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Electronic Arts (EA) Earnings Report: Q3 2016 Conference Call Transcript

The following Electronic Arts conference call took place on January 28, 2016, 05:00 PM ET. This is a transcript of that earnings call:

Company Participants

- Chris Evenden; Electronic Arts Inc.; VP of IR
- Andrew Wilson; Electronic Arts Inc.; CEO
- Blake Jorgensen; Electronic Arts Inc.; CFO
- Peter Moore; Electronic Arts Inc.; EVP, COO, and Chief Competition Officer

Other Participants

- Chris Merwin; Barclays Capital; Analyst
- Stephen Jim; Unidentified; Analyst
- Colin Sebastian; Robert W. Baird & Company, Inc,; Analyst
- Brian Pitz; Unidentified; Analyst
- Justin Post; Unidentified; Analyst
- Arvind Bhatia; Sterne Agee & Leach Inc; Analyst
- Mike Olson; Piper Jaffray & Co; Analyst
- Drew Crum; Stifel Nicolaus; Analyst
- Ben Schachter; Macquarie Research; Anaylst
- Neil Doshi; Mizuho Securities; Analyst
- Doug Creutz; Cowen and Company; Analyst
- Eric Handler; MKM Partners; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

At this time, I would like to welcome everyone to the Q3 fiscal-year 2016 EA earnings conference call.

(Operator Instructions)

I will now turn call over to our host, Mr. Chris Evenden, Vice President of Investor Relations. Sir, please go ahead.

Chris Evenden (VP of IR):

Thank you, Operator. Welcome to EA's fiscal 2016 third-quarter earnings call. With me on the call today are Andrew Wilson, our CEO; Blake Jorgensen, our CFO. And Peter Moore, our COO, will be joining us for the Q&A portion of the call.

Please note that our SEC filings and our earnings release are available at ir.ea.com. In addition, we have posted earning slides to accompany our prepared remarks. Lastly, after the call, we will post our prepared remarks, an audio replay of this call, and a transcript.

A couple of notes regarding upcoming events. We are holding our investor day on Tuesday, May 17 at our Redwood City headquarters. This will be a great opportunity for members of the financial community to

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hear from our senior management team and meet with them in an informal environment.

In addition, Blake will be presenting at the Morgan Stanley conference on Tuesday, March 1, and our Q4 and year-end earnings call is scheduled for Tuesday, May 10.

This presentation and our comments include forward-looking statements regarding future events and the future financial performance of the Company. Actual events and results may differ materially from our expectations. We refer you to our most recent Form 10-Q for a discussion of risks that could cause actual results to differ materially from those discussed today. Electronic Arts makes these statements as of today, January 28, 2016, and disclaims any duty to update them.

During this call, unless otherwise stated, the financial metrics will be presented on a non-GAAP basis. Our earnings release and the earnings slides provide a reconciliation of our GAAP to non-GAAP measures. These non-GAAP measures are not intended to be considered in isolation from, as a substitute for, or superior to our GAAP results. We encourage investors to consider all measures before making an investment decision. All comparisons made in the course of this call are against the same period in the prior year, unless otherwise stated.

Now I'll turn the call over to Andrew.

Andrew Wilson (CEO):

Thank you, Chris. Q3 FY2016 was a great quarter for Electronic Arts . Across all key platforms, we delivered amazing new experiences for our players and live services that enabled them to play more of the games they love. Non-GAAP revenue and earnings were above our guidance for the quarter and we are raising our full-year non-GAAP guidance as we continue our strong momentum into the final quarter of the year.

Our highlights from the holiday quarter capture how players are engaging across the increasing breadth and depth of games and services from Electronic Arts . Q3 was a breakthrough quarter for our partnership with Disney and Lucasfilm on the Star Wars franchise. With Star Wars Battlefront, our team at DICE delivered a game with amazing visual fidelity, unmatched authenticity, and true Star Wars action fantasies that are fun for fans of all ages. It became the largest launch ever for a Star Wars game and exceeded our guidance for the full year.

The journey is just beginning for Battlefront fans. Earlier this week, we announced our first free content update as well as the four expansion packs to come for Star Wars Battlefront. And there are many new experiences in development for every player in the growing community.

Star Wars fans are deeply engaged in their experiences on mobile and PC as well. On mobile, Star Wars Galaxy of Heroes quickly built a strong player base after it launched in November, reaching the top five most downloaded iOS games in more than 130 countries.

On PC, our Star Wars: The Old Republic community has grown to the highest subscriber level in nearly three years, driven by the latest digital expansion, Knights of the Fallen Empire. More great content is on the way for players in each of these experiences as well as new Star Wars titles for multiple platforms in development across the Company.

Continuing the mobile momentum, Madden NFL Mobile is a cultural hit that topped the US App Store charts over the holiday period. Player engagement is thriving, with monthly active players up nearly 50% year over year and our live events driving 2.5 times more games played over the previous years.

Madden NFL Mobile continues to illustrate the opportunity for sports games on mobile devices. Just as we have demonstrated on other platforms, great sports experiences will ignite fans' unbridled commitment to the teams and sports they love, driving deeper engagement over time.

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Building on the success of Madden NFL Mobile, we are excited to bring more compelling EA sports experiences to our players on mobile devices. As the top game publisher on PlayStation 4 and Xbox One consoles in the Western world for calendar year 2015, EA continues to captivate players with some of the world's biggest and most popular franchises. Madden NFL 16 was the number one sports title in the US, and FIFA 16 was the number one title across all genres in Europe for calendar year 2015.

Player engagement continues to grow across our entire EA sports portfolio, with monthly active players growing more than 10% year over year in the third quarter. And the return of Need for Speed delivered for racing car and car culture enthusiasts, with more than twice as many monthly active players in Q3 compared to our previous game.

