

ELECTRONIC ARTS INC.
Form 10-Q
February 06, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
p 1934
For the Quarterly Period Ended December 31, 2017
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 94-2838567

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

209 Redwood Shores Parkway 94065

Redwood City, California
(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 NO

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

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

Large accelerated filer Accelerated filer ..

Non-accelerated filer Smaller reporting company ..

Emerging growth company (Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

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As of February 2, 2018, there were 306,727,995 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.

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PART I – FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

ELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

| (Unaudited) (In millions, except par value data) | December 31, 2017 | March 31, 2017 (a) |
|--|----------------------|--------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,566 | \$2,565 |
| Short-term investments | 2,318 | 1,967 |
| Receivables, net of allowances of \$231 and \$145, respectively | 886 | 359 |
| Other current assets | 196 | 308 |
| Total current assets | 5,966 | 5,199 |
| Property and equipment, net | 447 | 434 |
| Goodwill | 1,879 | 1,707 |
| Acquisition-related intangibles, net | 81 | 8 |
| Deferred income taxes, net | 159 | 286 |
| Other assets | 110 | 84 |
| TOTAL ASSETS | \$ 8,642 | \$7,718 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 91 | \$87 |
| Accrued and other current liabilities | 1,070 | 789 |
| Deferred net revenue (online-enabled games) | 1,946 | 1,539 |
| Total current liabilities | 3,107 | 2,415 |
| Senior notes, net | 992 | 990 |
| Income tax obligations | 194 | 104 |
| Deferred income taxes, net | 2 | 1 |
| Other liabilities | 261 | 148 |
| Total liabilities | 4,556 | 3,658 |
| Commitments and contingencies (See Note 12) | | |
| Stockholders' equity: | | |
| Common stock, \$0.01 par value. 1,000 shares authorized; 307 and 308 shares issued and outstanding, respectively | 3 | 3 |
| Additional paid-in capital | 723 | 1,049 |
| Retained earnings | 3,455 | 3,027 |
| Accumulated other comprehensive loss | (95 |) (19) |
| Total stockholders' equity | 4,086 | 4,060 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 8,642 | \$7,718 |

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

(a) Derived from audited Consolidated Financial Statements.

Table of ContentsELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

| (Unaudited) | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------|----------------------|---------|
| (In millions, except per share data) | December 31, | | December 31, | |
| | 2017 | 2016 | 2017 | 2016 |
| Net revenue: | | | | |
| Product | \$547 | \$ 649 | \$1,829 | \$1,753 |
| Service and other | 613 | 500 | 1,739 | 1,565 |
| Total net revenue | 1,160 | 1,149 | 3,568 | 3,318 |
| Cost of revenue: | | | | |
| Product | 352 | 389 | 716 | 796 |
| Service and other | 149 | 127 | 328 | 300 |
| Total cost of revenue | 501 | 516 | 1,044 | 1,096 |
| Gross profit | 659 | 633 | 2,524 | 2,222 |
| Operating expenses: | | | | |
| Research and development | 329 | 285 | 985 | 870 |
| Marketing and sales | 230 | 240 | 511 | 511 |
| General and administrative | 120 | 110 | 343 | 329 |
| Amortization of intangibles | 1 | 2 | 4 | 5 |
| Total operating expenses | 680 | 637 | 1,843 | 1,715 |
| Operating income (loss) | (21) | (4) | 681 | 507 |
| Interest and other income (expense), net | 5 | (2) | 14 | (13) |
| Income (loss) before provision for (benefit from) income taxes | (16) | (6) | 695 | 494 |
| Provision for (benefit from) income taxes | 170 | (5) | 259 | 93 |
| Net income (loss) | \$(186) | \$ (1) | \$436 | \$401 |
| Earnings (loss) per share: | | | | |
| Basic | \$(0.60) | \$ (0.00) | \$1.41 | \$1.33 |
| Diluted | \$(0.60) | \$ (0.00) | \$1.40 | \$1.28 |
| Number of shares used in computation: | | | | |
| Basic | 308 | 303 | 309 | 302 |
| Diluted | 308 | 303 | 312 | 314 |
| See accompanying Notes to Condensed Consolidated Financial Statements (unaudited). | | | | |

Table of ContentsELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

| (Unaudited) | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|---|-------|---|-------|
| (In millions) | 2017 | 2016 | 2017 | 2016 |
| Net income (loss) | \$(186) | \$(1) | \$436 | \$401 |
| Other comprehensive income (loss), net of tax: | | | | |
| Net losses on available-for-sale securities | (4) | (5) | (4) | (5) |
| Net gains (losses) on derivative instruments | (6) | 31 | (96) | 48 |
| Foreign currency translation adjustments | (12) | (17) | 24 | (28) |
| Total other comprehensive income (loss), net of tax | (22) | 9 | (76) | 15 |
| Total comprehensive income (loss) | \$(208) | \$8 | \$360 | \$416 |

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

Table of ContentsELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| (Unaudited) | Nine Months Ended | |
|---|----------------------|----------|
| (In millions) | December 31, 2017 | 2016 |
| OPERATING ACTIVITIES | | |
| Net income | \$436 | \$401 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation, amortization and accretion | 97 | 140 |
| Stock-based compensation | 173 | 144 |
| Change in assets and liabilities: | | |
| Receivables, net | (527) | (367) |
| Other assets | 79 | 40 |
| Accounts payable | 16 | (6) |
| Accrued and other liabilities | 265 | 276 |
| Deferred income taxes, net | 130 | — |
| Deferred net revenue (online-enabled games) | 408 | 513 |
| Net cash provided by operating activities | 1,077 | 1,141 |
| INVESTING ACTIVITIES | | |
| Capital expenditures | (87) | (94) |
| Proceeds from maturities and sales of short-term investments | 1,656 | 968 |
| Purchase of short-term investments | (2,012) | (1,372) |
| Acquisition, net of cash acquired | (150) | — |
| Net cash used in investing activities | (593) | (498) |
| FINANCING ACTIVITIES | | |
| Payment of convertible notes | — | (163) |
| Proceeds from issuance of common stock | 57 | 33 |
| Cash paid to taxing authorities for shares withheld from employees | (112) | (112) |
| Repurchase and retirement of common stock | (453) | (383) |
| Net cash used in financing activities | (508) | (625) |
| Effect of foreign exchange on cash and cash equivalents | 25 | (28) |
| Increase (decrease) in cash and cash equivalents | 1 | (10) |
| Beginning cash and cash equivalents | 2,565 | 2,493 |
| Ending cash and cash equivalents | \$2,566 | \$2,483 |
| Supplemental cash flow information: | | |
| Cash paid during the period for income taxes, net | \$46 | \$51 |
| Cash paid during the period for interest | 21 | 23 |
| Non-cash investing activities: | | |
| Change in accrued capital expenditures | \$(13) | \$(16) |

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

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

(1) DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

We are a global leader in digital interactive entertainment. We develop, market, publish and deliver games, content and online services that can be played by consumers on a variety of platforms, which include game consoles, PCs, mobile phones and tablets. In our games, we use established brands that we either wholly own (such as Battlefield, Mass Effect, Need for Speed, The Sims and Plants v. Zombies) or license from others (such as FIFA, Madden NFL and Star Wars). We also publish and distribute games developed by third parties.

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 year ending March 31, 2018 contains 52 weeks and ends on March 31, 2018. Our results of operations for the fiscal year ended March 31, 2017 contained 52 weeks and ended on April 1, 2017. Our results of operations for the three months ended December 31, 2017 and 2016 contained 13 weeks each and ended on December 30, 2017 and December 31, 2016, respectively. Our results of operations for the nine months ended December 31, 2017 and 2016 contained 39 weeks each and ended on December 30, 2017 and December 31, 2016, 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 Condensed Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017, as filed with the United States Securities and Exchange Commission (“SEC”) on May 24, 2017.

Reclassifications

Certain prior year amounts were reclassified to conform to current year presentation.

Recently Adopted Accounting Standards

We adopted Accounting Standards Update (“ASU”) 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, at the beginning of fiscal year 2018. We reflected excess tax benefits of \$40 million for the nine months ended December 31, 2017 in the Condensed Consolidated Statement of Income as a component of the provision for income taxes, whereas for the three and nine months ended December 31, 2016 they were recognized in additional paid-in-capital in the Condensed Consolidated Balance Sheets. The impact was immaterial for the three months ended December 31, 2017.

The pronouncement also resulted in two changes to our cash flow presentation, which we applied retrospectively for comparability. Excess tax benefits are now presented as operating activities rather than financing activities, and cash payments to tax authorities in connection with shares withheld to meet statutory tax withholding requirements are now presented as a financing activity instead of an operating activity. The net increase to our reported net cash provided by operating activities and corresponding increase to cash used in financing activities resulting from the adoption of ASU 2016-09 for the nine months ended December 31, 2017 and 2016 are as follows:

| | |
|----------------|-----------|
| | Nine |
| | months |
| | ended |
| | December |
| | 31, |
| (In millions): | 2017 2016 |

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| | | |
|---|-------|-------|
| Excess tax benefits from stock-based compensation | \$40 | \$53 |
| Cash paid to taxing authorities for shares withheld from employees | 112 | 112 |
| Increase to net cash provided by operating activities and net cash used in financing activities | \$152 | \$165 |

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Impact of Recently Issued Accounting Standards

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), (the “New Revenue Standard”), which will replace existing guidance under U.S. GAAP, including industry-specific requirements, and will provide companies with a single principles-based revenue recognition model for recognizing revenue from contracts with customers. The core principle of the New Revenue Standard is that a company should recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. In addition, the FASB has issued several amendments to the New Revenue Standard, including principal versus agent considerations, clarifications on identification of performance obligations, and accounting for licenses of intellectual property. The amendments are intended to address implementation issues that were raised by stakeholders and provide additional practical expedients to reduce the cost and complexity of adoption.

The New Revenue Standard is effective for us beginning in the first quarter of fiscal year 2019 and permits the use of either the full retrospective or modified retrospective transition methods. We anticipate adopting the New Revenue Standard on April 1, 2018 using the modified retrospective method, which recognizes the cumulative effect of initially applying the New Revenue Standard as an adjustment to retained earnings at the adoption date. We have reached conclusions on several key accounting assessments related to the New Revenue Standard and have identified certain impacts to our Condensed Consolidated Financial Statements.

The New Revenue Standard will have a significant impact on our Condensed Consolidated Financial Statements and related disclosures as it relates to the accounting for substantially all of our transactions with multiple elements or “bundled” arrangements. For example, for sales of online-enabled games, as currently reported we do not have vendor-specific objective evidence of fair value (“VSOE”) for unspecified future updates, and thus, revenue from the entire sales price is recognized ratably over the estimated offering period. However, under the New Revenue Standard, the VSOE requirement for undelivered elements is eliminated, allowing us to essentially “break-apart” our online-enabled games and account for the various promised goods or services identified as separate performance obligations.

For example, for the sale of an online-enabled game, we usually have multiple distinct performance obligations such as software, future update rights, and an online service. The software performance obligation represents the initial game delivered digitally or via physical disc. The future update rights performance obligation may include software patches or updates, maintenance, and/or additional free content to be delivered in the future. And lastly, the online service performance obligation consists of providing the customer with a service of online activities (e.g., online playability). Under current software revenue recognition rules, we recognize as revenue the entire sales price over the estimated offering period. However, under the New Revenue Standard, we currently estimate that a significant portion of the sales price will be allocated to the software performance obligation and recognized upon delivery, and the remaining portion will be allocated to the future update rights and the online service performance obligations and recognized ratably over the estimated offering period. As a result, we expect a significant portion of our annual revenue, and thereby annual profit, will shift from the first and fourth fiscal quarters to the second and third fiscal quarters which is historically when a significant portion of our annual bookings and software deliveries have been made. Further, we expect the net cumulative effect adjustment upon adoption to result in a pre-tax increase to retained earnings in the range of \$600 million to \$800 million. The range is based on our actual results through the third quarter of fiscal 2018 and our forecast of sales activity during the fourth quarter of fiscal 2018. These initial estimates will continue to be refined as we approach the adoption of the New Revenue Standard.

In addition, both portions of sales price allocated to future update rights and online services will be classified as service revenue under the New Revenue Standard (currently, future update rights are generally presented as product revenue). Therefore, upon adoption, an increased portion of our sales from online-enabled games will be presented as service revenue than is currently reported today. Also, upon adoption of the New Revenue Standard, a substantial majority of our sales returns and price protection reserves will be classified as liabilities (currently, these allowances are classified as contra-assets within receivables on our Condensed Consolidated Balance Sheets).

We expect to further refine our estimate of the impact to our consolidated financial statements during the fourth quarter of fiscal year 2018. We will continue to monitor additional changes, modifications, clarifications or

interpretations by the SEC, which may impact current expectations. It is possible that during the fourth quarter of fiscal year 2018, we could identify items that result in additional material changes to our Condensed Consolidated Financial Statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments (Topic 825-10), which requires that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The ASU also impacts financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. The requirements will be effective for us beginning in the first quarter of fiscal year 2019. We do not expect the adoption to have a material impact on our Condensed Consolidated Financial Statements.

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In March 2016, the FASB issued ASU 2016-04, Liabilities – Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products. The amendments in the ASU are designed to provide guidance and eliminate diversity in the accounting for derecognition of prepaid stored-value product liabilities. Typically, a prepaid stored-value product liability is to be derecognized when it is probable that a significant reversal of the recognized breakage amount will not subsequently occur. This is when the likelihood of the product holder exercising its remaining rights becomes remote. This estimate shall be updated at the end of each period. The amendments in this ASU are effective for us beginning in the first quarter of fiscal year 2019. Early adoption is permitted. We do not expect the adoption to have a material impact on our Condensed Consolidated Financial Statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This update is intended to reduce the existing diversity in practice in how certain transactions are classified in the statement of cash flows. This update is effective for us beginning in the first quarter of fiscal year 2019. Early adoption is permitted, provided that all of the amendments are adopted in the same period. We do not expect the adoption to have a material impact on our Condensed Consolidated Financial Statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force), which requires amounts generally described as restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown in the statement of cash flows. This update is effective for us beginning in the first quarter of fiscal year 2019. Early adoption is permitted. We do not expect the adoption to have a material impact on our Condensed Consolidated Financial Statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The FASB issued this standard to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. We anticipate adopting this standard beginning in the first quarter of fiscal year 2020, when the updated guidance is effective for us. We are currently evaluating the impact of this new standard on our Condensed Consolidated Financial Statements and related disclosures.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This update is intended to make more financial and nonfinancial hedging strategies eligible for hedge accounting. It also amends the presentation and disclosure requirements and changes how companies assess effectiveness. This update is effective for us beginning in the first quarter of fiscal year 2020. Early adoption is permitted. We are currently evaluating the timing of adoption and impact of this new standard on our Condensed Consolidated Financial Statements and related disclosures.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326). The standard changes the methodology for measuring credit losses on financial instruments and the timing of when such losses are recorded. ASU 2016-13 is effective for us beginning in the first quarter of fiscal year 2021. Early adoption is permitted beginning in the first quarter of fiscal year 2020. We are currently evaluating the timing of adoption and impact of this new standard on our Condensed Consolidated Financial Statements and related disclosures.

In January 2017, the FASB issued ASU 2017-04, Intangibles—Goodwill and Other (Topic 350). The standard simplifies the goodwill impairment test. This update removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. This update is effective for us beginning in the first quarter of fiscal year 2021. Early adoption is permitted for any impairment tests performed after January 1, 2017. We anticipate early adopting ASU 2017-04 during the fourth quarter of fiscal year 2018. We do not expect the adoption to have a material impact on our Condensed Consolidated Financial Statements.

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(2) FAIR VALUE MEASUREMENTS

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

Fair Value Hierarchy

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

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

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

As of December 31, 2017 and March 31, 2017, 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 | | | | Balance Sheet Classification |
|--|---|--|---|--|---|
| | As of December 31, 2017 | Quoted Prices in Active Markets for Identical Financial Instruments (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| Assets | | | | | |
| Bank and time deposits | \$ 299 | \$ 299 | \$ — | \$ — | Cash equivalents |
| Money market funds | 563 | 563 | — | — | Cash equivalents |
| Available-for-sale securities: | | | | | |
| Corporate bonds | 1,258 | — | 1,258 | — | Short-term investments and cash equivalents |
| U.S. Treasury securities | 446 | 446 | — | — | Short-term investments |
| U.S. agency securities | 118 | — | 118 | — | Short-term investments and cash equivalents |
| Commercial paper | 341 | — | 341 | — | Short-term investments and cash equivalents |
| Foreign government securities | 100 | — | 100 | — | Short-term investments and cash equivalents |
| Asset-backed securities | 134 | — | 134 | — | Short-term investments |
| Certificates of deposit | 22 | — | 22 | — | Short-term investments |
| Foreign currency derivatives | 8 | — | 8 | — | Other current assets and other assets |
| Deferred compensation plan assets ^(a) | 10 | 10 | — | — | Other assets |
| Total assets at fair value | \$ 3,299 | \$ 1,318 | \$ 1,981 | \$ — | |

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Liabilities

| | | | | | |
|---|--------|-------|-------|--------|---|
| Contingent consideration ^(b) | \$ 122 | \$ — | \$ — | \$ 122 | Other liabilities |
| Foreign currency derivatives | 41 | — | 41 | — | Accrued and other current liabilities and other liabilities |
| Deferred compensation plan liabilities ^(a) | 11 | 11 | — | — | Other liabilities |
| Total liabilities at fair value | \$ 174 | \$ 11 | \$ 41 | \$ 122 | |

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| | |
|---------------------------------|--|
| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Contingent Consideration |
| Balance as of March 31, 2017 | \$ — |
| Additions | 122 |
| Balance as of December 31, 2017 | \$ 122 |

| | Fair Value Measurements at Reporting Date Using | | | | Balance Sheet Classification |
|---|---|--|---------------------------------------|------|---|
| | Quoted Prices in Active Markets for Identical Financial Instruments | Significant Other Observable Inputs | Significant Unobservable Inputs | | |
| As of March 31, 2017 | (Level 1) | (Level 2) | (Level 3) | | |
| Assets | | | | | |
| Bank and time deposits | \$233 | \$ 233 | \$ — | \$ — | Cash equivalents |
| Money market funds | 405 | 405 | — | — | Cash equivalents |
| Available-for-sale securities: | | | | | |
| Corporate bonds | 963 | — | 963 | — | Short-term investments and cash equivalents |
| U.S. Treasury securities | 460 | 460 | — | — | Short-term investments and cash equivalents |
| U.S. agency securities | 172 | — | 172 | — | Short-term investments and cash equivalents |
| Commercial paper | 270 | — | 270 | — | Short-term investments and cash equivalents |
| Foreign government securities | 113 | — | 113 | — | Short-term investments |
| Asset-backed securities | 135 | — | 135 | — | Short-term investments |
| Foreign currency derivatives | 19 | — | 19 | — | Other current assets and other assets |
| Deferred compensation plan assets ^(a) | 8 | 8 | — | — | Other assets |
| Total assets at fair value | \$2,778 | \$ 1,106 | \$ 1,672 | \$ — | |
| Liabilities | | | | | |
| Foreign currency derivatives | \$8 | \$ — | \$ 8 | \$ — | Accrued and other current liabilities and other liabilities |
| Deferred compensation plan liabilities ^(a) | 9 | 9 | — | — | Other liabilities |
| Total liabilities at fair value | \$17 | \$ 9 | \$ 8 | \$ — | |

(a) The Deferred Compensation Plan assets consist of various mutual funds. See Note 13 in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017, for additional information regarding our Deferred

Compensation Plan.

