

ZYNGA INC  
Form 10-K  
February 21, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 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**  
**(State or Other Jurisdiction of**

**42-1733483**  
**(I.R.S. Employer**

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Incorporation or Organization)

Identification Number)

699 Eighth Street

San Francisco, CA 94103

(Address of Principal Executive Offices) (Zip Code)

(855) 449-9642

(Registrant's Telephone Number, including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:

Name of each exchange on which registered:

Class A Common Stock, par value \$.00000625 per share

The Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ☐ 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 ☒ 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 ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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 ☒

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 ☒

The aggregate market value of the voting stock held by non-affiliates of the registrant on June 30, 2013, based upon the closing price of \$2.78 of the registrant's Class A Common Stock as reported on the NASDAQ Global Select Market, was approximately \$1.903 billion, which excludes 118.1 million shares of the registrant's common stock held on June 30, 2013 by current executive officers, directors, and stockholders that the registrant has concluded are affiliates of the registrant.

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As of February 14, 2014, there were 730,851,627 shares of the registrant's Class A common stock outstanding, 125,516,497 shares of the registrant's Class B common stock outstanding and 20,517,472 shares of the registrant's Class C common stock outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the 2014 Annual Meeting of Stockholders are incorporated herein by reference in Part III of this Annual Report on Form 10-K to the extent stated herein. The proxy statement will be filed with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended December 31, 2013.

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**Zynga Inc.**

**Form 10-K**

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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 MUPs mean monthly unique payers in 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.

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**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K contains forward-looking statements. In some cases you can identify these statements by forward-looking words such as believe, may, will, might, estimate, continue, anticipate, intend, could, should, would, project, plan, similar 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;

our relationship with any other partners or platform providers;

our ability to successfully acquire and integrate companies and assets, including but not limited to our recently completed acquisition of NaturalMotion Limited ( NaturalMotion );

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

our ability to sustain and expand 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 categories;

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;

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;

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

our estimated savings and charges associated with our restructuring efforts;

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.

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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 Annual Report on Form 10-K. Moreover, we operate in a very competitive and rapidly changing environment and industry. New risks may also 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 Annual Report on Form 10-K 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.

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**PART I**

**ITEM 1. BUSINESS**

**Overview**

Zynga Inc. ( Zynga, we or the Company ) is a leading provider of social game services. We develop, market and operate social games as live services played over the Internet, social networking sites and mobile platforms. Our games are accessible on Facebook and other social networks, mobile platforms and Zynga.com. Generally, all of our games are free to play, and we generate revenue through the in-game sale of virtual goods, mobile game download fees and advertising services.

We are a pioneer and innovator of social games and a leader in making play a core activity on the Internet. We believe our leadership position in social games is the result of our significant investment in our people, content, brand, technology and infrastructure. Our leadership position in social games is defined by the following:

***Engaged and Global Community of Players.*** According to AppData, as of December 31, 2013, we had three of the top 10 games on Facebook based on DAUs. Our players are also highly engaged, with our games being played by 27 million DAUs, worldwide, as of December 31, 2013.

***Leading Portfolio of Social Games.*** We have many of the most popular and successful online social games, including the *FarmVille*, *Words With Friends* and *Zynga Poker* franchises.

***Scalable Technology and Data.*** We process and serve more than 300 terabytes of content for our players every day. We continually analyze game data to optimize our games. We believe that combining data analytics with creative game design enables us to create a superior player experience.

On mobile platforms, we have several popular game franchises, including *Words With Friends* and *Zynga Poker*. Two mobile games we released in 2013 *Running With Friends*, rebranded as *Stampede Run*, and *Solstice Arena* received Apple's Editor's Choice honors, demonstrating our commitment to developing high quality mobile social games.

We leverage our scale to increase player engagement, cross-promote our portfolio of games, continually enhance existing games, launch new games and build the Zynga brand. We believe our scale results in network effects that deliver compelling value to our players, and we are committed to making significant investments to grow our community of players, their engagement and monetization over time.

