

GLU MOBILE INC  
Form 10-Q  
May 06, 2016  
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

---

FORM 10-Q

---

(Mark One)

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

For the Quarterly Period Ended March 31, 2016

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 001-33368

---

Glu Mobile Inc.

(Exact name of the Registrant as Specified in its Charter)

---

Delaware                      91-2143667  
(State or Other Jurisdiction of    (I.R.S. Employer  
Incorporation or Organization) Identification No.)

Edgar Filing: GLU MOBILE INC - Form 10-Q

500 Howard Street, Suite 300

San Francisco, California 94105

(Address of Principal Executive Offices, including Zip Code)

(415) 800-6100

(Registrant's Telephone number, including Area Code)

---

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

Shares of Glu Mobile Inc. common stock, \$0.0001 par value per share, outstanding as of May 1, 2016: 132,309,543.



Table of Contents

GLU MOBILE INC.

FORM 10-Q

Quarterly Period Ended March 31, 2016

TABLE OF CONTENTS

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>ITEM 1. FINANCIAL STATEMENTS (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of March 31, 2016 and December 31, 2015</u>	3
<u>Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2016 and Three Months Ended March 31, 2015</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income/(Loss) for the Three Months Ended March 31, 2016 and Three Months Ended March 31, 2015.</u>	5
<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2016 and Three Months ended March 31, 2015.</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	24
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	35
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	37
<u>PART II. OTHER INFORMATION</u>	
<u>ITEM 1. LEGAL PROCEEDINGS</u>	38
<u>ITEM 1A. RISK FACTORS</u>	38
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	63

<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	63
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	63
<u>ITEM 5. OTHER INFORMATION</u>	63
<u>ITEM 6. EXHIBITS</u>	63
<u>SIGNATURES</u>	64

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## GLU MOBILE INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(in thousands, except per share data)

	March 31, 2016	December 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 159,283	\$ 180,542
Accounts receivable, net	16,745	17,956
Prepaid royalties (including prepaid royalties to a related party of \$5,118 and \$7,949 as of March 31, 2016 and December 31, 2015, respectively)	30,412	23,715
Prepaid expenses and other assets	15,205	14,841
Total current assets	221,645	237,054
Property and equipment, net	5,282	5,447
Restricted cash	1,498	1,498
Long-term prepaid royalties (including long-term prepaid royalties to a related party of \$4,882 and \$2,051 as of March 31, 2016 and December 31, 2015, respectively)	46,017	46,944
Other long-term assets	9,317	1,386
Intangible assets, net (including intangible assets acquired from a related party of \$5,000 and \$5,000 as of March 31, 2016 and December 31, 2015, respectively)	20,442	22,767
Goodwill	87,899	87,890
Total assets	\$ 392,100	\$ 402,986
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 9,055	\$ 9,386
Accrued liabilities	1,752	1,996
Accrued compensation	4,504	7,100
Accrued royalties (including accrued royalties to a related party of \$5,118 and \$10,449 as of March 31, 2016 and December 31, 2015, respectively)	14,140	21,032

Edgar Filing: GLU MOBILE INC - Form 10-Q

Deferred revenue	30,750	31,112
Total current liabilities	60,201	70,626
Long-term accrued royalties (including long-term accrued royalties to a related party of \$4,882 and \$2,051 as of March 31, 2016 and December 31, 2015, respectively)	28,193	24,347
Other long-term liabilities	1,397	1,585
Total liabilities	89,791	96,558
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.0001 par value; 5,000 shares authorized at March 31, 2016 and December 31, 2015; no shares issued and outstanding at March 31, 2016 and December 31, 2015	—	—
Common stock, \$0.0001 par value; 250,000 shares authorized at March 31, 2016 and December 31, 2015; 132,229 and 131,580 shares issued and outstanding at March 31, 2016 and December 31, 2015	13	13
Additional paid-in capital	562,373	557,748
Accumulated other comprehensive loss	(279)	(85)
Accumulated deficit	(259,798)	(251,248)
Total stockholders' equity	302,309	306,428
Total liabilities and stockholders' equity	\$ 392,100	\$ 402,986

The accompanying Notes are an integral part of these Unaudited Condensed Consolidated Financial Statements.

Table of Contents

GLU MOBILE INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands, except per share data)

	Three Months Ended March 31,	
	2016	2015
Revenue	\$ 54,528	\$ 69,470
Cost of revenue:		
Platform commissions, royalties and other	20,363	26,310
Amortization of intangible assets	2,324	2,434
Total cost of revenue	22,687	28,744
Gross profit	31,841	40,726
Operating expenses:		
Research and development	20,312	18,243
Sales and marketing	12,624	12,438
General and administrative	7,984	7,406
Amortization of intangible assets	—	127
Restructuring charge	106	—
Total operating expenses	41,026	38,214
Income/(loss) from operations	(9,185)	2,512
Interest and other expense, net:		
Interest income	21	6
Other income/(expense)	448	(290)
Interest and other income/(expense), net	469	(284)
Income/(loss) before income taxes	(8,716)	2,228
Income tax benefit/(provision)	166	(1,104)
Net income/(loss)	\$ (8,550)	\$ 1,124
Net/(loss) income per share:		
Basic	\$ (0.07)	\$ 0.01
Diluted	(0.07)	0.01
Weighted average common shares outstanding:		
Basic	129,171	103,869
Diluted	129,171	107,851



The accompanying Notes are an integral part of these Unaudited Condensed Consolidated Financial Statements.

Table of Contents

GLU MOBILE INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)

(Unaudited)

(in thousands)

	Three Months Ended March 31,	
	2016	2015
Net income/(loss)	\$ (8,550)	\$ 1,124
Other comprehensive loss:		
Foreign currency translation adjustments	(194)	(279)
Other comprehensive loss	(194)	(279)
Comprehensive income/(loss)	\$ (8,744)	\$ 845

The accompanying Notes are an integral part of these Unaudited Condensed Consolidated Financial Statements.

Table of Contents

GLU MOBILE INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	Three Months Ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net income/(loss)	\$ (8,550)	\$ 1,124
Adjustments to reconcile net income/(loss) to net cash used in operating activities:		
Depreciation	656	706
Amortization of intangible assets	2,324	2,561
Mark to market adjustment on long-term investments	(300)	—
Non-cash foreign currency translation (gain)/loss	(148)	290
Stock-based compensation	3,545	2,129
Non-cash warrant expense	9	93
Impairment of prepaid royalties and guarantees	43	—
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable	1,138	7,592
Prepaid royalties	(5,228)	(9,587)
Prepaid expenses and other assets	(634)	1,954
Accounts payable and other accrued liabilities	(259)	(54)
Accrued liabilities	100	—
Accrued compensation	(2,596)	(2,620)
Accrued royalties and license fees (including accrued royalties and license fees to a related party of \$2,500 and \$0 as of March 31, 2016 and March 31, 2015, respectively)	(1,129)	(2,591)
Deferred revenue	(362)	(6,672)
Accrued restructuring	(342)	—
Other long-term liabilities	(57)	(37)
Net cash used in operating activities	(11,790)	(5,112)
Cash flows from investing activities:		
Purchase of property and equipment	(608)	(499)
Net cash paid for acquisitions	—	(351)
Investments in Plain Vanilla Corp. and Dairy Free Games, Inc. (Note 6)	(7,000)	(250)
Purchase of intangible assets (including purchase of intangible assets from a related party of \$2,500 and \$0 as of March 31, 2016 and March 31, 2015, respectively)	(2,500)	—
Net cash used in investing activities	(10,108)	(1,100)
Cash flows from financing activities:		

Edgar Filing: GLU MOBILE INC - Form 10-Q

Proceeds from exercise of stock options and purchases under the ESPP	1,129	1,601
Taxes paid related to net share settlement of equity awards	(577)	(318)
Excess tax benefit from stock awards	—	14
Proceeds from exercise of stock warrants and issuance of common stock	—	10
Net cash provided by financing activities	552	1,307
Effect of exchange rate changes on cash	87	(324)
Net increase/(decrease) in cash and cash equivalents	(21,259)	(5,229)
Cash and cash equivalents at beginning of period	180,542	70,912
Cash and cash equivalents at end of period	\$ 159,283	\$ 65,683

The accompanying Notes are an integral part of these Unaudited Condensed Consolidated Financial Statements.

Table of Contents

GLU MOBILE INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share data)

Note 1 — The Company, Basis of Presentation and Summary of Significant Accounting Policies

Glu Mobile Inc. (the “Company” or “Glu”) was incorporated in Nevada in May 2001 and reincorporated in the state of Delaware in March 2007. The Company develops, publishes, and markets a portfolio of games designed to appeal to a broad cross section of the users of smartphones and tablet devices who download and make purchases within its games through direct-to-consumer digital storefronts, such as the Apple App Store, Google Play Store, Amazon Appstore and others (“Digital Storefronts”). The Company creates games based on its own original brands, games based on celebrities and other well-known brands and properties.

Principles of Consolidation and Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles in the United States (“U.S. GAAP”) for complete financial statements and should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on March 4, 2016. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, which the Company believes are necessary for a fair statement of the Company’s financial position as of March 31, 2016 and its unaudited condensed consolidated results of operations for the three months ended March 31, 2016 and 2015, respectively. These unaudited condensed consolidated financial statements are not necessarily indicative of the results to be expected for the entire year. The unaudited condensed consolidated balance sheet presented as of December 31, 2015 has been derived from the audited consolidated financial statements as of that date, and the unaudited condensed consolidated balance sheet presented as of March 31, 2016 has been derived from the unaudited condensed consolidated financial statements as of that date.

The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated.

Variable Interest Entities

The Company has interests in other entities that are variable interest entities (“VIEs”). Determining whether to consolidate a VIE requires judgment in assessing (i) whether an entity is a VIE and (ii) if the Company is the entity’s primary beneficiary and thus required to consolidate the entity. To determine if the Company is the primary beneficiary of a VIE, the Company evaluates whether it has (i) the power to direct the activities that most significantly impact the VIE’s economic performance and (ii) the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. The Company’s evaluation includes identification of significant activities and an assessment of its ability to direct those activities based on governance provisions and other applicable agreements and circumstances. The Company’s assessment of whether it is the primary beneficiary of its VIEs requires significant assumptions and judgment.

#### Concentration of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash, cash equivalents and accounts receivable.

The Company derives its accounts receivable from revenue earned from customers or through Digital Storefronts located in the United States and other locations outside of the United States. The Company performs ongoing credit evaluations of its customers’ and the Digital Storefronts’ financial condition and requires no collateral from its customers or the Digital Storefronts. The Company bases its allowance for doubtful accounts on management’s best estimate of the

## Table of Contents

amount of probable credit losses in the Company's existing accounts receivable. The Company reviews past due balances over a specified amount individually for collectability on a monthly basis. It reviews all other balances quarterly. The Company charges off accounts receivable balances against the allowance when it determines that the amount will not be recovered.

The following table summarizes the revenue from customers or aggregate purchases through Digital Storefronts that accounted for more than 10% of the Company's revenue for the periods indicated:

	Three Months Ended	
	March 31,	
	2016	2015
Apple	51.3%	53.6%
Google	27.4%	27.3%

At March 31, 2016, Apple Inc. ("Apple") accounted for 40.9%, Google Inc. ("Google") accounted for 20.8%, and Jirbo Inc. (dba AdColony) ("AdColony") accounted for 20.6% of the Company's total accounts receivable. At December 31, 2015, Apple accounted for 31.4%, AdColony accounted for 26.2%, and Google accounted for 19.2% of total accounts receivable. No other customer or Digital Storefront represented more than 10% of the Company's total accounts receivable as of these dates.

## Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU 2016-19 simplifies some aspects of the accounting for share-based payment award transactions, including: (a) income tax consequences, (b) classification of awards as either equity or liabilities, and (c) classification on the statement of cash flows. Early adoption is permitted. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The Company is currently evaluating the effect that the updated standard will have on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers, which amends the principal-versus agent implementation guidance in the new revenue standard (ASU 2014-09), and clarifies that an entity should evaluate whether it is the principal or the agent for each specified good or service promised in a contract

with a customer. The updated standard will replace most existing revenue recognition guidance under U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. Early adoption is permitted. The updated standard will be effective for the Company beginning January 1, 2018. The Company has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. The new guidance requires lessees to recognize most leases as assets and liabilities on the balance sheet. Qualitative and quantitative disclosures will be enhanced to better understand the amount, timing and uncertainty of cash flows arising from leases. The guidance is effective for annual and interim periods beginning after December 31, 2018. The updated standard mandates a modified retrospective transition method with early adoption permitted. The Company is currently evaluating the effect that the updated standard will have on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments — Overall - Recognition and Measurement of Financial Assets and Financial Liabilities." The new guidance requires entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize any changes in fair value in net income unless the investments qualify for a practicability exception. The updated standard is effective for interim and annual reporting periods beginning after December 15, 2017. The Company is currently evaluating the effect that the updated standard will have on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes. The new guidance requires that deferred tax assets and liabilities be classified as noncurrent in a classified statement of financial



Table of Contents

position. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Company early adopted this guidance on a prospective basis as of December 31, 2015. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, Simplifying the Accounting for Measurement-Period Adjustments. The new guidance requires that adjustments made to provisional amounts recognized in a business combination be recorded in the period such adjustments are determined, rather than retrospectively adjusting previously reported amounts. The new standard has been effective for fiscal years, and interim periods within those fiscal years, since December 15, 2015. The adoption of this standard did not have a material impact on the Company's financial statements.

In April 2015, the FASB issued ASU 2015-05, Intangibles-Goodwill and Other-Internal-Use Software. The standard amended the existing accounting standards for intangible assets and provides explicit guidance to customers in determining the accounting for fees paid in a cloud computing arrangement, wherein the arrangements that do not convey a software license to the customer are accounted for as service contracts. The pronouncement has been effective for reporting periods beginning after December 15, 2015. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis. ASU 2015-02 changes the guidance with respect to the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The new standard has been effective for all annual periods, and interim periods within those annual periods, beginning after December 15, 2015. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. The new standard provides guidance around management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosure.

The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. Under this guidance, revenue is recognized when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The updated standard will replace most existing revenue recognition guidance under U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method with early adoption permitted. The updated standard will be effective for the Company beginning January 1, 2018. The Company has not yet selected a transition method and is

currently evaluating the effect that the updated standard will have on its consolidated financial statements.

Note 2 — Net Income/(Loss) Per Share

The Company computes basic net income/(loss) per share by dividing its net income or loss for the period by the weighted average number of common shares outstanding during the period less the weighted average common shares subject to restrictions imposed by the Company. Diluted net income/(loss) per share reflects the potential dilution that could occur from shares of common stock issuable through stock-based compensation plans (including stock options,

Table of Contents

restricted stock units (“RSUs”) and common stock issuable through the Company’s employee stock purchase plan), and warrants by application of the treasury stock method.

	Three Months Ended March 31,	
	2016	2015
Net income/(loss)	\$ (8,550)	\$ 1,124
Shares used to compute net income/(loss) per share:		
Weighted average common shares outstanding	131,870	107,509
Weighted average common shares subject to restrictions	(2,699)	(3,640)
Weighted average shares used to compute basic net income/(loss) per share	129,171	103,869
Dilutive potential common shares	—	3,982
Weighted average shares used to compute diluted net income/(loss) per share	129,171	107,851
Basic net income/(loss) per share	\$ (0.07)	\$ 0.01
Diluted net income/(loss) per share	\$ (0.07)	\$ 0.01

The following weighted average options to purchase common stock, warrants to purchase common stock, unvested shares of common stock subject to restrictions, and RSUs have been excluded from the computation of net income/(loss) per share of common stock for the periods presented because including them would have had an anti-dilutive effect:

	Three Months Ended March 31,	
	2016	2015
Warrants to purchase common stock	4,267	2,439
Unvested common shares subject to restrictions	2,699	3,451
Options to purchase common stock	7,053	5,767
RSUs	7,002	3,573
	21,021	15,230

## Note 3 — Fair Value Measurements

## Fair Value Measurements

The Company accounts for fair value in accordance with Accounting Standards Codification (“ASC”) 820, Fair Value Measurements and Disclosures (“ASC 820”). Fair value is defined under ASC 820 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The inputs to the valuation techniques used to measure fair value are classified into the following categories:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Table of Contents

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

As of March 31, 2016, the Company's financial assets and financial liabilities are presented below at fair value and were classified within the fair value hierarchy as follows (in thousands):

	Level 1	Level 2	Level 3	March 31, 2016
Financial Assets				
Cash and cash equivalents	159,283	—	—	159,283
Restricted cash	1,498	—	—	1,498
Convertible promissory note investment in Plain Vanilla Corp.	—	—	2,900	2,900
Call option to acquire Plain Vanilla Corp. (1)	—	—	2,100	2,100
Total Financial Assets	160,781	—	5,000	165,781

(1) These assets are carried on the consolidated balance sheet on a historical cost basis (see "Note 6 - Investments")

As of December 31, 2015, the Company's financial assets and financial liabilities are presented below at fair value and were classified within the fair value hierarchy as follows (in thousands):

	Level 1	Level 2	Level 3	December 31, 2015
Financial Assets				
Cash and cash equivalents	180,542	—	—	180,542
Restricted cash	1,498	—	—	1,498
Total Financial Assets	182,040	—	—	182,040

The Company's cash and cash equivalents, which were held in operating bank accounts, are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. In addition, the Company's restricted cash is classified within Level 1 of the fair value hierarchy. The carrying value of accounts receivable and payables approximates fair value due to the short time to expected payment or receipt of cash.

The Company engaged third party valuation experts to aid management in its analysis of the fair value of the promissory note issued to the Company, and the Company's option to acquire all of the outstanding equity ("call option") of, Plain Vanilla Corp ("Plain Vanilla"). See "Note 6 – Investments" below for further information on the promissory note and call option.

The fair value of the promissory note was estimated using a probability weighted assessment of the expected cash flows discounted to their present value. The discount rate of 88.1% used in the analysis reflects the early stage nature of the entity and the overall gaming industry indices. The assumptions used in the expected cash flows model are level 3 inputs as defined above. The fair value of the call option was estimated using the probability weighted Black-Scholes valuation model. The Black-Scholes valuation model requires inputs such as the expected term of the call option, expected volatility and risk-free interest rate. Certain of these inputs are subjective and require significant analysis and judgment to develop. The weighted average assumptions used by the company are level 3 inputs as defined above and are noted in the following table:

	Three Months Ended March 31, 2016	
Dividend yield	—	%
Risk-free interest rate	0.47	%
Expected volatility	45.00	%
Expected term (in years)	0.95	

Table of Contents

The following table presents the changes in fair value of the Plain Vanilla promissory note and the call option:

	Three months ended March 31, 2016		
	Asset at the beginning of the period (1)	Increase/ (decrease) in fair value	Asset at the end of the period
Convertible promissory note investment in Plain Vanilla Corp.	2,600	300	2,900
Call option to acquire Plain Vanilla Corp. (2)	2,400	(300)	2,100

(1) As of the investment date of January 19, 2016 (see “Note 6 - Investments”)

(2) These assets are carried on the consolidated balance sheet on a historical cost basis (see “Note 6 - Investments”)

#### Note 4 — Balance Sheet Components

##### Accounts Receivable

	March 31, 2016	December 31, 2015
Accounts receivable	\$ 17,461	\$ 18,672
Less: Allowance for doubtful accounts	(716)	(716)
	\$ 16,745	\$ 17,956

Accounts receivable includes amounts billed and unbilled as of the respective balance sheet dates, but net of platform commissions paid to the Digital Storefronts. The Company had no significant bad debts during the three ended March 31, 2016 and 2015.

##### Prepaid expenses and other

	March 31, 2016	December 31, 2015
Deferred platform commission fees	7,953	7,675
Deferred royalties	3,065	2,668
Taxes receivable	739	759
Other	3,448	3,739

\$ 15,205      \$ 14,841

### Property and Equipment

	March 31, 2016	December 31, 2015
Computer equipment	\$ 6,423	\$ 6,106
Furniture and fixtures	1,054	1,053
Software	7,605	7,408
Leasehold improvements	3,681	3,661
	18,763	18,228
Less: Accumulated depreciation and amortization	(13,481)	(12,781)
	\$ 5,282	\$ 5,447

Depreciation expense for the three months ended March 31, 2016 and 2015 was \$656 and \$706, respectively.

### Other Long-Term Liabilities

	March 31, 2016	December 31, 2015
Deferred rent	\$ 605	\$ 692
Uncertain tax position obligations	609	567
Other	183	326
	\$ 1,397	\$ 1,585



Table of Contents

## Note 5 — Goodwill and Intangible Assets

## Intangible Assets

The Company's intangible assets were acquired primarily in various acquisitions as well as in connection with the purchase of certain trademarks, brand assets and licensed content. The carrying amounts and accumulated amortization expense of the acquired intangible assets, including the impact of foreign currency exchange translation, at March 31, 2016 and December 31, 2015 were as follows:

	Estimated Useful Life	March 31, 2016			December 31, 2015		
		Gross Carrying Value (Including Impact of Foreign Exchange)	Accumulated Amortization Expense (Including Impact of Foreign Exchange)	Net Carrying Value (Including Impact of Foreign Exchange)	Gross Carrying Value (Including Impact of Foreign Exchange)	Accumulated Amortization Expense (Including Impact of Foreign Exchange)	Net Carrying Value (Including Impact of Foreign Exchange)
Intangible assets amortized to cost of revenue:							
Titles, content and technology	3 yrs	\$ 34,683	\$ (24,771)	\$ 9,912	\$ 34,750	\$ (22,954)	\$ 11,796
Catalogs	1 yr	1,118	(1,118)	—	1,152	(1,152)	—
ProvisionX Technology	6 yrs	185	(185)	—	190	(190)	—
Carrier contract and related relationships	5 yrs	24,227	(20,876)	3,351	24,200	(20,597)	3,603
Licensed content	2.5 -5 yrs	7,878	(2,877)	5,001	7,866	(2,866)	5,000
Service provider license	9 yrs	457	(422)	35	454	(406)	48
Trademarks	7 yrs	5,217	(3,074)	2,143	5,217	(2,897)	2,320
		73,765	(53,323)	20,442	73,829	(51,062)	22,767
Other intangible assets amortized							

to operating  
expenses:

Emux

Technology	6 yrs	1,192	(1,192)	—	1,228	(1,228)	—
------------	-------	-------	---------	---	-------	---------	---

Non-compete agreements	4 yrs	5,374	(5,374)	—	5,391	(5,391)	—
------------------------	-------	-------	---------	---	-------	---------	---

		6,566	(6,566)	—	6,619	(6,619)	—
--	--	-------	---------	---	-------	---------	---

Total

intangibles

assets		\$ 80,331	\$ (59,889)	\$ 20,442	\$ 80,448	\$ (57,681)	\$ 22,767
--------	--	-----------	-------------	-----------	-----------	-------------	-----------

Acquisition-related intangibles included in the above table are finite-lived and are being amortized on a straight-line basis over their estimated lives, which approximates the pattern in which the economic benefits of the intangible assets are realized. The Company has included amortization of acquired intangible assets directly attributable to revenue-generating activities in cost of revenue and amortization of acquired intangible assets not directly attributable to revenue-generating activities in operating expenses.

