ELECTRONIC ARTS INC.
Form 10-Q
February 05, 2013
Table of Contents

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

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended December 31, 2012
OR

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

Delaware (State or other jurisdiction of incorporation or organization)	94-2838567 (I.R.S. Employer Identification No.)
209 Redwood Shores Parkway Redwood City, California	94065
(Address of principal executive offices)	(Zip Code)

(650) 628-1500
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES þ NO ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO þ
As of January 31, 2013, there were 300,076,045 shares of the Registrant's Common Stock, par value $0.01 per share, outstanding.

1

Table of Contents

ELECTRONIC ARTS INC.
FORM 10-Q
FOR THE PERIOD ENDED DECEMBER 31, 2012
Table of Contents

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, 2012	March 31, 2012 (a)
ASSETS		
Current assets:		
Cash and cash equivalents	$1,158	$1,293
Short-term investments	275	437
Marketable equity securities	59	119
Receivables, net of allowances of $284 and $252, respectively	382	366
Inventories	59	59
Deferred income taxes, net	67	67
Other current assets	229	268
Total current assets	2,229	2,609
Property and equipment, net	550	568
Goodwill	1,724	1,718
Acquisition-related intangibles, net	304	369
Deferred income taxes, net	47	42
Other assets	185	185
TOTAL ASSETS	$5,039	$5,491
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$93	$215
Accrued and other current liabilities	840	857
Deferred net revenue (packaged goods and digital content)	1,213	1,048
Total current liabilities	2,146	2,120
0.75% convertible senior notes due 2016, net	554	539
Income tax obligations	211	189
Deferred income taxes, net	2	8
Other liabilities	168	177
Total liabilities	3,081	3,033
Commitments and contingencies (See Note 13)		
Stockholders’ equity:		
Preferred stock, $0.01 par value. 10 shares authorized	—	—
Common stock, $0.01 par value. 1,000 shares authorized; 301 and 320 shares issued and outstanding, respectively	3	3
Paid-in capital	2,138	2,359
Accumulated deficit	(302)	(77)
Accumulated other comprehensive income	119	173
Total stockholders’ equity	1,958	2,458
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$5,039	$5,491

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

(a) Derived from audited consolidated financial statements.

3

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)	2012	2011	2012	2011
Net revenue:				
Product	$703	$884	$1,886	$2,370
Service and other	219	177	702	405
Total net revenue	922	1,061	2,588	2,775
Cost of revenue:				
Product	363	477	866	1,088
Service and other	66	75	213	136
Total cost of revenue	429	552	1,079	1,224
Gross profit	493	509	1,509	1,551
Operating expenses:				
Research and development	286	325	890	928
Marketing and sales	214	269	571	631
General and administrative	68	98	253	260
Acquisition-related contingent consideration	(45)	(11)	(65)	8
Amortization of intangibles	7	11	21	37
Restructuring and other charges	2	—	27	17
Total operating expenses	532	692	1,697	1,881
Operating loss	(39)	(183)	(188)	(330)
Gain on strategic investments, net	14	—	14	—
Interest and other income (expense), net	(8)	(10)	(17)	(13)
Loss before provision for (benefit from) income taxes	(33)	(193)	(191)	(343)
Provision for (benefit from) income taxes	12	12	34	(19)
Net loss	$(45)	$(205)	$(225)	$(324)
Net loss per share:				
Basic and Diluted	$(0.15)	$(0.62)	$(0.72)	$(0.98)
Number of shares used in computation:				
Basic and Diluted	304	332	313	331

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

Table of Contents

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

(Unaudited)	Three Months Ended December 31,		Nine Months Ended December 31,	
(In millions)	2012	2011	2012	2011
Net loss	$(45)	$(205)	$(225)	$(324)
Other comprehensive loss, net of tax:				
Change in unrealized gains on available-for-sale securities	(9)	(72)	(34)	(16)
Reclassification adjustment for realized gains on available-for-sale securities	(15)	—	(15)	(1)
Change in unrealized losses on derivative instruments	(2)	(1)	(4)	(2)
Reclassification adjustment for realized losses on derivative instruments	1	1	2	3
Foreign currency translation adjustments	(5)	4	(3)	(13)
Total other comprehensive loss, net of tax	(30)	(68)	(54)	(29)
Total comprehensive loss	$(75)	$(273)	$(279)	$(353)

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)	2012	2011
OPERATING ACTIVITIES		
Net loss	$(225)	$(324)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation, amortization and accretion, net	178	148
Stock-based compensation	122	129
Acquisition-related contingent consideration	(65)	8
Non-cash restructuring charges	7	(3)
Net gains on investments and sale of property and equipment	(12)	(12)
Change in assets and liabilities:		
Receivables, net	(18)	(176)
Inventories	—	11
Other assets	14	(81)
Accounts payable	(115)	(150)
Accrued and other liabilities	53	50
Deferred income taxes, net	(13)	(44)
Deferred net revenue (packaged goods and digital content)	165	434
Net cash provided by (used in) operating activities	91	(10)
INVESTING ACTIVITIES		
Capital expenditures	(81)	(128)
Proceeds from sale of property and equipment	—	26
Proceeds from sale of marketable equity securities	25	—
Proceeds from maturities and sales of short-term investments	404	463
Purchase of short-term investments	(244)	(374)
Acquisition-related restricted cash	25	—
Acquisition of subsidiaries, net of cash acquired	(10)	(676)
Net cash provided by (used in) investing activities	119	(689)
FINANCING ACTIVITIES		
Proceeds from issuance of common stock	19	39
Proceeds from borrowings on convertible senior notes, net of issuance costs	—	617
Proceeds from issuance of warrants	—	65
Purchase of convertible note hedge	—	(107)
Payment of debt issuance costs	(2)	—
Excess tax benefit from stock-based compensation	—	4
Repurchase and retirement of common stock	(336)	(230)
Acquisition-related contingent consideration payment	(28)	—
Net cash provided by (used in) financing activities	(347)	388
Effect of foreign exchange on cash and cash equivalents	2	(26)
Decrease in cash and cash equivalents	(135)	(337)
Beginning cash and cash equivalents	1,293	1,579
Ending cash and cash equivalents	$1,158	$1,242
Supplemental cash flow information:		
Cash paid (refunded) during the period for income taxes, net	$21	$(4)

