

ELECTRONIC ARTS INC.  
Form 10-Q  
November 08, 2016  
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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, 2016  
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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

As of November 3, 2016, there were 301,755,509 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.



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## 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>2016 | March<br>31,<br>2016 <sup>(a)</sup> |
|--|-----------------------|-------------------------------------|
| <b>ASSETS</b>  |                       |                                     |
| Current assets:  |                       |                                     |
| Cash and cash equivalents  | \$ 1,746              | \$2,493                             |
| Short-term investments   | 1,520                 | 1,341                               |
| Receivables, net of allowances of \$105 and \$159, respectively  | 723                   | 233                                 |
| Inventories  | 50                    | 33                                  |
| Other current assets   | 221                   | 254                                 |
| Total current assets   | 4,260                 | 4,354                               |
| Property and equipment, net  | 431                   | 439                                 |
| Goodwill   | 1,709                 | 1,710                               |
| Acquisition-related intangibles, net   | 28                    | 57                                  |
| Deferred income taxes, net   | 366                   | 387                                 |
| Other assets   | 98                    | 103                                 |
| <b>TOTAL ASSETS</b>  | <b>\$ 6,892</b>       | <b>\$7,050</b>                      |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                       |                                     |
| Current liabilities:   |                       |                                     |
| Accounts payable   | \$ 206                | \$89                                |
| Accrued and other current liabilities  | 777                   | 710                                 |
| 0.75% convertible senior notes due 2016, net   | —                     | 161                                 |
| Deferred net revenue (online-enabled games)  | 1,067                 | 1,458                               |
| Total current liabilities  | 2,050                 | 2,418                               |
| Senior notes, net  | 990                   | 989                                 |
| Income tax obligations   | 86                    | 80                                  |
| Deferred income taxes, net   | 2                     | 2                                   |
| Other liabilities  | 156                   | 163                                 |
| Total liabilities  | 3,284                 | 3,652                               |
| Commitments and contingencies (See Note 11)  |                       |                                     |
| 0.75% convertible senior notes due 2016 (See Note 10)  | —                     | 2                                   |
| Stockholders' equity:  |                       |                                     |
| Common stock, \$0.01 par value. 1,000 shares authorized; 300 and 301 shares issued and outstanding, respectively | 3                     | 3                                   |
| Additional paid-in capital   | 1,153                 | 1,349                               |
| Retained earnings  | 2,462                 | 2,060                               |
| Accumulated other comprehensive loss   | (10                   | ) (16 )                             |
| Total stockholders' equity   | 3,608                 | 3,396                               |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>  | <b>\$ 6,892</b>       | <b>\$7,050</b>                      |

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

(a) Derived from audited Consolidated Financial Statements.



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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

| (Unaudited)  | Three Months<br>Ended |          | Six Months<br>Ended   |         |
|--|-----------------------|----------|-----------------------|---------|
| (In millions, except per share data)   | September 30,<br>2016 | 2015     | September 30,<br>2016 | 2015    |
| Net revenue:   |                       |          |                       |         |
| Product  | \$420                 | \$434    | \$1,104               | \$1,177 |
| Service and other  | 478                   | 381      | 1,065                 | 841     |
| Total net revenue  | 898                   | 815      | 2,169                 | 2,018   |
| Cost of revenue:   |                       |          |                       |         |
| Product  | 317                   | 335      | 407                   | 429     |
| Service and other  | 84                    | 74       | 173                   | 153     |
| Total cost of revenue  | 401                   | 409      | 580                   | 582     |
| Gross profit   | 497                   | 406      | 1,589                 | 1,436   |
| Operating expenses:  |                       |          |                       |         |
| Research and development   | 291                   | 265      | 585                   | 561     |
| Marketing and sales  | 143                   | 156      | 271                   | 279     |
| General and administrative   | 111                   | 101      | 219                   | 199     |
| Amortization of intangibles  | 1                     | 3        | 3                     | 4       |
| Total operating expenses   | 546                   | 525      | 1,078                 | 1,043   |
| Operating income (loss)  | (49 )                 | (119 )   | 511                   | 393     |
| Interest and other income (expense), net   | (3 )                  | (9 )     | (11 )                 | (12 )   |
| Income (loss) before provision for (benefit from) income taxes                     | (52 )                 | (128 )   | 500                   | 381     |
| Provision for (benefit from) income taxes  | (14 )                 | 12       | 98                    | 79      |
| Net income (loss)  | \$(38 )               | \$(140 ) | \$402                 | \$302   |
| Earnings (loss) per share:   |                       |          |                       |         |
| Basic  | \$(0.13)              | \$(0.45) | \$1.34                | \$0.97  |
| Diluted  | \$(0.13)              | \$(0.45) | \$1.28                | \$0.90  |
| Number of shares used in computation:  |                       |          |                       |         |
| Basic  | 301                   | 312      | 301                   | 311     |
| Diluted  | 301                   | 312      | 315                   | 334     |
| See accompanying Notes to Condensed Consolidated Financial Statements (unaudited). |                       |          |                       |         |

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

| (Unaudited)  | Three Months<br>Ended |         | Six Months<br>Ended |       |
|--|-----------------------|---------|---------------------|-------|
| (In millions)  | September<br>30,      |         | September<br>30,    |       |
|  | 2016                  | 2015    | 2016                | 2015  |
| Net income (loss)  | \$(38)                | \$(140) | \$402               | \$302 |
| Other comprehensive income (loss), net of tax:   |                       |         |                     |       |
| Change in unrealized net gains and losses on available-for-sale securities                     | (1 )                  | 2       | 1                   | 1     |
| Reclassification adjustment for net realized gains and losses on available-for-sale securities | (1 )                  | (1 )    | 1                   | (1 )  |
| Change in unrealized net gains and losses on derivative instruments                            | (1 )                  | 5       | 27                  | (8 )  |
| Reclassification adjustment for net realized gains and losses on derivative instruments        | (4 )                  | (4 )    | (10 )               | (7 )  |
| Foreign currency translation adjustments   | (6 )                  | (32 )   | (11 )               | (31 ) |
| Total other comprehensive income (loss), net of tax  | (13 )                 | (30 )   | 6                   | (46 ) |
| Total comprehensive income (loss)  | \$(51)                | \$(170) | \$408               | \$256 |

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| (Unaudited)   | Six Months<br>Ended   |         |
|---|-----------------------|---------|
| (In millions)   | September 30,<br>2016 | 2015    |
| <b>OPERATING ACTIVITIES</b>   |                       |         |
| Net income  | \$402                 | \$302   |
| Adjustments to reconcile net income to net cash used in operating activities: |                       |         |
| Depreciation, amortization and accretion                                      | 91                    | 99      |
| Loss on conversion of senior notes  | —                     | 6       |
| Stock-based compensation  | 96                    | 89      |
| Change in assets and liabilities:   |                       |         |
| Receivables, net  | (493 )                | (379 )  |
| Inventories   | (17 )                 | (26 )   |
| Other assets  | 54                    | 39      |
| Accounts payable  | 133                   | 126     |
| Accrued and other liabilities   | (34 )                 | (149 )  |
| Deferred income taxes, net  | 20                    | 1       |
| Deferred net revenue (online-enabled games)                                   | (391 )                | (170 )  |
| Net cash used in operating activities   | (139 )                | (62 )   |
| <b>INVESTING ACTIVITIES</b>   |                       |         |
| Capital expenditures  | (69 )                 | (42 )   |
| Proceeds from maturities and sales of short-term investments                  | 644                   | 513     |
| Purchase of short-term investments  | (824 )                | (551 )  |
| Net cash used in investing activities   | (249 )                | (80 )   |
| <b>FINANCING ACTIVITIES</b>   |                       |         |
| Payment of convertible notes  | (163 )                | (198 )  |
| Proceeds from issuance of common stock  | 31                    | 84      |
| Excess tax benefit from stock-based compensation                              | 37                    | 65      |
| Repurchase and retirement of common stock                                     | (256 )                | (258 )  |
| Net cash used in financing activities   | (351 )                | (307 )  |
| Effect of foreign exchange on cash and cash equivalents                       | (8 )                  | (21 )   |
| Decrease in cash and cash equivalents   | (747 )                | (470 )  |
| Beginning cash and cash equivalents   | 2,493                 | 2,068   |
| Ending cash and cash equivalents  | \$1,746               | \$1,598 |
| Supplemental cash flow information:   |                       |         |
| Cash paid during the period for income taxes, net                             | \$26                  | \$26    |
| Cash paid during the period for interest                                      | \$22                  | \$3     |
| Non-cash investing activities:  |                       |         |
| Change in accrued capital expenditures  | \$(17 )               | \$(6 )  |

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



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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. We develop, market, publish and distribute games, content and services that can be played by consumers on a variety of platforms, which include consoles (such as the PlayStation from Sony, and the Xbox from Microsoft), PCs, mobile phones and tablets. Some of our games are based on our wholly-owned intellectual property (e.g., Battlefield, Mass Effect, Need for Speed, The Sims and Plants vs. Zombies), and some of our games leverage content that we license from others (e.g., FIFA, Madden NFL and Star Wars). We also publish and distribute games developed by third parties (e.g., Titanfall). Our products and services may be purchased through multiple distribution channels, including physical and online retailers, platform providers such as console manufacturers, providers of free-to-download PC games, mobile carriers and directly through Origin, our own digital distribution platform.

Our fiscal year is reported on a 52- or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal year ending March 31, 2017 contains 52 weeks and ends on April 1, 2017. Our results of operations for the fiscal year ended March 31, 2016 contained 53 weeks and ended on April 2, 2016. Our results of operations for the three months ended September 30, 2016 and 2015 contained 13 weeks each and ended on October 1, 2016 and October 3, 2015, respectively. Our results of operations for the six months ended September 30, 2016 and 2015 contained 26 and 27 weeks, respectively, and ended on October 1, 2016 and October 3, 2015, 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, 2016, as filed with the United States Securities and Exchange Commission (“SEC”) on May 27, 2016.

Impact of Recently Issued Accounting Standards

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, related to simplifications of employee share-based payment accounting. This pronouncement eliminates the APIC pool concept and requires that excess tax benefits and tax deficiencies be recorded in the income statement when awards are settled. The pronouncement also addresses simplifications related to statement of cash flows classification, accounting for forfeitures, and minimum statutory tax withholding requirements. The pronouncement is effective for annual periods (and for interim periods within those annual periods) beginning after December 15, 2016. We are currently evaluating the timing and the impact of this new standard on our Consolidated Financial Statements and related disclosures.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments (Topic 825-10), which requires that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The ASU also impacts financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments.

The requirements will be effective for annual periods (and interim periods within those annual periods) beginning after December 15, 2017. We are currently evaluating the impact of this new standard on our Consolidated Financial Statements and related disclosures.

In March 2016, the FASB issued ASU 2016-04, Liabilities – Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products. The amendments in the ASU are designed to provide guidance and eliminate diversity in the accounting for derecognition of prepaid stored-value product liabilities. Typically, a prepaid stored-value product liability is to be derecognized when it is probable that a significant reversal of the recognized breakage amount will not subsequently occur. This is when the likelihood of the product holder exercising its remaining rights becomes remote. This estimate shall be updated at the end of each period. The amendments in this ASU are effective for annual periods (and interim periods within those annual periods) beginning after December 15, 2017. Early adoption is permitted. We are currently evaluating the timing of adoption and impact of this new standard on our Consolidated Financial Statements and related disclosures.

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In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This update is intended to reduce the existing diversity in practice in how certain transactions are classified in the statement of cash flows. This update is effective for annual periods (and interim periods within those annual periods) beginning after December 15, 2017. Early adoption is permitted, provided that all of the amendments are adopted in the same period. We are currently evaluating the timing of adoption and impact of this new standard on our Consolidated Statements of Cash Flows.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The standard permits the use of either the retrospective or cumulative effect transition method. This new revenue standard, as amended by ASU 2015-14, is effective in the first quarter of fiscal year 2019. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which clarifies the guidance in the new revenue standard on assessing whether an entity is a principal or an agent in a revenue transaction. This conclusion impacts whether an entity reports revenue on a gross or net basis. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing, which clarifies the guidance in the new revenue standard regarding an entity's identification of its performance obligations in a contract, as well as an entity's evaluation of the nature of its promise to grant a license of intellectual property and whether or not that revenue is recognized over time or at a point in time. In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients, which amends the guidance in the new revenue standard on collectibility, noncash consideration, presentation of sales tax, and transition. The amendments are intended to address implementation issues that were raised by stakeholders and provide additional practical expedients to reduce the cost and complexity of applying the new revenue standard. These amendments have the same effective date as the new revenue standard. While we are currently evaluating the method of adoption and the impact of the new revenue standard, as amended, on our Consolidated Financial Statements and related disclosures, we believe the adoption of the new standard will have a significant impact on the accounting for certain transactions with multiple elements or "bundled" arrangements (for example, sales of online-enabled games for which we do not have vendor-specific objective evidence of fair value ("VSOE") for unspecified future updates) because the requirement to have VSOE for undelivered elements under current accounting standards is eliminated under the new standard. Accordingly, we may be required to recognize as revenue a portion of the sales price upon delivery of the software, as compared to the current requirement of recognizing the entire sales price ratably over an estimated offering period. In addition, based upon what we expect to be our performance obligations under the new standard, as amended, we believe that upon adoption, a larger portion of our bundled arrangements will be presented as service revenue instead of product revenue in our Consolidated Statements of Operations.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The FASB issued this update to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The updated guidance is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption of the update is permitted. We are currently evaluating the timing of adoption and impact of this new standard on our 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 fiscal years, and interim periods within those years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2018. We are currently evaluating the timing of adoption and impact of this new standard on our Consolidated Financial Statements and related disclosures.

(2) FAIR VALUE MEASUREMENTS

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

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## 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.