During the three months ended March 31, 2016 and 2015, the Company recorded amortization expense in the amounts of \$2,324 and \$2,434 respectively, in cost of revenue. During the three months ended March 31, 2016 and 2015, the Company recorded amortization expense in the amounts of \$0 and \$127, respectively, in operating expenses.

As of March 31, 2016, total expected future amortization related to intangible assets was as follows:

Year Ending December 31,	Amortization to Be Included in Cost of Revenue
2016	\$ 7,772
2017	8,076
2018	3,814
2019	780
2020 and thereafter	—
	\$ 20,442

Table of Contents

## Goodwill

Goodwill for the periods indicated was as follows:

	March 31, 2016	December 31, 2015
	Total	Total
Goodwill	\$ 161,001	\$ 161,075
Accumulated Impairment Losses	(73,111)	(73,111)
Balance as of January 1	87,890	87,964
Goodwill Acquired during the year	—	—
Effects of Foreign Currency Exchange	9	(74)
Balance as of period ended:	87,899	87,890
Goodwill	161,010	161,001
Accumulated Impairment Losses	(73,111)	(73,111)
Balance as of period ended	\$ 87,899	\$ 87,890

In accordance with ASC 350, the Company's goodwill is not amortized but is tested for impairment on an annual basis or whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. The Company performs its annual impairment review of its goodwill balance as of September 30 or more frequently if triggering events occur.

The Company evaluates qualitative factors and overall financial performance to determine whether it is necessary to perform the first step of the multiple-step goodwill test. This step is referred to as "Step 0." Step 0 involves, among other qualitative factors, weighing the relative impact of factors that are specific to the reporting unit as well as industry and macroeconomic factors. After assessing those various factors, if it is determined that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the entity will need to proceed to the first step of the goodwill impairment test. ASC 350 requires a multiple-step approach to testing goodwill for impairment for each reporting unit annually, or whenever events or changes in circumstances indicate the fair value of a reporting unit is below its carrying amount. The first step measures for impairment by applying the fair value-based tests at the reporting unit level. The second step (if necessary) measures the amount of impairment by applying the fair value-based tests to individual assets and liabilities within each reporting unit. The fair value of the reporting units is estimated using a combination of the market approach, which utilizes comparable companies' data, and/or the income approach, which uses discounted cash flows.

## Note 6 — Investments

In January 2016, the Company announced an investment of up to \$7,500 in promissory notes convertible into a minority equity stake in Plain Vanilla, of which \$5,000 was paid in January 2016 and the remaining \$2,500 is payable upon Plain Vanilla achieving certain operational milestones during the term of the note purchase agreement pursuant to which the promissory notes were issued. As part of the investment, the Company also received a call option to acquire all outstanding equity of Plain Vanilla for 15 months from the closing of the initial investment, unless earlier terminated by the Company, at a pre-agreed price. Plain Vanilla is the Icelandic developer of the mobile game QuizUp, and is financed primarily through equity investments.

In January 2016, the Company acquired a minority equity stake and entered into a commercial agreement with Dairy Free Games, Inc. ("Dairy Free"). As part of the arrangement, the Company invested \$2,000 in Dairy Free's Series A preferred stock. The Company also agreed to provide up to \$1,000 of recoupable and non-refundable development funding for a mobile game under development by Dairy Free. The development funding is payable in installments, including \$350 of which was paid in January 2016 and the remaining \$650 of which may become payable upon Dairy Free achieving certain milestones. Dairy Free is the developer of mobile video games and is financed primarily through equity investments.

Plain Vanilla and Dairy Free are VIEs; however, the Company has determined that it is not the primary beneficiary of these VIEs since the Company currently does not have the power to direct the activities of the VIEs that most significantly impact their economic performance. The Company made this determination based on the following factors: (i) the development stage of the VIEs' products; (ii) the Company's inability to exercise control or decision

## Table of Contents

making power over the VIEs, based on the Company's ownership percentage and voting rights, as well as its lack of involvement in day-to-day operations and management decisions; and (iii) the fact that the call option to acquire Plain Vanilla is currently significantly out of the money.

The Company has not accounted for these investments under ASC 323, Investments – Equity Method and Joint Ventures, as the convertible promissory note issued by Plain Vanilla and the preferred stock of Dairy Free have risk and rewards characteristics that are not substantially similar to the common stock of these entities.

For Plain Vanilla, the Company has elected the fair value option to account for its investment in the promissory notes. The call option was recorded at cost. As of the investment date, the fair value of the promissory note and the call option was determined to be \$2,600 and \$2,400, respectively, and recorded in other long-term assets. As of March 31, 2016, the Company fair valued the promissory note at \$2,900 and recorded a benefit of \$300 in other income.

For Dairy Free, the preferred stock investment was recorded at cost. As of the investment date and as of March 31, 2016, the preferred stock investment was recorded at \$2,000 in other long-term assets. The development funding will be recognized as research and development expense as the development activities are performed. For the three months ended March 31, 2016, the Company recognized \$260 in research and development expense related to this arrangement.

The Company is not obligated to provide any explicit or implicit financial or other support to Plain Vanilla and Dairy Free other than what was contractually agreed to in the respective investment agreements. The Company has no exposure to loss beyond its investment in Plain Vanilla and Dairy Free.

## Note 7 — Commitments and Contingencies

### Leases

The Company leases office space under non-cancelable operating facility leases with various expiration dates through November 2020. Rent expense for the three months ended March 31, 2016 and 2015 was \$1,241 and \$1,002, respectively. The terms of the facility leases provide for rental payments on a graduated scale. The Company recognizes rent expense on a straight-line basis over the lease period, and has accrued for rent expense incurred but not paid. The deferred rent balance was \$714 and \$749 at March 31, 2016 and December 31, 2015, respectively, of which \$605 and \$692 was included within other long-term liabilities at March 31, 2016 and December 31, 2015, respectively.

As of March 31, 2016, future minimum lease payments under non-cancelable operating leases were as follows:

Year Ending December 31,	Minimum Operating Lease Payments
2016	\$ 3,730
2017	4,435
2018	2,719
2019	2,306
2020 and thereafter	1,398
	\$ 14,588

#### Minimum Guaranteed Royalties and Developer Commitments

The Company has entered into license and publishing agreements with various celebrities, Hollywood studios, athletes, sports organizations, and other well-known brands and properties to develop and publish games for mobile devices. Pursuant to some of these agreements, the Company is required to make minimum guaranteed royalty payments regardless of revenue generated by the applicable game, which may not be dependent on any deliverables. The significant majority of these minimum guaranteed royalty payments are recoupable against future royalty obligations that would otherwise become payable, or in certain circumstances, where not recoupable, are capitalized and amortized over the lesser of (i) the estimated life of the title incorporating licensed content or (ii) the term of the license agreement.

Table of Contents

At March 31, 2016, future unpaid minimum guaranteed royalty commitments were as follows:

Year Ending December 31,	Future Minimum Guarantee Commitments	Future Minimum Developer Commitments
2016	\$ 35,019	\$ 800
2017	2,043	350
2018	23	—
	\$ 37,085	\$ 1,150

The amounts represented in the table above reflect our minimum cash obligations for the respective calendar years, but do not necessarily represent the periods in which they will be expensed in the Company's Consolidated Financial Statements.

Future developer commitments as of March 31, 2016 were \$1,150. These developer commitments reflect the Company's minimum cash obligations to external software developers ("third-party developers") to design and develop its software applications but do not necessarily represent the periods in which they will be expensed. The Company advances funds to these third-party developers, in installments, payable upon the completion of specified development milestones, and expenses third-party developer commitments as services are provided.

Licensor commitments include \$36,669 of commitments to licensors that have been recorded in current and long-term liabilities and a corresponding amount in current and long-term assets because payment is not contingent upon performance by the licensor. The classification of commitments between long-term and short-term is determined based on the timing of recoupment of earned royalties calculated on projected revenue for the licensed intellectual property games.

#### Income Taxes

As of March 31, 2016, unrecognized tax benefits and potential interest and penalties are classified within "other long-term liabilities" and "accounts payable" on the Company's unaudited condensed consolidated balance sheets. As of March 31, 2016, the settlement of \$609 of the Company's income tax liabilities could not be determined; however, the liabilities are not expected to become due within the next 12 months.

## Contingencies

From time to time, the Company is subject to various claims, complaints and legal actions in the normal course of business. The Company assesses its potential liability by analyzing specific litigation and regulatory matters using available information. The Company's estimate of losses is developed in consultation with inside and outside counsel, which involves a subjective analysis of potential results and outcomes, assuming various combinations of appropriate litigation and settlement strategies. After taking all of the above factors into account, the Company determines whether an estimated loss from a contingency should be accrued by assessing whether a loss is deemed reasonably probable and the amount can be reasonably estimated. The Company further determines whether an estimated loss from a contingency should be disclosed by assessing whether a material loss is deemed reasonably possible. Such disclosure will include an estimate of the additional loss or range of loss or will state that an estimate cannot be made.

On November 4, 2015, Just Games Interactive LLC (d/b/a Kung Fu Factory, f/k/a Tiny Fun Studios) ("Just Games") filed a complaint in the U.S. District Court for the Central District of California against the Company, Kristen Jenner (f/k/a Kris Kardashian) and additional yet-to-be named defendants. The complaint alleged direct copyright infringement against the Company and direct and contributory copyright infringement and breach of implied contract against the other defendants. Just Games was seeking at least \$10,000 in damages as well as other relief, including costs, permanent and temporary injunctive relief, an accounting of profits, a constructive trust and such other costs the Court deemed just and proper. The Company filed a motion to dismiss the complaint on January 27, 2016. On February 1, 2016, Just Games filed a voluntary motion to dismiss their case against the Company without prejudice.



## Table of Contents

The Company does not believe it is party to any currently pending litigation, the outcome of which is reasonably possible to have a material adverse effect on its operations, financial position or liquidity. However, the ultimate outcome of any litigation is uncertain and, regardless of outcome, litigation can have an adverse impact on the Company because of defense costs, potential negative publicity, diversion of management resources and other factors.

### Note 8 — Stockholders' Equity

#### Tencent Investment

On April 29, 2015, the Company entered into a purchase agreement with Tencent Holdings Limited ("Tencent") and Tencent's controlled affiliate, Red River Investment Limited ("Red River"). Pursuant to the Purchase Agreement, the Company issued to Red River in a private placement an aggregate of 21,000 shares of the Company's common stock (the "Shares") at a purchase price of \$6.00 per share, for aggregate net proceeds of \$125,156, after offering expenses. The Company issued 12,500 of the Shares to Red River on April 29, 2015 and issued the remaining 8,500 Shares at a second closing on June 3, 2015.

#### Warrants to Purchase Common Stock

##### Celebrity Warrants

During 2015, the Company issued warrants to celebrity licensors, and entities affiliated with one of the celebrity licensors, to purchase up to an aggregate of 1,100 shares of the Company's common stock, subject to adjustments for dividends, reorganizations and other common stock events (collectively, the "Celebrity Warrants"). With respect to Celebrity Warrants covering 1,000 shares, such warrants vest with respect to 50% of the underlying shares upon public announcement of the related license agreement, with the remaining shares vesting in equal monthly installments over 24 months, subject to full acceleration in the event of (i) the Company's full recoupment of the minimum guarantee payments under the related license agreement, (ii) the termination of the license agreement due to the Company's material breach of the agreement or (iii) a change of control of the Company. With respect to the remaining Celebrity Warrants covering 100 shares issued in 2015, such warrants vest in equal monthly installments over 60 months, with up to 25% of the shares subject to accelerated vesting in the event the celebrity licensor approves game design documentation by a certain date and the related game commercially launches by a certain date.

The fair value of the outstanding Celebrity Warrants is estimated using the Black-Scholes valuation model. The Black-Scholes valuation model requires inputs such as the expected term of the Celebrity Warrants, expected volatility and risk-free interest rate. Certain of these inputs are subjective and require significant analysis and

judgment to develop. The Company will estimate and record the fair value of these Celebrity Warrants using a Black-Scholes valuation model when the above vesting conditions have been met.

Each of the Celebrity Warrants may, at the election of the holder, be either exercised for cash or net exercised on a cashless basis. As of March 31, 2016, Celebrity Warrants covering 1,600 shares of the Company's common stock were outstanding.

With respect to the Celebrity Warrants covering the 100 shares issued in 2015, during the three months ended March 31, 2016 and 2015, the Company recorded a warrant compensation charge of \$9 and \$92, respectively, which was included within cost of revenue.

With respect to the Celebrity Warrants covering the 1,000 shares issued in 2015, the Company recorded a prepaid expense of \$62 and recorded \$310 under other long-term assets, in each case as of March 31, 2016. No amounts were recorded for such Celebrity Warrants as of March 31, 2015.

#### MGM Warrants

In July 2013, the Company and MGM Interactive Inc. ("MGM") entered into a warrant agreement that provided MGM the right to purchase up to 3,333 shares of the Company's common stock subject to adjustments for dividends,

## Table of Contents

reorganizations and other common stock events (the “MGM Warrant”). As of March 31, 2016, MGM Warrants covering 2,667 shares of the Company’s common stock were outstanding. These remaining shares vest and become exercisable based on conditions related to the Company releasing mobile games based on mutually agreed upon intellectual property licensed by MGM to the Company. During each of the three months ended March 31, 2016, and 2015, none of these vesting conditions were met.

The Company estimated the fair value of the Celebrity Warrants using the Black-Scholes valuation model and the weighted average assumptions noted in the following table:

	Three Months Ended March 31,	
	2016	2015
Dividend yield	— %	— %
Risk-free interest rate	1.53 %	1.99 %
Expected volatility	59.60%	61.10%
Expected term (in years)	5.62	5.42

Warrants outstanding at March 31, 2016 were as follows:

	Number of Shares Outstanding Under Warrant	Weighted Exercise Price per Share	Average Contractual Term
Warrants outstanding, December 31, 2015	4,267	\$ 3.61	
Granted	-	-	
Exercised	-	-	
Warrants outstanding, March 31, 2016	4,267	3.61	5.50

During the three months ended March 31, 2016 and 2015, warrant holders exercised warrants to purchase 0 and 7 shares of the Company’s common stock, respectively, and the Company received gross proceeds of \$0 and \$10, respectively, in connection with these exercises. These exercised warrants were issued by the Company in 2010 in connection with a private placement transaction.

Note 9 — Stock Option and Other Benefit Plans

2007 Equity Incentive Plan

In 2007, the Company's Board of Directors adopted, and the Company's stockholders approved, the 2007 Equity Incentive Plan (the "2007 Plan"). The 2007 Plan permits the Company to grant stock options, RSUs, and other stock-based awards to employees, non-employee directors and consultants. The 2007 Plan was amended and restated in 2013 (the "Amended 2007 Plan") to, among other things, increase the aggregate number of shares of common stock authorized for issuance under the plan by 7,200 shares. In April 2015, the Company's Board of Directors approved, and in June 2015, the Company's stockholders approved, the Second Amended and Restated 2007 Equity Incentive Plan (the "Second Amended 2007 Plan"). The Second Amended 2007 Plan includes an increase of 13,000 shares in the aggregate number of shares of common stock authorized for issuance under the plan. It also includes a fungible share provision, pursuant to which each share that is subject to a stock-based award that is not a "full value award" (restricted stock, RSUs, or other stock-based awards where the price charged to the participant for the award is less than 100% of the fair market value) reduces the number of shares available for issuance by 1.32 shares (previously this fungible ratio was 1.39 shares under the Amended 2007 Plan).

The Company may grant options under the 2007 Plan at prices no less than 85% of the estimated fair value of the shares on the date of grant as determined by its Board of Directors, provided, however, that (i) the exercise price of an incentive stock option ("ISO") or non-qualified stock options ("NSO") may not be less than 100% or 85%, respectively, of the estimated fair value of the underlying shares of common stock on the grant date, and (ii) the exercise price of an ISO or NSO granted to a 10% stockholder may not be less than 110% of the estimated fair value of the shares

## Table of Contents

on the grant date. The fair value of the Company's common stock is determined by the last sale price of such stock on the NASDAQ Global Market on the date of determination. The stock options granted to employees generally vest with respect to 25% of the underlying shares one year from the vesting commencement date and with respect to an additional 1/48th of the underlying shares per month thereafter. Stock options granted before October 25, 2007 and after June 4, 2015 have a contractual term of ten years and stock options granted on or after October 25, 2007 and before June 4, 2015 have a contractual term of six years.

As of March 31, 2016, 9,806 shares were available for future grants under the Second Amended 2007 Plan.

### 2007 Employee Stock Purchase Plan

In 2007, the Company's Board of Directors adopted, and the Company's stockholders approved, the 2007 Employee Stock Purchase Plan (the "2007 Purchase Plan"). As of March 31, 2016, 1,618 shares were available for issuance under the 2007 Purchase Plan.

### 2008 Equity Inducement Plan

In March 2008, the Company's Board of Directors adopted the 2008 Equity Inducement Plan (the "Inducement Plan") to augment the shares available under its existing 2007 Plan. The Company has not sought stockholder approval for the Inducement Plan. As such, awards under the Inducement Plan are granted in accordance with NASDAQ Listing Rule 5635(c)(4) and only to persons not previously an employee or director of the Company, or following a bona fide period of non-employment, as an inducement material to such individuals entering into employment with the Company. The Inducement Plan initially permitted the Company to grant only nonqualified stock options, but effective November 2013, the Compensation Committee of the Company's Board amended the Inducement Plan to permit the award of RSUs under the plan. The Company may grant NSOs under the Inducement Plan at prices less than 100% of the fair value of the shares on the date of grant, at the discretion of its Board of Directors. The fair value of the Company's common stock is determined by the last sale price of such stock on the NASDAQ Global Market on the date of determination. In December 2015, the Company's Compensation Committee approved an increase in the number of authorized shares of common stock available for grant under the Inducement Plan by 1,000 shares in connection with grants made to Nick Earl upon his hiring as President of Global Studios.

As of March 31, 2016, 526 shares of common stock were reserved for future grants under the Inducement Plan.

### Share-Based Awards Available for Grant

The calculation of share-based awards available for grant under the Second Amended 2007 Plan and 2008 Equity Inducement Plan for the three months ended March 31, 2016 is as follows:

	Shares
	Available
Balances at December 31, 2015	9,684
Share-based awards granted (1)	(262)
Share-based awards canceled (2)	910
Balances at March 31, 2016	10,332

- 
- (1) Under the terms of the Amended 2007 Plan, RSUs granted on or after June 6, 2013 but before June 4, 2015 reduced the number of shares available for grant by 1.39 shares for each share subject to an RSU award. Under the terms of the Second Amended 2007 Plan, RSUs granted on or after June 4, 2015 reduce the number of shares available for grant by 1.32 shares for each share subject to an RSU award.
- (2) Under the terms of the Amended 2007 Plan, RSUs forfeited and returned to the pool of shares available for grant that were granted on or after June 6, 2013 but before June 4, 2015 increase the pool by 1.39 shares for each share

Table of Contents

subject to an RSU that is forfeited. RSUs forfeited and returned to the pool of shares available for grant that were granted on or after June 4, 2015 increase the pool by 1.32 shares for each share subject to an RSU that is forfeited.

## RSU Activity

A summary of the Company's RSU activity for the three months ended March 31, 2016, is as follows:

	Number of Units Outstanding	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Awarded and unvested, December 31, 2015	7,344	4.40	
Granted	185	2.84	
Vested	(476)	5.08	
Forfeited	(334)	4.72	
Awarded and unvested, March 31, 2016	6,719	\$ 4.30	
Restricted stock units vested and expected to vest, March 31, 2016	5,741	\$ 4.30	\$ 16,190

## Stock Option Activity

The following table summarizes the Company's stock option activity for the three months ended March 31, 2016:

	Options Outstanding Weighted Number of Shares	Weighted Average Exercise Price	Average Contractual Term (Years)	Aggregate Intrinsic Value
Balances at December 31, 2015	7,164	3.73	4.05	\$ 389
Options granted	18	4.09		
Options canceled	(278)	4.72		
Options exercised	(57)	1.74		
Balances at March 31, 2016	6,847	\$ 3.71	3.78	\$ 607
Options vested and expected to vest at March 31, 2016	6,593	\$ 3.71	3.62	\$ 606
Options exercisable at March 31, 2016	4,795	\$ 3.69	2.56	\$ 590

The aggregate intrinsic value in the preceding table is calculated as the difference between the exercise price of the underlying awards and the quoted closing price of the Company's common stock on The NASDAQ Global Market of \$2.82 per share as of March 31, 2016 (the last trading day in the quarter). Consolidated net cash proceeds from option exercises were \$100 and \$895 for the three months ended March 31, 2016 and 2015, respectively. The Company realized \$0 of income tax benefit from stock option exercises during the three months ended March 31, 2016, and \$0 income tax benefit from stock option exercises during the three months ended March 31, 2015. As required, the Company presents excess tax benefits from the exercise of stock options, if any, as financing cash flows rather than operating cash flows.

