

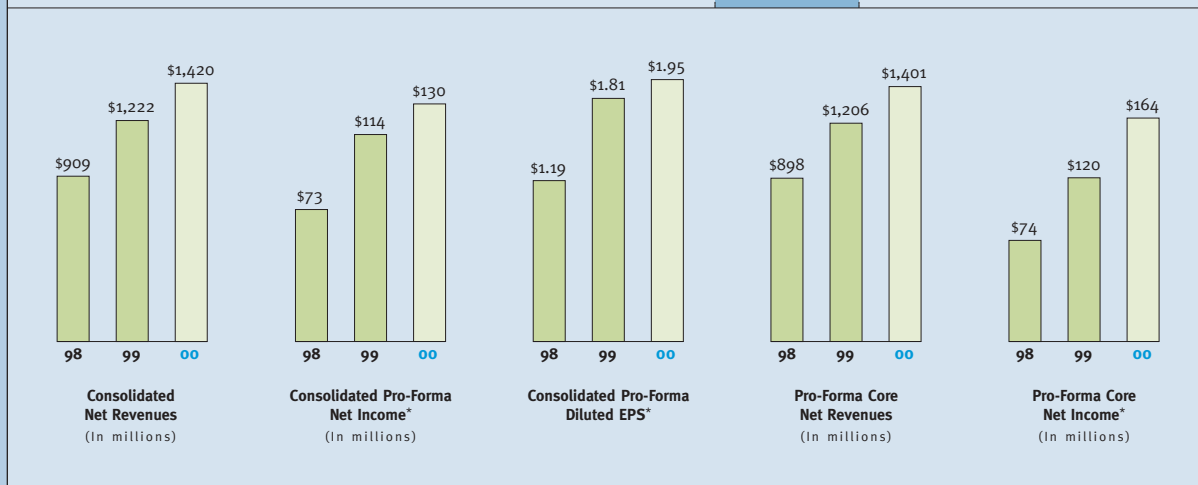
EA 2000 AR



ELECTRONIC ARTS™

2000 CONSOLIDATED FINANCIAL HIGHLIGHTS		2000	1999	% change
Fiscal years ended March 31,				
(In millions, except per share data)				
Net Revenues		\$ 1,420	\$ 1,222	16 %
Operating Income		154	105	47 %
Net Income		117	73	60 %
Diluted Earnings Per Share		1.76	1.15	53 %
Operating Income*		172	155	11 %
Pro-Forma Net Income*		130	114	14 %
Pro-Forma Diluted EPS*		1.95	1.81	8 %
Working Capital		440	333	32 %
Total Assets		1,192	902	32 %
Total Stockholders' Equity		923	663	39 %

2000 PRO-FORMA CORE FINANCIAL HIGHLIGHTS		2000	1999	% change
Fiscal years ended March 31,				
(In millions, except per share data)				
Net Revenues		\$ 1,401	\$ 1,206	16 %
Operating Income		208	114	82 %
Net Income		154	79	95 %
Pro-Forma Net Income*		164	120	37 %



### FISCAL 2000 OPERATING HIGHLIGHTS

- 16 percent increase in EA core net revenues
- 37 percent increase in EA core net income\*
- 69 titles released:
  - 30 PC
  - 30 PlayStation
  - 8 N64
  - 1 Mac
- Signed agreement to be exclusive provider of games on AOL properties
- Acquired:
  - DreamWorks Interactive™
  - Kesmai™
  - PlayNation

\* EXCLUDES GOODWILL AND ONE-TIME ITEMS IN EACH YEAR.

## CHAIRMAN'S LETTER

*TO OUR STOCKHOLDERS*

During fiscal year 2000 Electronic Arts (EA) significantly enhanced its strategic position in the interactive entertainment category. While continuing to create the world's greatest games on current platforms, EA has taken action to capitalize on technology breakthroughs and to help insulate the company from the cyclical economics that historically impact our industry during console transitions. Despite the console market transition beginning sooner than expected, we continued to grow revenues and profits during the year. We reached an important agreement with America Online, Inc. to be the exclusive provider of games on all AOL sites, increased market share on the critical PC platform, and positioned ourselves for leadership on the next generation of console platforms.

By managing the industry's best development talent, creating strong franchise properties, and expanding our global distribution, we increased revenues and profits in a challenging market environment. Including the results of our new online division, EA.com,<sup>(1)</sup> consolidated net revenues increased 16 percent to \$1,420 million. Consolidated net income, on an as-reported basis, including goodwill and one-time acquisition related charges, increased 60 percent to \$117 million; while consolidated diluted earnings per share increased 53 percent to \$1.76.

Consolidated pro-forma net income<sup>(2)</sup> excluding goodwill and one-time acquisition-related charges in both years, increased 14 percent to \$130 million. Consolidated pro-forma diluted earnings per share<sup>(2)</sup> increased 8 percent to \$1.95. Our core business, which excludes the results of EA.com, grew pro-forma net revenues<sup>(3)</sup> 16 percent to \$1,401 million. Pro-forma core net income<sup>(4)</sup> increased 37 percent to \$164 million for the core business.

**STRONGLY POSITIONED ON KEY PLATFORMS** We had multiple successes on the PC platform in fiscal year 2000. *SimCity 3000™* and *Command & Conquer™: Tiberian Sun™* each achieved No. 1 status on the PC best-seller list. For calendar year 1999, both products finished in the Top Ten, representing our best performance ever on the PC platform. In addition, we created an outstanding new franchise property—*The Sims™*—which was named Game of the Year by the Academy of Interactive Arts and Sciences.

On the console platforms, our EA SPORTS™ titles maintained a leadership position, with *Madden NFL™ 2000* once again winning the all-important football battle in North America. *FIFA 2000* dominated the European “football” category, with *NBA Live 2000*, *NHL® 2000*, *NASCAR® 2000*, *Triple Play 2001*, *Knockout Kings™ 2000* and *Tiger Woods PGA TOUR® Golf 2000* all leading in their respective categories. In addition, we bolstered our impressive motorsports lineup by signing a long-term license with Formula One. In March 2000, we released our first *F1* products, rounding out the strongest collection of sports properties in our industry. We also secured an exclusive five-year agreement for the James Bond license and will release *The World Is Not Enough* on multiple platforms in the coming year. In 1999, *Tomorrow Never Dies* was one of the leading products on the PlayStation® platform.

We further strengthened our Studio organization with the acquisition of DreamWorks Interactive, LLC. DreamWorks developed and published *Jurassic Park: The Lost World* and released *Medal Of Honor™*, a best-selling title during the most

recent holiday season. We expect to have an ongoing collaboration with DreamWorks SKG, allowing us to create unique and commercially viable content for the interactive entertainment market.

Given this unique combination of assets, we believe that Electronic Arts is well positioned to navigate successfully through the transition to the next generation of console technology. Equally important, we view cyclical transition as an opportunity to strengthen and streamline the company, and to clearly establish EA as the market leader of the future.

**INVESTING FOR ONLINE LEADERSHIP** While still in its infancy, analysts project that online interactive entertainment will generate revenues of up to \$2 billion in 2002<sup>(5)</sup>, an increase of more than 500 percent from \$300 million in 1999. During the year, we made a significant investment in EA.com, which we believe will help to establish us as the leading provider of interactive entertainment in the emerging online market. EA.com pro-forma revenues<sup>(3)</sup> totaled \$21 million in fiscal year 2000, with investment spending of \$63 million, resulting in a pro-forma net loss<sup>(6)</sup> of \$34 million. We expect that the online portion of our business will continue to generate a net loss in the coming fiscal year, as we position ourselves for this significant new opportunity.

In November 1999, we announced a wide-ranging strategic alliance with America Online. The agreement provides Electronic Arts with control of all programming, pricing and promotion on the AOL® games channel. This is an unprece-

dented arrangement, which provides EA with immediate access to nearly 60 million online consumers including 22 million AOL subscribers. We have created a separate class of stock, Class B Common Stock (Tracking Stock), to track the performance of the EA.com business, and plan to take this security public at a later date. AOL owns 10 percent of the Class B Common Stock with a warrant for an additional 5 percent ownership. News Corp., as partial consideration for the sale of their Kesmai development group to EA, received 5 percent of the tracking stock. We believe that the partnership with AOL, News Corp., EA Studios and our existing publishing organization is a formidable combination that will facilitate market leadership in this rapidly growing segment of the Internet.

**STRATEGIC GOALS FOR THE FUTURE** As we look ahead, we are focused on four strategic initiatives.

First, our goal is to be the market leader on the next generation of video game consoles, which includes Sony's PlayStation<sup>®2</sup> computer entertainment system, Microsoft's Xbox<sup>™</sup>, and Nintendo's Dolphin. We shipped our first product for the PlayStation 2 console in Japan in May 2000. Additional titles will be released beginning in the Fall of 2000 in conjunction with the launch of the PlayStation 2 console in North America and Europe.

Second, our objective is to be the leading publisher worldwide on the PC platform. We currently hold that position in Europe and Asia Pacific and intend to increase our share in fiscal year 2001. In North America, we believe we can move into the leadership position with a strong portfolio of titles that includes *The Sims*, *Command & Conquer: Red Alert<sup>™2</sup>*, *American McGee's Alice<sup>™</sup>*, *Black & White<sup>™</sup>*, *The World Is Not Enough*, and a full line up of EA SPORTS products.

Third, we intend to be the leading provider of interactive entertainment on the Internet. The ability to create compelling

content in our Studios and our new EA.com division, along with the unparalleled distribution and reach provided through our partnership with AOL, uniquely positions us for success in this environment. We plan to launch the EA.com<sup>SM</sup> site in summer 2000, with the full service operational in calendar 2001.

Fourth, but most importantly, we strive to be the No. 1 "people company" in the entertainment industry. Without doubt, our employees are the lifeblood of our company. They create the award-winning products, market and distribute them more effectively than any competitor, and provide the support functions that enable EA to be the premier company in our industry. It is imperative that our people are well trained, strongly motivated, recognized for their accomplishments and highly productive. We take this challenge seriously and are constantly working to enhance the quality of our organization.

We have every confidence that we can achieve each of these strategic objectives, and, in doing so, that we will continue to grow and prosper not only during the current console transition period but also in the years ahead.

I would like to acknowledge our employees for their tireless efforts, commitment to excellence and dedication to making EA the worldwide leader in our industry.

Finally, I thank our customers and stockholders for their continuing support and trust in Electronic Arts.

Sincerely,



Lawrence F. Probst III

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

***This Annual Report, including the Letter to Stockholders at pages 1 to 3, contains forward-looking statements about circumstances that have not yet occurred. All statements, trend analysis and other information related to markets, our products and trends in revenue, as well as other statements including such words as "anticipate", "believe" or "expect" and statements in the future tense are forward-looking statements. These forward-looking statements are subject to business and economic risks and actual events or our actual future results could differ materially from those set forth in the forward-looking statements due to such risks and uncertainties. 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 and performance include, but are not limited to those listed under the heading "Risk Factors" at page 32 of this Annual Report and under the same heading in our Annual report on Form 10-K for the year ended March 31, 2000.***

1. EA.COM, A DIVISION OF ELECTRONIC ARTS INC. ("ELECTRONIC ARTS") REPRESENTS ELECTRONIC ARTS' ONLINE AND E-COMMERCE BUSINESS. THE STATEMENT OF INCOME INCLUDES ALL REVENUES AND COSTS DIRECTLY AND INDIRECTLY ATTRIBUTABLE TO EA.COM, INCLUDING CHARGES FOR SHARED FACILITIES, FUNCTIONS AND SERVICES USED BY EA.COM AND PROVIDED BY ELECTRONIC ARTS. CERTAIN COSTS AND EXPENSES HAVE BEEN ALLOCATED BASED ON MANAGEMENT'S ESTIMATES OF THE COST OF SERVICES PROVIDED TO EA.COM BY ELECTRONIC ARTS.

2. PRO-FORMA CONSOLIDATED NET INCOME AND EARNINGS PER SHARE EXCLUDE PRE-TAX GOODWILL AMORTIZATION EXPENSE OF \$12 MILLION AND \$6 MILLION IN THE YEARS ENDED MARCH 31, 2000 AND 1999, RESPECTIVELY, AND \$7 MILLION AND \$44 MILLION RELATED TO ONE-TIME ACQUISITION RELATED CHARGES.

3. PRO-FORMA NET REVENUES FOR THE CORE BUSINESS INCLUDE INTERCOMPANY REVENUES FROM EA.COM.

4. PRO-FORMA CORE NET INCOME EXCLUDES THE OPERATIONS OF EA.COM, AND EXCLUDES PRE-TAX GOODWILL AMORTIZATION EXPENSE OF \$11 MILLION AND \$6 MILLION IN THE YEARS ENDED MARCH 31, 2000 AND 1999, RESPECTIVELY, AND \$3 MILLION AND \$44 MILLION RELATED TO ONE-TIME ACQUISITION RELATED CHARGES.

5. SOURCE: IDC/LINK

6. EA.COM PRO-FORMA NET LOSS EXCLUDES PRE-TAX GOODWILL AMORTIZATION EXPENSE OF \$1 MILLION IN THE YEAR ENDED MARCH 31, 2000 AND \$4 MILLION RELATED TO ONE-TIME ACQUISITION RELATED CHARGES.

It is a very exciting time to be working in Electronic Arts' Studios. The introduction of the next generation of video game consoles has revolutionized the art of interactive story telling and challenged the imagination of every artist, writer, engineer, designer and producer in our company. Our goal is to create software that adds a brand new dimension to gaming—faces that convey real emotion, sports characters that match the personalities of their superstar counterparts and a fluidity of motion that brings cinema-quality action to interactive entertainment. The next generation of games created by EA will be so realistic that, at a glance, they could be mistaken for a telecast of the events they represent.

EA Studios are the creative steam engine that will define the new technology for consumers worldwide. We've got the talent, resources, trademarks and creativity consumers look for in buying interactive titles today. That creativity, along with our track record for producing commercially successful titles, puts EA in a unique position to introduce new audiences to a revolution in entertainment—the interactive revolution.

**BUILDING FRANCHISES BASED ON QUALITY GAMEPLAY AND REALISM** EA Studios combine compelling content and great gameplay to create the most engaging entertainment experience available. Producers oversee product development and manage talent inside our own Studios and from the creative community at large.

From a core concept, designers and technologists work in parallel, developing storyboards and performing technology reviews. After feasibility reviews, products move to production where writers script dialogue and video, while graphic artists build extensive visual sequences to create worlds never before imagined. Audio specialists compose hours of original scores while software programmers create innovative ways to make the gaming experience more interactive.

EA titles frequently integrate renderings of marquee players to add realism to our EA SPORTS titles. For instance, Major League Soccer™ All-Star Eddie Pope, from DC United, participated in a motion-capture session for EA SPORTS' best-selling *FIFA 2000*. Motion-capture allowed EA to simulate Pope's exact moves in the game.

**PUSHING THE TECHNOLOGY** EA Studios are continually pushing the limits of technology to create more engaging gameplay. *Madden NFL 2001* for the PlayStation 2 console will utilize the strength of new technology to increase the overall game experience. The level of detail incorporated into the game far exceeds anything available today; characters are designed with facial hair and muscle tone—they even sweat.

In addition to bringing state-of-the-art technology to games, the Studio strives to create strong new franchises. EA's formula of developing franchises that can be iterated upon was successfully augmented during the year with titles like *The Sims* and *F1 2000*.

*The Sims* sold over one million copies in its first ten weeks. Its story lines appeal to both men and women and have a broader age appeal than other games created by EA; in fact, 25 percent of registered users are women. By expanding our audience to include more women and a wider range of age groups, *The Sims* has again proven that EA designs for mass-market success.

To develop *F1 2000*, EA secured the rights to one of the world's most coveted international motorsports licenses: Formula One. The license provides worldwide interactive rights to the drivers, teams, cars and tracks on the Formula One circuit. An estimated audience of over five billion fans makes Formula One the world's largest spectator sport. With 16 races on five continents over an eight-month period, Formula One is a uniquely global sport.

**CREATIVE BENCH STRENGTH—THE KEY TO A SUCCESSFUL STUDIO** In order to succeed, the Studios must continue to attract and retain the best available development talent. As technology becomes more powerful, dependence on internal talent becomes increasingly important.

EA's success is due in great part to our focus on internal product development. EA Studios employ more than 1,800 developers located in 13 studios in 5 countries. This is nearly double the number we employed just three years ago. The depth of EA's creative team is unmatched in the industry.

This talent base is critical to our success in developing titles for the PlayStation 2 console. Based upon Sony's projection that they will sell 100 million hardware units in four years, as well as on EA's leadership on this new console, we are uniquely positioned to capture this market growth. At the end of fiscal year 2000, EA Studios had more than 20 titles for the PlayStation 2 console under development. EA was the largest third-party developer and the only Western developer invited by Sony to participate in the Tokyo PlayStation Festival in February. We showcased three new titles: *FIFA Soccer World Championship*, *SSX* and *X Squad™*. *SSX*, a snowboard racing game, emerged as a crowd favorite and an early contender to be a new and internationally popular EA franchise.

While success of the new console is a key driver of future growth, the installed base of the earlier PlayStation console will continue to play a vital role. PlayStation represented 41 percent of net revenues in fiscal year 2000—continuing to develop key franchises for the best-selling platform of all time will serve EA well. EA will release approximately 20 titles in fiscal year 2001 for the original PlayStation console. With its installed user base of 73 million units worldwide, and current \$99 retail price, the PlayStation market will not disappear immediately. EA is committed to servicing this vital group of consumers throughout the console transition.

In addition, the strength of EA's Studio is a distinct advantage in the development of our online site, EA.com. We are re-engineering some of our most popular franchises to build

a strong online offering of accessible games for all levels of consumers. The Studio is developing original fiction specifically designed for online play. *Ultima™ Online* has proven that our Studios can create compelling, immersive online experiences for users. Now we are creating other products, which we believe will be equally compelling and immersive, but which we also believe will be poised for mass-market success.

EA has created a Studio that is renowned worldwide. The depth of that creative team has made us the world's leading interactive entertainment provider. Moreover, the depth of that creative team positions us to succeed in our goals of leadership on the PlayStation 2 console, on the PC platform and in the emerging online space.



## EA PUBLISHING

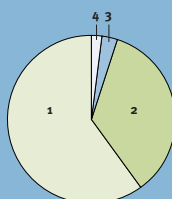
## BRAND MARKETING ON A GLOBAL SCALE

As the world's largest publisher of interactive entertainment software for the PC and console (PlayStation and Nintendo® 64) markets, EA drives our products to market like no other company. EA localizes, manufactures, packages, distributes, markets and sells titles created by our Studios, as well as by some third-party game developer partners, in over 75 countries on five continents. EA's size and reach, coupled with our ability to produce games for any console or platform, gives us a unique position in the industry.

EA is the No.1 publisher in most western markets, including the United States and Europe, as well as in most markets in Asia Pacific.

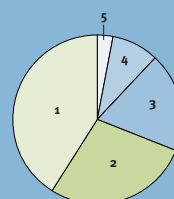
## EA Publishing Strengths

Our greatest strength lies in the quality of our publishing teams in North America, in nearly every western European country, in Japan and across most Asia-Pacific markets, including Australia, China and Korea. Highly successful, these outstanding teams manage a prodigious portfolio of products for both the console and PC entertainment software markets.



REVENUE MIX PERCENTAGE BY GEOGRAPHY

	00	99
1 North America	60	58
2 Europe	35	36
3 Asia Pacific	3	3
4 Japan	2	3



REVENUE MIX PERCENTAGE BY PLATFORM

	00	99
1 PlayStation	41	43
2 PC-CD	28	22
3 EA Distribution	19	20
4 N64	9	12
5 License, OEM & Other	3	3

**CONSOLES** EA has demonstrated clear and consistent leadership on the gaming console platforms. We are the No. 1 third-party publisher in the current console market, where the two most popular console hardware brands, PlayStation and Nintendo 64, have an established installed base of nearly 100 million units. According to TRST reports, the industry standard for market share reporting in North America, EA finished fiscal year 2000 with a 16 percent overall console share in North America, higher than any other third-party company. In Europe, we were also the No. 1 console publisher. Though we were not No. 1 overall in Japan, we did achieve the position of being the No. 1 company among Western based publishers.