Cash paid during the period for interest	$2	$—
Non-cash investing activities:		
Change in unrealized gains on available-for-sale securities, net of taxes	$(34)	$(16)
Equity issued in connection with acquisition	$—	$87

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

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

(1) DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

We develop, market, publish and distribute game software content and services that can be played by consumers on a variety of platforms, including video game consoles (such as the Sony PLAYSTATION 3, Microsoft Xbox 360, and Nintendo Wii), personal computers, mobile devices (such as the Apple iPhone and Google Android compatible phones), tablets and electronic readers (such as the Apple iPad and Amazon Kindle), and the Internet. Our ability to publish games across multiple platforms, through multiple distribution channels, and directly to consumers (online and wirelessly) has been, and will continue to be, a cornerstone of our product strategy. We have generated substantial growth in new business models and alternative revenue streams (such as subscription, micro-transactions, and advertising) based on the continued expansion of our online and wireless product and service offerings. Some of our games are based on our own wholly-owned intellectual property (e.g., Battlefield, Mass Effect, Need for Speed, The Sims, Bejeweled, and Plants v. Zombies), and some of our games are based on content that we license from others (e.g., FIFA, Madden NFL, and Star Wars: The Old Republic). Our goal is to turn our core intellectual properties into year-round businesses available on a range of platforms. Our products and services may be purchased through physical and online retailers, platform providers such as console manufacturers and mobile carriers via digital downloads, as well as directly through our own distribution platform, including online portals such as Origin and Play4Free.

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, 2013 and 2012 contain 52 weeks each, and ends or ended, as the case may be, on March 30, 2013 and March 31, 2012, respectively. Our results of operations for the three and nine months ended December 31, 2012 and 2011 contained 13 and 39 weeks each, respectively, and ended on December 29, 2012 and December 31, 2011, 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, 2012, as filed with the United States Securities and Exchange Commission (“SEC”) on May 25, 2012.

(2) SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition

We evaluate revenue recognition based on the criteria set forth in Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 605, Revenue Recognition and ASC 985-605, Software: Revenue Recognition. We classify our revenue as either product revenue or service and other revenue.

Product revenue. Our product revenue includes revenue associated with the sale of software games or related content, whether delivered via a physical disc (e.g., packaged goods) or via the Internet (e.g., full-game downloads, micro-transactions), and licensing of game software to third-parties. Product revenue also includes revenue from mobile full game downloads that do not require our hosting support, and sales of tangible products such as hardware, peripherals, or collectors' items.

Service and other revenue. Our service revenue includes revenue recognized from time-based subscriptions and games or related content that requires our hosting support in order to utilize the game or related content (i.e., cannot be played without an Internet connection). This includes (1) entitlements to content that are accessed through hosting services (e.g., micro-transactions for Internet-based, social network and mobile games), (2) massively multi-player online (“MMO”) games (both software game and subscription sales), (3) subscriptions for our Pogo-branded online game services, and (4) allocated service revenue from sales of software games with an online service element (i.e., “matchmaking” service). Our other revenue includes advertising and non-software licensing revenue.

Table of Contents

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

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

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

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

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

- Delivery. Delivery is considered to occur when a product is shipped and the risk of loss and rewards of ownership have transferred to the customer. For digital downloads, delivery is considered to occur when the software is made available to the customer for download. For services and other, delivery is generally considered to occur as the service is delivered, which is determined based on the underlying service obligation.

Online-Enabled Games

The majority of our software games can be connected to the Internet whereby a consumer may be able to download unspecified content or updates on a when-and-if-available basis (“unspecified updates”) for use with the original game software. In addition, we may also offer an online matchmaking service that permits consumers to play against each other via the Internet. Accounting principles generally accepted in the United States (“U.S. GAAP”) requires us to account for the consumer’s right to receive unspecified updates or the matchmaking service for no additional fee as a “bundled” sale, or multiple-element arrangement.

We have an established historical pattern of providing unspecified updates to online-enabled software games (e.g., player roster updates to Madden NFL 13) at no additional charge to the consumer. We do not have vendor specific objective evidence of fair value (“VSOE”) for these unspecified updates, and thus, as required by U.S. GAAP, we recognize revenue from the sale of these online-enabled games over the period we expect to offer the unspecified updates to the consumer (“estimated offering period”).

Estimated Offering Period

The offering period is not an explicitly defined period and thus, we recognize revenue over an estimated offering period, which is generally estimated to be six months beginning in the month after delivery.

