

ELECTRONIC ARTS INC.  
Form 10-Q  
February 09, 2010  
Table of Contents

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

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

For the Quarterly Period Ended December 31, 2009

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. 0-17948

**ELECTRONIC ARTS INC.**

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

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

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

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

**(650) 628-1500**

**94065**  
*(Zip Code)*

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

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

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

As of February 5, 2010, there were 326,644,249 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.

**Table of Contents**

**ELECTRONIC ARTS INC.**

**FORM 10-Q**

**FOR THE PERIOD ENDED DECEMBER 31, 2009**

**Table of Contents**

	<b>Page</b>
<b><u>Part I - FINANCIAL INFORMATION</u></b>	
Item 1. <u>Condensed Consolidated Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of December 31, 2009 and March 31, 2009</u>	3
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended December 31, 2009 and 2008</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended December 31, 2009 and 2008</u>	5
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	6
<u>Report of Independent Registered Public Accounting Firm</u>	29
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	54
Item 4. <u>Controls and Procedures</u>	57
<b><u>Part II - OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	58
Item 1A. <u>Risk Factors</u>	58
Item 6. <u>Exhibits</u>	67
<u>Signature</u>	68
<u>Exhibit Index</u>	69

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

<b>(Unaudited) (In millions, except par value data)</b>	<b>December 31, 2009</b>	<b>March 31, 2009 (a)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,114	\$ 1,621
Short-term investments	352	534
Marketable equity securities	318	365
Receivables, net of allowances of \$267 and \$217, respectively	495	116
Inventories	144	217
Deferred income taxes, net	95	51
Other current assets	264	216
Total current assets	2,782	3,120
Property and equipment, net	550	354
Goodwill	1,097	807
Acquisition-related intangibles, net	215	221
Deferred income taxes, net	74	61
Other assets	221	115
<b>TOTAL ASSETS</b>	<b>\$ 4,939</b>	<b>\$ 4,678</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 186	\$ 152
Accrued and other current liabilities	790	723
Deferred net revenue (packaged goods and digital content)	895	261
Total current liabilities	1,871	1,136
Income tax obligations	281	268
Deferred income taxes, net	49	42
Other liabilities	139	98
Total liabilities	2,340	1,544
Commitments and contingencies (See Note 11)		
Stockholders' equity:		
Preferred stock, \$0.01 par value. 10 shares authorized		
Common stock, \$0.01 par value. 1,000 shares authorized; 327 and 323 shares issued and outstanding, respectively	3	3
Paid-in capital	2,265	2,142
Retained earnings	93	800
Accumulated other comprehensive income	238	189

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

Total stockholders' equity	2,599	3,134
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 4,939</b>	<b>\$ 4,678</b>

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

(a) Derived from audited consolidated financial statements.

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

<b>(Unaudited)</b> <b>(In millions, except per share data)</b>	<b>Three Months Ended</b> <b>December 31,</b>		<b>Nine Months Ended</b> <b>December 31,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net revenue	\$ 1,243	\$ 1,654	\$ 2,675	\$ 3,352
Cost of goods sold	654	925	1,568	1,778
<b>Gross profit</b>	<b>589</b>	<b>729</b>	<b>1,107</b>	<b>1,574</b>
Operating expenses:				
Marketing and sales	208	250	559	575
General and administrative	84	82	241	258
Research and development	290	299	918	1,027
Acquired in-process technology		1		3
Amortization of intangibles	14	15	38	46
Certain abandoned acquisition-related costs				21
Goodwill impairment		368		368
Restructuring charges	100	18	120	41
<b>Total operating expenses</b>	<b>696</b>	<b>1,033</b>	<b>1,876</b>	<b>2,339</b>
Operating loss	(107)	(304)	(769)	(765)
Losses on strategic investments	(1)	(27)	(25)	(67)
Interest and other income (expense), net	(2)	14	8	36
Loss before provision for (benefit from) income taxes	(110)	(317)	(786)	(796)
Provision for (benefit from) income taxes	(28)	324	(79)	250
<b>Net loss</b>	<b>\$ (82)</b>	<b>\$ (641)</b>	<b>\$ (707)</b>	<b>\$ (1,046)</b>
Net loss per share:				
Basic and Diluted	\$ (0.25)	\$ (2.00)	\$ (2.18)	\$ (3.28)
Number of shares used in computation:				
Basic and Diluted	325	321	324	319

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

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

(Unaudited) (In millions)	Nine Months Ended December 31,	
	2009	2008
<b>OPERATING ACTIVITIES</b>		
Net loss	\$ (707)	\$ (1,046)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	145	147
Depreciation, amortization and accretion, net	142	152
Other non-cash restructuring charges	27	18
Net losses on investments and sale of property and equipment	20	67
Goodwill impairment		368
Acquired in-process technology		3
Change in assets and liabilities:		
Receivables, net	(356)	(476)
Inventories	77	(128)
Other assets	(53)	30
Accounts payable	36	102
Accrued and other liabilities	(42)	177
Deferred income taxes, net	(24)	258
Deferred net revenue (packaged goods and digital content)	634	125
Net cash used in operating activities	(101)	(203)
<b>INVESTING ACTIVITIES</b>		
Purchase of headquarters facilities	(233)	
Capital expenditures	(50)	(90)
Proceeds from sale of marketable equity securities	10	
Proceeds from maturities and sales of short-term investments	657	610
Purchase of short-term investments	(477)	(459)
Acquisition-related restricted cash	(100)	
Acquisition of subsidiaries, net of cash acquired	(278)	(58)
Net cash provided by (used in) investing activities	(471)	3
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of common stock	25	75
Excess tax benefit from stock-based compensation	13	2
Net cash provided by financing activities	38	77
Effect of foreign exchange on cash and cash equivalents	27	(51)
Decrease in cash and cash equivalents	(507)	(174)
Beginning cash and cash equivalents	1,621	1,553
Ending cash and cash equivalents	\$ 1,114	\$ 1,379
<b>Supplemental cash flow information:</b>		
Net cash paid during the period for income taxes	\$ 8	\$ 16

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

### Non-cash investing activities:

Change in unrealized losses on investments, net	\$ (34)	\$ (427)
Assumption of stock options in connection with acquisition	\$ 11	\$

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



---

**Table of Contents**

**ELECTRONIC ARTS INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

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

Our fiscal year is reported on a 52 or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ending or ended, as the case may be, March 31, 2010 and 2009 contain 53 and 52 weeks, respectively, and ends or ended, as the case may be, on April 3, 2010 and March 28, 2009, respectively. Our results of operations for the three months ended December 31, 2009 and 2008 contain 13 weeks and ended on January 2, 2010 and December 27, 2008, respectively. Our results of operations for the nine months ended December 31, 2009 and 2008 contain 40 and 39 weeks, respectively, and ended on January 2, 2010 and December 27, 2008, 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.

Certain reclassifications have been made to the fiscal year 2009 Condensed Consolidated Financial Statements to conform to the fiscal year 2010 presentation.

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, 2009, as filed with the United States Securities and Exchange Commission (SEC) on May 22, 2009.

**(2) FAIR VALUE MEASUREMENTS**

On April 1, 2009, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, as it applies to nonfinancial assets and nonfinancial liabilities. These nonfinancial items include assets and liabilities such as a reporting unit measured at fair value in a goodwill impairment test and nonfinancial assets acquired and liabilities assumed in a business combination. We measure certain financial and nonfinancial assets and liabilities at fair value on a recurring and nonrecurring basis.

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

Our money market funds, available-for-sale fixed income and marketable equity securities, deferred compensation plan assets, foreign currency derivatives and contingent consideration are measured and recorded at fair value on a recurring basis.

Our Level 1 assets are valued using quoted prices in active markets for identical instruments. Our Level 2 assets, including foreign currency derivatives, are valued using quoted prices for identical instruments in less active markets or using other observable market inputs for comparable instruments. Our Level 3 liabilities are valued using unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the contingent consideration. As of March 31, 2009, we did not have any Level 3 financial instruments that

were measured and recorded at fair value on a recurring basis.

**Table of Contents**

As of December 31, 2009 and March 31, 2009, our assets and liabilities that are measured and recorded at fair value on a recurring basis were as follows (in millions):

	As of December 31, 2009	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Financial Instruments			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
		(Level 1)	(Level 2)	(Level 3)			
<b>Assets</b>							
Money market funds	\$ 611	\$ 611					Cash equivalents
<b>Available-for-sale securities:</b>							
Marketable equity securities	318	318					Marketable equity securities
Corporate bonds	194			194			Short-term investments and cash equivalents
U.S. agency securities	87			87			Short-term investments and cash equivalents
U.S. Treasury securities	71	71					Short-term investments
Commercial paper	3			3			Short-term investments and cash equivalents
Asset-backed securities	1			1			Short-term investments
Deferred compensation plan assets <sup>(a)</sup>	12	12					Other assets
Foreign currency derivatives	2			2			Other current assets
Total assets at fair value	\$ 1,299	\$ 1,012		\$ 287	\$		
<b>Liabilities</b>							
Contingent consideration <sup>(b)</sup>	\$ 64					\$ 64	Other liabilities
Total liabilities at fair value	\$ 64					\$ 64	

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		Contingent Consideration
Beginning Balance			\$
Additions			64
Ending Balance			\$ 64

	As of March 31, 2009	(Level 1)	(Level 2)	(Level 3)	Balance Sheet Classification
<b>Assets</b>					
Money market funds	\$ 1,069	\$ 1,069			Cash equivalents
<b>Available-for-sale securities:</b>					
Marketable equity securities	365	365			Marketable equity securities
U.S. Treasury securities	212	212			Short-term investments and cash equivalents
Corporate bonds	133		133		Short-term investments and cash equivalents
U.S. agency securities	118		118		Short-term investments and cash equivalents
Commercial paper	118		118		

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

					Short-term investments and cash equivalents
Asset-backed securities	15		15		Short-term investments
Deferred compensation plan assets <sup>(a)</sup>	9	9			Other assets
Foreign currency derivatives	2		2		Other current assets
Total assets at fair value	\$ 2,041	\$ 1,655	\$ 386	\$	

(a) The deferred compensation plan assets consist of various mutual funds.

(b) The contingent consideration represents the estimated fair value of the additional variable cash consideration payable in connection with our acquisition of Playfish Limited ( Playfish ) that is contingent upon the achievement of certain performance milestones. We estimated the fair value using expected future cash flows over the period in which the obligation is expected to be settled, and applied a discount rate that appropriately captures a market participant's view of the risk associated with the obligation.

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

During the three and nine months ended December 31, 2009, certain of our nonfinancial assets were measured and recorded at fair value on a nonrecurring basis. During the three and nine months ended December 31, 2009 and the three months ended December 31, 2008, none of our financial assets were measured and recorded at fair value on a nonrecurring basis. During the nine months ended December 31, 2008, certain of our financial assets were measured and recorded at fair value on a nonrecurring basis. The impairment recorded during these periods on a nonrecurring basis was as follows (in millions):

	Fair Value Measurements Using			Total Impairments for the Three Months Ended December 31, 2009	Total Impairments for the Nine Months Ended December 31, 2009	
	Quoted Prices of Significant Active Market Assets	Significant Other Observable Inputs	Significant Unobservable Inputs			
	Net Carrying Value as of December 31, 2009	(Level 1)	(Level 2)	(Level 3)		
Assets						
Property and equipment, net <sup>(a)</sup>	\$ 21	\$ 19	\$ 4	\$ 2	\$ 5	
Acquisition-related intangibles				7	7	
Abandoned rights to intellectual property				9	10	
Total impairments for assets held as of December 31, 2009				\$ 18	\$ 22	
Impairment on acquisition-related intangibles no longer held				\$ 1	\$ 1	
Impairment on property and equipment no longer held				1	1	
Total impairments recorded for non-recurring measurements				\$ 20	\$ 24	
	Net Carrying Value as of December 31, 2008	(Level 1)	(Level 2)	(Level 3)	Total Impairments for the Three Months Ended December 31, 2008	Total Impairments for the Nine Months Ended December 31, 2008
Assets						
Other investments	\$ 8	\$ 8	\$	\$	\$	\$ 10
Total impairments for assets held as of December 31, 2008					\$	\$ 10

<sup>(a)</sup> Our carrying value as of December 31, 2009, did not equal our fair value measurements at the time of the impairments due to the subsequent recognition of depreciation expense.

**Table of Contents**

In connection with our fiscal 2010 restructuring, certain of our property and equipment, acquisition-related intangibles, and abandoned rights to intellectual property were impaired during the nine months ended December 31, 2009 due to events and circumstances that indicated that the carrying value of the assets was not recoverable. These impairments are included in restructuring charges in our Condensed Consolidated Statements of Operations.

Other investments included in the table above were measured and recorded on a nonrecurring basis using other observable market inputs for comparable instruments. During the nine months ended December 31, 2008, we measured certain of our other investments at fair value due to various factors, including but not limited to, the extent and duration during which the fair value had been below cost. See Note 3 for information regarding other investments.

**(3) FINANCIAL INSTRUMENTS**

On April 1, 2009, we adopted FASB ASC 825, *Financial Instruments*, which requires disclosures about the fair value of financial instruments for interim reporting periods of publicly traded companies. See Note 2 for information on the methods and assumptions used to estimate the fair value of our financial instruments.

**Cash, Cash Equivalents and Short-Term Investments**

Cash, cash equivalents and short-term investments consisted of the following as of December 31, 2009 and March 31, 2009 (in millions):

	As of December 31, 2009				As of March 31, 2009			
	Cost or Amortized Cost	Gross Unrealized Gains	Losses	Fair Value	Cost or Amortized Cost	Gross Unrealized Gains	Losses	Fair Value
<b>Cash and cash equivalents:</b>								
Cash	\$ 499	\$	\$	\$ 499	\$ 490	\$	\$	\$ 490
Money market funds	611			611	1,069			1,069
Commercial paper	2			2	39			39
U.S. agency securities	1			1	9			9
Corporate bonds	1			1	2			2
U.S. Treasury securities					12			12
<b>Cash and cash equivalents</b>	<b>1,114</b>			<b>1,114</b>	<b>1,621</b>			<b>1,621</b>
<b>Short-term investments:</b>								
Corporate bonds	191	2		193	130	1		131
U.S. agency securities	86			86	108	1		109
U.S. Treasury securities	71			71	198	2		200
Commercial paper	1			1	79			79
Asset-backed securities	1			1	15			15
<b>Short-term investments</b>	<b>350</b>	<b>2</b>		<b>352</b>	<b>530</b>	<b>4</b>		<b>534</b>
<b>Cash, cash equivalents and short-term investments</b>	<b>\$ 1,464</b>	<b>\$ 2</b>	<b>\$</b>	<b>\$ 1,466</b>	<b>\$ 2,151</b>	<b>\$ 4</b>	<b>\$</b>	<b>\$ 2,155</b>

As of December 31, 2009 and March 31, 2009, we had less than \$1 million in each period in gross unrealized losses primarily attributable to our corporate bonds and U.S. Treasury securities. As of December 31, 2009 and March 31, 2009, these gross unrealized losses were primarily in loss positions for less than 12 months.

We evaluate our investments for impairment quarterly. Factors considered in the review of investments with an unrealized loss include the credit quality of the issuer, the duration that the fair value has been less than the cost basis, severity of the impairment, reason for the decline in value and potential recovery period, the financial condition and near-term prospects of the investees, our intent and ability to hold the investments for a period of time sufficient to allow for any anticipated recovery in market value, as well as any contractual terms impacting the prepayment or

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

settlement process. Based on our review, we did not consider the investments listed above to be other-than-temporarily impaired as of December 31, 2009 and March 31, 2009.

**Table of Contents**

The following table summarizes the gross realized gains and losses from the sale of short-term investments for the three and nine months ended December 31, 2009 and 2008 (in millions):

	December 31, 2009		December 31, 2008	
	Three months ended	Nine months ended	Three months ended	Nine months ended
Short-term investments				
Gross realized gains	\$ 2	\$ 4	\$ 1	\$ 3
Gross realized losses				(2)
Net realized gains <sup>(a)</sup>	\$ 2	\$ 4	\$ 1	\$ 1

<sup>(a)</sup> Realized gains and losses are calculated based on the specific identification method.

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of December 31, 2009 and March 31, 2009 (in millions):

	As of December 31, 2009		As of March 31, 2009	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Short-term investments excluding asset-backed securities				
Due in 1 year or less	\$ 113	\$ 113	\$ 245	\$ 245
Due in 1-2 years	144	146	156	159
Due in 2-3 years	92	92	114	115
Asset-backed securities				
Weighted average maturity less than 1 year	1	1	15	15
Short-term investments	\$ 350	\$ 352	\$ 530	\$ 534

Asset-backed securities are separately disclosed as they are not due at a single maturity date.

**Foreign Currency Option Contracts**

As of December 31, 2009, our foreign currency option contracts had a cost of \$1 million, gross unrealized gains of \$1 million, and a fair value of \$2 million. As of March 31, 2009, our foreign currency option contracts had a cost of \$3 million, gross unrealized losses of \$1 million and a fair value of \$2 million. See Note 4 for information regarding our derivative financial instruments.

**Marketable Equity Securities**

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

Marketable equity securities consisted of the following as of December 31, 2009 and March 31, 2009 (in millions):



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

	<b>Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
As of December 31, 2009	\$ 139	\$ 179	\$	\$ 318
As of March 31, 2009	\$ 175	\$ 190	\$	\$ 365

During the three and nine months ended December 31, 2009, we recognized impairment charges of \$1 million and \$25 million, respectively, on our investment in The9. During the three and nine months ended December 31, 2008, we recognized impairment charges of \$27 million on our investment in The9 and \$57 million on our investments in Neowiz and The9, respectively. Due to various factors, including but not limited to the extent and duration during which the market prices had been below cost and our intent to hold certain securities, we concluded the decline in values were other-than-temporary. The impairments for the three and nine months ended December 31, 2009 and 2008 are included in losses on strategic investments on our Condensed Consolidated Statements of Operations.

---

**Table of Contents**

During the three and nine months ended December 31, 2009, we received proceeds of \$6 million and \$10 million, respectively, and realized gains and losses of less than \$1 million each, from selling a portion of our investment in The9. We did not sell any of our marketable equity securities during the three and nine months ended December 31, 2008.

***Other Investments Included in Other Assets***

Our other investments consist principally of non-voting preferred shares in two companies whose common stock is publicly traded and are accounted for under the cost method. Under this method these investments are recorded at cost on our Condensed Consolidated Balance Sheets until we determine that the fair values of the investments other-than-temporarily fall below their cost basis. We evaluate our investments for impairment quarterly. If we conclude that an investment is other-than-temporarily impaired, we will recognize an impairment charge at that time in our Condensed Consolidated Statements of Operations.

During the three and nine months ended December 31, 2009 and the three months ended December 31, 2008, we did not recognize any impairment charges with respect to these investments. During the nine months ended December 31, 2008, we recognized an impairment charge of \$10 million on these investments. Due to various factors, including but not limited to, the extent and duration during which the fair value had been below cost, we concluded the decline in values were other-than-temporary. The \$10 million impairment for the nine months ended December 31, 2008 is included in losses on strategic investments on our Condensed Consolidated Statements of Operations.

**(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 or accrued and other current liabilities, respectively, in 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 and whether it is designated and qualifies for hedge accounting.

