ELECTRONIC ARTS INC.
Form 10-Q
November 10, 2009

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 September 30, 2009

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. 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 ¨

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 November 6, 2009, there were 325,475,032 shares of the Registrant s Common Stock, par value $0.01 per share, outstanding.

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ELECTRONIC ARTS INC.

FORM 10-Q

FOR THE PERIOD ENDED SEPTEMBER 30, 2009

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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)	September 30, 2009	March 31, 2009 (a)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,042	$ 1,621
Short-term investments	583	534
Marketable equity securities	387	365
Receivables, net of allowances of $194 and $217, respectively	646	116
Inventories	250	217
Deferred income taxes, net	74	51
Other current assets	245	216
Total current assets	3,227	3,120
Property and equipment, net	569	354
Goodwill	817	807
Acquisition-related intangibles, net	194	221
Deferred income taxes, net	71	61
Other assets	124	115
TOTAL ASSETS	$ 5,002	$ 4,678
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 273	$ 152
Accrued and other current liabilities	848	723
Deferred net revenue (packaged goods and digital content)	792	261
Total current liabilities	1,913	1,136
Income tax obligations	316	268
Deferred income taxes, net	28	42
Other liabilities	89	98
Total liabilities	2,346	1,544
Commitments and contingencies (See Note 11)		
Stockholders equity:		
Preferred stock, $0.01 par value. 10 shares authorized		
Common stock, $0.01 par value. 1,000 shares authorized; 325 and 323 shares issued and outstanding, respectively	3	3
Paid-in capital	2,181	2,142
Retained earnings	175	800
Accumulated other comprehensive income	297	189

Total stockholders equity		2,656		3,134
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	5,002	$	4,678

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) (In millions, except per share data)	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Six Months Ended September 30, 2009	Six Months Ended September 30, 2008
Net revenue	$ 788	$ 894	$ 1,432	$ 1,698
Cost of goods sold	593	557	914	853
Gross profit	195	337	518	845
Operating expenses:				
Marketing and sales	187	197	351	325
General and administrative	91	92	157	176
Research and development	316	372	628	729
Acquired in-process technology				2
Amortization of intangibles	12	16	24	30
Certain abandoned acquisition-related costs		21		21
Restructuring charges	6	3	20	23
Total operating expenses	612	701	1,180	1,306
Operating loss	(417)	(364)	(662)	(461)
Losses on strategic investments	(8)	(34)	(24)	(40)
Interest and other income, net	7	7	10	23
Loss before benefit from income taxes	(418)	(391)	(676)	(478)
Benefit from income taxes	(27)	(81)	(51)	(73)
Net loss	$ (391)	$ (310)	$ (625)	$ (405)
Net loss per share:				
Basic and Diluted	$ (1.21)	$ (0.97)	$ (1.93)	$ (1.27)
Number of shares used in computation:				
Basic and Diluted	324	319	324	319

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)	Six Months Ended September 30, 2009	2008
OPERATING ACTIVITIES		
Net loss	$ (625)	$ (405)
Adjustments to reconcile net loss to net cash used in operating activities:		
Acquired in-process technology		2
Depreciation, amortization and accretion, net	94	104
Net losses on investments and sale of property and equipment	23	40
Non-cash restructuring charges	7	16
Stock-based compensation	77	103
Change in assets and liabilities:		
Receivables, net	(518)	(253)
Inventories	(30)	(163)
Other assets	(34)	18
Accounts payable	123	104
Accrued and other liabilities	73	104
Deferred income taxes, net	(43)	(122)
Deferred net revenue (packaged goods and digital content)	531	37
Net cash used in operating activities	(322)	(415)
INVESTING ACTIVITIES		
Purchase of headquarters facilities	(233)	
Capital expenditures	(34)	(63)
Proceeds from maturities and sales of investments	359	510
Purchase of short-term investments	(405)	(313)
Acquisition of subsidiaries, net of cash acquired	(3)	(42)
Net cash provided by (used in) investing activities	(316)	92
FINANCING ACTIVITIES		
Proceeds from issuance of common stock	25	69
Excess tax benefit from stock-based compensation		16
Net cash provided by financing activities	25	85
Effect of foreign exchange on cash and cash equivalents	34	(18)
Decrease in cash and cash equivalents	(579)	(256)
Beginning cash and cash equivalents	1,621	1,553
Ending cash and cash equivalents	$ 1,042	$ 1,297
Supplemental cash flow information:		
Net cash paid during the period for income taxes	$ 3	$ 11
Non-cash investing activities:		
Change in unrealized gains (losses) on investments, net	$ 29	$ (97)

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

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ELECTRONIC ARTS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

We develop, market, publish and distribute video game software and content that can be played by consumers on a variety of platforms, including video game consoles (such as the PLAYSTATION® 3, Microsoft Xbox 360 and Nintendo Wii), personal computers, handheld game players (such as the PlayStation® Portable (PSP) and the Nintendo DS) and wireless devices (such as cellular phones and smart phones including the Apple iPhone). 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, Dead Space 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.*, Harry Potter).

Our fiscal year is reported on a 52 or 53-week period that ends on the Saturday nearest March 31. Our results of operations for the fiscal years ending or ended, as the case may be, March 31, 2010 and 2009 contain 53 and 52 weeks, respectively, and ends or ended, as the case may be, on April 3, 2010 and March 28, 2009, respectively. Our results of operations for the three months ended September 30, 2009 and 2008 contain 13 weeks and ended on October 3, 2009 and September 27, 2008, respectively. Our results of operations for the six months ended September 30, 2009 and 2008 contain 27 and 26 weeks, respectively, and ended on October 3, 2009 and September 27, 2008, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

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

Certain reclassifications have been made to the fiscal year 2009 financial information to conform to the fiscal year 2010 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, 2009, as filed with the United States Securities and Exchange Commission (SEC) on May 22, 2009.

(2) FAIR VALUE MEASUREMENTS

On April 1, 2009, we adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures,* as it applies to nonfinancial assets and nonfinancial liabilities. These nonfinancial items include assets and liabilities such as a reporting unit measured at fair value in a goodwill impairment test and nonfinancial assets acquired and liabilities assumed in a business combination. We measure certain financial and nonfinancial assets and liabilities at fair value on a recurring and nonrecurring basis.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Our money market funds, available-for-sale fixed income and marketable equity securities, deferred compensation plan assets and foreign currency derivatives are measured and recorded at fair value on a recurring basis.

Our Level 1 financial instruments are valued using quoted prices in active markets for identical instruments. Our Level 2 financial instruments, including derivative instruments, are valued using quoted prices for identical instruments in less active markets or using other observable market inputs for comparable instruments. As of September 30, 2009 and March 31, 2009, we did not have any Level 3 financial instruments that were measured and recorded at fair value on a recurring basis.

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As of September 30, 2009 and March 31, 2009, our financial assets and liabilities that are measured and recorded at fair value on a recurring basis were as follows (in millions):

		Fair Value Measurements at Reporting Date Using			
	As of September 30, 2009	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance Sheet Classification
Assets					
Money market funds	$ 543	$ 543	$	$	Cash equivalents
Available-for-sale securities:					
Marketable equity securities	387	387			Marketable equity securities
Corporate bonds	224		224		Short-term investments
U.S. Treasury securities	191	191			Short-term investments
U.S. agency securities	149		149		Short-term investments
Commercial paper	18		18		Short-term investments and cash equivalents
Asset-backed securities	4		4		Short-term investments
Deferred compensation plan assets [a]	12	12			Other assets
Foreign currency derivatives	2		2		Other current assets
Total assets at fair value	$ 1,530	$ 1,133	$ 397	$	

	As of March 31, 2009	(Level 1)	(Level 2)	(Level 3)	Balance Sheet Classification
Assets					
Money market funds	$ 1,069	$ 1,069	$	$	Cash equivalents
Available-for-sale securities:					
Marketable equity securities	365	365			Marketable equity securities
U.S. Treasury securities	212	212			Short-term investments and cash equivalents
Corporate bonds	133		133		Short-term investments and cash equivalents
U.S. agency securities	118		118		Short-term investments and cash equivalents
Commercial paper	118		118		Short-term investments and cash equivalents
Asset-backed securities	15		15		Short-term investments
Deferred compensation plan assets [a]	9	9			Other assets
Foreign currency derivatives	2		2		Other current assets
Total assets at fair value	$ 2,041	$ 1,655	$ 386	$	

[a] The deferred compensation plan assets consist of various mutual funds.

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Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

During the three and six months ended September 30, 2009, none of our nonfinancial or financial assets were recorded at fair value on a nonrecurring basis. During the three and six months ended September 30, 2008, certain of our financial assets were measured and recorded at fair value and the impairments recorded during those periods on a nonrecurring basis were as follows (in millions):

		Fair Value Measurements Using				
	Net Carrying Value as of September 30, 2008	Quoted Prices in Active Markets for Identical Financial Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Impairment for the Three Months Ended September 30, 2008	Total Impairment for the Six Months Ended September 30, 2008
Assets						
Other investments	$ 8	$	$ 8	$	$ 9	$ 10
Total assets at fair value	$ 8	$	$ 8	$	$ 9	$ 10

Other investments included in the table above were measured and recorded on a nonrecurring basis using other observable market inputs for comparable instruments. During the three and six months ended September 30, 2008, we measured certain of our other investments at fair value due to various factors, including but not limited to, the extent and duration during which the fair value had been below cost. See Note 3 for information regarding other investments.

(3) FINANCIAL INSTRUMENTS

On April 1, 2009, we adopted FASB ASC 825, *Financial Instruments*, which requires disclosures about the fair value of financial instruments for interim reporting periods of publicly traded companies. See Note 2 for information on the methods and assumptions used to estimate the fair value of our financial instruments.

