ZYNGA INC
Form 10-Q
August 01, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2013

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______ to ________

Commission File Number: 001-35375

Zynga Inc.

(Exact name of registrant as specified in its charter)

Delaware	**42-1733483**
(State of Incorporation)	**(IRS Employer Identification No.)**
699 Eighth Street	
San Francisco, CA	**94103**
(Address of Principal Executive Offices)	**(Zip Code)**

(855) 449-9642

(Telephone No.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes ¨ No þ

As of July 15, 2013, there were 620,966,387 shares of the Registrant s Class A common stock outstanding, 162,861,476 shares of the Registrant s Class B common stock outstanding and 20,517,472 shares of the Registrant s Class C common stock outstanding.

Table of Contents

Zynga Inc.

Form 10-Q Quarterly Report

TABLE OF CONTENTS

Zynga, the Zynga logo and other trademarks or service marks of Zynga appearing in this report are the property of Zynga. Trade names, trademarks and service marks of other companies appearing in this report are the property of their respective holders.

References in this report to DAUs mean daily active users of our games, MAUs mean monthly active users of our games, MUUs mean monthly unique users of our games, ABPU means average daily bookings per average DAU and references to MUPs mean monthly unique payers of our games. Unless otherwise indicated, these metrics are based on internally-derived measurements across all platforms on which our games are played. For further information about ABPU, DAUs, MAUs, MUPs, and MUUs as measured by us, see the section titled Management s Discussion and Analysis of Financial Condition and Results of Operations Key Metrics.

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements. In some cases you can identify these statements by forward-looking words such as believe, may, will, estimate, continue, anticipate, intend, could, would, project, plan, outlook, target, expressions, or the negative or plural of these words or expressions. These forward-looking statements include, but are not limited to, statements concerning the following:

our future operational and strategic plans;

our future relationship with Facebook, changes in the Facebook platform or changes in our agreements with Facebook;

the timing and success of our transition away from Facebook Credits and adoption of Facebook s local currency-based payments model;

our ability to launch successful new games and hit games for web and mobile generally and in a timely matter;

sustaining and expanding our franchise games;

the growth of the social games market, including the mobile market and the advertising market;

our ability to expand our offerings across several game genres;

expanding our network, including creating and building a mobile network on multiple platforms and across multiple devices and the success of that network;

our ability to transition our web franchises to mobile and create new franchises on the web and mobile;

our ability to launch successful games, including invest & express games, on mobile;

our ability to successfully acquire and integrate companies and assets;

our plans and opportunities in real money gaming and agreement with bwin.party;

the ability of our games to generate revenue and bookings for a significant period of time after launch and the timing for market acceptance of new games;

retaining and adding players and increasing the monetization of our player base;

user traffic and publishing games from third-party developers on our network;

our evaluation of new business opportunities, including real money gaming;

our ability to rationalize our product pipeline, reduce marketing and technology expenditures and consolidate certain facilities;

our cost reduction plans and estimated savings and charges;

capital expenditures and investment in our network infrastructure, including data centers;

our use of working capital in general;

maintaining a technology infrastructure that can efficiently and reliably handle increased player usage, fast load times and the deployment of new features and products;

attracting and retaining qualified employees and key personnel;

maintaining, protecting and enhancing our intellectual property;

our ability to prevent credit card fraud and security breaches;

protecting our players information and adequately addressing privacy concerns; and

our stock repurchase program.

Table of Contents

These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in Part II. Item 1A. Risk Factors of this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment and industry. We are also highly reliant on Facebook and the Facebook platform for a significant portion of our revenue. Our relationship with Facebook, the Facebook platform and our agreements with Facebook are subject to change. New risks emerge from time to time. It is not possible for our management to predict all of the risks related to our business and operations, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. The achievement or success of the matters covered by such forward-looking statements involves significant risks, uncertainties and assumptions. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated, predicted or implied in the forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur, and reported results should not be considered as an indication of future performance. Factors that could cause or contribute to such differences include, but are not limited to, those described in the section titled Risk Factors. We undertake no obligation to update any forward-looking statements for any reason to conform these statements to actual results or to changes in our expectations.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Zynga Inc.