#### Stock-Based Compensation

The cost of RSUs is determined using the fair value of the Company's common stock based on the quoted closing price of the Company's common stock on the date of grant. RSUs typically vest and are settled over approximately a four-year period with 25% of the shares vesting on or around the one-year anniversary of the grant date and the remaining shares vesting quarterly thereafter. Compensation cost is amortized on a straight-line basis over the requisite service period.



Table of Contents

Under Compensation-Stock Compensation (“ASC 718”), the Company estimated the fair value of each option award on the grant date using the Black-Scholes option valuation model and the weighted average assumptions noted in the following table.

	Three Months Ended March 31,	
	2016	2015
Dividend yield	—%	—%
Risk-free interest rate	1.20%	1.25%
Expected volatility	56.1%	56.3%
Expected term (years)	4.00	4.00

The Company based its expected volatility on its own historical volatility and the historical volatility of a peer group of publicly traded entities. The expected term of options gave consideration to early exercises, post-vesting cancellations and the options’ contractual term ranging from six to ten years. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury Constant Maturity Rate as of the date of grant. The weighted-average fair value of stock options granted during the three months ended March 31, 2016 and 2015 was \$4.09 and \$4.38 per share, respectively.

The Company calculated employee stock-based compensation expense recognized for the three months ended March 31, 2016 and 2015 based on awards ultimately expected to vest and reduced it for estimated forfeitures. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The following table summarizes the consolidated stock-based compensation expense by line items in the unaudited condensed consolidated statement of operations:

	Three Months Ended March 31,	
	2016	2015
Research and development	\$ 1,194	\$ 760
Sales and marketing	292	218
General and administrative	2,059	1,151
Total stock-based compensation expense	\$ 3,545	\$ 2,129

As of March 31, 2016, the Company had \$24,344 of total unrecognized compensation expense related to RSUs, net of estimated forfeitures. As of March 31, 2016, the Company had \$2,872 of total unrecognized compensation expense related to stock options, net of estimated forfeitures. The unrecognized compensation expense related to RSUs will be recognized over a weighted average period of 2.84 years. The unrecognized compensation expense related to stock options will be recognized over a weighted average period of 2.51 years.

#### Note 10 — Income Taxes

The Company recorded an income tax benefit of \$166 and an income tax expense of \$1,104 for the three months ended March 31, 2016 and 2015, respectively. The change in income tax provision was due to changes in pre-tax income in the United States and certain foreign entities. The income tax rates vary from the Federal and State statutory rates due to the valuation allowances on the Company's net operating losses, foreign tax rate differences and withholding taxes.

The Company estimates its annual effective tax rate at the end of each quarterly period and records the tax effect of certain discrete items, which are unusual or occur infrequently, in the interim period in which they occur. In addition, jurisdictions with a projected loss for the year or a year-to-date loss where no tax benefit can be recognized and jurisdictions where a reliable estimate of ordinary income cannot be made are excluded from the estimated annual effective tax rate. The impact of such an exclusion could result in a higher or lower effective tax rate during a particular quarter depending on the mix and timing of actual earnings versus annual projections. The Company's ability to use its

Table of Contents

net operating loss carryforwards and federal and state tax credit carryforwards to offset future taxable income and future taxes, respectively, may be subject to restrictions attributable to equity transactions that result in changes in ownership as defined by Internal Revenue Code Section 382.

The Company accounts for uncertain tax positions in accordance with ASC 740. As of March 31, 2016 and December 31, 2015, the total amount of unrecognized tax benefits was \$9,714 and \$9,218, respectively. As of March 31, 2016 and December 31, 2015, approximately \$543 and \$540, respectively, of unrecognized tax benefits, if recognized, would impact the Company's effective tax rate. The remaining balance, if recognized, would adjust the Company's deferred tax assets, each of which are subject to a valuation allowance. As of March 31, 2016, the Company anticipated that the liability for uncertain tax positions, excluding interest and penalties, could decrease by approximately \$139 within the next twelve months due to the expiration of certain statutes of limitation in foreign jurisdictions in which the Company does business.

The Company's policy is to recognize interest and penalties related to unrecognized tax benefits in income tax expense. The Company recorded an expense of \$17 and \$20 related to interest on uncertain tax positions during the three months ended March 31, 2016 and 2015, respectively. As of March 31, 2016 and December 31, 2015, the Company had a liability of \$395 and \$375, respectively, related to interest and penalties for uncertain tax positions

The Company is subject to taxation in the United States and various foreign jurisdictions. The material jurisdictions subject to examination by tax authorities are primarily the State of California, United States, United Kingdom, Canada, and China. The Company's federal tax returns are open by statute for tax years 1997 and forward and California tax returns are open by statute for tax years 2003 and forward and could be subject to examination by the tax authorities. The statute of limitations for the Company's 2014 tax returns for the various entities in the United Kingdom is expected to be closed in 2016. The Company's China income tax returns are open by statute for tax years 2010 and forward.

Note 11 — Segment Reporting

ASC 280, Segment Reporting, establishes standards for reporting information about operating segments. It defines operating segments as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company's Chief Executive Officer, who is also the chief operating decision maker, makes decisions and manages the Company's operations as one reporting unit, rather than as three separate regional territories, which used to be considered as three reporting units. In prior years, the Company's Chief Executive Officer reviewed selected financial information on a geographic basis; however this information is included within one operating segment for purposes of allocating resources and evaluating financial performance.

Accordingly, the Company reports as a single reportable segment—“Mobile Games”. For purposes of enterprise-wide disclosures, the Company attributes revenue to geographic areas based on the country in which the distributor’s, advertising service provider’s or carrier’s principal operations are located. In the case of Digital Storefronts, revenue is attributed to the geographic location where the end-user makes the purchase. The Company generates its revenue in the following geographic regions:

	Three Months Ended March 31,	
	2016	2015
United States	\$ 39,625	\$ 44,340
Americas, excluding the United States	2,337	3,866
EMEA	7,353	11,732
APAC	5,213	9,532
	\$ 54,528	\$ 69,470

Table of Contents

The Company attributes its long-lived assets, which primarily consist of property and equipment, to a country primarily based on the physical location of the assets. Property and equipment, net of accumulated depreciation and amortization, summarized by geographic location was as follows:

	March 31, 2016	December 31, 2015
Americas	\$ 4,827	\$ 4,938
EMEA	367	408
APAC	88	101
	\$ 5,282	\$ 5,447

## Note 12 — Restructuring

During 2015 and the first three months of 2016, the Company's management approved restructuring plans to improve the effectiveness and efficiency of its operating model and reduce operating expenses Company-wide. During the year ended December 31, 2015, the Company recorded \$1,075 of restructuring charges related to employee termination costs in the Company's Beijing, China and Bellevue, Washington studios. During the three months ended March 31, 2016, the Company recorded \$106 of restructuring charges related to employee termination costs in the Company's Long Beach offices.

	Fiscal 2016 and 2015			
	Restructuring Workforce	Restructuring Facility	Restructuring Other	Restructuring Total
Balance as of Jan 1, 2015	\$ —	\$ —	\$ —	\$ —
Charges to operations	1,044	—	31	1,075
Charges settled in cash	(733)	—	—	(733)
Balance as of December 31, 2015	\$ 311	\$ —	\$ 31	\$ 342
Charges to operations	82	—	24	106
Charges settled in cash	(393)	—	(55)	(448)
Balance as of March 31, 2016	\$ —	\$ —	\$ —	\$ —

Note 13 — Related Party Transactions

The Company and an affiliate of one of the Company's principal stockholders entered into an agreement in November 2015 pursuant to which, the Company agreed, subject to certain conditions, to pay in the aggregate, up to \$15,000 in recoupable advanced royalties and non-recoupable license fees. As of March 31, 2016, the Company had paid an aggregate of \$5,000 of such amount, and the remaining \$10,000 is payable upon achievement of certain milestones.

Note 14 — Subsequent Events

In April 2016, the Company announced a cost reduction plan that includes a reduction in force of approximately 85 employees and the termination or restructuring of certain leases and other contracts in the Company's China and U.S. offices. In connection with these actions, the Company currently expects to record a restructuring charge of approximately \$2,250 to \$3,000. The Company currently estimates that approximately \$1,500 of such charges will be related to employee severance and benefits and approximately \$750 to \$1,500 will be related to lease, contract termination and other costs. The Company expects to recognize the severance and benefits charges during the second quarter of 2016 and the lease, contract termination and other costs during the second quarter of 2016 through the first quarter of 2017. The Company expects substantially all of the severance and benefit charges, and a majority of the lease, contract termination and other costs, to entail cash expenditures.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with (1) the unaudited condensed consolidated financial statements and related notes contained elsewhere in this report and (2) the audited consolidated financial statements and related notes and the Management's Discussion and Analysis of Financial Condition and Results of Operations section, included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 4, 2016. The information in this discussion and elsewhere in this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Such statements are based upon current expectations that involve risks and uncertainties. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, the words "may," "will," "believe," "anticipate," "plan," "expect," "intend," "could," "estimate," "continue" and expressions or variations identify forward-looking statements.

Our actual results and the timing of certain events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a discrepancy include, but are not limited to, those discussed elsewhere in this report, particularly in the section titled "Risk Factors" set forth in Part II, Item 1A of this report. All forward-looking statements in this report are based on information available to us as of the date hereof, and we assume no obligation to update any such forward-looking statements to reflect future events or circumstances, except as required by law.

Our Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") includes the following sections:

- An Overview that discusses at a high level our operating results and some of the trends that affect our business;
- Critical Accounting Policies and Estimates that we believe are important to understanding the assumptions and judgments underlying our financial statements;
- Recent Accounting Pronouncements;
- Results of Operations, including a more detailed discussion of our revenue and expenses; and
- Liquidity and Capital Resources, which discusses key aspects of our statements of cash flows, changes in our balance sheets and our financial commitments.

## Overview

This overview provides a high-level discussion of our operating results and some of the trends that affect our business. We believe that an understanding of these trends is important to understand our financial results for the three months ended March 31, 2016, as well as our future prospects. This summary is not intended to be exhaustive, nor is it intended to be a substitute for the detailed discussion and analysis provided elsewhere in this report, including our unaudited condensed consolidated financial statements and accompanying notes.

## Financial Results and Trends

Revenue for the three months ended March 31, 2016 was \$54.5 million, a 21.5% decrease compared to the three months ended March 31, 2015, in which we reported revenue of \$69.5 million. The decrease was primarily related to declining revenue on a year-over-year basis from catalog titles such as Kim Kardashian: Hollywood, Deer Hunter 2014 and Contract Killer: Sniper, and our inability to fully replace such declining revenue with revenue from new title launches, such as Katy Perry: Pop, James Bond: World of Espionage, and Deer Hunter 2016, which have failed to monetize and retain users at rates necessary to offset the declining catalog revenues. Revenue from micro-transactions



## Table of Contents

(in-app purchases) decreased by \$14.8 million for the three months ended March 31, 2016 compared to the three months ended March 31, 2015, which was partially offset by a \$413,000 increase from advertisements and offers.

We have concentrated our product development efforts towards developing games for smartphone and tablet devices. We generate the majority of our revenue from Apple's iOS platform, which accounted for 61.6% and 60.9% of our total revenue for the three months ended March 31, 2016 and 2015, respectively. We generated the majority of this iOS-related revenue through the Apple App Store, which represented 51.3% and 53.6% of our total revenue for the three months ended March 31, 2016 and 2015, respectively with the significant majority of such revenue derived from in-app purchases. We generated the balance of our iOS-related revenue from offers and advertisements in games distributed on the Apple App Store. In addition, we generated approximately 37.5% and 37.0% of our total revenue for the three months ended March 31, 2016 and 2015, respectively from the Android platform. We generated the majority of our Android-related revenue through the Google Play Store, which represented 27.4% and 27.3% of our total revenue for the three months ended March 31, 2016 and 2015, respectively, with the significant majority of such revenue derived from in-app purchases. We generated the balance of our Android-related revenue from other platforms that distribute apps that run the Android operating system (e.g., the Amazon App Store) and through offers and advertisements in games distributed through the Google Play Store and other Android platforms.

We are dedicated to extending our leadership positions in the action, celebrity, sports, and simulation gaming genres. Our leadership in the action category remains strong with our Deer Hunter and Contract Killer franchises, and we hope to expand that leadership in 2016 with the launch of Frontline Commando Rivals, which is a title under development through our strategic partnership to bring Tencent's highly successful action game in China, WeFire, to North America, Australia, New Zealand, EMEA and South America in 2016. We established our leadership in the celebrity gaming genre with Kim Kardashian: Hollywood, and we extended that leadership with the launch of our Kendall and Kylie title in February 2016 and with announcements of games to be developed with several additional celebrities, including Taylor Swift, Britney Spears and Nicki Minaj. Our sports label is headlined by our Tap Sports Baseball and Racing Rivals franchises, which we hope to maintain as the top baseball and racing franchises, respectively, on mobile in 2016, including through our recent successful release of Tap Sports Baseball 2016. The simulation category includes our Cooking Dash and Diner Dash franchises, and we look to bolster our position in this category in 2016 through our upcoming game featuring Gordon Ramsay and eventually through an invest-express resource management title in development out of our Portland, Oregon studio.

We believe that our games consistently have high production values, are visually appealing and have engaging core gameplay. These characteristics have typically helped to drive installs and awareness of our games and resulted in highly positive consumer reviews. We also believe that we have been a consistently good partner of both Apple and Google, which has contributed to the majority of our games being featured on their storefronts when they are commercially released.

We work closely with our celebrity licensors to engage their social media audiences and build games that will resonate with their unique fan bases. Our celebrity games utilize transmedia storytelling, leveraging the celebrity's built-in social media fan base to drive installs and awareness of the game, and then attempting to surprise and delight those fans with real-world events and other game content based on the celebrity's life. Our goal is for the game content

to become entwined with the celebrity's persona and social media presence, and to otherwise enhance interaction with the celebrity's fans. We also plan to build and nurture social communities in and around the games themselves, creating a new vehicle for strong, personal engagement with the celebrity's fan base. In order to capitalize on the impact of our celebrity licensors, we need to differentiate each game we release and space out our launch dates in order to avoid cannibalization of revenue from our existing games and to ensure that each game resonates with our players.

However, for us to continue driving installs and awareness of our games and to improve monetization and retention of our players, we must first ensure that each game we develop is built with strong core gameplay and a core monetization loop that incentivizes players to make in-app purchases. In addition, we must regularly update our games with compelling new content, deliver socio-competitive features like tournaments, player-versus-player gameplay and live events and build and nurture social media communities around our franchises both in-game and holistically via community features such as dedicated social channels. We have also made significant investments in our proprietary analytics and monetization infrastructure. With our enhanced analytics capabilities, we intend to devote resources towards segmenting and learning more about players of each of our franchises. We aim to connect our analytics and

## Table of Contents

monetization infrastructure to every element of our business – from marketing to merchandising– in order to improve player retention and monetization.

We also plan to continue monitoring the successful aspects of our games to drive downloads and enhance monetization and retention, whether by optimizing advertising revenue within each title, securing additional compelling licensing arrangements, building enhanced and more complex core gameplay, adding additional social features, tournaments and events or otherwise. Optimizing advertising revenue within our games requires us to continue taking advantage of positive trends in the mobile advertising space, particularly as brands continue to migrate budgets from web to mobile. Continuing to drive installs and awareness of our games through licensing efforts requires that we continue to partner with celebrities, social influencers, organizations and brands that resonate with potential players of our games. Partnering with desirable licensing partners and renewing our existing licenses require that we continue to develop successful games based on licensed content and are able to compete with other mobile gaming companies on financial and other terms in signing such partners. We also plan to continue introducing third-party licensed brands, properties and personalities into our games as additional licensed content, for cameo appearances or for limited time events in order to drive awareness and monetization.

Across the globe our industry is evidencing that hit titles generally remain higher in the top grossing charts for longer. We believe this is due to the continued specialization and investment of teams and companies in their hit titles, and the live, social nature of certain games. Our business developments and strategy position us to take advantage of these trends, as evidenced by the longevity of our Kim Kardashian: Hollywood and Racing Rivals titles and the continued strength of our Cooking Dash 2016 title. We plan to focus on regularly updating and otherwise supporting our most successful games in our efforts to ensure that those games monetize and retain users for even longer periods of time and to drive a larger part of our aggregate revenue from our existing titles.

Our net loss in the three months ended March 31, 2016 was \$8.6 million versus net income of \$1.1 million in the three months ended March 31, 2015. This decrease in our net income was primarily due to a decrease in revenue of \$14.9 million, and an increase in operating expenses of \$2.8 million. These unfavorable factors were partially offset by a decrease in cost of revenue of \$6.1 million. See “—Results of Operations—Comparison of the Three Months Ended March 31, 2016 and 2015” below for further details. Our operating results were also affected by fluctuations in foreign currency exchange rates of the currencies in which we incurred meaningful operating expenses (principally the British Pound Sterling, Euro, Chinese Renminbi, Russian Ruble, and Indian Rupee), and our customers’ reporting currencies, which fluctuated significantly in 2015 and the first three months of 2016.

Our ability to achieve and sustain profitability depends not only on our ability to grow our revenue, but also on our ability to manage our operating expenses. The largest component of our recurring expenses is personnel costs, which consist of salaries, benefits and incentive compensation, including bonuses and stock-based compensation. We have conducted several restructurings over the past six months, reducing our total headcount by approximately 100 positions. We expect these restructurings to reduce our operating expenses, however, our royalty payments and sales and marketing expenses may continue to rise as we release a greater number of applications featuring third-party licensed intellectual property and as we support our new title launches with advertising and other user acquisition efforts to drive downloads.

Cash and cash equivalents at March 31, 2016 totaled \$159.3 million, a decrease of \$21.3 million from the \$180.5 million balance at December 31, 2015. This decrease was primarily related to \$11.8 million of cash used in operations, including a \$5.2 million increase in prepaid royalties associated with minimum guaranteed royalty payments made to our licensors. Additionally, \$10.1 million of cash was used in investing activities related to our investments in Plain Vanilla Corp. (“Plain Vanilla”) and Dairy Free Games, Inc. (“Dairy Free”), purchases of intangible assets, and purchases of property and equipment. This decrease was partially offset by \$552,000 of cash provided by financing activities related to option exercises and purchases under our employee stock purchase plan.

## Key Operating Metrics

We manage our business by tracking various non-financial operating metrics that give us insight into user behavior in our games. The three metrics that we use most frequently are Daily Active Users (“DAU”), Monthly Active Users (“MAU”), and Average Revenue Per Daily Active User (“ARPDau”). Our methodology for calculating DAU, MAU, and ARPDau may differ from the methodology used by other companies to calculate similar metrics.

Table of Contents

DAU is the number of individuals who played a particular smartphone game on a particular day. An individual who plays two different games on the same day is counted as two active users for that day when we aggregate DAU across games. In addition, an individual who plays the same game on two different devices during the same day (e.g., an iPhone and an iPad) is also counted as two active users for each such day when we average or aggregate DAU over time. Average DAU for a particular period is the average of the DAUs for each day during that period. We use DAU as a measure of player engagement with the titles that our players have downloaded.

MAU is the number of individuals who played a particular smartphone game in the month for which we are calculating the metric. An individual who plays two different games in the same month is counted as two active users for that month when we aggregate MAU across games. In addition, an individual who plays the same game on two different devices during the same month (e.g., an iPhone and an iPad) is also counted as two active users for each such month when we average or aggregate MAU over time. Average MAU for a particular period is the average of the MAUs for each month during that period. We use the ratio between DAU and MAU as a measure of player retention.

ARPDau is the total free-to-play smartphone revenue – consisting of micro-transactions, advertisements and offers – for the measurement period divided by the number of days in the measurement period divided by the DAU for the measurement period. ARPDau reflects game monetization. Under our revenue recognition policy, we recognize this revenue over the estimated average playing period of a user, but our methodology for calculating our DAU does not align with our revenue recognition policy for micro-transactions and offers, under which we defer revenue. For example, if a title is introduced in the last month of a quarter, we defer a substantial portion of the micro-transaction and offer revenue to future months, but the entire DAU for the newly released title is included in the month of launch.

In addition, we also analyze social followers when determining which celebrities we might wish to partner with in developing games. Our social follower's metric represents the aggregate number of individuals who follow our celebrity licensors on social media platforms (as reported by such platforms). We calculate the aggregate number of social followers of a particular celebrity by adding the total followers of such celebrity on Facebook, Twitter, Instagram, and Vevo. There is fan overlap among these social channels and among our various celebrity licensors and such aggregate numbers have not been deduplicated. We use the number of social followers as a measure of the potential reach and engagement a particular celebrity may have with players of our games.

We calculate DAU, MAU and ARPDau for only our primary distribution platforms, such as Apple's App Store, the Google Play Store, Amazon's Appstore and the Mac App Store; we are not able to calculate these metrics across all of our distribution channels. In addition, the platforms that we include for purposes of this calculation have changed over time, and we expect that they will continue to change as our business evolves, but we do not expect that we will adjust prior metrics to take any such additions or deletions of distribution platforms into account. We believe that calculating these metrics for only our primary distribution platforms at a given period is generally representative of the metrics for all of our distribution platforms. Moreover, we rely on the data analytics software that we incorporate into our games to calculate and report the DAU, MAU and ARPDau of our games, and we make certain adjustments to the analytics data to address inconsistencies between the information as reported and our DAU and MAU calculation methodology.