We transact business in various foreign currencies and have significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. We purchase foreign currency option contracts, generally with maturities of 15 months or less, to reduce the volatility of cash flows primarily related to forecasted revenue and expenses denominated in certain foreign currencies. In addition, we utilize foreign currency forward contracts to mitigate foreign exchange rate risk associated with foreign-currency-denominated assets and liabilities, primarily intercompany receivables and payables. The foreign currency forward contracts generally have a contractual term of approximately three months or less and are transacted near month-end. At each quarter-end, the fair value of the foreign currency forward contracts generally is not significant. We do not use foreign currency option or foreign currency forward contracts for speculative or trading purposes.

***Cash Flow Hedging Activities***

Our foreign currency option contracts are designated and qualify as cash flow hedges. The effectiveness of the cash flow hedge contracts, including time value, is assessed monthly using regression, as well as other timing and probability criteria. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. The effective portion of gains or losses resulting from changes in fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income in stockholders' equity. The gross amount of the effective portion of gains or losses resulting from changes in fair value of these hedges 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. The ineffective portion of gains or losses resulting from changes in fair value, if any, is reported in each period in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. The effective portion of hedges recognized in accumulated other comprehensive income will be reclassified to our Condensed Consolidated Statements of Operations within 12 months. As of December 31, 2009, we had foreign currency option contracts to purchase approximately \$21 million in foreign currency and to sell approximately \$37 million of foreign currencies. As of December 31, 2009, these foreign currency option contracts outstanding had a total fair value of \$2 million and are included in other current assets. As of March 31, 2009, we had foreign currency option contracts to purchase approximately \$19 million in foreign currency and to sell approximately \$65 million of foreign currencies. As of March 31, 2009, these foreign currency option contracts outstanding had a total fair value of \$2 million and are included in other current assets.

The effect of foreign currency option contracts on our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2009 was immaterial.



**Table of Contents****Balance Sheet Hedging Activities**

Our foreign currency forward contracts are not designated as hedging instruments. Accordingly, any gains or losses resulting from changes in the fair value of the foreign currency forward contracts 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 associated with the underlying foreign-currency-denominated assets and liabilities, which are also reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. As of December 31, 2009, we had foreign currency forward contracts to purchase and sell approximately \$529 million in foreign currencies. Of this amount, \$390 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$131 million to purchase foreign currency in exchange for U.S. dollars and \$8 million to sell foreign currency in exchange for British pounds sterling. As of March 31, 2009, we had foreign currency forward contracts to purchase and sell approximately \$63 million in foreign currencies. Of this amount, \$53 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$7 million to purchase foreign currencies in exchange for U.S. dollars and \$3 million to sell foreign currencies in exchange for British pounds sterling. The fair value of our foreign currency forward contracts was immaterial as of December 31, 2009 and March 31, 2009.

The effect of foreign currency forward contracts on our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2009, was as follows (in millions):

	Three Months Ended December 31, 2009		Nine Months Ended December 31, 2009	
	Location of Gain Recognized in Income on Derivative	Amount of Gain Recognized in Income on Derivative	Location of Loss Recognized in Income on Derivative	Amount of Loss Recognized in Income on Derivative
Foreign currency forward contracts not designated as hedging instruments	Interest and other income (expense), net	\$ 5	Interest and other income (expense), net	\$ (7)

**(5) BUSINESS COMBINATIONS**

On April 1, 2009, we adopted FASB ASC 805, *Business Combinations*, which requires the recognition of assets acquired, liabilities assumed, and any noncontrolling interest in an acquiree at the acquisition date based on their fair value with limited exceptions. FASB ASC 805 changes the accounting treatment for certain specific items and includes a substantial number of new disclosure requirements.

**Playfish**

On November 9, 2009, we acquired all of the outstanding shares of Playfish for an aggregate purchase price of approximately \$308 million in cash and equity. Playfish is a developer of free-to-play social games that can be played on social networking platforms. This acquisition accelerates our participation in social gaming and contributes to our digital business. The following table summarizes the acquisition date fair value of the consideration transferred which consisted of the following (in millions):

Cash	\$ 297
Equity	11
<b>Total purchase price</b>	<b>\$ 308</b>

The equity included in the consideration above consisted of restricted stock and restricted stock units, whose fair value was determined based on the quoted market price of our common stock on the date of grant.

In addition, we may be required to pay additional variable cash consideration that is contingent upon the achievement of certain performance milestones through December 31, 2011. The additional consideration is limited to a maximum of \$100 million based on tiered revenue targets over a two-year period. The fair value of the contingent consideration arrangement at the acquisition date was \$64 million. We estimated the fair value of the contingent consideration using expected future cash flows over the period in which the obligation is expected to be settled, and applied a discount rate that appropriately captures a market participant's view of the risk associated with the obligation. This fair value is based on significant inputs not observable in the market. As of December 31, 2009, there were no significant changes in the range of outcomes for the contingent consideration.



**Table of Contents**

The preliminary allocation of the purchase price was based upon preliminary valuations for certain assets and will be completed during the fourth quarter of fiscal year 2010. The preliminary allocation of the purchase price may have material adjustments once the valuations have been completed. The following table summarizes the preliminary fair values of assets acquired and liabilities assumed as of December 31, 2009 (in millions):

Current assets	\$ 32
Deferred income taxes, net	22
Property and equipment, net	1
Goodwill	280
Finite-lived intangibles assets	45
Contingent consideration	(64)
Other liabilities	(8)
Total purchase price	\$ 308

All of the goodwill was assigned to one of our immaterial operating segments. None of the goodwill recognized upon acquisition is deductible for tax purposes. See Note 6 for additional information related to the changes in the carrying amount of goodwill and Note 15 for segment information.

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

Other acquisition-related intangibles acquired in this transaction are finite-lived and are being amortized on a straight-line basis over their estimated lives ranging from two to five years. The intangible assets as of the date of the acquisition include:

	Gross Carrying Amount (in millions)	Weighted-Average Useful Life (in years)
Registered User Base	\$ 29	2
Developed and Core Technology	10	5
Trade Names and Trademarks	4	5
Other Intangibles	2	4
Total Finite-Lived Intangibles	\$ 45	3

**Other Acquisitions**

During the nine months ended December 31, 2009, we completed two additional acquisitions that did not have a significant impact on our Condensed Consolidated Financial Statements.

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

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

As of March 31, 2009	Goodwill Acquired	Effects of Foreign Currency Translation	As of December 31, 2009
----------------------------	----------------------	--	-------------------------------

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

Label Segment	\$ 667	\$	\$ 6	\$ 673
Other Segments	140	282	2	424
<b>Total</b>	<b>\$ 807</b>	<b>\$ 282</b>	<b>\$ 8</b>	<b>\$ 1,097</b>

Purchased goodwill is not amortized but rather subject to at least an annual assessment for impairment by applying a fair value-based test.

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

**Table of Contents**

Adverse economic conditions, including the decline in our market capitalization and our expected financial performance, indicated that a potential impairment of goodwill existed during the three months ended December 31, 2008. As a result, we performed goodwill impairment tests for our reporting units and determined that the fair value of our EA Mobile reporting unit fell below the carrying value of that reporting unit. As a result, we conducted the second step in the impairment testing and determined that the EA Mobile reporting unit's goodwill was impaired. The fair value of the EA Mobile reporting unit was determined using the income approach. Substantially all of our goodwill associated with our EA Mobile reporting unit was derived from our acquisition of JAMDAT Mobile Inc. in February 2006. During the three months ended December 31, 2008, we recognized a goodwill impairment charge of \$368 million related to our EA Mobile reporting unit. During the three and nine months ended December 31, 2009, there were no indicators of impairment of our goodwill. See Note 15 for information regarding our segment information.

During the three months ended December 31, 2009, we estimated on a preliminary basis, the measurement of goodwill acquired in our acquisition of Playfish. The valuation will be completed in the fourth quarter of fiscal year 2010 and once completed there may be material adjustments to our goodwill amounts.

Acquisition-related intangibles, net, consist of the following (in millions):

	As of December 31, 2009			As of March 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net
Developed and Core Technology	\$ 253	\$ (148)	\$ 105	\$ 249	\$ (128)	\$ 121
Trade Names and Trademarks	88	(53)	35	86	(43)	43
Carrier Contracts and Related	85	(54)	31	85	(51)	34
Registered User Base and Other Intangibles	77	(33)	44	51	(28)	23
<b>Total</b>	<b>\$ 503</b>	<b>\$ (288)</b>	<b>\$ 215</b>	<b>\$ 471</b>	<b>\$ (250)</b>	<b>\$ 221</b>

Amortization of intangibles for the three and nine months ended December 31, 2009 was \$16 million (of which \$2 million was recognized as cost of goods sold) and \$46 million (of which \$8 million was recognized as cost of goods sold), respectively. Amortization of intangibles for the three and nine months ended December 31, 2008 was \$19 million (of which \$4 million was recognized as cost of goods sold) and \$57 million (of which \$11 million was recognized as cost of goods sold), respectively. Finite-lived intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the term of the related agreement, typically from two to fourteen years. During the three months ended December 31, 2009 we recognized impairment charges of \$8 million on certain acquisition-related intangibles in connection with our fiscal 2010 restructuring plan. There were no impairment charges during the three and nine months ended December 31, 2008. As of December 31, 2009 and March 31, 2009, the weighted-average remaining useful life for finite-lived intangible assets was approximately 5.2 years and 6.0 years, respectively.

As of December 31, 2009, future amortization of finite-lived intangibles that will be recorded in cost of goods sold and operating expenses is estimated as follows (in millions):

Fiscal Year Ending March 31,	
2010 (remaining three months)	\$ 17
2011	66
2012	46
2013	25
2014	17
Thereafter	44
<b>Total</b>	<b>\$ 215</b>





**Table of Contents****(7) RESTRUCTURING CHARGES**

Restructuring information as of December 31, 2009 was as follows (in millions):

	Fiscal 2010 Restructuring Facilities-		Fiscal 2009 Restructuring Facilities-		Fiscal 2008 Reorganization Facilities-		Other Restructurings Facilities-		Other	Total
	Workforce related	Other	Workforce related	Other	Workforce related	Other	Workforce related	Other		
Balances as of March 31, 2008	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Charges to operations			32	7	2		22	12	4	1
Charges settled in cash			(24)	(1)		(1)		(13)	(4)	(3)
Charges settled in non-cash				(1)	(2)		(22)			
Balances as of March 31, 2009				8	5			3		7
Charges to operations	63	6	27	1	13		3	7		
Charges settled in cash	(15)			(9)	(8)			(10)		
Charges settled in non-cash	(25)	(1)	(20)		(4)		(3)			
Accrual reclassification										(7)
Balances as of December 31, 2009	\$ 23	\$ 5	\$ 7	\$	\$ 6	\$	\$	\$	\$	\$ 41

***Fiscal 2010 Restructuring***

In the quarter ended December 31, 2009, we announced details of a restructuring plan to narrow our product portfolio to provide greater focus on titles with higher margin opportunities. Under this plan, we anticipate (1) reducing our workforce by approximately 1,350 employees, (2) consolidating or closing various facilities, (3) eliminating certain titles, and (4) incurring IT and other costs to assist in reorganizing certain activities. We expect the majority of these actions to be completed by March 31, 2010.

Since the inception of the fiscal 2010 restructuring plan through December 31, 2009, we have incurred charges of \$96 million, of which (1) \$63 million were for employee-related expenses, (2) \$27 million related to abandoned rights to intellectual property and intangible asset impairment costs, as well as other costs to assist in the reorganization of our business support functions, and (3) \$6 million related to the closure of certain of our facilities. The majority of the \$35 million restructuring accrual as of December 31, 2009 related to our fiscal 2010 restructuring is expected to be settled by March 2010. This accrual is included in other accrued expenses presented in Note 9 of the Notes to Condensed Consolidated Financial Statements.

During the remainder of fiscal year 2010, we anticipate incurring between \$35 million and \$40 million of restructuring charges related to the fiscal 2010 restructuring. Overall, including charges incurred through December 31, 2009, we expect to incur total cash and non-cash charges between \$150 million and \$155 million by March 31, 2012. These charges will consist primarily of (1) employee-related costs (approximately \$70 million), (2) intangible asset impairment, abandoned rights to intellectual property costs, and other costs to assist in the reorganization of our business support functions (approximately \$35 million), (3) facilities exit costs (approximately \$30 million), and (4) other reorganizational costs including IT and consulting costs (approximately \$20 million).

***Fiscal 2009 Restructuring***

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

**Table of Contents**

Since the inception of the fiscal 2009 restructuring plan through December 31, 2009, we have incurred charges of \$55 million, of which (1) \$33 million were for employee-related expenses, (2) \$20 million related to the closure of certain of our facilities, and (3) \$2 million related to asset impairments. After December 31, 2009, we anticipate incurring less than \$1 million of additional restructuring charges under this plan. The restructuring accrual of \$6 million as of December 31, 2009 related to our fiscal 2009 restructuring is expected to be settled by September 2016. This accrual is included in other accrued expenses presented in Note 9 of the Notes to Condensed Consolidated Financial Statements.

***Fiscal 2008 Reorganization***

In June 2007, we announced a plan to reorganize our business into several new divisions including, at the time four new Labels : EA SPORTS , EA Games, EA Casual Entertainment and The Sims in order to streamline decision-making, improve global focus, and speed new ideas to market. In October 2007, our Board of Directors approved a plan of reorganization ( fiscal 2008 reorganization plan ) in connection with the reorganization of our business into four new Labels. During fiscal year 2009, we consolidated and reorganized two of our Labels. As a result, we have three Labels, EA SPORTS, EA Games and EA Play, as well as a new organization, EA Interactive, which reports into our Publishing business. Each Label, as well as EA Interactive, operates with dedicated studio and product marketing teams focused on consumer-driven priorities.

Since the inception of the fiscal 2008 reorganization plan through December 31, 2009, we have incurred charges of \$141 million, of which (1) \$12 million were for employee-related expenses, (2) \$83 million related to the closure of our Chertsey, England and Chicago, Illinois facilities, which included asset impairment and lease termination costs, and (3) \$46 million related to other costs including other contract terminations, as well as IT and consulting costs to assist in the reorganization of our business support functions. We do not expect to incur any additional charges under this plan.

***Other Restructurings***

We also engaged in various other restructurings based on management decisions. From April 1, 2008 through June 30, 2009, \$7 million in cash had been paid out under these restructuring plans. The \$7 million restructuring accrual as of March 31, 2009 was reclassified during the three months ended June 30, 2009, from accrued and other current liabilities to other liabilities on our Condensed Consolidated Balance Sheet.

**(8) ROYALTIES AND LICENSES**

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

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

Our contracts with some licensors include minimum guaranteed royalty payments, which are initially recorded as an asset and as a liability at the contractual amount when no performance remains with the licensor. When performance remains with the licensor, we record guarantee payments as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract. Royalty liabilities are classified as current liabilities to the extent such royalty obligations are contractually due within the next twelve months. As of December 31, 2009 and March 31, 2009, approximately \$14 million and \$37 million, respectively, of minimum guaranteed royalty obligations had been recognized and are included in the royalty-related assets and liabilities tables below.

**Table of Contents**

Each quarter, we also evaluate the expected future realization of our royalty-based assets, as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are charged to research and development expense. Impairments or losses determined post-launch are charged to cost of goods sold. We evaluate long-lived royalty-based assets for impairment based on an undiscounted cash flow basis when impairment indicators exist. Unrecognized minimum royalty-based commitments are accounted for as executory contracts and, therefore, any losses on these commitments are recognized when the underlying intellectual property is abandoned (*i.e.*, cease use) or the contractual rights to use the intellectual property are terminated. During the three and nine months ended December 31, 2009, we recognized impairment charges of \$9 million and \$10 million, respectively. We recognized the \$9 million impairment charge during the three months ended December 31, 2009, in connection with our fiscal 2010 restructuring. This impairment is included in restructuring charges presented in Note 7 of the Notes to Condensed Consolidated Financial Statements. We had no impairment or loss charges during the three months ended December 31, 2008. During the nine months ended December 31, 2008, we recognized an impairment charge of \$5 million.

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 December 31, 2009	As of March 31, 2009
Other current assets	\$ 64	\$ 74
Other assets	41	47
<b>Royalty-related assets</b>	<b>\$ 105</b>	<b>\$ 121</b>

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

	As of December 31, 2009	As of March 31, 2009
Accrued and other current liabilities	\$ 213	\$ 237
Other liabilities	3	29
<b>Royalty-related liabilities</b>	<b>\$ 216</b>	<b>\$ 266</b>

In addition, as of December 31, 2009, we were committed to pay approximately \$1,305 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.

**(9) BALANCE SHEET DETAILS*****Inventories***

Inventories as of December 31, 2009 and March 31, 2009 consisted of (in millions):

	As of December 31, 2009	As of March 31, 2009
Raw materials and work in process	\$ 7	\$ 7

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

In-transit inventory		1	9
Finished goods		136	201
Inventories		\$ 144	\$ 217

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

Property and equipment, net, as of December 31, 2009 and March 31, 2009 consisted of (in millions):

	As of December 31, 2009	As of March 31, 2009
Computer equipment and software	\$ 720	\$ 663
Buildings	342	143
Leasehold improvements	103	125
Office equipment, furniture and fixtures	73	63
Land	64	11
Warehouse equipment and other	14	14
Construction in progress	10	16
	1,326	1,035
Less accumulated depreciation	(776)	(681)
Property and equipment, net	\$ 550	\$ 354

Depreciation expense associated with property and equipment amounted to \$30 million and \$93 million for the three and nine months ended December 31, 2009, respectively. Depreciation expense associated with property and equipment amounted to \$28 million and \$89 million for the three and nine months ended December 31, 2008, respectively.

On July 13, 2009, we purchased our Redwood Shores headquarters facilities comprised of approximately 660,000 square feet concurrent with the expiration and extinguishment of the lessor's financing agreements. These facilities were subject to leases, which expired in July 2009, and had previously been accounted for as operating leases. The total amount paid under the terms of the leases was \$247 million, of which \$233 million related to the purchase price of the facilities and \$14 million was for the loss on our lease obligation. This \$14 million loss is included in general and administrative expense on our Condensed Consolidated Statements of Operations. Subsequent to our purchase, we classified the facilities on our Condensed Consolidated Balance Sheet as property and equipment, net and recognized depreciation expense for the property acquired on a straight-line basis over the estimated useful lives, excluding the land acquired.

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

In connection with our acquisition of Playfish on November 9, 2009, we deposited \$100 million into an escrow account to be used to pay the former shareholders of Playfish in the event certain performance milestones through December 31, 2011 are achieved. During the three months ended December 31, 2009, no distributions were made from the restricted cash amount. As this deposit is restricted in nature, it has been included in other assets on our Condensed Consolidated Balance Sheet as of December 31, 2009. See Note 5 regarding our acquisition of Playfish.

***Accrued and Other Current Liabilities***

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

Accrued and other current liabilities as of December 31, 2009 and March 31, 2009 consisted of (in millions):

	As of December 31, 2009	As of March 31, 2009
Other accrued expenses	\$ 333	\$ 237
Accrued royalties	213	237
Accrued compensation and benefits	145	142
Deferred net revenue (other)	99	107
<b>Accrued and other current liabilities</b>	<b>\$ 790</b>	<b>\$ 723</b>

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.