In the console software industry, new technology typically triggers a transitional period every four to five years. The latest transition began just prior to the 1999 holiday season, as consumers began to delay purchases of new hardware and software titles in anticipation of the coming next generation consoles. Our expectation is that we will see the software market flatten out, or even decline slightly, until the PlayStation 2 console is launched outside of Japan in October 2000. We plan to focus on two major fronts: (1) generating the greatest possible sales from the currently installed console base, and (2) ensuring EA is solidly positioned to establish leadership on the new PlayStation 2 console and, potentially, on other new generation console platforms, when they are introduced.

**PC GAMES** In the PC segment, which has continued to grow at roughly 10 percent annually, EA has leveraged its global publishing capability. EA continues to demonstrate that localization of content creates enormous cross-cultural appeal. Simultaneous global launches of popular EA titles such as *Command & Conquer: Tiberian Sun*, *The Sims*, *FIFA 2000* and *SimCity 3000* have met with unprecedented success. EA's top-selling title in fiscal year 2000, *Tiberian Sun*, was the No. 1 PC game in the world, generating revenues in excess of \$75 million. *The Sims* was the No. 1 title worldwide in the fourth quarter of fiscal year 2000, and continues to top world charts with the promise of finishing calendar year 2000 as a best seller.

The size and the breadth of our skills provide EA with a unique ability to orchestrate simultaneous global launches with localized content and regional marketing. This advan-

tage has translated into greater volume and increased market share. In fiscal year 2000, EA increased market share in North America, Asia Pacific and Japan. In addition, EA has obtained market share leadership throughout Europe.

**THREE COUNTRIES—THREE SUCCESS STORIES** EA continues to aggressively grow share both in new markets as well as in those where we already own a leadership position.

**Korea:** In fiscal year 1999, EA opened an office in Korea, building a direct distribution business from the ground up. Within twelve short months, EA has successfully won the mind-share of retail outlets and consumers alike with our focus on localization and cultural issues. This is shown by EA's phenomenal growth from an estimate of less than 10 percent market share in fiscal year 1999 to more than 20 percent in fiscal year 2000. EA intends to capitalize on this momentum to achieve aggressive growth in this new market.

**Japan:** Japan is one of the few markets where EA's market share has been historically weak. This is changing. We have restructured operations in Japan, by hiring new management, building a direct PC distribution business and forming a new partnership with a leading Japanese video game publisher, SquareSoft. These changes have allowed us to restore the business to profitability and begin to increase our share in the PC market. We launched our first PlayStation 2 console title in Japan in May 2000, with plans to release additional titles in fall 2000. These releases will position us well for market share gains worldwide on the important console side of our business.

**Germany:** EA has developed a strong lead in Germany, the largest European market. During calendar year 1999, EA's PC titles were No. 1 for 23 weeks of the year. As a result, PC market share increased from 18 percent to 24 percent in calendar year 1999—helped in part by a successful premium price strategy on hits like *Command & Conquer: Tiberian Sun*. This position was underlined in the first week of April 2000 when the top four chart titles were all EA properties, *Command & Conquer: Tiberian Sun Firestorm™* (No. 1), *F1 2000* (No. 2), *The Sims* (No. 3) and *Need for Speed™: Porsche® Unlimited* (No. 4).

Korea, Japan, Germany—radically different markets, one common approach for EA.

By using our global publishing capability to adapt successful titles to local tastes, we then take these titles to market with



aggressive marketing while leveraging deep and strong retailer relationships. In the end, we achieve the goal of increasing our market share in both new and existing markets worldwide.

**BRANDING** One of the keys to success for Electronic Arts is in leveraging the equity our franchises have established with consumers worldwide. With that in mind, EA has unveiled a new branding strategy that aligns our Studios and publishing groups behind a consistent brand approach. To that end, we have unified all packaging and promotions under the EA brand umbrella using three brand logos: EA SPORTS, EA GAMES™ and EA.com.

EA SPORTS will continue to represent the high standard of games consumers have come to expect. EA GAMES is a new brand created to unify the entertainment portfolio that was previously marketed under six separate brand names. Going forward, powerful EA GAMES franchises such as *Command & Conquer*, *The Sims*, *SimCity™* and *James Bond* will be linked with solid EA GAMES branding. EA.com is the greatest new exposure consumers will have to our branding initiative. More than 22 million AOL subscribers will see the new logo and millions more will see it on affiliated AOL sites including Netcenter™, AOL.com and CompuServe®. The online audience brings new consumers into the EA family and, by using a logo so clearly linked to and identified with our EA SPORTS and EA GAMES logos, we stand to build the overall EA brand to great new heights.

At the core of this strategy is the iconography and equity of EA SPORTS, the flagship of EA's portfolio. EA SPORTS is the most powerfully branded franchise in the interactive gaming world. As always, high-quality gameplay and rich attention to detail are the critical elements of our EA SPORTS success. In addition, EA SPORTS titles capture consumer attention with the use of cyber-superstars—renderings of top athletes such

as Tiger Woods, Michael Jordan, Heavyweight Champion Lennox Lewis, Mike Piazza and Japanese soccer phenom Nakata. In North America, we continue to lead the sports category by a wide margin. The highlight for the year in North America was *Madden NFL Football 2000*, which sold over 2.1 million units and outdistanced its direct competition by a wide margin. EA's largest sports franchise worldwide, *FIFA Soccer*, continues to be a huge global success with revenues for *FIFA 2000* of over \$90 million. Recognizing the opportunity inherent in EA's worldwide distribution, EA SPORTS has reached out with existing franchises and created new titles to capture global market share.

**OUTLOOK FOR THE FUTURE** The console transition that started in fiscal year 2000 will continue in fiscal year 2001—it will prove to be a watershed period for our industry. Historically, transition has led to significant industry growth. The transition from prior technology typically brings with it a big step forward in the quality of the graphics displayed in our games and, with it, opens the game market to new consumers. These consumers demand increased realism and quality in the games they play. While these console transitions represent big opportunities for our industry, managing the transition will be challenging for EA and all our competitors. EA has successfully navigated several previous transitions and, in each instance, emerged stronger, more focused and with greater market share. As we position EA for leadership of future console markets, we look forward with an eye toward continued success through and beyond the current transition period. While we are managing the console transition, we will continue to drive toward an ever-higher market share on the PC side of the business. Looking forward, we are confident in our EA GAMES and EA SPORTS PC lineup and in our ability to manage it successfully. With the enormous success of our key PC franchises in fiscal year 2000, EA has proven an ability to create global winners in the PC market. We will be selecting from an even larger slate of winning titles in the coming year to continue to drive and build market leadership.



*DEFINING ONLINE ENTERTAINMENT*

One of our key long-term growth opportunities is EA.com. Announced in November 1999, EA.com will be the online entertainment destination that will revolutionize the interactive entertainment industry by bringing new consumers to the EA fold and new gaming experiences to millions of consumers. EA.com will offer a diverse array of interactive entertainment online that suits almost every taste, from those customers seeking simple, easy-to-play card games, to those wanting skill-oriented sports and adventure experiences, to those that revel in deeply immersive, persistent-world fantasies.

Our intention is to launch the world's best online gaming network with four distinct objectives:

- Develop and launch the best online games—great games are critical to leading this emerging new market.
- Offer games and web sites that are as easy to play and as easy to use as TV is to watch.
- Establish strong communities within our gaming network with the best services, programs and features, such as tournaments, competition ladders and great chat forums.
- Build and maintain a highly reliable network and infrastructure with high levels of customer service.

**THE BUSINESS MODEL** EA.com will generate revenues from both subscriptions and advertising. EA's Origin™ studio pioneered the online game subscription concept when *Ultima Online* first proved that consumers will pay a monthly subscription fee for a high-quality gaming experience. *Ultima Online* was the first title to achieve a large number of subscribers in a new genre of games called persistent-world fantasy. Persistent-world fantasies offer users an ongoing online experience that is evolving 24 hours a day. *Ultima Online* boasted nearly 160,000 active subscribers at the end of fiscal year 2000, with each subscriber paying \$10 monthly to participate in the community that has grown around this epic medieval fantasy—the average *Ultima* subscriber plays in excess of 20 hours per week.

Competition and imitation have followed, but *Ultima* continues to grow in membership and profitability. Our experience with this title indicates that consumers are willing to pay a subscription fee to experience quality games.

Advertising will comprise the other major component of the EA.com revenues. EA will sell advertising both on the web pages and within the games that consumers view and play online. We believe that the attractive demographic of online gamers, coupled with the “stickiness” of our games will allow us to reap premium rates for advertising on our sites.

**PARTNERSHIP WITH AMERICA ONLINE** In November 1999, we announced an unprecedented agreement with America Online, Inc. (AOL) that makes us the exclusive games channel

to the 22 million subscribers of the America Online service in North America as of March 2000. We have also agreed to exclusively provide the game channel content for AOL's web properties, including AOL.com, NetCenter, CompuServe and ICQ. Which will provide EA.com with access to nearly 60 million consumers, including 22 million AOL subscribers.

The marriage of one of the world's foremost developers and publishers of interactive content, Electronic Arts, with the world's most popular Internet service provider, AOL, will make EA.com a clear leader in online gaming. While AOL understands how to maintain a mass audience, EA is the leader in development of interactive entertainment.

**OUTLOOK FOR THE FUTURE** While online gaming is currently in its infancy, industry analysts predict online gaming revenues will reach over \$2 billion by 2002—an increase of more than 500 percent from 1999. Built into these projections is an assumption that as the Internet makes interactive entertainment more accessible, and as developers make the games easier to play online, there will be a significant broadening of the demographics of those playing interactive games. This trend is emerging in some of our greatest new PC game hits, like *The Sims*, where we are seeing the gaming audience expand to include more families and women. This new, expanded market is making up the bulk of those using most online game services today and should form an important component of EA.com's audience in the future. Online gaming has the potential to push interactive entertainment into living rooms around the world.

With this new audience, we believe that EA.com has a formidable set of advantages as we build toward market leadership in the coming years. We have the world's best game development teams within our Studios and within our EA.com division. We have our AOL partnership. We have the strength of the best brand name in the interactive entertainment industry in EA. We have the cross-marketing leverage inherent in managing the world's largest game software business. Our goal is to leverage these advantages to create something truly fun on the Internet with EA.com . . . and to achieve the leadership position in this exciting new market in the process.

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## SELECTED FIVE-YEAR FINANCIAL DATA

## ELECTRONIC ARTS AND SUBSIDIARIES

Years Ended March 31	2000	1999	1998	1997	1996
(In thousands, except per share data)					
<b>INCOME STATEMENT DATA</b>					
Net revenues	\$1,420,011	\$1,221,863	\$ 908,852	\$ 673,028	\$ 587,299
Cost of goods sold	705,808	627,823	481,233	328,943	291,491
Gross profit	714,203	594,040	427,619	344,085	295,808
Operating expenses:					
Marketing and sales	188,628	163,407	128,308	102,072	85,771
General and administrative	92,502	76,219	57,838	48,489	37,711
Research and development	260,759	199,141	145,732	130,755	108,043
Charge for acquired in-process technology	6,539	44,115	1,500	–	2,232
Merger costs	–	–	10,792	–	–
Amortization of intangibles	11,989	5,880	–	–	–
Total operating expenses	560,417	488,762	344,170	281,316	233,757
Operating income	153,786	105,278	83,449	62,769	62,051
Interest and other income, net	16,028	13,180	24,811	13,279	7,514
Income before provision for income taxes and minority interest	169,814	118,458	108,260	76,048	69,565
Provision for income taxes	52,642	45,414	35,726	26,003	22,584
Income before minority interest	117,172	73,044	72,534	50,045	46,981
Minority interest in consolidated joint venture	(421)	(172)	28	1,282	(304)
Net income	\$ 116,751 <sup>(a)</sup>	\$ 72,872 <sup>(b)</sup>	\$ 72,562 <sup>(c)</sup>	\$ 51,327	\$ 46,677 <sup>(d)</sup>
Net income per share amounts:					
Basic	\$ 1.86 <sup>(a)</sup>	\$ 1.20 <sup>(b)</sup>	\$ 1.23 <sup>(c)</sup>	\$ 0.89	\$ 0.84 <sup>(d)</sup>
Diluted	\$ 1.76 <sup>(a)</sup>	\$ 1.15 <sup>(b)</sup>	\$ 1.19 <sup>(c)</sup>	\$ 0.86	\$ 0.80 <sup>(d)</sup>
Number of shares used in computation:					
Basic	62,830	60,748	58,867	57,544	55,685
Diluted	66,371	63,272	60,958	59,557	58,190
<b>BALANCE SHEET DATA AT FISCAL YEAR END</b>					
Cash, cash equivalents and short-term investments	\$ 339,804	\$ 312,822	\$ 374,560	\$ 268,141	\$ 190,873
Marketable securities	236	4,884	3,721	5,548	37,869
Working capital	440,021	333,256	408,098	284,863	247,001
Long-term investments	8,400	18,400	24,200	34,478	30,319
Total assets	1,192,312	901,873	745,681	584,041	489,496
Total liabilities	265,302	236,209	181,713	136,237	108,668
Minority interest	3,617	2,733	–	28	1,277
Total stockholders' equity	923,393	662,931	563,968	447,776	379,551

NOTE: THE SELECTED FIVE-YEAR FINANCIAL DATA HAS BEEN RESTATED TO REFLECT THE ACQUISITION OF MAXIS, INC. WHICH WAS ACCOUNTED FOR AS A POOLING OF INTEREST.

(a) NET INCOME AND NET INCOME PER SHARE INCLUDE ONE-TIME ACQUISITION RELATED CHARGES OF \$4.5 MILLION, NET OF TAXES, INCURRED IN CONNECTION WITH THE ACQUISITION OF KESMAI AND OTHER BUSINESS COMBINATIONS MADE DURING THE YEAR AS WELL AS GOODWILL AMORTIZATION OF \$8.3 MILLION, NET OF TAXES.

(b) NET INCOME AND NET INCOME PER SHARE INCLUDE ONE-TIME ACQUISITION RELATED CHARGES OF \$37.5 MILLION, NET OF TAXES, INCURRED IN CONNECTION WITH THE ACQUISITION OF WESTWOOD STUDIOS AND OTHER BUSINESS COMBINATIONS MADE DURING THE YEAR AS WELL AS GOODWILL AMORTIZATION OF \$4.0 MILLION, NET OF TAXES.

(c) NET INCOME AND NET INCOME PER SHARE INCLUDE ONE-TIME ACQUISITION RELATED CHARGES OF \$1.0 MILLION, NET OF TAXES, INCURRED IN CONNECTION WITH THE ACQUISITION OF THE REMAINING MINORITY OWNERSHIP INTEREST IN ELECTRONIC ARTS VICTOR, INC. AS WELL AS MERGER COSTS OF \$7.2 MILLION, NET OF TAXES, ASSOCIATED WITH THE MERGER WITH MAXIS, OFFSET BY A ONE-TIME GAIN ON SALE OF CREATIVE WONDERS, LLC IN THE AMOUNT OF \$8.5 MILLION, NET OF TAXES.

(d) NET INCOME AND NET INCOME PER SHARE INCLUDE ONE-TIME ACQUISITION RELATED CHARGES OF \$1.5 MILLION, NET OF TAXES, INCURRED IN CONNECTION WITH THE ACQUISITION OF CINEMATRONICS LLC MADE BY MAXIS PRIOR TO THE MAXIS MERGER WITH ELECTRONIC ARTS.

PLEASE REFER TO MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR DISCUSSIONS OF EA CORE AND EA.COM PROFORMA FINANCIAL STATEMENTS.

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## ELECTRONIC ARTS AND SUBSIDIARIES

This Annual Report, including the "Letter to Stockholders" at pages 1 to 3 and the following "Management's Discussion and Analysis of Financial Condition and Results of Operations", contains forward-looking statements about circumstances that have not yet occurred. All statements, trend analysis and other information contained below relating to markets, our products and trends in revenue, as well as other statements including words such as "anticipate", "believe" or "expect" and statements in the future tense are forward-looking statements. These forward-looking statements are subject to business and economic risks and actual events or our actual future results could differ materially from those set forth in the forward-looking statements due to such risks and uncertainties. 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 and performance include, but are not limited to those discussed under the heading "Risk Factors" at page 32 of this Annual Report and under the same heading in our Annual Report on Form 10-K for the year ended March 31, 2000.

## RESULTS OF OPERATIONS

### Comparison of Fiscal 2000 to 1999:

#### Revenues

We derive revenues primarily from shipments of entertainment software, which includes EA Studio products for dedicated entertainment systems (that we call video game systems or consoles such as PlayStation and Nintendo 64), EA Studio personal computer products (or PC), and Affiliated Label (or AL) products that are published by third parties and distributed or co-published by us. We also derive revenues from licensing of EA Studio products and Affiliated Label products through hardware companies (or OEMs) and online subscription revenues.

Information about our net revenues for North America and foreign areas for fiscal 2000 and 1999 is summarized below (in thousands):

	2000	1999	Increase	% change
North America	\$ 846,637	\$ 704,998	\$ 141,639	20.1 %
Europe	492,430	443,937	48,493	10.9 %
Asia Pacific	47,573	39,560	8,013	20.3 %
Japan	33,371	33,368	3	0.0 %
International	573,374	516,865	56,509	10.9 %
Consolidated Net Revenues	\$ 1,420,011	\$ 1,221,863	\$ 198,148	16.2 %

**NORTH AMERICA NET REVENUES** The increase in North America net revenues for fiscal 2000 compared to fiscal 1999 was primarily attributable to:

- A 52% increase in PC revenues due to strong sales of *Command and Conquer: Tiberian Sun*, *Sim City 3000* as well as the fourth quarter shipment of *The Sims* in fiscal 2000.
- A 20% increase in PlayStation revenues due to more titles released during fiscal 2000 including *Madden NFL 2000*, *NBA 2000* and *Tomorrow Never Dies* as compared to fiscal 1999.
- A 17% increase in AL revenues primarily due to the shipment of titles published by Square EA offset by the loss of an affiliate, Accolade, due to its acquisition by a third party in the first quarter of the current fiscal year.
- These increases were partially offset by an expected decline in sales of Nintendo 64 ("N64") products.



**INTERNATIONAL NET REVENUES** The increase in international net revenues for fiscal 2000 compared to fiscal 1999 was attributable to the following:

- Europe's net revenues increased by 11% primarily due to an increase in sales of PC titles including *Command and Conquer: Tiberian Sun*, *Sim City 3000* and *The Sims* as well as an increase in PlayStation revenues due to the success of *FIFA 2000*, *Tomorrow Never Dies* and *F1 2000*. These increases were partially offset by an expected decline in sales of N64 products. Overall European revenues were adversely impacted by a devaluation of the Euro compared to the same period last year.
- Asia Pacific's net revenues increased 20% due to PC sales of *Command and Conquer: Tiberian Sun* and *Sim City 3000*.
- Japan's net revenues were flat compared to the prior year. PC and Affiliated Label revenues increased, offset by a decrease in PlayStation product sales primarily due to strong sales of *FIFA: Road to World Cup* and *World Cup 98* in the prior year.

Information about our net revenues by product line for fiscal 2000 and 1999 is presented below (in thousands):

	2000	1999	Increase/ (Decrease)	% change
EA Studio:				
PlayStation	\$ 586,821	\$ 519,830	\$ 66,991	12.9 %
PC	397,777	270,793	126,984	46.9 %
N64	120,415	152,349	(31,934)	(21.0) %
Online Subscriptions	16,771	12,570	4,201	33.4 %
License, OEM and Other	22,894	18,216	4,678	25.7 %
	1,144,678	973,758	170,920	17.6 %
Affiliated Label:				
	275,333	248,105	27,228	11.0 %
Consolidated Net Revenues	\$ 1,420,011	\$ 1,221,863	\$ 198,148	16.2 %

**PERSONAL COMPUTER PRODUCT NET REVENUES** We released 31 PC titles in fiscal 2000 compared to 29 PC titles in fiscal 1999. The worldwide increase in sales of PC revenues was primarily attributable to an increase in sales in North America and Europe due to the success of *Command and Conquer: Tiberian Sun* released in the second quarter of fiscal 2000 and continued strong catalog sales of *Sim City 3000* released in the fourth quarter of fiscal 1999. Other key titles in the current year include *The Sims* and *FIFA 2000*.

We expect revenues from PC products to grow in fiscal 2001, but as revenues for these products increase, they may not grow at the current rate.

**PLAYSTATION PRODUCT NET REVENUES** We released 30 new PlayStation titles in fiscal 2000 compared to 21 in fiscal 1999. The increase in PlayStation product sales was attributable to more titles released in the current fiscal year compared to the same period last year. Key releases for the year include *FIFA 2000*, *Tomorrow Never Dies*, *Madden NFL 2000*, *NBA 2000* and *Knockout Kings™ 2000*.

