ELECTRONIC ARTS INC.
Form 10-Q
August 09, 2016
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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 June 30, 2016
OR

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

Delaware	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 ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES þ NO ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO þ
As of August 4, 2016, there were 300,764,884 shares of the Registrant’s Common Stock, par value $0.01 per share, outstanding.

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PART I – FINANCIAL INFORMATION

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

(Unaudited) (In millions, except par value data)	June 30, 2016	March 31, 2016 [a]
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,042	$ 2,493
Short-term investments	1,385	1,341
Receivables, net of allowances of $135 and $159, respectively	246	233
Inventories	26	33
Other current assets	273	254
Total current assets	3,972	4,354
Property and equipment, net	435	439
Goodwill	1,708	1,710
Acquisition-related intangibles, net	42	57
Deferred income taxes, net	343	387
Other assets	105	103
TOTAL ASSETS	$ 6,605	$ 7,050
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 44	$ 89
Accrued and other current liabilities	597	710
0.75% convertible senior notes due 2016, net	136	161
Deferred net revenue (online-enabled games)	873	1,458
Total current liabilities	1,650	2,418
Senior notes, net	989	989
Income tax obligations	88	80
Deferred income taxes, net	2	2
Other liabilities	160	163
Total liabilities	2,889	3,652
Commitments and contingencies (See Note 11)		
0.75% convertible senior notes due 2016 (See Note 10)	—	2
Stockholders' equity:		
Common stock, $0.01 par value. 1,000 shares authorized; 301 and 301 shares issued and outstanding, respectively	3	3
Additional paid-in capital	1,210	1,349
Retained earnings	2,500	2,060
Accumulated other comprehensive income (loss)	3	(16)
Total stockholders' equity	3,716	3,396
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 6,605	$ 7,050

See accompanying Notes to Condensed Consolidated Financial Statements (unaudited).
(a) Derived from audited Consolidated Financial Statements.

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ELECTRONIC ARTS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)	Three Months Ended June 30,	
(In millions, except per share data)	2016	2015
Net revenue:		
Product	$684	$743
Service and other	587	460
Total net revenue	1,271	1,203
Cost of revenue:		
Product	90	94
Service and other	89	79
Total cost of revenue	179	173
Gross profit	1,092	1,030
Operating expenses:		
Research and development	294	296
Marketing and sales	128	123
General and administrative	108	98
Amortization of intangibles	2	1
Total operating expenses	532	518
Operating income	560	512
Interest and other income (expense), net	(8)	(3)
Income before provision for income taxes	552	509
Provision for income taxes	112	67
Net income	$440	$442
Earnings per share:		
Basic	$1.46	$1.42
Diluted	$1.40	$1.32
Number of shares used in computation:		
Basic	301	311
Diluted	315	335

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

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

(Unaudited)	Three Months Ended June 30,	
(In millions)	2016	2015
Net income	$440	$442
Other comprehensive income (loss), net of tax:		
Change in unrealized net gains and losses on available-for-sale securities	2	(1)
Change in unrealized net gains and losses on derivative instruments	28	(13)
Reclassification adjustment for net realized gains and losses on derivative instruments	(6)	(3)
Foreign currency translation adjustments	(5)	1
Total other comprehensive income (loss), net of tax	19	(16)
Total comprehensive income	$459	$426

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)	Three Months Ended June 30,	
(In millions)	2016	2015
OPERATING ACTIVITIES		
Net income	$440	$442
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation, amortization and accretion	46	49
Stock-based compensation	48	45
Change in assets and liabilities:		
Receivables, net	(12)	219
Inventories	7	3
Other assets	(1)	26
Accounts payable	(32)	(16)
Accrued and other liabilities	(202)	(331)
Deferred income taxes, net	43	—
Deferred net revenue (online-enabled games)	(585)	(508)
Net cash used in operating activities	(248)	(71)
INVESTING ACTIVITIES		
Capital expenditures	(40)	(24)
Proceeds from maturities and sales of short-term investments	276	249
Purchase of short-term investments	(317)	(365)
Net cash used in investing activities	(81)	(140)
FINANCING ACTIVITIES		
Payment of convertible notes	(27)	—
Proceeds from issuance of common stock	4	45
Excess tax benefit from stock-based compensation	33	40
Repurchase and retirement of common stock	(129)	(132)
Net cash used in financing activities	(119)	(47)
Effect of foreign exchange on cash and cash equivalents	(3)	—
Decrease in cash and cash equivalents	(451)	(258)
Beginning cash and cash equivalents	2,493	2,068
Ending cash and cash equivalents	$2,042	$1,810
Supplemental cash flow information:		
Cash paid during the period for income taxes, net	$10	$21
Cash paid during the period for interest	$—	$3
Non-cash investing activities:		
Change in accrued capital expenditures	$(13)	$(9)

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 are a global leader in digital interactive entertainment. We develop, market, publish and distribute games, content and services that can be played by consumers on a variety of platforms, which include consoles (such as the PlayStation from Sony, and the Xbox from Microsoft), PCs, mobile phones and tablets. Some of our games are based on our wholly-owned intellectual property (e.g., Battlefield, Mass Effect, Need for Speed, The Sims and Plants vs. Zombies), and some of our games leverage content that we license from others (e.g., FIFA, Madden NFL and Star Wars). We also publish and distribute games developed by third parties (e.g., Titanfall). Our products and services may be purchased through multiple distribution channels, including physical and online retailers, platform providers such as console manufacturers, providers of free-to-download PC games, mobile carriers and directly through Origin, our own digital distribution platform.

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 year ending March 31, 2017 contains 52 weeks and ends on April 1, 2017. Our results of operations for the fiscal year ended March 31, 2016 contained 53 weeks and ended on April 2, 2016. Our results of operations for the three months ended June 30, 2016 contained 13 weeks and ended on July 2, 2016. Our results of operations for the three months ended June 30, 2015 contained 14 weeks and ended on July 4, 2015. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

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

These Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016, as filed with the United States Securities and Exchange Commission (“SEC”) on May 27, 2016.

Recently Adopted Accounting Standards

In April 2015, the FASB issued ASU 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Topic 350-40). The amendments of this ASU help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement by providing guidance as to whether an arrangement includes the sale or license of software. The requirements will be effective for annual periods (and interim periods within those annual periods) beginning after December 15, 2015. The amendment may be adopted either prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. We adopted ASU 2015-05 in the first quarter of fiscal year 2017. The adoption did not have a material impact on our Consolidated Financial Statements.

