  |      |
| Item 1. <u>Condensed Consolidated Financial Statements (Unaudited)</u>   |      |
| <u>Condensed Consolidated Balance Sheets as of September 30, 2018 and March 31, 2018</u>   | 3    |
| <u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended September 30, 2018 and 2017</u>                  | 4    |
| <u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Six Months Ended September 30, 2018 and 2017</u> | 5    |
| <u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended September 30, 2018 and 2017</u>                            | 6    |
| <u>Notes to Condensed Consolidated Financial Statements</u>  | 7    |
| <u>Report of Independent Registered Public Accounting Firm</u>   | 37   |
| Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>                                   | 38   |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 58   |
| Item 4. <u>Controls and Procedures</u>   | 60   |
| <u>Part II - OTHER INFORMATION</u>   |      |
| Item 1. <u>Legal Proceedings</u>   | 61   |
| Item 1A. <u>Risk Factors</u>   | 61   |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   | 71   |
| Item 3. <u>Defaults Upon Senior Securities</u>   | 71   |
| Item 4. <u>Mine Safety Disclosures</u>   | 71   |
| Item 6. <u>Exhibits</u>  | 71   |
| <u>Exhibit Index</u>   | 72   |
| <u>Signature</u>   | 72   |

Table of Contents

## PART I – FINANCIAL INFORMATION

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

ELECTRONIC ARTS INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

| (Unaudited)<br>(In millions, except par value data)  | September 30,<br>2018 | March<br>31,<br>2018 <sup>(a)</sup> |
|--|-----------------------|-------------------------------------|
| <b>ASSETS</b>  |                       |                                     |
| Current assets:  |                       |                                     |
| Cash and cash equivalents  | \$ 2,881              | \$4,258                             |
| Short-term investments   | 1,664                 | 1,073                               |
| Receivables, net of allowances of \$10 and \$165, respectively   | 966                   | 385                                 |
| Other current assets   | 292                   | 288                                 |
| Total current assets   | 5,803                 | 6,004                               |
| Property and equipment, net  | 440                   | 453                                 |
| Goodwill   | 1,894                 | 1,883                               |
| Acquisition-related intangibles, net   | 100                   | 71                                  |
| Deferred income taxes, net   | 112                   | 84                                  |
| Other assets   | 101                   | 89                                  |
| <b>TOTAL ASSETS</b>  | <b>\$ 8,450</b>       | <b>\$8,584</b>                      |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                       |                                     |
| Current liabilities:   |                       |                                     |
| Accounts payable   | \$ 168                | \$48                                |
| Accrued and other current liabilities  | 907                   | 821                                 |
| Deferred net revenue (online-enabled games)  | 574                   | 1,622                               |
| Total current liabilities  | 1,649                 | 2,491                               |
| Senior notes, net  | 993                   | 992                                 |
| Income tax obligations   | 273                   | 250                                 |
| Deferred income taxes, net   | 1                     | 1                                   |
| Other liabilities  | 217                   | 255                                 |
| Total liabilities  | 3,133                 | 3,989                               |
| Commitments and contingencies (See Note 13)  |                       |                                     |
| Stockholders' equity:  |                       |                                     |
| Common stock, \$0.01 par value. 1,000 shares authorized; 304 and 306 shares issued and outstanding, respectively | 3                     | 3                                   |
| Additional paid-in capital   | 134                   | 657                                 |
| Retained earnings  | 5,199                 | 4,062                               |
| Accumulated other comprehensive loss   | (19                   | ) (127 )                            |
| Total stockholders' equity   | 5,317                 | 4,595                               |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>  | <b>\$ 8,450</b>       | <b>\$8,584</b>                      |

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

(a) Derived from audited Consolidated Financial Statements.

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

| (Unaudited)  | Three Months<br>Ended<br>September 30, |          | Six Months<br>Ended<br>September<br>30, |         |
|--|--|----------|---|---------|
| (In millions, except per share data)   | 2018                                   | 2017     | 2018                                    | 2017    |
| Net revenue:   |  |          |   |         |
| Product  | \$623                                  | \$454    | \$825                                   | \$1,282 |
| Service and other  | 663                                    | 505      | 1,598                                   | 1,126   |
| Total net revenue  | 1,286                                  | 959      | 2,423                                   | 2,408   |
| Cost of revenue:   |  |          |   |         |
| Product  | 222                                    | 300      | 290                                     | 364     |
| Service and other  | 196                                    | 89       | 343                                     | 179     |
| Total cost of revenue  | 418                                    | 389      | 633                                     | 543     |
| Gross profit   | 868                                    | 570      | 1,790                                   | 1,865   |
| Operating expenses:  |  |          |   |         |
| Research and development   | 339                                    | 331      | 701                                     | 656     |
| Marketing and sales  | 146                                    | 160      | 286                                     | 281     |
| General and administrative   | 117                                    | 118      | 231                                     | 223     |
| Acquisition-related contingent consideration                                       | 2                                      | —        | 2                                       | —       |
| Amortization of intangibles  | 6                                      | 2        | 12                                      | 3       |
| Total operating expenses   | 610                                    | 611      | 1,232                                   | 1,163   |
| Operating income (loss)  | 258                                    | (41)     | 558                                     | 702     |
| Interest and other income (expense), net   | 18                                     | 3        | 37                                      | 9       |
| Income (loss) before provision for (benefit from) income taxes                     | 276                                    | (38)     | 595                                     | 711     |
| Provision for (benefit from) income taxes  | 21                                     | (16)     | 47                                      | 89      |
| Net income (loss)  | \$255                                  | \$(22)   | \$548                                   | \$622   |
| Earnings (loss) per share:   |  |          |   |         |
| Basic  | \$0.84                                 | \$(0.07) | \$1.80                                  | \$2.01  |
| Diluted  | \$0.83                                 | \$(0.07) | \$1.77                                  | \$1.99  |
| Number of shares used in computation:  |  |          |   |         |
| Basic  | 305                                    | 309      | 305                                     | 309     |
| Diluted  | 307                                    | 309      | 309                                     | 313     |
| See accompanying Notes to Condensed Consolidated Financial Statements (unaudited). |  |          |   |         |

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

| (Unaudited)   | Three<br>Months<br>Ended<br>September<br>30, |        | Six Months<br>Ended<br>September<br>30, |       |
|---|--|--------|---|-------|
| (In millions)                                       | 2018   | 2017   | 2018                                    | 2017  |
| Net income (loss)                                   | \$255  | \$(22) | \$548                                   | \$622 |
| Other comprehensive income (loss), net of tax:      |  |        |   |       |
| Net gains on available-for-sale securities          | 1  | —      | 1                                       | —     |
| Net gains (losses) on derivative instruments        | 3  | (34 )  | 96                                      | (90 ) |
| Foreign currency translation adjustments            | 3  | 32     | (12 )                                   | 36    |
| Total other comprehensive income (loss), net of tax | 7  | (2 )   | 85                                      | (54 ) |
| Total comprehensive income (loss)                   | \$262  | \$(24) | \$633                                   | \$568 |

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

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

| (Unaudited)   | Six Months<br>Ended   |          |
|---|-----------------------|----------|
| (In millions)   | September 30,<br>2018 | 2017     |
| <b>OPERATING ACTIVITIES</b>   |                       |          |
| Net income  | \$ 548                | \$ 622   |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                       |          |
| Depreciation, amortization and accretion  | 74                    | 63       |
| Stock-based compensation  | 136                   | 110      |
| Change in assets and liabilities:   |                       |          |
| Receivables, net  | (422 )                | (454 )   |
| Other assets  | 20                    | 66       |
| Accounts payable  | 132                   | 104      |
| Accrued and other liabilities   | (25 )                 | 100      |
| Deferred income taxes, net  | (94 )                 | 40       |
| Deferred net revenue (online-enabled games)   | (375 )                | (423 )   |
| Net cash provided by (used in) operating activities   | (6 )                  | 228      |
| <b>INVESTING ACTIVITIES</b>   |                       |          |
| Capital expenditures  | (63 )                 | (63 )    |
| Proceeds from maturities and sales of short-term investments                                | 446                   | 1,050    |
| Purchase of short-term investments  | (1,029 )              | (1,395 ) |
| Acquisition, net of cash acquired   | (58 )                 | —        |
| Net cash used in investing activities   | (704 )                | (408 )   |
| <b>FINANCING ACTIVITIES</b>   |                       |          |
| Proceeds from issuance of common stock  | 36                    | 57       |
| Cash paid to taxing authorities for shares withheld from employees                          | (96 )                 | (105 )   |
| Repurchase and retirement of common stock   | (599 )                | (303 )   |
| Net cash used in financing activities   | (659 )                | (351 )   |
| Effect of foreign exchange on cash and cash equivalents                                     | (8 )                  | 33       |
| Decrease in cash and cash equivalents   | (1,377 )              | (498 )   |
| Beginning cash and cash equivalents   | 4,258                 | 2,565    |
| Ending cash and cash equivalents  | \$ 2,881              | \$ 2,067 |
| Supplemental cash flow information:   |                       |          |
| Cash paid during the period for income taxes, net   | \$ 78                 | \$ 28    |
| Cash paid during the period for interest  | 21                    | 21       |

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 are a global leader in digital interactive entertainment, with a mission to inspire the world to play. We develop, market, publish and distribute games, content and services that can be played on a variety of platforms including game consoles, PCs, mobile phones and tablets. In our games and services, we use brands that we either wholly own (such as Battlefield, Mass Effect, Need for Speed, The Sims, Plants v. Zombies and Titanfall) or license from others (such as FIFA, Madden NFL and Star Wars). We develop and publish games and services across diverse genres such as sports, first-person shooter, action, role-playing and simulation.

Our fiscal year is reported on a 52- or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal year ending March 31, 2019 contains 52 weeks and ends on March 30, 2019. Our results of operations for the fiscal year ended March 31, 2018 contained 52 weeks and ended on March 31, 2018. Our results of operations for the three months ended September 30, 2018 and 2017 contained 13 weeks each and ended on September 29, 2018 and September 30, 2017, respectively. Our results of operations for the six months ended September 30, 2018 and 2017 contained 26 weeks each and ended on September 29, 2018 and September 30, 2017, 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, 2018, as filed with the United States Securities and Exchange Commission (“SEC”) on May 23, 2018.

Recently Adopted Accounting Standards

In May 2014, the FASB issued the Accounting Standards Codification (“ASC”) Topic 606, Revenue From Contracts with Customers (the “New Revenue Standard” or “ASC 606”), which replaced ASC Topic 605, Revenue Recognition (the “Old Revenue Standard” or “ASC 605”), including industry-specific requirements, and provided companies with a single principles-based revenue recognition model for recognizing revenue from contracts with customers. The core principle of the New Revenue Standard is that a company should recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers.

We adopted the New Revenue Standard on April 1, 2018, the beginning of fiscal year 2019, using the modified retrospective method. We elected to apply the New Revenue Standard only to contracts that were not completed as of the adoption date. The comparative information for periods prior to April 1, 2018 has not been restated and continues to be reported under the accounting standards in effect for those periods.



7

---

Table of Contents

The net cumulative effect adjustment upon adoption resulted in an increase to retained earnings of \$590 million, net of tax, and included the impact from the following adjustments to our Condensed Consolidated Balance Sheet at April 1, 2018:

| BALANCE SHEETS<br>(In millions)               | Balance<br>at<br>March<br>31,<br>2018 | Adjustments<br>due to New<br>Revenue<br>Standard<br>Adoption | Balance<br>at<br>April 1,<br>2018 |
|---|---------------------------------------|--|-----------------------------------|
| <b>Assets</b>                                 |                                       |  |                                   |
| Receivables, net                              | \$385                                 | \$ 158   | \$543                             |
| Deferred income taxes, net                    | 84                                    | (64 )  | 20                                |
| <b>Liabilities</b>                            |                                       |  |                                   |
| Accrued and other current liabilities         |                                       |  |                                   |
| Sales return and price protection reserves    | \$—                                   | \$ 158   | \$158                             |
| Deferred net revenue (other)                  | 108                                   | (3 )   | 105                               |
| Deferred net revenue (online-enabled games)   | 1,622                                 | (673 )   | 949                               |
| <b>Stockholders' Equity</b>                   |                                       |  |                                   |
| Retained earnings                             | \$4,062                               | \$ 590   | \$4,652                           |
| Accumulated other comprehensive income (loss) | (127 )                                | 22   | (105 )                            |

The most significant impacts of the New Revenue Standard were:

The accounting for our transactions as multiple elements or “bundled” arrangements. Under prior software revenue recognition accounting standards, because we did not have vendor-specific objective evidence of fair value (“VSOE”) for unspecified future updates or online hosting, we were not able to account for performance obligations separately, and therefore, the entire sales price of most transactions that had multiple performance obligations was recognized ratably over the period we expected to provide the future updates and/or online hosting performance obligations (the “Estimated Offering Period”). Under the New Revenue Standard, this VSOE requirement was eliminated and was replaced with a requirement for us to determine our best estimate of the stand-alone selling price of each performance obligation and allocate the transaction price to each distinct performance obligation on a relative stand-alone selling price basis. Therefore, we are now able to account for performance obligations separately.

For example, for an individual sale of a game with both online and offline functionality, we typically have three distinct performance obligations; (1) the software license; (2) a right to receive future updates; and (3) online hosting. The software license performance obligation represents the game that is delivered digitally or via physical disc at the time of sale and typically provides access to offline core game content. The future update rights performance obligation includes updates on a when-and-if-available basis such as software patches or updates, and/or additional free content to be delivered in the future. The online hosting performance obligation consists of providing the customer with a hosted connection for online playability.

Since we do not sell the performance obligations on a stand-alone basis, we consider market conditions and other observable inputs to estimate the stand-alone selling price for each performance obligation. For games with services under the New Revenue Standard, generally 75 percent of the sales price is allocated to the software license performance obligation and recognized at a point in time upon delivery (which is usually at or near the same time as the booking of the transaction), and the remaining 25 percent is allocated to the future update rights and the online hosting performance obligations and recognized ratably over the Estimated Offering Period. For sales prior to April 1, 2018, our deferred revenue balances decreased by \$740 million upon adoption of the New Revenue Standard because

the software license performance obligation had been delivered in the prior fiscal year.

Mobile platform fees. The adoption of the New Revenue Standard also changed how we present mobile platform fees after March 31, 2018. Previously, mobile platform fees retained by third-party application storefronts such as the Apple App Store and Google Play, were reported on a net basis (i.e. as a reduction of net revenue) because we previously determined that generally, the third party was considered the primary obligor. Upon adoption of the New Revenue Standard, we concluded that we are the principal in the transactions, resulting in mobile platform fees now being reported within cost of revenue rather than as a reduction of net revenue. We recognized \$64 million of mobile platform fees at April 1, 2018 as an increase to our deferred revenue balances. Mobile platform fees for the three and six months ended September 30, 2018 were \$44 million and \$93 million, respectively, and accordingly increased both

Table of Contents

service and other net revenue and cost of revenue by this amount relative to the same period a year ago. While this change also decreased our gross margin percentage, it does not have a material impact on our annual total gross profit or overall profitability.

Increased portion of our sales from games with services are presented as service revenue. The amount of the transaction price allocated to future update rights and the online hosting performance obligations are presented as service revenue under the New Revenue Standard (previously, revenue associated with future update rights were generally presented as product revenue). Therefore, for the three and six months ended September 30, 2018, approximately \$102 million and \$288 million, respectively, of revenue for future update rights are now presented as service revenue under the New Revenue Standard as compared to product revenue under the Old Revenue Standard.

Sales returns and price protection reserves. Upon adoption, our sales returns and price protection reserves are now presented within accrued and other liabilities (previously, these allowances were presented as contra-assets within receivables on our Condensed Consolidated Balance Sheets). We reclassified \$158 million of sales returns and price protection reserves on April 1, 2018.

The adoption of the New Revenue Standard impacted our Condensed Consolidated Balance Sheet as of September 30, 2018 and our Condensed Consolidated Statement of Operations for the three and six months ended September 30, 2018 as follows:

| BALANCE SHEETS<br>(In millions)             | As of<br>September 30, 2018         |                                     | \$<br>Change |
|---|-------------------------------------|-------------------------------------|--------------|
|   | Under<br>New<br>Revenue<br>Standard | Under<br>Old<br>Revenue<br>Standard |              |
| <b>Assets</b>                               |                                     |                                     |              |
| Receivables, net                            | \$966                               | \$ 858                              | \$ 108       |
| Other current assets                        | 292                                 | 288                                 | 4            |
| Deferred income taxes, net                  | 112                                 | 151                                 | (39 )        |
| Other assets                                | 101                                 | 89                                  | 12           |
| <b>Liabilities</b>                          |                                     |                                     |              |
| Accrued and other current liabilities       |                                     |                                     |              |
| Sales return and price protection reserves  | \$ 108                              | \$ —                                | \$ 108       |
| Deferred net revenue (other)                | 113                                 | 157                                 | (44 )        |
| Deferred net revenue (online-enabled games) | 574                                 | 1,120                               | (546 )       |
| Other liabilities                           | 217                                 | 218                                 | (1 )         |
| <b>Stockholders' Equity</b>                 |                                     |                                     |              |
| Retained earnings                           | \$5,199                             | \$ 4,625                            | \$ 574       |
| Accumulated other comprehensive loss        | (19 )                               | (13 )                               | (6 )         |

Table of Contents

| (In millions, except per share data)            | Three Months Ended<br>September 30, 2018 |                                     |              |             |   |
|---|--|-------------------------------------|--------------|-------------|---|
|   | Under<br>New<br>Revenue<br>Standard      | Under<br>Old<br>Revenue<br>Standard | \$<br>Change | %<br>Change |   |
| Net revenue:                                    |  |                                     |              |             |   |
| Product   | \$623                                    | \$437                               | \$186        | 43          | % |
| Service and other                               | 663                                      | 517                                 | 146          | 28          | % |
| Total net revenue                               | 1,286                                    | 954                                 | 332          | 35          | % |
| Cost of revenue:                                |  |                                     |              |             |   |
| Product   | 222                                      | 280                                 | (58)         | (21)        | % |
| Service and other                               | 196                                      | 94                                  | 102          | 109         | % |
| Total cost of revenue                           | 418                                      | 374                                 | 44           | 12          | % |
| Gross profit                                    | 868                                      | 580                                 | 288          | 50          | % |
| Operating expenses:                             |  |                                     |              |             |   |
| Total operating expenses                        | 610                                      | 610                                 | —            | —           | % |
| Operating income (loss)                         | 258                                      | (30)                                | 288          | (960)       | % |
| Interest and other income (expense), net        | 18                                       | 18                                  | —            | —           | % |
| Income (loss) before provision for income taxes | 276                                      | (12)                                | 288          | (2,400)     | % |
| Provision for income taxes                      | 21                                       | 7                                   | 14           | 200         | % |
| Net income (loss)                               | \$255                                    | \$(19)                              | \$274        | (1,442)     | % |
| Earnings (loss) per share:                      |  |                                     |              |             |   |
| Basic   | \$0.84                                   | \$(0.06)                            | \$0.90       | (1,500)     | % |
| Diluted   | \$0.83                                   | \$(0.06)                            | \$0.89       | (1,483)     | % |

| (In millions, except per share data)     | Six Months Ended<br>September 30, 2018 |                                     |              |             |   |
|--|--|-------------------------------------|--------------|-------------|---|
|  | Under<br>New<br>Revenue<br>Standard    | Under<br>Old<br>Revenue<br>Standard | \$<br>Change | %<br>Change |   |
| Net revenue:                             |  |                                     |              |             |   |
| Product                                  | \$825                                  | \$1,153                             | \$(328)      | (28)        | % |
| Service and other                        | 1,598                                  | 1,217                               | 381          | 31          | % |
| Total net revenue                        | 2,423                                  | 2,370                               | 53           | 2           | % |
| Cost of revenue:                         |  |                                     |              |             |   |
| Product                                  | 290                                    | 358                                 | (68)         | (19)        | % |
| Service and other                        | 343                                    | 182                                 | 161          | 88          | % |
| Total cost of revenue                    | 633                                    | 540                                 | 93           | 17          | % |
| Gross profit                             | 1,790                                  | 1,830                               | (40)         | (2)         | % |
| Operating expenses:                      |  |                                     |              |             |   |
| Total operating expenses                 | 1,232                                  | 1,232                               | —            | —           | % |
| Operating income                         | 558                                    | 598                                 | (40)         | (7)         | % |
| Interest and other income (expense), net | 37                                     | 37                                  | —            | —           | % |
| Income before provision for income taxes | 595                                    | 635                                 | (40)         | (6)         | % |
| Provision for income taxes               | 47                                     | 71                                  | (24)         | (34)        | % |
| Net income                               | \$548                                  | \$564                               | \$(16)       | (3)         | % |
| Earnings per share:                      |  |                                     |              |             |   |

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

|         |        |         |          |       |
|---------|--------|---------|----------|-------|
| Basic   | \$1.80 | \$ 1.85 | \$(0.05) | (3 )% |
| Diluted | \$1.77 | \$ 1.83 | \$(0.06) | (3 )% |

10

---

## Table of Contents

The adoption of the New Revenue Standard accelerated the revenue recognition of prior period game sales into retained earnings, which will result in a one-time increase in cash taxes paid on our Condensed Consolidated Statement of Cash Flows for the fiscal year ending March 31, 2019.

Refer to the following sections of our Condensed Consolidated Financial Statements for the additional disclosures required by the New Revenue Standard:

See Note 2 — Summary of Significant Accounting Policies, for our updated revenue accounting policy, including significant judgments, under ASC 606. For a discussion of our revenue recognition policy as it relates to revenue transactions accounted for prior to April 1, 2018, which were accounted for under ASC 605, refer to our Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

See Note 10 — Balance Sheet Details, for a discussion on our contract liabilities (“deferred net revenue”) and our remaining performance obligations. We had an immaterial amount of contract assets as of April 1, 2018 and September 30, 2018.

See Note 16 — Segment Information, for our disaggregations of revenue.