Cash, Cash Equivalents, Short-Term Investments and Foreign Currency Option Contracts

Cash, cash equivalents and short-term investments consisted of the following as of September 30, 2009 and March 31, 2009 (in millions):

	As of September 30, 2009				As of March 31, 2009			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:								
Cash	$ 496	$	$	$ 496	$ 490	$	$	$ 490
Money market funds	543			543	1,069			1,069
Commercial paper	3			3	39			39
U.S. Treasury securities					12			12
U.S. agency securities					9			9
Corporate bonds					2			2
Cash and cash equivalents	1,042			1,042	1,621			1,621

Short-term investments:								
Corporate bonds	221	3		224	130	1		131
U.S. Treasury securities	190	1		191	198	2		200
U.S. agency securities	148	1		149	108	1		109
Commercial paper	15			15	79			79
Asset-backed securities	4			4	15			15
Short-term investments	578	5		583	530	4		534
Cash, cash equivalents and short-term investments	$ 1,620	$ 5	$	$ 1,625	$ 2,151	$ 4	$	$ 2,155

As of September 30, 2009 and March 31, 2009, we had less than $1 million in each period in gross unrealized losses primarily attributable to our corporate bonds and U.S. Treasury securities. As of September 30, 2009 and March 31, 2009, these gross unrealized losses were primarily in loss positions for less than 12 months.

We evaluate our investments for impairment quarterly. Factors considered in the review of investments with an unrealized loss include the credit quality of the issuer, the duration that the fair value has been less than the cost basis, severity of the impairment, reason for the decline in value and potential recovery period, the financial condition and near-term prospects of the investees, our intent and ability to hold the investments for a period of time sufficient to allow for any anticipated recovery in market value, as well as any contractual terms impacting the prepayment or settlement process. Based on our review, we did not consider the investments listed above to be other-than-temporarily impaired as of September 30, 2009 and March 31, 2009.

The following table summarizes the gross realized gains and losses from the sale of short-term investments for the three and six months ended September 30, 2009 and 2008 (in millions):

	September 30, 2009		September 30, 2008	
	Three months ended	Six months ended	Three months ended	Six months ended
Short-term investments				
Gross realized gains	$	$ 2	$ 2	$ 3
Gross realized losses			(1)	(2)
Net realized gains [a]	$	$ 2	$ 1	$ 1

[a] Realized gains and losses are calculated based on the specific identification method.

The following table summarizes the amortized cost and fair value of our short-term investments, classified by stated maturity as of September 30, 2009 and March 31, 2009 (in millions):

	As of September 30, 2009		As of March 31, 2009	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Short-term investments excluding asset-backed securities				
Due in 1 year or less	$ 188	$ 189	$ 245	$ 245
Due in 1-2 years	224	227	156	159
Due in 2-3 years	162	163	114	115
Asset-backed securities				
Weighted average maturity less than 1 year	4	4	15	15
Short-term investments	$ 578	$ 583	$ 530	$ 534

Asset-backed securities are separately disclosed as they are not due at a single maturity date. Our investment policy requires our asset-backed securities have weighted-average maturities of three years or less.

As of September 30, 2009, our foreign currency option contracts had a cost of $3 million, gross unrealized gains of $1 million, gross unrealized losses of $2 million and a fair value of $2 million. As of March 31, 2009, our foreign currency option contracts had a cost of $3 million, gross unrealized losses of $1 million and a fair value of $2 million. See Note 4 for information regarding our derivative financial instruments.

Marketable Equity Securities

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

Marketable equity securities consisted of the following (in millions):

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of September 30, 2009	$ 146	$ 241	$	$ 387
As of March 31, 2009	$ 175	$ 190	$	$ 365

During the three and six months ended September 30, 2009, we recognized impairment charges of $8 million and $24 million, respectively, on our investment in The9. During the three and six months ended September 30, 2008, we recognized impairment charges of $25 million and $30 million, respectively, on our Neowiz common shares. Due to various factors, including but not limited to, a change in the financial condition of one of the investee s business and the extent and duration during which the market prices had been below cost, we concluded the decline in values were other-than-temporary. The $8 million and $24 million impairments for the three and six months ended September 30, 2009, respectively, and the $25 million and $30 million impairments for the three and six months ended September 30, 2008, respectively, are included in losses on strategic investments on our Condensed Consolidated Statements of Operations.

During the three and six months ended September 30, 2009, we received proceeds of $4 million and recognized less than $1 million in realized losses from selling a portion of our investment in The9. We did not sell any of our marketable equity securities during the three and six months ended September 30, 2008.

Other Investments Included in Other Assets

Our other investments consist principally of non-voting preferred shares in two companies whose common stock is publicly traded and are accounted for under the cost method. Under this method these investments are recorded at cost on our Condensed Consolidated Balance Sheets until we determine that the fair values of the investments other-than-temporarily fall below their cost basis. We evaluate our investments for impairment quarterly. If we conclude that an investment is other-than-temporarily impaired, we will recognize an impairment charge at that time in our Condensed Consolidated Statements of Operations.

During the three and six months ended September 30, 2009, we did not recognize any impairment charges with respect to these investments. During the three and six months ended September 30, 2008, we recognized impairment charges of $9 million and $10 million, respectively, on these investments. Due to various factors, including but not limited to, the extent and duration during which the fair value had been below cost, we concluded the decline in values were other-than-temporary. The $9 million and $10 million impairments for the three and six months ended September 30, 2008, respectively, are included in losses on strategic investments on our Condensed Consolidated Statements of Operations.

(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 or accrued and other current liabilities, respectively, in 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 and whether it is designated and qualifies for hedge accounting.

We transact business in various foreign currencies and have significant international sales and expenses denominated in foreign currencies, subjecting us to foreign currency risk. We purchase foreign currency option contracts, generally with maturities of 15 months or less, to reduce the volatility of cash flows primarily related to forecasted revenue and expenses denominated in certain foreign currencies. In addition, we utilize foreign currency forward contracts to mitigate foreign exchange rate risk associated with foreign-currency-denominated assets and liabilities, primarily intercompany receivables and payables. The foreign currency forward contracts generally have a contractual term of approximately three months or less and are transacted near month-end. At each quarter-end, the fair value of the foreign currency forward contracts generally is not significant. We do not use foreign currency option or foreign currency forward contracts for speculative or trading purposes.

Cash Flow Hedging Activities

Our foreign currency option contracts are designated and qualify as cash flow hedges. The effectiveness of the cash flow hedge contracts, including time value, is assessed monthly using regression, as well as other timing and probability criteria. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. The effective portion of gains or losses resulting from changes in fair value of these hedges is initially reported, net of tax, as a component of accumulated other comprehensive

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income in stockholders equity. The gross amount of the effective portion of gains or losses resulting from changes in 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. 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. The effective portion of hedges recognized in accumulated other comprehensive income will be reclassified to our Condensed Consolidated Statements of Operations within 12 months. As of September 30, 2009, we had foreign currency option contracts to purchase approximately $36 million in foreign currency and to sell approximately $117 million of foreign currencies. As of September 30, 2009, these foreign currency option contracts outstanding had a total fair value of $2 million and are included in other current assets. As of March 31, 2009, we had foreign currency option contracts to purchase approximately $19 million in foreign currency and to sell approximately $65 million of foreign currencies. As of March 31, 2009, these foreign currency option contracts outstanding had a total fair value of $2 million and are included in other current assets.

The effect of foreign currency option contracts on our Condensed Consolidated Statements of Operations for the three and six months ended September 30, 2009 was immaterial.

Balance Sheet Hedging Activities

Our foreign currency forward contracts are not designated as hedging instruments. Accordingly, any gains or losses resulting from changes in the fair value of the foreign currency forward contracts are reported in interest and other income, net, in our Condensed Consolidated Statements of Operations. The gains and losses on these foreign currency forward contracts generally offset the gains and losses associated with 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 September 30, 2009, we had foreign currency forward contracts to purchase and sell approximately $320 million in foreign currencies. Of this amount, $286 million represented contracts to sell foreign currencies in exchange for U.S. dollars, $26 million to purchase foreign currencies in exchange for U.S. dollars and $8 million to sell foreign currency in exchange for British pounds sterling. As of March 31, 2009, we had foreign currency forward contracts to purchase and sell approximately $63 million in foreign currencies. Of this amount, $53 million represented contracts to sell foreign currencies in exchange for U.S. dollars, $7 million to purchase foreign currencies in exchange for U.S. dollars and $3 million to sell foreign currencies in exchange for British pounds sterling. The fair value of our foreign currency forward contracts was immaterial as of September 30, 2009 and March 31, 2009.

The effect of foreign currency forward contracts on our Condensed Consolidated Statements of Operations for the three and six months ended September 30, 2009, was as follows (in millions):

	Three Months Ended September 30, 2009		**Six Months Ended September 30, 2009**	
	Location of Loss Recognized in Income on Derivative	**Amount of Loss Recognized in Income on Derivative**	**Location of Loss Recognized in Income on Derivative**	**Amount of Loss Recognized in Income on Derivative**
Foreign currency forward contracts not designated as hedging instruments	Interest and other income, net	$ (4)	Interest and other income, net	$ (12)

(5) BUSINESS COMBINATIONS

On April 1, 2009, we adopted FASB ASC 805, *Business Combinations*, which requires the recognition of assets acquired, liabilities assumed, and any noncontrolling interest in an acquiree at the acquisition date based on their fair value with limited exceptions. FASB ASC 805 changes the accounting treatment for certain specific items and includes a substantial number of new disclosure requirements. The adoption of FASB ASC 805 did not have a significant impact on our Condensed Consolidated Financial Statements for the three and six months ended September 30, 2009.