Sony has announced the release of the PlayStation 2 console in the United States and Europe in the fall of 2000. Although our PlayStation products will be playable on the PlayStation 2 console, we expect sales of current PlayStation products to decline in fiscal 2001.

Under the terms of a licensing agreement entered into with Sony Computer Entertainment of America in July 1994 (the "Sony Agreement"), as amended, we are authorized to develop and distribute software products compatible with the PlayStation. Pursuant to the Sony Agreement, we engage Sony to manufacture PlayStation Compact Disks for distribution by us. Accordingly, we have limited ability to control our supply of PlayStation products or the timing of their delivery.

**AFFILIATED LABEL PRODUCT NET REVENUES** AL product sales increased due to higher sales in North America. The increase in Affiliated Label revenues compared to the same period last year was due to the distribution of titles by Square EA, including *Final Fantasy® VIII*, partially offset by the termination of our distribution agreement with Accolade, which was acquired by a third party.

**N64® PRODUCT NET REVENUES** The expected decrease in N64 revenues for fiscal 2000 compared to the same period last year was due to the weak market for N64 products as well as strong comparisons of *World Cup 98* in the prior year. We released eight titles in fiscal 2000, including *WCW™ Mayhem*, compared to nine titles in fiscal 1999. We expect revenues from N64 products to decline significantly in fiscal 2001.

Under the terms of the N64 Agreement, we engage Nintendo to manufacture our N64 cartridges for distribution by us. Accordingly, we have little ability to control our supply of N64 cartridges or the timing of their delivery. A shortage of microchips or other factors outside our control could impair our ability to obtain an adequate supply of cartridges.

In connection with our purchases of N64 cartridges for distribution in North America, Nintendo requires us to provide irrevocable letters of credit prior to Nintendo's acceptance of purchase orders from us for purchases of these cartridges. For purchases of N64 cartridges for distribution in Japan and Europe, Nintendo requires us to make cash deposits. Furthermore, Nintendo maintains a policy of not accepting returns of N64 cartridges. Because of these and other factors, the carrying of an inventory of cartridges entails significant capital and risk.

**ONLINE SUBSCRIPTION REVENUES** Online subscription revenues are revenues collected for Internet game play on our websites. The increase in online revenues for fiscal 2000 as compared to fiscal 1999 was attributable to the following:

- The average number of paying customers for *Ultima Online* increased to over 140,000 for fiscal 2000 as compared to over 105,000 in fiscal 1999.
- The increase in paying customers was due to continued strong sales of *Ultima Online*, the addition of new events within the *Ultima* worlds and the release of *Ultima Online: The Second Age™* in October 1998. *Ultima Online: The Second Age* added features including new worlds, monsters and an in-game chat feature.
- We established servers for *Ultima Online* in Europe in June 1999 and in Japan in October 1998. This local dial-in capability resulted in new customers in those territories for the fiscal 2000, as compared to fiscal 1999.

**LICENSE, OEM AND OTHER REVENUES** The increase in license, OEM and other revenues was primarily due to the following:

- License/OEM revenues increased due to the sales of Game Boy® Color titles in the current fiscal year.
- Other revenues decreased primarily due to decreases in 32-bit products, other than PlayStation as we are no longer publishing games for those platforms.

**NET REVENUES BY SEGMENT** As a result of the approval of the Tracking Stock proposal (See Note 2) to authorize issuance of a new series of common stock designated as Class B common stock, intended to reflect the performance of EA.com, management considers EA.com a separate reportable segment. Accordingly, prior period information has been restated to disclose this separate segment. We operate in two principal business segments globally:

- Electronic Arts core (“EA Core”) business segment: creation, marketing and distribution of entertainment software.
- EA.com business segment: creation, marketing and distribution of entertainment software which can be played or sold online.

EA.com, a division of Electronic Arts Inc., represents Electronic Arts’ online and e-Commerce businesses. EA.com’s business includes subscription revenues collected for Internet game play on our websites, sales of packaged goods for Internet-only based games and sales of Electronic Arts games sold through EA.com websites. The statement of income includes all revenues and costs directly attributable to EA.com, including charges for shared facilities, functions and services used by EA.com and provided by Electronic Arts. Certain costs and expenses have been allocated based on management’s estimates of the cost of services provided to EA.com by Electronic Arts.

Information about our net revenues by segment for fiscal 2000 and 1999 is presented below (in thousands):

Year Ended March 31, 2000	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Net revenues from unaffiliated customers	\$ 1,399,093	\$ 20,918	\$ –	\$ 1,420,011
Group sales	2,014	–	(2,014) <sup>(a)</sup>	–
Total net revenues	1,401,107	20,918	(2,014)	1,420,011
Cost of goods sold from unaffiliated customers	700,024	5,784	–	705,808
Group cost of goods sold	–	2,014	(2,014)	–
Total cost of goods sold	700,024	7,798	(2,014)	705,808
Gross profit	701,083	13,120	–	714,203
Operating expenses:				
Marketing and sales	185,714	2,914	–	188,628
General and administrative	87,513	4,989	–	92,502
Research and development	205,933	34,775	20,051 <sup>(b)</sup>	260,759
Network development and support	–	20,051	(20,051)	–
Charge for acquired in-process technology	2,670	3,869	–	6,539
Amortization of intangibles	10,866	1,123	–	11,989
Total operating expenses	492,696	67,721	–	560,417
Operating income (loss)	208,387	(54,601)	–	153,786
Interest and other income, net	16,017	11	–	16,028
Income (loss) before provision for income				
taxes and minority interest	224,404	(54,590)	–	169,814
Provision for income taxes	52,642	–	–	52,642
Income (loss) before minority interest	171,762	(54,590)	–	117,172
Minority interest in consolidated joint venture	(421)	–	–	(421)
Net income (loss)	\$ 171,341	\$ (54,590)	\$ –	\$ 116,751

Year Ended March 31, 1999	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Net revenues from unaffiliated customers	\$ 1,204,689	\$ 17,174	\$ -	\$ 1,221,863
Group sales	985	-	(985) <sup>(a)</sup>	-
Total net revenues	1,205,674	17,174	(985)	1,221,863
Cost of goods sold from unaffiliated customers	624,252	3,571	-	627,823
Group cost of goods sold	-	985	(985)	-
Total cost of goods sold	624,252	4,556	(985)	627,823
Gross profit	581,422	12,618	-	594,040
Operating expenses:				
Marketing and sales	161,029	2,378	-	163,407
General and administrative	74,995	1,224	-	76,219
Research and development	181,245	8,050	9,846 <sup>(b)</sup>	199,141
Network development and support	-	9,846	(9,846)	-
Charge for acquired in-process technology	44,115	-	-	44,115
Amortization of intangibles	5,880	-	-	5,880
Total operating expenses	467,264	21,498	-	488,762
Operating income (loss)	114,158	(8,880)	-	105,278
Interest and other income, net	13,180	-	-	13,180
Income (loss) before provision for income taxes and minority interest	127,338	(8,880)	-	118,458
Provision for income taxes	45,414	-	-	45,414
Income (loss) before minority interest	81,924	(8,880)	-	73,044
Minority interest in consolidated joint venture	(172)	-	-	(172)
Net income (loss)	\$ 81,752	\$ (8,880)	\$ -	\$ 72,872

(a) REPRESENTS ELIMINATION OF INTERCOMPANY SALES OF ELECTRONIC ARTS PACKAGED GOODS PRODUCTS TO EA.COM; AND REPRESENTS ELIMINATION OF ROYALTIES PAID TO ELECTRONIC ARTS BY EA.COM FOR INTELLECTUAL PROPERTY RIGHTS.

(b) REPRESENTS RECLASSIFICATION OF NETWORK DEVELOPMENT AND SUPPORT TO RESEARCH AND DEVELOPMENT.

The increase in net revenues for EA.com for fiscal 2000 as compared to fiscal 1999 was attributable to the following:

- Higher online revenues from increased subscriptions to *Ultima Online*.
- Higher internet-based e-Commerce revenues.
- Partially offset by lower *Ultima Online* packaged product revenues due to the decrease in the average selling price.

The following table presents pro-forma results of operations allocating taxes between EA Core and EA.com. Consolidated taxes have been allocated to EA Core and EA.com on a pro rata basis based on the consolidated effective tax rates, thereby giving EA.com the tax benefit of its losses which is utilized by the consolidated group. Such tax benefit could not be recognized by EA.com on a stand-alone basis. The sum of tax expense and tax benefit for EA Core and EA.com is the same as consolidated tax expense. This presentation represents how management analyzes each segment of the business (in thousands):

Year Ended March 31, 2000	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Income (loss) before provision for income taxes and minority interest	\$ 224,404	\$ (54,590)	\$ -	\$ 169,814
Provision (benefit) for income taxes	69,565	(16,923)	-	52,642
Income (loss) before minority interest	154,839	(37,667)	-	117,172
Minority interest in consolidated joint venture	(421)	-	-	(421)
Net income (loss)	\$ 154,418	\$ (37,667)	\$ -	\$ 116,751

Year Ended March 31, 1999	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Income (loss) before provision for income taxes and minority interest	\$ 127,338	\$ (8,880)	\$ -	\$ 118,458
Provision (benefit) for income taxes	48,256	(2,842)	-	45,414
Income (loss) before minority interest	79,082	(6,038)	-	73,044
Minority interest in consolidated joint venture	(172)	-	-	(172)
Net income (loss)	\$ 78,910	\$ (6,038)	\$ -	\$ 72,872

#### Costs and Expenses, Interest and Other Income, Net, Income Taxes and Net Income

Information about our costs and expenses, interest and other income, net, income taxes and net income for fiscal 2000 and 1999 is presented below:

	Percent of Net Revenues	
	2000	1999
Cost of goods sold	49.7 %	51.4 %
Marketing and sales	13.3	13.4
General and administrative	6.5	6.2
Research and development (includes network development and support)	18.4	16.3
Charge for acquired in-process technology	0.5	3.6
Amortization of intangibles	0.8	0.5
Interest and other income, net	1.1	1.1
Income taxes – effective tax rate	31.0	38.3
Net income	8.2 %	6.0 %

**COST OF GOODS SOLD** Cost of goods sold as a percentage of revenues decreased in fiscal 2000 due to:

- An increase in sales of higher margin PC titles as a percentage of revenues.
- An increase in sales of higher margin AL co-published titles which make up a greater amount of total AI revenues as compared to the prior year.
- A decrease in sales of lower margin N64 titles.
- Higher average margin for PC sales due to higher percentage of revenues from internally developed and Intellectual Property owned titles, such as *Command and Conquer: Tiberian Sun*, *Sim City 3000* and *The Sims*.
- Partially offset by a decrease, as a percentage of revenues, of PlayStation products.

**MARKETING AND SALES** Marketing and sales expenses increased in absolute dollars by 15% primarily attributed to:

- Increased print, Internet and television advertising to support new releases.
- Increased cooperative advertising associated with higher revenues in North America and Europe as compared to the prior year.
- Additional headcount related to the continued expansion of our worldwide distribution business.

**GENERAL AND ADMINISTRATIVE** General and administrative expenses increased in absolute dollars by 21% primarily due to:

- An increase in payroll and occupancy costs to support the increase in growth in North America and Europe.
- Increased general and administrative spending for EA.com. EA.com expanded its staff and incurred additional administrative related costs required to support growth of the business. We anticipate a continued increase in the absolute dollars spent on general and administrative related expenses for EA.com.

**RESEARCH AND DEVELOPMENT** The increase in absolute dollars by 31% for research and development expenses (including Network Development and Support) was due to:

- Increased research and development spending due to the ongoing investment in our online business. EA.com increased the number of online projects in development and increased development staff. We believe that continued spending for EA.com game development is critical to the growth of the business and to meet certain targeted launch commitments. EA.com intends to increase the number of online games in development and significantly increase development and production staff. As a result, research and development expenses are expected to increase in absolute dollars.
- Additional headcount-related expenses attributable to the increased in-house development capacity and a higher number of SKUs released in fiscal 2000.
- An increase in development spending for next generation console products including development for the PlayStation 2 console.

We released a total of 69 new products in fiscal 2000 compared to 59 in fiscal 1999.

**NETWORK DEVELOPMENT AND SUPPORT** The increase in network development and support expenses was due to:

- The ongoing investment in our online business.
- EA.com's network and development support expenses increased due to increased spending for network infrastructure in preparation for new online products and the EA.com game site. In addition, we incurred higher infrastructure costs related to increased server capacity for *Ultima Online*, allowing EA.com to serve a higher number of active subscribers.

We expect network development and support expenses to increase in absolute dollars in the future.

**CHARGE FOR ACQUIRED IN-PROCESS TECHNOLOGY****FISCAL 2000:**

- In connection with the acquisition of Kesmai by EA.com in the fourth fiscal quarter of fiscal 2000, we allocated and expensed \$3,869,000 of the purchase price to acquired in-process technology. Kesmai had various projects in progress at the time of the acquisition. As of the acquisition date, costs to complete Kesmai projects acquired were expected to be approximately \$10,550,000 in future periods. We believe there have been no significant changes to these estimates as of March 31, 2000. We currently expect to complete the development of these projects at various dates through fiscal 2002 and to publish the projects upon completion. In conjunction with the merger of Kesmai, we accrued approximately \$200,000 related to direct transaction costs and other related costs. At March 31, 2000 there were \$133,000 in accruals remaining related to these items.
- In connection with the acquisitions of two development companies by EA Core, made in the 2nd and 4th quarters of fiscal 2000, we allocated and expensed \$2,670,000 of the purchase price to acquired in-process technology.

**FISCAL 1999:**

- In connection with the acquisition of Westwood by EA Core in September 1998, we allocated and expensed \$41,836,000 of the purchase price to acquired in-process technology.
- Additionally, in connection with the acquisition of two software development companies by EA Core, in the first quarter of fiscal 1999, we incurred a total charge of \$2,279,000 for acquired in-process technology.

These charges were made after we concluded that the in-process technology had not reached technological feasibility and had no alternative future use after taking into consideration the potential for usage of the software in different products and resale of the software.

**AMORTIZATION OF INTANGIBLES** The amortization of intangibles results primarily from the acquisitions of Westwood, Kesmai, ABC Software and other acquisitions made in fiscal 2000. Amortization of intangibles was \$10,866,000 for EA Core and \$1,123,000 for EA.com.

**INTEREST AND OTHER INCOME, NET** Interest and other income, net, increased in absolute dollars primarily due to realized gains on sales of marketable securities and the sale of our interest in an affiliate. Those gains were partially offset by a write-off of a note receivable from an affiliate in the current year as well as a gain on sale of land recognized in the prior year.

**INCOME TAXES** Our effective tax rate was 31.0% for fiscal 2000 and 38.3% for fiscal 1999. The effective tax rate was lower than the comparable prior year period (excluding the effect of the one-time charges in the prior year) primarily as a result of a higher portion of international income for fiscal 2000 subject to a lower foreign tax rate as compared to the prior year. Our effective tax rate for fiscal 1999 was negatively affected as there was no tax benefit recorded for a portion of the charges related to the acquired in-process technology. Excluding the effect of these charges, the effective tax rate for fiscal 1999 would have been 32.0%.

**NET INCOME** In absolute dollars, reported net income increased by 60% primarily related to higher revenues and gross profits as compared to the same period last year. The increase was also due to significant one-time charges for acquired in-process technology in the prior year. This was partially offset by higher costs incurred by EA.com for the development of online projects, the network infrastructure development and higher infrastructure costs for *Ultima Online* and *Ultima Online: The Second Age*.

Excluding the one-time charges relating to acquired in-process technology of \$4,512,000, net of taxes, in the current year, net income would have been \$121,263,000. Excluding the one-time charges relating to acquired in-process technology of \$37,506,000, net of taxes in the prior year, net income would have been \$110,378,000.

Excluding one-time charges related to acquired in-process technology and goodwill amortization, net income would have been \$129,535,000 for fiscal 2000. Excluding one-time charges relating to acquired in-process technology and goodwill amortization, net income would have been \$114,376,000 for fiscal 1999.

#### Comparison of Fiscal 1999 to 1998:

##### Revenues

Information about our net revenues for North America and foreign areas for fiscal 1999 and 1998 is summarized below (in thousands):

	1999	1998	Increase/ (Decrease)	% change
North America	\$ 704,998	\$ 519,423	\$ 185,575	35.7 %
Europe	443,937	325,938	117,999	36.2 %
Asia Pacific	39,560	41,494	(1,934)	(4.7) %
Japan	33,368	21,997	11,371	51.7 %
International	516,865	389,429	127,436	32.7 %
Consolidated Net Revenues	\$ 1,221,863	\$ 908,852	\$ 313,011	34.4 %

**NORTH AMERICA NET REVENUES** The increase in North America net revenues was mainly attributable to:

- Strong growth in N64 and PlayStation systems. Net revenues from PlayStation and N64 increased 51% due to a larger market and greater installed base for these platforms as well as more title releases for N64 in comparison to the prior year.
- AL sales increased 53% compared to the prior year primarily due to the distribution of products published by Square EA.
- PC revenues increased 11% due to key title releases during the year.

**INTERNATIONAL NET REVENUES** The increase in international net revenues for fiscal 1999 compared to fiscal 1998 was attributable to the following:

- Europe's net revenues increased primarily due to an increase in sales of PlayStation and Affiliated Label products.
- Japan's net revenues increased primarily due to the sales of *FIFA: Road to World Cup 98*.
- Offset by a decrease in Asia Pacific net revenues due to the weakness in Asian currencies. In local currency, in spite of weak economies, net revenues for Asia Pacific increased compared to the prior year.



Information about our net revenues by product line for fiscal 1999 and 1998 is presented below (in thousands):

	1999	1998	Increase/ (Decrease)	% change
EA Studio:				
PlayStation	\$ 519,830	\$ 380,299	\$ 139,531	36.7 %
PC	270,793	231,034	39,759	17.2 %
N64	152,349	56,677	95,672	168.8 %
Online subscriptions	12,570	4,451	8,119	182.4 %
License, OEM and Other	18,216	50,526	(32,310)	(63.9) %
	973,758	722,987	250,771	34.7 %
Affiliated Label:	248,105	185,865	62,240	33.5 %
Consolidated Net Revenues	\$ 1,221,863	\$ 908,852	\$ 313,011	34.4 %

**PLAYSTATION PRODUCT NET REVENUES** We released 21 new PlayStation titles in fiscal 1999 compared to 25 in fiscal 1998. The increase in PlayStation product sales was attributable to the greater installed base of PlayStation game consoles and the releases of key titles for this platform including *FIFA 99*, *World Cup 98* and *Madden NFL 99*.

**PERSONAL COMPUTER PRODUCT NET REVENUES** We released 29 PC titles in fiscal 1999 compared to 30 PC titles in fiscal 1998. The worldwide increase in sales of PC products was primarily attributable to an increase in sales in Europe and North America due to the related releases of key titles for this platform including *SimCity 3000*.

**N64 PRODUCT NET REVENUES** The increase in N64 revenues was primarily due to more title releases for this platform compared to the prior year and a larger N64 market. We released nine titles in fiscal 1999, including *NASCAR® 99*, compared to two titles in fiscal 1998.

**AFFILIATED LABEL PRODUCT NET REVENUES** AL product sales increased due to higher sales in North America and Europe. This increase was primarily attributable to the distribution of products published by Square EA in North America and the acquisition of ABC Software in Switzerland.

**ONLINE SUBSCRIPTION REVENUES** The increase in online revenues for fiscal 1999 as compared to fiscal 1998 was attributable to the following:

- The average paying customers for *Ultima Online* increased to over 105,000 for fiscal 1999 as compared to over 74,000 for fiscal 1998, due to continued strong sales of *Ultima Online* and the release of *Ultima Online: The Second Age* in the third quarter of fiscal 1999. *Ultima Online: The Second Age* added features such as new worlds, monsters and in-game chat features.
- EA.com established servers providing local dial-in capability for *Ultima Online* in Japan in the third quarter of fiscal 1999. We only had servers in North America in fiscal 1998.

**LICENSE, OEM AND OTHER REVENUES** The decrease in license, OEM, online and other revenues was primarily due to the following:

- Net revenues derived from 32-bit products other than PlayStation decreased primarily due to lower sales of Sega Saturn® products. We released no new Sega Saturn titles in fiscal 1999 compared to eight in fiscal 1998.
- Net revenues generated by 16-bit video game cartridge-based products decreased in fiscal 1999 as compared to fiscal 1998. As the 16-bit video game market has been replaced by 32-bit and 64-bit systems, we did not release any new titles in fiscal 1999.
- Licensing of EA Studio products increased primarily as a result of an increase in the revenues generated by licensing of our products in Europe.

