ELECTRONIC ARTS INC.
Form 10-Q
February 04, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended December 31, 2014
OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to
Commission File No. 000-17948
ELECTRONIC ARTS INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	94-2838567 (I.R.S. Employer Identification No.)
209 Redwood Shores Parkway Redwood City, California	94065
(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 þ 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 þ 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	þ	Accelerated filer	¨
Non-accelerated filer (Do not check if a smaller reporting company)	¨	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 þ
As of January 30, 2015, there were 310,035,894 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) (In millions, except par value data)	December 31, 2014	March 31, 2014 [(a)]
ASSETS		
Current assets:		
Cash and cash equivalents	$2,166	$1,782
Short-term investments	774	583
Receivables, net of allowances of $189 and $186, respectively	488	327
Inventories	39	56
Deferred income taxes, net	57	74
Other current assets	230	316
Total current assets	3,754	3,138
Property and equipment, net	461	510
Goodwill	1,718	1,723
Acquisition-related intangibles, net	127	177
Deferred income taxes, net	6	28
Other assets	101	140
TOTAL ASSETS	$6,167	$5,716
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$77	$119
Accrued and other current liabilities	813	781
Deferred net revenue (online-enabled games)	1,583	1,490
0.75% convertible senior notes due 2016, net	596	—
Total current liabilities	3,069	2,390
0.75% convertible senior notes due 2016, net	—	580
Income tax obligations	88	189
Deferred income taxes, net	85	18
Other liabilities	201	117
Total liabilities	3,443	3,294
Commitments and contingencies (See Note 13)		
0.75% convertible senior notes due 2016 (See Note 12)	37	—
Stockholders’ equity:		
Preferred stock, $0.01 par value. 10 shares authorized	—	—
Common stock, $0.01 par value. 1,000 shares authorized; 310 and 311 shares issued and outstanding, respectively	3	3
Paid-in capital	2,152	2,353
Retained earnings	509	29
Accumulated other comprehensive income	23	37
Total stockholders’ equity	2,687	2,422
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$6,167	$5,716

See accompanying Notes to Condensed Consolidated Financial Statements (unaudited).
(a) Derived from audited consolidated financial statements.

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ELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)	Three Months Ended December 31,		Nine Months Ended December 31,	
(In millions, except per share data)	2014	2013	2014	2013
Net revenue:				
Product	$606	$485	$1,899	$1,378
Service and other	520	323	1,431	1,074
Total net revenue	1,126	808	3,330	2,452
Cost of revenue:				
Product	300	438	899	909
Service and other	101	79	296	215
Total cost of revenue	401	517	1,195	1,124
Gross profit	725	291	2,135	1,328
Operating expenses:				
Research and development	283	275	809	836
Marketing and sales	169	214	482	525
General and administrative	107	91	287	305
Acquisition-related contingent consideration	—	—	(2)	(37)
Amortization of intangibles	4	4	11	12
Restructuring and other charges	—	(1)	—	(2)
Total operating expenses	563	583	1,587	1,639
Operating income (loss)	162	(292)	548	(311)
Interest and other income (expense), net	(6)	(6)	(20)	(19)
Income (loss) before provision for income taxes	156	(298)	528	(330)
Provision for income taxes	14	10	48	29
Net income (loss)	$142	$(308)	$480	$(359)
Net income (loss) per share:				
Basic	$0.46	$(1.00)	$1.54	$(1.17)
Diluted	$0.44	$(1.00)	$1.49	$(1.17)
Number of shares used in computation:				
Basic	311	309	312	307
Diluted	323	309	322	307

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

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ELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)	Three Months Ended December 31,		Nine Months Ended December 31,	
(In millions)	2014	2013	2014	2013
Net income (loss)	$142	$(308)	$480	$(359)
Other comprehensive income (loss), net of tax:				
Change in unrealized net gains and losses on available-for-sale securities	(1)	—	(1)	—
Reclassification adjustment for net realized gains on available-for-sale securities	(1)	—	(1)	—
Change in unrealized net gains and losses on derivative instruments	1	(4)	11	(15)
Reclassification adjustment for net realized losses on derivative instruments	1	3	8	5
Foreign currency translation adjustments	(30)	(9)	(31)	(7)
Total other comprehensive loss, net of tax	(30)	(10)	(14)	(17)
Total comprehensive income (loss)	$112	$(318)	$466	$(376)

