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Conference Call Transcript

ERTS - Q1 2012 Electronic Arts Inc Earnings Conference Call

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PRESENTATION

Operator

Welcome and thank you for standing by. At this time, all participants are in a listen-only mode.

(Operator Instructions). Today's call 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.

Rob Sison - Electronic Arts Inc. - VP, IR

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Thank you. Welcome to EA's fiscal 2012 first-quarter earnings call. With me on the call today is John Riccitiello, our CEO; Eric Brown, CFO; Peter Moore, President of EA SPORTS; and Frank Gibeau, President of EA Games.

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, an audio replay of this call and 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-K for a discussion of risks that could cause actual results to differ materially from those discussed today. Electronic Arts makes these statements as of July 26, 2011 and disclaims any duty to update them.

Throughout this call, we will discuss both GAAP and non-GAAP financial measures. 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

Thanks, Rob. Our first quarter was an excellent start to fiscal 12 with results ahead of expectations both top and bottom line versus the guidance provided on our Q4 call.

We came in at the high end of the range for both revenue and non-GAAP EPS versus the updated guidance provided on our July 12 call when we announced the agreement to acquire PopCap Games.

Our top line reflected strong performance of Portal 2. The bottom line reflected strong performance from digital games and services and ongoing cost management initiatives. We are off to a good start to the year and feel bolstered by strong pre-orders for Battlefield 3 and STAR WARS.

We are also pleased to see that the NFL lockout is resolved. While we are increasing revenue guidance to include the addition of PopCap, we feel it is still too early in the year to revise our FY 12 EPS guidance. Accordingly, we are reaffirming our non-GAAP EPS range of \$0.70 to \$0.90.

On today's call, I will update you on the progress of key titles and initiatives. Eric will provide a financial and sector update on Q1 followed by greater detail on our financial guidance for Q2 and fiscal 2012. Peter will offer some color on our football and soccer franchises as well as our Free to Play sports titles.

Before we begin, I'd like to offer a brief overview of the industry. Most of us on this call recognize that the industry has radically changed and the pace of change has accelerated dramatically.

Gone forever is the four to five year console cadence that gave developers ample time to invest and retool for the next big wave. Consider that just 18 months ago there was no iPad.

Google was just experimenting with Android and most big games were limited to a single revenue opportunity at launch. Consider that each of the major consoles now has a controller that encourages users to get off the couch and get into the action.

On smartphones and tablets like the iPhone and iPad, the top paid apps are all games. Recognize that the fastest-growing revenue streams for console, PC, smartphones and tablets are all digital and that EA is partnering with its retail and platform partners to help jointly grow these digital revenue streams.

While the game industry has fundamentally changed, games are reaching a far larger audience base than ever before. With this in mind, we're building our business around three key strategies.

Intellectual property. First, we're building the strength of our most important IP and for EA, this means about a dozen very substantial IPs.

Each of these will be transformed into year-round businesses with major package goods launches, social launches, mobile launches, downloadable content and micro transactions. EA's Fiscal 12 SKU plan and title focus on Battlefield, Need for Speed, Madden, [fee for] The Sims and Mass Effects are all great examples of this strategy.

Earlier this month, we announced the acquisition of PopCap Games and when this transaction closes, this incredibly talented team will further strengthen EA's already strong portfolio of intellectual property. Platform. Second, we're working to establish EA as a platform while maintaining a strong partnership with key retailers, both retail and digital retailers.

GameStop with 11.5 million registered users of their PowerUp Rewards program is proving to be one of our best partners in digital. In June, we unveiled Origin as a leading direct-to-consumer digital service and now offer several titles on this platform. We believe that Origin will scale quickly with the addition of third parties and with the launch of Battlefield 3 and STAR WARS later this year.

Talent. Our creative teams are taking on the challenge to develop and manage content across the full spectrum of our many channels and business models. This makes the job more interesting and rewarding and also connects them more closely with the changing marketplace.

We recognize that creative and engineering talent is at the core of what we do and we're making sure that EA is the best place to work for these industry leaders. The investment we're making in Austin, Texas is a great example of our commitment to this strategy. With that, I will turn the call over to Eric.

Eric Brown - Electronic Arts Inc. - CFO

Thank you, John. EA performance in Q1 exceeded the non-GAAP revenue and EPS guidance that we provided on the Q4 earnings call and is at the upper end of the financial update that we provided on July 12.

Q1 non-GAAP revenue was \$524 million driven by strong performance of Portal 2 which sold over 2 million units in the quarter. Catalog revenue was \$144 million or 27% of Q1 non-GAAP revenue resulting from strong performance by Crysis 2, FIFA 11, and Tiger Woods PGA TOUR 12 -- The Masters.

Q1 Digital non-GAAP revenue was a record \$209 million, growing 11% year over year. Excluding nonrecurring adjustments in Q1 Fiscal 11 non-GAAP digital revenue increased 24% year over year. On a trailing 12-month basis console, DLC and microtransactions grew over 100%.

Q1 non-GAAP gross profit margin was 55% compared to 59.6% a year ago. The decrease is due to higher distribution revenue.

On a GAAP basis, gross profit margin was 76% compared to 72.8% last year. Q1 non-GAAP operating expenses were \$462 million compared to \$430 million a year ago but better than our main guidance due to tight cost controls. The year-over-year increase is mainly due to FX and a higher cost from recent acquisitions.

GAAP operating expenses were \$532 million in the quarter. Q1 non-GAAP operating loss was \$174 million versus a non-GAAP operating loss of \$109 million a year ago. On a GAAP basis, operating income was \$227 million versus \$98 million a year ago.

Non-GAAP loss per share was \$0.37 versus a loss per share of \$0.24 a year ago. GAAP diluted earnings per share was \$0.66 versus diluted earnings per share of \$0.29 a year ago.

Headcount, we ended the quarter with 7973 employees versus 7758 a year ago and 7645 in Q4 fiscal 2011. 22% of our employees are in low cost locations and a breakdown of headcount is 5783 in R&D, 988 in marketing and sales, 1010 in G&A and 192 in cost of goods. Recent acquisitions have added approximately 141 to headcount year over year.

