ELECTRONIC ARTS INC.
Form 10-Q
February 05, 2008

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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, 2007

OR

o **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. 0-17948

ELECTRONIC ARTS INC.

(*Exact name of registrant as specified in its charter*)

Delaware	**94-2838567**
(State or other jurisdiction of incorporation or organization)	*(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 o

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. (Check one):

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

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

As of January 31, 2008, there were 316,779,415 shares of the Registrant s Common Stock, par value $0.01 per share, outstanding.

ELECTRONIC ARTS INC.
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FOR THE PERIOD ENDED DECEMBER 31, 2007
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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, 2007**		**March 31, 2007 (a)**
ASSETS				
Current assets:				
Cash and cash equivalents	$	1,878	$	1,371
Short-term investments		705		1,264
Marketable equity securities		837		341
Receivables, net of allowances of $259 and $214, respectively		830		256
Inventories		178		62
Deferred income taxes, net		122		84
Other current assets		347		219
Total current assets		4,897		3,597
Property and equipment, net		393		484
Investments in affiliates		29		6
Goodwill		737		734
Other intangibles, net		170		210
Deferred income taxes, net		89		25
Other assets		130		90
TOTAL ASSETS	$	6,445	$	5,146
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$	371	$	180
Accrued and other current liabilities		782		814
Deferred net revenue (packaged goods and digital content)		595		32
Total current liabilities		1,748		1,026
Income tax obligations		301		
Deferred income taxes, net		8		8
Other liabilities		85		80
Total liabilities		2,142		1,114
Commitments and contingencies (See Note 9)				

Stockholders equity:				
Preferred stock, $0.01 par value. 10 shares authorized				
Common stock, $0.01 par value. 1,000 shares authorized; 317 and 311 shares issued and outstanding, respectively		3		3
Paid-in capital		1,726		1,412
Retained earnings		1,981		2,323
Accumulated other comprehensive income		593		294
Total stockholders equity		4,303		4,032
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	6,445	$	5,146

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

(a) Derived from audited financial statements.

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ELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended December 31,		Nine Months Ended December 31,	
(Unaudited)	**2007**	**2006**	**2007**	**2006**
(In millions, except per share data)				
Net revenue	$ 1,503	$ 1,281	$ 2,537	$ 2,478
Cost of goods sold	782	470	1,342	977
Gross profit	721	811	1,195	1,501
Operating expenses:				
Marketing and sales	213	165	459	350
General and administrative	95	91	250	222
Research and development	321	330	829	783
Amortization of intangibles	7	7	21	20
Acquired in-process technology		1		3
Restructuring charges	78	2	85	12
Total operating expenses	714	596	1,644	1,390
Operating income (loss)	7	215	(449)	111
Interest and other income, net	20	25	78	69
Income (loss) before provision for (benefit from) income taxes and minority interest	27	240	(371)	180
Provision for (benefit from) income taxes	60	84	(10)	83
Income (loss) before minority interest	(33)	156	(361)	97
Minority interest		4		4
Net income (loss)	$ (33)	$ 160	$ (361)	$ 101
Net income (loss) per share:				
Basic	$ (0.10)	$ 0.52	$ (1.15)	$ 0.33
Diluted	$ (0.10)	$ 0.50	$ (1.15)	$ 0.32
Number of shares used in computation:				
Basic	315	309	313	307
Diluted	315	319	313	316

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) (In millions)	Nine Months Ended December 31, 2007	Nine Months Ended December 31, 2006
OPERATING ACTIVITIES		
Net income (loss)	$ (361)	$ 101
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization and accretion	115	110
Stock-based compensation	105	105
Minority interest		(4)
Non-cash restructuring charges	42	
Net losses on investments and sale of property and equipment	8	1
Acquired in-process technology		3
Change in assets and liabilities:		
Receivables, net	(539)	(338)
Inventories	(108)	(7)
Other assets	(56)	63
Accounts payable	169	1
Accrued and other liabilities	183	160
Deferred income taxes, net	(68)	(35)
Deferred net revenue (packaged goods and digital content)	563	23
Net cash provided by operating activities	53	183
INVESTING ACTIVITIES		
Capital expenditures	(62)	(118)
Purchase of marketable equity securities and investments in affiliates	(277)	(1)
Proceeds from maturities and sales of short-term investments	1,978	911
Purchase of short-term investments	(1,388)	(1,086)
Loan advance	(30)	
Acquisition of subsidiaries, net of cash acquired		(94)
Net cash provided by (used in) investing activities	221	(388)
FINANCING ACTIVITIES		
Proceeds from issuance of common stock	160	133
Excess tax benefit from stock-based compensation	45	27
Repayment of note assumed in connection with acquisition		(14)
Net cash provided by financing activities	205	146

Effect of foreign exchange on cash and cash equivalents	28	16
Increase (decrease) in cash and cash equivalents	507	(43)
Beginning cash and cash equivalents	1,371	1,242
Ending cash and cash equivalents	1,878	1,199
Short-term investments	705	1,212
Ending cash, cash equivalents and short-term investments	$ 2,583	$ 2,411
Supplemental cash flow information:		
Cash paid during the period for income taxes	$ 23	$ 46
Non-cash investing activities:		
Change in unrealized gains on investments, net	$ 254	$ 80

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

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 interactive software games that are playable by consumers on video game consoles (such as the Sony PlayStation® 2 and PLAYSTATION® 3, Microsoft Xbox 360 and Nintendo Wii), personal computers, mobile platforms (including cellular handsets and handheld game players such as the PlayStation® Portable (PSP) and the Nintendo DS) and online (over the Internet and other proprietary online networks). Some of our games are based on content that we license from others (e.g., Madden NFL Football, Harry Potter and FIFA Soccer), and some of our games are based on our own wholly-owned intellectual property (e.g., The Sims, Need for Speed and POGO). Our goal is to publish titles with global mass-market appeal, which often means translating and localizing them for sale in non-English speaking countries. In addition, we also attempt to create software game franchises that allow us to publish new titles on a recurring basis that are based on the same property. Examples of this franchise approach are the annual iterations of our sports-based products (e.g., Madden NFL Football, NCAA® Football and FIFA Soccer), wholly-owned properties that can be successfully sequeled (e.g., The Sims, Need for Speed and Battlefield) and titles based on long-lived literary and/or movie properties (e.g., Lord of the Rings and Harry Potter).

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.

Certain prior-year amounts have been reclassified to conform to the fiscal 2008 presentation.

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, 2007, as filed with the United States Securities and Exchange Commission (SEC) on May 30, 2007.

(2) FISCAL YEAR AND FISCAL QUARTER

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 ended March 31, 2008 and 2007 contain 52 weeks and end on March 29, 2008 and March 31, 2007, respectively. Our results of operations for the three months ended December 31, 2007 and 2006 contain 13 weeks and ended on December 29, 2007 and December 30, 2006, respectively. Our results of operations for the nine months ended December 31, 2007 and 2006 contain 39 weeks and ended on December 29, 2007 and December 30, 2006, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

(3) FINANCIAL INSTRUMENTS

Marketable Equity Securities

Our investments in marketable equity securities consist of investments in common stock of publicly traded companies.

In May 2007, we entered into a licensing agreement with and made a strategic equity investment in The9 Limited (The9), a leading online game operator in China. We purchased approximately 15 percent of the outstanding common shares (representing 15 percent of the voting rights at that time) of The9 for approximately $167 million. Our agreement with The9 requires us to hold these common shares until May 2008. The licensing agreement gives The9 exclusive publishing rights for *EA SPORTS FIFA Online* in mainland China.

In April 2007, we expanded our commercial agreements with, and made strategic equity investments in, Neowiz Corporation and a related online gaming company, Neowiz Games. We refer to Neowiz Corporation and Neowiz Games collectively as Neowiz . Based in Korea, Neowiz is an online media and gaming company with which we partnered in 2006 to launch *EA*

SPORTS FIFA Online in Korea. We purchased 15 percent of the then-outstanding common shares (representing 15 percent of the voting rights at that time) of Neowiz Corporation and 15 percent of the outstanding common shares (representing 15 percent of the voting rights at the time) of Neowiz Games, for approximately $83 million. As discussed below, we also purchased preferred shares of Neowiz which we classified as investments in affiliates on our Condensed Consolidated Balance Sheets.

During the three months ended December 31, 2007, we recognized an impairment charge of $9 million with respect to our Neowiz Corporation common shares. Due to various factors, including the extent and duration during which the market price had been below cost, we concluded the decline in value was other-than-temporary as defined by Statement of Financial Accounting Standard (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* , as amended. The $9 million impairment is included in interest and other income, net, on our Condensed Consolidated Statements of Operations.

As of December 31, 2007, we had gross unrealized gains of $588 million and gross unrealized losses of $84 million in our marketable security investments. Based on our review, we do not consider the investments with gross unrealized losses to be other-than-temporarily impaired as of December 31, 2007. We evaluate our investments for impairment quarterly. If we conclude that an investment is other-than-temporarily impaired, we will recognize an impairment charge in income at that time.

Investments in Affiliates

In April 2007, we also purchased all of the then outstanding non-voting preferred shares of Neowiz for approximately $27 million. The preferred shares will become convertible into approximately 4 percent of the outstanding voting common shares of Neowiz in April 2008. We account for our investment in Neowiz under the cost method as prescribed by Accounting Principles Board Opinion No. 18, as amended, *The Equity Method of Accounting for Investments in Common Stock* .

During the three months ended December 31, 2007, we recognized an impairment charge of $3 million with respect to our Neowiz Corporation preferred shares. Due to various factors, including the extent and duration during which the fair value had been below cost, we concluded the decline in value was other-than-temporary as defined by SFAS No. 115, as amended. The $3 million impairment is included in interest and other income, net, on our Condensed Consolidated Statements of Operations.

(4) GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill information is as follows (in millions):

	As of March 31, 2007	Goodwill Acquired	Effects of Foreign Currency Translation	As of December 31, 2007
Goodwill	$ 734	$	$ 3	$ 737

Finite-lived intangibles consist of the following (in millions):

	As of December 31, 2007			As of March 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Other Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Other Intangibles, Net
Developed and Core Technology	$ 183	$ (87)	$ 96	$ 183	$ (62)	$ 121
Carrier Contracts and Related	85	(32)	53	85	(19)	66

Trade Name	44	(26)	18	44	(24)	20
Subscribers and Other Intangibles	16	(13)	3	16	(13)	3
Total	$ 328	$ (158)	$ 170	$ 328	$ (118)	$ 210

Amortization of intangibles for the three and nine months ended December 31, 2007 was $13 million (of which $6 million was recognized as cost of goods sold) and $41 million (of which $20 million was recognized as cost of goods sold), respectively.

Amortization of intangibles for the three and nine months ended December 31, 2006 was $14 million (of which $7 million was recognized as cost of goods sold) and $40 million (of which $20 million was recognized as cost of goods sold), respectively. Finite-lived intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the term of the related agreement, typically from two to twelve years. As of December 31, 2007 and March 31, 2007, the weighted-average remaining useful life for finite-lived intangible assets was approximately 6.1 years and 6.3 years, respectively.

As of December 31, 2007, future amortization of finite-lived intangibles that will be recorded in cost of goods sold and operating expenses is estimated as follows (in millions):

Fiscal Year Ending March 31,	
2008 (remaining three months)	$ 12
2009	41
2010	34
2011	29
2012	9
Thereafter	45
Total	$ 170

(5) RESTRUCTURING

Restructuring information as of December 31, 2007 was as follows (in millions):

	Fiscal 2008 Reorganization			Fiscal 2006 International Publishing Reorganization			Fiscal 2006, 2004, 2003 and 2002 Restructurings		
	Workforce	Facilities-related	Other	Workforce	Facilities-related	Other	Workforce	Facilities-related	Total
Balances as of March 31, 2006	$	$	$	$ 1	$ 8	$ 2	$ 3	$ 7	$ 21
Charges to operations				10	1	4			15
Charges utilized in cash				(11)		(5)	(3)	(7)	(26)
Balances as of March 31, 2007					9	1			10
Charges to operations	12	44	25	4					85
Charges utilized in cash	(8)		(9)	(3)		(1)			(21)
Charges utilized non-cash		(41)	(1)						(42)
Balances as of December 31, 2007	$ 4	$ 3	$ 15	$ 1	$ 9	$	$	$	$ 32

Fiscal 2008 Reorganization

In June 2007, we announced a plan to reorganize our business into several new divisions, including four new Labels : EA SPORTS, EA Games, EA Casual Entertainment and The Sims. Each Label will operate with dedicated studio and product marketing teams focused on consumer-driven priorities. The new structure is designed to streamline decision-making, improve global focus, and speed new ideas to the market. In October 2007, our Board of Directors approved a plan of reorganization (fiscal 2008 reorganization) in connection with the reorganization of our business into four new Labels.

Since inception of the fiscal 2008 reorganization through December 31, 2007, we incurred charges of $81 million, of which (1) $12 million were employee-related expenses, (2) $44 million related to the closure of our Chertsey, England and Chicago, Illinois facilities which included asset impairment and lease termination costs, and (3) $25 million related to other costs including other contract terminations as well as IT and consulting costs to assist in the reorganization of our business support functions. During the fourth quarter of fiscal 2008, we anticipate that we will complete the closure of our Chertsey, England facility and consolidate our local operations and employees in our Guildford, England facility. Over the next 21 months, we expect to continue to incur IT and consulting costs to assist in the reorganization of our business support functions. The restructuring accrual of $22 million as of December 31, 2007 is expected to be utilized by June 30, 2009. This accrual is included in other accrued expenses presented in Note 7 of the Notes to Condensed Consolidated Financial Statements.

During the three months ended December 31, 2007, we commenced marketing our facility in Chertsey, England for sale. Our reorganization charges include $37 million to write our Chertsey facility down to its estimated fair value (less costs to sell the property). We also reclassified the estimated fair value of the Chertsey facility from property and equipment, net, to other current assets as an asset held for sale on our Condensed Consolidated Balance Sheet.

In connection with our fiscal 2008 reorganization, in fiscal 2008 we anticipate incurring between $85 million and $90 million of charges of which $81 million was recognized during the nine months ended December 31, 2007. Overall, including charges incurred through December 31, 2007, we expect to incur between $90 million and $110 million in charges in connection with our fiscal 2008 reorganization, which will result in cash and non-cash expenditures by fiscal 2010. These charges will consist primarily of employee-related costs (approximately $14 million), facility exit costs (approximately $45 million), as well as other reorganization costs including other contract terminations and IT and consulting costs to assist in the reorganization of our business support functions (approximately $40 million).

Fiscal 2006 International Publishing Reorganization

In November 2005, we announced plans to establish an international publishing headquarters in Geneva, Switzerland. Through the quarter ended September 30, 2006, we relocated certain employees to our new facility in Geneva, closed certain facilities in the United Kingdom, and made other related changes in our international publishing business. Since the inception of the reorganization plan, through December 31, 2007, we have incurred reorganization charges of approximately $33 million, of which $17 million was for employee-related expenses, $9 million for the closure of certain United Kingdom facilities, and $7 million in other costs. The restructuring accrual of $10 million as of December 31, 2007 is expected to be utilized by March 2017. This accrual is included in other accrued expenses presented in Note 7 of the Notes to Condensed Consolidated Financial Statements.

In connection with our fiscal 2006 international publishing reorganization, in fiscal 2008, we expect to incur $6 million of reorganization charges, of which $4 million was incurred during the nine months ended December 31, 2007. Overall, including charges incurred through December 31, 2007, we expect to incur between $50 million and $55 million of reorganization charges in connection with our fiscal 2006 international publishing reorganization, substantially all of which will result in cash expenditures by 2017. These reorganization charges will consist primarily of employee-related relocation assistance (approximately $30 million), facility exit costs (approximately $15 million), and other reorganization costs (approximately $7 million).

(6) ROYALTIES AND LICENSES

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

Royalty-based obligations with content licensors and distribution affiliates are either paid in advance and capitalized as prepaid royalties or are accrued as incurred and subsequently paid. These royalty-based obligations are generally expensed to cost of goods sold generally at the greater of the contractual rate or an effective royalty rate based on the total projected net revenue. Prepayments made to thinly capitalized independent software developers and co-publishing affiliates are generally in connection with the development of a particular product and, therefore, we are generally subject to development risk prior to the release of the product. Accordingly, payments that are due prior to completion of a product are generally expensed to research and development over the development period as the services are incurred. Payments due after completion of the product (primarily royalty-based in nature) are generally expensed as cost of goods sold.

Our contracts with some licensors include minimum guaranteed royalty payments which are initially recorded as an asset and as a liability at the contractual amount when no performance remains with the licensor. When performance remains with the licensor, we record guarantee payments as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract. Minimum royalty payment obligations are classified as current liabilities to the extent such royalty payments are contractually due within the next

twelve months. As of December 31, 2007 and March 31,

2007, approximately $12 million and $9 million, respectively, of minimum guaranteed royalty obligations are included in the royalty-related assets and liabilities tables below.

Each quarter, we also evaluate the future realization of our royalty-based assets as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are charged to research and development expense. Impairments or losses determined post-launch are charged to cost of goods sold. In either case, we rely on estimated revenue to evaluate the future realization of prepaid royalties and commitments. If actual sales or revised revenue estimates fall below the initial revenue estimate, then the actual charge taken may be greater in any given quarter than anticipated. During the three and nine months ended December 31, 2007, we recognized impairment charges of $2 million and $3 million, respectively. We had no impairments during the three and nine months ended December 31, 2006.

The current and long-term portions of prepaid royalties and minimum guaranteed royalty-related assets, included in other current assets and other assets, consisted of (in millions):

	As of December 31, 2007	As of March 31, 2007
Other current assets	$ 60	$ 69
Other assets	63	40
Royalty-related assets	$ 123	$ 109

At any given time, depending on the timing of our payments to our co-publishing and/or distribution affiliates, content licensors and/or independent software developers, we recognize unpaid royalty amounts owed to these parties as either accounts payable or accrued liabilities. The current and long-term portions of accrued royalties, included in accrued and other current liabilities as well as other liabilities, consisted of (in millions):

	As of December 31, 2007	As of March 31, 2007
Accrued and other current liabilities	$ 231	$ 91
Other liabilities	4	3
Royalty-related liabilities	$ 235	$ 94

In addition, as of December 31, 2007, we were committed to pay approximately $1,414 million to content licensors and co-publishing and/or distribution affiliates, but performance remained with the counterparty (i.e., delivery of the product or content or other factors) and such commitments were therefore not recorded in our Condensed Consolidated Financial Statements. See Note 9 of the Notes to Condensed Consolidated Financial Statements.

