Strategic Review of Electronic Arts
Part 1: Company Overview

NIBC | NATIONAL INVESTMENT BANKING
COMPETITION & CONFERENCE

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Electronic Arts

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Company Overview

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EA is the 3rd largest video game manufacturer in North America and has experienced strong share price performance on the back of favorable 2014 results

Company Highlights

- **History:** Founded in 1982, taken public in 1989, and had the leading sales during both 6th and 7th generations for consoles; today EA is the 3rd largest video game developer
- **Valuation:** 2011 through 2012 had EA faced with end of console cycle and poor free cash flow due to increased operating expenses, but valuation improved after 2012 with higher digital sales
- **Strategy:** Historically focused on “packaged goods” products that are sold through retailers but shifting business model to delivering games via online platforms and reducing number of titles
- **2014 Success:** EA had a very successful year in FY 2014 (EBITDA +49.6% YoY), primarily due to success in its FIFA 14 and Battlefield franchises, and increasing margins via cost reductions and a higher digital mix in its revenue stream
- **Major Corporate Finance Transactions:** $1.3bn acquisition of PopCap Games (2011), $391m acquisition of Playfish (2009), $620m acquisition of VG Holdings (2008)

Valuation and Share Performance

Key Valuation Statistics ($m)

EV*	$9,511	Revenue	$4,021
Market Cap*	$11,241	EBITDA	$944
P/E*	19.6x	EBITDA Margin	23.5%
EV/EBITDA*	9.7x	Debt / EV	6%
Cash	$2,365	Total Debt	$580

*As of September 26th, 2014
**All other figures as of FY14 (year end March 31st, 2014)

	Publisher	US Video Game Publishing
1	Activision	$2,172
2	Microsoft	$1,577
3	Electronic Arts	$1,359
4	Nintendo	$865
5	Sony	$680
6	Take Two	$648
7	Ubisoft	$451

* All revenues are for 2013 and in $m

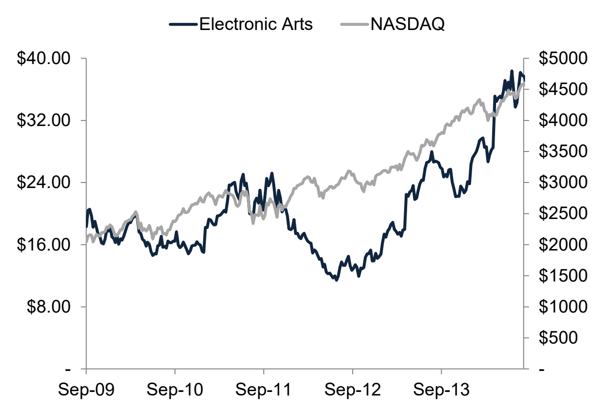
Other Notable Global Publishers

Konami, THQ, Square Enix, Sega

Revenue Mix	%	Gross ($mm)
Packaged Goods	53%	$2,149
Digital	45%	$1,793
Distribution	2%	$79

Key Franchises	Platform
FIFA	Console/PC/Mobile
Madden NFL	Console
NBA Live	Console
Need for Speed	Console/PC
SimCity	PC
Battlefield	Console/PC