Cash flow from operations this quarter totaled a loss of \$274 million versus a loss of \$148 million a year ago. The change in operating cash flow is primarily due to prepaid royalties.

Trailing 12-month operating cash flow was positive \$194 million. EA has approximately \$5.58 per share in cash, short-term investments and marketable securities.

Roughly 55% of our cash and short-term investments are onshore. Inventory levels were well-managed in the quarter at \$75 million compared to \$82 million in the prior year.

Reserves for sales returns and allowances as a percentage of trailing six-month non-GAAP net revenue were 15% up from 13% a year ago and were up in a nine month basis to 8% from 7% last year. Sector performance. Overall the worldwide interactive entertainment segment was up mid single digits in the June quarter.

Packaged goods were down 11% for the quarter but digital continues to perform well and is up over 20% for the quarter. For the June quarter, the Western World packaged goods market was down 5% comprised of 4% growth in high-definition platforms and a 19% decline in low definition platforms.

Calendar year to date, the Western World packaged goods market was down 9% comprised of a 2% decline in high-definition platforms and a 19% decline in low-definition platforms. EA was the number one publisher in the Western World for the quarter with 16% share in North America, 17% share in Europe and 16% share overall in the Western World versus 14% a year ago.

Digital highlights for Q1 fiscal 2012. Q1 non-GAAP digital revenue increased by 24% year over year to \$209 million excluding the \$20 million of nonrecurring revenue that we identified in Q1 last year.

DLC and free-to-play microtransaction content was \$70 million in Q1, up 32% versus last year. Mobile and other handheld digital revenue was \$59 million, up 9% versus last year thanks to growth in smartphone related revenue which more than offset a reduction in feature phone related revenue.

Full game downloads were \$32 million, up 39% year over year. Revenue from subscriptions, advertising and other was \$48 million, down 17% year over year due to nonrecurring items last year.

The top three digital revenue generators for Q1 were FIFA 2011, Battlefield -- Bad Company 2 and Dragon Age 2. Notable console DLC contributors include FIFA 11, Battlefield -- Bad Company 2 and Mass Effect 2. Notable digital full game downloads include Dragon Age 2, Crysis 2 and Battlefield -- Bad Company 2.

As at the end of Q1, we had approximately 125 million users in our nucleus consumer registration system up from 67 million year ago. In social network gaming, EA has 32 million monthly active users and 5 million daily active users.

Playfish experienced improved monetization on the continued strength of Pet Society, Restaurant City, FIFA Superstars and Madden Superstars with non-GAAP revenue up 75% year over year. Moving on to fiscal 2012 guidance.

EA is reaffirming its full-year non-EPS guidance of \$0.70 to \$0.90 diluted earnings per share which shows EPS growth of more than 14% at the midpoint versus our Fiscal 11 result. This assumes that the PopCap transaction closes in August.

There are several key assumptions worth noting. The PopCap acquisition is expected to be non-GAAP EPS neutral to EA's fiscal year 2012 due to one-time transaction costs which impact our Q2 results.

Star Wars -- The Old Republic is targeted to launch in holiday of 2011 but our guidance range accounts for a range of ship dates within the fiscal year. Fiscal 12 non-GAAP revenue. EA is increasing its full-year non-GAAP revenue guidance to \$3.9 billion to \$4.1 billion, up a total of \$150 million from our May guidance.

This upward revision is driven by two factors. First as noted in our July 12 call, we're adding \$50 million to \$75 million in revenue for PopCap. Secondly, we're increasing our forecast due to FX and higher distribution revenue.

Our distribution revenue expectations are now approximately \$250 million versus our previous estimate of \$200 million. EA is increasing its non-GAAP digital revenue expectations to \$1.1 billion to \$1.15 billion compared to previous guidance of approximately \$1.05 billion to \$1.1 billion due to the PopCap acquisition.

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And for EA published titles, our non-GAAP revenue expectations are now \$2.55 billion to \$2.70 billion. Our Fiscal 12 title slate is reaffirmed and includes a total of 22 primary titles.

Fiscal 12 GAAP revenue and EPS. Including PopCap, our Fiscal 12 GAAP net revenue guidance is approximately \$3.825 billion to \$4.025 billion.

Our Fiscal 12 GAAP EPS guidance now ranges from a loss of \$0.10 to earnings of \$0.21 which is approximately \$0.05 lower than we provided on July 12 primarily due to the impact of the convertible notes offering that we closed on July 20. GAAP tax is expected to be a benefit of approximately \$30 million.

Gross profit margins. Consistent with our previous guidance, we expect full-year GAAP gross profit margins of approximately 61% and we expect full-year non-GAAP gross profit margins of approximately 63%.

Operating expenses. We expect Fiscal 12 non-GAAP operating expenses to be approximately \$2.15 billion which is up due to FX and the new PopCap operating expenses.

GAAP operating expenses are expected to be approximately \$2.4 billion. Our Fiscal 12 non-GAAP EPS range corresponds to a non-GAAP operating income margin of approximately 8% to 10% with approximately \$5 million in other income and expense, a full-year non-GAAP tax rate of 28% and an increased share count due to the acquisition resulting in an estimated 334 million diluted shares for the year.

Q2 and full-year phasing. For Q2 Fiscal 12, we expect the following for non-GAAP results. Revenue between \$925 million and \$975 million and non-GAAP loss per share of minus \$0.13 to minus \$0.03, an increase of \$0.02 since our July 12 call.

Non-GAAP gross profit margin is expected to be approximately 58%. Operating expense is expected to be between \$580 million to \$600 million, a non-GAAP tax rate of 20% and the diluted share count is an estimated 331 million.

For GAAP results, we expect the following for Q2 Fiscal 12. Revenue between \$675 million and \$725 million and GAAP diluted loss per share of \$1.03 to minus \$0.87. Gross profit margin is expected to be 41% to 42%, operating expense is expected to be \$650 million to \$670 million and share count is an estimated 331 million.