Impact of Recently Issued Accounting Standards

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, related to simplifications of employee share-based payment accounting. This pronouncement eliminates the APIC pool concept and requires that excess tax benefits and tax deficiencies be recorded in the income statement when awards are settled. The pronouncement also addresses simplifications related to statement of cash flows classification, accounting for forfeitures, and minimum statutory tax withholding requirements. The pronouncement is effective for annual periods (and for interim periods within those annual periods) beginning after December 15, 2016. We are currently evaluating the timing and the impact of this new standard on our Consolidated Financial Statements and related disclosures.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments (Topic 825-10), which requires that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The ASU also impacts financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments.

The requirements will be effective for annual periods (and interim periods within those annual periods) beginning after December 15, 2017. We are currently evaluating the impact of this new standard on our Consolidated Financial Statements and related disclosures.

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In March 2016, the FASB issued ASU 2016-04, Liabilities – Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products. The amendments in the ASU are designed to provide guidance and eliminate diversity in the accounting for derecognition of prepaid stored-value product liabilities. Typically, a prepaid stored-value product liability is to be derecognized when it is probable that a significant reversal of the recognized breakage amount will not subsequently occur. This is when the likelihood of the product holder exercising its remaining rights becomes remote. This estimate shall be updated at the end of each period. The amendments in this ASU are effective for annual periods (and interim periods within those annual periods) beginning after December 15, 2017. Early adoption is permitted. We are currently evaluating the timing of adoption and impact of this new standard on our Consolidated Financial Statements and related disclosures.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The standard permits the use of either the retrospective or cumulative effect transition method. This new revenue standard, as amended by ASU 2015-14, is effective in the first quarter of fiscal year 2019. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which clarifies the guidance in the new revenue standard on assessing whether an entity is a principal or an agent in a revenue transaction. This conclusion impacts whether an entity reports revenue on a gross or net basis. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing, which clarifies the guidance in the new revenue standard regarding an entity’s identification of its performance obligations in a contract, as well as an entity’s evaluation of the nature of its promise to grant a license of intellectual property and whether or not that revenue is recognized over time or at a point in time. In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients. which amends the guidance in the new revenue standard on collectibility, noncash consideration, presentation of sales tax, and transition. The amendments are intended to address implementation issues that were raised by stakeholders and provide additional practical expedients to reduce the cost and complexity of applying the new revenue standard. These amendments have the same effective date as the new revenue standard. While we are currently evaluating the method of adoption and the impact of the new revenue standard, as amended, on our Consolidated Financial Statements and related disclosures, we believe the adoption of the new standard may have a significant impact on the accounting for certain transactions with multiple elements or “bundled” arrangements (for example, sales of online-enabled games for which we do not have VSOE for unspecified future updates) because the requirement to have VSOE for undelivered elements under current accounting standards is eliminated under the new standard. Accordingly, we may be required to recognize as revenue a portion of the sales price upon delivery of the software, as compared to the current requirement of recognizing the entire sales price ratably over an estimated offering period. While we are still evaluating the total impact of the new revenue standard, as amended, we believe adoption of this new standard will have a material impact on our Consolidated Financial Statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The FASB issued this update to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The updated guidance is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption of the update is permitted. We are currently evaluating the timing of adoption and impact of this new standard on our Consolidated Financial Statements and related disclosures.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326). The standard changes the methodology for measuring credit losses on financial instruments and the timing of when such losses are recorded. ASU 2016-13 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2018. We are currently evaluating the timing of adoption and impact of this new standard on our Consolidated Financial Statements and related disclosures.

(2) FAIR VALUE MEASUREMENTS

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

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Fair Value Hierarchy

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

As of June 30, 2016 and March 31, 2016, our assets and liabilities that were measured and recorded at fair value on a recurring basis were as follows (in millions):

		Fair Value Measurements at Reporting Date Using			
		Quoted Prices in Active Markets for Identical Financial Instruments	Significant Other Observable Inputs	Significant Unobservable Inputs	
	As of June 30, 2016	(Level 1)	(Level 2)	(Level 3)	Balance Sheet Classification
Assets					
Bank and time deposits	$243	$ 243	$ —	$ —	Cash equivalents
Money market funds	308	308	—	—	Cash equivalents
Available-for-sale securities:					
Corporate bonds	713	—	713	—	Short-term investments and cash equivalents
U.S. Treasury securities	362	362	—	—	Short-term investments and cash equivalents
U.S. agency securities	155	—	155	—	Short-term investments
Commercial paper	72	—	72	—	Short-term investments and cash equivalents
Foreign government securities	114	—	114	—	Short-term investments
Foreign currency derivatives	37	—	37	—	Other current assets and other assets
Deferred compensation plan assets [(a)]	9	9	—	—	Other assets
Total assets at fair value	$2,013	$ 922	$ 1,091	$ —	
Liabilities					
Foreign currency derivatives	4	—	4	—	Accrued and other current liabilities and other liabilities
Deferred compensation plan liabilities [(a)]	10	10	—	—	Other liabilities
Total liabilities at fair value	$14	$ 10	$ 4	$ —	

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		Fair Value Measurements at Reporting Date Using			
	As of March 31, 2016	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
Assets					
Bank and time deposits	$345	$ 345	$ —	$ —	Cash equivalents
Money market funds	143	143	—	—	Cash equivalents
Available-for-sale securities:					
Corporate bonds	623	—	623	—	Short-term investments and cash equivalents
U.S. Treasury securities	407	407	—	—	Short-term investments and cash equivalents
U.S. agency securities	170	—	170	—	Short-term investments and cash equivalents
Commercial paper	81	—	81	—	Short-term investments and cash equivalents
Foreign government securities	122	—	122	—	Short-term investments and cash equivalents
Foreign currency derivatives	16	—	16	—	Other current assets and other assets
Deferred compensation plan assets [(a)]	8	8	—	—	Other assets
Total assets at fair value	$1,915	$ 903	$ 1,012	$ —	
Liabilities					
Foreign currency derivatives	10	—	10	—	Accrued and other current liabilities and other liabilities
Deferred compensation plan liabilities [(a)]	9	9	—	—	Other liabilities
Total liabilities at fair value	$19	$ 9	$ 10	$ —	

(a) The Deferred Compensation Plan assets consist of various mutual funds. See Note 15 in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016, for additional information regarding our Deferred Compensation Plan.

(3) FINANCIAL INSTRUMENTS

Cash and Cash Equivalents

As of June 30, 2016 and March 31, 2016, our cash and cash equivalents were $2,042 million and $2,493 million, respectively. Cash equivalents were valued at their carrying amounts as they approximate fair value due to the short maturities of these financial instruments.