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

As of September 30, 2016 and March 31, 2016, 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                                |
|---|---|---|---|--|---|
|   | As of<br>September<br>30,<br>2016               | Quoted Prices in<br>Active Markets<br>for<br>Identical<br>Financial<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |   |
| <b>Assets</b>   |   |   |   |  |   |
| Bank and time deposits                                | \$ 236  | \$ 236  | \$ —  | \$ —   | Cash equivalents  |
| Money market funds                                    | 185   | 185   | —   | —  | Cash equivalents  |
| Available-for-sale securities:                        |   |   |   |  |   |
| Corporate bonds                                       | 739   | —   | 739   | —  | Short-term investments                                      |
| U.S. Treasury securities                              | 379   | 379   | —   | —  | Short-term investments                                      |
| U.S. agency securities                                | 163   | —   | 163   | —  | Short-term investments and cash equivalents                 |
| Commercial paper                                      | 110   | —   | 110   | —  | Short-term investments and cash equivalents                 |
| Foreign government securities                         | 115   | —   | 115   | —  | Short-term investments                                      |
| Asset-backed securities                               | 54  | —   | 54  | —  | Short-term investments                                      |
| Foreign currency derivatives                          | 33  | —   | 33  | —  | Other current assets and other assets                       |
| Deferred compensation plan assets <sup>(a)</sup>      | 9   | 9   | —   | —  | Other assets  |
| <b>Total assets at fair value</b>                     | <b>\$ 2,023</b>                                 | <b>\$ 809</b>   | <b>\$ 1,214</b>   | <b>\$ —</b>  |   |
| <b>Liabilities</b>                                    |   |   |   |  |   |
| Foreign currency derivatives                          | 11  | —   | 11  | —  | Accrued and other current liabilities and other liabilities |
| Deferred compensation plan liabilities <sup>(a)</sup> | 10  | 10  | —   | —  | Other liabilities   |
| <b>Total liabilities at fair value</b>                | <b>\$ 21</b>                                    | <b>\$ 10</b>  | <b>\$ 11</b>  | <b>\$ —</b>  |   |



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|   | Fair Value Measurements at Reporting Date Using |  |   |   | Balance Sheet Classification                                |
|---|---|--|---|---|---|
|   | As of<br>March<br>31,<br>2016                   | Quoted Prices in<br>Active Markets<br>for Identical<br>Financial<br>Instruments<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level<br>3) |   |
| <b>Assets</b>   |   |  |   |   |   |
| Bank and time deposits                                | \$ 345  | \$ 345   | \$ —  | \$ —  | Cash equivalents  |
| Money market funds                                    | 143   | 143  | —   | —   | Cash equivalents  |
| Available-for-sale securities:                        |   |  |   |   |   |
| Corporate bonds                                       | 623   | —  | 623   | —   | Short-term investments and cash equivalents                 |
| U.S. Treasury securities                              | 407   | 407  | —   | —   | Short-term investments and cash equivalents                 |
| U.S. agency securities                                | 170   | —  | 170   | —   | Short-term investments and cash equivalents                 |
| Commercial paper                                      | 81  | —  | 81  | —   | Short-term investments and cash equivalents                 |
| Foreign government securities                         | 122   | —  | 122   | —   | Short-term investments and cash equivalents                 |
| Foreign currency derivatives                          | 16  | —  | 16  | —   | Other current assets and other assets                       |
| Deferred compensation plan assets <sup>(a)</sup>      | 8   | 8  | —   | —   | Other assets  |
| <b>Total assets at fair value</b>                     | <b>\$ 1,915</b>                                 | <b>\$ 903</b>  | <b>\$ 1,012</b>   | <b>\$ —</b>   |   |
| <b>Liabilities</b>                                    |   |  |   |   |   |
| Foreign currency derivatives                          | 10  | —  | 10  | —   | Accrued and other current liabilities and other liabilities |
| Deferred compensation plan liabilities <sup>(a)</sup> | 9   | 9  | —   | —   | Other liabilities   |
| <b>Total liabilities at fair value</b>                | <b>\$ 19</b>                                    | <b>\$ 9</b>  | <b>\$ 10</b>  | <b>\$ —</b>   |   |

The Deferred Compensation Plan assets consist of various mutual funds. See Note 15 in our Annual Report on (a) Form 10-K for the fiscal year ended March 31, 2016, for additional information regarding our Deferred Compensation Plan.

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

As of September 30, 2016 and March 31, 2016, our cash and cash equivalents were \$1,746 million and \$2,493 million, respectively. Cash equivalents were valued at their carrying amounts as they approximate fair value due to the short maturities of these financial instruments.

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## Short-Term Investments

Short-term investments consisted of the following as of September 30, 2016 and March 31, 2016 (in millions):

|                               | As of September 30, 2016 |       |                   |            | As of March 31, 2016 |       |                   |            |
|-------------------------------|--------------------------|-------|-------------------|------------|----------------------|-------|-------------------|------------|
|                               | Amortized Cost           | Gains | Unrealized Losses | Fair Value | Amortized Cost       | Gains | Unrealized Losses | Fair Value |
| Corporate bonds               | \$738                    | \$ 1  | \$                | —\$739     | \$620                | \$ 1  | \$                | —\$621     |
| U.S. Treasury securities      | 378                      | 1     | —                 | 379        | 389                  | 1     | —                 | 390        |
| U.S. agency securities        | 154                      | —     | —                 | 154        | 167                  | —     | —                 | 167        |
| Commercial paper              | 79                       | —     | —                 | 79         | 50                   | —     | —                 | 50         |
| Foreign government securities | 115                      | —     | —                 | 115        | 113                  | —     | —                 | 113        |
| Asset-backed securities       | 54                       | —     | —                 | 54         | —                    | —     | —                 | —          |
| Short-term investments        | \$1,518                  | \$ 2  | \$                | —\$1,520   | \$1,339              | \$ 2  | \$                | —\$1,341   |

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of September 30, 2016 and March 31, 2016 (in millions):

|                        | As of September 30, 2016 |            | As of March 31, 2016 |            |
|------------------------|--------------------------|------------|----------------------|------------|
|                        | Amortized Cost           | Fair Value | Amortized Cost       | Fair Value |
| Short-term investments |                          |            |                      |            |
| Due in 1 year or less  | \$749                    | \$749      | \$571                | \$571      |
| Due in 1-2 years       | 415                      | 416        | 461                  | 462        |
| Due in 2-3 years       | 295                      | 296        | 295                  | 296        |
| Due in 3-4 years       | 59                       | 59         | 12                   | 12         |
| Short-term investments | \$1,518                  | \$1,520    | \$1,339              | \$1,341    |

## (4) DERIVATIVE FINANCIAL INSTRUMENTS

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

We transact business in various foreign currencies and have significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. We purchase foreign currency forward contracts, generally with maturities of 18 months or less, to reduce the volatility of cash flows primarily related to forecasted revenue and expenses denominated in certain foreign currencies. Our cash flow risks are primarily related to fluctuations in the Euro, British pound sterling, Canadian dollar, Swedish krona, Australian dollar, Chinese yuan and South Korean won. In addition, we utilize foreign currency forward contracts to mitigate foreign exchange risk associated with foreign-currency-denominated monetary assets and liabilities, including third party receivables and payables as well as intercompany balances. The foreign currency forward contracts not designated as hedging instruments generally have a contractual term of approximately 3 months or less and are transacted near month-end. We do not use foreign currency forward contracts for speculative trading purposes.



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## 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<br>30, 2016 |                     |                         | As of March 31,<br>2016 |                     |                         |
|-------------------------------|-----------------------------|---------------------|-------------------------|-------------------------|---------------------|-------------------------|
|                               | Notional<br>Amount          | Fair Value<br>Asset | Fair Value<br>Liability | Notional<br>Amount      | Fair Value<br>Asset | Fair Value<br>Liability |
| Forward contracts to purchase | \$137                       | \$—                 | \$ 2                    | \$148                   | \$5                 | \$ 1                    |
| Forward contracts to sell     | \$936                       | \$33                | \$ 9                    | \$685                   | \$11                | \$ 9                    |

The net impact of the effective portion of gains and losses from our cash flow hedging activities in our Condensed Consolidated Statements of Operations was a gain of \$5 million for the three months ended September 30, 2016 and a gain of \$4 million for the three months ended September 30, 2015.

The net impact of the effective portion of gains and losses from our cash flow hedging activities in our Condensed Consolidated Statements of Operations was a gain of \$11 million for the six months ended September 30, 2016 and a gain of \$7 million for the six months ended September 30, 2015.

During the three and six months ended September 30, 2016 and 2015, we reclassified an immaterial amount of the ineffective portion of gains or losses resulting from changes in fair value into interest and other income (expense), net. The amount excluded from the assessment of hedge effectiveness during three and six months ended September 30, 2016 and 2015 and recognized in interest and other income (expense), net, was immaterial.

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## Balance Sheet Hedging Activities

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

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

|                               | As of September<br>30, 2016 |                               | As of March 31,<br>2016 |                               |
|-------------------------------|-----------------------------|-------------------------------|-------------------------|-------------------------------|
|                               | Notional<br>Amount          | Fair Value<br>Asset/Liability | Notional<br>Amount      | Fair Value<br>Asset/Liability |
| Forward contracts to purchase | \$ 89                       | \$ —                          | —\$ 108                 | \$ —                          |
| Forward contracts to sell     | \$ 485                      | \$ —                          | —\$ 159                 | \$ —                          |

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, 2016 and 2015 was immaterial, and is included in interest and other income (expense), net.

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

The changes in accumulated other comprehensive income (loss) by component, net of tax, for the three months ended September 30, 2016 and 2015 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, 2016  | \$ 3   | \$ 36   | \$ (36 )  | \$ 3   |
| Other comprehensive income (loss) before reclassifications              | (1 )   | (1 )  | (6 )  | (8 )   |
| Amounts reclassified from accumulated other comprehensive income (loss) | (1 )   | (4 )  | —   | (5 )   |
| Total other comprehensive income (loss), net of tax                     | (2 )   | (5 )  | (6 )  | (13 )  |
| Balance as of September 30, 2016  | \$ 1   | \$ 31   | \$ (42 )  | \$(10) |
|   | 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, 2015  | \$ (4 )  | \$ 5  | \$ (15 )  | \$(14) |
| Other comprehensive income (loss) before reclassifications              | 2  | 5   | (32 )   | (25 )  |
| Amounts reclassified from accumulated other comprehensive income (loss) | (1 )   | (4 )  | —   | (5 )   |
| Total other comprehensive income (loss), net of tax                     | 1  | 1   | (32 )   | (30 )  |
| Balance as of September 30, 2015  | \$ (3 )  | \$ 6  | \$ (47 )  | \$(44) |

The changes in accumulated other comprehensive income (loss) by component, net of tax, for the six months ended September 30, 2016 and 2015 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, 2016   | \$ 1   | \$ 14   | \$ (31 )  | \$(16) |
| Other comprehensive income (loss) before reclassifications              | 1  | 27  | (11 )   | 17     |
| Amounts reclassified from accumulated other comprehensive income (loss) | (1 )   | (10 )   | —   | (11 )  |
| Total other comprehensive income (loss), net of tax                     | —  | 17  | (11 )   | 6      |
| Balance as of September 30, 2016  | \$ 1   | \$ 31   | \$ (42 )  | \$(10) |
|   | 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  |

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|   |         |       |          |        |
|---|---------|-------|----------|--------|
| Balances as of March 31, 2015   | \$ (3 ) | \$ 21 | \$ (16 ) | \$ 2   |
| Other comprehensive income (loss) before reclassifications              | 1       | (8 )  | (31 )    | (38 )  |
| Amounts reclassified from accumulated other comprehensive income (loss) | (1 )    | (7 )  | —        | (8 )   |
| Total other comprehensive income (loss), net of tax                     | —       | (15 ) | (31 )    | (46 )  |
| Balance as of September 30, 2015  | \$ (3 ) | \$ 6  | \$ (47 ) | \$(44) |

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The effects on net income of amounts reclassified from accumulated other comprehensive income (loss) for the three and six months ended September 30, 2016 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>2016                                  | Six<br>Months<br>Ended<br>September<br>30, 2016 |
| (Gains) losses on available-for-sale securities           |   |   |
| Interest and other income (expense), net                  | \$ (1 )   | \$ (1 )   |
| Net of tax  | \$ (1 )   | \$ (1 )   |
| (Gains) losses on cash flow hedges from forward contracts |   |   |
| Net revenue   | \$ (4 )   | \$ (9 )   |
| Research and development                                  | —   | (1 )  |
| Net of tax  | \$ (4 )   | \$ (10 )  |
| Total (gain) loss reclassified, net of tax                | \$ (5 )   | \$ (11 )  |

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

| Statement of Operations Classification                    | Amount<br>Reclassified From<br>Accumulated<br>Other<br>Comprehensive<br>Income (Loss) |   |
|---|---|---|
|   | Three<br>Months<br>Ended<br>September<br>30,<br>2015                                  | Six<br>Months<br>Ended<br>September<br>30, 2015 |
| (Gains) losses on available-for-sale securities           |   |   |
| Interest and other income (expense), net                  | \$ (1 )   | \$ (1 )   |
| Net of tax  | \$ (1 )   | \$ (1 )   |
| (Gains) losses on cash flow hedges from forward contracts |   |   |
| Net revenue   | \$ (6 )   | \$ (14 )  |
| Research and development                                  | 2   | 7   |
| Net of tax  | \$ (4 )   | \$ (7 )   |
| Total (gain) loss reclassified, net of tax                | \$ (5 )   | \$ (8 )   |

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

The changes in the carrying amount of goodwill for the six months ended September 30, 2016 are as follows (in millions):

|                        | As of<br>March<br>31,<br>2016 | Activity | Effects of<br>Foreign<br>Currency<br>Translation | As of<br>September<br>30, 2016 |
|------------------------|-------------------------------|----------|--|--------------------------------|
| Goodwill               | \$2,078                       | \$       | —\$ (1 )   | \$ 2,077                       |
| Accumulated impairment | (368 )                        | —        | —  | (368 )                         |
| Total                  | \$1,710                       | \$       | —\$ (1 )   | \$ 1,709                       |

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

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

|  | As of September 30, 2016 |                          |                                      | As of March 31, 2016  |                          |                                      |
|--|--------------------------|--------------------------|--------------------------------------|-----------------------|--------------------------|--------------------------------------|
|  | Gross Carrying Amount    | Accumulated Amortization | Acquisition-Related Intangibles, Net | Gross Carrying Amount | Accumulated Amortization | Acquisition-Related Intangibles, Net |
| Developed and core technology              | \$412                    | \$ (395)                 | \$ 17                                | \$412                 | \$ (368)                 | \$ 44                                |
| Trade names and trademarks                 | 106                      | (95)                     | 11                                   | 106                   | (93)                     | 13                                   |
| Registered user base and other intangibles | 5                        | (5)                      | —                                    | 5                     | (5)                      | —                                    |
| Carrier contracts and related              | 85                       | (85)                     | —                                    | 85                    | (85)                     | —                                    |
| Total                                      | \$608                    | \$ (580)                 | \$ 28                                | \$608                 | \$ (551)                 | \$ 57                                |

Amortization of intangibles for the three and six months ended September 30, 2016 and 2015 are classified in the Condensed Consolidated Statement of Operations as follows (in millions):

|                           | Three Months Ended September 30, 2016 |       | Six Months Ended September 30, 2015 |       |
|---------------------------|---------------------------------------|-------|-------------------------------------|-------|
|                           | 2016                                  | 2015  | 2016                                | 2015  |
| Cost of service and other | \$ 8                                  | \$ 8  | \$ 16                               | \$ 16 |
| Cost of product           | 4                                     | 3     | 9                                   | 7     |
| Operating expenses        | 1                                     | 3     | 3                                   | 4     |
| Total                     | \$ 13                                 | \$ 14 | \$ 28                               | \$ 27 |

Acquisition-related intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the agreement terms, typically from 2 to 14 years. As of September 30, 2016 and March 31, 2016, the weighted-average remaining useful life for acquisition-related intangible assets was approximately 1.6 years and 1.6 years, respectively.

As of September 30, 2016, future amortization of acquisition-related intangibles that will be recorded in the Condensed Consolidated Statement of Operations is estimated as follows (in millions):

|                              |      |
|------------------------------|------|
| Fiscal Year Ending March 31, |      |
| 2017 (remaining six months)  | \$9  |
| 2018                         | 17   |
| 2019                         | 2    |
| Total                        | \$28 |

**(7) ROYALTIES AND LICENSES**

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

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

royalty-based in nature) are generally expensed as cost of revenue.

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



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amounts will be recognized in our Condensed Consolidated Statements of Operations within the next 12 months. Royalty liabilities are classified as current liabilities to the extent such royalty payments are contractually due within the next 12 months.

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

During the three and six months ended September 30, 2016 and 2015, 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, 2016 | As of<br>March<br>31,<br>2016 |
|------------------------|--------------------------------|-------------------------------|
| Other current assets   | \$ 69                          | \$ 54                         |
| Other assets           | 54                             | 63                            |
| Royalty-related assets | \$ 123                         | \$ 117                        |

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, 2016 | As of<br>March<br>31,<br>2016 |
|-----------------------------|--------------------------------|-------------------------------|
| Accrued royalties           | \$ 162                         | \$ 159                        |
| Other liabilities           | 111                            | 118                           |
| Royalty-related liabilities | \$ 273                         | \$ 277                        |

As of September 30, 2016, we were committed to pay approximately \$1,425 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 11 for further information on our developer and licensor commitments.