**Table of Contents*****Deferred Net Revenue (Packaged Goods and Digital Content)***

Deferred net revenue (packaged goods and digital content) was \$895 million as of December 31, 2009 and \$261 million as of March 31, 2009. Deferred net revenue (packaged goods and digital content) includes the deferral of (1) the total net revenue from bundle sales of certain online-enabled packaged goods and digital content for which either we do not have vendor-specific objective evidence of fair value ( VSOE ) for the online service that we provide in connection with the sale of the software or we have an obligation to provide future incremental unspecified digital content, (2) revenue from certain packaged goods sales of massively-multiplayer online role-playing games, and (3) revenue from the sale of certain incremental content associated with our core subscription services that can only be played online, which are types of micro-transactions. We recognize revenue from sales of online-enabled packaged goods and digital content for which (1) we do not have VSOE for the online service that we provided in connection with the sale and (2) we have an obligation to deliver incremental unspecified digital content in the future without an additional fee on a straight-line basis over an estimated six month period beginning in the month after shipment. However, we expense the cost of goods sold related to these transactions during the period in which the product is delivered (rather than on a deferred basis).

**(10) 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 or a year-to-date loss where no tax benefit can be recognized are excluded from the estimated annual effective tax rate. The impact of such an exclusion could result in a higher or lower effective tax rate during a particular quarter depending on the mix and timing of actual earnings versus annual projections.

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

The Worker, Homeownership and Business Assistance Act of 2009 ( the Act ) was signed into law on November 6, 2009. The Act provides that taxpayers may elect to increase the carry back period for tax losses incurred in a taxable year beginning or ending in either 2008 or 2009. During the three months ended December 31, 2009, we elected to increase the carry back period for tax losses incurred in fiscal year 2009. This election resulted in a reduction in the valuation allowance on our U.S. deferred tax assets due to an increase in the sources of taxable income from the extended carry back period. As a result, we recorded a tax benefit of approximately \$28 million in the three months ended December 31, 2009 for the reduction in the valuation allowance.

In determining the valuation allowance we recorded at June 30, 2009, we did not include as a source of future taxable income the taxable temporary difference related to the accumulated tax depreciation on our headquarters facilities in Redwood City, California. On July 13, 2009, we purchased our Redwood Shores headquarters facilities concurrent with the expiration and extinguishment of the lessor's financing agreements. These facilities were subject to leases which expired in July 2009, and had been accounted for as operating leases. The total amount paid under the terms of the leases was \$247 million, of which \$233 million related to the purchase price of the facilities and \$14 million was for the loss on our lease obligation. Therefore, in the fiscal quarter ended September 30, 2009, we recorded a tax benefit of approximately \$31 million, consisting of approximately \$6 million related to the loss on our lease obligation and a \$25 million reduction in our valuation allowance due to the inclusion of a significant portion of the remaining taxable temporary difference as a source of future taxable income.

On May 27, 2009, the Ninth Circuit Court of Appeals (the Court) overturned a 2005 Tax Court decision ( 2009 Decision ) in *Xilinx Inc. v. Commissioner* ( Xilinx ). The Court's 2009 Decision changed the tax treatment of share-based compensation expenses for the purpose of determining intangible development costs under an entity's research and development cost sharing arrangement. The Court held that related parties to such an arrangement must share stock option costs, notwithstanding the U.S. Tax Court's finding that unrelated parties in such an arrangement would not share such costs. The case is subject to further appeal. Nevertheless, as a result of this decision, we recorded additional reserves for unrecognized tax benefits of approximately \$59 million during the nine months ended December 31, 2009. These reserves relate primarily to windfall tax benefits recognized for stock-based compensation, and were therefore recorded as reductions in paid-in capital.





---

**Table of Contents**

A portion of the additional reserves for unrecognized tax benefits recorded as a result of the Xilinx decision were included as a source of taxable income in determining the valuation allowance we recorded at June 30, 2009. As a result, we recorded a tax benefit of approximately \$11 million in the three months ended June 30, 2009 for the corresponding reduction in the valuation allowance.

The tax benefit reported for the three and nine months ended December 31, 2009 is based on our projected annual effective tax rate for fiscal year 2010, and also includes certain discrete tax charges recorded during the period. Our effective tax rates for the three and nine months ended December 31, 2009 were a tax benefit of 24.9 percent and 10.0 percent, respectively. The effective tax rates for the three and nine months ended December 31, 2008 are not meaningful due to the discrete tax charge of \$244 million to establish the deferred tax valuation allowance. The effective tax rates for the three and nine months ended December 31, 2009 differ from the statutory rate of 35.0 percent primarily due to U.S. losses for which no benefit is recognized, non-U.S. losses with a reduced or zero tax benefit, partially offset by benefits related to the resolution of examinations by taxing authorities and reductions in the valuation allowance on U.S. deferred tax assets. The effective tax rates for the three and nine months ended December 31, 2009 differ from the same periods in fiscal year 2009 primarily due to the discrete tax charge to establish the valuation allowance in fiscal year 2009, tax charges incurred in fiscal year 2009 related to our integration of VG Holding Corp., and tax benefits related to the resolution of tax examinations.

During the three months ended September 30, 2009, we reached a final settlement with the Internal Revenue Service ( IRS ) for the fiscal years 1997 through 1999. As a result, we recorded a tax benefit of approximately \$6 million due to a reduction in our accrual for interest and penalties.

During the three months ended June 30, 2009, we recorded approximately \$21 million of previously unrecognized tax benefits and reduced our accrual for interest and penalties by approximately \$12 million due to the expiration of statutes of limitation in the United Kingdom.

During the three and nine months ended December 31, 2009, we recorded an increase of \$8 million and an increase of \$18 million in gross unrecognized tax benefits, respectively. This includes a reduction in gross unrecognized tax benefits of approximately \$48 million related to the settlements with the IRS for fiscal years 1997 through 1999 during the three months ended September 30, 2009. This settlement and agreement to pay will be partially offset by prior cash deposits of approximately \$40 million. The total gross unrecognized tax benefits as of December 31, 2009 is \$296 million, of which approximately \$31 million would be offset by prior cash deposits to tax authorities for issues pending resolution. A portion of our unrecognized tax benefits will affect our effective tax rate if they are recognized upon favorable resolution of the uncertain tax positions. As of December 31, 2009, approximately \$92 million of the unrecognized tax benefits would affect our effective tax rate, approximately \$125 million would result in adjustments to deferred tax assets with corresponding adjustments to the valuation allowance, and approximately \$65 million would increase paid-in capital.

During the three and nine months ended December 31, 2009, we recorded no net increase in tax and a net increase of \$1 million, respectively, for accrued interest and penalties related to tax positions taken on our tax returns, including a reduction related to the settlement with the IRS for fiscal years 1997 through 1999. As of December 31, 2009, the combined amount of accrued interest and penalties related to uncertain tax positions was approximately \$57 million.

The IRS has completed its examination of our federal income tax returns through fiscal year 2005. As of December 31, 2009, the IRS had proposed, and we had agreed to, certain adjustments to our tax returns. The effects of these adjustments have been considered in estimating our future obligations for unrecognized tax benefits and are not expected to have a material impact on our financial position or results of operations. As of December 31, 2009, we had not agreed to certain other proposed adjustments for fiscal years 2000 through 2005, and those issues were pending resolution by the Appeals section of the IRS. Furthermore, the IRS has commenced an examination of our fiscal year 2006, 2007 and 2008 tax returns. We are also under income tax examination in Canada for fiscal years 2004 and 2005, in France for fiscal years 2006 through 2008, and in Germany for fiscal years 2004 through 2007. We remain subject to income tax examination in Canada for fiscal years after 2001, in France for fiscal years after 2005, in Germany for fiscal years after 2003, in the United Kingdom for fiscal years after 2007, and in Switzerland for fiscal years after 2007.

**Table of Contents**

The timing of the resolution of income tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued for each year. Although potential resolution of uncertain tax positions involve multiple tax periods and jurisdictions, it is reasonably possible that a reduction of up to \$20 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 our income tax provision (benefit) and therefore benefit the resulting effective tax rate. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements.

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

As of December 31, 2009, we leased certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities. See Note 9 regarding the purchase of our Redwood Shores headquarters facilities on July 13, 2009.

The following table summarizes our minimum contractual obligations as of December 31, 2009 (in millions):

<b>Fiscal Year Ending March 31,</b>	<b>Leases <sup>(a)</sup></b>
2010 (remaining three months)	\$ 13
2011	45
2012	34
2013	28
2014	20
Thereafter	38
<b>Total</b>	<b>\$ 178</b>

<sup>(a)</sup> Lease commitments have not been reduced by minimum sub-lease rentals for unutilized office space resulting from our reorganization activities of approximately \$10 million due in the future under non-cancelable sub-leases.

The 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 expensed in our Condensed Consolidated Financial Statements. Included in the amounts above are \$2 million and \$3 million in lease commitments for fiscal years 2010 and 2011, respectively, for leases expiring in less than one year as of December 31, 2009.

***Legal Proceedings***

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

**(12) STOCK-BASED COMPENSATION*****Valuation Assumptions***

We are required to estimate the fair value of share-based payment awards on the date of grant. We recognize compensation costs for stock-based payment transactions to employees based on their grant-date fair value over the service period for which such awards are expected to vest. The fair value of restricted stock units and restricted stock is determined based on the quoted market price of our common stock on the date of grant. The fair value of stock options and stock purchase rights granted pursuant to our equity incentive plans and our 2000 Employee Stock Purchase Plan ( ESPP ), respectively, is determined using the Black-Scholes valuation model. The determination of fair value is affected by our stock price, as well as assumptions regarding subjective and complex variables such as expected employee exercise behavior and our expected stock price

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

volatility over the expected term of the award. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. The key assumptions for the Black-Scholes valuation calculation are:

*Risk-free interest rate.* The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option.

**Table of Contents**

*Expected volatility.* We use a combination of historical stock price volatility and implied volatility computed based on the price of options publicly traded on our common stock for our expected volatility assumption.

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

*Expected dividends.*

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

	Stock Option Grants				ESPP	
	Three Months Ended December 31, 2009		Nine Months Ended December 31, 2008		Nine Months Ended December 31, 2009	
Risk-free interest rate	1.4 - 2.7%	1.0 - 1.8%	1.4 - 3.0%	1.0 - 3.8%	0.2 - 0.4%	1.9 - 2.1%
Expected volatility	41 - 45%	44 - 52%	41 - 48%	32 - 52%	45 - 57%	35%
Weighted-average volatility	43%	48%	45%	42%	51%	35%
Expected term	4.4 years	4.2 years	4.2 years	4.3 years	6-12 months	6-12 months
Expected dividends	None	None	None	None	None	None

There were no ESPP shares valued during the three months ended December 31, 2009 and 2008.

**Stock-Based Compensation Expense**

Employee stock-based compensation expense recognized during the three and nine months ended December 31, 2009 and 2008 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. In subsequent periods, if actual forfeitures differ from those estimates, an adjustment to stock-based compensation expense will be recognized at that time.

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

	Three Months Ended December 31, 2009		Nine Months Ended December 31, 2008	
	2009	2008	2009	2008
Cost of goods sold	\$	\$	\$	\$
Marketing and sales	4	5	12	15
General and administrative	9	11	24	34
Research and development	29	28	82	97
Restructuring charges	26		26	
Stock-based compensation expense	68	44	145	147
Provision for income taxes		21		
Stock-based compensation expense, net of tax	\$ 68	\$ 65	\$ 145	\$ 147

As of December 31, 2009, our total unrecognized compensation cost related to stock options was \$87 million and is expected to be recognized over a weighted-average service period of 2.5 years. As of December 31, 2009, our total unrecognized compensation cost related to restricted stock, restricted stock units and notes payable in shares of common stock (collectively referred to as restricted stock rights) was \$352 million (inclusive of approximately \$65 million of additional remaining compensation cost associated with the Employee Stock Option Exchange Program discussed below) and is expected to be recognized over a weighted-average service period of 2.0 years.



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

The following table summarizes our stock option activity for the nine months ended December 31, 2009:

	Options (in thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding as of March 31, 2009	34,360	\$ 42.04		
Granted	4,303	20.44		
Exchange Program (granted)	18	17.43		
Exercised	(572)	15.20		
Forfeited, cancelled or expired	(4,394)	41.97		
Exchange Program (cancelled)	(16,561)	49.11		
Outstanding as of December 31, 2009	17,154	30.68	5.9	\$ 5
Exercisable as of December 31, 2009	9,398	36.27	3.5	\$ 1

The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price as of December 31, 2009, which would have been received by the option holders had all the option holders exercised their options as of that date. The weighted-average grant date fair values of stock options granted during the three and nine months ended December 31, 2009 were \$6.86 and \$7.85, respectively. The weighted-average grant-date fair values of stock options granted during the three and nine months ended December 31, 2008 were \$6.48 and \$10.35, respectively. We issue new common stock from our authorized shares upon the exercise of stock options.

**Restricted Stock Rights**

The following table summarizes our restricted stock rights activity, excluding performance-based restricted stock unit activity discussed below, for the nine months ended December 31, 2009:

	Restricted Stock Rights (in thousands)	Weighted- Average Grant Date Fair Value
Balance as of March 31, 2009	7,559	\$ 42.76
Granted	4,934	18.99
Exchange Program (granted)	5,919	17.43
Vested	(1,774)	44.95
Forfeited or cancelled	(733)	36.94
Balance as of December 31, 2009	15,905	25.98

The weighted-average grant date fair value of restricted stock rights is based on the quoted market price of our common stock on the date of grant. The weighted-average grant date fair values of restricted stock rights granted during the three and nine months ended December 31, 2009 were \$17.26 and \$18.14, respectively. The weighted-average grant date fair values of restricted stock rights granted during the three and nine months ended December 31, 2008 were \$17.99 and \$33.51, respectively.

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

The following table summarizes our performance-based restricted stock unit activity for the nine months ended December 31, 2009:

	<b>Performance- Based Restricted Stock Units (in thousands)</b>	<b>Weighted- Average Grant Date Fair Value</b>
Balance as of March 31, 2009	3,008	\$ 47.59
Granted	236	20.93
Vested	(97)	17.73
Forfeited or cancelled	(393)	30.99
Balance as of December 31, 2009	2,754	48.73

The weighted-average grant date fair value of performance-based restricted stock units is based on the quoted market price of our common stock on the date of grant. There were no performance-based restricted stock units granted during the three months ended December 31, 2009. The weighted-average grant date fair value of performance-based restricted stock units granted during the nine months ended December 31, 2009 was \$20.93. The weighted-average grant date fair values of performance-based restricted stock units granted during the three and nine months ended December 31, 2008 were \$15.90 and \$46.05, respectively.

***ESPP***

During the nine months ended December 31, 2009 and 2008, we issued approximately 1.2 million shares and 519 thousand shares, respectively, under the ESPP with exercise prices for purchase rights of \$13.86 and \$40.20, respectively. The estimated weighted-average fair values of purchase rights during the nine months ended December 31, 2009 and 2008 were \$6.25 and \$12.20, respectively.

***Employee Stock Option Exchange Program***

On October 21, 2009, we launched a voluntary Employee Stock Option Exchange Program ( Exchange Program ) to permit our eligible employees to exchange outstanding eligible options for a lesser number of restricted stock units, shares of restricted stock (in Canada only), or new options (in China only) to be granted under our 2000 Equity Incentive Plan (the Equity Plan ). The Exchange Program offer period began on October 21, 2009 and ended on November 18, 2009.

The Exchange Program was open to all employees designated for participation by the Compensation Committee of the Board of Directors. However, members of the Board of Directors, the Named Executive Officers identified in our definitive proxy statement filed with the SEC on June 12, 2009 and employees of Denmark, due to restrictions arising under local laws of that country, were not eligible to participate.

Options eligible for the Exchange Program were those options that were granted prior to October 21, 2008, that had an exercise price per share that was greater than \$28.18, which was the 52-week high trading price of our common stock measured as of the start date of the Exchange Program, as reported on The NASDAQ Global Select Market, and that upon conversion using the exchange ratio applicable for such options resulted in four or more shares of restricted stock units, shares of restricted stock or new options, as the case may be.

Eligible options exchanged under the program were cancelled following the expiration of the offer and either restricted stock units, shares of restricted stock or new options, as the case may be, were granted. For restricted stock units, shares of restricted stock or new options issued in exchange for unvested options, compensation expense will be recorded based on the grant-date fair value of the options tendered over their remaining original vesting period of those options. Restricted stock units, shares of restricted stock and new options issued in connection with the Exchange Program will vest over a period of up to three years.

The Exchange Program resulted in options to purchase approximately 16,561,000 shares of our common stock being exchanged for approximately 4,996,000 shares of restricted stock units, approximately 923,000 shares of restricted stock and approximately 18,000 new options.



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

Due to the structure of the Exchange Program as a value-for-value exchange for the eligible options tendered for exchange, and certain assumptions we are required to use regarding the eligible options for accounting purposes, we will recognize an incremental accounting charge of approximately \$70 million over the vesting period of the restricted stock units, restricted stock and options issued in the Exchange Program in addition to recognizing any remaining unrecognized expense for the stock options surrendered in the exchange. We recorded approximately \$5 million of the incremental charge in the three months ended December 31, 2009.

**Table of Contents****Annual Meeting of Stockholders**

At our Annual Meeting of Stockholders, held on July 29, 2009, in addition to approving our Exchange Program discussed above, our stockholders also approved amendments to the Equity Plan to (1) increase the number of shares authorized for issuance under the Equity Plan by 20.8 million shares and (2) amend the Equity Plan so that each share subject to a full value stock award would reduce the number of shares available for issuance by 1.43 shares, instead of the current multiple of 1.82 shares. Our stockholders also approved an amendment to the ESPP to increase the number of shares authorized under the ESPP by 3 million shares.

**(13) COMPREHENSIVE LOSS**

We are required to classify items of other comprehensive income (loss) by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and paid-in capital in the equity section of a balance sheet. Accumulated other comprehensive income primarily includes foreign currency translation adjustments, and the net of tax amounts for unrealized gains (losses) on investments and unrealized gains (losses) on derivative instruments designated as cash flow hedges. Foreign currency translation adjustments are not adjusted for income taxes as they relate to indefinite investments in non-U.S. subsidiaries.

The components of comprehensive loss, net of related immaterial taxes, for the three and nine months ended December 31, 2009 and 2008 are summarized as follows (in millions):

	<b>Three Months Ended December 31,</b>		<b>Nine Months Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net loss	\$ (82)	\$ (641)	\$ (707)	\$ (1,046)
Other comprehensive income (loss):				
Change in unrealized losses on investments	(63)	(333)	(34)	(427)
Reclassification adjustment for losses (gains) realized on investments	(1)	27	21	57
Change in unrealized gains (losses) on derivative instruments	(1)	11	(3)	15
Reclassification adjustment for losses (gains) on derivative instruments	2	(8)		(7)
Foreign currency translation adjustments	4	(71)	65	(88)
Total other comprehensive income (loss)	(59)	(374)	49	(450)
Total comprehensive loss	\$ (141)	\$ (1,015)	\$ (658)	\$ (1,496)

**(14) NET LOSS PER SHARE**

As a result of our net loss for the three and nine months ended December 31, 2009, we have excluded certain equity-based instruments from the diluted loss per share calculation as their inclusion would have had an antidilutive effect. Had we reported net income for these periods, an additional 2 million shares of common stock would have been included in the number of shares used to calculate diluted earnings per share in each of the three and nine months ended December 31, 2009. Options to purchase and restricted stock units and restricted stock to be released in the amount of 32 million shares and 36 million shares of common stock were excluded from the computation of diluted shares for the three and nine months ended December 31, 2009, respectively, as their inclusion would have had an antidilutive effect. For the three and nine months ended December 31, 2009, the weighted-average exercise prices of these shares were \$29.86 and \$34.73 per share, respectively.