Beginning in the first quarter of 2014, we have estimated the DAU and MAU for certain older titles because the analytics tools incorporated into those titles are incompatible with newer device operating systems (e.g., iOS 9), preventing us from collecting complete data. For these titles, we estimate DAU and MAU by extrapolating from each affected title's historical data in light of the behavior of similar titles for which complete data is available. The table below sets forth our aggregate DAU, MAU and ARPDau for all of our then-active smartphone titles for the periods specified, followed by a qualitative discussion of the changes in these metrics. Aggregate DAU and MAU include users of both our free-to-play and premium titles, whereas aggregate ARPDau is calculated based only on revenue from our free-to-play games. Aggregate DAU and MAU for each period presented represents the aggregate metric for the last month of the period. For example, DAU for the three months ended March 31, 2016 is aggregate daily DAU for the month of March 2016 calculated for all active smartphone free-to-play and premium titles in that month across the distribution platforms for which we calculate the metric.

Table of Contents

	Three Months Ended March 31,	
	2016	2015
	(In thousands, except aggregate ARPDau)	
Aggregate DAU	4,935	5,986
Aggregate MAU	42,391	54,605
Aggregate ARPDau \$	0.12	\$ 0.13

The decrease in aggregate DAU and MAU for the three months ended March 31, 2016 as compared to the same period of the prior year was primarily related to fewer downloads of our new title launches in the first quarter of 2016 as compared to the first quarter of 2015 and lower retention of users for existing titles, particularly for our Kim Kardashian: Hollywood, Racing Rivals and Deer Hunter 2014 titles.

Our aggregate ARPDau decreased slightly for the three months ended March 31, 2016 as compared to the same period of the prior year, due to lower monetization on certain titles. Future increases in our aggregate DAU, MAU and ARPDau will depend on our ability to retain current players, attract new paying players, launch new games and expand into new markets and distribution platforms.

We rely on a very small portion of our total users for nearly all of our revenues derived from in-app purchases. Since the launch of our first free-to-play titles in the fourth quarter of 2010, the percentage of unique paying users for our largest revenue-generating free-to-play games has typically been less than 2%, when measured as the number of unique paying users on a given day divided by the number of unique users on that day, though this percentage fluctuates, and it may be higher than 2% for certain of our games during specific, relatively short time periods, such as immediately following worldwide launch or the week following content updates, marketing campaigns or certain other events.

## Significant Transactions

## Tencent Investment

On April 29, 2015, we entered into a purchase agreement with Tencent Holdings Limited (“Tencent”) and Tencent’s controlled affiliate, Red River Investment Limited (“Red River”), pursuant to which we issued to Red River an aggregate of 21,000,000 shares of our common stock at a purchase price of \$6.00 per share, for aggregate net proceeds of \$125.2 million, after offering expenses. We issued 12,500,000 of these shares to Red River on April 29, 2015 and issued the remaining 8,500,000 shares at a second closing on June 3, 2015. In addition, we entered into a registration rights agreement with Tencent and Red River pursuant to which we agreed to file up to two registration statements

with the SEC within 45 days of a request made by Red River at any time following the six month anniversary of the initial closing and to use all reasonable efforts to have such registration statement declared effective by the SEC within 120 days after such request.

#### Plain Vanilla Corp. Investment

In January 2016, we announced an investment of up to \$7.5 million in promissory notes convertible into a minority equity stake in Plain Vanilla of which \$5.0 million was paid in January 2016 and the remaining \$2.5 million is payable upon Plain Vanilla achieving certain operational milestones during the term of the note purchase agreement pursuant to which the promissory notes were issued. As part of the investment, we also received a call option to acquire all outstanding equity of Plain Vanilla for 15 months from the closing of the initial investment, unless earlier terminated by the Company, at a pre-agreed price. Plain Vanilla is the Icelandic developer of the mobile game QuizUp.

#### Critical Accounting Policies and Estimates

Due to our investments in Plain Vanilla and Dairy Free in January 2016, we added a significant accounting policy relating to variable interest entities in the first quarter of 2016. See “Note 1 - The Company, Basis of Presentation and Summary of Significant Accounting Policies” of our unaudited condensed consolidated financial statements in this report. There were no other significant changes in our Critical Accounting Policies and Estimates during the three



## Table of Contents

months ended March 31, 2016 as compared to the Critical Accounting Policies and Estimates disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on March 4, 2016.

## Recent Accounting Pronouncements

Information with respect to Recent Accounting Pronouncements may be found in Note 1 of the Notes to Unaudited Condensed Consolidated Financial Statements in this report, which information is incorporated herein by reference.

## Results of Operations

The following sections discuss and analyze the changes in the significant line items in our statements of operations for the comparison periods identified.

## Comparison of the Three Months Ended March 31, 2016 and 2015

### Revenue

	Three Months Ended March 31,	
	2016	2015
Revenue by Type	(In thousands)	
Micro-Transactions	\$ 44,516	\$ 59,308
Advertisements	2,733	2,570
Offers	7,032	6,782
Other	247	810
Total revenue	\$ 54,528	\$ 69,470

Our revenue decreased \$14.9 million, or 21.5%, from \$69.5 million for the three months ended March 31, 2015 to \$54.5 million for the three months ended March 31, 2016, which was primarily related to a \$14.8 million decrease in our revenue from micro-transactions (in-app purchases). This decrease was partially offset by a \$413,000 increase in our revenue from advertisements and offers. These decreases were primarily related to an \$11.6 million year-over-year decline in revenue from our Kim Kardashian: Hollywood game, as well as year-over-year declines in

revenue from our Deer Hunter 2014 and Contract Killer: Sniper games of \$7.0 million and \$5.5 million, respectively. These decreases were partially offset by increased revenue from new title launches such as the release of our Kendall and Kylie title in February 2016, and the continued success of our Cooking Dash 2016 title.

We generate revenue from micro-transactions, advertisements and offers, and we sometimes change the focus of our monetization efforts among methods within a given game over the life of the title in an attempt to maximize revenue. For example, we may elect to disable advertisements within a game if we believe doing so will encourage users to play the game longer and thus increase the chance that they will make micro-transactions or complete offers, which generally result in higher revenue for us than advertisements. We rely on a very small portion of our total users for nearly all of our revenue derived from in-app purchases. Since the launch of our first free-to-play titles in the fourth quarter of 2010, the percentage of unique paying users for our largest revenue-generating free-to-play games has typically been less than 2%, when measured as the number of unique paying users on a given day divided by the number of unique users on that day, though this percentage fluctuates, and it may be higher than 2% for certain of our games during specific, relatively short time periods, such as immediately following a worldwide launch or the week following content updates, marketing campaigns or certain other events. Our revenue does not include approximately \$30.8 million of revenue as of March 31, 2016 relating primarily to micro-transactions and offers that have been deferred over the weighted average useful lives of paying users.

In the first three months of 2016, Kim Kardashian: Hollywood, Cooking Dash 2016, Racing Rivals, and Deer Hunter 2016, were our top four revenue-generating games and comprised 24.0%, 15.9%, 13.6%, and 11.6%, respectively, of revenue for the period. No other game generated more than 10% of revenue during the quarter. In the first three months of 2015, Kim Kardashian: Hollywood, Racing Rivals, Deer Hunter 2014, and Contract Killer: Sniper

Table of Contents

were our top four revenue-generating games and comprised 35.5%, 17.5%, 13.7% and 10.7%, respectively, of revenue for the period. No other game generated more than 10% of revenue during the period.

International revenue (defined as revenue generated from distributors, advertising service providers and carriers whose principal operations are located outside the United States or, in the case of the digital storefronts, the revenue generated by end-user purchases made outside of the United States) decreased by \$10.2 million, from \$25.1 million in the three months ended March 31, 2015 to \$14.9 million in the three months ended March 31, 2016. This was primarily related to a \$4.4 million decrease in our EMEA revenue, a \$4.4 million decrease in our APAC revenue and a \$1.5 million decrease in our Americas (excluding the United States) revenue.

## Cost of Revenue

	Three Months Ended March 31, 2016      2015 (In thousands)	
Cost of revenue:		
Platform commissions, royalties and other	\$ 20,363	\$ 26,310
Amortization of intangible assets	2,324	2,434
Total cost of revenue	\$ 22,687	\$ 28,744
Revenue	\$ 54,528	\$ 69,470
Gross margin	58.4%	58.6%

Our cost of revenue decreased \$6.1 million, or 21.1%, from \$28.7 million in the three months ended March 31, 2015 to \$22.7 million in the three months ended March 31, 2016. This decrease was primarily due to a \$4.5 million decrease in platform commission fees due to a lower volume of revenue transactions through the digital storefronts, and a \$2.0 million decrease in royalties associated with a decrease in royalty-burdened revenue, primarily related to lower revenue from our Kim Kardashian: Hollywood title. Revenue attributable to games based upon original intellectual property increased as a percentage of revenue from 41.5% in the three months ended March 31, 2015 to 46.6% in the three months ended March 31, 2016. The average royalty rate that we paid on games based on licensed intellectual property, excluding royalty impairments, increased from 17.5% in the three months ended March 31, 2015 to 17.7% in the three months ended March 31, 2016, due to a larger portion of our royalty payments attributable to games based on or significantly incorporating third-party licensed content which are burdened by higher royalty rates.

Overall royalties, including impairment of prepaid royalties and guarantees, as a percentage of total revenue decreased from 10.2% in the three months ended March 31, 2015 to 9.5% in the three months ended March 31, 2016. We expect our cost of revenue to rise in 2016 as royalty payments increase due to a greater percentage of titles released featuring third-party licensed brands, properties and content as opposed to titles solely utilizing our original intellectual property.

## Research and Development Expenses

	Three Months Ended March 31, 2016      2015 (In thousands)	
Research and development expenses	\$ 20,312	\$ 18,243
Percentage of revenue	37.3%	26.3%

Our research and development expenses increased \$2.1 million or 11.3%, from \$18.2 million in the three months ended March 31, 2015 to \$20.3 million in the three months ended March 31, 2016. The increase in research and development costs was primarily due to a \$1.7 million increase in salaries and benefits as our research and development headcount increased from 561 employees at March 31, 2015 to 583 employees at March 31, 2016, \$691,000 increase in outside services primarily related to external development, a \$434,000 increase in stock compensation, and a \$309,000 increase in allocated charges for equipment, facilities and depreciation. These increases were partially offset by a \$1.2 million decrease in variable compensation resulting from lower attainment of employee and executive bonus targets. As a percentage of revenue, research and development expenses increased from 26.3% in the three months ended March 31, 2015 to 37.3% in the three months ended March 31, 2016. We expect our research and development expenses to decline

Table of Contents

due primarily to reductions in personnel costs following the restructurings we implemented during the fourth quarter of 2015 and the first half of 2016.

## Sales and Marketing Expenses

	Three Months Ended March 31, 2016      2015 (In thousands)	
Sales and marketing expenses	\$ 12,624	\$ 12,438
Percentage of revenue	23.2%	17.9%

Our sales and marketing expenses increased approximately \$186,000, or 1.5%, from \$12.4 million in the three months ended March 31, 2015 to \$12.6 million in the three months ended March 31, 2016. The increase was primarily due to a \$532,000 increase in marketing promotions associated with our free-to-play games, a \$213,000 increase in professional fees including outsourced customer support, and a \$92,000 increase in software licenses. These increases were partially offset by a \$381,000 decrease in variable compensation resulting from lower attainment of employee and executive bonus targets in 2016, as well as an \$116,000 decrease in allocated charges for facilities and depreciation. As a percentage of revenue, sales and marketing expenses increased from 17.9% in the three months ended March 31, 2015 to 23.2% in the three months ended March 31, 2016. We expect our sales and marketing expenditures to continue to increase in 2016 in absolute dollars in connection with the sales and marketing initiatives we intend to undertake related to our existing games and new games we expect to release during the remainder of 2016.

## General and Administrative Expenses

	Three Months Ended March 31, 2016      2015 (In thousands)	
General and administrative expenses	\$ 7,984	\$ 7,406
Percentage of revenue	14.6%	10.7%

Our general and administrative expenses increased \$578,000, or 7.8%, from \$7.4 million in the three months ended March 31, 2015 to \$8.0 million in the three months ended March 31, 2016. The increase in general and administrative expenses was primarily due to a \$908,000 increase in stock based compensation, a \$192,000 increase in salaries and benefits, as headcount increased from 77 employees at March 31, 2015 to 96 employees at March 31, 2016, a \$633,000 increase in allocated charges for facilities and depreciation and a \$491,000 increase in professional, accounting, and consulting fees. These increases were partially offset by a \$1.1 million decrease in variable compensation resulting from lower attainment of employee and executive bonus targets. As a percentage of revenue, general and administrative expenses increased from 10.7% in the three months ended March 31, 2015 to 14.6% in the three months ended March 31, 2016. We expect our general and administrative expenditures to decline for the remainder of 2016 due primarily to the restructurings we implemented in the fourth quarter of 2015 and first half of 2016.

#### Other Operating Expenses

We incurred a restructuring charge of \$106,000 in the three months ended March 31, 2016, primarily due to costs associated with reductions in headcount in certain of our U.S. offices in the first quarter of 2016. We did not incur any restructuring charges in the three months ended March 31, 2015. We expect our restructuring costs to continue to rise in the second quarter of 2016 in connection with our additional restructuring activities.

#### Interest and Other Income/(Expense), Net

Interest and other income/(expense), net, increased from a net expense of \$284,000 in the three months ended March 31, 2015 to income of \$469,000 in the three months ended March 31, 2016. This increase was primarily attributable to a \$300,000 increase related to the change in fair value of our investment in a promissory note issued by

Table of Contents

Plain Vanilla, as compared to the same period from the prior year, as well as an increase due to foreign currency gains related to the revaluation of certain assets and liabilities including accounts payable and accounts receivable caused by the fluctuation in foreign exchange rates against the U.S. Dollar.

## Income Tax Benefit/ (Expense)

Our income tax benefit/ (expense) changed from a \$1.1 million tax expense in the three months ended March 31, 2015 to a tax benefit of \$166,000 in the three months ended March 31, 2016. This change was primarily due to changes in the jurisdictions included in the anticipated effective tax rate computation and changes in pre-tax income in certain foreign entities. The provision for income taxes differs from the amount computed by applying the statutory U.S. federal rate principally due to the effect of our non-U.S. operations, non-deductible stock-based compensation expense, and change in foreign withholding taxes.

Our effective income tax rates for future periods will depend on a variety of factors, including changes in the deferred tax valuation allowance, as well as changes in our business such as intercompany transactions, any acquisitions, any changes in our international structure, any changes in the geographic location of our business functions or assets, changes in the geographic mix of our income, any changes in or termination of our agreements with tax authorities, changes in applicable accounting rules, applicable tax laws and regulations, rulings and interpretations thereof, developments in tax audit and other matters, and variations in our annual pre-tax income or loss. We incur certain tax expenses that do not decline proportionately with declines in our pre-tax consolidated income or loss. As a result, in absolute dollar terms, our tax expense will have a greater influence on our effective tax rate at lower levels of pre-tax income or loss than at higher levels. In addition, at lower levels of pre-tax income or loss, our effective tax rate will be more volatile. At March 31, 2016, we anticipated that the liability for uncertain tax positions, excluding interest and penalties, could decrease by approximately \$139,000 within the next twelve months due to the expiration of certain statutes of limitation in foreign jurisdictions in which we do business.

## Liquidity and Capital Resources

	Three Months Ended March 31, 2016                      2015 (In thousands)	
Consolidated Statement of Cash Flows Data:		
Cash flows used in operating activities	(11,790)	(5,112)
Cash flows used in investing activities	(10,108)	(1,110)
Cash flows provided by financing activities	552	1,307

Since our inception, we have generally incurred recurring losses and negative annual cash flows from operating activities. As of March 31, 2016, we had an accumulated deficit of \$259.8 million.

## Operating Activities

In the three months ended March 31, 2016, net cash used in operating activities was \$11.8 million versus \$5.1 million of net cash used in operating activities for the three months ended March 31, 2015, which was primarily due to an \$8.6 million net loss, a \$5.2 million increase in prepaid royalties, a \$2.6 million decrease in accrued compensation, and a \$1.1 million decrease in accrued royalties. These amounts were partially offset by a \$1.1 million decrease in accounts receivable and adjustments for non-cash items, including stock-based compensation expense of \$3.5 million, amortization of intangible assets of \$2.3 million, and depreciation expense of \$656,000.

In the three months ended March 31, 2015, net cash used in operating activities was \$5.1 million, which was primarily due to a \$9.6 million increase in prepaid royalties, a \$6.7 million decrease in deferred revenue, a \$2.6 million decrease in accrued compensation, and a \$2.6 million decrease in accrued royalties. These amounts were partially offset by a \$7.6 million decrease in accounts receivable, a \$2.0 million decrease in prepaid expenses and other current assets, and adjustments for non-cash items, including amortization of intangible assets of \$2.6 million, stock-based



## Table of Contents

compensation expense of \$2.1 million, depreciation expense of \$706,000, and a non-cash foreign currency translation loss of \$290,000.

### Investing Activities

In the three months ended March 31, 2016, we used \$10.1 million of cash for investing activities primarily related to investments in Plain Vanilla and Dairy Free of \$7.0 million in the aggregate, purchases of intangible assets of \$2.5 million, and property and equipment purchases of \$608,000.

In the three months ended March 31, 2015, we used \$1.1 million of cash for investing activities primarily related to property and equipment purchases of \$499,000, acquisition consideration paid to former Cie Games stockholders of \$351,000, and other investments of \$250,000.

### Financing Activities

In the three months ended March 31, 2016, net cash provided by financing activities was \$552,000 due primarily to \$1.1 million related to option and warrant exercises and purchases under our employee stock purchase plan. These cash inflows were partially offset by \$577,000 of taxes paid related to net share settlement of RSUs that vested during the first quarter of 2016.

In the three months ended March 31, 2015, net cash provided by financing activities was \$1.3 million due to option and warrant exercises and purchases under our employee stock purchase plan. These cash inflows were partially offset by taxes paid related to net share settlement of RSUs that vested during the first quarter of 2015.

### Sufficiency of Current Cash and Cash Equivalents

Our cash and cash equivalents were \$159.3 million as of March 31, 2016. Cash and cash equivalents held outside of the United States in various foreign subsidiaries were \$6.2 million as of March 31, 2016, most of which were held by our United Kingdom, Chinese, and Russian subsidiaries. Under current tax laws and regulations, if cash and cash equivalents held outside the United States are distributed to the United States in the form of dividends or otherwise, we may be subject to additional United States income taxes and foreign withholding taxes. We have not provided deferred taxes on unremitted earnings attributable to foreign subsidiaries because these earnings are intended to be reinvested indefinitely.

As discussed in “Significant Transactions” above, on April 29, 2015, we received aggregate net proceeds of \$125.2 million, after offering expenses, in connection with the purchase by Red River of 21,000,000 shares of our common stock.

We expect to fund our operations, grow our business and satisfy our contractual obligations during the next 12 months primarily through our cash and cash equivalents and cash flows from operations. We believe our cash and cash equivalents and cash inflows will be sufficient to meet our anticipated cash needs for at least the next 12 months; however, our cash requirements for the next 12 months may be greater than we anticipate due to, among other reasons, revenue that is lower than we currently anticipate, greater than expected operating expenses, particularly with respect to our research and development and sales and marketing initiatives, use of cash to pay minimum guaranteed royalties, use of cash to fund our foreign operations, use of cash to repurchase our common stock pursuant to the \$50.0 million stock repurchase program approved by our board of directors in January 2016, potential use of cash to exercise, at our election, our call option to acquire the outstanding equity of Plain Vanilla for a pre-arranged price, and the impact of foreign currency rate changes, unanticipated limitations or timing restrictions on our ability to access funds that are held in our non-U.S. subsidiaries or any investments or acquisitions that we may decide to pursue. We expect to continue to use cash to fund minimum guaranteed royalty payments during the remainder of 2016 as milestone payments become due on applications we publish and/or develop that incorporate third party licensed property. If the games we develop based on such licensing arrangements fail to perform in accordance with our expectations, we may not fully recoup these minimum guaranteed royalty payments, which would negatively impact our operating results.

Table of Contents

If our cash sources are insufficient to satisfy our cash requirements, we may seek to raise additional capital. However, we may be unable to do so on terms that are favorable to us or at all.

## Contractual Obligations

The following table is a summary of our contractual obligations as of March 31, 2016:

	Payments Due by Period				
	Total	2016 (remaining nine months)	2017-2018	2019-2020	Thereafter
	(In thousands)				
Operating lease obligations	\$ 14,588	\$ 3,730	\$ 7,154	\$ 3,704	\$ —
Guaranteed royalties (1)	37,085	35,019	2,066	—	—
Developer Commitments (2)	1,150	800	350	—	—
Total contractual obligations	\$ 52,823	\$ 39,549	\$ 9,570	\$ 3,704	\$ —

- 
- (1) We have entered into license and publishing agreements with various celebrities and other owners of brands, properties and other content to develop and publish games and other software applications for mobile devices. These agreements typically require us to make non-refundable, but recoupable payments of minimum guaranteed royalties or license fees as up-front payments or over the term of the agreement.
- (2) From time to time we enter into contracts with various external software developers to design and develop games and other software applications. We advance funds to these third-party developers, typically payable in installments upon the completion of specified development milestones.
- (3) We have omitted uncertain income tax liabilities from this table due to the inherent uncertainty regarding the timing of potential issue resolution. Specifically, either the underlying positions have not been fully developed enough under audit to quantify at this time or the years relating to the issues for certain jurisdictions are not currently under audit. At March 31, 2016, we had \$939,000 of gross unrecognized tax benefits, of which \$609,000 was included in "Other long-term Liabilities" and \$330,000 was included in "Accounts Payable" in the consolidated balance sheet.

## Fair Value Measurements

For Plain Vanilla, we have elected the fair value option to account for our investment in the promissory note. The call option was recorded at cost. As of the investment date, the fair value of the promissory note and the call option was determined to be \$2.6 million and \$2.4 million, respectively and recorded in other long term assets. As of March 31, 2016, we fair valued the promissory note at \$2.9 million and recorded a benefit of \$300,000 in other income.

