

ZYNGA INC
Form 10-Q
August 05, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 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 June 30, 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: 001-35375

Zynga Inc.

(Exact name of registrant as specified in its charter)

Delaware 42-1733483
(State of or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

699 Eighth Street 94103
San Francisco, CA (Zip Code)
(Address of principal executive offices)

(855) 449-9642

(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 Exchange Act Rule 12b-2). Yes No

As of July 15, 2016, there were 764,838,158 shares of the Registrant's Class A common stock outstanding, 96,732,511 shares of the Registrant's Class B common stock outstanding and 20,517,472 shares of the Registrant's Class C common stock outstanding.

Zynga Inc.

Form 10-Q Quarterly Report

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

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

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- our future spend, including spend on R&D and marketing and our future margins;
- our future operational plans, use of cash, strategies and prospects;
- the breadth and depth of our game slate for 2016 and the success of this slate and future launches from this slate;
- the timely launch and success of our games
- our ability to change our mix of R&D and unlaunched game slate to live games;
- our ability to increase the predictability of our business and to continue to transition to mobile;
- our planned launch of mobile first games and new features for existing games;
- our ability to grow mobile bookings in 2016 and beyond;
- our cost structure and cost reduction plans and estimated savings and charges, including our reduction in workforce and reduction in centralized services costs and spend;
- our ability to accelerate execution, drive profitability and nurture creativity and innovation while reducing costs and lowering discretionary spend;
- our ability to execute against our turnaround strategy and deliver long-term value to our shareholders, employees and players and fulfill our mission to connect the world through games;
- our ability to accurately forecast our upcoming game launches and bookings and revenue related to upcoming game launches and our existing games;
- our ability to accurately forecast our bookings, revenue and performance of our existing games;
- our relationship or agreements with key licensing partners, additional platform providers or any other key partners;
- our ability to launch and monetize successful new games and features for web and mobile in a timely manner and the success of these games and features;
- our ability to sustain player engagement, optimize our games to increase long-term player retention and monetize our live games and games in geo-lock testing;
- our ability to renew our existing brand, technology and content licenses as they expire and secure new licenses for top brands;
- the success of our acquisitions;
- the process of integrating newly acquired businesses with ours, including but not limited to our expected ability to expand our creative pipeline, accelerate our growth on mobile and deliver hit games on schedule from such newly acquired businesses;
- the effectiveness of our marketing program and initiatives and our ability to obtain game featuring from partners;
- our strategy of backing proven teams to develop or expand our game offerings in the content categories where we are focused, the timely launch of our games in these categories and the success of these games;
- our relationship with Facebook, changes in the Facebook platform or changes in our agreement with Facebook;
- our relationship with Apple, Google and other Android platform providers, changes to the Android or iOS platforms or changes in our agreements with Apple, Google or other Android platform providers;
- our ability to attract and retain key employees in light of business challenges, including employees key to franchise games and planned launches and senior management;
- the impact of change in our senior management team and management teams, new hires and other changes in our organization;
- the strength of our balance sheet and our ability to effectively manage our cost structure and investments;

- our ability to efficiently deploy employees and leverage our teams and talent, including shifting resources when necessary to prioritize more important projects;
- our ability to use data analytics to improve our player experience, gameplay and monetization;
- our ability to manage new IP costs;
- competition in our industry;
- our ability to maintain technology infrastructure and employees that can efficiently and reliably handle increased player usage, changes in mobile devices and game platforms, fast load times and the rapid deployment of new features and products;
- our ability to anticipate and address technical challenges that may arise;
- our ability to protect our players' information and adequately address privacy concerns;
- our ability to maintain reliable security services and infrastructure to protect against security breaches, computer malware and hacking attacks;
- market opportunity in the social gaming market, including the mobile market, the advertising market, the market for social game categories in which we invest, and our ability to capitalize on and contribute to this market opportunity;
- the success of our advertising offerings, and our ability to grow advertising bookings;
- our ability to successfully monitor and adapt to changes in gaming platform and consumer demand as the industry continues to evolve;
- our ability to develop, identify, market and launch hit games and new features and content for our existing games in a timely manner;
- the ability of our games to generate revenue and bookings for a significant period of time after launch and the timing for market acceptance of new games;
- attrition or decline in existing games' audience and financial performance, including franchise games;
- our ability to utilize, protect, defend and enforce our intellectual property;
- our exposure to intellectual property disputes and other litigation;
- our exposure to illegitimate credit card activity and other security risks, including sales or purchases of virtual goods used in our games through unauthorized or illegitimate third-party websites;
- our ability to manage risks, costs and other challenges associated with international expansion;
- the impact of laws and regulations on our business;
- our evaluation of new business opportunities and acquisitions by us, including integration of newly acquired businesses;
- changes in corporate strategy or management;
- our ability to understand industry trends, such as seasonality, and position our business to take advantage of these trends;
- our ability to build on our social legacy in both our web games and our new mobile games and build a player network across mobile games;
- our ability to operate in an entrepreneurial manner, successfully invest in and innovate on game mechanics and successfully invest in and leverage data and analytics in our operations; and
- the effectiveness of our cost cutting activities and our ability to control and reduce expenses, including our estimated savings and charges associated with our restructuring efforts.