For full-year phasing, please consider the following. In the second half we expect to begin seeing a more ratable and profitable P&L based on subscription revenue growth from Star Wars -- The Old Republic and leverage from higher unit sales of key owned IP such as Battlefield 3.

We expect Fiscal 12's quarterly revenue phasing to be similar to Fiscal 11 with non-GAAP revenue distributed as follows. Q1 approximately 13%, Q2 approximately 24%, Q3 approximately 39%, Q4 approximately 24%.

Cash flow. We expect Fiscal 12 operating cash flow to be \$250 million to \$300 million, consistent with our previous guidance. We expect Fiscal 12 capital spending of \$125 million to \$150 million.

Foreign exchange. Our guidance assumes the following FX rates for fiscal year.

\$1.44 to the euro, \$1.03 to the Canadian dollar and \$1.61 to the British pound. The weakness in the US dollar since our May call has been reflected in our updated guidance.

On July 20, 2011 we completed our private placement of \$632.5 million aggregate principal amount of 0.75% convertible senior notes due 2016. The overall after-tax cost of capital in this transaction is approximately 1.5%.

There is minimal potential shareholder dilution as the call spread overlay increased the effective conversion (inaudible) price to 75% and \$41.14 respectively. There is no ownership dilution to common stockholders below \$41.14 per share and only half a percentage point of dilution for each \$5.00 increment above \$41. This financing allows us to complete the PopCap transaction while giving us the flexibility to keep the share repurchase program intact.

In Q1 Fiscal 12, EA repurchased 4 million shares at a cost of \$91 million. \$451 million remains authorized for the repurchase program over the next 12 months.

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We expect that EA will exit Fiscal 12 with a non-GAAP EPS run rate and operating margin greater than what is indicated by our full-year guidance range. The principal driver here is the ship date of STAR WARS.

We opened the year with STAR WARS and development and incurring expense. We closed the year with STAR WARS in operation generating high margin ratable digital revenue and profits. PopCap will also be non-GAAP EPS accretive to Fiscal 13 by at least \$0.10 per share.

Lastly, our assumptions on the sector. We expect the worldwide interactive entertainment segment will grow 5% to 10% in Calendar 11 versus Calendar 10 with more than 20% growth in digital and an approximate 6% decrease in packaged goods. We expect the packaged goods segment to remain bifurcated with stronger growth of approximately 5% in high-definition consoles and PC, offsetting a 19% decline in standard definition.

Now I'll turn the call over to Peter Moore for an update on EA SPORTS.

Peter Moore - Electronic Arts Inc. - President, EA SPORTS

Thanks, Eric. I'm dialing in from here in New York where about an hour ago the Madden team and I just came out of a meeting with our NFL partners. We're working closely with both the NFL and the Players Association.

Both sides recognize that between signing free agents, rookies and other undrafted players, there's a lot to do before the start of the season. We're now fully engaged in the promotional ramp up to the launch of Madden NFL on August 30. Like the players and the owners, we couldn't be happier with this resolution and we are beyond excited about having a full season of football this year.

As you know, we have two outstanding American football franchises, Madden NFL and NCAA Football. This year's product and marketing strategy was designed to limit any downside from the potential of an NFL lockout.

We built a plan to double down on college football and that strategy has paid out nicely. After two weeks of sales, we were up 17% year on year with more than 700,000 units sold through. We are hopeful that the strong performance we've seen to date will carry on through the college season.

Let's move to FIFA. FIFA 12 will launch on 12 platforms this year and we expect double-digit growth over last year's game.

Our wildly successful FIFA Ultimate Team digital mode is a big part of our growth forecast. Last year, FIFA 11 Ultimate Team captured 3.3 million players with a net average revenue per paying user of \$51. As impressive as that number is, keep in mind that it represents only 40% of the installed base who actually downloaded this feature.

Next month at gamescom in Cologne, we will unveil a plan to give FIFA 12 owners 100% access to this mode. I believe Ultimate Team could add as much as \$5.00 of net revenue to every packaged goods unit sold of FIFA 12.

Next, a quick update on SSX, a fan favorite and one of the most critically acclaimed franchises of the last generation. We unveiled the new game at E3 and critics responded with seven Sports Game of the Show awards.

Ramping up the global appeal of this game, we will debut new content in Cologne next month. We're excited to have another global title of this magnitude and plan to release SSX in Fiscal Q4.

Finally, I want to update you on our progress on Facebook where we host the Superstar series for Madden, FIFA and World Series Baseball. Each of these games has shown good monthly growth and built a strong base of dedicated fans.

We see EA SPORTS on Facebook not only as a scalable, stand-alone business, but also as a gateway for bringing new players to deeper EA SPORTS experiences on consoles, tablets, and smartphones. Among those who do spend money on Superstars, the average lifetime revenue per paying user is \$56, surpassing the net revenue we received from players on consoles.

Facebook is a platform we will grow on with deeper and more engaging experiences for our fans. All in all on discs and online, it's shaping up to be another good year for EA SPORTS. Now back to John.

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John Riccitiello - Electronic Arts Inc. - CEO

Thanks, Peter. Starting in Fiscal 12, our focus is on one, IP, building roughly 12 franchises into year-round business across a range of platforms, packaged goods and digital.

Two, platform; building a solid ecosystem for leveraging our content and services, focusing on our own platform, Origin, while supporting our retail partners. And three, talent; investing in our creative and engineering talent to drive and maintain our IP across multiple platforms from console to social and PC to mobile.

FY 12 is not just about strategy though. It's about some explosive programs and tangible objectives which will mark FY 12 as a positive inflection point for Electronic Arts. Among the most exciting are these.

We will launch Star Wars -- The Old Republic and compete for a big slice of the MMO market. We will launch Battlefield 3 head-to-head against a tough competitor, leveraging the strength we are now seeing in pre-orders to take share in the all-important FPS sector.

