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Electronic Arts, Inc. *(EA)*

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MANAGEMENT DISCUSSION SECTION

Michael Pachter
Analyst, Wedbush Securities, Inc.

Welcome. I'm Michael Pachter of Wedbush Securities. We have Electronic Arts presenting today. I've been doing one-sentence intros, but I have a couple of sentences for John Riccitiello. Back in 2002, John was President of Electronic Arts and left and came back. In 2002, I thought the guy was a complete moron. He had this vision that EA was going to dominate in online game play, mobile, there was no such things as social, so casual. And I thought, it's packaged goods dude, don't take your eye off the ball, you're completely wrong. And here we're, it's a decade later, and I was wrong. And I honestly consider John a visionary. I don't know why the market doesn't consider him a visionary. He's going to tell you what a visionary is. They have a phenomenal business. I am a huge fan.

John Riccitiello, CEO of Electronic Arts. Thanks for being here.

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

Thank you. My pleasure. I wasn't expecting that introduction. So, could you write something like that at the end of this? So -

Michael Pachter
Analyst, Wedbush Securities, Inc.

I'd be happy to.

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

So, I am not going to read the Safe Harbor statement. I'm going to talk you through three things before we have an opportunity to go into some Q&A. I always think Q&A is the better part of these sections, so I'll try to keep it brief.

But I'm going to start with industry trends, and I, frankly, think that industry trends feel pretty good right now. What this slide shows is it breaks the industry down into reasonably logical chunks. There is the packaged goods business, which is low definition, or standard definition. That includes things like the Wii and handhelds. The chunk above that is high definition packaged goods, and what's above that is the pure digital models, mobile, social et cetera. It's a global presentation.

There's one thing on this slide that is very obvious and one thing that's not so obvious. If you just look at the green and the red, that's a 15% growth business. That feels pretty good. It's an overall CAGR of 8%, and what's happening is low definition is sort of sucking the top line out of it a little bit.

What's not obvious on this slide is a big chunk of that green stuff up there, the digital growth, is also attached to a high definition console. So with the high definition console business this past year 2011 by way of example, you can see it went from $13.7 billion to $13.9 billion, but it also added about $1 billion in digital in the year. So there's actually more growth in the high definition arena than you would otherwise notice.

If you look more specifically at the digital arena, you'll see the year-to-year performance, or the 2.3 to 3.1 that I referenced a minute ago, but by and large, digital has been a really, really nice business. Mobile handheld is up. Console digital is up, PC – casual PC, which includes the Facebook style businesses there.

So if you're an American, you tend to think of casual PC as really only including Facebook. It includes a lot of other things. We have things like Need for Speed, World, and Battlefield play for free. And there's companies like Big Fish and lots of different things in that arena, but it represents a big opportunity in our business and a big part of the growth.

What's actually fueling us, and I think an area for people to get their minds around, is recently as this 2002 timeframe that Michael mentioned a minute ago, there was probably at best a quarter of a billion people around the world that could or did play games. They had to have a console or a pretty significant high-end PC to really engage in the business.

Today there's – the most conservative estimates suggest that there's about a billion people in the gaming industry or gamers and probably getting close to two billion by the end of this year. New users are coming in, driven by frankly, access. Got an iPhone? You're probably a gamer. Got a Facebook account? You're probably a gamer. And what that does, it brings new people in, if you will, new blood, new revenue, new growth.

I'd just put a sticker on the upper right, so it's now about 60% of our total business in one way, shape, or form. It's digital. We had prognosticated that in 2011, it would get to be 50%. When we made that prognostication – and by the way, it hit 51%. When we made that prognostication four years prior, it was a little over 12%. People thought we were nuts. This is where the market's going.

In terms of HD package and digital, this pretty much tells you story that I was trying to tell you a minute ago in terms of there is a digital component that's very important on HD package. So industry is simple. It's led by digital and it's growing. HD console and PC continue to grow. Standard definition is a drag and it makes NPD data just a pain to interpret and understand and a lot of folks, they read January NPD data and they think the world's coming apart. It's not coming apart for us. It might be for others.