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

Inventories as of September 30, 2016 and March 31, 2016 consisted of (in millions):

|                                   | As of<br>September<br>30, 2016 | As of<br>March<br>31,<br>2016 |
|-----------------------------------|--------------------------------|-------------------------------|
| Finished goods                    | \$ 41                          | \$ 32                         |
| Raw materials and work in process | 9                              | 1                             |

Inventories                                   \$ 50     \$ 33

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## Property and Equipment, Net

Property and equipment, net, as of September 30, 2016 and March 31, 2016 consisted of (in millions):

|  | As of<br>September<br>30, 2016 | As of<br>March<br>31,<br>2016 |
|--|--------------------------------|-------------------------------|
| Computer, equipment and software             | \$ 709                         | \$ 684                        |
| Buildings                                    | 315                            | 313                           |
| Leasehold improvements                       | 129                            | 129                           |
| Equipment, furniture and fixtures, and other | 81                             | 80                            |
| Land   | 61                             | 61                            |
| Construction in progress                     | 3                              | 15                            |
|  | 1,298                          | 1,282                         |
| Less: accumulated depreciation               | (867 )                         | (843 )                        |
| Property and equipment, net                  | \$ 431                         | \$ 439                        |

During the three and six months ended September 30, 2016, depreciation expense associated with property and equipment was \$28 million and \$57 million, respectively. During the three and six months ended September 30, 2015 depreciation expense associated with property and equipment was \$30 million and \$60 million respectively.

## Accrued and Other Current Liabilities

Accrued and other current liabilities as of September 30, 2016 and March 31, 2016 consisted of (in millions):

|                                       | As of<br>September<br>30, 2016 | As of<br>March<br>31,<br>2016 |
|---------------------------------------|--------------------------------|-------------------------------|
| Other accrued expenses                | \$ 289                         | \$ 218                        |
| Accrued compensation and benefits     | 175                            | 256                           |
| Accrued royalties                     | 162                            | 159                           |
| Deferred net revenue (other)          | 151                            | 77                            |
| Accrued and other current liabilities | \$ 777                         | \$ 710                        |

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

## Deferred Net Revenue (Online-Enabled Games)

Deferred net revenue (online-enabled games) was \$1,067 million and \$1,458 million as of September 30, 2016 and March 31, 2016, respectively. Deferred net revenue (online-enabled games) generally includes the unrecognized revenue from bundled sales of online-enabled games for which we do not have VSOE for the obligation to provide unspecified updates. We recognize revenue from the sale of online-enabled games for which we do not have VSOE for the unspecified updates on a straight-line basis, generally over an estimated nine-month period beginning in the month after shipment for physical games sold through retail and an estimated six-month period for digitally-distributed games. However, we expense the cost of revenue related to these transactions generally during the period in which the product is delivered (rather than on a deferred basis).

## (9) INCOME TAXES

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

timing of actual earnings versus annual projections.

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

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In addition to considering forecasts of future taxable income, we are also required to evaluate and quantify other possible sources of taxable income in order to assess the realization of our deferred tax assets, namely the reversal of existing deferred tax liabilities, the carry back of losses and credits as allowed under current tax law, and the implementation of tax planning strategies. Evaluating and quantifying these amounts involves significant judgments. Each source of income must be evaluated based on all positive and negative evidence; this evaluation involves assumptions about future activity.

In the fourth quarter of fiscal year 2016, we determined that the positive evidence overcame any negative evidence and concluded that it was more likely than not that the U.S. deferred tax assets were realizable. As a result, we released the valuation allowance against all of the U.S. federal deferred tax assets and a portion of the U.S. state deferred tax assets during the fourth quarter of fiscal year 2016, and we continue to believe those deferred tax assets are realizable as of September 30, 2016. We maintain a valuation allowance related to specific U.S. state deferred tax assets and foreign capital loss carryovers, due to uncertainty about the future realization of these assets.

The provision for income taxes reported for the three and six months ended September 30, 2016 is based on our projected annual effective tax rate for fiscal year 2017, and also includes certain discrete items recorded during the period. Our effective tax rate for the three and six months ended September 30, 2016 was 26.9 percent and 19.6 percent, respectively, as compared to 9.4 percent and 20.7 percent, respectively, for the same period of fiscal year 2016. The effective tax rate for the three and six months ended September 30, 2016 was reduced, when compared to the statutory rate of 35.0 percent, due primarily to non-U.S. profits subject to a reduced or zero tax rate. The effective tax rate for the three and six months ended September 30, 2015 was reduced, when compared to the statutory rate of 35.0 percent, by the utilization of U.S. deferred tax assets which were subject to a valuation allowance and non-U.S. profits subject to a reduced or zero tax rate. Conversely, the effective tax rate for the three and six months ended September 30, 2015 was increased due to a discrete expense of \$25 million and \$65 million, respectively, for excess tax benefits from stock-based compensation deductions allocated directly to contributed capital. The effective tax rate for the three and six months ended September 30, 2016 differs from the same periods in fiscal year 2016 primarily due to the utilization of U.S. deferred tax assets in fiscal year 2016 which were subject to a valuation allowance and the discrete expense for excess tax benefits from stock-based compensation deductions allocated directly to contributed capital in fiscal year 2016.

During the three and six months ended September 30, 2016, we recorded a net increase of \$10 million and \$18 million, respectively, in gross unrecognized tax benefits. The total gross unrecognized tax benefits as of September 30, 2016 is \$349 million. A portion of our unrecognized tax benefits will affect our effective tax rate if they are recognized upon favorable resolution of the uncertain tax positions. As of September 30, 2016, if recognized, approximately \$322 million of the unrecognized tax benefits would affect our effective tax rate and approximately \$28 million would result in adjustments to deferred tax assets with corresponding adjustments to the valuation allowance.

During the three and six months ended September 30, 2016, we recorded a net increase of \$1 million and \$2 million, respectively, for accrued interest and penalties related to tax positions taken on our tax returns. As of September 30, 2016, the combined amount of accrued interest and penalties related to uncertain tax positions included in income tax obligations on our Condensed Consolidated Balance Sheet was approximately \$16 million.

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

We are also currently under income tax examination in the United Kingdom for fiscal years 2010 through 2014, and in France for fiscal years 2014 through 2016. We remain subject to income tax examination for several other jurisdictions including in Germany for fiscal years after 2012, in the United Kingdom for fiscal years after 2014, in Canada for fiscal years after 2008, and in Switzerland for fiscal years after 2007.

The timing of the resolution of income tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued for each year. Although potential resolution of uncertain tax positions involves multiple tax periods and jurisdictions, it is reasonably possible that a reduction of up to \$67 million of unrecognized tax benefits may occur within the next 12 months, some of which, depending on the nature of the settlement or expiration of statutes of limitations, may affect the Company's income tax provision and therefore benefit the resulting effective tax rate. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements.

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## (10) FINANCING ARRANGEMENTS

## 0.75% Convertible Senior Notes Due 2016

In July 2011, we issued \$632.5 million aggregate principal amount of 0.75% Convertible Senior Notes due 2016 (the “Convertible Notes”). The Convertible Notes matured on July 15, 2016. The Convertible Notes were senior unsecured obligations which paid interest semiannually in arrears at a rate of 0.75% per annum on January 15 and July 15 of each year.

The Convertible Notes were convertible into cash and shares of our common stock based on an initial conversion value of 31.5075 shares of our common stock per \$1,000 principal amount of Convertible Notes (equivalent to an initial conversion price of approximately \$31.74 per share). Upon conversion of the Convertible Notes, holders received cash up to the principal amount of each Convertible Note, and any excess conversion value was delivered in shares of our common stock. The Convertible Notes do not contain any financial covenants.

Upon conversion of any Convertible Notes, we delivered cash up to the principal amount of the Convertible Notes and any excess conversion value was delivered in shares of our common stock. During the three months ended September 30, 2016, approximately \$136 million principal value of the Convertible Notes were converted by holders thereof. During the three months ended September 30, 2016, we repaid the remaining principal balance on the Convertible Notes of \$136 million and issued approximately 2.5 million shares of common stock to noteholders with a fair value of \$193 million on the final maturity date of July 15, 2016. We also received and cancelled approximately 2.5 million shares of common stock from the exercise of the Convertible Note Hedge during the three months ended September 30, 2016. During the six months ended September 30, 2016, we repaid \$163 million of the principal balance of the Convertible Notes and issued approximately 2.9 million shares of common stock to noteholders with a fair value of \$222 million, resulting in a loss on extinguishment of \$0.3 million.

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

|  | As of<br>September<br>30, 2016 | As of<br>March<br>31,<br>2016 |
|--|--------------------------------|-------------------------------|
| Principal amount of Convertible Notes                | \$                             | —\$ 163                       |
| Unamortized debt discount of the liability component | —                              | (2 )                          |
| Net carrying value of Convertible Notes              | \$                             | —\$ 161                       |
| Fair value of Convertible Notes (Level 2)            | \$                             | —\$ 338                       |

## Convertible Note Hedge and Warrants Issuance

In July 2011, we entered into certain agreements designed to reduce the potential dilution with respect to our common stock upon conversion of the Convertible Notes (“the Convertible Note Hedge”). We paid \$107 million for the Convertible Note Hedge, which was recorded as an equity transaction. The Convertible Note Hedge, subject to customary anti-dilution adjustments, provided us with the option to acquire, on a net settlement basis, approximately 19.9 million shares of our common stock, equal to the number of shares of our common stock that notionally underlie the Convertible Notes at a strike price of \$31.74, which corresponds to the conversion price of the Convertible Notes. During the three and six months ended September 30, 2016, we received 2.5 million and 2.9 million shares, respectively, of our common stock under the Convertible Note Hedge.

Separately, in July 2011 we also entered into privately negotiated warrant transactions with certain counterparties whereby we sold to independent third parties warrants (the “Warrants”) to acquire, subject to customary anti-dilution adjustments that are substantially the same as the anti-dilution provisions contained in the Convertible Notes, up to 19.9 million shares of our common stock (which is also equal to the number of shares of our common stock that notionally underlie the Convertible Notes), with a strike price of \$41.14. The Warrants have a dilutive effect with respect to our common stock to the extent that the market price per share of our common stock exceeds \$41.14 on or prior to the expiration date of the Warrants. The Warrants automatically exercise over a 60 trading day period that

began on October 17, 2016. Based on the closing price of our common stock of \$85.40 at the end of the quarter ended September 30, 2016, approximately 10.3 million shares of our common stock would be issuable to Warrants holders. The actual amount of shares issuable upon exercise will be determined based upon the market price of our common stock during the 60 day trading period that began on October 17, 2016. We received proceeds of \$65 million from the sale of the Warrants in fiscal year 2012.



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

Prior to conversion of the Convertible Notes, we included the effect of the additional potential dilutive shares if our common stock price exceeded \$31.74 per share using the treasury stock method. If the average price of our common stock exceeds \$41.14 per share for a quarterly period, we also include the effect of the additional potential dilutive shares related to the Warrants using the treasury stock method. Prior to conversion, the Convertible Note Hedge was not considered for purposes of the EPS calculation, as its effect would have been anti-dilutive. Upon conversion, the Convertible Note Hedge offset the dilutive effect of the Notes when the stock price was above \$31.74 per share. See Note 13 for additional information related to our EPS.

## 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 was 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, 2016 | As of<br>March<br>31,<br>2016 |
|--------------------------------------|--------------------------------|-------------------------------|
| 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                  | (2 )                           | (2 )                          |
| Unamortized debt issuance costs      | (8 )                           | (9 )                          |
| Net carrying value of Senior Notes   | \$ 990                         | \$989                         |
| Fair value of Senior Notes (Level 2) | \$ 1,082                       | \$1,039                       |

As of September 30, 2016, the remaining life of the 2021 Notes and 2026 Notes is approximately 4.4 and 9.4 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

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

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

The credit agreement contains customary events of default, including among others, non-payment defaults, covenant defaults, cross-defaults to material indebtedness, bankruptcy and insolvency defaults, material judgment 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, 2016, 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, 2016 and 2015 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>2016 |       | Six Months<br>Ended<br>September<br>30,<br>2015 |        |
|-------------------------------------|--|-------|---|--------|
| Amortization of debt discount       | (1 )   | (5 )  | (2 )  | (11 )  |
| Amortization of debt issuance costs | —  | —     | (1 )  | (1 )   |
| Coupon interest expense             | (10 )  | (1 )  | (21 )   | (2 )   |
| Total interest expense              | \$(11)   | \$(6) | \$(24)  | \$(14) |

(11) COMMITMENTS AND CONTINGENCIESLease Commitments

As of September 30, 2016, we leased certain facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.

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

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

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include, but are not limited to: FIFA (Fédération Internationale de Football Association), FIFPRO Foundation, FAPL (Football Association Premier League Limited), and DFL Deutsche Fußball Liga GmbH (German

Soccer League) (professional soccer); Dr. Ing. h.c. F. Porsche AG, Ferrari S.p.A. (Need For Speed and Real Racing games); National Basketball Association (professional basketball); PGA TOUR (professional golf); National Hockey League and NHL Players' Association (professional hockey); National Football League Properties and PLAYERS Inc. (professional football); Zuffa, LLC (Ultimate Fighting Championship); ESPN (content in EA SPORTS games); Disney Interactive (Star Wars); Fox Digital Entertainment, Inc. (The Simpsons); Universal Studios Inc. (Pets); and Respawn. 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

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conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.

The following table summarizes our minimum contractual obligations as of September 30, 2016 (in millions):

|  | Fiscal Years Ending March 31,<br>2017<br>(Remaining<br>six<br>mos.) |       |       |       |       |         |            |       |
|--|---|-------|-------|-------|-------|---------|------------|-------|
|  | Total   | 2018  | 2019  | 2020  | 2021  | 2022    | Thereafter |       |
| Unrecognized commitments                       |   |       |       |       |       |         |            |       |
| Developer/licensor commitments                 | \$1,427   | \$66  | \$315 | \$300 | \$251 | \$210   | \$206      | \$79  |
| Marketing commitments                          | 503   | 29    | 79    | 111   | 91    | 93      | 74         | 26    |
| Operating leases                               | 234   | 16    | 38    | 34    | 31    | 29      | 23         | 63    |
| Senior Notes interest                          | 278   | 17    | 41    | 41    | 41    | 41      | 19         | 78    |
| Other purchase obligations                     | 93  | 25    | 18    | 13    | 9     | 7       | 4          | 17    |
| Total unrecognized commitments                 | 2,535   | 153   | 491   | 499   | 423   | 380     | 326        | 263   |
| Recognized commitments                         |   |       |       |       |       |         |            |       |
| Senior Notes principal and interest            | 1,004   | 4     | —     | —     | —     | 600     | —          | 400   |
| Licensing and lease obligations <sup>(a)</sup> | 136   | 11    | 23    | 24    | 25    | 26      | 27         | —     |
| Total recognized commitments                   | 1,140   | 15    | 23    | 24    | 25    | 626     | 27         | 400   |
| Total commitments                              | \$3,675   | \$168 | \$514 | \$523 | \$448 | \$1,006 | \$353      | \$663 |

Lease commitments have not been reduced for approximately \$1 million due in the future from third parties under (a) non-cancelable sub-leases. See Note 7 for additional information regarding recognized obligations from our licensing-related commitments.

The unrecognized amounts represented in the table above reflect our minimum cash obligations for the respective fiscal years, but do not necessarily represent the periods in which they will be recognized and expensed in our Condensed Consolidated Financial Statements. In addition, the amounts in the table above are presented based on the dates the amounts are contractually due as of September 30, 2016; however, certain payment obligations may be accelerated depending on the performance of our operating results. Furthermore, up to \$32 million of the unrecognized amounts in the table above may be payable, at the licensor's election, in shares of our common stock, subject to a \$10 million maximum during any fiscal year. The number of shares to be issued will be based on fair market value at the time of issuance.

In addition to what is included in the table above, as of September 30, 2016, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$86 million, of which we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

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, where the case is pending.

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.



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## (12) STOCK-BASED COMPENSATION

## Valuation Assumptions

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

The determination 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 determine the fair value of our stock-based awards as follows:

**Restricted Stock Units.** The fair value of 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 determined using a Monte-Carlo simulation model. Key assumptions for the Monte-Carlo simulation model are the risk-free interest rate, expected volatility, expected dividends and correlation coefficient.