Madden will hit the market in August perfectly positioned to leverage the renewed excitement around this year's NFL season. Our FIFA franchise will be propelled to new heights across a multitude of platforms, digital and packaged goods.

The Sims is going social. This year the brand hit social and if it all goes as we hope, social will never be the same.

Origin is now live and will continue to expand those capabilities and services to better support our customers on a 24/7 basis. We expect to close the PopCap transaction in August, bringing one of the most talented studio teams to Electronic Arts.

We started the fiscal year with single-digit operating margins and expect to finish the fiscal year in double-digit operating margins. And we will have a digital business with revenues well above \$1 billion.

We intend to finish the fiscal year a much different company than we started -- more diversified, more digital and more profitable. With that, Peter, Eric, Frank and I will take your questions.

QUESTION AND ANSWER

Operator

(Operator Instructions) Brian Pitz, UBS.

Tim O'Shea - UBS - Analyst

Yes, this is Tim O'Shea speaking for Brian. So congratulations on the quarter.

I was wondering if you could give us a little more color on the status with Facebook. I think I heard you say that average lifetime revenue per user is \$56.

Can you give us a little maybe some color on what percentage of users are actually paying to play the games? And if you could just remind me what games specifically you're seeing the \$56 lifetime revenue for?

Peter Moore - Electronic Arts Inc. - President, EA SPORTS

Tim, I will take that. That was my comment.

There are three games we are looking at there. That's our Madden Superstars, FIFA Superstars and our World Series Superstars games.

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The metric I'm referring to is average revenue per paying user which when we look at the lifetime value right now, the \$56 is accumulated spend of the people who actually pay us. We're not breaking out paying users yet but as you can imagine and such is the nature of these type of games, it's within the small single digits. The great majority of people still play for free. And we enjoy them adding to the ecosystem of that type of game.

John Riccitiello - *Electronic Arts Inc. - CEO*

One of the positive aspects of Facebook credits is the primary impediment to getting above low to mid single digits for paying users among the total audience of those playing is many people don't want to stop their gameplay and enter a credit card. If the Facebook credits ecosystem expands and they see a third or half or three quarters of their users with credit balances, we think that is a growth engine for us and if you will a play field leveling program for Electronic Arts in social.

Operator

Brian Fitzgerald, UBS.

Brian Fitzgerald - *UBS - Analyst*

The question we had was regard to Battlefield 3. I wasn't sure if he had asked that.

John Riccitiello - *Electronic Arts Inc. - CEO*

No, please go ahead.

Brian Fitzgerald - *UBS - Analyst*

Okay, so in terms of Battlefield 3 pre-orders to date, can we get some color on that perhaps relative to Medal of Honor and which platform is seeing the most interest there?

Frank Gibeau - *Electronic Arts Inc. - President, EA Games*

Hi, this is Frank. Battlefield 3 we have been competing against Battlefield -- Bad Company 2. That's where we see a 10x increase over that title based on the same number of weeks pre-release.

In terms of comparison to Medal of Honor, it's significantly ahead of Medal of Honor as well. We are very aggressive about the title right now, feeling very good about it and fully expect to take share this fall.

Operator

Brian Karimzad, Goldman Sachs.

Brian Karimzad - *Goldman Sachs - Analyst*

One on The Old Republic, can you help us understand how the capacity management is going to work at launch? What kind of leadtimes you have to add capacity? And how do you plan to manage the effect of people wanting to level up, put their friends together if demand starts to significantly exceed the capacity out of the gate?

Eric Brown - *Electronic Arts Inc. - CFO*

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Yes, I think we're in pretty good shape to do that. We've got a very aggressive plan to be able to scale multiple millions of users coming into the STAR WARS franchise in service this fall.

We're looking at pre-order campaigns and telemetry coming in from retail as well as online to get a sense of the overall base and it's very strong. We're pretty relaxed about what we're going to be able to achieve there.

We'll be able to scale up and light up new servers on a fairly quick base. We've got a plan to do that over the months following ship and we have a lot of capacity built into that.

Brian Karimzad - Goldman Sachs - Analyst

Okay, and then just one on The Sims Social. I know it's marketing stuff you may not be able to share but any sense on intent to play as a percentage of that user base? It shipped over 100 million units so far.

John Riccitiello - Electronic Arts Inc. - CEO

So just for everybody on the call, the 100 million units, it's like 120 million units now in terms of lifetime units at The Sims franchise. And no, we aren't going to put out the stats because you're right, they're highly sensitive competitive comparisons which is one of the reasons we also aren't giving you a launch date.

It's relatively easy for a competitor to buy all the relevant advertising say 24, 36, 48 hours prior to a release. So in the social and frankly also in mobile, you're often going to learn about our big ideas in terms of the specifics shortly after the fact as opposed to leading into them because the market dynamics are so sizably different than retail.

Brian Karimzad - Goldman Sachs - Analyst

Understood, thank you.

Operator

Edward Williams, BMO Capital Markets.

Edward Williams - BMO Capital Markets - Analyst

Just a couple questions also on STAR WARS. Can you talk a little bit about what you see as being the size of the MMO RPG market as a whole as we look at North America and Europe, how you kind of go about trying to get a sense for the scale and the interest in that specific genre?

And then also in terms of STAR WARS, is this something we should kind of look for kind of after-the-fact in terms of when we can get some details and thinking about modeling it and looking at how many orders have gone? Will we hear that kind of after-the-fact or can we hear about it kind of leading into it?

Eric Brown - Electronic Arts Inc. - CFO

I think on the next call, we will definitely be briefing you in more detail on how the launch is shaping up and how we're tracking there in terms of your second part. The MMO category is extremely large.

It's a tens of millions of person opportunity for us both in Europe and the West. It's not only personified by World of Warcraft but you see a lot of other games in there like the RuneScape, MapleStory that qualify as MMOs and also contribute to that overall market size.