As a result of our net loss for the three and nine months ended December 31, 2008, we have excluded certain equity-based instruments from the diluted loss per share calculation as their inclusion would have had an antidilutive effect. Had we reported net income for these periods, an additional 1 million shares and 6 million shares of common stock would have been included in the number of shares used to calculate diluted earnings per share for the three and nine months ended December 31, 2008, respectively. Options to purchase and restricted stock units to be released in the amount of 38 million shares and 27 million shares of common stock were excluded from the computation of diluted shares for the three and nine months ended December 31, 2008, respectively, as their inclusion would have had an antidilutive effect. For the three and nine months ended December 31, 2008, the weighted-average exercise prices of these shares were \$39.28 and \$46.28 per share, respectively.



**Table of Contents****(15) SEGMENT INFORMATION**

Our reporting segments are based upon: our internal organizational structure; the manner in which our operations are managed; the criteria used by our Chief Executive Officer, our Chief Operating Decision Maker ( CODM ), to evaluate segment performance; the availability of separate financial information; and overall materiality considerations.

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

The following table summarizes the financial performance of the Label segment and a reconciliation of the Label segment's profit to our consolidated operating loss for the three and nine months ended December 31, 2009 and 2008 (in millions):

	<b>Three Months Ended December 31,</b>		<b>Nine Months Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Label segment:				
Net revenue	\$ 1,247	\$ 1,640	\$ 3,062	\$ 3,228
Depreciation and amortization	(13)	(17)	(42)	(52)
Other expenses	(947)	(1,294)	(2,491)	(2,764)
Label segment profit	287	329	529	412
Reconciliation to consolidated operating loss:				
Other:				
Change in deferred net revenue (packaged goods and digital content)	(103)	(88)	(634)	(125)
Other net revenue	99	102	247	249
Depreciation and amortization	(33)	(30)	(97)	(94)
Other expenses	(357)	(617)	(814)	(1,207)
Consolidated operating loss	\$ (107)	\$ (304)	\$ (769)	\$ (765)

Label segment profit differs from the consolidated operating loss primarily due to the exclusion of (1) certain corporate and other functional costs that are not allocated to the Labels, (2) the deferral of certain net revenue related to online-enabled packaged goods and digital content (see Note 9 of the Notes to Condensed Consolidated Financial Statements), and (3) the results of EA Mobile and our Switzerland distribution revenue that has not been allocated to the Labels. Our CODM reviews assets on a consolidated basis and not on a segment basis.

**Table of Contents**

Information about our total net revenue by platform for the three and nine months ended December 31, 2009 and 2008 is presented below (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
<b>Consoles</b>				
Xbox 360	\$ 348	\$ 448	\$ 592	\$ 873
PLAYSTATION 3	236	297	499	579
Wii	196	254	499	457
PlayStation 2	44	179	111	352
Total Consoles	824	1,178	1,701	2,261
<b>Mobile Platforms</b>				
Nintendo DS	63	118	113	183
Wireless	56	49	157	140
PSP	30	36	88	130
Total Mobile	149	203	358	453
PC	212	215	509	532
Licensing and Other	58	58	107	106
Total Net Revenue	\$ 1,243	\$ 1,654	\$ 2,675	\$ 3,352

Information about our operations in North America, Europe and Asia for the three and nine months ended December 31, 2009 and 2008 is presented below (in millions):

	North America	Europe	Asia	Total
<b>Three months ended December 31, 2009</b>				
Net revenue from unaffiliated customers	\$ 693	\$ 489	\$ 61	\$ 1,243
Long-lived assets	1,341	480	41	1,862
<b>Three months ended December 31, 2008</b>				
Net revenue from unaffiliated customers	\$ 957	\$ 623	\$ 74	\$ 1,654
Long-lived assets	1,192	183	41	1,416
<b>Nine months ended December 31, 2009</b>				
Net revenue from unaffiliated customers	\$ 1,515	\$ 1,015	\$ 145	\$ 2,675
<b>Nine months ended December 31, 2008</b>				
Net revenue from unaffiliated customers	\$ 1,941	\$ 1,253	\$ 158	\$ 3,352

Our direct sales to GameStop Corp. represented approximately 14 percent and 15 percent of total net revenue for the three and nine months ended December 31, 2009, respectively, and approximately 14 percent of total net revenue for each of the three and nine months ended December 30, 2008. Our direct sales to Wal-Mart Stores, Inc. represented approximately 12 percent and 13 percent of total net revenue for the three and nine months ended December 31, 2009, respectively, and approximately 14 percent and 13 percent of total net revenue for the three and nine months ended December 31, 2008, respectively. Our direct sales to Best Buy Co., Inc. represented approximately 11 percent of total net revenue for the three months ended December 31, 2009.

**(16) COLLABORATIVE ARRANGEMENTS**

On April 1, 2009, we adopted FASB ASC 808, *Collaborative Arrangements*. FASB ASC 808 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. The adoption of FASB ASC 808 did not have a significant impact on our Condensed Consolidated Financial Statements for the

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

three and nine months ended December 31, 2009 and 2008.

**Table of Contents**

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

In October 2009, the FASB issued Accounting Standards Update ( ASU ) 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements*. This guidance modifies the fair value requirements of FASB ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements*, by allowing the use of the best estimate of selling price in addition to vendor specific objective evidence and third-party evidence for determining the selling price of a deliverable. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence, (b) third-party evidence, or (c) estimates. In addition, the residual method of allocating arrangement consideration is no longer permitted. ASU 2009-13 is effective for fiscal years beginning on or after June 15, 2010. We do not expect the adoption of ASU 2009-13 to have a material impact on our Condensed Consolidated Financial Statements.

In October 2009, the FASB issued ASU 2009-14, *Software (Topic 985) Certain Revenue Arrangements that Include Software Elements*. This guidance modifies the scope of FASB ASC subtopic 965-605, *Software-Revenue Recognition*, to exclude from its requirements non-software components of tangible products and software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality. ASU 2009-14 is effective for fiscal years beginning on or after June 15, 2010. We do not expect the adoption of ASU 2009-14 to have a material impact on our Condensed Consolidated Financial Statements.

**(18) SUBSEQUENT EVENTS**

We have evaluated our Condensed Consolidated Financial Statements for subsequent events through the date the financial statements were issued on February 9, 2010.

On January 13, 2010, the Court issued an order withdrawing its 2009 Decision opinion in Xilinx, which was filed on May 27, 2009. The order was issued without comment from the Court. In its 2009 Decision, the Court initially overturned a 2005 U.S. Tax Court decision in Xilinx. The Court's 2009 Decision held that related parties in a research and development cost sharing arrangement must share stock option costs, notwithstanding the U.S. Tax Court's finding that unrelated parties in such an arrangement would not share such costs. As a result of the 2009 Decision, we recorded additional reserves for unrecognized tax benefits of approximately \$59 million during the nine months ended December 31, 2009. As of February 9, 2010, it is not clear what further action the Court may take. Although the Court may issue a revised opinion, it is not clear whether such a revised opinion would reach the same outcome. Alternatively, the Court may grant a request for a review by additional members of the Court. The future impact on our Condensed Consolidated Financial Statements is uncertain until the Court takes further action.

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders

Electronic Arts Inc.:

We have reviewed the condensed consolidated balance sheet of Electronic Arts Inc. and subsidiaries (the Company) as of January 2, 2010, the related condensed consolidated statements of operations for the three- and nine-month periods ended January 2, 2010 and December 27, 2008, and the related condensed consolidated statements of cash flows for the nine-month periods ended January 2, 2010 and December 27, 2008. 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 March 28, 2009, and the related consolidated statements of operations, stockholders equity and comprehensive loss, and cash flows for the year then ended (not presented herein); and in our report dated May 21, 2009, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of March 28, 2009, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Mountain View, California

February 9, 2010



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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial position, made in this Quarterly Report on Form 10-Q are forward looking. We use words such as anticipate, believe, expect, intend, estimate (and the negative of any of these terms), future and similar expressions to help identify forward-looking statements. These forward-looking statements are subject to business and economic risk and reflect management's current expectations, and involve subjects that are inherently uncertain and difficult to predict. Our actual results could differ materially. We will not necessarily update information if any forward-looking statement later turns out to be inaccurate. Risks and uncertainties that may affect our future results include, but are not limited to, those discussed 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, 2009 as filed with the Securities and Exchange Commission (SEC) on May 22, 2009 and in other documents we have filed with the SEC.

**OVERVIEW**

The following overview is a top-level discussion of our operating results, as well as some of the trends and drivers that affect our business. Management believes that an understanding of these trends and drivers is important in order to understand our results for the three and nine months ended December 31, 2009, as well as our future prospects. This summary is not intended to be exhaustive, nor is it intended to be a substitute for the detailed discussion and analysis provided elsewhere in this Form 10-Q, including in the remainder of Management's Discussion and Analysis of Financial Condition and Results of Operations, Risk Factors, and the Condensed Consolidated Financial Statements and related notes. Additional information can be found in the Business section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2009 as filed with the SEC on May 22, 2009 and in other documents we have filed with the SEC.

***About Electronic Arts***

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

***Special Note Regarding Deferred Net Revenue***

Many of our software products are developed with the ability to connect to the Internet. Depending on the type of product, this feature permits consumers to play against others via the Internet and/or receive additional updates or content from us. For those games that consumers can play via the Internet, we may provide a matchmaking online service which permits consumers to connect with other consumers to play against each other. In those situations where we do not separately sell this online service, we account for the sale of the software product as a bundle sale, or multiple element arrangement, in which we sell both the software product and the online service for one combined price. Through fiscal year 2007, for accounting purposes, vendor-specific objective evidence of fair value (VSOE) existed for the online service. Accordingly, we allocated the revenue collected from the sale of the software product between the online service offered and the software product and recognized the amounts allocated to each element separately. However, starting in fiscal year 2008, VSOE did not exist for the online service and we began to recognize all of the revenue from the sale of these bundle sales on a deferred basis over an estimated online service period, which we estimate to be six months beginning in the month after shipment.

---

## **Table of Contents**

In addition, we also provide updates or additional content ( digital content ) for some software products to be delivered via the Internet. For some software products, at the date of sale we had an obligation to make available for download via the Internet incremental unspecified future digital content without an additional fee. In those transactions, we also accounted for the sale of the software product as a bundle sale and recognized the revenue on a deferred basis over the period in which we expect to make available the incremental unspecified digital content.

On a quarterly basis, the deferral amount will vary significantly depending upon the number of titles we release, the timing of their release, sales volume, returns and price protection provided for these online-enabled software products. In addition, we expense the cost of goods sold related to these transactions during the period in which the product is delivered (rather than on a deferred basis), which inherently creates volatility in our reported gross profit percentages.

### ***Financial Results***

Total net revenue for the three months ended December 31, 2009 was \$1,243 million, down \$411 million as compared to the three months ended December 31, 2008. At December 31, 2009, the change in deferred net revenue associated with sales of online-enabled packaged goods and digital content increased by \$103 million as compared to September 30, 2009, directly reducing the amount of reported net revenue during the three months ended December 31, 2009. At December 31, 2008, the change in deferred net revenue associated with sales of online-enabled packaged goods and digital content increased by \$88 million as compared to September 30, 2008, directly reducing the amount of reported net revenue during the three months ended December 31, 2008. Without these changes in deferred net revenue, reported net revenue decreased by approximately \$396 million during the three months ended December 31, 2009 as compared to the three months ended December 31, 2008. Net revenue for the three months ended December 31, 2009, was driven by *FIFA 10*, *Left 4 Dead 2*, and *Madden NFL 10*.

Net loss for the three months ended December 31, 2009 was \$82 million as compared to a net loss of \$641 million for the three months ended December 31, 2008. Diluted loss per share for the three months ended December 31, 2009 was \$0.25 as compared to a diluted loss per share of \$2.00 for the three months ended December 31, 2008. Net loss decreased during the three months ended December 31, 2009 as compared to the three months ended December 31, 2008 primarily as a result of (1) the recognition of \$368 million of goodwill impairment during the three months ended December 31, 2008, (2) a \$352 million decrease in our income tax provision primarily due to the discrete tax charge to establish the valuation allowance we recognized during the three months ended December 2008, and (3) a \$271 million decrease in cost of goods sold. These decreases were partially offset by (1) a decrease of \$411 million in net revenue and (2) an \$82 million increase in restructuring charges primarily from our fiscal 2010 restructuring.

During the nine months ended December 31, 2009, we used \$101 million of cash in operating activities as compared to using \$203 million of cash for the nine months ended December 31, 2008. The decrease in cash used in operating activities for the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008 was primarily due to decreases in personnel-related costs and external development and contracted services as part of our cost reduction initiatives, as well as a reduction in incentive-based compensation payments.

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

*Economic Environment.* As a result of the national and global economic downturn, overall consumer spending has declined. Retailers globally have taken a more conservative stance in ordering game inventory. The decline in the packaged goods sector contributed to the decline in anticipated demand for our products during the 2009 holiday selling season. We remain cautious about our future sales in light of the economic environment and the impact it has had on our business.

*Current Generation Game Consoles.* Video game hardware systems have historically had a life cycle of four to six years, which causes the video game software market to be cyclical as well. The current cycle began with Microsoft's launch of the Xbox 360 in 2005, and continued in 2006 when Sony and Nintendo launched their next-generation systems, the PLAYSTATION 3 and the Wii, respectively. Unlike past cycles, we believe this current cycle may be extended, partly due to the growth of online services and content, the greater graphic and processing power of the current-generation hardware and the introduction of new peripherals. However, growth in the installed base of the Xbox 360, the PLAYSTATION 3 and the Wii may slow down in light of the economic environment. Consequently, our industry may experience slower growth than in recent years.

**Table of Contents**

*Online Content and Services.* In addition to selling packaged goods games, we also provide a variety of electronically delivered products and services. Many of our games that are available as packaged goods products are also available by direct electronic download through the Internet (from websites that we maintain and others that we license). We also offer electronically delivered content and services that are add-ons or related to our packaged goods products (e.g., game enhancements or matchmaking services), and other games, content and services that are available only via electronic delivery (such as games for wireless devices, and Internet-only games and game services). Electronically delivered content and services are generally offered to consumers as subscription services, electronic downloads for a one-time fee, or on an advertising-supported basis. We have made significant investments in electronically delivered content and services, and we believe that this will become an increasingly important part of our business over time.

*Mobile Platforms.* Advances in mobile technology have resulted in a variety of new and evolving platforms for on-the-go interactive entertainment that appeal to a broad consumer base. Our efforts in mobile interactive entertainment are focused in two areas packaged goods games for handheld game systems and downloadable games for wireless devices. We expect sales of games for wireless devices to continue to be an important part of our business worldwide.

***Recent Developments***

*Acquisition of Playfish Limited.* On November 9, 2009, we acquired all of the outstanding shares of Playfish Limited ( Playfish ) for an aggregate purchase price of approximately \$308 million in cash and equity. In addition, we may be required to pay additional variable cash consideration that is contingent upon the achievement of certain performance milestones through December 31, 2011. This additional consideration is limited to a maximum of \$100 million. Playfish is a developer of free-to-play social games that can be played on social networking platforms.

*Fiscal 2010 Restructuring.* In the quarter ended December 31, 2009, we announced details of a restructuring plan to narrow our product portfolio to provide greater focus on titles with higher margin opportunities. Under this plan, we anticipate (1) reducing our workforce by approximately 1,350 employees, (2) consolidating or closing various facilities, (3) eliminating certain titles, and (4) incurring IT and other costs to assist in reorganizing certain activities. We expect the majority of these actions to be completed by March 31, 2010.

Since the inception of this restructuring plan through December 31, 2009, we have incurred charges of approximately \$96 million. During the remainder of fiscal year 2010, we anticipate incurring between \$35 million and \$40 million of restructuring charges, primarily consisting of facilities exit and employee-related costs, related to the fiscal 2010 restructuring. Overall, including charges incurred through December 31, 2009, we expect to incur total cash and non-cash charges between \$150 million and \$155 million by March 31, 2012. These charges will consist primarily of (1) employee-related costs (approximately \$70 million), (2) intangible asset impairment, abandoned rights to intellectual property costs, and other costs to assist in the reorganization of our business support functions (approximately \$35 million), (3) facilities exit costs (approximately \$30 million), and (4) other reorganizational costs including IT and consulting costs (approximately \$20 million).

*Employee Stock Option Exchange Program.* On October 21, 2009, we launched a voluntary Employee Stock Option Exchange Program ( Exchange Program ) to permit our eligible employees to exchange outstanding eligible options for a lesser number of restricted stock units, shares of restricted stock (in Canada only), or new options (in China only) to be granted under our 2000 Equity Incentive Plan (the Equity Plan ). The Exchange Program offer period began on October 21, 2009 and ended on November 18, 2009.

Options eligible for the Exchange Program were those options that were granted prior to October 21, 2008, that had an exercise price per share that was greater than \$28.18, which was the 52-week high trading price of our common stock measured as of the start date of the Exchange Program, as reported on The NASDAQ Global Select Market, and that upon conversion using the exchange ratio applicable for such options resulted in four or more shares of restricted stock units, shares of restricted stock or new options, as the case may be.

The Exchange Program resulted in options to purchase approximately 16,561,000 shares of our common stock being exchanged for approximately 4,996,000 shares of restricted stock units, approximately 923,000 shares of restricted stock and approximately 18,000 new options.

Due to the structure of the Exchange Program as a value-for-value exchange for the eligible options tendered for exchange, and certain assumptions we are required to use regarding the eligible options for accounting purposes, we will recognize an incremental accounting charge of approximately \$70 million over the vesting period of the restricted stock units, restricted stock and options issued in the Exchange Program in addition to recognizing any remaining unrecognized expense for the stock options surrendered in the exchange.

**Table of Contents**

*Redwood Shores Headquarters Facilities Purchase.* On July 13, 2009, we purchased our Redwood Shores headquarters facilities comprised of approximately 660,000 square feet concurrent with the expiration and extinguishment of the lessor's financing agreements. These facilities were subject to leases, which expired in July 2009, and had previously been accounted for as operating leases. The total amount paid under the terms of the leases was \$247 million, of which \$233 million related to the purchase price of the facilities and \$14 million was for the loss on our lease obligation. Subsequent to our purchase, we classified the facilities on our Condensed Consolidated Balance Sheet as property and equipment, net and recognized depreciation expense for the property acquired on a straight-line basis over the estimated useful lives, excluding the land acquired.