(b) The contingent consideration represents the estimated fair value of the additional variable cash consideration payable in connection with our acquisition of Respawn Entertainment, LLC (“Respawn”) that is contingent upon the achievement of certain performance milestones. We estimated the fair value using a probability-weighted income approach combined with a real options methodology, and applied a discount rate that appropriately captures the risk associated with the obligation. The discount rates used ranged from 2.7 percent to 3.3 percent. See Note 6 for additional information regarding the Respawn acquisition.

(3) FINANCIAL INSTRUMENTS

Cash and Cash Equivalents

As of December 31, 2017 and March 31, 2017, our cash and cash equivalents were \$2,566 million and \$2,565 million, respectively. Cash equivalents were valued using quoted market prices or other readily available market information.

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Short-Term Investments

Short-term investments consisted of the following as of December 31, 2017 and March 31, 2017 (in millions):

| | As of December 31, 2017 | | | Fair Value | As of March 31, 2017 | | | Fair Value |
|-------------------------------|-------------------------|-----------|-------------------------------|------------|----------------------|-----------|-------------------------------|------------|
| | Cost | Amortized | Gross Unrealized Gains/Losses | | Cost | Amortized | Gross Unrealized Gains/Losses | |
| Corporate bonds | \$1,212 | \$ — | \$ (3) | \$1,209 | \$944 | \$ — | \$ (1) | \$943 |
| U.S. Treasury securities | 448 | — | (2) | 446 | 414 | — | (1) | 413 |
| U.S. agency securities | 117 | — | (2) | 115 | 152 | — | (1) | 151 |
| Commercial paper | 294 | — | — | 294 | 212 | — | — | 212 |
| Foreign government securities | 98 | — | — | 98 | 113 | — | — | 113 |
| Asset-backed securities | 135 | — | (1) | 134 | 135 | — | — | 135 |
| Certificates of deposit | 22 | — | — | 22 | — | — | — | — |
| Short-term investments | \$2,326 | \$ — | \$ (8) | \$2,318 | \$1,970 | \$ — | \$ (3) | \$1,967 |

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of December 31, 2017 and March 31, 2017 (in millions):

| | As of December 31, 2017 | | As of March 31, 2017 | |
|----------------------------|-------------------------|------------|----------------------|------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Short-term investments | | | | |
| Due within 1 year | \$1,598 | \$1,596 | \$1,237 | \$1,236 |
| Due 1 year through 5 years | 725 | 719 | 721 | 719 |
| Due after 5 years | 3 | 3 | 12 | 12 |
| Short-term investments | \$2,326 | \$2,318 | \$1,970 | \$1,967 |

(4) DERIVATIVE FINANCIAL INSTRUMENTS

The assets or liabilities associated with our derivative instruments and hedging activities are recorded at fair value in other current assets/other assets, or accrued and other current liabilities/other 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 forward contracts, generally with maturities of 18 months or less, to reduce the volatility of cash flows primarily related to forecasted revenue and expenses denominated in certain foreign currencies. Our cash flow risks are primarily related to fluctuations in the Euro, British pound sterling, Canadian dollar, Swedish krona, Australian dollar, Chinese yuan and South Korean won. In addition, we utilize foreign currency forward contracts to mitigate foreign currency exchange risk associated with foreign-currency-denominated monetary assets and liabilities, primarily intercompany receivables and payables. The foreign currency forward contracts not designated as hedging instruments generally have a contractual term of approximately three months or less and are transacted near month-end. We do not use foreign currency forward contracts for speculative trading purposes.

Table of Contents**Cash Flow Hedging Activities**

Certain of our forward 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 derivative assets or liabilities associated with our hedging activities are recorded at fair value in other current assets/other assets, or accrued and other current liabilities/other liabilities, respectively, on our Condensed Consolidated Balance Sheets. 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 (loss) 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 (loss) 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 (loss) to interest and other income (expense), net, in our Condensed Consolidated Statements of Operations.

Total gross notional amounts and fair values for currency derivatives with cash flow hedge accounting designation are as follows (in millions):

| | As of December 31, 2017 | | | As of March 31, 2017 | | |
|-------------------------------|-------------------------|------------|-----------------|----------------------|------------|-----------------|
| | Notional Amount | Fair Value | Asset/Liability | Notional Amount | Fair Value | Asset/Liability |
| Forward contracts to purchase | \$209 | \$5 | \$ 1 | \$185 | \$— | \$ 5 |
| Forward contracts to sell | \$985 | \$1 | \$ 33 | \$840 | \$19 | \$ 3 |

The net impact of the effective portion of gains and losses from our cash flow hedging activities in our Condensed Consolidated Statements of Operations was a loss of \$8 million for the three months ended December 31, 2017 and a gain of \$8 million for the three months ended December 31, 2016.

The net impact of the effective portion of gains and losses from our cash flow hedging activities in our Condensed Consolidated Statements of Operations was a gain of \$14 million for the nine months ended December 31, 2017 and a gain of \$18 million for the nine months ended December 31, 2016.

The amount excluded from the assessment of hedge effectiveness during the three months ended December 31, 2017 and 2016 and recognized in interest and other income (expense), net, was immaterial.

The amount excluded from the assessment of hedge effectiveness was a gain of \$7 million for the nine months ended December 31, 2017 and recognized in interest and other income (expense), net. The amount excluded from the assessment of hedge effectiveness was immaterial for the nine months ended December 31, 2016.

Balance Sheet Hedging Activities

Our foreign currency forward contracts that are not designated as hedging instruments are accounted for as derivatives whereby the fair value of the contracts are 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.

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Total gross notional amounts and fair values for currency derivatives that are not designated as hedging instruments are accounted for as follows (in millions):

| | As of December 31, 2017 | | As of March 31, 2017 | |
|-------------------------------|----------------------------|-------------------------------|-------------------------|-------------------------------|
| | Notional Amount | Fair Value Asset/Liability | Notional Amount | Fair Value Asset/Liability |
| Forward contracts to purchase | \$354 | \$1 | \$87 | \$— |
| Forward contracts to sell | \$785 | \$7 | \$166 | \$— |

The effect of foreign currency forward contracts not designated as hedging instruments in our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2017 and 2016, was as follows (in millions):

| | Statement of Operations Classification | Amount of Gain (Loss) Recognized in the Statement of Operations | | | |
|---|---|--|-------|--|-------|
| | | Three Months Ended December 31, 2017 | | Nine Months Ended December 31, 2016 | |
| Foreign currency forward contracts not designated as hedging instruments | Interest and other income (expense), net | \$ (4) | \$ 49 | \$ (13) | \$ 50 |

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(5) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The changes in accumulated other comprehensive income (loss) by component, net of tax, for the three months ended December 31, 2017 and 2016 are as follows (in millions):

| | Unrealized Net Gains (Losses) on Available-for-Sale Securities | Unrealized Net Gains (Losses) on Derivative Instruments | Foreign Currency Translation Adjustments | Total |
|---|--|---|---|--------|
| Balances as of September 30, 2017 | \$ (3) | \$ (58) | \$ (12) | \$(73) |
| Other comprehensive income (loss) before reclassifications | (4) | (14) | (12) | (30) |
| Amounts reclassified from accumulated other comprehensive income (loss) | — | 8 | — | 8 |
| Total other comprehensive income (loss), net of tax | (4) | (6) | (12) | (22) |
| Balance as of December 31, 2017 | \$ (7) | \$ (64) | \$ (24) | \$(95) |
| | Unrealized Net Gains (Losses) on Available-for-Sale Securities | Unrealized Net Gains (Losses) on Derivative Instruments | Foreign Currency Translation Adjustments | Total |
| Balances as of September 30, 2016 | \$ 1 | \$ 31 | \$ (42) | \$(10) |
| Other comprehensive income (loss) before reclassifications | (5) | 39 | (17) | 17 |
| Amounts reclassified from accumulated other comprehensive income (loss) | — | (8) | — | (8) |
| Total other comprehensive income (loss), net of tax | (5) | 31 | (17) | 9 |
| Balance as of December 31, 2016 | \$ (4) | \$ 62 | \$ (59) | \$(1) |

The changes in accumulated other comprehensive income (loss) by component, net of tax, for the nine months ended December 31, 2017 and 2016 are as follows (in millions):

| | Unrealized Net Gains (Losses) on Available-for-Sale Securities | Unrealized Net Gains (Losses) on Derivative Instruments | Foreign Currency Translation Adjustments | Total |
|---|--|---|---|--------|
| Balances as of March 31, 2017 | \$ (3) | \$ 32 | \$ (48) | \$(19) |
| Other comprehensive income (loss) before reclassifications | (4) | (82) | 34 | (52) |
| Amounts reclassified from accumulated other comprehensive income (loss) | — | (14) | (10) | (24) |
| Total other comprehensive income (loss), net of tax | (4) | (96) | 24 | (76) |
| Balance as of December 31, 2017 | \$ (7) | \$ (64) | \$ (24) | \$(95) |
| | Unrealized Net Gains (Losses) on Available-for-Sale Securities | Unrealized Net Gains (Losses) on Derivative Instruments | Foreign Currency Translation Adjustments | Total |
| Balances as of March 31, 2016 | \$ 1 | \$ 14 | \$ (31) | \$(16) |

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| | | | | | | | | | |
|---|----|----|-----|-----|----|--------|---|------|---|
| Other comprehensive income (loss) before reclassifications | (4 |) | 66 | (28 |) | 34 | | | |
| Amounts reclassified from accumulated other comprehensive income (loss) | (1 |) | (18 |) | — | (19 | | | |
| Total other comprehensive income (loss), net of tax | (5 |) | 48 | (28 |) | 15 | | | |
| Balance as of December 31, 2016 | \$ | (4 |) | \$ | 62 | \$ (59 |) | \$(1 |) |

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The effects on net income of amounts reclassified from accumulated other comprehensive income (loss) for the three and nine months ended December 31, 2017 were as follows (in millions):

| Statement of Operations Classification | Amount Reclassified From Accumulated Other Comprehensive Income (Loss) Three Months Ended December 31, 2017 | Nine Months Ended December 31, 2017 |
|---|--|---|
| (Gains) losses on cash flow hedges from forward contracts | | |
| Net revenue | \$ 9 | \$ (13) |
| Research and development | (1) | (1) |
| Total, net of tax | \$ 8 | \$ (14) |
| (Gains) losses on foreign currency translation | | |
| Interest and other income (expense), net | \$ — | \$ (10) |
| Total, net of tax | \$ — | \$ (10) |
| Total net (gain) loss reclassified, net of tax | \$ 8 | \$ (24) |

The effects on net income of amounts reclassified from accumulated other comprehensive income (loss) for the three and nine months ended December 31, 2016 were as follows (in millions):

| Statement of Operations Classification | Amount Reclassified From Accumulated Other Comprehensive Income (Loss) Three Months Ended December 31, 2016 | Nine Months Ended December 31, 2016 |
|---|--|---|
| (Gains) losses on available-for-sale securities | | |
| Interest and other income (expense), net | \$ — | \$ (1) |
| Total, net of tax | \$ — | \$ (1) |
| (Gains) losses on cash flow hedges from forward contracts | | |
| Net revenue | \$ (9) | \$ (18) |
| Research and development | 1 | — |
| Total, net of tax | \$ (8) | \$ (18) |

Total net (gain) loss reclassified, net of tax \$ (8) \$ (19)

(6) BUSINESS COMBINATIONS

Respawn Entertainment, LLC

On December 1, 2017, we completed our acquisition of Respawn Entertainment, LLC (“Respawn”), a leading game development studio and creators of games including the critically-acclaimed Titanfall franchise. The total purchase price was \$273 million, which consisted of \$151 million in cash and the acquisition date fair value of contingent consideration of \$122 million. The purchase price was preliminarily allocated to Respawn’s net tangible and intangible assets based upon their estimated fair values as of December 1, 2017, resulting in \$167 million being preliminarily allocated to goodwill that consists largely of workforce and synergies with our existing business, all of which is expected to be deductible for tax purposes. \$78 million was preliminarily allocated to intangible assets acquired; and \$28 million was preliminarily allocated to net tangible assets acquired. The fair values assigned to assets acquired and liabilities assumed are based on management’s best estimates and assumptions as of the reporting date and are considered preliminary pending finalization of the valuation analyses pertaining to assets acquired and liabilities assumed, valuation of the contingent consideration as well as the calculation of any deferred tax assets and liabilities. The Company expects to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

The payment of the contingent consideration is based on the achievement of certain performance milestones through the end of calendar year 2022 at the latest. The maximum amount of contingent consideration we may be required to pay is \$140 million. The fair value of the contingent consideration is included in other liabilities on our Condensed Consolidated Balance Sheet. As

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of December 31, 2017, there were no significant changes in the range of expected outcomes for the contingent consideration from the acquisition date.

Subsequent to the acquisition, we also granted an aggregate of \$167 million of restricted stock unit awards of our common stock to Respawn employees that will be recognized over a four year period as stock-based compensation expense. The fair value of these equity awards was based on the quoted market price of our common stock on the date of grant.

The results of operations of Respawn and the preliminary fair value of the assets acquired and liabilities assumed have been included in our Consolidated Financial Statements since the date of acquisition. Pro forma results of operations have not been presented because the effect of the acquisition was not material to our Consolidated Statements of Operations.

During the three and nine months ended December 31, 2016, there were no acquisitions.

(7) GOODWILL AND ACQUISITION-RELATED INTANGIBLES, NET

The changes in the carrying amount of goodwill for the nine months ended December 31, 2017 are as follows (in millions):

| | As of March 31, 2017 | Activity | Effects of Foreign Currency Translation | As of December 31, 2017 |
|------------------------|-------------------------------|----------|--|-------------------------------|
| Goodwill | \$2,075 | \$ 167 | \$ 5 | \$ 2,247 |
| Accumulated impairment | (368) | — | — | (368) |
| Total | \$1,707 | \$ 167 | \$ 5 | \$ 1,879 |

Goodwill represents the excess of the purchase price over the fair value of the underlying acquired net tangible and intangible assets.

During the three months ended December 31, 2017, we estimated, on a preliminary basis, goodwill acquired in our acquisition of Respawn. The Company expects to finalize the valuation of the Respawn acquisition as soon as practicable, but not later than one year from the acquisition date. Once completed, there may be material adjustments to our goodwill amounts.

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

| | As of December 31, 2017 | | | As of March 31, 2017 | | |
|--|-----------------------------|-----------------------------|---|-----------------------------|-----------------------------|---|
| | Gross Carrying Amount | Accumulated Amortization | Acquisition- Related Intangibles, Net | Gross Carrying Amount | Accumulated Amortization | Acquisition- Related Intangibles, Net |
| Developed and core technology | \$419 | \$ (412) | \$ 7 | \$412 | \$ (412) | \$ — |
| Trade names and trademarks | 153 | (103) | 50 | 106 | (98) | 8 |
| Registered user base and other intangibles | 5 | (5) | — | 5 | (5) | — |
| Carrier contracts and related | 85 | (85) | — | 85 | (85) | — |
| In-process research and development | 24 | — | 24 | — | — | — |
| Total | \$686 | \$ (605) | \$ 81 | \$608 | \$ (600) | \$ 8 |

During the three months ended December 31, 2017, we estimated, on a preliminary basis, the fair value of acquisition-related intangible assets of \$78 million in connection with the Respawn acquisition, of which \$47 million was allocated to trade names and trademarks, \$24 million are allocated to in-process research and development, and \$7 million was allocated to developed and core technology. Excluding the in-process research and development assets, the weighted-average useful life of the Respawn acquired intangible assets was approximately 7.1 years.

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Amortization of intangibles for the three and nine months ended December 31, 2017 and 2016 are classified in the Condensed Consolidated Statement of Operations as follows (in millions):

| | Three Months Ended December 31, 2017 | | Nine Months Ended December 31, 2016 | |
|---------------------------|---|-------|--|-------|
| Cost of service and other | \$ — | \$ — | \$ — | \$ 16 |
| Cost of product | 1 | 18 | 1 | 27 |
| Operating expenses | 1 | 2 | 4 | 5 |
| Total | \$ 2 | \$ 20 | \$ 5 | \$ 48 |

Acquisition-related intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the agreement terms, ranging from 1 to 14 years. As of December 31, 2017 and March 31, 2017, the weighted-average remaining useful life for acquisition-related intangible assets was approximately 6.7 years and 1.4 years, respectively.

As of December 31, 2017, 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, | |
| 2018 (remaining three months) | \$5 |
| 2019 | 13 |
| 2020 | 6 |
| 2021 | 6 |
| 2022 | 6 |
| 2023 | 6 |
| Thereafter | 15 |
| Total | \$57 |

(8) ROYALTIES AND LICENSES

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

Royalty-based obligations with content licensors and distribution affiliates are either paid in advance and capitalized as prepaid royalties or are accrued as incurred and subsequently paid. These royalty-based obligations are generally expensed to cost of revenue 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.

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 and service sales. Any impairments or losses determined before the launch of a product are generally charged to research and development expense. Impairments or losses determined post-launch are charged to cost of revenue. We evaluate long-lived royalty-based assets for impairment using undiscounted cash flows when impairment indicators exist. If an impairment exists, then the assets are written down to fair value. Unrecognized minimum royalty-based commitments are accounted for as executory contracts, and therefore, any losses on these commitments are recognized when the underlying intellectual property is abandoned (i.e., cease use) or the contractual rights to use the intellectual property are terminated.

During the three and nine months ended December 31, 2017, we did not recognize any material losses or impairment charges on royalty-based commitments.

During the three and nine months ended December 31, 2016, we determined that the carrying value of one of our royalty-based assets and previously unrecognized minimum royalty-based commitments were not recoverable. We recognized an impairment charge of \$12 million on the asset and a loss of \$10 million on the previously unrecognized minimum royalty-based commitment. Of the total \$22 million loss, \$10 million was included in cost of service revenue and \$12 million was included in research and development expenses in our Condensed Consolidated Statements of Operations.

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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, 2017 | As of March 31, 2017 |
|------------------------|-------------------------------|-------------------------------|
| Other current assets | \$ 20 | \$ 79 |
| Other assets | 34 | 39 |
| Royalty-related assets | \$ 54 | \$ 118 |

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 classify any recognized unpaid royalty amounts due 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, 2017 | As of March 31, 2017 |
|-----------------------------|-------------------------------|-------------------------------|
| Accrued royalties | \$ 260 | \$ 165 |
| Other liabilities | 80 | 97 |
| Royalty-related liabilities | \$ 340 | \$ 262 |

As of December 31, 2017, we were committed to pay approximately \$987 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 12 for further information on our developer and licensor commitments.