Consistent with our free-to-play business model, a small portion of our players have historically been payers. During the three months ended December 31, 2013, we had approximately 1.3 million MUPs (excluding payers who use certain payment methods for which unique payer data is not available). Because the opportunity for social interactions increases as the number of players increases, we believe that maintaining and growing our overall number of players, including the number of players who may not purchase virtual goods, is important to the success of our business. As a result, we believe that the number of players who choose to purchase virtual goods will continue to constitute a small portion of our overall players.

Our top three games historically have contributed the majority of our revenue. Our top three games accounted for 54%, 55% and 57% of our online game revenue in 2013, 2012 and 2011, respectively.

On February 11, 2014, we completed the acquisition of 100% of the equity interests in NaturalMotion pursuant to the share purchase agreement, dated January 30, 2014, by and among us, Zynga Game International Limited, NaturalMotion, NaturalMotion's shareholders and Shareholder Representative Services LLC, as sellers' representative. NaturalMotion's shareholders and vested option holders received an aggregate of \$391 million in cash and 39.8 million shares of our Class A common stock.



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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 Asia and Europe. We were originally organized in April 2007 and 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. As of December 31, 2013, we had 2,034 full-time employees.

While 2013 was a challenging year for the Company, we believe we exit 2013 well-positioned to meet our near-term and long-term objectives and execute on our corporate strategy. In 2014, we intend to continue to drive efficiencies to align our cost structure with our strategic initiatives. In 2013, in addition to enhancing our executive management team, we reduced our capital expenditures by \$90.2 million (excluding the purchase of our headquarters building in 2012), reduced headcount by over 1,000 employees, and reduced total costs and expenses by \$525.3 million.

### **Our Social Games**

We design our social games to provide players with shared experiences that surprise and delight them. Our social games leverage the global connectivity and distribution on Facebook and other Internet-based social networks, Zynga.com, and on mobile platforms including Apple's App Store for iOS devices and the Google Play App Store for Android devices. Our games are generally free to play, span a number of categories and attract a community of players that is demographically and geographically diverse. We operate our games as live services and update them with fresh content and new features to make them more social, enhance player engagement and improve monetization. We analyze the data generated by our players' game play and social interactions to guide the creation of new content and features. We use this ongoing feedback loop to keep our games compelling and enhance the player experience.

We generate revenue from the following online services:

#### ***Virtual Goods and Paid Downloads***

Our primary revenue source is the sale of virtual currency that players use to buy in-game virtual goods. Virtual currency can also be earned for free through game play or by accepting promotional offers from our advertising partners. We also generate revenue when players purchase mobile game downloads.

#### ***Advertising***

Our advertising services offer creative ways for marketers and advertisers to reach and engage with our players. The goal of our engagement-based advertising is to enhance the player experience while delivering real value to advertisers. Our advertising offerings include:

*Branded Virtual Goods and Sponsorships* that integrate advertising within game play;

*Engagement Ads and Offers* in which players can answer certain questions, watch-to-earn engagements or sign up for third party services to receive virtual currency;

*Mobile Ads* through ad-supported free versions of our mobile games, such as *Words with Friends*;

*Display Ads* in our online web games that include banner advertisements; and

*Licensing* our brands.

### **Our Strategy**

Our mission is to connect the world through games. In pursuit of our mission, we encourage entrepreneurship and intelligent risk-taking to produce great games and breakthrough innovations. Our goal from a content perspective is to create top hits that engage mainstream global

audiences.

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In 2014, we expect to move aggressively into new game categories that align with the timeless entertainment categories that consumers care about.

We believe expanding our offerings across several game categories is critical to our success. We plan to invest in several game categories, including the following:

***Farm.*** Represented by our market-leading web games such as *FarmVille* and *FarmVille 2*, these games allow our players to express their personalities by customizing the appearances of their characters. We aspire to bring this category to our players on mobile devices in 2014.

***Casino.*** *Zynga Poker* was our first social game and is the largest free-to-play online poker game in the world. We also launched *Hit it Rich Slots* in the third quarter of 2013 and made this game accessible on iPad devices in the fourth quarter of 2013.

***Words.*** Includes one of our most popular mobile-game titles in *Words With Friends*. Games in this category provide chances for friendly competition and allow our players to quickly connect with friends and family when they start a game and to build and enhance these relationships throughout the game experience.