Short-Term Investments

Short-term investments consisted of the following as of June 30, 2016 and March 31, 2016 (in millions):

	As of June 30, 2016			As of March 31, 2016		
	Cost or	Gross Unrealized	Fair	Cost or	Gross Unrealized	Fair

	Amortized Cost	Gains	Losses	Value	Amortized Cost	Gains	Losses	Value
Corporate bonds	$709	$ 2	$ —	$711	$620	$ 1	$ —	$621
U.S. Treasury securities	350	2	—	352	389	1	—	390
U.S. agency securities	154	1	—	155	167	—	—	167
Commercial paper	53	—	—	53	50	—	—	50
Foreign government securities	114	—	—	114	113	—	—	113
Short-term investments	$1,380	$ 5	$ —	$1,385	$1,339	$ 2	$ —	$1,341

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The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of June 30, 2016 and March 31, 2016 (in millions):

	As of June 30, 2016		As of March 31, 2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Short-term investments				
Due in 1 year or less	$661	$661	$571	$571
Due in 1-2 years	400	402	461	462
Due in 2-3 years	314	317	295	296
Due in 3-4 years	5	5	12	12
Short-term investments	$1,380	$1,385	$1,339	$1,341

(4) DERIVATIVE FINANCIAL INSTRUMENTS

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

We transact business in various foreign currencies and have significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. We purchase foreign currency forward contracts, generally with maturities of 18 months or less, to reduce the volatility of cash flows primarily related to forecasted revenue and expenses denominated in certain foreign currencies. Our cash flow risks are primarily related to fluctuations in the Euro, British pound sterling, Canadian dollar, Swedish krona, Australian dollar, Chinese yuan and South Korean won. In addition, we utilize foreign currency forward contracts to mitigate foreign exchange risk associated with foreign-currency-denominated monetary assets and liabilities, including third party receivables and payables as well as intercompany balances. The foreign currency forward contracts not designated as hedging instruments generally have a contractual term of approximately 3 months or less and are transacted near month-end. We do not use foreign currency forward contracts for speculative trading purposes.

Cash Flow Hedging Activities

Certain of our forward contracts are designated and qualify as cash flow hedges. The effectiveness of the cash flow hedge contracts, including time value, is assessed monthly using regression analysis, as well as other timing and probability criteria. To qualify for hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedges and must be highly effective in offsetting changes to future cash flows on hedged transactions. The derivative assets or liabilities associated with our hedging activities are recorded at fair value in other current assets/other assets, or accrued and other current liabilities/other liabilities, respectively, on our Condensed Consolidated Balance Sheets. The effective portion of gains or losses resulting from changes in the fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive income (loss) in stockholders' equity. The gross amount of the effective portion of gains or losses resulting from changes in the fair value of these hedges is subsequently reclassified into net revenue or research and development expenses, as appropriate, in the period when the forecasted transaction is recognized in our Condensed Consolidated Statements of Operations. In the event that the gains or losses in accumulated other comprehensive income (loss) are deemed to be ineffective, the ineffective portion of gains or losses resulting from changes in fair value, if any, is reclassified to interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. In the event that the underlying forecasted transactions do not occur, or it becomes remote that they will occur, within the defined hedge period, the gains or losses on the related cash flow hedges are reclassified from accumulated other comprehensive income (loss) to interest and other income (expense), net, in our Condensed Consolidated Statements of Operations.

Total gross notional amounts and fair values for currency derivatives with cash flow hedge accounting designation are as follows (in millions):

	As of June 30, 2016			As of March 31, 2016		
	Notional	Fair Value		Notional	Fair Value	
	Amount	Asset	Liability	Amount	Asset	Liability
Forward contracts to purchase	$114	$1	$ 2	$148	$5	$ 1
Forward contracts to sell	$834	$36	$ 2	$685	$11	$ 9

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The net impact of the effective portion of gains and losses from our cash flow hedging activities in our Condensed Consolidated Statements of Operations was a gain of $6 million for the three months ended June 30, 2016 and a gain of $3 million for the three months ended June 30, 2015.

During the three months ended June 30, 2016 and 2015, we reclassified an immaterial amount of the ineffective portion of gains or losses resulting from changes in fair value into interest and other income (expense), net.

The amount excluded from the assessment of hedge effectiveness during three months ended June 30, 2016 and 2015 and recognized in interest and other income (expense), net, was immaterial.

Balance Sheet Hedging Activities

Our foreign currency forward contracts that are not designated as hedging instruments are accounted for as derivatives whereby the fair value of the contracts are reported as other current assets or accrued and other current liabilities on our Condensed Consolidated Balance Sheets, and gains and losses resulting from changes in the fair value are reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. The gains and losses on these foreign currency forward contracts generally offset the gains and losses in the underlying foreign-currency-denominated monetary assets and liabilities, which are also reported in interest and other income (expense), net, in our Condensed Consolidated Statements of Operations. The fair value of our foreign currency forward contracts was measured using Level 2 inputs.

Total gross notional amounts and fair values for currency derivatives that are not designated as hedging instruments are accounted for as follows (in millions):

	As of June 30, 2016			As of March 31, 2016		
	Notional Amount	Fair Value Asset	Fair Value Liability	Notional Amount	Fair Value Asset	Fair Value Liability
Forward contracts to purchase	$132	$ —	$ —	$108	$ —	$ —
Forward contracts to sell	$175	$ —	$ —	$159	$ —	$ —

The effect of foreign currency forward contracts not designated as hedging instruments in our Condensed Consolidated Statements of Operations for the three months ended June 30, 2016 and 2015 was immaterial, and is included in interest and other income (expense), net.

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(5) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The changes in accumulated other comprehensive income (loss) by component, net of tax, for the three months ended June 30, 2016 and 2015 are as follows (in millions):

	Unrealized Net Gains (Losses) on Available-for-Sale Securities	Unrealized Net Gains (Losses) on Derivative Instruments	Foreign Currency Translation Adjustments	Total
Balances as of March 31, 2016	$ 1	$ 14	$ (31)	$ (16)
Other comprehensive income (loss) before reclassifications	2	28	(5)	25
Amounts reclassified from accumulated other comprehensive income (loss)	—	(6)	—	(6)
Total other comprehensive income (loss), net of tax	2	22	(5)	19
Balance as of June 30, 2016	$ 3	$ 36	$ (36)	$ 3

	Unrealized Net Gains (Losses) on Available-for-Sale Securities	Unrealized Net Gains (Losses) on Derivative Instruments	Foreign Currency Translation Adjustments	Total
Balances as of March 31, 2015	$ (3)	$ 21	$ (16)	$ 2
Other comprehensive income (loss) before reclassifications	(1)	(13)	1	(13)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(3)	—	(3)
Total other comprehensive income (loss), net of tax	(1)	(16)	1	(16)
Balance as of June 30, 2015	$ (4)	$ 5	$ (15)	$ (14)