(9) BALANCE SHEET DETAILS

Property and Equipment, Net

Property and equipment, net, as of December 31, 2017 and March 31, 2017 consisted of (in millions):

| | As of December 31, 2017 | As of March 31, 2017 |
|--|-------------------------------|-------------------------------|
| Computer, equipment and software | \$ 724 | \$ 723 |
| Buildings | 336 | 316 |
| Leasehold improvements | 137 | 126 |
| Equipment, furniture and fixtures, and other | 81 | 82 |
| Land | 66 | 61 |
| Construction in progress | 7 | 7 |
| | 1,351 | 1,315 |
| Less: accumulated depreciation | (904) | (881) |
| Property and equipment, net | \$ 447 | \$ 434 |

During the three and nine months ended December 31, 2017, depreciation expense associated with property and equipment was \$30 million and \$89 million, respectively.

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During the three and nine months ended December 31, 2016, depreciation expense associated with property and equipment was \$29 million and \$86 million, respectively.

Accrued and Other Current Liabilities

Accrued and other current liabilities as of December 31, 2017 and March 31, 2017 consisted of (in millions):

| | As of December 31, 2017 | As of March 31, 2017 |
|---------------------------------------|-------------------------------|-------------------------------|
| Other accrued expenses | \$ 346 | \$ 210 |
| Accrued compensation and benefits | 249 | 267 |
| Accrued royalties | 260 | 165 |
| Deferred net revenue (other) | 215 | 147 |
| Accrued and other current liabilities | \$ 1,070 | \$ 789 |

Deferred net revenue (other) includes the deferral of subscription revenue, advertising revenue, licensing arrangements, and other revenue for which revenue recognition criteria has not been met.

Deferred Net Revenue (Online-Enabled Games)

Deferred net revenue (online-enabled games) was \$1,946 million and \$1,539 million as of December 31, 2017 and March 31, 2017, respectively. Deferred net revenue (online-enabled games) generally includes the unrecognized revenue from bundled sales of online-enabled games for which we do not have VSOE for the obligation to provide unspecified updates. We recognize revenue from the sale of online-enabled games for which we do not have vendor-specific objective evidence of fair value (“VSOE”) for the unspecified updates on a straight-line basis, generally over an estimated nine-month period beginning in the month after shipment for physical games sold through retail and an estimated six-month period for digitally-distributed games. However, we expense the cost of revenue related to these transactions generally during the period in which the product is delivered (rather than on a deferred basis).

(10) INCOME TAXES

The provision for income taxes for the three and nine months ended December 31, 2017 is based on our projected annual effective tax rate for fiscal year 2018, adjusted for specific items that are required to be recognized in the period in which they are incurred. Our effective tax rate and resulting provision for income taxes for the three and nine months ended December 31, 2017 was significantly impacted by the U.S. Tax Cuts and Jobs Act (the “U.S. Tax Act”), enacted on December 22, 2017. The U.S. Tax Act significantly revised the U.S. corporate income tax system by, among other things, lowering the U.S. corporate income tax rates, generally implementing a territorial tax system and imposing a one-time transition tax on the deemed repatriation of undistributed earnings of foreign subsidiaries (the “Transition Tax”).

Our effective tax rate for the three and nine months ended December 31, 2017 was negative 1,062.5 percent and positive 37.3 percent, respectively, as compared to 83.3 percent and 18.8 percent, respectively for the same periods in fiscal year 2017. The effective tax rate for the three and nine months ended December 31, 2017 was negatively impacted by the provisional income tax effects of the U.S. Tax Act, offset by earnings realized in countries that have lower statutory tax rates and the recognition of excess tax benefits from stock-based compensation. Without the provisional tax charge of the U.S. Tax Act, our effective tax rate for the three and nine months ended December 31, 2017 would have been 37.5 percent and 11.9 percent, respectively.

We have a March 31 fiscal year-end; therefore, the lower corporate tax rate enacted by the U.S. Tax Act will be phased in, resulting in a U.S. statutory federal rate of 31.6 percent for our fiscal year ending March 31, 2018, and 21.0 percent for subsequent fiscal years. When compared to the statutory rate of 31.6 percent, the effective tax rate for the three and nine months ended December 31, 2017 was higher primarily due to the income tax impacts of the U.S. Tax Act, offset by earnings realized in countries that have lower statutory tax rates and the recognition of excess tax benefits from stock-based compensation. We anticipate that the impact of excess tax benefits and tax deficiencies may result in significant fluctuations to our effective tax rate in the future. Excluding excess tax benefits, our effective tax rate would have been negative 1,075.0 percent and positive 43.6 percent, respectively, for the three and nine months

ended December 31, 2017.

We recorded a provision for income taxes of \$170 million and \$259 million for the three and nine months ended December 31, 2017, respectively, including \$176 million which is a reasonable estimate of the impacts of the U.S. Tax Act. We recorded a reasonable estimate of \$151 million related to the Transition Tax. The final calculations of the Transition Tax may differ from our estimates, potentially materially, due to, among other things, changes in interpretations of the U.S. Tax Act, our analysis of the U.S. Tax Act, or any updates or changes to estimates that we have utilized to calculate the transition impacts, including impacts from changes to current year earnings estimates and assertions.

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In addition, we provisionally recorded a tax charge related to the remeasurement of U.S. deferred tax assets and liabilities as a result of the reduction of the U.S. corporate tax rate and a tax benefit related to the deferred tax impacts of global intangible income. The impact of these, as well as certain other charges and benefits, were not material individually, or in the aggregate, and are provisional for the same reasons as stated above.

Reasonable estimates of the impacts of the U.S. Tax Act are provided in accordance with SEC guidance that allows for a measurement period of up to one year after the enactment date of the U.S. Tax Act to finalize the recording of the related tax impacts. We expect to complete the accounting under the U.S. Tax Act as soon as practicable, but in no event later than one year from the enactment date of the U.S. Tax Act.

We file income tax returns and are subject to income tax examinations in various jurisdictions with respect to fiscal years after 2008. The timing and potential resolution of income tax examinations is highly uncertain. While we continue to measure our uncertain tax positions, the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued. It is reasonably possible that a reduction of up to \$45 million of unrecognized tax benefits may occur within the next 12 months, a portion of which would impact our effective tax rate. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements.

(11) FINANCING ARRANGEMENTS**Senior Notes**

In February 2016, we issued \$600 million aggregate principal amount of 3.70% Senior Notes due March 1, 2021 (the “2021 Notes”) and \$400 million aggregate principal amount of 4.80% Senior Notes due March 1, 2026 (the “2026 Notes,” and together with the 2021 Notes, the “Senior Notes”). Our proceeds were \$989 million, net of discount of \$2 million and issuance costs of \$9 million. Both the discount and issuance costs are being amortized to interest expense over the respective terms of the 2021 Notes and the 2026 Notes using the effective interest rate method. The effective interest rate is 3.94% for the 2021 Notes and 4.97% for the 2026 Notes. Interest is payable semiannually in arrears, on March 1 and September 1 of each year.

The carrying and fair values of the Senior Notes are as follows (in millions):

| | As of December 31, 2017 | As of March 31, 2017 |
|--------------------------------------|-------------------------------|-------------------------------|
| Senior Notes: | | |
| 3.70% Senior Notes due 2021 | \$ 600 | \$600 |
| 4.80% Senior Notes due 2026 | 400 | 400 |
| Total principal amount | \$ 1,000 | \$1,000 |
| Unaccreted discount | (2) | (2) |
| Unamortized debt issuance costs | (6) | (8) |
| Net carrying value of Senior Notes | \$ 992 | \$990 |
| | | |
| Fair value of Senior Notes (Level 2) | \$ 1,059 | \$1,054 |

As of December 31, 2017, the remaining life of the 2021 Notes and 2026 Notes is approximately 3.2 years and 8.2 years, respectively.

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The Senior Notes are senior unsecured obligations and rank equally with all our other existing and future unsubordinated obligations and any indebtedness that we may incur from time to time under our Credit Facility.

The 2021 Notes and the 2026 Notes are redeemable at our option at any time prior to February 1, 2021 or December 1, 2025, respectively, subject to a make-whole premium. Within one and three months of maturity, we may redeem the 2021 Notes or the 2026 Notes, respectively, at a redemption price equal to 100% of the aggregate principal amount plus accrued and unpaid interest. In addition, upon the occurrence of a change of control repurchase event, the holders of the Senior Notes may require us to repurchase all or a portion of the Senior Notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The Senior Notes also include covenants that limit our ability to incur liens on assets and to enter into sale and leaseback transactions, subject to certain allowances.

Credit Facility

In March 2015, we entered into a \$500 million senior unsecured revolving credit facility (“Credit Facility”) with a syndicate of banks. The Credit Facility terminates on March 19, 2020. The Credit Facility contains an option to arrange with existing lenders and/or new lenders 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 March 19, 2020.

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.

The credit agreement contains customary events of default, including among others, non-payment defaults, covenant defaults, cross-defaults to material indebtedness, bankruptcy and insolvency defaults, material judgment 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 facility, an obligation by any guarantors to repay the obligations in full and an increase in the applicable interest rate.

As of December 31, 2017, no amounts were outstanding under the Credit Facility. \$2 million of debt issuance costs that were paid in connection with obtaining this credit facility are being amortized to interest expense over the 5-year term of the Credit Facility.

Interest Expense

The following table summarizes our interest expense recognized for the three and nine months ended December 31, 2017 and 2016 that is included in interest and other income (expense), net on our Condensed Consolidated Statements of Operations (in millions):

| | Three | Nine |
|--|--------|--------|
| | Months | Months |
| | Ended | Ended |

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| | December | | December | |
|-------------------------------------|----------|--------|----------|--------|
| | 31, | | 31, | |
| | 2017 | 2016 | 2017 | 2016 |
| Amortization of debt discount | \$— | \$— | \$— | \$(2) |
| Amortization of debt issuance costs | — | (1) | (1) | (2) |
| Coupon interest expense | (10) | (10) | (31) | (31) |
| Other interest expense | — | (1) | — | (1) |
| Total interest expense | \$(10) | \$(12) | \$(32) | \$(36) |

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(12) COMMITMENTS AND CONTINGENCIES

Lease Commitments

As of December 31, 2017, 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, but are not limited to: FIFA (Fédération Internationale de Football Association), FIFPRO Foundation, FAPL (Football Association Premier League Limited), and DFL Deutsche Fußball Liga E.V. (German Soccer League) (professional soccer); Dr. Ing. h.c. F. Porsche AG, Ferrari S.p.A. and Automobili Lamborghini S.p.A (Need For Speed and Real Racing games); National Basketball Association (professional basketball); National Hockey League and NHL Players’ Association (professional hockey); National Football League Properties and PLAYERS Inc. (professional football); William Morris Endeavor Entertainment LLC (professional mixed martial arts); ESPN (content in EA SPORTS games); Disney Interactive (Star Wars); and Fox Digital Entertainment, Inc. (The Simpsons). 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.

The following table summarizes our minimum contractual obligations as of December 31, 2017 (in millions):

| | | Fiscal Years Ending March 31, 2018 (Remaining three mos.) | | | | | | |
|-------------------------------------|---------|---|-------|-------|---------|-------|------------|--------|
| | Total | 2019 | 2020 | 2021 | 2022 | 2023 | Thereafter | |
| Unrecognized commitments | | | | | | | | |
| Developer/licensor commitments | \$987 | \$26 | \$224 | \$229 | \$205 | \$222 | \$80 | \$ 1 |
| Marketing commitments | 355 | 9 | 86 | 83 | 77 | 73 | 27 | — |
| Operating leases | 249 | 8 | 43 | 39 | 39 | 32 | 25 | 63 |
| Senior Notes interest | 227 | 7 | 41 | 41 | 41 | 20 | 19 | 58 |
| Other purchase obligations | 109 | 9 | 30 | 27 | 14 | 9 | 6 | 14 |
| Total unrecognized commitments | 1,927 | 59 | 424 | 419 | 376 | 356 | 157 | 136 |
| Recognized commitments | | | | | | | | |
| Senior Notes principal and interest | 1,013 | 13 | — | — | 600 | — | — | 400 |
| Licensing obligations | 107 | 6 | 23 | 25 | 26 | 27 | — | — |
| Total recognized commitments | 1,120 | 19 | 23 | 25 | 626 | 27 | — | 400 |
| Total commitments | \$3,047 | \$78 | \$447 | \$444 | \$1,002 | \$383 | \$157 | \$ 536 |

The unrecognized amounts represented in the table above reflect our minimum cash obligations for the respective fiscal years, but do not necessarily represent the periods in which they will be recognized and expensed in our

Condensed Consolidated Financial Statements.

In addition, the amounts in the table above are presented based on the dates the amounts are contractually due as of December 31, 2017; however, certain payment obligations may be accelerated depending on the performance of our operating results. Furthermore, up to \$32 million of the unrecognized amounts in the table above may be payable, at the licensor's

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election, in shares of our common stock, subject to a \$10 million maximum during any fiscal year. The number of shares to be issued will be based on their fair market value at the time of issuance.

In addition to what is included in the table above, as of December 31, 2017, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling \$98 million, of which we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur. Furthermore, we had a \$104 million income tax payable recorded during the three months ended December 31, 2017 related to the provisional Transition Tax, which we expect to pay in installments over the next 8 years. Of the \$104 million, \$8 million is included in accrued and other current liabilities and the remaining \$96 million is included in income tax obligations on our Condensed Consolidated Balance Sheet.

In addition to what is included in the table above, as of December 31, 2017, we may be required to pay up to \$140 million of cash consideration in connection with the Respawn acquisition based on the achievement of certain performance milestones through the end of calendar year 2022 at the latest. As of December 31, 2017, we have recorded \$122 million of contingent consideration on our Condensed Consolidated Balance Sheet representing the estimated fair value.

Legal Proceedings

On July 29, 2010, Michael Davis, a former NFL running back, filed a putative class action in the United States District Court for the Northern District of California against the Company, alleging that certain past versions of Madden NFL included the images of certain retired NFL players without their permission. In March 2012, the trial court denied the Company's request to dismiss the complaint on First Amendment grounds. In January 2015, that trial court decision was affirmed by the Ninth Circuit Court of Appeals and the case was remanded back to the United States District Court for the Northern District of California, where the case is pending.

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

(13) STOCK-BASED COMPENSATION

Valuation Assumptions

We estimate the fair value of stock-based awards on the date of grant. We recognize compensation costs for stock-based awards to employees based on the grant-date fair value using a straight-line approach over the service period for which such awards are expected to vest.

The determination of the fair value of market-based restricted stock units, stock options and ESPP purchase rights is affected by assumptions regarding subjective and complex variables. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. We determine the fair value of our stock-based awards as follows:

Restricted Stock Units and Performance-Based Restricted Stock Units. The fair value of restricted stock units and performance-based restricted stock units (other than market-based restricted stock units) is determined based on the quoted market price of our common stock on the date of grant.

Market-Based Restricted Stock Units. Market-based restricted stock units consist of grants of performance-based restricted stock units to certain members of executive management that vest contingent upon the achievement of pre-determined market and service conditions (referred to herein as "market-based restricted stock units"). The fair value of our market-based restricted stock units is determined using a Monte-Carlo simulation model. Key assumptions for the Monte-Carlo simulation model are the risk-free interest rate, expected volatility, expected dividends and correlation coefficient.

Stock Options and Employee Stock Purchase Plan. The fair value of stock options and stock purchase rights granted pursuant to our equity incentive plans and our 2000 Employee Stock Purchase Plan, as amended ("ESPP"), respectively,

is determined using the Black-Scholes valuation model based on the multiple-award valuation method. Key assumptions of the Black-Scholes valuation model are the risk-free interest rate, expected volatility, expected term and expected dividends. The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option. Expected volatility is based on a combination of historical stock price volatility and implied volatility of publicly-traded options on our common stock. Expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.

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There were an insignificant number of stock options granted during the three and nine months ended December 31, 2017 and 2016.

The estimated assumptions used in the Black-Scholes valuation model to value our ESPP purchase rights were as follows:

| | ESPP Purchase Rights | |
|-----------------------------|----------------------|---------------|
| | Three Months Ended | |
| | December 31, | |
| | 2017 | 2016 |
| Risk-free interest rate | 1.13 - 1.24% | 0.5 - 0.6% |
| Expected volatility | 28 | % 29 - 32% |
| Weighted-average volatility | 28 | % 31 |
| Expected term | 6 - 12 months | 6 - 12 months |
| Expected dividends | None | None |

There were no market-based restricted stock units granted during the three months ended December 31, 2017 and 2016.

Stock-Based Compensation Expense

Employee stock-based compensation expense recognized during the three and nine months ended December 31, 2016 was calculated based on awards ultimately expected to vest and was reduced for estimated forfeitures. We adopted ASU 2016-09 at the beginning of fiscal year 2018 and elected to account for forfeitures as they occur. The adoption resulted in a cumulative-effect adjustment of \$8 million, net of tax, decrease to retained earnings.

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

| | Three | | Nine | |
|----------------------------------|----------|-------|----------|--------|
| | Months | | Months | |
| | Ended | | Ended | |
| | December | | December | |
| | 31, | | 31, | |
| | 2017 | 2016 | 2017 | 2016 |
| Cost of revenue | \$ — | \$ — | \$ 2 | \$ 2 |
| Research and development | 38 | 27 | 102 | 81 |
| Marketing and sales | 8 | 8 | 24 | 23 |
| General and administrative | 17 | 13 | 45 | 38 |
| Stock-based compensation expense | \$ 63 | \$ 48 | \$ 173 | \$ 144 |

During the three months ended December 31, 2017, we recognized a \$4 million deferred income tax benefit related to our stock-based compensation expense. During the three months ended December 31, 2016, we recognized a \$10 million deferred income tax benefit related to our stock-based compensation expense.

During the nine months ended December 31, 2017, we recognized a \$26 million deferred income tax benefit related to our stock-based compensation expense. During the nine months ended December 31, 2016, we recognized a \$28 million deferred income tax benefit related to our stock-based compensation expense.

As of December 31, 2017, our total unrecognized compensation cost related to restricted stock units, market-based restricted stock units, performance-based restricted stock units, and stock options was \$556 million and is expected to be recognized over a weighted-average service period of 2.3 years. Of the \$556 million of unrecognized compensation cost, \$459 million relates to restricted stock units, \$58 million relates to market-based restricted stock units, and \$39

million relates to performance-based restricted stock units at 103 percent average vesting target.

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Stock Options

The following table summarizes our stock option activity for the nine months ended December 31, 2017:

| | Options (in thousands) | Weighted- Average Exercise Prices | Weighted- Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (in millions) |
|-------------------------------------|---------------------------|---|---|---|
| Outstanding as of March 31, 2017 | 2,377 | \$ 33.35 | | |
| Granted | 3 | 108.88 | | |
| Exercised | (746) | 40.58 | | |
| Forfeited, cancelled or expired | (2) | 45.15 | | |
| Outstanding as of December 31, 2017 | 1,632 | \$ 30.20 | 5.67 | \$ 122 |
| Vested and expected to vest | 1,632 | \$ 30.20 | 5.67 | \$ 122 |
| Exercisable as of December 31, 2017 | 1,612 | \$ 30.24 | 5.66 | \$ 121 |

The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price as of December 31, 2017, which would have been received by the option holders had all the option holders exercised their options as of that date. We issue new common stock from our authorized shares upon the exercise of stock options.