Live services are at the core of how we help our players connect with each other and stay engaged in their favorite games longer. Our EA Sports Ultimate Team services continued to engage more fans year over year in Q3, driven in part by new experiences like FUT Draft in FIFA 16 and draft champions in Madden NFL 16. We also continue to see long-term engagement across Battlefield 4 and Battlefield Hardline. In Q3, our players logged more than 150 million hours of Battlefield gameplay.

Our subscription programs represent a key opportunity to connect players to even more great games. EA Access continues to grow on subscribers and more than 60% of those players have used EA Access to try a game they haven't previously played.

Based on the success of EA Access, we've just launched Origin Access, expanding our succession programs to the PC platform. Early reaction for Origin Access has been equally positive and it's clear that our global player base sees value in this innovative approach to playing more games.

EA Access and Origin Access are great examples of how EA is working to help players with one of the more compelling challenges in entertainment today. In a world that sees more competition than ever for our players' time, we are focused on delivering services that reduce friction and barriers to discovery, allowing them to maximize the time they have to play their favorite games or try something new.

Through deeper relationships, we can help more players connect to vibrant communities, access more games and content, and engage in experiences that are meaningful, personal, and fun. In Q3, we captivated players with stunning new experiences and more great content for the games and services they love.

Now I'll hand the call over to Blake for a deeper look at our financials.

Blake Jorgensen (CFO):

Thanks, Andrew. EA's non-GAAP net revenue was $1.803 billion, which was $28 million above our guidance. The quarter's revenue was 26% higher than the prior year's, primarily driven by Star Wars Battlefront and Need for Speed, but also by growth across the breadth of our platform, including Ultimate Team , mobile, and catalog.

Star Wars Battlefront surpassed our full-year fiscal guidance of 13 million units, which includes over 1 million units bundled with consoles. On a constant currency basis, revenue would have been up 35% year on year.

Our non-GAAP digital net revenue for the quarter increased 16% year over year to a record $807 million, 45% of this quarter's revenue. It was also a record for the trailing 12-month period, which was up 11% to $2.42 billion.

Breaking down our digital revenue into its key components highlights the performance of each of these businesses this quarter. Extra content and free-to-play contributed $360 million, up 15% over the prior

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year. The principle driver of the growth was Ultimate Team .

In particular, FIFA Ultimate Team showed strong growth, up 8% year on year, or 18% year on year at constant currency. Madden Ultimate Team and Hockey Ultimate Team also grew. Finally, FIFA Online 3, our PC free-to-play title in China and Korea, continues to perform well and is tracking to our expectations. Mobile generated $162 million in the quarter, up 17% year on year.

Our big launch during the quarter was Star Wars Galaxy of Heroes. And it has performed extremely well, a great start for our newest live service. In addition, Madden NFL Mobile was in the top three grossing apps in the US on the iOS App Store through the important Christmas period, and peaked at number one on Christmas Day., to join our broad strong portfolio of revenue-generating titles, which also include SimCity BuildIt, Sims FreePlay, The Simpsons Tapped Out, Need for Speed: No Limits, and Real Racing 3.

Full-game PC and console downloads generated $195 million, up 39% over the prior year, driven by Star Wars Battlefront and offset by FX. Star Wars Battlefront was our largest digital launch ever. Although it did lean more towards physical copies over the full quarter, as holiday gift giving became the dominant driver of purchases.

Note that the revenue from the large number of copies sold bundled with consoles is counted as physical revenue, even though they are distributed as digital codes. And this revenue will be recognized in our fourth quarter.

Subscriptions, advertising, and other digital revenue contributed $90 million, down 10% from last year due to the natural decline in the recognition of Battlefield 4 premium revenue. However, EA Access is delivering strong sustained growth, and we launched a similar PC subscription, Origin Access, in January. Our most recent update to Star Wars: The Old Republic has fueled subscriber growth with its rich content and deep storytelling.

Moving onto gross margin. Our non-GAAP gross margin for the quarter was 70.4%, down from last year's 72.8% and 110 basis points below our guidance. The decrease from last year was driven largely by mix with Dragon Age: Inquisition last year compared to the royalty bearing Star Wars Battlefront this year. We had factored into guidance our expectations that Star Wars Battlefront would be a strong gift giving title, but it skewed even more physical than we had anticipated.

The other significant driver of the margin shortfall versus guidance this quarter was also a positive. The strong performance of our royalty bearing console and mobile games, which triggered greater royalty expenses than expected.

Our non-GAAP operating expenses for the quarter were $511 million, down $10 million year on year driven by FX. At constant currency, OpEx would've been $22 million up, driven chiefly by increased investment in marketing to support the bigger launches this quarter compared to a year ago. The improvement on guidance was driven by phasing and continued cost control. The resulting non-GAAP diluted EPS was $1.83 per share, which is $0.08 better than guidance due to our strong top-line performance and continued cost management.

Our cash and short-term investments at the end of the quarter were $3.23 billion or approximately $10.42 per share. 51% of this cash and short-term investment balance is held onshore. This is down from 57% held onshore last quarter, the difference being partly driven by stock repurchases and settlements of early redemptions of our convertible notes.

During Q3, we settled $95 million in early conversions of our convertible notes. Through December 31, we redeemed $293 million of the $633 million total, and as of yesterday, we received notices for an additional $177 million to settle in Q4. We have updated the dilution table on our website accordingly.

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We also repurchased 1.8 million shares at a cost of $126 million, leaving $672 million in our two-year, $1 billion buyback program we began in May 2015. The current rate of repurchases keeps us on track to complete the full $1 billion in that time.

Net cash provided by operating activities for the quarter was $889 million. This is by a significant margin the largest quarterly operating cash flow ever generated in the history of the Company, and $207 million more than last year. On a trailing 12-month basis, operating cash flow was $1.025 billion.

