

ELECTRONIC ARTS INC.
Form 10-Q
February 07, 2011
[Table of Contents](#)

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

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

For the Quarterly Period Ended December 31, 2010

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)

209 Redwood Shores Parkway

Redwood City, California
(Address of principal executive offices)

94-2838567
(I.R.S. Employer

Identification No.)

94065
(Zip Code)

(650) 628-1500

(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 2, 2011, there were 334,316,218 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, 2010

Table of Contents

	Page
<u>Part I - FINANCIAL INFORMATION</u>	
Item 1. <u>Condensed Consolidated Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of December 31, 2010 and March 31, 2010</u>	3
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended December 31, 2010 and 2009</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended December 31, 2010 and 2009</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
<u>Part II - OTHER INFORMATION</u>	
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****(Unaudited)**

(In millions, except par value data)	December 31, 2010	March 31, 2010 (a)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,353	\$ 1,273
Short-term investments	511	432
Marketable equity securities	107	291
Receivables, net of allowances of \$336 and \$217, respectively	390	206
Inventories	105	100
Deferred income taxes, net	22	44
Other current assets	226	239
Total current assets	2,714	2,585
Property and equipment, net	502	537
Goodwill	1,107	1,093
Acquisition-related intangibles, net	160	204
Deferred income taxes, net	44	52
Other assets	200	175
TOTAL ASSETS	\$ 4,727	\$ 4,646
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 162	\$ 91
Accrued and other current liabilities	746	717
Deferred net revenue (packaged goods and digital content)	1,100	766
Total current liabilities	2,008	1,574
Income tax obligations	184	242
Deferred income taxes, net	4	2
Other liabilities	173	99
Total liabilities	2,369	1,917
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; 334 and 330 shares issued and outstanding, respectively	3	3
Paid-in capital	2,504	2,375
Retained earnings (accumulated deficit)	(304)	123
Accumulated other comprehensive income	155	228

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

Total stockholders' equity	2,358	2,729
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 4,727	\$ 4,646

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

(a) Derived from audited consolidated financial statements.

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

(Unaudited)	Three Months Ended December 31,		Nine Months Ended December 31,	
(In millions, except per share data)	2010	2009	2010	2009
Net revenue	\$ 1,053	\$ 1,243	\$ 2,499	\$ 2,675
Cost of goods sold	586	654	1,171	1,568
Gross profit	467	589	1,328	1,107
Operating expenses:				
Marketing and sales	253	208	553	559
General and administrative	75	84	226	241
Research and development	273	290	825	918
Amortization of intangibles	14	14	44	38
Acquisition-related contingent consideration	1		(25)	
Restructuring and other charges	154	100	162	120
Total operating expenses	770	696	1,785	1,876
Operating loss	(303)	(107)	(457)	(769)
Gains (losses) on strategic investments, net		(1)	23	(25)
Interest and other income (expense), net		(2)	6	8
Loss before provision for (benefit from) income taxes	(303)	(110)	(428)	(786)
Provision for (benefit from) income taxes	19	(28)	(1)	(79)
Net loss	\$ (322)	\$ (82)	\$ (427)	\$ (707)
Net loss per share:				
Basic and Diluted	\$ (0.97)	\$ (0.25)	\$ (1.29)	\$ (2.18)
Number of shares used in computation:				
Basic and Diluted	332	325	330	324

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

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

(Unaudited)		Nine Months Ended December 31,	
(In millions)		2010	2009
OPERATING ACTIVITIES			
Net loss		\$ (427)	\$ (707)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation, amortization and accretion, net		138	142
Stock-based compensation		138	145
Other non-cash restructuring charges		1	27
Net losses (gains) on investments and sale of property and equipment		(24)	20
Acquisition-related contingent consideration		(25)	
Change in assets and liabilities:			
Receivables, net		(180)	(356)
Inventories		(4)	77
Other assets		(9)	(53)
Accounts payable		59	36
Accrued and other liabilities		34	(42)
Deferred income taxes, net		32	(24)
Deferred net revenue (packaged goods and digital content)		334	634
Net cash provided by (used in) operating activities		67	(101)
INVESTING ACTIVITIES			
Purchase of headquarters facilities			(233)
Capital expenditures		(38)	(50)
Proceeds from sale of marketable equity securities		132	10
Proceeds from maturities and sales of short-term investments		282	657
Purchase of short-term investments		(367)	(477)
Acquisition-related restricted cash			(100)
Acquisition of subsidiaries, net of cash acquired		(16)	(278)
Net cash used in investing activities		(7)	(471)
FINANCING ACTIVITIES			
Proceeds from issuance of common stock		17	25
Excess tax benefit from stock-based compensation			13
Net cash provided by financing activities		17	38
Effect of foreign exchange on cash and cash equivalents		3	27
Increase (decrease) in cash and cash equivalents		80	(507)
Beginning cash and cash equivalents		1,273	1,621
Ending cash and cash equivalents		\$ 1,353	\$ 1,114
Supplemental cash flow information:			
Cash paid during the period for income taxes, net		\$ 11	\$ 8