Restricted Stock Units

The following table summarizes our restricted stock unit activity for the nine months ended December 31, 2017:

| | Restricted Stock Rights (in thousands) | Weighted- Average Grant Date Fair Values |
|-------------------------------------|--|--|
| Outstanding as of March 31, 2017 | 5,153 | \$ 65.03 |
| Granted | 3,661 | 109.33 |
| Vested | (2,370) | 111.14 |
| Forfeited or cancelled | (330) | 77.44 |
| Outstanding as of December 31, 2017 | 6,114 | \$ 73.01 |

Performance-Based Restricted Stock Units

Our performance-based restricted stock units cliff vest after a four-year performance period contingent upon the achievement of pre-determined performance-based milestones and service conditions. If these performance-based milestones are not met but service conditions are met, the performance-based restricted stock units will not vest, in which case any compensation expense we have recognized to date will be reversed. Each quarter, we update our assessment of the probability that the specified performance criteria will be achieved. We amortize the fair values of performance-based restricted stock units over the requisite service period. The number of shares of common stock to be issued at vesting will range from zero percent to 200 percent of the target number of performance-based restricted stock units attributable to each performance-based milestone.

The following table summarizes our performance-based restricted stock unit activity, presented with the maximum number of shares that could potentially vest, for the nine months ended December 31, 2017:

| | Performance- Based Restricted Stock Units (in thousands) | Weighted- Average Grant Date Fair Value |
|-------------------------------------|---|---|
| Outstanding as of March 31, 2017 | — | \$ — |
| Granted | 796 | 110.51 |
| Forfeited or cancelled | — | — |
| Outstanding as of December 31, 2017 | 796 | \$ 110.51 |

Market-Based Restricted Stock Units

Our market-based restricted stock units vest contingent upon the achievement of pre-determined market and service conditions. If these market conditions are not met but service conditions are met, the market-based restricted stock units will not vest;

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however, any compensation expense we have recognized to date will not be reversed. The number of shares of common stock to be issued at vesting will range from zero percent to 200 percent of the target number of market-based restricted stock units based on our total stockholder return (“TSR”) relative to the performance of companies in the NASDAQ-100 Index for each measurement period, generally over either a one-year, two-year cumulative and three-year cumulative period, or over a two-year and four-year cumulative period.

The following table summarizes our market-based restricted stock unit activity, presented with the maximum number of shares that could potentially vest, for the nine months ended December 31, 2017:

| | Market-Based Restricted Stock Units (in thousands) | Weighted- Average Grant Date Fair Value |
|-------------------------------------|--|---|
| Outstanding as of March 31, 2017 | 1,282 | \$ 87.37 |
| Granted | 706 | 140.93 |
| Vested | (430) | 76.27 |
| Forfeited or cancelled | (216) | 91.88 |
| Outstanding as of December 31, 2017 | 1,342 | \$ 118.35 |

Stock Repurchase Program

In May 2015, our Board of Directors authorized a program to repurchase up to \$1 billion of our common stock. We repurchased approximately 0.3 million shares for approximately \$31 million under this program during the three months ended June 30, 2017. We completed repurchases under the May 2015 program in April 2017.

In May 2017, a Special Committee of our Board of Directors, on behalf of the full Board of Directors, authorized a program to repurchase up to \$1.2 billion of our common stock. This stock repurchase program expires on May 31, 2019. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase a specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and nine months ended December 31, 2017, we repurchased approximately 1.4 million and 3.8 million shares for approximately \$150 million and \$422 million, respectively, under this program. We are actively repurchasing shares under this program.

The following table summarizes total shares repurchased during the three and nine months ended December 31, 2017 and 2016:

| | May 2015 Program | May 2017 Program | Total |
|--------------------------------------|---------------------|---------------------|---------------|
| (in millions) | Shares | Amount | Shares Amount |
| Three months ended December 31, 2017 | — | \$ — | 1.4 \$ 150 |
| Nine months ended December 31, 2017 | 0.3 | \$ 31 | 3.8 \$ 422 |
| Three months ended December 31, 2016 | 1.5 | \$ 127 | — \$ — |
| Nine months ended December 31, 2016 | 5.0 | \$ 383 | — \$ — |

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(14) EARNINGS (LOSS) PER SHARE

The following table summarizes the computations of basic earnings per share (“Basic EPS”) and diluted earnings per share (“Diluted EPS”). Basic EPS is computed as net income divided by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock-based compensation plans including stock options, restricted stock, restricted stock units, ESPP purchase rights, warrants, and other convertible securities using the treasury stock method.

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|--|---------------------------------------|-----------|--|--------|
| (In millions, except per share amounts) | 2017 | 2016 | 2017 | 2016 |
| Net income (loss) | \$(186) | \$ (1) | \$436 | \$401 |
| Shares used to compute earnings (loss) per share: | | | | |
| Weighted-average common stock outstanding — basic | 308 | 303 | 309 | 302 |
| Dilutive potential common shares related to stock award plans and from assumed exercise of stock options | — | — | 3 | 3 |
| Dilutive potential common shares related to the Convertible Notes ^(a) | — | — | — | 1 |
| Dilutive potential common shares related to the Warrants ^(a) | — | — | — | 8 |
| Weighted-average common stock outstanding — diluted | 308 | 303 | 312 | 314 |
| Earnings (loss) per share: | | | | |
| Basic | \$(0.60) | \$ (0.00) | \$1.41 | \$1.33 |
| Diluted | \$(0.60) | \$ (0.00) | \$1.40 | \$1.28 |

As a result of our net loss for the three months ended December 31, 2017, we have excluded all potentially dilutive common shares from the diluted loss per share calculation as their inclusion would have had an antidilutive effect. Had we reported net income for this period, an additional 3 million shares of common stock related to our outstanding equity-based instruments would have been included in the number of shares used to calculate Diluted EPS for the three months ended December 31, 2017.

As a result of our net loss for the three months ended December 31, 2016, we have excluded all potentially dilutive common shares from the diluted loss per share calculation as their inclusion would have had an antidilutive effect. Had we reported net income for this period, an additional 3 million shares of common stock related to our outstanding equity-based instruments and an additional 7 million shares related to the Warrants would have been included in the number of shares used to calculate Diluted EPS for the three months ended December 31, 2016.

For the nine months ended December 31, 2017 and 2016, an immaterial amount of restricted stock units and market-based restricted stock units were excluded from the treasury stock method computation of diluted shares as their inclusion would have had an antidilutive effect. Our performance-based restricted stock units, which are considered contingently issuable shares, are also excluded from the treasury stock method computation because the related performance-based milestones were not achieved as of the end of the reporting period.

See Note 10 - Financing Arrangements in our Annual Report on Form 10-K for the fiscal year ended March 31, (a)2017, for additional information regarding the potential dilutive shares related to our Convertible Notes and Warrants.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Electronic Arts Inc.:

We have reviewed the condensed consolidated balance sheet of Electronic Arts Inc. and subsidiaries as of December 31, 2017, and the related condensed consolidated statements of operations and comprehensive income (loss) for the three month and nine-month periods ended December 31, 2017 and December 31, 2016, and the related condensed consolidated statements of cash flows for the nine-month periods ended December 31, 2017 and December 31, 2016. These condensed consolidated financial statements are the responsibility of the Company's management. We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Electronic Arts Inc. and subsidiaries as of April 1, 2017, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated May 24, 2017, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of April 1, 2017, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Santa Clara, California

February 6, 2018

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, made in this Quarterly Report are forward looking. Examples of forward-looking statements include statements related to industry prospects, our future economic performance including anticipated revenues and expenditures, results of operations or financial position, and other financial items, our business plans and objectives, including our intended product releases, and may include certain assumptions that underlie the forward-looking statements. We use words such as "anticipate," "believe," "expect," "intend," "estimate" (and the negative of any of these terms), "future" and similar expressions to help identify forward-looking statements. These forward-looking statements are subject to business and economic risk and reflect management's current expectations, and involve subjects that are inherently uncertain and difficult to predict. Our actual results could differ materially from those in the forward-looking statements. We will not necessarily update information if any forward-looking statement later turns out to be inaccurate. Risks and uncertainties that may affect our future results include, but are not limited to, those discussed in this report under the heading "Risk Factors" in Part II, Item 1A, as well as in our Annual Report on Form 10-K for the fiscal year ended March 31, 2017 as filed with the Securities and Exchange Commission ("SEC") on May 24, 2017 and in other documents we have filed with the SEC.

OVERVIEW

The following overview is a high-level discussion of our operating results, as well as some of the trends and drivers that affect our business. Management believes that an understanding of these trends and drivers provides important context for our results for the three and nine months ended December 31, 2017, as well as our future prospects. This summary is not intended to be exhaustive, nor is it intended to be a substitute for the detailed discussion and analysis provided elsewhere in this Form 10-Q, including in the remainder of "Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), "Risk Factors," and the Condensed Consolidated Financial Statements and related Notes. Additional information can be found in the "Business" section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2017 as filed with the SEC on May 24, 2017 and in other documents we have filed with the SEC.

About Electronic Arts

We are a global leader in digital interactive entertainment. We develop, market, publish and deliver games, content and online services that can be played by consumers on a variety of platforms, which include game consoles, PCs, mobile phones and tablets. In our games, we use established brands that we either wholly own (such as Battlefield, Mass Effect, Need for Speed, The Sims and Plants v. Zombies), or license from others (such as FIFA, Madden NFL and Star Wars). We also publish and distribute games developed by third parties.

Financial Results

Our key financial results for our fiscal quarter ended December 31, 2017 were as follows:

- Total net revenue was \$1,160 million, up 1 percent year-over-year. On a constant currency basis, we estimate that total net revenue would have been \$1,165 million, up 1 percent year over year.
- Digital net revenue was \$780 million, up 14 percent year-over-year.
- International net revenue was \$708 million, up 20 percent year-over-year. On a constant currency basis, we estimate that international net revenue would have been \$713 million, up 21 percent year over year.
- Gross margin was 56.8 percent, up 1.7 percentage points year-over-year.
- Operating expenses were \$680 million, up 7 percent year-over-year. On a constant currency basis, we estimate that operating expenses would have been \$669 million, up 5 percent year over year.
- Net loss was \$186 million with diluted loss per share of \$0.60. \$176 million of the net loss, or approximately \$0.57 per share resulted from the application of the U.S. Tax Act.
- Total cash, cash equivalents and short-term investments were \$4,884 million.

From time to time, we make comparisons of current periods to prior periods with reference to constant currency. Constant currency comparisons are based on translating local currency amounts in the current period at actual foreign exchange rates from the prior comparable period. We evaluate our financial performance on a constant currency basis in order to facilitate period-to-period comparisons without regard to the impact of changing foreign currency exchange rates.

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Trends in Our Business

Digital Business. Players increasingly purchase our games digitally and engage with the live services associated with our portfolio of games. For example, the Ultimate Team mode incorporated into iterations of our FIFA, Madden NFL and NHL franchises and live services available digitally for our Star Wars, Battlefield and The Sims franchises have extended the life of those games by engaging players for longer periods of time. Our digital transformation is also creating opportunities in platforms, content models and modalities of play. For example, we have leveraged franchises typically associated with consoles and traditional PC gaming, such as FIFA, Madden NFL, The Sims, SimCity and Star Wars, to create mobile and PC free-to-download games that are monetized through a business model in which we sell incremental content and/or features in discrete transactions. We also provide our EA Access service on Xbox One and Origin Access service on PC which offer players access to a selection of EA games and other benefits for a monthly or annual fee.

Our digital transformation also gives us the opportunity to strengthen our player network. We are investing in a technology foundation to enable us to build personalized player relationships that can last for years instead of days or weeks by connecting our players to us and to each other. This connection allows us to market and deliver content and services for popular franchises like FIFA, Battlefield and Star Wars to our players more efficiently. That same foundation also enables new player-centric ways to discover and try new experiences, such as our subscription-based EA Access and Origin Access services.

We significantly increased our digital net revenue from \$2,199 million in fiscal year 2015 to \$2,409 million in fiscal year 2016 and \$2,874 million during fiscal year 2017. We expect this portion of our business to continue to grow through fiscal year 2018 and beyond as we continue to focus on developing and monetizing products and services that can be delivered digitally.

Foreign Currency Exchange Rates. International sales are a fundamental part of our business, and the strengthening of the U.S. dollar (particularly relative to the Euro, British pound sterling, Australian dollar, Chinese yuan and South Korean won) has a negative impact on our reported international net revenue, but a positive impact on our reported international operating expenses (particularly the Swedish krona and Canadian dollar) because these amounts are translated at lower rates as compared to periods in which the U.S. dollar is weaker. Volatility in exchange rates remains elevated as compared to historical standards, and macroeconomic factors such as events related to the United Kingdom's vote to leave the European Union inject uncertainty. While we use foreign currency hedging contracts to mitigate some foreign currency exchange risk, these activities are limited in the protection that they provide us and can themselves result in losses.

Mobile and PC Free-to-Download Games. The global adoption of mobile devices and a business model for those devices that allows consumers to try new games with no up-front cost and pay for additional content or in-game items, has led to significant growth in the mobile gaming industry. We expect this growth to continue during our 2018 fiscal year. Likewise, the wide consumer acceptance of free-to-download, microtransaction-based PC games played over the Internet has broadened our consumer base. We expect revenue generated from mobile and PC free-to-download games to remain an important part of our business.

Concentration of Sales Among the Most Popular Games. In all major segments of our industry, we see a large portion of games sales concentrated on the most popular titles. Similarly, a significant portion of our revenue historically has been derived from games based on a few popular franchises, several of which we have released on an annual or bi-annual basis. The increased importance to our business of revenue attributable to our live services, has accelerated this trend. For example, we derive a material portion of our revenue from the Ultimate Team game mode which is available in our annualized FIFA, Madden NFL and NHL games.

Recurring Revenue Sources. Our business model includes revenue that we deem recurring in nature, such as revenue from our annualized titles (such as FIFA and Madden NFL) and associated live services, our ongoing mobile business and subscription programs. We have been able to forecast revenue from these areas of our business with greater confidence than for new offerings. As we continue to leverage the digital transformation in our industry and incorporate new content models and modalities of play into our games, our goal is to continue to look for opportunities to expand the recurring portion of our business.

Net Bookings. In order to improve transparency into our business, we disclose an operating performance metric, net bookings. Net bookings is defined as the net amount of products and services sold digitally or sold-in physically in the period. Net bookings is calculated by adding total net revenue to the change in deferred net revenue for online-enabled games.

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The following is a calculation of our total net bookings for the periods presented:

| (In millions) | Three Months | | Nine Months | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | Ended December 31, | Ended December 31, | Ended December 31, | Ended December 31, |
| | 2017 | 2016 | 2017 | 2016 |
| Total net revenue | \$1,160 | \$1,149 | \$3,568 | \$3,318 |
| Change in deferred net revenue (online-enabled games) | 811 | 921 | 357 | 532 |
| Net bookings | \$1,971 | \$2,070 | \$3,925 | \$3,850 |

Net bookings were \$1,971 million for the three months ended December 31, 2017, driven by sales related to FIFA Ultimate Team, Star Wars Battlefront II, and The Sims 4. Net bookings decreased \$99 million or 5 percent as compared to the three months ended December 31, 2016 due primarily to lower sales of Star Wars Battlefront II, which launched during the three months ended December 31, 2017, as compared to Battlefield 1, which launched during the three months ended December 31, 2016, partially offset by an increase in net bookings associated with our live services business. Digital net bookings were \$1,230 million for the three months ended December 31, 2017, an increase of \$135 million or 12 percent as compared to three months ended December 31, 2016. The increase in digital net bookings was driven by live services which grew \$221 million or 39 percent year-over-year, primarily due to our Ultimate Team game mode and The Sims 4; and our mobile business which grew \$9 million or 5 percent year-over-year, primarily due to FIFA Mobile. These increases were offset by a decrease of \$95 million or 27 percent in our full game PC and console downloads due to lower net bookings associated with Star Wars Battlefront II as compared to Battlefield 1, which launched during the three months ended December 31, 2016.

Recent Developments

Stock Repurchase Program. In May 2017, a Special Committee of our Board of Directors, on behalf of the full Board of Directors, authorized a program to repurchase up to \$1.2 billion of our common stock. This stock repurchase program expires on May 31, 2019. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase a specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and nine months ended December 31, 2017, we repurchased approximately 1.4 million and 3.8 million shares for approximately \$150 million and \$422 million, respectively, under this program. We are actively repurchasing shares under this program.

Acquisition of Respawn LLC. On December 1, 2017 we completed the acquisition of Respawn. Respawn is a leading game development studio and creators of games including the critically-acclaimed Titanfall franchise. In connection with the acquisition, we paid \$151 million in cash. In addition, we granted long-term equity awards in the form of restricted stock units to employees with a grant date fair value of \$167 million. Furthermore, we may be required to pay variable cash consideration that is contingent upon the achievement of certain performance milestones relating to the development of future titles, through the end of calendar 2022. The additional consideration is limited to a maximum of \$140 million.

U.S. Tax Act. On December 22, 2017, the U.S. Tax Act was enacted which significantly revises the U.S. corporate income tax system by, among other things, lowering the U.S. corporate income tax rate, generally implementing a territorial tax system, and imposing the Transition Tax. We recorded a provisional \$176 million tax charge during the three months ended December 31, 2017 as a result of the application of the U.S. Tax Act; \$151 million of which relates to the Transition Tax.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

We derive revenue principally from sales of interactive software games, and related content and services on game consoles, PCs, mobile phones and tablets. We evaluate revenue recognition based on the criteria set forth in 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 product content or updates, whether delivered digitally (e.g., full-game downloads, extra-content) or via a physical disc (e.g., packaged goods), 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 (e.g., premium mobile games) in order to utilize the game or related content (i.e. can be played with or without an Internet connection), 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, games, content or updates that requires our hosting support in order to utilize the game or related content (i.e., can only be played with an Internet connection). This includes (1) entitlements to content that are accessed through hosting services (e.g., microtransactions for Internet-based, social network and free-to-download mobile games), (2) massively multi-player online (“MMO”) games (both software game and subscription sales), (3) subscriptions for our Battlefield Premium, EA and Origin Access, and Pogo-branded online game services, and (4) allocated service revenue from sales of software games with a service of online activities (e.g., online playability). Our other revenue includes advertising and non-software licensing revenue.

With respect to the allocated service revenue from sales of software games with a service of online activities (“online services”) 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 online services with the residual value allocated to product revenue. Our estimate of the selling price of the online services are comprised of several factors including, but not limited to, prior selling prices for the online services, 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 services on a regular basis and use this methodology consistently to allocate revenue between product and service for software game sales with online services.

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. For packaged goods, 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. If there is significant uncertainty of acceptance, revenue is recognized once acceptance is reasonably assured.

Online-Enabled Games

The majority of our software games and related content have online connectivity 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 a service of online activities (e.g., online playability) without a separate fee. U.S. GAAP requires us to account for the consumer’s right to receive unspecified updates or the service of online activities for no additional fee as a “bundled” sale, or multiple-element arrangement.