### Other Recently Issued Accounting Standards

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The FASB issued this standard to increase transparency and comparability among organizations by recognizing right-of-use assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. In July 2018, the FASB issued ASU 2018-11, Targeted Improvements, which provides entities with optional transition relief by allowing entities to use the effective date of the new lease standard as the date of initial application on transition, instead of at the beginning of the earliest comparative period presented. We anticipate adopting this standard using this optional transition method beginning in the first quarter of fiscal year 2020, when the updated guidance is effective for us, and accordingly, we will not adjust prior periods for the effects of the new lease standard. We are evaluating the impact of this new standard on our Condensed Consolidated Financial Statements, but expect it to have a significant impact to our consolidated balance sheet as a result of establishing right-of-use assets and lease liabilities for our operating leases. In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This update is intended to make more financial and nonfinancial hedging strategies eligible for hedge accounting. It also amends the presentation and disclosure requirements and changes how companies assess effectiveness. This update is effective for us beginning in the first quarter of fiscal year 2020. Early adoption is permitted. We are currently evaluating the timing of adoption and impact of this new standard on our Condensed Consolidated Financial Statements and related disclosures.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326). The standard changes the methodology for measuring credit losses on financial instruments and the timing of when such losses are recorded. ASU 2016-13 is effective for us beginning in the first quarter of fiscal year 2021. Early adoption is permitted beginning in the first quarter of fiscal year 2020. We are currently evaluating the timing of adoption and impact of this new standard on our Condensed Consolidated Financial Statements and related disclosures.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement. This update changes the fair value measurement disclosure requirements. It summarizes the key provisions including the new, eliminated, and modified disclosure requirements. This update is effective for us beginning in the first quarter of fiscal year 2021. Early adoption is permitted. We are currently evaluating the timing of adoption and impact of this new standard on our Condensed Consolidated Financial Statements and related disclosures.

In August 2018, the FASB issued ASU 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40). This update requires a customer in a cloud computing service arrangement to follow the internal-use software guidance in order to determine which implementation costs to defer and recognize as an asset. This update is effective for us beginning in the first quarter of fiscal year 2021. Early adoption is permitted. We are currently evaluating the timing of adoption and impact of this new standard on our Condensed Consolidated Financial Statements and related

disclosures.

11

---



Table of Contents

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As discussed in Note 1 — Description of Business and Basis of Presentation, we adopted the New Revenue Standard on April 1, 2018. Other than adoption of this New Revenue Standard, there were no significant changes to our accounting policies during the six months ended September 30, 2018. Refer to Note 1 — Description of Business and Summary of Significant Accounting Policies in our Annual Report on Form 10-K for the year ended March 31, 2018 for a summary of our other significant accounting policies.

Revenue Recognition

We derive revenue principally from sales of our games, and related extra-content and services that can be played by customers on a variety of platforms which include game consoles, PCs, mobile phones and tablets. Our product and service offerings include, but are not limited to, the following:

full games with both online and offline functionality (“Games with Services”), which generally includes (1) the initial game delivered digitally or via physical disc at the time of sale and typically provide access to offline core game content (“software license”); (2) updates on a when-and-if-available basis, such as software patches or updates, and/or additional free content to be delivered in the future (“future update rights”); and (3) a hosted connection for online playability (“online hosting”);

full games with online-only functionality which require an Internet connection to access all gameplay and functionality (“Online-Hosted Service Games”);

extra content related to Games with Services and Online-Hosted Service Games which provides access to additional in-game content;

subscriptions, such as Origin Access and EA Access, that generally offers access to a selection of full games, in-game content, online services and other benefits typically for a recurring monthly or annual fee; and

licensing our games to third parties to distribute and host our games.

Effective April 1, 2018, we evaluate revenue recognition based on the criteria set forth in ASC 606, Revenue from Contracts with Customers.

We evaluate and recognize revenue by:

identifying the contract(s) with the customer;

identifying the performance obligations in the contract;

determining the transaction price;

allocating the transaction price to performance obligations in the contract; and

recognizing revenue as each performance obligation is satisfied through the transfer of a promised good or service to a customer (i.e., “transfer of control”).

Online-Enabled Games

Games with Services. Our sales of Games with Services are evaluated to determine whether the software license, future update rights and the online hosting are distinct and separable. Sales of Games with Services are generally

determined to have three distinct performance obligations: software license, future update rights, and the online hosting.

Since we do not sell the performance obligations on a stand-alone basis, we consider market conditions and other observable inputs to estimate the stand-alone selling price for each performance obligation. We recognize revenue from these arrangements upon transfer of control for each performance obligation. For the portion of the transaction price allocated to the software license, revenue is recognized when control of the license has been transferred to the customer. For the portion of the transaction price allocated to the future update rights and the online hosting, revenue is recognized as the services are provided.

## Table of Contents

Online-Hosted Service Games. Sales of our Online-Hosted Service Games are determined to have one distinct performance obligation: the online hosting. We recognize revenue from these arrangements as the service is provided.

Extra Content. Revenue received from sales of downloadable content are derived primarily from the sale of virtual currencies and digital in-game content to our customers to enhance their gameplay experience. Sales of extra content are accounted for in a manner consistent with the treatment for our Games with Services and Online-Hosted Service Games as discussed above, depending upon whether or not the extra content has offline functionality.

## Subscriptions

Revenue from subscriptions is recognized over the subscription term as the service is provided.

## Licensing Revenues

In certain countries, we utilize third-party licensees to distribute and host our games in accordance with license agreements, for which the licensees typically pay us a fixed minimum guarantee and/or sales-based royalties. These arrangements typically include multiple performance obligations, such as a time-based license of software and future update rights. We recognize as revenue a portion of the minimum guarantee when we transfer control of the license of software (generally upon commercial launch) and the remaining portion ratably over the contractual term in which we provide the licensee with future update rights. Any sales-based royalties are generally recognized as the related sales occur by the licensee.

## Revenue Classification

We classify our revenue as either product revenue or service and other revenue. Generally, performance obligations that are recognized upfront upon transfer of control are classified as product revenue, while performance obligations that are recognized over the Estimated Offering Period or subscription period as the services are provided are classified as service revenue.

Product revenue. Our product revenue includes revenue allocated to the software license performance obligation. Product revenue also includes revenue from the licensing of software to third-parties.

Service and other revenue. Our service revenue includes revenue allocated to the future update rights and the online hosting performance obligations. This also includes revenue allocated to the future update rights from the licensing of software to third-parties, software that offers an online-only service such as our Ultimate Team game mode, and subscription services.

## Significant Judgments around Revenue Arrangements

Identifying performance obligations. Performance obligations promised in a contract are identified based on the goods and services that will be transferred to the customer that are both capable of being distinct, (i.e., the customer can benefit from the goods or services either on its own or together with other resources that are readily available), and are distinct in the context of the contract (i.e., it is separately identifiable from other goods or services in the contract). To the extent a contract includes multiple promises, we must apply judgment to determine whether those promises are separate and distinct performance obligations. If these criteria are not met, the promises are accounted for as a combined performance obligation.

Determining the transaction price. The transaction price is determined based on the consideration that we will be entitled to receive in exchange for transferring our goods and services to the customer. Determining the transaction

price often requires significant judgment, based on an assessment of contractual terms and business practices. It further includes review of variable consideration such as discounts, sales returns, price protection, and rebates, which is estimated at the time of the transaction. See below for additional information regarding our sales returns and price protection reserves. In addition, the transaction price does not include an estimate of the variable consideration related to sales-based royalties. Sales-based royalties are recognized as the sales occur.

## Table of Contents

Allocating the transaction price. Allocating the transaction price requires that we determine an estimate of the relative stand-alone selling price for each distinct performance obligation. Determining the relative stand-alone selling price is inherently subjective, especially in situations where we do not sell the performance obligation on a stand-alone basis (which occurs in the majority of our transactions). In those situations, we determine the relative stand-alone selling price based on various observable inputs using all information that is reasonably available. Examples of observable inputs and information include: historical internal pricing data, cost plus margin analyses, third-party external pricing of similar or same products and services such as software licenses and maintenance support within the enterprise software industry. The results of our analysis resulted in a specific percentage of the transaction price being allocated to each performance obligation.

Determining the Estimated Offering Period. The offering period is the period in which we offer to provide the future update rights and/or online hosting for the game and related extra content sold. Because the offering period is not an explicitly defined period, we must make an estimate of the offering period for the service related performance obligations (i.e., future update rights and online hosting). Determining the Estimated Offering Period is inherently subjective and is subject to regular revision. Generally, we consider the average period of time customers are online when estimating the offering period. We also consider the estimated period of time between the date a game unit is sold to a reseller and the date the reseller sells the game unit to the customer (i.e., time in channel). Based on these two factors, we then consider the method of distribution. For example, games sold at retail would have a composite offering period equal to the online gameplay period plus time in channel as opposed to digitally-distributed software licenses which are delivered immediately via digital download and therefore, the offering period is estimated to be only the online gameplay period.

Additionally, we consider results from prior analyses, known and expected online gameplay trends, as well as disclosed service periods for competitors' games in determining the Estimated Offering Period for future sales. We believe this provides a reasonable depiction of the transfer of future update rights and online hosting to our customers, as it is the best representation of the time period during which our games are played. We recognize revenue for future update rights and online hosting performance obligations ratably on a straight-line basis over this period as there is a consistent pattern of delivery for these performance obligations. These performance obligations are generally recognized over an estimated nine-month period beginning in the month after shipment for software licenses sold through retail and an estimated six-month period for digitally-distributed software licenses.

## Deferred Net Revenue

Because the majority of our sales transactions include future update rights and online hosting performance obligations, which are subject to a recognition period of generally six to nine months, our deferred net revenue balance is material. This balance increases from period to period by the revenue being deferred for current sales with these service obligations and is reduced by the recognition of revenue from prior sales that were deferred. Generally, revenue is recognized as the services are provided.

## Principal Agent Considerations

We evaluate sales to end customers of our full games and related content via third-party storefronts, including digital storefronts such as Microsoft's Xbox Store, Sony's PlayStation Store, Apple App Store, and Google Play Store, in order to determine whether or not we are acting as the principal in the sale to the end customer, which we consider in determining if revenue should be reported gross or net of fees retained by the third-party storefront. An entity is the principal if it controls a good or service before it is transferred to the end customer. Key indicators that we evaluate in determining gross versus net treatment include but are not limited to the following:

the underlying contract terms and conditions between the various parties to the transaction;

• which party is primarily responsible for fulfilling the promise to provide the specified good or service to the end customer;

• which party has inventory risk before the specified good or service has been transferred to the end customer; and

• which party has discretion in establishing the price for the specified good or service.

Based on an evaluation of the above indicators, except as discussed below, we have determined that generally the third party is considered the principal to end customers for the sale of our full games and related content. We therefore report revenue related to these arrangements net of the fees retained by the storefront. However, for sales arrangements via Apple App Store and Google Play Store, EA is considered the principal to the end customer and thus, we report revenue on a gross basis and mobile platform fees are reported within cost of revenue.

## Table of Contents

### Payment Terms

Substantially all of our transactions have payment terms, whether customary or on an extended basis, of less than one year; therefore, we generally do not adjust the transaction price for the effects of any potential financing components that may exist.

### Sales and Value-Added Taxes

Revenue is recorded net of taxes assessed by governmental authorities that are imposed at the time of the specific revenue-producing transaction between us and our customer, such as sales and value-added taxes.

### Sales Returns and Price Protection Reserves

Sales returns and price protection are considered variable consideration under ASC 606. We reduce revenue for estimated future returns and price protection which may occur with our distributors and retailers (“channel partners”). Price protection represents our practice to provide our channel partners with a credit allowance to lower their wholesale price on a particular game unit that they have not resold to customers. The amount of the price protection for permanent markdowns is the difference between the old wholesale price and the new reduced wholesale price. Credits are also given for short-term promotions that temporarily reduce the wholesale price. In certain countries we also have a practice for allowing channel partners to return older products in the channel in exchange for a credit allowance.

When evaluating the adequacy of sales returns and price protection reserves, we analyze the following: historical credit allowances, current sell-through of our channel partners’ inventory of our products, current trends in retail and the video game industry, changes in customer demand, acceptance of our products, and other related factors. In addition, we monitor the volume of sales to our channel partners and their inventories, as substantial overstocking in the distribution channel could result in high returns or higher price protection in subsequent periods.

### (3) FAIR VALUE MEASUREMENTS

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

#### Fair Value Hierarchy

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

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

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

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

Table of Contents

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

As of September 30, 2018 and March 31, 2018, our assets and liabilities that were measured and recorded at fair value on a recurring basis were as follows (in millions):

|   | Fair Value Measurements at Reporting Date Using                     |                                     |                                 |        | Balance Sheet Classification                                |
|---|---|-------------------------------------|---------------------------------|--------|---|
|   | Quoted Prices in Active Markets for Identical Financial Instruments | Significant Other Observable Inputs | Significant Unobservable Inputs |        |   |
| As of   | (Level 1)   | (Level 2)                           | (Level 3)                       |        |   |
| As of September 30, 2018                              |   |                                     |                                 |        |   |
| <b>Assets</b>   |   |                                     |                                 |        |   |
| Bank and time deposits                                | \$ 24   | \$ 24                               | \$ —                            | \$ —   | Cash equivalents  |
| Money market funds                                    | 1,138   | 1,138                               | —                               | —      | Cash equivalents  |
| Available-for-sale securities:                        |   |                                     |                                 |        |   |
| Corporate bonds                                       | 762   |                                     | 762                             | —      | Short-term investments and cash equivalents                 |
| U.S. Treasury securities                              | 281   | 281                                 | —                               | —      | Short-term investments and cash equivalents                 |
| U.S. agency securities                                | 73  | —                                   | 73                              | —      | Short-term investments                                      |
| Commercial paper                                      | 392   | —                                   | 392                             | —      | Short-term investments and cash equivalents                 |
| Foreign government securities                         | 79  | —                                   | 79                              | —      | Short-term investments                                      |
| Asset-backed securities                               | 121   | —                                   | 121                             | —      | Short-term investments                                      |
| Certificates of deposit                               | 21  | —                                   | 21                              | —      | Short-term investments                                      |
| Foreign currency derivatives                          | 49  | —                                   | 49                              | —      | Other current assets and other assets                       |
| Deferred compensation plan assets <sup>(a)</sup>      | 12  | 12                                  | —                               | —      | Other assets  |
| Total assets at fair value                            | \$ 2,952  | \$ 1,455                            | \$ 1,497                        | \$ —   |   |
| <b>Liabilities</b>                                    |   |                                     |                                 |        |   |
| Contingent consideration <sup>(b)</sup>               | \$ 124  | \$ —                                | \$ —                            | \$ 124 | Accrued and other current liabilities and other liabilities |
| Foreign currency derivatives                          | 10  | —                                   | 10                              | —      | Accrued and other current liabilities and other liabilities |
| Deferred compensation plan liabilities <sup>(a)</sup> | 12  | 12                                  | —                               | —      | Other liabilities   |
| Total liabilities at fair value                       | \$ 146  | \$ 12                               | \$ 10                           | \$ 124 |   |

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



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

|                                     | Consideration |
|-------------------------------------|---------------|
| Balance as of March 31, 2018        | \$ 122        |
| Additions                           | —             |
| Change in fair value <sup>(c)</sup> | 2             |
| Balance as of September 30, 2018    | \$ 124        |

16

---

Table of Contents

|   | Fair Value Measurements at Reporting Date Using                                 |  |                                       |        | Balance Sheet Classification                                |
|---|---|--|---------------------------------------|--------|---|
|   | Quoted Prices in<br>Active Markets<br>for Identical<br>Financial<br>Instruments | Significant<br>Other<br>Observable<br>Inputs | Significant<br>Unobservable<br>Inputs |        |   |
| As of<br>March<br>31,<br>2018                         | (Level 1)   | (Level 2)                                    | (Level 3)                             |        |   |
| <b>Assets</b>   |   |  |                                       |        |   |
| Bank and time deposits                                | \$286   | \$ 286                                       | \$ —                                  | \$ —   | Cash equivalents  |
| Money market funds                                    | 1,876   | 1,876  | —                                     | —      | Cash equivalents  |
| Available-for-sale securities:                        |   |  |                                       |        |   |
| Corporate bonds                                       | 624   | —  | 624                                   | —      | Short-term investments                                      |
| U.S. Treasury securities                              | 210   | 210  | —                                     | —      | Short-term investments                                      |
| U.S. agency securities                                | 78  | —  | 78                                    | —      | Short-term investments                                      |
| Commercial paper                                      | 150   | —  | 150                                   | —      | Short-term investments and cash equivalents                 |
| Foreign government securities                         | 52  | —  | 52                                    | —      | Short-term investments                                      |
| Certificates of Deposit                               | 2   | —  | 2                                     | —      | Cash equivalents  |
| Foreign currency derivatives                          | 4   | —  | 4                                     | —      | Other current assets and other assets                       |
| Deferred compensation plan assets <sup>(a)</sup>      | 10  | 10   | —                                     | —      | Other assets  |
| Total assets at fair value                            | \$3,292   | \$ 2,382                                     | \$ 910                                | \$ —   |   |
| <b>Liabilities</b>                                    |   |  |                                       |        |   |
| Contingent consideration <sup>(b)</sup>               | \$122   | \$ —   | \$ —                                  | \$ 122 | Other liabilities   |
| Foreign currency derivatives                          | 56  | —  | 56                                    | —      | Accrued and other current liabilities and other liabilities |
| Deferred compensation plan liabilities <sup>(a)</sup> | 11  | 11   | —                                     | —      | Other liabilities   |
| Total liabilities at fair value                       | \$189   | \$ 11  | \$ 56                                 | \$ 122 |   |

The Deferred Compensation Plan assets consist of various mutual funds. See Note 14 in our Annual Report on (a) Form 10-K for the fiscal year ended March 31, 2018, for additional information regarding our Deferred Compensation Plan.

The contingent consideration represents the estimated fair value of the additional variable cash consideration payable in connection with our acquisition of Respawn Entertainment, LLC (“Respawn”) that is contingent upon the achievement of certain performance milestones. We estimated fair value using a probability-weighted income (b) approach combined with a real options methodology, and applied a discount rate that appropriately captures the risk associated with the obligation. At September 30, 2018, the discount rates used ranged from 3.3 percent to 3.7 percent. At March 31, 2018, the discount rates used ranged from 3.3 percent to 3.6 percent. See Note 6 in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018, for additional information regarding the Respawn acquisition.

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

(4) FINANCIAL INSTRUMENTS

Cash and Cash Equivalents

As of September 30, 2018 and March 31, 2018, our cash and cash equivalents were \$2,881 million and \$4,258 million, respectively. Cash equivalents were valued using quoted market prices or other readily available market information.

17

---

Table of Contents

## Short-Term Investments

Short-term investments consisted of the following as of September 30, 2018 and March 31, 2018 (in millions):

|                               | As of September 30, 2018 |       |         |            | As of March 31, 2018 |       |         |            |
|-------------------------------|--------------------------|-------|---------|------------|----------------------|-------|---------|------------|
|                               | Amortized Cost           | Gains | Losses  | Fair Value | Amortized Cost       | Gains | Losses  | Fair Value |
| Corporate bonds               | \$739                    | \$ —  | \$ (3 ) | \$736      | \$629                | \$ —  | \$ (5 ) | \$624      |
| U.S. Treasury securities      | 279                      | —     | (2 )    | 277        | 212                  | —     | (2 )    | 210        |
| U.S. agency securities        | 74                       | —     | (1 )    | 73         | 79                   | —     | (1 )    | 78         |
| Commercial paper              | 357                      | —     | —       | 357        | 109                  | —     | —       | 109        |
| Foreign government securities | 80                       | —     | (1 )    | 79         | 53                   | —     | (1 )    | 52         |
| Asset-backed securities       | 121                      | —     | —       | 121        | —                    | —     | —       | —          |
| Certificates of deposit       | 21                       | —     | —       | 21         | —                    | —     | —       | —          |
| Short-term investments        | \$1,671                  | \$ —  | \$ (7 ) | \$1,664    | \$1,082              | \$ —  | \$ (9 ) | \$1,073    |

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of September 30, 2018 and March 31, 2018 (in millions):

|                            | As of September 30, 2018 |            | As of March 31, 2018 |            |
|----------------------------|--------------------------|------------|----------------------|------------|
|                            | Amortized Cost           | Fair Value | Amortized Cost       | Fair Value |
| Short-term investments     |                          |            |                      |            |
| Due within 1 year          | \$1,218                  | \$1,216    | \$521                | \$520      |
| Due 1 year through 5 years | 451                      | 446        | 561                  | 553        |
| Due after 5 years          | 2                        | 2          | —                    | —          |
| Short-term investments     | \$1,671                  | \$1,664    | \$1,082              | \$1,073    |

## (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/other assets, or accrued and other current liabilities/other liabilities, respectively, on our Condensed Consolidated Balance Sheets. As discussed below, the accounting for gains and losses resulting from changes in fair value depends on the use of the derivative instrument and whether it is designated and qualifies for hedge accounting.

We transact business in various foreign currencies and have significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. We purchase foreign currency forward contracts, generally with maturities of 18 months or less, to reduce the volatility of cash flows primarily related to forecasted revenue and expenses denominated in certain foreign currencies. Our cash flow risks are primarily related to fluctuations in the Euro, British pound sterling, Canadian dollar, Swedish krona, Australian dollar, Chinese yuan and South Korean won. In addition, we utilize foreign currency forward contracts to mitigate foreign currency exchange risk associated with foreign-currency-denominated monetary assets and liabilities, primarily intercompany receivables and payables. The foreign currency forward contracts not designated as hedging instruments generally have a contractual term of approximately three months or less and are transacted near month-end. We do not use foreign currency forward contracts for speculative trading purposes.

Table of Contents**Cash Flow Hedging Activities**

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

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

|                               | As of September 30,<br>2018 |                     |           | As of March 31,<br>2018 |                     |           |
|-------------------------------|-----------------------------|---------------------|-----------|-------------------------|---------------------|-----------|
|                               | Notional<br>Amount          | Fair Value<br>Asset | Liability | Notional<br>Amount      | Fair Value<br>Asset | Liability |
| Forward contracts to purchase | \$236                       | \$1                 | \$ 7      | \$329                   | \$2                 | \$ 4      |
| Forward contracts to sell     | \$1,453                     | \$48                | \$ —      | \$1,575                 | \$1                 | \$ 48     |

The net impact of the effective portion of gains and losses from our cash flow hedging activities in our Condensed Consolidated Statements of Operations was a loss of \$1 million and a gain of \$5 million for the three months ended September 30, 2018 and 2017, respectively.

The net impact of the effective portion of gains and losses from our cash flow hedging activities in our Condensed Consolidated Statements of Operations was a loss of \$16 million and a gain of \$22 million for the six months ended September 30, 2018 and 2017, respectively.