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

Non-cash investing activities:

Change in unrealized gains (losses) on investments, net of taxes	\$ 23	\$ (34)
Assumption of restricted stock 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), mobile devices (such as cellular and smart phones including the Apple iPhone), and wireless devices such as the Apple iPad. Some of our games are based on content that we license from others (*e.g.*, FIFA, Madden NFL, Harry Potter, and Hasbro's toy and game intellectual properties), and some of our games are based on our own wholly-owned intellectual property (*e.g.*, The Sims, Need for Speed, and Dead Space). Our goal is to publish titles with global mass-market appeal, which often means translating and localizing them for sale in non-English speaking countries. In addition, we also attempt to create software game franchises that allow us to publish new titles on a recurring basis that are based on the same property. Examples of this franchise approach are the annual iterations of our sports-based products (*e.g.*, FIFA, Madden NFL, and NCAA Football), wholly-owned properties that can be successfully sequenced (*e.g.*, The Sims, Need for Speed, and Battlefield) and titles based on long-lived literary and/or movie properties (*e.g.*, Harry Potter).

Our fiscal year is reported on a 52 or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ending or ended, as the case may be, March 31, 2011 and 2010 contain 52 and 53 weeks, respectively, and ends or ended, as the case may be, on April 2, 2011 and April 3, 2010, respectively. Our results of operations for the three months ended December 31, 2010 and 2009 contained 13 weeks each, and ended on January 1, 2011 and January 2, 2010, respectively. Our results of operations for the nine months ended December 31, 2010 and 2009 contained 39 and 40 weeks, respectively, and ended on January 1, 2011 and January 2, 2010, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

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

These Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2010, as filed with the United States Securities and Exchange Commission (SEC) on May 28, 2010.

(2) FAIR VALUE MEASUREMENTS

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

Fair Value Hierarchy

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

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

Level 2. Observable inputs other than quoted prices included within Level 1, such as quoted prices for similar assets or liabilities, quoted prices in markets with insufficient volume or infrequent transactions (less active markets), or model-derived valuations in

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

which all significant inputs are observable or can be derived principally from or corroborated with observable market data for substantially the full term of the assets or liabilities.

Table of Contents

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

As of December 31, 2010 and March 31, 2010, our assets and liabilities that were measured and recorded at fair value on a recurring basis were as follows (in millions):

	As of December 31, 2010	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Financial Instruments			Significant Other Observable Inputs	Significant Unobservable Inputs	Balance Sheet Classification
		(Level 1)	(Level 2)	(Level 3)			
Assets							
Money market funds	\$ 433	\$ 433	\$	\$			Cash equivalents
Available-for-sale securities:							
Corporate bonds	260			260			Short-term investments
U.S. Treasury securities	136	136					Short-term investments and cash equivalents
U.S. agency securities	111			111			Short-term investments
Marketable equity securities	107	107					Marketable equity securities
Commercial paper	21			21			Short-term investments and cash equivalents
Deferred compensation plan assets ^(a)	13	13					Other assets
Foreign currency derivatives	1			1			Other current assets
Total assets at fair value	\$ 1,082	\$ 689	\$	393	\$		
Liabilities							
Contingent consideration ^(b)	\$ 43	\$	\$		\$ 43		Other liabilities
Total liabilities at fair value	\$ 43	\$	\$		\$ 43		

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)			Contingent Consideration
Balance as of March 31, 2010			\$ 65
Additions			3
Change in fair value ^(c)			(25)
Balance as of December 31, 2010			\$ 43

	As of March 31, 2010	(Level 1)	(Level 2)	(Level 3)	Balance Sheet Classification
Assets					
Money market funds	\$ 619	\$ 619	\$	\$	Cash equivalents
Available-for-sale securities:					
Marketable equity securities	291	291			Marketable equity securities
Corporate bonds	234		234		Short-term investments and cash equivalents
U.S. agency securities	118		118		Short-term investments and cash equivalents

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

U.S. Treasury securities	93	93			Short-term investments and cash equivalents
Commercial paper	12		12		Short-term investments and cash equivalents
Deferred compensation plan assets ^(a)	12	12			Other assets
Foreign currency derivatives	2		2		Other current assets
Total assets at fair value	\$ 1,381	\$ 1,015	\$ 366	\$	
Liability					
Contingent consideration ^(b)	\$ 65	\$	\$	\$ 65	Accrued and other current liabilities and other liabilities
Total liability at fair value	\$ 65	\$	\$	\$ 65	

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

Table of Contents

(b) The contingent consideration represents the estimated fair value of the additional variable cash consideration payable in connection with our acquisitions of Playfish Limited (Playfish) in fiscal year 2010 and Chillingo Limited (Chillingo) in fiscal year 2011 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.