The effects on net income of amounts reclassified from accumulated other comprehensive income (loss) for the three months ended June 30, 2016 and 2015 were as follows (in millions):

	Amount Reclassified From Accumulated Other Comprehensive Income (Loss)	
Statement of Operations Classification	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015
(Gains) losses on cash flow hedges from forward contracts		
Net revenue	$ (5)	$ (8)
Research and development	(1)	5
Total amount reclassified, net of tax	$ (6)	$ (3)

(6) GOODWILL AND ACQUISITION-RELATED INTANGIBLES, NET

The changes in the carrying amount of goodwill for the three months ended June 30, 2016 are as follows (in millions):

	As of March 31, 2016	Activity	Effects of Foreign Currency Translation	As of June 30, 2016
Goodwill	$2,078	$ —	$ (2)	$2,076
Accumulated impairment	(368)	—	—	(368)
Total	$1,710	$ —	$ (2)	$1,708

Goodwill represents the excess of the purchase price over the fair value of the underlying acquired net tangible and intangible assets. Goodwill is not amortized, but rather subject to at least an annual assessment for impairment by applying a fair value-based test.

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

	As of June 30, 2016			As of March 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net
Developed and core technology	$412	$ (382)	$ 30	$412	$ (368)	$ 44
Trade names and trademarks	106	(94)	12	106	(93)	13
Registered user base and other intangibles	5	(5)	—	5	(5)	—
Carrier contracts and related	85	(85)	—	85	(85)	—
Total	$608	$ (566)	$ 42	$608	$ (551)	$ 57

Amortization of intangibles for the three months ended June 30, 2016 and 2015 are classified in the Condensed Consolidated Statement of Operations as follows (in millions):

	Three Months Ended June 30,	
	2016	2015
Cost of service and other	$8	$ 8
Cost of product	5	4
Operating expenses	2	1
Total	$15	$ 13

Acquisition-related intangible assets are amortized using the straight-line method over the lesser of their estimated useful lives or the agreement terms, typically from 2 to 14 years. As of June 30, 2016 and March 31, 2016, the weighted-average remaining useful life for acquisition-related intangible assets was approximately 1.5 years and 1.6 years, respectively.

As of June 30, 2016, future amortization of acquisition-related intangibles that will be recorded in the Condensed Consolidated Statement of Operations is estimated as follows (in millions):

Fiscal Year Ending March 31,	
2017 (remaining nine months)	$23
2018	17
2019	2
Total	$42

(7) 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 products.

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 revenue at the greater of the contractual rate or an effective royalty rate based on the total projected net revenue for contracts with guaranteed minimums. 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 revenue.

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. Prepaid royalties are classified as current assets to the extent that such

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amounts will be recognized in our Condensed Consolidated Statements of Operations within the next 12 months. Royalty liabilities are classified as current liabilities to the extent such royalty payments are contractually due within the next 12 months.

Each quarter, we also evaluate the expected 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 and service sales. Any impairments or losses determined before the launch of a product are generally charged to research and development expense. Impairments or losses determined post-launch are charged to cost of revenue. We evaluate long-lived royalty-based assets for impairment using undiscounted cash flows when impairment indicators exist. If impairment exists, then the assets are written down to fair value. Unrecognized minimum royalty-based commitments are accounted for as executory contracts, and therefore, any losses on these commitments are recognized when the underlying intellectual property is abandoned (i.e., cease use) or the contractual rights to use the intellectual property are terminated.

During the three months ended June 30, 2016 and 2015, we did not recognize any material losses or impairment charges on royalty-based commitments, respectively.

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 June 30, 2016	As of March 31, 2016
Other current assets	$ 99	$ 54
Other assets	60	63
Royalty-related assets	$ 159	$ 117

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 classify any recognized unpaid royalty amounts due to these parties as accrued liabilities. The current and long-term portions of accrued royalties, included in accrued and other current liabilities and other liabilities, consisted of (in millions):

	As of June 30, 2016	As of March 31, 2016
Accrued royalties	$ 126	$ 159
Other liabilities	118	118
Royalty-related liabilities	$ 244	$ 277

As of June 30, 2016, we were committed to pay approximately $1,385 million to content licensors, independent software developers, 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 11 for further information on our developer and licensor commitments.

(8) BALANCE SHEET DETAILS

Inventories

Inventories as of June 30, 2016 and March 31, 2016 consisted of (in millions):

	As of June 30, 2016	As of March 31, 2016
Finished goods	$ 26	$ 32
Raw materials and work in process	—	1

Inventories	$ 26	$ 33

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Property and Equipment, Net

Property and equipment, net, as of June 30, 2016 and March 31, 2016 consisted of (in millions):

	As of June 30, 2016	As of March 31, 2016
Computer, equipment and software	$695	$684
Buildings	316	313
Leasehold improvements	129	129
Equipment, furniture and fixtures, and other	80	80
Land	61	61
Construction in progress	8	15
	1,289	1,282
Less: accumulated depreciation	(854)	(843)
Property and equipment, net	$435	$439

During the three months ended June 30, 2016 and 2015, depreciation expense associated with property and equipment was $29 million and $30 million, respectively.

Accrued and Other Current Liabilities

Accrued and other current liabilities as of June 30, 2016 and March 31, 2016 consisted of (in millions):

	As of June 30, 2016	As of March 31, 2016
Other accrued expenses	$204	$ 218
Accrued compensation and benefits	196	256
Accrued royalties	126	159
Deferred net revenue (other)	71	77
Accrued and other current liabilities	$597	$ 710

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 (Online-Enabled Games)

Deferred net revenue (online-enabled games) was $873 million and $1,458 million as of June 30, 2016 and March 31, 2016, respectively. Deferred net revenue (online-enabled games) generally includes the unrecognized revenue from bundled sales of online-enabled games for which we do not have vendor-specific objective evidence of fair value (“VSOE”) for the obligation to provide unspecified updates. We recognize revenue from the sale of online-enabled games for which we do not have VSOE for the unspecified updates on a straight-line basis, generally over an estimated nine-month period beginning in the month after shipment for physical games sold through retail and an estimated six-month period for digitally-distributed games. However, we expense the cost of revenue related to these transactions generally during the period in which the product is delivered (rather than on a deferred basis).

(9) INCOME TAXES

We estimate our annual effective tax rate at the end of each quarterly period, and we record the tax effect of certain discrete items, which are unusual or occur infrequently, in the interim period in which they occur, including changes in judgment about deferred tax valuation allowances. In addition, jurisdictions with a projected loss for the year, jurisdictions with a year-to-date loss where no tax benefit can be recognized, and jurisdictions where we are unable to estimate an annual effective tax rate are excluded from the estimated annual effective tax rate. The impact of such an exclusion could result in a higher or lower effective tax rate during a particular quarter depending on the mix and timing of actual earnings versus annual projections.