Turning to guidance, we expect our fourth-quarter non-GAAP net revenue to be $875 million, $21 million lower than last year's. The decline is driven by the absence of last year's Battlefield Hardline, offset by Plants vs. Zombies: Garden Warfare 2, UFC 2, and Unravel this year. Sales of our new titles have been strong and we believe continued weakness in the game sale for last-generation consoles will continue to be a headwind. Finally, we expect FX to impact sales by around $40 million in the quarter compared to last year.

Non-GAAP gross margin is forecasted to be 76%, 60 basis points above last year's. We expect our Q4 non-GAAP operating expense to be $500 million, down slightly year on year, driven by FX and partially offset by increased investment in R&D. This results in a non-GAAP diluted EPS of $0.40 per share as compared to $0.39 last year.

Our Q4 GAAP net revenue is expected to be $1.275 billion as compared to $1.185 billion in the prior year. GAAP earnings per diluted share is expected to be $1.46 as compared to $1.19 in the prior year.

I would like to highlight one item related to income taxes that is not included in this GAAP guidance. As a result of our GAAP earnings in the US over the last two years, in the fourth quarter, we may record a material income tax credit due to a reversal of a significant portion of the valuation allowance we have against our US deferred tax assets. This would significantly increase our GAAP earnings per share, but would have no effect on non-GAAP earnings or cash flow.

Our Q4 outlook would result in a full-year non-GAAP revenue of $4.517 billion and non-GAAP EPS of $3.04 per share. This is an increase from our previous guidance of $4.5 billion and $3 per share, respectively. Our anticipated operating margin remains at 28%.

Our Q4 GAAP guidance implies full-year GAAP revenue of $4.363 billion and fully diluted GAAP EPS of $2.23 per share. Regarding cash flow for the full fiscal year, we are maintaining our operating cash flow guidance at approximately $1.2 billion, and free cash flow guidance of at least $1.1 billion, as capital expenditure is tracking below our $100 million estimate for the year.

Despite the considerable uncertainty around the state of the world economy, we remain confident in our ability to continue to grow earnings and cash flow. Q3 was another strong quarter for Electronic Arts and a new high water mark for cash generation.

Our strategy is to assemble a broad portfolio of games, leveraging both wholly owned and licensed IP. This builds a deep catalog that sells for years and provides the right balance of innovation and predictability for long-term earnings and cash flow growth.

Now I'll turn the call back to Andrew.

Andrew Wilson (CEO):

Thanks, Blake. FY2016 has been a groundbreaking year so far for Electronic Arts on so many fronts: stunning new games, dynamics services, and new opportunities to connect and celebrate the passion for play we share with our players.

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Amazing game experiences begin with creativity and innovation. And we have focused on delivering that to players wherever they want to play. Leveraging the powerful Star Wars IP, we are now connected with players in large services across three games on three platforms and three business models.

In Star Wars Battlefront, an HD console experience, we are building a major franchise with passionate fans. In Star Wars Galaxy of Heroes, a free-to-download game on mobile, we have a successful new live service. And in Star Wars: The Old Republic, we've demonstrated the longevity of an experience that has great IP and content that continues to deliver enjoyment for our players.

In Q4, we will go live with three new titles that further reflect the creativity, innovation, and variety in our experiences today. Unravel launches on February 9, bringing Yarny's journey to life in the charming and beautiful world crafted by our partners at Coldwood Interactive.

On February 23, Plants vs. Zombies: Garden Warfare 2 goes live, with all its over-the-top action and hilarious characters ready for new and existing fans of this beloved franchise. Then on March 15, we return to the octagon, with EA Sports UFC 2 set to debut, featuring new fighters, new physics, and new modes for fight fans around the world.

Looking ahead to FY2017, we will introduce breakthrough games from some of our biggest and most popular franchises. In Q1, we will begin with the creative and innovative Mirror's Edge Catalyst from DICE launching in May. A great lineup of EA Sports titles are in development for next year and we look forward to sharing more about these new experiences in the months ahead.

An all new Battlefield game from DICE will arrive in time for the holidays. We are excited to have a new Titanfall experience coming from our friends at Respawn, and of course Mass Effect: Andromeda from the team at BioWare will launch later in the fiscal year. Players in our live services will continue to experience engaging new content, expansions, and updates and will have more new mobile titles as well.

Competition runs deep in the DNA of Electronic Arts and we are thrilled to share the passion with our players through our new competitive gaming division led by Peter Moore. For years, we've experienced the energy of competitive gaming through events and tournaments for our EA Sports and Battlefield communities.

As the global gaming audience grows, we are working to deliver our best-in-class program of competitions that are accessible, engaging, and entertaining at all levels, celebrating the talent and skill of our players. We are already underway, with players competing in the Madden NFL live challenge that culminates with the finals here in San Francisco during Super Bowl week. We are excited to have Peter and the team unveil more of our plans as we get into FY2017.

From our new titles to our live services, new programs like Origin Access to new frontiers like competitive gaming, Electronic Arts continues to focus on putting our players first in everything we do. Games deliver on a fundamental human need for entertainment. And for each of us, that means something unique and personal: a need to connect, to compete, to explore, to improve, to challenge, to share.

We are focused on understanding these needs for every player, building stronger relationships so we can fulfill them at the right place and time, and unlocking the full potential of play through amazing new experiences. The commitment we have to our players continues to transform Electronic Arts and galvanizes our efforts to deliver disruptive and innovative new ways to play.

Now Blake, Peter and I are here for your questions.

QUESTIONS & ANSWERS

Operator:

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Operator Instructions

Our frist question comes from the line of Chris Merwin with Barclays Capital.

Chris Merwin (Analyst - Barclays Capital):

Thanks for taking my question.

I just had one on digital downloads. This past holiday season, I think we've seen some industry data points that showed the AAA launches really inflected higher in terms of digital, but digital downloads were just a bit lighter than what we would've expected for you all.