(7) BALANCE SHEET DETAILS

Inventories

Inventories as of December 31, 2007 and March 31, 2007 consisted of (in millions):

	As of December 31, 2007	As of March 31, 2007

Raw materials and work in process	$	11	$	1
In-transit inventory		36		
Finished goods (including manufacturing royalties)		131		61
Inventories	$	178	$	62

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Property and Equipment, Net

Property and equipment, net, as of December 31, 2007 and March 31, 2007 consisted of (in millions):

	As of December 31, 2007	As of March 31, 2007
Computer equipment and software	$ 624	$ 555
Buildings	156	194
Leasehold improvements	124	110
Office equipment, furniture and fixtures	76	70
Land	11	65
Warehouse equipment and other	10	10
Construction in progress	10	10
	1,011	1,014
Less accumulated depreciation	(618)	(530)
Property and equipment, net	$ 393	$ 484

During the three months ended December 31, 2007, we commenced marketing our facility in Chertsey, England for sale. Therefore, we reclassified the estimated fair value of the Chertsey facility from property and equipment, net, to other current assets as an asset held for sale on our Condensed Consolidated Balance Sheet.

Depreciation expense associated with property and equipment amounted to $32 million and $94 million for the three and nine months ended December 31, 2007, respectively. Depreciation expense associated with property and equipment amounted to $24 million and $70 million for the three and nine months ended December 31, 2006, respectively.

Accrued and Other Current Liabilities

Accrued and other current liabilities as of December 31, 2007 and March 31, 2007 consisted of (in millions):

	As of December 31, 2007	As of March 31, 2007
Other accrued expenses	$ 238	$ 152
Accrued royalties	231	91
Accrued compensation and benefits	171	206
Accrued value added taxes	73	23
Deferred net revenue (other)	68	58
Accrued income taxes	1	284
Accrued and other current liabilities	$ 782	$ 814

Deferred net revenue (other) includes the deferral of subscription revenue, deferrals related to our Switzerland distribution business, advertising revenue, licensing arrangements and other revenue for which revenue recognition criteria has not been met.

Deferred Net Revenue (Packaged Goods and Digital Content)

Deferred net revenue (packaged goods and digital content) was $595 million as of December 31, 2007 and $32 million as of March 31, 2007. Deferred net revenue (packaged goods and digital content), includes the deferral of (1) the total

revenue from the sale of certain online-enabled packaged goods and PC digital downloads for which we are not able to objectively determine the fair value of the online service we provide in connection with the sale of the software, and (2) revenue from the sale of certain incremental content related to our core subscription services playable only online, which are types of micro-transactions . We recognize revenue from sales of online-enabled software products for which we are not able to objectively

determine the fair value of the online service on a straight-line basis over an estimated six month period beginning in the month after shipment.

(8) INCOME TAXES

In February 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* , that clarifies the accounting and recognition for income tax positions taken or expected to be taken in our tax returns. On May 2, 2007, the FASB issued FASB Staff Position (FSP) FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48* , which amends FIN No. 48 to provide guidance on how an entity should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. We adopted FIN No. 48 and FSP FIN 48-1 on April 1, 2007, and recognized the cumulative effect of a change in accounting principle by recognizing a decrease in the liability for unrecognized tax benefits of $18 million, with a corresponding increase to beginning retained earnings. In our second quarter of fiscal 2008, we increased the beginning retained earnings by approximately $1 million to reflect an immaterial revision to the cumulative effect of the adoption of FIN No. 48. We also recognized an additional decrease in the liability for unrecognized tax benefits of $14 million with a corresponding increase in beginning paid-in capital related to the tax benefits of employee stock options. The total liability for gross unrecognized tax benefits included in our Condensed Consolidated Balance Sheet as of April 1, 2007, in non-current other liabilities was $283 million. Of this amount, $41 million of liabilities would be offset by prior cash deposits to tax authorities for issues pending resolution. As of April 1, 2007, approximately $239 million of the liability for unrecognized tax benefits would affect our effective tax rate if recognized upon resolution of the uncertain tax positions. The liability for unrecognized tax benefits increased by approximately $1 million during the three months ended December 31, 2007, and $10 million during the nine months ended December 31, 2007.

Interest and penalties related to estimated obligations for tax positions taken in our tax returns are recognized in income tax expense in our Condensed Consolidated Statements of Operations. As of April 1, 2007, the combined amount of accrued interest and penalties related to tax positions taken on our tax returns and included in non-current other liabilities was approximately $42 million. Approximately $4 million and $13 million of accrued interest expense related to estimated obligations for unrecognized tax benefits was recognized during the three months and nine months ended December 31, 2007, respectively.

Prior to April 1, 2007, we presented our estimated liability for unrecognized tax benefits as a current liability. Beginning on April 1, 2007, however, FIN No. 48 requires us to classify liabilities for unrecognized tax benefits based on whether we expect payment will be made within the next 12 months. Amounts expected to be paid within the next 12 months are classified as a current liability and all other amounts are classified as a non-current liability. In addition, prior to April 1, 2007 we presented our estimated state, local and interest liabilities net of the estimated benefit we expect to receive from deducting such payments on future tax returns (i.e., on a net basis). Beginning on April 1, 2007, FIN No. 48 requires this estimated benefit to be classified as a deferred tax asset instead of a reduction of the overall liability (i.e., on a gross basis).

We file income tax returns in the U.S., including various state and local jurisdictions. Our subsidiaries file tax returns in various foreign jurisdictions, including Canada, France, Germany, Switzerland and the United Kingdom. The Internal Revenue Service (IRS) has completed its examination of our federal income tax returns through fiscal year 2003. As of December 31, 2007, the IRS had proposed, and we had agreed to, certain adjustments to our tax returns. The effects of these adjustments have been considered in estimating our future obligations for unrecognized tax benefits and are not expected to have a material impact on our financial position or results of operations. As of December 31, 2007, we had not agreed to certain other proposed adjustments for fiscal years 1997 through 2003, and those issues were pending resolution by the Appeals section of the IRS. Furthermore, the IRS has commenced an examination of our fiscal year 2004 and 2005 tax returns. We are also under income tax examination in Canada for fiscal years 2004 and 2005. We remain subject to income tax examination in Canada for fiscal years after 1999, in France, Germany, and the United Kingdom for fiscal years after 2003, and in Switzerland for fiscal years after 2006. The timing of the resolution of income tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued for each year. While it is reasonably possible that some of the issues in the IRS and Canadian examinations could be resolved

in the next 12 months, at this stage of the process it is not practicable to estimate a range of the potential change in the underlying unrecognized tax benefits.

With respect to our projected annual effective income tax rate at the end of each quarter prior to the end of a fiscal year, we are required to make a projection of several items, including our projected mix of full-year income in each jurisdiction in which we operate and the related income tax expense in each jurisdiction. While this projection is always inherently uncertain, until the third quarter of fiscal 2008, our interim projected tax rate for fiscal 2008 was unusually volatile and subject to significantly greater variation.

The tax rate reported for the nine months ended December 31, 2007 is based on our projected annual effective tax rate for fiscal 2008. Our effective tax rates for the three and nine months ended December 31, 2007 were 221.1 percent and 2.9 percent, respectively. The volatility in our quarterly and year-to-date tax rate is primarily driven by the forecasted geographic mix of income, as well as certain restructuring costs and impairment losses on investments that result in zero tax benefits in the third quarter. We incur certain tax expenses that do not decline proportionately with declines in our pre-tax consolidated income or loss. As a result, in absolute dollar terms, our tax expense will have a greater influence on our effective tax rate at lower levels of pre-tax income or loss than at higher levels. In addition, at lower levels of pre-tax income or loss, our effective tax rate will be more volatile.

The tax rate reported for the nine months ended December 31, 2006 was based on our projected annual effective tax rate for fiscal 2007. Our effective tax rates for the three and nine months ended December 31, 2006 were 34.9 percent and 45.9 percent respectively. These rates included various adjustments recorded in the three months ended December 31, 2006 for the reinstatement of the federal research credit, additional income tax benefit resulting from certain intercompany transactions, offset by additional tax expense due to the development of certain tax audit related matters.

(9) COMMITMENTS AND CONTINGENCIES

Lease Commitments and Residual Value Guarantees

We lease certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We are required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and will be required to pay any increases over the base year of these expenses on the remainder of our facilities.

In February 1995, we entered into a build-to-suit lease (Phase One Lease) with a third-party lessor for our headquarters facilities in Redwood City, California (Phase One Facilities). The Phase One Facilities comprise a total of approximately 350,000 square feet and provide space for sales, marketing, administration and research and development functions. In July 2001, the lessor refinanced the Phase One Lease with Keybank National Association through July 2006. The Phase One Lease expires in January 2039, subject to early termination in the event the underlying financing between the lessor and its lenders is not extended. Subject to certain terms and conditions, we may purchase the Phase One Facilities or arrange for the sale of the Phase One Facilities to a third party.

Pursuant to the terms of the Phase One Lease, we have an option to purchase the Phase One Facilities at any time for a purchase price of $132 million. In the event of a sale to a third party, if the sale price is less than $132 million, we will be obligated to reimburse the difference between the actual sale price and $132 million, up to a maximum of $117 million, subject to certain provisions of the Phase One Lease, as amended.

On May 26, 2006, the lessor extended its loan financing underlying the Phase One Lease with its lenders through July 2007, and on May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor s loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009; otherwise the lease will terminate. We account for the Phase One Lease arrangement as an operating lease in accordance with SFAS No. 13, *Accounting for Leases* , as amended.

In December 2000, we entered into a second build-to-suit lease (Phase Two Lease) with Keybank National Association for a five and one-half year term beginning in December 2000 to expand our Redwood City, California headquarters facilities and develop adjacent property (Phase Two Facilities). Construction of the Phase Two Facilities was completed in June 2002. The Phase Two Facilities comprise a total of approximately 310,000 square feet and provide space for sales, marketing, administration and research and development functions. Subject to certain terms and conditions, we may purchase the Phase Two Facilities or arrange for the sale of the Phase Two Facilities to a third party.

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Pursuant to the terms of the Phase Two Lease, we have an option to purchase the Phase Two Facilities at any time for a purchase price of $115 million. In the event of a sale to a third party, if the sale price is less than $115 million, we will be obligated to reimburse the difference between the actual sale price and $115 million, up to a maximum of $105 million, subject to certain provisions of the Phase Two Lease, as amended.

On May 26, 2006, the lessor extended the Phase Two Lease through July 2009 subject to early termination in the event the underlying loan financing between the lessor and its lenders is not extended. Concurrently with the extension of the lease, the lessor extended the loan financing underlying the Phase Two Lease with its lenders through July 2007. On May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor s loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009, otherwise the lease will terminate. We account for the Phase Two Lease arrangement as an operating lease in accordance with SFAS No. 13, as amended.

We believe that, as of December 31, 2007, the estimated fair values of both properties under these operating leases exceeded their respective guaranteed residual values.

The two lease agreements with Keybank National Association described above require us to maintain certain financial covenants as shown below, all of which we were in compliance with as of December 31, 2007.

Financial Covenants		Requirement		Actual as of December 31, 2007
Consolidated Net Worth (in millions)		equal to or greater than	$ 2,430	$ 4,303
Fixed Charge Coverage Ratio		equal to or greater than	3.00	4.56
Total Consolidated Debt to Capital		equal to or less than	60%	5.4%
Quick Ratio	Q1 & Q2	equal to or greater than	1.00	N/A
	Q3 & Q4	equal to or greater than	1.75	11.65

Development, Celebrity, League and Content Licenses: Payments and Commitments

The products we produce in our studios are designed and created by our employee designers, artists, software programmers and by non-employee software developers (independent artists or third-party developers). We typically advance development funds to the independent artists and third-party developers during development of our games, usually in installment payments made upon the completion of specified development milestones. Contractually, these payments are generally considered advances against subsequent royalties on the sales of the products. These terms are set forth in written agreements entered into with the independent artists and third-party developers.

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include: FIFA, FIFPRO Foundation, UEFA and FAPL (Football Association Premier League Limited) (professional soccer); NASCAR (stock car racing); National Basketball Association (professional basketball); PGA TOUR and Tiger Woods (professional golf); National Hockey League and NHL Players Association (professional hockey); Warner Bros. (Harry Potter and Batman); New Line Productions and Saul Zaentz Company (The Lord of the Rings); Red Bear Inc. (John Madden); National Football League Properties and PLAYERS Inc. (professional football); Collegiate Licensing Company (collegiate football and basketball); Viacom Consumer Products (The Godfather); ESPN (content in EA SPORTS™ games); Twentieth Century Fox Licensing and Merchandising (The Simpsons); and Hasbro, Inc. (a wide array of Hasbro intellectual properties). These developer and content license commitments represent the sum of (1) the cash payments due under non-royalty-bearing licenses and services agreements, and (2) the minimum guaranteed payments and advances against royalties due under royalty-bearing licenses and services agreements, the majority of which are conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.

The following table summarizes our minimum contractual obligations and commercial commitments as of December 31, 2007 (in millions):

	Contractual Obligations			Commercial Commitments	
Fiscal Year Ending March 31,	Leases (1)	Developer/ Licensor Commitments (2)	Marketing	Letter of Credit, Bank and Other Guarantees	Total
2008 (remaining three months)	$ 15	$ 47	$ 7	$ 5	$ 74
2009	57	204	34		295
2010	42	184	39		265
2011	32	237	41		310
2012	28	77	25		130
Thereafter	63	677	185		925
Total	$ 237	$ 1,426	$ 331	$ 5	$ 1,999

(1) Lease commitments include contractual rental commitments of $14 million under real estate leases for unutilized office space resulting from our restructuring activities. These amounts, net of estimated future sub-lease income, were expensed in the periods of the related restructuring and are included in our accrued and other current liabilities reported on our Condensed Consolidated Balance Sheets as of December 31, 2007. See Note 5 of the Notes to Condensed Consolidated Financial Statements.

(2) Developer/licensor commitments include $12 million of commitments to developers or licensors that have been recorded in current and long-term liabilities and a corresponding amount in current and long-term assets in our Condensed Consolidated Balance Sheets as of December 31, 2007 because payment is not contingent upon performance by the developer or licensor.

The amounts represented in the table above reflect our minimal cash obligations for the respective fiscal years, but do not necessarily represent the periods in which they will be expensed in our Condensed Consolidated Financial Statements.

In addition to what is included in the table above, as discussed in Note 8 of the Notes to Condensed Consolidated Financial Statements, we adopted the provisions of FIN No. 48. As of December 31, 2007, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling $341 million, of which approximately $41 million is offset by prior cash deposits to tax authorities for issues pending resolution. For the remaining liability, we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

The commitments table disclosed above does not include any commitments related to our acquisition of VG Holding Corp., which are described below.

Acquisition of VG Holding Corp.

In October 2007, we entered into a definitive merger agreement to acquire all of the outstanding capital stock of VG Holding Corp. (VGH), owner of both BioWare Corp. and Pandemic Studios, LLC, which create action, adventure and role-playing games. VGH is headquartered in Menlo Park, California. BioWare Corp. and Pandemic Studios are located in Edmonton, Canada; Los Angeles, California; Austin, Texas; and Brisbane, Australia. In January 2008, we completed our acquisition of VGH and paid approximately $620 million in cash to the stockholders of VGH and issued approximately $160 million in equity-based awards to certain key employees of BioWare and Pandemic. These awards are subject to time-based or performance-based vesting criteria. In addition, we loaned VGH $30 million during the period from October 2007 through the completion of the acquisition.

Legal proceedings

We are subject to claims and litigation arising in the ordinary course of business. We do not believe that any liability from any reasonably foreseeable disposition of such claims and litigation, individually or in the aggregate, would have a material adverse effect on our consolidated financial position or results of operations.

Director Indemnity Agreements

We have entered into indemnification agreements with each of the members of our Board of Directors at the time they joined the Board to indemnify them to the extent permitted by law against any and all liabilities, costs, expenses, amounts paid in settlement and damages incurred by the directors as a result of any lawsuit, or any judicial, administrative or investigative proceeding in which the directors are sued or charged as a result of their service as members of our Board of Directors.

(10) STOCK-BASED COMPENSATION

We are required to estimate the fair value of share-based payment awards on the date of grant. We recognize compensation costs for stock-based payment transactions to employees based on their grant-date fair value over the service period for which such awards are expected to vest. The fair value of restricted stock units is determined based on the quoted price of our common stock on the date of grant. The fair value of stock options and stock purchase rights granted pursuant to our employee stock purchase plan (ESPP) is determined using the Black-Scholes valuation model. The determination of fair value is affected by our stock price as well as assumptions regarding subjective and complex variables such as expected employee exercise behavior and our expected stock price volatility over the expected term of the award. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. We estimated the following key assumptions for the Black-Scholes valuation calculation:

Risk-free interest rate. The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option.

Expected volatility. We use a combination of historical stock price volatility and implied volatility computed based on the price of options publicly traded on our common stock for our expected volatility assumption.

Expected term. The expected term represents the weighted-average period the stock options are expected to remain outstanding. The expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.

Expected dividends.

The assumptions used in the Black-Scholes valuation model to value our option grants and employee stock purchase plan were as follows:

	Stock Option Grants				Employee Stock Purchase Plan	
	Three Months Ended December 31,		Nine Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006	2007	2006
Risk-free interest rate	3.3 - 3.8%	4.5 - 4.6%	3.3 - 5.1%	4.5 - 5.1%	4.2%	3.7 - 5.1%
Expected volatility	33 - 34%	32 - 43%	31 - 37%	32 - 46%	32 - 33%	30 - 36%
Weighted-average volatility	34%	35%	32%	35%	33%	33%
Expected term	4.3 years	4.2 years	4.4 years	4.2 years	6-12 months	6-12 months
Expected dividends	None	None	None	None	None	None

There were no employee stock purchase plan shares valued during the three months ended December 31, 2007 and 2006.

Employee stock-based compensation expense recognized during the three and nine months ended December 31, 2007 and 2006 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. In subsequent periods, if actual forfeitures differ from those estimates, an adjustment to stock-based compensation expense will be recognized at that time.

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
Cost of goods sold	$ 1	$	$ 1	$ 1
Marketing and sales	5	5	15	14
General and administrative	11	10	29	30
Research and development	21	20	60	60
Stock-based compensation expense	38	35	105	105
Benefit from income taxes	(7)	(7)	(20)	(22)
Stock-based compensation expense, net of tax	$ 31	$ 28	$ 85	$ 83

As of December 31, 2007, our total unrecognized compensation cost related to stock options was $183 million and is expected to be recognized over a weighted-average service period of 2.4 years. As of December 31, 2007, our total unrecognized compensation cost related to restricted stock and restricted stock units (collectively referred to as restricted stock rights) was $158 million and is expected to be recognized over a weighted-average service period of 1.9 years.