***Racing.*** We recently entered into this category with our February 2014 acquisition of NaturalMotion, developer of *CSR Racing*, and aspire to work with NaturalMotion to enhance our product offering in this category.

***People Simulation.*** We also recently entered into this category with NaturalMotion's *Clumsy Ninja*, a popular mobile game that was downloaded 10 million times in its first week of its November 2013 launch according to Apple.

We also intend to invest in other strategic categories in the future.

## **Our Content**

***Make Games Free, Accessible and Fun.*** We operate our games as live services that are available anytime and anywhere. We design our social games to provide players with easy access to shared experiences that delight, amuse and entertain, and we will continue to update our games on an ongoing basis with fresh content and new features to make them more social and fun for our players.

***Sustain and Grow Existing Franchises.*** We will continue to enhance our market-leading franchises including *FarmVille*, *Words with Friends* and *Casino*. We regularly update our games after launch to encourage social interactions, add new content and features and seek to improve monetization.

***Create New Hits.*** We will continue to invest in building new games to expand the categories of games that we offer to make our best titles available to players on multiple platforms so they can access our games anytime on their various devices.

***Growth on Mobile.*** We believe there is a large opportunity to extend our brand and games to mobile platforms including Apple iOS and Google Android. We aspire to bring our popular *FarmVille* franchise to our mobile audience in 2014. We also believe our recently completed acquisition of NaturalMotion accelerates our mobile game strategy and adds titles in various strategic game categories.

## **Our Network**

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Players progress faster in their games by connecting with friends and other players in our network to instantly get what they need to complete quests, obtain virtual items and enhance their experience. We aspire to leverage our existing and new games to bring the best social playing experiences to our audience, starting with our *Words With Friends* players, and further broaden to other games to ultimately create the best experience for play that includes mobile and web players.

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### **Technology and Tools**

We have invested extensively in developing our proprietary technology stack, which has the ability to handle sudden bursts of activity for millions of players over a short period of time with high levels of performance and reliability. Our proprietary technology stack includes datacenter and cloud computing management, a shared code base, network and cross-promotional features and proprietary data analytics. Our technology stack also supports the growth of our 2D and 3D game engines across the mobile business in addition to supporting high-level security and anti-fraud infrastructure. We believe that investing in technology tools, including the simulation technologies we recently acquired with our purchase of NaturalMotion, can be a competitive advantage and we will continue to innovate and optimize in these areas to cost-effectively ensure high performance and availability of our social games as well as extend our technology leadership.

### **Marketing**

We acquire most of our players through unpaid channels by cross-promoting new games to our existing audience. We have been able to build a large community of players through the viral and sharing features provided by social networks, the social innovations in our games and the network effects of our games.

We are committed to connecting with our players. We have fan pages, generally on Facebook, for each of our games to connect with our players; and we leverage various other forms of social media, including Twitter, to communicate with them. We periodically host live and online player events. We also advertise our games on networks such as Facebook via various in-app advertising partners. In 2013 and 2012, we spent \$60.6 million and \$102.2 million, respectively, on these player acquisition costs.

### **Agreements with Facebook**

To date, we have derived a significant portion of our bookings (69% in 2013) and revenue (75% in 2013) and acquired a significant number of our players from our games played on Facebook. We have entered into two addenda to Facebook's standard terms of service that govern the distribution, promotion and operation of our games through the Facebook platform. Our first addendum required us to use Facebook Credits as the primary payment method for any of our games that are either on the Facebook platform or that utilize the data from the Facebook social graph, and requires Facebook to remit to us an amount equal to 70% of the price we requested to be charged to our players. The second addendum obligated us to use Facebook Credits as the sole in-game payment mechanism in any games launched on our own social gaming network, and entitled Facebook to retain 30% of the stated price for transactions on our network. The second addendum also required us to use Facebook as the exclusive social platform for the Zynga properties and to exclusively launch certain of our games on the Facebook platform for up to twelve months following such addendum, subject to certain exceptions.

In June 2012, Facebook announced its plans to discontinue the use of Facebook Credits and instead would offer pricing of our virtual goods in local currencies. Facebook continues to retain 30% of the requested price for transactions on their platform under the terms of their new payments program. We completed our transition away from Facebook Credits and our adoption of Facebook's local currency-based payments model in our games in the fourth quarter of 2013.