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

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Our assets that were measured and recorded at fair value on a nonrecurring basis during the three and nine months ended December 31, 2009, and impairments on those assets were as follows (in millions):

	Fair Value Measurements Using			Total Impairments	
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	for the Three Months Ended December 31, 2009	Total Impairments for the Nine Months Ended December 31, 2009
	Net Carrying Value as of December 31, (Level 1)	(Level 2)	(Level 3)		
Assets					
Property and equipment, net ^(a)	\$ 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

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

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

There were no material impairment charges for assets and liabilities measured at fair value on a nonrecurring basis in periods subsequent to initial recognition during the three and nine months ended December 31, 2010.

Table of Contents**(3) FINANCIAL INSTRUMENTS*****Cash and Cash Equivalents***

As of December 31, 2010 and March 31, 2010, our cash and cash equivalents were \$1,353 million and \$1,273 million, respectively. Cash equivalents were valued at their carrying amounts as they approximate fair value due to the short maturities of these financial instruments.

Short-Term Investments

Short-term investments consisted of the following as of December 31, 2010 and March 31, 2010 (in millions):

	As of December 31, 2010				As of March 31, 2010			
	Cost or Amortized Cost	Gross Gains	Unrealized Losses	Fair Value	Cost or Amortized Cost	Gross Gains	Unrealized Losses	Fair Value
Corporate bonds	\$ 259	\$ 1	\$	\$ 260	\$ 231	\$ 2	\$	\$ 233
U.S. Treasury securities	125	1		126	83			83
U.S. agency securities	111			111	115			115
Commercial paper	14			14	1			1
Short-term investments	\$ 509	\$ 2	\$	\$ 511	\$ 430	\$ 2	\$	\$ 432

We evaluate our investments for impairment quarterly. Factors considered in the review of investments with an unrealized loss include the credit quality of the issuer, the duration that the fair value has been less than the adjusted cost basis, severity of the impairment, reason for the decline in value and potential recovery period, the financial condition and near-term prospects of the investees, our intent to sell the investments, any contractual terms impacting the prepayment or settlement process, as well as if we would be required to sell an investment due to liquidity or contractual reasons before its anticipated recovery. Based on our review, we did not consider the investments listed above to be other-than-temporarily impaired as of December 31, 2010 and March 31, 2010.

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of December 31, 2010 and March 31, 2010 (in millions):

	As of December 31, 2010		As of March 31, 2010	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Short-term investments				
Due in 1 year or less	\$ 215	\$ 215	\$ 165	\$ 165
Due in 1-2 years	169	170	174	176
Due in 2-3 years	125	126	91	91
Short-term investments	\$ 509	\$ 511	\$ 430	\$ 432

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 adjusted cost basis is other-than-temporary. We evaluate these investments for impairment quarterly. If we conclude that an investment is other-than-temporarily impaired, we will recognize an impairment charge at that time in our Condensed Consolidated Statements of Operations.

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

Marketable equity securities consisted of the following as of December 31, 2010 and March 31, 2010 (in millions):

	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of December 31, 2010	\$ 24	\$ 83	\$	\$ 107
As of March 31, 2010	\$ 132	\$ 159	\$	\$ 291

During the nine months ended December 31, 2010, we recognized impairment charges of \$2 million on our investment in The9. We did not recognize any impairment charges during the three months ended December 31, 2010 on our marketable equity securities. 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. Due to various factors, including but not limited to, the extent and duration during which the market prices of these securities had been below adjusted cost and our intent to hold these securities, we concluded the decline in values were other-than-temporary. The impairments for the nine months ended December 31, 2010 and the three and nine months ended December 31, 2009 are included in gains (losses) on strategic investments, net, in our Condensed Consolidated Statements of Operations.

Table of Contents

During the nine months ended December 31, 2010, we received proceeds of \$121 million from the sale of our investment in Ubisoft and realized gains of \$28 million, net of costs to sell. During the nine months ended December 31, 2010, we sold the remaining portion of our investment in The9 and received proceeds of \$11 million and realized losses of \$3 million. 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. The realized gains and losses for the nine months ended December 31, 2010 and the three and nine months ended December 31, 2009 are included in gains (losses) on strategic investments, net, in our Condensed Consolidated Statements of Operations.

Other Investments Included in Other Assets

Our other investments, included in other assets on our Condensed Consolidated Balance Sheets, 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 until we determine that the fair value of the investment has fallen below its adjusted cost basis and that such decline is other-than-temporary. We evaluate these investments for impairment quarterly. When we conclude that an investment is other-than-temporarily impaired, we recognize an impairment charge at that time in our Condensed Consolidated Statements of Operations.

During the three and nine months ended December 31, 2010 and 2009, we did not recognize any impairment charges with respect to these investments.

(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, on our Condensed Consolidated Balance Sheets. As discussed below, the accounting for gains and losses resulting from changes in fair value depends on the use of the derivative instrument and whether it is designated and qualifies for hedge accounting.