We have an established historical pattern of providing unspecified updates (e.g., player roster updates to Madden NFL 18) to online-enabled games and related content at no additional charge to the consumer. Because we do not have vendor-specific objective evidence of fair value (“VSOE”) for these unspecified updates, we are required by current U.S. GAAP to recognize as

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revenue the entire sales price of these online-enabled games and related content over the period we expect to offer the unspecified updates to the consumer (“estimated offering period”).

Estimated Offering Period

Because the offering period is not an explicitly defined period, we must make an estimate of the offering period. 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 our evaluation date is April 1, 2017, we evaluate all online-enabled games released between April 1, 2015 and March 31, 2016. 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 (i.e., time in channel). Based on these two calculations we then consider the method of distribution. For example, physical software games sold at retail would have a composite offering period equal to the online gameplay plus time in channel as opposed to digitally distributed software games which are delivered immediately via digital download and thus have no concept of channel. Additionally, we consider results from prior analyses, known and expected online gameplay trends, as well as disclosed service periods for competitors’ games in determining the estimated offering period for future sales.

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.

We recognize revenue from the sale of online-enabled games for which we do not have VSOE for the unspecified updates on a straight-line basis, generally over an estimated nine-month period beginning in the month after shipment for physical games sold through retail and an estimated six-month period for digitally-distributed games.

Deferred Net Revenue (online-enabled games)

Because the majority of our sales are subject to a deferral period of generally six to nine months, our deferred net revenue (online-enabled games) balance is material. This balance increases from period to period by the revenue being deferred for current sales and is reduced by the recognition of revenue from prior sales that were deferred (i.e., the “net change” in the deferred balance). However, given the seasonal sales nature of our business, the net change in the deferred balance may be material from period to period. For example, because our sales have historically been highest in the fiscal third quarter, the deferred net revenue (online-enabled games) balance generally increases significantly in the third fiscal quarter. Similarly, because sales have historically been lowest in the first fiscal quarter, the deferred net revenue (online-enabled games) balance generally decreases significantly in the first fiscal quarter of a fiscal year.

Other Multiple-Element Arrangements

In some of our multiple-element arrangements, we sell non-software products with software and/or software-related offerings. These non-software products are generally music soundtracks, 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.

We determine the selling price for a non-software product deliverable based on the following selling price hierarchy: VSOE (i.e., the price we charge when the non-software product is sold separately) if available, third-party evidence (“TPE”) of fair value (i.e., the price charged by others for similar non-software 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,

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sales channels and other factors. 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.

Principal Agent Considerations

We evaluate sales of our interactive software games, extra-content, and services from our subscription offerings via third party storefronts, including digital channel storefronts such as Microsoft's Xbox Store, Sony's PlayStation Store, Apple App Store, and Google Play, in order to determine whether or not we are acting as the primary obligor in the sale to the end consumer, which we consider in determining if revenue should be reported gross or net of fees retained by the storefront. Key indicators that we evaluate in determining gross versus net treatment include but are not limited to the following:

- The party responsible for delivery/fulfillment of the product or service to the end consumer
- The party responsible for the billing, collection of fees and refunds to the end consumer
- The storefront and Terms of Sale that govern the end consumer's purchase of the product or service
- The party that sets the pricing with the end consumer and has credit risk

Based on evaluation of the above indicators, we have determined that generally the third party is considered the primary obligor to end consumers for the sale of our interactive software games. We therefore report revenue related to these arrangements net of the fees retained by the storefront.

Sales Returns and Allowances and Bad Debt Reserves

We reduce revenue 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 that they have not resold to end consumers. 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 partners' 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, and 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.

Fair Value Estimates

Business Combinations. We must estimate the fair value of assets acquired, liabilities and contingencies assumed, acquired in-process technology, and contingent consideration issued in a business combination. Our assessment of the estimated fair value of each of these can have a material effect on our reported results as intangible assets are amortized over various estimated useful lives. Furthermore, the estimated fair value assigned to an acquired asset or liability has a direct impact on the amount

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we recognize as goodwill, which is an asset that is not amortized. Determining the fair value of assets acquired requires an assessment of the highest and best use or the expected price to sell the asset and the related expected future cash flows. Determining the fair value of acquired in-process technology also requires an assessment of our expectations related to the use of that technology. Determining the fair value of an assumed liability requires an assessment of the expected cost to transfer the liability. Determining the fair value of contingent consideration requires an assessment of the probability-weighted expected future cash flows over the period in which the obligation is expected to be settled, and applying a discount rate that appropriately captures the risk associated with the obligation. The significant unobservable inputs used in the fair value measurement of the contingent consideration payable are forecasted earnings. Significant changes in forecasted earnings would result in significantly higher or lower fair value measurement. This fair value assessment is also required in periods subsequent to a business combination. Such estimates are inherently difficult and subjective and can have a material impact on our Consolidated Financial Statements.

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. Significant judgment is required to estimate the effective royalty rate for a particular contract. Because the computation of effective royalty rates requires us to project future revenue, it is inherently subjective as our future revenue projections must anticipate a number of factors, including (1) the total number of titles subject to the contract, (2) the timing of the release of these titles, (3) the number of software units and amount of extra content that we expect to sell, which can be impacted by a number of variables, including product quality, number of platforms we release on, the timing of the title's release and competition, and (4) future pricing. Determining the effective royalty rate for our titles is particularly challenging due to the inherent difficulty in predicting the popularity of entertainment products. Furthermore, if we conclude that we are unable to make a reasonably reliable forecast of projected net revenue, we recognize royalty expense at the greater of contract rate or on a straight-line basis over the term of the contract. Accordingly, if our future revenue projections change, our effective royalty rates would change, which could impact the amount and timing of royalty expense we recognize.

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

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 and service sales. Any impairments or losses determined before the launch of a product are generally charged to research and development expense. Impairments or losses determined post-launch are charged to cost of revenue. We evaluate long-lived royalty-based assets for impairment using undiscounted cash flows when impairment indicators exist. If impairment exists, then the assets are written down to fair value. 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.

Income Taxes

We recognize deferred tax assets and liabilities for both (1) the expected impact of differences between the financial statement amount and the tax basis of assets and liabilities and (2) the expected future tax benefit to be derived from tax losses and tax

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credit carryforwards. 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.

In addition to considering forecasts of future taxable income, we are also required to evaluate and quantify other possible sources of taxable income in order to assess the realization of our deferred tax assets, namely the reversal of existing deferred tax liabilities, the carryback of losses and credits as allowed under current tax law, and the implementation of tax planning strategies. Evaluating and quantifying these amounts involves significant judgments. Each source of income must be evaluated based on all positive and negative evidence; this evaluation involves assumptions about future activity.

In the fourth quarter of fiscal year 2016, we realized significant U.S. pre-tax income for both the fourth quarter and the fiscal year ended March 31, 2016. As a result, we released the valuation allowance against all of the U.S. federal deferred tax assets and a portion of the U.S. state deferred tax assets during the fourth quarter of fiscal year 2016. We continue to maintain a valuation allowance related to specific U.S. state deferred tax assets and foreign capital loss carryovers, due to uncertainty about the future realization of these assets.

Our effective tax rate and resulting provision for income taxes for the three and nine months ended December 31, 2017 was significantly impacted by the U.S. Tax Act, enacted on December 22, 2017. The U.S. Tax Act significantly revises the U.S. corporate income tax system by, among other things, lowering the U.S. corporate income tax rates, generally implementing a territorial tax system and imposing the Transition Tax.

The final calculations of tax expenses and tax benefits resulting from the U.S. Tax Act may differ from our estimates, potentially materially, due to, among other things, changes in interpretations of the U.S. Tax Act, our analysis of the U.S. Tax Act, or any updates or changes to estimates that we have utilized to calculate the transition impacts, including impacts from changes to current year earnings estimates and assertions.

Reasonable estimates of the impacts of the U.S. Tax Act are provided in accordance with SEC guidance that allows for a measurement period of up to one year after the enactment date of the U.S. Tax Act to finalize the recording of the related tax impacts. We expect to complete the accounting under the U.S. Tax Act as soon as practicable, but in no event later than one year from the enactment date of the U.S. Tax Act.

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

IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

The information under the subheading “Impact of Recently Issued Accounting Standards” in Note 1 - Description of Business and Basis of Presentation to the Condensed Consolidated Financial Statements in this Form 10-Q is incorporated by reference into this Item 2.

RESULTS OF OPERATIONS

Our fiscal year is reported on a 52- or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal year ending March 31, 2018 contains 52 weeks and ends on March 31, 2018. Our results of operations for the fiscal year ended March 31, 2017 contained 52 weeks and ended on April 1, 2017. Our results of operations for the three months ended December 31, 2017 and 2016 contained 13 weeks each and ended on December 30, 2017 and December 31, 2016, respectively. Our results of operations for the nine months ended December 31, 2017 and 2016 contained 39 each and ended on December 30, 2017 and December 31, 2016, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

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Net Revenue

Net revenue consists of sales generated from (1) video games sold as digital downloads or as packaged goods and designed for play on game consoles and PCs, (2) video games for mobile phones and tablets, (3) separate software products and extra-content and online game services associated with these products, (4) licensing our game software to third parties, (5) allowing other companies to manufacture and sell our products in conjunction with other products, and (6) advertisements on our online web pages and in our games. We recognize revenue from the sale 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 for digitally-delivered games and content and an estimated nine-month period beginning in the month after shipment for physical games sold through retail.

We provide two different measures of our Net Revenue. (1) Net Revenue by Product revenue and Service and other revenue, and (2) Net Revenue by Type, which is primarily based on method of distribution. Management places a greater emphasis and focus on assessing our business through a review of the Net Revenue by Type (Digital, and Packaged goods and other) than by Net Revenue by Product revenue and Service and other revenue.

Net Revenue Quarterly Analysis

Net Revenue

For the three months ended December 31, 2017, net revenue was \$1,160 million and increased \$11 million, or 1 percent, as compared to the three months ended December 31, 2016. This increase was driven by a \$217 million increase in revenue primarily from the FIFA franchise and Mass Effect: Andromeda. This increase was partially offset by a \$206 million decrease in revenue primarily from the Battlefield and Titanfall franchises.

Net Revenue by Product Revenue and Service and Other Revenue

Our Net Revenue by Product revenue and Service and other revenue for the three months ended December 31, 2017 and 2016 was as follows (in millions):

| | Three Months Ended December 31, | | | |
|-------------------|---------------------------------|---------|-----------|----------|
| | 2017 | 2016 | \$ Change | % Change |
| Net revenue: | | | | |
| Product | \$547 | \$649 | \$ (102) | (16)% |
| Service and other | 613 | 500 | 113 | 23 % |
| Total net revenue | \$1,160 | \$1,149 | \$ 11 | 1 % |

Product Revenue

For the three months ended December 31, 2017, Product net revenue was \$547 million, primarily driven by FIFA 18, Madden NFL 18, and The Sims 4. Product net revenue decreased \$102 million, or 16 percent, as compared to the three months ended December 31, 2016. This decrease was driven by a \$218 million decrease primarily from the Battlefield franchise and Titanfall 2. This decrease was partially offset by a \$116 million increase primarily from Mass Effect: Andromeda, The Sims 4, and the FIFA franchise.

Service and Other Revenue

For the three months ended December 31, 2017, Service and other net revenue was \$613 million, primarily driven by FIFA Ultimate Team, Star Wars: Galaxy of Heroes and Battlefield 1 Premium. Service and other net revenue for the

three months ended December 31, 2017 increased \$113 million, or 23 percent, as compared to the three months ended December 31, 2016. This increase was driven by a \$147 million increase primarily from FIFA Ultimate Team and Battlefield 1 Premium. This increase was partially offset by a \$34 million decrease primarily from the Plants vs. Zombies franchise.

Supplemental Net Revenue by Type

As we continue to evolve our business and more of our products are delivered to consumers digitally, we place a greater emphasis and focus on assessing our business performance through a review of net revenue by type.

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Our net revenue by type for the three months ended December 31, 2017 and 2016 was as follows (in millions):

| | Three Months Ended December | | | |
|------------------------------|-----------------------------|----------|-----------|----------|
| | 2017 | 2016 | \$ Change | % Change |
| Full game downloads | \$ 143 | \$ 169 | \$ (26) | (15)% |
| Live services ^(a) | 476 | 369 | 107 | 29 % |
| Mobile | 161 | 147 | 14 | 10 % |
| Total Digital | \$ 780 | \$ 685 | \$ 95 | 14 % |
| Packaged goods and other | \$ 380 | \$ 464 | \$ (84) | (18)% |
| Net revenue | \$ 1,160 | \$ 1,149 | \$ 11 | 1 % |

(a) Live services net revenue is comprised of net revenue previously presented as “Extra content” and “Subscription, advertising, and other” through the fourth quarter of fiscal 2017.

Digital Net Revenue

Digital net revenue includes full game downloads, live services, and mobile revenue. Digital net revenue includes game software distributed through our direct-to-consumer PC platform Origin, distributed wirelessly through mobile carriers, or licensed to our third-party publishing partners who distribute our games digitally.

For the three months ended December 31, 2017, digital net revenue was \$780 million primarily driven by FIFA Ultimate Team, Madden Ultimate Team, and FIFA Online 3 in Asia. Digital net revenue for the three months ended December 31, 2017 increased \$95 million, or 14 percent, as compared to the three months ended December 31, 2016. This increase is due to (1) a \$107 million or 29 percent increase in live services net revenue primarily driven by our Ultimate Team game mode and Battlefield 1 Premium and (2) a \$14 million or 10 percent increase in mobile net revenue primarily driven by Star Wars: Galaxy of Heroes and FIFA Mobile. These increases were offset by a \$26 million or 15 percent decrease in full-game download net revenue primarily driven by Battlefield 1.

Packaged Goods and Other Net Revenue

Packaged goods and other net revenue includes revenue from software that is distributed physically. This includes (1) net revenue from game software distributed physically through traditional channels such as brick and mortar retailers, and (2) our software licensing revenue from third parties (for example, makers of console platforms, personal computers or computer accessories) who include certain of our products for sale with their products (“OEM bundles”).

For the three months ended December 31, 2017, packaged goods and other net revenue was \$380 million, primarily driven by FIFA 18, Madden NFL 18, and Mass Effect: Andromeda. Packaged goods and other net revenue for the three months ended December 31, 2017 decreased \$84 million, or 18 percent, as compared to the three months ended December 31, 2016. This decrease was driven by a \$162 million decrease in net revenue primarily from the Battlefield and Titanfall franchises. This decrease was partially offset by a \$78 million increase primarily from the Mass Effect and FIFA franchises.

Net Revenue Year-to-Date Analysis

Net Revenue

For the nine months ended December 31, 2017, net revenue was \$3,568 million and increased \$250 million, or 8 percent, as compared to the nine months ended December 31, 2016. This increase was driven by a \$769 million increase in revenue primarily from the FIFA and Battlefield franchises, and Mass Effect: Andromeda. This increase was partially offset by a \$519 million decrease in revenue primarily from the Star Wars and Need for Speed franchises.

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Net Revenue by Product Revenue and Service and Other Revenue

Our Net Revenue by Product revenue and Service and other revenue for the nine months ended December 31, 2017 and 2016 was as follows (in millions):

| | Nine Months Ended December 31, | | | |
|-------------------|--------------------------------|----------|-----------|----------|
| | 2017 | 2016 | \$ Change | % Change |
| Net revenue: | | | | |
| Product | \$ 1,829 | \$ 1,753 | \$ 76 | 4 % |
| Service and other | 1,739 | 1,565 | 174 | 11 % |
| Total net revenue | \$ 3,568 | \$ 3,318 | \$ 250 | 8 % |

Product Revenue

For the nine months ended December 31, 2017, Product net revenue was \$1,829 million, primarily driven by Battlefield 1, FIFA 17, and FIFA 18. Product net revenue increased \$76 million, or 4 percent, as compared to the nine months ended December 31, 2016. This increase was driven by a \$482 million increase primarily from Battlefield 1 and Mass Effect: Andromeda. This increase was partially offset by a \$406 million decrease primarily from Star Wars Battlefront and UFC 2.

Service and Other Revenue

For the nine months ended December 31, 2017, Service and other net revenue was \$1,739 million, primarily driven by FIFA Ultimate Team, Star Wars: Galaxy of Heroes and Battlefield 1 Premium. Service and other net revenue for the nine months ended December 31, 2017 increased \$174 million, or 11 percent, as compared to the nine months ended December 31, 2016. This increase was driven by a \$338 million increase primarily from FIFA Ultimate Team and Battlefield 1 Premium. This increase was partially offset by a \$164 million decrease primarily from Need for Speed (2015) and the Plants vs. Zombies franchise.

Supplemental Net Revenue by Type

Our net revenue by type for the nine months ended December 31, 2017 and 2016 was as follows (in millions):

| | Nine Months Ended December 31, | | | |
|------------------------------|--------------------------------|----------|-----------|----------|
| | 2017 | 2016 | \$ Change | % Change |
| Full game downloads | \$ 475 | \$ 400 | \$ 75 | 19 % |
| Live services ^(a) | 1,385 | 1,079 | 306 | 28 % |
| Mobile | 488 | 461 | 27 | 6 % |
| Total Digital | \$ 2,348 | \$ 1,940 | \$ 408 | 21 % |
| Packaged goods and other | \$ 1,220 | \$ 1,378 | \$ (158) | (11)% |
| Net revenue | \$ 3,568 | \$ 3,318 | \$ 250 | 8 % |

(a) Live services net revenue is comprised of net revenue previously presented as “Extra content” and “Subscription, advertising, and other” through the fourth quarter of fiscal 2017.

Digital Net Revenue

For the nine months ended December 31, 2017, digital net revenue was \$2,348 million primarily driven by FIFA Ultimate Team, Battlefield 1, and FIFA Online 3 in Asia. Digital net revenue for the nine months ended December 31, 2017 increased \$408 million, or 21 percent, as compared to the nine months ended December 31, 2016. This increase is due to (1) a \$75 million or 19 percent increase in full-game download net revenue primarily driven by Mass Effect: Andromeda and Battlefield 1, (2) a \$306 million or 28 percent increase in live services net revenue primarily driven by our Ultimate Team game mode and Battlefield 1 Premium, and (3) a \$27 million or 6 percent increase in mobile net revenue primarily driven by Star Wars: Galaxy of Heroes and FIFA Mobile.

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Packaged Goods and Other Net Revenue

For the nine months ended December 31, 2017, packaged goods and other net revenue was \$1,220 million, primarily driven by FIFA 17, Battlefield 1 and FIFA 18. Packaged goods and other net revenue for the nine months ended December 31, 2017 decreased \$158 million, or 11 percent, as compared to the nine months ended December 31, 2016. This decrease was driven by a \$465 million decrease in net revenue primarily from the Star Wars and Need for Speed franchises. This decrease was partially offset by a \$307 million increase primarily from the Battlefield and Mass Effect franchises.