Share Price	Current: $35.96	High / Low: $20.47 / $38.64



*Share price as of September 26th, 2014

Strategic Objectives

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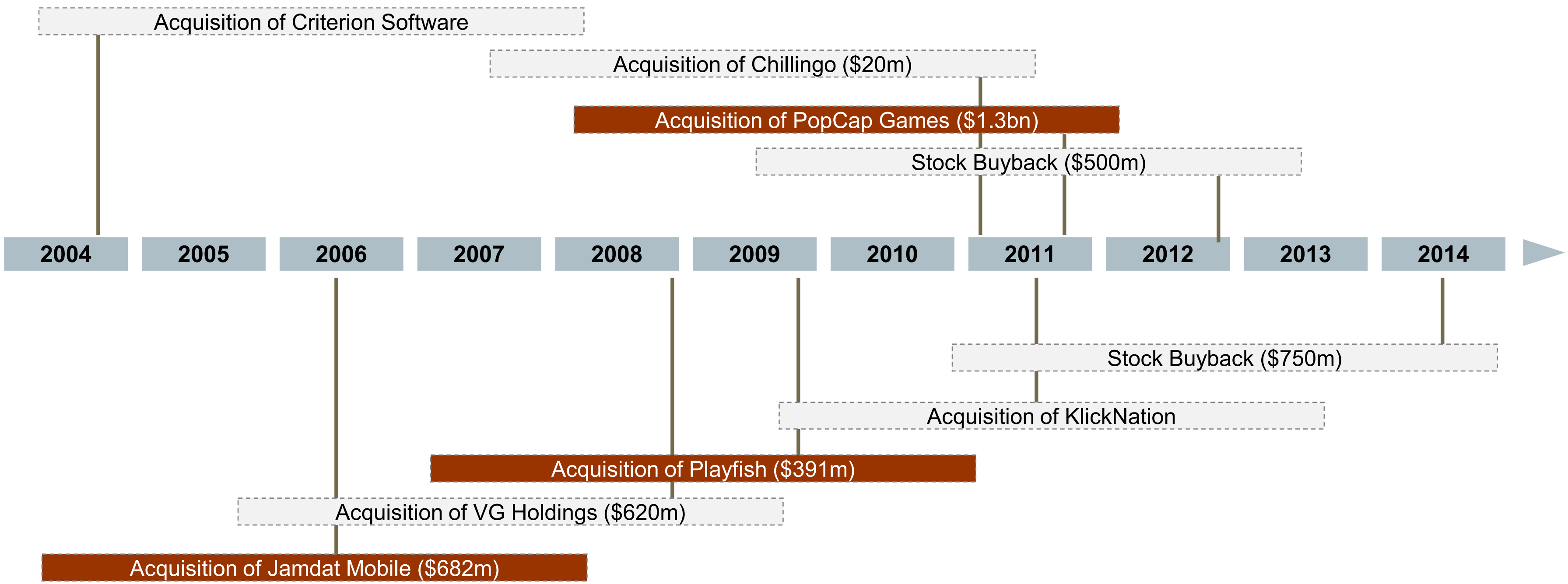
EA is focused on growing EBITDA through expanding margins from focusing on more AAA but fewer titles and achieving revenue growth from increased sales in digital segment

Strategic Objectives	Financial Objectives
▪ Maintain market leadership in core segment of games for dedicated video game players ▪ Grow segment that appeals to casual gamers through mobile and Internet platforms ▪ Aggressively reduce the number of significant title releases ▪ Create steady revenue stream by building additional content and online features	▪ Maintain high cash balance ($2,365m as of YE FY2014) to remain flexible for future M&A possibilities ▪ Continue cost cutting initiatives in operating expenses to improve operating margins; FY2014 non-GAAP EBITDA margin at 23.5% ▪ Provide games to consumers via digital platforms to improve margins and enhance user functionality

Corporate Finance Transactions



Business Model

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Historical performance has been volatile but packaged goods sales are expected to be replaced by strong digital sales which are forecasted to drive revenue growth at improved margins

Revenue and Cost Drivers

Packaged Goods Revenues: Games sold through packaged and physical distribution have been in long-term decline as distribution shifts to digital

Digital Revenues: Games capable of digital download and access over Internet have increased 24% YoY as market grows rapidly

- Full game downloads: Can be purchased through digital game portals
- Free to play downloads (F2P): Players must pay to access additional content
- Mobile/Social Network/Casual games: Less sophisticated games for new platforms
- Extra content: Micro-transactions as bonuses/upgrades to original content

Cost Structure: Overall cost structure is higher than for peer group but forecasted to improve as focus shifts to more blockbusters and digital segments

- Production costs (30%-33%)
- Fixed Costs:
  - Product development (13%-30%)
  - Sales and Marketing (13%-21%)
  - General and Admin (5%-7%)
- Fixed costs per blockbuster title are typically +$100m with sales between $30-$300m

Expected Pipeline

Release	Titles	Genre	Revenue ($m)
FY 2014			
F1Q14	*Titanfall*	FPS	
F2Q14	*2014 FIFA*	Sports	
FQ314	*UFC 2014*	Sports	
F4Q14	*DragonAge*	RPG	
FY 2015			
F2Q15	*Madden NFL 15*	Sports	$256
F2Q15	*FIFA 15*	Sports	$109
F2Q15	*NHL 15*	Sports	$37
F2Q15	*The Sims 4*	Simulation	$47
F3Q15	*NBA Live 15*	Sports	
F4Q15	*Battlefield*	FPS	$69
F4Q15	*Golf*	Sports	
FY 2016			
TBA	*Mirror's Edge*	Action	
TBA	*Star Wars Battlefront*	Action	