**Stock Options and Employee Stock Purchase Plan.** The fair value of stock options and stock purchase rights granted pursuant to our equity incentive plans and our 2000 Employee Stock Purchase Plan, as amended (“ESPP”), respectively, is determined using the Black-Scholes valuation model based on the multiple-award valuation method. Key assumptions of the Black-Scholes valuation model are the risk-free interest rate, expected volatility, expected term and expected dividends. The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option. Expected volatility is based on a combination of historical stock price volatility and implied volatility of publicly-traded options on our common stock. Expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior. There were an insignificant number of stock options granted during the three and six months ended September 30, 2016 and 2015.

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, |                 |   |
|-----------------------------|---|-----------------|---|
|                             | 2016  | 2015            |   |
| Risk-free interest rate     | 0.5 - 0.6%  | 0.3 - 0.4%      |   |
| Expected volatility         | 29 - 32%  | 32              | % |
| Weighted-average volatility | 31  | % 32            | % |
| Expected term               | 6 - 12 months   | 6 - 11.5 months |   |
| Expected dividends          | None  | None            |   |

There were no market-based restricted stock units granted during the three months ended September 30, 2016 and 2015.

## Stock-Based Compensation Expense

Employee stock-based compensation expense recognized during the three and six months ended September 30, 2016 and 2015 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures.

In subsequent periods, if actual forfeitures differ from those estimates, an adjustment to stock-based compensation expense will be recognized at that time.



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The following table summarizes stock-based compensation expense resulting from stock options, restricted stock units, market-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>2016 |       | Six<br>Months<br>Ended<br>September<br>30,<br>2015 |       |
|----------------------------------|--|-------|--|-------|
| Cost of revenue                  | \$ 1   | \$ 1  | \$ 2   | \$ 1  |
| Research and development         | 27   | \$ 25 | 54   | 51    |
| Marketing and sales              | 8  | 7     | 15   | 12    |
| General and administrative       | 12   | 11    | 25   | 25    |
| Stock-based compensation expense | \$ 48  | \$ 44 | \$ 96  | \$ 89 |

During the three months ended September 30, 2016, we recognized a \$9 million deferred income tax benefit related to our stock-based compensation expense. During the three months ended September 30, 2015, we did not recognize any benefit from income taxes related to our stock-based compensation expense due to the U.S. valuation allowance.

During the six months ended September 30, 2016, we recognized an \$18 million deferred income tax benefit related to our stock-based compensation expense. During the six months ended September 30, 2015, we did not recognize any benefit from income taxes related to our stock-based compensation expense due to the U.S. valuation allowance.

As of September 30, 2016, our total unrecognized compensation cost related to restricted stock units and market-based restricted stock units was \$352 million and is expected to be recognized over a weighted-average service period of 1.8 years. Of the \$352 million of unrecognized compensation cost, \$49 million relates to market-based restricted stock units. As of September 30, 2016, our total unrecognized compensation cost related to stock options was \$5 million and is expected to be recognized over a weighted-average service period of 1.0 year.

During the three and six months ended September 30, 2016, we recognized \$4 million and \$37 million, respectively, of excess tax benefit from stock-based compensation deductions; this amount is reported in the financing activities on our Condensed Consolidated Statement of Cash Flows.

During the three and six months ended September 30, 2015, we recognized \$25 million and \$65 million, respectively, of excess tax benefit from stock-based compensation deductions; this amount is reported in the financing activities on our Condensed Consolidated Statement of Cash Flows.

**Stock Options**

The following table summarizes our stock option activity for the six months ended September 30, 2016:

|                                      | 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, 2016     | 3,278                     | \$ 35.09                                |   |   |
| Granted                              | 3                         | 69.77                                   |   |   |
| Exercised                            | (318)                     | 30.06                                   |   |   |
| Forfeited, cancelled or expired      | (31)                      | 35.84                                   |   |   |
| Outstanding as of September 30, 2016 | 2,932                     | \$ 35.66                                | 5.04  | \$ 146  |
| Vested and expected to vest          | 2,874                     | \$ 35.75                                | 4.99  | \$ 143  |
| Exercisable as of September 30, 2016 | 2,337                     | \$ 36.83                                | 4.44  | \$ 114  |

The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price as of September 30, 2016, 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.

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## Restricted Stock Units

The following table summarizes our restricted stock unit activity for the six months ended September 30, 2016:

|                                      | Restricted<br>Stock Rights<br>(in thousands) | Weighted-<br>Average Grant<br>Date Fair Values |
|--------------------------------------|--|--|
| Outstanding as of March 31, 2016     | 7,157  | \$ 44.04                                       |
| Granted                              | 2,330  | 75.31  |
| Vested                               | (3,384 )                                     | 35.43  |
| Forfeited or cancelled               | (364 )                                       | 55.26  |
| Outstanding as of September 30, 2016 | 5,739  | \$ 61.10                                       |

The weighted-average grant date fair values of restricted stock units granted during the three and six months ended September 30, 2016 were \$79.16 and \$75.31, respectively.

## Market-Based Restricted Stock Units

Our market-based restricted stock units vest contingent upon the achievement of pre-determined market and service conditions. If these market conditions are not met but service conditions are met, the market-based restricted stock units will not vest; however, any compensation expense we have recognized to date will not be reversed. The number of shares of common stock to be received at vesting will range from zero percent to 200 percent of the target number of market-based restricted stock units based on our total stockholder return ("TSR") relative to the performance of companies in the NASDAQ-100 Index for each measurement period, generally over a one-year, two-year cumulative and three-year cumulative period. In the table below, we present shares granted at 100 percent of target of the number of market-based restricted stock units that may potentially vest. The maximum number of shares of common stock that could vest is approximately 0.7 million for market-based restricted stock units granted during the six months ended September 30, 2016. As of September 30, 2016, the maximum number of shares that could vest is approximately 1.3 million for market-based restricted stock units outstanding.

The following table summarizes our market-based restricted stock unit activity for the six months ended September 30, 2016:

|                                      | Market-Based<br>Restricted<br>Stock<br>Units<br>(in thousands) | Weighted-<br>Average Grant<br>Date Fair Value |
|--------------------------------------|--|---|
| Outstanding as of March 31, 2016     | 636  | \$ 64.49                                      |
| Granted                              | 353  | 98.04   |
| Vested                               | (558 )   | 50.08   |
| Vested above target                  | 238  | 44.99   |
| Forfeited or cancelled               | (15 )  | 86.39   |
| Outstanding as of September 30, 2016 | 654  | \$ 87.29                                      |

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## Stock Repurchase Program

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

In May 2015, our Board of Directors authorized a program to repurchase up to \$1 billion of our common stock. This stock repurchase program, which expires on May 31, 2017, supersedes and replaces the stock repurchase authorization approved in May 2014. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase any specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and six months ended September 30, 2016, we repurchased approximately 1.6 million and 3.5 million shares for approximately \$127 million and \$256 million, respectively. We continue to actively repurchase shares.

The following table summarizes total shares repurchased during the three and six months ended September 30, 2016 and 2015:

| (in millions)                         | May 2014 Program |        | May 2015 Program |        | Total  |        |
|---------------------------------------|------------------|--------|------------------|--------|--------|--------|
|                                       | Shares           | Amount | Shares           | Amount | Shares | Amount |
| Three months ended September 30, 2016 | —                | \$ —   | 1.6              | \$ 127 | 1.6    | \$ 127 |
| Six months ended September 30, 2016   | —                | \$ —   | 3.5              | \$ 256 | 3.5    | \$ 256 |
| Three months ended September 30, 2015 | —                | \$ —   | 1.8              | \$ 126 | 1.8    | \$ 126 |
| Six months ended September 30, 2015   | 1.0              | \$ 57  | 3.0              | \$ 201 | 4.0    | \$ 258 |

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## (13) EARNINGS (LOSS) PER SHARE

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

|  | Three Months<br>Ended<br>September 30, |          | Six Months<br>Ended<br>September<br>30, |        |
|--|--|----------|---|--------|
| (In millions, except per share amounts)  | 2016                                   | 2015     | 2016                                    | 2015   |
| Net income (loss)  | \$(38 )                                | \$(140 ) | \$402                                   | \$302  |
| Shares used to compute earnings (loss) per share:  |  |          |   |        |
| Weighted-average common stock outstanding — basic  | 301                                    | 312      | 301                                     | 311    |
| Dilutive potential common shares related to stock award plans and from assumed exercise of stock options | —                                      | —        | 3                                       | 7      |
| Dilutive potential common shares related to the Convertible Notes  | —                                      | —        | 2                                       | 9      |
| Dilutive potential common shares related to the Warrants   | —                                      | —        | 9                                       | 7      |
| Weighted-average common stock outstanding — diluted  | 301                                    | 312      | 315                                     | 334    |
| Earnings (loss) per share:   |  |          |   |        |
| Basic  | \$(0.13)                               | \$(0.45) | \$1.34                                  | \$0.97 |
| Diluted  | \$(0.13)                               | \$(0.45) | \$1.28                                  | \$0.90 |

As a result of our net loss for the three months ended September 30, 2016, 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 and an additional 10 million shares related to the Warrants would have been included in the number of shares used to calculate Diluted EPS for the three months ended September 30, 2016.

As a result of our net loss for the three months ended September 30, 2015, we have excluded all potentially dilutive common shares from the diluted loss per share calculation as their inclusion would have had an antidilutive effect. Had we reported net income for this period, an additional 6 million shares of common stock related to our outstanding equity-based instruments, an additional 7 million shares of common stock related to the Notes, and an additional 8 million shares related to the Warrants would have been included in the number of shares used to calculate Diluted EPS for the three months ended September 30, 2015.

For the six months ended September 30, 2016 and 2015, an immaterial amount of options to purchase, restricted stock units and restricted stock to be released were excluded from the treasury stock method computation of diluted shares as their inclusion would have had an antidilutive effect.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Electronic Arts Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Electronic Arts Inc. and subsidiaries as of October 1, 2016, and the related condensed consolidated statements of operations and comprehensive income (loss) for the three-month and six-month periods ended October 1, 2016, and October 3, 2015, and the related condensed consolidated statements of cash flows for the six-month periods ended October 1, 2016 and October 3, 2015. These condensed consolidated financial statements are the responsibility of the Company's management.

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

Accordingly, we do not express such an opinion.

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

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Electronic Arts Inc. and subsidiaries as of April 2, 2016, and the related consolidated statements of operations, comprehensive income (loss), stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated May 26, 2016, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of April 2, 2016, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Santa Clara, California

November 8, 2016

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

CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, made in this Quarterly Report are forward looking. Examples of forward-looking statements include statements related to industry prospects, our future economic performance including anticipated revenues and expenditures, results of operations or financial position, and other financial items, our business plans and objectives, including our intended product releases, and may include certain assumptions that underlie the forward-looking statements. We use words such as "anticipate," "believe," "expect," "intend," "estimate" (and the negative of any of these terms), "future" and similar expressions to help identify forward-looking statements. These forward-looking statements are subject to business and economic risk and reflect management's current expectations, and involve subjects that are inherently uncertain and difficult to predict. Our actual results could differ materially from those in the forward-looking statements. We will not necessarily update information if any forward-looking statement later turns out to be inaccurate. Risks and uncertainties that may affect our future results include, but are not limited to, those discussed in this report under the heading "Risk Factors" in Part II, Item 1A, as well as in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016 as filed with the Securities and Exchange Commission ("SEC") on May 27, 2016 and in other documents we have filed with the SEC.

OVERVIEW

The following overview is a high-level discussion of our operating results, as well as some of the trends and drivers that affect our business. Management believes that an understanding of these trends and drivers provides important context for our results for the three and six months ended September 30, 2016, as well as our future prospects. This summary is not intended to be exhaustive, nor is it intended to be a substitute for the detailed discussion and analysis provided elsewhere in this Form 10-Q, including in the remainder of "Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")," "Risk Factors," and the Condensed Consolidated Financial Statements and related Notes. Additional information can be found in the "Business" section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2016 as filed with the SEC on May 27, 2016 and in other documents we have filed with the SEC.

About Electronic Arts

We are a global leader in digital interactive entertainment. We develop, market, publish and distribute games content and services that can be played by consumers on a variety of platforms, which include consoles (such as the PlayStation from Sony and the Xbox from Microsoft), PCs, mobile phones and tablets. Some of our games are based on our wholly-owned intellectual property (e.g., Battlefield, Mass Effect, Need for Speed, The Sims and Plants vs. Zombies), and some of our games leverage content that we license from others (e.g., FIFA, Madden NFL and Star Wars). We also publish and distribute games developed by third parties (e.g., Titanfall). Our products and services may be purchased through multiple distribution channels, including physical and online retailers, platform providers such as console manufacturers, providers of free-to-download PC games, mobile carriers and directly through Origin, our own digital distribution platform.

Financial Results

Our key financial results for our quarter ended September 30, 2016 were as follows:

Total net revenue was \$898 million, up 10 percent year-over-year. On a constant currency basis, we estimate that total net revenue would have been \$931 million, up 14 percent year over year.

Digital revenue was \$566 million, up 13 percent year-over-year.

International net revenue was \$509 million, up 17 percent year-over-year.

Gross margin was 55.3 percent.

Operating expenses were \$546 million. On a constant currency basis, we estimate that total operating expenses would have been \$551 million, up less than 1 percent year over year.

Net loss was \$38 million, with diluted losses per share of \$0.13.

¶ Total cash, cash equivalents and short-term investments was \$3,266 million.

From time to time, we will make comparisons of current periods to prior periods with reference to constant currency. Constant currency comparisons are based on translating local currency amounts in the current period at actual foreign exchange rates from the prior comparable period. We evaluate our financial performance on a constant currency basis in order to facilitate period-to-period comparisons without regard to the impact of changing foreign currency exchange rates.

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### Trends in Our Business

**Digital Transformation.** Our business continues to transform from a traditional packaged goods business model to one in which our games and services are sold and delivered digitally, with additional content, features and services helping to extend the life of our packaged goods and digital games. For example, the Ultimate Team mode incorporated into iterations of our FIFA, Madden NFL and NHL franchises and expansion packs available digitally for our Star Wars, Battlefield and Sims franchises have kept many of our players engaged with those games for longer periods of time. Our digital transformation is also creating opportunities in platforms, content models and modalities of play. For example, we have leveraged 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 free-to-download games that are monetized through a business model through which we sell incremental content and/or features in discrete transactions. We also provide our EA Access service for the Xbox One and Origin Access service on PC which offer players access to a selection of EA games and other benefits for a monthly or annual fee.

Our digital transformation also gives us the opportunity to strengthen our player network. We are investing in a technology foundation to enable us to build player relationships that can last for years instead of for 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 experiences, such as our subscription-based EA Access and Origin Access services.

We significantly increased our digital net revenue from \$1,833 million in fiscal year 2014 to \$2,199 million in fiscal year 2015 and \$2,409 million during fiscal year 2016. We expect this portion of our business to continue to grow through fiscal year 2017 and beyond as we continue to focus on developing and monetizing products and services that can be delivered digitally.

**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. Volatility in exchange rates remains elevated as compared to historical standards, and macroeconomic events like the United Kingdom's vote to leave the European Union are injecting even more uncertainty. 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.