Looking at Electronic Arts, a couple of points about where we are. So first off, we're actually kind of proud of our position in the marketplace. You can see lots of places we're either number one or number two or in a nice position.

I'm going to put a giant disclaimer on this slide for the one place where I think it's misleading to say that we're number two, which is in social, because it's literally one giant player and a lot dwarfs. We're the tallest dwarf. We have a lot of opportunity in front of us. So I almost wanted to put an asterisk by the number two, but I didn't, so I'm giving you a verbal asterisk. But the rest of the positions, we're in a really, really, really good competitive position in all of these businesses and frankly I think this collection of assets is going to be increasingly valuable over time. Every one of these is a growth arena.

In terms of our business, calendar 2011 to calendar 2010 if you just look at the HD and digital business, we exited, largely, the distribution business, putting out somebody else's Rock Bank or third-party games from other companies through the retail channel. This is what we actually reported 2011 over 2010. We showed 18% growth on our HD business, and we showed 48% growth in our digital business.

Hidden in the large mass of $16.5 of our share price or whatever we're trading at today, we showed some really strong growth that I think is largely lost on a public that's looking at a lot of other things.

In terms of our digital business, this is a closer snapshot on digital, trailing 12 ending – Q3 means December quarter for us, so that's ending December. We went from 721 to 1,070. In the quarterly, we went from 211 to 377. A lot of people think that, oh that quarterly number must have been driven by Star Wars. It wasn't, in large part because you need to be 30 days past the purchase of the disc to become a subscriber to show up in this chart in a meaningful way.

We did have some digital downloads that were here, but the subscription doesn't kick in until the current quarter. It didn't really kick in last quarter. So, all-in-all, our digital business is screaming. Frankly, if that's all we were, people might like us better, but whether it is or it isn't, it's an awfully good story. And it's certainly not the story that I think most people understand when they look at our company.

In terms of market share, I will tell you the first two are really good data points. The third is harder to measure, but at least it's a consistent measure. So we've actually published, three years ago, what we include in digital and we put it up on our website. And it's a – we've been measuring it and tracking it consistently. But we've gained share in every sector that matters, and that's a good performance on a calendar basis.

Star Wars, this is an area that I think has got a lot of people anxious. I've heard from investors today saying that we must have 800,000 subscribers. I heard 600,000 yesterday. So what I think a lot of people have misunderstood is we said we had 1.7 million subscribers on the last call, which was about a month ago. What that was about was the fact that only about – just about half that number had triggered through their 30-day point and become active subscribers, our definition of recurring subscribers.

We had about half that total still in the 30-day trial period, but they're subscribers because that first month is including with a package good. What I said a month ago was, just over half. I can now confirm for you today that the vast majority of the 1.7 is now triggered through that point and they're recurring subscribers.

What happens from here? So we didn't go backwards like a lot of folks thought we had. Michael pointed out that would have been mathematically impossible to me in a side-bar conversation. He was, in fact, right in his analysis, but it doesn't seem that most people had figured that out. Thank you, Michael, for the vote of confidence.

So where we are right now with Star Wars: The Old Republic is this. We've captured a great business. It's the most successful MMO through this period in the history of our industry. But we are nowhere relative to sort of what the opportunity in front of us is. What happens from here are content releases every quarter, systems, and tutorials, and feature upgrades quarter to quarter and a future of expansion of content. What we tailored the game for was the core user. We tailored the game for people that have played more than one MMO and were existing MMO players.

What we do from here is our expansion content and our feature upgrades are designed to do things like make the download a lot smaller, so new users can find entry into the game a lot easier. Features like buddy keys, so you can have a friend that hasn't yet paid for the game, to bring that hurdle down, free into the game for a short period of time, so they can get, like, the equivalent of a weekend pass. Things that are designed to increase the funnel at the top, that means content changes. It means feature changes. It means new ways to bring the product to market.

