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EA - Q2 2013 Electronic Arts Inc. Earnings Conference Call

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OVERVIEW:
EA reported 2Q13 GAAP net revenue of $711m and GAAP loss per share of $1.21. Expects FY13 GAAP revenue to be $3.85-4.00b and GAAP EPS to be loss between $0.27 a share and $0.06 a share. Co. expects 3Q13 GAAP revenue to be $0.9-1.0b and GAAP EPS to be loss between $0.71 a share and $0.57 a share.

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Blake Jorgensen *Electronic Arts Inc. - CFO*

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CONFERENCE CALL PARTICIPANTS

Colin Sebastian *Robert W. Baird & Company - Analyst*

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PRESENTATION

Operator

Welcome, and thank you for standing by. At this time, all participants are in a listen-only mode. During the question-and-answer session, (Operator Instructions). Today's conference is being recorded. If you have any objections, you may disconnect at this time.

Now I will turn the meeting over to Mr. Rob Sison, Vice President of Investor Relations. Go ahead. You may begin.

Rob Sison - ***Electronic Arts Inc. - VP of IR***

Thank you. Welcome to EA's fiscal 2013 second-quarter earnings call. With me on the call today are John Riccitiello, our CEO; Blake Jorgensen, CFO; and Frank Gibeau, President of Labels. Peter Moore, COO, will be joining us for the Q&A portion of the call.

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

This presentation and our comments include forward-looking statements regarding future events and the future financial performance of the Company. Actual events and results may differ materially from our expectations. We refer you to our most recent Form 10-Q for a discussion of risks that could cause actual results to differ materially from those discussed today. Electronic Arts makes these statements as of October 30, 2012, and disclaims any duty to update them.

Throughout this call, we will discuss both GAAP and non-GAAP financial measures. The comparable measures for certain non-GAAP measures to be discussed are -- for Q2, net revenue of $711 million; digital revenue of $320 million -- $324 million; gross margin of 37.4%; operating expenses of $630 million; and resulting loss per share of $1.21.

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

Now, I'll turn the call over to John Riccitiello. John?

John Riccitiello *- Electronic Arts Inc. - CEO*

Good afternoon. And for those calling in or listening in from the East Coast, we hope you and your families are safe.

EA delivered a very strong performance in the second quarter of fiscal '13. Our non-GAAP revenue was $1.08 billion in the quarter, higher than a year ago, despite a significant headwind from the declining packaged goods channel. Non-GAAP diluted earnings per share was $0.05 above the mid-point of our guidance, making this our 11th straight quarter of meeting or beating guidance.

And I'm proud to say that we're tracking towards another sharp increase in EPS in fiscal '13. Our performance in Q2 was led by very strong sales in our EA sports titles, Madden NFL 13 and FIFA Soccer 13. Consistent strength on smartphones and tablets (technical difficulty) difficulty) -- sector.

Digital games and services are surging. Mobile is scaling nicely, and free-to-play is bringing in millions of new consumers. The growth in social network gaming has slowed, and console packaged goods are declining, which is typical for console games this late in the cycle.

Despite the volatility and headwinds, EA is performing well. We focused our title count and managed costs. We have diversified our platform partners and business model so that EA is less vulnerable to weakness in a single-channel platform or business model. We've got more big franchises than any other publisher. And in most of these, we're performing very well.

We are managing the ups and downs. Our Q1 and Q2 were better than expected. Our Q3 appears soft, due mostly to Medal of Honor. We're expecting a strong finish in Q4, driven by a powerful slate of titles. Taken together, we are updating our fiscal '13 non-GAAP EPS guidance to a range of $1 to $1.15, down a nickel from our original guidance, which reflects a weakness in Q3 associated with Medal of Honor. At the mid-point, our guidance is to deliver over 25% non-GAAP EPS growth and to beat the current Street EPS estimate for our fiscal year.

Next, I want to highlight our progress on three key strategies. By now, you will recognize these strategies as our mantra -- brand, platform, and talent. Our focus on brand centers on constantly improving the quality of our key franchises. We make fewer titles, but we make them bigger by making them better.

We transformed the revenue model by adding digital content and services with extensive relationship with consumers. This strategy is working for EA, and here is one key highlight to prove the point. Since we adopted the fewer, bigger, better brand approach in 2007, EA has delivered the five biggest revenue hits in our Company's entire history.

Our platform strategy is about taking our brand into new fast-growing digital channels, and also building our own platform technology to facilitate growth in these platforms and on our own origin service. We are building bridges to the next generation of games and technology. This strategy is delivering for us, and here's a proof point.

Inclusive of our successes in Battlefield 3 Premium, EA is currently tied for first in digital revenue among Western gaming companies. Over the past five years, we have consistently grown our digital revenues, averaging annual growth of nearly 40%.

Our third strategic initiative is talent. We are evolving our core capabilities to better address both the art and science of gaming. In addition to having the best creative talent in our studios, we are adding new DNA to build our engineering and analytic capabilities. We are building this capability to support network and platform technologies that will define the most profitable companies in years to come.

To summarize, the Games sector is in a volatile period of change and transition, awaiting new catalysts for even more rapid growth. EA is executing well in this environment, and investing for strong growth in leadership and what comes next. Since the San Francisco Giants won the World Series, I'll use a baseball analogy. EA doesn't win every inning, but we've put a lot of runs in the scoreboard, and we expect to finish the season at the top of the standings, and to continue to do so for years to come.

With that, I'll turn it over to our new CFO, Blake Jorgensen.

Blake Jorgensen *- Electronic Arts Inc. - CFO*

Thanks, John. Before I discuss the quarter, I'd like to make a few comments and observations about EA after my first eight weeks on the job.

First, I'm very excited to join this great company. The management team and all the people I've met are true leaders in the industry, and extremely dedicated to developing and delivering world-class entertainment to consumers around the world. I'm fully aligned with the strategy of the Company, and believe we need to continue our journey of focus on those products and activities that generate the greatest shareholder returns.