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

Cash Flow Hedging Activities

Our foreign currency option contracts are designated and qualify as cash flow hedges. The effectiveness of the cash flow hedge contracts, including time value, is assessed monthly using regression analysis, as well as other timing and probability criteria. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedges and must be highly effective in offsetting changes to future cash flows on hedged transactions. The effective portion of gains or losses resulting from changes in the fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income in stockholders' equity. The gross amount of the effective portion of gains or losses resulting from changes in the fair value of these hedges is subsequently reclassified into net revenue or research and development expenses, as appropriate, in the period when the forecasted transaction is recognized in our Condensed Consolidated Statements of Operations. In the event that the gains or losses in accumulated other comprehensive income are deemed to be ineffective, the ineffective portion of gains or losses resulting from changes in fair value, if any, is reclassified to interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. In the event that the underlying forecasted transactions do not occur, or it becomes remote that they will occur, within the defined hedge period, the gains or losses on the related cash flow hedges are reclassified from accumulated other comprehensive income to interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. During the reporting periods, all forecasted transactions occurred and, therefore, there were no such gains or losses reclassified into interest and other income (expense), net. As of December 31, 2010, we had foreign currency option contracts to purchase approximately \$59 million in foreign currency and to sell approximately \$57 million of foreign currency. All of the foreign currency option contracts outstanding as of December 31, 2010 will mature in the next 12 months. As of March 31, 2010, we had foreign currency option contracts to purchase approximately \$18 million in foreign currency and to sell approximately \$30 million of foreign currencies. As of December 31, 2010 and March 31, 2010, these outstanding foreign currency option contracts had a total fair value of \$1 million and \$2 million, respectively, and are included in other current assets.

Table of Contents

The effect of the gains and losses from our foreign currency option contracts in our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2010 and 2009 was immaterial.

Balance Sheet Hedging Activities

Our foreign currency forward contracts are not designated as hedging instruments, and are accounted for as derivatives whereby the fair value of the contracts is reported as other current assets or accrued and other current liabilities on our Condensed Consolidated Balance Sheets, and gains and losses resulting from changes in the fair value are reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. The gains and losses on these foreign currency forward contracts generally offset the gains and losses in the underlying foreign-currency-denominated monetary assets and liabilities, which are also reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. As of December 31, 2010, we had foreign currency forward contracts to purchase and sell approximately \$468 million in foreign currencies. Of this amount, \$454 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$6 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, 2010, we had foreign currency forward contracts to purchase and sell approximately \$431 million in foreign currencies. Of this amount, \$293 million represented contracts to sell foreign currencies in exchange for U.S. dollars, \$127 million to purchase foreign currency in exchange for U.S. dollars and \$11 million to sell foreign currency in exchange for British pounds sterling. The fair value of our foreign currency forward contracts was immaterial as of December 31, 2010 and March 31, 2010.

The effect of foreign currency forward contracts in our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2010 and 2009, was as follows (in millions):

	Location of Gain (Loss) Recognized in Income on Derivative	Amount of Gain (Loss) Recognized in Income on Derivative			
		Three Months Ended		Nine Months Ended	
		December 31, 2010	December 31, 2009	December 31, 2010	December 31, 2009
Foreign currency forward contracts not designated as hedging instruments	Interest and other income (expense), net	\$ 12	\$ 5	\$ 7	\$ (7)
(5) BUSINESS COMBINATIONS					

Fiscal Year 2011 Acquisition

In October 2010, we acquired all of the outstanding shares of Chillingo Limited in cash. Chillingo publishes games and software for various mobile platforms. In addition, we may be required to pay additional variable cash that is contingent upon the achievement of certain performance milestones through March 31, 2014.

Fiscal Year 2010 Acquisitions**Playfish**

In November 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. The following table summarizes the acquisition date fair value of the consideration transferred which consisted of the following (in millions):

Cash	\$ 297
Equity	11
Total purchase price	\$ 308

Table of Contents

The equity included in the consideration above consisted of restricted stock and restricted stock units, using 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 estimated fair value of the contingent consideration arrangement at the acquisition date was \$63 million. We estimated the fair value of the contingent consideration using probability assessments of 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.

The final allocation of the purchase price was based upon valuations for certain assets and was completed during the fourth quarter of fiscal year 2010. The following table summarizes the fair values of assets acquired and liabilities assumed at the date of acquisition (in millions):

Current assets	\$ 32
Deferred income taxes, net	20
Property and equipment, net	1
Goodwill	274
Finite-lived intangibles assets	53
Contingent consideration	(63)
Other liabilities	(9)
 Total purchase price	 \$ 308

All of the goodwill was initially assigned to our Playfish operating segment, but subsequently a portion was re-allocated to other 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	\$ 33	2
Developed and core technology	13	5
Trade names and trademarks	4	5
Other intangibles	3	4
 Total finite-lived intangibles	 \$ 53	 3

Other Fiscal Year 2010 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.