I am not giving you my fiscal 2013 guidance, but it is very clear on the surface that some of the craziness that was out there in terms of misunderstanding [ph] this is that I can (10:04) clear up today. It's a very strong entry. We still have a lot of future in front of us. We're two months into the launch, a lot more to go, but 1.7 million, vast majority now, are recurring subscribers.

This is just something I thought I'd put up here just for fun, as we look at our performance. This is the section, we're looking at the performance of our business and so far this year, and this is the first-person shooter market, Western Europe and North America. And yes, it's been a growth business. You can see we've got the growth numbers on the side. That's total industry value, and this is what our market share has been doing and red is what the other guy's market share has been doing.

I wanted to point out that we put forward a pretty ambitious plan to say we take share. And we have, in fact, taken share in each of the last two years. We expect to take dramatic share over the course of next three to four years. We – I'm not taking back anything that I said two years ago when I said we'd stop at nothing over a five-year timeframe to take market share leadership here.

We think we have better technology. We have the strongest teams in the industry. We think our IP stands up. They've got an advantage for now, but we are after this business and we're making good progress. For what it's worth, I think they've got a great business. This is not a criticism of my competition. It's an opportunity for Electronic Arts.

Another point to make is that we have shown margin improvement. We have a long way to go. We'll probably end up talking about margin in our Q&A session, but this is just an indication of where we've been. One of the factors as we go forward, as we continue to expand our margin, is that probably the biggest inflection point for us in fiscal 2013 is fiscal 2012 was a year where we carried 12 month of Star Wars cost and we basically had three months of Star Wars revenue.

As we got look into the fiscal 2013, we have 12 months of Star Wars cost and 12 months of Star Wars revenue. That is a very different proposition. The second thing as you look at this chart, you'll notice the gross margins growing from 49% to 63% over a period of three years.

What's actually happening there are two really important underlying trends. The first of them is we are exiting the distribution business, so that sort of improves our underlying performance, but the second thing that's happening is we're still nascent in a number of our business models. We have a very mature Java/BREW business on mobile, but we're on the early innings. While we're the leader in IOS, we are lesser scaled there then we ultimately will be. Ditto with social.

When you're at lesser scale, there's often a number of things that put you in a position where your margins are lower than they ultimately can be. I think there will be continued opportunity for us to increase our gross margins while also generating leverage in our operating expenses as we look forward to the future.

So our position is relatively straightforward. We're number one or two in most important sectors in the Western world, long way to go in Asia. We are gaining share in all of the sectors that matter, and we're showing both top line growth and margin expansion.

As we look to the path forward, I'm going to start by saying what the assets are that we're bringing to the table. The first of them is brands. These billions of consumers that are now living in our industry are interested in brands. And there is no company that you could put up here with a chart like this – and I'm going to see things like and Dragon Age and Mass Effect and SimCity, et cetera enter the billion dollar arena probably each over the course of the next year to year and a half.

My competition generally can put one or two or three things on a chart like this. And some of my competition that's more purely in the digital arena can't put anything up on a chart like this. These IP matter and they matter a lot. And they're a significant differentiator for us and we're very proud of our intellectual property.

One of the things that's exciting about the intellectual property is it's doing well as we move it across business models and channels. So if you take three of our most IP, Battlefield, FIFA and the SIMS, we've executed and successfully gone to the top, or near the tops, of the arena in each of the places we pushed it. So what this shows us is that our intellectual property is interesting to consumers. They're aware of it, and they want to participate in it.

Our breadth and strength across these different types of business models and platforms is unique to Electronic Arts, so we feel really, really good about what this says about our opportunity as we move forward. And one way to get a sense of that is – now we didn't – this is nowhere near all of the digital revenue we generate on FIFA, but we wanted to come up. We just launched the packaged goods game four months to go. So we wanted to be able to track like on like and I didn't want to give you a projection against an actual.