Determining the estimated offering period is inherently subjective and is subject to regular revision based on historical online usage. For example, in determining the estimated offering period for unspecified updates associated with our online-enabled games, we consider the period of time consumers are online as online connectivity is required. On an annual basis, we review consumers' online gameplay of all online-enabled games that have been released 12 to 24 months prior to the evaluation date. For example, if the evaluation date is April 1, 2012, we evaluate all online-enabled games released between April 1, 2010 and March 31, 2011. Based on this population of games, for all players that register the game online within the first six months of release of the game to the general public, we compute the weighted-average number of days for each online-enabled game, based on when a player initially registers the game online to when that player last plays the game online. We then compute the weighted-average number of days for all online-enabled games by multiplying the weighted-average number of days for each online-enabled game by its relative percentage of total units sold from these online-enabled games (i.e., a game with more units sold will have a higher weighting to the overall computation than a game with fewer units sold). Under a similar computation, we also consider the estimated period of time between the date a game unit is sold to a reseller and the date the reseller sells the game unit to an end consumer. Based on the sum of these two calculations, we then consider the results from prior years,

Table of Contents

known online gameplay trends, as well as disclosed service periods for competitors' games to determine the estimated offering period for unspecified updates. Similar computations are also made for the estimated service period related to our MMO games, which is generally estimated to be eighteen months.

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

Other Multiple-Element Arrangements

In some of our multiple element arrangements, we sell tangible products with software and/or software-related offerings. These tangible products are generally either peripherals or ancillary collectors' items, such as figurines and comic books. Revenue for these arrangements is allocated to each separate unit of accounting for each deliverable using the relative selling prices of each deliverable in the arrangement based on the selling price hierarchy described below. If the arrangement contains more than one software deliverable, the arrangement consideration is allocated to the software deliverables as a group and then allocated to each software deliverable in accordance with ASC 985-605.

We determine the selling price for a tangible product deliverable based on the following selling price hierarchy: VSOE (i.e., the price we charge when the tangible product is sold separately) if available, third-party evidence (“TPE”) of fair value (i.e., the price charged by others for similar tangible products) if VSOE is not available, or our best estimate of selling price (“BESP”) if neither VSOE nor TPE is available. Determining the BESP is a subjective process that is based on multiple factors including, but not limited to, recent selling prices and related discounts, market conditions, customer classes, sales channels and other factors. In accordance with ASC 605, provided the other three revenue recognition criteria other than delivery have been met, we recognize revenue upon delivery to the customer as we have no further obligations.

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

Sales Returns and Allowances and Bad Debt Reserves

We reduce revenue primarily for estimated future returns and price protection which may occur with our distributors and retailers (“channel partners”). Price protection represents our practice to provide our channel partners with a credit allowance to lower their wholesale price on a particular product in the channel. The amount of the price protection is generally the difference between the old wholesale price and the new reduced wholesale price. In certain countries for our PC and console packaged goods software products, we also have a practice of allowing channel partners to return older software products in the channel in exchange for a credit allowance. As a general practice, we do not give cash refunds.

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

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

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

Table of Contents

(3) FAIR VALUE MEASUREMENTS

There are various valuation techniques used to estimate fair value, the primary of which 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 consider assumptions that market participants would use when pricing the asset or liability. We measure certain financial and nonfinancial assets and liabilities at fair value on a recurring and nonrecurring basis.

Fair Value Hierarchy

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

As of December 31, 2012 and March 31, 2012, our assets and liabilities that were measured and recorded at fair value on a recurring basis were as follows (in millions):

		Fair Value Measurements at Reporting Date Using			
		Quoted Prices in Active Markets for Identical Financial Instruments	Significant Other Observable Inputs	Significant Unobservable Inputs	
	As of December 31, 2012	(Level 1)	(Level 2)	(Level 3)	Balance Sheet Classification
Assets					
Money market funds	$363	$363	$—	$—	Cash equivalents
Available-for-sale securities:					
Corporate bonds	149	—	149	—	Short-term investments
U.S. agency securities	68	—	68	—	Short-term investments
Marketable equity securities	59	59	—	—	Marketable equity securities
U.S. Treasury securities	56	56	—	—	Short-term investments
Commercial paper	3	—	3	—	Short-term investments and cash equivalents
Deferred compensation plan assets (a)	11	11	—	—	Other assets
Foreign currency derivatives	2	—	2	—	Other current assets
Total assets at fair value	$711	$489	$222	$—	
Liabilities					
Contingent consideration (b)	$42	$—	$—	$42	Accrued and other current liabilities and other liabilities
Total liabilities at fair value	$42	$—	$—	$42	

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

Contingent

	Consideration
Balance as of March 31, 2012	$112
Change in fair value [c]	(65)
Payments [d]	(5)
Balance as of December 31, 2012	$42

10

Table of Contents

		Fair Value Measurements at Reporting Date Using			
	As of March 31, 2012	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
Assets					
Money market funds	$490	$490	$—	$—	Cash equivalents
Available-for-sale securities:					
U.S. Treasury securities	170	170	—	—	Short-term investments and cash equivalents
Corporate bonds	150	—	150	—	Short-term investments
Marketable equity securities	119	119	—	—	Marketable equity securities
U.S. agency securities	116	—	116	—	Short-term investments
Commercial paper	16	—	16	—	Short-term investments and cash equivalents
Deferred compensation plan assets (a)	11	11	—	—	Other assets
Foreign currency derivatives	2	—	2	—	Other current assets
Total assets at fair value	$1,074	$790	$284	$—	
Liabilities					
Contingent consideration (b)	$112	$—	$—	$112	Accrued and other current liabilities and other liabilities
Total liabilities at fair value	$112	$—	$—	$112	

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
	Contingent Consideration
Balance as of March 31, 2011	$51
Additions	100
Change in fair value (c)	11
Payment (d)	(25)
Reclassification (e)	(25)
Balance as of March 31, 2012	$112

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

(b) The contingent consideration as of December 31, 2012 and March 31, 2012 represents the estimated fair value of the additional variable cash consideration payable primarily in connection with our acquisitions of PopCap Games, Inc. (“PopCap”), KlickNation Corporation (“KlickNation”), and Chillingo Limited (“Chillingo”) that are contingent upon the achievement of certain performance milestones. We estimated the fair value of the acquisition-related contingent consideration payable using probability-weighted discounted cash flow models, and applied a discount rate that appropriately captures the risk associated with the obligation. The weighted average of the discount rates used during the nine months ended December 31, 2012 and during the fiscal year 2012, was 12 percent. The significant unobservable input used in the fair value measurement of the contingent consideration payable are forecasted earnings. Significant changes in forecasted earnings would result in a significantly higher or lower fair value measurement. At December 31, 2012 and March 31, 2012, the fair market value of acquisition-related contingent consideration totaled $42 million and $112 million, respectively, compared to a maximum potential payout of $566 million and $572 million, respectively.