$ thousands	2010	2011	2012	2013	2014	2015E	2016E	2017E	2018E	2019E
Packaged Goods Revenues	2,526	2,781	2,736	2,028	2,149	1,977	2,076	2,034	1,993	1,953
Packaged goods revenue growth		*10.0%*	*(1.6)%*	*(25.9)%*	*6.0%*	*(8.0)%*	*5.0%*	*(2.0)%*	*(2.0)%*	*(2.0)%*
Digital Revenues	522	833	1,225	1,663	1,793	2,080	2,350	2,632	2,948	3,272
Digital goods revenue growth		*60.0%*	*47.1%*	*35.8%*	*7.8%*	*16.0%*	*13.0%*	*12.0%*	*11.0%*	*11.0%*
Total Revenues	4,159	3,828	4,184	3,793	4,021	4,132	4,501	4,742	5,017	5,301
Revenue growth		*8.0%*	*9.4%*	*(9.4)%*	*6.0%*	*2.8%*	*8.9%*	*5.4%*	*5.8%*	*5.7%*
EBITDA margin	*9.3%*	*12.9%*	*14.7%*	*16.6%*	*23.5%*	*25.1%*	*25.7%*	*26.6%*	*27.1%*	*27.3%*
Total EBITDA	388	493	613	631	944	1,037	1,157	1,261	1,359	1,447

- Segmented non-GAAP revenues exclude Distribution revenue
- Fiscal years ended March 31st

Capital Requirements

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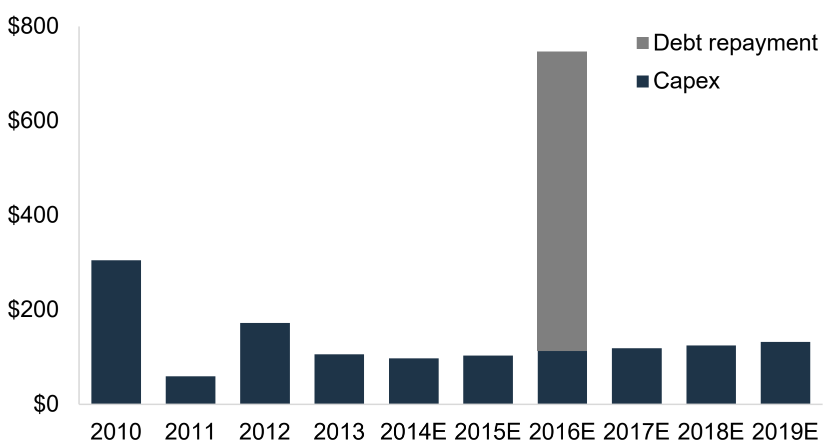
Capital requirements and development expenditures can comfortably be served from internal cashflows although EA retains significant cash on hand to opportunistically pursue acquisitions

Capital Requirements

- Massive, multi-player online games (MMOGs) require significant server capacity and need to be maintained frequently to create high quality experience
- Deal flexibility is critical in industry with major players holding significant cash on hand to compete to acquire the best game developers
- Game development costs can be fairly intensive depending on type of game but are typically funded from internal cashflows
  - Upfront development costs comprise around 35% of sales and are typically incurred between 24 and 36 months
  - New open-word game "Destiny" developed by Activision-Blizzard is reported to cost $500m in development plus marketing costs

	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E
Historical & Forecasted Capex ($m)	$305	$59	$172	$106	$97	$103	$113	$119	$125	$132
Capex /Sales	7.3%	1.5%	4.1%	2.8%	2.4%	2.5%	2.5%	2.5%	2.5%	2.5%
Debt repayment ($m)	-	-	-	-	-	-	$633	-	-	-



Debt Facility	Outs. ($m)	Avail. ($m)	Issued Maturity	Interest rate	Notes
Convertible Senior Unsecured Notes	$633	$0	2011 / 2016	0.75%	$633mm outstanding; converts at $31.74/sh; used for acquisition of PopCap
Revolving Credit Facility	$0	$500	2012	Adjusted LIBOR	$500m available; used for general corporate purposes