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(6) GOODWILL AND ACQUISITION-RELATED INTANGIBLES, NET

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

	As of March 31, 2009	Goodwill Acquired	Effects of Foreign Currency Translation	As of September 30, 2009
Label Segment	$ 667	$	$ 6	$ 673
EA Mobile Segment	140	2	2	144
Total	$ 807	$ 2	$ 8	$ 817

Acquisition-related intangibles, net, consist of the following (in millions):

	As of September 30, 2009			As of March 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Acquisition-Related Intangibles, Net
Developed and Core Technology	$ 253	$ (142)	$ 111	$ 249	$ (128)	$ 121
Trade Name	87	(54)	33	86	(43)	43
Carrier Contracts and Related	85	(53)	32	85	(51)	34
Subscribers and Other Intangibles	49	(31)	18	51	(28)	23
Total	$ 474	$ (280)	$ 194	$ 471	$ (250)	$ 221

Amortization of intangibles for the three and six months ended September 30, 2009 was $15 million (of which $3 million was recognized as cost of goods sold) and $30 million (of which $6 million was recognized as cost of goods sold), respectively. Amortization of intangibles for the three and six months ended September 30, 2008 was $20 million (of which $4 million was recognized as cost of goods sold) and $37 million (of which $7 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 fifteen years. As of September 30, 2009 and March 31, 2009, the weighted-average remaining useful life for finite-lived intangible assets was approximately 5.8 years and 6.0 years, respectively.

As of September 30, 2009, 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,	
2010 (remaining six months)	$ 28
2011	52
2012	36
2013	21
2014	14
Thereafter	43
Total	$ 194

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(7) RESTRUCTURING CHARGES

Restructuring information as of September 30, 2009 was as follows (in millions):

	Fiscal 2009 Restructuring			Fiscal 2008 Reorganization			Other Restructurings			
	Workforce	Facilities-related	Other	Workforce	Facilities-related	Other	Workforce	Facilities-related	Other	Total
Balances as of March 31, 2008	$	$	$	$ 1	$	$ 4	$	$ 9	$	$ 14
Charges to operations	32	7	2		22	12	4	1		80
Charges settled in cash	(24)	(1)		(1)		(13)	(4)	(3)		(46)
Charges settled in non-cash		(1)	(2)		(22)					(25)
Balances as of March 31, 2009	8	5				3		7		23
Charges to operations	1	10			3	6				20
Charges settled in cash	(9)	(3)				(7)				(19)
Charges settled in non-cash		(4)			(3)					(7)
Accrual reclassification								(7)		(7)
Balances as of September 30, 2009	$	$ 8	$	$	$	$ 2	$	$	$	$ 10

Fiscal 2009 Restructuring

In fiscal year 2009, we announced details of a cost reduction plan as a result of our performance combined with the economic environment. This plan includes a narrowing of our product portfolio, a reduction in our worldwide workforce of approximately 11 percent, or 1,100 employees, the closure of 10 facilities, and reductions in other variable costs and capital expenditures.

Since the inception of the fiscal 2009 restructuring plan through September 30, 2009, we have incurred charges of $52 million, of which (1) $33 million were for employee-related expenses, (2) $17 million related to the closure of certain of our facilities, and (3) $2 million related to asset impairments. The restructuring accrual of $8 million as of September 30, 2009 related to our fiscal 2009 restructuring is expected to be settled by September 2016. This accrual is included in other accrued expenses presented in Note 9 of the Notes to Condensed Consolidated Financial Statements.

During the remainder of fiscal year 2010, we anticipate incurring less than $1 million of restructuring charges related to the fiscal 2009 restructuring. Overall, including charges incurred through September 30, 2009, we expect to incur total cash and non-cash charges between $52 million and $55 million by March 2010. These charges will consist primarily of employee-related costs (approximately $33 million), facility exit costs (approximately $18 million), as well as other costs including asset impairment costs (approximately $2 million).

Fiscal 2008 Reorganization

In June 2007, we announced a plan to reorganize our business into several new divisions including, at the time four new Labels: EA SPORTS, EA Games, EA Casual Entertainment and The Sims in order to streamline decision-making, improve global focus, and speed new ideas to market. In October 2007, our Board of Directors approved a plan of reorganization (fiscal 2008 reorganization plan) in connection with the reorganization of our business into four new Labels. During fiscal year 2009, we consolidated and reorganized two of our Labels. As a result, we have three Labels, EA SPORTS, EA Games and EA Play, as well as a new organization, EA Interactive, which reports into our Publishing business. Each Label, as well as EA Interactive, operates with dedicated studio and product marketing teams focused on consumer-driven priorities.

Since the inception of the fiscal 2008 reorganization plan through September 30, 2009, we have incurred charges of $140 million, of which (1) $12 million were for employee-related expenses, (2) $83 million related to the closure of our Chertsey, England and Chicago, Illinois facilities, which included asset impairment and lease termination costs, and (3) $45 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. The restructuring accrual of $2 million as of September 30, 2009 related to our fiscal 2008 reorganization is expected to be settled by March 2010. This accrual is included in other accrued expenses presented in Note 9 of the Notes to Condensed Consolidated Financial Statements.

During the remainder of fiscal year 2010, we anticipate incurring approximately $1 million of restructuring charges related to the fiscal 2008 reorganization. Overall, including charges incurred through September 30, 2009, we expect to incur total cash and non-cash charges between $141 million and $145 million by March 2010. These charges will consist primarily of employee-related costs (approximately $12 million), facility exit costs (approximately $83 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 $46 million).

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Other Restructurings

We also engaged in various other restructurings based on management decisions. From April 1, 2008 through September 30, 2009, $7 million in cash had been paid out under these restructuring plans. The $7 million restructuring accrual as of March 31, 2009 was reclassified as of September 30, 2009 from accrued and other current liabilities to other liabilities on our Condensed Consolidated Balance Sheet.

(8) 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 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. Royalty liabilities are classified as current liabilities to the extent such royalty obligations are contractually due within the next twelve months. As of September 30, 2009 and March 31, 2009, approximately $23 million and $37 million, respectively, of minimum guaranteed royalty obligations had been recognized and are included in the royalty-related assets and liabilities tables below.

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 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. We evaluate long-lived royalty-based assets for impairment based on an undiscounted cash flow basis when impairment indicators exist. 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 six months ended September 30, 2009, we recognized impairment charges of $1 million. We had no loss or impairment charges during the three months ended September 30, 2009. During the three and six months ended September 30, 2008, we recognized an impairment charge of $5 million.

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 September 30, 2009	As of March 31, 2009
Other current assets	$ 82	$ 74
Other assets	44	47
Royalty-related assets	$ 126	$ 121

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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 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 September 30, 2009	As of March 31, 2009
Accrued and other current liabilities	$ 321	$ 237
Other liabilities	12	29
Royalty-related liabilities	$ 333	$ 266

In addition, as of September 30, 2009, we were committed to pay approximately $1,480 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.

(9) BALANCE SHEET DETAILS

Inventories

Inventories as of September 30, 2009 and March 31, 2009 consisted of (in millions):

	As of September 30, 2009	As of March 31, 2009
Raw materials and work in process	$ 21	$ 7
In-transit inventory	14	9
Finished goods	215	201
Inventories	$ 250	$ 217

Property and Equipment, Net

Property and equipment, net, as of September 30, 2009 and March 31, 2009 consisted of (in millions):

	As of September 30, 2009	As of March 31, 2009
Computer equipment and software	$ 712	$ 663
Buildings	338	143
Leasehold improvements	105	125
Office equipment, furniture and fixtures	72	63
Land	64	11
Warehouse equipment and other	14	14
Construction in progress	13	16
	1,318	1,035
Less accumulated depreciation	(749)	(681)

Property and equipment, net	$ 569	$ 354

Depreciation expense associated with property and equipment amounted to $30 million and $62 million for the three and six months ended September 30, 2009, respectively. Depreciation expense associated with property and equipment amounted to $29 million and $61 million for the three and six months ended September 30, 2008, respectively.

On July 13, 2009, we purchased our Redwood Shores headquarters facilities comprised of approximately 660,000 square feet concurrent with the expiration and extinguishment of the lessor s financing agreements. These facilities were subject to leases, which expired in July 2009, and had previously been accounted for as operating leases. The total amount paid under the terms of the leases was $247 million, of which $233 million related to the purchase price of the facilities and $14 million was for the loss on our lease

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obligation. This $14 million loss is included in General and administrative expense on our Condensed Consolidated Statements of Operations. Subsequent to our purchase, we classified the facilities on our Condensed Consolidated Balance Sheet as property and equipment, net and recognized depreciation expense for the property acquired on a straight-line basis over the estimated useful lives, excluding the land acquired.

Accrued and Other Current Liabilities

Accrued and other current liabilities as of September 30, 2009 and March 31, 2009 consisted of (in millions):

	As of September 30, 2009	As of March 31, 2009
Accrued royalties	$ 321	$ 237
Other accrued expenses	305	237
Accrued compensation and benefits	122	142
Deferred net revenue (other)	100	107
Accrued and other current liabilities	$ 848	$ 723

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 $792 million as of September 30, 2009 and $261 million as of March 31, 2009. Deferred net revenue (packaged goods and digital content) includes the deferral of (1) the total net revenue from bundle sales of certain online-enabled packaged goods and digital content for which either we do not have vendor-specific objective evidence of fair value (VSOE) for the online service that we provide in connection with the sale of the software or we have an obligation to provide future incremental unspecified digital content, (2) revenue from certain packaged goods sales of massively-multiplayer online role-playing games, and (3) revenue from the sale of certain incremental content associated with our core subscription services that can only be played online, which are types of micro-transactions. We recognize revenue from sales of online-enabled packaged goods and digital content for which (1) we do not have VSOE for the online service that we provided in connection with the sale and (2) we have an obligation to deliver incremental unspecified digital content in the future without an additional fee on a straight-line basis over an estimated six month period beginning in the month after shipment. However, 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).

(10) 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 or a year-to-date loss where no tax benefit can be recognized 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 carry forwards. 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. It is generally difficult to conclude that a valuation allowance is not needed when there is significant negative evidence, such as cumulative losses in recent years. Forecasts of future taxable income are considered to be less objective than past results, particularly in light of the economic environment. Therefore, cumulative losses weigh heavily in the overall assessment. Based on the assumptions and requirements noted above, we have recorded a valuation allowance against most of our U.S. deferred tax assets. In addition, we expect to provide a valuation allowance on future U.S. tax benefits until we can sustain a level of profitability or until other significant positive evidence arises that suggest that these benefits are more likely than not to be realized.