As of March 31, 2016, our financial assets and financial liabilities are presented below at fair value and were classified within the fair value hierarchy as follows (in thousands):

	Level 1	Level 2	Level 3	March 31, 2016
Financial Assets				
Cash and cash equivalents	159,283	—	—	159,283
Restricted cash	1,498	—	—	1,498
Convertible promissory note investment in Plain Vanilla Corp.	—	—	2,900	2,900
Call option to acquire Plain Vanilla Corp. (1)	—	—	2,100	2,100
Total Financial Assets	160,781	—	5,000	165,781

(2) These assets are carried on the consolidated balance sheet on a historical cost basis (see “Note 6 - Investments”)

As of December 31, 2015, our financial assets and financial liabilities are presented below at fair value and were classified within the fair value hierarchy as follows (in thousands):

	Level 1	Level 2	Level 3	December 31, 2015
Financial Assets				
Cash and cash equivalents	180,542	—	—	180,542
Restricted cash	1,498	—	—	1,498
Total Financial Assets	182,040	—	—	182,040

Table of Contents

Our cash and cash equivalents, which were held in operating bank accounts, are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. In addition, our restricted cash is classified within Level 1 of the fair value hierarchy. The carrying value of accounts receivable and payables approximates fair value due to the short time to expected payment or receipt of cash.

We engaged third party valuation experts to aid us in our analysis of the fair value of the promissory note issued to us by, and the call option for, Plain Vanilla.

The fair value of the promissory note was estimated using a probability weighted assessment of the expected cash flows discounted to their present value. The discount rate of 88.1% used in the analysis reflects the early stage nature of the entity and the overall gaming industry indices. The assumptions used in the expected cash flows model are level 3 inputs as defined above. The fair value of the call option was estimated using the probability weighted Black-Scholes valuation model. The Black-Scholes valuation model requires inputs such as the expected term of the call option, expected volatility and risk-free interest rate. Certain of these inputs are subjective and require significant analysis and judgment to develop. The weighted average assumptions used by the company are level 3 inputs as defined above and are noted in the following table:

	Three Months Ended March 31, 2016	
Dividend yield	—	%
Risk-free interest rate	0.47	%
Expected volatility	45	%
Expected term (in years)	0.95	

The following table presents the changes in fair value of the Plain Vanilla promissory note and the call option (in thousands):

	Three months ended March 31, 2016		
	Asset at the beginning of the period (1)	Increase/ (decrease) in fair value	Asset at the end of the period
Convertible promissory note investment in Plain Vanilla Corp.	2,600	300	2,900
Call option to acquire Plain Vanilla Corp. (2)	2,400	(300)	2,100

- (1) As of the investment date of January 19, 2016 - (see "Note 6 - Investments")
- (2) These assets are carried on the consolidated balance sheet on a historical cost basis (see "Note 6 - Investments")

#### Off-Balance Sheet Arrangements

At March 31, 2016, we did not have any significant off-balance sheet arrangements requiring disclosure under Item 303(a)(4)(ii) of Regulation S-K, other than those listed in our contractual obligations table above.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information in this section should be read in connection with the information on financial market risk related to changes in interest rates and non-U.S. currency exchange rates in Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," in our Annual Report on Form 10-K for the year ended December 31, 2015. Our market risk profile has not changed significantly during the three months ended March 31, 2016.

#### Interest Rate and Credit Risk

Our exposure to interest rate risk relates primarily to our investment portfolio and the potential losses arising from changes in interest rates.

## Table of Contents

We are potentially exposed to the impact of changes in interest rates as they affect interest earned on our investment portfolio. As of March 31, 2016, we had no short-term investments and substantially all \$159.3 million of our cash and cash equivalents was held in operating bank accounts earning nominal interest. Accordingly, we do not believe that a 10% change in interest rates would have a significant impact on our interest income, operating results or liquidity related to these amounts.

The primary objectives of our investment activities are, in order of importance, to preserve principal, provide liquidity and maximize income without significantly increasing risk. We do not currently use or plan to use derivative financial instruments in our investment portfolio.

As of March 31, 2016 and December 31, 2015, our cash and cash equivalents were maintained by financial institutions in the United States, the United Kingdom, Canada, China, Hong Kong, India, Russia, Japan, and Korea, and our current deposits are likely in excess of insured limits.

Our accounts receivable primarily relate to revenue earned from digital storefront operators and advertising platforms. We perform ongoing credit evaluations of our customers' and the digital storefronts' financial condition but generally require no collateral from them.

At March 31, 2016, Apple Inc. accounted for 40.9%, Google Inc. accounted for 20.8%, and Jirbo Inc. (dba AdColony) accounted for 20.6% of our total accounts receivable. At December 31, 2015, Apple accounted for 55.0% and Google accounted for 15.2% of total accounts receivable. No other customer or Digital Storefront represented more than 10% of our total accounts receivable as of these dates.

## Foreign Currency Exchange Risk

We transact business in more than 100 countries in more than 30 different currencies, and in 2015 and the first three months of 2016, some of these currencies fluctuated significantly. Our revenue are usually denominated in the functional currency of the carrier or distributor while the operating expenses of our operations outside of the United States are maintained in their local currency, with the significant operating currencies consisting of British Pound Sterling ("GBP"), Chinese Renminbi, Euro, and Russian Ruble. Although recording operating expenses in the local currency of our foreign operations mitigates some of the exposure of foreign currency fluctuations, variances among the currencies of our customers and our foreign operations relative to the U.S. Dollar ("USD") could have and have had a material impact on our results of operations.

Our foreign currency exchange gains and losses have been generated primarily from fluctuations in GBP versus the USD, the Russian Ruble versus the USD and in the Euro versus GBP. At month-end, non-functional currency-denominated accounts receivable and intercompany balances are marked to market and unrealized gains and losses are included in other income (expense), net. Translation adjustments arising from the use of differing exchange rates are included in accumulated other comprehensive income in stockholders' equity. We have in the past experienced, and in the future expect to experience, foreign currency exchange gains and losses on our accounts receivable and intercompany receivables and payables. Foreign currency exchange gains and losses could have a material adverse effect on our business, operating results and financial condition.

There is also additional risk if the currency is not freely or actively traded. Some currencies, such as the Chinese Renminbi, in which our Chinese operations principally transact business, are subject to limitations on conversion into other currencies, which can limit our ability to react to foreign currency devaluations.

To date, we have not engaged in exchange rate hedging activities, and we do not expect to do so in the foreseeable future.

#### Inflation

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we might not be able to offset these



Table of Contents

higher costs fully through price increases. Our inability or failure to do so could harm our business, operating results and financial condition.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Based upon an evaluation of the effectiveness of disclosure controls and procedures, our Chief Executive Officer (CEO) and Chief Financial Officer (CFO) have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures, as defined under Rule 13a-15(e) and 15d-15(e) of the Exchange Act, were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the three months ended March 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On November 4, 2015, Just Games Interactive LLC (d/b/a Kung Fu Factory, f/k/a Tiny Fun Studios) (“Just Games”) filed a complaint in the U.S. District Court for the Central District of California against us, Kristen Jenner (f/k/a Kris Kardashian) and additional yet-to-be named defendants. The complaint alleged direct copyright infringement against us and direct and contributory copyright infringement and breach of implied contract against the other defendants. Just Games was seeking at least \$10.0 million in damages as well as other relief, including costs, permanent and temporary injunctive relief, an accounting of profits, a constructive trust and such other costs the Court deemed just and proper. We filed a motion to dismiss the complaint on January 27, 2016. On February 1, 2016, Just Games filed a voluntary motion to dismiss their case against us without prejudice.

From time to time, we are subject to various claims, complaints and legal actions in the normal course of business. We are not currently party to any pending litigation, the outcome of which will have a material adverse effect on our operations, financial position or liquidity. However, the ultimate outcome of any litigation is uncertain and, regardless of outcome, litigation can have an adverse impact on us because of defense costs, potential negative publicity, diversion of management resources and other factors.

Item 1A. Risk Factors

Our business is subject to many risks and uncertainties, which may affect our future financial performance. If any of the events or circumstances described below occurs, our business and financial performance could be harmed, our actual results could differ materially from our expectations and the market value of our stock could decline. The risks and uncertainties discussed below are not the only ones we face. There may be additional risks and uncertainties not currently known to us or that we currently do not believe are material that may harm our business and financial performance. Because of the risks and uncertainties discussed below, as well as other variables affecting our operating results, past financial performance should not be considered as a reliable indicator of future performance and investors should not use historical trends to anticipate results or trends in future periods.

We have a history of net losses, may incur substantial net losses in the future and may not achieve and sustain profitability or growth in future periods.

We have incurred significant losses since inception, including a net loss of \$7.2 million in 2015 and a net loss of \$8.6 million for the first quarter of 2016. As of March 31, 2016, we had an accumulated deficit of \$259.8 million. While

we have conducted several restructurings over the past six months aimed at reducing our fixed costs and operating more efficiently, our costs may continue to rise as we implement additional initiatives designed to increase revenue, including developing new games with greater complexity, higher production values and deeper social features, running live operations on our games, and taking other steps to strengthen our company. We anticipate that the costs of acquiring new players and otherwise marketing our new titles will continue to rise (particularly since advertising costs in our industry have generally been rising and downloads of our games are decreasing as users spend more time on alternative software applications, such as social media and messaging applications), and we may continue to increase the amount we pay for licenses to third party intellectual property (particularly with regards to celebrity licensors), including incurring significant minimum guaranteed royalty payments. If our revenue does not increase at a rate sufficient to offset these additional expenses, if the launch dates for our games are delayed, such is the case with our launch of Frontline Commando Rivals, a title under development through our strategic partnership with Tencent, if we experience unexpected significant increases in operating expenses or if we are required to take additional charges related to impairments or restructurings, we will continue to incur losses. For example, we expect to incur restructuring charges in the second quarter of 2016 following our headcount reductions initiated in April 2016. Given the declines in overall downloads of mobile gaming applications as compared to non-gaming applications, and the significant amount of time and attention users are dedicating to social media and other non-gaming applications, increasing revenue has been, and may continue to be, challenging. This industry trend has been negatively impacting us, as the number of downloads of sequels to certain of our most successful franchises, including the launches of Deer Hunter 2016 and Eternity Warriors 4, have downloaded at significantly lower rates as compared to predecessor versions.

## Table of Contents

If we fail to develop and publish new mobile games that achieve market acceptance, as well as continue to enhance our existing games, particularly our most successful games, our revenue would suffer.

Our business depends on developing and publishing mobile games that consumers will download and spend time and money playing. We must continue to invest significant resources in research and development, technology, analytics and marketing to introduce new games and continue to update our successful free-to-play games, and we often must make decisions about these matters well in advance of a product release to timely implement them. Our success depends, in part, on unpredictable and volatile factors beyond our control, including consumer preferences, competing gaming and non-gaming related applications, new mobile platforms and the availability of other entertainment activities. If our games do not meet consumer expectations, or they are not brought to market in a timely and effective manner, our business, operating results and financial condition would be harmed. Historically, we have focused on developing and publishing shooters and other action games primarily directed at male audiences. While our Kim Kardashian: Hollywood, Kendall and Kylie, and Cooking Dash 2016 titles have been commercially successful, our Katy Perry Pop game was not and meeting consumer expectations could prove more challenging for us in the future as we release a greater number of games that are primarily targeted toward female audiences (such as our other games under development in the celebrity and resource management genres). Even if our games are successfully introduced and initially adopted, a failure to continue to update them with compelling content or a subsequent shift in the entertainment preferences of consumers could cause a decline in our games' popularity that could materially reduce our revenue and harm our business, operating results and financial condition, which effect would be magnified for our most successful games. It is difficult to predict when and how quickly one of our games will decline. As a result of 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, and if, as we anticipate, we launch fewer titles in 2016 than in prior years, we may be less likely to launch a game that achieves significant commercial success. If rates of decline are higher than expected in a particular quarterly period and/or we experience delays in the launch of new games, such as Frontline Commando Rivals, that we expect to offset these declines, or the new games we launch fail to download and/or monetize as we anticipate, we may not meet our expectations or the expectations of securities analysts or investors for a given quarter. In addition, our Kim Kardashian: Hollywood game benefitted significantly from awareness of the game through media coverage and social media channels, and such viral success can be difficult to predict or to repeat in the future, or as in the case of Kendall and Kylie, may not translate into the level of sustained commercial success we experienced with Kim Kardashian: Hollywood. Furthermore, we compete for the discretionary spending of consumers, who face a vast array of entertainment choices, including social media and other non-gaming related apps, games played on personal computers and consoles, television, movies, sports and the Internet. If we are unable to sustain sufficient interest in our games compared to other forms of entertainment, our business and financial results would be seriously harmed.

Successfully developing and monetizing free-to-play games is a challenging business model.

In early 2010, we changed our business model to focus on becoming a leading developer and publisher of "free-to-play" games for smartphone and tablet devices. Free-to-play games are games that a player can download and play for free, but which allow players to access a variety of additional content and features for a fee and to engage with various advertisements and offers that generate revenue for us. The most successful recent launches of free-to-play games tend to include socio-competitive gameplay, player versus player activities, regularly updated content and other complex technological and creative attributes associated with Games-as-a-Service, or GaaS, offerings. While we are working to include such features in our games, many of our historical games did not include some or all of these GaaS features, and we may not successfully execute this transition. In addition, following the success of our Kim Kardashian: Hollywood game, we expanded our efforts to build the premier celebrity gaming platform. We are partnering with A-list celebrities to selectively collaborate on future games, and if those games fail to perform to expected levels, such as occurred with our Katy Perry Pop title, our revenue could be limited and our business and operating results would suffer. Our efforts to develop free-to-play games, celebrity and other licensed property games

and our transition towards becoming a GaaS company may prove unsuccessful or, even if successful, it may take more time than we anticipate to achieve significant revenue because, among other reasons:

- our free-to-play strategy assumes that a large number of players will download our games because they are free and that we will then be able to effectively monetize the games; however, players may not widely

## Table of Contents

download our games for a variety of reasons, including competition for downloads with social media and other non-gaming related applications, poor consumer reviews or other negative publicity, ineffective or insufficient marketing efforts, lack of sufficient social and community features, lack of prominent storefront featuring, failure to reach and maintain Top Free App Store rankings, and the relatively large file size of some of our games—our games often utilize a significant amount of the available memory on a user’s device, and due to the inherent limitations of the smartphone platforms and telecommunications networks, which at most only allow applications that are less than 100 megabytes to be downloaded over a carrier’s wireless network, players must download our games that exceed 100 megabytes either via a wireless Internet (wifi) connection or initially to their computer and then side-loaded to their device, and Apple’s requirement that games released on the Apple App Store include 64-bit support has resulted in an increase to the file sizes of our games, potentially making our games more difficult for our players to download;

- even if our games are widely downloaded, we may fail to retain users or optimize the monetization of these games, such as has been the case with our Kendall and Kylie title, which may occur for a variety of reasons, including poor game design or quality, lack of GaaS features, gameplay issues such as game unavailability, long load times or an unexpected termination of the game due to data server or other technical issues, lack of differentiation from predecessor games or other competitive games, differences in user demographics and purchasing power or our failure to effectively respond and adapt to changing user preferences through game updates;
- future celebrity and other licensed property games that we release may fail to resonate with consumers, may cannibalize revenue from our existing games, and may cost more to build than other titles due to the minimum guaranteed royalty payments to our celebrity licensors and due to the need to differentiate gameplay among titles featuring celebrities. It is unclear whether future celebrity-based games have the potential to generate revenue at levels similar to our Kim Kardashian: Hollywood title or whether these games can be successful at all, including that the number of social media followers for a particular celebrity may have limited impact on the financial success of a title (as occurred with our Katy Perry Pop title) or the number of initial downloads may not result in significant financial success on a sustained basis (as occurred with our Kendall and Kylie title);
- we intend to continue to develop a significant number of games based upon our own intellectual property, rather than celebrities or well-known licensed brands and properties, and we may encounter difficulties in generating sufficient consumer interest in and downloads of our games, particularly considering we have experienced significantly fewer downloads of recent launches of game sequels as compared to their predecessors;
- many well-funded public and private companies have released, or plan to release, free-to-play games, including those provided under the GaaS model and those partnering with celebrities or other well-known licensed brands or properties, and this competition will make it more difficult for us to differentiate our games and derive significant revenue from them;
- competitors have released, and may release in the future, other mobile software applications featuring celebrities (including our own celebrity partners), and this competition may make it more difficult for us to derive significant revenue from our celebrity games;
  - free-to-play games, including those delivered as a service, and particularly those featuring celebrities, have a relatively limited history, and it is unclear how popular this style of game will become or remain or its revenue potential;
- we may have difficulty hiring the experienced monetization, live operations, server technology, user experience and product management personnel that we require to support our continued transition to becoming a GaaS company and to building the premier celebrity gaming platform, or may face difficulties in developing our GaaS technology platform and incorporating it into our products or developing unique

## Table of Contents

gameplay;

- we will depend on the proper and continued functioning of our own servers and third-party infrastructure to operate our connected games that are delivered as a service; and
- the Federal Trade Commission (the “FTC”) has indicated that it intends to review issues related to in-app purchases, particularly with respect to games that are marketed primarily to minors (for example, the FTC reached a settlement with Apple in January 2014 and with Google in September 2014 on this issue, and in April 2016, a federal court granted summary judgment in favor of the FTC finding Amazon liable for unfairly billing consumers for unauthorized in-app purchases by minors), and the FTC might issue rules significantly restricting or even prohibiting in-app purchases or name us as a defendant in a future class-action lawsuit.

If we do not achieve a sufficient return on our investment with respect to our free-to-play business model, it will negatively affect our operating results and may require us to formulate a new business strategy.

We rely on a very small portion of our total players for nearly all of our revenue that we derive from in-app purchases.

We rely on a very small portion of our total players for nearly all of our revenue derived from in-app purchases (as opposed to advertisements and incentivized offers) and installation rates and user-growth have declined for us with many of our recent product launches. Since the launch of our first free-to-play titles in the fourth quarter of 2010, the percentage of unique paying players for our largest revenue-generating free-to-play games has typically been less than 2%, when measured as the number of unique paying users on a given day divided by the number of unique users on that day, though this percentage fluctuates, and it may be higher than 2% for some of our games during specific, relatively short time periods, such as immediately following worldwide launch or the week following content updates, marketing campaigns or certain other events. To significantly increase our revenue, we must increase the number of downloads of our games, increase the number of players who convert into paying players by making in-app purchases, increase the amount that our paying players spend in our games and/or increase the length of time our players generally play our games. We might not succeed in our efforts to increase the monetization rates of our users, particularly if we do not increase the amount of social features in our games or otherwise succeed in our transition to becoming a GaaS company. If we are unable to convert non-paying players into paying players, or if we are unable to retain our paying players or if the average amount of revenue that we generate from our players does not increase or declines, our business may not grow, our financial results will suffer, and our stock price may decline.

We derive the majority of our revenue from Apple’s App Store and the Google Play Store, and if we are unable to maintain a good relationship with each of Apple and Google or if either of these storefronts were unavailable for any prolonged period of time, our business will suffer.

The majority of our smartphone revenue has historically been derived from Apple’s iOS platform, which accounted for 61.6% of our total revenue for the three months ended March 31, 2016 compared with 60.9% of our total revenue for the three months ended March 31, 2015. We generated the majority of this iOS-related revenue from the Apple App Store, which represented 51.3% and 53.6% of our total revenue for the three months ended March 31, 2016 and 2015, respectively, with the significant majority of such revenue derived from in-app purchases. We generated the balance of our iOS-related revenue from offers and advertisements in games distributed on the Apple App Store and, to a far lesser extent, sales of premium games. In addition, we derived approximately 37.5% and 37.0% of our total revenue for the three months ended March 31, 2016 and 2015, respectively, from the Android platform. We generated the majority of our Android-related revenue from the Google Play Store, which represented 27.4% and 27.3% of our total revenue for the three months ended March 31, 2016 and 2015, respectively, with the significant majority of such revenue derived from in-app purchases. We believe that we have good relationships with each of Apple and Google, which have contributed to the majority of our games released in the last several years being featured on their respective storefronts upon commercial release. If we do not continue to receive prominent featuring, users may find

it more difficult to discover our games and we may not generate significant revenue from them. We may also be required to spend significantly more on marketing campaigns to generate substantial revenue on these platforms. In addition, currently



## Table of Contents

neither Apple nor Google charge a publisher when it features one of their apps. If either Apple or Google were to charge publishers to feature an app, it could cause our marketing expenses to increase considerably. Accordingly, any change or deterioration in our relationship with Apple or Google could materially harm our business and likely cause our stock price to decline.

We also rely on the continued functioning of the Apple App Store and the Google Play Store. In the past these digital storefronts have been unavailable for short periods of time or experienced issues with their in-app purchasing functionality. For example, on March 11, 2015, the Apple App Store experienced an approximately 12-hour global outage, which resulted in players and potential players of our games being unable to both download our games and make in-app purchases within our games during such outage. If such events recur on a prolonged basis or other similar issues arise that impact our ability to generate revenue from these storefronts, it would have a material adverse effect on our revenue and operating results. In addition, if these storefront operators fail to provide high levels of service, our players' ability to access our games may be interrupted or players may not receive the virtual currency or goods for which they have paid, which may adversely affect our brand.

The operators of digital storefronts on which we publish our free-to-play games and the advertising channels through which we acquire some of our players in many cases have the unilateral ability to change and interpret the terms of our and others' contracts with them.