Blake, I know you obviously commented that Star Wars was a much more heavily gifted title during the holiday season, which I think makes a lot of sense, given the younger audience. So next year when you release Battlefield 5, are you expecting to see more of an inflection in digital downloads and is 1 point gross margin expansion per year still the right target going forward?

And just a second quick question, was wondering if you wouldn't mind telling us how engagement has been trending for Star Wars relative to maybe Battlefield 4? And when we think about the DLCs you'll be selling for that title, is it fair to assume that the attach rate would be comparable to that of Battlefield 4? Thanks.

Blake Jorgensen (CFO):

Sure. Let me start with the full game download and Andrew might want to talk to a little bit about the Battlefront engagement. First, remind you that full game downloads generated $195 million, up 39% year over year. So while we might not have done as many on Star Wars as we thought we could do, that's still a big number. And many of our other titles are obviously skewing heavily towards full game downloads, since you couldn't have gotten a number of that size in the quarter without that.

We were surprised that more gift giving was done with Star Wars, which obviously impacted the digital downloads. And my guess is that that will be less so next year because Battlefront tends to skew less towards gift giving and less -- and more towards PC. There's a very hard-core PC audience that's a Battlefield audience, and they tend to obviously do more physical -- or digital downloads than physical.

So we should tend to see a return to that gross margin guidance that we've talked about in the past. We'll obviously give you detailed gross guidance in May for the full year, but based on what we know about the Star Wars title and gift giving, we would be very surprised if we didn't shift back to the improvements in gross margin that we saw.

Andrew Wilson (CEO):

And on engagement, engagement has been strong. It's been a great game to play across multiple generations, so the audience is much wider than a traditional Battlefield audience, which is great for us. We are introducing new people to Electronic Arts and to games and the first-person shooter genre. We have just announced our first batch of free content and our four maps that will form part of the premium service, and we expect strong engagement with that going forward.

Chris Merwin (Analyst - Barclays Capital):

All right. Great. Thank you.

Operator:

Our next question comes from the line of Stephen Jim.

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Stephen Jim (Analyst - Unidentified):

Hey, guys. This is Chris on for Stephen. Congrats on the quarter. Two quick questions from our end. You said you sold in 13 million units of Battlefront and 1 million of them were bundled. Wondering if you guys are seeing any excess inventory in the channel.

And then can you touch a bit on what you've seen so far with Origins Access? Do the subscribers have the same propensity to try new games, maybe new genres that they have not played before, just like EA Access?

Blake Jorgensen (CFO):

So on the Origin Access piece that we just rolled it out, so it's very early days and it's hard to get any data yet. So more to come on that. But obviously we are very excited about what we have been seeing in EA Access and that was part of the reason we decided to roll out Origin Access. It's a different group of titles because not all of our titles are PC titles.

So we will probably see some different dynamics between players, but we hope to see similar dynamics than we have seen in EA Access. Because it's exciting to see obviously people broaden their interest in more games than simply one franchise.

On your first question, can you go back and just repeat again what you were looking for there?

Stephen Jim (Analyst - Unidentified):

Yes. You guys said you've sold in 13 million units of Battlefront, and 1 million of that was consistent in the bundles. Do you guys have any excess inventory in the channel?

Blake Jorgensen (CFO):

No, we're very comfortable with where the channel is. We actually had a very strong sellthrough during the quarter as well as sell-in. And there are some accounts, obviously, that are replenishing in their -- as they get through their January time frame. And we are very comfortable with where the channel inventory is now.

Stephen Jim (Analyst - Unidentified):

Okay. Thanks, guys.

Operator:

Our next question comes from the line of Colin Sebastian.

Colin Sebastian (Analyst - Robert W. Baird & Company, Inc,):

Great, thanks. Was wondering if you could comment on the progress of the next Titanfall, and with that the overall relationship with Respawn, if for instance, there are opportunities to expand that relationship to a couple other titles.

And then I was hoping Peter could expand on the EA Sports opportunity: how large do you guys think this could be, how impactful could be to the overall business over the near term, and then the longer-term as well. That would be helpful. Thanks.

Andrew Wilson (CEO):

I'll take the Titanfall question. Again, it's a little early to start talking about the details of Titanfall in this

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juncture, and that wasn't the purpose of raising it. What I would say, having seen the game, is it's looking fantastic. Our relationship with Respawn is extremely strong; we have great faith in that entire team to build a spectacular game and are really looking forward to sharing more details in the months ahead.

Peter Moore (EVP, COO, and Chief Competition Officer):

As regards competitive gaming, obviously we see a great opportunity going forward here. I'll remind you and I know you know this that we've been doing this for a number of years, whether it's been our involvement with FIFA with the FIFA Interactive World Cup.

As was mentioned in the prepared remarks, we're looking forward to the finals of the Madden Challenge series at the Madden Bowl on Thursday night here in the Bay Area. But we also see this may be a little different late then maybe some of our publishing brethren that are in the marketplace right now, and we see this as a tool and a platform to increase engagement.

More and more session days with games is good for Electronic Arts ; it's good for our players. We are taking a very player-first view on this in which we are building community. It's clearly an entertainment medium, I think there's a lot of excitement around it, and I can't think of anybody that's better served with the diversity of our portfolio when you think about sports titles in particular, FIFA and Madden, as well as our Battlefield franchise that has been able to build a meaningful business over the next couple of years.

Colin Sebastian (Analyst - Robert W. Baird & Company, Inc,):

Thank you.

Operator:

Our next question comes from the line of Brian Pitz.

Brian Pitz (Analyst - Unidentified):

(technical difficulty) [Shae] in for Brian. Just another question on Star Wars. So just wondering how much of the mix shift towards physical discs do you attribute to heavy promotional activity, like GameStop's $40 sale? So just curious about how those kinds of retail promotions, how effective are they in terms of attracting new users?