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

Table of Contents

(d) During the nine months ended December 31, 2012, we made payments totaling $5 million to settle certain performance milestones achieved in connection with two of our acquisitions. During the fourth quarter of fiscal year 2012, we made a payment of $25 million to settle certain performance milestones achieved through December 31, 2011 in connection with our acquisition of Playfish Limited ("Playfish").

(e) During the fourth quarter of fiscal year 2012, we reclassified $25 million of contingent consideration in connection with our acquisition of Playfish to other current liabilities in our Condensed Consolidated Balance Sheet as the contingency was settled. This amount was paid during the second quarter of fiscal 2013.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

During the three and nine months ended December 31, 2012, our assets that were measured and recorded at fair value on a nonrecurring basis and the related impairments on those assets were as follows:

		Fair Value Measurements at Reporting Date Using				
	Net Carrying Value as of December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Impairments for the Three Months Ended December 31, 2012	Total Impairments for the Nine Months Ended December 31, 2012
Assets						
Acquisition-related intangible assets	$15	$—	$—	$ 15	$6	$8
Total impairments recorded for nonrecurring measurements on assets held as of December 31, 2012					$6	$8

During the three and nine months ended December 31, 2012, we became aware of facts and circumstances that indicated that the carrying value of some of our acquisition-related intangible assets were not recoverable. This impairment is included in cost of product revenue on our Condensed Consolidated Statement of Operations. During the three and nine months ended December 31, 2011, there were no material impairment charges for assets and liabilities measured at fair value on a nonrecurring basis in periods subsequent to initial recognition.

(4) FINANCIAL INSTRUMENTS

Cash and Cash Equivalents

As of December 31, 2012 and March 31, 2012, our cash and cash equivalents were $1,158 million and $1,293 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, 2012 and March 31, 2012 (in millions):

	As of December 31, 2012				As of March 31, 2012			
	Cost or Amortized Cost	Gross Unrealized		Fair Value	Cost or Amortized Cost	Gross Unrealized		Fair Value
		Gains	Losses			Gains	Losses	
Corporate bonds	$148	$1	$—	$149	$149	$1	$—	$150
U.S. agency securities	68	—	—	68	116	—	—	116
U.S. Treasury securities	56	—	—	56	166	—	—	166
Commercial paper	2	—	—	2	5	—	—	5
Short-term investments	$274	$1	$—	$275	$436	$1	$—	$437

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, the severity of the impairment, the 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

Table of Contents

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 these investments to be other-than-temporarily impaired as of December 31, 2012 and March 31, 2012.

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of December 31, 2012 and March 31, 2012 (in millions):

	As of December 31, 2012		As of March 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Short-term investments				
Due in 1 year or less	$65	$65	$207	$207
Due in 1-2 years	96	97	123	124
Due in 2-3 years	113	113	106	106
Short-term investments	$274	$275	$436	$437

Marketable Equity Securities

Our investments in marketable equity securities 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 the 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 recognize an impairment charge at that time in our Condensed Consolidated Statements of Operations.

Marketable equity securities consisted of the following as of December 31, 2012 and March 31, 2012 (in millions):

	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of December 31, 2012	$21	$38	$—	$59
As of March 31, 2012	$32	$87	$—	$119

Our marketable equity securities as of December 31, 2012 and March 31, 2012 consisted of common shares of Neowiz Corporation and Neowiz Games, collectively referred to as "Neowiz." We did not recognize any impairment charges during the three and nine months ended December 31, 2012 and 2011 on our marketable equity securities. During the three months ended December 31, 2012, we sold a portion of our investment in Neowiz and received proceeds of $25 million and realized a gain of $14 million, net of costs to sell. The realized gain is included in gain on strategic investments, net, in our Condensed Consolidated Statement of Operations. Subsequent to December 31, 2012, we sold our remaining investment in Neowiz for $46 million and realized a gain of $25 million, net of costs to sell. We did not sell any of our marketable securities during the nine months ended December 31, 2011.

0.75% Convertible Senior Notes Due 2016

The following table summarizes the carrying value and fair value of our 0.75% Convertible Senior Notes due 2016 as of December 31, 2012 and March 31, 2012 (in millions):

	As of December 31, 2012		As of March 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
0.75% Convertible Senior Notes due 2016	$554	$583	$539	$584

The carrying value of the 0.75% Convertible Senior Notes due 2016 excludes the fair value of the equity conversion feature, which was classified as equity upon issuance, while the fair value is based on quoted market prices for the 0.75% Convertible Senior Notes due 2016, which includes the equity conversion feature. The fair value of the 0.75% Convertible Senior Notes due 2016 is classified as level 2 within the fair value hierarchy. See Note 12 for additional information related to our 0.75% Convertible Senior Notes due 2016.