The amount excluded from the assessment of hedge effectiveness was a gain of \$7 million during the three months ended September 30, 2018 and recognized in interest and other income (expense), net. The amount excluded from the assessment of hedge effectiveness was immaterial for the three months ended September 30, 2017.

The amount excluded from the assessment of hedge effectiveness was a gain of \$14 million and \$5 million during the six months ended September 30, 2018 and 2017, respectively, and recognized in interest and other income (expense), net.

**Balance Sheet Hedging Activities**

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



Table of Contents

Total gross notional amounts and fair values for currency derivatives that are not designated as hedging instruments are accounted for as follows (in millions):

|                               | As of September 30, 2018 |              | As of March 31, 2018 |              |
|-------------------------------|--------------------------|--------------|----------------------|--------------|
|                               | Notional Amount          | Fair Value   | Notional Amount      | Fair Value   |
|                               | As Asset                 | As Liability | As Asset             | As Liability |
| Forward contracts to purchase | \$233                    | \$—          | \$210                | \$1          |
| Forward contracts to sell     | \$565                    | \$—          | \$257                | \$3          |

The effect of foreign currency forward contracts not designated as hedging instruments in our Condensed Consolidated Statements of Operations for the three and six months ended September 30, 2018 and 2017 was as follows (in millions):

|  | Statement of Operations Classification   | Amount of Gain (Loss) Recognized in the Statement of Operations |         |                                     |         |
|--|--|---|---------|-------------------------------------|---------|
|  |  | Three Months Ended September 30, 2018                           |         | Six Months Ended September 30, 2017 |         |
| Foreign currency forward contracts not designated as hedging instruments | Interest and other income (expense), net | \$ (5 )   | \$ (3 ) | \$ 4                                | \$ (9 ) |

Table of Contents

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

The changes in accumulated other comprehensive income (loss) by component, net of tax, for the three months ended September 30, 2018 and 2017 are as follows (in millions):

|   | Unrealized Net<br>Gains (Losses)<br>on<br>Available-for-Sale<br>Securities | Unrealized<br>Net Gains<br>(Losses) on<br>Derivative<br>Instruments | Foreign<br>Currency<br>Translation<br>Adjustments | Total  |
|---|--|---|---|--------|
| Balances as of June 30, 2018  | \$ (8 )  | \$ 27   | \$ (45 )  | \$(26) |
| Other comprehensive income (loss) before reclassifications              | 1  | 2   | 3   | 6      |
| Amounts reclassified from accumulated other comprehensive income (loss) | —  | 1   | —   | 1      |
| Total other comprehensive income (loss), net of tax                     | 1  | 3   | 3   | 7      |
| Balances as of September 30, 2018                                       | \$ (7 )  | \$ 30   | \$ (42 )  | \$(19) |
| Balances as of June 30, 2017  | \$ (3 )  | \$ (24 )  | \$ (44 )  | \$(71) |
| Other comprehensive income (loss) before reclassifications              | —  | (29 )   | 32  | 3      |
| Amounts reclassified from accumulated other comprehensive income (loss) | —  | (5 )  | —   | (5 )   |
| Total other comprehensive income (loss), net of tax                     | —  | (34 )   | 32  | (2 )   |
| Balances as of September 30, 2017                                       | \$ (3 )  | \$ (58 )  | \$ (12 )  | \$(73) |

The changes in accumulated other comprehensive income (loss) by component, net of tax, for the six months ended September 30, 2018 and 2017 are as follows (in millions):

|   | Unrealized Net<br>Gains (Losses)<br>on<br>Available-for-Sale<br>Securities | Unrealized<br>Net Gains<br>(Losses) on<br>Derivative<br>Instruments | Foreign<br>Currency<br>Translation<br>Adjustments | Total   |
|---|--|---|---|---------|
| Balances as of March 31, 2018   | \$ (8 )  | \$ (89 )  | \$ (30 )  | \$(127) |
| Cumulative-effect adjustment from the adoption of ASC 606               | —  | 22  | —   | 22      |
| Cumulative-effect adjustment from the adoption of ASU 2018-02           | —  | 1   | —   | 1       |
| Balances as of April 1, 2018  | (8 )   | (66 )   | (30 )   | (104 )  |
| Other comprehensive income (loss) before reclassifications              | 1  | 80  | (12 )   | 69      |
| Amounts reclassified from accumulated other comprehensive income (loss) | —  | 16  | —   | 16      |
| Total other comprehensive income (loss), net of tax                     | 1  | 96  | (12 )   | 85      |
| Balances as of September 30, 2018                                       | \$ (7 )  | \$ 30   | \$ (42 )  | \$(19 ) |





Table of Contents

|   | Unrealized Net<br>Gains (Losses)<br>on<br>Available-for-Sale<br>Securities | Unrealized<br>Net Gains<br>(Losses) on<br>Derivative<br>Instruments | Foreign<br>Currency<br>Translation<br>Adjustments | Total  |
|---|--|---|---|--------|
| Balances as of March 31, 2017   | \$ (3 )  | \$ 32   | \$ (48 )  | \$(19) |
| Other comprehensive income (loss) before reclassifications              | —  | (68 )   | 46  | (22 )  |
| Amounts reclassified from accumulated other comprehensive income (loss) | —  | (22 )   | (10 )   | (32 )  |
| Total other comprehensive income (loss), net of tax                     | —  | (90 )   | 36  | (54 )  |
| Balances as of September 30, 2017                                       | \$ (3 )  | \$ (58 )  | \$ (12 )  | \$(73) |

The effects on net income of amounts reclassified from accumulated other comprehensive income (loss) for the three and six months ended September 30, 2018 were as follows (in millions):

| Statement of Operations Classification                    | Amount Reclassified<br>From Accumulated<br>Other<br>Comprehensive<br>Income (Loss) |   |
|---|--|---|
|   | Three<br>Months<br>Ended<br>September<br>30,<br>2018                               | Six<br>Months<br>Ended<br>September<br>30, 2018 |
| (Gains) losses on cash flow hedges from forward contracts |  |   |
| Net revenue   | \$ (2 )  | \$ 12   |
| Research and development                                  | 3  | 4   |
| Total net (gain) loss reclassified, net of tax            | \$ 1   | \$ 16   |

The effects on net income of amounts reclassified from accumulated other comprehensive income (loss) for the three and six months ended September 30, 2017 were as follows (in millions):

| Statement of Operations Classification                    | Amount<br>Reclassified From<br>Accumulated<br>Other<br>Comprehensive<br>Income (Loss) |   |
|---|---|---|
|   | Three<br>Months<br>Ended<br>September<br>30,<br>2017                                  | Six<br>Months<br>Ended<br>September<br>30, 2017 |
| (Gains) losses on cash flow hedges from forward contracts |   |   |
| Net revenue   | \$ (3 )   | \$ (22 )  |
| Research and development                                  | (2 )  | —   |
| Total, net of tax   | \$ (5 )   | \$ (22 )  |

|  |         |          |
|--|---------|----------|
| (Gains) losses on foreign currency translation |         |          |
| Interest and other income (expense), net       | \$ —    | \$ (10 ) |
| Total, net of tax                              | \$ —    | \$ (10 ) |
| <br>   |         |          |
| Total net (gain) loss reclassified, net of tax | \$ (5 ) | \$ (32 ) |

## (7) BUSINESS COMBINATIONS

## GameFly Cloud Gaming

On May 3, 2018, we acquired cloud gaming technology assets and personnel from a wholly-owned subsidiary of GameFly, Inc. based in Israel (“GameFly Cloud Gaming”) for total cash consideration of \$50 million. The purchase price was allocated to the acquired net tangible and intangible assets based on their estimated fair values as of May 3, 2018, resulting in \$43 million allocated to intangible assets, and \$7 million allocated to goodwill that consists largely of expected synergies and workforce, substantially all of which is expected to be deductible for tax purposes. Subsequent to the acquisition, we also granted approximately \$4 million in long-term equity in the form of restricted stock units to certain employees.

The results of operations attributable to the assets and personnel acquired in the GameFly Cloud Gaming acquisition and the fair value of the assets acquired have been included in our Condensed Consolidated Financial Statements since the date of acquisition. Pro forma results of operations have not been presented because the effect of the acquisition was not material to our Condensed Consolidated Statements of Operations.

Table of Contents

During the three months ended September 30, 2018, we completed one acquisition that was not material to our Condensed Consolidated Financial Statements.

During three and six months ended September 30, 2017, there were no acquisitions.

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

The changes in the carrying amount of goodwill for the six months ended September 30, 2018 are as follows (in millions):

|                        | As of<br>March<br>31,<br>2018 | Activity | Effects of<br>Foreign<br>Currency<br>Translation | As of<br>September<br>30, 2018 |
|------------------------|-------------------------------|----------|--|--------------------------------|
| Goodwill               | \$2,251                       | \$ 14    | \$ (3 )  | \$ 2,262                       |
| Accumulated impairment | (368 )                        | —        | —  | (368 )                         |
| Total                  | \$1,883                       | \$ 14    | \$ (3 )  | \$ 1,894                       |

Goodwill represents the excess of the purchase price over the fair value of the underlying acquired net tangible and intangible assets.

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

|  | As of September 30, 2018    |                             |   | As of March 31, 2018        |                             |   |
|--|-----------------------------|-----------------------------|---|-----------------------------|-----------------------------|---|
|  | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Acquisition-<br>Related<br>Intangibles, Net | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Acquisition-<br>Related<br>Intangibles, Net |
| Developed and core technology              | \$460                       | \$ (420 )                   | \$ 40                                       | \$417                       | \$ (414 )                   | \$ 3  |
| Trade names and trademarks                 | 161                         | (115 )                      | 46  | 161                         | (107 )                      | 54  |
| Registered user base and other intangibles | 5                           | (5 )                        | —   | 5                           | (5 )                        | —   |
| Carrier contracts and related              | 85                          | (85 )                       | —   | 85                          | (85 )                       | —   |
| In-process research and development        | 14                          | —                           | 14  | 14                          | —                           | 14  |
| Total                                      | \$725                       | \$ (625 )                   | \$ 100                                      | \$682                       | \$ (611 )                   | \$ 71                                       |

The fair value of acquisition-related intangible assets acquired in the GameFly Cloud Gaming acquisition during the three months ended June 30, 2018 was \$43 million, all of which was allocated to developed and core technology, and has a useful life of approximately 4.0 years.

Amortization of intangibles for the three and six months ended September 30, 2018 and 2017 are classified in the Condensed Consolidated Statement of Operations as follows (in millions):

|                                   | Three<br>Months<br>Ended<br>September<br>30,<br>2018 |      | Six Months<br>Ended<br>September<br>30,<br>2017 |      |
|-----------------------------------|--|------|---|------|
|                                   | 2018   | 2017 | 2018  | 2017 |
| Cost of service and other revenue | \$ —   | \$ — | \$ —  | \$ — |
| Cost of product revenue           | 1  | —    | 2   | —    |
| Operating expenses                | 6  | 2    | 12  | 3    |
| Total                             | \$ 7   | \$ 2 | \$ 14   | \$ 3 |

Acquisition-related intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the agreement terms, ranging from 1 to 9 years. As of September 30, 2018 and March 31, 2018, the weighted-average remaining useful life for acquisition-related intangible assets was approximately 3.9 years and 4.3 years, respectively.



Table of Contents

As of September 30, 2018, future amortization of finite-lived acquisition-related intangibles that will be recorded in the Condensed Consolidated Statement of Operations is estimated as follows (in millions):

|                              |       |
|------------------------------|-------|
| Fiscal Year Ending March 31, |       |
| 2019 (remaining six months)  | \$ 12 |
| 2020                         | 22    |
| 2021                         | 22    |
| 2022                         | 22    |
| 2023                         | 8     |
| Thereafter                   | —     |
| Total                        | \$ 86 |

**(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.

During the three and six months ended September 30, 2018 and 2017, we did not recognize any material losses or impairment charges on royalty-based commitments, respectively.

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

|                        |                                |                               |
|------------------------|--------------------------------|-------------------------------|
|                        | As of<br>September<br>30, 2018 | As of<br>March<br>31,<br>2018 |
| Other current assets   | \$ 59                          | \$ 68                         |
| Other assets           | 32                             | 34                            |
| Royalty-related assets | \$ 91                          | \$ 102                        |

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

|                             |                                |                               |
|-----------------------------|--------------------------------|-------------------------------|
|                             | As of<br>September<br>30, 2018 | As of<br>March<br>31,<br>2018 |
| Accrued royalties           | \$ 155                         | \$ 171                        |
| Other liabilities           | 63                             | 74                            |
| Royalty-related liabilities | \$ 218                         | \$ 245                        |

As of September 30, 2018, we were committed to pay approximately \$790 million to content licensors, independent software developers, and co-publishing and/or distribution affiliates, but performance remained with the counterparty (i.e., delivery of the product or content or other factors) and such commitments were therefore not recorded in our Condensed Consolidated Financial Statements. See Note 13 for further information on our developer and licensor commitments.



Table of Contents

## (10) BALANCE SHEET DETAILS

## Property and Equipment, Net

Property and equipment, net, as of September 30, 2018 and March 31, 2018 consisted of (in millions):

|  | As of<br>September<br>30, 2018 | As of<br>March<br>31,<br>2018 |
|--|--------------------------------|-------------------------------|
| Computer, equipment and software             | \$ 742                         | \$ 744                        |
| Buildings                                    | 342                            | 336                           |
| Leasehold improvements                       | 135                            | 139                           |
| Equipment, furniture and fixtures, and other | 82                             | 84                            |
| Land   | 66                             | 66                            |
| Construction in progress                     | 9                              | 7                             |
|  | 1,376                          | 1,376                         |
| Less: accumulated depreciation               | (936 )                         | (923 )                        |
| Property and equipment, net                  | \$ 440                         | \$ 453                        |

During the three and six months ended September 30, 2018 depreciation expense associated with property and equipment was \$30 million and \$60 million, respectively.

During the three and six months ended September 30, 2017 depreciation expense associated with property and equipment was \$30 million and \$59 million, respectively.

## Accrued and Other Current Liabilities

Accrued and other current liabilities as of September 30, 2018 and March 31, 2018 consisted of (in millions):

|  | As of<br>September<br>30, 2018 | As of<br>March<br>31,<br>2018 |
|--|--------------------------------|-------------------------------|
| Other accrued expenses                     | \$ 359                         | \$ 260                        |
| Accrued compensation and benefits          | 172                            | 282                           |
| Accrued royalties                          | 155                            | 171                           |
| Sales return and price protection reserves | 108                            | —                             |
| Deferred net revenue (other)               | 113                            | 108                           |
| Accrued and other current liabilities      | \$ 907                         | \$ 821                        |

Deferred net revenue (other) includes the deferral of subscription revenue, advertising revenue, licensing arrangements, and other revenue for which revenue recognition criteria has not been met.

As a result of the adoption of the New Revenue Standard, as of September 30, 2018, our sales returns and price protection reserves are now classified within accrued and other liabilities (previously, these allowances were classified as a contra-asset within receivables on our Condensed Consolidated Balance Sheets).

## Deferred net revenue

Deferred net revenue as of September 30, 2018 and April 1, 2018, as adjusted, consisted of (in millions):

|   | As of<br>September<br>30, 2018 | As of<br>April 1,<br>2018 (as<br>adjusted) |
|---|--------------------------------|--|
| Deferred net revenue (online-enabled games) | \$ 574                         | \$ 949                                     |
| Deferred net revenue (other)                | 113                            | 105  |
| Deferred net revenue (noncurrent)           | 12                             | 5  |
| Total Deferred net revenue                  | \$ 699                         | \$ 1,059                                   |





## Table of Contents

Total deferred net revenue decreased by \$360 million, from April 1, 2018, as adjusted, to September 30, 2018. The change was driven by \$1,128 million of revenue that was deferred. This was offset by the portion of the net bookings that was deferred and recognized, totaling \$1,488 million. Of the \$1,488 million, \$1,019 million relates to revenue recognized in the six months ended September 30, 2018 that was included in the deferred revenue balance as of April 1, 2018, as adjusted.

### Remaining Performance Obligations

As of September 30, 2018, revenue allocated to remaining performance obligations consists of our deferred revenue balance of \$699 million. These balances exclude any estimates for future variable consideration as we have elected the optional exemption to exclude sales-based royalty revenue. We expect to recognize substantially all of these balances as revenue over the next 12 months.

## (11) INCOME TAXES

The provision for income taxes for the three and six months ended September 30, 2018 is based on our projected annual effective tax rate for fiscal year 2019, adjusted for specific items that are required to be recognized in the period in which they are incurred.

Our effective tax rate for the three and six months ended September 30, 2018 was 7.6 percent and 7.9 percent, respectively, as compared to 42.1 percent and 12.5 percent, respectively, for the same period in fiscal year 2018. The effective tax rate for the three and six months ended September 30, 2018 was impacted by the lower U.S. statutory tax rate as a result of the U.S. Tax Cuts and Jobs Act enacted on December 22, 2017 (the “U.S. Tax Act”) and earnings realized in countries that have lower statutory tax rates, partially offset by less excess tax benefits from stock-based compensation recognized in the current period as compared to the same period in fiscal year 2018.

When compared to the statutory rate of 21.0 percent, the effective tax rate for the three and six months ended September 30, 2018 was lower due to earnings realized in countries that have lower statutory tax rates and the recognition of excess tax benefits from stock-based compensation. Excluding excess tax benefits, our effective tax rate would have been 9.8 percent and 10.6 percent, respectively, for the three and six months ended September 30, 2018. The U.S. Tax Act significantly revised the U.S. corporate income tax system by, among other things, lowering the U.S. corporate income tax rates to 21.0 percent, generally implementing a territorial tax system and imposing a one-time transition tax on the deemed repatriation of undistributed earnings of foreign subsidiaries (the “Transition Tax”).

We recorded a provisional tax expense of \$235 million related to the U.S. Tax Act for the fiscal year ended March 31, 2018, \$192 million of which relates to the Transition Tax. During the three and six months ended September 30, 2018, we made no material adjustments to these provisional amounts. The final calculation of taxes attributable to the U.S. Tax Act may differ from our estimates, potentially materially, due to, among other things, changes in interpretations of the U.S. Tax Act, our further analysis of the U.S. Tax Act, or any updates or changes to estimates that we have utilized to calculate the transition impacts.

Reasonable estimates of the impacts of the U.S. Tax Act are provided in accordance with SAB 118, the SEC guidance that allows for a measurement period of up to one year after the enactment date of the U.S. Tax Act to finalize the recording of the related tax impacts. We expect to complete the accounting under the U.S. Tax Act as soon as practicable, but in no event later than one year from the enactment date of the U.S. Tax Act.

The U.S. Tax Act creates new U.S. taxes on foreign earnings. Our provision for income taxes for the three and six months ended September 30, 2018 provisionally does not reflect any deferred tax impacts of the U.S. taxes on foreign earnings. Because of the complexity of the rules regarding the new tax on foreign earnings, we are continuing to evaluate this accounting policy election.

We file income tax returns and are subject to income tax examinations in various jurisdictions with respect to fiscal years after 2008. The timing and potential resolution of income tax examinations is highly uncertain. While we continue to measure our uncertain tax positions, the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued. It is reasonably possible that a

reduction of up to \$16 million of unrecognized tax benefits may occur within the next 12 months, a portion of which would impact our effective tax rate. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements and tax interpretations, including the Altera opinion.

Table of Contents

## (12) FINANCING ARRANGEMENTS

## Senior Notes

In February 2016, we issued \$600 million aggregate principal amount of 3.70% Senior Notes due March 1, 2021 (the “2021 Notes”) and \$400 million aggregate principal amount of 4.80% Senior Notes due March 1, 2026 (the “2026 Notes,” and together with the 2021 Notes, the “Senior Notes”). Our proceeds were \$989 million, net of discount of \$2 million and issuance costs of \$9 million. Both the discount and issuance costs are being amortized to interest expense over the respective terms of the 2021 Notes and the 2026 Notes using the effective interest rate method. The effective interest rate is 3.94% for the 2021 Notes and 4.97% for the 2026 Notes. Interest is payable semiannually in arrears, on March 1 and September 1 of each year.

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

|                                      | As of<br>September<br>30, 2018 | As of<br>March<br>31,<br>2018 |
|--------------------------------------|--------------------------------|-------------------------------|
| Senior Notes:                        |                                |                               |
| 3.70% Senior Notes due 2021          | \$ 600                         | \$600                         |
| 4.80% Senior Notes due 2026          | 400                            | 400                           |
| Total principal amount               | \$ 1,000                       | \$1,000                       |
| Unaccreted discount                  | (1 )                           | (2 )                          |
| Unamortized debt issuance costs      | (6 )                           | (6 )                          |
| Net carrying value of Senior Notes   | \$ 993                         | \$992                         |
| Fair value of Senior Notes (Level 2) | \$ 1,024                       | \$1,038                       |

As of September 30, 2018, the remaining life of the 2021 Notes and 2026 Notes is approximately 2.4 years and 7.4 years, respectively.

The Senior Notes are senior unsecured obligations and rank equally with all our other existing and future unsubordinated obligations and any indebtedness that we may incur from time to time under our Credit Facility.

The 2021 Notes and the 2026 Notes are redeemable at our option at any time prior to February 1, 2021 or December 1, 2025, respectively, subject to a make-whole premium. Within one and three months of maturity, we may redeem the 2021 Notes or the 2026 Notes, respectively, at a redemption price equal to 100% of the aggregate principal amount plus accrued and unpaid interest. In addition, upon the occurrence of a change of control repurchase event, the holders of the Senior Notes may require us to repurchase all or a portion of the Senior Notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The Senior Notes also include covenants that limit our ability to incur liens on assets and to enter into sale and leaseback transactions, subject to certain allowances.

## Credit Facility

In March 2015, we entered into a \$500 million senior unsecured revolving credit facility (“Credit Facility”) with a syndicate of banks. The Credit Facility terminates on March 19, 2020. The Credit Facility contains an option to arrange with existing lenders and/or new lenders to provide up to an aggregate of \$250 million in additional commitments for revolving loans. Proceeds of loans made under the Credit Facility may be used for general corporate purposes.

The loans bear interest, at our option, at the base rate plus an applicable spread or an adjusted LIBOR rate plus an applicable spread, in each case with such spread being determined based on our consolidated leverage ratio for the preceding fiscal quarter. We are also obligated to pay other customary fees for a credit facility of this size and type. Interest is due and payable in arrears quarterly for loans bearing interest at the base rate and at the end of an interest

period (or at each three month interval in the case of loans with interest periods greater than three months) in the case of loans bearing interest at the adjusted LIBOR rate. Principal, together with all accrued and unpaid interest, is due and payable on March 19, 2020.