**Mobile and PC Free-to-Download Games.** The proliferation of mobile phones and tablets has significantly increased the consumer base for mobile games. The broad consumer acceptance of business models which allow consumers to try new games with no up-front cost and pay for additional content or in-game items, has led to growth in the mobile gaming industry. Likewise, the mass introduction and wide consumer acceptance of free-to-download, micro-transaction-based PC games played over the Internet has also broadened our consumer base. We expect revenue generated from mobile and PC free-to-download games to remain an important part of our business. We track an estimate of monthly active users ("MAUs") for our mobile business, which we believe is a useful indicator of player engagement trends for that business. For the three months ended September 30, 2016, we had average MAUs of over 145 million. MAUs are the aggregate number of individuals who accessed a particular game on a particular device in the last 30 days as of the measurement date. For our calculation, an individual who either plays two of our games on a single device, or the same game on two devices in the relevant period, would be counted as two users. Average MAUs for a particular period is the average of the MAUs at each month-end during that period. MAUs

are calculated using internal company data based on tracking the activity of user accounts. We also include in this calculation data provided by our third party publishing partners for certain games that we develop but we exclude information from third party titles that we publish. From time to time, we adjust the calculation for user activity that is inconsistent with our methodology. We believe that the numbers are reasonable estimates of our user base for the applicable period of measurement; however, factors relating to user activity may impact these numbers. Our methodology for calculating MAUs may differ from the methodology used by other companies to calculate this metric.

**Concentration of Sales Among the Most Popular Games.** In all major segments of our industry, we see a large portion of games sales concentrated on the most popular titles, and many of those titles are sequels of prior games. Similarly, a significant portion of our revenue historically has been derived from games and services based on a few popular franchises, several of which we have released on an annual or bi-annual basis. For example, in fiscal year 2016, net revenue generated from the sale of products and services associated with our three largest franchises accounted for approximately 55 percent of our net revenue. We expect this trend to continue.

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**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 services, our ongoing mobile business and subscription programs. We have greater confidence in our ability to forecast revenue from these areas of our business than for new offerings. As we continue to leverage the digital transformation in our industry and incorporate new 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 Sales.** In order to improve transparency into our business, we have introduced an operating performance metric, net sales. Net sales is defined as the net amount of products and services sold digitally or sold-in physically in the period.

Net sales were \$1.10 billion for the three months ended September 30, 2016, driven by successful sports launches and growth in our mobile business. Net sales decreased \$48 million or 4%, from the three months ended September 30, 2015 due primarily to the timing of our FIFA launches. FIFA 17 was launched four days before the end of the fiscal quarter ended September 30, 2016, while FIFA 16 launched eleven days before the end of the fiscal quarter ended September 30, 2015. Digital net sales were \$486 million for the three months ended September 30, 2016, an increase of \$6 million or 1% from the three months ended September 30, 2015. The increase in digital net sales was driven by year-over-year growth in mobile and full game downloads, partially offset by a year-over-year decrease in extra content, driven primarily by the first week of FIFA 17 digital sales, almost all of which will be captured in the fiscal quarter ending December 31, 2016.

### Recent Developments

**Stock Repurchase Program.** In May 2015, our Board of Directors authorized a program to repurchase up to \$1 billion of our common stock. This stock repurchase program expires on May 31, 2017. During the three months ended September 30, 2016, we repurchased approximately 1.6 million shares for approximately \$127 million under this program. During the six months ended September 30, 2016, we repurchased approximately 3.5 million shares for approximately \$256 million under this program. We continue to actively repurchase shares.

In February 2016, we announced a new \$500 million stock repurchase program. This new program was incremental to the existing two-year \$1 billion stock repurchase program announced in May 2015. We completed repurchases under the February 2016 program during the quarter ended March 31, 2016. We repurchased approximately 7.8 million shares for approximately \$500 million under this new 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.

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

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

Product revenue. Our product revenue includes revenue associated with the sale of software games or related content, whether delivered via a physical disc (e.g., packaged goods) or delivered digitally (e.g., full-game downloads, extra-content), and licensing of game software to third-parties. Product revenue also includes revenue from mobile full game downloads that do not require our hosting support (e.g., premium mobile games) in order to utilize the game or related content (i.e. can be played with or without an Internet connection), and sales of tangible products such as hardware, peripherals, or collectors' items.

Service and other revenue. Our service revenue includes revenue recognized from time-based subscriptions and games or related content that requires our hosting support in order to utilize the game or related content (i.e., can only be played with an Internet connection). This includes (1) entitlements to content that are accessed through hosting services (e.g., micro-transactions for Internet-based, social network and free-to-download mobile games), (2) massively multi-player online

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(“MMO”) games (both software game and subscription sales), (3) subscriptions for our Battlefield Premium, EA Access, and Pogo-branded online game services, and (4) allocated service revenue from sales of software games with an online service element (i.e., “matchmaking” service). Our other revenue includes advertising and non-software licensing revenue.

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

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

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

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

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

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

### Online-Enabled Games

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

We have an established historical pattern of providing unspecified updates (e.g., player roster updates to Madden NFL 17) to online-enabled games and related content at no additional charge to the consumer. We do not have vendor-specific objective evidence of fair value (“VSOE”) for these unspecified updates, and thus, as required by U.S. GAAP, we recognize revenue from the sale of these online-enabled games and related content over the period we expect to offer the unspecified updates to the consumer (“estimated offering period”).

### Estimated Offering Period

Because the offering period is not an explicitly defined period, we must make an estimate of the offering period. Determining the estimated offering period is inherently subjective and is subject to regular revision based on historical online usage. For example, in determining the estimated offering period for unspecified updates associated with our online-enabled games, we consider the period of time consumers are online as online connectivity is required. On an annual basis, we review consumers' online gameplay of all online-enabled games that have been released 12 to 24 months prior to the evaluation date. For example, if our evaluation date is April 1, 2016, we evaluate all online-enabled games released between April 1, 2014 and March 31, 2015. Based on this population of games, for all players that register the game online within the first six months of release of the game to the general public, we compute the weighted-average number of days for each online-enabled game, based on when a player initially registers the game online to when that player last plays the game online. We then compute the weighted-average number of days for all online-enabled games by multiplying the weighted-average number of days for each online-enabled game by its relative percentage of total units sold from these online-enabled games (i.e., a game with more units sold will have a higher weighting to the overall computation than a game with fewer units sold). Under a similar computation, we

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also consider the estimated period of time between the date a game unit is sold to a reseller and the date the reseller sells the game unit to an end consumer (i.e., time in channel). Based on these two calculations we then consider the method of distribution. For example, physical software games sold at retail would have a composite offering period equal to the online gameplay plus time in channel as opposed to digitally distributed software games which are delivered immediately via digital download and thus have no concept of channel. Additionally, we consider results from prior analyses, known and expected online gameplay trends, as well as disclosed service periods for competitors' games in determining the estimated offering period for future sales.

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

### Other Multiple-Element Arrangements

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

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

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

### Principal Agent Considerations

We evaluate sales of our interactive software games via third party storefronts, including digital storefronts such as Microsoft's Xbox Games Store, Sony PSN, Apple App Store, and Google Play, in order to determine whether or not we are acting as the primary obligor in the sale to the end consumer, which we consider in determining if revenue should be reported gross or net of fees retained by the storefront. Key indicators that we evaluate in determining gross versus net treatment include but are not limited to the following:

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

Based on evaluation of the above indicators, we have determined that generally the third party is considered the primary obligor to end consumers for the sale of our interactive software games. We therefore report revenue related to these arrangements net of the fees retained by the storefront.





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### Sales Returns and Allowances and Bad Debt Reserves

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 product that they have not resold to end consumers. The amount of the price protection is generally the difference between the old wholesale price and the new reduced wholesale price. In certain countries for our PC and console packaged goods software products, we also have a practice of allowing channel partners to return older software products in the channel in exchange for a credit allowance. As a general practice, we do not give cash refunds.

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

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

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

### Royalties and Licenses

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

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

change, our effective royalty rates would change, which could impact the amount and timing of royalty expense we recognize.

Prepayments made to thinly capitalized independent software developers and co-publishing affiliates are generally made in connection with the development of a particular product, and therefore, we are generally subject to development risk prior to the release of the product. Accordingly, payments that are due prior to completion of a product are generally expensed to 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

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licensor, we record guarantee payments as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract. Royalty liabilities are classified as current liabilities to the extent such royalty payments are contractually due within the next 12 months.

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

### Income Taxes

We recognize deferred tax assets and liabilities for both (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 carry back of losses and credits as allowed under current tax law, and the implementation of tax planning strategies. Evaluating and quantifying these amounts involves significant judgments. Each source of income must be evaluated based on all positive and negative evidence; this evaluation involves assumptions about future activity.

In the fourth quarter of fiscal year 2016, we realized significant U.S. pre-tax income for both the fourth quarter and the fiscal year ended March 31, 2016. As of March 31, 2016, we had reported positive operating performance in the U.S. for two consecutive fiscal years and had also reported a cumulative three-year U.S. pre-tax profit. In addition, during the fourth quarter of fiscal year 2016, we completed our financial plan for fiscal year 2017 and expect continued positive operating performance in the U.S. We also considered forecasts of future taxable income and evaluated the utilization of tax credit carryforwards prior to their expiration. After considering these factors, we determined that the positive evidence overcame any negative evidence and concluded that it was more likely than not that the U.S. deferred tax assets were realizable. As a result, we released the valuation allowance against all of the U.S. federal deferred tax assets and a portion of the U.S. state deferred tax assets during the fourth quarter of fiscal year 2016. We continue to maintain a valuation allowance related to specific U.S. state deferred tax assets and foreign capital loss carryovers, due to uncertainty about the future realization of these assets.

Historically, we have considered all undistributed earnings of our foreign subsidiaries to be indefinitely reinvested outside of the United States and, accordingly, no U.S. taxes have been provided thereon. During the fourth quarter of fiscal year 2016 we reevaluated our intent to indefinitely reinvest all earnings of foreign subsidiary companies, and concluded that a portion of earnings of certain subsidiaries will no longer be considered to be indefinitely reinvested. We currently intend to continue to indefinitely reinvest a substantial majority of the undistributed earnings of our foreign subsidiaries outside of the United States.

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

of disputes with tax authorities. The ultimate resolution of these issues may take extended periods of time due to examinations by tax authorities and statutes of limitations. In addition, changes in our business, including acquisitions, changes in our international corporate structure, changes in the geographic location of business functions or assets, changes in the geographic mix and amount of income, as well as changes in our agreements with tax authorities, valuation allowances, applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audit and other matters, and variations in the estimated and actual level of annual pre-tax income can affect the overall effective income tax rate.

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## 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, 2017 contains 52 weeks and ends on April 1, 2017. Our results of operations for the fiscal year ended March 31, 2016 contained 53 weeks and ended on April 2, 2016. Our results of operations for the three months ended September 30, 2016 and 2015 contained 13 weeks each and ended on October 1, 2016 and October 3, 2015, respectively. Our results of operations for the six months ended September 30, 2016 and 2015 contained 26 and 27 weeks, respectively, and ended on October 1, 2016 and October 3, 2015, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

## Net Revenue

Net revenue consists of sales generated from (1) video games sold as packaged goods or as digital downloads and designed for play on consoles (such as the PlayStation from Sony and the Xbox from Microsoft) and PCs, (2) video games for mobile phones and tablets, (3) separate software products and extra-content and online game services associated with these products, (4) licensing our game software to third parties, (5) allowing other companies to manufacture and sell our products in conjunction with other products, and (6) advertisements on our online web pages and in our games. We recognize revenue from the sale of online-enabled games for which we do not have VSOE for the unspecified updates on a straight-line basis, generally over an estimated nine-month period beginning in the month after shipment for physical games sold through retail and an estimated six-month period for digitally-delivered games and content.

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 Revenue 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 Revenue Composition (Packaged goods and other, and Digital) than by Net Revenue by Product revenue and Service and other revenue.

## Net Revenue Quarterly Analysis

## Net Revenue

For the three months ended September 30, 2016, net revenue was \$898 million and increased \$83 million, or 10 percent, as compared to the three months ended September 30, 2015. This increase was driven by a \$251 million increase in revenue primarily from the Star Wars, Need for Speed, and UFC franchises. This increase was partially offset by a \$168 million decrease in revenue primarily from the Battlefield, Dragon Age, and The Sims franchises.

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

Our net revenue by product revenue and service and other revenue for the three months ended September 30, 2016 and 2015 was as follows (in millions):

|                   | Three Months Ended |       |              |             |
|-------------------|--------------------|-------|--------------|-------------|
|                   | September 30,      |       |              |             |
|                   | 2016               | 2015  | \$<br>Change | %<br>Change |
| Net revenue:      |                    |       |              |             |
| Product           | \$420              | \$434 | \$ (14 )     | (3 )%       |
| Service and other | 478                | 381   | 97           | 25 %        |
| Total net revenue | \$898              | \$815 | \$ 83        | 10 %        |

## Product Revenue

For the three months ended September 30, 2016, product net revenue was \$420 million, primarily driven by Star Wars Battlefront, FIFA 16, and FIFA Online 3 in Asia. Product net revenue decreased \$14 million, or 3 percent, as compared to the three months ended September 30, 2015. This decrease was driven by a \$178 million decrease primarily from the Battlefield, Dragon Age, and FIFA franchises. This decrease was partially offset by a \$164 million increase primarily from Star Wars Battlefront and the UFC franchise.

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## Service and Other Revenue

For the three months ended September 30, 2016, service and other net revenue was \$478 million, primarily driven by FIFA Ultimate Team, Need for Speed 2015, and Star Wars: Galaxy of Heroes. Service and other net revenue for the three months ended September 30, 2016 increased \$97 million, or 25 percent, as compared to the three months ended September 30, 2015. This increase was driven by a \$127 million increase primarily from Need for Speed 2015, FIFA Ultimate Team and the Star Wars franchise. This increase was partially offset by a \$30 million decrease primarily from The Simpsons Tapped Out, Command and Conquer Tiberium Alliances, The Sims FreePlay, and Titanfall.

## Supplemental Net Revenue by Revenue Composition

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

Our net revenue by revenue composition for the three months ended September 30, 2016 and 2015 was as follows (in millions):

|                                       | Three Months Ended |       |        |        |
|---------------------------------------|--------------------|-------|--------|--------|
|                                       | September 30,      |       | \$     | %      |
|                                       | 2016               | 2015  | Change | Change |
| Full game downloads                   | \$94               | \$82  | \$ 12  | 15 %   |
| Extra content                         | 240                | 213   | 27     | 13 %   |
| Subscriptions, advertising, and other | 83                 | 84    | (1 )   | (1 )%  |
| Mobile                                | 149                | 123   | 26     | 21 %   |
| Total Digital                         | \$566              | \$502 | \$ 64  | 13 %   |
| Packaged goods and other              | \$332              | \$313 | \$ 19  | 6 %    |
| Net revenue                           | \$898              | \$815 | \$ 83  | 10 %   |

## Digital Net Revenue

Digital net revenue includes full-game downloads, extra content, subscriptions, advertising and other, and mobile revenue. Digital net revenue includes internally-developed and co-published game software distributed through our direct-to-consumer platform Origin, distributed wirelessly through mobile carriers, or licensed to our third-party publishing partners who distribute our games digitally.

For the three months ended September 30, 2016, digital net revenue was \$566 million primarily driven by FIFA Ultimate Team, FIFA Online 3 in Asia, and Star Wars: Galaxy of Heroes. Digital net revenue for the three months ended September 30, 2016 increased \$64 million, or 13 percent, as compared to the three months ended September 30, 2015. This increase is due to (1) a \$27 million or 13 percent increase in extra content net revenue primarily driven by revenue associated with our Ultimate Team game mode, (2) a \$26 million or 21 percent increase in mobile net revenue primarily driven by Star Wars: Galaxy of Heroes, Need for Speed No Limits, and Madden NFL Mobile, and (3) a \$12 million or 15 percent increase in full-game download net revenue primarily driven by Need for Speed 2015, Battlefield 4, and Star Wars Battlefront. These increases are partially offset by a \$1 million or 1 percent decrease in subscription net revenue primarily due to Star Wars: The Old Republic.