13

Table of Contents

(5) 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 12 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 qualify for hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedges and must be highly effective in offsetting changes to future cash flows on hedged transactions. The 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. As of December 31, 2012, we had foreign currency option contracts to purchase approximately $86 million in foreign currency and to sell approximately $179 million of foreign currency. All of the foreign currency option contracts outstanding as of December 31, 2012 will mature in the next 12 months. As of March 31, 2012, we had foreign currency option contracts to purchase approximately $74 million in foreign currency and to sell approximately $78 million of foreign currency. As of December 31, 2012 and March 31, 2012, these foreign currency option contracts outstanding had a total fair value of $2 million, after each date, and are included in other current assets.

The effective and ineffective portions 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, 2012 and 2011 were 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, 2012, we had foreign currency forward contracts to purchase and sell approximately $523 million in foreign currencies. Of this amount, $489 million represented contracts to sell foreign currencies in exchange for U.S. dollars, $26 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, 2012, we had foreign currency forward contracts to purchase and sell approximately $242 million in foreign currencies. Of this amount, $197 million represented contracts to sell foreign currencies in exchange for U.S. dollars, $37 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 December 31, 2012 and March 31, 2012, the fair value of our foreign currency forward contracts was immaterial and is included in accrued and other liabilities.

Table of Contents

The effect of foreign currency forward contracts in our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2012 and 2011, was as follows (in millions):

		Amount of Gain (Loss) Recognized in Income from Derivatives			
	Location of Gain (Loss) Recognized in Income from Derivatives	Three Months Ended December 31,		Nine Months Ended December 31,	
		2012	2011	2012	2011
Foreign currency forward contracts not designated as hedging instruments	Interest and other income (expense), net	$(10)	$19	$(9)	$33

(6) BUSINESS COMBINATIONS

During the nine months ended December 31, 2012, we completed one acquisition that did not have a significant impact on our Condensed Consolidated Financial Statements.

(7) GOODWILL AND ACQUISITION-RELATED INTANGIBLES, NET

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

	EA Labels Segment
As of March 31, 2012	
Goodwill	$2,086
Accumulated impairment	(368)
Total	1,718
Activity for the nine months ended December 31, 2012	
Goodwill acquired	3
Effects of foreign currency translation	3
Total for the nine months ended December 31, 2012	6
As of December 31, 2012	
Goodwill	2,092
Accumulated impairment	(368)
Total	$1,724

Amortization of intangibles for the three and nine months ended December 31, 2012 and 2011 are classified in the Condensed Consolidated Statement of Operations as follows (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Cost of product	$15	$10	$32	$18
Cost of service and other	8	4	20	7
Operating expenses	7	11	21	37
Total	$30	$25	$73	$62

Table of Contents

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

	As of December 31, 2012			As of March 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net
Developed and core technology	$524	$ (274)	$ 250	$518	$ (229)	$ 289
Trade names and trademarks	130	(94)	36	131	(84)	47
Registered user base and other intangibles	90	(85)	5	90	(80)	10
Carrier contracts and related	85	(72)	13	85	(67)	18
In-process research and development	—	—	—	5	—	5
Total	$829	$ (525)	$ 304	$829	$ (460)	$ 369

Acquisition-related intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the agreement terms, typically from two to fourteen years. As of December 31, 2012 and March 31, 2012, the weighted-average remaining useful life for acquisition-related intangible assets was approximately 4.4 years and 5.7 years, respectively.

As of December 31, 2012, future amortization of acquisition-related intangibles that will be recorded in the Condensed Consolidated Statement of Operations is estimated as follows (in millions):

Fiscal Year Ending March 31,	
2013 (remaining three months)	$20
2014	80
2015	75
2016	61
2017	33
2018	11
Thereafter	24
Total	$304

(8) RESTRUCTURING AND OTHER CHARGES

Restructuring and other restructuring plan-related information as of December 31, 2012 was as follows (in millions):

	Fiscal 2013 Restructuring			Fiscal 2011 Restructuring		Other Restructurings and Reorganization		
	Workforce	Facilities-related	Other	Workforce	Other	Facilities-related	Other	Total
Balances as of March 31, 2011	$—	$—	$—	$3	$101	$8	$5	$117
Charges to operations	—	—	—	(1)	21	(12)	8	16
Charges settled in cash	—	—	—	(2)	(47)	7	(13)	(55)
Balances as of March 31, 2012	—	—	—	—	75	3	—	78
Charges to operations	10	4	9	—	5	(1)	—	27
Charges settled in cash	(10)	—	(1)	—	(16)	(1)	—	(28)
Changes settled in non-cash	—	(1)	(7)	—	—	1	—	(7)
Balances as of December 31, 2012	$—	$3	$1	$—	$64	$2	$—	$70

Fiscal 2013 Restructuring

On May 7, 2012, we announced a restructuring plan to align our cost structure with our ongoing digital transformation. Under this plan, we reduced our workforce, terminated licensing agreements, and consolidated or closed various facilities. As of December 31, 2012, we have completed all actions under this restructuring plan.

Table of Contents

Since the inception of the fiscal 2013 restructuring plan through December 31, 2012, we have incurred charges of $23 million, consisting of (1) $10 million in employee-related expenses, (2) $9 million related to license termination costs, and (3) $4 million related to the closure of certain of our facilities. Substantially all of these costs will be settled in cash by March 31, 2013, with the exception of approximately $4 million of license and lease termination costs, which will be settled by August 2016. We do not expect to incur any additional restructuring charges under this plan.

Fiscal 2011 Restructuring

In fiscal year 2011, we announced 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 had workforce reductions and facilities closures through March 31, 2011. Substantially all of these exit activities were completed by March 31, 2011.