Consolidated Balance Sheets

(In thousands, except par value)

(Unaudited)

	June 30, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 217,332	$ 385,949
Marketable securities	897,935	898,821
Accounts receivable, net of allowance of $0 and $160 at June 30, 2013 and December 31, 2012 respectively	73,564	106,327
Income tax receivable	5,835	5,607
Deferred tax assets	18,981	30,122
Restricted cash	3,549	28,152
Other current assets	28,714	29,392
Total current assets	1,245,910	1,484,370
Long-term marketable securities	417,655	367,543
Goodwill	228,079	208,955
Other intangible assets, net	33,807	33,663
Property and equipment, net	413,344	466,074
Other long-term assets	17,064	15,715
Total assets	$ 2,355,859	$ 2,576,320
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 21,654	$ 23,298
Other current liabilities	89,321	146,883
Deferred revenue	262,213	338,964
Total current liabilities	373,188	509,145
Long-term debt		100,000
Deferred revenue	7,861	8,041
Deferred tax liabilities		24,584
Other non-current liabilities	112,810	109,047
Total liabilities	493,859	750,817
Stockholders equity:		
Common stock, $.00000625 par value, and additional paid in capital authorized shares: 2,020,517; shares outstanding: 802,674 (Class A, 619,047, Class B, 163,110, Class C, 20,517) as of June 30, 2013 and 779,250 (Class A, 589,100, Class B, 169,633, Class C, 20,517) as of December 31, 2012	2,776,854	2,725,605
Treasury stock		(295,113)
Accumulated other comprehensive income (loss)	(1,911)	(1,447)
Accumulated deficit	(912,943)	(603,542)

Total stockholders equity	1,862,000	1,825,503
Total liabilities and stockholders equity	$ 2,355,859	$ 2,576,320

See accompanying notes.

3

Table of Contents

Zynga Inc.

Consolidated Statements of Operations

(In thousands, except per share data)

(Unaudited)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Revenue:				
Online game	$ 203,326	$ 291,548	$ 432,892	$ 584,328
Advertising	27,409	40,945	61,432	69,137
Total revenue	230,735	332,493	494,324	653,465
Costs and expenses:				
Cost of revenue	61,077	94,841	130,471	184,963
Research and development	124,322	171,316	253,503	358,192
Sales and marketing	31,163	56,055	58,470	112,892
General and administrative	44,541	48,730	87,181	121,445
Total costs and expenses	261,103	370,942	529,625	777,492
Income (loss) from operations	(30,368)	(38,449)	(35,301)	(124,027)
Interest income	1,105	1,084	2,268	2,375
Other income (expense), net	(4,531)	21,250	(5,394)	20,108
Income (loss) before income taxes	(33,794)	(16,115)	(38,427)	(101,544)
(Provision for) benefit from income taxes	17,989	(6,696)	26,755	(6,618)
Net loss	$ (15,805)	$ (22,811)	$ (11,672)	$ (108,162)
Net loss per share attributable to common stockholders				
Basic	$ (0.02)	$ (0.03)	$ (0.01)	$ (0.15)
Diluted	$ (0.02)	$ (0.03)	$ (0.01)	$ (0.15)
Weighted average common shares used to compute net loss per share attributable to common stockholders:				
Basic	793,541	730,510	786,784	718,554
Diluted	793,541	730,510	786,784	718,554

See accompanying notes.

4

Table of Contents

Zynga Inc.