And just on the same subject, I know you take a 20% reserve on gross revenue for each unit shipped. I'm just curious if you can quantify the impact to your P&L when GameStop offers discounts like we saw. How's the impact -- how does this impact gross margin? Thanks.

Blake Jorgensen (CFO):

Let me first speak to just discounting in general. This is a business that in the holiday time frame, between Black Friday and Christmas, has traditionally done a lot of discounting. It's a way of driving volume, particularly when people are now buying for the first time a new console, often they want to build up their software inventory pretty quickly. And we find that discounting helps drive people into the engagement.

We obviously share that view with the retailers and we help support the retailers in that each year with specific programs, and I think we've done that year over year and it really doesn't impact that. We are also doing discounting on the digital side to try to keep the two aligned.

We don't want to have a disconnect between pricing in one area and pricing in another. And so you'll tend to see us drive volumes through discounting and it's pretty consistent year in and year out. I would say this year, our programs were very similar to what you saw last year or similar to what we've seen with all of our other industry partners and titles that they may have had. There wasn't a lot of difference

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between years.

On the sales reserve, we take the sales reserves upfront at the start of each quarter in anticipation of what our sell-in is going to be. And we use those sales reserves during a quarter on a very formalized planned method. So all of these sales get planned well in advance and we need to make sure that we have the appropriate reserves in place to help pay for those over time. And so we will be setting up sales reserves each quarter as we go in, and those tend not to impact margins or margins that we forecast, because they are already built into the numbers.

Brian Pitz (Analyst - Unidentified):

Thanks. And then if I could, I believe that Andrew mentioned that you were attracting a new type of demographic to Star Wars. I'm just wondering for any sort of color on that: who are the new players, what does the demographic breakdown look like of that game, and what types of new -- what's the new demographic you are attracting to the EA tent. Thanks.

Andrew Wilson (CEO):

I can take that. So what we've seen is really there's two groups that have either come for the first time or have come back to gaming. The first group is people, quite frankly, of my generation or my vintage, who have been gamers in the past have for whatever reason kind of moved away from it and particularly moved away from core FPS shooters because they have become very hard and complicated, and quite frankly brutal to play online. They've come back in light of the Star Wars IP and the commitment and the passion they have around that from their youth.

At the same time, they now have kids who are of game playing age who may have not got into the first-person shooter universe yet because of the nature of the content inside of some of those games. So we are seeing fathers and sons play; we are seeing mothers and daughters play because of the broad appeal.

So the big groups that we've added as kind of a youth demographic, it skews typically younger than we have seen before, as well as an older demographic that we may have had interaction with some years ago, but had lapsed out in recent years, particularly from the first-person shooter universe. And we are looking now at how we continue to provide content and experiences that engage those two new groups so that we maintain relationships with them over time.

Brian Pitz (Analyst - Unidentified):

Great, thank you.

Operator:

Our next question comes from the line of Justin Post.

Justin Post (Analyst - Unidentified):

Thanks for taking my question. This is Ryan on for Justin. First on Star Wars, congratulations on the shipments. Wondering if you could talk about how demand is looking in early 4Q, and then maybe how much you expect that title to contribute, either digitally or physically or combined during the quarter.

And then you highlighted some of the titles that you guys are working on especially for next year. Wondering how you're thinking about spacing for all those titles: Battlefield, Mass Effect, Titanfall, and maybe Mirror's Edge is in there as well.

And then lastly, just going to the digital and the mix shift, is it fair to say that really this digital mix shift

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away from full game downloads is one-time in nature, and just really the specific Star Wars title? Or is there any reason for us to think that EA won't continue to see the benefit on the margin side from the industry going digitally into 4Q and then into fiscal 2017?

Blake Jorgensen (CFO):

Let me start there. I don't think there's any indication that this mix shift is anything but a Star Wars Battlefront opportunity. Remember the movie was out, all things Star Wars for the month of December, and it was the perfect gift giving opportunity.

And typically with gifts, someone wants to have a package under a tree or in a gift pile somewhere versus a digital code. And that was the driver of the shift. We could see -- when we do the next Battlefront, we could see something like that, but we have no idea on exact timing yet for ourselves or the industry, and exactly how the buzz around Star Wars will be when that comes again the next time around.

So right now, I would say nothing would imply to us that the digital journey is slowing in anyway. And in fact, if we look at all of our non-Star Wars products, every one of them were up digitally in full game downloads and the digital engagement associated with them. You look at the Ultimate Team statistics we gave you, that's clear sign that people are playing and engaging longer and longer around the titles.

In terms of guidance, guidance on Star Wars, we are not going to break out individual guidance. Obviously, we'll end up selling more than the 13 million units, as we've already gotten there. We did sell more in the third quarter, so we may ultimately sell less in the fourth quarter than we originally thought. But we will clearly sell more overall and that's built into our guidance for the fourth quarter.

I will remind people about fourth quarter, though. Don't forget that there is a continued FX headwind that we've called out, that's $40 million of headwind. I'm not sure everyone is modeling that into their models. And we are not ignoring the fact that there is a economic headwind out there around the world that hasn't really impacted us, but we are being conservative when we give our guidance around watching that closely.

In terms of next year's guidance, the title slate that we talked about on the core titles along with the traditional sports titles, the one thing to note is Q1, the only title we have in Q1 is Mirror's Edge, plus all of our catalog business and live services business. But our core console title will be Mirror's Edge.

And as you're doing -- we'll give you real full-year guidance in May when we sit down to do the next earnings call. But as you're starting to think about guidance for Q1 and next year, don't forget about the continued FX headwinds, which are impacting us, as well as in Q1, one specific item. Remember that last year in Q1, we had a $30 million benefit -- one-time benefit from FIFA Online 3 as we started that up, and we had deferred revenue all into Q1. So that was high profit revenue that came into Q1. A couple of basic things for your model, but things to remember.