Since the inception of the fiscal 2011 restructuring plan through December 31, 2012, we have incurred charges of $173 million, consisting of (1) $130 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) $12 million in employee-related expenses. The $64 million restructuring accrual as of December 31, 2012 related to the fiscal 2011 restructuring is expected to be settled by June 2016. We currently estimate recognizing in future periods through June 2016, approximately $9 million for the accretion of interest expense related to our amended licensing and developer agreements, of which $1 million will be recognized during the remainder of fiscal year 2013. This interest expense will be included in restructuring and other charges in our Condensed Consolidated Statement of Operations.

Overall, including $173 million in charges incurred through December 31, 2012, we expect to incur total cash and non-cash charges between $180 million and $185 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 $170 million) and (2) employee-related costs ($12 million).

Other Restructurings and Reorganization

We also engaged in various other restructurings and a reorganization based on management decisions made prior to fiscal 2011. We do not expect to incur any additional restructuring charges under these plans. The $2 million restructuring accrual as of December 31, 2012 related to our other restructuring plans is expected to be settled by September 2016.

(9) ROYALTIES AND LICENSES

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

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

Our contracts with some licensors include minimum guaranteed royalty payments, which are initially recorded as an asset and as a liability at the contractual amount when no performance remains with the licensor. When performance remains with the licensor, we record guarantee payments as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract. Royalty liabilities are classified as current liabilities to the extent such royalty payments are contractually due within the next 12 months.

Each quarter, we also evaluate the expected future realization of our royalty-based assets, as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are charged to research and development expense.

Table of Contents

Impairments or losses determined post-launch are charged to cost of revenue. We evaluate long-lived royalty-based assets for impairment generally 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 nine months ended December 31, 2012, we recognized losses of $15 million on previously unrecognized royalty-based commitments, inclusive of $9 million in license termination costs related to our fiscal 2013 restructuring. During the three months ended December 31, 2011, we did not recognize any losses or impairment charges on unrecognized minimum royalty-based commitments and royalties-based assets. During the nine months ended December 31, 2011, we recognized additional losses of $14 million representing an adjustment to our fiscal 2011 restructuring. The losses related to restructuring and other plan-related activities are presented in Note 8.

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, 2012	As of March 31, 2012
Other current assets	$47	$85
Other assets	92	102
Royalty-related assets	$139	$187

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, 2012	As of March 31, 2012
Accrued royalties	$123	$98
Other accrued expenses	23	23
Other liabilities	50	52
Royalty-related liabilities	$196	$173

As of December 31, 2012, $1 million of restructuring accruals related to the fiscal 2013 restructuring plan, and $64 million of restructuring accruals related to the fiscal 2011 restructuring plan are included in royalty-related liabilities in the table above. See Note 8 for details of restructuring and other restructuring plan-related activities and Note 10 for the details of our accrued and other current liabilities.

In addition, as of December 31, 2012, we were committed to pay approximately $1,166 million to content licensors, independent software developers, and co-publishing and/or distribution affiliates, but performance remained with the counterparty (i.e., delivery of the product or content or other factors) and such commitments were therefore not recorded in our Condensed Consolidated Financial Statements. See Note 13 for further information on our developer and licensor commitments.

(10) BALANCE SHEET DETAILS

Inventories

Inventories as of December 31, 2012 and March 31, 2012 consisted of (in millions):

	As of December 31, 2012	As of March 31, 2012
Raw materials and work in process	$1	$—
Finished goods	58	59
Inventories	$59	$59

Property and Equipment, Net

Property and equipment, net, as of December 31, 2012 and March 31, 2012 consisted of (in millions):

	As of December 31, 2012	As of March 31, 2012
Computer equipment and software	$649	$575
Buildings	340	339
Leasehold improvements	131	121
Office equipment, furniture and fixtures	72	72
Land	64	64
Warehouse equipment and other	10	10
Construction in progress	9	38
	1,275	1,219
Less: accumulated depreciation	(725)	(651)
Property and equipment, net	$550	$568

Depreciation expense associated with property and equipment was $30 million and $87 million for the three and nine months ended December 31, 2012, respectively. Depreciation expense associated with property and equipment was $23 million and $74 million for the three and nine months ended December 31, 2011, respectively.

Acquisition-Related Restricted Cash Included in Other Current Assets

Included in other current assets on our Condensed Consolidated Balance Sheets was $6 million and $31 million of acquisition-related restricted cash as of December 31, 2012 and March 31, 2012, respectively. As these deposits are restricted in nature, they are excluded from cash and cash equivalents.

Accrued and Other Current Liabilities

Accrued and other current liabilities as of December 31, 2012 and March 31, 2012 consisted of (in millions):

	As of December 31, 2012	As of March 31, 2012
Other accrued expenses	$332	$441
Deferred net revenue (other)	198	85
Accrued compensation and benefits	187	233
Accrued royalties	123	98
Accrued and other current liabilities	$840	$857

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 $1,213 million and $1,048 million as of December 31, 2012 and March 31, 2012, respectively. Deferred net revenue (packaged goods and digital content) generally includes the unrecognized revenue from bundled sales of certain online-enabled games for which we do not have VSOE for the obligation to provide unspecified updates. We recognize revenue from the sales of online-enabled games for which we do not have VSOE for the unspecified updates on a straight-line basis, generally over an estimated six-month period beginning in the month after shipment. However, we expense the cost of revenue related to these transactions during the period in which the product is delivered (rather than on a deferred basis).

(11) INCOME TAXES

We estimate our annual effective tax rate at the end of each quarterly period, and we record the tax effect of certain discrete items, which are unusual or occur infrequently, in the interim period in which they occur, including changes in judgment about deferred tax valuation allowances. In addition, jurisdictions with a projected loss for the year, jurisdictions with a year-to-date

Table of Contents

loss where no tax benefit can be recognized, and jurisdictions where we are unable to estimate an annual effective tax rate are excluded from the estimated annual effective tax rate. The impact of such an exclusion could result in a higher or lower effective tax rate during a particular quarter depending on the mix and timing of actual earnings versus annual projections.