The following table summarizes our stock option activity for the nine months ended December 31, 2007:

	Options (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding as of March 31, 2007	35,864	$ 40.75		
Activity for the nine months ended December 31, 2007:				
Granted	5,760	50.65		
Exercised	(4,957)	28.18		
Forfeited, cancelled or expired	(1,917)	53.51		
Outstanding as of December 31, 2007	34,750	$ 43.48	6.30	$ 539
Exercisable as of December 31, 2007	21,704	$ 37.83	5.01	$ 458

The weighted-average grant-date fair value of stock options granted during the three and nine months ended December 31, 2007 was $18.81 and $17.25, respectively. The weighted-average grant-date fair value of stock options granted during the three and nine months ended December 31, 2006 was $19.14 and $17.82, respectively.

The following table summarizes our restricted stock rights activity for the nine months ended December 31, 2007:

	Restricted Stock	Weighted-

	Rights (in thousands)		Average Grant Date Fair Value
Balance as of March 31, 2007	2,134	$	52.62
Activity for the nine months ended December 31, 2007:			
Granted	2,416		51.23
Vested	(377)		53.26
Forfeited or cancelled	(336)		51.99
Balance as of December 31, 2007	3,837	$	51.74

The weighted-average grant date fair value of restricted stock rights is based on the quoted market value of our common stock on the date of grant. The weighted-average fair value of restricted stock rights granted during the three and nine months ended

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December 31, 2007 was $57.95 and $51.23, respectively. The weighted-average fair value of restricted stock rights granted during the three and nine months ended December 31, 2006 was $55.57 and $52.89, respectively.
Information related to stock issuances under the ESPP are as follows:

	Nine Months Ended December 31,	
	2007	2006
Number of shares issued (in thousands)	494	370
Exercise prices for purchase rights	$ 42.86	$ 43.10
Estimated weighted-average fair value of purchase rights	$ 14.69	$ 17.30

At our Annual Meeting of Stockholders, held on July 26, 2007, our stockholders approved amendments to the 2000 Equity Incentive Plan to (a) increase the number of shares authorized for issuance under the Equity Plan by 9 million, (b) decrease by 4 million shares the limit on the total number of shares underlying awards of restricted stock and restricted stock units that may be granted under the Equity Plan from 15 million to 11 million shares, and (c) revise the amount and nature of automatic initial and annual grants to our non-employee directors under the Equity Plan by adding restricted stock units and decreasing the size of stock option grants. Our stockholders also approved an amendment to the 2000 Employee Stock Purchase Plan to increase by 1.5 million the number of shares of common stock reserved for issuance under the Purchase Plan.

(11) COMPREHENSIVE INCOME (LOSS)

We are required to classify items of other comprehensive income (loss) by their nature in a financial statement and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of the balance sheet. Accumulated other comprehensive income primarily includes foreign currency translation adjustments, and the net-of-tax amounts for unrealized gains (losses) on investments and unrealized gains (losses) on derivatives designated as cash flow hedges.

The components of comprehensive income (loss) for the three and nine months ended December 31, 2007 and 2006 are summarized as follows (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
Net income (loss)	$ (33)	$ 160	$ (361)	$ 101
Other comprehensive income:				
Change in unrealized gains (losses) on investments, net of tax expense of $0, $0 and $3, $0, respectively	125	30	251	80
Reclassification adjustment for (gains) losses realized on investments in net income (loss), net of tax expense of ($1), $0 and ($2), $0, respectively	7		6	1
Change in unrealized gains (losses) on derivative instruments, net of tax expense (benefit) of $0, $0 and $1, $0, respectively	6	(1)	4	(4)
Reclassification adjustment for (gains) losses on derivative instruments in net income (loss), net of tax (expense) benefit of $0, $0 and ($1), $0, respectively	(2)	2	(3)	2
Foreign currency translation adjustments	5		41	26
Total other comprehensive income	141	31	299	105

Total comprehensive income (loss)	$ 108	$ 191	$ (62)	$ 206

The foreign currency translation adjustments are not adjusted for income taxes as they relate to indefinite investments in non-U.S. subsidiaries.

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(12) NET INCOME (LOSS) PER SHARE

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

(In millions, except per share amounts)	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
Net income (loss)	$ (33)	$ 160	$ (361)	$ 101
Shares used to compute net income (loss) per share:				
Weighted-average common stock outstanding basic	315	309	313	307
Dilutive potential common shares		10		9
Weighted-average common stock outstanding diluted	315	319	313	316
Net income (loss) per share:				
Basic	$ (0.10)	$ 0.52	$ (1.15)	$ 0.33
Diluted	$ (0.10)	$ 0.50	$ (1.15)	$ 0.32

As a result of our net loss for the three and nine months ended December 31, 2007, we have excluded certain stock awards from the diluted earnings (loss) per share calculation as their inclusion would have been antidilutive. Had we reported net income for these periods, an additional 8 million and 7 million shares of potential common stock equivalents would have been included in the number of shares used to calculate diluted earnings per share for the three and nine months ended December 31, 2007, respectively.

Options to purchase 13 million and 17 million shares of common stock were excluded from the above computation of diluted shares for the three and nine months ended December 31, 2007, respectively, as their inclusion would have been antidilutive. For the three and nine months ended December 31, 2007, the weighted-average exercise price of these shares was $54.55 and $54.48 per share, respectively.

Options to purchase 15 million and 16 million shares of common stock were excluded from the above computation of diluted shares for the three and nine months ended December 31, 2006, respectively, as their inclusion would have been antidilutive. For the three and nine months ended December 31, 2006, the weighted-average exercise price of these shares was $55.44 and $56.13 per share, respectively.

(13) SEGMENT INFORMATION

Our reporting segments are based upon: our internal organizational structure; the manner in which our operations are managed; the criteria used by our Chief Executive Officer, our chief operating decision maker, to evaluate segment performance; the availability of separate financial information; and overall materiality considerations.

As of December 31, 2007, we managed and reported our business primarily based on geographical performance. Accordingly, our combined global publishing organizations represent our reportable segment, our Publishing segment, due to their similar economic characteristics, products and distribution methods. Publishing refers to the manufacturing, marketing, advertising and distribution of products developed or co-developed by us, or distribution of certain third-party publishers products through our co-publishing and distribution program.

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The following table summarizes the financial performance of our Publishing segment and a reconciliation of our Publishing segment s profit to our consolidated operating income (loss) (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
Publishing segment:				
Net revenue	$ 1,669	$ 1,246	$ 2,917	$ 2,372
Depreciation and amortization	(6)	(6)	(16)	(17)
Other expenses	(988)	(615)	(1,809)	(1,314)
Publishing segment profit	675	625	1,092	1,041
Reconciliation to consolidated operating income (loss):				
Other:				
Change in deferred net revenue (packaged goods and digital content)	(231)		(563)	
Other net revenue	65	35	183	106
Depreciation and amortization	(39)	(32)	(119)	(93)
Other expenses	(463)	(413)	(1,042)	(943)
Consolidated operating income (loss)	$ 7	$ 215	$ (449)	$ 111

Publishing segment profit differs from consolidated operating income (loss) primarily due to the exclusion of (1) substantially all of our research and development expense, as well as certain corporate functional costs that are not allocated to the publishing organizations, and (2) the deferral of certain net revenue related to packaged goods and digital content (see Note 7 of the Notes to Condensed Consolidated Financial Statements). Our Chief Executive Officer reviews assets on a consolidated basis and not on a segment basis.

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Information about our total net revenue by platform for the three and nine months ended December 31, 2007 and 2006 is presented below (in millions):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2007	2006	2007	2006
Consoles				
Xbox 360	$ 196	$ 172	$ 461	$ 399
PlayStation 2	301	400	435	769
Wii	139	29	227	29
PLAYSTATION 3	102	41	130	41
Xbox	3	62	19	150
Nintendo GameCube	1	32	5	56
Total Consoles	742	736	1,277	1,444
PC	148	218	316	370
Mobility				
Nintendo DS	122	55	195	77
PSP	74	118	115	219
Cellular Handsets	38	35	108	104
Game Boy Advance	2	21	8	35
Total Mobility	236	229	426	435
Co-publishing and Distribution	320	49	391	130
Internet Services, Licensing and Other				
Subscription Services	23	24	69	55
Licensing, Advertising and Other	34	25	58	44
Total Internet Services, Licensing and Other	57	49	127	99
Total Net Revenue	$ 1,503	$ 1,281	$ 2,537	$ 2,478

Information about our operations in North America, Europe and Asia for the three and nine months ended December 31, 2007 and 2006 is presented below (in millions):

	North America	Europe	Asia	Total
Three months ended December 31, 2007				
Net revenue from unaffiliated customers	$ 768	$ 668	$ 67	$ 1,503
Long-lived assets	1,123	169	8	1,300
Three months ended December 31, 2006				
Net revenue from unaffiliated customers	$ 637	$ 583	$ 61	$ 1,281
Long-lived assets	1,137	254	11	1,402
Nine months ended December 31, 2007				
Net revenue from unaffiliated customers	$ 1,292	$ 1,119	$ 126	$ 2,537
Nine months ended December 31, 2006				

Net revenue from unaffiliated customers	$ 1,359	$ 997	$ 122	$ 2,478

Our direct sales to GameStop Corp. represented approximately 12 percent of total net revenue for both the three and nine months ended December 31, 2007, and approximately 10 percent and 12 percent of total net revenue for the three and nine months ended December 31, 2006, respectively. Our direct sales to Wal-Mart Stores, Inc. represented approximately 12 percent and 11 percent of total net revenue for the three and nine months ended December 31, 2007, respectively, and approximately 13 percent of total net revenue for both the three and nine months ended December 31, 2006.

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(14) IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. Fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Fair value measurements would be separately disclosed by level within the fair value hierarchy. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of SFAS No. 157 to have a material impact on our Condensed Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. It also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The provisions of SFAS No. 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007. This Statement should not be applied retrospectively to fiscal years beginning prior to the effective date, except as permitted with early adoption. We are evaluating if we will adopt SFAS No. 159 and what impact the adoption will have on our Condensed Consolidated Financial Statements if we adopt. If we adopt SFAS No. 159, it could have a material impact on our Condensed Consolidated Financial Statements.

In June 2007, the FASB ratified the Emerging Issues Task Force s (EITF) consensus conclusion on EITF 07-03, *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development*. EITF 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under this conclusion, an entity is required to defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-03 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007 and requires prospective application for new contracts entered into after the effective date. We do not expect the adoption of EITF 07-03 to have a material impact on our Condensed Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007) (SFAS No. 141(R)), *Business Combinations*, which requires the recognition of assets acquired, liabilities assumed, and any noncontrolling interest in an acquiree at the acquisition date fair value with limited exceptions. SFAS No. 141(R) will change the accounting treatment for certain specific items and includes a substantial number of new disclosure requirements. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of SFAS No. 141(R) will have a material impact on our Condensed Consolidated Financial Statements for acquisitions consummated after April 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51*, which establishes new accounting and reporting standards for noncontrolling interest (minority interest) and for the deconsolidation of a subsidiary. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We do not expect the adoption of SFAS No. 160 to have a material impact on our Condensed Consolidated Financial Statements.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Electronic Arts Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Electronic Arts Inc. and subsidiaries (the Company) as of December 29, 2007, and the related condensed consolidated statements of operations for the three-month and nine-month periods ended December 29, 2007 and December 30, 2006, and the related condensed consolidated statement of cash flows for the nine-month periods ended December 29, 2007 and December 30, 2006. These condensed consolidated financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

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

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Electronic Arts Inc. and subsidiaries as of March 31, 2007, and the related consolidated statements of operations, stockholder s equity and comprehensive income, and cash flows for the year then ended (not presented herein); and in our report dated May 29, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of March 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP
Mountain View, California
February 4, 2008

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, including statements regarding industry prospects and future results of operations or financial position, made in this Quarterly Report on Form 10-Q are forward looking. We use words such as anticipate , believe , expect , intend estimate (and the negative of any of these terms), future and similar expressions to help identify forward-looking statements. These forward-looking statements are subject to business and economic risk and reflect management s current expectations, and involve subjects that are inherently uncertain and difficult to predict. Our actual results could differ materially. We will not necessarily update information if any forward-looking statement later turns out to be inaccurate. Risks and uncertainties that may affect our future results include, but are not limited to, those discussed in this report under the heading Risk Factors in Part II, Item 1A, as well as in our Annual Report on Form 10-K for the fiscal year ended March 31, 2007 as filed with the Securities and Exchange Commission (SEC) on May 30, 2007 and in other documents we have filed with the SEC.

OVERVIEW

The following overview is a top-level discussion of our operating results as well as some of the trends and drivers that affect our business. Management believes that an understanding of these trends and drivers is important in order to understand our results for the three and nine months ended December 31, 2007, as well as our future prospects. This summary is not intended to be exhaustive, nor is it intended to be a substitute for the detailed discussion and analysis provided elsewhere in this Form 10-Q, including in the remainder of Management s Discussion and Analysis of Financial Condition and Results of Operations , Risk Factors and the Condensed Consolidated Financial Statements and related notes. Additional information can be found in the Business section of our Annual Report on Form 10-K for the fiscal year ended March 31, 2007 as filed with the SEC on May 30, 2007 and in other documents we have filed with the SEC.

About Electronic Arts

We develop, market, publish and distribute interactive software games that are playable by consumers on video game consoles (such as the Sony PlayStation® 2 and PLAYSTATION® 3, Microsoft Xbox 360 and Nintendo Wii), personal computers, mobile platforms (including cellular handsets and handheld game players such as the PlayStation® Portable (PSP) and the Nintendo DS) and online (over the Internet and other proprietary online networks). Some of our games are based on content that we license from others (e.g., Madden NFL Football, Harry Potter and FIFA Soccer), and some of our games are based on our own wholly-owned intellectual property (e.g., The Sims, Need for Speed and POGO). Our goal is to publish titles with global mass-market appeal, which often means translating and localizing them for sale in non-English speaking countries. In addition, we also attempt to create software game franchises that allow us to publish new titles on a recurring basis that are based on the same property. Examples of this franchise approach are the annual iterations of our sports-based products (e.g., Madden NFL Football, NCAA® Football and FIFA Soccer), wholly-owned properties that can be successfully sequeled (e.g., The Sims, Need for Speed and Battlefield) and titles based on long-lived literary and/or movie properties (e.g., Lord of the Rings and Harry Potter).

Overview of Financial Results

Special Note Regarding Deferred Net Revenue

The ubiquity of high-speed Internet access and the integration of network connectivity into new generation game consoles are expected to continue to increase demand for games with online-enabled features. To address this demand, many of our software products are developed with the ability to be connected to, and played via, the Internet. In order for consumers to participate in online communities and play against one another via the Internet, we (either directly or through outsourced arrangements with third parties) maintain servers which support an online service we offer to consumers for activities such as matchmaking, roster updates, tournaments and player rankings. In situations where we do not separately sell this online service, we account for the sale of the software product as a bundle sale, or multiple element arrangement, in which we sell both the software product and the online service for one combined price.

Through fiscal 2007, for accounting purposes, vendor specific objective evidence of fair value existed for the online service. Accordingly, we allocated the revenue collected from the sale of the software product between the online service offered and

the software product and recognized the amounts allocated to each element separately. However, starting in fiscal 2008, for accounting purposes, the required vendor specific objective evidence of fair value does not exist for the online service related to certain of our online-enabled software products. This prevents us from allocating and separately recognizing revenue related to the software product and the online service. Accordingly, starting in fiscal 2008, we began to recognize all of the revenue from the sale of our online-enabled software products for the PC, PlayStation 2, PLAYSTATION 3, Wii and the PSP on a deferred basis over an estimated online service period, which we estimate to be six months beginning in the month after shipment. We anticipate that we will defer approximately $350 million to $450 million in net revenue from the sale of these online-enabled software products from fiscal 2008 into fiscal 2009. On a quarterly basis, this amount will vary significantly depending upon the number of titles we release, the timing of their release, sales volume, returns and price protection provided for these online-enabled software products. In addition, we expense the cost of goods sold related to these transactions during the period in which the product is delivered (rather than on a deferred basis), which inherently creates volatility in our reported gross margin percentages.

As of December 31, 2007, we had an accumulated balance of $595 million of deferred net revenue related to online-enabled packaged goods and digital content, substantially all of which was driven by sales made during the six months ended December 31, 2007.

Financial Results

Total net revenue for the three months ended December 31, 2007 was $1,503 million, up $222 million as compared to the three months ended December 31, 2006. The impact of deferrals related to packaged goods and digital content for the three months ended December 31, 2007 decreased our reported net revenue by $231 million. Net revenue was driven by sales of *Rock Band , Need for Speed ProStreet, The Simpsons Game, FIFA 08,* and *Madden NFL 08.*

Net loss for the three months ended December 31, 2007 was $33 million as compared to net income of $160 million for the three months ended December 31, 2006. Diluted loss per share for the three months ended December 31, 2007 was $0.10 as compared to diluted income per share of $0.50 for the three months ended December 31, 2006. Net income decreased during the three months ended December 31, 2007 as compared to the three months ended December 31, 2006 primarily due to (1) a decrease in gross profit of $90 million due to the net deferral of $231 million of net revenue related to certain of our online-enabled packaged goods and digital content products which will be recognized in future periods, and (2) an increase in restructuring expense of $76 million primarily resulting from our fiscal 2008 reorganization.

During the nine months ended December 31, 2007, we generated $53 million of cash from operating activities as compared to $183 million for the nine months ended December 31, 2006. The decrease in cash provided by operating activities for the nine months ended December 31, 2007 as compared to the nine months ended December 31, 2006 was primarily due to (1) an increase in operating expenses paid resulting from an increase in advertising and marketing costs, external development expenses and personnel-related expenses, and (2) a $90 million increase in incentive-based compensation payments made in fiscal 2008 related to fiscal 2007.

Management s Overview of Historical and Prospective Business Trends

Fiscal 2008 Reorganization. In June 2007, we announced a plan to reorganize our business into several new divisions, including four new Labels : EA SPORTS, EA Games, EA Casual Entertainment and The Sims. Each Label will operate with dedicated studio and product marketing teams focused on consumer-driven priorities. The new structure is designed to streamline decision-making, improve global focus, and speed new ideas to the market. In October 2007, our Board of Directors approved a plan of reorganization (fiscal 2008 reorganization) in connection with the reorganization of our business into four new Labels.