I joined EA because the Company is now in the middle of an exciting transformation to a truly digital business, that will allow us to grow and improve our profitability over time. My focus at EA will be to help lead the Company in improving our operating margins, increasing the return on capital, and generating greater free cash flow for investors.

In conversations with investors and analysts, I'll be direct and transparent, providing the information required to follow our business. I'll help people understand the changes in the financial results as we move further into a digital business. And I'll provide key metrics and guidance when they are appropriate for understanding our performance in future outlook. But I will stop providing metrics if they no longer provide useful information on our business performance.

I look forward to working with each of you. And now let me turn to our business and quarterly performance.

First, let me start with a brief review of the Gaming sector for the quarter. We estimate that the worldwide video games sector grew in the high single digit percentages. We are encouraged the digital market continues to grow more than 20% over the prior year as the packaged goods market slows. In addition, the mobile business continues to expand, while the social network game gaming growth has slowed recently.

For EA, both FIFA Soccer 13 and Madden NFL 13 debuted as the top two best-selling titles for the Western world in the month of September. And NHL 13 made the top 10 list. Additionally, we saw solid catalog performances from Battlefield 3 and FIFA Soccer 12, as well as continued growth in our mobile business.

Our Q2 non-GAAP net revenue was $1.08 billion, which was in line with our revenue guidance, and 4% higher than the same period last year, driven by our FIFA, Madden, and NHL titles. EA's Q2 non-GAAP digital net revenue increased 45% year-over-year to $314 million, and for the trailing 12 months, exceeded $1.4 billion, representing a year-over-year growth of 59%.

For the quarter, each digital revenue channel demonstrated more than 30% growth versus the prior year. For example, extra content and free to play were up 34%, led by Battlefield 3, Sin City Social, and Mass Effect 3. Full game downloads were up 46%, with continued strong demand for Battlefield 3. Mobile business alone was approximately $88 million, up 60% over the prior year.

Smartphone and tablet revenue accounted for $66 million of this quarter's revenue, growing at more than 120% year-over-year. The primary drivers include FIFA World Class Soccer in Japan and Bejeweled Glitz on a worldwide basis. The Simpsons Tapped Out launched in mid-August, and has led top grossing applications in the Apple app store for most of the month of October. Frank will provide more color on this business later.

Subscriptions, advertising, and other digital revenue grew 48%, driven by Star Wars, The Old Republic and other key properties. As mentioned on the last call, a free-to-play option for the Star Wars game will be available this quarter, and we will provide more insight regarding the results of this change in future calls.

Also, the non-GAAP revenue continues to exclude our Battlefield 3 Premium subscription service. $43 million of Battlefield 3 Premium sales were generated in the September quarter, bringing the total Premium revenue from this year to approximately $80 million. As a reminder, we will recognize these sales as revenue in the fourth quarter when we release the fifth expansion pack entitled Endgame.

A quick update on Origin. We now have over 30 million registered users, including 13 million mobile gamers to date, and revenue was up sharply year-over-year off a small base. Additionally, we have signed agreements with over 70 independent developers to publish their games on our platform, along with our own bath catalog of titles and new launches.

Moving on to gross margins. Our non-GAAP gross margin was up 1% over prior-year's results, driven by the growth of our digital business. Operating expenses for the quarter came in at $20 million lower than expectations, due to the phasing of marketing expenses out of the quarter, slower than anticipated hiring, and our focus on improving operating efficiencies. The resulting non-GAAP diluted EPS was $0.15 for the quarter, $0.05 above the midpoint of our guidance and market consensus.

Now turning to cash. Our cash, short-term investments, and marketable securities at the end of the quarter were $1.3 billion, or approximately $4.21 a share. Roughly half that cash is held outside of the US. Net cash used in operating activities for the quarter was $28 million. And on a trailing 12-month basis, operating cash flow was $490 million, an increase of $183 million over Q1. During Q2, EA repurchased 8.4 million shares at a cost of $108 million. As a reminder, the 500 million share repurchase program was initiated in August, and we continue to actively repurchase shares under this program.

In summary, for Q2, we delivered revenue in line with our guidance. And regarding non-GAAP EPS, we were able to overdeliver through favorable product mix, the management of our marketing and operating expenses.

Now turning to guidance, GAAP revenue for the third quarter is expected to be between $900 million and $1 billion, as compared to $1.06 billion in the prior year. GAAP EPS for the third quarter is expected to be a loss between $0.71 a share and $0.57 a share, as compared to a loss of $0.62 per share in the prior year.

Non-GAAP revenue for the quarter is expected to be between $1.25 billion and $1.35 billion, a decline in comparison from last year's $1.65 billion, which included the launch of Battlefield 3 and Star Wars, The Old Republic. Both titles drove packaged goods and full game digital download revenue. Frank will provide an update on our third-quarter titles in his section.

Regarding our operating expenses, we expect our total non-GAAP operating expenses to be less than $600 million for the quarter, with marketing and sales down versus prior-year due to fewer titles. For the quarter, we expect non-GAAP diluted EPS to be between $0.50 and $0.60 a share, as compared to $0.99 a share last year. This reflects weaker than expected performance from Medal of Honor, Warfighter, and our decision to cancel our NBA title.

For fiscal full-year '13, GAAP revenue for the full year is expected to be between $3.85 billion and $4 billion, and GAAP EPS is expected to be a loss between $0.27 a share and $0.06 a share. Non-GAAP revenue for the fiscal year is now expected to be between $4.05 billion and $4.2 billion. Operating expenses are still expected to be approximately $2.2 billion, but we continue to focus on cost management and efficiencies.

We've lowered our non-GAAP EPS estimate to be between $1 and $1.15 a share. The nickel adjustment is coming out of the third quarter based on the guidance that I just provided. It is offset by a benefit from a reduced share count due to our share repurchase program.

Cash flow for fiscal '13, we reconfirm our operating cash flow and capital expense projections of at least $400 million and $100 million, respectively. This implies an expected free cash flow generation of over $300 million or three times what we generated in fiscal 2012.