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

circumstances discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated, predicted or implied in the forward-looking statements.

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Zynga Inc.

Consolidated Balance Sheets

(In thousands, except par value)

(Unaudited)

	June 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 828,388	\$ 742,217
Marketable securities	40,050	245,033
Accounts receivable, net of allowance of \$0 at June 30, 2016 and December 31, 2015	65,074	79,610
Income tax receivable	1,949	5,233
Restricted cash	2,081	209
Other current assets	28,135	39,988
Total current assets	965,677	1,112,290
Goodwill	627,760	657,671
Other intangible assets, net	50,263	64,016
Property and equipment, net	269,769	273,221
Restricted cash	250	986
Other long-term assets	30,694	16,446
Total assets	\$ 1,944,413	\$ 2,124,630
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 11,900	\$ 29,676
Other current liabilities	62,199	77,691
Deferred revenue	116,765	128,839
Total current liabilities	190,864	236,206
Deferred revenue	100	204
Deferred tax liabilities	5,962	6,026
Other non-current liabilities	79,531	95,293
Total liabilities	276,457	337,729
Stockholders' equity:		
Common stock, \$0.00000625 par value, and additional paid in capital - authorized		
shares: 2,020,517; shares outstanding: 882,087 shares (Class A, 764,830, Class B,		
96,740 Class C, 20,517) as of June 30, 2016 and 903,617 (Class A, 769,533,		
Class B, 113,567, Class C, 20,517) as of December 31, 2015		
	3,297,066	3,234,551
Treasury stock	—	(98,942)
Accumulated other comprehensive income (loss)	(100,518)	(52,388)

Accumulated deficit	(1,528,592)	(1,296,320)
Total stockholders' equity	1,667,956	1,786,901
Total liabilities and stockholders' equity	\$1,944,413	\$ 2,124,630

See accompanying notes.

Zynga Inc.

Consolidated Statements of Operations

(In thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue:				
Online game	\$ 135,823	\$ 162,161	\$ 272,880	\$ 310,124
Advertising and other	45,912	37,757	95,576	73,087
Total revenue	181,735	199,918	368,456	383,211
Costs and expenses:				
Cost of revenue	56,103	57,779	113,242	115,401
Research and development	66,233	90,896	153,970	198,416
Sales and marketing	40,631	41,119	86,975	72,958
General and administrative	25,374	37,805	47,758	78,186
Total costs and expenses	188,341	227,599	401,945	464,961
Income (loss) from operations	(6,606)	(27,681)	(33,489)	(81,750)
Interest income	761	605	1,466	1,399
Other income (expense), net	1,905	1,199	4,005	9,558
Income (loss) before income taxes	(3,940)	(25,877)	(28,018)	(70,793)
Provision for (benefit from) income taxes	506	991	2,986	2,571
Net income (loss)	\$(4,446)	\$(26,868)	\$(31,004)	\$(73,364)
Net income (loss) per share attributable to common				
stockholders:				
Basic	\$(0.01)	\$(0.03)	\$(0.04)	\$(0.08)
Diluted	\$(0.01)	\$(0.03)	\$(0.04)	\$(0.08)
Weighted average common shares used to compute net income				
(loss) per share attributable to common stockholders:				
Basic	873,393	911,699	872,243	905,058
Diluted	873,393	911,699	872,243	905,058

See accompanying notes.

Zynga Inc.

Consolidated Statements of Comprehensive Income (Loss)

(In thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income (loss)	\$(4,446)	\$(26,868)	\$(31,004)	\$(73,364)
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	(30,931)	26,725	(48,260)	4,112
Net change on unrealized gains (losses) on available-for-sale investments, net of tax	(6)	(60)	130	378
Other comprehensive income (loss):	(30,937)	26,665	(48,130)	4,490
Comprehensive income (loss):	\$(35,383)	\$(203)	\$(79,134)	\$(68,874)

See accompanying notes.