Since inception of the fiscal 2008 reorganization through December 31, 2007, we incurred charges associated with (1) the closure of our Chertsey, England and Chicago, Illinois facilities, which included asset impairment and lease termination costs, (2) employee-related expenses, and (3) other costs including other contract terminations as well as IT and consulting costs to assist in the reorganization of our business support functions. During the fourth quarter of fiscal 2008, we anticipate that we will complete the closure of our Chertsey, England facility and consolidate our local operations and employees in our Guildford, England facility. Over the next 21 months, we expect to continue to incur IT and consulting costs to assist in the reorganization of our business support functions.

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Including charges incurred through December 31, 2007, we expect to incur between $90 million and $110 million in charges in connection with our fiscal 2008 reorganization, which will result in cash and non-cash expenditures by 2009. These charges will consist primarily of employee-related costs (approximately $14 million), facility exit costs (approximately $45 million), as well as other reorganization costs including other contract terminations and IT and consulting costs to assist in the reorganization of our business support functions (approximately $40 million).

Transition to a New Generation of Consoles. Video game hardware systems have historically had a life cycle of four to six years, which causes the video game software market to be cyclical as well. Microsoft launched the Xbox 360 in November 2005, while Sony and Nintendo launched the PLAYSTATION 3 and the Wii, respectively, in November 2006. We have continued to develop and market new titles for prior-generation video game systems such as the PlayStation 2 while also making significant investments in products for the new systems. As the prior-generation systems reach the end of their life cycle and the installed base of the new systems continues to grow, our sales of video games for prior-generation systems will continue to decline as (1) we produce fewer titles for prior-generation systems, (2) consumers replace their prior-generation systems with the new systems, and/or (3) consumers reduce game software purchases for certain prior-generation consoles generally until they are able to purchase a new video game hardware system. This decline in prior-generation product sales could ultimately be greater or faster than we anticipate, and sales of products for the new platforms may be lower or increase more slowly than we anticipate. Moreover, we expect development costs for the new video game systems to be greater on a per-title basis than development costs for prior-generation video game systems.

We have incurred increased costs during this transition as we have continued to develop and market new titles for certain prior-generation video game platforms while also making significant investments in products for the new generation platforms. As a result of these factors, we expect research and development expenses to increase in fiscal 2008 as compared to fiscal 2007; however, we expect research and development expenses to decline as a percentage of net revenue in fiscal 2008 as compared to fiscal 2007.

Online. Today, we generate net revenue from a variety of online products and services, including casual games and downloadable content marketed under our Pogo brand, persistent state world games such as *Ultima Online*™ and *Dark Age of Camelot*®, PC-based downloadable content and online-enabled packaged goods. In addition, we are anticipating the release of a new massively multiplayer online role-playing game, *Warhammer*® *Online*. We intend to make significant investments in online products, infrastructure and services and believe that online gameplay will become an increasingly important part of our business in the long term.

Expansion of Mobile Platforms. Advances in mobile technology have resulted in a variety of new and evolving platforms for on-the-go interactive entertainment that appeal to a broader demographic of consumers. Our efforts to capitalize on the growth in mobile interactive entertainment are focused in two broad areas packaged goods games for handheld game systems and downloadable games for cellular handsets.

We have developed and published games for a variety of handheld platforms for several years. More recently, the Sony PSP and the Nintendo DS, with their enhanced graphics, deeper gameplay, and online functionality, provide a richer mobile gaming experience for consumers.

We expect sales of games for handhelds and cellular handsets to continue to be an increasingly important part of our business worldwide.

Acquisitions and Investments. We have engaged in, evaluated, and expect to continue to engage in and evaluate, a wide array of potential strategic transactions, including acquisitions of companies, businesses, intellectual properties, and other assets. Since the beginning of fiscal 2007, we have announced and/or completed several acquisitions and investments, including:

In January 2008, we completed our acquisition of VG Holding Corp. (VGH), owner of both BioWare Corp. and Pandemic Studios, LLC, which create action, adventure and role-playing games. VGH is headquartered in Menlo Park, California. BioWare Corp. and Pandemic Studios are located in Edmonton, Canada; Los Angeles, California; Austin, Texas; and Brisbane, Australia.

In May 2007, we entered into a licensing agreement with and made a strategic equity investment in The9 Limited (The9), a leading online game operator in China. The licensing agreement gives The9 exclusive

publishing rights for *EA SPORTS   FIFA Online* in mainland China.

In April 2007, we expanded our commercial agreements with and made strategic equity investments in Neowiz Corporation and a related online gaming company, Neowiz Games (we refer to Neowiz Corporation and Neowiz Games collectively as Neowiz). Based in Korea, Neowiz is an online media and gaming company with which we partnered in 2006 to launch *EA SPORTS FIFA Online* in Korea.

In October 2006, the remaining outstanding shares of Digital Illusions C.E. (DICE) located in Sweden were purchased, thereby completing the acquisition of the remaining minority interest of DICE.

In July 2006, we acquired Mythic Entertainment, Inc., located in Virginia, as part of our efforts to accelerate our growth in the massively multiplayer online role-playing market.

International Operations and Foreign Currency Exchange Impact. International sales are a fundamental part of our business. Net revenue from international sales accounted for approximately 49 percent of our total net revenue during the first nine months of fiscal 2008 and approximately 45 percent of our total net revenue during the first nine months of fiscal 2007. Our international net revenue was primarily driven by sales in Europe and, to a much lesser extent, in Asia. Year-over-year, we estimate that foreign exchange rates had a favorable impact on our net revenue of $90 million, or 4 percent, for the nine months ended December 31, 2007. We believe that in order to succeed internationally, it is important to locally develop content that is specifically directed toward local cultures and consumers.

Stock-Based Compensation. Beginning on April 1, 2006, we adopted Statement of Financial Accounting Standard No. 123 (revised 2004) (SFAS No. 123(R)), *Share-Based Payment* , and applied the provisions of Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payment* , to our adoption of SFAS No. 123(R). During the three and nine months ended December 31, 2007, we recognized stock-based compensation of $38 million and $105 million, pre-tax, and $31 million and $85 million, net of tax, respectively. During the three and nine months ended December 31, 2006, we recognized stock-based compensation of $35 million and $105 million, pre-tax, and $28 million and $83 million, net of tax, respectively. Stock-based compensation expense has been reflected in the respective functional line items on our Condensed Consolidated Statements of Operations.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Revenue Recognition, Sales Returns, Allowances and Bad Debt Reserves

We derive revenue principally from sales of interactive software games designed for play on video game consoles (such as the PlayStation 2, PLAYSTATION 3, Xbox 360 and Wii), PCs and mobile platforms including handheld game players (such as the Sony PSP and Nintendo DS), and cellular handsets. We evaluate the recognition of revenue based on the criteria set forth in Statement of Position (SOP) 97-2, *Software Revenue Recognition* , as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions* and SAB No. 104, *Revenue Recognition* . We evaluate revenue recognition using the following basic criteria 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 products must be present in order to recognize revenue.

Delivery. Delivery is considered to occur when a product is shipped and the risk of loss and rewards of ownership have been transferred to the customer. For online game services, delivery is considered to occur as the service is provided. For digital downloads that do not have an online service

component, delivery is considered to occur generally when the download occurs.

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. We conduct a credit review of each customer involved in a significant transaction to determine the creditworthiness of the customer. 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, we recognize revenue when collection becomes probable (generally upon cash collection).

Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue we report in each period. For example, for multiple element arrangements, we must make assumptions and judgments in order to: (1) determine whether and when each element has been delivered; (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services; (3) determine whether vendor-specific objective evidence of fair value (VSOE) exists for each undelivered element; and (4) allocate the total price among the various elements we must deliver. Changes to any of these assumptions or judgments, or changes to the elements in a software arrangement, could cause a material increase or decrease in the amount of revenue that we report in a particular period. For example, in connection with some of our packaged goods product sales, we offer an online service without an additional fee. Prior to fiscal 2008, we were able to determine VSOE for the online service to be delivered; therefore, we were able to allocate the total price received from the combined product and online service sale between these two elements and recognize the related revenue separately. However, starting in fiscal 2008, VSOE does not exist for the online service to be delivered for certain platforms and all revenue from these transactions are recognized over the estimated online service period. More specifically, starting in fiscal 2008, we began to recognize the revenue from sales of certain online-enabled packaged goods on a straight-line basis over a six month period beginning in the month after shipment. Accordingly, this relatively small change (from having VSOE for the online service to no longer having VSOE) has had a significant effect on our reported results.

Determining whether a transaction constitutes an online game service transaction or a download of a product requires judgment and can be difficult. The accounting for these transactions is significantly different. Revenue from product downloads is generally recognized when the download occurs (assuming all other recognition criteria are met). Revenue from online game services is recognized as the services are rendered. If the service period is not defined, we recognize the revenue over the estimated service period. Determining the estimated service period is inherently subjective and is subject to regular revision based on historical online usage.

Product revenue, including sales to resellers and distributors (channel partners), is recognized when the above criteria are met. We reduce product revenue for estimated future returns, price protection, and other offerings, which may occur with our customers and channel partners. Price protection represents the right to receive a credit allowance in the event we lower our wholesale price on a particular product. The amount of the price protection is generally the difference between the old price and the new price. In certain countries, we have stock-balancing programs for our PC and video game system products, which allow for the exchange of these products by resellers under certain circumstances. It is our general practice to exchange products or give credits rather than to give cash refunds.

In certain countries, from time to time, we decide to provide price protection for both our PC and video game system products. When evaluating the adequacy of sales returns and price protection allowances, we analyze historical returns, current sell-through of distributor and retailer inventory of our products, current trends in retail and the video game segment, changes in customer demand and acceptance of our 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 costs in subsequent periods.

In the future, actual returns and price protections may materially exceed our estimates as unsold 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 products. For example, the risk of product returns and/or price protection for our products may continue to increase as the PlayStation 2 console moves through its lifecycle. While we believe we can make reliable estimates regarding these matters, these estimates are inherently

subjective. Accordingly, if our estimates changed, our returns and price protection reserves would change, which would impact the total net revenue we report. For example, if actual returns and/or price protection were significantly greater than the reserves we have established, our actual results would decrease our reported total net revenue. Conversely, if actual returns and/or price protection were significantly less than our reserves, this would increase our reported total net revenue. In addition, if our estimates of returns and price protection related

to online-enabled packaged goods products change, the amount of net deferred revenue we recognize in the future would change.

Significant judgment is required to estimate our allowance for doubtful accounts in any accounting period. We determine our allowance for doubtful accounts by evaluating customer creditworthiness in the context of current economic trends and historical experience. Depending upon the overall economic climate and the financial condition of our customers, the amount and timing of our bad debt expense and cash collection could change significantly.

Royalties and Licenses

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

Royalty-based obligations with content licensors and distribution affiliates are either paid in advance and capitalized as prepaid royalties or are accrued as incurred and subsequently paid. These royalty-based obligations are generally expensed to cost of goods sold generally at the greater of the contractual rate or an effective royalty rate based on the total projected net revenue. Significant judgment is required to estimate the effective royalty rate for a particular contract. Because the computation of effective royalty rates requires us to project future revenue, it is inherently subjective as our future revenue projections must anticipate a number of factors, including (1) the total number of titles subject to the contract, (2) the timing of the release of these titles, (3) the number of software units we expect to sell which can be impacted by a number of variables, including product quality and competition, and (4) future pricing. Determining the effective royalty rate for our titles is particularly challenging due to the inherent difficulty in predicting the popularity of entertainment products. Accordingly, if our future revenue projections change, our effective royalty rates would change, which could impact the royalty expense we recognize. Prepayments made to thinly capitalized independent software developers and co-publishing affiliates are generally made in connection with the development of a particular product and, therefore, we are generally subject to development risk prior to the release of the product. Accordingly, payments that are due prior to completion of a product are generally expensed to research and development over the development period as the services are incurred. Payments due after completion of the product (primarily royalty-based in nature) are generally expensed as cost of goods sold.

Our contracts with some licensors include minimum guaranteed royalty payments which are initially recorded as an asset and as a liability at the contractual amount when no performance remains with the licensor. When performance remains with the licensor, we record guarantee payments as an asset when actually paid and as a liability when incurred, rather than recording the asset and liability upon execution of the contract. Minimum royalty payment obligations are classified as current liabilities to the extent such royalty payments are contractually due within the next twelve months. As of December 31, 2007 and March 31, 2007, approximately $12 million and $9 million, respectively, of minimum guaranteed royalty obligations had been recognized in each period.

Each quarter, we also evaluate the future realization of our royalty-based assets as well as any unrecognized minimum commitments not yet paid to determine amounts we deem unlikely to be realized through product sales. Any impairments or losses determined before the launch of a product are charged to research and development expense. Impairments or losses determined post-launch are charged to cost of goods sold. In either case, we rely on estimated revenue to evaluate the future realization of prepaid royalties and commitments. If actual sales or revised revenue estimates fall below the initial revenue estimate, then the actual charge taken may be greater in any given quarter than anticipated. During the three and nine months ended December 31, 2007, we recognized impairment charges of $2 million and $3 million, respectively. We had no impairments during the three and nine months ended December 31, 2006.

Valuation of Long-Lived Assets, including goodwill and other intangible assets

We evaluate both purchased intangible assets and other long-lived assets in order to determine if events or changes in circumstances indicate a potential impairment in value exists. This evaluation requires us to estimate, among other things, the remaining useful lives of the assets and future cash flows of the business. These evaluations and estimates

require the use of judgment. Our actual results could differ materially from our current estimates.

Under current accounting standards, we make judgments about the recoverability of purchased intangible assets and other long-lived assets whenever events or changes in circumstances indicate a potential impairment in the remaining value of the assets recorded on our Condensed Consolidated Balance Sheets. In order to determine if a potential impairment has occurred, management makes various assumptions about the future value of the asset by evaluating future business prospects and estimated cash flows. Our future net cash flows are primarily dependent on the sale of products for play on proprietary video game consoles, handheld game players, PCs, and cellular handsets (platforms). The sales of our products are affected by our ability to accurately predict which platforms and which products we develop will be successful. Also, our revenue and earnings are dependent on our ability to meet our product release schedules. Due to product sales shortfalls, we may not realize the future net cash flows necessary to recover our long-lived assets, which may result in an impairment charge being recorded in the future. During the three and nine months ended December 31, 2007, we recognized $42 million of impairment charges related to our fiscal 2008 reorganization associated with the closures of our facilities in Chertsey, England and Chicago, Illinois. We recognized an insignificant amount of impairment during the three and nine months ended December 31, 2006.

SFAS No. 142, *Goodwill and Other Intangible Assets* requires at least an annual assessment for impairment of goodwill by applying a fair-value-based test. A two-step approach is required to test goodwill for impairment for each reporting unit. The first step tests for impairment by applying fair value-based tests at the reporting unit level. The second step (if necessary) measures the amount of impairment by applying fair value-based tests to individual assets and liabilities within each reporting unit. Application of the goodwill impairment test requires judgment, including identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. The fair value of each reporting unit is estimated using a discounted cash flow methodology which requires significant judgment to estimate the future cash flows, determine the appropriate discount rates, growth rates and other assumptions. The determination of fair value for each reporting unit could be materially affected by changes in these estimates and assumptions which could trigger impairment. In fiscal 2007, we completed the first step of the annual goodwill impairment testing as of January 1, 2007 and found no indicators of impairment of our recorded goodwill. We did not recognize an impairment loss on goodwill in fiscal 2007, 2006 or 2005. Future impairment tests may result in a charge to earnings and there is a potential for a write-down of goodwill in connection with the annual impairment test.

Stock-Based Compensation

We are required to estimate the fair value of share-based payment awards on the date of grant. The estimated fair value of stock options and stock purchase rights granted pursuant to our employee stock purchase plan is determined using the Black-Scholes valuation model. The Black-Scholes valuation model requires us to make certain assumptions about the future. The determination of fair value is affected by our stock price as well as assumptions regarding subjective and complex variables such as expected employee exercise behavior and our expected stock price volatility over the term of the award. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. We estimated the following key assumptions for the Black-Scholes valuation calculation:

Risk-free interest rate. The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the expected term of the option.

Expected volatility. We use a combination of historical stock price volatility and implied volatility computed based on the price of options publicly traded on our common stock for our expected volatility assumption.

Expected term. The expected term represents the weighted-average period the stock options are expected to remain outstanding. The expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.

Expected dividends.

Employee stock-based compensation expense was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. Forfeitures are revised, if necessary, in subsequent periods if actual forfeitures

differ from those estimates and an adjustment will be recognized at that time.

Changes to our underlying stock price, our assumptions used in the Black-Scholes option valuation calculation and our forfeiture rate as well as future grants of equity could significantly impact compensation expense to be recognized during fiscal 2008 and future periods.

We continue to recognize the remaining compensation expense for options granted prior to our adoption of SFAS No. 123(R) using the accelerated approach over the requisite service period. However, in conjunction with our adoption of SFAS No. 123(R) in fiscal 2007, we changed our method of recognizing our stock-based compensation expense for post-adoption grants to the straight-line approach over the requisite service period.

Income Taxes

We adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* , in the first quarter of fiscal 2008. See Note 8 of the Notes to Condensed Consolidated Financial Statements.

In the ordinary course of our business, there are many transactions and calculations where the tax law and ultimate tax determination is uncertain. As part of the process of preparing our Condensed Consolidated Financial Statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate prior to the completion and filing of tax returns for such periods. This process requires estimating both our geographic mix of income and our uncertain tax positions in each jurisdiction where we operate. These estimates involve complex issues and require us to make judgments, such as anticipating the positions that we will take on tax returns prior to our actually preparing the returns and the outcomes of disputes with tax authorities. The ultimate resolution of these issues may take extended periods of time due to examinations by tax authorities and statutes of limitations. We are also required to make determinations of the need to record deferred tax liabilities and the recoverability of deferred tax assets. A valuation allowance is established to the extent recovery of deferred tax assets is not likely based on our estimation of future taxable income in each jurisdiction.

In addition, changes in our business, including acquisitions, changes in our international corporate structure, changes in the geographic location of business functions or assets, changes in the geographic mix and amount of income, as well as changes in our agreements with tax authorities, valuation allowances, applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audit and other matters, and variations in the estimated and actual level of annual pre-tax income can affect the overall effective income tax rate.