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In determining the valuation allowance we recorded at June 30, 2009, we did not include as a source of future taxable income the taxable temporary difference related to the accumulated tax depreciation on our headquarters facilities in Redwood City, California. On July 13, 2009, we purchased our Redwood Shores headquarters facilities concurrent with the expiration and extinguishment of the lessor s financing agreements. These facilities were subject to leases which expired in July 2009, and had been accounted for as operating leases. The total amount paid under the terms of the leases was $247 million, of which $233 million related to the purchase price of the facilities and $14 million was for the loss on our lease obligation. Therefore, in the fiscal quarter ended September 30, 2009, we recorded a tax benefit of approximately $31 million, consisting of approximately $6 million related to the loss on our lease obligation and a $25 million reduction in our valuation allowance due to the inclusion of a significant portion of the remaining taxable temporary difference as a source of future taxable income.

On May 27, 2009, the U.S. Court of Appeals for the Ninth Circuit overturned a 2005 Tax Court decision in *Xilinx Inc. v. Commissioner* (Xilinx). The Court s decision changed the tax treatment of share-based compensation expenses for the purpose of determining intangible development costs under an entity s research and development cost sharing arrangement. The Court held that related parties to such an arrangement must share stock option costs, notwithstanding the U.S. Tax Court s finding that unrelated parties in such an arrangement would not share such costs. The case is subject to further appeal. Nevertheless, as a result of this decision, we recorded additional reserves for unrecognized tax benefits of approximately $56 million during the three months ended June 30, 2009. These reserves relate primarily to windfall tax benefits recognized for stock-based compensation, and were therefore recorded as reductions in paid-in capital.

A portion of the additional reserves for unrecognized tax benefits recorded as a result of the Xilinx decision were included as a source of taxable income in determining the valuation allowance we recorded at June 30, 2009. As a result, we recorded a tax benefit of approximately $11 million in the three months ended June 30, 2009 for the corresponding reduction in the valuation allowance.

The tax benefit reported for the three and six months ended September 30, 2009 is based on our projected annual effective tax rate for fiscal year 2010, and also includes certain discrete tax charges recorded during the period. Our effective tax rates for the three and six months ended September 30, 2009 were a tax benefit of 6.7 percent and 7.6 percent, respectively, compared to a tax benefit of 20.6 percent and 15.3 percent for the same periods in fiscal 2009. The effective tax rates for the three and six months ended September 30, 2009 differ from the statutory rate of 35.0 percent primarily due to U.S. losses for which no benefit is recognized, non-U.S. losses with a reduced or zero tax benefit, partially offset by benefits related to the resolution of examinations by taxing authorities and reductions in the valuation allowance on U.S. deferred tax assets. The effective tax rates for the three and six months ended September 30, 2009 differ from the same periods in fiscal year 2009 primarily due to reduced or zero tax benefit on losses incurred, changes in the deferred tax valuation allowance, tax charges incurred in fiscal year 2009 related to our integration of VG Holding Corp., and tax benefits related to the resolution of tax examinations.

During the three months ended September 30, 2009, we reached a final settlement with the Internal Revenue Service (IRS) for the fiscal years 1997 through 1999. As a result, we recorded a tax benefit of approximately $6 million due to a reduction in our accrual for interest and penalties.

During the three months ended June 30, 2009, we recorded approximately $21 million of previously unrecognized tax benefits and reduced our accrual for interest and penalties by approximately $12 million due to the expiration of statutes of limitation in the United Kingdom.

During the three and six months ended September 30, 2009, we recorded a decrease of $35 million and an increase of $10 million in gross unrecognized tax benefits, respectively. This includes a reduction in gross unrecognized tax benefits of approximately $48 million related to the settlements with the IRS for fiscal years 1997 through 1999. This settlement and agreement to pay will be partially offset by prior cash deposits of approximately $40 million. The total gross unrecognized tax benefits as of September 30, 2009 is $288 million, of which approximately $16 million would be offset by prior cash deposits to tax authorities for issues pending resolution. 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 September 30, 2009, approximately $114 million of the unrecognized tax benefits would affect our effective tax rate, approximately $88 million would result in adjustments to deferred tax assets with corresponding adjustments to the valuation allowance, and approximately $58 million would increase paid-in capital.

During the three and six months ended September 30, 2009, we recorded a net decrease in tax expense of $3 million and a net increase of $1 million, respectively, for accrued interest and penalties related to tax positions taken on our tax returns, including a reduction related to the settlement with the IRS for fiscal years 1997 thru 1999. As of September 30, 2009, the combined amount of accrued interest and penalties related to uncertain tax positions was approximately $57 million.

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The IRS has completed its examination of our federal income tax returns through fiscal year 2005. As of September 30, 2009, 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 September 30, 2009, we had not agreed to certain other proposed adjustments for fiscal years 2000 through 2005, and those issues were pending resolution by the Appeals section of the IRS. Furthermore, the IRS has commenced an examination of our fiscal year 2006, 2007 and 2008 tax returns. We are also under income tax examination in Canada for fiscal years 2004 and 2005, in France for fiscal years 2006 through 2008, and in Germany for fiscal years 2004 through 2007. We remain subject to income tax examination in Canada for fiscal years 2000 and after 2001, in France for fiscal years after 2005, in Germany for fiscal years after 2003, in the United Kingdom for fiscal years after 2007, 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. Although potential resolution of uncertain tax positions involve multiple tax periods and jurisdictions, it is reasonably possible that a reduction of up to $20 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 our 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.

(11) COMMITMENTS AND CONTINGENCIES

Lease Commitments

As of September 30, 2009, we leased certain of our current 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. See Note 9 regarding the purchase of our Redwood Shores headquarters facilities on July 13, 2009.

The following table summarizes our minimum contractual obligations as of September 30, 2009 (in millions):

Fiscal Year Ending March 31,	**Leases** [(a)]
2010 (remaining six months)	$ 28
2011	44
2012	34
2013	28
2014	20
Thereafter	39
Total	$ 193

(a) Lease commitments have not been reduced by minimum sub-lease rentals for unutilized office space resulting from our reorganization activities of approximately $13 million due in the future under non-cancelable sub-leases.

The 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 expensed in our Condensed Consolidated Financial Statements. Included in the amounts above are $6 million and $1 million in lease commitments for fiscal years 2010 and 2011, respectively, for leases expiring in less than one year as of September 30, 2009.

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 condensed consolidated financial position or results of operations.

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(12) 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 market price of our common stock on the date of grant. The fair value of stock options and stock purchase rights granted pursuant to our equity incentive plans and our 2000 Employee Stock Purchase Plan (ESPP), respectively, 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. The key assumptions for the Black-Scholes valuation calculation are:

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 estimated assumptions used in the Black-Scholes valuation model to value our option grants and ESPP were as follows:

	Stock Option Grants				ESPP			
	Three Months Ended September 30,		Six Months Ended September 30,		Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008	2009	2008	2009	2008
Risk-free interest rate	1.6 - 2.8%	2.1 - 2.9%	1.6 - 3.0%	2.1 - 3.8%	0.2 - 0.4%	1.9 - 2.1%	0.2 - 0.4%	1.9 - 2.1%
Expected volatility	41 - 45%	33 - 34%	41 - 48%	32 - 34%	45 - 57%	35%	45 - 57%	35%
Weighted-average volatility	44%	34%	45%	33%	51%	35%	51%	35%
Expected term	4.4 years	4.2 years	4.2 years	4.3 years	6-12 months	6-12 months	6-12 months	6-12 months
Expected dividends	None	None	None	None	None	None	None	None

Employee stock-based compensation expense recognized during the three and six months ended September 30, 2009 and 2008 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 ESPP included in our Condensed Consolidated Statements of Operations (in millions):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Cost of goods sold	$	$	$ 1	$ 1
Marketing and sales	5	5	8	10
General and administrative	10	13	15	23

Research and development	29	35	53	69
Stock-based compensation expense	44	53	77	103
Benefit from income taxes		(12)		(21)
Stock-based compensation expense, net of tax	$ 44	$ 41	$ 77	$ 82

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As of September 30, 2009, our total unrecognized compensation cost related to stock options was $151 million and is expected to be recognized over a weighted-average service period of 2.4 years. As of September 30, 2009, our total unrecognized compensation cost related to restricted stock, restricted stock units and notes payable in shares of common stock (collectively referred to as restricted stock rights) was $280 million and is expected to be recognized over a weighted-average service period of 2.6 years.

The following table summarizes our stock option activity for the six months ended September 30, 2009:

	Options (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
Outstanding as of March 31, 2009	34,360	$ 42.04		
Granted	4,145	20.53		
Exercised	(559)	15.17		
Forfeited, cancelled or expired	(3,632)	42.09		
Outstanding as of September 30, 2009	34,314	39.87	6.1	$ 7
Exercisable as of September 30, 2009	22,011	44.62	4.7	$

The aggregate intrinsic value represents the total pre-tax intrinsic value based on our closing stock price as of September 30, 2009, which would have been received by the option holders had all option holders exercised their options as of that date. The weighted-average grant-date fair values of stock options granted during the three and six months ended September 30, 2009 were $7.68 and $7.88, respectively. The weighted-average grant-date fair values of stock options granted during the three and six months ended September 30, 2008 were $13.71 and $15.41, respectively. We issue new common stock from our authorized shares upon the exercise of stock options.