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

Table of Contents

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

As of September 30, 2018, no amounts were outstanding under the Credit Facility. \$2 million of debt issuance costs that were paid in connection with obtaining this credit facility are being amortized to interest expense over the 5-year term of the Credit Facility.

**Interest Expense**

The following table summarizes our interest expense recognized for the three and six months ended September 30, 2018 and 2017 that is included in interest and other income (expense), net on our Condensed Consolidated Statements of Operations (in millions):

|                                     | Three<br>Months<br>Ended<br>September<br>30,<br>2018 |        | Six Months<br>Ended<br>September<br>30,<br>2017 |        |
|-------------------------------------|--|--------|---|--------|
| Amortization of debt issuance costs | \$—  | \$—    | (1 )  | (1 )   |
| Coupon interest expense             | (11 )  | (11 )  | (21 )   | (21 )  |
| Total interest expense              | \$(11)   | \$(11) | \$(22)  | \$(22) |

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

As of September 30, 2018, we leased certain facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.

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

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

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include, but are not limited to: FIFA (Fédération Internationale de Football Association), FIFPRO Foundation, FAPL (Football Association Premier League Limited), and DFL Deutsche Fußball Liga E.V. (German Soccer League) (professional soccer); National Basketball Association (professional basketball); National Hockey League and NHL Players’ Association (professional hockey); National Football League Properties and PLAYERS Inc. (professional football); William Morris Endeavor Entertainment LLC (professional mixed martial arts); ESPN (content in EA SPORTS games); Disney Interactive (Star Wars); and Fox Digital Entertainment, Inc. (The Simpsons). These developer and content license commitments represent the sum of (1) the cash payments due under non-royalty-bearing licenses and services agreements and (2) the minimum guaranteed payments and advances against royalties due under royalty-bearing licenses and services agreements, the majority of which are conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.



Table of Contents

The following table summarizes our minimum contractual obligations as of September 30, 2018 (in millions):

|                                     | Total   | Fiscal Years Ending March 31,<br>2019<br>(Remaining<br>six<br>mos.) |       |         |       |       |            |       |
|-------------------------------------|---------|---|-------|---------|-------|-------|------------|-------|
|                                     |         | 2020  | 2021  | 2022    | 2023  | 2024  | Thereafter |       |
| Unrecognized commitments            |         |   |       |         |       |       |            |       |
| Developer/licensor commitments      | \$790   | \$64  | \$229 | \$257   | \$196 | \$43  | \$1        | \$—   |
| Marketing commitments               | 303     | 28  | 89    | 85      | 75    | 26    | —          | —     |
| Operating leases                    | 219     | 18  | 41    | 40      | 33    | 26    | 19         | 42    |
| Senior Notes interest               | 196     | 18  | 41    | 41      | 19    | 20    | 19         | 38    |
| Other purchase obligations          | 90      | 15  | 32    | 15      | 9     | 6     | 3          | 10    |
| Total unrecognized commitments      | 1,598   | 143   | 432   | 438     | 332   | 121   | 42         | 90    |
| Recognized commitments              |         |   |       |         |       |       |            |       |
| Senior Notes principal and interest | 1,003   | 3   | —     | 600     | —     | —     | —          | 400   |
| Transition Tax                      | 25      | 1   | —     | —       | —     | 3     | 5          | 16    |
| Licensing and lease obligations     | 90      | 12  | 25    | 26      | 27    | —     | —          | —     |
| Total recognized commitments        | 1,118   | 16  | 25    | 626     | 27    | 3     | 5          | 416   |
| Total commitments                   | \$2,716 | \$159   | \$457 | \$1,064 | \$359 | \$124 | \$47       | \$506 |

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

In addition, the amounts in the table above are presented based on the dates the amounts are contractually due as of September 30, 2018; however, certain payment obligations may be accelerated depending on the performance of our operating results. Furthermore, up to \$30 million of the unrecognized amounts in the table above may be payable, at the licensor's election, in shares of our common stock, subject to a \$10 million maximum during any fiscal year. The number of shares to be issued will be based on their fair market value at the time of issuance.

In addition to what is included in the table above, as of September 30, 2018, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$248 million, of which 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 September 30, 2018, we may be required to pay up to \$140 million of cash consideration in connection with the December 1, 2017 acquisition of Respawn based on the achievement of certain performance milestones through the end of calendar year 2022. As of September 30, 2018, we have recorded \$124 million of contingent consideration on our Condensed Consolidated Balance Sheet representing the estimated fair value.

Subsequent to September 30, 2018, we entered into various service and lease agreements with third parties which contingently commits us to pay an additional approximately \$137 million at various dates through fiscal year 2025.

#### Legal Proceedings

On July 29, 2010, Michael Davis, a former NFL running back, filed a putative class action in the United States District Court for the Northern District of California against the Company, alleging that certain past versions of Madden NFL included the images of certain retired NFL players without their permission. In March 2012, the trial court denied the Company's request to dismiss the complaint on First Amendment grounds. In January 2015, that trial court decision was affirmed by the Ninth Circuit Court of Appeals and the case was remanded back to the United States District Court for the Northern District of California. In August 2018, the United States District Court for the Northern District of California denied the plaintiffs' motion for class certification, which the plaintiffs have appealed.



Governmental authorities in Belgium have sought to limit or discontinue the use of in-game mechanics involving a randomized selection of virtual items. On August 10, 2018, we were notified that the Belgian Gambling Commission made a referral to the

Table of Contents

Belgian Public Prosecutor’s Office regarding the use such mechanics in the FIFA Ultimate Team service included in FIFA 18. The Public Prosecutor is investigating the referral and has not yet determined whether to initiate proceedings against the Company, certain subsidiaries of the Company, and/or certain executive officers of the Company. The Company does not believe that its products and services violate applicable gambling laws, and is engaged in discussions with appropriate governmental authorities in Belgium.

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

(14) STOCK-BASED COMPENSATION

Valuation Assumptions

We recognize compensation cost for stock-based awards to employees based on the awards’ estimated grant-date fair value using a straight-line approach over the service period for which such awards are expected to vest. We account for forfeitures as they occur.

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

**Restricted Stock Units and Performance-Based Restricted Stock Units.** The fair value of restricted stock units 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.

**Market-Based Restricted Stock Units.** Market-based restricted stock units consist of grants of performance-based restricted stock units to certain members of executive management that vest contingent upon the achievement of pre-determined market and service conditions (referred to herein as “market-based restricted stock units”). The fair value of our market-based restricted stock units is estimated 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, as amended (“ESPP”), respectively, is estimated using the Black-Scholes valuation model based on the multiple-award valuation method. Key assumptions of the Black-Scholes valuation model are the risk-free interest rate, expected volatility, expected term and expected dividends. The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option. Expected volatility is based on a combination of historical stock price volatility and implied volatility of publicly-traded options on our common stock. An expected term is estimated based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.

There were an insignificant number of stock options granted during the three and six months ended September 30, 2018 and 2017.

The estimated assumptions used in the Black-Scholes valuation model to value our ESPP purchase rights were as follows:

|                         | ESPP Purchase Rights<br>Three Months Ended<br>September 30, |            |
|-------------------------|---|------------|
|                         | 2018  | 2017       |
| Risk-free interest rate | 2.2 - 2.5%  | 1.1 - 1.2% |

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

|                             |               |   |               |   |
|-----------------------------|---------------|---|---------------|---|
| Expected volatility         | 29            | % | 28            | % |
| Weighted-average volatility | 29            | % | 28            | % |
| Expected term               | 6 - 12 months |   | 6 - 12 months |   |
| Expected dividends          | None          |   | None          |   |

There were no market-based restricted stock units granted during the three months ended September 30, 2018 and 2017.

30

---

Table of Contents

## Stock-Based Compensation Expense

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

|                                  | Three<br>Months<br>Ended<br>September<br>30,<br>2018 |       | Six Months<br>Ended<br>September<br>30,<br>2017 |        |
|----------------------------------|--|-------|---|--------|
| Cost of revenue                  | \$ 1   | \$ 1  | \$ 2  | \$ 2   |
| Research and development         | 39   | 36    | 86  | 64     |
| Marketing and sales              | 9  | 9     | 16  | 16     |
| General and administrative       | 17   | 16    | 32  | 28     |
| Stock-based compensation expense | \$ 66  | \$ 62 | \$ 136  | \$ 110 |

During the three months ended September 30, 2018, we recognized a \$9 million deferred income tax benefit related to our stock-based compensation expense. During the three months ended September 30, 2017, we recognized a \$12 million deferred income tax benefit related to our stock-based compensation expense.

During the six months ended September 30, 2018, we recognized a \$17 million deferred income tax benefit related to our stock-based compensation expense. During the six months ended September 30, 2017, we recognized a \$22 million deferred income tax benefit related to our stock-based compensation expense.

As of September 30, 2018, our total unrecognized compensation cost related to restricted stock units, market-based restricted stock units, performance-based restricted stock units was \$578 million and is expected to be recognized over a weighted-average service period of 2.2 years. Of the \$578 million of unrecognized compensation cost, \$493 million relates to restricted stock units, \$64 million relates to market-based restricted stock units, and \$21 million relates to performance-based restricted stock units at 100 percent average vesting target.

## Stock Options

The following table summarizes our stock option activity for the six months ended September 30, 2018:

|                                      | Options<br>(in thousands) | Weighted-<br>Average<br>Exercise Prices | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic Value<br>(in millions) |
|--------------------------------------|---------------------------|---|---|---|
| Outstanding as of March 31, 2018     | 1,615                     | \$ 30.28                                |   |   |
| Granted                              | 2                         | 123.80                                  |   |   |
| Exercised                            | (184 )                    | 31.48                                   |   |   |
| Outstanding as of September 30, 2018 | 1,433                     | \$ 30.28                                | 5.10  | \$ 129  |
| Vested and expected to vest          | 1,433                     | \$ 30.28                                | 5.10  | \$ 129  |
| Exercisable as of September 30, 2018 | 1,433                     | \$ 30.28                                | 5.10  | \$ 129  |

The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price as of September 30, 2018, which would have been received by the option holders had all the option holders exercised their options as of that date. We issue new common stock from our authorized shares upon the exercise of stock options.



Table of Contents

## Restricted Stock Units

The following table summarizes our restricted stock unit activity for the six months ended September 30, 2018:

|                                      | Restricted<br>Stock Rights<br>(in thousands) | Weighted-<br>Average Grant<br>Date Fair Values |
|--------------------------------------|--|--|
| Outstanding as of March 31, 2018     | 5,948  | \$ 94.57                                       |
| Granted                              | 1,626  | 140.68   |
| Vested                               | (1,757 )                                     | 81.71  |
| Forfeited or cancelled               | (359 )                                       | 108.16   |
| Outstanding as of September 30, 2018 | 5,458  | \$ 111.55                                      |

## Performance-Based Restricted Stock Units

Our performance-based restricted stock units cliff vest after a four-year performance period contingent upon the achievement of pre-determined performance-based milestones based on our non-GAAP net revenue and free cash flow as well as service conditions. If these performance-based milestones are not met but service conditions are met, the performance-based restricted stock units will not vest, in which case any compensation expense we have recognized to date will be reversed. Each quarter, we update our assessment of the probability that the non-GAAP net revenue and free cash flow performance milestones will be achieved. We amortize the fair values of performance-based restricted stock units over the requisite service period. The performance-based restricted stock units contain threshold, target and maximum milestones for each of non-GAAP net revenue and free cash flow. The number of shares of common stock to be issued at vesting will range from zero percent to 200 percent of the target number of performance-based restricted stock units attributable to each performance-based milestone based on the company's performance as compared to these threshold, target and maximum performance-based milestones. Each performance-based milestone is weighted evenly where 50 percent of the total performance-based restricted stock units that vest will be determined based on non-GAAP net revenue and the other 50 percent will be determined based on free cash flow. The number of shares that vest based on each performance-based milestone is independent from the other.

The following table summarizes our performance-based restricted stock unit activity, presented with the maximum number of shares that could potentially vest, for the six months ended September 30, 2018:

|                                      | Performance-<br>Based<br>Restricted<br>Stock Units<br>(in<br>thousands) | Weighted-<br>Average Grant<br>Date Fair Value |
|--------------------------------------|---|---|
| Outstanding as of March 31, 2018     | 796   | \$ 110.51                                     |
| Granted                              | —   | —   |
| Forfeited or cancelled               | (217 )  | 110.51  |
| Outstanding as of September 30, 2018 | 579   | \$ 110.51                                     |

## Market-Based Restricted Stock Units

Our market-based restricted stock units vest contingent upon the achievement of pre-determined market and service conditions. If these market conditions are not met but service conditions are met, the market-based restricted stock units will not vest; however, any compensation expense we have recognized to date will not be reversed. The number of shares of common stock to be issued at vesting will range from zero percent to 200 percent of the target number of market-based restricted stock units based on our total stockholder return ("TSR") relative to the performance of companies in the NASDAQ-100 Index for each measurement period, over either a one-year, two-year cumulative and three-year cumulative period.



Table of Contents

The following table summarizes our market-based restricted stock unit activity, presented with the maximum number of shares that could potentially vest, for the six months ended September 30, 2018:

|                                      | Market-Based                                   |   |
|--------------------------------------|--|---|
|                                      | Restricted<br>Stock<br>Units<br>(in thousands) | Weighted-<br>Average Grant<br>Date Fair Value |
| Outstanding as of March 31, 2018     | 1,342  | \$ 118.35                                     |
| Granted                              | 573  | 185.24  |
| Vested                               | (415 )   | 98.48   |
| Forfeited or cancelled               | (525 )   | 135.76  |
| Outstanding as of September 30, 2018 | 975  | \$ 156.76                                     |

## Stock Repurchase Program

In May 2015, our Board of Directors authorized a program to repurchase up to \$1 billion of our common stock. We repurchased approximately 0.3 million shares for approximately \$31 million under this program during the three months ended June 30, 2017. We completed repurchases under the May 2015 program in April 2017.

In May 2017, a Special Committee of our Board of Directors, on behalf of the full Board of Directors, authorized a program to repurchase up to \$1.2 billion of our common stock. We repurchased approximately 0.6 million shares for approximately \$76 million under this program during the three months ended June 30, 2018. During the three and six months ended September 30, 2017, we repurchased approximately 1.3 million and 2.4 million shares for approximately \$153 million and \$272 million, respectively, under this program. This program was superseded and replaced by a new stock repurchase program approved in May 2018.

In May 2018, a Special Committee of our Board of Directors, on behalf of the full Board of Directors, authorized a program to repurchase up to \$2.4 billion of our common stock. This stock repurchase program supersedes and replaces the May 2017 program, and expires on May 31, 2020. Under this program, we may purchase stock in the open market or through privately negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans.

The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase a specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and six months ended September 30, 2018, we repurchased approximately 2.3 million and 4.0 million shares for approximately \$299 million and \$523 million, respectively, under this program.

The following table summarizes total shares repurchased during the three and six months ended September 30, 2018 and 2017:

| (in millions)                         | May 2015<br>Program |        | May 2017<br>Program |        | May 2018<br>Program |        | Total  |        |
|---------------------------------------|---------------------|--------|---------------------|--------|---------------------|--------|--------|--------|
|                                       | Shares              | Amount | Shares              | Amount | Shares              | Amount | Shares | Amount |
| Three months ended September 30, 2018 | —                   | \$ —   | —                   | \$ —   | 2.3                 | \$ 299 | 2.3    | \$ 299 |
| Six months ended September 30, 2018   | —                   | \$ —   | 0.6                 | \$ 76  | 4.0                 | \$ 523 | 4.6    | \$ 599 |
| Three months ended September 30, 2017 | —                   | \$ —   | 1.3                 | \$ 153 | —                   | \$ —   | 1.3    | \$ 153 |
| Six months ended September 30, 2017   | 0.3                 | \$ 31  | 2.4                 | \$ 272 | —                   | \$ —   | 2.7    | \$ 303 |





Table of Contents

## (15) EARNINGS (LOSS) PER SHARE

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

|  | Three Months Ended |               | Six Months Ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | September 30,      | September 30, | September 30,    | September 30, |
| (In millions, except per share amounts)  | 2018               | 2017          | 2018             | 2017          |
| Net income (loss)  | \$255              | \$(22 )       | \$548            | \$622         |
| Shares used to compute earnings (loss) per share:  |                    |               |                  |               |
| Weighted-average common stock outstanding — basic  | 305                | 309           | 305              | 309           |
| Dilutive potential common shares related to stock award plans and from assumed exercise of stock options | 2                  | —             | 4                | 4             |
| Weighted-average common stock outstanding — diluted  | 307                | 309           | 309              | 313           |
| Earnings (loss) per share:   |                    |               |                  |               |
| Basic  | \$0.84             | \$(0.07)      | \$1.80           | \$2.01        |
| Diluted  | \$0.83             | \$(0.07)      | \$1.77           | \$1.99        |

For the three months ended September 30, 2018 and six months ended September 30, 2018 and 2017, an immaterial amount of restricted stock units and market-based restricted stock units were excluded from the treasury stock method computation of diluted shares as their inclusion would have had an antidilutive effect. Our performance-based restricted stock units, which are considered contingently issuable shares, are also excluded from the treasury stock method computation because the related performance-based milestones were not achieved as of the end of the reporting period.

As a result of our net loss for the three months ended September 30, 2017, we have excluded all potentially dilutive common shares from the diluted loss per share calculation as their inclusion would have had an antidilutive effect. Had we reported net income for this period, an additional 3 million shares of common stock related to our outstanding equity-based instruments would have been included in the number of shares used to calculate Diluted EPS for the three months ended September 30, 2017.

Table of Contents

## (16) SEGMENT INFORMATION

Our reporting segment is based upon: our internal organizational structure; the manner in which our operations are managed; the criteria used by our Chief Executive Officer, our Chief Operating Decision Maker (“CODM”), to evaluate segment performance; the availability of separate financial information; and overall materiality considerations. Our CODM currently reviews total company operating results to assess overall performance and allocate resources. As of September 30, 2018, we have only one reportable segment, which represents our only operating segment.

Information about our total net revenue by composition and by platform for the three and six months ended September 30, 2018 and 2017 is presented below (in millions):

|                            | Three<br>Months<br>Ended<br>September<br>30,<br>2018 |        | Six Months<br>Ended<br>September 30,<br>2017 |          |
|----------------------------|--|--------|--|----------|
| Net revenue by composition |  |        |  |          |
| Full game downloads        | \$ 148   | \$ 123 | \$ 264                                       | \$ 332   |
| Live services              | 412  | 408    | 1,022  | 909      |
| Mobile                     | 220  | 158    | 451  | 327      |
| Total Digital              | 780  | 689    | 1,737  | 1,568    |
| Packaged goods and other   | 506  | 270    | 686  | 840      |
| Net revenue                | \$ 1,286   | \$ 959 | \$ 2,423                                     | \$ 2,408 |

Digital net revenue includes full-game downloads, live services, and mobile revenue. Full game downloads includes revenue from digital sales of full games on console and PC. Live services includes revenue from sales of extra content for console, PC, browser games, game software licensed to our third-party publishing partners who distribute our games digitally, subscriptions, and advertising. Mobile includes revenue from the sale of full games and extra content on mobile phones and tablets.

Packaged goods net revenue includes revenue from software that is sold physically. This includes (1) net revenue from game software sold physically through traditional channels such as brick and mortar retailers, and (2) our software licensing revenue from third parties (for example, makers of console platforms, personal computers or computer accessories) who include certain of our products for sale with their products (“OEM bundles”). Other revenue includes our non-software licensing revenue.

|                      | Three<br>Months<br>Ended<br>September<br>30,<br>2018 |        | Six Months<br>Ended<br>September 30,<br>2017 |          |
|----------------------|--|--------|--|----------|
| Platform net revenue |  |        |  |          |
| Console              | \$ 917   | \$ 595 | \$ 1,622                                     | \$ 1,629 |
| PC / Browser         | 149  | 196    | 346  | 436      |
| Mobile               | 220  | 162    | 453  | 333      |
| Other                | —  | 6      | 2  | 10       |
| Net revenue          | \$ 1,286   | \$ 959 | \$ 2,423                                     | \$ 2,408 |



Table of Contents

Net revenue from unaffiliated customers in North America and internationally for the three and six months ended September 30, 2018 and 2017 is presented below (in millions):

|   | Three<br>Months<br>Ended<br>September<br>30,<br>2018 |       | Six Months<br>Ended<br>September 30,<br>2017 |         |
|---|--|-------|--|---------|
| Net revenue from unaffiliated customers |  |       |  |         |
| North America                           | \$475  | \$427 | \$917  | \$1,038 |
| International                           | 811  | 532   | 1,506  | 1,370   |
| Net revenue                             | \$1,286  | \$959 | \$2,423                                      | \$2,408 |

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors

Electronic Arts, Inc.:

Results of Review of Interim Financial Information

We have reviewed the condensed consolidated balance sheet of Electronic Arts, Inc. and subsidiaries (the Company) as of September 29, 2018, the related condensed consolidated statements of operations and comprehensive income for the three-month and six-month periods ended September 29, 2018 and September 30, 2017, the related condensed consolidated statements of cash flows for the six-month periods ended September 29, 2018 and September 30, 2017, and the related notes (collectively, the consolidated interim financial information). Based on our reviews, we are not aware of any material modifications that should be made to the consolidated interim financial information for it to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Company as of March 31, 2018, and the related consolidated statements of operations and comprehensive income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated May 23, 2018, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of March 31, 2018, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

This consolidated interim financial information is the responsibility of the Company's management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our reviews in accordance with the standards of the PCAOB. A review of consolidated 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 PCAOB, 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.

(Signed) KPMG LLP  
Santa Clara, California  
November 6, 2018

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. We use words such as “anticipate,” “believe,” “expect,” “intend,” “estimate,” “plan,” “predict,” “seek,” “goal,” “will,” “may,” “likely,” “should,” “could” (and the negative of any of these terms) and similar expressions to identify forward-looking statements. In addition, any statements that refer to projections of our future financial performance, trends in our business, projections of markets relevant to our business, uncertain events and assumptions and other characterizations of future events or circumstances are forward-looking statements. Forward-looking statements consist of, among other things, statements related to industry prospects, our future financial performance, and our business plans and objectives, and may include certain assumptions that underlie the forward-looking statements. These forward-looking statements are not guarantees of future performance and reflect management's current expectations. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that might cause or contribute to such differences include those discussed in Part II, Item 1A of this Quarterly Report under the heading “Risk Factors” in, as well as in other documents we have filed with the Securities and Exchange Commission (“SEC”), including our Annual Report on Form 10-K for the fiscal year ended March 31, 2018. We assume no obligation to revise or update any forward-looking statement for any reason, except as required by law.