Zynga Inc.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended June 30,	
	2016	2015
Operating activities:		
Net income (loss)	\$(31,004)	\$(73,364)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	21,647	31,062
Stock-based expense	56,507	69,367
(Gain) loss from sales of investments, assets and other, net	242	(5,650)
Accretion and amortization on marketable securities	311	3,884
Deferred income taxes	1,570	1,241
Changes in operating assets and liabilities:		
Accounts receivable, net	14,536	6,857
Income tax receivable	772	(1,529)
Other assets	(4,442)	(8,792)
Accounts payable	(14,316)	12,762
Deferred revenue	(12,178)	(41,340)
Other liabilities	(22,404)	(37,298)
Net cash provided by (used in) operating activities	11,241	(42,800)
Investing activities:		
Purchases of marketable securities	—	(101,091)
Sales and maturities of marketable securities	204,802	490,667
Acquisition of property and equipment	(3,947)	(5,239)
Business acquisitions, net of cash acquired	(14,220)	—
Proceeds from sale of property and equipment	1,577	—
Proceeds from sale of equity method investment	—	10,507
Net cash provided by (used in) investing activities	188,212	394,844
Financing activities:		
Taxes paid related to net share settlement of equity awards	(1,665)	(1,413)
Repurchases of common stock	(112,392)	—
Proceeds from employee stock purchase plan and exercise of stock options	2,885	4,335
Acquisition-related contingent consideration payment	—	(10,790)
Net cash provided by (used in) financing activities	(111,172)	(7,868)
Effect of exchange rate changes on cash and cash equivalents	(2,110)	(51)
Net increase (decrease) in cash and cash equivalents	86,171	344,125
Cash and cash equivalents, beginning of period	742,217	131,303
Cash and cash equivalents, end of period	\$828,388	\$475,428

See accompanying notes.

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Zynga Inc.

Notes to Consolidated Financial Statements

(Unaudited)

1. Overview and Summary of Significant Accounting Policies

Organization and Description of Business

Zynga Inc. (“Zynga,” “we” or the “Company”) develops, markets, and operates social games as live services played over the Internet and on social networking sites and mobile platforms. We generate revenue through the in-game sale of virtual goods and through advertising. Our operations are headquartered in San Francisco, California, and we have several operating locations in the U.S., as well as various international office locations in North America, Asia and Europe.

We completed our initial public offering in December 2011 and our Class A common stock is listed on the NASDAQ Global Select Market under the symbol “ZNGA.”

Basis of Presentation and Consolidation

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

The accompanying interim consolidated financial statements and these related notes should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2015.

Unaudited Interim Financial Information

The accompanying interim consolidated balance sheet as of June 30, 2016, the interim consolidated statements of operations, the interim consolidated statements of comprehensive income (loss) for the three and six months ended June 30, 2016 and 2015, the interim consolidated statements of cash flows for the six months ended June 30, 2016 and 2015 and the related footnote disclosures are unaudited. These unaudited consolidated interim financial statements have been prepared in accordance with U.S. GAAP. In management’s opinion, the unaudited consolidated interim financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments of a normal recurring nature necessary for the fair presentation of the Company’s statement of financial position and operating results for the periods presented. The results for the three and six months ended June 30, 2016 are not necessarily indicative of the results expected for the full fiscal year or any other future period.

Use of Estimates

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

estimates.

Changes in our estimated average life of durable virtual goods resulted in an increase in revenue and income from operations of \$1.9 million and \$2.2 million in the three and six months ended June 30, 2016, respectively, which is the result of adjusting the remaining recognition period of deferred revenue generated in prior periods at the time of a change in estimate. We also recognized \$2.3 million and \$3.6 million of revenue and income from continuing operations in the three and six months ended June 30, 2016, respectively, due to changes in our estimated average life of durable virtual goods for games that have been discontinued as there is no further service obligation after the closure of these games. These changes in estimates did not impact our reported earnings per share for the three months ended June 30, 2016 and resulted in a \$0.01 per share impact on our reported earnings per share for the six months ended June 30, 2016.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (Topic 606),” which requires revenue to be 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. ASU 2014-09 supersedes the existing revenue recognition guidance in “Revenue Recognition (Topic 605)”. In July 2015, the FASB voted to amend ASU 2014-09 by approving a one-year deferral of the effective date as well as allowing early adoption as of the original effective date. Accordingly, the Company may adopt the standard in either the first quarter of 2017 or 2018. In March 2016, the FASB issued ASU 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net),” which clarifies the implementation guidance on principal versus agent consideration in determining whether an entity controls a specified good or service before it is transferred to the customer. We are currently in the process of evaluating the timing of adoption of ASU 2014-09 and ASU 2016-08 as well as the impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842),” which requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. For lessors, accounting for leases will remain substantially the same as in prior periods. The standard is effective in the first quarter of 2019 and early adoption is permitted. While the Company expects adoption of this new standard to increase reported assets and liabilities, we are currently in the process of evaluating the timing of adoption of ASU 2016-02 as well as the full impact on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting,” to simplify the accounting for share-based payment transactions, including income taxes and classification in the statement of cash flows. It also provides an option to recognize gross share-based compensation expense with actual forfeitures recognized as they occur. The standard is effective in the first quarter of 2017 and early adoption is permitted. We are currently in the process of evaluating the timing of adoption of ASU 2016-09 as well as the impact on our consolidated financial statements.