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

During the three and nine months ended December 31, 2011, we recorded approximately $3 million and $58 million, respectively, of additional net deferred tax liabilities related to the PopCap and KlickNation acquisitions. These additional deferred tax liabilities create a new source of taxable income, thereby requiring us to release a portion of our deferred tax asset valuation allowance with a related reduction in income tax expense for the three and nine months ended December 31, 2011 of approximately $3 million and $58 million, respectively.

The provision for income taxes reported for the three and nine months ended December 31, 2012 is based on our projected annual effective tax rate for fiscal year 2013, and also includes certain discrete tax benefits recorded during the period. Our effective tax rate for the three and nine months ended December 31, 2012 was a tax expense of 36.4 percent and 17.8 percent, respectively, as compared to a tax expense of 6.2 percent and a tax benefit of 5.5 percent, respectively, for the same periods of fiscal 2012. The effective tax rate for the three and nine months ended December 31, 2012 differs from the statutory rate of 35.0 percent primarily due to the U.S. losses for which no benefit is recognized, the nontaxable change in the estimated fair value of acquisition-related contingent consideration, and non-U.S. losses with a reduced or zero tax benefit. The effective tax rate for the three and nine months ended December 31, 2011 differs from the statutory rate of 35.0 percent primarily due to the utilization of U.S. deferred tax assets which were subject to a valuation allowance, a reduction in the U.S. valuation allowance related to the PopCap acquisition, and non-U.S. profits subject to a reduced or zero tax rate. The effective tax rate for the three and nine months ended December 31, 2012 differs from the same period in fiscal year 2012 primarily due to greater tax benefits recorded in fiscal year 2012 related to the reduction of the U.S. valuation allowance for the PopCap acquisition.

During the three months ended December 31, 2012, we recorded a net increase of $5 million in gross unrecognized tax benefits. The total gross unrecognized tax benefits as of December 31, 2012 is $288 million, of which approximately $46 million is 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, 2012, if recognized, approximately $106 million of the unrecognized tax benefits would affect our effective tax rate and approximately $170 million would result in adjustments to deferred tax assets with corresponding adjustments to the valuation allowance.

During the three months ended December 31, 2012, we recorded a net increase in taxes of $1 million for accrued interest and penalties related to tax positions taken on our tax returns. As of December 31, 2012, 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 $24 million.

The IRS has completed its examination of our federal income tax returns through fiscal year 2008. As of December 31, 2012, the IRS had proposed certain adjustments to our tax returns. The effects of these adjustments have been considered in estimating our future obligations for unrecognized tax benefits and are not expected to have a material impact on our financial position or results of operations. Some of these proposed adjustments are pending resolution by the Appeals division of the IRS. Furthermore, the IRS is currently examining our returns for fiscal years 2009 through 2011.

We are also currently under income tax examination in Canada for fiscal years 2004 and 2005, and in France for fiscal years 2006 through 2007. We remain subject to income tax examination for several other jurisdictions including Canada for fiscal years after 2003, in France for fiscal years after 2008, in Germany for fiscal years after 2007, in the United Kingdom for fiscal years after 2009, 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 $84 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.

(12) FINANCING ARRANGEMENTS

0.75% Convertible Senior Notes Due 2016

In July 2011, we issued $632.5 million aggregate principal amount of 0.75% Convertible Senior Notes due 2016 (the “Notes”). The Notes are senior unsecured obligations which pay interest semiannually in arrears at a rate of 0.75 percent per annum on January 15 and July 15 of each year, beginning on January 15, 2012 and will mature on July 15, 2016, unless earlier purchased or converted in accordance with their terms prior to such date. The Notes are senior in right of payment to any unsecured indebtedness that is expressly subordinated in right of payment to the Notes.

The Notes are convertible into cash and shares of our common stock based on an initial conversion value of 31.5075 shares of our common stock per $1,000 principal amount of Notes (equivalent to an initial conversion price of approximately $31.74 per share). Upon conversion of the Notes, holders will receive cash up to the principal amount of each Note, and any excess conversion value will be delivered in shares of our common stock. Prior to April 15, 2016, the Notes are convertible only if (1) the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130 percent of the conversion price ($41.26 per share) on each applicable trading day; (2) during the five business day period after any ten consecutive trading day period in which the trading price per $1,000 principal amount of notes falls below 98 percent of the last reported sale price of our common stock multiplied by the conversion rate on each trading day; or (3) specified corporate transactions, including a change in control, occur. On or after April 15, 2016, a holder may convert any of its Notes at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date. The conversion rate is subject to customary anti-dilution adjustments (for example, certain dividend distributions or tender or exchange offer of our common stock), but will not be adjusted for any accrued and unpaid interest. The Notes are not redeemable prior to maturity except for specified corporate transactions and events of default, and no sinking fund is provided for the Notes. The Notes do not contain any financial covenants.

We separately account for the liability and equity components of the Notes. The carrying amount of the equity component representing the conversion option is equal to the fair value of the Convertible Note Hedge, as described below, which is a substantially identical instrument and was purchased on the same day as the Notes. The carrying amount of the liability component was determined by deducting the fair value of the equity component from the par value of the Notes as a whole, and represents the fair value of a similar liability that does not have an associated convertible feature. A liability of $525 million as of the date of issuance was recognized for the principal amount of the Notes representing the present value of the Notes’ cash flows using a discount rate of 4.54 percent. The excess of the principal amount of the liability component over its carrying amount is amortized to interest expense over the term of the Notes using the effective interest method. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for $15 million of issuance costs related to the Notes issuance, we allocated $13 million to the liability component and $2 million to the equity component. Debt issuance costs attributable to the liability component are being amortized to interest expense over the term of the Notes, and issuance costs attributable to the equity component were netted with the equity component in additional paid-in capital.