## Packaged Goods and Other Net Revenue

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

For the three months ended September 30, 2016, packaged goods and other net revenue was \$332 million, primarily driven by Star Wars Battlefront, FIFA 16, and Need for Speed 2015. Packaged goods and other net revenue for the three months ended September 30, 2016 increased \$19 million, or 6 percent, as compared to the three months ended September 30, 2015. This



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increase was driven by an increase in sales primarily from the Star Wars and Need for Speed franchises, partially offset by the Battlefield franchise and Dragon Age: Inquisition.

## Change in Deferred Net Revenue (online-enabled games)

“Revenue Deferral” generally relates to the deferral of revenue for sales of online-enabled games and content for which we do not have VSOE for unspecified updates to be delivered after the initial sale or for which we have a continuing service obligation. “Recognition of Revenue Deferral” generally relates to revenue that has been deferred and is recognized in the current fiscal period. Fluctuations in the Revenue Deferral are largely dependent upon the amounts of online-enabled games and content that we sell, while the Recognition of Revenue Deferral for a period is also dependent upon (1) the amount deferred, (2) the period of time the unspecified updates and service obligations are to be provided, and (3) the timing of the sale. “Change in deferred net revenue (online-enabled games)” is the net impact of Revenue Deferral and Recognition of Revenue Deferral.

Our revenue from the sales of online-enabled games and content is generally deferred and recognized over an estimated nine-month period beginning in the month after shipment for physical games sold through retail and an estimated six-month period for digitally delivered games and content, and therefore, the related revenue recognized during the fiscal quarter ended September 30 is primarily due to revenue from sales that occurred during the preceding six-month period for digitally delivered games and content, and the preceding nine-month period for physical games sold through retail. Consequently, most Revenue Deferrals incurred in the first quarter of a fiscal year are recognized within the same fiscal year; however, substantially all of the Revenue Deferrals incurred in the last month of a fiscal year will be recognized in the subsequent fiscal year.

Our Revenue Deferral and Recognition of Revenue Deferral, including the impact from related cash flow hedges, for the three months ended September 30, 2016 and 2015 was as follows (in millions):

|   | Three Months Ended September 30, |         |           |          |
|---|----------------------------------|---------|-----------|----------|
|   | 2016                             | 2015    | \$ Change | % Change |
| Digital   | \$342                            | \$336   | \$6       | 2%       |
| Packaged goods and other                              | 591                              | 641     | (50)      | (8)%     |
| Revenue Deferral                                      | \$933                            | \$977   | \$(44)    | (5)%     |
| Digital   | \$(422)                          | \$(358) | \$(64)    | 18%      |
| Packaged goods and other                              | (311)                            | (288)   | (23)      | 8%       |
| Recognition of Revenue Deferral                       | \$(733)                          | \$(646) | \$(87)    | 13%      |
| Digital   | \$(80)                           | \$(22)  | \$(58)    | 264%     |
| Packaged goods and other                              | 280                              | 353     | (73)      | (21)%    |
| Change in deferred net revenue (online-enabled games) | \$200                            | \$331   | \$(131)   | (40)%    |

## Revenue Deferral

## Digital

Revenue Deferral for the three months ended September 30, 2016 was \$342 million, primarily driven by FIFA Ultimate Team, Star Wars: Galaxy of Heroes, and Madden Ultimate Team. Revenue Deferral for the three months ended September 30, 2016 increased \$6 million, or 2 percent, as compared to the three months ended September 30, 2015.

Packaged Goods and Other

Revenue Deferral for the three months ended September 30, 2016 was \$591 million, primarily driven by FIFA 17, Madden NFL 17 and NHL 17. Revenue Deferral for the three months ended September 30, 2016 decreased \$50 million, or 8 percent, as compared to the three months ended September 30, 2015. This decrease was primarily due to a decrease in Revenue Deferral due to FIFA 16 being launched one week earlier than FIFA 17.

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## Recognition of Revenue Deferral

## Digital

The Recognition of Revenue Deferral for the three months ended September 30, 2016 was \$422 million, primarily driven by FIFA Ultimate Team, Star Wars: Galaxy of Heroes, and The Sims 4. The Recognition of Revenue Deferral for the three months ended September 30, 2016 increased \$64 million, or 18 percent, as compared to the three months ended September 30, 2015. This increase was primarily due to an increase in the Recognition of Revenue Deferral from FIFA Ultimate Team, Star Wars: Galaxy of Heroes, and Star Wars Battlefront.

## Packaged Goods and Other

The Recognition of Revenue Deferral for the three months ended September 30, 2016 was \$311 million, primarily driven by Star Wars Battlefront, FIFA 16, and Madden NFL 16. The Recognition of Revenue Deferral for the three months ended September 30, 2016 increased \$23 million, or 8 percent, as compared to the three months ended September 30, 2015. This increase was primarily a result of an increase in the Recognition of Revenue Deferral due to Star Wars Battlefront.

## Net Revenue Year-to-Date Analysis

## Net Revenue

For the six months ended September 30, 2016, net revenue was \$2,169 million and increased \$151 million, or 7 percent, as compared to the six months ended September 30, 2015. This increase was driven by a \$538 million increase in revenue primarily from the Star Wars, Need for Speed and UFC franchises. This increase was partially offset by a \$387 million decrease in revenue primarily from the Battlefield, Dragon Age, and The Sims franchises.

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

Our net revenue by product revenue and service and other net revenue for the six months ended September 30, 2016 and 2015 was as follows (in millions):

|                   | Six Months Ended September 30, |         |          |        |
|-------------------|--------------------------------|---------|----------|--------|
|                   | 2016                           | 2015    | \$       | %      |
|                   |                                |         | Change   | Change |
| Net revenue:      |                                |         |          |        |
| Product           | \$1,104                        | \$1,177 | \$ (73 ) | (6 )%  |
| Service and other | 1,065                          | 841     | 224      | 27 %   |
| Total net revenue | \$2,169                        | \$2,018 | \$ 151   | 7 %    |

## Product Revenue

For the six months ended September 30, 2016, product net revenue was \$1,104 million, primarily driven by Star Wars Battlefront, FIFA 16, and Madden NFL 16. Product net revenue decreased \$73 million, or 6 percent, as compared to the six months ended September 30, 2015. This decrease was driven by a \$441 million decrease primarily from the Battlefield, Dragon Age, and FIFA franchises. This decrease was partially offset by a \$368 million increase primarily from Star Wars Battlefront and the UFC franchise.

## Service and Other Revenue

For the six months ended September 30, 2016, service and other net revenue was \$1,065 million, primarily driven by FIFA Ultimate Team, Need for Speed 2015, and Star Wars: Galaxy of Heroes. Service and other net revenue for the

six months ended September 30, 2016 increased \$224 million, or 27 percent, as compared to the six months ended September 30, 2015. This increase was driven by a \$285 million increase primarily from Need for Speed 2015, FIFA Ultimate Team and the Star Wars franchise. This increase was partially offset by a \$61 million decrease primarily from The Simpsons Tapped Out, Titanfall, Command and Conquer Tiberium Alliances, and The Sims FreePlay.

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Our net revenue by revenue composition for the six months ended September 30, 2016 and 2015 was as follows (in millions):

|                                       | Six Months Ended September 30, |         |              |             |
|---------------------------------------|--------------------------------|---------|--------------|-------------|
|                                       | 2016                           | 2015    | \$<br>Change | %<br>Change |
| Full game downloads                   | \$231                          | \$201   | \$ 30        | 15 %        |
| Extra content                         | 540                            | 504     | 36           | 7 %         |
| Subscriptions, advertising, and other | 170                            | 155     | 15           | 10 %        |
| Mobile                                | 314                            | 265     | 49           | 18 %        |
| Total Digital                         | \$1,255                        | \$1,125 | \$ 130       | 12 %        |
| Packaged goods and other              | \$914                          | \$893   | \$ 21        | 2 %         |
| Net revenue                           | \$2,169                        | \$2,018 | \$ 151       | 7 %         |

## Digital Net Revenue

For the six months ended September 30, 2016, digital net revenue was \$1,255 million primarily driven by FIFA Ultimate Team, FIFA Online 3 in Asia, and Star Wars: Galaxy of Heroes. Digital net revenue for the six months ended September 30, 2016 increased \$130 million, or 12 percent, as compared to the six months ended September 30, 2015. This increase is due to (1) a \$49 million or 18 percent increase in mobile net revenue primarily driven by Star Wars: Galaxy of Heroes, Madden NFL Mobile and Need for Speed No Limits, (2) a \$36 million or 7 percent increase in extra content net revenue primarily driven by sales associated with our Ultimate Team game mode, (3) a \$30 million or 15 percent increase in full-game download net revenue primarily driven by Star Wars Battlefront, Need for Speed 2015, and FIFA 16, and (4) a \$15 million or 10 percent increase in subscription net revenue primarily due to EA Access and Origin Access.

## Packaged Goods and Other Net Revenue

For the six months ended September 30, 2016, packaged goods and other net revenue was \$914 million, primarily driven by FIFA 16, Star Wars Battlefront, and Madden NFL 16. Packaged goods and other net revenue for the six months ended September 30, 2016 increased \$21 million, or 2 percent, as compared to the six months ended September 30, 2015. This increase was driven by an increase in revenue primarily from the Star Wars, Need for Speed and UFC franchises, partially offset by the Battlefield and FIFA franchises and Dragon Age: Inquisition.

## Change in Deferred Net Revenue (online-enabled games)

Our Revenue Deferral and Recognition of Revenue Deferral, including the impact from related cash flow hedges, for the six months ended September 30, 2016 and 2015 was as follows (in millions):

|                                 | Six Months Ended September 30, |           |              |             |
|---------------------------------|--------------------------------|-----------|--------------|-------------|
|                                 | 2016                           | 2015      | \$<br>Change | %<br>Change |
| Digital                         | \$769                          | \$705     | \$ 64        | 9 %         |
| Packaged goods and other        | 685                            | 767       | (82 )        | (11 )%      |
| Revenue Deferral                | \$1,454                        | \$1,472   | \$ (18 )     | (1 )%       |
| Digital                         | \$(970 )                       | \$(818 )  | \$(152 )     | 19 %        |
| Packaged goods and other        | (873 )                         | (833 )    | (40 )        | 5 %         |
| Recognition of Revenue Deferral | \$(1,843)                      | \$(1,651) | \$(192 )     | 12 %        |

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|   |          |          |          |       |
|---|----------|----------|----------|-------|
| Digital   | \$(201 ) | \$(113 ) | \$(88 )  | 78 %  |
| Packaged goods and other                              | (188 )   | (66 )    | (122 )   | 185 % |
| Change in deferred net revenue (online-enabled games) | \$(389 ) | \$(179 ) | \$(210 ) | 117 % |

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## Revenue Deferral

## Digital

Revenue Deferral for the six months ended September 30, 2016 was \$769 million, primarily driven by FIFA Ultimate Team, Star Wars: Galaxy of Heroes, and The Sims 4. Revenue Deferral for the six months ended September 30, 2016 increased \$64 million, or 9 percent, as compared to the six months ended September 30, 2015.

## Packaged Goods and Other

Revenue Deferral for the six months ended September 30, 2016 was \$685 million, primarily driven by FIFA 17, Madden NFL 17 and NHL 17. Revenue Deferral for the three months ended September 30, 2016 decreased \$82 million, or 11 percent, as compared to the six months ended September 30, 2015. This decrease was primarily due to a decrease in Revenue Deferral due to Battlefield Hardline.

## Recognition of Revenue Deferral

## Digital

The Recognition of Revenue Deferral for the six months ended September 30, 2016 was \$970 million, primarily driven by FIFA Ultimate Team, Star Wars: Galaxy of Heroes, and Star Wars Battlefront. The Recognition of Revenue Deferral for the six months ended September 30, 2016 increased \$152 million, or 19 percent, as compared to the six months ended September 30, 2015. This increase was primarily due to an increase in the Recognition of Revenue Deferral from FIFA Ultimate Team, Star Wars: Galaxy of Heroes, and Star Wars Battlefront.

## Packaged Goods and Other

The Recognition of Revenue Deferral for the six months ended September 30, 2016 was \$873 million, primarily driven by FIFA 16, Star Wars Battlefront and Madden NFL 16. The Recognition of Revenue Deferral for the six months ended September 30, 2016 increased \$40 million, or 5 percent, as compared to the six months ended September 30, 2015. This increase was primarily a result of an increase in the Recognition of Revenue Deferral due to Star Wars Battlefront, offset by Battlefield Hardline.

## Cost of Revenue Quarterly Analysis

Cost of revenue for the three months ended September 30, 2016 and 2015 was as follows (in millions):

|                       | September 30,<br>2016 | % of<br>Related<br>Net<br>Revenue | September 30,<br>2015 | % of<br>Related<br>Net<br>Revenue | %<br>Change | Change<br>as a<br>% of<br>Related<br>Net<br>Revenue |
|-----------------------|-----------------------|-----------------------------------|-----------------------|-----------------------------------|-------------|---|
| Cost of revenue:      |                       |                                   |                       |                                   |             |   |
| Product               | \$ 317                | 75.5 %                            | \$ 335                | 77.2 %                            | (5.4 )%     | (1.7 )%   |
| Service and other     | 84                    | 17.6 %                            | 74                    | 19.4 %                            | 13.5 %      | (1.8 )%   |
| Total cost of revenue | \$ 401                | 44.7 %                            | \$ 409                | 50.2 %                            | (2.0 )%     | (5.5 )%   |

## Cost of Product Revenue

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

Cost of product revenue decreased by \$18 million, or 5.4 percent during the three months ended September 30, 2016, as compared to the three months ended September 30, 2015. This decrease was primarily due to a decrease in inventory and royalty costs driven by Rory McIlroy PGA Tour, which did not have a comparable title in the current quarter.



Table of Contents**Cost of Service and Other Revenue**

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

Cost of service and other revenue increased by \$10 million, or 13.5 percent during the three months ended September 30, 2016, as compared to the three months ended September 30, 2015. The increase was primarily due to an increase in costs associated with FIFA Ultimate Team game mode.

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

During the three months ended September 30, 2016, total cost of revenue as a percentage of total net revenue decreased by 5.5 percent as compared to the three months ended September 30, 2015. This decrease was primarily due to the recognition of revenue deferral from Star Wars Battlefront which increased net revenue for the three months ended September 30, 2016.

**Cost of Revenue Year-to-Date Analysis**

Cost of revenue for the six months ended September 30, 2016 and 2015 was as follows (in millions):

|                       | September 30,<br>2016 | % of<br>Related<br>Net<br>Revenue | September 30,<br>2015 | % of<br>Related<br>Net<br>Revenue | %<br>Change | Change<br>as a<br>% of<br>Related<br>Net<br>Revenue |
|-----------------------|-----------------------|-----------------------------------|-----------------------|-----------------------------------|-------------|---|
| Cost of revenue:      |                       |                                   |                       |                                   |             |   |
| Product               | \$ 407                | 36.9 %                            | \$ 429                | 36.4 %                            | (5.1 )%     | 0.5 %   |
| Service and other     | 173                   | 16.2 %                            | 153                   | 18.2 %                            | 13.1 %      | (2.0 )%   |
| Total cost of revenue | \$ 580                | 26.7 %                            | \$ 582                | 28.8 %                            | (0.3 )%     | (2.1 )%   |

**Cost of Product Revenue**

Cost of product revenue decreased by \$22 million or 5.1 percent during the six months ended September 30, 2016, as compared to the six months ended September 30, 2015. This decrease was primarily due to a decrease in inventory and royalty costs driven by Rory McIlroy PGA Tour, launched during the six months ended September 30, 2015, which did not have a comparable title in the current year.

**Cost of Service and Other Revenue**

Cost of service and other revenue increased by \$20 million, or 13.1 percent during the six months ended September 30, 2016, as compared to the six months ended September 30, 2015. The increase was primarily due to an increase in costs associated with supporting our FIFA Ultimate Team service.