**NET REVENUES BY SEGMENT** Information about our net revenues by segment for fiscal 1999 and 1998 is presented below (in thousands):

Year Ended March 31, 1999	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Net revenues from unaffiliated customers	\$ 1,204,689	\$ 17,174	\$ -	\$ 1,221,863
Group sales	985	-	(985) <sup>(a)</sup>	-
Total net revenues	1,205,674	17,174	(985)	1,221,863
Cost of goods sold from unaffiliated customers	624,252	3,571	-	627,823
Group cost of goods sold	-	985	(985)	-
Total cost of goods sold	624,252	4,556	(985)	627,823
Gross profit	581,422	12,618	-	594,040
Operating expenses:				
Marketing and sales	161,029	2,378	-	163,407
General and administrative	74,995	1,224	-	76,219
Research and development	181,245	8,050	9,846 <sup>(b)</sup>	199,141
Network development and support	-	9,846	(9,846)	-
Charge for acquired in-process technology	44,115	-	-	44,115
Amortization of intangibles	5,880	-	-	5,880
Total operating expenses	467,264	21,498	-	488,762
Operating income (loss)	114,158	(8,880)	-	105,278
Interest and other income, net	13,180	-	-	13,180
Income (loss) before provision for income taxes and minority interest	127,338	(8,880)	-	118,458
Provision for income taxes	45,414	-	-	45,414
Income (loss) before minority interest	81,924	(8,880)	-	73,044
Minority interest in consolidated joint venture	(172)	-	-	(172)
Net income (loss)	\$ 81,752	\$ (8,880)	\$ -	\$ 72,872

Year Ended March 31, 1998	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Net revenues from unaffiliated customers	\$ 897,877	\$ 10,975	\$ -	\$ 908,852
Group sales	538	-	(538) <sup>(a)</sup>	-
Total net revenues	898,415	10,975	(538)	908,852
Cost of goods sold from unaffiliated customers	478,967	2,266	-	481,233
Group cost of goods sold	-	538	(538)	-
Total cost of goods sold	478,967	2,804	(538)	481,233
Gross profit	419,448	8,171	-	427,619
Operating expenses:				
Marketing and sales	125,711	2,597	-	128,308
General and administrative	57,650	188	-	57,838
Research and development	137,360	5,352	3,020 <sup>(b)</sup>	145,732
Network development and support	-	3,020	(3,020)	-
Charge for acquired in-process technology	1,500	-	-	1,500
Merger costs	10,792	-	-	10,792
Total operating expenses	333,013	11,157	-	344,170
Operating income (loss)	86,435	(2,986)	-	83,449
Interest and other income, net	24,811	-	-	24,811
Income (loss) before provision for income taxes and minority interest	111,246	(2,986)	-	108,260
Provision for income taxes	35,726	-	-	35,726
Income (loss) before minority interest	75,520	(2,986)	-	72,534
Minority interest in consolidated joint venture	28	-	-	28
Net income (loss)	\$ 75,548	\$ (2,986)	\$ -	\$ 72,562

(a) REPRESENTS ELIMINATION OF INTERCOMPANY SALES OF ELECTRONIC ARTS PACKAGED GOODS PRODUCTS TO EA.COM; AND REPRESENTS ELIMINATION OF ROYALTIES PAID TO ELECTRONIC ARTS BY EA.COM FOR INTELLECTUAL PROPERTY RIGHTS.

(b) REPRESENTS RECLASSIFICATION OF NETWORK DEVELOPMENT AND SUPPORT TO RESEARCH AND DEVELOPMENT.

The increase in net revenues for EA.com for fiscal 1999 as compared to fiscal 1998 was mainly attributable to the following:

- Higher online revenues from subscriptions for *Ultima Online: The Second Age*, the upgrade to *Ultima Online*.
- Mitigated by lower product revenues from *Ultima Online* for fiscal 1999 as compared to fiscal 1998.

The following table presents pro-forma results of operations allocating taxes between EA Core and EA.com. Consolidated taxes have been allocated to EA Core and EA.com on a pro rata basis based on the consolidated effective tax rates, thereby giving EA.com the tax benefit of its losses which is utilized by the consolidated group. Such tax benefit could not be recognized by EA.com on a stand-alone basis. The sum of tax expense and tax benefit for EA Core and EA.com is the same as consolidated tax expense. This presentation represents how management analyzes each segment of the business (in thousands):

Year Ended March 31, 1999	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Income (loss) before provision for income taxes and minority interest	\$ 127,338	\$ (8,880)	\$ -	\$ 118,458
Provision (benefit) for income taxes	48,256	(2,842)	-	45,414
Income (loss) before minority interest	79,082	(6,038)	-	73,044
Minority interest in consolidated joint venture	(172)	-	-	(172)
Net income (loss)	\$ 78,910	\$ (6,038)	\$ -	\$ 72,872

Year Ended March 31, 1998	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Income (loss) before provision for income taxes and minority interest	\$ 111,246	\$ (2,986)	\$ -	\$ 108,260
Provision (benefit) for income taxes	36,711	(985)	-	35,726
Income (loss) before minority interest	74,535	(2,001)	-	72,534
Minority interest in consolidated joint venture	28	-	-	28
Net income (loss)	\$ 74,563	\$ (2,001)	\$ -	\$ 72,562

#### Costs and Expenses, Interest and Other Income, Net, Income Taxes and Net Income

Information about our costs and expenses, interest and other income, net, income taxes and net income for fiscal 1999 and 1998 is presented below:

	Percent of Net Revenues	
	1999	1998
Cost of goods sold	51.4 %	52.9 %
Marketing and sales	13.4	14.1
General and administrative	6.2	6.4
Research and development (includes network development and support)	16.3	16.0
Charge for acquired in-process technology	3.6	0.2
Amortization of intangibles	0.5	-
Merger costs	-	1.2
Interest and other income, net	1.1	2.7
Income taxes – effective tax rate	38.3	33.0
Net income	6.0 %	8.0 %

**COST OF GOODS SOLD** Cost of goods sold as a percentage of revenues decreased in fiscal 1999 primarily due to lower artist royalties, including savings related to an acquisition of a software development company during fiscal 1999, partially offset by higher sales of lower margin N64 products.

**MARKETING AND SALES** Marketing and sales expenses increased 27% primarily attributed to:

- Increased print, Internet and television advertising to support new releases.
- Increased cooperative advertising associated with higher revenues in North America and Europe as compared to the prior year.
- Additional headcount related to the continued expansion of our worldwide distribution business.
- The acquisitions of ABC Software and Westwood Studios.

**GENERAL AND ADMINISTRATIVE** General and administrative expenses increased 32% primarily due to an increase in headcount and occupancy costs to support the increase in growth in North America and Europe operations, including the opening of additional international offices in Europe and the acquisition of ABC Software.

**RESEARCH AND DEVELOPMENT** The increase in absolute dollars for research and development expenses (including Network Development and Support) was due to:

- Additional headcount-related expenses attributable to the acquisition of Westwood Studios, Inc. and certain assets of the Irvine, California-based Virgin Studio (collectively "Westwood") in September 1998 and Tiburon Entertainment, Inc. in April 1998.
- Higher development costs per title, as products are including more content and are more complex and time consuming to develop.
- An increase in development costs for *Ultima Online*.
- A higher number of projects in development in fiscal 1999 as compared to fiscal 1998 for EA.com

We released a total of 59 new products in fiscal 1999 compared to 71 in fiscal 1998.

**NETWORK DEVELOPMENT AND SUPPORT** The increase in network development and support expenses for EA.com was due to higher design, engineering and software maintenance costs associated with the *Ultima Online* worlds.

**CHARGE FOR ACQUIRED IN-PROCESS TECHNOLOGY** In connection with the purchase of Westwood in September 1998, we allocated and expensed \$41,836,000 of the \$122,688,000 purchase price to in-process research and development projects. This allocation represents the estimated fair value based on risk-adjusted cash flows related to the incomplete research and development projects. At the date of acquisition, this amount was expensed as a non-recurring charge as the in-process technology had not yet reached technological feasibility and had no alternative future uses. Westwood had three major PC projects in progress at the time of the acquisition including two in the best-selling franchise *Command and Conquer* and one in the critically acclaimed *Lands of Lore™* series. As of the acquisition date, costs to complete the Westwood projects acquired were expected to be approximately \$9.1 million in fiscal 1999, \$10.6 million in fiscal 2000 and \$1.0 million in fiscal 2001. We believe there have been no significant changes to these estimates. We currently expect to complete the development of these projects at various dates through fiscal 2001 and to publish the products upon completion.

The nature of the efforts required to develop the acquired in-process technology into commercially viable products principally relate to the completion of all planning, designing and testing activities necessary to establish that the product can be produced to meet our design requirements including functions, features and technical performance requirements. Though we currently expect that the acquired in-process technology will be successfully developed, there can be no assurance that commercial or technical viability of these products will be achieved. Furthermore, future developments in the entertainment software industry, changes in computer or video game console technology, changes in other product offerings or other developments may cause us to alter or abandon these plans.

The value assigned to purchased in-process technology was determined by estimating the completion percentage of research and development efforts at the acquisition date, forecasting risk adjusted revenues considering the completion percentage, estimating the resulting net cash flows from the projects and discounting the net cash flows to their present values. The completion percentages were estimated based on cost incurred to date, importance of the completed development tasks and the elapsed portion of the total project time. The revenue projection used to value the in-process research and development is based on unit sales forecasts for worldwide sales territories and adjusted to consider only the revenue related to development achievements completed at the acquisition date. Net cash flow estimates include cost of goods sold and sales, marketing and general and administrative expenses and taxes forecasted based on historical operating characteristics. In addition, net cash flow estimates were adjusted to allow for fair return on working capital and fixed assets, charges for franchise and technology leverage and return on other intangibles. Appropriate risk adjusted discount rates ranging from 20% to 22.5% were used to discount the net cash flows back to their present value. The remaining identified intangibles will be amortized on a straight-line basis over two to twelve years based on expected useful lives of franchise tradenames, existing products and technologies, retention of workforce, and other intangible assets. If these projects are not successfully developed, we may not realize the value assigned to the in-process research and development projects. In addition, the value of other acquired intangible assets may also become impaired.

In conjunction with the merger of Westwood, we accrued approximately \$1,500,000 related to direct transaction costs and other related accruals. At March 31, 2000, there were \$500,000 in accruals remaining related to these items.

Additionally, for fiscal 1999, the charge for in-process research and development also included write-offs of \$2,279,000 associated with the acquisition of two software development companies in the first quarter.

For fiscal 1998, we incurred a charge of \$1,500,000 for acquired in-process technology in connection with the acquisition of the remaining 35% minority ownership interest in Electronic Arts Victor, Inc. in December 1997. This charge was made after we concluded that the in-process technology had no alternative future use after taking into consideration the potential for usage of the software in different products and resale of the software.

**AMORTIZATION OF INTANGIBLES** Amortization of intangibles results from the acquisitions of Westwood and ABC Software in the second quarter of fiscal 1999.

**MERGER COSTS** On July 25, 1997, we completed a merger with Maxis, Inc. ("Maxis"). In conjunction with the merger, we recorded costs of \$10,792,000 which included direct transaction fees and costs associated with integrating the operations of the two companies. At March 31, 1999, there were no accruals remaining related to these merger costs.

**OPERATING INCOME** Operating income increased due to:

- Higher net revenues and related gross profit partially offset by increased operating expenses including the charges for acquired in-process technology of \$44,115,000 in the current fiscal year.
- Partially offset by merger costs of \$10,792,000 and a charge for acquired in-process technology of \$1,500,000 related to the acquisitions in the prior fiscal year.

Excluding one-time items in both years, as noted above, operating income would have been \$149,393,000 in fiscal 1999 and \$95,741,000 in fiscal 1998.

**INTEREST AND OTHER INCOME, NET** The decrease in interest and other income, net, was primarily attributable to the sale of our 50% ownership interest in Creative Wonders, LLC in December 1997. The sale resulted in a gain in the prior year of \$12,625,000.

**INCOME TAXES** Electronic Arts' effective tax rate was 38.3% for fiscal 1999 and 33.0% for fiscal 1998. Our effective tax rate for fiscal 1999 was negatively affected as there was no tax benefit recorded for a portion of the charges related to the acquired in-process technology. Excluding the effect of these charges, the effective tax rate for fiscal 1999 would have been 32.0% as compared to a 33.0% tax rate for fiscal 1998. The lower rate of 32.0% results primarily from a higher portion of international income subject to a lower foreign tax rate as compared to the prior year and an increase in the federal research and experimental credit.

**MINORITY INTEREST IN CONSOLIDATE JOINT VENTURE.**

- In the first quarter of fiscal 1999, we formed EA Square KK which is seventy percent owned by us and thirty percent owned by Square Co. Ltd. ("Square"), a leading developer and publisher of entertainment software in Japan. Minority interest for fiscal 1999 represents Square's 30% interest in the net income of EA Square KK.
- For fiscal 1998, the minority interest represented the 35% interest in Electronic Arts Victor, Inc. ("EAV") owned by Victor Entertainment Industries, Inc. ("VEI"). We acquired the remaining 35% minority ownership interest in EAV held by VEI in December 1997.

**NET INCOME** In absolute dollars, reported net income was flat due to the one-time charges related to acquisitions offsetting significantly higher operating income. The increase in net income, excluding one-time charges, was due to higher revenues and gross profits, partially offset by higher spending on development of online projects, higher support costs for *Ultima Online* and *Ultima Online: The Second Age*, and higher network infrastructure costs associated with *Ultima Online* worlds.

- For fiscal 1998, net income included a one-time gain on sale of Creative Wonders, LLC in the amount of \$8,459,000, net of taxes, offset by Maxis merger costs and a charge for acquired in-process developments of \$8,236,000, net of taxes.
- For fiscal 1999, net income included one-time charges for acquired in-process technology of \$37,506,000, net of taxes.

Excluding one-time items in both years, as noted above, net income increased to \$110,378,000 in fiscal 1999 from \$72,339,000, or 53% over fiscal 1998.

## LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2000, our working capital was \$440,021,000 compared to \$333,256,000 at March 31, 1999. Cash, cash equivalents and short-term investments increased by approximately \$26,982,000 in fiscal 2000. We generated \$45,336,000 of cash from operations in fiscal 2000 which was reduced by a payment of \$36,000,000 to AOL as discussed below. In addition, \$85,589,000 was provided through the sale of equity securities under our stock plans and \$20,000,000 was provided through the sale of shares of Class B common stock and warrants to AOL.

Reserves for bad debts and sales returns decreased from \$72,850,000 at March 31, 1999 to \$65,067,000 at March 31, 2000. Reserves have been charged for returns of product and price protection credits issued for products sold in prior periods. Management believes these reserves are adequate based on historical experience and its current estimate of potential returns and allowances.

During fiscal 2000, we invested \$22,500,000 in cash for the acquisition of Kesmai and \$22,096,000 for other acquisitions made during the year. In addition, we invested approximately \$37,400,000 for new facilities in Europe and Canada and \$61,400,000 in computer equipment worldwide.

Our principal source of liquidity is \$339,804,000 in cash, cash equivalents and short-term investments. Management believes the existing cash, cash equivalents, short-term investments, marketable securities and cash generated from operations will be sufficient to meet cash and investment requirements of Electronic Arts and EA.com for the next twelve months and the foreseeable future.

Included in the amounts above is the following for the EA.com business:

- To date EA.com has been funded solely by Electronic Arts (including proceeds from the sale of stock to AOL in the amount of \$20,000,000). This funding has been accounted for as capital contributions from Electronic Arts. Excess cash generated from operations is transferred to Electronic Arts, and has been accounted for as a return of capital. We anticipate these funding procedures will continue in the near-term. However, Electronic Arts may, at its discretion, provide funds to EA.com under a debt arrangement, instead of treating such funding as a capital contribution.
- During fiscal 2000 EA.com used \$68,329,000 of cash in operations (including payments to AOL of approximately \$36,000,000), \$37,605,000 in capital expenditures for computer equipment, network infrastructure, internal use software and related third party software, \$1,499,000 for an investment in a 3rd party developer, \$32,539,000 for the acquisition of Kesmai and another acquisition, offset by \$140,410,000 provided through capital contributions from Electronic Arts.
- During fiscal 1999, EA.com used \$9,086,000 of cash in operations and \$1,881,000 in capital expenditures for computer equipment, network infrastructure and related software, offset by \$10,967,000 provided through the capital contribution from Electronic Arts.

As required by Statement of Position 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" issued by the American Institute of Certified Public Accountants, EA.com has capitalized consulting, hardware, software and direct payroll-related costs associated with the implementation of customized internal-use software. These costs relate to game site application and infrastructure design and development, as well as costs relating to providing customer account management and building in e-Commerce functionality and interfaces. As of March 31, 2000, EA.com has capitalized approximately \$26,318,000 of these costs. EA.com expects to incur additional costs in the next year in connection with their effort to build and support the game sites at launch.



EA.com is required to pay \$50,000,000 to AOL as a carriage fee (including certain advertising fees of which \$604,000 was expensed in the twelve months ended March 31, 2000) under the AOL agreement. Of this amount, \$25,000,000 was paid upon signing the agreement and the remainder is due in four equal annual installments on the first four anniversaries of the initial payment. Payment of the first annual installment of \$6,250,000 will be accelerated to June 1, 2000 since certain launch requirements will not be met by that date. EA.com is also required to pay to AOL \$31,000,000 as an advance of a minimum guaranteed revenue share for revenues generated by subscriptions and other certain commercial transactions on the EA.com site. Of this amount, \$11,000,000 was paid upon signing of the agreement and the remainder is due in four equal annual installments on the first anniversary of the initial payment.

EA.com also made a commitment to spend \$15,000,000 in offline media advertisements promoting our online games, including those on the AOL service, during the term of the AOL agreement.

Future liquidity needs of EA.com will be met by Electronic Arts as Electronic Arts intends to continue to fund the cash requirements of EA.com for the foreseeable future.

## YEAR 2000 READINESS DISCLOSURE

### Year 2000 Status

As of the date of this filing, we have not incurred any significant business disruptions as a result of Year 2000 issues. However, while no such occurrence has developed, Year 2000 issues that may arise related to key suppliers and service providers may not become apparent immediately. We have received assurances of Year 2000 compliance from key suppliers. We have also received assurances from key service providers such as financial institutions, our payroll service provider, and our retirement plan administrator as to their Year 2000 readiness. We will continue to monitor our own systems and our business partners to identify and address any potential risk situations related to the Year 2000. We can provide no assurance that we will not be adversely affected by these suppliers and service providers due to noncompliance in the future.

## EURO CONVERSION

On January 1, 1999, eleven of the fifteen member countries of the European Union established fixed conversion rates between their existing currencies (the "legacy currency") and the one common legal currency known as the "Euro". From January 1, 1999 through June 30, 2002 the countries will be able to use their legacy currencies or the Euro to transact business. By July 1, 2002, at the latest, the conversion to the Euro will be complete at which time the legacy currencies will no longer be legal tender. The fixed conversion rates between their existing currencies have eliminated exchange rate risk among the member countries.

The conversion to the Euro has reduced the number of forward contracts that we use to hedge the exchange rate risk. The forward contracts that were used to hedge the individual legacy currencies have been replaced by a single Euro hedge contract and the intercompany transactions among subsidiaries within the European Union are no longer subject to exchange rate risk.

We do not anticipate any material impact from the Euro conversion on our financial information systems which currently accommodate multiple currencies. Computer software changes necessary to comply with the Year 2000 issue are generally compliant to the Euro conversion issue. Due to numerous uncertainties, we cannot reasonably estimate the effect that the Euro conversion issue will have on our pricing or market strategies, and the impact, if any, it will have on our financial condition and results of operations.

## RISK FACTORS

Our business is subject to many risks and uncertainties which may affect our performance. Some of those risks and uncertainties are as follows:

- Platform transitions such as the one now occurring typically depress the market for videogame software until new platforms achieve a wide market acceptance.
- New video game platforms create additional technical and business model uncertainties.
- Our significant investment in EA.com may not be successful or generate profits.
- Product development schedules are frequently unreliable particularly for products for new platforms and make predicting quarterly results difficult.
- The business models and technology for e-Commerce and online gaming are unproven.
- Our business, our products and our distribution are subject to increasing regulation in key territories.
- Our platform licensors are our chief competitors and frequently control the manufacturing of our video game products.
- We face intense competition for talent from highly valued Internet companies.