So we just took the first four months of digital revenue associated with the packaged goods and all things that are digital in that same timeframe. And this is what we've done over four years digital for the first four months post release of the packaged good, 1 million became 3 became, 12 became 53. That's a pretty staggering fact.

By the way it's not going to be 500 next year. So there is a bit of a diminishing return proposition in here, but we are in the process of building substantial pure digital revenue streams and we're going to have a number of franchises – this will end up being at least double that number on FIFA, because it's over the 12-month period. And we're going to see that happening with franchise, after franchise, after franchise within the EA portfolio.

Another aspect of our business going forward is the platform side. Now I had [ph] a – recently, I cited here (15:40) how Star Wars as part of our platform, and it is. But I've already talked to you about Star Wars.

I wanted to bring about another aspect of our business that most people may or may not notice, which is Origin. There was a lot of, at least noise that I was hearing, that it was folly to imagine we could become a direct-to-consumer retailer. We did that a) because of the margin opportunity. We can absorb 20, 30, 40 points of incremental margin, and second we can control the presentation of our brands.

But where people also thought we wouldn't be able to do that, there was some talk about whether or not third parties would be interested in joining our platform. Well, we launched the platform in June of last year – or the service in June of last year. We generated $120 million of revenue over the course of the first six or seven months. We've signed up 30 third-party publishing partners and there's more every quarter.

The client itself, which is a live client that updates on its own, brings new content to the user, is currently on 10 million desktops. And we're reaching, through the nucleus registration system, 188 million consumers. So this represents the earliest innings of an opportunity for Electronic Arts. This 188 million excludes the Nucleus users, or the Origin users in mobile, which if you've got a mobile device you can see and operate and use. We'll be merging those together and that will represent, I think, a pretty significant advantage that none of our competitors have the like of.

So my summary before we get into Q&A is pretty straightforward. I like this business. I have to say I didn't know that I would be able to say that three years ago. I was a real believer in the digital opportunity, but if the packaged goods business cratered too fast, we would have had a problem. It already represents a little bit of headwind, but the digital business around the packaged goods business has been strong enough that in general, I think it's fair to say that that high single-digit aggregate growth rate is likely here for a very long time.

We're not going to see sort of scissor movements, where one part of the business declines so fast that the other part can't recover. We've now seen that for three years. Everything I'm seeing right now suggests to me that we've got a good solid industry that gets better from here.

Within this sector, EA is gaining share. We're gaining share. We're increasing our position. We're strengthening our IP. We're growing our margins.

And then lastly as we look forward, I think our asset portfolio is relatively unique. Our intellectual property, the characteristics of our business that are starting to look like a platform, are distinguishing features for Electronic Arts to start to see the kind of margin expansion you could be proud of. I mean I'm very happy that we didn't end up in the category of big companies in one arena that couldn't make the transition and fell on their ass. A lot of companies have been through that in different forms of media. It's been a tough transition to get where we are. But from here, I think it gets better. And with that, time for questions.

QUESTION AND ANSWER SECTION

Michael Pachter
Analyst, Wedbush Securities, Inc.

Q

We'll do them on the microphone, which it is on right now. And I'm just going to start with an easy one. Mass Effect launched. Highest rated game of the year so far, tell me how it's doing?

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

A

Thank you. I'm glad somebody asked that question. So well, first off, this is our perspective, Mass Effect is one of my favorite intellectual properties. It's been played in my household every night for the past 30 to 40 days. It's – my family is addicted to it, as am I. And if you don't know, it's had 21,000 perfect 100 ratings. Most of the more influential reviewers have given it 10 out of 10, or a 9.5 out of 10s. We're averaging at 94, so that's awfully good.

We introduced it Tuesday night in the United States. It's being introduced tonight at midnight, or I guess it's already tonight at midnight in the UK. And in Europe, I don't have any information on Europe, obviously, because it just introduced in the last hour or so. In North America first day, so the first 24-hour period, we sold through 890,000 copies by our estimate. That's a 24-hour period in one geography. So that's a good start. It isn't frankly – we sort of anticipated it would do well, so it's doing really well. So we're happy. It's not a negative bit of news. It's a positive bit of news.