OVERVIEW

The following overview is a high-level discussion of our operating results, as well as some of the trends and drivers that affect our business. Management believes that an understanding of these trends and drivers provides important context for our results for the three months ended September 30, 2018, as well as our future prospects. This summary is not intended to be exhaustive, nor is it intended to be a substitute for the detailed discussion and analysis provided elsewhere in this Form 10-Q, including in the remainder of “Management's Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”),” “Risk Factors,” and the 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, 2018 as filed with the SEC on May 23, 2018 and in other documents we have filed with the SEC.

About Electronic Arts

We are a global leader in digital interactive entertainment, with a mission to inspire the world to play. We develop, market, publish and deliver games and services that can be played on a variety of platforms, including game consoles, PCs, mobile phones and tablets. In our games and services, we use brands that we either wholly own (such as Battlefield, Mass Effect, The Sims and Plants v. Zombies), or license from others (such as FIFA, Madden NFL and Star Wars). We develop and publish games and services across diverse genres such as sports, first-person shooter, action, role-playing and simulation. We believe that the breadth and depth of our portfolio gives us the opportunity to engage an increasing number of players across more platforms and geographies and through more business models.

Financial Results

We adopted the New Revenue Standard on April 1, 2018, the beginning of fiscal year 2019, using the modified retrospective method. The comparative information for periods prior to April 1, 2018 has not been restated. For comparability, Note 1 — Description of Business and Basis of Presentation in Part I, Item 1 of this Form 10-Q includes our pro-forma financial results under the Old Revenue Standard for the three and six months ended September 30, 2018.

Our key financial results for our fiscal quarter ended September 30, 2018 were as follows:

Total net revenue was \$1,286 million, up 34 percent year-over-year. Under the Old Revenue Standard, total net revenue would have been \$954 million, down 1 percent year-over-year.

Digital net revenue was \$780 million, up 13 percent year-over-year. Under the Old Revenue Standard, digital net revenue would have been \$699 million, up 1 percent year-over-year.

Gross margin was 67.5 percent, up 8.1 percentage points year-over-year. Under the Old Revenue Standard, gross margin would have been 60.8 percent, up 1.4 percentage points year-over-year.

Operating expenses were \$610 million, down less than 1 percent year-over-year.

Net income was \$255 million with diluted earnings per share of \$0.83. Under the Old Revenue Standard, net loss would have been \$19 million with diluted loss per share of \$0.06.

Total cash, cash equivalents and short-term investments were \$4,545 million.



## Table of Contents

From time to time, we make comparisons of current periods to prior periods with reference to constant currency. For the fiscal quarter ended September 30, 2018, foreign currency exchange rates did not have a material impact on our net revenue and operating expenses.

### Trends in Our Business

**Digital Business.** Players increasingly purchase our games as digital downloads, as opposed to purchasing physical discs, and engage with the live services we provide on an ongoing basis. Our live services provide additional depth and engagement opportunities for our players and include microtransactions, extra content, subscriptions, and esports. Our net revenue attributable to live services comprised 40 percent of our total net revenue during fiscal year 2018 and we expect that live services net revenue will continue to be material to our business. Our most popular live service is the Ultimate Team mode associated with our sports franchises. Ultimate Team allows players to collect and trade current and former professional players in order to build and compete as a personalized team. Net revenue from Ultimate Team represented approximately 21 percent of our total net revenue during fiscal year 2018, a substantial portion of which was derived from FIFA Ultimate Team. Our digital transformation is also creating opportunities in platforms, business models and the way in which players engage with our games and services. For example, we have leveraged brands and assets from franchises typically associated with consoles and traditional PC gaming, such as FIFA, Madden NFL, The Sims, SimCity and Star Wars, to create mobile and PC games that are monetized through live services associated with the game. We also provide our EA Access, Origin Access and Origin Access Premier subscription services, which offer access to a selection of full games, in-game content, online services and other benefits, typically for a monthly or annual fee.

We significantly increased our digital net revenue from \$2,409 million in fiscal year 2016 to \$2,874 million in fiscal year 2017 and \$3,450 million during fiscal year 2018. We expect this portion of our business to continue to grow through fiscal year 2019 and beyond as we continue to focus on developing and monetizing products and services that can be delivered digitally.

**Technological Infrastructure.** As our digital business has grown, our games and services increasingly depend on the reliability, availability and security of our technological infrastructure. We are investing and expect to continue to invest in technology, hardware and software to support our games and services, including with respect to security protections. Our industry is prone to, and our systems and networks are subject to, cyber-attacks, computer viruses, worms, phishing attacks, malicious software programs, and other information security incidents that seek to exploit, disable, damage, disrupt or gain access to our networks, our products and services, supporting technological infrastructure, intellectual property and other assets. We expect these threats to our systems and networks to continue.

**Player Network.** We have made, and expect to continue to make, investments that strengthen our player network, which connects our players to each other and to the games they love. We are adopting consistent, cross-company methodologies to better understand our players' needs and will continue to invest in technology that enables us to build personalized player relationships that can last for years instead of days or weeks by connecting our players to us and to each other. This connection allows us to market and deliver content and services for popular franchises like FIFA, Battlefield and Star Wars to our players more efficiently. That same foundation also enables new player-centric ways to discover and try new games and experiences, such as our subscription-based EA Access, Origin Access and Origin Access Premier services.

**Concentration of Sales Among the Most Popular Games.** In all major segments of our industry, we see a large portion of games sales concentrated on the most popular titles. Similarly, a significant portion of our revenue historically has been derived from games based on a few popular franchises, several of which we have released on an annual or bi-annual basis. In particular, we have historically derived a significant portion of our net revenue from our largest and

most popular game, FIFA, the annualized version of which is consistently one of the best-selling games in the marketplace.

**Mobile and PC Free-to-Download Games.** The global adoption of mobile devices and a business model for those devices that allows consumers to try new games with no up-front cost, and that are monetized through the live service associated with the game, has led to significant growth in the mobile gaming industry. We expect this growth to continue during our 2019 fiscal year. Likewise, the wide consumer acceptance of free-to-download, live service-based PC games played over the Internet has broadened our consumer base. We expect revenue generated from mobile and PC free-to-download games to remain an important part of our business.

**Recurring Revenue Sources.** Our business model includes revenue that we deem recurring in nature, such as revenue from our annualized titles (such as FIFA and Madden NFL) and associated live services, subscriptions and our ongoing mobile business. We have been able to forecast revenue from these areas of our business with greater relative confidence than for new games, services and business models. As we continue to leverage the digital transformation in our industry and incorporate new

Table of Contents

content models and modalities of play into our games, our goal is to continue to look for opportunities to expand the recurring portion of our business.

Net Bookings. In order to improve transparency into our business, we disclose an operating performance metric, net bookings. Net bookings is defined as the net amount of products and services sold digitally or sold-in physically in the period. Net bookings is calculated by adding total net revenue to the change in deferred net revenue for online-enabled games, and, for periods after the fourth quarter of fiscal 2018, mobile platform fees.

The following is a calculation of our total net bookings for the periods presented:

|   | Three Months  |         | Six Months    |         |
|---|---------------|---------|---------------|---------|
|   | Ended         |         | Ended         |         |
|   | September 30, |         | September 30, |         |
| (In millions)   | 2018          | 2017    | 2018          | 2017    |
| Total net revenue                                     | \$1,286       | \$959   | \$2,423       | \$2,408 |
| Change in deferred net revenue (online-enabled games) | (20 )         | 220     | (359 )        | (454 )  |
| Mobile platform fees                                  | \$(44 )       | —       | \$(93 )       | —       |
| Net bookings  | \$1,222       | \$1,179 | \$1,971       | \$1,954 |

Net bookings were \$1,222 million for the three months ended September 30, 2018 driven by sales related to FIFA 19, Madden NFL 19, and The Sims 4. Net bookings increased \$43 million or 4 percent as compared to the three months ended September 30, 2017 due primarily to the FIFA franchise and The Sims 4 on a year-over-year basis, partially offset by a decrease in Star Wars Battlefront during the three months ended September 30, 2018. Digital net bookings were \$637 million for the three months ended September 30, 2018, an increase of \$58 million or 10 percent as compared to three months ended September 30, 2017, driven by sales of FIFA 19, FIFA Ultimate Team and Madden Ultimate Team. The increase in digital net bookings was primarily driven by our full game PC and console downloads, which grew \$38 million or 32 percent year-over-year, primarily due to the timing of recognition of net bookings from FIFA 19, the earlier launch of Madden NFL 19 as compared to Madden NFL 18, and the ongoing shift to digital download of our games, and live services which grew \$18 million or 6 percent year-over-year, primarily due to the FIFA and Madden franchises and The Sims 4, offset by the effects of the transition from FIFA Online 3 to FIFA Online 4 in Asia.

#### Recent Developments

Stock Repurchase Program. In May 2018, a Special Committee of our Board of Directors, on behalf of the full Board of Directors, authorized a program to repurchase up to \$2.4 billion of our common stock. This stock repurchase program supersedes and replaces the May 2017 program, and expires on May 31, 2020. Under this program, we may purchase stock in the open market or through privately negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase a specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and six months ended September 30, 2018, we repurchased approximately 2.3 million and 4.0 million shares for approximately \$299 million and \$523 million, respectively, under this program.

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). The preparation of these Condensed Consolidated Financial Statements requires management to make estimates and assumptions that affect the reported amounts of assets and

liabilities, contingent assets and liabilities, and revenue and expenses during the reporting periods. The policies discussed below are considered by management to be critical because they are not only important to the portrayal of our financial condition and results of operations, but also because application and interpretation of these policies requires both management judgment and estimates of matters that are inherently uncertain and unknown. As a result, actual results may differ materially from our estimates.

For a complete discussion of our critical accounting policies and estimates with respect to revenue recognition for revenue transactions occurring prior to April 1, 2018, which were accounted for under ASC 605, Revenue Recognition, refer to Part II, Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” under the subheading Critical Accounting Policies and Estimates included in our Annual Report on Form 10-K for our fiscal year ended March 31, 2018, filed with the SEC on May 23, 2018. With respect to revenue transactions occurring on April 1, 2018 and onward, our revenue recognition accounting policy is set forth below and follows ASC 606, Revenue from Contracts with Customers.

## Table of Contents

### Revenue Recognition

We derive revenue principally from sales of our games, and related extra-content and services that can be played by customers on a variety of platforms which include game consoles, PCs, mobile phones and tablets. Our product and service offerings include, but are not limited to, the following:

full games with both online and offline functionality (“Games with Services”), which generally includes (1) the initial game delivered digitally or via physical disc at the time of sale and typically provide access to offline core game content (“software license”); (2) updates on a when-and-if-available basis, such as software patches or updates, and/or additional free content to be delivered in the future (“future update rights”); and (3) a hosted connection for online playability (“online hosting”);

full games with online-only functionality which require an Internet connection to access all gameplay and functionality (“Online-Hosted Service Games”);

extra content related to Games with Services and Online-Hosted Service Games which provides access to additional in-game content;

subscriptions, such as Origin Access and EA Access, that generally offers access to a selection of full games, in-game content, online services and other benefits typically for a recurring monthly or annual fee; and

licensing our games to third parties to distribute and host our games.

Effective April 1, 2018, we evaluate revenue recognition based on the criteria set forth in ASC 606, Revenue from Contracts with Customers.

We evaluate and recognize revenue by:

identifying the contract(s) with the customer;

identifying the performance obligations in the contract;

determining the transaction price;

allocating the transaction price to performance obligations in the contract; and

recognizing revenue as each performance obligation is satisfied through the transfer of a promised good or service to a customer (i.e., “transfer of control”).

### Online-Enabled Games

Games with Services. Our sales of Games with Services are evaluated to determine whether the software license, future update rights and the online hosting are distinct and separable. Sales of Games with Services are generally determined to have three distinct performance obligations: software license, future update rights, and the online hosting.

Since we do not sell the performance obligations on a stand-alone basis, we consider market conditions and other observable inputs to estimate the stand-alone selling price for each performance obligation. We recognize revenue from these arrangements upon transfer of control for each performance obligation. For the portion of the transaction price allocated to the software license, revenue is recognized when control of the license has been transferred to the

customer. For the portion of the transaction price allocated to the future update rights and the online hosting, revenue is recognized as the services are provided.

**Online-Hosted Service Games.** Sales of our Online-Hosted Service Games are determined to have one distinct performance obligation: the online hosting. We recognize revenue from these arrangements as the service is provided.

**Extra Content.** Revenue received from sales of downloadable content are derived primarily from the sale of virtual currencies and digital in-game content to our customers to enhance their gameplay experience. Sales of extra content are accounted for in a manner consistent with the treatment for our Games with Services and Online-Hosted Service Games as discussed above, depending upon whether or not the extra content has offline functionality.

## Table of Contents

### Subscriptions

Revenue from subscriptions is recognized over the subscription term as the service is provided.

### Licensing Revenues

In certain countries, we utilize third-party licensees to distribute and host our games in accordance with license agreements, for which the licensees typically pay us a fixed minimum guarantee and/or sales-based royalties. These arrangements typically include multiple performance obligations, such as a time-based license of software and future update rights. We recognize as revenue a portion of the minimum guarantee when we transfer control of the license of software (generally upon commercial launch) and the remaining portion ratably over the contractual term in which we provide the licensee with future update rights. Any sales-based royalties are generally recognized as the related sales occur by the licensee.

### Revenue Classification

We classify our revenue as either product revenue or service and other revenue. Generally, performance obligations that are recognized upfront upon transfer of control are classified as product revenue, while performance obligations that are recognized over the Estimated Offering Period or subscription period as the services are provided are classified as service revenue.

**Product revenue.** Our product revenue includes revenue allocated to the software license performance obligation. Product revenue also includes revenue from the licensing of software to third-parties.

**Service and other revenue.** Our service revenue includes revenue allocated to the future update rights and the online hosting performance obligations. This also includes revenue allocated to the future update rights from the licensing of software to third-parties, software that offers an online-only service such as our Ultimate Team game mode, and subscription services.

### Significant Judgments around Revenue Arrangements

**Identifying performance obligations.** Performance obligations promised in a contract are identified based on the goods and services that will be transferred to the customer that are both capable of being distinct, (i.e., the customer can benefit from the goods or services either on its own or together with other resources that are readily available), and are distinct in the context of the contract (i.e., it is separately identifiable from other goods or services in the contract). To the extent a contract includes multiple promises, we must apply judgment to determine whether those promises are separate and distinct performance obligations. If these criteria are not met, the promises are accounted for as a combined performance obligation.

**Determining the transaction price.** The transaction price is determined based on the consideration that we will be entitled to receive in exchange for transferring our goods and services to the customer. Determining the transaction price often requires significant judgment, based on an assessment of contractual terms and business practices. It further includes review of variable consideration such as discounts, sales returns, price protection, and rebates, which is estimated at the time of the transaction. See below for additional information regarding our sales returns and price protection reserves. In addition, the transaction price does not include an estimate of the variable consideration related to sales-based royalties. Sales-based royalties are recognized as the sales occur.

**Allocating the transaction price.** Allocating the transaction price requires that we determine an estimate of the relative stand-alone selling price for each distinct performance obligation. Determining the relative stand-alone selling price is

inherently subjective, especially in situations where we do not sell the performance obligation on a stand-alone basis (which occurs in the majority of our transactions). In those situations, we determine the relative stand-alone selling price based on various observable inputs using all information that is reasonably available. Examples of observable inputs and information include: historical internal pricing data, cost plus margin analyses, third-party external pricing of similar or same products and services such as software licenses and maintenance support within the enterprise software industry. The results of our analysis resulted in a specific percentage of the transaction price being allocated to each performance obligation.

Determining the Estimated Offering Period. The offering period is the period in which we offer to provide the future update rights and/or online hosting for the game and related extra content sold. Because the offering period is not an explicitly defined period, we must make an estimate of the offering period for the service related performance obligations (i.e., future update rights and online hosting). Determining the Estimated Offering Period is inherently subjective and is subject to regular revision. Generally, we consider the average period of time customers are online when estimating the offering period. We also consider the estimated period of time between the date a game unit is sold to a reseller and the date the reseller sells the game unit to the



## Table of Contents

customer (i.e., time in channel). Based on these two factors, we then consider the method of distribution. For example, games sold at retail would have a composite offering period equal to the online gameplay period plus time in channel as opposed to digitally-distributed software licenses which are delivered immediately via digital download and therefore, the offering period is estimated to be only the online gameplay period.

Additionally, we consider results from prior analyses, known and expected online gameplay trends, as well as disclosed service periods for competitors' games in determining the Estimated Offering Period for future sales. We believe this provides a reasonable depiction of the transfer of future update rights and online hosting to our customers, as it is the best representation of the time period during which our games are played. We recognize revenue for future update rights and online hosting performance obligations ratably on a straight-line basis over this period as there is a consistent pattern of delivery for these performance obligations. These performance obligations are generally recognized over an estimated nine-month period beginning in the month after shipment for software licenses sold through retail and an estimated six-month period for digitally-distributed software licenses.

### Deferred Net Revenue

Because the majority of our sales transactions include future update rights and online hosting performance obligations, which are subject to a recognition period of generally six to nine months, our deferred net revenue balance is material. This balance increases from period to period by the revenue being deferred for current sales with these service obligations and is reduced by the recognition of revenue from prior sales that were deferred. Generally, revenue is recognized as the services are provided.

### Principal Agent Considerations

We evaluate sales to end customers of our full games and related content via third-party storefronts, including digital storefronts such as Microsoft's Xbox Store, Sony's PlayStation Store, Apple App Store, and Google Play Store, in order to determine whether or not we are acting as the principal in the sale to the end customer, which we consider in determining if revenue should be reported gross or net of fees retained by the third-party storefront. An entity is the principal if it controls a good or service before it is transferred to the end customer. Key indicators that we evaluate in determining gross versus net treatment include but are not limited to the following:

- the underlying contract terms and conditions between the various parties to the transaction;
- which party is primarily responsible for fulfilling the promise to provide the specified good or service to the end customer;
- which party has inventory risk before the specified good or service has been transferred to the end customer; and
- which party has discretion in establishing the price for the specified good or service.

Based on an evaluation of the above indicators, except as discussed below, we have determined that generally the third party is considered the principal to end customers for the sale of our full games and related content. We therefore report revenue related to these arrangements net of the fees retained by the storefront. However, for sales arrangements via Apple App Store and Google Play Store, EA is considered the principal to the end customer and thus, we report revenue on a gross basis and mobile platform fees are reported within cost of revenue.

### Payment Terms

Substantially all of our transactions have payment terms, whether customary or on an extended basis, of less than one year; therefore, we generally do not adjust the transaction price for the effects of any potential financing components that may exist.

Sales and Value-Added Taxes

Revenue is recorded net of taxes assessed by governmental authorities that are imposed at the time of the specific revenue-producing transaction between us and our customer, such as sales and value-added taxes.

## Table of Contents

### Sales Returns and Price Protection Reserves

Sales returns and price protection are considered variable consideration under ASC 606. We reduce revenue for estimated future returns and price protection which may occur with our distributors and retailers (“channel partners”). Price protection represents our practice to provide our channel partners with a credit allowance to lower their wholesale price on a particular game unit that they have not resold to customers. The amount of the price protection for permanent markdowns is the difference between the old wholesale price and the new reduced wholesale price. Credits are also given for short-term promotions that temporarily reduce the wholesale price. In certain countries we also have a practice for allowing channel partners to return older products in the channel in exchange for a credit allowance.

When evaluating the adequacy of sales returns and price protection reserves, we analyze the following: historical credit allowances, current sell-through of our channel partners’ inventory of our products, current trends in retail and the video game industry, changes in customer demand, acceptance of our products, and other related factors. In addition, we monitor the volume of sales to our channel partners and their inventories, as substantial overstocking in the distribution channel could result in high returns or higher price protection in subsequent periods.

In the future, actual returns and price protections may materially exceed our estimates as unsold products in the distribution channels are exposed to rapid changes in customer preferences, market conditions or technological obsolescence due to new platforms, product updates or competing 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 and would impact the transaction price and thus, the total net revenue and related balance sheet accounts that we report.

### Fair Value Estimates

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

### Royalties and Licenses

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

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

## Table of Contents

conclude that we are unable to make a reasonably reliable forecast of projected net revenue, we recognize royalty expense at the greater of contract rate or on a straight-line basis over the term of the contract. Accordingly, if our future revenue projections change, our effective royalty rates would change, which could impact the amount and timing of royalty expense we recognize.

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

Our contracts with some licensors include minimum guaranteed royalty payments, which are initially recorded as an asset and as a liability at the contractual amount when no performance remains with the licensor. When performance remains with the licensor, we record guarantee payments as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract.

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

### Income Taxes

We recognize deferred tax assets and liabilities for both (1) the expected impact of differences between the financial statement amount and the tax basis of assets and liabilities and (2) the expected future tax benefit to be derived from tax losses and tax credit carryforwards. We record a valuation allowance against deferred tax assets when it is considered more likely than not that all or a portion of our deferred tax assets will not be realized. In making this determination, we are required to give significant weight to evidence that can be objectively verified.

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 carryback 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.

We recorded a provisional tax expense of \$235 million related to the U.S. Tax Act for the fiscal year ended March 31, 2018, \$192 million of which relates to the Transition Tax. During the three and six months ended September 30, 2018, we made no material adjustments to these provisional amounts. The final calculation of taxes attributable to the U.S. Tax Act may differ from our estimates, potentially materially, due to, among other things, changes in interpretations of the U.S. Tax Act, our further analysis of the U.S. Tax Act, or any updates or changes to estimates that we have utilized to calculate the transition impacts.

Reasonable estimates of the impacts of the U.S. Tax Act are provided in accordance with SAB 118, the SEC guidance that allows for a measurement period of up to one year after the enactment date of the U.S. Tax Act to finalize the recording of the related tax impacts. We expect to complete the accounting under the U.S. Tax Act as soon as practicable, but in no event later than one year from the enactment date of the U.S. Tax Act.