But we are excited about the rest of the slate. You should assume that Battlefield would come typically in the third quarter when we normally have it. We are not yet announcing when Titanfall or Mass Effect: Andromeda will come, but you should assume that is in the back half of the year as well because the second quarter was so dominated by our sports titles.

Justin Post (Analyst - Unidentified):

Okay, great. And then if I can add one last follow-up. It was nice pickup in mobile revenue. Do you guys happen to have an update MAU figure that you can share?

Blake Jorgensen (CFO):

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We don't. But we probably will in the next quarter.

Justin Post (Analyst - Unidentified):

Okay. Great, thanks, guys.

Operator:

Our next question comes from the line of Arvind Bhatia with Sterne, Agee & Leach, Inc.

Arvind Bhatia (Analyst - Sterne Agee & Leach Inc):

Thank you. A couple of questions. One, I know you guys touched on Madden NFL Mobile did really well this quarter. Wondering what are some of the learnings -- Andrew in particular -- that maybe could apply to FIFA Mobile and other titles specifically.

And then wondering if you guys are willing to share the mix of full game digital downloads on some of the key titles during the quarter. And for any of you, I guess, just would love some thoughts on virtual reality and your efforts there currently. Thank you.

Andrew Wilson (CEO):

I'll take the Madden Mobile one. As we think about all of our mobile games, we really think about them on four vectors: discovery, how someone will find the title, whether that's through an App Store or through social representation; onboarding, how someone will get into the title; the gameplay mechanic itself, so actually what do you do while you are playing the game; and then how do we run the service that actually surrounds that game to make it new and interesting, fun and dynamic and engaging on a moment-to-moment day-to-day basis.

As we look at what we've done with Madden NFL Mobile over the last couple of years, you will have seen we've fundamentally overhauled all four of those vectors since we first launched Madden on mobile devices. We now believe we have landed in a place that has a game that is very social in nature, has a game that onboards new players and a broad demographic of players. We have a game mechanic that feels right for mobile devices, and our teams are delivering live events that tie to the passion that players have for the real world of the NFL and are very engaging for them from an ongoing basis, both during the weekend games and the week leading up to those games.

All of those opportunities presently learning for us as we take these types of things to our other sports games on mobile. And we expect to be able to do well in those areas.

Blake Jorgensen (CFO):

Your second question was about trends and full game downloads. We clearly continue to see the trending upwards; we see titles running anywhere between 20% and 30%-plus. We've always seen FIFA skew lower because of in Europe, many retailers use that as a loss leader to drive traffic into their stores, and that tends to be a physical copy.

But in the rest of our sports portfolio, we tend to see strong digital full game. Really, Star Wars was the only gen-4 title that indexed lower than the average because of the gift giving issue. So we are very comfortable with the continuation of where that trend is going industrywide.

Arvind Bhatia (Analyst - Sterne Agee & Leach Inc):

Got it. And then on VR?

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Andrew Wilson (CEO):

The context of VR?

Arvind Bhatia (Analyst - Sterne Agee & Leach Inc):

Just wondering what your investments are currently and how you are viewing sort of the opportunity this year and perhaps over the next couple of years. If you have any titles currently in development, and any early thoughts there.

Andrew Wilson (CEO):

Sure. I'll echo what we talked about on some previous calls, which is we believe that VR is going to be an important part of our industry. We do believe it's a number of years out before it's a meaningful part of our industry, but right now, we are investing at a core engine level. We've talked about Frostbite as we move to a single engine for the Company, and that team is working to ensure that they can output virtual reality experiences regardless of device.

And then we have a few key game teams around the Company who are doing targeted experiments as it relates to very engaging virtual reality experiences in the context of particular genres. I would expect that we would start to surface some of those over the coming years. And that we would start to build it into more fully fleshed experiences over time.

Arvind Bhatia (Analyst - Sterne Agee & Leach Inc):

Great. Thank you.

Operator:

Our next question comes from the line of Mike Olson with Piper Jaffray & Co.

Mike Olson (Analyst - Piper Jaffray & Co):

Good afternoon. You had a obviously big launch with Star Wars in the quarter, and no doubt that had some marketing and other expenses. And yet the overall OpEx was basically down year over year, so the cost containment efforts continue to remain strong.

How do you think about OpEx going forward with a lot of these incremental titles coming in fiscal 2017? Is there a reason to think that OpEx will start to creep higher? Is that kind of a reasonable multi-year run rate going forward where we are at this year?

Blake Jorgensen (CFO):

I think pure dollar OpEx has gotten -- we've gotten a benefit this year of FX on our OpEx line because many of our studios are outside the US. So we have a large base obviously in Sweden and Canada, in Romania, in Australia. Many in China; many of those have obviously come in at lower dollar costs.

We've tried to report each quarter what the actual dollar costs are, and you've seen some continued investment. Our goal is to try to keep R&D expenses around the 22% to 23% of revenue line, which means if our revenue is growing, we are clearly continuing to invest in R&D. We think that's very important for our future.

You will see marketing expenses bounce around depending on the title in the quarter. So this quarter, our marketing expenses were up, if you FX adjust them, and that was driven by the fact that we had a fairly large title this year that we didn't have in last year's third quarter. This year, Star Wars; obviously

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last year, our large title was Battlefront Hardline in the fourth quarter. And so you get some of that timing differences.

But you'll continue to see general increases in OpEx with a goal to try to target R&D around the 22% 23%, we're trying to push marketing expenses down into the 13% range and hold G&A in that 8% to 7% range if possible. So that's what you're going to see as a percentage of revenue and hopefully it will continue to be reflected in our business going forward.

Mike Olson (Analyst - Piper Jaffray & Co):

Okay. And then just one quick one. Is there any detail you can give on the timing of the first monetized Star Wars expansion pack? Is that in the month of March, and if so, can you say is it early or late in the month?