The second thing about it, and this is actually a really telling point, is something that happened at GameStop and I'm kind of happy with. There was post-release downloadable content available at launch. Now, you could buy that post-release downloadable content through Xbox or PFN or, through Game Stop. The tie ratio at the register is the highest in their history, higher than any other game. They had a 40% tie at the register day one. That's the best they've seen. Paul Raines was very proud of himself, did a hell of a job with it. And so, they're building their digital business while we're building our digital business.

And for what it's worth, 40% is what we had to the retailer. While we haven't tallied the numbers yet, we clearly will get incremental through Xbox Live and other live services. So, we're feeling awfully good about the launch.

Michael Pachter
Analyst, Wedbush Securities, Inc.

Q

Any questions. I got another one. Give us a path to double-digit margins if you can. I mean, you say you're confident in growth. What's it take? What kind of growth do you need to see to get to double-digit margins?

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

A

So, let me try to take you from here through to the next couple years on that question. So what Michael's referring to is once upon a time, meaning a year ago when I gave guidance for fiscal '12 and I guided people to $0.70 to $0.90 for the year, I also told people that we would be able to get into double-digit margins if not – and I guided people to believe that our goals without any sort of dramatic transformation was to get into the mid-teens, in terms of our operating margins. I think that that vision and that opportunity is still intact.

Now, let me just touch on a couple more specific points. Let me start in Q4. So, we recently gave guidance in Q4, I'm going to try to refine that that a little bit. Star Wars, as you've seen doing well, it's an important factor. It's doing largely in-line with – it's in line with our expectations. Mass Effect doing well, a little bit better, but reasonably in line with expectations.

One of the challenges that we have this quarter is we did flag a risk on one of the major European retailers having trouble, costing us sort of mid-single-digit EPS. That now looks like all but a certainty. It was a risk a month ago. Now it looks like a fact, although we're still praying for the lenders to get rational and keep them in business. You probably know who I'm talking about. So that's an important consideration. But by and large, I'm sort of in the middle of our range for the current quarter, one headwind being a European retailer.

As we look forward, I don't think I've been more positive about our business in a very long time. We have a lot of things that feel like tailwinds for us right now. And then we see some significant opportunities as we moving forward.

So when I was thinking a year or ago about – and I told people sort of a three-year timeframe to try to get it into the mid-teens. And at that time we were at 6%, so that's a big shift. What I was talking about was getting our mobile business to scale, getting our social business to scale, continuing to make that fewer, better, bigger aspect of our packaged goods business growing share off fewer titles.

We grew share, as you saw a minute ago, on high definition in the last calendar year, and we did it on 25 titles compared to 35 a year before. That improves our margin to be able to do just that, and then the added digital content. I believe that will continue into fiscal 2013 into fiscal 2014. So we're going to continue to make progress on our margins, we'll be getting official guidance for FY'13 in May. So we still feel that that's all true. Nothing has shifted relative to our expectations.

The second thing that I think – that I'm more bullish on than ever before is I've learned some things. The first thing I've learned – and I have to admit, I didn't know how to think about this a year ago when I was talking about it, which was, yes, we have to make FIFA available on Facebook. Yes, we have to make Battlefield available in mobile. Yes, we have to make Need for Speed available on a micro-transaction free to play basis. And while that's worked gloriously in Korea, I didn't know that western consumers were going to behave like Korean consumers.

By the way, the Korea story is a pretty simple one. We more than doubled our net revenues at the top line for FIFA when we went from a packaged goods business to a pure free-to-play digital model. We didn't know what that was going to look like in the West and a lot of very smart analysts put their hands up and said, well, if you're going to give it away, how are you going to make money?

And so, I was a little anxious about that, too. You have to go after it, because what happens if someone else makes the equivalent of Battlefield on a free-to-play basis or a Need for Speed, or a Madden or FIFA, so we had to be there. And every data point I've seen, and I mean, literally every data point I've seen, is the businesses who are moving digital are the business that are growing the fastest.