On November 28, 2012, we amended our agreements with Facebook such that our use of the Facebook platform and any data from Facebook on any Zynga service offered through a Zynga game page (for example, on Zynga.com) were governed by Facebook's standard terms of service beginning on March 31, 2013. Under the current terms of service, we are limited in our ability to use a Facebook user's friends list and Facebook's communication channels to promote Zynga.com. In December 2012, Facebook amended its standard terms of service to prohibit (i) apps on the Facebook canvas from promoting or linking to game sites other than Facebook and (ii) the use of emails obtained from Facebook to promote or link to desktop web games on platforms other than Facebook. We are prohibited from cross-promoting traffic to games that are offered on platforms other than Facebook from our games on Facebook. We are not permitted to use e-mail addresses obtained from Facebook to promote desktop web games that are not on the Facebook platform, subject to certain limited exceptions.

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As of March 31, 2013, we are no longer obligated to display Facebook advertising units or utilize Facebook's payment services (Facebook Credits and/or local-currency based payments) on any Zynga game pages. We have the right to process our own payments, and Facebook no longer has the right to receive 30% of the proceeds from payments made on Zynga.com (or any other platforms or social networks other than Facebook).

In addition, as of March 31, 2013, we are no longer required to use Facebook as the exclusive social platform for Zynga properties, and are no longer required to grant certain title exclusivities of Zynga games on the Facebook platform, subject to certain exceptions. However, any social game launched after March 31, 2013 by Zynga will generally be available through the Facebook web site concurrent with, or shortly following, the time such game is made available on another social platform or a Zynga property.

The addenda, including our recent amendments, with Facebook will each expire in 2015. Our current agreements with Facebook allow our users to use Zynga/Facebook co-branded game cards for redemption in our games on Facebook and also allow for our own Zynga game cards, which were previously printed and delivered to our distributors and retailers, to continue to be sold to game players until all such cards are sold. We do not plan to print and sell more of our own cards for redemption on the Facebook platform, however, since March 31, 2013, we have the right to sell our own game cards on other platforms, including on Zynga.com.

## **Intellectual Property**

Our business is significantly based on the creation, acquisition, use and protection of intellectual property. Some of this intellectual property is in the form of software code, patented technology and trade secrets that we use to develop our games and to enable them to run properly on multiple platforms. Other intellectual property we create includes product and feature names and audio-visual elements, including graphics, music, story lines and interface design.

While most of the intellectual property we use is created by us, we have acquired rights to proprietary intellectual property. We have also obtained rights to use intellectual property through licenses and service agreements with third parties. These licenses typically limit our use of intellectual property to specific uses and for specific time periods.

We protect our intellectual property rights by relying on federal, state and common law rights, as well as contractual restrictions. We actively seek patent protection covering inventions originating from the company and acquire patents we believe may be useful or relevant to our business. We control access to our proprietary technology by entering into confidentiality and invention assignment agreements with our employees and contractors, and confidentiality agreements with third parties. We also actively engage in monitoring and enforcement activities with respect to infringing uses of our trademarks, copyrights, and domain names by third parties.

In addition to these contractual arrangements, we also rely on a combination of trade secret, copyright, trademark, trade dress, domain name and patents to protect our games and other intellectual property. We typically own the copyright to the software code to our content, as well as the trademark for the brand or title under which our games are marketed. We pursue the registration of our domain names, copyrights, trademarks, patents, and service marks in the United States and, for some, in locations outside the United States. Our registered trademarks in the United States include Zynga and the names of our games, among others.

Circumstances outside our control could pose a threat to our intellectual property rights. For example, effective intellectual property protection may not be available in the United States or other countries in which our games are distributed. Also, the efforts we have taken to protect our proprietary rights may not be sufficient or effective. Any significant impairment of our intellectual property rights could harm our business or our ability to compete. Also, protecting our intellectual property rights is costly and time-consuming. Any unauthorized disclosure or use of our intellectual property could make it more expensive to do business, thereby harming our operating results.