The calculation of our tax liabilities involves accounting for uncertainties in the application of complex tax rules, regulations and practices. As a result of the implementation of FIN No. 48, we recognize benefits for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition of a benefit (or the absence of a liability) by determining if the weight of available evidence indicates that it is more likely than not that the position taken will be sustained upon audit, including resolution of related appeals or litigation processes, if any. If it is not, in our judgment, more likely than not that the position will be sustained, then we do not recognize any benefit for the position. If it is more likely than not that the position will be sustained, a second step in the process is required to estimate how much of the benefit we will ultimately receive. This second step requires that we estimate and measure the tax benefit as the largest amount that is more than 50 percent likely of being realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts. We reevaluate these uncertain tax positions on a quarterly basis. This evaluation is based on a number of factors including, but not limited to, changes in facts or circumstances, changes in tax law, new facts, correspondence with tax authorities during the course of an audit, effective settlement of audit issues, and commencement of new audit activity. Such a change in recognition or measurement could result in the recognition of a tax benefit or an additional charge to the tax provision in the period. As a result of the adoption of FIN No. 48, we expect our tax rate to be more volatile.

With respect to our projected annual effective income tax rate at the end of each quarter prior to the end of a fiscal year, we are required to make a projection of several items, including our projected mix of full-year income in each jurisdiction in which we operate and the related income tax expense in each jurisdiction. While this projection is inherently uncertain, for fiscal 2008, our projected tax rate is unusually volatile and subject to significantly greater variation.

RESULTS OF OPERATIONS

Our fiscal year is reported on a 52 or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ended March 31, 2008 and 2007 contain 52 weeks and end on March 29, 2008 and March 31, 2007,

respectively. Our results of operations for the three months ended December 31, 2007 and 2006 contain 13 weeks and ended on December 29, 2007 and December 30, 2006, respectively. Our results of operations for the nine months ended December 31, 2007 and 2006 contain 39 weeks and ended on December 29, 2007 and December 30, 2006, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

Net Revenue

Net revenue consists of (1) sales of interactive software packaged goods games designed for play on video game consoles (such as the PlayStation 2, PLAYSTATION 3, Xbox 360 and Wii), PCs and handheld game players (such as the Sony PSP, Nintendo DS and Nintendo Game Boy Advance) and cellular handsets, (2) sales of interactive online-enabled packaged goods and digital content and the online service associated with the game, (3) sales of services in connection with games playable online only, (4) revenue from programming third-party web sites with our game content, (5) revenue from allowing other companies to manufacture and sell our products in conjunction with other products, and (6) selling advertisements on our online web pages and in our games.

During the three and nine months ended December 31, 2007, we recognized total net revenue of $1,503 million and $2,537 million, respectively. Our total net revenue during the three and nine months ended December 31, 2007 includes $284 million and $392 million, respectively, recognized from sales of certain online-enabled packaged goods and digital content. The deferral of net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by $231 million and $563 million during the three and nine months ended December 31, 2007, respectively, as compared to the same periods a year ago.

From a geographical perspective, our total net revenue for the three and nine months ended December 31, 2007 and 2006 was as follows (in millions):

	Three Months Ended December 31,					%
	2007		2006		Increase	Change
North America	$ 768	51%	$ 637	50%	$ 131	21%
Europe	668	44%	583	45%	85	15%
Asia	67	5%	61	5%	6	10%
International	735	49%	644	50%	91	14%
Total Net Revenue	$ 1,503	100%	$ 1,281	100%	$ 222	17%

	Nine Months Ended December 31,				Increase /	%
	2007		2006		(Decrease)	Change
North America	$ 1,292	51%	$ 1,359	55%	$ (67)	(5%)
Europe	1,119	44%	997	40%	122	12%
Asia	126	5%	122	5%	4	3%
International	1,245	49%	1,119	45%	126	11%
Total Net Revenue	$ 2,537	100%	$ 2,478	100%	$ 59	2%

North America

For the three months ended December 31, 2007, net revenue in North America was $768 million, driven by sales of *Rock Band, Madden NFL 08,* and *Need for Speed ProStreet*.

Net revenue for the three months ended December 31, 2007 increased 21 percent as compared to the three months ended December 31, 2006. The deferral of net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by $93 million[a] during the three months ended December 31, 2007. From an operational perspective, the increase in net revenue was driven by (1) a $217 million increase in net revenue from co-publishing and distribution titles (which does not include an additional $18 million of deferred net revenue that will be

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recognized in future periods), and (2) a $53 million increase in net revenue from sales of titles for the Wii (which does not include an additional $15 million of deferred net revenue that will be recognized in future periods). These increases were partially offset by (1) a $67 million decrease in net revenue from sales of titles for the PlayStation 2 (which does not include an additional $17 million of deferred net revenue that will be recognized in future periods), (2) a $43 million decrease in net revenue from sales of titles for the Xbox, and (3) a $31 million decrease in net revenue from sales of titles for the PC (which includes the recognition of $4 million of deferred net revenue).

For the nine months ended December 31, 2007, net revenue in North America was $1,292 million, driven by sales of *Madden NFL 08, Rock Band,* and *NCAA® Football 08*.

Net revenue for the nine months ended December 31, 2007 decreased 5 percent as compared to the nine months ended December 31, 2006. The deferral of net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by $264 million[b] during the nine months ended December 31, 2007. From an operational perspective, the decrease in net revenue was driven by (1) a $234 million decrease in net revenue from sales of titles for the PlayStation 2 (which does not include an additional $90 million of deferred net revenue that will be recognized in future periods), (2) a $101 million decrease in net revenue from sales of titles for the Xbox, and (3) a $65 million decrease in net revenue from sales of titles for the PSP (which does not include an additional $33 million of deferred net revenue that will be recognized in future periods). These decreases were partially offset by (1) a $215 million increase in net revenue from co-publishing and distribution titles (which does not include an additional $18 million of deferred net revenue that will be recognized in future periods), (2) a $95 million increase in net revenue from sales of titles for the Wii (which does not include an additional $28 million of deferred net revenue that will be recognized in future periods), and (3) a $33 million increase in net revenue from sales of titles for the Nintendo DS.

[a] The net deferral of $93 million of net revenue related to certain of our packaged goods and digital content sales during the three months ended December 31, 2007, which will be recognized in future periods, consisted of (1) $24 million of net revenue related to the PLAYSTATION 3, (2) $20 million of net revenue related to the PSP, (3) $18 million of net revenue related to co-publishing and distribution titles, (4) $17 million of net revenue related to the PlayStation 2, (5) $15 million of net revenue related to the Wii, and (6) $3 million of other net revenue. These deferrals were offset by the recognition of $4 million of deferred net revenue related to the PC.

[b] The net deferral of $264 million of net revenue related to certain of our packaged goods and digital content sales during the nine months ended December 31, 2007, which will be recognized in future periods, consisted of (1) $90 million of net revenue related to the PlayStation 2, (2) $82 million of net revenue related to the PLAYSTATION 3, (3) $33 million of net revenue related to the PSP, (4) $28 million of net revenue related to the Wii, (5) $18 million of net revenue related to co-publishing and distribution titles, (6) $6 million of net revenue related to the PC, (7) $1 million of net revenue from cellular handsets, and (8) $6 million of other net revenue.

We continue to expect net revenue for North America to increase during fiscal 2008 as compared to fiscal 2007.

Europe

For the three months ended December 31, 2007, net revenue in Europe was $668 million, driven by sales of *Need for Speed ProStreet, The Simpsons Game,* and *FIFA 08.* We estimate that foreign exchange (primarily the Euro and the British pound sterling) increased reported net revenue by approximately $57 million, or 10 percent, for the three months ended December 31, 2007 as compared to the three months ended December 31, 2006. Excluding the effect of foreign exchange rates, we estimate that net revenue increased by approximately $28 million, or 5 percent, for the three months ended December 31, 2007.

Net revenue for the three months ended December 31, 2007 increased 15 percent as compared to the three months ended December 31, 2006. The deferral of net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by $124 million[c] during the three months ended December 31, 2007. From an operational perspective the increase in net revenue was driven by (1) a $53 million increase in net revenue from sales of titles for the Wii (which does not include an additional $1 million of deferred net revenue that will be recognized in future periods), (2) $52 million of net revenue from co-publishing and distribution titles (which does not include an additional $30 million of deferred net revenue that will

be recognized in future periods), and (3) a $43 million increase in net revenue from sales of titles for the PLAYSTATION 3 (which does not include an additional $63 million of deferred net revenue that will be recognized in future periods). These increases were partially offset by (1) a $34 million decrease in net revenue

from sales of titles for the PC (which does not include an additional $9 million of deferred net revenue that will be recognized in future periods), and (2) a $32 million decrease in net revenue from sales of titles for the PlayStation 2 (which does not include an additional $6 million of deferred net revenue that will be recognized in future periods).

For the nine months ended December 31, 2007, net revenue in Europe was $1,119 million, driven by sales of *FIFA 08, Need for Speed ProStreet,* and *The Simpsons Game.* We estimate that foreign exchange (primarily the Euro and the British pound sterling) increased reported net revenue by approximately $83 million, or 8 percent, for the nine months ended December 31, 2007 as compared to the nine months ended December 31, 2006. Excluding the effect of foreign exchange rates, we estimate that net revenue increased by approximately $39 million, or 4 percent, for the nine months ended December 31, 2007.

Net revenue for the nine months ended December 31, 2007 increased 12 percent as compared to the nine months ended December 31, 2006. The deferral of net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by $272 million[d] during the nine months ended December 31, 2007. From an operational perspective, the increase in net revenue was driven by (1) a $94 million increase in net revenue from sales of titles for the Wii (which does not include an additional $12 million of deferred net revenue that will be recognized in future periods), (2) a $76 million increase in net revenue from sales of titles for the Nintendo DS, and (3) a $53 million increase in net revenue from sales of titles for the PLAYSTATION 3 (which does not include an additional $91 million of deferred net revenue that will be recognized in future periods). These increases were partially offset by a $95 million decrease in net revenue from sales of titles for the PlayStation 2 (which does not include an additional $67 million of deferred net revenue that will be recognized in future periods).

[c] The net deferral of $124 million of net revenue related to certain of our packaged goods and digital content sales during the three months ended December 31, 2007, which will be recognized in future periods, consisted of (1) $63 million of net revenue related to the PLAYSTATION 3, (2) $30 million of net revenue related to co-publishing and distribution titles, (3) $15 million of net revenue related to the PSP, (4) $9 million of net revenue related to the PC, (5) $6 million of net revenue related to the PlayStation 2, and (6) $1 million of net revenue related to the Wii.

[d] The net deferral of $272 million of net revenue related to certain of our packaged goods and digital content sales during the nine months ended December 31, 2007, which will be recognized in future periods, consisted of (1) $91 million of net revenue related to the PLAYSTATION 3, (2) $67 million of net revenue related to the PlayStation 2, (3) $39 million of net revenue related to the PC, (4) $32 million of net revenue related to the PSP, (5) $30 million of net revenue related to co-publishing and distribution titles, (6) $12 million of net revenue related to the Wii, and (7) $1 million of other net revenue.

We continue to expect net revenue for Europe to increase during fiscal 2008 as compared to fiscal 2007.

Asia

For the three months ended December 31, 2007, net revenue in Asia was $67 million, driven by sales of *The Simpsons Game, Need for Speed ProStreet*, and *FIFA 08.* We estimate that foreign exchange increased reported net revenue by approximately $6 million, or 10 percent, for the three months ended December 31, 2007 as compared to the three months ended December 31, 2006. Excluding the effect of foreign exchange rates, we estimate that net revenue remained flat during the three months ended December 31, 2007 as compared to the three months ended December 31, 2006.

Net revenue for the three months ended December 31, 2007 increased 10 percent as compared to the three months ended December 31, 2006. The deferral of net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by $14 million[e] during the three months ended December 31, 2007. From an operational perspective, the increase in net revenue was driven by (1) a $5 million increase in sales of titles for the PLAYSTATION 3 (which does not include an additional $6 million of deferred net revenue that will be recognized in future periods), and (2) a $5 million increase in net revenue from sales of titles for the Nintendo DS. These increases were partially offset by a $6 million decrease in net revenue from sales of titles for the PC (which does not include an additional $1 million of deferred net revenue that will be recognized in future periods).

For the nine months ended December 31, 2007, net revenue in Asia was $126 million, driven by sales of *The Simpsons Game, Need for Speed ProStreet* and *Harry Potter and the Order of the Phoenix* . We estimate that foreign exchange rates increased our reported net revenue by $7 million, or 6 percent, for the nine months ended December 31, 2007 as compared to the nine

months ended December 31, 2006. Excluding the effect of foreign exchange rates, we estimate that net revenue decreased by $3 million, or 3 percent, for the nine months ended December 31, 2007.

Net revenue for the nine months ended December 31, 2007 increased 3 percent as compared to the nine months ended December 31, 2006. The deferral of net revenue related to certain of our packaged goods and digital content sales, which will be recognized in future periods, decreased our reported net revenue by $27 million[f] during the nine months ended December 31, 2007. From an operational perspective, the increase in net revenue was driven by (1) a $10 million increase in net revenue from sales of titles for the Nintendo DS, (2) a $9 million increase in net revenue from sales of titles for the Wii (which does not include an additional $1 million of deferred net revenue that will be recognized in future periods), and (3) a $9 million increase in net revenue from sales of titles of the PLAYSTATION 3 (which does not include an additional $10 million of deferred net revenue that will be recognized in future periods). These increases were partially offset by (1) a $7 million decrease in net revenue from sales of titles for the PC (which does not include an additional $3 million of deferred net revenue that will be recognized in future periods), (2) a $6 million decrease in net revenue from sales of titles for the PSP (which does not include an additional $3 million of deferred net revenue that will be recognized in future periods), and (3) a $5 million decrease in net revenue from sales of titles for the PlayStation 2 (which does not include an additional $5 million of deferred net revenue that will be recognized in future periods).

(e) The net deferral of $14 million of net revenue related to certain of our packaged goods and digital content sales during the three months ended December 31, 2007, which will be recognized in future periods, consisted of (1) $6 million of net revenue related to the PLAYSTATION 3, (2) $4 million of net revenue related to co-publishing and distribution titles, (3) $1 million of net revenue related to the PlayStation 2, (4) $1 million of net revenue related to the PC, (5) $1 million of net revenue related to the PSP, and (6) $1 million of net revenue related to the Wii.

(f) The net deferral of $27 million of net revenue related to certain of our packaged goods and digital content sales during the nine months ended December 31, 2007, which will be recognized in future periods, consisted of (1) $10 million of net revenue related to the PLAYSTATION 3, (2) $5 million of net revenue related to the PlayStation 2, (3) $4 million of net revenue related to co-publishing and distribution titles, (4) $3 million of net revenue related to the PC, (5) $3 million of net revenue related to the PSP, (6) $1 million of net revenue related to the Wii, and (7) $1 million of other net revenue.

Cost of Goods Sold

Cost of goods sold for our packaged-goods business consists of (1) product costs, (2) certain royalty expenses for celebrities, professional sports and other organizations and independent software developers, (3) manufacturing royalties, net of volume discounts and other vendor reimbursements, (4) expenses for defective products, (5) write-offs of post-launch prepaid royalty costs, (6) amortization of certain intangible assets, (7) personnel-related costs, and (8) distribution costs. We generally recognize volume discounts when they are earned from the manufacturer (typically in connection with the achievement of unit-based milestones), whereas other vendor reimbursements are generally recognized as the related revenue is recognized. Cost of goods sold for our online products consists primarily of data center and bandwidth costs associated with hosting our web sites, credit card fees and royalties for use of third-party properties. Cost of goods sold for our web site advertising business primarily consists of ad-serving costs.

Costs of goods sold for the three and nine months ended December 31, 2007 and 2006 were as follows (in millions):

	December 31, 2007	% of Net Revenue	December 31, 2006	% of Net Revenue	% Change	Change as a % of Net Revenue
Three months ended	$ 782	52.0%	$ 470	36.7%	66.4%	15.3%
Nine months ended	$ 1,342	52.9%	$ 977	39.4%	37.4%	13.5%

For the three months ended December 31, 2007, cost of goods sold increased by 15.3 percent as a percentage of total net revenue as compared to the three months ended December 31, 2006. This increase was primarily due to:

The increase in net deferrals of $231 million of net revenue related to certain online-enabled packaged goods and digital content. Overall, we estimate the revenue deferral negatively impacted cost of goods sold as a percent of total net revenue by 7 percent, and

Higher co-publishing and distribution royalty costs of approximately 9.5 percent as a percentage of total net revenue primarily driven by higher sales of titles from our co-publishing and distribution franchises that have a lower gross margin.

As a percentage of total net revenue, the increases above were partially offset by a decrease of approximately 1 percent in lower operations and warranty costs during the three months ended December 31, 2007 as compared to the three months ended December 31, 2006.

For the nine months ended December 31, 2007, cost of goods sold increased by 13.5 percent as a percentage of total net revenue as compared to the nine months ended December 31, 2006. This increase was primarily due to:

The increase in net deferrals of $563 million of net revenue related to certain online-enabled packaged goods and digital content. Overall, we estimate the revenue deferral negatively impacted cost of goods sold as a percent of total net revenue by 9.5 percent, and

Higher co-publishing and distribution royalty costs of approximately 5 percent as a percentage of total net revenue primarily driven by higher sales of titles from our co-publishing and distribution franchises that have a lower gross margin.

As a percentage of total net revenue, the increases above were partially offset by a decrease of approximately 1 percent in license royalty rates primarily due to a higher proportion of sales from our owned intellectual property franchises that have lower royalty rates during the nine months ended December 31, 2007 as compared to the nine months ended December 31, 2006.

Although there can be no assurance, and our actual results could differ materially, in the short term we expect our gross margin as a percentage of total net revenue to decline in fiscal 2008 as compared to fiscal 2007 as a result of (1) increased deferred net revenue related to certain online-enabled packaged goods (we recognize the expense of the cost of goods sold related to these transactions during the period in which the product is delivered) and (2) a higher mix of co-publishing and distribution net revenue that has a lower gross margin.

Marketing and Sales

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

Marketing and sales expenses for the three and nine months ended December 31, 2007 and 2006 were as follows (in millions):

	December 31, 2007	% of Net Revenue	December 31, 2006	% of Net Revenue	$ Change	% Change
Three months ended	$ 213	14%	$ 165	13%	$ 48	29%
Nine months ended	$ 459	18%	$ 350	14%	$ 109	31%

Marketing and sales expenses as a percentage of net revenue were adversely impacted by our deferral of net revenue related to online-enabled packaged goods and digital content during fiscal 2008.

For the three months ended December 31, 2007, marketing and sales expenses increased by $48 million, or 29 percent, as compared to the three months ended December 31, 2006. $44 million of the increase was for marketing,

advertising and promotional expenses primarily to support our launch of new franchises and incremental spend on recurring franchises.