We distribute our free-to-play games through direct-to-consumer digital storefronts, for which the distribution terms and conditions are often "click through" agreements that we are not able to negotiate with the storefront operator. For example, we are subject to each of Apple's and Google's standard click-through terms and conditions for application developers, which govern the promotion, distribution and operation of apps, including our games, on their storefronts. Each of Apple and Google can unilaterally change its standard terms and conditions with no prior notice to us. In addition, the agreement terms can be vague and subject to changing interpretations by the storefront operator. Further, these storefront operators typically have the right to prohibit a developer from distributing its applications on its storefront if the developer violates its standard terms and conditions. For example, in the second quarter of 2011, Apple began prohibiting virtual currency-incented advertising offers in games that directed users to download other applications from the Apple App Store in order to complete the offer. These offers accounted for approximately one-third of our smartphone revenue during the three months ended June 30, 2011, and our inability to subsequently use such offers negatively impacted our smartphone revenue thereafter. In addition, Apple informed us early in the fourth quarter of 2012 that we could no longer include links to Tapjoy's HTML5 website in our games, which negatively impacted our ability to generate revenue through incented offers. Apple has implemented restrictions related to games that include guns, including changing its game rating methodology, which has resulted in all of our games that include gun violence receiving a 17+ rating, and prohibiting some depictions of guns in game icons and other storefront art; these restrictions, could potentially negatively impact the number of people playing these "shooter" games and the revenue we generate from these games. During the second quarter of 2014, there were reports that Apple was considering prohibiting some types of virtual currency-incented video advertising in games that promoted other applications available on the Apple App Store. These incented video advertisements generate a meaningful percentage of our overall revenue, and any prohibition of these advertisements would have had a negative impact on our revenue. In the fourth quarter of 2014, Apple informed developers that beginning on February 1, 2015 all new applications, and beginning June 1, 2015 all updates to existing applications, submitted to the Apple App Store must include 64-bit support. We did not previously build our games to include 64-bit support nor did the Unity development engine that we utilize to create many of our games support 64-bit development; however, we worked with Unity to ensure that we met Apple's requirement. Building our games to support 64-bit development has increased the file sizes of our games making it more difficult for players to download our games and potentially negatively impacting the number of downloads and active users of our titles, particularly for those games where we are unable to keep file sizes below 100 megabytes, which is the maximum file size that can currently be downloaded over any carrier's wireless network (requiring download over wifi networks). In addition, we believe that Apple may

have made changes to its algorithms that determine the App Store's Top Free application rankings, as games currently have a more difficult time achieving and maintaining Top Free rankings than has historically been the case. The Top Free rankings are one of the primary means for consumers to discover our games, and to the extent that algorithm changes have occurred that make it more difficult for mobile games to reach and maintain Top Free spots, it would contribute to fewer installs of our games. If Apple or Google, or any other key storefront operator, determines that we or one of our key vendors are violating its standard terms and conditions, by a new interpretation or otherwise, or prohibits us from distributing our games on its storefront, it would

## Table of Contents

materially harm our business and likely cause our stock price to significantly decline.

In addition, in the first quarter of 2014, Facebook prohibited HasOffers, whose software development kit we had incorporated into our games to track advertising metrics, from participating in Facebook's mobile measurement program because Facebook asserted that HasOffers had violated its agreement with Facebook. As a result, we removed HasOffers' software development kit from our games and replaced it with software from a new vendor. While this change did not adversely impact our revenue or operations, any similar changes or prohibitions in the future could negatively impact our revenue or otherwise materially harm our business, and we may not receive significant or any advance warning of such changes.

The markets in which we operate are highly competitive, and many of our competitors have significantly greater resources than we do.

Developing, distributing and selling mobile games is a highly competitive business, characterized by frequent product introductions and rapidly emerging new platforms, technologies and storefronts. For players, we compete primarily on the basis of game quality, brand and customer reviews. We also compete more generally for the time and attention of users of smartphones and tablet devices who are spending ever-increasing amounts of time on social media and messaging applications. We compete for promotional and digital storefront placement based on our relationship with the digital storefront owner, historical performance, game quality, perception of sales potential, customer reviews and relationships with celebrities and other licensors of brands and other content. For celebrities, brands and other content licensors, we compete based on royalty and other economic terms, historical financial performance of celebrity and other third-party licensed brand and property games, perceptions of development quality, porting abilities, speed of execution, distribution breadth and relationships with storefront owners. We also compete for experienced and talented employees.

We compete with a continually increasing number of companies, including Activision (particularly through its acquisition of King Digital Entertainment), DeNA, Disney, Electronic Arts (EA Mobile), Gameloft, Gamevil, GREE, GungHo Online Entertainment, Nexon, Warner Brothers, and Zynga and many well-funded private companies, including Kabam, Machine Zone, Pocket Gems, Rovio, SGN Games, Storm 8/Team Lava, and Supercell. In addition, we face competition from online game developers and distributors who are primarily focused on specific international markets. We could also face increased competition if those companies choose to compete more directly in the United States or the other markets that are significant to us or if large companies with significant online presences such as Apple, Google, Amazon, Facebook or Yahoo, choose to enter or expand in the games space or develop competing games. We also compete for downloads and time spent on mobile devices with companies that develop popular social media and messaging applications, such as Facebook (with its Facebook, Facebook Messenger, Instagram, WhatsApp and other applications), Pinterest, Reddit, Snapchat, Twitter, Vevo and YouTube, companies that develop streaming music applications, such as Pandora, Spotify and Tidal, and with companies that create non-gaming related software applications for celebrities.

In addition, given the open nature of the development and distribution for smartphones and tablets and the relatively low barriers to entry, we also compete or will compete with a vast number of small companies and individuals who are able to create and launch games and other content for these devices using relatively limited resources and with relatively limited start-up time or expertise. As an example of the competition that we face, it has been estimated that more than 2.2 million applications, including more than 525,000 active games, were available on Apple's U.S. App Store as of March 31, 2016. The proliferation of titles in these open developer channels makes it difficult for us to differentiate ourselves from other developers and to compete for players without substantially increasing our marketing expenses and development costs.

Some of our competitors and our potential competitors have one or more advantages over us, either globally or in particular geographic markets, which include:

- significantly greater financial resources;
- greater experience with free-to-play games, GaaS business models, and building social and community features into mobile games, as well as more effective game monetization;

Table of Contents

- stronger brand and consumer recognition regionally or worldwide;
- the capacity to leverage their marketing expenditures across a broader portfolio of mobile and non-mobile products;
- larger installed user bases from their existing mobile games;
- larger installed user bases from related platforms, such as console gaming or social networking websites, to which they can market and sell mobile games;
- more substantial intellectual property of their own from which they can develop games without having to pay royalties;
- lower labor and development costs and better overall economies of scale;
- greater platform-specific focus, experience and expertise; and
- broader global distribution and presence.

If we are unable to compete effectively or we are not as successful as our competitors in our target markets, our sales could decline, our margins could decline and we could lose market share, any of which would materially harm our business, operating results and financial condition.

Our players may decide to select competing forms of entertainment instead of playing our games.

We also face competition for the leisure time, attention and discretionary spending of our players. Other forms of leisure time activities, such as social media and messaging applications, personal computer and console games, television, movies, sports, and the Internet, are generally much larger and more well-established options for consumers. In addition, competition for the attention of players on their mobile devices is intense, as the number of apps on mobile devices is increasing dramatically. In particular, non-gaming applications for mobile devices, such as social media and messaging, music and dating applications, have become increasingly popular, making it more difficult for mobile games to generate the same level of consumer interest and number of downloads as in prior periods. In addition, celebrities like Kim Kardashian West, Kylie Jenner and Kendall Jenner, have launched their own personal media applications, and those applications, or similar applications launched by other of our celebrity partners could compete with our celebrity games for the time, attention and spending of our players. If our players do not find our games to be compelling or if other leisure time activities are perceived by our players to offer greater variety, affordability, interactivity and overall enjoyment, our business could be materially and adversely affected.

Our financial results could vary significantly from quarter to quarter and are difficult to predict, which in turn could cause volatility in our stock price.

Our revenue and operating results could vary significantly from quarter to quarter due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. In addition, we may not be able to accurately predict our future revenue or results of operations. This unpredictability may become more pronounced in future quarters as we anticipate releasing fewer games in 2016 as compared to recent years. We base our current and future expense levels on our internal operating plans and sales forecasts, and our operating costs are to a large extent fixed. As a result, we may not be able to reduce our costs sufficiently to compensate for an unexpected shortfall in revenue, and even a small shortfall in revenue could disproportionately and adversely affect financial results for that quarter.

In addition to other risk factors discussed in this section, factors that may contribute to the variability of our quarterly

Table of Contents

results include:

- our ability to increase the number of our paying players and the amount that each paying player spends in our games;
- the popularity and monetization rates of our new games released during the quarter and the ability of games released in prior periods to sustain their popularity and monetization rates;
- the number and timing of new games released by us and our competitors, particularly those games that may represent a significant portion of revenue in a quarter, which timing can be impacted by internal development delays, shifts in product strategy and how quickly digital storefront operators review and approve our games for commercial release;
- changes in the prominence of storefront featuring for our games and those of our competitors;
- the loss of, or changes to, one of our distribution platforms;
- changes to the Apple iOS platform or the Google Android platform that we are not able to adapt to our game offerings;
- fluctuations in the size and rate of growth of overall consumer demand for smartphones, tablets, games and related content;
- changes in the mix of revenue derived from games based on original intellectual property versus licensed intellectual property (including that we currently anticipate that a majority of our title launches for the remainder of 2015 and throughout 2016 will be based on or will significantly incorporate licensed intellectual property rather than being wholly original Glu intellectual property games);
- changes in the mix of revenue derived from in-app purchases, advertisements and offers, which mix often depends on the nature of new titles launched during the quarter;
- changes in the mix of revenue derived from first party titles and third party titles;
- changes in the amount of money we spend marketing our titles in a particular quarter, including the average amount we pay to acquire each new user, as well as changes in the timing of these marketing expenses within the quarter;
- decisions by us to incur additional expenses, such as increases in research and development, or unanticipated increases in vendor-related costs, such as hosting fees;
- the timing of successful mobile device launches;
- the seasonality of our industry;
- changes in accounting rules, such as those governing recognition of revenue, including the period of time over which we recognize revenue for in-app purchases of virtual currency and goods within some of our games;
- the amount and timing of charges related to any future impairments of goodwill, intangible assets, prepaid royalties and guarantees; for example, in the three months ended March 31, 2016, we impaired \$43,000 related to contractual minimum guarantee commitments and other prepaid royalties, and we may be required to take significantly larger impairments in future periods if the games we are developing that have significant contractual minimum guarantee commitments associated with them are not successful;

## Table of Contents

and

- macro-economic fluctuations in the United States and global economies, including those that impact discretionary consumer spending.

If we do not successfully establish and maintain awareness of our brand and games, if we fail to develop high-quality, engaging games that are differentiated from our prior games, if we incur excessive expenses promoting and maintaining our brand or our games or if our games contain defects or objectionable content, our operating results and financial condition could be harmed.

We believe that establishing and maintaining our brand is critical to establishing a direct relationship with players who purchase our products from direct-to-consumer channels and to maintaining our existing relationships with distributors and content licensors, as well as potentially developing new such relationships. Increasing awareness of our brand and recognition of our games is particularly important in connection with our strategic focus of developing games based on our own intellectual property, games based on our celebrity partners and our other game franchises that incorporate third party brands and properties. Our ability to promote the Glu brand and increase recognition of our games depends on our ability to develop high-quality, engaging games, including integrating the level of social and community features appropriate for a game's target audience and partnering with celebrities with fan bases that can support successful mobile games. If consumers, digital storefront owners and branded content owners do not perceive our existing games as high-quality or if we introduce new games that are not favorably received by them, then we may not succeed in building brand recognition and brand loyalty in the marketplace. In addition, globalizing and extending our brand and recognition of our games is costly and involves extensive management time to execute successfully, particularly as we expand our efforts to increase awareness of our brand and games among international consumers. Although we make significant sales and marketing expenditures in connection with the launch of our games, these efforts may not succeed in increasing awareness of our brand or the new games. If we fail to increase and maintain brand awareness and consumer recognition of our games, our potential revenue could be limited, our costs could increase and our business, operating results and financial condition could suffer.

In addition, if a game contains objectionable content, we could experience damage to our reputation and brand. Our games may contain violence or other content that some consumers may find objectionable. For example, Apple has assigned each of our shooter games a 17-and-older rating due to its violence. In addition, Google required us to submit two versions of our Blood & Glory and Contract Killer: Zombies games, one of which did not depict blood. Despite these ratings and precautions, consumers may be offended by some of our game content and children to whom these games are not targeted may choose to play them without parental permission nonetheless. In addition, our employees or employees of outside developers could include hidden features in one of our games without our knowledge, which might contain profanity, graphic violence, sexually explicit or otherwise objectionable material. If consumers believe that a game we published contains objectionable content, it could harm our brand, consumers could refuse to download it or demand a refund for any in-app purchases, and could pressure the digital storefront operators to no longer allow us to publish the game on their platforms. Similarly, if any of our games are introduced with defects or have playability issues, we may receive negative user reviews and our brand may be damaged. For example, our Kendall and Kylie title has experienced bugs and other playability issues, particularly for those users who have been playing on certain Android devices, which may have harmed monetization of the game. These issues could be exacerbated if our customer service department does not timely and adequately address issues that our players have encountered with our games.

We have depended on a small number of games for a significant portion of our revenue in recent fiscal periods. If these games do not succeed or we do not release highly successful new games, our revenue would decline.

In the mobile gaming industry, new games are frequently introduced, but a relatively small number of games account for a significant portion of industry sales. Similarly, a significant portion of our revenue comes from a limited number of games, although the games in that group have shifted over time. Our top four titles for the three months ended

March 31, 2016, (Kim Kardashian: Hollywood, Cooking Dash 2016, Racing Rivals, and Deer Hunter 2016) generated approximately 65.1% of our revenue during the period, while our top four titles for three months ended March 31, 2015 (Kim Kardashian: Hollywood, Racing Rivals, Deer Hunter 2014, and Contract Killer: Sniper), generated approximately 77.4% of our revenue during the period; no other game generated more than 10% of our revenue during



## Table of Contents

the respective periods. In particular, Kim Kardashian: Hollywood, which was launched in June 2014, remains our largest revenue generating title, having generated 24.0% and 35.5% of our revenue for the three months ended March 31, 2016 and 2015, respectively. However, we expect revenue from each of our top four titles from the three months ended March 31, 2016 to decline in the remainder of 2016. In addition, revenue from Kim Kardashian: Hollywood is in part tied to the continued popularity of Kim Kardashian West and her marketing efforts through social media and other channels, and we have little to no control over these matters and they are hard for us to predict. Accordingly, we must continue to launch new games that generate significant revenue to continue to grow revenue in the future, which we have sometimes failed to do. For example, the Katy Perry Pop title we launched in the fourth quarter of 2015 failed to generate meaningful revenue, and revenue from our Kendall and Kylie title declined significantly from its peak level following global launch. In addition, sequels to some of our most successful game franchises have failed to download and monetize at the levels of predecessor versions, and we have experienced disappointing results from several recent games based on film franchises, including our James Bond: World of Espionage game. Failure to differentiate, innovate and otherwise improve our game franchises would lead to revenue declines.

We expect a significant percentage of our product launches for the foreseeable future to be in the celebrity genre, including three titles in 2016 featuring female musicians. If these games do not succeed, our operating results and financial condition could be harmed and investors may question the viability of our celebrity product strategy.

We intend to launch within the next nine months, games featuring Britney Spears, Gordon Ramsay, Nicki Minaj and Taylor Swift, and have entered into agreements with additional celebrities to create games that we expect to launch by the end of 2017. Games featuring celebrities will account for a significant percentage of our overall title releases in 2016, and will also account for a significant portion of our forecasted revenue. We face a number of risks in our ability to successfully develop and monetize games featuring celebrities. For example, although Kim Kardashian: Hollywood has been by far the most successful mobile game featuring a celebrity and our Kendall and Kylie game achieved initial success following its worldwide launch in February 2016, we and other game developers have failed to achieve success with games featuring other celebrities, including our Katy Perry Pop title. Further, we have been unable to sustain the initial success experienced with our Kendall and Kylie game. Accordingly, it is possible that there is something unique about Kim Kardashian West, the nature of her celebrity and the demographics and purchasing power of her fan base that has led to the continued and sustained success of Kim Kardashian: Hollywood that will not be replicable in games featuring other celebrities, particularly musicians. We plan to release three new games in 2016 featuring female musicians – Britney Spears, Nicki Minaj and Taylor Swift – and it is possible that games featuring these celebrities will not be commercially successful in the same manner as our only prior game featuring a female musician, Katy Perry Pop. In addition, some of the celebrities with whom we have partnered may have similar fan bases, and any actual overlap in the audiences for our different celebrity games could result in market saturation or cannibalization of revenue of our own games. We must also differentiate our various celebrity games in order to ensure our games remain fresh and engaging and to satisfy our celebrity partners. However, differentiating the game engines for our various celebrity titles could lead to increased development costs and potential product launch delays and may result in games that do not monetize as well as Kim Kardashian: Hollywood. If our new celebrity games are not successful, our business and operating results would suffer and investors may question the viability of our celebrity product strategy.

## Table of Contents

We rely on a combination of our own servers and technology and third party infrastructure to operate our games. If we experience any system or network failures, unexpected technical problems, cyber attacks or any other interruption to our games, it could reduce our sales, increase costs, or result in a loss of revenue or loss of end users of our games.

We rely on digital storefronts and other third-party networks to deliver games to our players and on their or other third parties' billing systems to track and account for our game downloads. We also rely on our own servers and third-party infrastructure to operate our connected games, and our reliance on such third-party infrastructure and our GaaS technology platform will increase as we continue transitioning to becoming a GaaS company. In particular, a significant portion of our game traffic is hosted by Amazon Web Services, which service provides server redundancy and uses multiple locations on various distinct power grids. Amazon may terminate its agreement with us upon 30 days' notice. Amazon experienced a power outage during the second quarter of 2012, which affected the playability of our games for approximately one day. In addition, Amazon effected a large scale maintenance reboot of a portion of its systems during September 2014 to remedy a security flaw, and in September 2015, there was an outage of AWS Dynamo DB that affected our Deer Hunter 2016 game. While none of these events adversely impacted our business, a similar outage of a longer duration could. In addition, the operation of our online-only games that we began releasing in the fourth quarter of 2013 will depend on the continued functionality of our GaaS technology platform. As a result, we could experience unexpected technical problems with regard to the operation of our online-only games, particularly if the number of concurrent users playing our games is significantly more than we anticipate. Any technical problem with, cyber attack on, or loss of access to these third parties' or our systems, servers or other technologies, including the GaaS technology platform, could result in the inability of end users to download or play our games, cause interruption to gameplay, prevent the completion of billing for a game or result in the loss of users' virtual currency or other in-app purchases, interfere with access to some aspects of our games or result in the theft of end-user personal information. For example, in July 2014, users could not play our Kim Kardashian: Hollywood game for about six hours due to a problem with one of our servers, and in November 2014, March 2015 and April 2015, we experienced similar outages with respect to our Racing Rivals game. In addition, at launch in September 2015, our Eternity Warriors 4 title experienced intermittent server issues that left the game temporarily inoperable. More recently, we have experienced technical issues with our Kendall and Kylie title that have caused users to lose their game play data, including accumulated virtual currency and achieved levels. If users are unable to access and play our games for any period of time, if virtual assets are lost, or if users do not receive their purchased virtual currency, we may receive negative publicity and game ratings, we may lose players of our games, we may be required to issue refunds, and we may become subject to regulatory investigation or class action litigation, any of which would negatively affect our business. Any of these problems could require us to incur substantial repair costs, distract management from operating our business and result in a loss of revenue.

Cyber attacks, security breaches, and computer viruses could harm our business, reputation, brand and operating results.

Cyber attacks, security breaches, and computer viruses have occurred on our systems in the past and may occur on our systems in the future. We store sensitive information, including personal information about our employees. In addition, our games involve the storage and transmission of players' personal information in our facilities and on our equipment, networks and corporate systems run by us or managed by third-parties including Apple, Google, and Facebook. Security breaches of our systems or the systems of third-parties on which we rely could expose us to litigation, remediation costs, increased costs for security measures, loss of revenue, damage to our reputation and potential liability. Our player data, corporate systems, third-party systems and security measures may be breached due to the actions of outside parties, employee error, malfeasance, a combination of these, or otherwise, and, as a result, an unauthorized party may obtain access to our data, our employees' data, our players' data or our advertisers' data. We were the victim of a cyber attack in early November 2014, when an animal rights group took down our main website and user forums, and in January 2016 another cyber attack caused us to take down our user forums for nearly a week. In October 2013, we were also the victim of a "CryptoLocker" ransomware attack that temporarily prevented our

access to sensitive company files. Although these incidents did not result in a material loss of revenue, any future incidents, particularly of longer duration, could damage our brand and reputation and result in a material loss of revenue. Maintaining an international presence in China and elsewhere, we may place ourselves at increased risk of cyber attacks, such as the denial of service attacks that affected Sony Pictures in the fourth quarter of 2014. In addition, as highlighted by recent reports that ISIS terrorists may have used Sony's PlayStation 4 network to plan attacks, the chat

Table of Contents

and other social features in our games could potentially be used by terrorist organizations or other criminals to communicate or for other nefarious purposes, which could severely damage our brand and reputation. If an actual or perceived security breach occurs, the market perception of the effectiveness of our security measures could be harmed, we could lose players and advertisers, and we could suffer significant legal and financial harm due to such events or in connection with remediation efforts, investigation costs or penalties, changed security and system protection measures. Any of these actions could have a material and adverse effect on our business, reputation and operating results.

If we fail to maintain and enhance our capabilities for porting games to a broad array of mobile devices, particularly those running the Android operating system, our revenue and financial results could suffer.