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Companies in the Internet, games, social media, technology and other industries may own large numbers of patents, copyrights and trademarks and may frequently request license agreements, threaten litigation or file suit against us based on allegations of infringement or other violations of intellectual property rights. From time to time, we have faced, and we expect to face in the future, allegations by third parties, including our competitors and non-practicing entities, that we have infringed their copyrights, trademarks, patents and other intellectual property rights. As we face increasing competition and as our business grows, including into new areas, we will likely face more claims of infringement.

### **Competition**

We face significant competition in all aspects of our business. Specifically, we compete for the leisure time, attention and discretionary spending of our players with other social game developers on the basis of a number of factors, including quality of player experience, brand awareness and reputation and access to distribution channels.

We believe we compete favorably on these factors. However, our industry is evolving rapidly and is becoming increasingly competitive. Other developers of social games could develop more compelling content that competes with our social games and adversely affects our ability to attract and retain players and their entertainment time. These competitors, including companies of which we may not be currently aware, may take advantage of social networks, access to a large user base and their network effects to grow rapidly and virally.

Our competitors include:

*Developers for Web and Mobile Games:* We face competition from a number of competitors who develop web and mobile games. These competitors, some of which have significant financial, technical and other resources, greater name recognition and have longer operating histories, may create similar games to reach our players. The mobile game sector specifically is characterized by frequent product introductions, rapidly emerging mobile platforms, new technologies and new mobile application storefronts. Some of these competitors include Electronic Arts Inc., King.com, and The Walt Disney Company, DeNA Co. Ltd., Gameloft, Glu Mobile, GREE International Inc., Gungho Online Entertainment Inc., Kabam, Rovio Mobile Ltd. and Supercell. Because our games are free to play, we compete primarily on the basis of player experience rather than price. We also expect new competitors to enter the market and existing competitors to allocate more resources to develop and market competing games and applications.

*Other Game Developers:* Our players may also play other games on personal computers and consoles, some of which include social features that compete with our social games and have community functions where game developers can engage with their players. Some of these competitors include Activision Blizzard, Inc., Electronic Arts, Riot Games, Valve, Take-Two Interactive, SEGA of America, Inc. and The Walt Disney Company.

*Other Forms of Media and Entertainment:* We compete more broadly for the leisure time and attention of our players with providers of other forms of Internet and mobile entertainment, including social networking, online casual entertainment and music. To the extent existing or potential players choose to read, watch or listen to online content or streaming video or radio, play interactive video games at home or on their computer or mobile devices rather than play social games, these content services pose a competitive threat.

### **Our Mission and Core Commitments**

We were founded on a deeply held passion for games and for family and friends playing together. Our passion for delivering great consumer experiences is at the core of our mission: to connect the world through games. Our mission and our core commitments form the foundation for everything we do: design social games that everyone wants to play, assemble and retain talented teams, prioritize our opportunities and make investment decisions.

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We encourage innovation, the creation of compelling game experiences and moving with a sense of urgency to capitalize on our opportunities for our success and the benefit of our players. These factors are critical to extending our leadership position as we seek to continue building successful franchises. We remain steadfast in our commitment to surprise and delight our players. We believe our unique company culture serves as the foundation of our success. Our core commitments help guide the company and we believe will help us deliver on our following commitments:

Grow and sustain proven hits

Create new hits

Growth on mobile

Build our network

Drive efficiencies

### **Research and Development**

We believe continued investment in enhancing existing games and developing new games, and in software development tools and code modification, is important to attaining our strategic objectives. Our research and development expenses were \$413.0 million, \$645.6 million and \$727.0 million in 2013, 2012 and 2011, respectively, which included stock-based expense of \$61.9 million, \$200.6 million and \$374.9, respectively.

### **Government Regulation**

We are subject to a number of foreign and domestic laws and regulations that affect companies conducting business on the Internet, many of which are still evolving and could be interpreted in ways that could harm our business. In the United States and internationally, laws relating to the liability of providers of online services for activities of their users and other third parties are currently being tested by a number of claims, including actions based on invasion of privacy and other torts, unfair competition, copyright and trademark infringement, and other theories based on the nature and content of the materials searched, the ads posted, or the content provided by users. Any court ruling or other governmental action that imposes liability on providers of online services for the activities of their users and other third parties could harm our business. We are potentially subject to a number of foreign and domestic laws and regulations that affect the offering of certain types of content, such as that which depicts violence, many of which are ill defined, still evolving and could be interpreted in ways that could harm our business or expose us to liability.