2. Marketable Securities

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

	June 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value
U.S. government and government agency debt securities	\$33,005	\$ 4	\$ —	\$ 33,009
Corporate debt securities	7,041	—	—	7,041
Total	\$40,046	\$ 4	\$ —	\$ 40,050

	December 31, 2015			
	Amortized	Gross Unrealized	Gross Unrealized	Aggregate

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	Cost	Gains	Losses	Fair Value
U.S. government and government agency debt securities	\$ 145,066	\$ —	\$ (80)	\$ 144,986
Corporate debt securities	100,093	12	(58)	100,047
Total	\$245,159	\$ 12	\$ (138)	\$245,033

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

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

	June 30, 2016
Due within one year	\$40,050
After one year through three years	—
Total	\$40,050

Changes in market interest rates and bond yields caused certain investments to fall below their cost basis, resulting in unrealized losses on marketable securities. As of June 30, 2016, we had unrealized losses of \$0.1 thousand related to marketable securities that had a fair value of \$5.5 million. As of December 31, 2015, we had unrealized losses of \$0.1 million related to marketable securities that had a fair value of \$199.1 million. None of these securities were in a material continuous unrealized loss position for more than 12 months.

As of June 30, 2016 and December 31, 2015, we did not consider any of our marketable securities to be other-than-temporarily impaired. When evaluating our investments for other-than-temporary impairment, we review factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer, our ability and intent to hold the security to maturity and whether it is more likely than not that we will be required to sell the investment before recovery of its cost basis.

3. Fair Value Measurements

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

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

Our contingent consideration liability represents the estimated fair value of the additional consideration payable in connection with our acquisitions of Rising Tide Games, Inc. (“Rising Tide”) and Zindagi Games, Inc. (“Zindagi”). The amount payable is contingent upon the achievement of certain performance targets. We estimated the acquisition date fair value of the contingent consideration payable using discounted cash flow models, and applied a discount rate that appropriately captured a market participant’s view of the risk associated with the obligations. The significant unobservable inputs used in the fair value measurement of the acquisition-related contingent consideration payable were forecasted future cash flows and the timing of those cash flows and the risk-adjusted discount rate. Significant changes in actual and forecasted future cash flows may result in significant charges or benefits to our future operating expenses.

In the third quarter of 2015, we acquired Rising Tide. Under the terms of the agreement, the contingent consideration of up to \$140.0 million may be payable based on the achievement of certain future performance targets during the three year period following the acquisition date. We initially estimated the acquisition date fair value of the contingent consideration payable using discounted cash flow models, and applied a risk-adjusted discount rate that appropriately captured a market participant’s view of the risk associated with the obligations. In the second quarter of 2016, we updated this analysis and recorded the change in estimated fair value of the contingent consideration liability as a benefit of approximately \$13.3 million within Research and Development in our consolidated statement of operations, reducing the liability to \$7.2 million. The decrease in the fair value of the liability is primarily driven by a decline in our expectations about the future performance of the acquired games.

In the first quarter of 2016, we acquired Zindagi. Under the terms of the agreement, the contingent consideration may be payable based on the achievement of certain future performance targets during the three year period following the acquisition date. We initially estimated the acquisition date fair value of the contingent consideration payable using discounted cash flow models, and applied a risk-adjusted discount rate that appropriately captured a market participant’s view of the risk associated with the obligations. In the second quarter of 2016, we updated this analysis and recorded the change in estimated fair value of the contingent consideration liability as a benefit of approximately \$1.1 million within Research and Development in our consolidated statement of operations. The current contingent consideration liability is \$0.2 million, however, the maximum contingent consideration that could be earned and payable by us is \$60.0 million.

Fair value is a market-based measurement that should be determined based on assumptions that knowledgeable and willing market participants would use in pricing an asset or liability. The valuation techniques used to measure the fair value of the Company's debt instruments and all other financial instruments, all of which have counterparties with high credit ratings, were valued based on quoted market prices or model-driven valuations using significant inputs derived from or corroborated by observable market data. We use a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

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

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

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

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

	June 30, 2016			Total
	Level 1	Level 2	Level 3	
Assets:				
Money market funds ⁽¹⁾	\$572,500	\$—	\$—	\$572,500
U.S. government and government agency debt securities	—	33,009	—	33,009
Corporate debt securities ⁽¹⁾	—	122,076	—	122,076
Total	\$572,500	\$155,085	\$—	\$727,585
Liabilities:				
Contingent consideration	\$—	\$—	\$7,390	\$7,390

	December 31, 2015			Total
	Level 1	Level 2	Level 3	
Assets:				