We recognize deferred tax assets and liabilities for both the expected impact of differences between the financial statement amount and the tax basis of assets and liabilities and for the expected future tax benefit to be derived from tax losses and tax credit carryforwards. We record a valuation allowance against deferred tax assets when it is considered more likely than not that all or a portion of our deferred tax assets will not be realized. In making this determination, we are required to give significant weight to evidence that can be objectively verified.

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In addition to considering forecasts of future taxable income, we are also required to evaluate and quantify other possible sources of taxable income in order to assess the realization of our deferred tax assets, namely the reversal of existing deferred tax liabilities, the carry back of losses and credits as allowed under current tax law, and the implementation of tax planning strategies. Evaluating and quantifying these amounts involves significant judgments. Each source of income must be evaluated based on all positive and negative evidence; this evaluation involves assumptions about future activity.

In the fourth quarter of fiscal year 2016, we determined that the positive evidence overcame any negative evidence and concluded that it was more likely than not that the U.S. deferred tax assets were realizable. As a result, we released the valuation allowance against all of the U.S. federal deferred tax assets and a portion of the U.S. state deferred tax assets during the fourth quarter of fiscal year 2016, and we continue to believe those deferred tax assets are realizable as of June 30, 2016. We maintain a valuation allowance related to specific U.S. state deferred tax assets and foreign capital loss carryovers, due to uncertainty about the future realization of these assets.

The provision for income taxes reported for the three months ended June 30, 2016 is based on our projected annual effective tax rate for fiscal year 2017, and also includes certain discrete items recorded during the period. Our effective tax rate for the three months ended June 30, 2016 was 20.3 percent as compared to 13.2 percent, for the same period of fiscal year 2016. The effective tax rate for the three months ended June 30, 2016 was reduced, when compared to the statutory rate of 35.0 percent, due primarily to non-U.S. profits subject to a reduced or zero tax rate. The effective tax rate for the three months ended June 30, 2015 was reduced, when compared to the statutory rate of 35.0 percent, by the utilization of U.S. deferred tax assets which were subject to a valuation allowance and non-U.S. profits subject to a reduced or zero tax rate. Conversely, the effective tax rate for the three months ended June 30, 2015 was increased due to a discrete expense of $40 million for excess tax benefits from stock-based compensation deductions allocated directly to contributed capital. The effective tax rate for the three months ended June 30, 2016 differs from the same period in fiscal year 2016 primarily due to the utilization of U.S. deferred tax assets which were subject to a valuation allowance and the discrete expense of $40 million for excess tax benefits from stock-based compensation deductions allocated directly to contributed capital in fiscal year 2016.

During the three months ended June 30, 2016, we recorded a net increase of $8 million in gross unrecognized tax benefits. The total gross unrecognized tax benefits as of June 30, 2016 is $339 million. A portion of our unrecognized tax benefits will affect our effective tax rate if they are recognized upon favorable resolution of the uncertain tax positions. As of June 30, 2016, if recognized, approximately $312 million of the unrecognized tax benefits would affect our effective tax rate and approximately $27 million would result in adjustments to deferred tax assets with corresponding adjustments to the valuation allowance.

During the three months ended June 30, 2016, we recorded a net increase of $1 million for accrued interest and penalties related to tax positions taken on our tax returns. As of June 30, 2016, the combined amount of accrued interest and penalties related to uncertain tax positions included in income tax obligations on our Condensed Consolidated Balance Sheet was approximately $15 million.

We file income tax returns in the United States, 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 IRS is currently examining our returns for fiscal years 2009 through 2011, and we remain subject to income tax examination by the IRS for fiscal years after 2012.

We are also currently under income tax examination in the United Kingdom for fiscal years 2010 through 2014, and in France for fiscal years 2014 through 2016. We remain subject to income tax examination for several other jurisdictions including in Germany for fiscal years after 2012, in the United Kingdom for fiscal years after 2014, in Canada for fiscal years after 2008, and in Switzerland for fiscal years after 2007.

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. Although potential resolution of uncertain tax positions involve multiple tax periods and jurisdictions, it is

reasonably possible that a reduction of up to $50 million of unrecognized tax benefits may occur within the next 12 months, some of which, depending on the nature of the settlement or expiration of statutes of limitations, may affect the Company's income tax provision and therefore benefit the resulting effective tax rate. The actual amount could vary significantly depending on the ultimate timing and nature of any settlements.

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(10) FINANCING ARRANGEMENT

0.75% Convertible Senior Notes Due 2016

In July 2011, we issued $632.5 million aggregate principal amount of 0.75% Convertible Senior Notes due 2016 (the "Convertible Notes"). The Convertible Notes matured on July 15, 2016. The Convertible Notes were senior unsecured obligations which paid interest semiannually in arrears at a rate of 0.75% per annum on January 15 and July 15 of each year.

The Convertible Notes were convertible into cash and shares of our common stock based on an initial conversion value of 31.5075 shares of our common stock per $1,000 principal amount of Convertible Notes (equivalent to an initial conversion price of approximately $31.74 per share). Upon conversion of the Convertible Notes, holders received cash up to the principal amount of each Convertible Note, and any excess conversion value was delivered in shares of our common stock. The Convertible Notes do not contain any financial covenants.

The carrying value of the Convertible Notes continued to be classified as a current liability and the excess of the principal amount over the carrying value of the Convertible Notes continued to be classified in temporary equity in the Condensed Consolidated Balance Sheets as of June 30, 2016.

Upon conversion of any Convertible Notes, we delivered cash up to the principal amount of the Convertible Notes and any excess conversion value was delivered in shares of our common stock. During the three months ended June 30, 2016, approximately $27 million principal value of the Convertible Notes were converted by holders thereof. During the three months ended June 30, 2016, we repaid $27 million of the principal balance of the Convertible Notes and issued approximately 0.4 million shares of common stock to noteholders with a fair value of $29 million, resulting in a loss on extinguishment of $0.3 million. We also received and cancelled approximately 0.4 million shares of common stock from the exercise of the Convertible Note Hedge during the three months ended June 30, 2016. Based on the closing price of our common stock of $75.87 at the end of the quarter ended June 30, 2016, the if-converted value of our Convertible Notes outstanding in aggregate exceeded their principal amount by $189 million.