In addition, rising concern about the use of social networking technologies for illegal conduct, such as the unauthorized dissemination of national security information, money laundering or supporting terrorist activities may in the future produce legislation or other governmental action that could require changes to our games or restrict or impose additional costs upon the conduct of our business.

Some of our games or features are based upon traditional casino games, such as poker. We have structured and operate these games and features, including *Zynga Poker*, with the gambling laws in mind and believe that these games or features do not constitute gambling.

We also offer our players various types of sweepstakes, giveaways and promotion opportunities. We are subject to laws in a number of jurisdictions concerning the operation and offering of such activities, many of which are still evolving and could be interpreted in ways that could harm our business. Any court ruling or other governmental action that imposes liability on providers of online services could result in criminal or civil liability and could harm our business.

In the area of information security and data protection, many states have passed laws requiring notification to users when there is a security breach for personal data, such as the 2002 amendment to California's Information Practices Act, or requiring the adoption of minimum



information security standards that are often

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vaguely defined and difficult to implement. The costs of compliance with these laws may increase in the future as a result of changes in interpretation. Furthermore, any failure on our part to comply with these laws may subject us to significant liabilities.

We are also subject to federal, state and foreign laws regarding privacy and protection of player data, including the collection of data from minors. We post our Privacy Policy and Terms of Service online, in which we describe our practices concerning the use, transmission and disclosure of player data. Any failure by us to comply with our posted privacy policy or privacy related laws and regulations could result in proceedings against us by governmental authorities or others, which could harm our business. In addition, the interpretation of many data protection laws, and their application to the Internet is unclear and in a state of flux. There is a risk that these laws may be interpreted and applied in conflicting ways from state to state, country to country, or region to region, and in a manner that is not consistent with our current data protection practices. Complying with these varying international requirements could cause us to incur additional costs and change our business practices. Further, any failure by us to adequately protect our players' information and data could result in a loss of player confidence in our services and ultimately in a loss of players, which could adversely affect our business.

With the move of our services to mobile devices, we are also subject to additional regulations regarding communication via this channel, such as the Telephone Consumer Protection Act (TCPA). The interpretation of many of these laws, including the TCPA, and their application to current means of communication through mobile devices is unclear and in a state of flux. These laws may be interpreted and applied in a manner that is not consistent with current industry practices. The costs of compliance with these laws may increase in the future as a result of changes in interpretation and may greatly reduce our ability to contact our players through this channel. Furthermore, failure on our part to comply with these laws may subject us to significant liabilities.

In addition, some concern has been expressed in Europe and in certain countries that social gaming should be regulated to protect consumers, in particular minors and persons susceptible to addiction to social games. This concern could lead to the adoption of legislation or regulations that may impose additional burdens upon us, prohibit the offering of our games to certain users or territories, increase our costs or require changes to our games.

Also, because our services are accessible worldwide, certain foreign jurisdictions have claimed and others may claim that we are required to comply with their laws, including in jurisdictions where we have no local entity, employees or infrastructure.

Separately, we have a partnership agreement with bwin.party to develop, test and operate certain real money online poker and casino games in the United Kingdom. The real money games are powered by the established operating platform and software of bwin.party and operate under bwin.party's gambling licenses in the applicable jurisdictions. Previously in December 2012, we filed an Application for a Preliminary Finding of Suitability with the Nevada Gaming Control Board, but have since withdrawn this application.

## **Available Information**

Our website is located at [www.zynga.com](http://www.zynga.com), and our investor relations website is located at <http://investor.zynga.com>. The following filings are available through our investor relations website after we file them with the SEC: Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and our Proxy Statements for our annual meetings of stockholders, for the last year. These filings are also available for download free of charge on our investor relations website. Further, a copy of this Annual Report on Form 10-K is located at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330.

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We webcast our earnings calls and certain events we participate in or host with members of the investment community on our investor relations website. Additionally, we provide notifications of news or announcements regarding our financial performance, including SEC filings, investor events, press and earnings releases as part of our investor relations website. Investors and others can receive notifications of new information posted on our investor relations website in real time by signing up for email alerts and RSS feeds. Further corporate governance information, including our certificate of incorporation, bylaws, governance guidelines, board committee charters, and code of conduct, is also available on our investor relations website under the heading Corporate Governance. The contents of our websites are not incorporated by reference into this Annual Report on Form 10-K or in any other report or document we file with the SEC, and any references to our websites are intended to be inactive textual references only.