And in fact, my fastest two growing packaged goods franchises this past year were FIFA and Battlefield, and they're the ones that we've put most forward on a pure digital model where you can get a similar or identical experience free. We're bringing them in. We're moving them up, and that feels really, really good. So that's one new piece of information.

The second piece of information is with Nintendo in particular, but some inklings for the rest, we're more bullish about the opportunity for console going forward. High definition console this past year, particularly the attach rate for digital assets, has been very strong. I think that bodes well for long term and we're gaining share there and I anticipate we'll continue to grow share there.

So we feel really good about our prospects. I'm not giving you any official guidance. I will do that in May. But what I've said before remains true today. If anything, I'm more bullish.

Q

Just two questions for you. Can you talk about or help us understand in the history of the company, what do we use as a good proxy for when you felt like the investment community's view on and your company and the business itself was in parity. I – you made a comment about stock price earlier, and you said people – I think you alluded to the fact that people are missing something. And I'm just trying to understand what historically people could kind of look at and maybe there isn't an exact comparison, but just in your opinion. And then second question is can you just talk about the exodus of some key personnel, and what you've done around that or how should we interpret that? Thank you.

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

A

Sure, let me take the second part first, because that's easier. So CFO left recently, Eric Brown, great guy. I hired him out of college 23 years ago. He's worked with me in three companies. He wants to be and will be a CEO in his life. I'm not going anywhere. I'm encouraged to be – unless you guys want to me to go someplace else, but you are the investors, for that matter.

But the truth is he wanted – he had an ambition he wanted to realize, couldn't realize it in the timeframe that was close to his ambition. So, we understood that sometime last year and he found what he was looking for and I'm really happy for him. They are absolutely no issues. We didn't fire him, and there were no issues in the underlying financials, I mean that kind of stuff. This was all about a good guy realizing his carrier goals that he couldn't realize inside of Electronic Arts. I feel great for him.

As a couple of others guys have left, in particular, a couple of guys going to Zynga. If you looked at their filings, they made a lot of money. To a person, they came and saw me at one point in the process, usually in tears or close to tears, with a story that basically goes like this. I love my company. I love Electronic Arts. I bleed blue, but they're going to give me a bank account in the first 12 or 24 months that I couldn't get anywhere and may never get anywhere for the rest of my life. So it was more about personal balance sheet stuff.

To a person, they've told me – and I think if you speak to them, would probably say they believe in the Electronic Arts story and sort of where it's going. So I don't feel at all weakened by it. A couple of them were good guys. A couple guys they got that were probably not doing so well, but they don't seem to distinguish between the two, because they don't know – we don't publish personnel appraisals publicly. But they got some good guys and I think we're fine.

As regards the stock and how it's been viewed, I don't know that there are any CEOs in America that actually think their stocks are fully and briskly appreciated. So as a starting point, mine was almost a throw-away comment. But I would say that being a student of this – I've been at EA long enough, all but a few years since 1997. And I've watched times when I think we're undervalued and times when I think, frankly, we were overvalued. And I think we're in the undervalued category right now. When we were at EA – when I was at EA in 1997, 1998, 1999, I knew we were undervalued, because I could see how we would double and triple our margins while growing our top line.

And we did that, and the marketplace ultimately caught up and we got sort of what should have been five years of stock appreciation in two as a consequence of people taking a while to catch on to the story.

I think it's fair to say when I returned in 2007, first thing I realized was that we were probably overvalued. We were trading like we were at the king – the top of the world, but all of our investment was really on the PS3 when the market was going for the Wii, and we're really won't ready for digital. Our margins were collapsing, and our quality was down. But the Street hadn't yet caught up to that insight. Unfortunately, that's not of a fun thing to have to wrestle with.