For a discussion of these and other important risk factors, see the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended March 31, 2000.

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Market Risk

We are exposed to various market risks, including the changes in foreign currency exchange rates and interest rates. Market risk is the potential loss arising from changes in market rates and prices. Foreign exchange contracts used to hedge foreign currency exposures and short-term investments are subject to market risk. We do not consider our cash and cash equivalents to be subject to interest rate risk due to their short maturities. We do not enter into derivatives or other financial instruments for trading or speculative purposes.

**FOREIGN CURRENCY EXCHANGE RATE RISK** We utilize foreign exchange contracts to hedge foreign currency exposures of underlying assets and liabilities, primarily certain intercompany receivables that are denominated in foreign currencies, thereby, limiting our risk. Gains and losses on foreign exchange contracts are reflected in the income statement. At March 31, 2000, we had foreign exchange contracts, all with maturities of less than nine months to purchase and sell approximately \$242,143,000 in foreign currencies, primarily British Pounds, European Currency Units (“Euro”), Canadian Dollars, Japanese Yen and other currencies.

Fair value represents the difference in value of the contracts at the spot rate and the forward rate. The counterparties to these contracts are substantial and creditworthy multinational commercial banks. The risks of counterparty nonperformance associated with these contracts are not considered to be material. Notwithstanding our efforts to manage foreign exchange risks, there can be no assurances that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations.

The table below provides information about our foreign currency forward exchange contracts at March 31, 2000. The information is provided in U.S. dollar equivalents and presents the notional amount (forward amount), the weighted average contractual foreign currency exchange rates and fair value.

	Contract Amount	Weighted- Average Contract Rate	Fair Value
	(In thousands)		(In thousands)
Foreign currency to be sold under contract:			
British Pound	\$ 111,138	1.5877	\$ (469)
Euro	59,378	0.9734	(273)
Japanese Yen	15,476	104.0300	410
Canadian Dollar	13,615	1.4689	(63)
Australian Dollar	6,058	0.6058	(27)
South African Rand	4,686	6.4023	56
Swedish Krona	2,326	8.5993	(19)
Norwegian Krone	1,312	8.3871	(15)
Danish Krone	1,304	7.6716	(6)
Brazilian Real	1,259	1.7480	(11)
Swiss Franc	899	1.6681	(25)
New Zealand Dollar	488	0.4876	(2)
<b>Total</b>	<b>\$ 217,939</b>		<b>\$ (444)</b>
Foreign currency to be purchased under contract:			
British Pound	\$ 24,204	1.5944	\$ (75)
<b>Total</b>	<b>\$ 24,204</b>		<b>\$ (75)</b>
<b>Grand total</b>	<b>\$ 242,143</b>		<b>\$ (519)</b>

While the contract amounts provide one measurement of the volume of these transactions, they do not represent the amount of our exposure to credit risk. The amounts (arising from the possible inability of counterparties to meet the terms of their contracts) are generally limited to the amounts, if any, by which the counterparties' obligations exceed our obligations as these contracts can be settled on a net basis at our option. We control credit risk through credit approvals, limits and monitoring procedures.

**INTEREST RATE RISK** Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We manage our interest rate risk by maintaining an investment portfolio primarily consisting of debt instruments of high credit quality and relatively short average maturities. We also manage our interest rate risk by maintaining sufficient cash and cash equivalent balances such that we are typically able to hold our investments to maturity. At March 31, 2000, our cash equivalents, short-term and long-term investments included debt securities of \$194,769,000. Notwithstanding our efforts to manage interest rate risks, there can be no assurances that we will be adequately protected against the risks associated with interest rate fluctuations.

The table below presents the amounts and related weighted average interest rates of our investment portfolio at March 31, 2000:

	Average Interest Rate	Cost	Fair Value
<i>(Dollars in thousands)</i>			
Cash equivalents <sup>(1)</sup>			
Fixed rate	0.00 %	\$ —	\$ —
Variable rate	4.15 %	\$ 92,830	\$ 92,830
Short-term investments <sup>(1)(2)</sup>			
Fixed rate	4.05 %	\$ 83,639	\$ 83,539
Variable rate	6.87 %	\$ 10,000	\$ 10,000
Long-term investments <sup>(1)</sup>			
Fixed rate	0.00 %	\$ —	\$ —
Variable rate	6.35 %	\$ 8,400	\$ 8,162

(1) SEE DEFINITION IN NOTE 1 OF THE NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS.

(2) MATURITY DATES FOR SHORT-TERM INVESTMENTS RANGE FROM 6 MONTHS TO 3 YEARS.

## INDEPENDENT AUDITORS' REPORT

### *ELECTRONIC ARTS AND SUBSIDIARIES*

#### The Board of Directors and Stockholders

#### **ELECTRONIC ARTS INC. AND SUBSIDIARIES:**

We have audited the accompanying consolidated balance sheets of Electronic Arts Inc. and subsidiaries as of March 31, 2000 and 1999, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended March 31, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Electronic Arts Inc. and subsidiaries as of March 31, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2000, in conformity with generally accepted accounting principles.

**KPMG LLP**

Mountain View, California

April 28, 2000

## CONSOLIDATED BALANCE SHEETS

### ELECTRONIC ARTS AND SUBSIDIARIES

As of March 31,	2000	1999
(In thousands, except share data)		
<b>ASSETS</b>		
Current assets:		
Cash, cash equivalents and short-term investments	\$ 339,804	\$ 312,822
Marketable securities	236	4,884
Receivables, less allowances of \$65,067 and \$72,850, respectively	234,087	149,468
Inventories, net	22,986	22,376
Other current assets	108,210	79,915
Total current assets	705,323	569,465
Property and equipment, net	285,466	181,266
Long-term investments	8,400	18,400
Investment in affiliates	22,601	25,864
Goodwill and other intangibles, net	117,236	90,682
Other assets	53,286	16,196
	<b>\$ 1,192,312</b>	<b>\$ 901,873</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 97,703	\$ 63,881
Accrued and other liabilities	167,599	172,328
Total current liabilities	265,302	236,209
Minority interest in consolidated joint venture	3,617	2,733
Stockholders' equity:		
Preferred stock, \$0.01 par value. Authorized 10,000,000 shares	-	-
Common stock		
Class A common stock, \$0.01 par value. Authorized 400,000,000 shares; issued 64,434,544 and 61,291,849 shares; outstanding 64,434,544 and 61,169,286 shares, respectively	644	613
Class B common stock, \$0.01 par value. Authorized 100,000,000 shares; issued and outstanding 6,000,000 shares in 2000	60	-
Paid-in capital	412,682	267,699
Treasury stock, at cost; 0 and 122,563 shares in 2000 and 1999, respectively	-	(4,926)
Retained earnings	516,368	402,112
Accumulated other comprehensive loss	(6,361)	(2,567)
Total stockholders' equity	923,393	662,931
	<b>\$ 1,192,312</b>	<b>\$ 901,873</b>

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

## CONSOLIDATED STATEMENTS OF INCOME

### ELECTRONIC ARTS AND SUBSIDIARIES

Years Ended March 31,	2000	1999	1998
(In thousands, except per share data)			
Net revenues	\$ 1,420,011	\$ 1,221,863	\$ 908,852
Cost of goods sold	705,808	627,823	481,233
Gross profit	714,203	594,040	427,619
Operating expenses:			
Marketing and sales	188,628	163,407	128,308
General and administrative	92,502	76,219	57,838
Research and development	260,759	199,141	145,732
Charge for acquired in-process technology	6,539	44,115	1,500
Merger costs	-	-	10,792
Amortization of intangibles	11,989	5,880	-
Total operating expenses	560,417	488,762	344,170
Operating income	153,786	105,278	83,449
Interest and other income, net	16,028	13,180	24,811
Income before provision for income taxes and minority interest	169,814	118,458	108,260
Provision for income taxes	52,642	45,414	35,726
Income before minority interest	117,172	73,044	72,534
Minority interest in consolidated joint venture	(421)	(172)	28
Net income	\$ 116,751	\$ 72,872	\$ 72,562
Net income per share:			
Basic	\$ 1.86	\$ 1.20	\$ 1.23
Diluted	\$ 1.76	\$ 1.15	\$ 1.19
Number of shares used in computation:			
Basic	62,830	60,748	58,867
Diluted	66,371	63,272	60,958

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, INCLUDING SEGMENT INFORMATION IN NOTE 18.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

### ELECTRONIC ARTS AND SUBSIDIARIES

Years Ended March 31, 2000, 1999 and 1998	Class A Common Stock		Class B Common Stock		Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total
	Shares	Amount	Shares	Amount				Shares	Amount	
(In thousands)										
Balances at										
March 31, 1997	58,263	\$583	-	\$ -	\$188,547	\$257,978	\$668	-	\$ -	\$447,776
Net income						72,562				72,562
Change in										
unrealized appreciation of investments, net							1,882			1,882
Reclassification										
adjustment for gains realized in net income, net							(2,745)			(2,745)
Translation adjustment							(1,273)			(1,273)
Comprehensive income										70,426
Proceeds from sales										
of shares through stock plans	1,897	19			37,729					37,748
Tax benefit related to stock options					7,931					7,931
Repayment of notes receivable					87					87
Balances at										
March 31, 1998	60,160	602	-	-	234,294	330,540	(1,468)	-	-	563,968
Net income						72,872				72,872
Change in unrealized										
appreciation of investments, net							2,533			2,533
Reclassification										
adjustment for gains realized in net income, net							(989)			(989)
Translation adjustment							(2,643)			(2,643)
Comprehensive income										71,773
Proceeds from sales										
of shares through stock plans	1,132	11			27,791	(1,300)		100	4,075	30,577
Purchase of treasury stock								(223)	(9,001)	(9,001)
Tax benefit related to stock options					5,614					5,614
Balances at										
March 31, 1999	61,292	613	-	-	267,699	402,112	(2,567)	(123)	(4,926)	662,931



Years Ended March 31, 2000, 1999 and 1998	Class A Common Stock		Class B Common Stock		Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total
	Shares	Amount	Shares	Amount				Shares	Amount	
(In thousands)										
Balances at										
March 31, 1999	61,292	613	-	-	267,699	402,112	(2,567)	(123)	(4,926)	662,931
Net income						116,751				116,751
Change in										
unrealized										
appreciation of										
investments, net							1,739			1,739
Reclassification										
adjustment for										
gains realized in										
net income, net							(5,194)			(5,194)
Translation adjustment							(339)			(339)
Comprehensive income										112,957
Proceeds from sales										
of shares through										
stock plans	3,143	31			83,127	(2,495)		123	4,926	85,589
Issuance of Class B										
common stock			6,000	60	27,993					28,053
Issuance of Class B										
stock warrant					1,300					1,300
Tax benefit related										
to stock options					32,563					32,563
Balances at										
March 31, 2000	64,435	\$644	6,000	\$60	\$412,682	\$516,368	\$(6,361)	-	\$ -	\$923,393

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

### ELECTRONIC ARTS AND SUBSIDIARIES

Years Ended March 31,	2000	1999	1998
(In thousands)			
<b>OPERATING ACTIVITIES:</b>			
Net income	\$ 116,751	\$ 72,872	\$ 72,562
Adjustments to reconcile net income to net cash provided by operating activities:			
Minority interest in consolidated joint venture	421	172	(28)
Equity in net (income) loss of affiliates	(1,138)	155	1,162
Gain on sale of affiliate	(842)	-	(12,625)
Depreciation and amortization	46,725	40,461	26,907
Loss on sale of fixed assets	31	729	1,813
Loss on disposition of assets related to merger	-	-	5,607
Gain on sale of marketable securities	(7,528)	(1,454)	(4,098)
Provision for doubtful accounts	6,714	6,027	4,302
Charge for acquired in-process technology	6,539	44,115	1,500
Change in assets and liabilities, net of acquisitions:			
Receivables	(77,779)	(11,702)	(40,432)
Inventories	(579)	1,282	(1,753)
Other assets	(69,727)	(24,266)	(5,660)
Accounts payable	29,673	1,622	12,783
Accrued liabilities	(6,919)	32,797	29,217
Deferred income taxes	2,994	(12,042)	(12,264)
Net cash provided by operating activities	45,336	150,768	78,993
<b>INVESTING ACTIVITIES:</b>			
Proceeds from sale of property and equipment	444	8,281	25
Proceeds from sales of marketable securities, net	8,598	1,818	4,514
Proceeds from sale of affiliate	8,842	-	-
Capital expenditures	(134,884)	(115,820)	(45,238)
Investment in affiliates, net	(4,099)	(5,478)	16,579
Purchase of held-to-maturity securities	-	-	(1,008)
Proceeds from maturity of securities	-	17,306	13,338
Change in short-term investments, net	(13,860)	76,755	(34,504)
Acquisition of Westwood Studios, Inc.	-	(122,688)	-
Acquisition of Kesmai	(22,500)	-	-
Acquisition of other subsidiaries, net of cash acquired	(22,096)	(11,805)	(3,225)
Net cash used in investing activities	(179,555)	(151,631)	(49,519)

Years Ended March 31,	2000	1999	1998
(In thousands)			
<b>FINANCING ACTIVITIES:</b>			
Proceeds from sales of Class A shares through employee stock plans and other plans	85,589	30,577	37,748
Proceeds from sales of Class B shares and stock warrants to AOL	20,000	—	—
Purchase of treasury shares	—	(9,001)	—
Repayment of notes receivable	—	—	87
Tax benefit from exercise of stock options	32,563	5,614	7,931
Proceeds from minority interest investment in consolidated joint venture	—	2,109	—
Net cash provided by financing activities	138,152	29,299	45,766
Translation adjustment	124	(2,191)	(1,273)
Increase in cash and cash equivalents	4,057	26,245	73,967
Beginning cash and cash equivalents	242,208	215,963	141,996
Ending cash and cash equivalents	246,265	242,208	215,963
Short-term investments	93,539	70,614	158,597
Ending cash, cash equivalents and short-term investments	\$ 339,804	\$ 312,822	\$ 374,560
Supplemental cash flow information:			
Cash paid during the year for income taxes	\$ 15,525	\$ 43,050	\$ 32,888
Non-cash investing activities:			
Class B common stock issued in connection with the Kesmai acquisition	\$ 9,353	\$ —	\$ —
Change in unrealized appreciation of investments and marketable securities	\$ (5,008)	\$ 1,805	\$ (1,411)

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2000, 1999 and 1998

## ELECTRONIC ARTS AND SUBSIDIARIES

### (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**CONSOLIDATION** The accompanying consolidated financial statements include the accounts of Electronic Arts Inc. and its wholly-owned and majority-owned subsidiaries (the “Company”). All significant intercompany balances and transactions have been eliminated in consolidation.

A summary of the significant accounting policies applied in the preparation of the accompanying consolidated financial statements of the Company follows:

**(A) FISCAL YEAR** The Company’s fiscal year is reported on a 52/53-week period that ends on the Saturday nearest to March 31 in each year. The results of operations for fiscal 2000, 1999 and 1998 contain 52 weeks. For clarity of presentation herein, all fiscal periods are treated as ending on a calendar month end.

**(B) REVENUE RECOGNITION** The Company’s revenue recognition policies are in compliance with American Institute of Certified Public Accountants Statement of Position (“SOP”) 97-2, “*Software Revenue Recognition*”, and SOP 98-4, “*Deferral of the Effective Date of a Provision of SOP 97-2*”, which provide guidance on generally accepted accounting principles for recognizing revenue on software transactions. SOP 97-2 requires that revenue recognized from software arrangements be allocated to each element of the arrangement based on the relative fair values of the elements. The Company has adopted the provisions of these SOPs as of April 1, 1998. The adoption has, in certain circumstances, resulted in the deferral of certain revenues associated with the Company’s sales promotions and products with multiple deliverable elements. Neither the changes in certain business practices nor the deferral of certain revenues have resulted in a material impact on the Company’s operating results, financial position or cash flows for the fiscal year ended March 31, 2000. Total deferred revenue at March 31, 2000 and 1999 was \$1,847,000, and \$8,206,000, respectively.

In December 1998, the Accounting Standards Executive Committee of the AICPA issued SOP 98-9, “*Software Revenue Recognition, with Respect to Certain Arrangements*,” which required recognition of revenue using the “residual method” in a multiple element arrangement when fair value does not exist for one or more of the undelivered elements in the arrangement. SOP 98-9 is effective for transactions entered into after March 15, 1999. Under the “residual method”, the total fair value of the undelivered elements is deferred and subsequently recognized in accordance with SOP 97-2. The adoption of SOP 98-9 in fiscal year 2000 did not have a material change in the accounting for revenues for the Company.

**Product Sales:** The Company recognizes revenue upon shipment of its packaged goods products based on “FOB Shipping” terms. Under FOB Shipping terms, title and risk of loss are transferred when the products are delivered to the customer. In order to recognize revenue, the Company must not have any continuing obligations and it must also be probable that the Company will collect the accounts receivable. Subject to certain limitations, the Company permits customers to obtain exchanges within certain specified periods and provides price protection on certain unsold merchandise. Revenue is recognized net of an allowance for returns and price protection.

**Online Subscription Revenues:** Online subscription revenues are derived principally from subscription revenues collected from customers for online play, who are only contractually obligated for pay on a month-to-month basis. Prepaid monthly subscription revenues, including revenues collected from credit card sales as well as sales of *Gametime* subscription cards, are deferred and subsequently recognized ratably over the period for which the hosting services are provided.

**Software Licenses:** For those agreements which provide the customers the right to multiple copies in exchange for guaranteed minimum royalty amounts, revenue is recognized at delivery of the product master or the first copy. Per copy royalties on sales that exceed the guarantee are recognized as earned.

Revenue from the licensing of software was \$21,704,000, \$17,788,000, and \$15,431,000 for the fiscal years ended March 31, 2000, 1999 and 1998, respectively.

**(C) CASH AND INVESTMENTS** Cash equivalents consist of highly liquid investments with insignificant rate risk and with maturities of three months or less at the date of purchase. Short-term investments include securities with maturities greater than three months and less than one year, except for certain investments with stated maturities greater than one year. Long-term investments consist of securities with maturities greater than one year.

The Company accounts for investments under Statement of Financial Accounting Standards No. 115, *“Accounting for Certain Investments in Debt and Equity Securities,”* (“SFAS 115”). The Company’s policy is to protect the value of its investment portfolio and to minimize principal risk by earning returns based on current interest rates. Management determines the appropriate classification of its debt and equity securities at the time of purchase and reevaluates such designation as of each balance sheet date. Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. Securities classified as held-to-maturity are carried at amortized cost, which is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest income. Debt securities, not classified as held-to-maturity, are classified as available-for-sale and are stated at fair value. Securities sold is based on the specific identification method.

**(D) PREPAID ROYALTIES** Prepaid royalties consist primarily of prepayments for manufacturing royalties, original equipment manufacturer (OEM) fees and license fees paid to celebrities and professional sports organizations for use of their trade name. Also included in prepaid royalties are prepayments made to independent software developers under development arrangements that have alternative future uses. Prepaid royalties are expensed at the contractual royalty rate as cost of goods sold based on actual net product sales. Management evaluates the future realization of prepaid royalties quarterly and charges to income any amounts that management deems unlikely to be realized through product sales. Royalty advances are classified as current and non-current assets based upon estimated net product sales for the following year. The current portion of prepaid royalties, included in other current assets, was \$54,970,000 and \$35,057,000 at March 31, 2000 and 1999, respectively. The long-term portion of prepaid royalties, included in other assets, was \$11,373,000 and \$7,602,000 at March 31, 2000 and 1999, respectively.

**(E) SOFTWARE DEVELOPMENT COSTS** Research and development costs, which consist primarily of software development costs, are expensed as incurred. Statement of Financial Accounting Standards No. 86, *“Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed”* (“SFAS 86”), provides for the capitalization of certain software development costs incurred after technological feasibility of the software is established or for development costs that have alternative future uses. Under the Company’s current practice of developing new products, the technological feasibility of the underlying software is not established until substantially all product development is complete, which generally includes the development of a working model. The software development costs that have been capitalized to date have been insignificant.

