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Zynga's Real Game Could Be Fraudville

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| about: [ZNGA](#), includes: [ATVI](#)

Disclosure: I have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.

Zynga ([ZNGA](#)) is [being sued](#) and investigated by several high profile law firms representing investors who feel they were recently ripped off by the Zynga IPO. Zynga used a combination of GAAP and Non-GAAP accounting to offset losses and inflate their stock price before issuing a waiver so select insiders could offload their stock at \$12.00 a share. and then posted those offset losses to Q2 after the insiders sold millions of shares.

Lockup waivers aren't totally uncommon, but to many investors hurt by this action it appears Zynga used illegal insider trading tactics to fill their rich buddies' pockets while moms and dads lost their children's college tuition.

The regular employees must have been livid as they watched superiors dumping stock and raking in millions. They were still locked out and could only watch their shares dwindle to worthlessness. Now Pincus is making equity grants to those very employees so they don't jump ship. The equity grants further dilute the company stock which is already nearly worthless.

It appears to me and many others in the world that many of Zynga's games are [copy / theft / hacks](#) of other companies' hard work. The most recent example is the [alleged copyright theft](#) of EA's "The Sims Social". Zynga released "The Ville" which copies EA's game down to the color palate used for avatar skin tones. This should not sit well with potential investors who know Zynga needs to produce new and popular titles to remain profitable. It would seem Zynga is mostly capable of creating clones of successful titles released by other companies. In fact it seems to be their modus operandi as clarified by the following statement:

In September 2010, [SF Weekly reported](#) that an employee recalled Mark Pincus saying, "I don't fucking want innovation. You're not smarter than your competitor. Just copy what they do and do it until you get their numbers."

Before I became interested in the inside workings of Zynga I played their Zynga Poker game on Facebook. In the beginning the game seemed pretty normal. I would win and lose just about equally. One day I decided to play on bigger virtual tables and purchased virtual chips for \$5. I was amazed that the odds somehow seemed to magically change in my favor, I could not lose a hand and I was able to quickly reach 20 Million in virtual currency. Then the ads began to appear after small losses begging me to buy more chips. After declining several times I noticed I could not win a single hand. The odds seem to have changed in Zynga's favor. I then tested my theory with multiple accounts with the exact same outcome. I was then convinced that Zynga Poker might be rigged though I can't be 100% certain.

When I learned about the Zynga IPO I went through the numbers and was shocked to see analysts placing greater value on Zynga than competitors that have been making games for the last 30 years. In fact Zynga was so over valued that companies like Activision ([ATVI](#)) looked poor in comparison.

I wrote about my concerns. I warned people not to buy the stock because I strongly felt a fraud was being played out and that the stock was going to quickly plunge to below \$3 a share. In fact, I wrote about this before the Q2 losses and insider trading began. People crucified me. Guess what? I was right.

Something else began to bother me about Zynga that people seem to be ignoring. Zynga does not release game by

game income data. It is reminiscent of the current Mitt Romney tax returns. What are they hiding? To find my answers I had to read between the lines and examine their [SEC IPO Prospectus](#).

From Zynga's SEC IPO Prospectus:

- In April 2007, we began operations and by the end of 2008 had launched several games, including *Zynga Poker* in July 2007 and *Mafia Wars* in June 2008 on multiple platforms, including Facebook and Myspace.
- Our top three games vary over time but historically have contributed the majority of our revenue. Our top three games accounted for 93%, 83%, 78% and 59% of our online game revenue in 2008, 2009, 2010 and for the nine months ended September 30, 2011, respectively.

As it would appear, Zynga Poker, the game I believe might cheat players to inspire chip purchase has been up to 93% of Zynga's game income at times. That thought bothers me to the very core of my being. I would love to see this game formally investigated.

It is almost undeniable that [Zynga hijacks games](#) from other companies and it certainly appears to me that their poker game is rigged. To many people Zynga sure looks guilty of illegal insider trading. I personally find it extremely odd that all the insiders knew exactly when to sell.

Returning to the Insider Sell-off here are some facts:

Zynga went public in December of 2011 with a stock price of \$10 a share. A Positive 1Q helped raise the stock price above \$12 a share. Early investors and company employees had a lock-up period and were unable to sell their shares until May 28th of 2012. Zynga filed an [amendment to the form S-1](#) which *waived* the lockup restrictions allowing a select group of insiders to dump shares. Using Underwriters Morgan Stanley and Goldman Sachs those insiders offloaded \$515 million worth of shares on April 3rd at \$12 a share. Because of Zynga's creative Non-GAAP accounting they were able to shift previous losses from Q1 to Q2 and the insiders dumped shares before the dismal Q2 report. Coincidence?

To better understand Zynga's creative accounting you might want to check out an article by Forbes titled "[How Zynga, Facebook and Groupon's Go-To Auditor Rewrites Accounting Rules](#)". Not too surprisingly their "Go-To Auditor" happens to be Ernst & Young.

Ernst & Young has been involved in 11 major [accounting scandals](#) since 1996. As a matter of record they have been involved in more accounting scandals than any other firm and most other firms combined.

I urge you to seriously investigate Zynga before investing in the company. I do not believe they will survive the pending lawsuits filed against them and when / if they are de-listed you probably won't get your money back. The way Zynga is managed makes me highly doubt their future survival.

Additional disclosure: The views expressed in this article are my own and not necessarily the views of Seeking Alpha or seekingalpha.com. I have absolutely no intention of purchasing Zynga stock ever.

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