ELECTRONIC ARTS INC.
Form 10-Q
February 05, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

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

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

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

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

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

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PART I – FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)
ELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

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

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

(a) Derived from audited consolidated financial statements.

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ELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)	Three Months Ended December 31,		Nine Months Ended December 31,	
(In millions, except per share data)	2012	2011	2012	2011
Net revenue:				
Product	$703	$884	$1,886	$2,370
Service and other	219	177	702	405
Total net revenue	922	1,061	2,588	2,775
Cost of revenue:				
Product	363	477	866	1,088
Service and other	66	75	213	136
Total cost of revenue	429	552	1,079	1,224
Gross profit	493	509	1,509	1,551
Operating expenses:				
Research and development	286	325	890	928
Marketing and sales	214	269	571	631
General and administrative	68	98	253	260
Acquisition-related contingent consideration	(45)	(11)	(65)	8
Amortization of intangibles	7	11	21	37
Restructuring and other charges	2	—	27	17
Total operating expenses	532	692	1,697	1,881
Operating loss	(39)	(183)	(188)	(330)
Gain on strategic investments, net	14	—	14	—
Interest and other income (expense), net	(8)	(10)	(17)	(13)
Loss before provision for (benefit from) income taxes	(33)	(193)	(191)	(343)
Provision for (benefit from) income taxes	12	12	34	(19)
Net loss	$(45)	$(205)	$(225)	$(324)
Net loss per share:				
Basic and Diluted	$(0.15)	$(0.62)	$(0.72)	$(0.98)
Number of shares used in computation:				
Basic and Diluted	304	332	313	331

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

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

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

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

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ELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)	Nine Months Ended December 31,	
(In millions)	2012	2011
OPERATING ACTIVITIES		
Net loss	$(225)	$(324)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation, amortization and accretion, net	178	148
Stock-based compensation	122	129
Acquisition-related contingent consideration	(65)	8
Non-cash restructuring charges	7	(3)
Net gains on investments and sale of property and equipment	(12)	(12)
Change in assets and liabilities:		
Receivables, net	(18)	(176)
Inventories	—	11
Other assets	14	(81)
Accounts payable	(115)	(150)
Accrued and other liabilities	53	50
Deferred income taxes, net	(13)	(44)
Deferred net revenue (packaged goods and digital content)	165	434
Net cash provided by (used in) operating activities	91	(10)
INVESTING ACTIVITIES		
Capital expenditures	(81)	(128)
Proceeds from sale of property and equipment	—	26
Proceeds from sale of marketable equity securities	25	—
Proceeds from maturities and sales of short-term investments	404	463
Purchase of short-term investments	(244)	(374)
Acquisition-related restricted cash	25	—
Acquisition of subsidiaries, net of cash acquired	(10)	(676)
Net cash provided by (used in) investing activities	119	(689)
FINANCING ACTIVITIES		
Proceeds from issuance of common stock	19	39
Proceeds from borrowings on convertible senior notes, net of issuance costs	—	617
Proceeds from issuance of warrants	—	65
Purchase of convertible note hedge	—	(107)
Payment of debt issuance costs	(2)	—
Excess tax benefit from stock-based compensation	—	4
Repurchase and retirement of common stock	(336)	(230)
Acquisition-related contingent consideration payment	(28)	—
Net cash provided by (used in) financing activities	(347)	388
Effect of foreign exchange on cash and cash equivalents	2	(26)
Decrease in cash and cash equivalents	(135)	(337)
Beginning cash and cash equivalents	1,293	1,579
Ending cash and cash equivalents	$1,158	$1,242
Supplemental cash flow information:		
Cash paid (refunded) during the period for income taxes, net	$21	$(4)

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

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

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

(1) DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

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

Our fiscal year is reported on a 52- or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ending or ended, as the case may be, March 31, 2013 and 2012 contain 52 weeks each, and ends or ended, as the case may be, on March 30, 2013 and March 31, 2012, respectively. Our results of operations for the three and nine months ended December 31, 2012 and 2011 contained 13 and 39 weeks each, respectively, and ended on December 29, 2012 and December 31, 2011, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

The Condensed Consolidated Financial Statements are unaudited and reflect all adjustments (consisting only of normal recurring accruals unless otherwise indicated) that, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. The preparation of these Condensed Consolidated Financial Statements requires management to make estimates and assumptions that affect the amounts reported in these Condensed Consolidated Financial Statements and accompanying notes. Actual results could differ materially from those estimates. The results of operations for the current interim periods are not necessarily indicative of results to be expected for the current year or any other period.

These Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2012, as filed with the United States Securities and Exchange Commission (“SEC”) on May 25, 2012.

(2) SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition

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

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

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

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

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

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

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

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

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

Online-Enabled Games

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

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

Estimated Offering Period

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

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

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

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

Other Multiple-Element Arrangements

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

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

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

Sales Returns and Allowances and Bad Debt Reserves

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

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

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

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

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(3) FAIR VALUE MEASUREMENTS

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

Fair Value Hierarchy

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

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

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
	Contingent

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

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

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

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

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

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

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

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

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

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

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

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

(4) FINANCIAL INSTRUMENTS

Cash and Cash Equivalents

As of December 31, 2012 and March 31, 2012, our cash and cash equivalents were $1,158 million and $1,293 million, respectively. Cash equivalents were valued at their carrying amounts as they approximate fair value due to the short maturities of these financial instruments.