We feel very bullish to be able to come into this category with a fresh offering, something that's brand-new that appeals to the majority of that category and it's a category that hasn't seen a lot of releases that have hit scale over the years and we feel like we're in good position to pick up on

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a lot of latent demand, frankly people who have played Warcraft which is the market leader in laps to bring them back into the market and activate them that way. So, it's a big segment, it's a strong segment. And yes, I think the response on pre-orders over the last five days has indicated that we've got something that's going to appeal to that overall market.

John Riccitiello - *Electronic Arts Inc. - CEO*

A couple of added points -- this is John. One is that there are -- the reason I think Frank was -- broad earnings commentary on the size of the sector, there's about as many definitions of what's included in the RPG MMO market. Our internal market, our judgment based on what we've included, shows it in the double-digit millions of subscribers in the Western markets; 12, 14 depending on what's included or not and higher if you start including some of the lower price per month competitors.

In terms of how to frame the business model and its impact on margins which I think -- which were getting out there [bad] these are actually pretty complex models. But you need a lot of information like over the lifetime of a user, churn rates, you need to know a lot about conversion from the initial purchase.

And at least at this point, we are obviously not in a position to give you that. But we have framed this in prior discussion.

What we told folks was that this is the product that it starts to make profitability, about 0.5 million subs. At about 1 million subs, it's a business that makes good money on an ongoing basis but it doesn't feel great about the historical investment to -- that sort of got us here.

And anything north of 1 million as we approach 1.5 million or 2 million starts to look like a great investment and justifies the entire purchase price of BGA Fireware in a very positive way. So we framed that out. We also said as we get into that latter category, we're moving from the high 30s to the mid-40s in operating contribution.

So if you pin those two points, you can put a lot of numbers in there, but that sort of gives you a frame for how to look at that. We had provided that same framework previously because we recognized how difficult it might be from the outside looking in for modeling an MMO from Electronic Arts.

Edward Williams - *BMO Capital Markets - Analyst*

Great, thanks a lot, John. And just one other quick question for you. What is your thought on getting third parties on to Origin?

John Riccitiello - *Electronic Arts Inc. - CEO*

We've had a lot of inbound inquiry about getting on. I think forward-looking publishers really want their content on any and every platform possible. One more sale is better than not.

By way of example, even though we have Origin, we are pushing EA content digitally on any and every EPL platform we can and in fact just this morning we were talking to the guy (inaudible) I was personally talking to him about just that.

They are great partners for us in and around things like -- you've been reading about lately about what we're trying to do on the subscription side for a marketing service for the sports business and we will be great partners for a lot of our digital initiatives. So we love what we're getting with Origin. If you will, we hope to be HBO meets Netflix for gaming, but we're also very keen to have our content distributed anywhere and everywhere gamers are.

Operator

Arvind Bhatia, Stern Agee.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

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Just a couple of product-related questions. One on Harry Potter, any color if you could provide us how that product is doing in the market right now. And then on FIFA, given it's the end of the quarter, but you can recognize revenue of course upon shipment. Eric, can you give us some color on how to model that for the September quarter versus December?

Eric Brown - Electronic Arts Inc. - CFO

Well in regards to FIFA, it's still a -- we still think of that principally as packaged goods. So we're expecting the non-GAAP revenue to hit the September month there for fiscal Q2. So we expect it to be a normalized launch in respect to how it launched last year.

John Riccitiello - Electronic Arts Inc. - CEO

In terms of Harry Potter, we had a good solid sell-in. I do not have great data at this point on sellthrough; a little early to read. We will obviously be putting more information on that in the course of the next call.

Arvind Bhatia - Sterne, Agee & Leach, Inc. - Analyst

Let me ask another one then. Housekeeping -- catalog for the quarter, Eric?

Eric Brown - Electronic Arts Inc. - CFO

Our catalog performed well. We will pull the catalog stat here for you in just a moment. I think it was 27% in the comments.

And so reasonable catalog percentage. Most notable for us though in the quarter is the percent of digital. Digital was 40% of overall revenue in the quarter versus the 524 of non-GAAP net revenue and that's -- I think that's one of the highest numbers we've experience in terms of mix.

John Riccitiello - Electronic Arts Inc. - CEO

On that one stat I would draw your thoughts to was in the release. On a trailing 12-month basis our digital was up 35%.

We've noted in recent quarters a number of sort of lumpy entries where we get some one-time revenue. But the trailing 12 is a good way to iron all that out and it shows growth across the EA's range of digital offering that's greater than the industry. So we are gaining share.

Arvind Bhatia - Sterne, Agee & Leach, Inc. - Analyst

That's great. Thanks, guys.

Operator

Justin Post, Bank of America.

Ryan Goodman - BofA Merrill Lynch - Analyst

This is Ryan G. calling in for Justin. Couple of questions for you guys.

First, with Playfish and PopCap soon part of your digital portfolio, do you think you really have enough there to win on the social platforms? Or do you really -- is it possible you might need more assets to go head-to-head with the likes of Zinga and those players?

And then second, maybe this is for Peter, but on sports, what do you really attribute the growth in that category to? With FIFA growing really well last year and then NCAA off to a good start this year, is it just simply product innovation or is there more going on there?

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John Riccitiello - Electronic Arts Inc. - CEO

So I'll start with the social side. First off, I would say we definitely think we have the assets we need to grow in social, but I would certainly not limit it to PopCap and Playfish.

We have as Peter just mentioned a few moments ago, we are pushing hard on social with our sports businesses and we've already announced Sims Social which is intellectual property from EA's core that's being built at our Playfish studio in the UK. You will see -- you've seen Hasbro up. You're going to see a lot from the games label.

I was personally addicted to Dragon Age Legends, one of the great products out there, core in its orientation. And I am a gigantic believer that the PopCap intellectual properties are going to do really well there.

I think we're good and one of the things I said on the call when we announced the PopCap transaction is that our DAUs are about 10 million combining EA, Playfish, PopCap together. And I felt there was a possibility of getting to about 20 million within about a year.

That is based on my read of our title slate. We haven't released that information to you but it's my read of that title slate and what it can do.