Consolidated Statements of Comprehensive Income (Loss)

(In thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	**2012**	**2013**	**2012**
Net income (loss)	$ (15,805)	$ (22,811)	$ (11,672)	$ (108,162)
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	(617)	(374)	(1,459)	(253)
Net change on unrealized gains (losses) on available-for-sale investments, net of tax	(1,121)	(148)	(1,428)	5
Net change on unrealized gains (losses) on derivative instruments	2,059		2,423	
Other comprehensive income (loss):	321	(522)	(464)	(248)
Comprehensive income (loss):	$ (15,484)	$ (23,333)	$ (12,136)	$ (108,410)

See accompanying notes.

5

Table of Contents

Zynga Inc.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Operating activities:		
Net income (loss)	$ (11,672)	$ (108,162)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	62,919	68,605
Stock-based expense	55,810	229,307
(Gain) loss from sales of investments, assets and other, net	4,932	(398)
Net gain on termination of lease and purchase of building		(19,886)
Tax benefits from stock-based awards	(10,617)	5,210
Excess tax benefits from stock-based awards	10,617	(5,210)
Accretion and amortization on marketable securities	9,585	7,129
Deferred income taxes	(16,500)	(7,540)
Changes in operating assets and liabilities:		
Accounts receivable, net	32,909	24,754
Income tax receivable	(228)	14,169
Other assets	4,527	(9,545)
Accounts payable	(1,644)	(9,389)
Deferred revenue	(76,931)	(22,713)
Other liabilities	(37,907)	(20,490)
Net cash provided by operating activities	25,800	145,841
Investing activities:		
Purchases of marketable securities	(623,717)	(1,238,115)
Sales of marketable securities	146,123	80,098
Maturities of marketable securities	415,161	274,076
Purchase of corporate headquarters building		(233,700)
Acquisition of property and equipment	(6,290)	(77,915)
Business acquisition, net of cash acquired	(18,054)	(192,764)
Restricted cash	227	6,536
Other investing activities, net	(661)	(2,256)
Net cash provided by (used in) investing activities	(87,211)	(1,384,040)
Financing activities:		
Proceeds from debt, net of issuance costs		99,780
Taxes paid related to net share settlement of equity awards	(667)	(25,090)
Repurchases of common stock	(2,432)	
Proceeds from exercise of stock options	3,618	12,029
Proceeds from employee stock purchase plan	3,506	
Excess tax benefits from stock-based awards	(10,617)	5,210
Repayment of debt	(100,000)	
	(106,592)	91,929

Effect of exchange rate changes on cash and cash equivalents	(614)	(93)
Net increase (decrease) in cash and cash equivalents	(168,617)	(1,146,363)
Cash and cash equivalents, beginning of period	385,949	1,582,343
Cash and cash equivalents, end of period	$ 217,332	$ 435,980

See accompanying notes.

Table of Contents

Zynga Inc.

Notes to Consolidated Financial Statements

(Unaudited)

1. Overview and Summary of Significant Accounting Policies

Organization and Description of Business

Zynga Inc. (Zynga, we or the Company) develops, markets and operates online social games as live services played over the Internet and on social networking sites and mobile platforms. We generate revenue through the in-game sale of virtual goods and through advertising. Our operations are headquartered in San Francisco, California, and we have several operating locations in the U.S. as well as various international office locations in Canada, Asia and Europe. We completed our initial public offering in December 2011 and our Class A common stock is listed on the NASDAQ Global Select Market under the symbol ZNGA.

Basis of Presentation and Consolidation

The accompanying consolidated financial statements are presented in accordance with United States generally accepted accounting principles (U.S. GAAP). The consolidated financial statements include the operations of us and our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in the consolidation.

Accounting Policy Updates

The accompanying interim consolidated financial statements and these related notes should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2012 (the Annual Report).

In June 2013, the Financial Accounting Standards Board ratified Emerging Issues Task Force (EITF) Issue 13-C, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists which concludes an unrecognized tax benefit should be presented as a reduction of a deferred tax asset when settlement in this manner is available under the tax law. The Company will adopt this amendment in the first quarter of 2014. We do not expect our adoption of this standard to have a material impact on our financial statements.