We've been through the restructuring. I completely get the period of time when people are saying, well, they've said they can do all these things in digital and they said they can do fewer, better, bigger and generate more revenue, and they've said that there's going to be growth in the industry. And yes, all of these things are true, but I think there's clearly, at some level, a wait-and-see situation with EA. It does seem like you had your Star Wars, what's next. And we had our Mass Effect. And then what's next, and I think in time, all stocks are valued rationally, but not maybe always at the moment. Yeah. Oh, you have the mic.

Q

Just on the subs for Star Wars, because you said that the vast major of recurring, is that – does recurring mean paid?

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

A

A recurring means that they've paid for and committed to more time beyond the initial trial period.

Q

Got it.

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

A

So, it means they did one of two things. They gave us a credit card, which is now in our system, or they went into a retailer and gave cash to buy cards to put those in the system. There's a small number of people on a relative basis in America that don't have credit cards, and some of them go into retail, buy prepaid cards and use that for a subscription. They do that for us, WoW, RuneScape, and lots of other things.

Q

And just a follow up – I'm not going to ask you to comment on next gen consoles, when they're going to launch, but do you see the next gen console being a meaningfully more expensive console to develop for like the last cycle?

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

A

I don't know that there's any reasonable way for me to answer that question without breaking a sort of non-disclosure agreements that I have with – because you could backwards engineer what their underlying engineering is if I say it wouldn't be more expensive. And if I tell you it is more expensive, you'll guess that they've made architecture changes in chipsets and GPUs.

Let me answer your question a little bit orthogonally, which is I wouldn't have told you what I said about the margin opportunity if I was really worried about the composite of the business opportunity and it costing a giant problem. And I'll be able to expand on that a little bit more in the May call, but I really don't want to – I'd much rather – I don't like it when Microsoft or Sony start telling you about my business and I would just as soon the guys at Microsoft and Sony tell you about theirs. Yeah.

Q

So maybe you can talk a little bit about you said you think your stock is undervalued, and you're right. Most CEOs, most of them think it's – their stocks are undervalued. I'd say arguably the difference is, particularly lately, a lot of them are acting a lot more like their stocks are undervalued. You guys, if you're doing well, doing poorly, I mean one thing that's been pretty consistent going back a long time is you're growth-oriented. You're acquisition-oriented. I mean you guys – look back just recently, right. I mean you almost paid [ph] top – top (32:05), I don't know how you describe it for Take-Two. You would have – and then, right at the height of the Zynga frenzy, you paid $1 billion dollars for PopCap. So value investors, you had a $4, you had $7-$8 a share in cash and now you've spent that in PopCap. Whether or not that was good or not, I mean the history of the company has been not returning it to shareholders, doing things that you think are going to make you grow.

Assuming that you now, you bought the right property, PopCap, you're doing well in games and your vision comes through. Looking forward, do you think it might be a good idea for – a lot of companies have recently come out, tech companies in particular, have sort of rethought things a little bit and said, you know what, as we make money in the future, we are committed to returning a significant portion of that to shareholders through dividends or through buybacks. I mean is that a philosophical change that you might be willing to considerate at some point?

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

A

I don't think you want me to change, because I told you I liked that idea a year ago when I announced the $600 million buyback, which we're sort of halfway through. And obviously adding to that requires us – we said we'd do it over the first 15 months. We're now nine months into it or thereabout, nine or 10 months into it, and I'd like to finish one before I go to my board and talk about the next one. But I'm actually a real believer in retuning shareholder – or cash to shareholders in efficient ways. I think a buyback, there's debates about whether dividends make more sense and there's pros and cons for both. But I'm a real believer in that.

In terms of the opportunity going forward, of that $1.70 billion that I've reported – the estimated Street number for us this year's about $1.2 million – only about $200 million of the $1.2 billion is straight-up acquisitions. The balance of it is organic application of our own IP. So, we feel pretty good about our ability to grow, but one of the things we needed to do was to get some capability in the pure digital arena and some IP that I think is more relevant to some of the platforms, which is what PopCap brought us.