Cost of Revenue Quarterly Analysis

Cost of revenue for the three months ended December 31, 2017 and 2016 was as follows (in millions):

| | December 31, 2017 | % of Related Net Revenue | December 31, 2016 | % of Related Net Revenue | % Change | Change as a % of Related Net Revenue |
|-----------------------|----------------------|-----------------------------------|----------------------|-----------------------------------|-------------|---|
| Cost of revenue: | | | | | | |
| Product | \$ 352 | 64.4 % | \$ 389 | 59.9 % | (9.5)% | 4.5 % |
| Service and other | 149 | 24.3 % | 127 | 25.4 % | 17.3 % | (1.1)% |
| Total cost of revenue | \$ 501 | 43.2 % | \$ 516 | 44.9 % | (2.9)% | (1.7)% |

Cost of Product Revenue

Cost of product revenue consists of (1) manufacturing royalties, net of volume discounts and other vendor reimbursements, (2) certain royalty expenses for celebrities, professional sports leagues, movie studios and other organizations, and independent software developers, (3) inventory costs, (4) expenses for defective products, (5) write-offs of post launch prepaid royalty costs and losses on previously unrecognized licensed intellectual property commitments, (6) amortization of certain intangible assets, (7) personnel-related costs, and (8) warehousing and distribution costs. We generally recognize volume discounts when they are earned from the manufacturer (typically in connection with the achievement of unit-based milestones); whereas other vendor reimbursements are generally recognized as the related revenue is recognized.

Cost of product revenue decreased by \$37 million, or 9.5 percent during the three months ended December 31, 2017, as compared to the three months ended December 31, 2016. This decrease was primarily due to a decrease in inventory costs associated with Battlefield 1 and Titanfall 2 which were launched during the three months ended December 31, 2016, and a decrease in intangible amortization. These decreases were partially offset by an increase in the royalty costs associated with our product launches during the three months ended December 31, 2017, as compared to the three months ended December 31, 2016.

Cost of Service and Other Revenue

Cost of service and other revenue consists primarily of (1) royalty costs, (2) data center, bandwidth and server costs associated with hosting our online games and websites, (3) inventory costs, (4) platform processing fees from operating our website-based games on third party platforms, and (5) credit card fees associated with our service revenue.

Cost of service and other revenue increased by \$22 million, or 17.3 percent during the three months ended December 31, 2017, as compared to the three months ended December 31, 2016. This increase was primarily due to an increase in royalty costs associated with higher sales from FIFA Ultimate Team and Madden Ultimate Team.

Total Cost of Revenue as a Percentage of Total Net Revenue

During the three months ended December 31, 2017, total cost of revenue as a percentage of total net revenue decreased by \$15 million, or 1.7 percent as compared to the three months ended December 31, 2016. This decrease was primarily due to a decrease in inventory and warehouse operations costs as a result of the closure of our Switzerland distribution business in fiscal year 2017, and an increase in the proportion of our digital net revenues to packaged goods and other net revenues, which generally have higher costs than our digital products and services.

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Cost of Revenue Year-to-Date Analysis

Cost of revenue for the nine months ended December 31, 2017 and 2016 was as follows (in millions):

| | December 31, 2017 | % of Related Net Revenue | December 31, 2016 | % of Related Net Revenue | % Change | Change as a % of Related Net Revenue |
|-----------------------|----------------------|-----------------------------------|----------------------|-----------------------------------|-------------|---|
| Cost of revenue: | | | | | | |
| Product | \$ 716 | 39.1 % | \$ 796 | 45.4 % | (10.1)% | (6.3)% |
| Service and other | 328 | 18.9 % | 300 | 19.2 % | 9.3 % | (0.3)% |
| Total cost of revenue | \$ 1,044 | 29.3 % | \$ 1,096 | 33.0 % | (4.7)% | (3.7)% |

Cost of Product Revenue

Cost of product revenue decreased by \$80 million, or 10.1 percent during the nine months ended December 31, 2017, as compared to the nine months ended December 31, 2016. This decrease was primarily due to a decrease in inventory costs associated with Battlefield 1 and Titanfall 2 which were launched during the nine months ended December 31, 2016, a decrease in inventory and warehouse operations costs as a result of the closure of our Switzerland distribution business in fiscal year 2017, and a \$26 million decrease in intangible amortization. These decreases were partially offset by an increase in royalty costs associated with our product launches during the nine months ended December 31, 2017, as compared to the nine months ended December 31, 2016.

Cost of Service and Other Revenue

Cost of service and other revenue increased by \$28 million, or 9.3 percent during the nine months ended December 31, 2017, as compared to the nine months ended December 31, 2016. This increase was primarily due to an increase in royalty costs associated with higher sales from FIFA Ultimate Team and Madden Ultimate Team, offset by a \$16 million decrease in intangible amortization.

Total Cost of Revenue as a Percentage of Total Net Revenue

During the nine months ended December 31, 2017, total cost of revenue as a percentage of total net revenue decreased by \$52 million, or 3.7 percent as compared to the nine months ended December 31, 2016. This decrease was primarily due to a decrease in inventory and warehouse operations costs as a result of the closure of our Switzerland distribution business in fiscal year 2017, and an increase in the proportion of our digital net revenues to packaged goods and other net revenues, which generally have a higher costs than our digital products and services.

Research and Development

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

Research and development expenses for the three and nine months ended December 31, 2017 and 2016 were as follows (in millions):

| | December 31, 2017 | % of Net Revenue | December 31, 2016 | % of Net Revenue | \$ Change | % Change |
|--------------------|----------------------|---------------------|----------------------|---------------------|-----------|----------|
| Three months ended | \$ 329 | 28 % | \$ 285 | 25 % | \$ 44 | 15 % |
| Nine months ended | \$ 985 | 28 % | \$ 870 | 26 % | \$ 115 | 13 % |

Research and development expenses increased by \$44 million, or 15 percent, during the three months ended December 31, 2017, as compared to the three months ended December 31, 2016. This \$44 million increase was primarily due to (1) a \$30 million increase in personnel-related costs primarily resulting from an increase in headcount and workforce investments, (2) an \$11 million increase in stock-based compensation, and (3) a \$7 million increase in facilities-related costs. These increases were partially offset by a \$12 million decrease primarily due to a loss on a royalty-based commitment and impairment on a royalty-based asset during the three-months ended December 31, 2016.

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Research and development expenses increased by \$115 million, or 13 percent, during the nine months ended December 31, 2017, as compared to the nine months ended December 31, 2016. This \$115 million increase was primarily due to (1) a \$59 million increase in personnel-related costs primarily resulting from an increase in headcount and workforce investments, (2) a \$21 million increase in stock-based compensation, (3) a \$14 million increase in facilities-related costs, and (4) a \$12 million decrease primarily due to a loss on a royalty-based commitment and impairment on a royalty-based asset during the three-months ended December 31, 2016.

Marketing and Sales

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

Marketing and sales expenses for the three and nine months ended December 31, 2017 and 2016 were as follows (in millions):

| | December 31, 2017 | % of Net Revenue | December 31, 2016 | % of Net Revenue | \$ Change | % Change |
|--------------------|----------------------|---------------------|----------------------|---------------------|-----------|----------|
| Three months ended | \$ 230 | 20 % | \$ 240 | 21 % | \$ (10) | (4)% |
| Nine months ended | \$ 511 | 14 % | \$ 511 | 15 % | \$ — | — % |

Marketing and sales expenses decreased by \$10 million, or 4 percent, during the three months ended December 31, 2017, as compared to the three months ended December 31, 2016. This \$10 million decrease was primarily due to a \$10 million decrease in advertising and promotional spending.

Marketing and sales expenses remained consistent during the nine months ended December 31, 2017, as compared to the nine months ended December 31, 2016.

General and Administrative

General and administrative expenses consist of personnel and related expenses of executive and administrative staff, corporate functions such as finance, legal, human resources, and information technology, related overhead costs, fees for professional services such as legal and accounting, and allowances for doubtful accounts.

General and administrative expenses for the three and nine months ended December 31, 2017 and 2016 were as follows (in millions):

| | December 31, 2017 | % of Net Revenue | December 31, 2016 | % of Net Revenue | \$ Change | % Change |
|--------------------|----------------------|---------------------|----------------------|---------------------|-----------|----------|
| Three months ended | \$ 120 | 10 % | \$ 110 | 10 % | \$ 10 | 9 % |
| Nine months ended | \$ 343 | 10 % | \$ 329 | 10 % | \$ 14 | 4 % |

General and administrative expenses increased by \$10 million, or 9 percent, during the three months ended December 31, 2017, as compared to the three months ended December 31, 2016. This \$10 million increase was primarily due to (1) a \$6 million increase in contracted services primarily due to higher legal expenses, (2) a \$5 million increase in personnel-related costs primarily resulting from an increase in headcount, and (3) a \$4 million increase in stock-based compensation. These increases were partially offset by a \$9 million decrease in facility-related costs.

General and administrative expenses increased by \$14 million, or 4 percent, during the nine months ended December 31, 2017, as compared to the nine months ended December 31, 2016. This \$14 million increase was primarily due to (1) a \$10 million increase in contracted services primarily due to higher legal expenses, (2) a \$7 million increase in personnel-related costs primarily resulting from an increase in headcount, and (3) a \$7 million increase in stock-based compensation. These increases were partially offset by a \$10 million decrease in facility-related costs.

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Income Taxes

Provision for income taxes for the three and nine months ended December 31, 2017 and 2016 were as follows (in millions):

| | December 31, 2017 | Effective Tax Rate | December 31, 2016 | Effective Tax Rate |
|-----------------------|-------------------|--------------------|-------------------|--------------------|
| Three Months Ended \$ | 170 | (1,062.5)% | \$ (5) | 83.3 % |
| Nine Months Ended \$ | 259 | 37.3 % | \$ 93 | 18.8 % |

The provision for income taxes for the three and nine months ended December 31, 2017 is based on our projected annual effective tax rate for fiscal year 2018, adjusted for specific items that are required to be recognized in the period in which they are incurred. Our effective tax rate and resulting provision for income taxes for the three and nine months ended December 31, 2017 was significantly impacted by the U.S. Tax Cuts and Jobs Act (the "U.S. Tax Act"), enacted on December 22, 2017. The U.S. Tax Act significantly revises the U.S. corporate income tax system by, among other things, lowering the U.S. corporate income tax rates, generally implementing a territorial tax system and imposing the Transition Tax.

Our effective tax rate for the three and nine months ended December 31, 2017 was negative 1,062.5 percent and positive 37.3 percent, respectively, as compared to 83.3 percent and 18.8 percent, respectively for the same periods in fiscal year 2017. The effective tax rate for the three and nine months ended December 31, 2017 was negatively impacted by the provisional income tax effects of the U.S. Tax Act, offset by earnings realized in countries that have lower statutory tax rates and the recognition of excess tax benefits from stock-based compensation. Without the provisional tax charge of the U.S. Tax Act, our effective tax rate for the three and nine months ended December 31, 2017 would have been 37.5 percent and 11.9 percent, respectively.

We have a March 31 fiscal year-end; therefore, the lower corporate tax rate enacted by the U.S. Tax Act will be phased in, resulting in a U.S. statutory federal rate of 31.6 percent for our fiscal year ending March 31, 2018, and 21.0 percent for subsequent fiscal years. When compared to the statutory rate of 31.6 percent, the effective tax rate for the three and nine months ended December 31, 2017 was higher primarily due to the income tax impacts of the U.S. Tax Act, offset by earnings realized in countries that have lower statutory tax rates and the recognition of excess tax benefits from stock-based compensation. We anticipate that the impact of excess tax benefits and tax deficiencies may result in significant fluctuations to our effective tax rate in the future. Excluding excess tax benefits, our effective tax rate would have been negative 1,075.0 percent and positive 43.6 percent, respectively, for the three and nine months ended December 31, 2017.

We recorded a provision for income taxes of \$170 million and \$259 million for the three and nine months ended December 31, 2017, respectively, including \$176 million which is a reasonable estimate of the impacts of the U.S. Tax Act. We recorded a reasonable estimate of \$151 million related to the Transition Tax. The final calculation of the Transition Tax may differ from our estimates, potentially materially, due to, among other things, changes in interpretations of the U.S. Tax Act, our analysis of the U.S. Tax Act, or any updates or changes to estimates that we have utilized to calculate the transition impacts, including impacts from changes to current year earnings estimates and assertions.

In addition, we provisionally recorded a tax charge related to the remeasurement of U.S. deferred tax assets and liabilities as a result of the reduction of the U.S. corporate tax rate and a tax benefit related to the deferred tax impacts of global intangible income. The impact of these, as well as certain other charges and benefits, were not material individually, or in the aggregate, and are provisional for the same reasons as stated above.

Reasonable estimates of the impacts of the U.S. Tax Act are provided in accordance with SEC guidance that allows for a measurement period of up to one year after the enactment date of the U.S. Tax Act to finalize the recording of the related tax impacts. We expect to complete the accounting under the U.S. Tax Act as soon as practicable, but in no event later than one year from the enactment date of the U.S. Tax Act.

We file income tax returns and are subject to income tax examinations in various jurisdictions with respect to fiscal years after 2008. The timing and potential resolution of income tax examinations is highly uncertain. While we continue to measure our uncertain tax positions, the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued. It is reasonably possible that a

reduction of up to \$45 million of unrecognized tax benefits may occur within the next 12 months, a portion of which would impact our effective tax rate. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements.

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LIQUIDITY AND CAPITAL RESOURCES

| (In millions) | As of December 31, 2017 | As of March 31, 2017 | Increase/(Decrease) |
|----------------------------|-------------------------------|----------------------------|---------------------|
| Cash and cash equivalents | \$ 2,566 | \$ 2,565 | \$ 1 |
| Short-term investments | 2,318 | 1,967 | 351 |
| Total | \$ 4,884 | \$ 4,532 | \$ 352 |
| Percentage of total assets | 57 % | 59 % | |

| (In millions) | Nine Months Ended December 31, | | |
|---|--------------------------------------|---------|--------|
| | 2017 | 2016 | Change |
| Net cash provided by operating activities | \$1,077 | \$1,141 | \$(64) |
| Net cash used in investing activities | (593) | (498) | (95) |
| Net cash used in financing activities | (508) | (625) | 117 |
| Effect of foreign exchange on cash and cash equivalents | 25 | (28) | 53 |
| Net increase in cash and cash equivalents | \$1 | \$(10) | \$11 |

Changes in Cash Flow

Operating Activities. Net cash provided by operating activities decreased by \$64 million during the nine months ended December 31, 2017 as compared to the nine months ended December 31, 2016. The decrease is primarily driven by a \$160 million decrease in accounts receivables collections due to the timing of customer receipts and game launches during the three months ended December 31, 2017 as compared to the three months ended December 31, 2016. This decrease was partially offset by a \$46 million increase in operating cash flows as a result of sales related to the FIFA, Star Wars, and Need for Speed franchises and a \$39 million increase in other assets primarily due to higher prepaid royalties during the nine months ended December 31, 2017, as compared to the nine months ended December 31, 2016.

Investing Activities. Net cash used in investing activities increased by \$95 million during the nine months ended December 31, 2017 as compared to the nine months ended December 31, 2016 primarily driven by a \$640 million increase in the purchase of short-term investments, and the payment of \$150 million in connection with the acquisition of Respawn. This increase is partially offset by a \$688 million increase in proceeds from the sales and maturities of short-term investments.

Financing Activities. Net cash used in financing activities decreased by \$117 million during the nine months ended December 31, 2017 as compared to the nine months ended December 31, 2016 primarily due to a repayment of \$163 million of our formerly outstanding convertible notes during the nine months ended December 31, 2016 and a \$24 million increase in proceeds from the exercise of stock options and the purchase of ESPP during the nine months ended December 31, 2017 as compared to the nine months ended December 31, 2016. This decrease was partially offset by a \$70 million increase in the repurchase and retirement of common stock during the nine months ended December 31, 2017 as compared to the nine months ended December 31, 2016.

Cash Flow Reclassifications. The adoption of ASU 2016-09 at the beginning of fiscal year 2018 resulted in two changes to our cash flow presentation. First, excess tax benefits are now presented as operating activities rather than as financing activities. Second, cash payments to taxing authorities in connection with shares withheld to meet statutory tax withholding requirements are now presented as a financing activity rather than as an operating activity. Both of these changes had the effect of increasing our cash provided by operating activities and increasing our cash used in financing activities for the nine months ended December 31, 2017 and 2016. We recast our cash flow presentation for the nine months ended December 31, 2016 to reflect the adoption of ASU 2016-09. For more information, see Note 1 - Description of Business and Basis of Presentation to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to ASU 2016-09.

Short-term Investments

Due to our mix of fixed and variable rate securities, our short-term investment portfolio is susceptible to changes in short-term interest rates. As of December 31, 2017, our short-term investments had gross unrealized losses of \$8 million, or less than 1 percent of the total in short-term investments, and gross unrealized gains of less than \$1 million, or less than 1 percent of the total in short-term investments. From time to time, we may liquidate some or all of our short-term investments to fund operational needs or other activities, such as capital expenditures, business acquisitions or stock repurchase programs.

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Depending on which short-term investments we liquidate to fund these activities, we could recognize a portion, or all, of the gross unrealized gains or losses.

Senior Notes

In February 2016, we issued \$600 million aggregate principal amount of the 2021 Notes and \$400 million aggregate principal amount of the 2026 Notes. We used the net proceeds of \$989 million for general corporate purposes, including the payment of our formerly outstanding convertible notes and the repurchase of our common stock, including under the \$500 million stock repurchase program approved in February 2016 and completed in March 2016. The effective interest rate is 3.94% for the 2021 Notes and 4.97% for the 2026 Notes. Interest is payable semiannually in arrears, on March 1 and September 1 of each year. See Note 11 - Financing Arrangements to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our Senior Notes, which is incorporated by reference into this Item 2.

Credit Facility

In March 2015, we entered into a \$500 million senior unsecured revolving credit facility with a syndicate of banks. As of December 31, 2017, no amounts were outstanding under the credit facility.

See Note 11 - Financing Arrangements to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to the above items, which is incorporated by reference into this Item 2.

Financial Condition

We believe that our cash, cash equivalents, short-term investments, cash generated from operations and available financing facilities will be sufficient to meet our operating requirements for at least the next 12 months, including working capital requirements, capital expenditures, debt repayment obligations, and potentially, future acquisitions, stock repurchases, or strategic investments. We may choose at any time to raise additional capital to repay debt, strengthen our financial position, facilitate expansion, repurchase our stock, pursue strategic acquisitions and investments, and/or to take advantage of business opportunities as they arise. There can be no assurance, however, that such additional capital will be available to us on favorable terms, if at all, or that it will not result in substantial dilution to our existing stockholders.

As of December 31, 2017, approximately \$3.1 billion of our cash, cash equivalents, and short-term investments were domiciled in foreign tax jurisdictions. As a result of the U.S. Tax Act, which generally implemented a territorial tax system, a substantial portion of this amount is available for repatriation.

In May 2015, our Board of Directors authorized a program to repurchase up to \$1 billion of our common stock. We repurchased approximately 0.3 million shares for approximately \$31 million under this program during the three months ended June 30, 2017. We completed repurchases under the May 2015 program in April 2017.