For the nine months ended December 31, 2007, marketing and sales expenses increased by $109 million, or 31 percent, as compared to the nine months ended December 31, 2006. The increase was principally due to (1) an increase of $93 million in marketing, advertising and promotional expenses primarily to support our launch of new franchises and incremental spend on recurring franchises, as well as (2) an $18 million increase in additional personnel-related costs primarily resulting from an increase in headcount. These increases were partially offset by $7 million of incentive based compensation expense.

We expect marketing and sales expenses to increase in absolute dollars in fiscal 2008 as compared to fiscal 2007 primarily due to higher advertising and marketing activity to support our titles.

General and Administrative

General and administrative expenses consist of personnel and related expenses of executive and administrative staff, fees for professional services such as legal and accounting, and allowances for doubtful accounts.

General and administrative expenses for the three and nine months ended December 31, 2007 and 2006 were as follows (in millions):

	December 31, 2007	% of Net Revenue	December 31, 2006	% of Net Revenue	$ Change	% Change
Three months ended	$ 95	6%	$ 91	7%	$ 4	4%
Nine months ended	$ 250	10%	$ 222	9%	$ 28	13%

General and administrative expenses as a percentage of net revenue were adversely impacted by our deferral of net revenue related to online-enabled packaged goods and digital content during fiscal 2008.

For the three months ended December 31, 2007, general and administrative expenses increased by $4 million, or 4 percent, as compared to the three months ended December 31, 2006. The increase was primarily due to an increase of $7 million in additional personnel-related costs primarily due to an increase in headcount, offset by $5 million incentive-based compensation expense.

For the nine months ended December 31, 2007, general and administrative expenses increased by $28 million, or 13 percent, as compared to the nine months ended December 31, 2006. The increase was primarily due to (1) an increase in contracted services associated with IT systems initiatives and professional services of $13 million, (2) an increase of $13 million in additional personnel-related costs primarily due to an increase in headcount, and (3) an increase in facilities-related expenses of $11 million. These increases were partially offset by $5 million of incentive-based compensation expense.

We expect general and administrative expenses to increase in absolute dollars in fiscal 2008 as compared to fiscal 2007 primarily due to an increase in personnel-related costs.

Research and Development

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

Research and development expenses for the three and nine months ended December 31, 2007 and 2006 were as follows (in millions):

	December 31, 2007	% of Net Revenue	December 31, 2006	% of Net Revenue	$ Change	% Change
Three months ended	$ 321	21%	$ 330	26%	$ (9)	(3%)
Nine months ended	$ 829	33%	$ 783	32%	$ 46	6%

Research and development expenses as a percentage of net revenue were adversely impacted by our deferral of net revenue related to online-enabled packaged goods and digital content during fiscal 2008.

For the three months ended December 31, 2007, research and development expenses decreased by $9 million, or 3 percent, as compared to the three months ended December 31, 2006. The decrease was primarily due to $28 million of incentive-based compensation expense, partially offset by a $13 million increase in additional personnel-related costs.

For the nine months ended December 31, 2007, research and development expenses increased by $46 million, or 6 percent, as compared to the nine months ended December 31, 2006. The increase was primarily due to (1) an increase of $48 million in additional personnel-related costs, (2) higher external development costs of $30 million to support our new releases such as *Crysis*® and *The Simpsons Game*, and (3) an increase in facilities-related expenses of $7 million to support our research and development functions worldwide. These increases were partially offset by $38 million of incentive-based compensation expense.

We expect research and development expenses to increase in absolute dollars in fiscal 2008 as compared to fiscal 2007 primarily due to (1) a greater number of titles in development in fiscal 2008 as compared to fiscal 2007, and (2) our acquisition of VGH.

Acquired In-process Technology

In connection with the completion of our acquisition of VGH in January 2008, we expect to incur expenses related to acquired in-process technology associated with this acquisition during the three months ended March 31, 2008.

Restructuring Charges

Restructuring charges for the three and nine months ended December 31, 2007 and 2006 were as follows (in millions):

	December 31, 2007	% of Net Revenue	December 31, 2006	% of Net Revenue	$ Change	% Change
Three months ended	$ 78	5%	$ 2		$ 76	3800%
Nine months ended	$ 85	3%	$ 12		$ 73	608%

In connection with our fiscal 2008 reorganization, during the nine months ended December 31, 2007, we incurred approximately $81 million of reorganization charges, of which $44 million was for facilities-related expenses, $25 million was for other expenses including contracted services costs to assist in the reorganization of our business support functions, and $12 million was for employee-related expenses.

In connection with our fiscal 2006 international publishing reorganization, during the nine months ended December 31, 2007, we incurred approximately $4 million of employee-related expenses. During the nine months ended December 31, 2006, reorganization charges were approximately $12 million, of which $8 million was for

employee-related expenses.

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Interest and Other Income, Net

Interest and other income, net, for the three and nine months ended December 31, 2007 and 2006 were as follows (in millions):

	December 31, 2007	% of Net Revenue	December 31, 2006	% of Net Revenue	$ Change	% Change
Three months ended	$ 20	1%	$ 25	2%	$ (5)	(20%)
Nine months ended	$ 78	3%	$ 69	3%	$ 9	13%

For the three months ended December 31, 2007, interest and other income, net, decreased by $5 million, or 20 percent, as compared to the three months ended December 31, 2006, primarily due to the recognition of a $12 million impairment of our investment in Neowiz Corporation s common and preferred shares, partially offset by a $4 million gain recognized due to changes in foreign exchange rates.

For the nine months ended December 31, 2007, interest and other income, net, increased by $9 million, or 13 percent, as compared to the nine months ended December 31, 2006, primarily due to (1) an increase of $8 million in interest income resulting from higher yields on our cash, cash equivalent and short-term investment balances, (2) a $7 million gain recognized due to changes in foreign exchange rates, and (3) $6 million in net gains realized on sales of our short-term investments. These increases were partially offset by the recognition of a $12 million impairment of our investment in Neowiz Corporation s common and preferred shares.

As of December 31, 2007, we had gross unrealized gains of $588 million and gross unrealized losses of $84 million in our marketable security investments. Based on our review, we do not consider the investments with gross unrealized losses to be other-than-temporarily impaired as of December 31, 2007. We evaluate our investments for impairment quarterly. If we conclude that an investment is other-than-temporarily impaired, we will recognize an impairment charge in income at that time.

Income Taxes

Income tax expense (benefit) for the three and nine months ended December 31, 2007 and 2006 were as follows (in millions):

	December 31, 2007	Effective Tax Rate	December 31, 2006	Effective Tax Rate	% Change
Three months ended	$ 60	221.1%	$ 84	34.9%	(29%)
Nine months ended	$ (10)	2.9%	$ 83	45.9%	(112%)

The tax rate reported for the nine months ended December 31, 2007 is based on our projected annual effective tax rate for fiscal 2008. Our effective tax rates for the three and nine months ended December 31, 2007 were 221.1 percent and 2.9 percent, respectively. The volatility in our quarterly tax rate is primarily driven by the forecasted geographic mix of income, as well as impairment losses on investments and certain restructuring costs that result in zero tax benefits in the third quarter.

The overall effective income tax rate for the fiscal year could be different from the tax rates in effect for the three and nine months ended December 31, 2007 and will be dependent on our profitability for the remainder of the fiscal year. In addition, our effective income tax rates for the remainder of fiscal 2008 and future periods will depend on a variety of factors, including changes in our business such as acquisitions and intercompany transactions (for example, the

acquisition of and intercompany transactions relating to both Mythic and DICE in prior years, and the acquisition of VGH in fiscal 2008), changes in our international structure, changes in the geographic location of business functions or assets, changes in the geographic mix of income, as well as changes in, or termination of, our agreements with tax authorities, valuation allowances, applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audit and other matters, and variations in the estimated and actual level of annual pre-tax income or loss. We incur certain tax expenses that do not decline proportionately with declines in our pre-tax consolidated income or loss. As a result, in absolute dollar terms, our tax expense will have a greater influence on our effective tax rate at lower levels of pre-tax income or loss than at higher levels. In addition, at lower levels of pre-tax income or loss, our effective tax rate will be more volatile.

We historically have considered undistributed earnings of our foreign subsidiaries to be indefinitely reinvested outside of the United States and, accordingly, no U.S. taxes have been provided thereon. Although we repatriated funds under the American Jobs Creation Act of 2004 in fiscal 2006, we currently intend to continue to indefinitely reinvest the undistributed earnings of our foreign subsidiaries outside of the United States.

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Impact of Recently Issued Accounting Standards

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. Fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Fair value measurements would be separately disclosed by level within the fair value hierarchy. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of SFAS No. 157 to have a material impact on our Condensed Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. It also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The provisions of SFAS No. 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007. This Statement should not be applied retrospectively to fiscal years beginning prior to the effective date, except as permitted with early adoption. We are evaluating if we will adopt SFAS No. 159 and what impact the adoption will have on our Condensed Consolidated Financial Statements if we adopt. If we adopt SFAS No. 159, it could have a material impact on our Condensed Consolidated Financial Statements.

In June 2007, the FASB ratified the Emerging Issues Task Force s (EITF) consensus conclusion on EITF 07-03, *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development*. EITF 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under this conclusion, an entity is required to defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-03 is effective for interim or annual reporting periods in fiscal years beginning after December 15, 2007 and requires prospective application for new contracts entered into after the effective date. We do not expect the adoption of EITF 07-03 to have a material impact on our Condensed Consolidated Financial Statements.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007) (SFAS No. 141(R)), *Business Combinations*, which requires the recognition of assets acquired, liabilities assumed, and any noncontrolling interest in an acquiree at the acquisition date fair value with limited exceptions. SFAS No. 141(R) will change the accounting treatment for certain specific items and includes a substantial number of new disclosure requirements. SFAS No. 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of SFAS No. 141(R) will have a material impact on our Condensed Consolidated Financial Statements for acquisitions consummated after April 1, 2009.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51*, which establishes new accounting and reporting standards for noncontrolling interest (minority interest) and for the deconsolidation of a subsidiary. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We do not expect the adoption of SFAS No. 160 to have a material impact on our Condensed Consolidated Financial Statements.

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LIQUIDITY AND CAPITAL RESOURCES

(In millions)	As of December 31, 2007	As of March 31, 2007	Increase/ (Decrease)
Cash and cash equivalents	$ 1,878	$ 1,371	$ 507
Short-term investments	705	1,264	(559)
Marketable equity securities	837	341	496
Total	$ 3,420	$ 2,976	$ 444
Percentage of total assets	53%	58%	

(In millions)	Nine Months Ended December 31, 2007	2006	Increase/ (Decrease)
Cash provided by operating activities	$ 53	$ 183	$ (130)
Cash provided by (used in) investing activities	221	(388)	609
Cash provided by financing activities	205	146	59
Effect of foreign exchange on cash and cash equivalents	28	16	12
Net increase (decrease) in cash and cash equivalents	$ 507	$ (43)	$ 550

Changes in Cash Flow

During the nine months ended December 31, 2007, we generated $53 million of cash from operating activities as compared to $183 million for the nine months ended December 31, 2006. The decrease in cash provided by operating activities for the nine months ended December 31, 2007 as compared to the nine months ended December 31, 2006 was primarily due to (1) an increase in operating expenses paid resulting from an increase in advertising and marketing costs, external development expenses and personnel-related expenses, and (2) a $90 million increase in incentive-based compensation payments made in fiscal 2008 related to fiscal 2007.

For the nine months ended December 31, 2007, we generated $1,978 million of cash proceeds from maturities and sales of short-term investments and $160 million in proceeds from sales of common stock through our stock-based compensation plans. Our primary use of cash in non-operating activities consisted of $1,388 million used to purchase short-term investments and $277 million used to purchase marketable equitable securities and investments in affiliates.

Short-term investments and marketable equity securities

Due to our mix of fixed and variable rate securities, our short-term investment portfolio is susceptible to changes in short-term interest rates. As of December 31, 2007, our short-term investments had gross unrealized gains of $4 million, or 1 percent of the total in short-term investments. From time to time, we may liquidate some or all of our short-term investments to fund operational needs or other activities, such as capital expenditures, business acquisitions or stock repurchase programs. Depending on which short-term investments we liquidate to fund these activities, we could recognize a portion, or all, of the gross unrealized gains. As of December 31, 2007, we had no intention of selling any short-term investments that had an unrealized loss.

Marketable equity securities increased to $837 million as of December 31, 2007, from $341 million as of March 31, 2007. This increase was primarily due to (1) an increase of $339 million in the fair value of our investment in Ubisoft Entertainment, and (2) our fiscal 2008 investments in The9 and Neowiz common stock, which had a combined fair value of $157 million as of December 31, 2007.

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Receivables, net

Our gross accounts receivable balances were $1,089 million and $470 million as of December 31, 2007 and March 31, 2007, respectively. The increase in our accounts receivable balance was primarily due to higher sales volumes in the third quarter of fiscal 2008 as compared to the fourth quarter of fiscal 2007, which was expected as we traditionally have higher sales during our third fiscal quarter as compared to our fourth fiscal quarter. We expect our accounts receivable balance to decrease during the three months ending March 31, 2008 based on our collections and our lower sales volume. Reserves for sales returns, pricing allowances and doubtful accounts increased in absolute dollars from $214 million as of March 31, 2007 to $259 million as of December 31, 2007. As a percentage of trailing nine month net revenue, reserves increased from 8 percent as of March 31, 2007, to 10 percent as of December 31, 2007. The 2 percent increase was primarily due to an increase in deferred net revenue that will be recognized in future periods. We believe these reserves are adequate based on historical experience and our current estimate of potential returns, pricing allowances and doubtful accounts.

Inventories

Inventories increased to $178 million as of December 31, 2007, from $62 million as of March 31, 2007 primarily as a result of our *Rock Band* inventory in the amount of $59 million of which approximately $35 million was in-transit as of December 31, 2007, as well as the seasonality and growth of our business.

Other current assets

Other current assets increased to $347 million as of December 31, 2007, from $219 million as of March 31, 2007, primarily due to the reclassification of our Chertsey, England facility from property and equipment, net, to other current assets as an asset held for sale, our loan advance to VGH and an increase in vendor rebates. In January 2008, we completed our acquisition of VGH.

Accounts payable

Accounts payable increased to $371 million as of December 31, 2007, from $180 million as of March 31, 2007, primarily due to higher expenditures during the third quarter of fiscal 2008 as compared to the fourth quarter of fiscal 2007 as a result of the higher inventory purchases and marketing expenditures in conjunction with the seasonality of our business.

Accrued and other current liabilities

Our accrued and other current liabilities decreased to $782 million as of December 31, 2007 from $814 million as of March 31, 2007. The decrease was primarily due to (1) $283 million of current income taxes accrued being reclassified to long-term income tax obligations as a result of our adoption of FIN No. 48 (see Note 8 of the Notes to Condensed Consolidated Financial Statements), and (2) a decrease of $48 million in accrued incentive-based compensation. These decreases were partially offset by an increase of $140 million in royalties payable and $50 million in value-added taxes payable.

Deferred income taxes, net

Our net deferred income tax asset position increased by $100 million as of December 31, 2007 as compared to March 31, 2007 primarily due to increases of (1) $38 million in deferred tax assets related to stock-based compensation, (2) $36 million in deferred tax assets related to the adoption of FIN No. 48, and (3) $28 million in deferred tax assets resulting from the tax benefit we recognized related to our operating loss during the nine months ended December 31, 2007.

Financial Condition

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

In January 2008, we completed our acquisition of VGH and paid approximately $620 million in cash to the stockholders of VGH.

The loan financing arrangements supporting our Redwood City headquarters leases with Keybank National Association, described in the Off-Balance Sheet Commitments section below, are scheduled to expire in July 2008. Upon expiration of the financing, we may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor s loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009, otherwise the leases will terminate. Upon expiration of the leases, we may purchase the facilities for $247 million, or arrange for a sale of the facilities to a third party. In the event of a sale to a third party, if the sale price is less than $247 million, we will be obligated to reimburse the difference between the actual sale price and $247 million, up to maximum of $222 million, subject to certain provisions of the leases.

As of December 31, 2007, approximately $1,384 million of our cash, cash equivalents, short-term investments and marketable equity securities that was generated from operations was domiciled in foreign tax jurisdictions. While we have no plans to repatriate these funds to the United States in the short term, if we choose to do so, we would accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

We have a shelf registration statement on Form S-3 on file with the SEC. This shelf registration statement, which includes a base prospectus, allows us at any time to offer any combination of securities described in the prospectus in one or more offerings up to a total amount of $2 billion. Unless otherwise specified in a prospectus supplement accompanying the base prospectus, we would use the net proceeds from the sale of any securities offered pursuant to the shelf registration statement for general corporate purposes, including for working capital, financing capital expenditures, research and development, marketing and distribution efforts and, if opportunities arise, for acquisitions or strategic alliances. Pending such uses, we may invest the net proceeds in interest-bearing securities. In addition, we may conduct concurrent or other financings at any time.

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

Contractual Obligations and Commercial Commitments

Development, Celebrity, League and Content Licenses: Payments and Commitments

The products we produce in our studios are designed and created by our employee designers, artists, software programmers and by non-employee software developers (independent artists or third-party developers). We typically advance development funds to the independent artists and third-party developers during development of our games, usually in installment payments made upon the completion of specified development milestones. Contractually, these payments are generally considered advances against subsequent royalties on the sales of the products. These terms are set forth in written agreements entered into with the independent artists and third-party developers.