*International Operations and Foreign Currency Exchange Impact.* International sales are a fundamental part of our business. Net revenue from Europe and Asia sales accounted for approximately 43 percent of our total net revenue during the nine months ended December 31, 2009 and approximately 42 percent of our total net revenue during the nine months ended December 31, 2008. We believe that in order to succeed internationally, it is important to develop content locally that is specifically directed toward local cultures and customs. Year-over-year, we estimate that foreign exchange rates had an unfavorable impact on our net revenue of approximately \$53 million, or 1 percent, for the nine months ended December 31, 2009. During the nine months ended December 31, 2009, the U.S. dollar strengthened against most major currencies, including the Euro and the British pound sterling. In addition, our international investments and our cash and cash equivalents denominated in foreign currencies are subject to fluctuations in foreign currency. If the U.S. dollar continues to strengthen against these currencies, then foreign exchange rates may continue to have an unfavorable impact on our results of operations and our financial condition.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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

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

We derive revenue principally from sales of interactive software games designed for play on video game consoles (such as the PLAYSTATION 3, Xbox 360 and Wii), PCs, handheld game players (such as the PSP and Nintendo DS), and wireless devices (such as cellular phones and smart phones including the Apple iPhone). We evaluate revenue recognition based on the criteria set forth in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 985-605, *Software: Revenue Recognition*, and Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*. We evaluate and recognize revenue when all four of the following criteria are met:

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

*Delivery.* Delivery is considered to occur when a product is shipped and the risk of loss and rewards of ownership have been transferred to the customer. For online game services, delivery is considered to occur as the service is provided. For digital downloads that do not have an online service component, delivery is considered to occur generally when the download is made available.

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

*Collection is deemed probable.* We conduct a credit review of each customer involved in a significant transaction to determine the creditworthiness of the customer. Collection is deemed probable if we expect the customer to be able to pay amounts under the arrangement as those amounts become due. If we determine that collection is not probable, we recognize revenue when collection becomes probable (generally upon cash collection).



---

**Table of Contents**

Determining whether and when some of these criteria have been satisfied often involves assumptions and management judgments that can have a significant impact on the timing and amount of revenue we report in each period. For example, for multiple element arrangements, we must make assumptions and judgments in order to (1) determine whether and when each element has been delivered, (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services, (3) determine whether VSOE exists for each undelivered element, and (4) allocate the total price among the various elements we must deliver. Changes to any of these assumptions or management judgments, or changes to the elements in a software arrangement, could cause a material increase or decrease in the amount of revenue that we report in a particular period. For example, in connection with some of our packaged goods product sales, we offer an online service without an additional fee. Prior to fiscal year 2008, we were able to determine VSOE for the online service to be delivered; therefore, we were able to allocate the total price received from the combined product and online service sale between these two elements and recognize the related revenue separately. However, starting in fiscal year 2008, VSOE no longer existed for the online service to be delivered for certain platforms and all revenue from these transactions is recognized over the estimated online service period. More specifically, starting in fiscal year 2008, we began to recognize the revenue from sales of certain online-enabled packaged goods on a straight-line basis over a six month period beginning in the month after shipment. Accordingly, this relatively small change (from having VSOE for the online service to no longer having VSOE) has had a significant effect on our reported results.

In addition, for some software products we also provide updates or additional content ( digital content ) to be delivered via the Internet that can be used with the original software product. In many cases we separately sell digital content for an additional fee; however some purchased digital content can only be accessed via the Internet (*i.e.*, the consumer never takes possession of the digital content). We account for online transactions in which the consumer does not take possession of the digital content as a service transaction and, accordingly, we recognize the associated revenue over the estimated service period. In other transactions, at the date we sell the software product we have an obligation to provide incremental unspecified digital content in the future without an additional fee. In these cases, we account for the sale of the software product as a multiple element arrangement and recognize the revenue on a straight-line basis over the estimated life of the game.

Determining whether a transaction constitutes an online service transaction or a digital content download of a product requires judgment and can be difficult. The accounting for these transactions is significantly different. Revenue from product downloads is generally recognized when the download is made available (assuming all other recognition criteria are met). Revenue from an online game service is recognized as the service is rendered. If the service period is not defined, we recognize the revenue over the estimated service period. Determining the estimated service period is inherently subjective and is subject to regular revision based on historical online usage. In addition, determining whether we have an implicit obligation to provide incremental unspecified future digital content without an additional fee can be difficult.

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

In certain countries, from time to time, we decide to provide price protection for our software products. When evaluating the adequacy of sales returns and price protection allowances, we analyze historical returns, current sell-through of distributor and retailer inventory of our software products, current trends in retail and the video game segment, changes in customer demand and acceptance of our software products, and other related factors. In addition, we monitor the volume of sales to our channel partners and their inventories, as substantial overstocking in the distribution channel could result in high returns or higher price protection costs in subsequent periods.

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

## **Table of Contents**

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

### ***Fair Value Estimates***

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

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

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

*Business Combinations.* We must estimate the fair value of assets acquired, liabilities and contingencies assumed, acquired in-process technology, and contingent consideration in a business combination. Our assessment of the estimated fair value of each of these can have a material effect on our reported results as intangible assets and acquired in-process technology are amortized over various estimated useful lives. Furthermore, a change in the estimated fair value of an asset or liability often has a direct impact on the amount to recognize as goodwill, an asset that is not amortized. Determining the fair value of acquired assets requires an assessment of the highest and best use or the expected price to sell the asset and the related expected future cash flows. Determining the fair value of acquired in-process technology also requires an assessment of our expectations related to the use of that asset. Determining the fair value of an assumed liability requires an assessment of the expected cost to transfer the liability. Such estimates are inherently difficult and subjective and can have a material impact on our financial statements.

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

---

**Table of Contents**

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

To determine the fair values of the reporting units used in the first step, we use a combination of the market approach, which utilizes comparable companies' data, and/or the income approach, which utilizes discounted cash flows. Each step requires us to make judgments and involves the use of significant estimates and assumptions. These estimates and assumptions include long-term growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates based on our weighted average cost of capital, future economic and market conditions and determination of appropriate market comparables. These estimates and assumptions have to be made for each reporting unit evaluated for impairment. Our estimates for market growth, our market share and costs are based on historical data, various internal estimates and certain external sources, and are based on assumptions that are consistent with the plans and estimates we are using to manage the underlying business. Our business consists of developing, marketing and distributing video game software using both established and emerging intellectual properties and our forecasts for emerging intellectual properties are based upon internal estimates and external sources rather than historical information and have an inherently higher risk of accuracy. If future forecasts are revised, they may indicate or require future impairment charges. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates.

*Assessment of Impairment of Short-Term Investments, Marketable Equity Securities and Other Investments.* We periodically review our short-term investments, marketable equity securities and other investments for impairment. Our short-term investments consist of securities with remaining maturities greater than three months at the time of purchase and our marketable equity securities consist of investments in common stock of publicly traded companies, both are accounted for as available-for-sale. Unrealized gains and losses on our short-term investments and marketable equity securities are recorded to other comprehensive income, net of tax, until either (1) the security is sold or (2) we determine that the decline in the fair value of a security to a level below its cost basis is other-than-temporary. Determining whether the decline in fair value is other-than-temporary requires management judgment based on the specific facts and circumstances of each security. The ultimate value realized on these securities is subject to market price volatility until they are sold. We consider various factors in determining whether we should recognize an impairment charge, including the duration that the fair value has been less than the cost basis, severity of the impairment, reason for the decline in value and potential recovery period, the financial condition and near-term prospects of the investees, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. During the three and nine months ended December 31, 2009, we recognized impairment charges of \$1 million and \$25 million, respectively, on our marketable equity securities. During the three and nine months ended December 31, 2008, we recognized impairment charges of \$27 million and \$57 million, respectively, on our marketable equity securities. Our ongoing consideration of these factors could result in additional impairment charges in the future, which could have a material impact on our financial results.

Our other investments consist principally of non-voting preferred shares in two companies whose common stocks are publicly traded and are accounted for under the cost method. Under this method, these investments are recorded at cost until we determine that the fair values of the investments have fallen below their cost basis and that such declines are other-than-temporary. We monitor these investments for impairment and make appropriate reductions in the carrying values if we determine that an impairment charge is required, based primarily on the financial condition and near-term prospects of the investees. We had no impairment charges during the three and nine months ended December 31, 2009 and during the three months ended December 31, 2008. During the nine months ended December 31, 2008, we recognized impairment charges of \$10 million on our other investments.

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



## **Table of Contents**

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

We are required to estimate the fair value of share-based payment awards on the date of grant. The estimated fair value of stock options and stock purchase rights granted pursuant to our employee stock purchase plan is determined using the Black-Scholes valuation model, which requires us to make certain assumptions about the future. Determining the estimated fair value is affected by our stock price, as well as assumptions regarding subjective and complex variables such as expected employee exercise behavior and our expected stock price volatility over the term of the award. The key assumptions for the Black-Scholes valuation calculation are:

*Risk-free interest rate.* The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option.

*Expected volatility.* We use a combination of historical stock price volatility and implied volatility computed based on the price of options publicly traded on our common stock for our expected volatility assumption.

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

*Expected dividends.*

Changes to our underlying stock price, our assumptions used in the Black-Scholes option valuation calculation and our forfeiture rate, which is based on historical data, as well as future equity granted or assumed through acquisitions could significantly impact compensation expense to be recognized in future periods.

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

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

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

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

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

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

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. These obligations are classified as current liabilities to the extent such royalty payments are contractually due within the next twelve months. As of December 31, 2009 and March 31, 2009, approximately \$14 million and \$37 million, respectively, of minimum guaranteed royalty obligations had been recognized.

**Table of Contents**

Each quarter, we also evaluate the expected future realization of our royalty-based assets, as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are charged to research and development expense. Impairments or losses determined post-launch are charged to cost of goods sold. We evaluate long-lived royalty-based assets for impairment based on an undiscounted cash flow basis when impairment indicators exist. Unrecognized minimum royalty-based commitments are accounted for as executory contracts and, therefore, any losses on these commitments are recognized when the underlying intellectual property is abandoned (*i.e.*, cease use) or the contractual rights to use the intellectual property are terminated. During the three and nine months ended December 31, 2009, we recognized impairment charges of \$9 million and \$10 million, respectively. We recognized the \$9 million impairment charge during the three months ended December 31, 2009, in connection with our fiscal 2010 restructuring. This impairment is included in restructuring charges presented in Note 7 of the Notes to Condensed Consolidated Financial Statements. We had no impairment or loss charges during the three months ended December 31, 2008. During the nine months ended December 31, 2008, we recognized an impairment charge of \$5 million.

***Income Taxes***

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

In addition to considering forecasts of future taxable income, we are also required to evaluate and quantify other possible sources of taxable income in order to assess the realization of our deferred tax assets, namely the reversal of existing deferred tax liabilities, the carry back of losses and credits as allowed under current tax law, and the implementation of tax planning strategies. Evaluating and quantifying these amounts involves significant judgments. Each source of income must be evaluated based on all positive and negative evidence; this evaluation involves assumptions about future activity. Certain taxable temporary differences that are not expected to reverse during the carry forward periods permitted by tax law cannot be considered as a source of future taxable income that may be available to realize the benefit of deferred tax assets. For example, in determining the valuation allowance we recorded at June 30, 2009, we did not include as a source of future taxable income the taxable temporary difference related to the accumulated tax depreciation on our headquarters facilities in Redwood City, California. On July 13, 2009, we purchased our Redwood Shores headquarters facilities concurrent with the expiration and extinguishment of the lessor's financing agreements. These facilities were subject to leases which expired in July 2009, and had been accounted for as operating leases. The total amount paid under the terms of the leases was \$247 million, of which \$233 million related to the purchase price of the facilities and \$14 million was for the loss on our lease obligation. Therefore, in the fiscal quarter ended September 30, 2009, we recorded a tax benefit of approximately \$31 million, consisting of approximately \$6 million related to the loss on our lease obligation and a \$25 million reduction in our valuation allowance due to the inclusion of a significant portion of the remaining taxable temporary difference as a source of future taxable income.

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

The Worker, Homeownership and Business Assistance Act of 2009 (the Act) was signed into law on November 6, 2009. The Act provides that taxpayers may elect to increase the carry back period for tax losses incurred in a taxable year beginning or ending in either 2008 or 2009. During the three months ended December 31, 2009, we elected to increase the carry back period for tax losses incurred in fiscal year 2009. This election resulted in a reduction in the valuation allowance on our U.S. deferred tax assets due to an increase in the sources of taxable income from the extended carry back period. As a result, we recorded a tax benefit of approximately \$28 million in the three months ended December 31, 2009 for the reduction in the valuation allowance.

**Table of Contents**

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

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

**RESULTS OF OPERATIONS**

Our fiscal year is reported on a 52 or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ending or ended, as the case may be, March 31, 2010 and 2009 contain 53 and 52 weeks, respectively, and ends or ended, as the case may be, on April 3, 2010 and March 28, 2009, respectively. Our results of operations for the three months ended December 31, 2009 and 2008 contain 13 weeks and ended on January 2, 2010 and December 27, 2008, respectively. Our results of operations for the nine months ended December 31, 2009 and 2008 contain 40 and 39 weeks, respectively, and ended on January 2, 2010 and December 27, 2008, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

**Net Revenue**

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

During the three and nine months ended December 31, 2009, we recognized total net revenue of \$1,243 million and \$2,675 million, respectively. Our total net revenue during the three and nine months ended December 31, 2009 includes \$622 million and \$1,124 million, respectively, recognized from sales of certain online-enabled packaged goods and digital content that either (1) we were not able to objectively determine the fair value (as defined by U.S. Generally Accepted Accounting Principles for software sales) of the online service that we provided in connection with the sale or (2) we had an obligation to deliver incremental unspecified digital content in the future without an additional fee. When we refer to deferral of net revenue in this Net Revenue section, we mean the deferral of (1) the total net revenue from bundle sales of certain online-enabled packaged goods and PC digital downloads for which either we do not have VSOE for the online service that we provide in connection with the sale of the software or we have an obligation to provide future incremental unspecified digital content, (2) revenue from certain packaged goods sales of massively-multiplayer online role-playing games, and (3) revenue from the sale of certain incremental content associated with our core subscription services that can only be played online, which are types of micro-transactions. The change in deferred net revenue decreased our reported net revenue \$103 million and \$634 million during the three and nine months ended December 31, 2009, respectively. The change in deferred net revenue decreased our reported net revenue \$88 million and \$125 million during the three and nine months ended December 31, 2008, respectively.

**Table of Contents**

From a geographical perspective, our total net revenue for the three and nine months ended December 31, 2009 and 2008 was as follows (in millions):

	Three Months Ended December 31,				Decrease	% Change
	2009		2008			
North America	\$ 693	56%	\$ 957	58%	\$ (264)	(28%)
Europe	489	39%	623	38%	(134)	(22%)
Asia	61	5%	74	4%	(13)	(18%)
International	550	44%	697	42%	(147)	(21%)
<b>Total Net Revenue</b>	<b>\$ 1,243</b>	<b>100%</b>	<b>\$ 1,654</b>	<b>100%</b>	<b>\$ (411)</b>	<b>(25%)</b>

	Nine Months Ended December 31,				Decrease	% Change
	2009		2008			
North America	\$ 1,515	57%	\$ 1,941	58%	\$ (426)	(22%)
Europe	1,015	38%	1,253	37%	(238)	(19%)
Asia	145	5%	158	5%	(13)	(8%)
International	1,160	43%	1,411	42%	(251)	(18%)
<b>Total Net Revenue</b>	<b>\$ 2,675</b>	<b>100%</b>	<b>\$ 3,352</b>	<b>100%</b>	<b>\$ (677)</b>	<b>(20%)</b>

The overall change in deferred net revenue for the three and nine months ended December 31, 2009 and 2008 was as follows (in millions):

	Three Months Ended December 31,		Increase / (Decrease)
	2009	2008	
PLAYSTATION 3	\$ (49)	\$ (58)	\$ 9
Xbox 360	(29)		(29)
Nintendo DS	(12)		(12)
PC	(8)	21	(29)
PSP	(3)	(34)	31
Wii	(1)	(27)	26
PlayStation 2		11	(11)
Other	(1)	(1)	
<b>Total Impact on Net Revenue</b>	<b>\$ (103)</b>	<b>\$ (88)</b>	<b>\$ (15)</b>

	Nine Months Ended December 31,		Increase / (Decrease)
	2009	2008	
Xbox 360	\$ (281)	\$	\$ (281)
PLAYSTATION 3	(207)	(48)	(159)
PC	(99)	(68)	(31)
Wii	(22)	(35)	13
Nintendo DS	(12)		(12)
PlayStation 2	(7)	27	(34)

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

PSP	(6)		(6)
Other		(1)	1
<b>Total Impact on Net Revenue</b>	<b>\$ (634)</b>	<b>\$ (125)</b>	<b>\$ (509)</b>

**Table of Contents****North America**

For the three months ended December 31, 2009, net revenue in North America was \$693 million, driven by *Left 4 Dead 2*, *Madden NFL 10*, and *Rock Band 2*. Net revenue for the three months ended December 31, 2009 decreased \$264 million, or 28 percent, as compared to the three months ended December 31, 2008. From an operational perspective, the decrease in net revenue was driven by (1) a \$73 million decrease in net revenue from sales of titles for the PlayStation 2, (2) a \$63 million decrease in net revenue from sales of titles for the PLAYSTATION 3, (3) a \$52 million decrease in net revenue from sales of titles for the Xbox 360, and (4) a \$47 million decrease in net revenue from sales of titles for the Wii.

The change in deferral of net revenue decreased our reported net revenue by \$87 million during the three months ended December 31, 2009, as compared to an increase in our reported net revenue of \$47 million for the three months ended December 31, 2008.

The change in deferred net revenue for the three months ended December 31, 2009 and 2008 for North America was as follows (in millions):

	Three Months Ended December 31,		Increase / (Decrease)
	2009	2008	
PLAYSTATION 3	\$ (38)	\$ 21	\$ (59)
Xbox 360	(35)	1	(36)
Wii	(6)	(15)	9
PSP	(3)	(7)	4
Nintendo DS	(4)		(4)
PC		39	(39)
PlayStation 2		9	(9)
Other	(1)	(1)	
<b>Total Impact on Net Revenue</b>	<b>\$ (87)</b>	<b>\$ 47</b>	<b>\$ (134)</b>

For the nine months ended December 31, 2009, net revenue in North America was \$1,515 million, driven by *The Beatles : Rock Band*, *Madden NFL 10* and *Left 4 Dead 2*. Net revenue for the nine months ended December 31, 2009 decreased \$426 million, or 22 percent, as compared to the nine months ended December 31, 2008. From an operational perspective, the decrease in net revenue was driven by (1) a \$203 million decrease in net revenue from sales of titles for the Xbox 360, (2) a \$154 million decrease in net revenue from sales of titles for the PlayStation 2, and (3) a \$60 million decrease in net revenue from sales of titles for the PLAYSTATION 3.

The change in deferral of net revenue decreased our reported net revenue by \$352 million during the nine months ended December 31, 2009, as compared to a decrease in our reported net revenue of \$55 million for the nine months ended December 31, 2008.

The change in deferred net revenue for the nine months ended December 31, 2009 and 2008 for North America was as follows (in millions):

	Nine Months Ended December 31,		Increase / (Decrease)
	2009	2008	
Xbox 360	\$ (187)	\$	\$ (187)
PLAYSTATION 3	(106)	(20)	(86)
PC	(31)	(26)	(5)
Wii	(13)	(22)	9
PlayStation 2	(8)	8	(16)
PSP	(3)	6	(9)
Other	(4)	(1)	(3)
<b>Total Impact on Net Revenue</b>	<b>\$ (352)</b>	<b>\$ (55)</b>	<b>\$ (297)</b>





**Table of Contents**

We expect net revenue for North America to decrease during fiscal year 2010 as compared to fiscal year 2009 due to an expected increase in deferred net revenue related to our online-enabled packaged goods and digital content.