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

During the six months ended September 30, 2016, total cost of revenue as a percentage of total net revenue decreased by 2.1% as compared to the six months ended September 30, 2015. This decrease was primarily due to the recognition of revenue deferral from Star Wars Battlefront which increased net revenue for the six months ended September 30, 2015.

**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.

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Research and development expenses for the three and six months ended September 30, 2016 and 2015 were as follows (in millions):

|                    | September 30,<br>2016 | % of Net<br>Revenue | September 30,<br>2015 | % of Net<br>Revenue | \$ Change | % Change |
|--------------------|-----------------------|---------------------|-----------------------|---------------------|-----------|----------|
| Three months ended | \$ 291                | 32 %                | \$ 265                | 33 %                | \$ 26     | 10 %     |
| Six months ended   | \$ 585                | 27 %                | \$ 561                | 28 %                | \$ 24     | 4 %      |

Research and development expenses increased by \$26 million, or 10 percent, during the three months ended September 30, 2016, as compared to the three months ended September 30, 2015. This \$26 million increase was primarily due to (1) a \$12 million increase in personnel-related costs primarily resulting from increase in headcount and lower government tax incentives, (2) an \$8 million increase in contracted services due to development advances to third-party developers primarily related to Star Wars and Battlefield 1, and (3) a \$6 million increase in facility-related costs.

Research and development expenses increased by \$24 million, or 4 percent, during the six months ended September 30, 2016, as compared to the six months ended September 30, 2015. This \$24 million increase was primarily due to a \$24 million increase in contracted services due to development advances to third-party developers primarily related to Star Wars and Battlefield 1 and a \$5 million increase in facility-related costs, partially offset by an \$8 million decrease due to gains from our cash flow hedging activities incurred during the six months ended September 30, 2016.

#### 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, 2016 and 2015 were as follows (in millions):

|                    | September 30,<br>2016 | % of Net<br>Revenue | September 30,<br>2015 | % of Net<br>Revenue | \$ Change | % Change |
|--------------------|-----------------------|---------------------|-----------------------|---------------------|-----------|----------|
| Three months ended | \$ 143                | 16 %                | \$ 156                | 19 %                | \$ (13 )  | (8 )%    |
| Six months ended   | \$ 271                | 12 %                | \$ 279                | 14 %                | \$ (8 )   | (3 )%    |

Marketing and sales expenses decreased by \$13 million, or 8 percent, during the three months ended September 30, 2016, as compared to the three months ended September 30, 2015. This \$13 million decrease was primarily driven by a decrease in advertising for the Madden and FIFA franchises, partially offset by advertising expenses for Titanfall 2 during the three months ended September 30, 2016.

Marketing and sales expenses decreased by \$8 million, or 3 percent, during the six months ended September 30, 2016, as compared to the six months ended September 30, 2015. This \$8 million decrease was driven by a decrease in advertising on the Madden and FIFA franchises, partially offset by advertising expenses for Battlefield 1 and Titanfall 2 during the six months ended September 30, 2016.

#### 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, 2016 and 2015 were as follows (in millions):

|                    | September 30,<br>2016 | % of Net<br>Revenue | September 30,<br>2015 | % of Net<br>Revenue | \$ Change | % Change |
|--------------------|-----------------------|---------------------|-----------------------|---------------------|-----------|----------|
| Three months ended | \$ 111                | 12 %                | \$ 101                | 12 %                | \$ 10     | 10 %     |
| Six months ended   | \$ 219                | 10 %                | \$ 199                | 10 %                | \$ 20     | 10 %     |

General and administrative expenses increased by \$10 million, or 10 percent, during the three months ended September 30, 2016, as compared to the three months ended September 30, 2015. This \$10 million increase was primarily due to a \$5 million increase in personnel-related costs resulting from an increase in headcount and a \$3 million increase in contracted services.

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General and administrative expenses increased by \$20 million, or 10 percent, during the six months ended September 30, 2016, as compared to the six months ended September 30, 2015. This \$20 million increase was primarily due to (1) a \$6 million increase in facility-related expense primarily due to office expansions, (2) a \$6 million increase in contracted services, and (3) a \$5 million increase in personnel-related costs resulting from an increase in headcount.

## Income Taxes

Provision for (benefit from) income taxes for the three and six months ended September 30, 2016 and 2015 were as follows (in millions):

|                             | September 30, 2016 | Effective Tax Rate | September 30, 2015 | Effective Tax Rate |
|-----------------------------|--------------------|--------------------|--------------------|--------------------|
| Three months ended \$ (14 ) | 26.9 %             | \$ 12              | 9.4 %              |                    |
| Six months ended \$ 98      | 19.6 %             | \$ 79              | 20.7 %             |                    |

The provision for (benefit from) income taxes reported for the three and six months ended September 30, 2016 is based on our projected annual effective tax rate for fiscal year 2017, and also includes certain discrete items recorded during the period. Our effective tax rate for the three and six months ended September 30, 2016 was 26.9 percent and 19.6 percent, respectively, as compared to 9.4 percent and 20.7 percent, respectively, for the same period of fiscal year 2016. The effective tax rate for the three and six months ended September 30, 2016 was reduced, when compared to the statutory rate of 35.0 percent, due primarily to non-U.S. profits subject to a reduced or zero tax rate. The effective tax rate for the three and six months ended September 30, 2015 was reduced, when compared to the statutory rate of 35.0 percent, by the utilization of U.S. deferred tax assets which were subject to a valuation allowance and non-U.S. profits subject to a reduced or zero tax rate. Conversely, the effective tax rate for the three and six months ended September 30, 2015 was increased due to a discrete expense of \$25 million and \$65 million, respectively, for excess tax benefits from stock-based compensation deductions allocated directly to contributed capital. The effective tax rate for the three and six months ended September 30, 2016 differs from the same periods in fiscal year 2016 primarily due to the utilization of U.S. deferred tax assets in fiscal year 2016 which were subject to a valuation allowance and the discrete expense for excess tax benefits from stock-based compensation deductions allocated directly to contributed capital in fiscal year 2016.

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## LIQUIDITY AND CAPITAL RESOURCES

| (In millions)              | As of<br>September<br>30, 2016 | As of<br>March<br>31, 2016 | Increase/(Decrease) |
|----------------------------|--------------------------------|----------------------------|---------------------|
| Cash and cash equivalents  | \$ 1,746                       | \$2,493                    | \$ (747 )           |
| Short-term investments     | 1,520                          | 1,341                      | 179                 |
| Total                      | \$ 3,266                       | \$3,834                    | \$ (568 )           |
| Percentage of total assets | 47 %                           | 54 %                       |                     |

| (In millions)   | Six Months<br>Ended<br>September 30, |         |          |
|---|--------------------------------------|---------|----------|
|   | 2016                                 | 2015    | Change   |
| Net cash used in operating activities                   | \$(139)                              | \$(62 ) | \$(77 )  |
| Net cash used in investing activities                   | (249 )                               | (80 )   | (169 )   |
| Net cash used in financing activities                   | (351 )                               | (307 )  | (44 )    |
| Effect of foreign exchange on cash and cash equivalents | (8 )                                 | (21 )   | 13       |
| Net decrease in cash and cash equivalents               | \$(747)                              | \$(470) | \$(277 ) |

## Changes in Cash Flow

Operating Activities. Net cash used in operating activities increased by \$77 million during the six months ended September 30, 2016 as compared to the six months ended September 30, 2015. The increase is primarily driven by a \$114 million decrease in accounts receivable collections due to the timing of game launches, in particular Battlefield Hardline. Accounts receivables for Battlefield Hardline, which launched in March 2015, was collected in the six months ended September 30, 2015. There was no comparable launch in March 2016.

Investing Activities. Net cash used in investing activities increased by \$169 million during the six months ended September 30, 2016 as compared to the six months ended September 30, 2015 primarily driven by a \$273 million increase in the purchase of short-term investments and a \$27 million increase in capital expenditures. This was offset by a \$131 million increase in proceeds from the sales and maturities of short-term investments.

Financing Activities. Net cash used in financing activities increased by \$44 million during the six months ended September 30, 2016 as compared to the six months ended September 30, 2015 primarily due to a \$53 million decrease in proceeds from the exercise of stock options and a \$28 million decrease in excess tax benefit from stock-based compensation recognized during the six months ended September 30, 2016 as compared to the six months ended September 30, 2015. These increases were partially offset by a \$35 million decrease in repayments related to our convertible senior notes during the six months ended September 30, 2016 as compared to the six months ended September 30, 2015.

## 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, 2016, our short-term investments had gross unrealized gains of \$2 million, or less than 1 percent of the total in short-term investments, and gross unrealized losses of less than \$1 million, or less than 1 percent of the total in short-term investments. From time to time, we may liquidate some or all of our short-term investments to fund operational needs or other activities, such as capital expenditures, business acquisitions or stock repurchase programs. Depending on which short-term investments we liquidate to fund these activities, we could recognize a portion, or all, of the gross unrealized gains or losses.

## Convertible Notes and Convertible Note Hedge

In July 2011, we issued \$632.5 million aggregate principal amount of Convertible Notes. The Convertible Notes matured on July 15, 2016. During the three months ended September 30, 2016, approximately \$136 million principal value of the Convertible Notes were converted by holders thereof. During the three months ended September 30,

2016, we repaid the remaining principal balance on the Convertible Notes of \$136 million and issued approximately 2.5 million shares of common stock to noteholders with a fair value of \$193 million on the final maturity date of July 15, 2016. We also received and cancelled approximately 2.5 million shares of common stock from the exercise of the Convertible Note Hedge during the three months ended September 30, 2016.

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Warrants

We have outstanding Warrants with independent third parties to acquire up to 19.9 million shares of our common stock (which is also equal to the number of shares of our common stock that notionally underlie the Convertible Notes), with a strike price of \$41.14. The Warrants have a dilutive effect with respect to our common stock to the extent that the market price per share of our common stock exceeds \$41.14 on or prior to the expiration date of the Warrants. The Warrants automatically exercise over a 60 trading day period that began on October 17, 2016. Based on the closing price of our common stock of \$85.40 at the end of the quarter ended September 30, 2016, approximately 10.3 million shares of our common stock would be issuable to Warrant holders. The actual amount of shares issuable upon exercise will be determined based upon the market price of our common stock during the 60 day trading period that began on October 17, 2016.

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 \$990 million for general corporate purposes, including the payment of amounts due upon conversion of our Convertible Notes and the repurchase of our common stock, including under the \$500 million stock repurchase program approved in February 2016 and completed in March 2016. The effective interest rate was 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.

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, 2016, no amounts were outstanding under the credit facility.

See Note 10 - Financing Arrangements to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to 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.

As of September 30, 2016, approximately \$1.9 billion of our cash, cash equivalents, and short-term investments were domiciled in foreign tax jurisdictions. While we have no plans to repatriate these funds to the United States in the short term, if we choose to do so, we may be required to accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

In May 2015, our Board of Directors authorized a program to repurchase up to \$1 billion of our common stock. This stock repurchase program expires on May 31, 2017. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase any specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and six months ended September 30, 2016, we repurchased approximately 1.6 million and 3.5 million shares for approximately \$127 million and \$256 million, respectively. We continue to actively repurchase shares. As of September 30, 2016, \$282 million was available to be repurchased under this program.

We have a “shelf” registration statement on Form S-3 on file with the SEC. This shelf registration statement, which includes a base prospectus, allows us at any time to offer any combination of securities described in the prospectus in one or more offerings. Unless otherwise specified in a prospectus supplement accompanying the base prospectus, we would use the net proceeds from the sale of any securities offered pursuant to the shelf registration statement for



general corporate purposes, including for working capital, financing capital expenditures, research and development, marketing and distribution efforts, and if opportunities arise, for acquisitions or strategic alliances. Pending such uses, we may invest the net proceeds in interest-bearing securities. In addition, we may conduct concurrent or other financings at any time.

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

Contractual Obligations and Commercial Commitments

Note 11 - Commitments and Contingencies to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our contractual obligations and commercial commitments is incorporated by reference into this Item 2.

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OFF-BALANCE SHEET COMMITMENTS

As of September 30, 2016, 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.

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Item 3: Quantitative and Qualitative Disclosures About Market Risk

**MARKET RISK**

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

**Foreign Currency Exchange Rate Risk**

**Foreign Currency Exchange Rates.** International sales are a fundamental part of our business, and 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.** From time to time, we hedge a portion of our foreign currency risk related to forecasted foreign-currency-denominated sales and expense transactions by purchasing foreign currency forward contracts that generally have maturities of 18 months or less. These transactions are designated and qualify as cash flow hedges. Our hedging programs are designed to reduce, but do not entirely eliminate, the impact of currency exchange rate movements in net revenue and research and development expenses.

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

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

Notwithstanding our efforts to mitigate some foreign currency exchange rate risks, there can be no assurance that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations. As of September 30, 2016, 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 \$83 million and \$167 million, respectively. As of September 30, 2016, 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 \$27 million and \$53 million, respectively. This sensitivity analysis assumes an adverse shift of all foreign currency exchange rates; however, all foreign currency exchange rates do not always move in such manner and actual results may differ materially. See Note 4 - Derivative Financial Instruments to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our derivative financial instruments, which is incorporated by reference into this Item 3.

**Interest Rate Risk**

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

are required to be reinvested at the then-current market rates, interest income on a portfolio consisting of short-term investments is more subject to market fluctuations than a portfolio of longer term investments. Additionally, the contractual terms of the investments do not permit the issuer to call, prepay or otherwise settle the investments at prices less than the stated par value. Our investments are held for purposes other than trading. Also, we do not use derivative financial instruments in our short-term investment portfolio.

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As of September 30, 2016, 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. At any time, a sharp change in interest rates could have a significant impact on the fair value of our investment portfolio. The following table presents the hypothetical changes in the fair value of our short-term investment portfolio as of September 30, 2016, 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<br>Given an Interest Rate<br>Decrease<br>of X Basis Points |           |          | Fair Value<br>as of<br>September<br>30, 2016 | Valuation of Securities<br>Given<br>an Interest Rate Increase<br>of<br>X Basis Points |          |          |
|-------------------------------|--|-----------|----------|--|---|----------|----------|
|                               | (150 BPS)  | (100 BPS) | (50 BPS) |  | 50 BPS  | 100 BPS  | 150 BPS  |
| Corporate bonds               | \$750  | \$ 746    | \$ 742   | \$ 739                                       | \$735   | \$ 732   | \$ 728   |
| U.S. Treasury securities      | 386  | 384       | 381      | 379  | 376   | 373      | 371      |
| U.S. agency securities        | 157  | 156       | 155      | 154  | 154   | 153      | 151      |
| Commercial paper              | 79   | 79        | 79       | 79   | 78  | 78       | 78       |
| Foreign government securities | 117  | 116       | 116      | 115  | 114   | 114      | 113      |
| Asset-backed securities       | 55   | 55        | 55       | 54   | 54  | 53       | 53       |
| Total short-term investments  | \$1,544  | \$ 1,536  | \$ 1,528 | \$ 1,520                                     | \$1,511   | \$ 1,503 | \$ 1,494 |

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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, 2016 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.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The information under the subheading “Legal Proceedings” in Note 11 - Commitments and Contingencies to the Condensed Consolidated Financial Statements in this Form 10-Q is incorporated by reference into this Part II.

Item 1A. Risk Factors

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

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

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

We maintain a relatively limited product portfolio in an effort to focus on developing high-quality products with the potential to become “hits”. High-quality titles, even if highly-reviewed, may not turn into “hit” products. Many “hit” products within our industry are iterations of prior hit products with large established consumer bases and significant brand recognition, which makes competing in certain product categories challenging. In addition, hit products or services of our competitors may take a larger share of consumer spending than we anticipate, which could cause our products and services to underperform relative to revenue expectations. Publishing a relatively small number of major titles each year also concentrates risk in those titles and means each major title has greater associated risk. The increased importance of extra content and live services revenue to our business heightens this risk as extra content and live services for poorly-received or underperforming games may generate lower than expected sales. A significant portion of our revenue has historically been derived from games and services based on a few popular franchises. For example, in fiscal year 2016, net revenue generated from the sale of products and services associated with our three largest franchises accounted for approximately 55 percent of our net revenue. The underperformance of a single major title and the associated extra content may have a large adverse impact on our financial results.