In addition, we have certain celebrity, league and content license contracts that contain minimum guarantee payments and marketing commitments that may not be dependent on any deliverables. Celebrities and organizations with whom we have contracts include: FIFA, FIFPRO Foundation, UEFA and FAPL (Football Association Premier League Limited) (professional soccer); NASCAR (stock car racing); National Basketball Association (professional basketball); PGA TOUR and Tiger Woods (professional golf); National Hockey League and NHL Players Association (professional hockey); Warner Bros. (Harry Potter and Batman); New Line Productions and Saul Zaentz Company (The Lord of the Rings); Red Bear Inc. (John Madden); National Football League Properties and PLAYERS Inc. (professional football); Collegiate Licensing Company (collegiate football and basketball); Viacom Consumer Products (The Godfather); ESPN (content in EA SPORTS™ games); Twentieth Century Fox Licensing and

Merchandising (The Simpsons); and Hasbro, Inc. (a wide array of Hasbro intellectual properties). These developer and content license commitments represent the sum of (1) the cash payments due under non-royalty-bearing licenses and services agreements, and (2) the minimum guaranteed payments and advances against royalties due under royalty-bearing

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licenses and services agreements, the majority of which are conditional upon performance by the counterparty. These minimum guarantee payments and any related marketing commitments are included in the table below.
The following table summarizes our minimum contractual obligations and commercial commitments as of December 31, 2007, and the effect we expect them to have on our liquidity and cash flow in future periods (in millions):

Fiscal Year Ending March 31,	Contractual Obligations			Commercial Commitments	
	Leases [1]	Developer/ Licensor Commitments [2]	Marketing	Letter of Credit, Bank and Other Guarantees	Total
2008 (remaining three months)	$ 15	$ 47	$ 7	$ 5	$ 74
2009	57	204	34		295
2010	42	184	39		265
2011	32	237	41		310
2012	28	77	25		130
Thereafter	63	677	185		925
Total	$ 237	$ 1,426	$ 331	$ 5	$ 1,999

(1) See discussion on operating leases in the Off-Balance Sheet Commitments section below for additional information. Lease commitments include contractual rental commitments of $14 million under real estate leases for unutilized office space resulting from our restructuring activities. These amounts, net of estimated future sub-lease income, were expensed in the periods of the related restructuring and are included in our

accrued and other current liabilities reported on our Condensed Consolidated Balance Sheets as of December 31, 2007. See Note 5 of the Notes to Condensed Consolidated Financial Statements.

(2) Developer/licensor commitments include $12 million of commitments to developers or licensors that have been recorded in current and long-term liabilities and a corresponding amount in current and long-term assets in our Condensed Consolidated Balance Sheets as of December 31, 2007 because payment is not contingent upon performance by the developer or licensor.

The amounts represented in the table above reflect our minimal cash obligations for the respective fiscal years, but do not necessarily represent the periods in which they will be expensed in our Condensed Consolidated Financial Statements.

In addition to what is included in the table above, as discussed in Note 8 of the Notes to Condensed Consolidated Financial Statements, we adopted the provisions of FIN No. 48. As of December 31, 2007, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling $341 million, of which approximately $41 million is offset by prior cash deposits to tax authorities for issues pending resolution. For the remaining liability, we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

The commitments table disclosed above does not include any commitments related to our acquisition of VG Holding Corp., which are described below.

Acquisition of VG Holding Corp.

In October 2007, we entered into a definitive merger agreement to acquire all of the outstanding capital stock of VG Holding Corp. (VGH), owner of both BioWare Corp. and Pandemic Studios, LLC, which create action, adventure and role-playing games. VGH is headquartered in Menlo Park, California. BioWare Corp. and Pandemic Studios are located in Edmonton, Canada; Los Angeles, California; Austin, Texas; and Brisbane, Australia. In January 2008, we completed our acquisition of VGH and paid approximately $620 million in cash to the stockholders of VGH and issued approximately $160 million in equity-based awards to certain key employees of BioWare and Pandemic. These awards are subject to time-based or performance-based vesting criteria. In addition, we loaned VGH $30 million during the period from October 2007 through the completion of the acquisition.

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OFF-BALANCE SHEET COMMITMENTS

Lease Commitments and Residual Value Guarantees

We lease certain of our current facilities, furniture and equipment under non-cancelable operating lease agreements. We are required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and will be required to pay any increases over the base year of these expenses on the remainder of our facilities.

In February 1995, we entered into a build-to-suit lease (Phase One Lease) with a third-party lessor for our headquarters facilities in Redwood City, California (Phase One Facilities). The Phase One Facilities comprise a total of approximately 350,000 square feet and provide space for sales, marketing, administration and research and development functions. In July 2001, the lessor refinanced the Phase One Lease with Keybank National Association through July 2006. The Phase One Lease expires in January 2039, subject to early termination in the event the underlying financing between the lessor and its lenders is not extended. Subject to certain terms and conditions, we may purchase the Phase One Facilities or arrange for the sale of the Phase One Facilities to a third party.

Pursuant to the terms of the Phase One Lease, we have an option to purchase the Phase One Facilities at any time for a purchase price of $132 million. In the event of a sale to a third party, if the sale price is less than $132 million, we will be obligated to reimburse the difference between the actual sale price and $132 million, up to a maximum of $117 million, subject to certain provisions of the Phase One Lease, as amended.

On May 26, 2006, the lessor extended its loan financing underlying the Phase One Lease with its lenders through July 2007, and on May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor s loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009; otherwise the lease will terminate. We account for the Phase One Lease arrangement as an operating lease in accordance with SFAS No. 13, *Accounting for Leases* , as amended.

In December 2000, we entered into a second build-to-suit lease (Phase Two Lease) with Keybank National Association for a five and one-half year term beginning in December 2000 to expand our Redwood City, California headquarters facilities and develop adjacent property (Phase Two Facilities). Construction of the Phase Two Facilities was completed in June 2002. The Phase Two Facilities comprise a total of approximately 310,000 square feet and provide space for sales, marketing, administration and research and development functions. Subject to certain terms and conditions, we may purchase the Phase Two Facilities or arrange for the sale of the Phase Two Facilities to a third party.

Pursuant to the terms of the Phase Two Lease, we have an option to purchase the Phase Two Facilities at any time for a purchase price of $115 million. In the event of a sale to a third party, if the sale price is less than $115 million, we will be obligated to reimburse the difference between the actual sale price and $115 million, up to a maximum of $105 million, subject to certain provisions of the Phase Two Lease, as amended.

On May 26, 2006, the lessor extended the Phase Two Lease through July 2009 subject to early termination in the event the underlying loan financing between the lessor and its lenders is not extended. Concurrently with the extension of the lease, the lessor extended the loan financing underlying the Phase Two Lease with its lenders through July 2007. On May 14, 2007, the lenders extended this financing again for an additional year through July 2008. We may request, on behalf of the lessor and subject to lender approval, an additional one-year extension of the loan financing between the lessor and the lenders. In the event the lessor s loan financing with the lenders is not extended, we may loan to the lessor approximately 90 percent of the financing, and require the lessor to extend the remainder through July 2009, otherwise the lease will terminate. We account for the Phase Two Lease arrangement as an operating lease in accordance with SFAS No. 13, as amended.

We believe that, as of December 31, 2007, the estimated fair values of both properties under these operating leases exceeded their respective guaranteed residual values.

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The two lease agreements with Keybank National Association described above require us to maintain certain financial covenants as shown below, all of which we were in compliance with as of December 31, 2007.

Financial Covenants		Requirement		Actual as of December 31, 2007
Consolidated Net Worth (in millions)		equal to or greater than	$ 2,430	$ 4,303
Fixed Charge Coverage Ratio		equal to or greater than	3.00	4.56
Total Consolidated Debt to Capital		equal to or less than	60%	5.4%
Quick Ratio	Q1 & Q2	equal to or greater than	1.00	N/A
	Q3 & Q4	equal to or greater than	1.75	11.65

Director Indemnity Agreements

We have entered into indemnification agreements with each of the members of our Board of Directors at the time they joined the Board to indemnify them to the extent permitted by law against any and all liabilities, costs, expenses, amounts paid in settlement and damages incurred by the directors as a result of any lawsuit, or any judicial, administrative or investigative proceeding in which the directors are sued or charged as a result of their service as members of our Board of Directors.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

MARKET RISK

We are exposed to various market risks, including changes in foreign currency exchange rates, interest rates and market prices. Market risk is the potential loss arising from changes in market rates and market prices. We employ established policies and practices to manage these risks. Foreign exchange option and forward contracts are used to hedge anticipated exposures or mitigate some existing exposures subject to foreign exchange risk as discussed below. We have not historically, nor do we currently, hedge our short-term investment portfolio. We do not consider our cash and cash equivalents to be exposed to significant interest rate risk because our cash and cash equivalent portfolio consists of highly liquid investments with original maturities of three months or less. We also do not currently hedge our market price risk relating to our equity investments. Further, we do not enter into derivatives or other financial instruments for trading or speculative purposes.

Foreign Currency Exchange Rate Risk

Cash Flow Hedging Activities. From time to time, we hedge a portion of our foreign currency risk related to forecasted foreign-currency-denominated sales and expense transactions by purchasing option contracts that generally have maturities of 15 months or less. These transactions are designated and qualify as cash flow hedges. The derivative assets associated with our hedging activities are recorded at fair value in other current assets in our Condensed Consolidated Balance Sheets. The effective portion of gains or losses resulting from changes in fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income in stockholders equity and subsequently reclassified into net revenue or operating expenses, as appropriate in the period when the forecasted transaction is recorded. The ineffective portion of gains or losses resulting from changes in fair value, if any, is reported in each period in interest and other income, net, in our Condensed Consolidated Statements of Operations. Our hedging programs are designed to reduce, but do not entirely eliminate, the impact of currency exchange rate movements in revenue and operating expenses. As of December 31, 2007, we had foreign currency option contracts to purchase approximately $45 million in foreign currencies and to sell approximately $183 million of foreign currencies. As of December 31, 2007, these foreign currency option contracts outstanding had a total fair value of $6 million, included in other current assets.

Balance Sheet Hedging Activities. We use foreign exchange forward contracts to mitigate foreign currency risk associated with foreign-currency-denominated assets and liabilities, primarily intercompany receivables and payables. The forward contracts generally have a contractual term of three months or less and are transacted near month-end. Our foreign exchange forward contracts are not designated as hedging instruments under SFAS No. 133 and are accounted for as derivatives whereby the fair value of the contracts are reported as other current assets or other current liabilities in our Condensed Consolidated Balance Sheets, and gains and losses from changes in fair value are reported in interest and other income, net. The gains and losses on these forward contracts generally offset the gains and losses on the underlying foreign-currency-denominated assets and liabilities, which are also reported in interest and other income, net, in our Condensed Consolidated Statements of Operations. As of December 31, 2007, we had forward foreign exchange contracts to purchase and sell approximately $547 million in foreign currencies. Of this amount, $521 million represented contracts to sell foreign currencies in exchange for U.S. dollars and $26 million to sell foreign currencies in exchange for British pounds sterling. The fair value of our forward contracts was immaterial as of December 31, 2007.

The counterparties to these forward and option contracts are creditworthy multinational commercial banks; therefore, the risk of counterparty nonperformance is not considered to be material.

Notwithstanding our efforts to mitigate some foreign currency exchange rate risks, there can be no assurance that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations. As of December 31, 2007, a hypothetical adverse foreign currency exchange rate movement of 10 percent or 15 percent would result in a potential loss in fair value of our option contracts used in cash flow hedging of $5 million in both scenarios. A hypothetical adverse foreign currency exchange rate movement of 10 percent or 15 percent would result in potential losses on our forward contracts used in balance sheet hedging of $52 million and $77 million, respectively, as of December 31, 2007. This sensitivity analysis assumes a parallel adverse shift in foreign currency exchange rates, which do not always move in the same direction. Actual results may differ materially.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our short-term investment portfolio. We manage our interest rate risk by maintaining an investment portfolio generally consisting of debt instruments of high credit quality and relatively short maturities. Additionally, the contractual terms of the securities do not permit the issuer to call, prepay or otherwise settle the securities at prices less than the stated par value of the securities. Our investments are held for purposes other than trading. Also, we do not use derivative financial instruments in our short-term investment portfolio.

As of December 31, 2007 and March 31, 2007, our short-term investments were classified as available-for-sale and, consequently, recorded at fair market value with unrealized gains or losses resulting from changes in fair value reported as a separate component of accumulated other comprehensive income, net of any tax effects, in stockholders equity. Our portfolio of short-term investments consisted of the following investment categories, summarized by fair value as of December 31, 2007 and March 31, 2007 (in millions):

	As of December 31, 2007	As of March 31, 2007
Corporate bonds	$ 271	$ 226
U.S. agency securities	142	264
Commercial paper	121	574
Asset-backed securities	101	108
U.S. Treasury securities	70	92
Total short-term investments	$ 705	$ 1,264

Notwithstanding our efforts to manage interest rate risks, there can be no assurance that we will be adequately protected against risks associated with interest rate fluctuations. At any time, a sharp change in interest rates could have a significant impact on the fair value of our investment portfolio. The following table presents the hypothetical changes in fair value in our short-term investment portfolio as of December 31, 2007, arising from potential changes in interest rates. The modeling technique estimates the change in fair value from immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points (BPS), 100 BPS, and 150 BPS.

(In millions)	Valuation of Securities Given an Interest Rate Decrease of X Basis Points			Fair Value as of December 31,	Valuation of Securities Given an Interest Rate Increase of X Basis Points		
	(150 BPS)	(100 BPS)	(50 BPS)	2007	50 BPS	100 BPS	150 BPS
Corporate bonds	$ 277	$ 275	$ 274	$ 271	$ 269	$ 268	$ 266
U.S. agency securities	145	144	143	142	141	140	139
Commercial paper	121	121	121	121	121	121	121
Asset-backed securities	102	102	101	101	101	100	100
U.S. Treasury securities	72	71	70	70	69	68	67
Total short-term investments	$ 717	$ 713	$ 709	$ 705	$ 701	$ 697	$ 693

Market Price Risk

The value of our equity investments in publicly traded companies is subject to market price volatility. As of December 31, 2007 and March 31, 2007, our marketable equity securities were classified as available-for-sale and, consequently, were recorded in our Condensed Consolidated Balance Sheets at fair market value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income, net of any tax effects, in stockholders equity. The fair value of our marketable equity securities was $837 million and $341 million as of December 31, 2007 and March 31, 2007, respectively.

At any time, a sharp change in market prices in our investments in marketable equity securities could have a significant impact on the fair value of our investments. The following table presents hypothetical changes in the fair value of our marketable equity securities as of December 31, 2007, arising from changes in market prices plus or minus 25 percent, 50 percent and 75 percent.

(In millions)	Valuation of Securities Given an X Percentage Decrease in Each Stock s Market Price			Fair Value as of December 31, 2007	Valuation of Securities Given an X Percentage Increase in Each Stock s Market Price		
	(75%)	(50%)	(25%)		25%	50%	75%
Marketable equity securities	$ 209	$ 419	$ 628	$ 837	$ 1,046	$ 1,256	$ 1,465

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Item 4. Controls and Procedures

Definition and limitations of disclosure controls

Our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this report, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial and Administrative Officer, as appropriate to allow timely decisions regarding required disclosure. Our management evaluates these controls and procedures on an ongoing basis.

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

Evaluation of disclosure controls and procedures

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

Changes in internal control over financial reporting

During the quarter ended December 31, 2007, no changes occurred in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to claims and litigation arising in the ordinary course of business. We do not believe that any liability from any reasonably foreseeable disposition of such claims and litigation, individually or in the aggregate, would have a material adverse effect on our consolidated financial position or results of operations.

Item 1A. Risk Factors

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

Our business is highly dependent on the success and availability of video game hardware systems manufactured by third parties, as well as our ability to develop commercially successful products for these systems.

We derive most of our revenue from the sale of products for play on video game hardware systems (which we also refer to as platforms) manufactured by third parties, such as Sony s PlayStation 2 and PLAYSTATION 3, Microsoft s Xbox 360 and Nintendo s Wii. The success of our business is driven in large part by the commercial success and adequate supply of these video game hardware systems, our ability to accurately predict which systems will be successful in the marketplace, and our ability to develop commercially successful products for these systems. We must make product development decisions and commit significant resources well in advance of anticipated product ship dates. A platform for which we are developing products may not succeed or may have a shorter life cycle than anticipated. If consumer demand for the systems for which we are developing products is lower than our expectations, our revenue will suffer, we may be unable to fully recover the investments we have made in developing our products, and our financial performance will be harmed. Alternatively, a system for which we have not devoted significant resources could be more successful than we had initially anticipated, causing us to miss out on meaningful revenue opportunities.

Our industry is cyclical and is in the early stage of the current cycle. During the transition, consumers may be slower to adopt new video game systems than we anticipate, and our operating results may suffer and become more difficult to predict.

Video game hardware systems have historically had a life cycle of four to six years, which causes the video game software market to be cyclical as well. Microsoft launched the Xbox 360 in November 2005, while Sony and Nintendo launched the PLAYSTATION 3 and the Wii, respectively, in November 2006. We have continued to develop and market new titles for prior-generation video game systems such as the PlayStation 2 while also making significant investments in products for the new systems. As prior-generation systems reach the end of their life cycle and the installed base of the new systems continues to grow, our sales of video games for prior-generation systems will continue to decline as (1) we produce fewer titles for prior-generation systems, (2) consumers replace their prior-generation systems with the new systems, and/or (3) consumers defer game software purchases until they are able to purchase a new video game hardware system. This decline in prior-generation product sales may be greater or faster than we anticipate, and sales of products for the new platforms may be lower or increase more slowly than we anticipate. Moreover, we expect development costs for the new video game systems to be greater on a per-title basis than development costs for prior-generation video game systems. As a result of these factors, during the next several quarters, we expect our operating results to be more volatile and difficult to predict, which could cause our stock price to fluctuate significantly.

If we do not consistently meet our product development schedules, our operating results will be adversely affected.

Our business is highly seasonal, with the highest levels of consumer demand and a significant percentage of our sales occurring in the December quarter. In addition, we seek to release many of our products in conjunction with specific events, such as the release of a related movie or the beginning of a sports season or major sporting event. If we miss

these key selling periods for any reason, including product delays or delayed introduction of a new platform for which we have developed products, our sales will suffer disproportionately. Likewise, if a key event to which our product release schedule is tied were to be delayed or

cancelled, our sales would also suffer disproportionately. Our ability to meet product development schedules is affected by a number of factors, including the creative processes involved, the coordination of large and sometimes geographically dispersed development teams required by the increasing complexity of our products and the platforms for which they are developed, and the need to fine-tune our products prior to their release. We have experienced development delays for our products in the past, which caused us to push back release dates. In the future, any failure to meet anticipated production or release schedules would likely result in a delay of revenue and/or possibly a significant shortfall in our revenue, harm our profitability, and cause our operating results to be materially different than anticipated.

Our business is intensely competitive and hit driven. If we do not continue to deliver hit products and services or if consumers prefer our competitors products or services over our own, our operating results could suffer.

Competition in our industry is intense and we expect new competitors to continue to emerge in the United States and abroad. While many new products and services are regularly introduced, only a relatively small number of hit titles accounts for a significant portion of total revenue in our industry. Hit products or services offered by our competitors may take a larger share of consumer spending than we anticipate, which could cause revenue generated from our products and services to fall below expectations. If our competitors develop more successful products or services, offer competitive products or services at lower price points or based on payment models perceived as offering a better value proposition (such as pay-for-play or subscription-based models), or if we do not continue to develop consistently high-quality and well-received products and services, our revenue, margins, and profitability will decline.