**(F) INVENTORIES** Inventories are stated at the lower of cost or market. Inventories at March 31, 2000 and 1999 consisted of:

	2000	1999
<i>(in thousands)</i>		
Raw materials and work in process	\$ 920	\$ 2,983
Finished goods	22,066	19,393
	<u>\$ 22,986</u>	<u>\$ 22,376</u>

**(G) ADVERTISING COSTS** The Company generally expenses advertising costs as incurred, except for production costs associated with media campaigns which are deferred and charged to expense at the first run of the ad. Cooperative advertising with distributors and retailers is accrued when revenue is recognized. Cooperative advertising credits are reimbursed when qualifying claims are submitted. For the fiscal years ended March 31, 2000, 1999 and 1998, advertising expenses totaled approximately \$87,377,000, \$72,437,000 and \$55,090,000, respectively.

**(H) PROPERTY AND EQUIPMENT** Property and equipment are stated at cost. Depreciation is calculated using the accelerated and straight-line methods over the following useful lives:

Buildings	20 to 25 years
Computer equipment and software	3 to 7 years
Furniture and equipment	3 to 7 years
Leasehold improvements	Lesser of the lease terms or the estimated useful lives of the improvements

**(I) INTANGIBLE ASSETS** Intangible assets net of amortization at March 31, 2000 and 1999, of \$117,236,000, and \$90,682,000, respectively, include goodwill, costs of obtaining product technology and noncompete covenants which are amortized using the straight-line method over the lesser of their estimated useful lives or the agreement terms, typically from two to twelve years. Amortization expense for fiscal years ended March 31, 2000, 1999 and 1998 was \$11,989,000, \$5,880,000, and \$692,000, respectively. The Company assesses the recoverability of goodwill by determining whether the carried value of the assets may be recovered through estimated future cash flows.

**(J) INCOME TAXES** Income tax expense is based on reported earnings before income taxes. Deferred income taxes reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes.

**(K) FOREIGN CURRENCY TRANSLATION** For each of the Company's foreign subsidiaries the functional currency is its local currency. Assets and liabilities of foreign operations are translated into U.S. dollars using current exchange rates, and revenues and expenses are translated into U.S. dollars using average exchange rates. The effects of foreign currency translation adjustments are deferred and included as a component of accumulated other comprehensive income (loss) in stockholders' equity.

Foreign currency transaction gains and losses are a result of the effect of exchange rate changes on transactions denominated in currencies other than the functional currency. Included in interest and other income in the statements of income are foreign currency transaction losses of \$1,781,000, \$1,168,000 and \$517,000, for the fiscal years ended March 31, 2000, 1999 and 1998, respectively.

**(L) NET INCOME PER SHARE** The following summarizes the computations of Basic Earnings Per Share (“EPS”) and Diluted EPS. Basic EPS is computed as net earnings divided by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur from common shares issuable through stock-based compensation plans including stock options, restricted stock awards, warrants and other convertible securities using the treasury stock method.

Years Ended March 31,	2000	1999	1998
(In thousands, except for per share amounts):			
Net income	\$ 116,751	\$ 72,872	\$ 72,562
Shares used to compute net income per share:			
Weighted-average common shares	62,830	60,748	58,867
Dilutive stock options	3,541	2,524	2,091
Dilutive potential common shares	66,371	63,272	60,958
Net income per share:			
Basic	\$ 1.86	\$ 1.20	\$ 1.23
Diluted	\$ 1.76	\$ 1.15	\$ 1.19

Excluded from the above computation of weighted-average shares for diluted EPS for the fiscal years ended March 31, 2000, 1999 and 1998 were options to purchase 229,000, 645,000 and 137,000 shares of common stock, respectively, as the options’ exercise price was greater than the average market price of the common shares. For the fiscal year ended March 31, 2000, the weighted-average exercise price of the respective options was \$81.88. Class B common stock, authorized on March 22, 2000 was excluded from the Company’s calculations of basic and diluted EPS because its impact on the calculation is immaterial.

**(M) EMPLOYEE BENEFITS** The Company has a 401(k) Plan covering substantially all of its U.S. employees. The 401(k) Plan permits the Company to make discretionary contributions to employees’ accounts based on the Company’s financial performance. The Company contributed \$1,799,000, \$2,092,000 and \$902,000 to the Plan in fiscal 2000, fiscal 1999 and fiscal 1998, respectively.

**(N) STOCK-BASED COMPENSATION** The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (“APB 25”).

**(O) IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS** In December 1999, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin No. 101 (“SAB 101”), “Revenue Recognition,” which outlines the basic criteria that must be met to recognize revenue and provides guidance for presentation of revenue and for disclosure related to revenue recognition policies in financial statements filed with the SEC. SAB 101 is effective for fiscal years beginning after December 15, 1999, except, as amended by SAB 101A, registrants with fiscal years that begin between December 16, 1999 and March 15, 2000 may report a change in accounting principle no later than the second quarter of fiscal years beginning after December 15, 1999. The Company believes the adoption of SAB 101 will not have a material impact on the Company’s financial position and results of operations.

In March 2000, the Emerging Issues Task Force issued No. 00-02 (“EITF 00-02”), *“Accounting for Web Site Development Costs”*. EITF 00-02 states that all costs relating to software used to operate a web site and relating to development of initial graphics and web page design should be accounted for using Statement of Position (“SOP”) 98-1. Under this SOP, costs incurred in the preliminary project stage should be expensed as incurred, as should most training and data conversion costs. External direct costs of materials and services and internal direct payroll-related costs should be capitalized once certain criteria are met. EITF 00-02 is effective for all fiscal quarters beginning after June 30, 2000. The Company does not expect a significant impact on the results of operations, financial position or cash flows on the EITF’s effective date.

In March 2000, the Emerging Issues Task Force issued No. 00-03 (“EITF 00-03”), *“Application of AICPA SOP 97-2, “Software Revenue Recognition, “to Arrangements That Include the Right to Use Software Stored on Another Entity’s Hardware”*, which discusses the effect on revenue recognition of a software vendor’s obligation to host its software that previously was licensed to a customer. The EITF has reached the conclusion that, if the customer is unable to utilize the software on the customer’s hardware or contract with another party unrelated to the vendor to host the software, then the arrangement with the customer is outside the scope of SOP 97-2 and should be treated as a service contract. The Company may be required to change the timing of its revenue recognition related to product revenues. The Company believes the adoption of EITF 00-03 will not have a material impact on the Company’s financial position and results of operations.

In June 1998, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 133 (“SFAS 133”) *“Accounting for Derivative Instruments and Hedging Activities”*, which establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS 133 is effective as of the beginning of the first quarter of the fiscal year beginning after June 15, 2000. The Company is determining the effect of SFAS 133 on its financial statements.

In March 1998, the American Institute of Certified Public Accountants (“AICPA”) issued SOP 98-1, *“Accounting for the Costs of Computer Software Developed or Obtained for Internal Use”*. SOP 98-1 requires that consulting, hardware, software and direct payroll-related costs associated with the implementation of customized internal-use software be capitalized and amortized over the estimated useful life of the software. These costs relate to game site application and infrastructure design and development, as well as costs related to providing customer account management and building in e-Commerce functionality and interfaces. SOP 98-1 is effective for financial statements issued for fiscal years beginning after December 15, 1998. As of March 31, 2000, the Company has capitalized \$26,318,000 of these costs associated with the effort to build and support the EA.com game sites at launch.

**(P) USE OF ESTIMATES** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include provisions for doubtful accounts, sales returns and allowances, warranty provisions, and estimates regarding the recoverability of prepaid royalty advances and inventories. Actual results could differ from those estimates.

**(Q) RECLASSIFICATIONS** Certain amounts have been reclassified to conform to fiscal 2000 presentation.



**(R) LONG-LIVED ASSETS** The Company evaluates long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value.

## (2) APPROVAL OF THE TRACKING STOCK PROPOSAL

On March 22, 2000, the stockholders of Electronic Arts voted on and approved a proposal (the "Tracking Stock Proposal") to authorize the issuance of a new series of common stock to be designated as Class B common stock ("Tracking Stock"), intended to reflect the performance of Electronic Arts' online and e-Commerce division ("EA.com"). As a result of the approval of the Tracking Stock Proposal, Electronic Arts' existing common stock has been re-classified as Class A common stock ("Class A Stock") and that stock will reflect the performance of Electronic Arts' other businesses ("EA Core").

## (3) FINANCIAL INSTRUMENTS

### (A) CASH AND INVESTMENTS

March 31,	2000	1999
<i>(in thousands)</i>		
Cash and cash equivalents:		
Cash	\$ 153,436	\$ 106,641
Municipal securities	81,326	—
Money market funds	11,503	135,567
Cash and cash equivalents	246,265	242,208
Short-term investments:		
Available-for-sale		
Municipal securities	76,513	21,700
Corporate bonds	3,013	—
U.S. Agency bonds	4,013	—
Money market preferreds	—	43,114
Held-to-maturity		
U.S. Treasury securities	10,000	5,800
Short-term investments	93,539	70,614
Cash, cash equivalents and short-term investments	\$ 339,804	\$ 312,822
Long-term investments:		
U.S. Treasury securities	\$ 8,400	\$ 18,400

Long-term and short-term held-to-maturity investments include commercial notes with original maturities of five to eight years secured by U.S. Treasury Notes which enable the Company to take advantage of certain tax incentives from its Puerto Rico operation. These investments are treated as held-to-maturity for financial reporting purposes.

The fair value of held-to-maturity securities at March 31, 2000 was \$18,162,000 which included gross unrealized losses of \$238,000. The fair value of held-to-maturity securities at March 31, 1999 was \$24,353,000 which included gross unrealized gains of \$153,000.

**(B) MARKETABLE SECURITIES** Marketable securities are comprised of equity securities. The Company has accounted for investments in equity securities as “available-for-sale” and has stated applicable investments at fair value, with net unrealized appreciation reported as a separate component of accumulated other comprehensive income (loss) in stockholders’ equity. Marketable securities had an aggregate cost of \$15,000 and \$585,000 at March 31, 2000 and 1999, respectively. At March 31, 2000, marketable securities included gross unrealized gains of \$221,000. At March 31, 1999 marketable securities included gross unrealized gains of \$4,299,000.

For the fiscal years ended March 31, 2000 and 1999, the fair value of marketable securities sold was \$8,604,000 and \$1,818,000, respectively. The gross realized gains from these sales totaled \$7,528,000 and \$1,454,000 for fiscal 2000 and 1999, respectively. The gain on sale of investments is based on the specific identification method.

**(C) FOREIGN CURRENCY FORWARD EXCHANGE CONTRACTS** The Company utilizes foreign exchange contracts to hedge foreign currency exposures of underlying assets and liabilities, primarily certain intercompany receivables that are denominated in foreign currencies, thereby limiting our risk. The Company does not use forward exchange contracts for speculative or trading purposes. The Company’s accounting policies for these instruments are based on the Company’s designation of such instruments as hedging transactions. The criteria the Company uses for designating an instrument as a hedge include the instrument’s effectiveness in risk reduction and one-to-one matching of forward exchange contracts to underlying transactions. Gains and losses on currency forward contracts that are designated and effective as hedges of firm commitments are deferred and recognized in income in the same period that the underlying transactions are settled. Gains and losses on currency forward contracts that are designated and effective as hedges of existing transactions are recognized in income in the same period as losses and gains on the underlying transactions are recognized and generally offset. Gains and losses on any instruments not meeting the above criteria would be recognized in income in the current period. The Company transacts business in various foreign currencies. At March 31, 2000, the Company had foreign exchange contracts, all with maturities of less than nine months, to purchase and sell approximately \$242,143,000 in foreign currencies, primarily in British Pounds, Euro, Canadian Dollars, Japanese Yen and other European currencies.

Fair value represents the difference in value of the contracts at the spot rate and the forward rate, plus the unamortized premium or discount. At March 31, 2000, fair value of these contracts is not significant. The counterparties to these contracts are substantial and creditworthy multinational commercial banks. The risks of counterparty nonperformance associated with these contracts are not considered to be material. Notwithstanding our efforts to manage foreign exchange risk, there can be no assurances that our hedging activities will adequately protect us against the risks associated with foreign currency fluctuations.

#### (4) COMMITMENTS

**LEASE OBLIGATIONS** The Company leases certain of its current facilities and certain equipment under non-cancelable operating lease agreements. The Company is required to pay property taxes, insurance and normal maintenance costs for certain of its facilities and will be required to pay any increases over the base year of these expenses on the remainder of the Company's facilities.

In February 1995, the Company entered into a master operating lease, as subsequently amended, for land and a building to be constructed in Redwood City, California. The initial term of the lease is for a period of three years from November 30, 1998. Monthly lease payments are based upon the London InterBank Offered Rate. The Company has the option to purchase the property for the unamortized financed balance at any time after the non-cancelable lease term, or it may terminate the lease at any time after the non-cancelable term by arranging a third party sale or by making a termination payment. Should the Company elect to terminate the lease, it will guarantee a residual value of up to 85% of the unamortized value of the property. As part of the agreement, the Company must also comply with certain financial covenants.

Total future minimum lease commitments as of March 31, 2000 are:

**Year Ended March 31:**

(in thousands)

	2001	\$ 22,760
	2002	16,477
	2003	7,266
	2004	5,681
	2005	3,745
	Thereafter	7,719
		<u>\$ 63,648</u>

Total rent expense for all operating leases was \$23,591,000, \$19,480,000 and \$13,842,000, for the fiscal years ended March 31, 2000, 1999 and 1998, respectively.

#### (5) AMERICA ONLINE, INC. ("AOL") AGREEMENT

In November 1999, Electronic Arts Inc., EA.com and AOL entered into a five year agreement which establishes the basis for EA.com's production of a games site on the world wide web that will be available to AOL subscribers and to users of other branded AOL properties. Under this agreement, EA.com is required to launch its site no later than June 1, 2000, although, under certain circumstances described in the agreement, this date can be extended to September 1, 2000. If the site is not launched within the specified time frame, and if prescribed additions to the site are not achieved within a specified time frame or the site does not contain content as required under the agreement, then, under certain circumstances, AOL would have the ability to terminate the agreement.

The Company is required to pay \$50,000,000 to AOL as a carriage fee (including certain advertising fees of which \$604,000 was expensed for the fiscal year ended March 31, 2000) under the AOL agreement. Of this amount, \$25,000,000 was paid upon signing the agreement and the remainder is due in four equal installments on the first four anniversaries of the initial payment. Payment of the first annual installment of \$6,250,000 will be accelerated to June 1, 2000 since certain launch requirements will not be met by that date. The Company is also required to pay to AOL \$31,000,000 as an advance of a minimum guaranteed revenue share for revenues generated by subscriptions and other certain commercial transactions on the EA.com site. Of this amount \$11,000,000 was paid upon signing of the agreement and the remainder is due in four equal annual installments on the first anniversary of the initial payment. The fair value of the payments made under the AOL agreement was determined by an independent valuation and the resulting amounts will be amortized (beginning with the site launch) over the remaining term of the five year agreement. Advances of \$35,395,000 are included in other long-term assets as of March 31, 2000.

The Company also committed to spend \$15,000,000 in offline media advertisements promoting its games on AOL during the term of the agreement.

**SALE OF CLASS B COMMON STOCK AND WARRANT TO AOL** In connection with the agreement with AOL, the Company sold shares of Class B common stock to AOL (the "AOL Shares") representing 10 percent of the initial equity value attributable to EA.com valued at \$18,700,000.

In addition to the AOL Shares, the Company sold AOL a warrant (the "AOL Warrant") to purchase shares of Class B common stock representing an additional 5 percent of the initial equity value attributable to EA.com for \$1,300,000. The aggregate exercise price of the AOL Warrant will be \$40,000,000. The AOL Warrant expires at the latest at the fifth anniversary of its date of issuance, and under certain conditions may expire at an earlier date.

**AOL EXCHANGE RIGHTS** If a Qualified Public Offering (as defined in the AOL Agreement) does not occur within 12 months following the initial sale of the AOL Shares to AOL, then AOL may exchange their Class B common stock shares for a number of Class A common stock based on the ratio of per share price paid by AOL for the Class B stock relative to \$83.7958.

## (6) CONCENTRATION OF CREDIT RISK

The Company extends credit to various companies in the retail and mass merchandising industry. Collection of trade receivables may be affected by changes in economic or other industry conditions and may, accordingly, impact the Company's overall credit risk. Although the Company generally does not require collateral, the Company performs ongoing credit evaluations of its customers and reserves for potential credit losses are maintained.

Short-term investments are placed with high credit-quality financial institutions or in short-duration high quality securities. The Company limits the amount of credit exposure in any one institution or type of investment instrument.

## (7) LITIGATION

The Company is subject to pending claims and litigation. Management, after review and consultation with counsel, considers that any liability from the disposition of such lawsuits would not have a material adverse effect upon the consolidated financial condition of the Company.

## (8) PREFERRED STOCK

At March 31, 2000 and 1999, the Company had 10,000,000 and 1,000,000 shares, respectively, of Preferred Stock authorized but unissued. The rights, preferences, and restrictions of the Preferred Stock may be designated by the Board of Directors without further action by the Company's stockholders.

## (9) TREASURY STOCK

In February 1999, the Board of Directors approved a plan to purchase up to two million shares of the Company's common stock. For the year ended March 31, 2000, the Company did not repurchase shares. For the year ended March 31, 1999, the Company repurchased 222,500 shares for approximately \$9,001,000 under this program. For the fiscal years ended March 31, 2000 and 1999, 122,563 and 99,937 shares were reissued under the Company's Stock Plans, respectively.

When treasury shares were reissued, any excess of the average acquisition cost of the shares over the proceeds from reissuance was charged to retained earnings.

## (10) STOCK PLANS

**(A) EMPLOYEE STOCK PURCHASE PLAN** The Company has an Employee Stock Purchase Plan program whereby eligible employees may authorize payroll deductions of up to 10% of their compensation to purchase shares at 85% of the lower of the fair market value of the Common Stock on the date of commencement of the offering or on the last day of the six-month purchase period. The program commenced in September 1991. In fiscal 2000, 245,523 shares were purchased by the Company and distributed to employees at prices ranging from \$32.41 to \$58.28. In fiscal 1999, 241,514 shares were purchased by the Company and distributed to employees at prices ranging from \$26.19 to \$36.60. In fiscal 1998, 199,680 shares were purchased by the Company and distributed to employees at prices ranging from \$26.14 to \$26.19 per share. The weighted average fair value of the fiscal 2000, fiscal 1999 and fiscal 1998 awards was \$20.00, \$18.27 and \$9.43, respectively. Under the Employee Stock Purchase Plan 30,928 shares were distributed from reissued treasury stock in fiscal 1999. No shares were distributed from reissued treasury stock in fiscal 2000 or fiscal 1998. At March 2000, the Company had 366,921 shares of its Common Stock reserved for future issuance under the Plan.

Prior to the Maxis merger in July 1997, Maxis employees were eligible to participate in an employee stock purchase plan. In fiscal 1998, Maxis purchased 7,684 shares under this plan which were distributed to participating employees. Shares were purchased at prices ranging from \$27.70 to \$27.99 in fiscal 1998.

**(B) STOCK OPTION PLANS** The Company's 1991 Stock Option Plan, 1993 Stock Option Plan, 1995 Stock Option Plan, and Directors' Plan ("Option Plans") provide stock options for employees, officers and directors. Pursuant to these Option Plans, the Board of Directors may grant non-qualified and incentive stock options to employees and officers and non-qualified options to directors, at not less than the fair market value on the date of grant.

Together with the Tracking Stock Proposal, the stockholders approved the Electronic Arts Inc. 2000 Class B Equity Incentive Plan and the Electronic Arts Inc. 2000 Class A Equity Incentive Plan. The Class B equity plan allows the award of stock options or restricted stock for up to an aggregate of 6,000,000 shares of Class B common stock and the Class A equity plan allows the award of stock options and restricted stock for up to an aggregate of 3,100,000 shares of Class A common stock. Each includes a provision for automatic option grants to the Company's outside directors. As of March 31, 2000 there were no shares granted under either plan.

Under the Company's stock option plans, 122,563 and 69,009 shares were reissued from treasury stock in fiscal 2000 and 1999, respectively. No shares were distributed from reissued treasury stock in fiscal 1998.

The options generally expire ten years from the date of grant and are generally exercisable in monthly increments over 50 months. Certain options assumed in connection with the Maxis merger in fiscal 1998 expire ten years from the date of grant, and vest and become exercisable at a rate of 25% on the first anniversary of the date of grant and 25% of the shares each year thereafter.

Class B common stock grants will generally vest over 50 months with 2% vesting per month.