Operating Analysis

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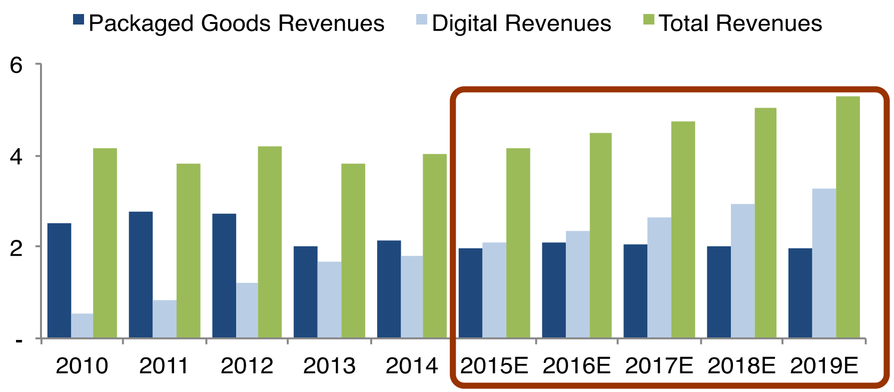
Positive drivers including focus on AAA titles and expansion of digital is expected to outweigh headwinds from growing competition and increased royalty expenses

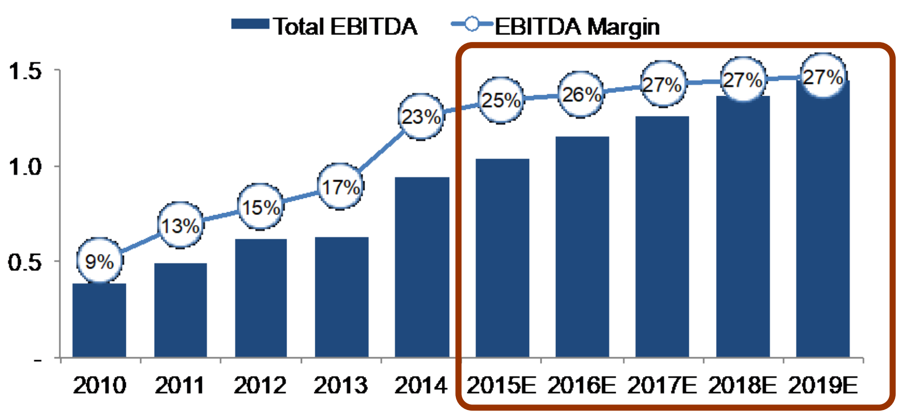
Total and Segmented Revenues

(In billions)



Total Non-GAAP EBITDA and Margin

(In billions)



- Revenue forecast based on analyst reports
- Fiscal years end March 31st

Trajectory

- Significant growth in digital revenues while packaged goods are in decline
- Uplift in 2014 EBITDA due to significant margin expansion from higher digital mix

Positive Drivers

- Management is focused on introducing cost cutting initiatives to improve margins, such as an increasingly focused marketing program
- Focus on producing less titles and directing a larger percentage of the budget to AAA releases
- Majority of growth in mobile / online gaming which accounts for less of EA's core business
- Tighter integration of Gen 8 consoles with PlayStation Network and Xbox LIVE should support 2015 revenue growth in the digital segment
- FY 2015 revenue could see high growth due to 3rd year of console cycle historically being very profitable for game developers & publishers

Negative Drivers

- Growing competition and consolidation in the industry is putting pressure on margins and ability of companies to differentiate
- Dependency on AAA releases makes revenue and cash flow stream more volatile and difficult for management to forecast where to allocate budget
- Royalty expenses are likely to weigh on revenues for the next 2 years
- Headwinds will surface for packaged goods revenue due to from transition to game development higher margin PC and mobile platforms