**Europe**

For the three months ended December 31, 2009, net revenue in Europe was \$489 million, driven by *FIFA 10*, *The Sims 3*, and *Need for Speed Shift*. Net revenue for the three months ended December 31, 2009 decreased \$134 million, or 22 percent, as compared to the three months ended December 31, 2008. From an operational perspective the decrease in net revenue was driven by (1) a \$57 million decrease in net revenue from sales of titles for the PlayStation 2, (2) a \$45 million decrease in net revenue from sales of titles for the Xbox 360, and (3) a \$39 million decrease in net revenue from sales of titles for the Nintendo DS.

The change in deferral of net revenue decreased our reported net revenue by \$8 million during the three months ended December 31, 2009, as compared to a decrease in our reported net revenue of \$123 million for the three months ended December 31, 2008.

We estimate that foreign exchange rates (primarily the British pound sterling) decreased reported net revenue, including the foreign exchange impact from deferred net revenue, by approximately \$19 million, or 3 percent, for the three months ended December 31, 2009, as compared to the three months ended December 31, 2008. Excluding the effect of foreign exchange rates from net revenue, we estimate that net revenue decreased by approximately \$115 million, or 19 percent, for the three months ended December 31, 2009, as compared to the three months ended December 31, 2008.

The change in deferred net revenue for the three months ended December 31, 2009 and 2008 for Europe was as follows (in millions):

	Three Months Ended December 31,		Increase / (Decrease)
	2009	2008	
PC	\$ (8)	\$ (15)	\$ 7
Nintendo DS	(7)		(7)
PLAYSTATION 3	(6)	(71)	65
PSP	1	(26)	27
Wii	4	(12)	16
Xbox 360	9	(1)	10
Other	(1)	2	(3)
Total Impact on Net Revenue	\$ (8)	\$ (123)	\$ 115

For the nine months ended December 31, 2009, net revenue in Europe was \$1,015 million, driven by *FIFA 10*, *The Sims 3*, and *FIFA 09*. Net revenue for the nine months ended December 31, 2009 decreased \$238 million, or 19 percent, as compared to the nine months ended December 31, 2008. From an operational perspective the decrease in net revenue was driven by (1) a \$79 million decrease in net revenue from sales of titles for the PlayStation 2, (2) a \$73 million decrease in net revenue from sales of titles for the Xbox 360, (3) a \$54 million decrease in net revenue from sales of titles for the Nintendo DS, and (4) a \$28 million decrease in net revenue from sales of titles for the PC.

The change in deferral of net revenue decreased our reported net revenue by \$260 million during the nine months ended December 31, 2009, as compared to a decrease in our reported net revenue of \$65 million for the nine months ended December 31, 2008.

We estimate that foreign exchange rates (primarily the British pound sterling) decreased reported net revenue, including the foreign exchange impact from deferred net revenue, by approximately \$50 million, or 4 percent, for the nine months ended December 31, 2009, as compared to the nine months ended December 31, 2008. Excluding the effect of foreign exchange rates from net revenue, we estimate that net revenue decreased by approximately \$188 million, or 15 percent, for the nine months ended December 31, 2009, as compared to the nine months ended December 31, 2008.

**Table of Contents**

The change in deferred net revenue for the nine months ended December 31, 2009 and 2008 for Europe was as follows (in millions):

	Nine Months Ended December 31,		Increase / (Decrease)
	2009	2008	
PLAYSTATION 3	\$ (92)	\$ (26)	\$ (66)
Xbox 360	(85)		(85)
PC	(66)	(35)	(31)
Wii	(8)	(13)	5
Nintendo DS	(7)	(1)	(6)
PSP	(3)	(7)	4
PlayStation 2	1	17	(16)
Total Impact on Net Revenue	\$ (260)	\$ (65)	\$ (195)

We expect net revenue for Europe to decrease during fiscal year 2010 as compared to fiscal year 2009 due to an expected increase in deferred net revenue related to our online-enabled packaged goods and digital content.

**Asia**

For the three months ended December 31, 2009, net revenue in Asia was \$61 million, driven by *FIFA 10*, *Left 4 Dead 2*, and *The Sims 3*. Net revenue for the three months ended December 31, 2009 decreased \$13 million, or 18 percent, as compared to the three months ended December 31, 2008. From an operational perspective, the decrease in net revenue was driven by (1) a \$5 million decrease in net revenue from sales of titles for the PlayStation 2, (2) a \$3 million decrease in net revenue from sales of titles for the Xbox 360, (3) a \$2 million decrease in net revenue from sales of titles for the PLAYSTATION 3, and (4) a \$2 million decrease in net revenue from sales of titles for the Nintendo DS.

The change in deferral of net revenue decreased our reported net revenue by \$8 million during the three months ended December 31, 2009, as compared to a decrease in our reported net revenue of \$12 million for the three months ended December 31, 2008.

We estimate that foreign exchange rates (particularly the Australian dollar) increased reported net revenue, including the foreign exchange impact from deferred net revenue, by approximately \$3 million, or 4 percent, for the three months ended December 31, 2009, as compared to the three months ended December 31, 2008. Excluding the effect of foreign exchange rates from net revenue, we estimate that net revenue decreased by approximately \$16 million, or 22 percent, for the three months ended December 31, 2009, as compared to the three months ended December 31, 2008.

The change in deferred net revenue for the three months ended December 31, 2009 and 2008 for Asia was as follows (in millions):

	Three Months Ended December 31,		Increase / (Decrease)
	2009	2008	
PLAYSTATION 3	\$ (5)	\$ (8)	\$ 3
Xbox 360	(3)		(3)
Other		(4)	4
Total Impact on Net Revenue	\$ (8)	\$ (12)	\$ 4

For the nine months ended December 31, 2009, net revenue in Asia was \$145 million, driven by *The Sims 3*, *FIFA 10*, and *FIFA Online 2*. Net revenue for the nine months ended December 31, 2009 decreased \$13 million, or 8 percent, as compared to the nine months ended December 31, 2008. From an operational perspective, the decrease in net revenue was driven by (1) an \$8 million decrease in net revenue from sales of titles for the PlayStation 2, (2) a \$5 million decrease in net revenue from sales of titles for the Xbox 360, (3) a \$5 million decrease in net revenue from sales of titles for the Nintendo DS, and (4) a \$4 million decrease in net revenue from sales of titles for the PLAYSTATION 3. These decreases were partially offset by a \$10 million increase in net revenue from sales of titles for the Wii.



**Table of Contents**

The change in deferral of net revenue decreased our reported net revenue by \$22 million during the nine months ended December 31, 2009, as compared to a decrease in our reported net revenue of \$5 million for the nine months ended December 31, 2008.

We estimate that foreign exchange rates (particularly the Australian dollar) decreased reported net revenue, including the foreign exchange impact from deferred net revenue, by approximately \$3 million, or 2 percent, for the nine months ended December 31, 2009, as compared to the nine months ended December 31, 2008. Excluding the effect of foreign exchange rates from net revenue, we estimate that net revenue decreased by approximately \$10 million, or 6 percent, for the nine months ended December 31, 2009, as compared to the nine months ended December 31, 2008.

The change in deferred net revenue for the nine months ended December 31, 2009 and 2008 for Asia was as follows (in millions):

	Nine Months Ended December 31,		Increase / (Decrease)
	2009	2008	
PLAYSTATION 3	\$ (9)	\$ (2)	\$ (7)
Xbox 360	(9)		(9)
PC	(2)	(7)	5
Other	(2)	4	(6)
<b>Total Impact on Net Revenue</b>	<b>\$ (22)</b>	<b>\$ (5)</b>	<b>\$ (17)</b>

We expect net revenue for Asia to decrease during fiscal year 2010 as compared to fiscal year 2009 due to an expected increase in deferred net revenue related to our online-enabled packaged goods and digital content.

**Cost of Goods Sold**

Cost of goods sold for our packaged-goods business consists of (1) product costs, (2) certain royalty expenses for celebrities, professional sports and other organizations and independent software developers, (3) manufacturing royalties, net of volume discounts and other vendor reimbursements, (4) expenses for defective products, (5) write-offs of post-launch prepaid royalty costs, (6) amortization of certain intangible assets, (7) personnel-related costs, and (8) distribution costs. We generally recognize volume discounts when they are earned from the manufacturer (typically in connection with the achievement of unit-based milestones), whereas other vendor reimbursements are generally recognized as the related revenue is recognized. Cost of goods sold for our online products consists primarily of data center and bandwidth costs associated with hosting our web sites, credit card fees and royalties for use of third-party properties. Cost of goods sold for our web site advertising business primarily consists of server costs.

Cost of goods sold for the three and nine months ended December 31, 2009 and 2008 were as follows (in millions):

	December 31, 2009	% of Net Revenue	December 31, 2008	% of Net Revenue	% Change	Change as a % of Net Revenue
Three months ended	\$ 654	52.6%	\$ 925	55.9%	(29.3%)	(3.3%)
Nine months ended	\$ 1,568	58.6%	\$ 1,778	53.0%	(11.8%)	5.6%

During the three months ended December 31, 2009, cost of goods sold decreased by 3.3 percent as a percentage of total net revenue as compared to the three months ended December 31, 2008. This decrease was primarily due to (1) lower co-publishing and distribution royalty costs resulting from sales of higher margin titles, which positively impacted cost of goods sold as a percentage of total revenue by approximately 2.5 percent and (2) a greater percentage of net revenue from EA studio products, which have a higher margin than our co-publishing and distribution products, which positively impacted cost of goods sold as a percentage of total revenue by approximately 2.3 percent. This decrease was partially offset by a \$15 million unfavorable change in deferred net revenue related to certain online-enabled packaged goods and digital content for the three months ended December 31, 2009, as compared to the three months ended December 31, 2008.



**Table of Contents**

During the nine months ended December 31, 2009, cost of goods sold increased by 5.6 percent as a percentage of total net revenue as compared to the nine months ended December 31, 2008. This increase was primarily due to a \$509 million unfavorable change in deferred net revenue related to certain online-enabled packaged goods and digital content for the nine months ended December 31, 2009, as compared to the nine months ended December 31, 2008. Overall, we estimate the unfavorable change in deferred net revenue related to certain online-enabled packaged goods and digital content negatively impacted cost of goods sold as a percent of total net revenue by 9.3 percentage points. The overall increase in cost of goods sold as a percentage of net revenue was partially mitigated by a greater percentage of net revenue from EA studio products, which have a higher margin than our co-publishing and distribution products, which positively impacted cost of goods sold as a percentage of total revenue by approximately 2.4 percent.

**Marketing and Sales**

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

Marketing and sales expenses for the three and nine months ended December 31, 2009 and 2008 were as follows (in millions):

	December 31, 2009	% of Net Revenue	December 31, 2008	% of Net Revenue	\$ Change	% Change
Three months ended	\$ 208	17%	\$ 250	15%	\$ (42)	(17%)
Nine months ended	\$ 559	21%	\$ 575	17%	\$ (16)	(3%)

Marketing and sales expenses decreased by \$42 million, or 17 percent, during the three months ended December 31, 2009, as compared to the three months ended December 31, 2008. The decrease was primarily due to a \$38 million decrease in marketing, advertising and promotional expenses resulting from higher spending in the prior year to support the launch of new franchises and for promoting established franchises.

Marketing and sales expenses decreased by \$16 million, or 3 percent, during the nine months ended December 31, 2009, as compared to the nine months ended December 31, 2008. The decrease was primarily due to a decrease of \$18 million in personnel-related costs primarily resulting from a decrease in headcount resulting from our cost reduction initiatives.

We expect marketing and sales expenses to increase in absolute dollars during fiscal year 2010 as compared to fiscal year 2009 primarily due to an increase in marketing and advertising expenses, partially offset by a decrease in personnel-related costs.

**General and Administrative**

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

General and administrative expenses for the three and nine months ended December 31, 2009 and 2008 were as follows (in millions):

	December 31, 2009	% of Net Revenue	December 31, 2008	% of Net Revenue	\$ Change	% Change
Three months ended	\$ 84	7%	\$ 82	5%	\$ 2	2%
Nine months ended	\$ 241	9%	\$ 258	8%	\$ (17)	(7%)

General and administrative expenses decreased by \$17 million, or 7 percent, during the nine months ended December 31, 2009, as compared to the nine months ended December 31, 2008. This decrease was primarily due to (1) a decrease of \$11 million in additional personal-related costs resulting from our cost reduction initiatives, (2) a decrease of \$10 million in stock-based compensation expense, and (3) an \$8 million decrease in bad debt expense. These decreases were partially offset by an increase in facilities related expenses primarily due to a \$14 million loss on our lease obligation related to our Redwood Shores headquarters facility.

**Table of Contents**

We expect general and administrative expenses to decrease in absolute dollars during fiscal year 2010 as compared to fiscal year 2009 primarily due to a decrease in personnel-related costs.

**Research and Development**

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

Research and development expenses for the three and nine months ended December 31, 2009 and 2008 were as follows (in millions):

	December 31, 2009	% of Net Revenue	December 31, 2008	% of Net Revenue	\$ Change	% Change
Three months ended	\$ 290	23%	\$ 299	18%	\$ (9)	(3%)
Nine months ended	\$ 918	34%	\$ 1,027	31%	\$ (109)	(11%)

Research and development expenses decreased by \$9 million, or 3 percent, during the three months ended December 31, 2009, as compared to the three months ended December 31, 2008. This decrease was primarily due to (1) a decrease of \$21 million in additional personnel-related costs primarily resulting from our cost reduction initiatives and (2) a decrease of \$14 million in external development and contracted services. These decreases were partially offset by a \$25 million increase in incentive-based compensation expense.

Research and development expenses decreased by \$109 million, or 11 percent, during the nine months ended December 31, 2009, as compared to the nine months ended December 31, 2008. The decrease was primarily due to (1) a decrease of \$75 million in additional personnel-related costs primarily resulting from our cost reduction initiatives, (2) a decrease of \$30 million in external development and contracted services, and (3) a decrease of \$15 million in stock-based compensation expense. These decreases were partially offset by a \$10 million increase in incentive-based compensation expense.

We expect research and development expenses to decrease in absolute dollars during fiscal year 2010 as compared to fiscal year 2009 primarily due to a decrease in personnel-related costs.

**Amortization of Intangibles**

Amortization of intangibles for the three and nine months ended December 31, 2009 and 2008 was as follows (in millions):

	December 31, 2009	% of Net Revenue	December 31, 2008	% of Net Revenue	\$ Change	% Change
Three months ended	\$ 14	1%	\$ 15	1%	\$ (1)	(7%)
Nine months ended	\$ 38	1%	\$ 46	1%	\$ (8)	(17%)

Amortization of intangibles decreased \$8 million, or 17 percent, during the nine months ended December 31, 2009, as compared to the nine months ended December 31, 2008, primarily due to a change in the estimated useful lives of certain intangibles.

**Certain Abandoned Acquisition-Related Costs**

Certain abandoned acquisition-related costs consist of costs we incurred in connection with the abandoned acquisition of Take-Two. On August 18, 2008, we allowed our tender offer for Take-Two shares to expire and on September 14, 2008, we announced that we had terminated discussions with Take-Two. As a result, during the nine months ended December 31, 2008, we recognized \$21 million in related costs consisting of legal, banking and other consulting fees.





**Table of Contents****Goodwill Impairment**

Adverse economic conditions, including the decline in our market capitalization and our expected financial performance at the time, indicated that a potential impairment of goodwill existed during the three months ended December 31, 2008. As a result, we performed goodwill impairment tests for our reporting units. As a result of the goodwill impairment analysis, we determined that our EA Mobile reporting unit's goodwill was impaired. Substantially all of our goodwill associated with our EA Mobile reporting unit was derived from our acquisition of JAMDAT Mobile Inc. in February 2006. During the three months ended December 31, 2008, we recognized a goodwill impairment charge of \$368 million related to our EA Mobile reporting unit. There were no indicators of impairment to our goodwill during the three and nine months ended December 31, 2009.

**Restructuring Charges**

Restructuring charges for the three and nine months ended December 31, 2009 and 2008 were as follows (in millions):

	December 31, 2009	% of Net Revenue	December 31, 2008	% of Net Revenue	\$ Change	% Change
Three months ended	\$ 100	8%	\$ 18	1%	\$ 82	456%
Nine months ended	\$ 120	4%	\$ 41	1%	\$ 79	193%

***Fiscal 2010 Restructuring***

In the quarter ended December 31, 2009, we announced details of a restructuring plan to narrow our product portfolio to provide greater focus on titles with higher margin opportunities. Under this plan, we anticipate (1) reducing our workforce by approximately 1,350 employees, (2) consolidating or closing various facilities, (3) eliminating certain titles, and (4) incurring IT and other costs to assist in reorganizing certain activities. We expect the majority of these actions to be completed by March 31, 2010.

During the three and nine months ended December 31, 2009, we incurred \$96 million of restructuring charges of which (1) \$63 million were for employee-related expenses, (2) \$27 million related to abandoned rights to intellectual property, intangible asset impairment costs, and other costs to assist in the reorganization of our business support functions, and (3) \$6 million related to the closure of certain of our facilities.

During the remainder of fiscal year 2010, we anticipate incurring between \$35 million and \$40 million of restructuring charges, primarily consisting of facilities exit and employee-related costs, related to the fiscal 2010 restructuring. Overall, including charges incurred through December 31, 2009, we expect to incur total cash and non-cash charges between \$150 million and \$155 million by March 31, 2012. These charges will consist primarily of (1) employee-related costs (approximately \$70 million), (2) intangible asset impairment, abandoned rights to intellectual property costs, and other costs to assist in the reorganization of our business support functions (approximately \$35 million), (3) facilities exit costs (approximately \$30 million), and (4) other reorganizational costs including IT and consulting costs (approximately \$20 million).

***Fiscal 2009 Restructuring***

During the nine months ended December 31, 2009, we incurred \$14 million of restructuring charges, primarily for facilities-related expenses. During the nine months ended December 31, 2008, we incurred approximately \$13 million of charges in connection with our fiscal 2009 restructuring, of which \$10 million was for employee-related expenses. After December 31, 2009, we anticipate incurring less than \$1 million of additional restructuring charges under this plan.

***Fiscal 2008 Reorganization***

During the nine months ended December 31, 2009, we incurred \$10 million of restructuring charges, primarily related to other expenses, including contracted services costs to assist in the reorganization of our business support functions. During the nine months ended December 31, 2008, we incurred approximately \$25 million of reorganization charges, of which \$16 million was related to facilities-related expenses and \$9 million related to other expenses, including contracted services costs to assist in the reorganization of our business support functions. We do not expect to incur any additional charges under this plan.



**Table of Contents****Losses on Strategic Investments**

Losses on strategic investments for the three and nine months ended December 31, 2009 and 2008 were as follows (in millions):

	December 31, 2009	% of Net Revenue	December 31, 2008	% of Net Revenue	\$ Change	% Change
Three months ended	\$ (1)		\$ (27)	(2%)	\$ 26	96%
Nine months ended	\$ (25)	(1%)	\$ (67)	(2%)	\$ 42	63%

During the three months ended December 31, 2009, losses on strategic investments decreased by \$26 million, or 96 percent, as compared to the three months ended December 31, 2008. We recognized \$1 million and \$27 million impairment charges on our investment in The9 during the three months ended December 31, 2009 and 2008, respectively.