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

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

	Label Segment	Other Segments	Total
As of March 31, 2010			
Goodwill	\$ 672	\$ 789	\$ 1,461
Accumulated impairment		(368)	(368)
	672	421	1,093
Goodwill acquired		13	13
Reallocation	16	(16)	
Effects of foreign currency translation	1		1
As of December 31, 2010			
Goodwill	689	786	1,475
Accumulated impairment		(368)	(368)
	\$ 689	\$ 418	\$ 1,107

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

	As of December 31, 2010			As of March 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net
Developed and core technology	\$ 259	\$ (174)	\$ 85	\$ 258	\$ (155)	\$ 103
Trade names and trademarks	90	(67)	23	89	(57)	32
Carrier contracts and related	85	(61)	24	85	(56)	29
Registered user base and other intangibles	86	(58)	28	79	(39)	40
Total	\$ 520	\$ (360)	\$ 160	\$ 511	\$ (307)	\$ 204

Amortization of intangibles for the three and nine months ended December 31, 2010 was \$17 million (of which \$3 million was recognized in cost of goods sold) and \$53 million (of which \$9 million was recognized in cost of goods sold), respectively. 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. Finite-lived intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the terms of the related agreement, typically from two to fourteen years. As of December 31, 2010 and March 31, 2010, the weighted-average remaining useful life for finite-lived intangible assets was approximately 5.0 years and 5.1 years, respectively.

As of December 31, 2010, 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,	
2011 (remaining three months)	\$ 16
2012	51

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

2013	28
2014	19
2015	15
Thereafter	31
Total	\$ 160

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

Restructuring and other restructuring plan-related information as of December 31, 2010 was as follows (in millions):

	Fiscal 2011 Restructuring		Fiscal 2010 Restructuring			Fiscal 2009 Restructuring		Other Restructurings			
	Workforce	Other	Workforce	Facilities-related	Other	Workforce	Facilities-related	Facilities-related	Other		Total
Balances as of March 31, 2009	\$	\$				\$	\$	\$	\$	\$	\$
Charges to operations			62	22	32	1	13	3	7		140
Charges settled in cash			(29)	(2)	(1)	(9)	(11)		(10)		(62)
Charges settled in non-cash			(25)	(9)	(24)		(4)	(3)			(65)
Accrual reclassification								(7)			(7)
Balances as of March 31, 2010			8	11	7		3				29
Charges to operations	16	135			11						162
Charges settled in cash	(6)	(33)	(7)	(4)	(15)		(1)				(66)
Charges settled in non-cash	(2)	(2)		1							(3)
Balances as of December 31, 2010	\$ 8	\$ 100	\$ 1	\$ 8	\$ 3	\$	\$ 2	\$	\$		\$ 122

Fiscal 2011 Restructuring

During the quarter ended December 31, 2010, we announced details of a plan focused on the restructuring of certain licensing and developer agreements in an effort to improve the long-term profitability of our packaged goods business. Under this plan, we amended certain licensing and developer agreements. To a much lesser extent, as part of this restructuring we have had and will continue to have, workforce reductions and facilities closures through March 31, 2011. Substantially all of these exit activities were completed during the quarter ended December 31, 2010.

As part of our fiscal 2011 restructuring plan, we amended certain license agreements during the quarter ended December 31, 2010 to terminate certain rights we previously had to use the licensors' intellectual property. However, under these agreements we continue to be obligated to pay the contractual minimum royalty-based commitments set forth in the original agreements. Accordingly, we recognized losses and impairments of \$102 million representing (1) the net present value of the estimated payments related to terminating these rights and (2) writing down assets associated with these agreements to their approximate fair value. In addition, for one agreement, the actual amount of the loss is variable and subject to periodic adjustments as it is dependent upon the actual revenue we generate from the games. In addition, because the loss for one agreement will be paid in installments through June 2016, our accrued loss was computed using the effective interest method. We currently estimate recognizing in future periods through June 2016, approximately \$21 million for the accretion of interest expense related to this obligation. This interest expense will be included in restructuring and other charges in our Condensed Consolidated Statement of Operations.

In addition, for the development of certain games, we previously entered into publishing agreements with independent software developers. Under these agreements, we were obligated to pay the independent software developers a predetermined amount (a Minimum Guarantee) upon delivery of a completed product. The independent software developers were thinly capitalized and financed the development of the products through bank borrowings. During the quarter ended December 31, 2010, in order to more directly influence the development, product quality and product completion, we amended these agreements whereby we agreed to advance a portion of the Minimum Guarantee prior to completion of the product which were used by the independent software developers to repay their bank loans. In addition, we are now committed to advance the remaining portion of the Minimum Guarantee during the remaining development period. As a result, we have now assumed development risk of the products.

Because the independent software developers are thinly capitalized, our sole ability to recover the Minimum Guarantee is effectively through publishing the software product in development. We also have exclusive rights to exploit the software product once completed. Therefore, we concluded that the substance of the arrangement is the purchase of research and development that has no alternative future use and should be expensed upon acquisition. Accordingly, we recognized a \$31 million charge in our Condensed Consolidated Statement of Operations during the three months ended December 31, 2010. In addition, we will recognize the remaining portion of the Minimum Guarantee to be advanced during the development period as research and development expense as the services are incurred.