We made the following additions to our accounting policies:

Stock Based Expense

For ZSUs granted prior to our initial public offering, and awards subject to a performance condition, we recognize stock-based compensation expense using the accelerated attribution method, net of estimated forfeitures, in which compensation cost for each vesting tranche in an award is recognized ratably from the service inception date to the vesting date for that tranche. For ZSUs granted after the initial public offering, which are only, or will be only, subject to a service condition, we recognize stock-based expense on a ratable basis over the requisite service period for the entire award.

Business Combinations

In line with our growth strategy, we have completed acquisitions to expand our social games and mobile offerings, obtain employee talent, and expand into new markets. We account for acquisitions of entities that include inputs and processes and have the ability to create outputs as business combinations. We allocate the purchase price of the acquisition, which includes the estimated acquisition date fair value of contingent consideration, to the tangible assets, liabilities and identifiable intangible assets acquired based on their estimated fair values. The excess of the purchase price over those fair values is recorded as goodwill. Determining the fair value of such items requires judgment, including estimating future cash flows or estimating the cost to recreate an acquired asset. If actual results are lower than estimates, we could be required to record impairment charges in the future. Acquired intangible assets are amortized over their estimated useful lives. Intangible assets with indefinite lives are not amortized but rather tested for impairment annually, or more frequently if circumstances exist which indicate an impairment may exist.

Acquisition-related expenses and restructuring costs are expensed as incurred. During the one-year period beginning with the acquisition date, we may record certain purchase accounting adjustments related to the fair value of assets acquired and liabilities assumed against goodwill. After the final determination of the fair value of assets acquired or liabilities assumed, any subsequent adjustments are recorded to our consolidated statements of operations. Subsequent to the measurement period, our final determination of any acquired tax attributes value will affect our provision for income taxes in our consolidated statement of operations and could have a material impact on our results of operations and financial position. We record changes in the fair value of contingent consideration liabilities within operating expenses in our consolidated statement of operations each reporting period.

Table of Contents

Unaudited Interim Financial Information

The accompanying interim consolidated balance sheet as of June 30, 2013, the interim consolidated statements of operations and, the interim consolidated statements of comprehensive income (loss) for the three and six months ended June 30, 2013 and 2012, and the interim consolidated statements of cash flows for the three and six months ended June 30, 2013 and 2012 and the related footnote disclosures are unaudited. These unaudited consolidated interim financial statements have been prepared in accordance with U.S. GAAP. In management s opinion, the unaudited consolidated interim financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments of a normal recurring nature necessary for the fair presentation of the Company s statement of financial position and operating results for the periods presented. The results for the three and six months ended June 30, 2013 are not necessarily indicative of the results expected for the full fiscal year or any other future period.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and notes thereto. Significant estimates and assumptions reflected in the financial statements include, but are not limited to, the estimated lives of virtual goods that we use for revenue recognition, useful lives of property and equipment and intangible assets, accrued liabilities, income taxes, accounting for business combinations, stock-based expense and evaluation of goodwill, intangible assets, and long-lived assets for impairment. Actual results could differ materially from those estimates.

2. Marketable Securities

The following tables summarize our amortized cost, gross unrealized gains and losses and fair value of our available-for-sale investments in marketable securities (in thousands):

	June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value
U.S. government and government agency debt securities	$ 445,676	$ 117	$ (166)	$ 445,627
Corporate debt securities	849,711	221	(961)	848,971
Municipal securities	20,984	8		20,992
Total	$ 1,316,371	$ 346	$ (1,127)	$ 1,315,590

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value
U.S. government and government agency debt securities	$ 464,517	$ 303	$ (5)	$ 464,815
Corporate debt securities	795,962	524	(170)	796,316
Municipal securities	5,234		(1)	5,233
Total	$ 1,265,713	$ 827	$ (176)	$ 1,266,364