During the nine months ended December 31, 2009, losses on strategic investments decreased by \$42 million, or 63 percent, as compared to the nine months ended December 31, 2008. We recognized a \$25 million impairment charge on our investment in The9 during the nine months ended December 31, 2009. During the nine months ended December 31, 2008, we recognized (1) \$40 million of impairment charges on our investments in Neowiz's common and preferred shares and (2) a \$27 million impairment charge on our investment in The9.

**Interest and Other Income (Expense), Net**

Interest and other income (expense), net, for the three and nine months ended December 31, 2009 and 2008 were as follows (in millions):

	December 31, 2009	% of Net Revenue	December 31, 2008	% of Net Revenue	\$ Change	% Change
Three months ended	\$ (2)		\$ 14	1%	\$ (16)	(114%)
Nine months ended	\$ 8		\$ 36	1%	\$ (28)	(78%)

During the three and nine months ended December 31, 2009, interest and other income, net, decreased by \$16 million, or 114 percent, and \$28 million, or 78 percent, respectively, as compared to the three and nine months ended December 31, 2008, primarily due to a decrease in interest income as a result of lower cash and cash equivalents and short-term investment balances.

**Income Taxes**

Income tax expense (benefit) for the three and nine months ended December 31, 2009 and 2008 were as follows (in millions):

	December 31, 2009	Effective Tax Rate	December 31, 2008	Effective Tax Rate	% Change
Three months ended	\$ (28)	(24.9%)	\$ 324	N/A	(109%)
Nine months ended	\$ (79)	(10.0%)	\$ 250	N/A	(132%)

The tax benefit reported for the three and nine months ended December 31, 2009 is based on our projected annual effective tax rate for fiscal 2010, and also includes certain discrete tax charges recorded during the period. Our effective tax rates for the three and nine months ended December 31, 2009 were tax benefits of 24.9 percent and 10.0 percent, respectively. The effective tax rates for the three and nine months ended December 31, 2008 are not meaningful due to the discrete tax charge of \$244 million to establish the deferred tax valuation allowance. The effective tax rates for the three and nine months ended December 31, 2009 differ from the statutory rate of 35.0 percent primarily due to U.S. losses for which no benefit is recognized, non-U.S. losses with a reduced or zero tax benefit, partially offset by benefits related to the resolution of examinations by taxing authorities and reductions in the valuation allowance on U.S. deferred tax assets. The effective tax rates for the three and nine months ended December 31, 2009 differ from the same periods in fiscal year 2009 primarily due to the discrete tax charge to establish the valuation allowance in fiscal year 2009, tax charges incurred in fiscal year 2009 related to our integration of VG Holding Corp., and tax benefits related to the resolution of tax examinations.



---

**Table of Contents**

Our effective income tax rates for fiscal year 2010 and future periods will depend on a variety of factors, including changes in the deferred tax valuation allowance, as well as changes in our business such as acquisitions and intercompany transactions, changes in our international structure, changes in the geographic location of business functions or assets, changes in the geographic mix of income, changes in or termination of our agreements with tax authorities, applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audit and other matters, and variations in our annual pre-tax income or loss. We incur certain tax expenses that do not decline proportionately with declines in our pre-tax consolidated income or loss. As a result, in absolute dollar terms, our tax expense will have a greater influence on our effective tax rate at lower levels of pre-tax income or loss than at higher levels. In addition, at lower levels of pre-tax income or loss, our effective tax rate will be more volatile.

Certain taxable temporary differences that are not expected to reverse during the carry forward periods permitted by tax law cannot be considered as a source of future taxable income that may be available to realize the benefit of deferred tax assets. For example, in determining the valuation allowance we recorded at June 30, 2009, we did not include as a source of future taxable income the taxable temporary difference related to the accumulated tax depreciation on our headquarters facilities in Redwood City, California. On July 13, 2009, we purchased our Redwood Shores headquarters facilities concurrent with the expiration and extinguishment of the lessor's financing agreements. These facilities were subject to leases which expired in July 2009, and had been accounted for as operating leases. The total amount paid under the terms of the leases was \$247 million, of which \$233 million related to the purchase price of the facilities and \$14 million was for the loss on our lease obligation. Therefore, in the fiscal quarter ended September 30, 2009, we recorded a tax benefit of approximately \$31 million, consisting of approximately \$6 million related to the loss on our lease obligation and a \$25 million reduction in our valuation allowance due to the inclusion of a significant portion of the remaining taxable temporary difference as a source of future taxable income.

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

**Impact of Recently Issued Accounting Standards**

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements*. This guidance modifies the fair value requirements of FASB ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements*, by allowing the use of the best estimate of selling price in addition to vendor specific objective evidence and third-party evidence for determining the selling price of a deliverable. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence, (b) third-party evidence, or (c) estimates. In addition, the residual method of allocating arrangement consideration is no longer permitted. ASU 2009-13 is effective for fiscal years beginning on or after June 15, 2010. We do not expect the adoption of ASU 2009-13 to have a material impact on our Condensed Consolidated Financial Statements.

In October 2009, the FASB issued ASU 2009-14, *Software (Topic 985) Certain Revenue Arrangements that Include Software Elements*. This guidance modifies the scope of FASB ASC subtopic 965-605, *Software-Revenue Recognition*, to exclude from its requirements non-software components of tangible products and software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality. ASU 2009-14 is effective for fiscal years beginning on or after June 15, 2010. We do not expect the adoption of ASU 2009-14 to have a material impact on our Condensed Consolidated Financial Statements.

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

(In millions)	As of December 31, 2009	As of March 31, 2009	Decrease
Cash and cash equivalents	\$ 1,114	\$ 1,621	\$ (507)
Short-term investments	352	534	(182)
Marketable equity securities	318	365	(47)
Total	\$ 1,784	\$ 2,520	\$ (736)
Percentage of total assets	36%	54%	

(In millions)	Nine Months Ended December 31,		Increase / (Decrease)
	2009	2008	
Cash used in operating activities	\$ (101)	\$ (203)	\$ 102
Cash provided by (used in) investing activities	(471)	3	(474)
Cash provided by financing activities	38	77	(39)
Effect of foreign exchange on cash and cash equivalents	27	(51)	78
Net decrease in cash and cash equivalents	\$ (507)	\$ (174)	\$ (333)

***Changes in Cash Flow***

During the nine months ended December 31, 2009, we used \$101 million of cash in operating activities as compared to using \$203 million of cash for the nine months ended December 31, 2008. The decrease in cash used in operating activities for the nine months ended December 31, 2009 as compared to the nine months ended December 31, 2008 was primarily due to decreases in personnel-related costs and external development and contracted services as part of our cost reduction initiatives, as well as a reduction in incentive-based compensation payments.

For the nine months ended December 31, 2009, we generated \$657 million of cash proceeds from maturities and sales of short-term investments. Our primary use of cash in non-operating activities consisted of (1) \$477 million used to purchase short-term investments, (2) \$283 million in capital expenditures, of which \$233 million was used to purchase our Redwood Shores headquarters facilities, (3) \$278 million used for acquisitions, of which \$275 million, net of cash acquired, was used to fund our acquisition of Playfish, and (4) a \$100 million increase in acquisition-related restricted cash for contingent consideration in connection with our acquisition of Playfish.

***Short-term Investments and Marketable Equity Securities***

Due to our mix of fixed and variable rate securities, our short-term investment portfolio is susceptible to changes in short-term interest rates. As of December 31, 2009, our short-term investments had gross unrealized gains of \$2 million, or 1 percent of the total in short-term investments, and gross unrealized losses of less than \$1 million, or less than 1 percent of the total in short-term investments. From time to time, we may liquidate some or all of our short-term investments to fund operational needs or other activities, such as capital expenditures, business acquisitions or stock repurchase programs. Depending on which short-term investments we liquidate to fund these activities, we could recognize a portion, or all, of the gross unrealized gains or losses.

The fair value of our marketable equity securities decreased to \$318 million as of December 31, 2009 from \$365 million as of March 31, 2009. This decrease was primarily due to (1) impairment charges of \$25 million recognized on our investment in The9, (2) an \$11 million decrease in the unrealized gains on our investments, and (3) an \$11 million decrease in the cost basis of our investment in The9 resulting from the sale of a portion of this investment.

---

**Table of Contents*****Receivables, Net***

Our gross accounts receivable balances were \$762 million and \$333 million as of December 31, 2009 and March 31, 2009, respectively. The increase in our accounts receivable balance was primarily due to higher sales volumes in the third quarter of fiscal year 2010 as compared to the fourth quarter of fiscal year 2009, which was expected as we traditionally have higher sales during our third quarter as compared to our fourth quarter. We expect our accounts receivable balance to decrease during the three months ending March 31, 2010 resulting from our collections and our lower seasonal sales volume. Reserves for sales returns, pricing allowances and doubtful accounts increased in absolute dollars from \$217 million as of March 31, 2009 to \$267 million as of December 31, 2009. As a percentage of trailing nine month net revenue, reserves increased from 6 percent as of March 31, 2009, to 10 percent as of December 31, 2009. We believe these reserves are adequate based on historical experience and our current estimate of potential returns, pricing allowances and doubtful accounts.

***Inventories***

Inventories decreased to \$144 million as of December 31, 2009 from \$217 million as of March 31, 2009, primarily as a result of lower Rock Band inventory.

***Other Current Assets and Other Assets***

Other current assets increased to \$264 million as of December 31, 2009, from \$216 million as of March 31, 2009, while other assets increased to \$221 million as of December 31, 2009 from \$115 million as of March 31, 2009. Other current assets and other assets combined, increased by \$154 million primarily due to (1) a \$100 million increase in acquisition-related restricted cash for contingent consideration in connection with our acquisition of Playfish, (2) a \$25 million increase in prepaid income taxes, and (3) a \$21 million increase in other receivable balances.

***Accounts Payable***

Accounts payable increased to \$186 million as of December 31, 2009, from \$152 million as of March 31, 2009, primarily due to higher inventory purchases in conjunction with the seasonality of our business.

***Accrued and Other Current Liabilities***

Our accrued and other current liabilities increased to \$790 million as of December 31, 2009 from \$723 million as of March 31, 2009. The \$67 million increase was primarily due to (1) a \$56 million increase in marketing and advertising accruals to support our current year releases, (2) a \$20 million increase in Value-Added Tax payables, and (3) an \$18 million increase in accrued restructuring primarily from our fiscal 2010 restructuring. These increases were partially offset by a \$24 million decrease in accrued royalties.

***Other Liabilities***

Our other liabilities increased to \$139 million as of December 31, 2009 from \$98 million as of March 31, 2009. The \$41 million increase was primarily due to the \$64 million of contingent consideration in connection with our acquisition of Playfish. This increase was partially offset by a \$25 million decrease in our minimum guaranteed royalty payments.

***Deferred Income Taxes, Net***

Our net deferred income tax asset position increased by \$48 million as of December 31, 2009 as compared to March 31, 2009, primarily due to (1) a \$22 million increase related to the acquisition of Playfish, (2) a \$42 million increase as a result of a decrease in the valuation allowance on domestic deferred tax assets, and (3) a decrease of \$21 million to net certain deferred tax assets with directly associated unrecognized benefits.

***Financial Condition***

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





---

## **Table of Contents**

The loan financing arrangements supporting our Redwood City headquarters leases, described in the *Off-Balance Sheet Commitments* section below, expired in July 2009. On July 13, 2009, we purchased our Redwood Shores headquarters facilities comprised of approximately 660,000 square feet concurrent with the expiration and extinguishment of the lessor's financing agreements. These facilities were subject to leases, which expired in July 2009, and had previously been accounted for as operating leases. The total amount paid under the terms of the leases was \$247 million, of which \$233 million related to the purchase price of the facilities and \$14 million was for the loss on our lease obligation.

As of December 31, 2009, approximately \$966 million of our cash, cash equivalents, short-term investments and marketable equity securities was domiciled in foreign tax jurisdictions. While we have no plans to repatriate these funds to the United States in the short term, if we choose to do so, we would be required to accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

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

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

## **Contractual Obligations and Commercial Commitments**

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

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

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include: FIFA, FIFPRO Foundation, and FAPL (Football Association Premier League Limited) (professional soccer); National Basketball Association (professional basketball); PGA TOUR and Tiger Woods (professional golf); National Hockey League and NHL Players Association (professional hockey); Warner Bros. (Harry Potter); Red Bear Inc. (John Madden); National Football League Properties and PLAYERS Inc. (professional football); Collegiate Licensing Company (collegiate football and basketball); ESPN (content in EA SPORTS games); Hasbro, Inc. (a wide array of Hasbro intellectual properties); and the Estate of Robert Ludlum (Robert Ludlum novels and films). These developer and content license commitments represent the sum of (1) the cash payments due under non-royalty-bearing licenses and services agreements, and (2) the minimum guaranteed payments and advances against royalties due under royalty-bearing licenses and services agreements, the majority of which are conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.

**Table of Contents**

The following table summarizes our minimum contractual obligations and commercial commitments as of December 31, 2009, and the effect we expect them to have on our liquidity and cash flow in future periods (in millions):

Fiscal Year Ending March 31,	Contractual Obligations			Other Purchase Obligations	Commercial Commitments		Total
	Leases <sup>(a)</sup>	Developer/ Licensor Commitments <sup>(b)</sup>	Marketing		Letter of Credit, Bank and Other Guarantees		
2010 (remaining three months)	\$ 13	\$ 20	\$ 16	\$	\$ 2	\$	\$ 51
2011	45	275	71	1			392
2012	34	245	46				325
2013	28	147	41				216
2014	20	12	23				55
Thereafter	38	620	131				789
<b>Total</b>	<b>\$ 178</b>	<b>\$ 1,319</b>	<b>\$ 328</b>	<b>\$ 1</b>	<b>\$ 2</b>		<b>\$ 1,828</b>

(a) See discussion on operating leases in the Off-Balance Sheet Commitments section below for additional information. Lease commitments have not been reduced by minimum sub-lease rentals for unutilized office space resulting from our reorganization activities of approximately \$10 million due in the future under non-cancelable sub-leases.

(b) Developer/licensor commitments include \$14 million of commitments to developers or licensors that have been recorded in current and long-term liabilities and a corresponding amount in current and long-term assets in our Condensed Consolidated Balance Sheet as of December 31, 2009 because payment is not contingent upon performance by the developer or licensor.

The 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 expensed in our Condensed Consolidated Financial Statements.

In addition to what is included in the table above, as of December 31, 2009, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$312 million, of which approximately \$31 million is offset by prior cash deposits to tax authorities for issues pending resolution. For the remaining liability, we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

In connection with our acquisition of Playfish on November 9, 2009, we may be required to pay additional variable cash consideration that is contingent upon the achievement of certain performance milestones through December 31, 2011. The additional consideration is limited to a maximum of \$100 million.

**OFF-BALANCE SHEET COMMITMENTS*****Lease Commitments***

As of December 31, 2009, we leased certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.

On July 13, 2009, we purchased our Redwood Shores headquarters facilities comprised of approximately 660,000 square feet concurrent with the expiration and extinguishment of the lessor's financing agreements. These facilities were subject to leases, which expired in July 2009, and had previously been accounted for as operating leases. The total amount paid under the terms of the leases was \$247 million, of which \$233 million related to the purchase price of the facilities and \$14 million was for the loss on our lease obligation. Subsequent to our purchase, we classified the facilities on our Condensed Consolidated Balance Sheet as property and equipment, net and recognized depreciation expense for the property acquired on a straight-line basis over the estimated useful lives, excluding the land acquired.



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

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

***Foreign Currency Exchange Rate Risk***

*Cash Flow Hedging Activities.* From time to time, we hedge a portion of our foreign currency risk related to forecasted foreign-currency-denominated sales and expense transactions by purchasing foreign currency option contracts that generally have maturities of 15 months or less. These transactions are designated and qualify as cash flow hedges. The derivative assets associated with our hedging activities are recorded at fair value in other current assets in our Condensed Consolidated Balance Sheets. The effective portion of gains or losses resulting from changes in fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income in stockholders' equity and subsequently reclassified into net revenue or research and development expenses, as appropriate in the period when the forecasted transaction is recorded. The ineffective portion of gains or losses resulting from changes in fair value, if any, is reported in each period in interest and other income, net, in our Condensed Consolidated Statements of Operations. Our hedging programs are designed to reduce, but do not entirely eliminate the impact of currency exchange rate movements in net revenue and research and development expenses. As of December 31, 2009, we had foreign currency option contracts to purchase approximately \$21 million in foreign currency and to sell approximately \$37 million of foreign currencies. As of December 31, 2009, these foreign currency option contracts outstanding had a total fair value of \$2 million, included in other current assets. As of March 31, 2009, we had foreign currency option contracts to purchase approximately \$19 million in foreign currency and to sell approximately \$65 million of foreign currencies. As of March 31, 2009, these foreign currency option contracts outstanding had a total fair value of \$2 million, included in other current assets.

*Balance Sheet Hedging Activities.* We use foreign currency forward contracts to mitigate foreign currency risk associated with foreign-currency-denominated assets and liabilities, primarily intercompany receivables and payables. The forward contracts generally have a contractual term of three months or less and are transacted near month-end. Our foreign currency forward contracts are not designated as hedging instruments, and are accounted for as derivatives whereby the fair value of the contracts is reported as other current assets or other current liabilities in our Condensed Consolidated Balance Sheets, and gains and losses from changes in fair value are reported in interest and other income, net. The gains and losses on these forward contracts generally offset the gains and losses on the underlying foreign-currency-denominated assets and liabilities, which are also reported in interest and other income, net, in our Condensed Consolidated Statements of Operations. In certain cases, the amount of such gains and losses will significantly differ from the amount of gains and losses recognized on the underlying foreign-currency-denominated asset or liability, in which case our results will be impacted. As of December 31, 2009, we had foreign currency forward contracts to purchase and sell approximately \$529 million in foreign currencies. Of this amount, \$390 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$131 million to purchase foreign currency in exchange for U.S. dollars and \$8 million to sell foreign currency in exchange for British pounds sterling. As of March 31, 2009, we had foreign currency forward contracts to purchase and sell approximately \$63 million in foreign currencies. Of this amount, \$53 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$7 million to purchase foreign currencies in exchange for U.S. dollars and \$3 million to sell foreign currencies in exchange for British pounds sterling. The fair value of our foreign currency forward contracts was immaterial as of December 31, 2009 and March 31, 2009.

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

**Table of Contents**

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 December 31, 2009, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 15 percent would have resulted in potential declines in the fair value of our foreign currency option contracts used in cash flow hedging of \$1 million and \$2 million, respectively. A hypothetical adverse foreign currency exchange rate movement of 10 percent or 15 percent would have resulted in potential losses on our foreign currency forward contracts used in balance sheet hedging of \$52 million and \$78 million, respectively, as of December 31, 2009. This sensitivity analysis assumes a parallel adverse shift of all foreign currency exchange rates against the U.S. dollar; however, all foreign currency exchange rates do not always move in such manner and actual results may differ materially.

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our short-term investment portfolio. We manage our interest rate risk by maintaining an investment portfolio generally consisting of debt instruments of high credit quality and relatively short maturities. However, because short-term investments mature relatively quickly and are required to be reinvested at the then current market rates, interest income on a portfolio consisting of short-term investments is more subject to market fluctuations than a portfolio of longer term investments. Additionally, the contractual terms of the investments do not permit the issuer to call, prepay or otherwise settle the investments at prices less than the stated par value. Our investments are held for purposes other than trading. Also, we do not use derivative financial instruments in our short-term investment portfolio.