With that, I'll now turn the call over to Frank.

Frank Gibeau - ***Electronic Arts Inc. - President of Labels***

Thanks. Now that Blake has briefed you on our financial performance, I'm going to provide some context around our ongoing success with core products. I want to show that, despite a couple of misses, we've got a great track record of rolling out big hits.

I'll start by providing some color around the outstanding performance of our EA sports portfolio. Madden, NHL, and FIFA are all meeting or significantly exceeding expectations. Madden NFL 13 just executed the biggest launch in four years. At the heart of this success is another big leap in product quality, a new gameplay engine that includes a huge physics upgrade and innovative online services, such as Connected Career Mode and Gridiron Club.

These breakthrough improvements were noticed by critics who awarded Madden 13 an 86 at launch, our biggest year-over-year Metacritic jump in four years. NHL 13 has stunned critics and fans with its graphics and year-over-year innovations. The 84 on Metacritic has helped offset the headwinds related to a strike-impacted season.

In September, we released FIFA 13, EA's biggest game of the year with more than 7.4 million units sold in the first four weeks. FIFA 13 launched with a 90 Metacritic, and quickly became the number one seller in more than 40 countries. FIFA Ultimate Team, a feature which allows fans to connect to manage teams and trade players, is now one of the most popular online services in gaming worldwide. Today, more than 2.5 million people are actively engaged in FIFA Ultimate Team, up 34% year-over-year. Now consider seven years into a console cycle, Madden and FIFA are tracking to their best performances ever.

Another breakout hit in the fiscal quarter was The Simpsons Tapped Out, a free-to-play mobile title which launched in August, and was the number one grossing game on IOS for most of last four weeks. The game has registered roughly 17 million downloads, and is generating meaningful revenue in more than 40 countries, including the UK, Germany, and France. This serves as another demonstration that mobile is rapidly scaling, and that EA leads with sustained share growth.

Now on to our expectations for Q3. I'll start with two franchises that have not met our expectations.

The first is NBA Live, which we elected to cancel this year. I'll address this in the context of our success on FIFA and Madden, where a spectacular core product sets us up for big opportunities with online services. This year's NBA Live did not meet that test. We take this situation seriously. EA Sports is committed to basketball, and we will publish a basketball game when we can match the quality of franchises like Madden NFL, NHL Hockey, Tiger Woods PGA Tour, and FIFA Soccer.

Next, Medal of Honor Warfighter shipped last week to a critical reception that fell below our expectations. While we're disappointed with the critical response, we believe this is a good game with a receptive audience. The game finished the weekend in the number one position in the UK. We will continue to support the game through the holidays with sales execution and marketing. This includes the compelling content download tied to the December release of Sony Pictures film, Zero Dark Thirty.

While we're not pleased with the situation on either of these titles, we are confident in the hit potential of the games that will follow. Our highly anticipated racing game, Need for Speed Most Wanted, debuted this week. And the early reviews are strong. Two of the most respected critical outlets, IGN and Game Informer, gave Need for Speed a 9 out of 10. And in the UK, The Guardian awarded the game a perfect score.

This spectacular open road racing experience is enhanced by Autolog 2.0, an innovative social component which assembled an online community to advance players through the game. Edge magazine said that Autolog is one of the most ambitious innovations in console gaming this generation. It's too early to celebrate, but Need for Speed Most Wanted launched today in North America, with pre-orders well ahead of last year's game.

Finally, two more positives in Q3. First, Battlefield 3 is still charting in the top 10, a full 12 months after it launched. The game has now sold in more than 17 million copies. And in five months, our Battlefield 3 Premium service already has more than 2.1 million active subscribers.

A steady stream of online content and services have extended the life cycle of this blockbuster, and created a large and persistent ecosystem of fans who pore over every new download of the game. We keep them supplied with digital content and they keep playing. A new expansion pack, Battlefield Aftermath, will be available for download this quarter; and another, Battlefield Endgame, is scheduled for Q4.

Second, I want to direct your attention to the release of Real Racing 3 in December. This was the only game on stage when Apple unveiled the iPhone 5. We believe they chose Real Racing 3 because the visuals are, quite frankly, incredibly close to what you see on current gen consoles. The EA Fire Monkey Studio that made this game has demonstrated an incredible mastery of the IOS format. If you want to understand why everyone is raving about mobile games, check out Real Racing 3 when it releases in December.

That's our portfolio through Q3. And we're planning a big finish in Q4, which has historically been a strong quarter for EA. Here is a snapshot of the three titles we think will be big hits.

On February 5, Dead Space 3 is coming to Xbox 360, PS3, and the PC. Each time our Visceral Studio releases a new game in this critically-acclaimed sci-fi-horror series, the game gets scarier and the audience gets bigger. In North America, presales for Dead Space 3 are up 28% over the same period before our last release on this franchise.

In February, we will debut Crisis 3, coming to the Xbox 360, PS3 and PC. Developed by our partners at Crytek, this one follows Crisis 2, which was widely considered to be the best-looking console shooter of this generation. We believe Crisis 3 will set the bar even higher. Crisis 3 has cultivated a large audience in both Europe and North America, and won several awards at E3 and Gamescom this year. This game has a lot of potential to be a breakaway hit, and we're going to give it a blockbuster marketing campaign.

And finally, SimCity, one of EA's flagship franchises, will launch on the PC and Mac on March 5. Consumer awareness is tracking ahead of our expectations for this breathtakingly cool new experience. We're really proud of this one, and it shows. SimCity won scores of prestigious awards this summer, including Game Informer's Best of the Show at E3 and the Best PC Game Award at Gamescom in Europe. We can't wait to release this one in March.

Now back to John.

John Riccitiello - ***Electronic Arts Inc. - CEO***

Thank you, Frank. If you've been following our quarterly calls for the past few years, you'll note a certain consistency to our narrative. We promise to build our biggest brands and we have. We promise to drive our business to new digital revenue models, both on third-party platforms and on our own -- we have.