In May 2017, a Special Committee of our Board of Directors, on behalf of the full Board of Directors, authorized a program to repurchase up to \$1.2 billion of our common stock. This stock repurchase program expires on May 31, 2019. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase a specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and nine months ended December 31, 2017, we repurchased approximately 1.4 million and 3.8 million shares for approximately \$150 million and \$422 million, respectively, under this program. We are actively repurchasing shares under this program.

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

concurrent or other financings at any time.

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

Contractual Obligations and Commercial Commitments

Note 12 - Commitments and Contingencies to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our contractual obligations and commercial commitments, which is incorporated by reference into this Item 2.

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OFF-BALANCE SHEET COMMITMENTS

As of December 31, 2017, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC, that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues and expenses, results of operations, liquidity, capital expenditures, or capital resources that are material to investors.

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Item 3: Quantitative and Qualitative Disclosures About Market Risk

MARKET RISK

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

Foreign Currency Exchange Risk

Foreign Currency Exchange Rates. International sales are a fundamental part of our business, and the strengthening of the U.S. dollar (particularly relative to the Euro, British pound sterling, Australian dollar, Chinese yuan and South Korean won) has a negative impact on our reported international net revenue, but a positive impact on our reported international operating expenses (particularly the Swedish krona and Canadian dollar) because these amounts are translated at lower rates as compared to periods in which the U.S. dollar is weaker. While we use foreign currency hedging contracts to mitigate some foreign currency exchange risk, these activities are limited in the protection that they provide us and can themselves result in losses.

Cash Flow Hedging Activities. We hedge a portion of our foreign currency risk related to forecasted foreign-currency-denominated sales and expense transactions by purchasing foreign currency forward contracts that generally have maturities of 18 months or less. These transactions are designated and qualify as cash flow hedges. Our hedging programs are designed to reduce, but do not entirely eliminate, the impact of currency exchange rate movements in net revenue and research and development expenses.

Balance Sheet Hedging Activities. We use foreign currency forward contracts to mitigate foreign currency exchange 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 three months or less and are transacted near month-end.

We believe the counterparties to our foreign currency forward contracts are creditworthy multinational commercial banks. While we believe the risk of counterparty nonperformance is not material, a sustained decline in the financial stability of financial institutions as a result of disruption in the financial markets could affect our ability to secure creditworthy counterparties for our foreign currency hedging programs.

Notwithstanding our efforts to mitigate some foreign currency exchange risks, there can be no assurance that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations. As of December 31, 2017, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 20 percent would have resulted in potential declines in the fair value on our foreign currency forward contracts used in cash flow hedging of \$122 million or \$244 million, respectively. As of December 31, 2017, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 20 percent would have resulted in potential losses on our foreign currency forward contracts used in balance sheet hedging of \$99 million or \$197 million, respectively. This sensitivity analysis assumes an adverse shift of all foreign currency exchange rates; however, all foreign currency exchange rates do not always move in such manner and actual results may differ materially. See Note 4 - Derivative Financial Instruments to the Condensed Consolidated Financial Statements in this Form 10-Q as it relates to our derivative financial instruments, which is incorporated by reference into this Item 3.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our short-term investment portfolio. We manage our interest rate risk by maintaining an investment portfolio generally consisting of debt instruments of high credit quality and relatively short maturities. However, because short-term investments mature relatively quickly and,

if reinvested, are invested at the then-current market rates, interest income on a portfolio consisting of short-term investments is subject to market fluctuations to a greater extent than a portfolio of longer term investments. Additionally, the contractual terms of the investments do not permit the issuer to call, prepay or otherwise settle the investments at prices less than the stated par value. Our investments are held for purposes other than trading. We do not use derivative financial instruments in our short-term investment portfolio.

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As of December 31, 2017, our short-term investments were classified as available-for-sale securities and, consequently, were recorded at fair value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive income (loss), net of tax, in stockholders' equity.

Notwithstanding our efforts to manage interest rate risks, there can be no assurance that we will be adequately protected against risks associated with interest rate fluctuations. Fluctuations in interest rates could have a significant impact on the fair value of our investment portfolio. The following table presents the hypothetical changes in the fair value of our short-term investment portfolio as of December 31, 2017, arising from potential changes in interest rates. The modeling technique estimates the change in fair value from immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points ("BPS"), 100 BPS, and 150 BPS.

| (In millions) | Valuation of Securities Given an Interest Rate Decrease of X Basis Points | | | Fair Value as of December 31, 2017 | Valuation of Securities Given an Interest Rate Increase of X Basis Points | | |
|-------------------------------|---|-----------|----------|------------------------------------|---|----------|----------|
| | | | | | | | |
| | (150 BPS) | (100 BPS) | (50 BPS) | | 50 BPS | 100 BPS | 150 BPS |
| Corporate bonds | \$1,221 | \$ 1,217 | \$ 1,212 | \$ 1,209 | \$1,204 | \$ 1,200 | \$ 1,196 |
| U.S. Treasury securities | 453 | 451 | 449 | 446 | 444 | 442 | 439 |
| U.S. agency securities | 118 | 117 | 117 | 115 | 116 | 115 | 114 |
| Commercial paper | 295 | 295 | 294 | 294 | 293 | 293 | 293 |
| Foreign government securities | 99 | 99 | 98 | 98 | 97 | 96 | 96 |
| Asset-backed securities | 136 | 135 | 135 | 134 | 134 | 133 | 133 |
| Certificates of deposit | 22 | 22 | 22 | 22 | 22 | 22 | 22 |
| Total short-term investments | \$2,344 | \$ 2,336 | \$ 2,327 | \$ 2,318 | \$2,310 | \$ 2,301 | \$ 2,293 |

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Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

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

Changes in internal control over financial reporting

There has been no change in our internal controls over financial reporting identified in connection with our evaluation that occurred during the fiscal quarter ended December 31, 2017 that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Limitations on effectiveness of disclosure controls

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

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The information under the subheading “Legal Proceedings” in Note 12 - Commitments and Contingencies to the Condensed Consolidated Financial Statements in this Form 10-Q is incorporated by reference into this Part II.

Item 1A. Risk Factors

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

Our business is intensely competitive and “hit” driven. We may not deliver “hit” products and services, or consumers may prefer our competitors’ products or services over our own.

Competition in our industry is intense. Many new products and services are regularly introduced in each major industry segment (console, mobile and PC free-to-download), but only a relatively small number of “hit” titles account for a significant portion of total revenue in each segment. Our competitors range from established interactive entertainment companies and diversified media companies to emerging start-ups, and we expect new competitors to continue to emerge throughout the world. If our competitors develop and market more successful and engaging products or services, offer competitive products or services at lower price points, or if we do not continue to develop consistently high-quality, well-received and engaging products and services, our revenue, margins, and profitability will decline.

We maintain a relatively limited product portfolio in an effort to focus on developing high-quality and engaging products with the potential to become hits. High-quality titles, even if highly-reviewed, may not turn into hit products. Many hit products within our industry are iterations of prior hit products with large established consumer bases and significant brand recognition, which makes competing in certain product categories challenging. In addition, hit products or services of our competitors may take a larger portion of consumer spending or time than we anticipate, which could cause our products and services to underperform relative to our expectations. Publishing a relatively small number of major titles each year also concentrates risk in those titles and means each major title has greater associated risk. A significant portion of our revenue historically has been derived from games and services based on a few popular franchises, and the underperformance of a single major title could have a material adverse impact on our financial results. The increased importance of live services revenue to our business heightens the risks associated with our limited product portfolio as live services that are either poorly-received or provided in connection with underperforming games may generate lower than expected sales.

Our business is dependent on the success and availability of platforms developed by third parties, as well as our ability to develop commercially successful products and services for these platforms.

The success of our business is driven in part by the commercial success and adequate supply of third party platforms for which we develop our products and services or through which our products and services are distributed. Our success also depends on our ability to accurately predict which platforms will be successful in the marketplace, our ability to develop commercially successful products and services for these platforms and our ability to effectively manage the transition from one generation of platforms to the next. We must make product development decisions and commit significant resources well in advance of anticipated platform release dates and may incur significant expense to adjust our product portfolio and development efforts in response to changing consumer platform preferences. Additionally, we may enter into certain exclusive licensing arrangements that affect our ability to deliver or market

products or services on certain platforms. A platform for which we are developing products and services may not succeed as expected or new platforms may take market share and interactive entertainment consumers away from platforms for which we have devoted significant resources. If consumer demand for the platforms for which we are developing products and services is lower than our expectations, we may be unable to fully recover the investments we have made in developing our products and services, and our financial performance will be harmed. Alternatively, a platform for which we have not devoted significant resources could be more successful than we initially anticipated, causing us to not be able to take advantage of meaningful revenue opportunities.

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Technology changes rapidly in our business and if we fail to anticipate or successfully implement new technologies or adopt new business strategies, technologies or methods, the quality, timeliness and competitiveness of our products and services may suffer.

Rapid technology changes in our industry require us to anticipate, sometimes years in advance, which technologies we must develop, implement and take advantage of in order to make our products and services competitive in the market. We have invested, and in the future may invest, in new business strategies, technologies, products, and services. For example, we are investing in the infrastructure for our EA Player Network which we expect will allow us to market and deliver content and services for our franchises more efficiently as well as enable new player-centric ways to discover and try new experiences. Such endeavors may involve significant risks and uncertainties, and no assurance can be given that the technology we choose to adopt and the products and services that we pursue will be successful. If we do not successfully implement these new technologies, our reputation may be materially adversely affected and our financial condition and operating results may be impacted. We also may miss opportunities to adopt technology, or develop products and services that become popular with consumers, which could adversely affect our financial results. It may take significant time and resources to shift our focus to such technologies, putting us at a competitive disadvantage.

Our development process usually starts with particular platforms and distribution methods in mind, and a range of technical development and feature goals that we hope to be able to achieve. We may not be able to achieve these goals, or our competition may be able to achieve them more quickly and effectively than we can. In either case, our products and services may be technologically inferior to those of our competitors, less appealing to consumers, or both. If we cannot achieve our technology goals within the original development schedule for our products and services, then we may delay their release until these goals can be achieved, which may delay or reduce revenue and increase our development expenses. Alternatively, we may increase the resources employed in research and development in an attempt to accelerate our development of new technologies, either to preserve our product or service launch schedule or to keep up with our competition, which would increase our development expenses.

We may experience security breaches and cyber threats.

We continually face cyber risks and threats that seek to damage, disrupt or gain access to our networks, our products and services, supporting infrastructure, intellectual property and other assets. In addition, we rely on technological infrastructure provided by third party business partners to support the online functionality of our products and services. These business partners, as well as our channel partners, also are subject to cyber risks and threats. Such cyber risks and threats may be difficult to detect. Both our partners and we have implemented certain systems, processes and technologies to guard against cyber risks and to help protect our data and systems. However, the techniques that may be used to obtain unauthorized access or disable, degrade, exploit or sabotage our products, services and systems change frequently and often are not detected. Our systems, processes and technologies, and the systems, processes and technologies of our business partners, may not be adequate. Any failure to prevent or mitigate security breaches or cyber risks, or respond adequately to a security breach or cyber risk, could result in interruptions to our products and services, degrade the user experience, cause consumers to lose confidence in our products, as well as significant legal and financial exposure. This could harm our business and reputation, disrupt our relationships with partners and diminish our competitive position.

Successful exploitation of our systems can have other negative effects upon the products, services and user experience we offer. In particular, the virtual economies that we have established in many of our games are subject to abuse, exploitation and other forms of fraudulent activity that can negatively impact our business. Virtual economies involve the use of virtual currency and/or virtual assets that can be used or redeemed by a player within a particular game or service. The abuse or exploitation of our virtual economies include the illegitimate generation and sale of virtual items

in black markets. Our online services have been impacted by in-game exploits and the use of automated processes to generate virtual currency illegitimately, and such activity may continue. These kinds of activities and the steps that we take to address these issues may result in a loss of anticipated revenue, interfere with players' enjoyment of a balanced game environment and cause reputational harm.

Our business could be adversely affected if our consumer protection, data privacy and security practices are not adequate, or perceived as being inadequate, to prevent data breaches, or by the application of consumer protection and data privacy and security laws generally.

In the course of our business, we collect, process, store and use consumer and other information, including personal information, passwords and credit card information. Although we take measures to protect this information from unauthorized access, acquisition, disclosure and misuse, our security controls, policies and practices may not be able to prevent the improper or unauthorized access,

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acquisition or disclosure of such information. For example, third parties may fraudulently induce employees or customers into disclosing identification or other sensitive information which may, in turn, be used to access our information technology systems. The unauthorized access, acquisition or disclosure of this information, or a perception that we do not adequately secure consumer and other information could result in legal liability, costly remedial measures, governmental and regulatory investigations, harm our profitability and reputation and cause our financial results to be materially affected. In addition, third party vendors and business partners receive access to information that we collect. These vendors and business partners may not prevent data security breaches with respect to the information we provide them or fully enforce our policies, contractual obligations and disclosures regarding the collection, use, storage, transfer and retention of personal data. A data security breach of one of our vendors or business partners could cause reputational harm to them and/or negatively impact our ability to offer our products and services.

We are subject to payment card association rules and obligations pursuant to contracts with payment card processors. Under these rules and obligations, if information is compromised, we could be liable to payment card issuers for the cost of associated expenses and penalties. In addition, if we fail to follow payment card industry security standards, even if no consumer information is compromised, we could incur significant fines or experience a significant increase in payment card transaction costs.

Data privacy, data protection, localization, security and consumer-protection laws are evolving, and the interpretation and application of these laws in the United States, Europe and elsewhere often are uncertain, contradictory and changing. It is possible that these laws may be interpreted or applied in a manner that is adverse to us or otherwise inconsistent with our practices, which could result in litigation, regulatory investigations and potential legal liability or require us to change our practices in a manner adverse to our business. As a result, our reputation and brand may be harmed, we could incur substantial costs, and we could lose both consumers and revenue.

We may experience outages, disruptions and/or degradations of our online services.

We are investing and expect to continue to invest in technology, hardware and software to support the online functionality of our portfolio of products and services. In addition, we rely on technological infrastructure provided by third party business partners. Launching and operating games and services with online features, developing related technologies and implementing online business initiatives is expensive and complex. Implementation of these technologies and execution of these initiatives could result in operational failures and other issues impacting the technical stability of our products and services. In addition, having access to the necessary infrastructure to support the online functionality of our products and services is vital to our growth and success. Our products and services could be adversely impacted by outages, disruptions, failures and/or degradations in our network and related infrastructure, as well as in the online platforms or services of key business partners who offer or support our products and services.

Negative player perceptions about our brands, products, services and/or business practices may damage our business and the costs incurred in addressing player concerns may increase our operating expenses.

Player expectations regarding the quality, performance and integrity of our products and services are high. Players may be critical of our brands, products, services and/or business practices for a wide variety of reasons. These negative player reactions may not be foreseeable or within our control to manage effectively, including perceptions about gameplay fairness, negative player reactions to game content, components and services, or objections to certain of our business practices. In the past, we have taken actions, including delaying the release of our games and discontinuing services for our games, after taking into consideration, among other things, feedback from the player community even if those decisions negatively impacted our operating results in the short term. We expect to continue to take actions to address concerns as appropriate, including actions that may result in additional expenditures and the loss of revenue. Negative player sentiment about our business practices also can lead to investigations from regulatory

agencies and consumer groups, as well as litigation, which, regardless of their outcome, may be costly, damaging to our reputation and harm our business.

We may not consistently meet our product development schedules or key events, sports seasons or movies that we tie our product release schedules to may be delayed, cancelled or poorly received.

Our ability to meet product development schedules is affected by a number of factors both within and outside our control, including feedback from our players, the creative processes involved, the coordination of large and sometimes geographically dispersed development teams, the complexity of our products and the platforms for which they are developed, the need to fine-tune our products prior to their release and, in certain cases, approvals from third parties. We have experienced development delays for our products in the past, which caused us to delay or cancel release dates. We also seek to release certain products in conjunction with key events, such as the beginning of a sports season, major sporting event, or the release of a related movie. If such a key event were delayed, cancelled or poorly received, our sales likely would suffer materially. Any failure to meet anticipated production or release schedules likely would result in a delay of revenue and/or possibly a significant shortfall in our revenue, increase our

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development and/or marketing expenses, harm our profitability, and cause our operating results to be materially different than anticipated.

Our business is highly seasonal with the highest percentage of our sales occurring in the quarter ending in December. While our sales generally follow this seasonal trend, there can be no assurance that this trend will continue. If we miss key selling periods for products, for any reason, including product delays, product cancellations, or delayed introduction of a new platform for which we have developed products and services or through which we distribute our products and services, our sales likely will suffer significantly. Additionally, macroeconomic conditions or the occurrence of unforeseen events that negatively impact retailer or consumer buying patterns, particularly during the quarter ending in December, likely will harm our financial performance disproportionately.

Our financial results are subject to currency fluctuations.

International sales are a fundamental part of our business. For our fiscal year ended March 31, 2017, international net revenue comprised 56 percent of our total net revenue, and we expect our international business to continue to account for a significant portion of our total net revenue. As a result of our international sales, and also the denomination of our foreign investments and our cash and cash equivalents in foreign currencies, we are exposed to the effects of fluctuations in foreign currency exchange rates. Strengthening of the U.S. dollar, particularly relative to the Euro, British pound sterling, Australian dollar, Chinese yuan and South Korean won, has a negative impact on our reported international net revenue but a positive impact on our reported international operating expenses (particularly when the U.S. dollar strengthens against the Swedish krona and the Canadian dollar) because these amounts are translated at lower rates. We use foreign currency hedging contracts to mitigate some foreign currency risk. However, these activities are limited in the protection they provide us from foreign currency fluctuations and can themselves result in losses.

We may not attract and retain key personnel.

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

We may experience declines or fluctuations in the recurring portion of our business.

Our business model includes revenue that we deem recurring in nature, such as revenue from our annualized titles (e.g., FIFA and Madden NFL), and associated services, and ongoing mobile businesses. While we have been able to forecast the revenue from these areas of our business with greater certainty than for new offerings, we cannot provide assurances that consumers will purchase these games and services on a consistent basis. Furthermore, we may cease to offer games and services that we previously had deemed to be recurring in nature. Consumer purchases of our games and services may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our games and services, our ability to improve and innovate our annualized titles, our ability to adapt our games and services to new platforms, outages and disruptions of online services, the games and services offered by our competitors, our marketing and advertising efforts or declines in consumer activity generally as a result of economic downturns, among others. The reception to our licensed sports games may be adversely impacted by circumstances outside our control impacting the sports leagues and organizations. Any decline or fluctuation in the recurring portion of our business may have a negative impact on our financial and operating results.

We could fail to successfully adopt new business models.

From time to time we seek to establish and implement new business models. Forecasting the success of any new business model is inherently uncertain and depends on a number of factors both within and outside of our control. Our actual revenue and profit for these businesses may be significantly greater or less than our forecasts. Additionally, these new business models could fail, resulting in the loss of our investment in the development and infrastructure needed to support these new business models, as well as the opportunity cost of diverting management and financial resources away from more successful and established businesses.