We derive the majority of our revenue from the sale of virtual goods within our games for smartphones and tablets that run Apple's iOS or Google's Android operating system. Unlike the Apple ecosystem in which Apple controls both the device (iPhone, iPod Touch and iPad) and the storefront (Apple's App Store), the Android ecosystem is highly fragmented since a large number of OEMs manufacture and sell Android-based devices that run a variety of versions of the Android operating system, and there are many Android-based storefronts in addition to the Google Play Store. For us to sell our games to the widest possible audience of Android users, we must port our games to a significant portion of the more than 1,000 Android-based devices that are commercially available, many of which have different technical requirements. Since the number of Android-based smartphones and tablets shipped worldwide is growing significantly, with more than one billion Android based devices sold worldwide in 2014, it is important that we maintain and enhance our porting capabilities, which could require us to invest considerable resources in this area. These additional costs could harm our business, operating results and financial condition. In addition, we must continue to increase the efficiency of our porting processes or it may take us longer to port games to an equivalent number of devices, which would negatively impact our margins. If we fail to maintain or enhance our porting capabilities, our revenue and financial results could suffer. For example, the technical issues we have experienced with our Kendall and Kylie title appear to be more pronounced on certain Android devices, and this may have harmed the revenue we are able to generate from users on Android devices.

We use a game development engine licensed from Unity Technologies to create many of our games. If we experience any prolonged technical issues with this engine or if we lose access to this engine for any reason, it could delay our game development efforts and cause our financial results to fall below expectations for a quarterly or annual period, which would likely cause our stock price to decline.

We use a game development engine licensed from Unity Technologies to create many of our games, and we expect to continue to use this engine for the foreseeable future. Because we do not own this engine, we do not control its operation or maintenance nor do we control how the engine is updated or upgraded. As a result, any prolonged technical issues with this engine might not be resolved quickly, despite the fact that we have contractual service level commitments from Unity. In addition, to the extent that we require any functionality that is not offered by Unity, as was the case when Apple initially announced its 64-bit requirement, we are dependent on Unity to update or upgrade its engine to offer such functionality. Furthermore, although Unity cannot terminate our agreement absent an uncured material breach of the agreement by us, we could lose access to this engine under certain circumstances, such as a natural disaster that impacts Unity or a bankruptcy event. If we experience any prolonged issues with the operation of the Unity game development engine, if the Unity game development engine does not offer the functionality we require or if we lose access to this engine for any reason, it could delay our game development efforts and cause us to not meet revenue expectations for a quarterly or annual period, which would likely cause our stock price to decline. For example, in the first quarter of 2016, we were unable to implement a significant update to our Racing Rivals title due to programming bugs in the Unity game development engine, which update we believe could have helped to increase revenue for that title during the quarter. Further, if one of our competitors acquired Unity, the acquiring company would be less likely to renew our agreement, which could impact our game development efforts in the future,

particularly with respect to sequels to games that were created on the Unity engine.

Table of Contents

We derive a significant portion of our revenue from advertisements and offers that are incorporated into our free-to-play games through relationships with third parties. If we lose the ability to provide these advertisements and offers for any reason, or if any events occur that negatively impact the revenue we receive from these sources, it would negatively impact our operating results.

We derive revenue from our free-to-play games through in-app purchases, advertisements and offers. We incorporate advertisements and offers into our games by implementing third parties' software development kits. We rely on these third parties to provide us with a sufficient inventory of advertisements and offers to meet the demand of our user base. If we exhaust the available inventory of these third parties, it will negatively impact our revenue. If our relationship with any of these third parties terminates for any reason, or if the commercial terms of our relationships do not continue to be renewed on favorable terms, we would need to locate and implement other third party solutions, which could negatively impact our revenue, at least in the short term. Furthermore, the revenue that we derive from advertisements and offers is subject to seasonality, as companies' advertising budgets are generally highest during the fourth quarter and decline significantly in the first quarter of the following year, which negatively impacts our revenue in the first quarter (and conversely significantly increases our marketing expenses in the fourth quarter).

In addition, the actions of the storefront operators can also negatively impact the revenue that we generate from advertisements and offers. For example, in the second quarter of 2011, Apple began prohibiting virtual currency-incented advertising offers in games that directed users to download other applications from the Apple App Store in order to complete the offer. These offers accounted for approximately one-third of our revenue during the three months ended September 30, 2011, and our inability to use such offers has negatively impacted our revenue. In addition, during the second quarter of 2014, there were reports that Apple was considering prohibiting certain types of virtual currency-incented video advertising in games that promoted other applications available on the Apple App Store. These incented video advertisements generate a meaningful percentage of our overall revenue, and any prohibition of these advertisements would have had a negative impact on our revenue. Any similar changes in the future that impact our revenue that we generate from advertisements and offers could materially harm our business.

## Table of Contents

We may not, or may be unable to, renew our existing celebrity, brand and other content licenses when they expire and may not choose to obtain additional licenses or be able to obtain new licenses on favorable terms, which could negatively impact our revenue if we fail to replace such revenue with revenue from games based on our own intellectual property.

Although we generated 93.3% of our revenue from games based on our own intellectual property during 2013, that percentage declined to 62.7% in 2014, 41.5% in 2015 and was 46.6% in the first three months of 2016, largely due to the success of Kim Kardashian: Hollywood and, to a lesser extent, Kendall and Kylie, Racing Rivals, Robocop: The Official Game, and the Tap Sports Baseball franchise. We expect our revenue derived from games based on or substantially incorporating third-party intellectual property to increase further in 2016, as we expect to continue to derive significant revenue from Kim Kardashian: Hollywood, Kendall and Kylie, Racing Rivals and Tap Sports Baseball 2016, and as all of the titles we plan to release in the remainder of 2016 will feature or otherwise leverage celebrities or other third-party licensed brands, properties or other content. Certain of our licenses expire at various times during the next several years, and we may be unable to renew these licenses on terms favorable to us or at all, and we may have difficulties obtaining licenses from new celebrities on terms acceptable to us, if at all. In addition, these licensors could decide to license to our competitors or develop and publish their own mobile games, competing with us in the marketplace. Failure to maintain or renew our existing licenses or to obtain additional licenses would prevent us from continuing to offer our current licensed games and introducing new mobile games based on such licensed content, which could harm our business, operating results and financial condition.

Securing license agreements to develop, publish and market games based on or significantly incorporating celebrities, third-party licensed brands, properties, and other content typically requires that we make minimum guaranteed royalty and other payments to such licensors, and to the extent such payments become impaired, our operating results would be harmed.

In connection with recently announced partnerships and other potential partnerships with celebrities and other licensors of third-party brands, properties and content, we have incurred and expect to continue to incur significant minimum guaranteed royalty and other payments. As a result, we may incur increased levels of impairments on such payments if our forecasts for these games are lower than we anticipated at the time we entered into the agreements. For example, in the three months ended March 31, 2016, we impaired \$43,000, related to contractual minimum guarantee and other payments primarily related to impairment of minimum guaranteed royalty payments and warrants issued in connection with our James Bond: World of Espionage title. In 2016, we expect that all of the games we release will be based on or otherwise incorporate celebrities and other third-party licensed brands, properties and other content as opposed to our original intellectual property games where we do not incur licensing fees and expenses. As a result, we may be required to take significantly larger impairments in future periods if the games we are developing that have significant contractual minimum guarantee commitments associated with them are not successful.

We publish games developed by third parties, which exposes us to a number of potential operational and legal risks.

Publishing games developed by third parties exposes us to a number of potential operational and legal risks. For example, we may be required to provide third party developers with upfront license fees or non-recoupable minimum guaranteed royalties in order to obtain the rights to publish their games, and we may incur significant costs marketing these games after they have been commercially launched. For example, we agreed to pay a significant license fee and minimum guaranteed royalty payment to an affiliate of Tencent Holdings Limited, or Tencent, to license and publish Tencent's WeFire game in the United States and international markets outside of Asia under the title Frontline Commando Rivals. Third-party games that we license and publish may not be commercially successful, particularly if they fail to appeal to Western audiences. We and other mobile gaming companies have failed in the past to achieve commercial success in bringing successful games developed and launched in Asia to Western markets, and we may

similarly fail to achieve commercial success with respect to our efforts relating to publishing Frontline Commando Rivals. In addition, if any of the games created by third party developers with which we work infringe intellectual property owned by others, or otherwise violate any third party's rights or any applicable laws and regulations, such as laws with respect to data collection and privacy, we would be exposed to potential legal risks by publishing these games.



Table of Contents

Our business and growth may suffer if we are unable to hire and retain key personnel.

Our future success will depend, to a significant extent, on our ability to retain and motivate our key personnel, namely our management team, particularly Niccolo de Masi, our President and Chief Executive Officer, as well as experienced game development personnel. In addition, to grow our business, execute on our business strategy and replace departing employees, we must identify, hire and retain qualified personnel, particularly additional game development teams to support our new product launches and monetization, live operations, server technology, user experience and product management personnel to support our continued transition to becoming a GaaS company and building the premier celebrity gaming platform. The gaming and technology industries are also traditionally male dominated, so it may be difficult for us to recruit and retain talented female personnel who may be needed to help us optimize our games that are targeted to a more female-focused audience, including much of our celebrity gaming platform. Recent stock price declines and headcount reductions may make it more difficult for us to attract and retain top talent. Competition for qualified management, game development and other staff is intense, particularly in the San Francisco Bay Area where we are headquartered. In addition, attracting and retaining qualified personnel may be particularly difficult for us if our stock price continues to decline or remains at current levels, since individuals may elect to seek employment with other companies that they believe have better long-term prospects or that present better opportunities for earning equity-based compensation. Competitors have in the past and may in the future attempt to recruit our employees, and our management and key employees are not bound by agreements that could prevent them from terminating their employment at any time. As we continue to develop expertise in free-to-play mobile gaming, operating a GaaS company, monetization and developing social and community features in particular, our competitors may increasingly seek to recruit our employees, particularly from our development studios. In addition, we do not maintain a key-person life insurance policy on any of our officers. Our business and growth may suffer if we are unable to hire and retain key personnel.

Any restructuring actions and cost reduction initiatives that we undertake may not deliver the results we expect, and these actions may adversely affect our business.

We have implemented a number of restructurings during the last several years in which we implemented certain restructuring actions and cost reduction initiatives to streamline operations and improve cost efficiencies. Our most recent restructurings included reductions in personnel supporting our studios in Beijing, China, Bellevue, Washington, San Mateo, California and Long Beach, California. We plan to continue to manage costs to better and more efficiently manage our business. This most recent restructuring plan and other such efforts could result in disruptions to our operations and adversely affect our business. In addition, we cannot be sure that the cost reduction and streamlining initiatives will be as successful in reducing our overall expenses as we expect or that additional costs will not offset any such reductions or streamlining. If our operating costs are higher than we expect or if we do not maintain adequate control of our costs and expenses, our operating results will suffer.

We may not realize the benefits expected through our strategic relationship with Tencent and other aspects of the relationship could have adverse effects on our business.

In April 2015, we entered into a strategic relationship with Tencent Holdings Limited, or Tencent, a leading Internet company in China and arguably the world's largest gaming company. Tencent, through a controlled affiliate, agreed to invest \$126.0 million in exchange for approximately 16.3% of our total outstanding common stock on a post-transaction basis. In November 2015, we entered into an agreement with Tencent to license and publish its game, WeFire, in the United States and international markets outside of Asia under the name Frontline Commando Rivals. Our agreement to publish Frontline Commando Rivals may not be successful, particularly given the license fees and royalties we will be required to pay under the agreement. In addition, we may not succeed in entering into any other agreements or operating partnerships with Tencent in the future. Even if we do enter into additional operational partnerships, it could take months to years to fully realize the benefits of such partnerships and, to the

extent such agreements involve publishing our games in China, some of our platform partners in China and other parts of Asia may view such a partnership negatively, and in fact, some partners in China may already view the fact that Tencent is a significant investor in us negatively, and we may find it more difficult to obtain featuring of our games from such partners in China going forward.

## Table of Contents

Tencent, through its controlled affiliates, held approximately 21.5% of the aggregate voting power of our common stock as of April 6, 2016, and could acquire up to 25.0% of the voting power through open-market purchases of our common stock. While Tencent has agreed to cause these shares to be voted with the majority recommendation of the independent members of our board of directors on most matters, Tencent could have considerable influence over matters such as approving a potential acquisition of us. Tencent was also granted the right to designate a member of our board of directors, initially appointing Tencent Senior Vice President, Steven Ma, and Mr. Ma or any future Tencent designee could have an actual or apparent conflict of interest in such matters. Tencent's investment in and position with us could also discourage others from pursuing any potential acquisition of us, which could have the effect of depriving the holders of our common stock of the opportunity to sell their shares at a premium over the prevailing market price.

Our reported financial results could be adversely affected by changes in financial accounting standards or by the application of existing or future accounting standards to our business as it evolves.

Our reported financial results are impacted by the accounting policies promulgated by the SEC and accounting standards bodies and the methods, estimates and judgments that we use in applying our accounting policies. Due to recent economic events, the frequency of accounting policy changes may accelerate, including conversion to unified international accounting standards. Policies affecting revenue recognition have affected, and could further significantly affect, the way we account for revenue. For example, the accounting for revenue derived from smartphone platforms and free-to-play games, particularly with regard to revenue generated from online digital storefronts, is still evolving and, in some cases, uncertain. In particular, we were required to file an amendment to our Annual Report on Form 10-K for the year ended December 31, 2012 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013 to restate or revise the financial statements contained in those reports (including for the year ended December 31, 2011) because we did not correctly apply the applicable revenue recognition accounting guidance relating to our smartphone revenue. While we believe that we are now correctly accounting for our smartphone revenue, this is an area that continues to involve significant discussion among accounting professionals and which is not completely settled. It is possible that the relative application, interpretation and weighting of the factors that relate to whether we should be considered the principal in the sales transaction of games sold through digital storefronts may evolve, and we may in the future conclude that our new accounting policy for smartphone revenue, as reflected in the restated financial statements, is incorrect, which could result in another restatement of affected financial statements. In addition, we currently defer revenue related to virtual goods and currency over the average playing period of paying users, which approximates the estimated weighted average useful life of the transaction. While we believe our estimates are reasonable based on available game player information, we may revise such estimates in the future as our games' operation periods change. Any adjustments arising from changes in the estimates of the lives of these virtual items would be applied to the current quarter and prospectively on the basis that such changes are caused by new information indicating a change in the game player behavior patterns of our paying users. Any changes in our estimates of useful lives of these virtual items may result in our revenue being recognized on a basis different from prior periods' and may cause our operating results to fluctuate. As we enhance, expand and diversify our business and product offerings, the application of existing or future financial accounting standards, particularly those relating to the way we account for our smartphone revenue, could have a significant adverse effect on our reported results although not necessarily on our cash flows.

If we are unable to maintain effective internal control over financial reporting, the accuracy and timeliness of our financial reporting may be adversely affected.

Maintaining effective internal control over financial reporting is necessary for us to produce reliable financial statements. In connection with the restatement of our financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, management, including our Chief Executive Officer and Chief Financial Officer, reassessed the effectiveness of our

internal control over financial reporting as of December 31, 2012. Based on this reassessment using the guidelines established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 1992, management had concluded that we did not maintain effective internal control over financial reporting as of December 31, 2012 because of a material weakness related to the application of revenue accounting guidance to our smartphone revenue for sales through digital storefronts. This control deficiency resulted in the misstatement of our revenue and cost of revenue, including gross margin percentages, and the related balance sheet accounts and financial disclosures for the years ended December 31, 2011 and 2012 (and the restatement of unaudited

## Table of Contents

interim condensed consolidated financial statements for the quarters ended March 31, June 30, and September 30 for such years). Although we have remediated this material weakness, if we are otherwise unable to maintain adequate internal controls for financial reporting, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal controls as required pursuant to the Sarbanes-Oxley Act, it could result in another material misstatement of our financial statements that would require a restatement, investor confidence in the accuracy and timeliness of our financial reports may be impacted or the market price of our common stock could be negatively impacted.

Our business will suffer if our acquisition and strategic investment activities are unsuccessful or disrupt our ongoing business, which may involve increased expenses and may present risks not contemplated at the time of the transactions.

We have acquired and invested in, and may continue to acquire and invest in, companies, products and technologies that complement our strategic direction. Acquisitions and investments involve significant risks and uncertainties, including:

- diversion of management's time and a shift of focus from operating the business to issues related to negotiation of acquisition or investment terms, integration and administration;
- our ability to successfully integrate acquired technologies and operations into our business and maintain uniform standards, controls, policies and procedures;
- significant competition from other acquirors and investors as the gaming industry consolidates and challenges in offering attractive consideration given the volatility of our stock price and potential difficulties in obtaining alternative financing;
- challenges retaining the key employees, customers and other business partners of the acquired or investee business;
- our ability to realize synergies expected to result from an acquisition or strategic investment;
- an impairment of acquired goodwill and other intangible assets or investments in future periods would result in a charge to earnings in the period in which the write-down occurs;
- the internal control environment of an acquired or investee entity may not be consistent with our standards and may require significant time and resources to improve;
  - in the case of foreign acquisitions or strategic investments, the need to integrate operations across different cultures and languages and to address the particular economic, currency, political and regulatory risks associated with specific countries; and
- liability for activities of the acquired or investee companies before the acquisition or investment, including violations of laws, rules and regulations, commercial disputes, tax liabilities, accounting standards and other known and unknown liabilities.

In addition, if we issue equity securities as consideration in an acquisition or strategic investment, as we did for our acquisitions of Griptonite, Inc., Blammo Games Inc., GameSpy Industries, Inc., PlayFirst, Inc. and Cie Games, Inc., our current stockholders' percentage ownership and earnings per share would be diluted. Because acquisitions and strategic investments are inherently risky, our transactions may not be successful and may, in some cases, harm our operating results or financial condition.

## Table of Contents

Changes in foreign exchange rates and limitations on the convertibility of foreign currencies could adversely affect our business and operating results.

We currently transact business in more than 100 countries and in dozens of different currencies, with Pounds Sterling, Euros and Chinese Renminbi being the primary international currencies in which we transact business. Conducting business in currencies other than U.S. Dollars subjects us to fluctuations in currency exchange rates that could have a negative impact on our reported operating results. We experienced significant fluctuations in currency exchange rates in 2015 and the first three months of 2016, and expect to experience continued significant fluctuations in the future. We incur expenses for employee compensation and other operating expenses at our non-U.S. locations in the local currency, and an increasing percentage of our international revenue is from customers who pay us in currencies other than the U.S. Dollar. Fluctuations in the exchange rates between the U.S. Dollar and those other currencies could result in the U.S. Dollar equivalent of these expenses being higher and/or the U.S. Dollar equivalent of the foreign-denominated revenue being lower than would be the case if exchange rates were stable. This could negatively impact our operating results. Conversely, the current economic crisis in Russia has led to a significant devaluation of the Ruble compared to the U.S. Dollar, which has reduced the effective salaries of our employees in our Moscow studio. As a result, we may be at risk of losing key employees to competitors who are willing to offer higher effective wages. To date, we have not engaged in exchange rate hedging activities, and we do not expect to do so in the foreseeable future.

We face additional risk if a currency is not freely or actively traded. Some currencies, such as the Chinese Renminbi in which our Chinese operations principally transact business, are subject to limitations on conversion into other currencies, which can limit our ability to react to rapid foreign currency devaluations and to repatriate funds to the United States should we require additional working capital.

We face added business, political, regulatory, operational, financial and economic risks as a result of our international operations and distribution, any of which could increase our costs and adversely affect our operating results.

International sales represented approximately 27.3% and 36.2% of our revenue during the three months ended March 31, 2016 and 2015, respectively. To target international markets, we develop games that are customized for consumers in those markets. We have international offices located in a number of foreign countries including Canada, China, India, Japan, Korea and Russia. We expect to increase our international presence (including to the extent we elect to exercise our call option to acquire Icelandic game developer, Plain Vanilla Corp.), and we expect international sales will continue to be an important component of our revenue, particularly in APAC markets. Risks affecting our international operations include:

- our ability to develop games that appeal to the tastes and preferences of consumers in international markets;
- difficulties developing, staffing, and simultaneously managing a large number of varying foreign operations as a result of distance, language, and cultural differences;
- multiple and conflicting laws and regulations, including complications due to unexpected changes in these laws and regulations;
- our ability to develop, customize and localize games that appeal to the tastes and preferences of consumers in international markets;
- competition from local game developers that have significant market share in certain foreign markets and a better understanding of local consumer preferences;
- potential violations of the Foreign Corrupt Practices Act and local laws prohibiting improper payments to government officials or representatives of commercial partners;



Table of Contents

- regulations that could potentially affect the content of our products and their distribution, particularly in China;
- foreign exchange controls that might prevent us from repatriating income earned in countries outside the United States, particularly China;
- potential adverse foreign tax consequences, since due to our international operations, we must pay income tax in numerous foreign jurisdictions with complex and evolving tax laws;
- political, economic and social instability, including the ongoing hostilities in Syria and the Crimea region and, in particular, the economic crisis in Russia, which could potentially negatively impact us given that we have a development studio in Moscow;
- restrictions on the export or import of technology;
- trade and tariff restrictions and variations in tariffs, quotas, taxes and other market barriers; and
- difficulties in enforcing intellectual property rights in certain countries.

These risks could harm our international operations, which, in turn, could materially and adversely affect our business, operating results and financial condition. In particular, we have over 100 employees located at our development studio in Moscow, Russia. The current economic crisis in Russia, including the destabilization of the Ruble, could lead to unstable political conditions, civil unrest or other developments that could materially affect our business, including through distractions and potential hardships to our Russian employees, restrictions on our ability to fund our Russian operations, and other difficulties that could cause delays to our game launches or even the cancellation of a game release and otherwise affect our ability to update and maintain games previously released from our Moscow studio.

If we fail to deliver our games at the same time as new mobile devices are commercially introduced, our revenue may suffer.