We have talked about investing in and transforming our talent base -- we have. Delivering on these strategies, combined with aggressive cost control, has allowed us to deliver double-digit EPS growth these past three years. And we are on track to do it again this year in fiscal 2013. We're consistent in delivering on our strategy and goals, and we are very serious about driving shareholder value.

With that, Blake, Frank, Peter, and I will take your questions.

QUESTION AND ANSWER

Operator

(Operator Instructions) Colin Sebastian, Robert Baird & Company.

Colin Sebastian *- Robert W. Baird & Company - Analyst*

Good quarter, guys. First, John, if we look out over the next 12 to 18 months, we may see new living room game platforms from Nintendo, Sony, Microsoft, and potentially even Apple. So I'm curious how EA is planning in distributing resources across each of these opportunities? And if there's any update to some of the financial framework you had provided before? And perhaps some of the progress to date on next gen software development?

And then, secondly, just realizing that Halo and Call of Duty have moved back, in terms of monetization of digital, away from a Premium or a subscription model, at least from the prior versions of games last year. Does that change at all your approach to the way you plan to charge for add-on content for future Battlefield titles? Thanks.

John Riccitiello *- Electronic Arts Inc. - CEO*

I think we'll split this one up. I'll let Frank handle the second part and I'll take the first.

So, we signaled on our last call, and have been investing some time, in what we understand to be the future framework of, if you will, of opportunity. I would have to refer you directly to the companies you mentioned -- Apple, Microsoft, or Sony -- as to the particulars of their launch plans.

But having said that, we've announced our investment. We believe we're going to get a strong return on investment. And we are long-term believers in the opportunity of gaming in the living room with ever-stronger devices driving that business. You know, I guess, in a word, we're not ready to make any announcements about next year. I would make these last observations.

We're entering what is clearly the -- you know, towards the tail end of a very long cycle. We've reached the bottom of our title count. We expect to increase slightly from here. And we see a lot of opportunity for the growth of our big franchises, like Battlefield, FIFA, The Sims, SimCity, Madden, Need for Speed, Mass Effect, Dragon Age, and others. We think it's an unparalleled portfolio, and we're putting the investment behind it to turn it into the biggest, most profitable business in our sector.

Frank Gibeau *- Electronic Arts Inc. - President of Labels*

Hi, this is Frank. I'll give you some color on the Battlefield Premium subscription service. The feedback that we have received since we launched that five months ago has been extremely positive, because, at its core, it's a great value for consumers.

The opportunity to buy, basically, five expansion packs for the price of four, with all of the additional services and components, is seen by subscribers as a very good value for money. And, in fact, our growth rate on that subscription is well ahead of our expectations and we're very pleased with it.

We also operate the ultimate team style of monetization online, which is more micro-transaction-based. And that's mainly focused on our sports business. But we're seeing good success on both of those console online services and don't see any reason to modify them going forward.

Colin Sebastian - ***Robert W. Baird & Company - Analyst***

Okay. Thanks very much.

Operator

Edward Williams, BMO Capital Markets.

Edward Williams - ***BMO Capital Markets - Analyst***

A quick question, if I could, on Medal of Honor and NBA Live. What, in your opinion, really, has kind of what drove the relative performance there? And how is it that you can think you can kind of prevent that from occurring again?

Frank Gibeau - ***Electronic Arts Inc. - President of Labels***

Yes, this is Frank. I'll take those. We take product quality very seriously at Electronic Arts, and it's kind of the lifeblood of what we do. And when we look at launches like Medal of Honor and NBA, we're not happy with the results there in terms of how have they been received, in the case of Medal of Honor, by the critics and reviewers. And in the case of NBA, it just didn't meet our standards of quality in order to go out and compete in basketball, at a level that we felt was necessary and important for EA Sports.

So in the case of basketball, we're committed to basketball, and we're going to be entering that category in the future. And it's going to be done in a way that we deliver a high-quality product.

On Medal of Honor, we're disappointed with the critical reception. Our internal testing and mock reviews indicated that the game is better than the actual score that we have right now. And we believe that it is. However, we are seeing some folks out there that just don't like the game. We believe that it's going to find an audience. It's been -- had a good track record over the weekend in the UK. We're going to continue to support the game going forward with marketing and additional content.

But I think when you look at those two products and you take a step back, and you look at the broader portfolio that Electronic Arts has been building, overall, we've got a quality record that's pretty remarkable inside the industry. I think no other studio has improved quality as dramatically as Electronic Arts over the last several years.

And, if you look at our recent track record, we've released the most popular FIFA game ever. We vastly improved Madden, in terms of its quality. Battlefield 3 is a top 10 game and has passed 17 million units. And today, we had a really good result with Need for Speed Most Wanted in terms of its release and the early critical reception.

So, we take quality very seriously. We're in a hit-driven business. And when we don't reach our own high internal expectations, trust me, we're going to school on what happened and what occurred, and we're going to do better going forward.

Edward Williams - ***BMO Capital Markets - Analyst***

So your thought at this point with regards to Need for Speed is that, as far as the initial channel sale, that's been in line with your expectations and has not necessarily been affected by the Medal of Honor release?

Peter Moore - ***Electronic Arts Inc. - COO***

Repeat that, Ed. I'm sorry. This is Peter.

Edward Williams - ***BMO Capital Markets - Analyst***

With regards to Need for Speed, the release of the game and the initial expectations in the channel sales, that has not been affected by the Medal of Honor performance?

Peter Moore *- Electronic Arts Inc. - COO*

Not at all. I was just glancing at Metacritic right there. We're at 86 of about an hour ago. In fact, we're being better reviewed than Assassin's Creed as it currently stands at a Metacritic point of view. Our retailers have had an early glimpse of Need for Speed; our selling is strong; our demand metrics; our definite purchase intent, for example, is strong. And our pre-orders, as was mentioned on the -- in the prepared remarks, are the highest we've ever seen for a Need for Speed franchise.