The following table summarizes our restricted stock rights activity, excluding performance-based restricted stock unit activity discussed below, for the six months ended September 30, 2009:

	Restricted Stock Rights (in thousands)	Weighted-Average Grant Date Fair Value
Balance as of March 31, 2009	7,559	$ 42.76
Granted	3,363	20.11
Vested	(1,029)	49.77
Forfeited or cancelled	(482)	40.89
Balance as of September 30, 2009	9,411	34.00

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 grant date fair values of restricted stock rights granted during the three and six months ended September 30, 2009 were $19.37 and $20.11, respectively. The weighted-average grant date fair values of restricted stock rights granted during the three and six months ended September 30, 2008 were $45.52 and $47.30, respectively.

The following table summarizes our performance-based restricted stock unit activity for the six months ended September 30, 2009:

	Performance-Based Restricted	Weighted-Average

	Stock Units (in thousands)	Grant Date Fair Value
Balance as of March 31, 2009	3,008	$ 47.59
Granted	236	20.93
Forfeited or cancelled	(392)	30.93
Balance as of September 30, 2009	2,852	47.67

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The weighted-average grant date fair value of performance-based restricted stock units is based on the quoted market value of our common stock on the date of grant. The weighted-average grant date fair values of performance-based restricted stock units granted during the three and six months ended September 30, 2009 were $20.89 and $20.93, respectively. The weighted-average grant date fair values of performance-based restricted stock units granted during the three and six months ended September 30, 2008 were $42.96 and $49.38, respectively.

During the six months ended September 30, 2009 and 2008, we issued approximately 1.2 million shares and 519 thousand shares, respectively, under the ESPP with exercise prices for purchase rights of $13.86 and $40.20, respectively. The estimated weighted-average fair values of purchase rights during the six months ended September 30, 2009 and 2008 were $6.25 and $12.20, respectively.

At our Annual Meeting of Stockholders, held on July 29, 2009, our stockholders approved our Employee Stock Option Exchange Program to permit our eligible employees to exchange, on a grant-by-grant basis, certain outstanding eligible options that are significantly underwater (that is, the exercise price is greater than the quoted market price at the time the Exchange Program was launched) for a lesser number of restricted stock units, shares of restricted stock (in Canada only), or new options (in China only) to be granted under our 2000 Equity Incentive Plan (the Equity Plan). The Exchange Program offer period began on October 21, 2009 and is expected to end on November 18, 2009, unless we extend the offer. It is open to all employees designated for participation by the Compensation Committee of the Board of Directors. However, members of the Board of Directors and the Named Executive Officers identified in our definitive proxy statement filed with the SEC on June 12, 2009 are not eligible to participate. Options eligible for the Exchange Program are those options that were granted prior to October 21, 2008, that have an exercise price per share that is greater than $28.18, which is the 52-week high trading price of our common stock prior to the start date of the Exchange Program, as reported on The NASDAQ Global Select Market, and that upon conversion using the exchange ratio applicable for such options would result in four or more shares of restricted stock units, shares of restricted stock or new options, as the case may be.

Our stockholders also approved amendments to the Equity Plan to (a) increase the number of shares authorized for issuance under the Equity Plan by 20.8 million shares and (b) amend the Equity Plan so that each share subject to a full value stock award would reduce the number of shares available for issuance by 1.43 shares, instead of the current multiple of 1.82 shares. Our stockholders also approved an amendment to the ESPP to increase the number of shares authorized under the ESPP by 3 million shares.

(13) COMPREHENSIVE 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 paid-in capital in the equity section of a 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 derivative instruments designated as cash flow hedges. Foreign currency translation adjustments are not adjusted for income taxes as they relate to indefinite investments in non-U.S. subsidiaries.

The components of comprehensive loss, net of related immaterial taxes, for the three and six months ended September 30, 2009 and 2008 are summarized as follows (in millions):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Net loss	$ (391)	$ (310)	$ (625)	$ (405)
Other comprehensive income (loss):				
Change in unrealized gains (losses) on investments	(48)	(92)	28	(94)
Reclassification adjustment for losses realized on investments	7	25	23	30
Change in unrealized gains (losses) on derivative instruments		5	(2)	4
Reclassification adjustment for losses (gains) on derivative instruments			(2)	1
Foreign currency translation adjustments	24	(17)	61	(17)
Total other comprehensive income (loss)	(17)	(79)	108	(76)
Total comprehensive loss	$ (408)	$ (389)	$ (517)	$ (481)

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(14) NET LOSS PER SHARE

As a result of our net loss for the three and six months ended September 30, 2009, we have excluded certain stock awards from the diluted loss per share calculation as their inclusion would have had an antidilutive effect. Had we reported net income for these periods, an additional 1 million shares of common stock would have been included in the number of shares used to calculate diluted earnings per share in each of the three and six month periods ended September 30, 2009. Options to purchase and restricted stock units to be released in the amount of 39 million shares and 38 million shares of common stock were excluded from the computation of diluted shares for the three and six months ended September 30, 2009, respectively, as their inclusion would have had an antidilutive effect. For the three and six months ended September 30, 2009, the weighted-average exercise prices of these shares were $35.73 and $36.43 per share, respectively.

As a result of our net loss for the three and six months ended September 30, 2008, we have excluded certain stock awards from the diluted loss per share calculation as their inclusion would have had an antidilutive effect. Had we reported net income for these periods, an additional 6 million shares of common stock would have been included in the number of shares used to calculate diluted earnings per share in each of the three and six month periods ended September 30, 2008. Options to purchase and restricted stock units to be released in the amount of 25 million shares and 23 million shares of common stock were excluded from the computation of diluted shares for the three and six months ended September 30, 2008, respectively, as their inclusion would have had an antidilutive effect. For the three and six months ended September 30, 2008, the weighted-average exercise prices of these shares were $50.80 and $52.43 per share, respectively.

(15) 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 (CODM), to evaluate segment performance; the availability of separate financial information; and overall materiality considerations.

Our business is currently organized around three operating labels, EA Games, EA SPORTS and EA Play, as well as EA Interactive, which reports into our Publishing business. In addition, our CODM regularly receives separate financial information for two distinct businesses within the EA Interactive organization: EA Mobile and Pogo. Accordingly, in assessing performance and allocating resources, our CODM reviews the results of our three Labels, as well as the two operating segments in EA Interactive: EA Mobile and Pogo. Due to their similar economic characteristics, products and distribution methods, EA Games, EA SPORTS, EA Play and Pogo s results are aggregated into one Reportable Segment (the Label segment) as shown below. The remaining operating segment s results are not material for separate disclosure and are included in the reconciliation of Label segment profit to consolidated operating loss below. In addition to assessing performance and allocating resources based on our operating segments as described herein, to a lesser degree, our CODM also continues to review results based on geographic performance.

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The following table summarizes the financial performance of the Label segment and a reconciliation of the Label segment s profit to our consolidated operating loss for the three and six months ended September 30, 2009 and 2008 (in millions):

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Six Months Ended September 30, 2009	Six Months Ended September 30, 2008
Label segment:				
Net revenue	$ 1,076	$ 1,050	$ 1,815	$ 1,588
Depreciation and amortization	(14)	(17)	(29)	(35)
Other expenses	(911)	(890)	(1,548)	(1,470)
Label segment profit	151	143	238	83
Reconciliation to consolidated operating loss:				
Other:				
Change in deferred net revenue (packaged goods and digital content)	(359)	(232)	(531)	(37)
Other net revenue	71	76	148	147
Depreciation and amortization	(31)	(32)	(63)	(63)
Other expenses	(249)	(319)	(454)	(591)
Consolidated operating loss	$ (417)	$ (364)	$ (662)	$ (461)

Label segment profit differs from the consolidated operating loss primarily due to the exclusion of (1) certain corporate and other functional costs that are not allocated to the Labels, (2) the deferral of certain net revenue related to online-enabled packaged goods and digital content (see Note 9 of the Notes to Condensed Consolidated Financial Statements), and (3) the results of EA Mobile and our Switzerland distribution revenue that has not been allocated to the Labels. Our CODM reviews assets on a consolidated basis and not on a segment basis.

Information about our total net revenue by platform for the three and six months ended September 30, 2009 and 2008 is presented below (in millions):

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Six Months Ended September 30, 2009	Six Months Ended September 30, 2008
Consoles				
Xbox 360	$ 171	$ 290	$ 244	$ 424
PLAYSTATION 3	142	120	263	282
Wii	142	94	303	203
PlayStation 2	40	77	67	173
Xbox		1		1
Total Consoles	495	582	877	1,083
Mobile Platforms				
Wireless	51	47	101	91
Nintendo DS	22	44	50	65
PSP	20	36	58	94
Total Mobile	93	127	209	250
PC	173	164	297	316
Licensing and Other	27	21	49	49
Total Net Revenue	$ 788	$ 894	$ 1,432	$ 1,698

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Information about our operations in North America, Europe and Asia for the three and six months ended September 30, 2009 and 2008 is presented below (in millions):

	North America	Europe	Asia	Total
Three months ended September 30, 2009				
Net revenue from unaffiliated customers	$ 479	$ 268	$ 41	$ 788
Long-lived assets	1,373	162	45	1,580
Three months ended September 30, 2008				
Net revenue from unaffiliated customers	$ 555	$ 301	$ 38	$ 894
Long-lived assets	1,607	204	28	1,839
Six months ended September 30, 2009				
Net revenue from unaffiliated customers	$ 822	$ 526	$ 84	$ 1,432
Six months ended September 30, 2008				
Net revenue from unaffiliated customers	$ 984	$ 630	$ 84	$ 1,698

Our direct sales to GameStop Corp. represented approximately 18 percent and 16 percent of total net revenue for the three and six months ended September 30, 2009, respectively, and approximately 17 percent and 15 percent of total net revenue for the three and six months ended September 30, 2008, respectively. Our direct sales to Wal-Mart Stores, Inc. represented approximately 14 percent and 13 percent of total net revenue for the three and six months ended September 30, 2009, respectively, and approximately 13 percent of total net revenue for each of the three and six months ended September 30, 2008. Our direct sales to Best Buy Co., Inc. represented approximately 10 percent of total net revenue for the three months ended September 30, 2008.