Table of Contents

The carrying values of the liability and equity components of the Notes are reflected in our Condensed Consolidated Balance Sheet as follows (in millions):

	As of December 31, 2012	As of March 31, 2012
Principal amount of Notes	$633	$633
Unamortized discount of the liability component	(79)	(94)
Net carrying amount of Notes	$554	$539
Equity component, net	$105	$105

As of December 31, 2012, the remaining life of the Notes is 3.5 years.

Convertible Note Hedge and Warrants Issuance

In addition, in July 2011, we entered into privately negotiated convertible note hedge transactions (the “Convertible Note Hedge”) with certain counterparties to reduce the potential dilution with respect to our common stock upon conversion of the Notes. The Convertible Note Hedge, subject to customary anti-dilution adjustments, provides us with the option to acquire, on a net settlement basis, approximately 19.9 million shares of our common stock at a strike price of $31.74, which corresponds to the conversion price of the Notes and is equal to the number of shares of our common stock that notionally underlie the Notes. As of December 31, 2012, we have not purchased any shares under the Convertible Note Hedge. We paid $107 million for the Convertible Note Hedge, which was recorded as an equity transaction.

Separately, in July 2011 we also entered into privately negotiated warrant transactions with the certain counterparties whereby we sold to independent third parties warrants (the “Warrants”) to acquire, subject to customary anti-dilution adjustments that are substantially the same as the anti-dilution provisions contained in the Notes, up to 19.9 million shares of our common stock (which is also equal to the number of shares of our common stock that notionally underlie the Notes), with a strike price of $41.14. The Warrants could have a dilutive effect with respect to our common stock to the extent that the market price per share of our common stock exceeds $41.14 on or prior to the expiration date of the Warrants. We received proceeds of $65 million from the sale of the Warrants.

Credit Facility

On August 30, 2012, we entered into a $500 million 3.5 years senior unsecured revolving credit facility with a syndicate of banks. The credit facility terminates on February 29, 2016 and contains an option to arrange with existing lenders and/or new lenders for them to provide up to an aggregate of $250 million in additional commitments for revolving loans. Proceeds of loans made under the credit facility may be used for general corporate purposes.

The loans bear interest, at our option, at the base rate plus an applicable spread or an adjusted LIBOR rate plus an applicable spread, in each case with such spread being determined based on our consolidated leverage ratio for the preceding fiscal quarter. We are also obligated to pay other customary fees for a credit facility of this size and type. Interest is due and payable in arrears quarterly for loans bearing interest at the base rate and at the end of an interest period (or at each three month interval in the case of loans with interest periods greater than three months) in the case of loans bearing interest at the adjusted LIBOR rate. Principal, together with all accrued and unpaid interest, is due and payable on February 29, 2016.

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

The credit agreement contains customary events of default, including among others, non-payment defaults, covenant defaults, bankruptcy and insolvency defaults and a change of control default, in each case, subject to customary exceptions for a credit facility of this size and type. The occurrence of an event of default could result in the acceleration of the obligations under the credit agreement, an obligation by any guarantors to repay the obligations in full and an increase in the applicable interest rate.

As of December 31, 2012, no amounts were outstanding under the credit facility. During the three months ended September 30, 2012, we paid $2 million of debt issuance costs in connection with obtaining this credit facility. These costs are deferred and are being amortized to interest expense over the 3.5 years term of the credit facility.

Table of Contents

Interest expense recognized related to our financing arrangements are as follows (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Amortization of debt discount	$5	$5	$15	$9
Amortization of debt issuance costs	—	—	2	1
Coupon interest expense	1	1	3	2
Other interest expense	1	1	1	1
Total interest expense	$7	$7	$21	$13

(13) COMMITMENTS AND CONTINGENCIES

Lease Commitments

As of December 31, 2012, we leased certain facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.

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

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

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include: 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, Tiger Woods and Augusta National (professional golf); National Hockey League and NHL Players’ Association (professional hockey); National Football League Properties, PLAYERS Inc., and Red Bear Inc. (professional football); Collegiate Licensing Company (collegiate football); Zuffa, LLC (Ultimate Fighting Championship); ESPN (content in EA SPORTS games); Hasbro, Inc. (most of Hasbro’s toy and game intellectual properties); and LucasArts and Lucas Licensing (Star Wars: The Old Republic). These developer and content license commitments represent the sum of (1) the cash payments due under non-royalty-bearing licenses and services agreements and (2) the minimum guaranteed payments and advances against royalties due under royalty-bearing licenses and services agreements, the majority of which are conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.

Table of Contents

The following table summarizes our minimum contractual obligations as of December 31, 2012 (in millions):

		Fiscal Year Ending March 31,						
	Total	2013 (Remaining three mos.)	2014	2015	2016	2017	2018	Thereafter
Unrecognized commitments								
Developer/licensor commitments	$1,166	$42	$174	$166	$207	$70	$54	$453
Marketing commitments	239	14	54	34	34	20	20	63
Operating leases	177	13	51	42	28	16	11	16
0.75% Convertible Senior Notes due 2016 interest [(a)]	19	2	5	5	5	2	—	—
Other purchase obligations	47	14	23	9	1	—	—	—
Total unrecognized commitments	1,648	85	307	256	275	108	85	532
Recognized commitments								
0.75% Convertible Senior Notes due 2016 principal [(a)]	633	—	—	—	—			