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We may be unable to maintain or acquire licenses to include intellectual property owned by others in our games, or to maintain or acquire the rights to publish or distribute games developed by others.

Many of our products and services are based on or incorporate intellectual property owned by others. For example, our EA Sports products include rights licensed from major sports leagues and players' associations and our Star Wars products include rights licensed from Disney. Competition for these licenses and rights is intense. If we are unable to maintain these licenses and rights or obtain additional licenses or rights with significant commercial value, our ability to develop and successful and engaging games and services may be adversely affected and our revenue, profitability and cash flows may decline significantly. Competition for these licenses also may increase the amounts that we must pay to licensors and developers, through higher minimum guarantees or royalty rates, which could significantly increase our costs and reduce our profitability.

External game developers may not meet product development schedules or otherwise honor their obligations.

We may contract with external game developers to develop our games or to publish or distribute their games. While we maintain contractual protections, we have less control over the product development schedules of games developed by external developers, and we depend on their ability to meet product development schedules. In addition, we may have disputes with external developers over game content, launch timing, achievement of certain milestones, the game development timeline, marketing campaigns or other matters. If we have disputes with external developers or they cannot meet product development schedules, acquire certain approvals or are otherwise unable or unwilling to honor their obligations to us, we may delay or cancel previously announced games, alter our launch schedule or experience increased costs and expenses, which could result in a delay or significant shortfall in anticipated revenue, harm our profitability and reputation, and cause our financial results to be materially affected.

The products or services we release may contain defects.

Our products and services are extremely complex software programs, and are difficult to develop and distribute. We have quality controls in place to detect defects in our products and services before they are released. Nonetheless, these quality controls are subject to human error, overriding, and reasonable resource or technical constraints. Therefore, these quality controls and preventative measures may not be effective in detecting all defects in our products and services before they have been released into the marketplace. In such an event, we could be required to, or may find it necessary to, offer a refund for the product or service, suspend the availability or sale of the product or service or expend significant resources to cure the defect, each of which could significantly harm our business and operating results.

Our business is subject to regulation, and changes in applicable regulations may negatively impact our business.

We are subject to a number of foreign and domestic laws and regulations that affect companies conducting business on the Internet. In addition, laws and regulations relating to user privacy, data collection, retention, electronic commerce, virtual items and currency, consumer protection, content, advertising, localization, and information security have been adopted or are being considered for adoption by many jurisdictions and countries throughout the world. These laws could harm our business by limiting the products and services we can offer consumers or the manner in which we offer them. The costs of compliance with these laws may increase in the future as a result of changes in interpretation. Furthermore, any failure on our part to comply with these laws or the application of these laws in an unanticipated manner may harm our business and result in penalties or significant legal liability.

We are subject to laws in certain foreign countries, and adhere to industry standards in the United States, that mandate rating requirements or set other restrictions on the advertisement or distribution of interactive entertainment software based on content. In addition, certain foreign countries allow government censorship of interactive entertainment

software products. Adoption of ratings systems, censorship or restrictions on distribution of interactive entertainment software based on content could harm our business by limiting the products we are able to offer to our customers. In addition, compliance with new and possibly inconsistent regulations for different territories could be costly, delay or prevent the release of our products in those territories.

In addition, we may include modes in our games that allow players to compete against each other and we may manage player competitions based on our products and services. Although we structure and operate these skill-based competitions with applicable laws in mind, our skill based competitions in the future could become subject to evolving rules and regulations and expose us to significant liability, penalties and reputational harm.

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Our marketing and advertising efforts may fail to resonate with our customers.

Our products and services are marketed worldwide through a diverse spectrum of advertising and promotional programs such as online and mobile advertising, television advertising, retail merchandising, marketing through websites, event sponsorship and direct communications with our consumers including via email. Furthermore, an increasing portion of our marketing activity is taking place on social media platforms that are outside of our direct control. Our ability to sell our products and services is dependent in part upon the success of these programs, and changes to consumer preferences, marketing regulations, technology changes or service disruptions may negatively impact our ability to reach our customers. Moreover, if the marketing for our products and services fails to resonate with our customers, particularly during the critical holiday season or during other key selling periods, or if advertising rates or other media placement costs increase, our business and operating results could be harmed.

A significant portion of our sales are made to a relatively small number of customers, and these sales may be disrupted.

We derive a significant percentage of our net revenue through sales to our top customers. The concentration of a significant percentage of our sales through a few large customers could lead to a short-term disruption to our business if certain of these customers significantly reduced their purchases or ceased to offer our products and services. We also could be more vulnerable to collection risk if one or more of these large customers experienced a deterioration of their business or declared bankruptcy. Additionally, receivables from our customers generally increase in our December fiscal quarter as sales of our products and services generally increase in anticipation of the holiday season. Having a significant portion of our net revenue concentrated in sales through a few customers could reduce our negotiating leverage with them. If one or more of our key customers experience deterioration in their business, or become unable to obtain sufficient financing to maintain their operations, our business could be harmed.

Our channel partners have significant influence over the products and services that we offer on their platforms.

Our agreements with our channel partners typically give them significant control over the approval, manufacturing and distribution of the products and services that we develop for their platform. In particular, our arrangements with Sony and Microsoft could, in certain circumstances, leave us unable to get our products and services approved, manufactured and distributed to customers. For our digital products and services delivered via digital channels such as Sony's PlayStation Store, Microsoft's Xbox Store, Apple's App Store and Google Play, each respective channel partner has policies and guidelines that control the promotion and distribution of these titles and the features and functionalities that we are permitted to offer through the channel. In addition, we are dependent on our channel partners to invest in, and upgrade, digital commerce capabilities in a manner than corresponds to the way in which consumers purchase our products and services. Failure by our channels partners to keep pace with consumer preferences could have an adverse impact on our ability to merchandise and commercialize our products and services which could harm our business and/or financial results.

Moreover, certain of our channel partners can determine and change unilaterally certain key terms and conditions, including the ability to change their user and developer policies and guidelines. In many cases our channel partners also set the rates that we must pay to provide our games and services through their online channels, and retain flexibility to change their fee structures or adopt different fee structures for their online channels, which could adversely impact our costs, profitability and margins. In addition, our channel partners control the information technology systems through which online sales of our products and service channels are captured. If our channel partners establish terms that restrict our offerings through their channels, significantly impact the financial terms on which these products or services are offered to our customers, or their information technology systems fail or cause an unanticipated delay in reporting, our business and/or financial results could be materially affected.

Our business is subject to risks generally associated with the entertainment industry.

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

Our business partners may be unable to honor their obligations to us or their actions may put us at risk.

We rely on various business partners, including third-party service providers, vendors, licensing partners, development partners, and licensees in many areas of our business. Their actions may put our business and our reputation at risk. For example, we may have disputes with our business partners that may impact our business and/or financial results. In many cases, our business partners

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may be given access to sensitive and proprietary information in order to provide services and support to our teams, and they may misappropriate our information and engage in unauthorized use of it. In addition, the failure of these third parties to provide adequate services and technologies, or the failure of the third parties to adequately maintain or update their services and technologies, could result in a disruption to our business operations. Further, disruptions in the financial markets, economic downturns, poor business decisions, or reputational harm may adversely affect our business partners and they may not be able to continue honoring their obligations to us or we may cease our arrangements with them. Alternative arrangements and services may not be available to us on commercially reasonable terms or we may experience business interruptions upon a transition to an alternative partner or vendor. If we lose one or more significant business partners, our business could be harmed and our financial results could be materially affected.

We may be subject to claims of infringement of third-party intellectual property rights.

From time to time, third parties may claim that we have infringed their intellectual property rights. For example, patent holding companies may assert patent claims against us in which they seek to monetize patents they have purchased or otherwise obtained. Although we take steps to avoid knowingly violating the intellectual property rights of others, it is possible that third parties still may claim infringement.

Existing or future infringement claims against us, whether valid or not, may be expensive to defend and divert the attention of our employees from business operations. Such claims or litigation could require us to pay damages and other costs. We also could be required to stop selling, distributing or supporting products, features or services which incorporate the affected intellectual property rights, redesign products, features or services to avoid infringement, or obtain a license, all of which could be costly and harm our business.

In addition, many patents have been issued that may apply to potential new modes of delivering, playing or monetizing interactive entertainment software products and services, such as those that we produce or would like to offer in the future. We may discover that future opportunities to provide new and innovative modes of game play and game delivery to consumers may be precluded by existing patents that we are unable to license on reasonable terms.

From time to time we may become involved in other legal proceedings.

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

Acquisitions, investments, divestitures and other strategic transactions could result in operating difficulties and other negative consequences.

We may make acquisitions or enter into other strategic transactions including (1) acquisitions of companies, businesses, intellectual properties, and other assets, (2) minority investments in strategic partners, and (3) investments in new interactive entertainment businesses as part of our long-term business strategy. These transactions involve significant challenges and risks including that the transaction does not advance our business strategy, that we do not realize a satisfactory return on our investment, that we acquire liabilities, diversion of management's attention from our other businesses, the incurrence of debt, contingent liabilities or amortization expenses, write-offs of goodwill, intangibles, or acquired in-process technology, or other increased cash and non-cash expenses. In addition, we may not integrate these businesses successfully, including experiencing difficulty in the integration of business systems and technologies, the integration and retention of new employees, or in the maintenance of key business and customer

relationships. These events could harm our operating results or financial condition. We also may divest or sell assets or a business and we may have difficulty selling such assets or business on acceptable terms in a timely manner. This could result in a delay in the achievement of our strategic objectives, cause us to incur additional expense, or the sale of such assets or business at a price or on terms that are less favorable than we anticipated.

Our products and brands are subject to the threat of piracy, unauthorized copying and other forms of intellectual property infringement.

We regard our products and brands as proprietary and take measures to protect our products, brands and other confidential information from infringement. We are aware that some unauthorized copying of our products and brands occurs, and if a significantly greater amount were to occur, it could negatively impact our business.

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Piracy and other forms of unauthorized copying and use of our content and brands are persistent problems for us, and policing is difficult. Further, the laws of some countries in which our products are or may be distributed either do not protect our products and intellectual property rights to the same extent as the laws of the United States, or are poorly enforced. Legal protection of our rights may be ineffective in such countries. In addition, although we take steps to enforce and police our rights, factors such as the proliferation of technology designed to circumvent the protection measures used by our business partners or by us, the availability of broadband access to the Internet, the refusal of Internet service providers or platform holders to remove infringing content in certain instances, and the proliferation of online channels through which infringing product is distributed all have contributed to an expansion in unauthorized copying of our products and brands.

We may experience outages, disruptions and/or degradations of our infrastructure.

We may experience outages, disruptions and/or degradations of our infrastructure, including information technology system failures and network disruptions. These may be caused by natural disasters, cyber-incidents, weather events, power disruptions, telecommunications failures, failed upgrades of existing systems or migrations to new systems, acts of terrorism or other events. System redundancy may be ineffective or inadequate, and our disaster recovery planning may not be sufficient for all eventualities. Such failures or disruptions could prevent access to our products, services or online stores selling our products and services or interruption in our ability to conduct critical business functions. Our corporate headquarters in Redwood City, CA and our studio in Burnaby, British Columbia are located in seismically active regions, and certain of our game development activities and other essential business operations are conducted at these locations. An event that results in the disruption or degradation of any of our critical business or information technology systems could harm our ability to conduct normal business operations.

We utilize debt financing and such indebtedness could adversely impact our business and financial condition.

We have \$1 billion in senior unsecured notes outstanding as well as an unsecured committed \$500 million revolving credit facility. While the facility is currently undrawn, we may use the proceeds of any future borrowings for general corporate purposes. We may also enter into other financial instruments in the future.

Our indebtedness could affect our financial condition and future financial results by, among other things:

Requiring the dedication of a substantial portion of any cash flow from operations to the payment of principal of, and interest on, our indebtedness, thereby reducing the availability of such cash flow to fund our growth strategy, working capital, capital expenditures and other general corporate purposes; and

Limiting our flexibility in planning for, or reacting to, changes in our business and our industry.

The agreements governing our indebtedness impose restrictions on us and require us to maintain compliance with specified covenants. In particular, the revolving credit facility includes a maximum capitalization ratio and minimum liquidity requirements. Our ability to comply with these covenants may be affected by events beyond our control. If we breach any of these covenants and do not obtain a waiver from the lenders or noteholders, then, subject to applicable cure periods, our outstanding indebtedness may be declared immediately due and payable. In addition, changes by any rating agency to our credit rating may negatively impact the value and liquidity of both our debt and equity securities, as well as the potential costs associated with any potential refinancing our indebtedness. Downgrades in our credit rating could also restrict our ability to obtain additional financing in the future and could affect the terms of any such financing.

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

We are subject to taxes in the United States and in various foreign jurisdictions. Significant judgment is required in determining our worldwide income tax provision, tax assets, and accruals for other taxes, and there are many transactions and calculations where the ultimate tax determination is uncertain. Our effective income tax rate could be adversely affected by our profit levels, changes in our business, reorganization of our business and operating structure, changes in the mix of earnings in countries with differing statutory tax rates, changes in the elections we make, changes in applicable tax laws or interpretations of existing tax laws, or changes in the valuation allowance for deferred tax assets, as well as other factors. The Tax Cuts and Jobs Act, enacted on December 22, 2017, represents a significant overhaul to the U.S. federal tax code. This tax legislation lowers the U.S. statutory tax rate, but also includes a number of provisions that could significantly and adversely impact our U.S. federal income tax position in a reporting period, including the limitation or elimination of certain deductions or credits, and ongoing tax requirements related to foreign earnings. During the three months ended December 31, 2017, we recorded a provision for income taxes of \$176 million which is a reasonable estimate of the impact of the U.S. Tax Act. The final calculation of tax expense resulting from the U.S. Tax

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Act may differ from our estimates, potentially materially, due to, among other things, changes in interpretations of the U.S. Tax Act, our analysis of the U.S. Tax Act, or any updates or changes to estimates that we have utilized to calculate the transition impacts, including impacts from changes to current year earnings estimates and assertions. In addition, any further changes to tax laws applicable to corporate multinationals in the countries in which we do business could adversely affect our effective tax rates, cause us to change the way in which we structure our business or result in other costs to us.

We are also required to pay taxes other than income taxes, such as payroll, sales, use, value-added, net worth, property and goods and services taxes, in both the United States and foreign jurisdictions. Furthermore, we are regularly subject to audit by tax authorities with respect to both income and such other non-income taxes. Unfavorable audit results or tax rulings, or other changes resulting in significant additional tax liabilities could have material adverse effects upon our earnings, cash flows, and financial condition.

Our reported financial results could be adversely affected by changes in financial accounting standards.

Our reported financial results are impacted by the accounting standards promulgated by the SEC and national accounting standards bodies and the methods, estimates, and judgments that we use in applying our accounting policies. These methods, estimates, and judgments are subject to risks, uncertainties, assumptions and changes that could adversely affect our reported financial position and financial results. In addition, changes to applicable financial accounting standards could adversely affect our reported financial position and financial results. For example, recently issued accounting standards are expected to materially change the way in which we recognize revenue and account for leases upon adoption. For more information, see Part I, Item 1 of this Form 10-Q in the Notes to Consolidated Financial Statements in Note 1 - Description of Business and Basis of Presentation under the subheading "Impact of Recently Issued Accounting Standards".

As we enhance, expand and diversify our business and product offerings, the application of existing or future financial accounting standards, particularly those relating to the way we account for revenue, costs and taxes, could have an adverse effect on our reported results although not necessarily on our cash flows.

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

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

Table of ContentsItem 2. Unregistered Sales of Equity Securities and Use of Proceeds
Stock Purchase Programs

In May 2015, our Board of Directors authorized a program to repurchase up to \$1 billion of our common stock. We repurchased approximately 0.3 million shares for approximately \$31 million under this program during the three months ended June 30, 2017. We completed repurchases under the May 2015 program in April 2017.

In May 2017, a Special Committee of our Board of Directors, on behalf of the full Board of Directors, authorized a program to repurchase up to \$1.2 billion of our common stock. This stock repurchase program expires on May 31, 2019. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase a specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three and nine months ended December 31, 2017, we repurchased approximately 1.4 million and 3.8 million shares for approximately \$150 million and \$422 million, respectively, under this program. We are actively repurchasing shares under this program.

The following table summarizes the number of shares repurchased during the three months ended December 31, 2017:

| Fiscal Month | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Programs | Maximum Dollar Value that May Still Be Purchased Under the Programs (in millions) |
|---------------------------------|---|---------------------------------------|--|--|
| October 1 - October 28, 2017 | 409,732 | \$116.42 | 409,732 | \$ 880 |
| October 29 - November 25, 2017 | 244,871 | \$112.41 | 244,871 | \$ 853 |
| November 26 - December 30, 2017 | 704,303 | \$106.33 | 704,303 | \$ 778 |
| | 1,358,906 | \$110.47 | 1,358,906 | |

Item 3. Defaults Upon Senior Securities
None.Item 4. Mine Safety Disclosures
Not applicable.

Item 6. Exhibits

The exhibits listed in the accompanying index to exhibits on Page 62 are filed or incorporated by reference as part of this report.

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FORM 10-Q
FOR THE PERIOD ENDED DECEMBER 31, 2017
EXHIBIT INDEX

| Number | Exhibit Title | Incorporated by Reference | | | Filed Herewith |
|---|--|---------------------------|----------|-------------|-------------------|
| | | Form | File No. | Filing Date | |
| <u>4.01</u> | <u>Specimen Common Stock Certificate</u> | | | | X |
| <u>15.1</u> | <u>Awareness Letter of KPMG LLP, Independent Registered Public Accounting Firm</u> | | | | X |
| <u>31.1</u> | <u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> | | | | X |
| <u>31.2</u> | <u>Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> | | | | X |
| Additional exhibits furnished with this report: | | | | | |
| <u>32.1</u> | <u>Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> | | | | X |
| <u>32.2</u> | <u>Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> | | | | X |
| 101.INS [†] | XBRL Instance Document | | | | X |
| 101.SCH [†] | XBRL Taxonomy Extension Schema Document | | | | X |
| 101.CAL [†] | XBRL Taxonomy Extension Calculation Linkbase Document | | | | X |
| 101.DEF [†] | XBRL Taxonomy Extension Definition Linkbase Document | | | | X |
| 101.LAB [†] | XBRL Taxonomy Extension Label Linkbase Document | | | | X |
| 101.PRE [†] | XBRL Taxonomy Extension Presentation Linkbase Document | | | | X |

*Management contract or compensatory plan or arrangement

Attached as Exhibit 101 to this Quarterly Report on Form 10-Q for the quarterly period ended December 31, 2017 are the following formatted in eXtensible Business Reporting Language ("XBRL"): (1) Condensed Consolidated Balance Sheets, (2) Condensed Consolidated Statements of Operations, (3) Condensed Consolidated Statements of Comprehensive Income (Loss), (4) Condensed Consolidated Statements of Cash Flows, and (5) Notes to Condensed Consolidated Financial Statements.

SIGNATURE

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

ELECTRONIC ARTS INC.
(Registrant)

/s/ Blake Jorgensen
DATED: Blake Jorgensen
February 6, 2018 Executive Vice President,
Chief Financial Officer

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