The U.S. Tax Act creates new U.S. taxes on foreign earnings. Our provision for income taxes for the three and six months ended September 30, 2018 provisionally does not reflect any deferred tax impacts of the U.S. taxes on foreign earnings. Because of the complexity of the rules regarding the new tax on foreign earnings, we are continuing to evaluate this accounting policy election.

Prior to the U.S. Tax Act, a substantial majority of undistributed earnings of our foreign subsidiaries were considered to be indefinitely reinvested. The U.S. Tax Act included a mandatory one-time tax on accumulated earnings of foreign subsidiaries, and as a result, substantially all previously unremitted earnings for which no U.S. deferred tax liability had been accrued have now been subject to U.S. tax.

## Table of Contents

As part of the process of preparing our Condensed Consolidated Financial Statements, we are required to estimate our income taxes in each jurisdiction 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 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 tax rate.

### IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

The information under the subheading “Other Recently Issued Accounting Standards” in Note 1 — Description of Business and Basis of Presentation to the Condensed Consolidated Financial Statements in this Form 10-Q is incorporated by reference into this Item 2.

### RESULTS OF OPERATIONS

Our fiscal year is reported on a 52- or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal year ending March 31, 2019 contains 52 weeks and ends on March 30, 2019. Our results of operations for the fiscal year ended March 31, 2018 contained 52 weeks and ended on March 31, 2018. Our results of operations for the three months ended September 30, 2018 and 2017 contained 13 weeks each and ended on September 29, 2018 and September 30, 2017, 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) full games sold as digital downloads or as packaged goods and designed for play on game consoles and PCs, (2) full games for mobile phones and tablets, (3) live services associated with these games, such as extra-content (4) subscriptions that generally offer access to a selection of full games, in-game content, online services and other benefits, and (5) licensing our games to third parties to distribute and host our games.

We provide two different measures of our Net Revenue: (1) Net Revenue by Product revenue and Service and other revenue, and (2) Net Revenue by Composition, which is primarily based on method of distribution. Management places a greater emphasis and focus on assessing our business through a review of the Net Revenue by Composition (Digital, and Packaged goods and other) than by Net Revenue by Product revenue and Service and other revenue.

#### Net Revenue Quarterly Analysis

On April 1, 2018, we adopted the New Revenue Standard, which significantly changes the way in which we recognize revenue, including the way in which we present mobile platform fees. We elected to apply the New Revenue Standard using the modified retrospective method. Because of that election, revenue for the three and six months ended September 30, 2017 has not been restated and is reported under the accounting standards in effect for that period. In order to facilitate year-over-year comparisons, in the Net Revenue and Cost of Revenue tables below, we have quantified the amount of the year-over-year change attributable to (1) the adoption of the New Revenue Standard, (2) the change in the way in which we present mobile platform fees and (3) our operations. The amount attributable to our operations is equivalent to the difference between current and prior period net revenues under the Old Revenue Standard. For more information on the adoption of the New Revenue Standard, including information related to the

change in how we report mobile revenue, please see Part I, Item 1 of this Form 10-Q in the Notes to Condensed Consolidated Financial Statements in Note 1 under the heading “Recently Adopted Accounting Standards”.



Table of Contents

## Net Revenue

Net revenue from our operations for the three months ended September 30, 2018 decreased \$5 million, as compared to the three months ended September 30, 2017. This decrease was driven by a \$214 million decrease in revenue primarily from the Battlefield franchise and Mass Effect: Andromeda. This decrease was partially offset by a \$209 million increase in revenue primarily from the Star Wars, The Sims and FIFA franchises.

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

Our Net Revenue by Product revenue and Service and other revenue for the three months ended September 30, 2018 and 2017 was as follows (in millions):

|                   |         | Three Months Ended September 30, |         | Changes due to: |                      |             |
|-------------------|---------|----------------------------------|---------|-----------------|----------------------|-------------|
|                   |         |                                  |         | ASC 606         | Mobile Platform Fees | Operational |
| 2018              | 2017    | Total Change                     | Adopted | ASC 606         |                      |             |
| Net revenue:      |         |                                  |         |                 |                      |             |
| Product           | \$623   | \$454                            | \$ 169  | \$186           | \$ —                 | \$ (17 )    |
| Service and other | 663     | 505                              | 158     | 102             | 44                   | 12          |
| Total net revenue | \$1,286 | \$959                            | \$ 327  | \$288           | \$ 44                | \$ (5 )     |

## Product Revenue

Product net revenue from our operations for the three months ended September 30, 2018 decreased \$17 million, as compared to the three months ended September 30, 2017. This decrease was driven by a \$194 million decrease primarily from Battlefield I and Mass Effect: Andromeda. This decrease was partially offset by a \$177 million increase primarily from Star Wars Battlefront II, The Sims 4 and Need for Speed Payback.

## Service and Other Revenue

Service and other net revenue from our operations for the three months ended September 30, 2018 increased \$12 million, as compared to the three months ended September 30, 2017. This increase was driven by a \$57 million increase primarily from FIFA Ultimate Team and Madden Ultimate Team. This increase was partially offset by a \$45 million decrease primarily from Star Wars: The Old Republic, Mass Effect: Andromeda, SimCity Mobile, Plants vs. Zombies: Garden Warfare 2 and Need for Speed 2015.

## Supplemental Net Revenue by Composition

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

Table of Contents

Our net revenue by composition for the three months ended September 30, 2018 and 2017 was as follows (in millions):

|                          | Three Months Ended September 30, |        |              | Changes due to:  |             |                      |
|--------------------------|----------------------------------|--------|--------------|------------------|-------------|----------------------|
|                          | 2018                             | 2017   | Total Change | ASC 606 Adoption | Mobile Fees | Platform Operational |
| Net revenue:             |                                  |        |              |                  |             |                      |
| Full game downloads      | \$ 148                           | \$ 123 | \$ 25        | \$ 32            | \$ —        | \$ (7 )              |
| Live services            | 412                              | 408    | 4            | (22 )            | —           | 26                   |
| Mobile                   | 220                              | 158    | 62           | 27               | 44          | (9 )                 |
| Total Digital            | \$ 780                           | \$ 689 | \$ 91        | \$ 37            | \$ 44       | \$ 10                |
| Packaged goods and other | \$ 506                           | \$ 270 | \$ 236       | \$ 251           | \$ —        | \$ (15 )             |
| Total net revenue        | \$ 1,286                         | \$ 959 | \$ 327       | \$ 288           | \$ 44       | \$ (5 )              |

## Digital Net Revenue

Digital net revenue includes full-game downloads, live services, and mobile revenue. Full game downloads includes revenue from digital sales of full games on console and PC. Live services includes revenue from sales of extra content for console, PC, browser games, game software licensed to our third-party publishing partners who distribute our games digitally, subscriptions, and advertising. Mobile includes revenue from the sale of full games and extra content on mobile phones and tablets.

Digital net revenue from our operations for the three months ended September 30, 2018 increased \$10 million, as compared to the three months ended September 30, 2017. This increase is due to a \$26 million increase in live services revenue primarily driven by our Ultimate Team game mode, offset by a \$9 million decrease in mobile revenue primarily driven by FIFA Online 3 in Asia and a \$7 million decrease in full-game download revenue primarily driven by Mass Effect: Andromeda.

## Packaged Goods and Other Net Revenue

Packaged goods net revenue includes revenue from software that is distributed physically. This includes (1) net revenue from game software distributed physically through traditional channels such as brick and mortar retailers, and (2) our software licensing revenue from third parties (for example, makers of console platforms, personal computers or computer accessories) who include certain of our products for sale with their products (“OEM bundles”). Other revenue includes our non-software licensing revenue.

Packaged goods and other net revenue from our operations for the three months ended September 30, 2018 decreased \$15 million, as compared to the three months ended September 30, 2017. This decrease was driven by a \$131 million decrease primarily from Battlefield 1 and Mass Effect: Andromeda, partially offset by a \$116 million increase primarily from Star Wars Battlefront II and the Need for Speed franchise.

## Net Revenue Year-to-Date Analysis

## Net Revenue

Net revenue from our operations for the six months ended September 30, 2018 decreased \$38 million, as compared to the six months ended September 30, 2017. This decrease was driven by a \$601 million decrease in revenue primarily from the Battlefield franchise and Mass Effect: Andromeda. This decrease was partially offset by a \$563 million increase in revenue primarily from the Star Wars, FIFA and The Sims franchises.

Table of Contents

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

Our Net Revenue by Product revenue and Service and other revenue for the six months ended September 30, 2018 and 2017 was as follows (in millions):

|                   |         | Six Months Ended September 30, |                        |                            |                  |             |
|-------------------|---------|--------------------------------|------------------------|----------------------------|------------------|-------------|
|                   |         | Total<br>Change                | Changes due to:        |                            |                  | Operational |
| 2018              | 2017    |                                | ASC<br>606<br>Adoption | Mobile<br>Platform<br>Fees | under<br>ASC 606 |             |
| Net revenue:      |         |                                |                        |                            |                  |             |
| Product           | \$825   | \$1,282                        | \$(457 )               | \$(328)                    | \$ —             | \$ (129 )   |
| Service and other | 1,598   | 1,126                          | 472                    | 288                        | 93               | 91          |
| Total net revenue | \$2,423 | \$2,408                        | \$ 15                  | \$(40 )                    | \$ 93            | \$ (38 )    |

## Product Revenue

Product net revenue from our operations for the six months ended September 30, 2018 decreased \$129 million, as compared to the six months ended September 30, 2017. This decrease was driven by a \$570 million decrease primarily from Battlefield I and Mass Effect: Andromeda. This decrease was partially offset by a \$441 million increase primarily from Star Wars Battlefront II, Need for Speed Payback and The Sims 4.

## Service and Other Revenue

Service and other net revenue from our operations for the six months ended September 30, 2018 increased \$91 million as compared to the six months ended September 30, 2017. This increase was driven by a \$185 million increase primarily from FIFA Ultimate Team and Madden Ultimate Team. This increase was partially offset by a \$94 million decrease primarily from Mass Effect: Andromeda, SimCity Mobile, Star Wars: The Old Republic, Plants vs. Zombies: Garden Warfare 2 and Need for Speed 2015.

## Supplemental Net Revenue by Composition

Our net revenue by composition for the six months ended September 30, 2018 and 2017 was as follows (in millions):

|                          |         | Six Months Ended September 30, |                        |                            |                  |             |
|--------------------------|---------|--------------------------------|------------------------|----------------------------|------------------|-------------|
|                          |         | Total<br>Change                | Changes due to:        |                            |                  | Operational |
| 2018                     | 2017    |                                | ASC<br>606<br>Adoption | Mobile<br>Platform<br>Fees | under<br>ASC 606 |             |
| Net revenue:             |         |                                |                        |                            |                  |             |
| Full game downloads      | \$264   | \$332                          | \$(68 )                | \$(28)                     | \$ —             | \$ (40 )    |
| Live services            | 1,022   | 909                            | 113                    | 5                          | —                | 108         |
| Mobile                   | 451     | 327                            | 124                    | 37                         | 93               | (6 )        |
| Total Digital            | \$1,737 | \$1,568                        | \$ 169                 | \$ 14                      | \$ 93            | \$ 62       |
| Packaged goods and other | \$686   | \$840                          | \$(154 )               | \$(54)                     | \$ —             | \$ (100 )   |
| Total net revenue        | \$2,423 | \$2,408                        | \$ 15                  | \$(40)                     | \$ 93            | \$ (38 )    |

## Digital Net Revenue

Digital net revenue from our operations for the six months ended September 30, 2018 increased \$62 million, as compared to the six months ended September 30, 2017. This increase is due to a \$108 million increase in live services revenue primarily driven by our Ultimate Team game mode, offset by a \$40 million decrease in full-game download revenue primarily driven by Battlefield 1 and a \$6 million decrease in mobile revenue primarily driven by the transition from FIFA Online 3 to FIFA Online 4 in Asia.

Table of Contents

## Packaged Goods and Other Net Revenue

Packaged goods and other net revenue from our operations for the six months ended September 30, 2018 decreased \$100 million, as compared to the six months ended September 30, 2017. This decrease was driven by a \$368 million decrease primarily from Battlefield 1 and Mass Effect: Andromeda. This decrease was partially offset by a \$268 million increase primarily from Star Wars Battlefront II and the Need for Speed franchise.

## Cost of Revenue Quarterly Analysis

Cost of revenue for the three months ended September 30, 2018 and 2017 was as follows (in millions):

| Three Months Ended September 30, |       |        | Changes due to: |        |          |             |
|----------------------------------|-------|--------|-----------------|--------|----------|-------------|
| 2018                             | 2017  | Total  | ASC             | Mobile | Platform | Operational |
|                                  |       | Change | 606             | Fees   | Adoption | under       |
|                                  |       |        |                 | ASC    | 606      |             |
| Cost of revenue:                 |       |        |                 |        |          |             |
| Product                          | \$222 | \$300  | (78 )           | \$(58) | \$ —     | \$ (20 )    |
| Service and other                | 196   | 89     | 107             | 58     | 44       | 5           |
| Total cost of revenue            | \$418 | \$389  | \$ 29           | \$—    | \$ 44    | \$ (15 )    |

## Cost of Product Revenue

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

Cost of product revenue from operations decreased by \$20 million during the three months ended September 30, 2018, as compared to the three months ended September 30, 2017. This decrease was primarily due to a decrease in inventory and royalty costs associated with the Madden franchise.

## Cost of Service and Other Revenue

Cost of service and other revenue consists primarily of (1) royalty costs, (2) data center, bandwidth and server costs associated with hosting our online games and websites, (3) inventory costs, (4) platform processing fees from operating our website-based games on third party platforms, (5) credit card fees and (6) mobile platform fees associated with our mobile revenue (for transactions in which we are acting as the principal in the sale to the end customer).

Operationally, cost of service and other revenue remained relatively consistent in the three months ended September 30, 2018, as compared to the three months ended September 30, 2017.



Table of Contents

## Cost of Revenue Year-to-Date Analysis

Cost of revenue for the six months ended September 30, 2018 and 2017 was as follows (in millions):

|      |      | Six Months Ended September 30, |  | Changes due to: |          |             |
|------|------|--------------------------------|--|-----------------|----------|-------------|
|      |      | Total                          |  | ASC             | Platform | Operational |
| 2018 | 2017 | Change                         |  | 606             | Fees     |             |
|      |      |                                |  | Adoption        | under    |             |
|      |      |                                |  | ASC 606         |          |             |

Cost of revenue:

|                       |       |       |         |        |       |         |
|-----------------------|-------|-------|---------|--------|-------|---------|
| Product               | \$290 | \$364 | \$(74 ) | \$(68) | \$ —  | \$ (6 ) |
| Service and other     | 343   | 179   | 164     | 68     | 93    | 3       |
| Total cost of revenue | \$633 | \$543 | \$ 90   | \$—    | \$ 93 | \$ (3 ) |

## Cost of Product Revenue

Cost of product revenue from operations decreased by \$6 million during the six months ended September 30, 2018, as compared to the six months ended September 30, 2017. This decrease was primarily due to a decrease in inventory and royalty costs associated with the Madden franchise, offset by an increase in the royalty costs associated with A Way Out.

## Cost of Service and Other Revenue

Operationally, cost of service and other revenue remained relatively consistent in the six months ended September 30, 2018, as compared to the six months ended September 30, 2017.

## Research and Development

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

Research and development expenses for the three and six months ended September 30, 2018 and 2017 were as follows (in millions):

|                    | September 30,<br>2018 | % of Net<br>Revenue | September 30,<br>2017 | % of Net<br>Revenue | \$ Change | % Change |
|--------------------|-----------------------|---------------------|-----------------------|---------------------|-----------|----------|
| Three months ended | \$ 339                | 26 %                | \$ 331                | 35 %                | \$ 8      | 2 %      |
| Six months ended   | \$ 701                | 29 %                | \$ 656                | 27 %                | \$ 45     | 7 %      |

Research and development expenses increased by \$8 million, or 2 percent, during the three months ended September 30, 2018, as compared to the three months ended September 30, 2017. This \$8 million increase was primarily due to a \$13 million increase in personnel-related costs primarily driven by an increase in headcount in connection with the Respawn acquisition and continued investment in our studios during the third quarter of fiscal year 2018, and a \$5 million increase in facility-related costs. These increases were partially offset by a \$15 million decrease in development advances primarily resulting from the extinguishment of development advances payable to Respawn.



Research and development expenses increased by \$45 million, or 7 percent, during the six months ended September 30, 2018, as compared to the six months ended September 30, 2017. This \$45 million increase was primarily due to a (1) \$44 million increase in personnel-related costs primarily driven by an increase in headcount in connection with the Respawn acquisition and continued investment in our studios, (2) \$22 million increase in stock-based compensation in connection with the Respawn acquisition, and (3) a \$9 million increase in facility-related costs. These increases were partially offset by a \$35 million decrease in development advances primarily resulting from the extinguishment of development advances payable to Respawn.

Table of Contents

## Marketing and Sales

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

Marketing and sales expenses for the three and six months ended September 30, 2018 and 2017 were as follows (in millions):

|                    | September 30,<br>2018 | % of Net<br>Revenue | September 30,<br>2017 | % of Net<br>Revenue | \$ Change | % Change |
|--------------------|-----------------------|---------------------|-----------------------|---------------------|-----------|----------|
| Three months ended | \$ 146                | 11 %                | \$ 160                | 17 %                | \$ (14 )  | (9 )%    |
| Six months ended   | \$ 286                | 12 %                | \$ 281                | 12 %                | \$ 5      | 2 %      |

Marketing and sales expenses decreased by \$14 million, or 9 percent, during the three months ended September 30, 2018, as compared to the three months ended September 30, 2017. This \$14 million decrease was primarily due to a \$12 million decrease in advertising and promotional spending on the FIFA and Madden franchises.

Marketing and sales expenses remained relatively consistent during the six months ended September 30, 2018, as compared to the six months ended September 30, 2017.

## General and Administrative

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

General and administrative expenses for the three and six months ended September 30, 2018 and 2017 were as follows (in millions):

|                    | September 30,<br>2018 | % of Net<br>Revenue | September 30,<br>2017 | % of Net<br>Revenue | \$ Change | % Change |
|--------------------|-----------------------|---------------------|-----------------------|---------------------|-----------|----------|
| Three months ended | \$ 117                | 9 %                 | \$ 118                | 12 %                | \$ (1 )   | (1 )%    |
| Six months ended   | \$ 231                | 10 %                | \$ 223                | 9 %                 | \$ 8      | 4 %      |

General and administrative expenses remained relatively consistent during the three months ended September 30, 2018, as compared to the three months ended September 30, 2017.

General and administrative expenses increased by \$8 million, or 4 percent, during the six months ended September 30, 2018, as compared to the six months ended September 30, 2017. This \$8 million increase was primarily due to a \$7 million increase in personnel-related costs primarily resulting from an increase in headcount and a \$4 million increase in stock-based compensation.

Table of Contents

## Interest and Other Income (Expense), Net

Interest and other income (expense), net consists of interest income (expense), foreign currency transaction gains (losses) and net gains (losses) on foreign currency forward contracts.

Interest and other income (expense), net, for the three and six months ended September 30, 2018 and 2017 were as follows (in millions):

|                    | September 30,<br>2018 | % of Net<br>Revenue | September 30,<br>2017 | % of Net<br>Revenue | \$ Change | % Change |
|--------------------|-----------------------|---------------------|-----------------------|---------------------|-----------|----------|
| Three months ended | \$ 18                 | 1 %                 | \$ 3                  | 0.3 %               | 15        | 500 %    |
| Six months ended   | \$ 37                 | 2 %                 | \$ 9                  | 0.4 %               | 28        | 311 %    |

Interest and other income (expense), net, increased by \$15 million, or 500 percent, during the three months ended September 30, 2018, as compared to the three months ended September 30, 2017. This \$15 million increase was primarily due to an \$8 million increase in interest income and an \$8 million increase in gains on foreign currency. Interest and other income (expense), net, increased by \$28 million, or 311 percent, during the six months ended September 30, 2018, as compared to the six months ended September 30, 2017. This \$28 million increase was primarily due to a \$21 million increase in foreign currency gains on forward contracts and a \$19 million increase in interest income, partially offset by a \$10 million foreign currency translation gain as a result of the closure of our Switzerland distribution business in the six months ended September 30, 2017 with no comparable activity in the six months ended September 30, 2018.

## Income Taxes

Provision for income taxes for the three and six months ended September 30, 2018 and 2017 were as follows (in millions):

|                    | September<br>30, 2018 | Effective<br>Tax Rate | September<br>30, 2017 | Effective<br>Tax Rate |
|--------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Three Months Ended | \$ 21                 | 7.6 %                 | \$ (16 )              | 42.1 %                |
| Six Months Ended   | \$ 47                 | 7.9 %                 | \$ 89                 | 12.5 %                |

The provision for income taxes for the three and six months ended September 30, 2018 is based on our projected annual effective tax rate for fiscal year 2019, adjusted for specific items that are required to be recognized in the period in which they incur.

Our effective tax rate and resulting provision for income taxes for the three and six months ended September 30, 2018 was significantly impacted by the U.S. Tax Act, enacted on December 22, 2017. Our effective tax rate for the three and six months ended September 30, 2018 was 7.6 percent and 7.9 percent, respectively, as compared to 42.1 percent and 12.5 percent, respectively, for the same period in fiscal year 2018. The effective tax rate for the three and six months ended September 30, 2018 was impacted by the lower U.S. statutory tax rate as a result of the U.S. Tax Act and earnings realized in countries that have lower statutory tax rates, partially offset by less excess tax benefits from stock-based compensation recognized in the current period as compared to the same period in fiscal year 2018. When compared to the statutory rate of 21.0 percent, the effective tax rate for the three and six months ended September 30, 2018 was lower due to earnings realized in countries that have lower statutory tax rates and the recognition of excess tax benefits from stock-based compensation. Excluding excess tax benefits, our effective tax rate would have been 9.8 percent and 10.6 percent, respectively, for the three and six months ended September 30, 2018. The U.S. Tax Act significantly revised the U.S. corporate income tax system by, among other things, lowering the U.S. corporate income tax rates to 21 percent, generally implementing a territorial tax system and imposing a one-time transition tax on the deemed repatriation of undistributed earnings of foreign subsidiaries.

We recorded a provisional tax expense of \$235 million related to the U.S. Tax Act for the fiscal year ended March 31, 2018, \$192 million of which relates to the Transition Tax. During the three months ended September 30, 2018, we made no material adjustments to these provisional amounts. The final calculation of taxes attributable to the U.S. Tax Act may differ from our estimates, potentially materially, due to, among other things, changes in interpretations of the

U.S. Tax Act, our further analysis of the U.S. Tax Act, or any updates or changes to estimates that we have utilized to calculate the transition impacts.