The carrying and fair values of the Convertible Notes are as follows (in millions):

	As of June 30, 2016	As of March 31, 2016
Principal amount of Convertible Notes	$ 136	$ 163
Unamortized debt discount of the liability component	—	(2)
Net carrying value of Convertible Notes	$ 136	$ 161
Fair value of Convertible Notes (Level 2)	$ 312	$ 338

Subsequent to the quarter ended June 30, 2016, we repaid the remaining principal balance on the Convertible Notes of $136 million and issued approximately 2.5 million shares of common stock to noteholders on the final maturity date of July 15, 2016. We also received and cancelled approximately 2.5 million shares of common stock from the exercise of the Convertible Note Hedge on July 15, 2016.

Convertible Note Hedge and Warrants Issuance

In July 2011, we entered into certain agreements designed to reduce the potential dilution with respect to our common stock upon conversion of the Convertible Notes ("the Convertible Note Hedge"). We paid $107 million for the Convertible Note Hedge, which was recorded as an equity transaction. The Convertible Note Hedge, subject to customary anti-dilution adjustments, provided us with the option to acquire, on a net settlement basis, approximately 19.9 million shares of our common stock equal to the number of shares of our common stock that notionally underlie the Convertible Notes at a strike price of $31.74, which corresponds to the conversion price of the Convertible Notes. During the quarter ended June 30, 2016, we received 0.4 million shares of our common stock under the Convertible Note Hedge.

Separately, in July 2011 we also entered into privately negotiated warrant transactions with certain counterparties whereby we sold to independent third parties warrants (the "Warrants") to acquire, subject to customary anti-dilution adjustments that are substantially the same as the anti-dilution provisions contained in the Convertible Notes, up to 19.9 million shares of our common stock (which is also equal to the number of shares of our common stock that notionally underlie the Convertible Notes), with a strike price of $41.14. The Warrants have a dilutive effect with respect to our common stock to the extent that the

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market price per share of our common stock exceeds $41.14 on or prior to the expiration date of the Warrants. The Warrants automatically exercise over a 60 trading day period beginning on October 17, 2016. Based on the closing price of our common stock of $75.87 at the end of the quarter ended June 30, 2016, approximately 9.1 million shares of our common stock would be issuable to Warrants holders. The actual amount of shares issuable upon exercise will be determined based upon the market price of our common stock during the 60 day trading period beginning on October 17, 2016. We received proceeds of $65 million from the sale of the Warrants in fiscal year 2012.

Effect of conversion on earning per share ("EPS")

The Convertible Notes had no impact on diluted EPS for periods where the average quarterly price of our common stock is below the conversion price of $31.74 per share. Prior to conversion, we included the effect of the additional potential dilutive shares if our common stock price exceeded $31.74 per share using the treasury stock method. If the average price of our common stock exceeds $41.14 per share for a quarterly period, we also include the effect of the additional potential dilutive shares related to the Warrants using the treasury stock method. Prior to conversion, the Convertible Note Hedge was not considered for purposes of the EPS calculation, as its effect would have been anti-dilutive. Upon conversion, the Convertible Note Hedge offset the dilutive effect of the Notes when the stock price was above $31.74 per share. See Note 13 for additional information related to our EPS.

Senior Notes

In February 2016, we issued $600 million aggregate principal amount of 3.70% Senior Notes due March 1, 2021 (the "2021 Notes") and $400 million aggregate principal amount of 4.80% Senior Notes due March 1, 2026 (the "2026 Notes," and together with the 2021 Notes, the "Senior Notes"). Our proceeds were $989 million, net of discount of $2 million and issuance costs of $9 million. Both the discount and issuance costs are being amortized to interest expense over the respective terms of the 2021 Notes and the 2026 Notes using the effective interest rate method. The effective interest rate was 3.94% for the 2021 Notes and 4.97% for the 2026 Notes. Interest is payable semiannually in arrears, on March 1 and September 1 of each year, beginning on September 1, 2016.

The carrying and fair values of the Senior Notes are as follows (in millions):

	As of June 30, 2016	As of March 31, 2016
Senior Notes:		
3.70% Senior Notes due 2021	$600	$600
4.80% Senior Notes due 2026	400	400
Total principal amount	$1,000	$1,000
Unaccreted discount	(2)	(2)
Unamortized debt issuance costs	(9)	(9)
Net carrying value of Senior Notes	$989	$989
Fair value of Senior Notes (Level 2)	$1,073	$1,039

As of June 30, 2016, the remaining life of the 2021 Notes and 2026 Notes is approximately 4.7 years and 9.7 years, respectively.

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The Senior Notes are senior unsecured obligations and rank equally with all our other existing and future unsubordinated obligations, including our Convertible Notes, and any indebtedness that we may incur from time to time under our Credit Facility.

The 2021 Notes and the 2026 Notes are redeemable at our option at any time prior to February 1, 2021 or December 1, 2025, respectively, subject to a make-whole premium. Within one and three months of maturity, we may redeem the 2021 Notes or the 2026 Notes, respectively, at a redemption price equal to 100% of the aggregate principal amount plus accrued and unpaid interest. In addition, upon the occurrence of a change of control repurchase event, the holders of the Senior Notes may require us to repurchase all or a portion of the Senior Notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The Senior Notes also include covenants that limit our ability to incur liens on assets and to enter into sale and leaseback transactions, subject to certain allowances.

Credit Facility

In March 2015, we entered into a $500 million senior unsecured revolving credit facility ("Credit Facility") with a syndicate of banks. The Credit Facility terminates on March 19, 2020. The Credit Facility contains an option to arrange with existing lenders and/or new lenders for them to provide up to an aggregate of $250 million in additional commitments for revolving loans. Proceeds of loans made under the Credit Facility may be used for general corporate purposes.

The loans bear interest, at our option, at the base rate plus an applicable spread or an adjusted LIBOR rate plus an applicable spread, in each case with such spread being determined based on our consolidated leverage ratio for the preceding fiscal quarter. We are also obligated to pay other customary fees for a credit facility of this size and type. Interest is due and payable in arrears quarterly for loans bearing interest at the base rate and at the end of an interest period (or at each three month interval in the case of loans with interest periods greater than three months) in the case of loans bearing interest at the adjusted LIBOR rate. Principal, together with all accrued and unpaid interest, is due and payable on March 19, 2020.

The credit agreement contains customary affirmative and negative covenants, including covenants that limit or restrict our ability to, among other things, incur subsidiary indebtedness, grant liens, dispose of all or substantially all assets and pay dividends or make distributions, in each case subject to customary exceptions for a credit facility of this size and type. We are also required to maintain compliance with a capitalization ratio and maintain a minimum level of total liquidity.

The credit agreement contains customary events of default, including among others, non-payment defaults, covenant defaults, cross-defaults to material indebtedness, bankruptcy and insolvency defaults, material judgment of defaults and a change of control default, in each case, subject to customary exceptions for a credit facility of this size and type. The occurrence of an event of default could result in the acceleration of the obligations under the credit facility, an obligation by any guarantors to repay the obligations in full and an increase in the applicable interest rate.