(16) COLLABORATIVE ARRANGEMENTS

On April 1, 2009, we adopted FASB ASC 808, *Collaborative Arrangements*. FASB ASC 808 defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties. The adoption of FASB ASC 808 did not have a significant impact on our Condensed Consolidated Financial Statements for the three and six months ended September 30, 2009 and 2008.

(17) IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, *Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements*. This guidance modifies the fair value requirements of FASB ASC subtopic 605-25, *Revenue Recognition-Multiple Element Arrangements*, by allowing the use of the best estimate of selling price in addition to vendor specific objective evidence and third-party evidence for determining the selling price of a deliverable. This guidance establishes a selling price hierarchy for determining the selling price of a deliverable, which is based on: (a) vendor-specific objective evidence, (b) third-party evidence, or (c) estimates. In addition, the residual method of allocating arrangement consideration is no longer permitted. ASU 2009-13 is effective for fiscal years beginning on or after June 15, 2010. We do not expect the adoption of ASU 2009-13 to have a material impact on our Condensed Consolidated Financial Statements.

In October 2009, the FASB issued ASU 2009-14, *Software (Topic 985) Certain Revenue Arrangements that Include Software Elements*. This guidance modifies the scope of FASB ASC subtopic 965-605, *Software-Revenue Recognition*, to exclude from its requirements non-software components of tangible products and software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product s essential functionality. ASU 2009-14 is effective for fiscal years beginning on or after June 15, 2010. We do not expect the adoption of ASU 2009-14 to have a material impact on our Condensed Consolidated Financial Statements.

In June 2009, the FASB issued accounting guidance contained within FASB ASC 810, *Consolidation*, which amends the consolidation guidance for variable interest entities and requires additional disclosures about a company s involvement in variable interest entities and any significant changes in risk exposure due to that involvement. This guidance is effective for fiscal years beginning after November 15, 2009. We do not expect this adoption to have a material impact on our Condensed Consolidated Financial Statements.

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(18) SUBSEQUENT EVENTS

We have evaluated our Condensed Consolidated Financial Statements for subsequent events through the date the financial statements were issued on November 10, 2009.

Playfish Acquisition

On November 9, 2009, Electronic Arts Nederland B.V. (EA Nederland), a wholly-owned subsidiary of Electronic Arts Inc. (EA), and the equity holders (the Sellers) of Playfish Limited (Playfish) entered into and closed a definitive agreement for the sale and purchase of Playfish, pursuant to which EA Nederland purchased all of the outstanding capital stock of Playfish. The consideration paid by EA Nederland consisted of: (1) approximately $275 million in cash and (2) approximately $25 million in equity retention arrangements in the form of restricted stock awards and restricted stock unit awards to acquire our common stock. In addition, the Sellers are entitled to additional variable cash consideration that is contingent upon the achievement of certain performance milestones through December 31, 2011. The additional consideration is limited to a maximum of $100 million.

Fiscal 2010 Restructuring

On November 6, 2009, our management initiated a plan of restructuring (the Plan) to narrow our product portfolio to provide greater focus on titles with higher margin opportunities. Under the Plan, we anticipate (1) reducing our workforce by approximately 1,300 employees, (2) consolidating or closing various facilities, (3) eliminating certain titles, and (4) incurring IT and other costs to assist in reorganizing certain activities. We expect the majority of these actions to be completed by March 31, 2010.

In connection with the Plan, we anticipate incurring between approximately $130 million and $150 million in total costs, of which approximately $80 million to $90 million will result in future cash expenditures. Approximately $100 million to $120 million of these charges are expected to occur during the fiscal year ending March 31, 2010. These costs will consist primarily of severance and other employee-related costs (approximately $50 million to $60 million), facility closures costs (approximately $35 million), asset impairments (approximately $25 million to $35 million), and various other reorganizational costs (approximately $20 million).

Worker, Homeownership and Business Assistance Act

The Worker, Homeownership and Business Assistance Act of 2009 (the Act) was signed into law on November 6, 2009. The Act provides that taxpayers may elect to increase the carry back period for tax losses incurred in a taxable year beginning or ending in either 2008 or 2009. We are in the process of determining whether to elect to increase the carry back period. If we make this election in fiscal year 2010, we may be required to reduce our deferred tax valuation allowance, which could reduce our fiscal year 2010 income tax expense. The amount of the reduction, if any, has not yet been determined.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Electronic Arts Inc.:

We have reviewed the condensed consolidated balance sheet of Electronic Arts Inc. and subsidiaries (the Company) as of October 3, 2009, the related condensed consolidated statements of operations for the three- and six-month periods ended October 3, 2009 and September 27, 2008, and the related condensed consolidated statements of cash flows for the six-month periods ended October 3, 2009 and September 27, 2008. These condensed consolidated financial statements are the responsibility of the Company s management.

We conducted our reviews 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 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 reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above 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 28, 2009, and the related consolidated statements of operations, stockholders equity and comprehensive loss, and cash flows for the year then ended (not presented herein); and in our report dated May 21, 2009, 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 28, 2009, 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

November 10, 2009

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

CAUTIONARY NOTE ABOUT FORWARD-LOOKING STATEMENTS

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 iden 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, 2009 as filed with the Securities and Exchange Commission (SEC) on May 22, 2009 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 six months ended September 30, 2009, 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, 2009 as filed with the SEC on May 22, 2009 and in other documents we have filed with the SEC.

About Electronic Arts

We develop, market, publish and distribute video game software and content that can be played by consumers on a variety of platforms, including video game consoles (such as the PLAYSTATION® 3, Microsoft Xbox 360 and Nintendo Wii), personal computers, handheld game players (such as the PlayStation® Portable (PSP) and the Nintendo DS) and wireless devices (such as cellular phones and smart phones including the Apple iPhone). 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, Dead Space 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.*, Harry Potter).

Special Note Regarding Deferred Net Revenue

Many of our software products are developed with the ability to connect to the Internet. Depending on the type of product, this feature permits consumers to play against others via the Internet and/or receive additional updates or content from us. For those games that consumers can play via the Internet, we may provide a matchmaking online service which permits consumers to connect with other consumers to play against each other. In those 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 year 2007, for accounting purposes, vendor-specific objective evidence of fair value (VSOE) 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 year 2008, VSOE did not exist for the online service and we began to recognize all of the revenue from the sale of these bundle sales on a deferred basis over an estimated online service period, which we estimate to be six months beginning in the month after shipment.

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In addition, we also provide updates or additional content (digital content) for some software products to be delivered via the Internet. For some software products, at the date of sale we had an obligation to make available for download via the Internet incremental unspecified future digital content without an additional fee. In those transactions, we also accounted for the sale of the software product as a bundle sale and recognized the revenue on a deferred basis over the period in which we expect to make available the incremental unspecified digital content.

On a quarterly basis, the deferral 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 profit percentages.

Financial Results

Total net revenue for the three months ended September 30, 2009 was $788 million, down $106 million as compared to the three months ended September 30, 2008. At September 30, 2009, deferred net revenue associated with sales of online-enabled packaged goods and digital content increased by $359 million as compared to June 30, 2009, directly reducing the amount of reported net revenue during the three months ended September 30, 2009. At September 30, 2008, deferred net revenue associated with sales of online-enabled packaged goods and digital content increased by $232 million as compared to June 30, 2008, directly decreasing the amount of reported net revenue during the three months ended September 30, 2008. Without these changes in deferred net revenue, reported net revenue increased by approximately $21 million during the three months ended September 30, 2009 as compared to the three months ended September 30, 2008. Net revenue for the three months ended September 30, 2009, was driven by *The Beatles : Rock Band*, *The Sims 3* and *FIGHT NIGHT Round 4*.

Net loss for the three months ended September 30, 2009 was $391 million as compared to a net loss of $310 million for the three months ended September 30, 2008. Diluted loss per share for the three months ended September 30, 2009 was $1.21 as compared to diluted loss per share of $0.97 for the three months ended September 30, 2008. Net loss increased during the three months ended September 30, 2009 as compared to the three months ended September 30, 2008 primarily as a result of (1) a decrease of $106 million in net revenue, (2) a $54 million decrease in our benefit from income taxes, and (3) a $36 million increase in cost of goods sold. These decreases were partially offset by (1) a $54 million decrease in research and development, general and administrative and marketing and sales personnel-related costs primarily as a result of decreases in salaries, incentive-based compensation and stock-based compensation expenses, (2) a $26 million decrease in impairment charges related to our losses on strategic investments, and (3) $21 million recognized during the three months ended September 30, 2008 related to certain abandoned acquisition-related costs.

During the six months ended September 30, 2009, we used $322 million of cash in operating activities as compared to using $415 million of cash for the six months ended September 30, 2008. The decrease in cash used in operating activities for the six months ended September 30, 2009 as compared to the six months ended September 30, 2008 was primarily due to decreases in additional personnel-related costs as a result of our fiscal 2009 restructuring and incentive-based compensation payments. These decreases were partially offset by an increase in advertising and marketing costs.

Trends in Our Business

Economic Environment. As a result of the national and global economic downturn, overall consumer spending has declined. Retailers globally have taken a more conservative stance in ordering game inventory. The decrease in retail orders contributed to the decline in anticipated demand for our products during the 2008 holiday selling season. We remain cautious about our future sales in light of the economic environment and the impact it has had on our retailers.

Current Generation Game 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. The current cycle began with Microsoft s launch of the Xbox 360 in 2005, and continued in 2006 when Sony and Nintendo launched their next-generation systems, the PLAYSTATION 3 and the Wii, respectively. Unlike past cycles, we believe this current cycle may be extended, partly due to the growth of online services and content, the greater graphic and processing power of the current-generation hardware and the introduction of new peripherals. However, growth in the installed base of the Xbox 360, the PLAYSTATION 3 and the Wii may slow down in light of the economic environment. Consequently, our industry may experience slower growth than in recent years.