Reasonable estimates of the impacts of the U.S. Tax Act are provided in accordance with SAB 118, the SEC guidance that allows for a measurement period of up to one year after the enactment date of the U.S. Tax Act to finalize the recording of the

Table of Contents

related tax impacts. We expect to complete the accounting under the U.S. Tax Act as soon as practicable, but in no event later than one year from the enactment date of the U.S. Tax Act.

The U.S. Tax Act creates new U.S. taxes on foreign earnings. Our provision for income taxes for the three and six months ended September 30, 2018 provisionally does not reflect any deferred tax impacts of the U.S. taxes on foreign earnings. Because of the complexity of the rules regarding the new tax on foreign earnings, we are continuing to evaluate this accounting policy election.

Table of Contents

## LIQUIDITY AND CAPITAL RESOURCES

| (In millions)              | As of<br>September<br>30, 2018 | As of<br>March<br>31, 2018 | Increase/(Decrease) |
|----------------------------|--------------------------------|----------------------------|---------------------|
| Cash and cash equivalents  | \$ 2,881                       | \$4,258                    | \$ (1,377 )         |
| Short-term investments     | 1,664                          | 1,073                      | 591                 |
| Total                      | \$ 4,545                       | \$5,331                    | \$ (786 )           |
| Percentage of total assets | 54 %                           | 62 %                       |                     |

| (In millions)   | Six Months<br>Ended<br>September 30, |         |          |
|---|--------------------------------------|---------|----------|
|   | 2018                                 | 2017    | Change   |
| Net cash provided by (used in) operating activities     | \$(6 )                               | \$228   | \$(234 ) |
| Net cash used in investing activities                   | (704 )                               | (408 )  | (296 )   |
| Net cash used in financing activities                   | (659 )                               | (351 )  | (308 )   |
| Effect of foreign exchange on cash and cash equivalents | (8 )                                 | 33      | (41 )    |
| Net decrease in cash and cash equivalents               | \$(1,377)                            | \$(498) | \$(879)  |

## Changes in Cash Flow

Operating Activities. Net cash used in operating activities increased by \$234 million during the six months ended September 30, 2018 as compared to the six months ended September 30, 2017. The increase is primarily driven by the timing of cash receipts related to the increase in digital net bookings that will be collected in the third quarter of fiscal year 2019, the timing of royalty payments, an increase in personnel-related costs and an increase in cash paid for taxes, offset by interest income and hedging activities.

Investing Activities. Net cash used in investing activities increased by \$296 million during the six months ended September 30, 2018 as compared to the six months ended September 30, 2017 primarily driven by a \$604 million decrease in proceeds from the sales and maturities of short-term investments and the payment of \$58 million in connection with mergers and acquisitions activity. This increase was partially offset by a \$366 million decrease in the purchase of short-term investments during the six months ended September 30, 2018 as compared to the six months ended September 30, 2017.

Financing Activities. Net cash used in financing activities increased by \$308 million during the six months ended September 30, 2018 as compared to the six months ended September 30, 2017 primarily due to a \$296 million increase in the repurchase and retirement of our common stock and a \$21 million decrease in proceeds from the exercise of stock options during the six months ended September 30, 2018 as compared to the six months ended September 30, 2017.

## Short-term Investments

Due to our mix of fixed and variable rate securities, our short-term investment portfolio is susceptible to changes in short-term interest rates. As of September 30, 2018, our short-term investments had gross unrealized losses of \$7 million, or less than 1 percent of the total in short-term investments, and gross unrealized gains 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.

## Senior Notes

In February 2016, we issued \$600 million aggregate principal amount of the 2021 Notes and \$400 million aggregate principal amount of the 2026 Notes. We used the net proceeds of \$989 million for general corporate purposes, including the payment of our formerly outstanding convertible notes and repurchases of our common stock. The

effective interest rate is 3.94% for the 2021 Notes and 4.97% for the 2026 Notes. Interest is payable semiannually in arrears, on March 1 and September 1 of each year. See Note 12 — Financing Arrangements to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our Senior Notes, which is incorporated by reference into this Item 2.

## Table of Contents

### Credit Facility

In March 2015, we entered into a \$500 million senior unsecured revolving credit facility with a syndicate of banks. As of September 30, 2018, no amounts were outstanding under the credit facility. See Note 12 — Financing Arrangements to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to the above items, which is incorporated by reference into this Item 2.

### Financial Condition

We believe that our cash, cash equivalents, short-term investments, cash generated from operations and available financing facilities will be sufficient to meet our operating requirements for at least the next 12 months, including working capital requirements, capital expenditures, debt repayment obligations, and potentially, future acquisitions, stock repurchases, or strategic investments. We may choose at any time to raise additional capital to repay debt, 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.

In May 2018, a Special Committee of our Board of Directors, on behalf of the full Board of Directors, authorized a program to repurchase up to \$2.4 billion of our common stock. This stock repurchase program supersedes and replaces the May 2017

program, and expires on May 31, 2020. Under this program, we may purchase stock in the open market or through privately negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans.

The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase a specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and six months ended September 30, 2018, we repurchased approximately 2.3 million and 4.0 million shares for approximately \$299 million and \$523 million, respectively, under this program.

In May 2017, a Special Committee of our Board of Directors, on behalf of the full Board of Directors, authorized a program to repurchase up to \$1.2 billion of our common stock. We repurchased approximately 0.6 million shares for approximately \$76 million under this program during the three months ended June 30, 2018. During the three and six months ended September 30, 2017, we repurchased approximately 1.3 million and 2.4 million shares for approximately \$153 million and \$272 million, respectively, under this program. This program was superseded and replaced by a new stock repurchase program approved in May 2018.

In May 2015, our Board of Directors authorized a program to repurchase up to \$1 billion of our common stock. We repurchased approximately 0.3 million shares for approximately \$31 million under this program during the three months ended June 30, 2017. We completed repurchases under the May 2015 program in April 2017.

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, which may include funding 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.

**Contractual Obligations and Commercial Commitments**

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

Table of Contents

OFF-BALANCE SHEET COMMITMENTS

As of September 30, 2018, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC, that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues and expenses, results of operations, liquidity, capital expenditures, or capital resources that are material to investors.

Table of Contents

Item 3: Quantitative and Qualitative Disclosures About Market Risk

**MARKET RISK**

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

**Foreign Currency Exchange Risk**

**Foreign Currency Exchange Rates.** International sales are a fundamental part of our business, and the strengthening of the U.S. dollar (particularly relative to the Euro, British pound sterling, Australian dollar, Chinese yuan and South Korean won) has a negative impact on our reported international net revenue, but a positive impact on our reported international operating expenses (particularly the Swedish krona and Canadian dollar) because these amounts are translated at lower rates as compared to periods in which the U.S. dollar is weaker. While we use foreign currency hedging contracts to mitigate some foreign currency exchange risk, these activities are limited in the protection that they provide us and can themselves result in losses.

**Cash Flow Hedging Activities.** We hedge a portion of our foreign currency risk related to forecasted foreign-currency-denominated sales and expense transactions by purchasing foreign currency forward contracts that generally have maturities of 18 months or less. These transactions are designated and qualify as cash flow hedges. Our hedging programs are designed to reduce, but do not entirely eliminate, the impact of currency exchange rate movements in net revenue and research and development expenses.

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

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

Notwithstanding our efforts to mitigate some foreign currency exchange risks, there can be no assurance that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations. As of September 30, 2018, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 20 percent would have resulted in potential declines in the fair value on our foreign currency forward contracts used in cash flow hedging of \$162 million or \$324 million, respectively. As of September 30, 2018, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 20 percent would have resulted in potential losses on our foreign currency forward contracts used in balance sheet hedging of \$80 million or \$159 million, respectively. This sensitivity analysis assumes an adverse shift of all foreign currency exchange rates; however, all foreign currency exchange rates do not always move in such manner and actual results may differ materially. See Note 5 — Derivative Financial Instruments to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our derivative financial instruments, which is incorporated by reference into this Item 3.

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our short-term investment portfolio. We manage our interest rate risk by maintaining an investment portfolio generally consisting of debt instruments of high credit quality and relatively short maturities. However, because short-term investments mature relatively quickly and,

if reinvested, are invested at the then-current market rates, interest income on a portfolio consisting of short-term investments is subject to market fluctuations to a greater extent 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. We do not use derivative financial instruments in our short-term investment portfolio.

Table of Contents

As of September 30, 2018, 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 (loss), net of tax, in stockholders' equity.

Notwithstanding our efforts to manage interest rate risks, there can be no assurance that we will be adequately protected against risks associated with interest rate fluctuations. Fluctuations in interest rates could have a significant impact on the fair value of our investment portfolio. The following table presents the hypothetical changes in the fair value of our short-term investment portfolio as of September 30, 2018, arising from potential changes in interest rates. The modeling technique estimates the change in fair value from immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points ("BPS"), 100 BPS, and 150 BPS.

| (In millions)                 | Valuation of Securities Given an Interest Rate Decrease of X Basis Points |           |          | Fair Value as of September 30, 2018 | 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               | \$744   | \$ 741    | \$ 738   | \$ 736                              | \$731   | \$ 728   | \$ 725   |
| U.S. Treasury securities      | 280   | 279       | 278      | 277                                 | 276   | 275      | 274      |
| U.S. agency securities        | 74  | 74        | 73       | 73                                  | 72  | 72       | 72       |
| Commercial paper              | 359   | 359       | 358      | 357                                 | 357   | 356      | 355      |
| Foreign government securities | 81  | 80        | 80       | 79                                  | 79  | 79       | 78       |
| Asset-backed securities       | 122   | 122       | 121      | 121                                 | 121   | 120      | 120      |
| Certificates of deposit       | 22  | 21        | 21       | 21                                  | 21  | 21       | 21       |
| Total short-term investments  | \$1,682   | \$ 1,676  | \$ 1,669 | \$ 1,664                            | \$1,657   | \$ 1,651 | \$ 1,645 |

Table of Contents

Item 4. Controls and Procedures

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 controls over financial reporting identified in connection with our evaluation that occurred during the fiscal quarter ended September 30, 2018 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Limitations on effectiveness of disclosure controls

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.

Table of Contents

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

Our business is intensely competitive and “hit” driven. We may not deliver “hit” products and services, or consumers may prefer our competitors’ products or services over our own.

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

We maintain a relatively limited product portfolio in an effort to focus on developing high-quality and engaging products with the potential to become hits. High-quality titles, even if highly-reviewed, may not turn into hit products. Many hit products within our industry are iterations of prior hit products with large established consumer bases and significant brand recognition, which makes competing in certain product categories challenging. In addition, hit products or services of our competitors may take a larger portion of consumer spending or time than we anticipate, which could cause our products and services to underperform relative to our expectations. Publishing a relatively small number of major titles each year also concentrates risk in those titles and means each major title has greater associated risk. A significant portion of our revenue historically has been derived from games and services based on a few popular franchises, and the underperformance of a single major title could have a material adverse impact on our financial results. For example, we have historically derived a significant portion of our net revenue from sales related to our largest and most popular game, FIFA, the annualized version of which is consistently one of the best-selling games in the marketplace. Any events or circumstances that negatively impact our FIFA franchise, such as game or service quality, the delay or cancellation of a product or service launch, or real or perceived security risks could negatively impact our financial results to a disproportionate extent.

The increased importance of live services revenue to our business heightens the risks associated with our limited product portfolio. Live services that are either poorly-received or provided in connection with underperforming games may generate lower than expected sales. Any lapse, delay or failure in our ability to provide high-quality live services content to consumers over an extended period of time could materially and adversely affect our financial results, consumer engagement with our live services, and cause harm to our reputation and brand. Our most popular live service is the Ultimate Team mode associated with our sports franchises. Any events or circumstances that negatively impact our ability to reliably provide content or sustain engagement for Ultimate Team, particularly FIFA Ultimate Team, would negatively impact our financial results to a disproportionate extent.

Technology changes rapidly in our business and we may fail to anticipate or successfully implement new technologies or adopt new business strategies, technologies or methods.

Rapid technology changes in our industry require us to anticipate, sometimes years in advance, which technologies we must develop, 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. For example, we are investing in the infrastructure for our EA Player Network which we expect will allow us to market and deliver content and services for our franchises more efficiently as well as enable new player-centric ways to discover and try new experiences. Such endeavors may involve significant risks and uncertainties, and no assurance can be given that the technology we choose to adopt and the products and services that we pursue will be successful. If we do not successfully implement these new technologies, our reputation and brand may be materially adversely affected and our financial condition and operating results may be impacted. We also may miss opportunities to adopt technology or develop products, services or new ways to engage with our games that become popular with



Table of Contents

consumers, which could adversely affect our financial results. It may take significant time and resources to shift our focus to such technologies, putting us at a competitive disadvantage.

Our development process usually starts with particular platforms and distribution methods in mind, and a range of technical development and feature 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 those of our competitors, less appealing to consumers, or both. If we cannot achieve our technology goals within the original development schedule for our products and services, then we may delay their release until these 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 experience security breaches and cyber threats.

Our industry is prone to, and our systems and networks are subject to, cyber-attacks, computer viruses, worms, phishing attacks, malicious software programs and other information security incidents that seek to exploit, disable, damage, disrupt or gain access to our networks, our products and services, supporting technological infrastructure, intellectual property and other assets. We expect these threats to our systems and networks to continue. In addition, we rely on technological infrastructure provided by third-party business partners to support the online functionality of our products and services. These business partners, as well as our channel partners, also are subject to cyber risks and threats. Both our partners and we have expended, and expect to continue to expend, financial and operational resources to implement certain systems, processes and technologies to guard against cyber risks and to help protect our data and systems. However, the techniques used to exploit, disable, damage, disrupt or gain access to our networks, our products and services, supporting technological infrastructure, intellectual property and other assets change frequently, continue to evolve in sophistication and volume, and often are not detected for long periods of time. Our systems, processes and technologies, and the systems, processes and technologies of our business partners, may not be adequate against all eventualities. In addition, the costs to respond to, mitigate, and/or notify affected parties of cyber-attacks and other security vulnerabilities are significant. Any failure to prevent or mitigate security breaches or cyber risks, or detect or respond adequately to a security breach or cyber risk, could result in a loss of anticipated revenue, interruptions to our products and services, cause us to incur significant remediation and notification costs, degrade the user experience, cause consumers to lose confidence in our products and services and significant legal and financial costs. This could harm our business, reputation and brand, disrupt our relationships with partners and customers and diminish our competitive position.

The virtual economies that we have established in many of our games are subject to abuse, exploitation and other forms of fraudulent activity that can negatively impact our business. Virtual economies involve the use of virtual currency and/or virtual assets that can be used or redeemed by a player within a particular game or service. The abuse or exploitation of our virtual economies include the illegitimate generation and sale of virtual items, including in black markets. Our online services have been impacted by in-game exploits and the use of automated or other fraudulent processes to generate virtual item or currency illegitimately, and such activity may continue. These abuses and exploits, and the steps that we take to address these abuses and exploits may result in a loss of anticipated revenue, increased costs to protect against or remediate these issues, interfere with players' enjoyment of a balanced game environment and cause harm to our reputation and brand.

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

In the course of our business, we collect, process, store and use consumer, employee and other information, including personal information, passwords, credit card information, gameplay details and banking information. Although we expend, and expect to continue to expend, financial and operational resources to create and enforce security measures, policies and controls that are designed to protect this information from improper or unauthorized access, acquisition and misuse and/or the uninformed disclosure, our security measures, policies and controls may not be able to successfully protect against all eventualities. The improper or unauthorized access, acquisition or misuse and/or uninformed disclosure of consumer and other information, or a perception that we do not adequately secure this information or provide consumers with adequate notice about the information that they authorize us to disclose, could result in legal liability, costly remedial measures, governmental and regulatory investigations, harm our profitability, reputation and brand, and cause our financial results to be materially affected. In addition, third party vendors and business partners receive access to information that we collect. These vendors and business partners may not prevent data security breaches with respect to the information we provide them or fully enforce our policies, contractual obligations and disclosures regarding the collection, use, storage, transfer and retention of personal data. A data security breach of one of our vendors or business partners

Table of Contents

could cause reputational and financial harm to them and us, negatively impact our ability to offer our products and services, and could result in legal liability, costly remedial measures, governmental and regulatory investigations, harm our profitability, reputation and brand, and cause our financial results to be materially affected.

We are subject to payment card association rules and obligations pursuant to contracts with payment card processors. Under these rules and obligations, if information is compromised, we could be liable to payment card issuers for the cost of associated expenses and penalties. In addition, if we fail to follow payment card industry security standards, even if no consumer information is compromised, we could incur significant fines or experience a significant increase in payment card transaction costs.

Data privacy, data protection, localization, security and consumer-protection laws are evolving, and the interpretation and application of these laws in the United States, Europe and elsewhere often are uncertain, contradictory and changing. For example, recent developments in Europe have created compliance uncertainty and increased the complexity of certain transfers of information from Europe to the United States. In addition, the European General Data Protection Regulation (GDPR), effective as of May 2018 applies to us because we receive and process the personal data of European Union residents. The GDPR contains significant penalties for non-compliance. It is possible that these laws may be interpreted or applied in a manner that is adverse to us, unforeseen, or otherwise inconsistent with our practices or that we may not adequately adapt our internal policies and/or procedures to evolving regulations, any of which could result in litigation, regulatory investigations and potential legal liability, require us to change our practices in a manner adverse to our business or limit access to our products and services in certain countries. As a result, our reputation and brand may be harmed, we could incur substantial costs, and we could lose both consumers and revenue.

We may experience outages, disruptions or degradations in our services, products and/or technological infrastructure.

The reliable performance of our products and services increasingly depends on the continuing operation and availability of our information technology systems and those of our external service providers, including third-party “cloud” computing services. Our games and services are complex software products, and maintaining the sophisticated technological infrastructure required to reliably deliver these games and services is expensive and complex. The reliable delivery and stability of our products and services could be adversely impacted by outages, disruptions, failures or degradations in our network and related infrastructure, as well as in the online platforms or services of key business partners who offer or support our products and services. Possible causes of these outages, disruptions, failures or degradations include natural disasters, power loss, terrorism, cyber-attacks, computer viruses, bugs or other malware or ransomware that may harm our systems. In addition, we occasionally migrate data among data centers and to third-party hosted environments and perform upgrades and maintenance on our systems.

If we were to experience an event that caused a significant system outage, disruption or degradation or if a transition among data centers or service providers or an upgrade or maintenance session encountered unexpected interruptions, unforeseen complexity or unplanned disruptions, our products and services may not be available to consumers or may not be delivered reliably and stably. As a result, our reputation and brand may be harmed, consumer engagement with our products and services may be reduced, and our revenue and profitability could be negatively impacted. We do not have redundancy for all our systems, many of our critical applications reside in only one of our data centers, and our disaster recovery planning may not account for all eventualities.

As our digital business grows, we will require an increasing amount of technical infrastructure, including network capacity and computing power to continue to satisfy the needs of consumers. We are investing, and expect to continue to invest, in technology, hardware and software to support our business, but it is possible that we may fail to scale effectively and grow our technical infrastructure to accommodate these increased demands, which may adversely affect the reliable and stable performance of our games and services, therefore negatively impacting engagement,

reputation, brand and revenue growth.

Negative perceptions about and responses to our brands, products, services and/or business practices may damage our business, and we may incur costs to address concerns.

Expectations regarding the quality, performance and integrity of our products and services are high. Players may be critical of our brands, products, services, business models and/or business practices for a wide variety of reasons, including perceptions about gameplay fun, fairness, game content, features or services, or objections to certain of our business practices. These negative responses may not be foreseeable. We also may not effectively manage these responses because of reasons within or outside of our control. For example, we have included in certain games the ability for players to purchase digital items, including in some instances virtual “packs”, “boxes” or “crates” that contain variable digital items. The inclusion of variable digital items in certain of our games has attracted the attention of our community and if the future implementation of these features creates a negative perception of gameplay fairness or other negative perceptions, our reputation and brand could be harmed and our revenue could be negatively impacted. In addition, we have taken actions, including delaying the release of our games and delaying or discontinuing features and services for our games, after taking into consideration, among other things, feedback from our community even if

Table of Contents

those decisions negatively impacted our operating results in the short term. We expect to continue to take actions to address concerns as appropriate, including actions that may result in additional expenditures and the loss of revenue. Negative sentiment about gameplay fairness, our business practices, business models or game content also can lead to investigations or increased scrutiny from governmental bodies and consumer groups, as well as litigation, which, regardless of their outcome, may be costly, damaging to our reputation and harm our business.

Our business depends on the success and availability of platforms developed by third parties and our ability to develop commercially successful products and services for those platforms.

The success of our business is driven in part by the commercial success and adequate supply of third party platforms for which we develop our products and services or through which our products and services are distributed. Our success also depends on our ability to accurately predict which platforms will be successful in the marketplace, our ability to develop commercially successful products and services for these platforms, our ability to simultaneously manage products and services on multiple platforms and our ability to effectively transition our products and services to new platforms. We must make product development decisions and commit significant resources well in advance of the commercial availability of new platforms, and we may incur significant expense to adjust our product portfolio and development efforts in response to changing consumer platform preferences. Additionally, we may enter into certain exclusive licensing arrangements that affect our ability to deliver or market products or services on certain platforms. A platform for which we are developing products and services may not succeed as expected or new platforms may take market share and interactive entertainment consumers away from platforms for which we have devoted significant resources. If consumer demand for the platforms for which we are developing products and services is lower than our expectations, we may be unable to fully recover the investments we have made in developing our products and services, and our financial performance will be harmed. Alternatively, a platform for which we have not devoted significant resources could be more successful than we initially anticipated, causing us to not be able to take advantage of meaningful revenue opportunities.

Government regulations applicable to us may negatively impact our business.

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, retention, consumer protection, content, advertising, localization, and information security, among others, have been adopted or are being considered for adoption by many jurisdictions and countries throughout the world. These laws could harm our business by limiting the products and services we can offer consumers or the manner in which we offer them. The costs of compliance with these laws may increase in the future as a result of changes in interpretation. Any failure on our part to comply with these laws or the application of these laws in an unanticipated manner may harm our business and result in penalties or significant legal liability.