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

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ELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)	Nine Months Ended December 31,	
(In millions)	2014	2013
OPERATING ACTIVITIES		
Net income (loss)	$480	$(359)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization and accretion	165	170
Stock-based compensation	108	111
Acquisition-related contingent consideration	(2)	(37)
Net loss on investments	—	1
Change in assets and liabilities:		
Receivables, net	(176)	(210)
Inventories	16	(12)
Other assets	137	17
Accounts payable	(29)	13
Accrued and other liabilities	68	75
Deferred income taxes, net	9	7
Deferred net revenue (online-enabled games)	93	655
Net cash provided by operating activities	869	431
INVESTING ACTIVITIES		
Capital expenditures	(63)	(81)
Proceeds from maturities and sales of short-term investments	520	331
Purchase of short-term investments	(717)	(270)
Acquisition of subsidiaries, net of cash acquired	—	(5)
Net cash used in investing activities	(260)	(25)
FINANCING ACTIVITIES		
Proceeds from issuance of common stock	31	51
Excess tax benefit from stock-based compensation	16	—
Repurchase and retirement of common stock	(242)	—
Acquisition-related contingent consideration payment	—	(1)
Net cash provided by (used in) financing activities	(195)	50
Effect of foreign exchange on cash and cash equivalents	(30)	(2)
Increase in cash and cash equivalents	384	454
Beginning cash and cash equivalents	1,782	1,292
Ending cash and cash equivalents	$2,166	$1,746
Supplemental cash flow information:		
Cash paid (refunded) during the period for income taxes, net	$(8)	$21
Cash paid during the period for interest	$3	$3

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

ELECTRONIC ARTS INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

We develop, market, publish and distribute game software content and services that can be played by consumers on a variety of platforms, including video game consoles (such as PlayStation 3 and 4 from Sony and Xbox 360 and Xbox One from Microsoft), personal computers (“PCs”), mobile phones and tablets. Our ability to deliver games and services across multiple platforms, through multiple distribution channels, and directly to consumers (online and wirelessly) has been, and will continue to be, a cornerstone of our product strategy. We have adopted new business models and alternative revenue streams (such as subscription, micro-transactions, and advertising) in connection with our online and wireless product and service offerings. Some of our games are based on our wholly-owned intellectual property (e.g., Battlefield, Mass Effect, Need for Speed, Dragon Age, The Sims, Bejeweled, and Plants vs. Zombies), and some of our games leverage content that we license from others (e.g., FIFA, Madden NFL and Star Wars). We also publish and distribute games developed by third parties (e.g., Titanfall). Our goal is to turn our intellectual properties into year-round businesses available on a range of platforms. Our products and services may be purchased through physical and online retailers, platform providers such as console manufacturers and mobile carriers via digital downloads, as well as directly through our own distribution platform, including online portals such as Origin.

Our fiscal year is reported on a 52- or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ending or ended, as the case may be, March 31, 2015 and 2014 contain 52 weeks each, and ends or ended, as the case may be, on March 28, 2015 and March 29, 2014, respectively. Our results of operations for the three and nine months ended December 31, 2014 and 2013 contained 13 and 39 weeks each and ended on December 27, 2014 and December 28, 2013, 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, 2014, as filed with the United States Securities and Exchange Commission (“SEC”) on May 21, 2014.

Change in Estimated Offering Period

Prior to July 1, 2013, for most sales, we estimated the offering period to be six months and recognized revenue over this period in the month after delivery. During the three months ended September 30, 2013, we completed our fiscal 2014 annual evaluation of the estimated offering period and noted that generally, consumers were playing our games online over a longer period of time. Based on this, we concluded that for physical software sales made after June 30, 2013, the estimated offering period should be increased to nine months, resulting in revenue being recognized over a longer period of time. This change in estimate resulted in an estimated decrease to net revenue and net income of $474 million and a decrease of $1.50 of diluted earnings per share for fiscal year 2014. During the three months ended December 31, 2014, this change in estimate resulted in an estimated increase to net revenue and net income of $180 million and an increase of $0.56 of diluted earnings per share. During the nine months ended December 31, 2014, this change in estimate resulted in an estimated increase to net revenue and net income of $466 million and an increase of $1.45 of diluted earnings per share. The estimated offering period for digitally distributed software games did not change and is six months. We completed our fiscal 2015 annual evaluation during the second quarter and determined that the estimated offering period for physical software sales and digital sales continues to be nine months and six months, respectively.