So all of the data indicates a very strong start. And this, of course, as you know too well, is a title with a very long tail that will sell well. So, no; no issues whatsoever. I don't think retailers link game performances from franchise to franchise. They place their orders accordingly based on their pre-orders and what they think their consumers are going to pick up.

Edward Williams *- BMO Capital Markets - Analyst*

Okay. And then just the last question is, you have -- you built up about 30 million registered users for origin, based on your comments. Can you give us an idea as to how many of them you're actually able to monetize at this point?

Peter Moore *- Electronic Arts Inc. - COO*

As of the latest data I looked at this morning, about 4.4 million people have actually purchased on Origin. And our average sale on Origin, actually, is about $64. So people are buying multiple games. The breakup of that 30 million is, I think, most interesting is we're now seeing as many as 13 million who are accessing Origin by their mobile devices.

So, with the 70-plus developers that are now putting content on the platform with our own content itself, and Medal of Honor debuted this week, obviously, our ability to be able to continue to drive strong commercial engagement, as well as community engagement, is going to be key. And the metrics all point towards that being a very strong part of our business.

John Riccitiello *- Electronic Arts Inc. - CEO*

Yes, and over the next couple of years, you should watch Origin carefully. It's a big part of our strategic drive. You'll see a lot of interesting things coming there. We think it represents huge opportunity for us.

Edward Williams *- BMO Capital Markets - Analyst*

Okay, great. Thank you very much.

Operator

Neil Doshi, Citigroup.

Neil Doshi *- Citigroup - Analyst*

Quick question on the social gaming side. I believe Facebook noted on their earnings call that that gaming at Zynga was up 40%. And on your earnings call, you also noted that there was a little bit of slowdown on the social gaming side. Is this more of a structural issue regarding gaming on Facebook? Or are you seeing -- or is there some sort of execution issues with producing games for the Facebook platform?

And then I have a follow-up, so.

John Riccitiello - ***Electronic Arts Inc. - CEO***

So, first off, I think it's always a little bit dangerous to try to answer the outcome of a game right in the middle of the event. It's a little too early to call the social gaming business.

But I would make some pretty clear observations. One is, when it was anticipated by some to double, double, and double again, a year to a year-and-a-half ago, we were quite comfortable with that it would double, and then we would start growing with the market. We never got to the second and the third double.

So we were never quite as positive on it as some, although we were believers in it. Currently, it hasn't declined as a sector, but it is showing slow growth. The most recent quarter was up versus a year ago, but down sequentially. But that down sequentially was probably more seasonal than anything. That's at the aggregate level.

My personal view is that Facebook has moved away from some of the game-base by viral channels, and consequently, has done a purposeful thing for the health of their own platform to diminish, if you will, the way a electric game could span people's depth and generate revenue.

So my second observation is the core games are doing better on that platform than some of the lighter things that have been more traditionally defining of the Facebook platform. I think a better way to think of it is this, though. People are accessing Facebook games on either a mobile device or a PC. Think of them as mobile games and PC games, and not so much as Facebook game.

My sense is what makes for a great mobile game will continue to be great. What makes for a great PC game will continue to be great. And there's a lot of opportunity with EA. We're growing rapidly on the PC side and rapidly on the mobile side. And we will continue to have entries on the Facebook side.

We have reduced our SKU plan some there, but we continue to have a belief that it's an important part of our mix. I hope that gets at it for you. I guess the headlines are, it's slowed versus the hype. It is certainly not dead. And we think of it as part of a mobile mix and part of a PC mix, and we continue to create entry. We just announced yesterday, for example, a strong tie between our NHL franchise and Facebook. And so it continues to be very useful and positive for us.

Neil Doshi - ***Citigroup - Analyst***

Great. Thanks. And then on the digital revenue side, you've had very strong digital revenue, which is great. However, I guess, on the gross margin side, we've seen margins kind of pick up modestly -- can you remind us what the margin profile is of your different digital revenue line items? And at what point do you think we'll start to see gross margins expand, I guess, more in line with the digital revenue growth?

Blake Jorgensen - ***Electronic Arts Inc. - CFO***

I can take that. It's Blake here. We don't disclose the differences between our margins, but what we have said, I think, in the past is that digital business does allow us, clearly, to operate at higher gross margins. We'll continue to see that growth over time. And we're very focused on it as a way of driving profitability, and really reaching a much higher operating margin target in the long run.

I can't give you a good sense of timing yet, because the business is growing so rapidly, it's difficult to predict. But we're very focused on trying to drive the profitability through improvement in gross margin. And you're seeing that as you compare our business over the last couple of years.

John Riccitiello - ***Electronic Arts Inc. - CEO***

Hey, and on the last call, we got a very similar question and -- well, maybe two ago. Hey, we've seen better than a dozen point pickup in our gross margins over the last four years. And we attributed it then to really two factors. About half of it coming from exiting the distribution business, the old Rock Band business field. We take a game and market up just for distribution fee. And the other aspect due to mix towards digital. But we've seen a big pickup at the consequence of digital and we expect to continue that. It's something that's been a key feature of our financial performance for the last four years.

Blake Jorgensen - ***Electronic Arts Inc. - CFO***

And just remember, when we talk about digital, we're talking about components of digital such as mobile, free-to-play, and others. And so each of those have different gross margin perspectives. But in general, most of those will give us a gross margin pickup as we move forward.

Neil Doshi - ***Citigroup - Analyst***

Great. Thank you, John. Thank you, Blake.

Operator

Brian Pitz, Jefferies.

Brian Pitz - ***Jefferies & Company - Analyst***

John, I think you suggested sharp increases in EPS going forward. Can you please help us characterize the primary drivers of this trend? Also, mobile revenue is up 60% year-over-year. Would you give us a sense for the key drivers of mobile growth?

And finally, it looks like you're taking down full-year guidance by about $50 million on revenue, $0.05 on earnings, despite the beat. Can you give us a sense for the drivers? Is it Warfighter's softness? Any color would be great. Thanks.