Our business depends, in part, on the commercial introduction of new mobile devices with enhanced features, including larger, higher resolution color screens, improved audio quality, and greater processing power, memory, battery life and storage. For example, the introduction of new and more powerful versions of Apple's iPhone and iPad and devices based on Google's Android operating system, have helped drive the growth of the mobile games market. In addition, consumers generally purchase the majority of content, such as our games, for a new device within a few months of purchasing it. We do not control the timing of these device launches. The mobile games market could also be disrupted by new technologies, such as the introduction of next generation virtual reality devices. Some manufacturers give us access to their new devices prior to commercial release. If one or more major manufacturers were to stop providing us access to new device models prior to commercial release, we might be unable to introduce games that are compatible with the new device when the device is first commercially released, and we might be unable to make compatible games for a substantial period following the device release. If we do not adequately build into our title plan the demand for games for a particular mobile device or experience game launch delays, we miss the opportunity to sell games when new mobile devices are shipped or our end users upgrade to a new mobile device, our revenue would likely decline and our business, operating results and financial condition would likely suffer.



## Table of Contents

If the use of smartphones and tablet devices as game platforms and the proliferation of mobile devices generally do not increase, our business could be adversely affected.

While the number of people using mobile Internet-enabled devices, such as smartphones and tablet devices, has increased dramatically in the past few years, the mobile market, particularly the market for mobile games, is still emerging, and it may not grow as we anticipate. Our future success is substantially dependent upon the continued growth of use of mobile devices for games, as opposed to social media applications or other uses. The proliferation of mobile devices may not continue to develop at historical rates and consumers may not continue to use mobile Internet-enabled devices as platforms for games. In addition, new and emerging technologies could make the mobile devices on which our games are currently released obsolete, requiring us to transition our business model to develop games for other next-generation platforms.

Our business is subject to increasing governmental regulation. If we do not successfully respond to these regulations, our business may suffer.

We are subject to a number of domestic and foreign laws and regulations that affect our business. Not only are these laws constantly evolving, which could result in their being interpreted in ways that could harm our business, but legislation is also continually being introduced that may affect both the content of our products and their distribution. In the United States, for example, numerous federal and state laws have been introduced which attempt to restrict the content or distribution of games. Legislation has been adopted in several states, and proposed at the federal level, that prohibits the sale of certain games to minors. If such legislation is adopted, it could harm our business by limiting the games we are able to offer to our customers or by limiting the size of the potential market for our games. We may also be required to modify certain games or alter our marketing strategies to comply with new and possibly inconsistent regulations, which could be costly or delay the release of our games. For example, the United Kingdom's Office of Fair Trading issued new principles in January 2014 relating to in-app purchases in free-to-play games that are directed towards children 16 and under, which principles became effective in April 2014. In addition, in response to a request made by the European Commission, Google no longer labels free-to-play games as free in European Union countries. Similarly, in the fourth quarter of 2014, Apple changed its label for free-to-download applications from "FREE" to "GET" in the Apple App Store. The FTC has also indicated that it intends to review issues related to in-app purchases, particularly with respect to games that are marketed primarily to minors; the FTC reached settlement agreements with Apple and Google on this subject and recently won a lawsuit against Amazon on this subject. If the FTC issues rules significantly restricting or even prohibiting in-app purchases, it would significantly impact our business strategy. In addition, two self-regulatory bodies in the United States (the Entertainment Software Rating Board) and in the European Union (Pan European Game Information (PEGI)) provide consumers with rating information on various products such as entertainment software similar to our products based on the content (for example, violence, sexually explicit content, language). Furthermore, the Chinese government has adopted measures designed to eliminate violent or obscene content in games. In response to these measures, some Chinese telecommunications operators have suspended billing their customers for certain mobile gaming platform services, including those services that do not contain offensive or unauthorized content, which could negatively impact our revenue in China. Any one or more of these factors could harm our business by limiting the products we are able to offer to our customers, by limiting the size of the potential market for our products, or by requiring costly additional differentiation between products for different territories to address varying regulations.

Furthermore, the growth and development of free-to-play gaming and the sale of virtual goods may prompt calls for more stringent consumer protection laws that may impose additional burdens on companies such as ours. We anticipate that scrutiny and regulation of our industry will increase and that we will be required to devote legal and other resources to addressing such regulation. For example, existing laws or new laws regarding the regulation of currency and banking institutions may be interpreted to cover virtual currency or goods. If that were to occur we may be required to seek licenses, authorizations or approvals from relevant regulators, the granting of which may depend

on us meeting certain capital and other requirements and we may be subject to additional regulation and oversight, all of which could significantly increase our operating costs. Changes in current laws or regulations or the imposition of new laws and regulations in the United States or elsewhere regarding these activities may dampen the growth of free-to-play gaming and impair our business.

## Table of Contents

We sometimes offer our players various types of sweepstakes, giveaways and promotional opportunities, and launched a version of our Frontline Commando: D-Day game utilizing the Skillz technology platform that allows players to compete against each other in tournaments for cash prizes. We have also in the past through a partnership with Probability PLC offered a suite of Glu branded mobile slots games in the United Kingdom and might continue to explore opportunities with respect to real money gambling. We are subject to laws in a number of jurisdictions concerning the operation and offering of such activities and games, 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 addition, because our services are available worldwide, certain foreign jurisdictions 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.

The laws and regulations concerning data privacy and data security are continually evolving, and our actual or perceived failure to comply with these laws and regulations could harm our business.

We are subject to federal, state and foreign laws regarding privacy and the protection of the information that we collect regarding our users, which laws are currently in a state of flux and likely to remain so for the foreseeable future. The U.S. government, including the FTC and the Department of Commerce, is continuing to review the need for greater regulation over collecting information concerning consumer behavior on the Internet and on mobile devices. For example, in December 2012, the FTC adopted amendments to the Children's Online Privacy Protection Act to strengthen privacy protections for children under age 13, which amendments became effective in July 2013. In addition, the European Union has proposed reforms to its existing data protection legal framework. In addition, in October 2015, the Court of Justice of the European Union issued a ruling striking down the longstanding Safe Harbor agreement between the United States and the European Union, which raises uncertainty regarding the ability of companies to transfer the personal data of European citizens to the United States. Various government and consumer agencies have also called for new regulation and changes in industry practices. For example, in February 2012, the California Attorney General announced a deal with Amazon, Apple, Google, Hewlett-Packard, Microsoft and Research in Motion to strengthen privacy protection for users that download third-party apps to smartphones and tablet devices. Additionally, in January 2014, the FTC announced a settlement with Apple related to in-app purchases made by minors. In April 2016, the FTC was also successful in a lawsuit against Amazon, with a Federal District Court granting summary judgment in favor of the FTC, finding Amazon liable for unfairly billing consumers for unauthorized in-app purchases by minors. In response to developments in the interpretation and understanding of regulations such as these and guidance and inquiries from the California Attorney General, we released updates to our My Dragon and Deer Hunter Reloaded games and made changes to our games in development to make our privacy policy readily accessible to players of these games as required by the California Online Privacy Protection Act. If we do not follow existing laws and regulations, as well as the rules of the smartphone platform operators, with respect to privacy-related matters, or if consumers raise any concerns about our privacy practices, even if unfounded, it could damage our reputation and operating results.

All of our games are subject to our privacy policy and our terms of service located on our corporate website. If we fail to comply with our posted privacy policy, terms of service or privacy-related laws and regulations, including with respect to the information we collect from users of our games, it could result in proceedings against us by governmental authorities or others, which could harm our business. In addition, interpreting and applying data protection laws to the mobile gaming industry is often unclear. 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 requirements could cause us to incur additional costs and change our business practices. Further, if we fail to adequately protect our users' privacy and data, it could result in a loss of player confidence in our services and ultimately in a loss of users, which could adversely affect 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 vaguely defined and difficult to implement. Costs to comply with these laws may increase as a result of changes in interpretation. Furthermore, any failure on our part to comply with these laws may subject us to significant liabilities. The security measures we have in

58

---

## Table of Contents

place to protect our data and the personal information of our employees, customers and partners could be breached due to cyber-attacks initiated by third party hackers, employee error or malfeasance, or otherwise. Because the techniques used to obtain unauthorized access, disable or degrade service or sabotage systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any breach or unauthorized access could materially interfere with our operations or our ability to offer our services or result in significant legal and financial exposure, damage to our reputation and a loss of confidence in the security of our data, which could have an adverse effect on our business and operating results.

Our stock price has fluctuated and declined significantly since our initial public offering in March 2007, and may continue to fluctuate, may not rise and may decline further.

The trading price of our common stock has fluctuated in the past and is expected to continue to fluctuate in the future, as a result of a number of factors, many of which are outside our control, such as changes in the operating performance and stock market valuations of other technology companies generally, or those in our industry in particular, such as Electronic Arts and Zynga. We also experience stock price volatility as investors monitor the performance of our games through third-party tools, such as App Annie, the Apple App Store's "Top Grossing" rankings and other measurements of the performance of our games.

In addition, The NASDAQ Global Market on which our common stock is listed has recently and in the past experienced extreme price and volume fluctuations that have affected the market prices of many companies, some of which appear to be unrelated or disproportionate to their operating performance. These broad market fluctuations could adversely affect the market price of our common stock. In the past, following periods of volatility in the market price of a particular company's securities, securities class action litigation has often been brought against that company. Securities class action litigation against us could result in substantial costs and divert our management's attention and resources.

If we do not adequately protect our intellectual property rights, it may be possible for third parties to obtain and improperly use our intellectual property and our business and operating results may be harmed.

Our intellectual property is essential to our business. We rely on a combination of patent, copyright, trademark, trade secret and other intellectual property laws and contractual restrictions on disclosure to protect our intellectual property rights. To date, we have only two issued U.S. patents (including a corresponding Patent Cooperation Treaty (PCT) international patent) and only eight U.S. patent applications currently outstanding, including two that we inherited through acquisitions (and we have four corresponding PCT international patent applications), so we will not be able to protect the vast majority of our technologies from independent invention by third parties. In addition, we have filed foreign patent applications on three of our eight U.S. patent applications and one of the issued U.S. patents, and an additional foreign patent application for our one of our issued U.S. patents. Despite our efforts to protect our intellectual property rights, unauthorized parties may attempt to copy or otherwise to obtain and use our technology and games, and some parties have distributed "jail broken" versions of our games where all of the content has been unlocked and made available for free. Further, some of our competitors have released games that are nearly identical to successful games released by their competitors in an effort to confuse the market and divert users from the competitor's game to the copycat game. We believe that these tactics were employed by Hothead Games in their game Kill Shot, which we believed infringed certain Glu copyrights and trade dress contained in our Deer Hunter 2014 game. We initiated litigation against Hothead Games in November 2014, and we entered into a settlement agreement with Hothead in August 2015 in which Hothead agreed to make payments to us, including ongoing payments, and we agreed to allow Hothead to continue to publish the Kill Shot game. To the extent competitors

continue to copy our games, it could reduce the amount of revenue we are able to generate from any infringed games. Monitoring unauthorized use of our games is difficult and costly, and we cannot be certain that the steps we have taken will prevent piracy and other unauthorized distribution and use of our technology and games, particularly in certain international jurisdictions, such as China, where the laws may not protect our intellectual property rights as fully as in the United States. In the future, we may institute additional litigation to enforce our intellectual property rights, which could result in substantial costs and divert our management's attention and our resources.

In addition, although we require our third-party developers to sign agreements not to disclose or improperly use our

## Table of Contents

trade secrets, to acknowledge that all inventions, trade secrets, works of authorship, developments and other processes generated by them on our behalf are our property and to assign to us any ownership they may have in those works, it may still be possible for third parties to obtain and improperly use our intellectual properties without our consent. This could harm our brand, business, operating results and financial condition.

We may become involved in intellectual property disputes, which may disrupt our business and require us to pay significant damage awards.

Third parties may sue us for intellectual property infringement, or initiate proceedings to invalidate our intellectual property, which, if successful, could disrupt our business, cause us to pay significant damage awards or require us to pay licensing fees. For example, on August 20, 2014, Inventor Holdings, LLC, a Delaware limited liability company, filed a complaint in the U.S. District Court for the District of Delaware alleging that we were infringing one of its patents and seeking unspecified damages, including interest, costs, expenses and an accounting of all infringing acts, attorneys' fees and such other costs as the Court deems just and proper. In September 2015, the Court granted our motion to dismiss the case brought by Inventor Holdings. In addition, in November 2014, Telinit Technologies, LLC, a Texas company, filed a complaint in the U.S. District Court for the Eastern District of Texas, Marshall Division, alleging that we were infringing one of its patents and seeking unspecified damages, attorneys' fees and costs. We settled the dispute with Telinit for an immaterial amount in January 2015. Finally, in November 2015, Just Games Interactive LLC (d/b/a Kung Fu Factory, f/k/a Tiny Fun Studios) ("Just Games") filed a complaint against us and Kristen Jenner (f/k/a Kris Kardashian) in the U.S. District Court for the Central District of California. The complaint alleged direct copyright infringement against us and seeking at least \$10.0 million in damages as well as other relief, including costs, permanent and temporary injunctive relief, an accounting of profits, a constructive trust and such other costs the Court deemed just and proper. We filed a motion to dismiss the complaint on January 27, 2016. On February 1, 2016, Just Games filed a voluntary motion to dismiss their case against us without prejudice. Despite our prior successes in defending against such claims, claims against us in the future could result in our being enjoined from using our intellectual property or licensed intellectual property, and we might incur significant licensing fees and could be forced to develop alternative technologies. We may also be required to pay penalties, judgments, royalties or significant settlement costs. If we fail or are unable to develop non-infringing technology or games or to license the infringed or similar technology or games on a timely basis, we may be forced to withdraw games from the market or be prevented from introducing new games. We might also incur substantial expenses in defending against third-party claims, regardless of their merit.

In addition, we use open source software in some of our games and expect to continue to use open source software in the future. We may face claims from companies that incorporate open source software into their products, claiming ownership of, or demanding release of, the source code, the open source software and/or derivative works that were developed using such software, or otherwise seeking to enforce the terms of the applicable open source license. These claims could also result in litigation, require us to purchase a costly license or require us to devote additional research and development resources to change our games, any of which would have a negative effect on our business and operating results.

We may become a party to litigation and regulatory inquiries, which could result in an unfavorable outcome and have an adverse effect on our business, financial condition, results of operation and cash flows.

We may become subject to various legal proceedings, claims and regulatory inquiries that arise out of the ordinary conduct of our business and are not yet resolved and additional claims and inquiries may arise in the future. In

addition, events may occur that give rise to a potential risk of litigation. The number and significance of regulatory inquiries have increased as our business has grown and evolved. Any proceedings, claims or inquiries initiated by or against us, whether successful or not, may be time consuming; result in costly litigation, damage awards, consent decrees, injunctive relief or increased costs of doing business, require us to change our business practices or products, require significant amounts of management time, result in diversion of significant operations resources or otherwise harm our business and future financial results.



Table of Contents

“Cheating” programs, scam offers, black-markets and other offerings or actions by unrelated third parties that seek to exploit our games and players affect the game-playing experience and may lead players to stop playing our games or divert revenue to unrelated third parties.

Unrelated third parties have developed, and may continue to develop, “cheating” programs, scam offers, black-markets and other offerings that may decrease our revenue generated from our virtual economies, divert our players from our games or otherwise harm us. Cheating programs enable players to exploit vulnerabilities in our games to obtain virtual currency or other items that would otherwise generate in-app purchases for us, play the games in automated ways or obtain unfair advantages over other players who do play fairly. Unrelated third parties attempt to scam our players with fake offers for virtual goods or other game benefits. We devote resources to discover and disable these programs and activities, but if we are unable to do so in a prompt and timely manner, our operations may be disrupted, our reputation damaged and players may play our games less frequently or stop playing our games altogether. This may lead to lost revenue from paying players, increased cost of developing technological measures to combat these programs and activities, legal claims relating to the diminution in value of our virtual currency and goods, and increased customer service costs needed to respond to disgruntled players.

Unanticipated changes in our income tax rates or exposure to additional tax liabilities may affect our future financial results.

Our future effective income tax rates may be favorably or unfavorably affected by unanticipated changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws or their interpretation. Determining our worldwide provision for income taxes requires significant judgments. The estimation process and applicable laws are inherently uncertain, and our estimates are not binding on tax authorities. Our effective tax rate could also be adversely affected by a variety of factors, many of which are beyond our control. Recent and contemplated changes to U.S. tax laws, including limitations on a taxpayer’s ability to claim and utilize foreign tax credits and defer certain tax deductions until earnings outside of the United States are repatriated to the United States, could impact the tax treatment of our foreign earnings. Further, the taxing authorities of the jurisdictions in which we operate may challenge our methodologies for valuing developed technology or intercompany arrangements, including our transfer pricing, or determine that the manner in which we operate our business is not consistent with the manner in which we report our income to the jurisdictions, which could increase our worldwide effective tax rate and harm our financial position and results of operations. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine if our provision for income taxes is adequate. These continuous examinations may result in unforeseen tax-related liabilities, which may harm our future financial results.

We must charge, collect and/or pay taxes other than income taxes, such as payroll, value-added, sales and use, net worth, property and goods and services taxes, in both the United States and foreign jurisdiction. If tax authorities assert that we have taxable nexus in a jurisdiction, they may seek to impose past as well as future tax liability and/or penalties. Any such impositions could also cause significant administrative burdens and decrease our future sales. Moreover, state and federal legislatures have been considering various initiatives that could change our tax position regarding sales and use taxes.

Finally, as we change our international operations, adopt new products and new distribution models, implement changes to our operating structure or undertake intercompany transactions in light of changing tax laws, our tax expense could increase.

Our facilities are located near known earthquake fault zones, and the occurrence of an earthquake or other natural disaster could damage our facilities and equipment, which could require us to curtail or cease operations.

Our principal offices are located in the San Francisco Bay Area, an area known for earthquakes. We are also vulnerable to damage from other types of disasters, including power loss, fires, explosions, floods, communications failures, terrorist attacks and similar events. If any natural or other disaster were to occur, our ability to operate our business could be impaired.

## Table of Contents

If securities or industry analysts do not publish research about our business, or publish negative or misinformed reports about our business, our share price and trading volume could decline and/or become more volatile.

The trading market for our common stock is affected by the research and reports that securities or industry analysts publish about our business. We do not have any control over these analysts. If one or more of the analysts who cover us downgrade our shares or lower their opinion of our shares, our share price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our share price or trading volume to decline. In addition, our share price and the volatility of our shares can be affected by misinformed or mistaken research reports on our business.

Our common stock price may be affected by third-party data regarding our games.

Third parties publish daily data about us and other mobile gaming companies with respect to downloads of our games, daily and monthly active users and estimated revenue generated by our games. These metrics can be volatile, particularly for specific games, and in many cases do not accurately reflect the actual levels of usage of our games across all platforms or the revenue generated by our games. To the extent that securities analysts or investors base their views of our business or prospects on such third-party data, the price of our common stock may be affected by such third party data and may not reflect the actual performance of our business.

Sales of substantial amounts of our common stock in the public markets, or the perception that such sales might occur, could reduce the price that our common stock might otherwise attain and may dilute your voting power and your ownership interest in us.

The market price of shares of our common stock could decline as a result of substantial sales of our common stock, particularly sales by our directors and their affiliates, executive officers, employees and significant stockholders, under our current shelf registration statements, through a large number of shares of our common stock becoming available for sale, or the perception in the market that holders of a large number of shares intend to sell their shares. For example, we issued 9,982,886 shares in connection with our acquisition of Cie Games, Inc. in August 2014. We filed a Registration Statement on Form S-3 covering the resale of such shares. Accordingly, the shares issued in the Cie Games acquisition are subject to only limited re-sale restrictions and sales of substantial amounts of such shares may occur. Also, while Tencent is prohibited from selling the shares it acquired from us for 18-months from April 29, 2015, following expiration of such lock-up period, Tencent would be free to sell those shares on the open-market, subject only to our black-out periods and other limitations under our insider trading policy.

Some provisions in our certificate of incorporation and bylaws, as well as Delaware law, may deter third parties from seeking to acquire us.

Our certificate of incorporation and bylaws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors, including the following:

- our board of directors is classified into three classes of directors with staggered three-year terms;
- only our chairman of the board, our lead independent director, our Chief Executive Officer, our president or a majority of our board of directors is authorized to call a special meeting of stockholders;
- our stockholders are able to take action only at a meeting of stockholders and not by written consent;
- only our board of directors and not our stockholders is able to fill vacancies on our board of directors;
- our certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval; and

- advance notice procedures apply for stockholders to nominate candidates for election as directors or to

Table of Contents

bring matters before a meeting of stockholders.

In addition, as a Delaware corporation, we are subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents certain stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of at least two-thirds of our outstanding common stock not held by such 15% or greater stockholder, although our board of directors waived this provision with respect to Tencent's potential acquisition of greater than 15% of our shares in connection with the Offering.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In January 2016, our Board of Directors authorized a share repurchase program of up to \$50 million of our outstanding common stock. The timing and amount of any stock repurchases will be determined based on market conditions, share price and other factors. The program does not require us to repurchase any specific number of shares of our common stock, and may be modified, suspended or terminated at any time without notice.

During the three months ended March 31, 2016 we did not repurchase any shares of our common stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The exhibits listed on the Exhibit Index (following the Signatures section of this report) are incorporated by reference into this Item 6.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GLU MOBILE INC.

Date: May 6, 2016 By: /s/ Niccolo M. de Masi  
Niccolo M. de Masi  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: May 6, 2016 By: /s/ Eric R. Ludwig  
Eric R. Ludwig  
Executive Vice President, Chief Operating Officer and Chief Financial Officer  
(Principal Financial Officer)

Table of Contents

## EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference				
		Form	File No.	Exhibit	Filing Date	Filed Herewith
31.01	Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a).					X
31.02	Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a) /15d-14(a).					X
32.01*	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).					X
32.02*	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).					X
101.INS	XBRL Report Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Calculation Linkbase Document					X
101.LAB	XBRL Taxonomy Label Linkbase Document					X
101.PRE	XBRL Presentation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X

---

\*This exhibit is not deemed “filed” for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that Glu Mobile Inc. specifically incorporates it by reference.