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Online Content and Services. In addition to selling packaged goods games, we also provide a variety of electronically delivered products and services. Many of our games that are available as packaged goods products are also available by direct electronic download through the Internet (from websites that we maintain and others that we license). We also offer electronically delivered content and services that are add-ons or related to our packaged goods products (*e.g.*, game enhancements or matchmaking services), and other games, content and services that are available only via electronic delivery (such as games for wireless devices, and Internet-only games and game services). Electronically delivered content and services are generally offered to consumers as subscription services, electronic downloads for a one-time fee, or on an advertising-supported basis. We have made significant investments in electronically delivered content and services, and we believe that this will become an increasingly important part of our business over time.

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 broad consumer base. Our efforts in mobile interactive entertainment are focused in two areas packaged goods games for handheld game systems and downloadable games for wireless devices. We expect sales of games for wireless devices to continue to be an important part of our business worldwide.

Recent Developments

International Operations and Foreign Currency Exchange Impact. International sales are a fundamental part of our business. Net revenue from international sales accounted for approximately 43 percent of our total net revenue during the six months ended September 30, 2009 and approximately 42 percent of our total net revenue during the six months ended September 30, 2008. Our international net revenue was primarily driven by sales in Europe and, to a much lesser extent, in Asia. We believe that in order to succeed internationally, it is important to develop content locally that is specifically directed toward local cultures and customs. Year-over-year, we estimate that foreign exchange rates had an unfavorable impact on our net revenue of approximately $39 million, or 2 percent, for the six months ended September 30, 2009. During the six months ended September 30, 2009, the U.S. dollar strengthened against most major currencies, including the Euro and the British pound sterling. In addition, our international investments and our cash and cash equivalents denominated in foreign currencies are subject to fluctuations in foreign currency. If the U.S. dollar continues to strengthen against these currencies, then foreign exchange rates may continue to have an unfavorable impact on our results of operations and our financial condition.

Deferred Income Tax Valuation Allowance. In the fiscal quarter ended December 31, 2008, we recorded a valuation allowance against most of our U.S. deferred tax assets. 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. Forecasts of future taxable income are considered to be less objective than past results. Therefore, cumulative losses weigh heavily in the overall assessment. Based on these requirements, we expect to provide a valuation allowance on future U.S. tax benefits until we can sustain a level of profitability or until other significant positive evidence arises that suggests that these benefits are more likely than not to be realized.

Redwood Shores Headquarters Facilities Purchase. On July 13, 2009, we purchased our Redwood Shores headquarters facilities comprised of approximately 660,000 square feet concurrent with the expiration and extinguishment of the lessor s financing agreements. These facilities were subject to leases, which expired in July 2009, and had previously been accounted for as operating leases. The total amount paid under the terms of the leases was $247 million, of which $233 million related to the purchase price of the facilities and $14 million was for the loss on our lease obligation. Subsequent to our purchase, we classified the facilities on our Condensed Consolidated Balance Sheet as property and equipment, net and recognized depreciation expense for the property acquired on a straight-line basis over the estimated useful lives, excluding the land acquired.

Fiscal 2010 Restructuring. On November 6, 2009, our management initiated a plan of restructuring (the Plan) to narrow our product portfolio to provide greater focus on titles with higher margin opportunities. Under the Plan, we anticipate (1) reducing our workforce by approximately 1,300 employees, (2) consolidating or closing various facilities, (3) eliminating certain titles, and (4) incurring IT and other costs to assist in reorganizing certain activities. We expect the majority of these actions to be completed by March 31, 2010.

In connection with the Plan, we anticipate incurring between approximately $130 million and $150 million in total costs, of which approximately $80 million to $90 million will result in future cash expenditures. Approximately $100 million to $120 million of these charges are expected to occur during the fiscal year ending March 31, 2010. These costs will consist primarily of severance and other employee-related costs (approximately $50 million to $60 million), facility closures costs (approximately $35 million), asset impairments (approximately $25 million to $35 million), and various other reorganizational costs (approximately $20 million).

Employee Stock Option Exchange Program. On October 21, 2009, we launched an Employee Stock Option Exchange Program to permit our eligible employees to exchange certain outstanding eligible options for a lesser number of restricted stock units, shares of restricted stock (in Canada only), or new options (in China only) to be granted under our 2000 Equity Incentive Plan (the Equity Plan). The Exchange Program offer period began on October 21, 2009 and is expected to end on November 18, 2009, unless we extend the offer. As of October 15, 2009, options held by eligible employees to purchase approximately 18,509,575 shares of our common stock had exercise prices greater than the threshold price of $28.18 per share, which was the 52-week high trading price of our common stock measured as of the start date of the Exchange Program, as reported on The NASDAQ Global Select Market, and are thus potentially eligible to participate in this offer. Assuming all such options are properly tendered for exchange, we will issue approximately 6,591,307 restricted stock units, shares of restricted stock and new stock options and cancel the tendered options. Due to the structure of the Exchange Program as a value-for-value exchange for the eligible options tendered for exchange, and certain assumptions we are required to use regarding the eligible options for accounting purposes, we expect to incur an accounting charge of approximately $60 million to $80 million over the vesting period of the restricted stock units issued in the Exchange Program in addition to recognizing any remaining unrecognized expense for the stock options surrendered in exchange for the restricted stock units.

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 management 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 3, Xbox 360 and Wii), PCs, handheld game players (such as the PSP and Nintendo DS), and wireless devices (such as cellular phones and smart phones including the Apple iPhone). We evaluate revenue recognition based on the criteria set forth in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 985-605, *Software: Revenue Recognition*, and Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition*. We evaluate and recognize revenue when all four of the following criteria are met:

- *Evidence of an arrangement*. Evidence of an agreement with the customer that reflects the terms and conditions to deliver products that 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 is made available.

- *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 management 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 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 management 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 year 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 year 2008, VSOE no longer existed for the online service to be delivered for certain platforms and all revenue from these transactions is recognized over the estimated online service period. More specifically, starting in fiscal year 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.

In addition, for some software products we also provide updates or additional content (digital content) to be delivered via the Internet that can be used with the original software product. In many cases we separately sell digital content for an additional fee; however some purchased digital content can only be accessed via the Internet (*i.e.*, the consumer never takes possession of the digital content). We account for online transactions in which the consumer does not take possession of the digital content as a service transaction and, accordingly, we recognize the associated revenue over the estimated service period. In other transactions, at the date we sell the software product we have an obligation to provide incremental unspecified digital content in the future without an additional fee. In these cases, we account for the sale of the software product as a multiple element arrangement and recognize the revenue on a straight-line basis over the estimated life of the game.

Determining whether a transaction constitutes an online service transaction or a digital content 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 is made available (assuming all other recognition criteria are met). Revenue from an online game service is recognized as the service is 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. In addition, determining whether we have an implicit obligation to provide incremental unspecified future digital content without an additional fee can be difficult.

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 software products, which allow for the exchange of these software products by resellers under certain circumstances. It is our general practice to exchange software products or give credits rather than to give cash refunds.

In certain countries, from time to time, we decide to provide price protection for our software 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 software products, current trends in retail and the video game segment, changes in customer demand and acceptance of our software products, and other related factors. In addition, we monitor the volume of sales to our channel partners and their inventories, as substantial overstocking in the distribution channel could result in high returns or higher price protection costs in subsequent periods.

In the future, actual returns and price protections may materially exceed our estimates as unsold software products in the distribution channels are exposed to rapid changes in consumer preferences, market conditions or technological obsolescence due to new platforms, product updates or competing software products. For example, the risk of product returns and/or price protection for our software 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 software products change, the amount of net deferred revenue we recognize in the future would change.

Significant management 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.

Fair Value Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States often requires us to determine the fair value of a particular item in order to fairly present our financial statements. Without an independent market or

another representative transaction, determining the fair value of a particular item requires us to make several assumptions that are inherently difficult to predict and can have a material impact on the conclusion on the appropriate accounting.

There are various valuation techniques used to estimate fair value. These include (1) the market approach where market transactions for identical or comparable assets or liabilities are used to determine the fair value, (2) the income approach, which uses valuation techniques to convert future amounts (for example, future cash flows or future earnings) to a single present value amount, and (3) the cost approach, which is based on the amount that would be required to replace an asset. For many of our fair value estimates, including our estimates of the fair value of acquired intangible assets and acquired in-process technology, we use the income approach. Using the income approach requires the use of financial models, which require us to make various estimates including, but not limited to (1) the potential future cash flows for the asset or liability being measured, (2) the timing of receipt or payment of those future cash flows, (3) the time value of money associated with the delayed receipt or payment of such cash flows, and (4) the inherent risk associated with the cash flows (risk premium). Making these cash flow estimates are inherently difficult and subjective, and, if any of the estimates used to determine the fair value using the income approach turns out to be inaccurate, our financial results may be negatively impacted. Furthermore, relatively small changes in many of these estimates can have a significant impact to the estimated fair value resulting from the financial models or the related accounting conclusion reached. For example, a relatively small change in the estimated fair value of an asset may change a conclusion as to whether an asset is impaired.

While we are required to make certain fair value assessments associated with the accounting for several types of transactions, the following areas are the most sensitive to the assessments:

Business Combinations. We must estimate the fair value of assets acquired, liabilities and contingencies assumed, acquired in-process technology, and contingent consideration in a business combination. Our assessment of the estimated fair value of each of these can have a material effect on our reported results as intangible assets and acquired in-process technology are amortized over various estimated useful lives. Furthermore, a change in the estimated fair value of an asset or liability often has a direct impact on the amount to recognize as goodwill, an asset that is not amortized. Determining the fair value of acquired assets requires an assessment of the highest and best use or the expected price to sell the asset and the related expected future cash flows. Determining the fair value of acquired in-process technology also requires an assessment of our expectations related to the use of that asset. Determining the fair value of an assumed liability requires an assessment of the expected cost to transfer the liability. Such estimates are inherently difficult and subjective and can have a material impact on our financial statements.