Blake Jorgensen (CFO):

I can't say much more than March. But I would assume that much of that revenue will probably fall in the first quarter versus the fourth quarter, but it's hard to see right now.

Mike Olson (Analyst - Piper Jaffray & Co):

Okay. That answers the question. Thank you.

Operator:

Drew Crum with Stifel Nicolus.

Drew Crum (Analyst - Stifel Nicolaus):

Good afternoon, everyone. So Ultimate Team up 13% in the quarter; it seems like an impressive number, given the comp. And I think you guys had some pull-forward recognized in the second quarter. So what is Ultimate Team up year to date and can you comment on the expectations on Ultimate Team going forward? And then I have a follow-up.

Blake Jorgensen (CFO):

I don't have the year-to-date number with me here. But it's fairly consistent with what it was in the quarter, just off the top of my head. And we are continuing to see that. Remember we had a slowdown in FIFA Ultimate Team in the fourth quarter last year as we put the price banding in to address the inflation in the marketplace issue that we saw.

We are currently forecasting that we will have a stronger fourth quarter than we did last year because obviously we've corrected some of those price and coin farming issues. So we should continue to see strong growth of Ultimate Team through the year, and probably for the full year clearly exceed because of the lean last quarter last year.

But clearly the business continues to grow, and we've done a good job of bringing new users, so we are not taxing the existing users. But it gets harder and harder to grow the business at the size that it's at. So we will see what it looks like for next year.

The other thing to really remember as you're looking at it is realize that a huge portion of the Ultimate Team audience for FIFA is outside the US. Large markets like France, Germany, UK, and so all of those markets have a headwind from FX that we are clearly seeing in the growth numbers. So as I mentioned today, 18% on a constant currency basis for Ultimate Team -- or for FIFA, and that's a pretty impressive growth rate on a business of that size.

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Drew Crum (Analyst - Stifel Nicolaus):

Got it. Okay, thanks. And aspirational number on R&D as a percentage of revenue, how important is culling less profitable or non-profitable titles in the portfolio? Do you have an opportunity to do that going forward? How you think about limiting the number of SKUs going forward? Thanks.

Blake Jorgensen (CFO):

We are down to less than 15 major SKUs. And that feels like a good size of the business and we are obviously announcing that we are investing in some action-based SKUs by bringing people like Jade Raymond and Amy Henning into our organization to help build those. And those are obviously a few years out in our SKU plan.

But clearly we want to try to grow genres, and grow our revenue base with more titles, both digital live services titles as well as traditional console titles. Part of -- to do that part of it is we have to be ruthless that we don't spend a lot of money on smaller titles, we size them correctly, but we also want to continue to look for ways to bring new, interesting titles to the market.

Look at Unravel as a perfect case of that. We're trying to address the marketplace for broader titles that address a wider audience in terms of types of games they are, the types of games people want to play. We are also trying to build enough product to be able to effectively run subscription-based businesses, and that requires a great portfolio, which we have and will continue to add to. We will always cull, but there's not a ton of things to cut back on today because we've brought the total number of titles down to a very perfect level for us now.

Operator:

Ben Schachter with Macquarie Research.

Ben Schachter (Anaylst - Macquarie Research):

So there's been a lot of pretty positive commentary, including Star Wars beating and getting reorders in 4Q, but then you don't see that really flow through for the fiscal-year guidance. I was wondering if you could just talk more about why, and is it all weakness in prior gen, is it all FX, is there anything else going on there that we should know about.

Secondly, FIFA in China, can you just talk about how meaningfully we should be thinking about that business for FY2017? And then finally, of course, I have to ask another VR question. And understanding that is not going to be meaningful for a number of years, is it possible that we will get any of those what you've defined the VR experiments or small experiences, any chance we will get those in calendar 2016? Thanks.

Blake Jorgensen (CFO):

I guess I would remind people that we did raise full-year guidance. That's the third time this year we've raised full-year guidance. We've got a track record I think of ten quarters in a row of beating our guidance. I think we've exhibited some conservatism in how we operate the business, which we think is a prudent thing to do. And we are sitting with an FX headwind and a lot of uncertainty in the economy.

You put all that together, I don't think that signals anything negative about the fourth quarter. It signals the way we've been approaching the business and operating the business. And that's what we are going to continue to do.

In terms of FIFA Online 3 in China, the key there is we are continuing to see very positive reactions. But

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we also have a very long-term view there. So that continued level that we've talked about, $10 million to $15 million a quarter, is still consistent with where we are. And when we give you guys guidance in the May time frame, we will update that number if it looks like it should be updated. But all is very positive in that. And our partner TenCent continues to be extremely happy.

With that, maybe I'll let Andrew hit the VR question, if there's anything more to say than we already said.

Andrew Wilson (CEO):

Not a lot more to say at this point. No announcements as to launch times or servicing the experiment at this stage. But as we go into calendar 2016, as we start to come closer to our EA player events in LA and in London, we will be talking more about our full title slate and some other new in-development products that we have running across our studios right now.

Operator:

Neil Doshi with Mizuho Securities.

Neil Doshi (Analyst - Mizuho Securities):

Two questions. Blake, can you talk a little bit about the macro environment and kind of what you guys are seeing as we move into calendar 2016? And then secondly, we've noticed -- I think Amazon announced that they are putting out a promotion for Prime members. So every time a large AAA game it goes up for sale on preorder, a couple weeks after, they're going to give a pretty hefty 20% discount.

Can you talk about whether you guys are helping to fund that or if that's something that Amazon is just kind of taking on their own. And how you think that could potentially impact digital sales, since those are primarily for physical discs. Thanks.

Blake Jorgensen (CFO):

On the macro environment, we've mentioned a couple of times our caution because of the macro environment. We have not seen anything in our business or heard anything from other players in the business that would imply any economic slowdown in entertainment software.