I feel good about those acquisitions. I guess I would argue that – I can never, if somebody came and showed me a digital business growing at 40% a year with $100 million bottom line off of a $200 million comp line and said you could buy it for $200 million, you would think I was sort of blowing my job if I didn't show up for it. And frankly, almost everything out there that I see is for sale. The number of companies that are in talks right now to transact is higher than I've ever seen it.

That's actually a good thing. A lot of supply brings down price. But having said, short of something that's sort of truly spectacular at a valuation range that I feel really good about, I don't see sort of big time M&A being in front of us. Now things that are transformative, CEOs have to look out for. If I can figure out a way to take my mid-teens to 30 through something magic that's available to us, again, I wouldn't be doing my job if I didn't look at it. But right now, I'm not spending much of my time at all looking at these $50 million companies with a $1 billion price tag. We have lots of them out there, and that's not what I'm spending my time on.

Q

Going back to the issue with Game Group out of the UK, so that's a -

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

A

I didn't mention Game Group, by the way.

Q

Okay. A UK retailer in distress, the $2.5 billion revenue retailer with 400 stores across sort of Europe, you guys have 18% worldwide market share. Obviously if that issue doesn't get resolved, significant revenue loss potentially. So how do we think about that? Does that – if they don't sell or they liquidate, does that go somewhere else? What happens to that, let's say, the longer term effect?

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

A

I'm really confident that the consumer that wants to buy Mass Effect or Madden or FIFA or whatever, if a particular retailer is gone, other retailers will absorb the business. There can be – and I talked more about this on the last quarterly call and highlighted a debt issue of mid-single digit EPS, if they don't survive and – or a major retailer doesn't survive. And that's still a real – now it's unfortunately more true than it was even a month ago, or more likely than it was even a month ago.

But I think in the fullness of time, I am extremely confident that, whether it's UK or France, or United States, et cetera, the retail marketplace will absorb that business. I don't think we're going to – we might lose 20,000 copies of Mass Effect 3 in the UK for the consumer that can't figure out another store to go to, but that would even surprise me. I mean I think we'll sell every unit. So, we love great retailer partners, and we, like I mentioned GameStop earlier and Best Buy and Amazon and others. They're great for us. If one goes away, the other guys pick up the slack. I really don't see it as anything other than a very temporary dislocation. Did I get to what you're after?

Q

Yes. [ph] And is there a broader effect of just the retail channel [indiscernible] down year-over-we started seeing some trends or it's just a short term [indiscernible] (37:47)?

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

A

Look, I think that the retailers that are – a lot of the Mass merchants are prospering right now. Not all of them, but a number of them are. The big box guys – different parts of the world have had different, some are doing really well, and some are not doing as well. Specialty retailer, some of our partners are really adapting well to the digital realities and creating substantial new revenue streams, and those that aren't are having a harder time, certainly all those that aren't are certainly talking a lot about it now.

But let's put it this way, I am really glad we've grown a $1.2 billion digital business in light of the circumstances in our industry. And I'm really glad – and the other reality is is that when I said HD grew by 10%, the top 10 grew by between 10% and 15%. I haven't looked at the number more recently, top 20 similarly.

So what's happening in our world is that the actual packaged goods business is under a lot of pressure, but if you're at the top of the charts in HD, you're in a great spot. You saw my HD numbers were up $600 million, $700 million calendar 2010 to calendar 2011. What did we do? We anticipated that HD was going to do better. We anticipated that the top of the charts would do better, and we doubled down on that part of the business and it's helped us gain share, drive profit. And that's what we want to continue to do. Ours is not a very forgiving business if you find yourself out of position on just those kinds of questions.

Michael Pachter
Analyst, Wedbush Securities, Inc. Q

[Question inaudible] (39:31) So thank you.

John S. Riccitiello
Chief Executive Officer, Electronic Arts, Inc.

Okay. Thank you.

Michael Pachter
Analyst, Wedbush Securities, Inc.

Thank you, John.