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation" ("SFAS 123"). Accordingly, no compensation expense has been recognized for options granted under the Company's employee-based stock option plans. Had compensation expense been determined based on the fair value at the grant dates for awards under those plans in accordance with the provisions of SFAS 123, the Company's pro forma net income and net income per share for fiscal 2000, 1999 and 1998 would have been:

	2000	1999	1998
<i>(In thousands, except per share data)</i>			
<b>Net income</b>			
As reported	\$ 116,751	\$ 72,872	\$ 72,562
Pro forma	\$ 78,380	\$ 45,886	\$ 52,892
<b>Earnings per share</b>			
As reported – basic	\$ 1.86	\$ 1.20	\$ 1.23
Pro forma – basic	\$ 1.26	\$ 0.77	\$ 0.91
As reported – diluted	\$ 1.76	\$ 1.15	\$ 1.19
Pro forma – diluted	\$ 1.19	\$ 0.74	\$ 0.88

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The following weighted-average assumptions are used for grants made in 2000, 1999 and 1998 under the stock plans: risk-free interest rates of 4.93% to 6.54% in 2000; 4.39% to 5.55% in 1999; and 5.31% to 6.42% in 1998; expected volatility of 65% in fiscal 2000, 59% in fiscal 1999 and 58% in fiscal 1998; expected lives of 2.29 years in fiscal 2000, 2.27 years in fiscal 1999 and 2.25 years in fiscal 1998 under the Option Plans and one year for the Employee Stock Purchase Plan. No dividends are assumed in the expected term. The Company's calculations are based on a multiple option valuation approach and forfeitures are recognized when they occur. The above disclosures include options granted under the former Maxis option plans as if they were initially granted by the Company.

Because SFAS 123 is applicable only to options granted subsequent to March 31, 1995, the impact of non-vested stock options granted prior to this date has been excluded from the pro forma calculation. Accordingly, pro forma adjustments are not indicative of future period pro forma adjustments as the pro forma effect will not be fully reflected until subsequent years.

Additional information regarding options outstanding as of March 31, 2000 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Shares	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
\$ 1.990 – \$ 23.500	1,684,898	4.21	\$ 16.48	1,444,433	\$ 15.34
23.750 – 29.875	1,544,350	6.52	27.37	1,144,030	27.66
30.000 – 35.000	1,524,245	6.97	34.15	653,137	33.49
35.063 – 43.125	1,263,602	8.08	39.64	365,063	40.01
43.625 – 46.875	1,467,705	8.62	44.61	404,804	44.12
47.125 – 57.938	1,025,608	8.77	50.62	208,722	49.82
59.750	1,826,819	9.39	59.75	205,977	59.75
66.375 – 83.875	761,102	9.68	74.38	20,293	72.67
87.813	185,600	9.93	87.81	56	87.81
91.938	183,025	9.65	91.94	7,147	91.94
<b>\$ 1.990 – \$ 91.938</b>	<b>11,466,954</b>	<b>7.65</b>	<b>\$ 42.60</b>	<b>4,453,662</b>	<b>\$ 29.86</b>

The following summarizes the activity under the Company's stock option plans during the fiscal years ended March 31, 2000, 1999 and 1998:

	Options Outstanding	
	Shares	Weighted-Average Exercise Price
Balance at March 31, 1997	8,323,568	\$ 21.97
Granted	3,833,539	32.92
Canceled	(616,275)	37.96
Exercised	(1,688,702)	18.92
Balance at March 31, 1998 (3,961,559 shares were exercisable at a weighted average price of \$18.83)	9,852,130	25.76
Granted	3,147,216	44.18
Canceled	(568,983)	34.74
Exercised	(991,104)	22.73
Balance at March 31, 1999 (5,094,075 shares were exercisable at a weighted average price of \$22.79)	11,439,259	30.65
Granted	3,907,976	63.84
Canceled	(860,586)	43.36
Exercised	(3,019,695)	24.83
Balance at March 31, 2000	11,466,954	\$ 42.60
Options available for grant at March 31, 2000	3,582,266	

**(11) PROPERTY AND EQUIPMENT**

Property and equipment at March 31, 2000 and 1999 consisted of:

	2000	1999
<i>(in thousands)</i>		
Computer equipment and software	\$ 213,815	\$ 127,330
Buildings	99,819	62,413
Land	51,686	50,570
Office equipment, furniture and fixtures	25,210	21,296
Leasehold improvements	12,157	5,749
Warehouse equipment and other	3,914	3,813
	406,601	271,171
Less accumulated depreciation and amortization	(121,135)	(89,905)
	\$ 285,466	\$ 181,266

Depreciation and amortization expenses associated with property and equipment amounted to \$34,736,000, \$34,581,000 and \$26,215,000, for the fiscal years ended March 31, 2000, 1999 and 1998, respectively.

**(12) ACCRUED AND OTHER LIABILITIES**

Accrued and other liabilities at March 31, 2000 and 1999 consisted of:

	2000	1999
<i>(in thousands)</i>		
Accrued compensation and benefits	\$ 59,580	\$ 46,541
Accrued expenses	37,840	46,595
Accrued royalties	36,566	36,429
Accrued income taxes	22,682	23,724
Warranty reserve	8,886	7,900
Deferred revenue	1,847	8,206
Deferred income taxes	198	2,933
	\$ 167,599	\$ 172,328

**(13) BUSINESS COMBINATIONS AND DIVESTITURE**

**(A) KESMAI** On February 7, 2000, the Company acquired Kesmai Corporation (now referred to as "Kesmai") from News America Corporation ("News Corp") in exchange for \$22,500,000 in cash and approximately 103,000 shares of the Company's existing common stock valued at \$8,650,000. Kesmai™ specializes in the design and development of multiplayer games delivered directly to consumers over the Internet and is a major provider of game content to the Games Channel on the AOL service. The issuance of these shares was temporary, pending the authorization of Class B common stock. Subsequently, on March 22, 2000, Class B shares were authorized. The Company granted 5 percent of the initial equity attributable to EA.com to News Corp, adjusting the total common stock consideration relating to the acquisition by \$703,000 to \$9,353,000. The Company has contributed Kesmai to the EA.com division.



The Company is also committed to spend \$5 million in advertising with News Corp. or any of its affiliates.

If a qualified public offering of Class B common stock does not occur within twenty-four months of News Corp's purchase of such shares, then News Corp has the right to (1) exchange Class B common stock for approximately 103,000 shares of Class A common stock, and (2) receive cash from Electronic Arts in the amount of \$9,650,000.

The acquisition has been accounted for under the purchase method. The results of operations of Kesmai and the estimated fair market values of the acquired assets and liabilities have been included in the consolidated financial statements from the date of acquisition. The adjusted allocation of the excess purchase price over the net tangible liabilities assumed was \$32,815,000, of which, based on management's estimates prepared in conjunction with a third party valuation consultant, \$3,869,000 was allocated to purchased in-process research and development and \$28,946,000 was allocated to other intangible assets. Amounts allocated to other intangibles include goodwill of \$18,932,000, existing technology of \$3,992,000, amounts attributed to a prior AOL agreement of \$3,131,000 and other intangibles of \$2,891,000. The allocation of intangible assets is being amortized over lives ranging from two to seven years.

Purchased in-process research and development includes the value of products in the development stage that are not considered to have reached technological feasibility or to have alternative future use. Accordingly, this non-recurring item was expensed in the Consolidated Statement of Income upon consummation of the acquisition. The non-recurring charge for in-process research and development reduced diluted earnings per share by approximately \$0.04 in the fiscal year 2000.

In connection with the acquisition of Kesmai, the Company allocated and expensed \$3,869,000 of the purchase price to acquired in-process technology. Kesmai had various projects in progress at the time of the acquisition. As of the acquisition date, costs to complete Kesmai projects acquired were expected to be approximately \$10,550,000 in future periods. The Company believes there have been no significant changes to these estimates as of March 31, 2000. The Company currently expects to complete the development of these projects at various dates through fiscal 2002 and to publish the projects upon completion. In conjunction with the merger of Kesmai, the Company accrued approximately \$200,000 related to direct transaction costs and other related costs. At March 31, 2000 there were \$133,000 in accruals remaining related to these items.

The purchase price for the Kesmai transaction was allocated to assets acquired and liabilities assumed as set forth below (in thousands):

Current assets (net of cash acquired)	\$	605
Fixed assets (net of depreciation)		759
In-process technology		3,869
Goodwill and other intangibles		28,946
Liabilities		(2,326)
Total cash and stock paid	\$	31,853

The following table reflects unaudited pro forma combined results of operations of the Company and Kesmai on the basis that the acquisition had taken place on April 1, 1998 (in thousands, except per share data):

Year Ended March 31,	2000	1999
Net revenues	\$ 1,421,313	\$ 1,223,444
Net income	\$ 113,996	\$ 64,237
Net income per share – basic	\$ 1.81	\$ 1.06
Net income per share – diluted	\$ 1.72	\$ 1.02
Number of shares used in computation - basic	62,830	60,748
Number of shares used in computation - diluted	66,371	63,272

In management's opinion, the unaudited pro forma combined results of operations are not indicative of the actual results that would have occurred had the acquisition been consummated at the beginning of fiscal 1999 or of future operations of the combined companies under the ownership and management of the Company.

**(B) WESTWOOD STUDIOS** In September 1998, the Company completed the acquisition of Westwood Studios, Inc. and certain assets of the Irvine, California – based Virgin Studio (collectively “Westwood”) for approximately \$122,688,000 in cash, including transaction expenses. The adjusted allocation of the excess purchase price over the net tangible liabilities assumed was \$128,573,000 of which, based on management's estimates prepared in conjunction with a third party valuation consultant, \$41,836,000 was allocated to purchased in-process research and development and \$86,737,000 was allocated to other intangible assets. Amounts allocated to other intangibles include franchise trade names of \$32,357,000, existing technology of \$6,510,000, workforces of \$1,680,000 and other goodwill of \$46,190,000 and are being amortized over lives ranging from two to twelve years. Purchased in-process research and development includes the value of products in the development stage that are not considered to have reached technological feasibility or to have alternative future use. Accordingly, this non-recurring item was expensed in the Consolidated Statement of Income upon consummation of the acquisition. The non-recurring charge for in-process research and development reduced diluted earnings per share by approximately \$0.59 in the fiscal year 1999. The results of the operations of Westwood and the estimated fair value of assets acquired and liabilities assumed are included in the Company's financial statements from the date of acquisition.

In conjunction with the merger of Westwood, the Company accrued approximately \$1,500,000 related to direct transaction costs and other related accruals. At March 31, 2000, there were \$500,000 in accruals remaining related to these items.

In connection with the Westwood acquisition, the purchase price has been allocated to the assets and liabilities assumed based upon the fair values on the date of acquisition, as follows (in thousands):

Current assets	\$	4,500
Property and equipment		3,257
In-process technology		41,836
Other intangible assets		86,737
Current liabilities		(13,642)
Total purchase price	\$	122,688

The following table reflects unaudited pro forma combined results of operations of the Company and Westwood on the basis that the acquisition had taken place on April 1, 1997 (in thousands, except per share data):

	1999	1998
Revenues	\$ 1,229,055	\$ 1,011,234
Net income	\$ 111,308	\$ 64,604
Net income per share – basic	\$ 1.83	\$ 1.10
Net income per share – diluted	\$ 1.76	\$ 1.06
Number of shares used in computation – basic	60,748	58,867
Number of shares used in computation – diluted	63,272	60,958

In management's opinion, the unaudited pro forma combined results of operations are not indicative of the actual results that would have occurred had the acquisition been consummated at the beginning of fiscal 1998 or at the beginning of fiscal 1999 or of future operations of the combined companies under the ownership and management of the Company.

**(C) ABC SOFTWARE** In July 1998, the Company acquired ABC Software AG and ABC Software GmbH (collectively "ABC"), independent distributors of entertainment, edutainment and application software in Switzerland and Austria, respectively, for approximately \$9,466,000 in cash (net of cash acquired of \$5,099,000) and \$570,000 in other consideration. The transaction has been accounted for under the purchase method. The excess purchase price over the fair value of the net tangible assets acquired of approximately \$7,377,000 was allocated to goodwill and is being amortized over 7 years.

**(D) SQUARE CO., LTD.** In May 1998, the Company and Square Co., Ltd. ("Square"), a leading developer and publisher of entertainment software in Japan, completed the formation of two new joint ventures in North America and Japan. In North America, the companies formed Square Electronic Arts, LLC ("Square EA"), which has exclusive publishing rights in North America for future interactive entertainment titles created by Square. Additionally, the Company has the exclusive right to distribute in North America products published by this joint venture. The Company contributed \$3,000,000 and owns a 30% minority interest in this joint venture while Square owns 70%. This joint venture is accounted for under the equity method.

In Japan, the companies established Electronic Arts Square KK ("EA Square KK"), which will localize and publish in Japan the Company's properties originally created in North America and Europe, as well as develop and publish original video games in Japan. The Company contributed cash and has a 70% majority ownership interest, while Square contributed cash and owns 30%. Accordingly, the assets, liabilities and results of operations for EA Square KK are included in the Company's Consolidated Balance Sheets and Results of Operations since June 1, 1998, the date of formation. Square's 30% interest in EA Square KK has been reflected as "Minority interest in consolidated joint venture" on the Company's Consolidated Financial Statements.

**(E) MAXIS, INC.** On July 25, 1997, the Company completed a merger with Maxis, Inc. ("Maxis"), a California-based interactive software developer. Under the transaction, approximately 4.1 million shares of Electronic Arts' stock were exchanged for all outstanding Maxis common stock. The transaction was accounted for as a pooling of interests. The accompanying financial statements, notes and analyses have been restated for all periods presented to reflect this transaction.

In conjunction with the merger of Maxis, the Company recorded costs of \$10,792,000. This charge included direct transaction fees for investment bankers, attorneys, accountants, and other related costs of approximately \$2,781,000 and costs associated with integrating the operations of the two companies of approximately \$8,011,000. Included in the integration costs were redundant facility costs, severance payments, equipment abandonment costs and other asset write downs, contract termination charges and other related expenses. Of the total merger costs, approximately \$5,185,000 related to cash expenditures while approximately \$5,607,000 related to noncash charges. At March 31, 2000, there were no accruals remaining related to these merger related costs.

**(F) CREATIVE WONDERS, LLC** In December 1997, the Company completed the sale of its 50% ownership interest in Creative Wonders, LLC, a joint venture company formed with the Walt Disney Company for \$16,750,000 in cash. The Company recognized a gain of \$12,625,000, which is included in interest and other income. Prior to the sale, the Company distributed children's interactive titles published and sold by the joint venture into the retail channel. The investment was accounted for under the equity method prior to sale.

**(G) OTHER BUSINESS COMBINATIONS** Additionally, during the year ended March 31, 2000, the Company acquired two software development companies. In connection with these acquisitions, the Company incurred a charge of \$2,670,000 for acquired in-process technology. The charge was made after the Company concluded that the in-process technology had not reached technological feasibility and had no alternative future use after taking into consideration the potential for usage of the software in different products and resale of the software.

During the quarter ended June 30, 1998, the Company acquired two software development companies. In connection with these acquisitions, the Company incurred a charge of \$2,279,000 for acquired in-process technology. The charge was made after the Company concluded that the in-process technology had not reached technological feasibility and had no alternative future use after taking into consideration the potential for usage of the software in different products and resale of the software.

#### (14) INCOME TAXES

The Company's pretax income from operations for the fiscal years ended March 31, 2000, 1999 and 1998 consisted of the following components:

	2000	1999	1998
<i>(in thousands)</i>			
Domestic	\$ 104,096	\$ 79,789	\$ 51,620
Foreign	65,718	38,669	56,640
Total pretax income	\$ 169,814	\$ 118,458	\$ 108,260

Income tax expense (benefit) for the fiscal years ended March 31, 2000, 1999 and 1998 consisted of:

	Current	Deferred	Total
<i>(in thousands)</i>			
2000:			
Federal	\$ 2,766	\$ 3,231	\$ 5,997
State	299	859	1,158
Foreign	15,573	(2,649)	12,924
Charge in lieu of taxes from employee stock plans	32,563	-	32,563
	\$ 51,201	\$ 1,441	\$ 52,642
1999:			
Federal	\$ 31,204	\$ (10,340)	\$ 20,864
State	4,401	(2,590)	1,811
Foreign	15,715	1,410	17,125
Charge in lieu of taxes from employee stock plans	5,614	-	5,614
	\$ 56,934	\$ (11,520)	\$ 45,414
1998:			
Federal	\$ 14,751	\$ (7,585)	\$ 7,166
State	1,361	(727)	634
Foreign	18,561	1,434	19,995
Charge in lieu of taxes from employee stock plans	7,931	-	7,931
	\$ 42,604	\$ (6,878)	\$ 35,726

The components of the net deferred tax assets as of March 31, 2000 and 1999 consist of:

	2000	1999
<i>(in thousands)</i>		
Deferred tax assets:		
Accruals, reserves and other expenses	\$ 70,131	\$ 76,015
Total gross deferred tax assets	70,131	76,015
Less: valuation allowance	-	-
Net deferred tax assets	\$ 70,131	\$ 76,015
Deferred tax liabilities:		
Undistributed earnings of DISC	(1,487)	(1,784)
Prepaid royalty expenses	(38,562)	(43,681)
Fixed assets	(3,249)	-
Unrealized gains on marketable securities	(68)	(1,395)
Other	-	(949)
Total gross deferred tax liabilities	\$ (43,366)	\$ (47,809)
Net deferred tax asset	\$ 26,765	\$ 28,206

At March 31, 2000, deferred tax assets of \$26,963,000 were included in other current assets.

The differences between the statutory income tax rate and the Company's effective tax rate, expressed as a percentage of income before provision for income taxes, for the years ended March 31, 2000, 1999 and 1998 were as follows:

	2000	1999	1998
Statutory Federal tax rate	35.0 %	35.0 %	35.0 %
State taxes, net of Federal benefit	1.5	1.5	1.0
Differences between statutory rate and foreign effective tax rate	(2.8)	(2.5)	(2.2)
Research and development credits	(1.7)	(2.1)	(0.6)
Nondeductible acquisition costs	-	7.4	-
Other	(1.0)	(1.0)	(0.2)
	31.0 %	38.3 %	33.0 %

The Company provides for U.S. taxes on an insignificant portion of the undistributed earnings of its foreign subsidiaries and does not provide taxes on the remainder. We have not provided for Federal income tax on approximately \$165,000,000 of undistributed earnings of our foreign subsidiaries, since we intend to reinvest this amount in foreign subsidiary operations indefinitely.

The Company's U.S. income tax returns for the years 1992 through 1995 have been examined by the Internal Revenue Service (IRS). In 1998, the Company received a notice of deficiencies from the IRS. These deficiencies relate primarily to operations in Puerto Rico, which the Company is contesting in Tax Court. The Company believes that any additional liabilities, if any, that arise from the outcome of this examination will not be material to the Company's consolidated financial statements.

**(15) INTEREST AND OTHER INCOME, NET**

Interest and other income, net for the years ended March 31, 2000, 1999 and 1998 consisted of:

	2000	1999	1998
<i>(in thousands)</i>			
Interest income	\$ 13,744	\$ 12,625	\$ 13,649
Gain on disposition of assets, net	8,339	725	14,910
Foreign currency losses	(1,781)	(1,168)	(517)
Equity in net gain (loss) of affiliates	1,138	(155)	(1,162)
Other income (expense), net	(5,412)	1,153	(2,069)
	\$ 16,028	\$ 13,180	\$ 24,811

**(16) COMPREHENSIVE INCOME**

In fiscal 1999, the Company adopted SFAS No. 130, "Reporting Comprehensive Income," which establishes standards for reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in financial statements. SFAS 130 requires classification of other comprehensive income in a financial statement and display of other comprehensive income separately from retained earnings and additional paid-in capital. Other comprehensive income includes primarily foreign currency translation adjustments and unrealized gains (losses) on investments.

The change in the components of accumulated other comprehensive income, net of taxes, is summarized as follows (in thousands):

	Foreign currency translation adjustments	Unrealized gains (losses) on investments	Accumulated other comprehensive income
Balance at March 31, 1997	\$ (1,925)	\$ 2,593	\$ 668
Other comprehensive loss	(1,273)	(863)	(2,136)
Balance at March 31, 1998	(3,198)	1,730	(1,468)
Other comprehensive income (loss)	(2,643)	1,544	(1,099)
Balance at March 31, 1999	(5,841)	3,274	(2,567)
Other comprehensive loss	(339)	(3,455)	(3,794)
Balance at March 31, 2000	\$ (6,180)	\$ (181)	\$ (6,361)

Change in unrealized gains (losses) on investments, net are shown net of taxes of \$(1,553,000), \$727,000 and \$(426,000) in fiscal 2000, 1999 and 1998, respectively.