As of June 30, 2016, no amounts were outstanding under the Credit Facility. $2 million of debt issuance costs that were paid in connection with obtaining this credit facility are being amortized to interest expense over the 5-year term of the Credit Facility.

Interest Expense

The following table summarizes our interest expense recognized for the three months ended June 30, 2016 and 2015 that is included in interest and other income (expense), net on our Condensed Consolidated Statements of Operations (in millions):

Three
Months

	Ended June 30,	
	2016	2015
Amortization of debt discount	(1)	(6)
Amortization of debt issuance costs	(1)	(1)
Coupon interest expense	(11)	(1)
Total interest expense	$(13)	$(8)

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(11) COMMITMENTS AND CONTINGENCIES
Lease Commitments
As of June 30, 2016, we leased certain facilities, furniture and equipment under non-cancelable operating lease agreements. We were required to pay property taxes, insurance and normal maintenance costs for certain of these facilities and any increases over the base year of these expenses on the remainder of our facilities.
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, but are not limited to: FIFA (Fédération Internationale de Football Association), FIFPRO Foundation, FAPL (Football Association Premier League Limited), and DFL Deutsche Fußball Liga GmbH (German Soccer League) (professional soccer); Dr. Ing. h.c. F. Porsche AG, Ferrari S.p.A. (Need For Speed and Real Racing games); National Basketball Association (professional basketball); PGA TOUR (professional golf); National Hockey League and NHL Players’ Association (professional hockey); National Football League Properties, PLAYERS Inc., and Red Bear Inc. (professional football); Zuffa, LLC (Ultimate Fighting Championship); ESPN (content in EA SPORTS games); Disney Interactive (Star Wars); Fox Digital Entertainment, Inc. (The Simpsons); Universal Studios Inc. (Minions); and Respawn. 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 as of June 30, 2016 (in millions):

		Fiscal Years Ending March 31,						
	Total	2017 (Remaining nine mos.)	2018	2019	2020	2021	2022	Thereafter
Unrecognized commitments								
Developer/licensor commitments	$1,387	$134	$302	$277	$240	$193	$185	$ 56
Marketing commitments	378	60	53	84	65	68	48	—
Operating leases	247	29	38	34	31	29	23	63
0.75% Convertible Senior Notes due 2016 interest [a]	—	—	—	—	—	—	—	—
Senior Notes interest	290	28	41	41	41	41	20	78
Other purchase obligations	97	26	18	12	8	6	5	22
Total unrecognized commitments	2,399	277	452	448	385	337	281	219
Recognized commitments								
0.75% Convertible Senior Notes due 2016 principal and interest [a]	136	136	—	—	—	—	—	—
Senior Notes principal and interest	1,014	14	—	—	—	600	—	400
Licensing and lease obligations [b]	142	17	23	24	25	26	27	—
Total recognized commitments	1,292	167	23	24	25	626	27	400

Total commitments	$3,691	$444	$475	$472	$410	$963	$308	$ 619

(a) Subsequent to the quarter ended June 30, 2016, we repaid the remaining principal and interest balance on the Convertible Notes of $136 million. See Note 10 for additional information regarding our Convertible Notes.

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(b) Lease commitments have not been reduced for approximately $2 million due in the future from third parties under non-cancelable sub-leases. See Note 7 for additional information regarding recognized obligations from our licensing-related commitments.

The unrecognized amounts represented in the table above reflect our minimum cash obligations for the respective fiscal years, but do not necessarily represent the periods in which they will be recognized and expensed in our Condensed Consolidated Financial Statements. In addition, the amounts in the table above are presented based on the dates the amounts are contractually due as of June 30, 2016; however, certain payment obligations may be accelerated depending on the performance of our operating results. Up to $32 million of the unrecognized amounts in the table above may be payable, at the licensor's election, in shares of our common stock, subject to a $10 million maximum during any fiscal year. The number of shares to be issued will be based on fair market value at the time of issuance.

In addition to what is included in the table above, as of June 30, 2016, we had a liability for unrecognized tax benefits and an accrual for the payment of related interest totaling $88 million, of which we are unable to make a reasonably reliable estimate of when cash settlement with a taxing authority will occur.

Subsequent to June 30, 2016, we entered into various licensor and marketing agreements with third parties, which contingently commits us to pay approximately $325 million at various dates through fiscal year 2023.

Legal Proceedings

On July 29, 2010, Michael Davis, a former NFL running back, filed a putative class action in the United States District Court for the Northern District of California against the Company, alleging that certain past versions of Madden NFL included the images of certain retired NFL players without their permission. In March 2012, the trial court denied the Company's request to dismiss the complaint on First Amendment grounds. In January 2015, that trial court decision was affirmed by the Ninth Circuit Court of Appeals and the case was remanded back to the United States District Court for the Northern District of California, where the case is pending.

We are also 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 Condensed Consolidated Financial Statements.

(12) STOCK-BASED COMPENSATION

Valuation Assumptions

We estimate the fair value of stock-based awards on the date of grant. We recognize compensation costs for stock-based awards to employees based on the grant-date fair value using a straight-line approach over the service period for which such awards are expected to vest.

The determination of the fair value of market-based restricted stock units, stock options and ESPP is affected by assumptions regarding subjective and complex variables. Generally, our assumptions are based on historical information and judgment is required to determine if historical trends may be indicators of future outcomes. We determine the fair value of our stock-based awards as follows:

- Restricted Stock Units. The fair value of restricted stock units is determined based on the quoted market price of our common stock on the date of grant.

- Market-Based Restricted Stock Units. Market-based restricted stock units consist of grants of performance-based restricted stock units to certain members of executive management that vest contingent upon the achievement of pre-determined market and service conditions (referred to herein as "market-based restricted stock units"). The fair value of our market-based restricted stock units is determined using a Monte-Carlo simulation model. Key assumptions for the Monte-Carlo simulation model are the risk-free interest rate, expected volatility, expected dividends and correlation coefficient.

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Stock Options and Employee Stock Purchase Plan. The fair value of stock options and stock purchase rights granted pursuant to our equity incentive plans and our 2000 Employee Stock Purchase Plan, as amended ("ESPP"), respectively, is determined using the Black-Scholes valuation model based on the multiple-award valuation method. Key assumptions of the Black-Scholes valuation model are the risk-free interest rate, expected volatility, expected term and expected dividends. The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant for the

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expected term of the option. Expected volatility is based on a combination of historical stock price volatility and implied volatility of publicly-traded options on our common stock. Expected term is determined based on historical exercise behavior, post-vesting termination patterns, options outstanding and future expected exercise behavior.
There were no ESPP shares issued during the three months ended June 30, 2016 and 2015. There were an insignificant number of stock options granted during the three months ended June 30, 2016 and 2015.