For what it's worth, that's still only about a third of where our leading competitor is, but it's a great position to be in. So we're not Babe Ruth at the plate pointing to a grand slam home run here. But we are telling you that we can do really well in the sector and we think we've got the right portfolio of intellectual property and development teams on the job.

Ryan Goodman - BofA Merrill Lynch - Analyst

Yes, as regards to the question on sports, I think product innovation is obviously key. But also we now look at a situation where we have really matured with our digital offerings. The ability to bring our sports consumers not only vertically down our franchises deep on multiple platforms but across, and I think the Ultimate Team stats and the Facebook stats that I presented to you in the prepared remarks are just the tip of the iceberg of what we are looking to do.

So we're not losing our consumers as readily as we did in the analog world if you will of the past. We're able to communicate with them every day.

Our marketing this year so far has been spectacular. And as I said, I just left the NFL offices where we presented our marketing plans for the next 60 days as we get close to launch.

But really I think the focus on online, connecting our consumers, communicating with them every day, driving hard at retail -- our retail partners are doing tremendous work for us on pre-sells and we're seeing strong growth at retail, in particular here in the US at GameStop, Best Buy and Wal-Mart as you might imagine. But they're also playing a very important part in the growth of our digital business.

They're strong partners not only with packaged goods, but also selling digital content and they're a very, very important part of the ecosystem now and beyond. So retail becomes even a bigger player as we have more offerings every single day rather than the singular launches we may have had in the past. So I would encapsulate as product innovation, digital offerings and then all wrapped up in tremendous world-class marketing.

Eric Brown - Electronic Arts Inc. - CFO

To put a point on the digital engagement of FIFA and how that's improved significantly year over year, as of the end of Q1 we realized \$64 million of digital non-GAAP revenue which is console DLC on FIFA 11 compared to \$33 million on the predecessor title FIFA 10; so basically a doubling in digital revenue on that one franchise year over year. Dam -- who was that Eric.

John Riccitiello - Electronic Arts Inc. - CEO

And the strong start on NCAA, we've given it a little bit more room by moving Madden back a couple weeks. But it's frankly a product that's being exceptionally well reviewed.

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Not just the professional reviewers, but if you read any of the social blogs that are sort of the lighter consumer, they're pegging this as one of the better football games ever. So quality pays.

Ryan Goodman - BofA Merrill Lynch - Analyst

Okay, great, and then one follow-up question maybe on Madden. With the NFL season seemingly back on track, has your outlook for that title changed at all or now with the move out of the launch date, has your outlook there changed?

Eric Brown - Electronic Arts Inc. - CFO

This is Eric. I will comment on that.

Certainly the news regarding the NFL resolution is positive. It's a latebreaking development. In terms of revenue impact, we expect some upside in the fiscal year that would start to appear in Q3 versus Q2. We will assess the initial sell-in later this quarter and provide a revenue update on our next call.

In terms of Fiscal 12 EPS impact, we have already pointed out the fact that we hedged our royalty costs and net margin meaning that we protected the P&L downside which at the same time limits net margin upside from a normal season scenario. To set expectations, we would not expect revenue upside to have a significant fiscal year 2012 EPS impact.

Operator

John Taylor, Arcadia.

John Taylor - Arcadia - Analyst

I've got a couple of questions. First, I wonder if you could briefly touch on the distribution upside and what's included in that number.

The second question, maybe I wonder (inaudible) maybe you can talk about sales and marketing and how that's being allocated amongst vehicles or whatever as the revenue mix shifts into other areas and you're addressing a different audience than maybe you have in the past. And the third question is I'm interested in your comment about revenue being up so much at Playfish. Is there anything you can sort of talk about there as it relates to increasing trends in revenue per paying or what the key levers are behind that.

Eric Brown - Electronic Arts Inc. - CFO

I'll take the first part of the three-part question. The distribution change, we have increased guidance from 200 million to 250 million and it's a function of the very strong performance Portal 2.

John Riccitiello - Electronic Arts Inc. - CEO

On the sales and marketing side, I would say that there's sort of two broad trends going on and it's obviously very specific to a lot of our products. But at the high level, the first thing I would articulate is that we've been shifting dollars from traditional television and from other sort of more traditional ways to bring product to market and investing increasingly in a variety of digital media where we have really, really, really good data on return on investment.

We are doing that across the portfolio of our products and that's working very well for us. In terms of our digital offerings, most of our digital offerings fit into one or both of the following categories.

They are either under the umbrella of a major brand launch and they in a way almost get free marketing. It's not exactly free, but there's no question that our sports franchises on Facebook benefit from very strong brand awareness.

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And so we're getting that with Dragon Age, we're getting that with our sports franchises, we get that with Hasbro. We've got major brands where our competitors have got to create their brands in order to elbow their way into the marketplace.

The second factor is just an honest admission that marketing spend on a lot of these products is a little bit tough to budget. The reason it's tough to budget is we measure so well.

And so when we are marketing a social product and we are seeing statistics that suggest that the revenue is significantly in excess of the advertising, we increase our advertising budgets immediately. And they flex up and down with our opportunity. And that's not just EA.

Most of the more sophisticated players in digital channels are operating just that same way. We do a lot of testing on the business model; what exactly works best for microtransaction for the offering and the price. But we also do it with our marketing and distribution.

If we buy an ad in a particular -- from one of our products like a Battlefield (inaudible) free or 1943, if we buy an ad on a gamer site and the click through is such that it's a positive return on investment, we do it again and then we do it again until it stops being a positive return on investment. So in general, spend is moving from if you will the analog world to the digital world.

And then secondly for our digital products and when we are in the digital world, we use a lot of data to help guide our spend. You're asking about what's been driving revenue on the social side and I would say that you might in a way think about it as a one win and one loss for EA and I hope to be in the two win category over the course of the next six months.

We have not seen the growth in DAUs that we would have liked with the last couple of releases. What we have seen is strong increases in revenue per paying user and revenue per user overall.

In other words, DAU is roughly flat, we roughly doubled our revenues. So what's happening is we're moving revenue per user up sharply.