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

## (17) DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

**Cash, cash equivalents, short-term investments, receivables, accounts payable and accrued liabilities** - the carrying amount approximates fair value because of the short maturity of these instruments.

**Long-term investments, investments classified as held-to-maturity and marketable securities** - fair value is based on quoted market prices.

## (18) SEGMENT INFORMATION

In 1999, the Company adopted SFAS No. 131, “*Disclosures about Segments of an Enterprise and Related Information*”, which supersedes SFAS No. 14, “*Financial Reporting for Segments of a Business Enterprise*”. SFAS No. 131 establishes standards for the reporting by public business enterprises of information about product lines, geographic areas and major customers. The method for determining what information to report is based on the way that management organizes the operating segments within the Company for making operational decisions and assessments of financial performance. The Company’s chief operating decision maker is considered to be the Company’s Chief Executive Officer (“CEO”). The CEO reviews financial information presented on a consolidated basis accompanied by disaggregated information about revenues by geographic region and by product lines for purposes of making operating decisions and assessing financial performance.

As a result of the approval of the Tracking Stock proposal to authorize issuance of a new series of common stock designated as Class B common stock, intended to reflect the performance of EA.com, management considers EA.com a separate reportable segment. Accordingly, prior period information has been restated to disclose separate segments. The Company operates in two principal business segments globally:

- Electronic Arts core (“EA Core”) business segment: creation, marketing and distribution of entertainment software.
- EA.com business segment: creation, marketing and distribution of entertainment software which can be played or sold online.

Please see the discussion regarding segment reporting in the MD&A.

Information about Electronic Arts business segments is presented below for the fiscal years ended March 31, 2000, 1999, 1998 (in thousands):

Year Ended March 31, 2000	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Net revenues from unaffiliated customers	\$ 1,399,093	\$ 20,918	\$ -	\$ 1,420,011
Group sales	2,014	-	(2,014) <sup>(a)</sup>	-
Total net revenues	1,401,107	20,918	(2,014)	1,420,011
Cost of goods sold from unaffiliated customers	700,024	5,784	-	705,808
Group cost of goods sold	-	2,014	(2,014)	-
Total cost of goods sold	700,024	7,798	(2,014)	705,808
Gross profit	701,083	13,120	-	714,203
Operating expenses:				
Marketing and sales	185,714	2,914	-	188,628
General and administrative	87,513	4,989	-	92,502
Research and development	205,933	34,775	20,051 <sup>(b)</sup>	260,759
Network development and support	-	20,051	(20,051)	-
Charge for acquired in-process technology	2,670	3,869	-	6,539
Amortization of intangibles	10,866	1,123	-	11,989
Total operating expenses	492,696	67,721	-	560,417
Operating income (loss)	208,387	(54,601)	-	153,786
Interest and other income, net	16,017	11	-	16,028
Income (loss) before provision for income taxes and minority interest	224,404	(54,590)	-	169,814
Provision for income taxes	52,642	-	-	52,642
Income (loss) before minority interest	171,762	(54,590)	-	117,172
Minority interest in consolidated joint venture	(421)	-	-	(421)
Net income (loss)	171,341	(54,590)	-	116,751
Interest income	13,733	11	-	13,744
Depreciation and amortization	39,818	6,907	-	46,725
Identifiable assets	1,085,411	106,901	-	1,192,312
Capital expenditures	97,279	37,605	-	134,884



Year Ended March 31, 1999	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Net revenues from unaffiliated customers	\$ 1,204,689	\$ 17,174	\$ -	\$ 1,221,863
Group sales	985	-	(985) <sup>(a)</sup>	-
Total net revenues	1,205,674	17,174	(985)	1,221,863
Cost of goods sold from unaffiliated customers	624,252	3,571	-	627,823
Group cost of goods sold	-	985	(985)	-
Total cost of goods sold	624,252	4,556	(985)	627,823
Gross profit	581,422	12,618	-	594,040
Operating expenses:				
Marketing and sales	161,029	2,378	-	163,407
General and administrative	74,995	1,224	-	76,219
Research and development	181,245	8,050	9,846 <sup>(b)</sup>	199,141
Network development and support	-	9,846	(9,846)	-
Charge for acquired in-process technology	44,115	-	-	44,115
Amortization of intangibles	5,880	-	-	5,880
Total operating expenses	467,264	21,498	-	488,762
Operating income (loss)	114,158	(8,880)	-	105,278
Interest and other income, net	13,180	-	-	13,180
Income (loss) before provision for income taxes and minority interest	127,338	(8,880)	-	118,458
Provision for income taxes	45,414	-	-	45,414
Income (loss) before minority interest	81,924	(8,880)	-	73,044
Minority interest in consolidated joint venture	(172)	-	-	(172)
Net income (loss)	81,752	(8,880)	-	72,872
Interest income	12,625	-	-	12,625
Depreciation and amortization	40,271	190	-	40,461
Identifiable assets	898,905	2,968	-	901,873
Capital expenditures	113,939	1,881	-	115,820

Year Ended March 31, 1998	EA Core (excl. EA.com)	EA.com	Adjustments and Eliminations	Electronic Arts
Net revenues from unaffiliated customers	\$ 897,877	\$ 10,975	\$ -	\$ 908,852
Group sales	538	-	(538) <sup>(a)</sup>	-
Total net revenues	898,415	10,975	(538)	908,852
Cost of goods sold from unaffiliated customers	478,967	2,266	-	481,233
Group cost of goods sold	-	538	(538)	-
Total cost of goods sold	478,967	2,804	(538)	481,233
Gross profit	419,448	8,171	-	427,619
Operating expenses:				
Marketing and sales	125,711	2,597	-	128,308
General and administrative	57,650	188	-	57,838
Research and development	137,360	5,352	3,020 <sup>(b)</sup>	145,732
Network development and support	-	3,020	(3,020)	-
Charge for acquired in-process technology	1,500	-	-	1,500
Merger costs	10,792	-	-	10,792
Total operating expenses	333,013	11,157	-	344,170
Operating income (loss)	86,435	(2,986)	-	83,449
Interest and other income, net	24,811	-	-	24,811
Income (loss) before provision for income taxes and minority interest	111,246	(2,986)	-	108,260
Provision for income taxes	35,726	-	-	35,726
Income (loss) before minority interest	75,520	(2,986)	-	72,534
Minority interest in consolidated joint venture	28	-	-	28
Net income (loss)	75,548	(2,986)	-	72,562
Interest income	13,649	-	-	13,649
Depreciation and amortization	26,805	102	-	26,907
Identifiable assets	745,000	681	-	745,681
Capital expenditures	44,715	523	-	45,238

(a) REPRESENTS ELIMINATION OF INTERCOMPANY SALES OF ELECTRONIC ARTS PACKAGED GOODS PRODUCTS TO EA.COM; AND REPRESENTS ELIMINATION OF ROYALTIES PAID TO ELECTRONIC ARTS BY EA.COM FOR INTELLECTUAL PROPERTY RIGHTS.

(b) REPRESENTS RECLASSIFICATION OF NETWORK DEVELOPMENT AND SUPPORT TO RESEARCH AND DEVELOPMENT.

Information about Electronic Arts' operations in the North America and foreign areas for the fiscal years ended March 31, 2000, 1999 and 1998 is presented below:

	North America	Europe	Asia Pacific (excluding Japan)	Japan	Eliminations	Total
<i>(in thousands)</i>						
<b>FISCAL 2000:</b>						
Net revenues from						
unaffiliated customers	\$ 846,637	\$ 492,430	\$ 47,573	\$ 33,371	\$ -	\$ 1,420,011
Intercompany revenues	28,701	28,385	9,059	-	(66,145)	-
<b>Total net revenues</b>	<b>875,338</b>	<b>520,815</b>	<b>56,632</b>	<b>33,371</b>	<b>(66,145)</b>	<b>1,420,011</b>
Operating income	101,919	48,712	3,623	1,921	(2,389)	153,786
Interest income	11,775	1,755	214	-	-	13,744
Depreciation and amortization	35,114	9,968	473	1,170	-	46,725
Capital expenditures	78,298	54,379	1,447	760	-	134,884
Identifiable assets	734,626	418,034	18,019	21,633	-	1,192,312
Long-lived assets	244,845	154,475	3,306	3,975	-	406,601
<b>FISCAL 1999:</b>						
Net revenues from						
unaffiliated customers	\$ 704,998	\$ 443,937	\$ 39,560	\$ 33,368	\$ -	\$ 1,221,863
Intercompany revenues	32,216	15,062	2,800	12	(50,090)	-
<b>Total net revenues</b>	<b>737,214</b>	<b>458,999</b>	<b>42,360</b>	<b>33,380</b>	<b>(50,090)</b>	<b>1,221,863</b>
Operating income	78,826	21,052	3,208	2,192	-	105,278
Interest income	9,931	2,551	143	-	-	12,625
Depreciation and amortization	29,272	9,399	506	1,284	-	40,461
Capital expenditures	54,029	58,383	418	2,990	-	115,820
Identifiable assets	596,357	268,152	20,938	16,426	-	901,873
Long-lived assets	174,582	91,546	2,051	2,992	-	271,171
<b>FISCAL 1998:</b>						
Net revenues from						
unaffiliated customers	\$ 519,423	\$ 325,938	\$ 41,494	\$ 21,997	\$ -	\$ 908,852
Intercompany revenues	45,913	21,613	513	133	(68,172)	-
<b>Total net revenues</b>	<b>565,336</b>	<b>347,551</b>	<b>42,007</b>	<b>22,130</b>	<b>(68,172)</b>	<b>908,852</b>
Operating income (loss)	31,852	51,807	6,995	(7,205)	-	83,449
Interest income	10,931	2,471	247	-	-	13,649
Depreciation and amortization	20,826	4,541	661	879	-	26,907
Capital expenditures	25,423	18,035	669	1,111	-	45,238
Identifiable assets	515,728	201,988	17,347	10,618	-	745,681
Long-lived assets	143,398	36,300	1,959	4,805	-	186,462

For the fiscal year ended March 31, 2000 and March 31, 1999, Electronic Arts had sales to one customer which represented 12% of total net revenues in both years. The Company had no sales to any one customer in excess of 10% of total net revenues for fiscal years ended March 31, 1998.

Information about Electronic Arts' net revenues by product line for the fiscal years ended March 31, 2000, 1999 and 1998 is presented below (in thousands):

	2000	1999	1998
PlayStation	\$ 586,821	\$ 519,830	\$ 380,299
PC	397,777	270,793	231,034
Affiliated label	275,333	248,105	185,865
N64	120,415	152,349	56,677
License, OEM and Other	39,665	30,786	54,977
	\$ 1,420,011	\$ 1,221,863	\$ 908,852

## QUARTERLY FINANCIAL AND MARKET INFORMATION (UNAUDITED)

### ELECTRONIC ARTS AND SUBSIDIARIES

	Quarter Ended				Year Ended
	June 30	Sept. 30	Dec. 31	March 31	
(In thousands, except per share data)					
<b>FISCAL 2000:</b>					
Net revenues	\$ 186,120	\$ 338,887	\$ 600,691	\$ 294,313	\$ 1,420,011
Operating income (loss)	(849)	23,697	129,536	1,402	153,786
Net income	2,326 <sup>(a)</sup>	18,132 <sup>(a)</sup>	92,861 <sup>(a)</sup>	3,432 <sup>(b)</sup>	116,751
Net income per share – basic	\$ 0.04 <sup>(a)</sup>	\$ 0.29 <sup>(a)</sup>	\$ 1.47 <sup>(a)</sup>	\$ 0.05 <sup>(b)</sup>	\$ 1.86
Net income per share – diluted	\$ 0.04 <sup>(a)</sup>	\$ 0.28 <sup>(a)</sup>	\$ 1.38 <sup>(a)</sup>	\$ 0.05 <sup>(b)</sup>	\$ 1.76
Common stock price per share					
High	\$ 54.81	\$ 76.19	\$ 120.94	\$ 102.19	\$ 120.94
Low	\$ 45.63	\$ 52.88	\$ 66.44	\$ 69.00	\$ 45.63
<b>FISCAL 1999:</b>					
Net revenues	\$ 178,221	\$ 245,763	\$ 520,155	\$ 277,724	\$ 1,221,863
Operating income (loss)	3,050	(29,545)	102,439	29,334	105,278
Net income (loss)	3,700 <sup>(c)</sup>	(25,273) <sup>(d)</sup>	72,531 <sup>(e)</sup>	21,914 <sup>(e)</sup>	72,872
Net income (loss) per share – basic	\$ 0.06 <sup>(c)</sup>	\$ (0.42) <sup>(d)</sup>	\$ 1.19 <sup>(e)</sup>	\$ 0.36 <sup>(e)</sup>	\$ 1.20
Net income (loss) per share – diluted	\$ 0.06 <sup>(c)</sup>	\$ (0.42) <sup>(d)</sup>	\$ 1.15 <sup>(e)</sup>	\$ 0.35 <sup>(e)</sup>	\$ 1.15
Common stock price per share					
High	\$ 54.81	\$ 55.56	\$ 56.00	\$ 52.19	\$ 56.00
Low	\$ 41.63	\$ 38.13	\$ 33.88	\$ 38.25	\$ 33.88
<b>FISCAL 1998:</b>					
Net revenues	\$ 123,712	\$ 189,828	\$ 391,245	\$ 204,067	\$ 908,852
Operating income (loss)	(4,807)	(3,080)	70,983	20,353	83,449
Net income (loss)	(1,451)	41 <sup>(f)</sup>	58,620 <sup>(g)</sup>	15,352	72,562
Net income (loss) per share – basic	\$ (0.02)	\$ – <sup>(f)</sup>	\$ 0.99 <sup>(g)</sup>	\$ 0.26	\$ 1.23
Net income (loss) per share – diluted	\$ (0.02)	\$ – <sup>(f)</sup>	\$ 0.96 <sup>(g)</sup>	\$ 0.25	\$ 1.19
Common stock price per share					
High	\$ 35.38	\$ 37.50	\$ 39.56	\$ 46.94	\$ 46.94
Low	\$ 20.13	\$ 30.75	\$ 29.94	\$ 34.94	\$ 20.13

(a) NET INCOME AND NET INCOME PER SHARE INCLUDE GOODWILL AMORTIZATION OF \$1.8 MILLION, NET OF TAXES.

(b) NET INCOME AND NET INCOME PER SHARE INCLUDE ONE-TIME ACQUISITION RELATED CHARGES OF \$4.5 MILLION, NET OF TAXES, INCURRED IN CONNECTION WITH THE ACQUISITION OF KESMAI AND OTHER BUSINESS COMBINATIONS MADE DURING THE QUARTER AS WELL AS GOODWILL AMORTIZATION OF \$2.9 MILLION, NET OF TAXES.

(c) NET INCOME AND NET INCOME PER SHARE INCLUDE ONE-TIME ACQUISITION RELATED CHARGES OF \$1.6 MILLION, NET OF TAXES, INCURRED IN CONNECTION WITH THE ACQUISITION OF TWO SOFTWARE DEVELOPMENT COMPANIES MADE DURING THE QUARTER.

(d) NET INCOME AND NET INCOME PER SHARE INCLUDE ONE-TIME ACQUISITION RELATED CHARGES OF \$35.9 MILLION, NET OF TAXES, INCURRED IN CONNECTION WITH THE ACQUISITION OF WESTWOOD STUDIOS AS WELL AS GOODWILL AMORTIZATION OF \$0.6 MILLION, NET OF TAXES.

(e) NET INCOME AND NET INCOME PER SHARE INCLUDE GOODWILL AMORTIZATION OF \$1.7 MILLION, NET OF TAXES.

(f) NET INCOME AND NET INCOME PER SHARE INCLUDE ONE-TIME MERGER RELATED CHARGES OF \$7.2 MILLION, NET OF TAXES, INCURRED IN CONNECTION WITH THE MERGER OF MAXIS, INC.

(g) NET INCOME AND NET INCOME PER SHARE INCLUDE ONE-TIME ACQUISITION RELATED CHARGES OF \$1.0 MILLION, NET OF TAXES, INCURRED IN CONNECTION WITH THE REMAINING MINORITY OWNERSHIP INTEREST IN ELECTRONIC ARTS VICTOR, INC. NET INCOME AND NET INCOME PER SHARE INCLUDE A ONE-TIME GAIN ON SALE OF CREATIVE WONDERS, LLC IN THE AMOUNT OF \$8.5 MILLION, NET OF TAXES.

The Company's common stock is traded in the over-the-counter market under the Nasdaq Stock Market symbol ERTS. The closing prices for the common stock in the table above represent the high and low closing prices as reported on the Nasdaq National Market.

## CORPORATE INFORMATION

### ELECTRONIC ARTS AND SUBSIDIARIES

#### CORPORATE OFFICERS

##### BOARD OF DIRECTORS

**M. Richard Asher**  
Consultant, Former President  
Polygram Records, Inc.

**William J. Byron**  
Former Owner and President  
CMA Sales

**Daniel H. Case III**  
President & CEO Chase H&Q

**Gary M. Kusin**  
President & CEO  
HQ Global Workplaces, Inc.

**Timothy Mott**  
Partner  
Ironwood Capital

**Lawrence F. Probst III**  
Chairman and Chief Executive Officer  
Electronic Arts

##### CORPORATE OFFICERS

**Lawrence F. Probst III**  
Chairman and Chief Executive Officer

**Don A. Matrick**  
President  
Worldwide Studios

**John S. Riccitiello**  
President and Chief Operating Officer

**William B. Gordon**  
Executive Vice President  
Chief Creative Officer

**E. Stanton McKee, Jr.**  
Executive Vice President and Chief  
Financial and Administrative Officer

**Nancy L. Smith**  
Executive Vice President  
and General Manager  
North American Publishing

**Ruth A. Kennedy**  
Senior Vice President,  
General Counsel, and Secretary

**J. Russell Rueff, Jr.**  
Senior Vice President,  
Human Resources

**David L. Carbone**  
Vice President  
Finance

#### CORPORATE OFFICES

##### CORPORATE HEADQUARTERS

209 Redwood Shores Parkway  
Redwood City, CA 94065  
(650) 628-1500

##### NORTH AMERICA

Burnaby, British Columbia  
Costa Mesa, California  
Irvine, California  
San Diego, California  
San Rafael, California  
Walnut Creek, California  
Maitland, Florida  
Chicago, Illinois  
Louisville, Kentucky  
Hunt Valley, Maryland  
Las Vegas, Nevada  
New York, New York  
Santa Isabel, Puerto Rico  
Austin, Texas  
Dallas, Texas  
Charlottesville, Virginia  
Bellevue, Washington

##### INTERNATIONAL

Adelaide, Australia  
The Gold Coast, Australia  
Mackay, Australia  
Melbourne, Australia  
Perth, Australia  
Sydney, Australia  
Neudorf, Austria  
Sao Paulo, Brazil  
Beijing, China  
Hong Kong, China  
Virum, Denmark  
Chertsey, England  
Turku, Finland  
Lyon, France  
Aachen, Germany  
Milano, Italy  
Tokyo, Japan  
Rotterdam, The Netherlands  
Auckland, New Zealand  
Oslo, Norway  
Lisbon, Portugal  
Singapore  
Cape Town, South Africa  
Johannesburg, South Africa  
Seoul, South Korea  
Barcelona, Spain  
Madrid, Spain  
Upplands Vasby, Sweden  
Sennwald, Switzerland  
Taipei, Taiwan  
Bangkok, Thailand

#### AUDITORS

KPMG LLP  
Mountain View, California

#### LEGAL COUNSEL

Fenwick & West  
Palo Alto, California

#### TRANSFER AGENT

Norwest Bank Minnesota  
St. Paul, Minnesota

#### FORM 10-K

A copy of the Company's Annual Report on Form 10-k, as filed with the Securities and Exchange Commission, will be furnished upon written request to:

Investor Relations Department  
Electronic Arts Inc.  
209 Redwood Shores Parkway  
Redwood City, CA 94065

#### ANNUAL MEETING

The Annual Meeting of stockholders will be held on July 27, 2000 at 3:00 P.M. at the Company's headquarters:

Electronic Arts Inc.  
209 Redwood Shores Parkway  
Redwood City, CA 94065





**ELECTRONIC ARTS**

209 Redwood Shores Parkway, Redwood City, CA 94065-1175

[www.ea.com](http://www.ea.com)