John Riccitiello - ***Electronic Arts Inc. - CEO***

So in terms of our expectations in the future, we've been showing sharp double-digit profit growth really since we restructured four years ago. And even at the midpoint of our guidance now, we're showing 25% growth.

We're doing it in a year when we're lapping Battlefield. So, if you think about that, that's a pretty stunning reality. And it's a composition shift in our P&L towards higher margin business is the primary driver there. Because it's clear, right now, we're not seeing a lot of topline revenue growth in this, a tail end of console gen 3 cycle.

The second point that I would say to you is, we're pretty strong believers in revenue growth going forward. We think we've reached sort of an end of an era. We are reaching a tipping point relative to digital. And we've intimated in as many ways as we can, but without getting ahead of ourselves, that we are believers, and it's worth investing in next generation technology, some of which aren't visible to all of you on the call.

When you take topline growth, together with the superior margin structure we've built around the advancing digital end of our business, we see the opportunity for continued margin expansion. But that's about as far as I'm going to get towards guiding you to years beyond this one. That's the framework. It's consistent what I've said at E3 and other public speaking events. But we're not, here on this call, ready to talk about what a fiscal '14 or fiscal '14 through '16 framing. We'll begin to do that over the course of the next few calls.

Blake Jorgensen - ***Electronic Arts Inc. - CFO***

Why don't I try to hit on the next two parts of the question. One is the digital question and then the second is the guidance question.

So digital, just hitting on some of the points that we made in the prepared remarks, key to digital growth have been across a wide variety of options for us or opportunities for us. Extra content and free-to-play has been a big driver. Battlefield is a great example of that. SimCity social as well. Free game downloads, up 46% when you look at Battlefield 3. The mobile business, up dramatically, up 60%, driven primarily by the new smartphone formats and tablets.

For those who haven't tried the Simpsons game, I think it's critical to go out and give it a go. It's been one of the top grossing apps on the app store and it's just a fabulous game. But Bejeweled Blitz, for example, one of the pop cap games we acquired, is doing extremely well. And then FIFA on the mobile business, smartphone business, has been great, particularly as people are playing Ultimate Team.

So that, plus the subscription business, continues to really drive the overall digital revenue. And as a reminder, we haven't booked any of the Battlefield 3 Premium sales starting north of $80 million this year. And they'll all get recognized at the tail end of the year.

On guidance, I'd say it's a combination of conservatism and impact from Medal of Honor. Our guidance, though, as a reminder also, is still above The Street in most cases. Our revenue guidance came down $50 million at the top end and the bottom end of the range, and is right on top of Street guidance. And then at the earnings level, we came down $0.05, but it's still above where Street guidance is.

We're confident in that because of the back half of the year portfolio that Frank spoke to you about, as well as the improvements in gross margin and our ability to hold OPEX. And that yields the guidance. But we think that's realistic relative to the disappointment in Medal of Honor.

Brian Pitz - ***Jefferies & Company - Analyst***

Great. Thanks. Yes, actually, my second question was more focused on mobile versus total digital, but it sounds like it was really Simpsons that was the key driver.

Blake Jorgensen - ***Electronic Arts Inc. - CFO***

(multiple speakers) It's FIFA, Simpsons, and Bejeweled, all three, were big drivers.

John Riccitiello - ***Electronic Arts Inc. - CEO***

And also Sims performed well in mobile for us as well. One thing to remember about mobile is, a few years ago, EA was pretty much a feature phone player, and we've completely transformed to putting leading microtransactions or free-to-play titles that monetize very well on smartphone. At this point, our focus has been IOS, and we've got a lot more coming. We feel very, very confident in that business.

Brian Pitz - ***Jefferies & Company - Analyst***

Great. Thanks for the color.

Operator

Justin Post, Merrill Lynch.

Justin Post - ***BofA Merrill Lynch - Analyst***

Sorry about that; I was on mute. Two questions for you. First, it looks like your guidance for Q4 obviously it is very back-end loaded. I'm getting $0.70 to $0.75 versus $0.17 last year. Can you talk about the impact of Battlefield earnings-wise in Q4? And why you're confident that you can grow earnings with catalog for the industry being down so much?

And then, John, maybe talk about just where we are in the cycle, as you see all the hard work coming. I mean, is there a chance that that packaged goods starts growing next year as an industry? Or can you give us any thoughts on -- you know, with the new consoles coming, how you think about next year? Thanks.

Blake Jorgensen - ***Electronic Arts Inc. - CFO***

So, Justin, why don't I take the first part. The Q4, the reality is our differences between where we were originally guiding on Q4, versus where we're currently guiding, aren't that different. We're up slightly versus our previous guidance. And that's really built on the strength of the fourth quarter titles, as well as just the continued strength in catalog. I don't think we're being overly optimistic.

We've had a strong catalog business. And it continues to perform really well. And it tends to perform well at the back half of the year. Q3 is really where the big difference came. And we -- I didn't mention before, but realized that FIFA 13 did extremely well in Q2. We're assuming that that may be pulling some of Q3's business. And that, in combination with the NBA business and the Medal of Honor business, is really what's brought Q3 down. We haven't really moved much from Q3 to Q4. It's basically stayed the same. It's really Q3 is where the big delta is.

John Riccitiello - ***Electronic Arts Inc. - CEO***

And just two quick thoughts on Q4 to give you a little color. Q4 has essentially been rising with the increased performance of Battlefield. So we keep selling subscriptions well ahead of our initial expectations. 100% of the revenue drops into Q4, and it's 100% fully owned IP. So it's very high margin.

The second component is, the only other thing that's comparable in our business with Battlefield's product subscription business in terms of margin impact -- is, in fact, better -- is selling SimCity. It's a PC-based, wholly-owned IP with a huge global audience. So it's a lot of owned IP in the quarter and it's very strong IP.