### **ITEM 1A. RISK FACTORS**

*We have identified the following risks and uncertainties that may have a material adverse effect on our business, financial condition or results of operations. The risks described below are not the only ones we face. Additional risks not presently known to us or that we currently believe are not material may also significantly impair our business operations. Our business could be harmed by any of these risks. The trading price of our Class A common stock could decline due to any of these risks, and you may lose all or part of your investment. In assessing these risks, you should also refer to the other information contained in this Annual Report on Form 10-K, including our consolidated financial statements and related notes.*

#### **Risks Related to Our Business and Industry**

***If our distribution channels or platform providers change their standard terms and conditions for developers in a way that is detrimental to us, our business will suffer.***

Facebook is currently the primary distribution, marketing, promotion and payment platform for our games. To date, we have derived a significant portion of our bookings (69% in the twelve months ended December 31, 2013) and revenue (75% in the twelve months ended December 31, 2013) and acquired a significant number of our players through Facebook. Except for certain limited addenda, we are subject to Facebook's standard terms and conditions for application developers, which govern the promotion, distribution between us and Facebook and operation of games and other applications on the Facebook platform, and which are subject to change by Facebook at its sole discretion at any time. If Facebook changes its standard terms and conditions in a way that is detrimental to us, our business would be harmed and our operating results would be adversely affected.

Our business may be harmed if:

Facebook discontinues or limits access to its platform by us;

Facebook terminates or seeks to terminate our contractual relationship altogether;

Facebook prohibits us from offering our games on the Facebook platform because it determines that we are a competitor or for other reasons;

Facebook modifies its terms of service or other policies, including fees charged to, or other restrictions on, us, other application developers, or Facebook changes how the personal information of its users is made available to application developers on the Facebook platform or shared by users;

Facebook establishes more favorable relationships with one or more of our competitors; or

Facebook develops its own competitive offerings.

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In addition, we have benefited from Facebook's strong brand recognition and large user base. If Facebook loses its market position or otherwise falls out of favor with Internet users or other factors cause its user base to stop growing or shrink, we would need to identify alternative channels for marketing, promoting and distributing our games, which would consume substantial resources and may not be effective, or available at all.

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Facebook has broad discretion to change its terms of service and other policies with respect to us and other developers, and those changes may be unfavorable to us. Facebook may also change its fee structure, add fees associated with access to and use of the Facebook platform, alter how we are able to advertise on the Facebook platform, change how the personal information of its users is made available to application developers on the Facebook platform or restrict how Facebook users can share information with friends on their platform or across platforms other than Facebook. For instance, beginning in early 2010, Facebook changed its policies for application developers regarding use of its communication channels. These changes limited the level of communication among users about applications on the Facebook platform. As a result, the number of our players on Facebook declined. Although our current agreements with Facebook allow our users to use Zynga-branded game cards in our games on Facebook until all such existing game cards are sold, our future bookings and revenue may be negatively impacted during this transition period and upon the expiration of our game card program. Any such changes in the future could significantly alter how players experience or interact within our games, which may harm our business.

Our social games also leverage the global connectivity and distribution of mobile platforms including Apple's App Store for iOS devices and the Google Play App Store for Android devices. We are subject to the terms of service of these third party platforms, which could be changed by such platform providers at any time. Such changes may decrease the visibility or availability of our games, limit our distribution capabilities, prevent access to our existing games, reduce the amount of revenue we may recognize from in-game purchases, or result in the exclusion of our games on such third party platforms. Any such changes could significantly harm our business in both the short-term and long-term.