As of December 31, 2009 and March 31, 2009, our short-term investments were classified as available-for-sale and, consequently, recorded at fair market value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive income, net of any tax effects, in stockholders' equity. Our portfolio of short-term investments consisted of the following investment categories, summarized by fair value as of December 31, 2009 and March 31, 2009 (in millions):

	As of December 31, 2009	As of March 31, 2009
Corporate bonds	\$ 193	\$ 131
U.S. agency securities	86	109
U.S. Treasury securities	71	200
Commercial paper	1	79
Asset-backed securities	1	15
Total short-term investments	\$ 352	\$ 534

Notwithstanding our efforts to manage interest rate risks, there can be no assurance that we will be adequately protected against risks associated with interest rate fluctuations. At any time, a sharp change in interest rates could have a significant impact on the fair value of our investment portfolio. The following table presents the hypothetical changes in fair value in our short-term investment portfolio as of December 31, 2009, arising from potential changes in interest rates. The modeling technique estimates the change in fair value from immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points ( BPS ), 100 BPS, and 150 BPS.

(In millions)	Valuation of Securities Given an Interest Rate Decrease of X Basis Points			Fair Value as of December 31, 2009	Valuation of Securities Given an Interest Rate Increase of X Basis Points		
	(150 BPS)	(100 BPS)	(50 BPS)		50 BPS	100 BPS	150 BPS
Corporate bonds	\$ 196	\$ 195	\$ 194	\$ 193	\$ 191	\$ 189	\$ 188
U.S. agency securities	88	87	86	86	86	85	85
U.S. Treasury securities	73	73	72	71	71	71	70
Commercial paper	1	1	1	1	1	1	1
Asset-backed securities	1	1	1	1	1	1	1
Total short-term investments	\$ 359	\$ 357	\$ 354	\$ 352	\$ 350	\$ 347	\$ 345



**Table of Contents*****Market Price Risk***

The value of our marketable equity securities in publicly traded companies is subject to market price volatility and foreign currency risk for investments denominated in foreign currencies. As of December 31, 2009 and March 31, 2009, our marketable equity securities were classified as available-for-sale and, consequently, were recorded in our Condensed Consolidated Balance Sheets at fair market value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of any tax effects, in stockholders' equity. The fair value of our marketable equity securities was \$318 million and \$365 million as of December 31, 2009 and March 31, 2009, respectively. In the three and nine months ended December 31, 2009, we recognized other-than-temporary impairment losses on our marketable equity securities of \$1 million and \$25 million, respectively. In the three and nine months ended December 31, 2008, we recognized other-than-temporary impairment losses on our marketable equity securities of \$27 million and \$57 million, respectively.

Our marketable equity securities have been and may continue to be adversely impacted by volatility in the public stock markets. At any time, a sharp change in market prices in our investments in marketable equity securities could have a significant impact on the fair value of our investments. The following table presents hypothetical changes in the fair value of our marketable equity securities as of December 31, 2009, arising from changes in market prices plus or minus 25 percent, 50 percent and 75 percent.

(In millions)	Valuation of Securities Given an X Percentage Decrease in Each Stock's Market Price			Fair Value as of December 31, 2009	Valuation of Securities Given an X Percentage Increase in Each Stock's Market Price		
	(75%)	(50%)	(25%)		25%	50%	75%
Marketable equity securities	\$ 80	\$ 159	\$ 239	\$ 318	\$ 398	\$ 477	\$ 557

**Table of Contents**

**Item 4. Controls and Procedures**

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

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

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

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

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

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

There has been no change in our internal control over financial reporting identified in connection with our evaluation that occurred during the three months ended December 31, 2009 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.



---

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

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

**Item 1A: Risk Factors**

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

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

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

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

Our business is highly seasonal, with the highest levels of consumer demand and a significant percentage of our sales occurring in the December quarter. In addition, we seek to release many of our products in conjunction with specific events, such as the release of a related movie or the beginning of a sports season or major sporting event. If we miss these key selling periods for any reason, including product delays or delayed introduction of a new platform for which we have developed products, our sales will suffer disproportionately. Likewise, if a key event to which our product release schedule is tied were to be delayed or cancelled, our sales would also suffer disproportionately. Our ability to meet product development schedules is affected by a number of factors, including the creative processes involved, the coordination of large and sometimes geographically dispersed development teams required by the increasing complexity of our products and the platforms for which they are developed, and the need to fine-tune our products prior to their release. We have experienced development delays for our products in the past, which caused us to push back release dates. In the future, any failure to meet anticipated production or release schedules would likely result in a delay of revenue and/or possibly a significant shortfall in our revenue, increase our development expense, harm our profitability, and cause our operating results to be materially different than anticipated.

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

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



## **Table of Contents**

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

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

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

As a result of the national and global economic downturn, overall consumer spending has declined and retailers globally have taken a more conservative stance in ordering game inventory. The decrease in discretionary consumer spending contributed to the decline in the anticipated demand for our products during the 2008 holiday selling season. Continued economic distress, which may result in a further decrease in demand for our products, particularly during key product launch windows, could have a material adverse impact on our operating results and financial condition. Uncertainty and adverse changes in the economy could also increase the risk of material losses on our investments, increase costs associated with developing and publishing our products, increase the cost and decrease the availability of sources of financing, and increase our exposure to material losses from bad debts, any of which could have a material adverse impact on our financial condition and operating results. In addition, the decline in our market capitalization and our expected financial performance indicated that a potential impairment of goodwill existed during fiscal year 2009. As a result, we performed goodwill impairment tests for our reporting units. Based on the results of our goodwill impairment analysis, we determined that our EA Mobile reporting unit's goodwill was impaired. During the fiscal year ended March 31, 2009, we recorded a goodwill impairment charge of \$368 million related to our EA Mobile reporting unit. For the nine months ended December 31, 2009, there were no events or circumstances that indicated an impairment of our goodwill. If we experience further deterioration in our market capitalization or our financial performance, we could be required to recognize significant impairment charges in future periods.

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

For the nine months ended December 31, 2009, Europe and Asia net revenue comprised 43 percent of our total net revenue. We expect our Europe and Asia sales to continue to account for a significant portion of our total net revenue. Such sales may be subject to unexpected regulatory requirements, tariffs and other barriers. Additionally, foreign sales are primarily made in local currencies, which may fluctuate against the U.S. dollar. In addition, our international investments and our cash and cash equivalents denominated in foreign currencies are subject to currency fluctuations. We use foreign currency forward contracts to mitigate some foreign currency risk associated with foreign currency denominated assets and liabilities (primarily certain intercompany receivables and payables) to a limited extent and foreign currency option contracts to hedge foreign currency forecasted transactions (primarily related to a portion of the revenue and expenses denominated in foreign currency generated by our operational subsidiaries). However, these activities are limited in the protection they provide us from foreign currency fluctuations and can themselves result in losses. The disruption in the global financial markets has also impacted many of the financial institutions with which we do business. A sustained decline in the financial stability of financial institutions as a result of the disruption in the financial markets could negatively impact our treasury operations, including our ability to secure credit-worthy counterparties for our foreign currency hedging programs. Accordingly, our results of operations, including our reported net revenue, operating expenses and net income, and financial condition can be adversely affected by unfavorable foreign currency fluctuations, especially the Euro, British pound sterling and Canadian dollar.

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

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



## **Table of Contents**

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

During the nine months ended December 31, 2009, approximately 79 percent of our United States sales were made to our top ten customers. In Europe, our top ten customers accounted for approximately 49 percent of our sales in that territory during the nine months ended December 31, 2009. Worldwide, we had direct sales to two customers, GameStop Corp. and Wal-Mart Stores Inc., which represented approximately 15 percent and 13 percent, respectively, of total net revenue for the nine months ended December 31, 2009. As a result of the economic downturn, retailers globally have taken a more conservative stance in ordering game inventory. Though our products are available to consumers through a variety of retailers, the concentration of our sales in one, or a few, large customers could lead to a short-term disruption in our sales if one or more of these customers significantly reduced their purchases or ceased to carry our products, and could make us more vulnerable to collection risk if one or more of these large customers became unable to pay for our products or declared bankruptcy. Additionally, our receivables from these large customers increase significantly in the December quarter as they make purchases in anticipation of the holiday selling season. Also, having such a large portion of our total net revenue concentrated in a few customers could reduce our negotiating leverage with these customers. If one or more of our key customers experience deterioration in their business, or become unable to obtain sufficient financing to maintain their operations, our business could be harmed.

**Our industry is cyclical, driven by the periodic introduction of new video game hardware systems. As we continue to move through the current cycle, our industry growth may slow down and as a result, our operating results may be difficult to predict.**

Video game hardware systems have historically had a life cycle of four to six years, which causes the video game software market to be cyclical as well. The current cycle began with Microsoft's launch of the Xbox 360 in 2005, and continued in 2006 when Sony and Nintendo launched their next-generation systems, the PLAYSTATION 3 and the Wii, respectively. Sales of software designed for these hardware systems represent the majority of our revenue, so our growth and success is highly correlated to sales of videogame hardware systems. While there are indications that this current cycle may be extended longer than prior cycles, in part, due to the growth of online services and content, the greater graphic and processing power of the current generation hardware, and the introduction of new peripherals, growth in the installed base of the current generation of video game systems may slow down in light of the current economic environment. This slow-down in sales of video game players may cause a corresponding slow-down in the growth of sales of video game software, which could significantly affect our operating results. Consequently, the decline in prior-generation product sales may be greater or faster than we anticipate, and sales of products for the new platforms may be lower or increase more slowly than we anticipate. Moreover, development costs for the current cycle of video game systems continue to be greater on a per-title basis than development costs for prior-generation video game systems. As a result of these factors, during the next several quarters and years, we expect our operating results to be difficult to predict.

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

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

## **Table of Contents**

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

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

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

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

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

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

Many of our products are based on or incorporate intellectual property owned by others. For example, our EA SPORTS products include rights licensed from major sports leagues and players' associations. Similarly, many of our other hit franchises, such as Harry Potter, are based on key film and literary licenses. In addition, some of our most successful products in fiscal years 2009 and 2010, the Rock Band and Left 4 Dead series were not developed by us, but for which we had acquired distribution rights. Competition for these licenses and rights is intense. If we are unable to maintain these licenses and rights or obtain additional licenses or rights with significant commercial value, our revenues, profitability and cash flows will decline significantly. Competition for these licenses may also drive up the advances, guarantees and royalties that we must pay to licensors and developers, which could significantly increase our costs and reduce our profitability.

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

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

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

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



## **Table of Contents**

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

We have engaged in, evaluated, and expect to continue to engage in and evaluate, a wide array of potential strategic transactions, including (1) acquisitions of companies, businesses, intellectual properties, and other assets, (2) minority investments in strategic partners, and (3) investments in new interactive entertainment businesses (for example, online and mobile games). Any of these strategic transactions could be material to our financial condition and results of operations. Although we regularly search for opportunities to engage in strategic transactions, we may not be successful in identifying suitable opportunities. We may not be able to consummate potential acquisitions or investments or an acquisition or investment we do consummate may not enhance our business or may decrease rather than increase our earnings. The process of acquiring and integrating a company or business, or successfully exploiting acquired intellectual property or other assets, could divert a significant amount of resources, as well as our management's time and focus and may create unforeseen operating difficulties and expenditures, particularly for a large acquisition. Additional risks and variations of the foregoing risks we face include:

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

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

Retaining key employees and maintaining the key business and customer relationships of the businesses we acquire,

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

The possibility that we will not discover important facts during due diligence that could have a material adverse impact on the value of the businesses we acquire,

Potential impairment charges incurred to write down the carrying amount of intangible assets generated as a result of an acquisition,

Litigation or other claims in connection with, or inheritance of claims or litigation risks as a result of, an acquisition, including claims from terminated employees, customers or other third parties,

Significant accounting charges resulting from the completion and integration of a sizeable acquisition and increased capital expenditures,

Significant acquisition-related accounting adjustments, particularly relating to an acquired company's deferred revenue, that may cause reported revenue and profits of the combined company to be lower than the sum of their stand-alone revenue and profits,

The possibility that the combined company would not achieve the expected benefits, including any anticipated operating and product synergies, of the acquisition as quickly as anticipated,

The possibility that the costs of, or operational difficulties arising from, an acquisition would be greater than anticipated,



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

The possibility that a change of control of a company we acquire triggers a termination of contractual or intellectual property rights important to the operation of its business.

## **Table of Contents**

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

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

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

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

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

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

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

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

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

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



## **Table of Contents**

While legal protections exist to combat piracy, preventing and curbing infringement through enforcement of our intellectual property rights may be difficult, costly and time consuming, particularly in countries where laws are less protective of intellectual property rights. Further, the scope of the legal protection of copyright and prohibitions against the circumvention of technological protection measures to protect copyrighted works are often under scrutiny by courts and governing bodies. The repeal or weakening of laws intended to combat piracy, protect intellectual property and prohibit the circumvention of technological protection measures could make it more difficult for us to adequately protect against piracy. These factors could have a negative effect on our growth and profitability in the future.

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

Throughout the history of our industry, many video games have been designed to include certain hidden content and gameplay features that are accessible through the use of in-game cheat codes or other technological means that are intended to enhance the gameplay experience. However, in several recent cases, hidden content or features have been found to be included in other publishers' products by an employee who was not authorized to do so or by an outside developer without the knowledge of the publisher. From time to time, some hidden content and features have contained profanity, graphic violence and sexually explicit or otherwise objectionable material. In a few cases, the Entertainment Software Ratings Board ( ESRB ) has reacted to discoveries of hidden content and features by reviewing the rating that was originally assigned to the product, requiring the publisher to change the game packaging and/or fining the publisher. Retailers have on occasion reacted to the discovery of such hidden content by removing these games from their shelves, refusing to sell them, and demanding that their publishers accept them as product returns. Likewise, consumers have reacted to the revelation of hidden content by refusing to purchase such games, demanding refunds for games they have already purchased, and refraining from buying other games published by the company whose game contained the objectionable material.

We have implemented preventative measures designed to reduce the possibility of hidden, objectionable content from appearing in the video games we publish. Nonetheless, these preventative measures are subject to human error, circumvention, overriding, and reasonable resource constraints. In addition, to the extent we acquire a company without similar controls in place, the possibility of hidden, objectionable content appearing in video games developed by that company but for which we are ultimately responsible could increase. If a video game we published were found to contain hidden, objectionable content, the ESRB could demand that we recall a game and change its packaging to reflect a revised rating, retailers could refuse to sell it and demand we accept the return of any unsold copies or returns from customers, and consumers could refuse to buy it or demand that we refund their money. This could have a material negative impact on our operating results and financial condition. In addition, our reputation could be harmed, which could impact sales of other video games we sell. If any of these consequences were to occur, our business and financial performance could be significantly harmed.

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

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

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

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

---

**Table of Contents**

We are also required to estimate what our tax obligations will be in the future. Although we believe our tax estimates are reasonable, the estimation process and applicable laws are inherently uncertain, and our estimates are not binding on tax authorities. The tax laws' treatment of software and internet-based transactions is particularly uncertain and in some cases currently applicable tax laws are ill-suited to address these kinds of transactions. Apart from an adverse resolution of these uncertainties, our effective tax rate also could be adversely affected by our profit level, by changes in our business or changes in our structure resulting from the reorganization of our business and operating structure, changes in the mix of earnings in countries with differing statutory tax rates, changes in the elections we make, changes in applicable tax laws (in the United States or foreign jurisdictions), or changes in the valuation allowance for deferred tax assets, as well as other factors. In fiscal year 2009, we recorded a valuation allowance against most of our U.S. deferred tax assets. We expect to provide a valuation allowance on future U.S. tax benefits until we can sustain a level of profitability or until other significant positive evidence arises that suggest that these benefits are more likely than not to be realized. Further, our tax determinations are regularly subject to audit by tax authorities and developments in those audits could adversely affect our income tax provision. Should our ultimate tax liability exceed our estimates, our income tax provision and net income or loss could be materially affected.

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

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

Furthermore, as we expand our international operations, adopt new products and new distribution models, implement changes to our operating structure or undertake intercompany transactions in light of changing tax laws, expiring rulings, acquisitions and our current and anticipated business and operational requirements, our tax expense could increase.

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

Our reported financial results are impacted by the accounting policies promulgated by the SEC and national accounting standards bodies and the methods, estimates, and judgments that we use in applying our accounting policies. Due to recent economic events, the frequency of accounting policy changes may accelerate. Policies affecting software revenue recognition have and could further significantly affect the way we account for revenue related to our products and services. Through fiscal year 2007, for accounting purposes, VSOE existed for the online service related to our online-enabled packaged software products. Accordingly, we allocated the revenue collected from the sale of the software product between the online service offered and the software product and recognized the amounts allocated to each element separately. However, starting in fiscal year 2008, VSOE did not exist for the online service and we began to recognize all of the revenue from bundle sales on a deferred basis over an estimated online service period, which we estimate to be six months beginning in the month after shipment. We expect that a more significant portion of our games will be online-enabled in the future and we could be required to recognize the related revenue over an extended period of time rather than at the time of sale. In addition, our adoption of FASB ASC 805, *Business Combinations* will have a material impact on our Condensed Consolidated Financial Statements for material acquisitions consummated after March 28, 2009. Similarly, changes in accounting standards relating to stock-based compensation require us to recognize significantly greater expense than we had been recognizing prior to the adoption of the new standard. As we enhance, expand and diversify our business and product offerings, the application of existing or future financial accounting standards, particularly those relating to the way we account for revenue and taxes, could have a significant adverse effect on our reported results although not necessarily on our cash flows.

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

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



**Table of Contents**

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

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

**Table of Contents****Item 6. Exhibits**

The following exhibits (other than exhibits 32.1 and 32.2, which are furnished with this report) are filed as part of, or incorporated by reference into, this report:

**Exhibit**

<b>Number</b>	<b>Title</b>
10.1	Third amendment to lease, dated December 24, 2009, by and between Liberty Property Limited Partnership, a Pennsylvania limited partnership and Electronic Arts Tiburon, a Florida corporation f/k/a Tiburon Entertainment, Inc.
15.1	Awareness Letter of KPMG LLP, Independent Registered Public Accounting Firm.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Executive Vice President, Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document. (*)
101.SCH	XBRL Taxonomy Extension Schema Document. (*)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document. (*)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document. (*)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document. (*)

Additional exhibits furnished with this report:

32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Executive Vice President, Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities and Exchange Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.



**Table of Contents**

**SIGNATURE**

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

DATED:  
February 9, 2010

ELECTRONIC ARTS INC.  
(Registrant)

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

**Table of Contents**

**ELECTRONIC ARTS INC.**

**FORM 10-Q**

**FOR THE PERIOD ENDED DECEMBER 31, 2009**

**EXHIBIT INDEX**

**EXHIBIT**

<b>NUMBER</b>	<b>EXHIBIT TITLE</b>
10.1	Third amendment to lease, dated December 24, 2009, by and between Liberty Property Limited Partnership, a Pennsylvania limited partnership and Electronic Arts Tiburon, a Florida corporation f/k/a Tiburon Entertainment, Inc.
15.1	Awareness Letter of KPMG LLP, Independent Registered Public Accounting Firm.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Executive Vice President, Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document. (*)
101.SCH	XBRL Taxonomy Extension Schema Document. (*)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document. (*)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document. (*)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document. (*)

Additional exhibits furnished with this report:

32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Executive Vice President, Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities and Exchange Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.