The estimated assumptions used in the Monte-Carlo simulation model to value our market-based restricted stock units were as follows:

	Three Months Ended June 30,	
	2016	2015
Risk-free interest rate	0.8 %	1.0 %
Expected volatility	16 - 57%	14 - 50%
Weighted-average volatility	29 %	26 %
Expected dividends	None	None

Stock-Based Compensation Expense
Employee stock-based compensation expense recognized during the three months ended June 30, 2016 and 2015 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 units, market-based restricted stock units, and the ESPP included in our Condensed Consolidated Statements of Operations (in millions):

	Three Months Ended June 30,	
	2016	2015
Cost of revenue	$1	$ —
Research and development	27	$ 26
Marketing and sales	7	5
General and administrative	13	14
Stock-based compensation expense	$48	$ 45

During the three months ended June 30, 2016, we recognized a $9 million deferred income tax benefit related to our stock-based compensation expense. During the three months ended June 30, 2015, we did not recognize any benefit from income taxes related to our stock-based compensation expense due to the U.S. valuation allowance.
As of June 30, 2016, our total unrecognized compensation cost related to restricted stock units and market-based restricted stock units (collectively referred to as “restricted stock rights”) was $383 million and is expected to be recognized over a weighted-average service period of 1.9 years. Of the $383 million of unrecognized compensation cost, $56 million relates to market-based restricted stock units. As of June 30, 2016, our total unrecognized compensation cost related to stock options was $7 million and is expected to be recognized over a weighted-average service period of 1.2 years.
During the three months ended June 30, 2016 and 2015, we recognized $33 million and $40 million, respectively, of excess tax benefit from stock-based compensation deductions; this amount is reported in the financing activities on our Condensed Consolidated Statement of Cash Flows.

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Stock Options

The following table summarizes our stock option activity for the three months ended June 30, 2016:

	Options (in thousands)	Weighted-Average Exercise Prices	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding as of March 31, 2016	3,278	$ 35.09		
Granted	1	62.89		
Exercised	(142)	30.69		
Forfeited, cancelled or expired	(26)	35.90		
Outstanding as of June 30, 2016	3,111	$ 35.30	5.27	$ 126
Vested and expected to vest	3,030	$ 35.41	5.20	$ 123
Exercisable as of June 30, 2016	2,381	$ 36.55	4.53	$ 94

The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price as of June 30, 2016, which would have been received by the option holders had all the option holders exercised their options as of that date. We issue new common stock from our authorized shares upon the exercise of stock options.

Restricted Stock Rights

The following table summarizes our restricted stock rights activity, excluding market-based restricted stock unit activity which is discussed below, for the three months ended June 30, 2016:

	Restricted Stock Rights (in thousands)	Weighted-Average Grant Date Fair Values
Outstanding as of March 31, 2016	7,157	$ 44.04
Granted	2,033	74.75
Vested	(3,037)	35.00
Forfeited or cancelled	(193)	51.92
Outstanding as of June 30, 2016	5,960	$ 58.87

The weighted-average grant date fair values of restricted stock rights granted during the three months ended June 30, 2016 and 2015 were $74.75 and $62.64, respectively.

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Market-Based Restricted Stock Units

Our market-based restricted stock units vest contingent upon the achievement of pre-determined market and service conditions. If these market conditions are not met but service conditions are met, the market-based restricted stock units will not vest; however, any compensation expense we have recognized to date will not be reversed. The number of shares of common stock to be received at vesting will range from zero percent to 200 percent of the target number of market-based restricted stock units based on our total stockholder return ("TSR") relative to the performance of companies in the NASDAQ-100 Index for each measurement period, generally over a one-year, two-year cumulative and three-year cumulative period. In the table below, we present shares granted at 100 percent of target of the number of market-based restricted stock units that may potentially vest. The maximum number of shares of common stock that could vest is approximately 0.7 million for market-based restricted stock units granted during the three months ended June 30, 2016. As of June 30, 2016, the maximum number of shares that could vest is approximately 1.3 million for market-based restricted stock units outstanding.

The following table summarizes our market-based restricted stock unit activity for the three months ended June 30, 2016:

	Market-Based Restricted Stock Units (in thousands)	Weighted-Average Grant Date Fair Value
Outstanding as of March 31, 2016	636	$ 64.49
Granted	353	98.04
Vested	(558)	50.08
Vested above target	238	44.99
Forfeited or cancelled	(4)	79.81
Outstanding as of June 30, 2016	665	$ 87.31

Stock Repurchase Program

In May 2014, a special committee of our Board of Directors, on behalf of the full Board of Directors, authorized a two-year program to repurchase up to $750 million of our common stock. Since inception, we repurchased approximately 9.2 million shares for approximately $394 million under this program.

In May 2015, our Board of Directors authorized a program to repurchase up to $1 billion of our common stock. This stock repurchase program, which expires on May 31, 2017, supersedes and replaces the stock repurchase authorization approved in May 2014. Under this program, we may purchase stock in the open market or through privately-negotiated transactions in accordance with applicable securities laws, including pursuant to pre-arranged stock trading plans. The timing and actual amount of the stock repurchases will depend on several factors including price, capital availability, regulatory requirements, alternative investment opportunities and other market conditions. We are not obligated to repurchase any specific number of shares under this program and it may be modified, suspended or discontinued at any time. During the three months ended June 30, 2016, we repurchased approximately 1.9 million shares for approximately $129 million under this program. We continue to actively repurchase shares.

The following table summarizes total shares repurchased during the three months ended June 30, 2016 and 2015:

	May 2014 Program		May 2015 Program		Total	
(in millions)	Shares	Amount	Shares	Amount	Shares	Amount
Three months ended June 30, 2016	—	$ —	1.9	$ 129	1.9	$ 129
Three months ended June 30, 2015	1.0	$ 57	1.2	$ 75	2.2	$ 132

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(13) EARNINGS 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 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 ESPP, warrants, and other convertible securities using the treasury stock method.

	Three Months Ended June 30,	
(In millions, except per share amounts)	2016	2015
Net income	$440	$442
Shares used to compute earnings per share:		
Weighted-average common stock outstanding — basic	301	311
Dilutive potential common shares related to stock award plans and from assumed exercise of stock options	4	8
Dilutive potential common shares related to the Convertible Notes	2	10
Dilutive potential common shares related to the Warrants	8	6
Weighted-average common stock outstanding — diluted	315	335
Earnings per share:		
Basic	$1.46	$1.42
Diluted	$1.40	$1.32