That's a very good thing. And that's going to help us a lot as we launch some major brands.

We have several major launches in the balance of the fiscal year on social where we have learned the right lessons around monetization. And then lastly if you go back to the July call that we made on PopCap, one of the things we pointed out is that they have a lot of interest in their products but relatively low monetization and that's an area where we think there's going to be strong synergy between our learnings and their IP.

Operator

Mike Hickey, Janco Partners.

Mike Hickey - Janco Partners - Analyst

Just curious on STAR WARS, you said record pre-orders. I was hoping you could wrap some context for us on that and maybe specifically how pre-orders for that game are pacing your expectations. And also curious on your beta testers, if you can give us any update there and perhaps what you're seeing in terms of your beta testers converting to pre-order buys?

Eric Brown - Electronic Arts Inc. - CFO

Sure, I'm not going to give you an actual number yet on the pre-orders. I want to get through the first week and let all the telemetry come in.

But in general the pre-order numbers are ahead of our expectations on STAR WARS. It's ahead of the curve that we plotted for what we need to do in terms of reaching our goals.

It's about -- it's the largest number we've done at EA in comparison to other titles. And the next closest title was Battlefield 3 and it was up significantly from there.

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In terms of the beta tests, we have thousands of people in a current beta test going on right now and we're learning a lot of great things and getting a lot of great telemetry that is improving the game on every new release. The purchase intent through third-party research companies is some of the highest numbers they've ever seen.

So some of our partners on that front have come back and given us extraordinarily high conversion rates from who's actually in the game and playing it through 10 levels, 20 levels and so forth and so on. As we get through the bulk of the summer, we're going to be ramping up our beta campaign and by the time we get to around September, we will be in a position to be able to really call the ball and get you the hard ship date.

Mike Hickey - *Janco Partners - Analyst*

Okay, great, and then one follow-up if I can. On your -- Eric, I know you raised your numbers for the year and that mostly reflected FX distribution and PopCap.

What I'm hearing from you guys is that STAR WARS is at a record level in terms of pre-orders. Madden, at least the season is back on. I think we have to be more helpful.

NCAA Football up strong, Battlefield 3 pre-orders I can imagine are likely outpacing our expectations. And hearing from Peter, it looks like FIFA, double-digit growth; that's the biggest franchise you have.

So are you just being conservative do you think, Eric, in terms of your outlook for the year or are these kind of in-line with what you are thinking? Or how should we wrap that up for the rest of your year?

Peter Moore - *Electronic Arts Inc. - President, EA SPORTS*

Well, I think it's important to keep in mind the shape of the fiscal and the quarters. We still have 150% of our non-GAAP EPS ahead of us, the all-important December quarter, and so I think that has to be taken into account as well.

I think it's fair to say that we are on track. We feel good about where we are. Our major titles, the initial indicators in terms of pre-orders, interest etc. are all positive.

But frankly speaking, we're just too early in the fiscal for us to flow through any of the revenue upside to the bottom line at this time or making any other adjustments to the full-year non-GAAP EPS range.

Operator

(Operator Instructions) Atul Bagga, ThinkEquity.

Atul Bagga - *ThinkEquity LLC - Analyst*

I have a couple of questions for you. (inaudible) I was hoping if you could help us understand the sequential decline in digital revenue from Q4 to Q1.

And second on Origin, can you talk about what are the KPIs or metrics that you're managing this business by? I know it's still in very early stages, but maybe if you can share some early reception -- number of partners, number of games, download, what are the things that you might be sharing with us? Thank you.

Eric Brown - *Electronic Arts Inc. - CFO*

So, in regard -- I'll take the first portion of the question here. So again -- so the sequential revenue is down but bear in mind, we had a large number of packaged goods titles shipping Q4.

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And so if we look at declines -- we also ran a large number of promotions in areas like mobile. So the packaged goods related revenue whether it's full-game PC downloads or console DLC, they're going to follow some patterns of seasonality that relate to when you ship the titles.

And so that's exactly as we expected. As we look at Q1 digital, it landed in line with our expectations for seasonality. So, we're not at all surprised at the overall outcome.

John Riccitiello - Electronic Arts Inc. - CEO

So -- this is John. With respect to KPIs in and around Origin, we have frankly several dozen that we're tracking very carefully.

And you know I don't think we've really come to a conclusion as to what we want to share on this call. But I will give you a couple of things that we have been through that give you some sense of where we are.

The first issue was whether this was going to stand up to traffic. A lot of folks put out platforms and they don't work.

They either fall from pressure to -- like we've managed the STAR WARS pre-order program through Origin. They can fall down for a bunch of reasons.

So the platform has demonstrated it to be very robust, very stable, up 99.99-something percent. So at least in terms of its stability, we feel great about it.

The second issue is are consumers using it. And while I'm not going to give you the numbers today, we're seeing good uptake.

By way of comparison, when we've had good success for example on Steam and then a similar -- that same title was released on Origin, we see similar revenues to a service that's much more mature and of higher scale at this point in time.

So we are seeing good revenue flow-through on Origin. And of course that's a good thing because we capture virtually 100% margins there.

I think the trick and probably the most important issue for us is watching how this thing scales. This is clearly going to be an issue of number of users, one, and ARPU per user like any digital business.

Obviously margins are going to be very, very important. But it is going to be how frequently we use -- how many we have, how frequently they use it and how much they spend when they use it.

We have three to four metrics around each of those because there's a different set of statistics around what actually defines a user. Is it past week, past month, past quarter? But as we manage through this process, we will come to a presentation for investors probably later in the fiscal years to give you the kind of visibility you're looking for.

But to be honest, what I was hoping for when we introduced it last month was to get through the pre-order launch of STAR WARS without falling over. And I know that may sound like a low bar, but that was actually a very important issue for a very complicated system that underlies Origin.

And the team nailed that with flying colors. I wanted to see the beginnings of consumer acceptance in terms of usage. We've seen good statistics there. And I wanted to see the beginnings of solid monetization. We've seen good statistics there.