Certain of our business models could be subject to new laws or regulations or evolving interpretations of existing laws and regulations. For example, the growth and development of electronic commerce, virtual items and virtual currency has prompted calls for laws and regulations that could limit or restrict the sale of our products and services or otherwise impact our products and services. In addition, we include modes in our games that allow players to compete against each other and manage player competitions that are based on our products and services. Although we structure and operate our skill-based competitions with applicable laws in mind, our skill-based competitions in the future could become subject to evolving laws and regulations. New laws related to these business models, or changes in the interpretation of current laws that impact these business models, could subject us to additional regulation and oversight, lessen the engagement with, and growth of, profitable business models, and expose us to increased compliance costs, significant liability, penalties and harm to our reputation and brand.

We are subject to laws in certain foreign countries, and adhere to industry standards in the United States, that mandate rating requirements or set other restrictions on the advertisement or distribution of interactive entertainment software based on content. In addition, certain foreign countries allow government censorship of interactive entertainment software products. Adoption of ratings systems, censorship or restrictions on distribution of interactive entertainment software based on content could harm our business by limiting the products we are able to offer to our customers. In addition, compliance with new and possibly inconsistent regulations for different territories could be costly, delay or prevent the release of our products in those territories.

We may not meet our product development schedules or key events, sports seasons and/or movies that are tied to our product release schedule to may be delayed, cancelled or poorly received.

Our ability to meet product development schedules is affected by a number of factors both within and outside our control, including feedback from our players, the creative processes involved, the coordination of large and sometimes geographically dispersed development teams, the complexity of our products and the platforms for which they are developed, the need to fine-tune our products prior to their release and, in certain cases, approvals from third parties. We have experienced development delays for our

## Table of Contents

products in the past, which caused us to delay or cancel release dates. We also seek to release certain products in conjunction with key events, such as the beginning of a sports season, major sporting event, or the release of a related movie. If such a key event were delayed, cancelled or poorly received, our sales likely would suffer materially. Any failure to meet anticipated production or release schedules likely would result in a delay of revenue and/or possibly a significant shortfall in our revenue, increase our development and/or marketing expenses, harm our profitability, and cause our operating results to be materially different than anticipated.

Historically our business has been highly seasonal with the highest percentage of our sales occurring in the quarter ending in December. While we expect this trend to continue in fiscal year 2019, there is no assurance that it will be so. If we miss key selling periods for products or services for any reason, including product delays or product cancellations our sales likely will suffer significantly. Additionally, macroeconomic conditions or the occurrence of unforeseen events that negatively impact consumer or retailer buying patterns, particularly during the quarter ending in December, likely will harm our financial performance disproportionately.

Our marketing and advertising efforts may fail to resonate with consumers.

Our products and services are marketed worldwide through a diverse spectrum of advertising and promotional programs, such as online and mobile advertising, television advertising, retail merchandising, marketing through websites, event sponsorship and direct communications with consumers including via email. Furthermore, an increasing portion of our marketing activity is taking place on social media platforms that are outside of our direct control. Our ability to sell our products and services is dependent in part upon the success of these programs, and changes to consumer preferences, marketing regulations, technology changes or service disruptions may negatively impact our ability to reach our customers. Moreover, if the marketing for our products and services fails 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, our business and operating results could be harmed.

We may not attract and retain key personnel.

The market for technical, creative, marketing and other personnel essential to the development, marketing and support of our products and services and management of our businesses is extremely competitive. Our leading position within the interactive entertainment industry makes us a prime target for recruiting our executives, as well as key creative and technical talent. We may experience significant compensation costs to hire and retain senior executives and other personnel that we deem critical to our success. If we cannot successfully recruit and retain qualified employees, or replace key employees following their departure, our ability to develop and manage our business will be impaired.

We may experience declines or fluctuations in the recurring portion of our business.

Our business model includes revenue that we deem recurring in nature, such as revenue from our annualized titles (e.g., FIFA and Madden NFL) and associated services, subscriptions and our ongoing mobile businesses. While we have been able to forecast the revenue from these areas of our business with greater relative confidence than for new games, services and business models, we cannot provide assurances that consumer demand will remain consistent. Furthermore, we may cease to offer games and services that we previously had deemed to be recurring in nature. Consumer demand may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our games and services, our ability to improve and innovate our annualized titles, our ability to adapt our games and services to new platforms and business models, outages and disruptions of online services, the games and services offered by our competitors, our marketing and advertising efforts or declines in consumer activity generally as a result of economic downturns, among others. The reception to our licensed sports games may be adversely impacted by circumstances outside our control impacting the sports leagues and organizations. Any decline or fluctuation in the recurring portion of our business may have a negative impact on our financial and operating

results.

65

---



Table of Contents

We could fail to successfully adopt new business models.

From time to time we seek to establish and implement new business models. Forecasting the success of any new business model is inherently uncertain and depends on a number of factors both within and outside of our control. Our actual revenue and profit for these businesses may be significantly greater or less than our forecasts. In addition, these new business models could fail, resulting in the loss of our investment in the development and infrastructure needed to support these new business models, as well as the opportunity cost of diverting management and financial resources away from more successful and established businesses. For example, we have devoted financial and operational resources to our subscription offerings without any assurance that these businesses will be financially successful. While we anticipate growth in this area of our business, consumer demand is difficult to predict as a result of a number of factors, including satisfaction with our products and services, our ability to provide engaging products and services, products and services offered by our competitors, reliability of our infrastructure, pricing, the actual or perceived security of our information technology systems and reductions in consumer spending levels. In addition, if our subscription offerings are successful, sales could be diverted from established business models. If we do not select a target price that is optimal for our subscription services, maintain our target pricing structure or correctly project renewal rates, our financial results may be harmed.

Acquisitions, investments, divestitures and other strategic transactions could result in operating difficulties and other negative consequences.

We have made and may continue to make acquisitions or enter 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 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 liabilities, that our due diligence process does not identify significant issues, liabilities or other challenges, diversion of management's attention from our other businesses, 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. In addition, we may not integrate these businesses successfully, for example with difficulties with the integration of business systems and technologies, the integration and retention of new employees, the implementation or remediation of the internal control environment of the acquired entity, or the maintenance of key business and customer relationships. These events could harm our operating results or financial condition. We also may divest or sell assets or a business and we may have difficulty selling such assets or business on acceptable terms in a timely manner. This could result in a delay in the achievement of our strategic objectives, cause us to incur additional expense, or the sale of such assets or business at a price or on terms that are less favorable than we anticipated.

We may be 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.

Many of our products and services are based on or incorporate intellectual property owned by others. For example, our EA Sports products include rights licensed from major sports leagues and players' associations and our Star Wars products include rights licensed from Disney. 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 ability to develop and successful and engaging games and services may be adversely affected and our revenue, profitability and cash flows may decline significantly. Competition for these licenses also may increase the amounts that we must pay to licensors and developers, through higher minimum guarantees or royalty rates, which could significantly increase our costs and reduce our profitability.

We rely on the systems of our platform partners who have significant influence over the products and services that we offer on their systems.

A significant percentage of our digital net revenue is attributable to sales of products and services through our significant platform partners, including Sony, Microsoft, Nintendo, Apple and Google. The concentration of a material portion of our digital sales in these platform partners exposes us to risks associated with these businesses. Any deterioration in the businesses of our platform partners could disrupt and harm our business, including by limiting the methods through which our digital products and services are offered and exposing us to collection risks.

In addition, our license agreements with our platform partners typically give them significant control over the approval, manufacturing and distribution of the products and services that we develop for their platform. In particular, our arrangements with Sony and Microsoft could, in certain circumstances, leave us unable to get our products and services approved, manufactured

Table of Contents

or distributed to customers. For our digital products and services delivered via digital channels maintained by, among others, Sony, Microsoft, Nintendo, Apple and Google, each respective platform partner has policies and guidelines that control the promotion and distribution of these titles and the features and functionalities that we are permitted to offer through the channel. In addition, we are dependent on our platform partners to invest in, and upgrade, digital commerce capabilities in a manner than corresponds to the way in which consumers purchase our products and services. Failure by our platform partners to keep pace with consumer preferences could have an adverse impact on our ability to merchandise and commercialize our products and services which could harm our business and/or financial results.

Moreover, certain of our platform partners can determine and change unilaterally certain key terms and conditions, including the ability to change their user and developer policies and guidelines. In many cases our platform partners also set the rates that we must pay to provide our games and services through their online channels, and retain flexibility to change their fee structures or adopt different fee structures for their online channels, which could adversely impact our costs, profitability and margins. In addition, our platform partners control the information technology systems through which online sales of our products and service channels are captured. If our platform partners establish terms that restrict our offerings through their platforms, significantly impact the financial terms on which these products or services are offered to our customers, or their information technology systems fail or cause an unanticipated delay in reporting, our business and/or financial results could be materially affected.

Our business is subject to risks generally associated with the entertainment industry.

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, 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.

Our business partners may be unable to honor their obligations to us or their actions may put us at risk.

We rely on various business partners, including third-party service providers, vendors, licensing partners, development partners, and licensees in many areas of our business. Their actions may put our business and our reputation and brand at risk. For example, we may have disputes with our business partners that may impact our business and/or financial results. In many cases, our business partners may be given access to sensitive and proprietary information in order to provide services and support to our teams, and they may misappropriate our information and engage in unauthorized use of it. In addition, the failure of these third parties to provide adequate services and technologies, or the failure of the third parties to adequately maintain or update their services and technologies, could result in a disruption to our business operations. Further, disruptions in the financial markets, economic downturns, poor business decisions, or reputational harm may adversely affect our business partners and they may not be able to continue honoring their obligations to us or we may cease our arrangements with them. 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 and our financial results could be materially affected.

The products or services we release may contain defects, bugs or errors.

Our products and services are extremely complex software programs, and are difficult to develop and distribute. We have quality controls in place to detect defects, bugs or other errors in our products and services before they are released. Nonetheless, these quality controls are subject to human error, overriding, and reasonable resource or technical constraints. Therefore, these quality controls and preventative measures may not be effective in detecting all

defects, bugs or errors in our products and services before they have been released into the marketplace. In such an event, the technological reliability and stability of our products and services could be below our standards and the standards of consumers and our reputation, brand and sales could be adversely affected. In addition, we could be required to, or may find it necessary to, offer a refund for the product or service, suspend the availability or sale of the product or service or expend significant resources to cure the defect, bug or error each of which could significantly harm our business and operating results.

We may be subject to claims of infringement of third-party intellectual property rights.

From time to time, third parties may claim that we have infringed their intellectual property rights. For example, patent holding companies may assert patent claims against us in which they seek to monetize patents they have purchased or otherwise obtained. Although we take steps to avoid knowingly violating the intellectual property rights of others, it is possible that third parties still may claim infringement.

Table of Contents

Existing or future infringement claims against us, whether valid or not, may be expensive to defend and divert the attention of our employees from business operations. Such claims or litigation could require us to pay damages and other costs. We also could be required to stop selling, distributing or supporting products, features or services which incorporate the affected intellectual property rights, redesign products, features or services 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 interactive entertainment 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.

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, disruptive to normal business operations and occupy a significant amount of our employees' time and attention. In addition, the outcome of any legal proceedings, claims, litigation, investigations or inquiries may be difficult to predict and could have a material adverse effect on our business, operating results, or financial condition.

Our products and brands are subject to the threat of piracy, unauthorized copying and other forms of intellectual property infringement.

We regard our products and brands as proprietary and take measures to protect our products, brands and other confidential information from infringement. We are aware that some unauthorized copying of our products and brands occurs, and if a significantly greater amount were to occur, it could negatively impact our business.

Piracy and other forms of unauthorized copying and use of our content and brands are persistent problems for us, and policing is difficult. Further, the laws of some countries in which our products are or may be distributed either do not protect our products and intellectual property rights to the same extent as the laws of the United States, or are poorly enforced. Legal protection of our rights may be ineffective in such countries. In addition, although we take steps to enforce and police our rights, factors such as the proliferation of technology designed to circumvent the protection measures used by our business partners or by us, the availability of broadband access to the Internet, the refusal of Internet service providers or platform holders to remove infringing content in certain instances, and the proliferation of online channels through which infringing product is distributed all have contributed to an expansion in unauthorized copying of our products and brands.

We may experience outages, disruptions and/or degradations of our infrastructure.

We may experience outages, disruptions and/or degradations of our infrastructure, including information technology system failures and network disruptions. These may be caused by natural disasters, cyber-incidents, weather events, power disruptions, telecommunications failures, failed upgrades of existing systems or migrations to new systems, acts of terrorism or other events, including cyber-attacks or malicious software programs that exploit vulnerabilities. System redundancy may be ineffective or inadequate, and our disaster recovery planning may not be sufficient for all eventualities. Such failures or disruptions could prevent access to our products, services or online stores selling our products and services or interruption in our ability to conduct critical business functions. Our corporate headquarters in Redwood City, CA and our studios in Los Angeles, California, Seattle, Washington and in Burnaby, British Columbia are located in seismically active regions, and certain of our game development activities and other essential business operations are conducted at these locations. An event that results in the disruption or degradation of any of

our critical business or information technology systems could harm our ability to conduct normal business operations and materially impact our reputation and brand, financial condition and operating results.

A significant portion of our packaged goods sales are made to a relatively small number of retail and distribution partners, and these sales may be disrupted.

We derive a significant percentage of our net revenue attributable to sales of our packaged goods products to our top retail and distribution partners. The concentration of a significant percentage of these sales through a few large partners could lead to a short-term disruption to our business if certain of these partners significantly reduced their purchases or ceased to offer our products. We also could be more vulnerable to collection risk if one or more of these partners experienced a deterioration of their business or declared bankruptcy. Additionally, receivables from these partners generally increase in our December fiscal quarter as sales

Table of Contents

of our products generally increase in anticipation of the holiday season. Having a significant portion of our packaged goods sales concentrated in a few partners could reduce our negotiating leverage with them. If one or more of these partners experience deterioration in their business, or become unable to obtain sufficient financing to maintain their operations, our business could be harmed.

External game developers may not meet product development schedules or otherwise honor their obligations.

We may contract with external game developers to develop our games or to publish or distribute their games. While we maintain contractual protections, we have less control over the product development schedules of games developed by external developers, and we depend on their ability to meet product development schedules. In addition, we may have disputes with external developers over game content, launch timing, achievement of certain milestones, the game development timeline, marketing campaigns or other matters. If we have disputes with external developers or they cannot meet product development schedules, acquire certain approvals or are otherwise unable or unwilling to honor their obligations to us, we may delay or cancel previously announced games, alter our launch schedule or experience increased costs and expenses, which could result in a delay or significant shortfall in anticipated revenue, harm our profitability and reputation, and cause our financial results to be materially affected.

Our financial results are subject to currency fluctuations.

International sales are a fundamental part of our business. For our fiscal year ended March 31, 2018, international net revenue comprised 59 percent of our total net revenue, and we expect our international business to continue to account for a significant portion of our total net revenue. As a result of our international sales, and also the denomination of our foreign investments and our cash and cash equivalents in foreign currencies, we are exposed to the effects of fluctuations in foreign currency exchange rates. Strengthening of the U.S. dollar, particularly relative to the Euro, British pound sterling, Australian dollar, Chinese yuan and South Korean won, has a negative impact on our reported international net revenue but a positive impact on our reported international operating expenses (particularly when the U.S. dollar strengthens against the Swedish krona and the Canadian dollar) because these amounts are translated at lower rates. We use foreign currency hedging contracts to mitigate some foreign currency risk. However, these activities are limited in the protection they provide us from foreign currency fluctuations and can themselves result in losses.

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

We have \$1 billion in senior unsecured notes outstanding as well as an unsecured committed \$500 million revolving credit facility. While the facility is currently undrawn, we may use the proceeds of any future borrowings for general corporate purposes. We may also enter into other financial instruments in the future.

Our indebtedness could affect our financial condition and future financial results by, among other things:

Requiring 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;

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

Increasing our vulnerability to adverse changes in general economic and industry conditions.

The agreements governing our indebtedness impose restrictions on us and require us to maintain compliance with specified covenants. In particular, the revolving credit facility includes a maximum capitalization ratio and minimum

liquidity requirements. Our ability to comply with these covenants may be affected by events beyond our control. If we breach any of these covenants and do not obtain a waiver from the lenders or noteholders, then, subject to applicable cure periods, our outstanding indebtedness may be declared immediately due and payable. In addition, changes by any rating agency to our credit rating may negatively impact the value and liquidity of both our debt and equity securities, as well as the potential costs associated with any potential refinancing our indebtedness.

Downgrades in our credit rating could also restrict our ability to obtain additional financing in the future and could affect the terms of any such financing.

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

We are subject to taxes in the United States and in various foreign jurisdictions. Significant judgment is required in determining our worldwide income tax provision, tax assets, and accruals for other taxes, and there are many transactions and calculations



Table of Contents

where the ultimate tax determination is uncertain. Our effective income tax rate is based in part on our corporate operating structure and the manner in which we operate our business and develop, value and use our intellectual property. Taxing authorities in jurisdictions in which we operate may challenge our methodologies for calculating our income tax provision or its underlying assumptions, which could increase our effective income tax rate and have an adverse impact on our results of operations and cash flows. In addition, our provision for income taxes could be adversely affected by our profit levels, changes in our business, changes in the mix of earnings in countries with differing statutory tax rates, changes in the elections we make, changes in applicable tax laws or interpretations of existing tax laws, or changes in the valuation allowance for deferred tax assets, as well as other factors. For example, the outcome of *Altera Corp. v. Commissioner*, currently pending before the Ninth Circuit Court of Appeals, as well as certain proposed regulations related to U.S. taxes on foreign earnings, could result in material changes to our consolidated financial statements.

The U.S. Tax Act, enacted on December 22, 2017, represents a significant overhaul to the U.S. federal tax code. This tax legislation lowers the U.S. statutory tax rate, but also includes a number of provisions that could significantly and adversely impact our U.S. federal income tax position in a reporting period, including the limitation or elimination of certain deductions or credits, and U.S. taxes on foreign earnings. The final calculation of tax expense resulting from the U.S. Tax Act may differ from our estimates, potentially materially. In addition, any further changes to tax laws applicable to corporate multinationals in the countries in which we do business could adversely affect our effective tax rates, cause us to change the way in which we structure our business or result in other costs.

We are also required to pay taxes other than income taxes, such as payroll, sales, use, value-added, net worth, property and goods and services taxes, in both the United States and foreign jurisdictions. Furthermore, we are regularly subject to audit by tax authorities with respect to both income and such other non-income taxes. Unfavorable audit results or tax rulings, or other changes resulting in significant additional tax liabilities, could have material adverse effects upon our earnings, cash flows, and financial condition.

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

Our reported financial results are impacted by the accounting standards promulgated by the SEC and national accounting standards bodies and the methods, estimates, and judgments that we use in applying our accounting policies. These methods, estimates, and judgments are subject to risks, uncertainties, assumptions and changes that could adversely affect our reported financial position and financial results. In addition, changes to applicable financial accounting standards could impact our reported financial position and financial results. For example, ASC 606, which we adopted at the beginning of fiscal year 2019, had a material impact on the way in which we recognize revenue and consequently, our diluted earnings per share. ASC 606 also required us to change how we present mobile platform fees. For more information on ASC 606 and other accounting standards, see Part I, Item 1 of this Form 10-Q in the Notes to the Condensed Consolidated Financial Statements in Note 1 — Description of Business and Basis of Presentation under the subheading “Recently Adopted Accounting Standards”.

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

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

The market price of our common stock historically has been, and we expect will continue to be, subject to significant fluctuations. These fluctuations may be due to factors specific to us (including those discussed in the risk factors above, as well as others not currently known to us or that we currently do not believe are material), to changes in securities analysts’ earnings estimates or ratings, to our results or future financial guidance falling below our

expectations and analysts' and investors' expectations, to factors affecting the entertainment, computer, software, Internet, media or electronics industries, to our ability to successfully integrate any acquisitions we may make, or to national or international economic conditions. In particular, economic downturns may contribute to the public stock markets experiencing extreme price and trading volume volatility. These broad market fluctuations could adversely affect the market price of our common stock.

Table of Contents

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

## Stock Purchase Programs

In May 2018, a Special Committee of our Board of Directors, on behalf of the full Board of Directors, authorized a program to

repurchase up to \$2.4 billion of our common stock. This stock repurchase program supersedes and replaces the May 2017

program, and expires on May 31, 2020. Under this program, we may purchase stock in the open market or through privately negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans.

The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability,

regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase a

specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and six months ended September 30, 2018, we repurchased approximately 2.3 million and 4.0 million shares for approximately \$299 million and \$523 million, respectively, under this program.

The following table summarizes the number of shares repurchased during the three months ended September 30, 2018:

| Fiscal Month                         | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price<br>Paid per<br>Share | Total   | Maximum<br>Dollar<br>Value that<br>May Still<br>Be<br>Purchased<br>Under the<br>Programs<br>(in<br>millions) |
|--------------------------------------|---|---------------------------------------|---|--|
|                                      |   |                                       | Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Programs |  |
| July 1, 2018 - July 28, 2018         | 605,297                                   | \$ 145.08                             | 605,297   | \$ 2,089   |
| July 29, 2018 - August 25, 2018      | 739,502                                   | \$ 129.55                             | 739,502   | \$ 1,993   |
| August 26, 2018 - September 29, 2018 | 989,512                                   | \$ 116.69                             | 989,512   | \$ 1,877   |
|                                      | 2,334,311                                 | \$ 128.13                             | 2,334,311   |  |

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 6. Exhibits

The exhibits listed in the accompanying index to exhibits on Page 72 are filed or incorporated by reference as part of this report.

Table of Contents

ELECTRONIC ARTS INC.  
 FORM 10-Q  
 FOR THE PERIOD ENDED SEPTEMBER 30, 2018  
 EXHIBIT INDEX

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

\*Management contract or compensatory plan or arrangement

\*\*Portions of this exhibit have been redacted pursuant to a confidential treatment request filed with the SEC.

Attached as Exhibit 101 to this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2018 are the following formatted in eXtensible Business Reporting Language ("XBRL"): (1) Condensed Consolidated Balance Sheets, (2) Condensed Consolidated Statements of Operations, (3) Condensed Consolidated Statements of Comprehensive Income, (4) Condensed Consolidated Statements of Cash Flows, and (5) Notes to Condensed Consolidated Financial Statements.

**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.

72

---

Table of Contents

ELECTRONIC ARTS INC.  
(Registrant)

DATED: /s/ Blake Jorgensen  
November 6, 2018 Blake Jorgensen  
Chief Operating Officer and  
Chief Financial Officer

73