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

Our 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 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 would likely suffer materially. Any failure to meet anticipated production or release schedules would likely result in a delay of revenue and/or possibly a significant shortfall in our revenue, increase our development and/or marketing expenses, harm our profitability, and cause our operating results to be materially different than anticipated.

Our business is highly seasonal with the highest percentage of our sales occurring in the quarter ending in December. While our sales generally follow this seasonal trend, there can be no assurance that this trend will continue. If we miss key selling periods for products, for any reason, including product delays, product cancellations, or delayed introduction of a new platform for which we have developed products, our sales are likely to suffer significantly. Additionally, macroeconomic conditions or the occurrence of unforeseen events that negatively impact retailer or consumer buying patterns during the quarter ending in December are likely to harm our financial performance disproportionately.

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Our business is dependent on the success and availability of platforms developed by third parties, as well as our ability to develop commercially successful products and services for these platforms.

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

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

Rapid technology changes in our industry require us to anticipate, sometimes years in advance, which technologies we must implement and take advantage of in order to make our products and services competitive in the market. We have invested, and in the future may invest, in new business strategies, technologies, products, and services. Such endeavors may involve significant risks and uncertainties, and no assurance can be given that the technology we choose to adopt and the products and services that we pursue will be successful and will not materially adversely affect our reputation, financial condition, and operating results. We also may miss opportunities to adopt technology, or develop products and services that become popular with consumers, which could adversely affect our revenues. It may take significant time and resources to shift our focus to such technologies, putting us at a competitive disadvantage.

Our product development usually starts with particular platforms and distribution methods in mind, and a range of technical development and game 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 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.

Security breaches and cyber threats could harm our reputation and adversely affect our business.

As our digital business grows, we continually face cyber risks and threats that seek to damage, disrupt or gain access to our networks, our products and services, and supporting infrastructure. Our business partners, including our

channel partners, also are subject to these risks. Such cyber risks and threats may be difficult to detect. Any failure to prevent or mitigate security breaches or cyber risk could result in interruptions to the services we provide, degrade the user experience, cause our users to lose confidence in our products, as well as significant legal and financial exposure. This could harm our business and reputation, disrupt our relationships with partners and diminish our competitive position.

Successful exploitation of our systems can have other negative effects upon the products, services and user experience we offer. In particular, 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 redeemed by a player within a particular game or game service. The abuse or exploitation of our virtual economies include the illegitimate generation and sale of virtual items in black markets. Our online services have been impacted by in-game exploits and the use of automated processes to generate virtual currency illegitimately in the past, which

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were traded in black markets. These kinds of activities and the steps that we take to address these issues may result in a loss of anticipated revenue, interfere with players' enjoyment of a balanced game environment and cause reputational harm.

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

We are investing and expect to continue to invest in technology, hardware and software to support the online functionality of our portfolio of products and services. Launching and operating games and services with online features, developing related technologies and implementing online business initiatives is expensive and complex. Execution of these initiatives could result in operational failures and other issues impacting the technical stability of our products and services. In addition, having the necessary infrastructure to support the online functionality of our products and services is vital to our growth and success. Our products and services could be adversely impacted by outages, disruptions and failures 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.

Our business is subject to currency fluctuations.

International sales are a fundamental part of our business. For our fiscal year ended March 31, 2016, international net revenue comprised 57 percent of our total net revenue, and we expect international sales 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.

Declines or fluctuations in the recurring portion of our business may have a negative impact on our financial and operating results.

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, and ongoing mobile businesses. While we are confident in our ability to forecast the revenue from these areas of our business with greater certainty than for new offerings, we cannot provide assurances that consumers will purchase these games and services on a consistent basis. Furthermore, we may cease to offer games and services that we previously had deemed to be recurring in nature. Consumer purchases of our games and services 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, outages and disruptions of our 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. Any decline or fluctuation in the recurring portion of our business may have a negative impact on our financial and operating results.

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

From time to time we seek to establish and implement new business models. Forecasting our revenues and profitability for any new business models is inherently uncertain and volatile. Our actual revenue and profit for these businesses may be significantly greater or less than our forecasts. Additionally, 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.

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

Many of our products and services are based on or incorporate intellectual property owned by others. For example, our EA SPORTS products include rights licensed from major sports leagues and players' associations 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 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.

If external game developers fail to meet product development schedules or are unable to honor their obligations to us, our financial results may be harmed.

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 these games developed by external game developers, and we depend on their ability to meet product development schedules. If these developers cannot meet product development schedules, acquire certain approvals or are otherwise unable to honor their obligations to us, we may delay or cancel previously announced games, 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 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 and other information, including personal information, passwords and credit card information. Although we take measures to protect this information from unauthorized access, acquisition, disclosure and misuse, our security controls, policies and practices may not be able to prevent the improper or unauthorized access, acquisition or disclosure of such information. In addition, third party vendors and business partners which in the course of our business receive access to information that we collect also 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. The unauthorized access, acquisition or disclosure of this information could significantly harm our reputation, compel us to comply with disparate breach notification laws and otherwise subject us to proceedings by governmental entities or others and substantial legal liability. A perception that we do not adequately secure consumer and other information could result in a loss of current or potential consumers and business partners, as well as a loss of anticipated revenues. Our key business partners also face these risks with respect to information they collect and data security breaches with respect to such information could cause reputational harm to them and negatively impact our ability to offer our products and services through their platforms.

We are also 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.

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

Negative player perceptions about our brands, products, services and/or business practices may damage our business and the costs incurred in addressing player concerns may increase our operating expenses.

Player expectations regarding the quality, performance and integrity of our products and services are high. Players may be critical of our brands, products, services and/or business practices for a wide variety of reasons. These negative player reactions

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may not be foreseeable or within our control to manage effectively, including perceptions about gameplay fairness, negative player reactions to game content, components and services, or objections to certain of our business practices. In the past, we have taken actions, including delaying the release of our games and discontinuing services for our games, after taking into consideration, among other things, feedback from the player community even if 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 player sentiment about our business practices also can lead to investigations from regulatory agencies and consumer groups, as well as litigation, which, regardless of their outcome, may be costly, damaging to our reputation and harm our business.

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

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 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 in our products and services before they have been released into the marketplace. In such an event, we could be required to or may find it necessary to 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, each of which could significantly harm our business and operating results.

During console system transition periods, our operating results have been volatile. Any inability to offset declining sales from legacy generation consoles could negatively impact our operating results.

Historically, new video game console systems have been developed and released every few years, which has caused the video game software market to be cyclical as well. In these periods of transition, sales of software for legacy generation console systems typically slow or decline in response to the anticipated and actual introduction of new consoles and new generation software sales typically stabilize after new consoles are widely established with the consumer base.

In November 2013 Sony released the PlayStation 4 and Microsoft released the Xbox One. Consistent with previous periods of console transition, we have seen consumers purchase fewer products and services for legacy generation consoles (i.e., the PlayStation 3 and Xbox 360, respectively) as the current generation consoles have gained consumer acceptance. During our 2016 fiscal year, sales associated with these legacy generation consoles declined significantly, and we expect these declines to continue, or possibly accelerate, during our 2017 fiscal year. Any inability to offset declining sales from legacy generation consoles could negatively impact our operating results.

Our business is subject to regulation and the adoption of proposed legislation we oppose could 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, electronic commerce, virtual items and currency, consumer protection, content, advertising, localization, and information security have been adopted or are being considered for adoption by many countries throughout the world. These laws could harm our business by limiting the products we are able to offer to our consumers or the manner in which we offer these products. The costs of compliance with these laws may increase in the future as a result of changes in interpretation. Furthermore, any failure on our part to comply with these laws or the application of these laws in an unanticipated manner may harm our business and result in penalties or significant legal liability.



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.

In addition, we may include additional competitive modes in our games and manage competitions based on our games and services. Although we structure and operate these skill based competitions with applicable laws in mind, our skill based competitions in the future could become subject to evolving rules and regulations and expose us to significant liability, penalties and reputational harm.

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

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

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

Our products and services are marketed worldwide through a diverse spectrum of advertising and promotional programs such as online and mobile advertising, television advertising, retail merchandising, marketing through websites, event sponsorship and direct communications with our consumers including via email. Our ability to sell our products and services is dependent in part upon the success of these programs. If the marketing for our products and services 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, these factors could have a material adverse impact on our business and operating results.

A significant portion of our sales are made to a relatively small number of customers, and disruptions to sales through these customers could negatively impact our business.

We derive a significant percentage of our net revenue through sales to our top customers. The concentration of a significant percentage of our sales through one, or a few, large customers could lead to a short-term disruption to our business if certain of these customers significantly reduced their purchases or ceased to carry our products. We also could be more vulnerable to collection risk if one or more of these large customers became unable to pay for our products or declared bankruptcy. Additionally, receivables from our customers generally increase in our December fiscal quarter as sales of our games and services generally increase in anticipation of the holiday season. Having a significant portion of our net revenue concentrated in sales through a few customers could reduce our negotiating leverage with these customers. If one or more of our key customers experience deterioration in their business, or become unable to obtain sufficient financing to maintain their operations, our business could be harmed.

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

Our agreements with our channel 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 and distributed to customers. For our digital products and services delivered via digital channels such as Sony's PlayStation Network, Microsoft's Xbox Store, Apple's App Store and the Google Play store, each respective channel partner has policies and guidelines that control the promotion and distribution of these titles and the features and functionalities that we are permitted to offer through the channel.

Moreover, certain of our channel 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 channel 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 channel partners control the information

technology systems through which online sales of our products and service channels are captured. If our channel partners establish terms that restrict our offerings through their channels, 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 harmed.

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

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

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

We rely on various business partners, including third-party service providers, vendors, licensing partners, development partners, and licensees in many areas of our business. In addition, we may have disputes with our business partners that may impact our business and/or financial results. Their actions may put our business and our reputation at risk. 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.

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

From time to time, third parties may 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. In addition, our products often utilize complex, cutting-edge technology that may be subject to intellectual property claims.

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

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

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



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

We may 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 unknown liabilities, 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, including experiencing difficulty in the integration of business systems and technologies, the integration and retention of new employees, or in the maintenance of key business and customer relationships. 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.

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 in our products, 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 and disruptions of our infrastructure that may harm our business.

We may be subject to outages or disruptions 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, acts of terrorism or other events. System redundancy may be ineffective or inadequate, and the Company's 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. Our corporate headquarters in Redwood City, CA and our studio 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 of any of our critical business or information technology systems could harm our ability to conduct normal business operations.

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;

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Utilizing funds that are domiciled in foreign tax jurisdictions in order to make the cash payments upon any repayment of our indebtedness. If we were to choose to use such funds, we would be required to accrue any additional taxes on any portion of the repatriation where no United States income tax had been previously provided; and Limiting our flexibility in planning for, or reacting to, changes in our business and our industry.

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.

In connection with the offering of our convertible senior notes, which matured in July 2016, we entered into separate, privately-negotiated warrant transactions whereby we sold warrants to independent third parties. The exercise of these warrants could have an effect on the market price of our common stock and the trading price of our senior unsecured notes.

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

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

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



do under current accounting standards. The new standard, as amended, will also likely result in a larger portion of our revenues presented as service revenue rather than product revenue.

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 a significant adverse effect on our reported results although not necessarily on our cash flows.

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

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

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

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

## Stock Purchase Programs

In May 2015, our Board of Directors authorized a program to repurchase up to \$1 billion of our common stock. This stock repurchase program, which expires on May 31, 2017. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase any specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and six months ended September 30, 2016, we repurchased approximately 1.6 million and 3.5 million shares for approximately \$127 million and \$256 million, respectively. We continue to actively repurchase shares.

The following table summarizes the number of shares repurchased during the three months ended September 30, 2016:

| Fiscal Month                      | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price<br>Paid per<br>Share | Total<br>Number of<br>Shares<br>as Part of<br>Publicly<br>Announced<br>Program | Maximum<br>Dollar<br>Value that<br>May Still<br>Be<br>Purchased<br>Under the<br>Program<br>(in<br>millions) |
|-----------------------------------|---|---------------------------------------|--|---|
| July 3 - July 30, 2016            | 499,316                                   | \$ 76.87                              | 499,316  | \$ 371  |
| July 31 - August 27, 2016         | 514,031                                   | \$ 78.60                              | 514,031  | \$ 331  |
| August 28, 2016 - October 1, 2016 | 586,506                                   | \$ 82.33                              | 586,506  | \$ 282  |
|                                   | 1,599,853                                 | \$ 79.43                              | 1,599,853  |   |

## Transactions Related to our Convertible Notes and Convertible Note Hedge

During the quarter ended September 30, 2016, we issued, in the aggregate, 2,480,815 shares of common stock to holders of our Convertible Notes. These shares of common stock were issued on the final maturity date of July 15, 2016 in reliance on Section 3(a)(9) of The Securities Act of 1933, as amended.

In connection with the conversions of the Convertible Notes that were settled during the quarter ended September 30, 2016, we exercised our option under the Convertible Note Hedge to acquire 2,480,818 shares of our common stock. The counterparties to the Convertible Note Hedge may be deemed “affiliated purchasers” and may have purchased the shares of our common stock deliverable to us upon exercise of our option during the quarter ended September 30, 2016.

For more information regarding the Notes and the conversion terms thereof, please see “Note 10 - Financing Arrangement” to the Condensed Consolidated Financial Statements in this Form 10-Q.

## 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 65 are filed or incorporated by reference as part of this report.

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SIGNATURE

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

ELECTRONIC ARTS INC.  
(Registrant)

/s/ Blake Jorgensen  
DATED: Blake Jorgensen  
November 8, 2016 Executive Vice President,  
Chief Financial Officer

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ELECTRONIC ARTS INC.  
 FORM 10-Q  
 FOR THE PERIOD ENDED SEPTEMBER 30, 2016  
 EXHIBIT INDEX

| Number  | Exhibit Title   | Incorporated by Reference |          |             | Filed<br>Herewith |
|---|---|---------------------------|----------|-------------|-------------------|
|   |   | Form                      | File No. | Filing Date |                   |
| 10.1  | Offer Letter for employment at Electronic Arts Inc. to Mala Singh, dated August 27, 2016  |                           |          |             | X                 |
| 15.1  | Awareness Letter of KPMG LLP, Independent Registered Public Accounting Firm   |                           |          |             | X                 |
| 31.1  | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |                           |          |             | X                 |
| 31.2  | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |                           |          |             | X                 |
| Additional exhibits furnished with this report: |   |                           |          |             |                   |
| 32.1  | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |                           |          |             | X                 |
| 32.2  | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |                           |          |             | X                 |
| 101.INS <sup>†</sup>                            | XBRL Instance Document  |                           |          |             | X                 |
| 101.SCH <sup>†</sup>                            | XBRL Taxonomy Extension Schema Document   |                           |          |             | X                 |
| 101.CAL <sup>†</sup>                            | XBRL Taxonomy Extension Calculation Linkbase Document   |                           |          |             | X                 |
| 101.DEF <sup>†</sup>                            | XBRL Taxonomy Extension Definition Linkbase Document  |                           |          |             | X                 |
| 101.LAB <sup>†</sup>                            | XBRL Taxonomy Extension Label Linkbase Document   |                           |          |             | X                 |
| 101.PRE <sup>†</sup>                            | XBRL Taxonomy Extension Presentation Linkbase Document  |                           |          |             | X                 |

Attached as Exhibit 101 to this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2016 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 (Loss), (4) Condensed Consolidated Statements of Cash Flows, and (5) Notes to Condensed Consolidated Financial Statements.