Short-Term Investments

Short-term investments consisted of the following as of December 31, 2012 and March 31, 2012 (in millions):

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

We evaluate our investments for impairment quarterly. Factors considered in the review of investments with an unrealized loss include the credit quality of the issuer, the duration that the fair value has been less than the adjusted cost basis, the severity of the impairment, the reason for the decline in value and potential recovery period, the financial condition and near-term prospects of the investees, our intent to sell the investments, any contractual terms impacting the prepayment or settlement

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process, as well as if we would be required to sell an investment due to liquidity or contractual reasons before its anticipated recovery. Based on our review, we did not consider these investments to be other-than-temporarily impaired as of December 31, 2012 and March 31, 2012.

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

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

Marketable Equity Securities

Our investments in marketable equity securities are accounted for as available-for-sale securities and are recorded at fair value. Unrealized gains and losses are recorded as a component of accumulated other comprehensive income in stockholders' equity, net of tax, until either the security is sold or we determine that the decline in the fair value of a security to a level below its adjusted cost basis is other-than-temporary. We evaluate these investments for impairment quarterly. If we conclude that an investment is other-than-temporarily impaired, we recognize an impairment charge at that time in our Condensed Consolidated Statements of Operations.

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

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

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

0.75% Convertible Senior Notes Due 2016

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

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

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

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(5) DERIVATIVE FINANCIAL INSTRUMENTS

The assets or liabilities associated with our derivative instruments and hedging activities are recorded at fair value in other current assets or accrued and other current liabilities, respectively, on our Condensed Consolidated Balance Sheets. As discussed below, the accounting for gains and losses resulting from changes in fair value depends on the use of the derivative instrument and whether it is designated and qualifies for hedge accounting.

We transact business in various foreign currencies and have significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. We purchase foreign currency option contracts, generally with maturities of 12 months or less, to reduce the volatility of cash flows primarily related to forecasted revenue and expenses denominated in certain foreign currencies. In addition, we utilize foreign currency forward contracts to mitigate foreign exchange rate risk associated with foreign-currency-denominated monetary assets and liabilities, primarily intercompany receivables and payables. The foreign currency forward contracts generally have a contractual term of approximately three months or less and are transacted near month-end. At each quarter-end, the fair value of the foreign currency forward contracts generally is not significant. We do not use foreign currency option or foreign currency forward contracts for speculative or trading purposes.

Cash Flow Hedging Activities

Our foreign currency option contracts are designated and qualify as cash flow hedges. The effectiveness of the cash flow hedge contracts, including time value, is assessed monthly using regression analysis, as well as other timing and probability criteria. To qualify for hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedges and must be highly effective in offsetting changes to future cash flows on hedged transactions. The effective portion of gains or losses resulting from changes in the fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income in stockholders' equity. The gross amount of the effective portion of gains or losses resulting from changes in the fair value of these hedges is subsequently reclassified into net revenue or research and development expenses, as appropriate, in the period when the forecasted transaction is recognized in our Condensed Consolidated Statements of Operations. In the event that the gains or losses in accumulated other comprehensive income are deemed to be ineffective, the ineffective portion of gains or losses resulting from changes in fair value, if any, is reclassified to interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. In the event that the underlying forecasted transactions do not occur, or it becomes remote that they will occur, within the defined hedge period, the gains or losses on the related cash flow hedges are reclassified from accumulated other comprehensive income to interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. As of December 31, 2012, we had foreign currency option contracts to purchase approximately $86 million in foreign currency and to sell approximately $179 million of foreign currency. All of the foreign currency option contracts outstanding as of December 31, 2012 will mature in the next 12 months. As of March 31, 2012, we had foreign currency option contracts to purchase approximately $74 million in foreign currency and to sell approximately $78 million of foreign currency. As of December 31, 2012 and March 31, 2012, these foreign currency option contracts outstanding had a total fair value of $2 million, after each date, and are included in other current assets.

The effective and ineffective portions of the gains and losses from our foreign currency option contracts in our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2012 and 2011 were immaterial.

Balance Sheet Hedging Activities

Our foreign currency forward contracts are not designated as hedging instruments, and are accounted for as derivatives whereby the fair value of the contracts is reported as other current assets or accrued and other current liabilities on our Condensed Consolidated Balance Sheets, and gains and losses resulting from changes in the fair value are reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. The gains and losses on these foreign currency forward contracts generally offset the gains and losses in the underlying foreign-currency-denominated monetary assets and liabilities, which are also reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. As of December 31, 2012, we had foreign currency forward contracts to purchase and sell approximately $523 million in foreign currencies. Of this amount, $489 million represented contracts to sell foreign currencies in exchange for U.S. dollars, $26 million to purchase foreign currency in exchange for U.S. dollars, and $8 million to sell foreign currency in exchange for British pounds sterling. As of March 31, 2012, we had foreign currency forward contracts to purchase and sell approximately $242 million in foreign currencies. Of this amount, $197 million represented contracts to sell foreign currencies in exchange for U.S. dollars, $37 million to purchase foreign currency in exchange for U.S. dollars, and $8 million to sell foreign currency in exchange for British pounds sterling. As of December 31, 2012 and March 31, 2012, the fair value of our foreign currency forward contracts was immaterial and is included in accrued and other liabilities.

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

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

(6) BUSINESS COMBINATIONS

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

(7) GOODWILL AND ACQUISITION-RELATED INTANGIBLES, NET

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

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

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

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

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

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

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

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

Fiscal Year Ending March 31,	
2013 (remaining three months)	$20
2014	80
2015	75
2016	