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Recently Adopted Accounting Standards

On April 1, 2014, we adopted ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. Under the new accounting standard, an unrecognized tax benefit is required to be presented as a reduction to a deferred tax asset if the disallowance of the uncertain tax position would reduce an available tax loss or tax credit carryforward instead of resulting in a cash tax liability. The ASU applies prospectively to all unrecognized tax benefits that exist as of the adoption date. As a result of the adoption, we reduced: (a) noncurrent income tax obligations by $96 million; (b) current deferred income tax assets by $18 million; and (c) noncurrent deferred income tax assets by $11 million. We increased noncurrent deferred income tax liabilities by $67 million. As the new accounting standard only impacted presentation, it did not have an impact on the Company's net financial position, results of operations, or cash flows.

Impact of Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, 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 new standard is effective for annual reporting periods beginning after December 15, 2016. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its Condensed Consolidated Financial Statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting. We expect to adopt this new standard in the first quarter of fiscal year 2018.

(2) FAIR VALUE MEASUREMENTS

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

Fair Value Hierarchy

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

- Level 1. Quoted prices in active markets for identical assets or liabilities.
- Level 2. Observable inputs other than quoted prices included within Level 1, such as quoted prices for similar assets or liabilities, quoted prices in markets with insufficient volume or infrequent transactions (less active markets), or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data for substantially the full term of the assets or liabilities.
- Level 3. Unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of assets or liabilities.

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Assets and Liabilities Measured at Fair Value on a Recurring Basis

As of December 31, 2014 and March 31, 2014, 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			
		Quoted Prices in Active Markets for Identical Financial Instruments	Significant Other Observable Inputs	Significant Unobservable Inputs	
	As of December 31, 2014	(Level 1)	(Level 2)	(Level 3)	Balance Sheet Classification
Assets					
Bank and time deposits	$98	$98	$—	$—	Cash equivalents
Money market funds	2	2	—	—	Cash equivalents
Available-for-sale securities:					
Corporate bonds	398	—	398	—	Short-term investments
U.S. Treasury securities	170	170	—	—	Short-term investments and cash equivalents
U.S. agency securities	126	—	126	—	Short-term investments
Commercial paper	108	—	108	—	Short-term investments and cash equivalents
Foreign currency derivatives	15	—	15	—	Other current assets
Deferred compensation plan assets [(a)]	10	10	—	—	Other assets
Total assets at fair value	$927	$280	$647	$—	
Liabilities					
Contingent consideration [(b)]	$—	$—	$—	$—	Accrued and other current liabilities
Foreign currency derivatives	9	—	9	—	Accrued and other current liabilities
Deferred compensation plan liabilities	10	10	—	—	Other liabilities
Total liabilities at fair value	$19	$10	$9	$—	

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
	Contingent Consideration
Balance as of March 31, 2014	$4
Change in fair value [(c)]	(2)
Payments [(d)]	(2)
Balance as of December 31, 2014 [(b)]	$—

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		Fair Value Measurements at Reporting Date Using			
	As of March 31, 2014	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
Assets					
Money market funds	$ 588	$ 588	$ —	$ —	Cash equivalents
Available-for-sale securities:					
Corporate bonds	279	—	279	—	Short-term investments
Commercial paper	146	—	146	—	Short-term investments and cash equivalents
U.S. Treasury securities	118	118	—	—	Short-term investments and cash equivalents
U.S. agency securities	89	—	89	—	Short-term investments and cash equivalents
Deferred compensation plan assets [(a)]	9	9	—	—	Other assets
Total assets at fair value	$ 1,229	$ 715	$ 514	$ —	
Liabilities					
Contingent consideration [(b)]	$ 4	$			