Assessment of Impairment of Goodwill and Other Long-Lived Assets. Current accounting standards require that we assess the recoverability of our finite lived acquisition-related intangible assets and other long-lived assets whenever events or changes in circumstances indicate the remaining value of the assets recorded on our Condensed Consolidated Balance Sheets is potentially impaired. In order to determine if a potential impairment has occurred, management must make various assumptions about the estimated fair value of the asset by evaluating future business prospects and estimated cash flows. For some assets, our estimated fair value is dependent upon predicting which of our products will be successful. This success is dependent upon several factors, which are beyond our control, such as which operating platforms will be successful in the marketplace. Also, our revenue and earnings are dependent on our ability to meet our product release schedules.

We are required to perform a two-step approach to testing goodwill for impairment for each reporting unit annually, or whenever events or changes in circumstances indicate the fair value of a reporting unit is below its carrying amount. Our reporting units are determined by the components of our operating segments that constitute a business for which both (1) discrete financial information is available and (2) segment management regularly reviews the operating results of that component. We are required to perform the impairment test at least annually by applying a fair-value-based test. The first step measures 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 the individual assets and liabilities within each reporting unit.

To determine the fair values of the reporting units used in the first step, we use a combination of the market approach, which utilizes comparable companies data, and/or the income approach, or discounted cash flows. Each step requires us to make judgments and involves the use of significant estimates and assumptions. These estimates and assumptions include long-term growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates based on our weighted average cost of capital, future economic and market conditions and determination of appropriate market comparables. These estimates and assumptions have to be made for each reporting unit evaluated for impairment. Our estimates for market growth, our market share and costs are based on historical data, various internal estimates and certain external sources, and are based on assumptions that are consistent with the plans and estimates we are using to manage the underlying business. Our business consists of developing, marketing and distributing video game software using both established and emerging intellectual properties and our forecasts for emerging intellectual properties are based upon internal estimates and external sources rather than historical information and have an inherently higher risk of accuracy. If future forecasts are revised, they may indicate or require future impairment charges. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates.

Assessment of Impairment of Short-Term Investments, Marketable Equity Securities and Other Investments. We periodically review our short-term investments, marketable equity securities and other investments for impairment. Our short-term investments consist of securities with remaining maturities greater than three months at the time of purchase and our marketable equity securities consist of investments in common stock of publicly traded companies, both are accounted for as available-for-sale. Unrealized gains and losses on our short-term investments and marketable equity securities are recorded to other comprehensive income, net of tax, until either (1) the security is sold or (2) we determine that the decline in the fair value of a security to a level below its cost basis is other-than-temporary. Determining whether the decline in fair value is other-than-temporary requires management judgment based on the specific facts and circumstances of each security. The ultimate value realized on these securities is subject to market price volatility until they are sold. We consider various factors in determining whether we should recognize an impairment charge, including the duration that the fair value has been less than the cost basis, severity of the impairment, reason for the decline in value and potential recovery period, the financial condition and near-term prospects of the investees, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. During the three and six months ended September 30, 2009, we recognized impairment charges of $8 million and $24 million, respectively, on our marketable equity securities. During the three and six months ended September 30, 2008, we recognized impairment charges of $25 million and $30 million, respectively, on our marketable equity securities. Our ongoing consideration of these factors could result in additional impairment charges in the future, which could have a material impact on our financial results.

Our other investments consist principally of non-voting preferred shares in two companies whose common stocks are publicly traded and are accounted for under the cost method. Under this method, these investments are recorded at cost until we determine that the fair values of the investments have fallen below their cost basis and that such declines are other-than-temporary. We monitor these investments for impairment and make appropriate reductions in the carrying values if we determine that an impairment charge is required, based primarily on the financial condition and near-term prospects of the investees. We had no impairment charges during the three and six months ended September 30, 2009. During the three and six months ended September 30, 2008, we recognized impairment charges of $9 million and $10 million, respectively, on our other investments.

Assessment of Inventory Obsolescence. We regularly review inventory quantities on-hand and in the retail channel. We write down inventory based on excess or obsolete inventories determined primarily by future anticipated demand for our products. Inventory write-downs are measured as the difference between the cost of the inventory and market value, based upon assumptions about future demand that are inherently difficult to assess. At the point of a loss recognition, a new, lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

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, which requires us to make certain assumptions about the future. Determining the estimated 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. The key assumptions for the Black-Scholes valuation calculation are:

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.

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Changes to our underlying stock price, our assumptions used in the Black-Scholes option valuation calculation and our forfeiture rate, which is based on historical data, as well as future equity granted or assumed through acquisitions could significantly impact compensation expense to be recognized in future periods.

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, the timing of the title s release 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 amount and timing of 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. These obligations are classified as current liabilities to the extent such royalty payments are contractually due within the next twelve months. As of September 30, 2009 and March 31, 2009, approximately $23 million and $37 million, respectively, of minimum guaranteed royalty obligations had been recognized.

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 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. We evaluate long-lived royalty-based assets for impairment based on an undiscounted cash flow basis when impairment indicators exist. 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 six months ended September 30, 2009, we recognized impairment charges of $1 million. We had no loss or impairment charges during the three months ended September 30, 2009. During the three and six months ended September 30, 2008, we recognized an impairment charge of $5 million.

Income Taxes

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 carry forwards. 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. It is generally difficult to conclude that a valuation allowance is not needed when there is significant

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negative evidence, such as cumulative losses in recent years. Forecasts of future taxable income are considered to be less objective than past results, particularly in light of the recent deterioration of the economic environment. Therefore, cumulative losses weigh heavily in the overall assessment.

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, and involve assumptions about future activity. Certain taxable temporary differences that are not expected to reverse during the carry forward periods permitted by tax law cannot be considered as a source of future taxable income that may be available to realize the benefit of deferred tax assets. For example, in determining the valuation allowance we recorded at June 30, 2009, we did not include as a source of future taxable income the taxable temporary difference related to the accumulated tax depreciation on our headquarters facilities in Redwood City, California. On July 13, 2009, we purchased our Redwood Shores headquarters facilities concurrent with the expiration and extinguishment of the lessor s financing agreements. These facilities were subject to leases which expired in July 2009, and had been accounted for as operating leases. The total amount paid under the terms of the leases was $247 million, of which $233 million related to the purchase price of the facilities and $14 million was for the loss on our lease obligation. Therefore, in the fiscal quarter ended September 30, 2009, we recorded a tax benefit of approximately $31 million, consisting of approximately $6 million related to the loss on our lease obligation and a $25 million reduction in our valuation allowance due to the inclusion of a significant portion of the remaining taxable temporary difference as a source of future taxable income.

Based on the assumptions and requirements noted above, we have recorded a valuation allowance against most of our U.S. deferred tax assets. In addition, we expect to provide a valuation allowance on future U.S. tax benefits until we can sustain a level of profitability or until other significant positive evidence arises that suggest that these benefits are more likely than not to be realized.

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 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 about the likely application of the tax law to our situation, as well as with respect to other matters, 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. 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.

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. We currently intend to continue to indefinitely reinvest the undistributed earnings of our foreign subsidiaries outside of the United States.

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 ending or ended, as the case may be, March 31, 2010 and 2009 contain 53 and 52 weeks, respectively, and ends or ended, as the case may be, on April 3, 2010 and March 28, 2009, respectively. Our results of operations for the three months ended September 30, 2009 and 2008 contain 13 weeks and ended on October 3, 2009 and September 27, 2008, respectively. Our results of operations for the six months ended September 30, 2009 and 2008 contain 27 and 26 weeks, respectively, and ended on October 3, 2009 and September 27, 2008, respectively. For simplicity of disclosure, all fiscal periods are referred to as ending on a calendar month end.

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Net Revenue

Net revenue consists of sales generated from (1) video games sold as packaged goods and designed for play on hardware consoles (such as the PLAYSTATION 3, Xbox 360 and Wii), PCs and handheld game players (such as the Sony PSP and Nintendo DS), (2) video games for wireless devices (such as cellular phones and smart phones including the Apple iPhone), (3) interactive online-enabled packaged goods, digital content, and online services associated with these games, (4) services in connection with some of our online games, (5) programming third-party web sites with our game content, (6) allowing other companies to manufacture and sell our products in conjunction with other products, and (7) advertisements on our online web pages and in our games.

During the three and six months ended September 30, 2009, we recognized total net revenue of $788 million and $1,432 million, respectively. Our total net revenue during the three and six months ended September 30, 2009 includes $290 million and $502 million, respectively, recognized from sales of certain online-enabled packaged goods and digital content that either (1) we were not able to objectively determine the fair value (as defined by U.S. Generally Accepted Accounting Principles for software sales) of the online service that we provided in connection with the sale or (2) we had an obligation to deliver incremental unspecified digital content in the future without an additional fee. When we refer to deferral of net revenue in this Net Revenue section, we mean the deferral of (1) the total net revenue from bundle sales of certain online-enabled packaged goods and PC digital downloads for which either we do not have VSOE for the online service that we provide in connection with the sale of the software or we have an obligation to provide future incremental unspecified digital content, (2) revenue from certain packaged goods sales of massively-multiplayer online role-playing games, and (3) revenue from the sale of certain incremental content associated with our core subscription services that can only be played online, which are types of micro-transactions. During the three and six months ended September 30, 2009, we deferred the recognition of $359 million and $531 million of net revenue, respectively, which decreased our reported net revenue, as compared to the deferral of $232 million and $37 million of net revenue during the three and six months ended September 30, 2008, respectively, which decreased our reported net during the three and six months ended September 30, 2008.

From a geographical perspective, our total net revenue for the three and six months ended September 30, 2009 and 2008 was as follows (in millions):

	Three Months Ended September 30,				Increase /	%
	2009		2008		(Decrease)	Change
North America	$ 479	61%	$ 555	62%	$ (76)	(14%)
Europe	268	34%	301	34%	(33)	(11%)
Asia	41	5%	38	4%	3	8%