### ***Our revenue, bookings and operating margins may decline.***

The industry in which we operate is highly competitive and rapidly changing, and relies heavily on successful product launches and compelling content, products and services. As such, if we fail to deliver such content, products and services or do not execute our strategy successfully, our revenue and bookings may decline. In addition, we believe that our operating margin will continue to experience downward pressure as a result of increasing competition. We expect to continue to expend substantial financial and other resources on game development, including mobile games, the expansion of our network, international expansion and our network infrastructure. Our operating costs will increase if we do not effectively manage costs. In addition, weak economic conditions or other factors could cause our business to contract, requiring us to implement significant additional cost cutting measures, including a decrease in research and development, which could harm our long-term prospects.

### ***Our quarterly operating results are volatile and difficult to predict, and our stock price may decline if we fail to meet the expectations of securities analysts or investors.***

Our bookings, revenue, player traffic and operating results could vary significantly from quarter-to-quarter and year-to-year and may fail to match our past performance or the expectations of securities analysts or investors because of a variety of factors, some of which are outside of our control. Any of these events could cause the market price of our Class A common stock to fluctuate. Factors that may contribute to the variability of our operating results include the risk factors listed in these Risk Factors and the factors discussed in the section titled Management's Discussion and Analysis of Financial Condition and Results of Operations Factors Affecting Our Performance.

In particular, we recognize revenue from the sale of our virtual goods in accordance with United States Generally Accepted Accounting Principles ( U.S. GAAP ), which is complex and based on our assumptions and historical data with respect to the sale and use of various types of virtual goods. In the event that such assumptions are revised based on new data or there are changes in the historical mix of virtual goods sold due to new game introductions, reduced virtual good sales in existing games or other factors or there are changes in our estimates of average playing periods and player life, the amount of revenue that we recognize in any particular

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period may fluctuate significantly. In addition, changes in the policies of Facebook, Apple or other third party platforms or accounting policies promulgated by the SEC and national accounting standards bodies affecting software and virtual goods revenue recognition could further significantly affect the way we report revenue related to our products. For example, we recognize revenue net of the amounts retained by Facebook related to Facebook Credits and local-currency transactions sold to the players of our games on Facebook under the terms of our agreement with Facebook. Such changes could have an adverse effect on our reported revenue, net income and earnings per share under U.S. GAAP. Additionally, NaturalMotion Limited, a company we recently acquired, reported its historical financial statements in accordance with U.K. GAAP, and we may have difficulty in reporting its financial results in accordance with our revenue recognition policies, which could have a negative effect on our reported financial results. For further information regarding our revenue recognition policy, see the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies - Revenue Recognition" in this Annual Report on Form 10-K.

It is difficult to predict when bookings from one of our games will begin to decline, as well as the decay rate for any particular game. As a result of this decline in the life cycle of our games, our business depends on our ability to consistently and timely launch new games or versions of games that achieve significant popularity and have the potential to become franchise games. If decay rates are higher than expected in a particular quarterly period and/or we experience delays in the launch of new games that we expect to offset these declines, we may not meet our expectations or the expectations of securities analysts or investors for a given quarter.

In addition, we have made in the past and we may make in the future, significant investments or changes in strategy that we think will benefit us in the long term, even if our decision negatively impacts our operating results in the short term. For example, in early 2013, we decided to discontinue development of certain games that were originally expected to be released and then meaningfully contribute to bookings for the second quarter of 2013, in order to focus on games with the potential of becoming franchise games that can drive long-term enterprise value. Although these discontinued games may have offered short-term bookings, we determined that they did not contribute meaningfully to the brand and our strategy in the long term.

Given the rapidly evolving social game industry in which we operate, our historical operating results may not be useful in predicting our future operating results. In addition, metrics we have developed or those available from third parties regarding our industry and the performance of our games, including DAUs, MAUs, MUUs, MUPs and ABPU may not be indicative of our financial performance.

***Our business will suffer if we are unable to continue to develop successful games for mobile platforms or successfully monetize mobile games we develop or acquire.***

Developing games for mobile platforms is an important component of our strategy. We have devoted and we expect to continue to devote substantial resources to the development of our mobile games, and we cannot guarantee that we will continue to develop games that appeal to players or advertisers. We may encounter difficulty in integrating features on games developed for mobile platforms that a sufficient number of players will pay for or otherwise sufficiently monetizing mobile games. Generally, our mobile games monetize at a lower rate than our web-based games and we may not be successful in our efforts to increase our monetization from mobile games. In addition, mobile games that we develop, or that companies we acquire