Table of Contents

Since the inception of the fiscal 2011 restructuring plan through December 31, 2010, we have incurred charges of \$151 million, consisting of (1) \$104 million related to the amendment of certain licensing agreements and other intangible asset impairment costs, (2) \$31 million related to the amendment of certain developer agreements, and (3) \$16 million in employee-related expenses. The \$108 million restructuring accrual as of December 31, 2010 related to the fiscal 2011 restructuring is expected to be settled by June 2016. During the remainder of fiscal year 2011, we anticipate incurring less than \$5 million of restructuring and other charges related to the fiscal 2011 restructuring.

Overall, including \$151 million in charges incurred through December 31, 2010, we expect to incur total cash and non-cash charges between \$170 million and \$180 million by June 2016. These charges will consist primarily of (1) charges, including accretion of interest expense, related to the amendment of certain licensing and developer agreements and other intangible asset impairment costs (approximately \$160 million) and (2) employee-related costs (approximately \$16 million).

Fiscal 2010 Restructuring

In fiscal year 2010, 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 reduced our workforce by approximately 1,100 employees and have (1) consolidated or closed various facilities, (2) eliminated certain titles, and (3) incurred IT and other costs to assist in reorganizing certain activities. The majority of these actions were completed by March 31, 2010.

Since the inception of the fiscal 2010 restructuring plan through December 31, 2010, we have incurred charges of \$127 million, consisting of (1) \$62 million in employee-related expenses, (2) \$43 million related to intangible asset impairment costs, abandoned rights to intellectual property, and other costs to assist in the reorganization of our business support functions, and (3) \$22 million related to the closure of certain of our facilities. The \$12 million restructuring accrual as of December 31, 2010 related to the fiscal 2010 restructuring is expected to be settled by September 2013. During the remainder of fiscal year 2011, we anticipate incurring less than \$5 million of restructuring charges related to the fiscal 2010 restructuring.

Overall, including charges incurred through December 31, 2010, we expect to incur total cash and non-cash charges between \$135 million and \$140 million by March 31, 2012. These charges consist primarily of (1) employee-related costs (approximately \$65 million), (2) intangible asset impairment costs, abandoned rights to intellectual property costs, and other costs to assist in the reorganization of our business support functions (approximately \$50 million), and (3) facilities exit costs (approximately \$25 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.

Since the inception of the fiscal 2009 restructuring plan through December 31, 2010, we have incurred charges of \$55 million, consisting of (1) \$33 million in employee-related expenses, (2) \$20 million related to the closure of certain of our facilities, and (3) \$2 million related to asset impairments. We do not expect to incur any additional restructuring charges under this plan. The restructuring accrual of \$2 million as of December 31, 2010 related to the fiscal 2009 restructuring is expected to be settled by September 2016.

Other Restructurings

We also engaged in various other restructurings based on management decisions. From April 1, 2009 through December 31, 2010, \$10 million in cash has been paid out under these restructuring plans. \$7 million of the 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. We do not expect to incur any additional charges under these plans.

(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.

Table of Contents

Royalty-based obligations with content licensors and distribution affiliates are either paid in advance and capitalized as prepaid royalties or are accrued as incurred and subsequently paid. These royalty-based obligations are generally expensed to cost of goods sold generally at the greater of the contractual rate for contracts with guaranteed minimums, or an effective royalty rate based on the total projected net revenue.

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

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

Each quarter, we also evaluate the expected future realization of our royalty-based assets, as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are charged to research and development expense. Impairments or losses determined post-launch are charged to cost of goods sold. We evaluate long-lived royalty-based assets for impairment using undiscounted cash flows when impairment indicators exist. Unrecognized minimum royalty-based commitments are accounted for as executory contracts and, therefore, any losses on these commitments are recognized when the underlying intellectual property is abandoned (*i.e.*, cease use) or the contractual rights to use the intellectual property are terminated. During the three months ended December 31, 2010, we recognized losses of \$75 million on our previously unrecognized minimum royalty-based commitments and impairment charges of \$27 million on our royalty-based assets, both related to our fiscal 2011 restructuring. During the nine months ended December 31, 2010, we recognized losses of \$85 million, inclusive of \$75 million related to our fiscal 2011 restructuring, on our previously unrecognized minimum royalty-based commitments and impairment charges of \$27 million on our royalty-based assets related to our fiscal 2011 restructuring. During the three months ended December 31, 2009, we recognized impairment charges of \$9 million on our royalty-based assets related to our fiscal 2010 restructuring. During the nine months ended December 31, 2009, we recognized impairment charges of \$10 million, inclusive of \$9 million related to our fiscal 2010 restructuring, on our royalty-based assets. The losses and impairment charges related to our restructuring and other restructuring plan-related activities are presented in Note 7 of the Notes to Condensed Consolidated Financial Statements.