We are in the process of reorganizing our business and operating structure. We may encounter a variety of issues in connection with the reorganization that could negatively impact our operating results, financial condition and ability to report our financial results.

In an effort to streamline our internal decision-making processes, improve our global focus, and accelerate the process of bringing new ideas to market, we have begun to reorganize our business into several new divisions, including four new Labels : The Sims, EA Games, EA SPORTS, and EA Casual Entertainment. The reorganization will present a number of operational challenges, which, if not successfully managed, could cause our operating results to suffer in the near-term and/or delay or inhibit the anticipated benefits of the reorganization. Implementing any reorganization necessarily requires time and focus from all levels of the organization time and focus that may be taken away from other business needs. For example, as our employees assume new responsibilities under the new structure, their responsibilities under the old structure may not be successfully re-assigned or adequately addressed, which could result in operational problems that negatively impact our financial condition and operating results. Similarly, as our employees roles and responsibilities change in a new structure, it is possible that we could experience a greater loss of key personnel than we have historically. Further, in connection with the reorganization, we anticipate that we will need to align some of our internal financial controls and procedures with our new organizational structure. Any delay or failure to align our internal controls over financial reporting could prevent us from reporting our financial results in a timely manner or lead to control deficiencies.

Technology changes rapidly in our business and if we fail to anticipate or successfully implement new technologies or the manner in which people play our games, the quality, timeliness and competitiveness of our products and services will suffer.

Rapid technology changes in our industry require us to anticipate, sometimes years in advance, which technologies we must implement and take advantage of in order to make our products and services competitive in the market. Therefore, we usually start our product development with a range of technical development goals that we hope to be able to achieve. We may not be able to achieve these goals, or our competition may be able to achieve them more quickly and effectively than we can. In either case, our products and services may be technologically inferior to our competitors , less appealing to consumers, or both. If we cannot achieve our technology goals within the original development schedule of our products and services, then we may delay their release until these technology goals can be achieved, which may delay or reduce revenue and increase our development expenses. Alternatively, we may increase the resources employed in research and development in an attempt to accelerate our development of new technologies, either to preserve our product or service launch schedule or to keep up with our competition, which would increase our development expenses.

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The video game hardware manufacturers set the royalty rates and other fees that we must pay to publish games for their platforms, and therefore have significant influence on our costs. If one or more of these manufacturers adopt a different fee structure for future game consoles, our profitability will be materially impacted.

In order to publish products for a video game system such as the Xbox 360, PLAYSTATION 3 or Wii, we must take a license from the manufacturer, which gives it the opportunity to set the fee structure that we must pay in order to publish games for that platform. Similarly, certain manufacturers have retained the flexibility to change their fee structures, or adopt different fee structures for online gameplay and other new features for their consoles. The control that hardware manufacturers have over the fee structures for their platforms and online access makes it difficult for us to predict our costs, profitability and impact on margins. Because publishing products for video game systems is the largest portion of our business, any increase in fee structures would significantly harm our ability to generate revenues and/or profits.

The video game hardware manufacturers are among our chief competitors and frequently control the manufacturing of and/or access to our video game products. If they do not approve our products, we will be unable to ship to our customers.

Our agreements with hardware licensors (such as Sony for the PLAYSTATION 3, Microsoft for the Xbox 360, and Nintendo for the Wii) typically give significant control to the licensor over the approval and manufacturing of our products, which could, in certain circumstances, leave us unable to get our products approved, manufactured and shipped to customers. These hardware licensors are also among our chief competitors. Generally, control of the approval and manufacturing process by the hardware licensors increases both our manufacturing lead times and costs as compared to those we can achieve independently. While we believe that our relationships with our hardware licensors are currently good, the potential for these licensors to delay or refuse to approve or manufacture our products exists. Such occurrences would harm our business and our financial performance.

We also require compatibility code and the consent of Microsoft, Sony and Nintendo in order to include online capabilities in our products for their respective platforms. As online capabilities for video game systems become more significant, Microsoft, Sony and Nintendo could restrict the manner in which we provide online capabilities for our products. If Microsoft, Sony or Nintendo refused to approve our products with online capabilities or significantly impacted the financial terms on which these services are offered to our customers, our business could be harmed.

If we are unable to maintain or acquire licenses to intellectual property, we will publish fewer hit titles and our revenue, profitability and cash flows will decline. Competition for these licenses may make them more expensive and increase our costs.

Many of our products are based on or incorporate intellectual property owned by others. For example, our EA SPORTS products include rights licensed from major sports leagues and players associations. Similarly, many of our other hit franchises, such as The Godfather, Harry Potter and Lord of the Rings, are based on key film and literary licenses. Competition for these licenses is intense. If we are unable to maintain these licenses or obtain additional licenses with significant commercial value, our revenues and profitability will decline significantly. Competition for these licenses may also drive up the advances, guarantees and royalties that we must pay to the licensor, which could significantly increase our costs.

Our business is subject to risks generally associated with the entertainment industry, any of which could significantly harm our operating results.

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

If we do not continue to attract and retain key personnel, we will be unable to effectively conduct our business.

The market for technical, creative, marketing and other personnel essential to the development and marketing of our products and management of our businesses is extremely competitive. Our leading position within the interactive

entertainment industry makes us a prime target for recruiting of executives and key creative talent. If we cannot successfully recruit and retain the

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employees we need, or replace key employees following their departure, our ability to develop and manage our business will be impaired.

If patent claims continue to be asserted against us, we may be unable to sustain our current business models or profits, or we may be precluded from pursuing new business opportunities in the future.

Many patents have been issued that may apply to widely-used game technologies, or to potential new modes of delivering, playing or monetizing game software products. For example, infringement claims under many issued patents are now being asserted against interactive software or online game sites. Several such claims have been asserted against us. We incur substantial expenses in evaluating and defending against such claims, regardless of the merits of the claims. In the event that there is a determination that we have infringed a third-party patent, we could incur significant monetary liability and be prevented from using the rights in the future, which could negatively impact our operating results. We may also discover that future opportunities to provide new and innovative modes of game play and game delivery to consumers may be precluded by existing patents that we are unable to license on reasonable terms.

Other intellectual property claims may increase our product costs or require us to cease selling affected products.

Many of our products include extremely realistic graphical images, and we expect that as technology continues to advance, images will become even more realistic. Some of the images and other content are based on real-world examples that may inadvertently infringe upon the intellectual property rights of others. Although we believe that we make reasonable efforts to ensure that our products do not violate the intellectual property rights of others, it is possible that third parties still may claim infringement. From time to time, we receive communications from third parties regarding such claims. Existing or future infringement claims against us, whether valid or not, may be time consuming and expensive to defend. Such claims or litigations could require us to stop selling the affected products, redesign those products to avoid infringement, or obtain a license, all of which would be costly and harm our business.

From time to time we may become involved in other legal proceedings which could adversely affect us.

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

Our business, our products and our distribution are subject to increasing regulation of content, consumer privacy, distribution and online hosting and delivery in the key territories in which we conduct business. If we do not successfully respond to these regulations, our business may suffer.

Legislation is continually being introduced that may affect both the content of our products and their distribution. For example, data and consumer protection laws in the United States and Europe impose various restrictions on our web sites. Those rules vary by territory although the Internet recognizes no geographical boundaries. Other countries, such as Germany, have adopted laws regulating content both in packaged games and those transmitted over the Internet that are stricter than current United States laws. In the United States, the federal and several state governments are continually considering content restrictions on products such as ours, as well as restrictions on distribution of such products. For example, recent legislation has been adopted in several states, and could be proposed at the federal level, that prohibits the sale of certain games (e.g., violent games or those with M (Mature) or AO (Adults Only) ratings) to minors. Any one or more of these factors could harm our business by limiting the products we are able to offer to our customers, by limiting the size of the potential market for our products, and by requiring costly additional differentiation between products for different territories to address varying regulations.

If one or more of our titles were found to contain hidden, objectionable content, our business could suffer.

Throughout the history of our industry, many video games have been designed to include certain hidden content and gameplay features that are accessible through the use of in-game cheat codes or other technological means that are intended to enhance the gameplay experience. However, in several recent cases, hidden content or features have been found to be included in other publishers products by an employee who was not authorized to do so or by an outside developer without the knowledge of the publisher. From time to time, some hidden content and features have contained profanity, graphic violence and sexually explicit or otherwise objectionable material. In a few cases, the

Entertainment Software Ratings Board (ESRB) has reacted to

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discoveries of hidden content and features by reviewing the rating that was originally assigned to the product, requiring the publisher to change the game packaging and/or fining the publisher. Retailers have on occasion reacted to the discovery of such hidden content by removing these games from their shelves, refusing to sell them, and demanding that their publishers accept them as product returns. Likewise, consumers have reacted to the revelation of hidden content by refusing to purchase such games, demanding refunds for games they ve already purchased, and refraining from buying other games published by the company whose game contained the objectionable material.
We have implemented preventative measures designed to reduce the possibility of hidden, objectionable content from appearing in the video games we publish. Nonetheless, these preventative measures are subject to human error, circumvention, overriding, and reasonable resource constraints. If a video game we published were found to contain hidden, objectionable content, the ESRB could demand that we recall a game and change its packaging to reflect a revised rating, retailers could refuse to sell it and demand we accept the return of any unsold copies or returns from customers, and consumers could refuse to buy it or demand that we refund their money. This could have a material negative impact on our operating results and financial condition. In addition, our reputation could be harmed, which could impact sales of other video games we sell. If any of these consequences were to occur, our business and financial performance could be significantly harmed.

If we ship defective products, our operating results could suffer.

Products such as ours are extremely complex software programs, and are difficult to develop, manufacture and distribute. We have quality controls in place to detect defects in the software, media and packaging of our products before they are released. Nonetheless, these quality controls are subject to human error, overriding, and reasonable resource constraints. Therefore, these quality controls and preventative measures may not be effective in detecting defects in our products before they have been reproduced and released into the marketplace. In such an event, we could be required to recall a product, or we may find it necessary to voluntarily recall a product, and/or scrap defective inventory, which could significantly harm our business and operating results.

Our international net revenue is subject to currency fluctuations.

For the nine months ended December 31, 2007, international net revenue comprised 49 percent of our total net revenue. We expect foreign sales to continue to account for a significant portion of our total net revenue. Such sales may be subject to unexpected regulatory requirements, tariffs and other barriers. Additionally, foreign sales are primarily made in local currencies, which may fluctuate against the U.S. dollar. While we use foreign exchange forward contracts to mitigate some foreign currency risk associated with foreign currency denominated assets and liabilities (primarily certain intercompany receivables and payables) and, from time to time, foreign currency option contracts to hedge foreign currency forecasted transactions (primarily related to a portion of the revenue and expenses denominated in foreign currency generated by our operational subsidiaries), our results of operations, including our reported net revenue and net income, and financial condition would be adversely affected by unfavorable foreign currency fluctuations, particularly the Euro, British pound sterling and Canadian dollar.

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

We are subject to income taxes in the United States and in various foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes, and, in the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain.
We are also required to estimate what our tax obligations will be in the future. Although we believe our tax estimates are reasonable, the estimation process and applicable laws are inherently uncertain, and our estimates are not binding on tax authorities. Our effective tax rate could be adversely affected by our profit level, by changes in our business or changes in our structure resulting from the reorganization of our business and operating structure, changes in the mix of earnings in countries with differing statutory tax rates, changes in the elections we make, changes in applicable tax laws as well as other factors. Further, our tax determinations are regularly subject to audit by tax authorities and developments in those audits could adversely affect our income tax provision. Should our ultimate tax liability exceed our estimates, our income tax provision and net income or loss could be materially affected.

We incur certain tax expenses that do not decline proportionately with declines in our consolidated pre-tax income or loss. As a result, in absolute dollar terms, our tax expense will have a greater influence on our effective tax rate at lower levels of pre-tax income or loss than higher levels. In addition, at lower levels of pre-tax income or loss, our effective tax rate will be more volatile.

We are also required to pay taxes other than income taxes, such as payroll, sales, use, value-added, net worth, property and goods and services taxes, in both the United States and various foreign jurisdictions. We are regularly under examination by tax authorities with respect to these non-income taxes. There can be no assurance that the outcomes from these examinations, changes in our business or changes in applicable tax rules will not have an adverse effect on our earnings and financial condition.

Our reported financial results could be adversely affected by changes in financial accounting standards or by the application of existing or future accounting standards to our business as it evolves.

As a result of the enactment of the Sarbanes-Oxley Act and the review of accounting policies by the SEC and national and international accounting standards bodies, the frequency of accounting policy changes may accelerate. For example, as discussed in Note 8 of the Notes to Condensed Consolidated Financial Statements, FIN No. 48 has affected the way we account for income taxes and may have a material impact on our financial results. Similarly, changes in accounting standards relating to stock-based compensation require us to recognize significantly greater expense than we had been recognizing prior to the adoption of the new standard. Likewise, policies affecting software revenue recognition have and could further significantly affect the way we account for revenue related to our products and services. For example, as our industry transitions to new video game hardware systems, we expect a more significant portion of our console and PC games will be online-enabled and, as a result, we will be required to recognize the related revenue over an extended period of time rather than at the time of sale. As we enhance, expand and diversify our business and product offerings, the application of existing or future financial accounting standards, particularly those relating to the way we account for revenue and taxes, could have a significant adverse effect on our reported results although not necessarily on our cash flows.

Changes in our worldwide operating structure or the adoption of new products and distribution models could have adverse tax consequences.

As we expand our international operations, adopt new products and new distribution models, implement changes to our operating structure or undertake intercompany transactions in light of changing tax laws, expiring rulings, acquisitions and our current and anticipated business and operational requirements, our tax expense could increase. For example, in the fourth quarter of fiscal 2006, we repatriated $375 million under the American Jobs Creation Act of 2004. As a result, we recognized an additional one-time tax expense in fiscal 2006 of $17 million.

The majority of our sales are made to a relatively small number of key customers. If these customers reduce their purchases of our products or become unable to pay for them, our business could be harmed.

During the nine months ended December 31, 2007, over 74 percent of our U.S. sales were made to seven key customers. In Europe, our top ten customers accounted for approximately 33 percent of our sales in that territory during the nine months ended December 31, 2007. Worldwide, we had direct sales to two customers, GameStop Corp. and Wal-Mart Stores, Inc., representing approximately 12 percent and 11 percent, respectively, of total net revenue for the nine months ended December 31, 2007. Though our products are available to consumers through a variety of retailers, the concentration of our sales in one, or a few, large customers could lead to a short-term disruption in our sales if one or more of these customers significantly reduced their purchases or ceased to carry our products, and could make us more vulnerable to collection risk if one or more of these large customers became unable to pay for our products. Additionally, our receivables from these large customers increase significantly in the December quarter as they stock up for the holiday selling season. Also, having such a large portion of our total net revenue concentrated in a few customers could reduce our negotiating leverage with these customers.

Acquisitions, investments and other strategic transactions could result in operating difficulties, dilution to our investors and other negative consequences.

We have engaged in, evaluated, and expect to continue to engage in and evaluate, a wide array of potential strategic transactions, including (i) acquisitions of companies, businesses, intellectual properties, and other assets, (ii) minority investments in strategic partners, and (iii) investments in new interactive entertainment businesses (for example,

online and

mobile games). Any of these strategic transactions could be material to our financial condition and results of operations. Although we regularly search for opportunities to engage in strategic transactions, we may not be successful in identifying suitable opportunities. We may not be able to consummate potential acquisitions or investments or an acquisition or investment may not enhance our business or may decrease rather than increase our earnings. In addition, the process of integrating an acquired company or business, or successfully exploiting acquired intellectual property or other assets, could divert a significant amount of our management s time and focus and may create unforeseen operating difficulties and expenditures. Additional risks we face include:

- The need to implement or remediate controls, procedures and policies appropriate for a public company in an acquired company that, prior to the acquisition, lacked these controls, procedures and policies,
- Cultural challenges associated with integrating employees from an acquired company or business into our organization,
- Retaining key employees from the businesses we acquire,
- The need to integrate an acquired company s accounting, management information, human resource and other administrative systems to permit effective management, and
- To the extent that we engage in strategic transactions outside of the United States, we face additional risks, including risks related to integration of operations across different cultures and languages, currency risks and the particular economic, political and regulatory risks associated with specific countries.

Future acquisitions and investments could involve the issuance of our equity securities, potentially diluting our existing stockholders, the incurrence of debt, contingent liabilities or amortization expenses, write-offs of goodwill, intangibles, or acquired in-process technology, or other increased expenses, any of which could harm our financial condition. Our stockholders may not have the opportunity to review, vote on or evaluate future acquisitions or investments.

Our products are subject to the threat of piracy by a variety of organizations and individuals. If we are not successful in combating and preventing piracy, our sales and profitability could be harmed significantly.

In many countries around the world, more pirated copies of our products are sold than legitimate copies. Though we believe piracy has not had a material impact on our operating results to date, highly organized pirate operations have been expanding globally. In addition, the proliferation of technology designed to circumvent the protection measures we use in our products, the availability of broadband access to the Internet, the ability to download pirated copies of our games from various Internet sites, and the widespread proliferation of Internet cafes using pirated copies of our products, all have contributed to ongoing and expanding piracy. Though we take steps to make the unauthorized copying and distribution of our products more difficult, as do the manufacturers of consoles on which our games are played, these efforts may not be successful in controlling the piracy of our products. This could have a negative effect on our growth and profitability in the future.

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

The market price of our common stock historically has been, and we expect will continue to be, subject to significant fluctuations. These fluctuations may be due to factors specific to us (including those discussed in the risk factors above as well as others not currently known to us or that we currently do not believe are material), to changes in securities analysts earnings estimates or ratings, to our results or future financial guidance falling below our expectations and analysts and investors expectations, to factors affecting the computer, software, Internet, entertainment, media or electronics industries, or to national or international economic conditions.

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Item 6. Exhibits

The following exhibits (other than exhibits 32.1 and 32.2, which are furnished with this report) are filed as part of, or incorporated by reference into, this report:

Exhibit Number	Title
15.1	Awareness Letter of KPMG LLP, Independent Registered Public Accounting Firm.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Executive Vice President, Chief Financial and Administrative Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Additional exhibits furnished with this report:

32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Executive Vice President, Chief Financial and Administrative Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURE

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

ELECTRONIC ARTS INC.
(Registrant)

/s/ Warren C. Jenson

DATED:
February 4, 2008

Warren C. Jenson
Executive Vice President,
Chief Financial and Administrative Officer

ELECTRONIC ARTS INC.
FORM 10-Q
FOR THE PERIOD ENDED DECEMBER 31, 2007
EXHIBIT INDEX

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