And Justin, I will give you points for trying very hard to get one more pint of blood out of us relative to understanding what next gen looks like. Once again, we're going to have to tell you that color on next gen needs to come from the people producing it. And color on our own fiscal '14 and beyond -- beyond what I've stated -- is going to have to wait for a future call.

Justin Post - ***BofA Merrill Lynch - Analyst***

Great. Thank you.

Operator

Sean McGowan, Needham.

Sean McGowan - ***Needham & Company - Analyst***

I was hoping you could give us a little update on where things stand with Star Wars, The Old Republic, the changes that you've made to the business model and how that's working, or anything you can give us on that. And then remind us on the Battlefield Premium, you've given us some great color on the revenue that's coming. What costs might have been deferred on that order, might show up in Q4 against that revenue? Thanks.

Frank Gibeau - ***Electronic Arts Inc. - President of Labels***

Yes. This is Frank. I'll start with the Star Wars question. As we announced on the last call, we are pivoting that business to open up a new free-to-play part of that business model. That starts this November. And so I think it's a little premature to be able to give you too much color on how that's going to go until we deploy it. In Blake's remarks, he mentioned that we'll have an update on a future call, giving you guys some more information on how the free-to-play conversion went on Star Wars. So, you know, (multiple speakers) --

Sean McGowan - ***Needham & Company - Analyst***

(multiple speakers) How is the existing business going?

Frank Gibeau - ***Electronic Arts Inc. - President of Labels***

(multiple speakers) -- and positive in Star Wars. The game is continuing to release content. People continue to be subscribing to the product. So, from that part of the business, the Premium subscription side of the business is very stable. And we're excited about the potential on the free-to-play option.

Sean McGowan - ***Needham & Company - Analyst***

Okay. And the people are hanging out -- those that already signed up are kind of staying?

Frank Gibeau - ***Electronic Arts Inc. - President of Labels***

Like I said, we feel good about stability in the community and people are excited about the new content packs that we've been releasing. So, yes.

Sean McGowan - ***Needham & Company - Analyst***

Thank you.

Blake Jorgensen - ***Electronic Arts Inc. - CFO***

And on your Battlefield question, we expense all of the costs associated with developing the extra content when it's developed. So that's been expensed in each quarter. So it's really the revenue that's getting recognized after all the packages have been delivered to the consumer.

Sean McGowan - ***Needham & Company - Analyst***

And there's no deferral of marketing costs?

Blake Jorgensen - ***Electronic Arts Inc. - CFO***

No.

Sean McGowan - ***Needham & Company - Analyst***

No? Okay. Great. Thank you.

John Riccitiello - ***Electronic Arts Inc. - CEO***

Think of Battlefield as a fourth-quarter business in a way where all the costs -- or most all the costs are in the first three quarters and all the revenues in the fourth.

Blake Jorgensen - ***Electronic Arts Inc. - CFO***

Yes. And you might have ongoing marketing costs that are associated with signing up new people, but for -- and those are relatively small because it's building off of the franchise. But for costs that are incurred in any of the quarters or the larger cost components are really the development, and all those have been put to bed in each of the quarters in which they occur.

Sean McGowan - ***Needham & Company - Analyst***

Got it. I just didn't know if there was some accounting principle that tried to match cost of revenue and you put it off. But you've answered the question. Thank you.

Blake Jorgensen - ***Electronic Arts Inc. - CFO***

Great.

Operator

Doug Creutz, Cowen and Company.

Doug Creutz - ***Cowen and Company - Analyst***

Yes. A couple of short ones. I think your last SimCity major release was SimCity 4 back in 2003. And I wondered if you could just remind us how many units you sold of that?

The second question is, I think it looks that you're guiding to about $1 billion in digital revenue in the back half of the year. And I was just wondering how you're anticipating that phasing between fiscal Q3 and fiscal Q4? Thanks.

Blake Jorgensen *- Electronic Arts Inc. - CFO*

So, on the revenue piece, we'll continue -- we won't split out a lot of detail on the forecast going forward, but you should consider the similar percentages in Q3 and Q4 that we've talked about before, and the trends that we've continued to see in growth off of that level. So if you're looking at roughly 300-plus-million in Q2 actuals going forward, you'll continue to see growth in those in Q3 and Q4. On the SimCity, we're just looking for the data right now and I don't have that on the top of my head. (multiple speakers)

John Riccitiello *- Electronic Arts Inc. - CEO*

We don't always carry it with us (multiple speakers). It was in the low to mid-single millions of units. But we'll look that up and get back to you, Doug. And just another factor on digital. Just remember, the majority of Battlefield Premium is the digital revenue sales for us again. So another observation to keep in mind is, it's lumpy relative to digital revenue in the fourth quarter because of the recognition of Battlefield Premium.

Doug Creutz *- Cowen and Company - Analyst*

Okay. Thank you.

Operator

Atul Bagga, Lazard Capital.

Atul Bagga *- Lazard Capital - Analyst*

Hey, guys, congratulations on the quarter. And I have two questions. Number one, on the digital title slate, I think in the last quarter call, you had highlighted you had 41 titles for this year's pipeline. In this earning call, I think you were highlighting 31 titles. Can you talk about, are these 10 titles getting pushed out to fiscal '14? Are or these are getting canceled? Any color on this would be great.

And, second, on the Battlefield, given the strong engagement that you're seeing with the user, strong catalog sales, would you ever consider making Battlefield as your annual franchise? Thank you.

Peter Moore *- Electronic Arts Inc. - COO*

Hey, Atul, it's Peter. I can give you a little bit of color without too much detail, unfortunately, on the change from 41 to 31. It's a combination of pushing some stuff out into the next fiscal year, killing a few things that we didn't think were relevant in the marketplace today, and a strong pivot towards mobile from social, in some instances, that would obviously push them back a quarter or two.

So, no real changes other than those to the lineup. And obviously, we're getting completely focused on the mobile business as well, but taking care, as John mentioned earlier, of making sure that we deliver our major brands in the social.