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, 2010	As of March 31, 2010
Other current assets	\$ 73	\$ 66
Other assets	37	36
Royalty-related assets	\$ 110	\$ 102

Table of Contents

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, 2010	As of March 31, 2010
Accrued and other current liabilities	\$ 169	\$ 144
Other liabilities	61	
Royalty-related liabilities	\$ 230	\$ 144

In addition, as of December 31, 2010, we were committed to pay approximately \$1,214 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, 2010 and March 31, 2010 consisted of (in millions):

	As of December 31, 2010	As of March 31, 2010
Raw materials and work in process	\$ 15	\$ 8
In-transit inventory	1	2
Finished goods	89	90
Inventories	\$ 105	\$ 100

Property and Equipment, Net

Property and equipment, net, as of December 31, 2010 and March 31, 2010 consisted of (in millions):

	As of December 31, 2010	As of March 31, 2010
Computer equipment and software	\$ 484	\$ 480
Buildings	349	347
Leasehold improvements	102	99
Office equipment, furniture and fixtures	66	71
Land	65	65
Warehouse equipment and other	10	10
Construction in progress	12	13
	1,088	1,085
Less accumulated depreciation	(586)	(548)

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

Property and equipment, net	\$	502	\$	537
-----------------------------	----	-----	----	-----

Depreciation expense associated with property and equipment was \$26 million and \$79 million for the three and nine months ended December 31, 2010, respectively. Depreciation expense associated with property and equipment was \$30 million and \$93 million for the three and nine months ended December 31, 2009, respectively.

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

In connection with our acquisition of Playfish in fiscal year 2010, we deposited \$100 million into an escrow account to pay the former shareholders of Playfish in the event certain performance milestones through December 31, 2011 are achieved. Through the nine months ended December 31, 2010, no distributions were made from the restricted cash amount. As this deposit is restricted in nature, it is excluded from cash and cash equivalents. As of December 31, 2010 and March 31, 2010, the estimated long-term portion of \$100 million and \$61 million, respectively, is included in other assets. As of March 31, 2010, the estimated short-term portion of \$39 million is included in other current assets on our Condensed Consolidated Balance Sheet. As of December 31, 2010, there was no estimated short-term portion.

Accrued and Other Current Liabilities

Accrued and other current liabilities as of December 31, 2010 and March 31, 2010 consisted of (in millions):

	As of December 31, 2010	As of March 31, 2010
Other accrued expenses	\$ 354	\$ 293
Accrued compensation and benefits	178	177
Accrued royalties	131	144
Deferred net revenue (other)	83	103
Accrued and other current liabilities	\$ 746	\$ 717

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

Deferred Net Revenue (Packaged Goods and Digital Content)

Deferred net revenue (packaged goods and digital content) was \$1,100 million as of December 31, 2010 and \$766 million as of March 31, 2010. Deferred net revenue (packaged goods and digital content) includes the unrecognized revenue from (1) bundled sales of certain online-enabled packaged goods and digital content for which either we do not have vendor-specific objective evidence of fair value (VSOE) for the online service that we provide in connection with the sale of the software or we have an obligation to provide future incremental unspecified digital content, (2) certain packaged goods sales of massively-multiplayer online role-playing games, and (3) sales of certain incremental content associated with our core subscription services that can only be played online, which are types of micro-transactions. We recognize revenue from sales of online-enabled packaged goods and digital content for which (1) we do not have VSOE for the online service that we provided in connection with the sale and (2) we have an obligation to deliver incremental unspecified digital content in the future without an additional fee on a straight-line basis generally over an estimated six month period beginning in the month after shipment. However, we expense the cost of goods sold related to these transactions during the period in which the product is delivered (rather than on a deferred basis).

(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.

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

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.

Table of Contents

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.

The tax expense reported for the three months ended December 31, 2010 and the tax benefit reported for the nine months ended December 31, 2010, are based on our projected annual effective tax rate for fiscal year 2011, and also includes certain discrete tax benefits recorded during the period. Our effective tax rates for the three and nine months ended December 31, 2010 were a tax expense of 6.3 percent and a tax benefit of 0.2 percent, respectively, compared to a tax benefit of 24.9 percent and 10.0 percent for the same periods in fiscal 2010. The effective tax rate for the three months ended December 31, 2010 differs from the statutory rate of 35.0 percent primarily due to U.S. losses for which no benefit is recognized and non-U.S. losses with a reduced or zero tax benefit. The effective tax rate for the nine months ended December 31, 2010 differs from the statutory rate of 35.0 percent primarily due to U.S. losses for which no benefit is recognized and non-U.S. losses with a reduced or zero tax benefit, partially offset by changes in the deferred tax valuation allowance and tax benefits related to the expiration of statutes of limitations and resolution of examinations by taxing authorities.

During the three months ended September 30, 2010, we reached a final settlement with the Internal Revenue Service (IRS) for the fiscal years 2000 through 2003. As a result, we recorded approximately \$18 million of previously unrecognized tax benefits and reduced our accrual for interest by approximately \$9 million.