Liquidity Analysis

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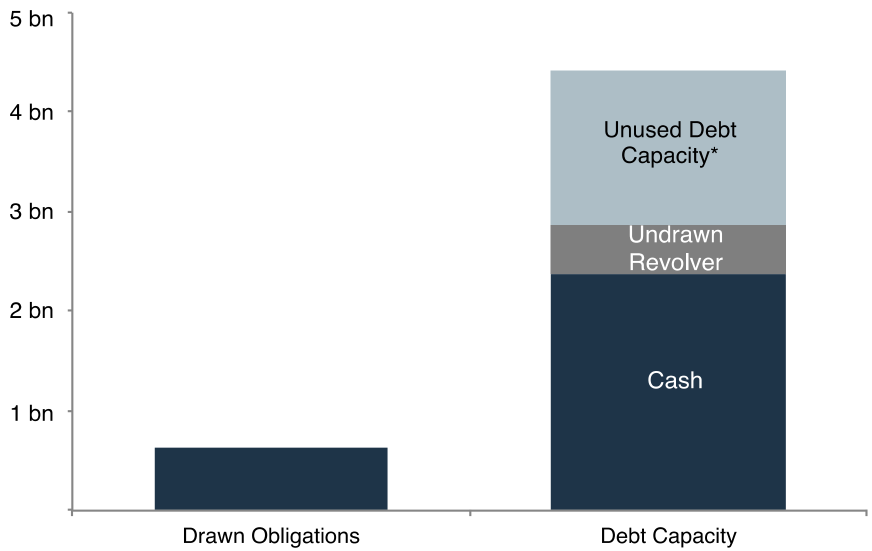
EA currently in significant net cash position with room to take on more debt although capacity may be limited by limited track record and changing market conditions

	2010A	2011A	2012A	2013A	2014A	2015E	2016E	2017E	2018E	2019E
Historical & Forecasted EBITDA ($m)	$388	$493	$613	$631	$944	$1,037	$1,156	$1,261	$1,359	$1,447
Debt / EBITDA						0.6 x	0.5 x	0.5 x	0.4 x	0.4 x
Interest Coverage						23.8 x	28.3 x	31.1 x	34.9 x	37.8 x
Debt / EV [2]	-	-	15.1%	8.6%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%

Sources: Bloomberg, CapIQ

1. Historical numbers & projected EBITDA are Non-GAAP
2. Historical EV and current EV for forecasts

Liquidity



* Based on 2x Debt / EBITDA

Credit Forecast

- No substantial change in credit unless a strategic acquisition opportunity rises which needs debt financing
- Risks include: Volatility of the video game industry, volatility of the mobile and free to play segments, investments in games that may underperform, lower visibility of revenue beyond fiscal 2018
- Credit facility's undrawn amount based on company's disclosure of available unused credit facility
- Common trend throughout video game industry is to maintain high leverage and high cash balances for deal flexibility
- Average Total Debt/EV is around 10% and average Total Debt/EBITDA is 3.9x in the industry

Ownership

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Shareholder base is stable with mostly institutional long-term investors which are expected to be open to EA pursuing further strategic acquisitions

Shareholder Characteristics

- The majority of EA ownership is held by institutional investors with the Top 10 Investors holding 39.96% of total shares
- EA's major shareholders are mostly long-term investors and no hedge funds
- Relatively insignificant insiders positions
- Most investors have done well recently and see EA as growth stock

Ownership (Top 10 Shareholders)

Institutional Investors	Shares	%	Value ($m)	% Ownership Acquired and Average Cost between Sep 2011 and Mar 2014	
Vanguard Group Inc.	23,162,510	7.41	837.09	1.40%	$25.60
Blackrock	22,868,722	7.32	826.47	NA	NA
American Century Companies	14,650,110	4.69	529.45	1.96%	$18.80
Alliance Bernstein LP	13,865,577	4.44	501.01	4.41%	$17.30
PRIMECAP Management Companies	12,525,669	4.01	452.67	(3.71)%	$38.00
State Street Corp.	12,025,129	3.85	434.58	0.35%	$18.20
FMR LLC	11,641,670	3.72	420.72	(5.37)%	$39.00
Columbia Management Invest.	9,899,719	3.17	357.77	0.37%	$26.50
JP Morgan Chase & Co.	9,616,494	3.08	347.54	2.63%	$14.50
Fidelity International	9,466,209	3.03	342.10	2.07%	$28.60
				Share Price (at Sep 26h, 2014)	**$35.96**

- Institutional Ownership: 98.53% (739 Institutional Owners)
- Fund Ownership: 58.48% (1,316 Fund Owners)
- Insider Ownership: 0.43%
- Basic Shares Outstanding: 312.61m (as of September 26th, 2014)