For more detail on our method for determining the fair value of our assets, see Note 3 Fair Value Measurements

Table of Contents

The estimated fair value of available-for-sale marketable securities, classified by their contractual maturities was as follows (in thousands):

	June 30, 2013
Due within one year	$ 897,935
After one year through three years	417,655
Total	$ 1,315,590

Changes in market interest rates and bond yields cause certain of our investments to fall below their cost basis, resulting in unrealized losses on marketable securities. As of June 30, 2013, we had unrealized losses of $1.1 million related to marketable securities that had a fair value of $610.6 million. As of December 31, 2012, we had unrealized losses of $0.2 million related to marketable securities that had a fair value of $417.7 million. None of these securities were in a continuous unrealized loss position for more than 12 months.

As of June 30, 2013 and December 31, 2012, we did not consider any of our marketable securities to be other-than-temporarily impaired. When evaluating our investments for other-than-temporary impairment, we review factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer, our ability and intent to hold the security and whether it is more likely than not that we will be required to sell the investment before recovery of its cost basis.

3. Fair Value Measurements

Our financial instruments consist of cash equivalents, short-term and long-term marketable securities and accounts receivable. Accounts receivable, net is stated at its carrying value, which approximates fair value.

Cash equivalents and short-term and long-term marketable securities, consisting of money market funds, U.S. government and government agency debt securities, municipal securities and corporate debt securities, are carried at fair value, which is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between knowledgeable and willing market participants.

Interest rate swaps are estimated using expected future cash flows related to our interest rate swap agreement, appropriately discounted considering the uncertainties associated with the obligation, and as calculated in accordance with the terms of the loan agreement and interest rate swap agreement. We determine the fair value of our interest rate swap by comparing the future discounted cash flows of the swap agreement based on its stated rate to the future discounted cash flows based on current market interest rates.

Contingent consideration represents the estimated fair value of the additional variable cash consideration payable in connection with our acquisition of Spooky Cool Labs LLC that is contingent upon the achievement of certain performance milestones. We estimated the fair value of the acquisition-related contingent consideration payable using probability-weighted discounted cash flow models, and applied a discount rate that appropriately captures a market participant s view of the risk associated with the obligations. The significant unobservable inputs used in the fair value measurement of the acquisition-related contingent consideration payable are forecasted future cash flows and the probability assumptions associated with such cash flows. Significant changes in actual and forecasted future cash flows may result in significant charges or benefits to our future operating expenses.

Fair value is a market-based measurement that should be determined based on assumptions that knowledgeable and willing market participants would use in pricing an asset or liability. We use a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Includes inputs, other than Level 1 inputs, that are directly or indirectly observable in the marketplace.

Level 3 Unobservable inputs that are supported by little or no market activity.

Table of Contents

The composition of our financial instruments among the three Levels of the fair value hierarchy are as follows (in thousands):

	June 30, 2013			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds (1)	$ 99,913	$	$	$ 99,913
U.S. government and government agency debt securities		445,629		445,629
Corporate debt securities (1)		850,208		850,208
Municipal securities (1)		24,944		24,944
Total	$ 99,913	$ 1,320,781	$	$ 1,420,694
Liabilities:				
Contingent consideration	$	$	$ 10,790	$ 10,790

	December 31, 2012			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds (1)	$ 226,993	$	$	$ 226,993
U.S. government and government agency debt securities		464,815		464,815
Corporate debt securities (1)		818,167		818,167
Municipal securities (1)		5,234		5,234
Total	$ 226,993	$ 1,288,216	$	$ 1,515,209
Liabilities:				
Interest rate swap agreements	$	$ 2,423	$	$ 2,423

(1) Includes amounts classified as cash and cash equivalents.

4. Property and Equipment

Property and equipment consist of the following (in thousands):

	June 30, 2013	December 31, 2012
Computer equipment	$ 261,300	$ 294,208
Software	27,217	28,594
Land		