John Riccitiello *- Electronic Arts Inc. - CEO*

It'd be clear. I mean, the lion's share of that and Peter is being careful. But to state it finally, we've reduced our SKU count against Facebook social on the casual line. So that's the primary issue. Frankly, the combination of factors in terms of revenue outcomes for titles from us and others in that arena, and the costs required has not proven to be a great equation. You can make a block, but you can't make enough to feel great about the investment. So we have reprioritized and taken from (technical difficulty).

Frank Gibeau - ***Electronic Arts Inc. - President of Labels***

Yes, I'll take the question on Battlefield. This is Frank. We -- we're committed to -- we're focused on building the next Battlefield experience right now, and our goal is to make a high-quality experience that grows the business. If we do that on an annual basis, that's not something that we've announced or are openly discussing at this point. We're really just focused on the next Battlefield.

Atul Bagga - ***Lazard Capital - Analyst***

And can I -- if I can have one more follow-up. So, you guys talked about NBA cancellation, some underperformance of Medal of Honor, and you're taking down your revenue guidance by about $50 million. Can you talk about what are the puts and takes? Is it mostly the strength of FIFA? What other things going on in the guidance? You talked about what's going down, but what's going up there? Thank you.

John Riccitiello - ***Electronic Arts Inc. - CEO***

So, broadly, the over-performance we've talked about already and I'll just bring you up to speed. We talked a lot about FIFA being positive. We've talked pretty sharp positive in the form of Battlefield and Battlefield Premium. We've talked about the Need for Speed relative to our initial expectations looks very strong.

Madden was a solid entry this year and mobile across the board. So those are generally our upside scenarios. We've got, what we think -- look, when you start the fiscal year, you don't know your fourth quarter of how in terms of the exact quality that they're finishing at.

Right now, what I've seen of Dead Space, what we've seen of Crisis, what we've seen on SimCity, could do nothing other than bolster our confidence in their ability, both titles, to deliver. So we feel good about our numbers, but you're right. We've had -- I mean, the principles outside this year were Medal of Honor, NBA, and, frankly, earlier, Star Wars has underperformed. So that's really the balance equation.

Rob Sison - ***Electronic Arts Inc. - VP of IR***

Sharon, we'll take one more question now. Thank you.

Operator

Thank you. Our last question will come from James Hardiman of Longbow Research. Go ahead, sir, your line is open.

James Hardiman - ***Longbow Research - Analyst***

Thanks for taking my call. Just to piggyback a little bit on the back-weighted guidance for the fourth quarter. Obviously, at any given point in time, your guidance is dependent on the releases that you have. Obviously, given all the releases that are scheduled for the fourth quarter, maybe a little bit more risk.

Can you go through some of the major titles that you have coming out in the fourth quarter, and just talk about the risk that those releases could get pushed back? Are the major console titles pretty much etched in stone? And -- or is there some risk associated with some of these pop cap games for the fourth quarter?

Frank Gibeau - ***Electronic Arts Inc. - President of Labels***

This is Frank. I'll try and give you some additional color. If you go back to our remarks, I called out three key blockbusters for us in Q4 with SimCity, Crisis, and Dead Space 3 -- all proven brands with great development teams working on those products. So we feel very good about the trajectory on those three games. And those are the primary drivers in the HD console PC business that we have.

In mobile, continuing to see strong growth in there. Obviously, the smartphones are going to be very popular items at Christmas this year. And we see that expansion in the installed base continuing to drive not only our new releases, as exemplified by Real Racing 3, but also our catalog titles and future releases and updates for pop cap.

As you might know, we've converted most of our, if not all, of our mobile business to a premium business model. So these are much more reflective of ongoing services that we are constantly updating. In the case of Simpsons, we did a Little Treehouse of Horrors update around Halloween that drove tremendous growth inside the revenue inside that business.

We're committed and going to continue to release timely updates of content inside the mobile business. And it's going to feel very much like an online service going forward. So I hope that gives you a little bit more color.

And then, of course, the Battlefield subscription Premium, we still have two more releases of Battlefield content inside that subscription with Aftermath and Endgame. That digital business continues to grow. And we're seeing continued and strong performance in FIFA Ultimate Team, which has gotten longer and longer legs over the years, where we see very high peaks in terms of our online community participation and revenue generation in Q4 in FIFA, as the season in the Premier lead as an example really heats up. And we're continually releasing content.

So it's a combination of proven brands with better related to new releases, as well as online services continuing to be updated and grown, coupled with, as Blake mentioned, a strong catalog business. Electronic Arts has a very diverse and deep catalog that always performs well for us at Christmas and in the Q4.

James Hardiman - ***Longbow Research - Analyst***

Very helpful. And just a quick follow-up. Gross margin guidance has really remained unchanged over the course of the year, despite topline guidance coming down a bit. What's going on there? Does that say anything about the revenues that are being lost, that were relatively low margin revenues any way? Is it a function of better mix from Battlefield? How should I think about your ability to maintain that gross margin number?

Blake Jorgensen - ***Electronic Arts Inc. - CFO***

Yes, I mean, I think as we mentioned, we're fairly confident in our ability to continue to drive gross margins. And, clearly, as you're looking at guidance, you should view that the gross margin guidance we've given in the past is definitely good and we'll probably exceed that. And that's being driven by the shift towards more digital business, and the portfolio effect of higher fully-owned IP, particularly in the back half of the year, where you get a much higher gross margin in the fourth quarter, based on the titles that Frank just talked about.

So all that leaves us with fairly good confidence around the direction for gross margin, both in the near-term as well as longer-term for the business.

James Hardiman - ***Longbow Research - Analyst***

Got it. Thanks, guys.

John Riccitiello - ***Electronic Arts Inc. - CEO***

All right. Well, thanks, everyone, for joining us on the call. For those of you on the East Coast, stay safe and we'll talk to you again in a quarter. Thanks very much.

Operator

This concludes today's conference. Thank you for your participation. You may now disconnect.