As I said, we have a level of conservatism about just the global economy, which at some point in time, there's trouble in the global economy that would impact everybody probably. I think our business seems to be operating pretty consistently, as it has been over the last couple of years. The console purchases up through the end of calendar year 2015, our estimate is 55 million units out there, which has exceeded virtually everyone's forecast for the year, and is now almost 50% higher than the previous console cycle.

So all of that is very, very positive; all the gameplay we are seeing and the engagement in things like Ultimate Team we're seeing as positive. We're just conscious of the fact that there's a lot of storm clouds out there and we want to be careful that we don't get ahead of ourselves or the economy in our forecast for the business. And that's what you are hearing.

The second part of the question was the Amazon issue. We do not fund the Amazon discount; that comes out of Amazon's own pocket. I think that's fairly consistent with how Amazon operates. And we don't have much say or view on pricing of anyone in the marketplace. That's their job, not our job. For us, if it brings new game players into the business, then we are excited, but we don't really have much more to say or control over their pricing strategy.

Neil Doshi (Analyst - Mizuho Securities):

All right. Thanks, Blake.

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Operator:

Doug Creutz with Cowen and Company.

Doug Creutz (Analyst - Cowen and Company):

Thanks. You guys announced your EA Play event a few days ago and obviously you made the interesting decision to not have a booth on the floor of E3 this year. Just curious as to your thinking about why do that? If I recall, one of your major competitors made a similar decision several years ago, ultimately decided it was not the way to go. Is there anything that's changed that's led you to that decision? Thanks.

Andrew Wilson (CEO):

What we have seen is more and more, we need to be close to our player. And what you've seen from us over the last couple of years in almost all of our actions, whether it relates to development or marketing or sales, is attempts by us and endeavors by us to get as close as possible to our players and get direct feedback from them. We believe that's the single best way to ensure that we are making games that they want to play. And that we are making some of the best games in the industry.

And we see this as an opportunity to do just that: get close to our player, invite them in in an environment where they feel comfortable to play games, give us feedback, and interact socially as they do, whether it's through social networks or with their friends or what have you.

We continue to be members of the ESA and we will have meeting rooms at E3 this year. So what we see we are doing is augmenting the overall E3 experience. And we are excited by what we are going to be able to do as it relates to EA Play and we are excited for what the industry is going to be able to do as it relates to E3 more broadly.

Blake Jorgensen (CFO):

To add to that, we are also doing a simultaneous event in London. And so in some ways, we're trying to do a more geographically spread way to introduce people to our new products.

Doug Creutz (Analyst - Cowen and Company):

Okay, thank you.

Operator:

Eric Handler with MKM Partners.

Eric Handler (Analyst - MKM Partners):

Thanks for taking my question just under the wire there. Two things for you. First, with Star Wars, obviously you are not making a Star Wars movie game, but you got nice leverage off of The Force Awakens this December.

How are you thinking about what you can do with Star Wars Battlefront next December, when the first spinoff movie comes out, Rogue One. Is there much you can do around that to keep monetization levels high?

And then secondly, looking at your mobile business, after the first two quarters of the year, mobile is really stagnant. You got strong growth in the third quarter with Madden and Star Wars. I'm just seeing as we think about the mobile business going forward, is this sort of the inflection point where we start seeing

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some reacceleration of revenue or (technical difficulty) sustainable is the improvements there? Or maybe talk about some of your plans with mobile.

Blake Jorgensen (CFO):

I'll start with Star Wars. I don't know; Andrew might want to chime in on the mobile piece. On Star Wars, the one thing that we are adhering to, and I think this is part of our arrangement with Lucas and Disney , is you can't make a game in Star Wars that violates the canon of Star Wars. Meaning, you can take something from the future and bring it back into the past unless it's a reference.

Not knowing yet exactly what the storyline in Rogue One is going to be, I can't comment on how that could come in. But to the extent that it's in the future around our current Battlefront game is all paced based on the historical Star Wars canon, which is 30 years before the most recent movie. That will limit our ability to bring some new content into that.

But more to come there. Obviously we're trying to stay tightly connected to the Star Wars beat for future movies, and we will obviously in future Star Wars games be able to tap the new characters and vehicles and so forth. But in our current game, and for that matter the DLC associated with that current game, obviously we will have to be careful that we don't violate the canon.

On mobile, obviously mobile -- one thing to remember is like our console business, mobile will always be a little choppy based on when new titles come out. But like most live services, they should be smoother than the historical beats around the console business. So over time, we hope to smooth that out. But there still may be some jumps up and down due to quarters.

Andrew Wilson (CEO):

On the Star Wars play, just to add a little, what we have seen is that the movie or the content of the movie itself hasn't impeded the engagement in various Star Wars games. We've seen that across console, PC, and mobile. And we would expect that as more great Star Wars films come out, we would see more great engagement in Star Wars content more broadly -- again, not just in Battlefront, but in Star Wars: The Old Republic and our mobile game, Galaxy of Heroes.

As we think about mobile, just to add to Blake's point, I think he is absolutely right. The one other thing that we would point to is as we look at our mobile portfolio, our titles typically have very long lifespans. The Sims FreePlay, The Simpsons Tapped Out, Real Racing 3 have continued to grow over a number of years.

And as we think about launching new titles, we are taking a little more time and being a little bit more calculated about how we launch, but we are doing so with a view that we are putting experiences into the marketplace that will live for many years and drive engagement and profitability for a number of years to come. And so as we look at the year to come, as we look at what we've done with Star Wars and Madden and some other titles that are coming down the chute, our expectation is that we are able to grow the overall business with them.

Doug Creutz (Analyst - Cowen and Company):

Great. Thank you very much.

Blake Jorgensen (CFO):

All right. Thank you, everyone. We will see you next quarter.

Operator:

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Ladies and gentlemen, this does conclude today's conference call.

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