From here, the fall will be very telling. We're going to see a lot of consumers on December 26 and the Monday before the holiday.

Atul Bagga - ThinkEquity LLC - Analyst

Just a quick follow-up on that. You had mentioned partnership with GameStop. And if I understood right, it seems like GameStop with their Impulse, Spawn and Kongregate acquisition, they are also working on a similar online gaming platform. Can you help us understand how the partnership with GameStop is going to work on the EA-Origin side?

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John Riccitiello - *Electronic Arts Inc. - CEO*

Sure, so it's really EA overall. So first off, we support virtually every retailer around the world as they enter the e-tailing business and it's actually pre the exception to the rule when a retailer doesn't have a big e-tailing business today.

In terms of our ecosystem versus theirs, they are going to have a loyal customer base inside of GameStop with loyalty programs across a range of products that is inclusive of EA and many other publishers. We're obviously going to be going deeper around our own particular offerings.

We think they coexist nicely. But by way of example, if they sell a downloadable product on GameStop, they get a retail margin as they do in retail.

And they also sell prepaid cards, they're going to be selling downloadable content where we're going to issue them codes. But we are very much strong enablers of GameStop and do not see a conflict.

And we're strong supporters of Wal-Mart and Best Buy and Media Markt and retailers around the world. This is core to our strategy.

Yes, our margins are better at Origin, but we think our ecosystem is critically important to the if you will the vitality of our sector and the Company. So we are strong on supporting them.

I think we have time for one more question.

Operator

Sean McGowan, Needham.

Sean McGowan - *Needham & Co. - Analyst*

A couple of quickies. Could you give us some bracketing of what you think the one-time charges will be for PopCap?

Eric Brown - *Electronic Arts Inc. - CFO*

Millions of dollars -- we haven't given a precise number but we expect substantial -- we incurred substantial legal cost to do the deal and we expect to incur systems and other integration related cost during the September quarter.

Sean McGowan - *Needham & Co. - Analyst*

And will it be taken care of in that quarter, assuming that the deal closes in this quarter?

Eric Brown - *Electronic Arts Inc. - CFO*

We expect to have a significant portion of them done in Q2 and there will be others trickling into the second half of the fiscal.

Sean McGowan - *Needham & Co. - Analyst*

Okay and then regarding the STAR WARS launch (multiple speakers)

John Riccitiello - *Electronic Arts Inc. - CEO*

Just to be clear on that, you understood though that that's offset by incremental margin driven by PopCap.

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Sean McGowan - *Needham & Co. - Analyst*

Yes.

John Riccitiello - *Electronic Arts Inc. - CEO*

So hence the forecast that it's EPS neutral this year and at least \$0.10 accretive next year as we're benefiting from the full drop-through and no restructuring charges.

Sean McGowan - *Needham & Co. - Analyst*

Right, and I understood it to mean that it was basically somewhat accretive excluding those one-time charges for this year.

On STAR WARS launch data, can you give us some -- I think you've commented on this in the past -- some idea of what potential range of impacts there could be depending on the launch date within the holiday period? And the kind of corollary to that, would there be any impact on the contribution from STAR WARS in the subsequent quarter, the fiscal fourth quarter, or beyond that depending on where in the holiday season it launches?

John Riccitiello - *Electronic Arts Inc. - CEO*

I'm going to top line that and maybe Eric or Frank will follow up. But when we provided our original guidance for the fiscal year, what we said was we're providing a relatively wide EPS range, \$0.70 to \$0.90.

And the reason we did that is while we were targeting Q3 for the launch of STAR WARS, we recognized the possibility that through beta testing feedback and/or operational scaling, there's a possibility that we may move the title into Q4. So really what our \$0.20 range or the lion's share of our \$0.20 range was dealing with the movement or the potential ship dates of the title.

What you've heard from us today is a series of good markers relevant to the progress that we're making -- both developing the product, consumer feedback and operational feedback. But the difference say between a Q3 and a Q4 launch date is a relatively binary event.

Hence we've kept the range intact. But our focus is strongly on Q3. That's what we're focused on, but we've maintained the guidance range which captures the -- a few more events as Eric mentioned in his comments.

Eric Brown - *Electronic Arts Inc. - CFO*

This is Eric. One other thing I would add maybe to assist with your modeling here is that we've given an updated non-GAAP OpEx number of \$2.15 billion for the full fiscal year and we see that as breaking down into approximately 49% falling into the first fiscal half and 51% falling into the second half.

So it gives you a little more context on what's happening in the respective Q3, Q4 versus first half time period in terms of OpEx.

Sean McGowan - *Needham & Co. - Analyst*

Okay, and then depending on whether it's Q3 or Q4, would there be any impact on your -- on the total number of users you would expect in the following fiscal year or does everybody who's going to sign up sign up right away and you don't lose time by maybe missing a few weeks?

John Riccitiello - *Electronic Arts Inc. - CEO*

It's actually because we're trying not for that to be the case, that we're giving you a range. What I mean by that, not to be cheeky, is that we have high expectations for the potential for the product.

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And the one mistake we don't want to make is if there is an issue to make sure that we ship the right product. But I mean yes, there's clearly scaling curves but we don't think the ship window is going to change the long-term potential of the title.

So I want to be clear about this. We are focused and driving hard towards Q3. We've kept the range out there as I think smart managers need to for a range of potential outcomes. Until something is certain, it's not done.

Most MMOs have been announced in terms of ship date four to eight weeks prior to introduction. That's relatively standard.

People have target quarters but whether it's World of Warcraft or it was our last launch or Sony's last launch; four, six weeks is relatively typical. You usually want to have high-scale testing completed under your belt before you open it up for the paying consumer because the paying consumer can be very harsh. They have high expectations for perfect performance and that's what we intend to provide at launch.

Rob Sison - Electronic Arts Inc. - VP, IR

Okay, so that's the last question. We thank you for your time today and we will look forward to speaking with you next quarter.

Operator

Thank you, this concludes today's presentation. You may disconnect at this time.

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