During the three and nine months ended December 31, 2010, we recorded a net increase of \$7 million and a net decrease of \$26 million, respectively, in gross unrecognized tax benefits. The total gross unrecognized tax benefits as of December 31, 2010 is \$252 million, of which approximately \$51 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, 2010, if recognized, approximately \$127 million of the unrecognized tax benefits would affect our effective tax rate and approximately \$112 million would result in adjustments to deferred tax assets with corresponding adjustments to the valuation allowance.

During the three and nine months ended December 31, 2010, we recorded a net increase of \$2 million and a net decrease \$13 million, respectively, for accrued interest and penalties related to tax positions taken on our tax returns. As of December 31, 2010, the combined amount of accrued interest and penalties related to uncertain tax positions included in income tax obligations on our Condensed Consolidated Balance Sheet was approximately \$26 million.

The IRS has completed its examination of our federal income tax returns through fiscal year 2005. As of December 31, 2010, the IRS had proposed, and we had agreed to, certain adjustments to our tax returns for fiscal years 2004 and 2005. 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, 2010, we had not agreed to certain other proposed adjustments for fiscal years 2004 and 2005, and those issues were pending resolution with the IRS. Furthermore, the IRS has commenced examinations of our fiscal year 2006, 2007 and 2008 tax returns. We are also currently under income tax examination in Canada for fiscal years 2004 and 2005, and in France for fiscal years 2006 through 2008. We remain subject to income tax examinations for several other jurisdictions including Canada for fiscal years after 2001, in France for fiscal years after 2008, in Germany for fiscal years after 2007, in the United Kingdom for fiscal years after 2008, 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 \$6 million of the reserves for unrecognized tax benefits may occur within the next 12 months, some of which, depending on the nature of the settlement or expiration of statutes of limitations, may affect our income tax provision (benefit) and therefore benefit the resulting effective tax rate. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements.

(11) COMMITMENTS AND CONTINGENCIES

Lease Commitments

As of December 31, 2010, we leased certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.

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

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

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include: FIFA, FIFPRO Foundation, FAPL (Football Association Premier League Limited), and DFL Deutsche Fußball Liga GmbH (German Soccer League) (professional soccer); National Basketball Association (professional basketball); PGA TOUR and Tiger Woods (professional golf); National Hockey League and NHL Players Association (professional hockey); Warner Bros. (Harry Potter); National Football League Properties, PLAYERS Inc., and Red Bear Inc. (professional football); Collegiate Licensing Company (collegiate football); ESPN (content in EA SPORTS games); Hasbro, Inc. (most of Hasbro's toy and game intellectual properties); LucasArts and Lucas Licensing (Star Wars: The Old Republic), 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 unrecognized minimum contractual obligations as of December 31, 2010 (in millions):

Fiscal Year Ending March 31,	Contractual Obligations				Total
	Leases ^(a)	Developer/ Licensor Commitments	Marketing	Other Purchase Obligations	
2011 (remaining three months)	\$ 13	\$ 30	\$ 18	\$ 1	\$ 62
2012	43	330	71	5	449
2013	35	180	36	3	254
2014	26	116	67	3	212
2015	21	106	32	2	161
Thereafter	24	452	128		604
Total	\$ 162	\$ 1,214	\$ 352	\$ 14	\$ 1,742

^(a) Lease commitments have not been reduced by minimum sub-lease rentals for unutilized office space resulting from our reorganization activities of approximately \$12 million due in the future under non-cancelable sub-leases.

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

In addition to what is included in the table above as of December 31, 2010, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$235 million, of which approximately \$51 million is offset by prior cash deposits to tax authorities for issues pending resolution. For the remaining liability, we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

In addition to what is included in the table above as of December 31, 2010, in connection with our acquisitions, we may be required to pay an additional \$110 million of cash consideration through March 31, 2014, that is contingent upon the achievement of certain performance milestones. As of December 31, 2010, we have accrued \$43 million of contingent consideration on our Condensed Consolidated Balance Sheet.

Legal Proceedings

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

Table of Contents**(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 awards to employees based on the grant-date fair value using a straight-line approach over the service period for which such awards are expected to vest. The 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 fair value of our stock options is based on the multiple-award valuation method. The determination of fair value of stock options and ESPP 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 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.

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 stock option grants and ESPP were as follows:

	Stock Option Grants				ESPP	
	Three Months Ended December 31,		Nine Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009	2010	2009
Risk-free interest rate	1.2 - 2.6%	1.4 - 2.7%	0.8 - 2.6%	1.4 - 3.0%	0.2 - 0.3%	0.2 - 0.4%
Expected volatility	41 - 43%	41 - 45%	41 - 45%	41 - 48%	38%	45 - 57%
Weighted-average volatility	42%	43%	43%	45%	38%	51%
Expected term	4.2 years	4.4 years	4.4 years	4.2 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, 2010 and 2009.

Stock-Based Compensation Expense

Employee stock-based compensation expense recognized during the three and nine months ended December 31, 2010 and 2009 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):

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2010	2009	2010	2009
Cost of goods sold	\$ 1	\$	\$ 2	\$