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10 SUPERIOR COURT OF THE STATE OF CALIFORNIA  
11 COUNTY OF SAN FRANCISCO

12  
13 IN RE KING DIGITAL ENTERTAINMENT  
14 plc SHAREHOLDER LITIGATION

Lead Case No. CGC-15-544770

CLASS ACTION

15  
16 This Document Relates To:  
17 ALL ACTIONS

**KING DEFENDANTS' AMENDED  
SUPPLEMENTAL SUBMISSION  
REGARDING PLAINTIFFS' MOTION FOR  
PRELIMINARY APPROVAL OF  
SETTLEMENT**

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1 **I. INTRODUCTION**

2 During the hearing on November 17, 2016 in connection with plaintiffs’ pending motion  
3 for preliminary approval of the class action settlement, the Court indicated that it would like the  
4 parties to provide additional information regarding the merits and defenses to plaintiffs’  
5 allegations, as well as causation and damages. This submission is made by defendants King  
6 Digital Entertainment PLC (“King” or the “Company”), Hope Cochran, Robert S. Cohn and E.  
7 Stanton McKee (collectively, the “King Defendants”) in response to the Court’s request.

8 In providing this information, the King Defendants have focused on the main issues in this  
9 case, and why they believe plaintiffs cannot establish liability if the case were litigated through  
10 summary judgment or trial. In addition, the King Defendants have previously filed (on December  
11 28, 2016) the Declaration of Alexander Aganin, Ph.D (“Aganin Decl.”), which addresses certain  
12 causation and damages issues.

13 As with all securities class action settlements, the proposed settlement in this case reflects  
14 a compromise in light of the risks, costs, and distraction associated with continued litigation. It  
15 was bargained for at arms-length, with the assistance of a highly experienced mediator (the Hon.  
16 Layn Phillips, a former federal judge). The parties argued their positions vigorously. While the  
17 King Defendants are highly confident that that they would have prevailed in this case, either on  
18 summary judgment or at trial, there are always risks that need to be considered and evaluated (in  
19 addition to the expense and distraction of ongoing litigation) that make settlement sensible. The  
20 King Defendants briefly summarize their position on the key issues below.

21 **II. DEFENDANTS BELIEVE THEY WOULD HAVE PREVAILED IF THE CASE**  
22 **HAD NOT BEEN SETTLED**

23 **A. King’s Business and Growth**

24 This litigation relates to the March 26, 2014 initial public offering of King stock. King is  
25 one of the world’s foremost developers of casual games. Among its games is Candy Crush Saga  
26 (“Candy Crush” or “CCS”), a global phenomenon which was the best monetizing casual game in  
27 history. Other popular games include Farm Heroes Saga, Pet Rescue Saga, Papa Pear Saga and  
28

1 Bubble Witch Saga. Prospectus, dated March 25, 2014 (“Prospectus”) at 1-4, 51-53.<sup>1</sup>

2 King’s game development and distribution have fueled incredible growth, both before **and**  
3 **after** the IPO. In 2013, bookings rose to \$1.98 billion (from \$181.6 million), and revenue rose to  
4 \$1.88 billion (from \$164.4 million). Prospectus at 10-11, 46-47. Profits increased more than  
5 **7000%**, from \$7.8 million in 2012 to \$567.6 million in 2013. *Id.* at 10. By the end of 2013, an  
6 average of 128 million daily active users (DAUs) played King’s games more than 1.2 billion  
7 times per day. *Id.* at 51-52. Other key metrics also increased, including:

- 8 • Monthly unique users (MUUs), the number of unique individuals who play any game  
9 on a specific platform in a 30-day period, which grew from 43 million to 304 million;
- 10 • Monthly active users (MAUs), a measurement of the overall size of King’s network  
11 of users and their regular engagement with its portfolio of games, which rose from  
12 67 million to 408 million; and
- 13 • Monthly unique payers (MUPs), the average number of unique individuals who  
14 purchased a virtual item at least once in a 30-day period, which increased from 1.3  
15 million to about 12.2 million (with a high of 13 million in the third quarter of 2013).

16 *Id.* at 52, 55-57.

17 Documents produced during discovery confirm that King anticipated that its business  
18 would continue to grow and prosper after the IPO, that such growth would be fueled by a diverse  
19 set of games, and that – as noted in the IPO Registration Statement and Prospectus – Candy Crush  
20 would continue to represent a smaller percentage of the Company’s business.

## 21 **B. King’s IPO, Final Registration Statement and Prospectus**

22 On March 25, 2014, King filed its final Registration Statement in connection with the IPO.  
23 It described King’s key business metrics, together with a detailed analysis of those metrics on a  
24 quarterly basis for the two years leading up to the IPO. *See* Prospectus at 5, 10-12, 46-50, 53-58.  
25 Among those metrics were: revenues; profits and adjusted EBITDA; gross bookings; DAUs;  
26 MAUs; MUUs; MUPs; and monthly gross average bookings per paying user (MGABPPU), a key  
27 measure of monetization across King’s network showing average spend per player per month. *Id.*

28 <sup>1</sup> The Prospectus was part of the final Registration Statement (“Registration Statement”) filed by  
King with the SEC on March 25, 2014 in connection with the initial public offering. The  
Prospectus is attached as Exhibit A to the Declaration of Marie C. Bafus (“Bafus Decl.”), filed  
concurrently herewith.

1 at 53-58. The Prospectus also provided comprehensive disclosures of the risks and challenges  
2 facing King, including the fact that, at the end of 2013, three games accounted for 95% of its  
3 bookings. *Id.* at 13-36, 51-60.

4 **C. King's Post-IPO Performance and Acquisition by Activision Blizzard**

5 King's first quarter ended on March 31, 2014, and its results were disclosed on May 7,  
6 2014. Revenues (\$607 million) and bookings (\$641 million) **increased** over the prior quarter.  
7 Bafus Decl., Ex. B at 2. As stated in the Prospectus, the portion of bookings attributable to Candy  
8 Crush declined (from 78% to 67%), reflecting greater diversification. User metrics were all up  
9 substantially, and while MUPs declined slightly from 12.2 million to 11.9 million (about 2%),  
10 revenues grew because the average payer continued to spend more (MGABPPU increased). *Id.* at  
11 3. Put simply, it was a strong quarter.

12 Moreover, the disclosures on May 7, 2014 were positive and consistent with analysts'  
13 expectations. For example, one analyst noted that (apart from the slight decline in MUPs) King's  
14 results for the first quarter as a public company reflected "strong growth on just about every other  
15 user metric." Second Am. Consol. Cmpl. ("SACC") ¶ 56.

16 In the conference call that followed the May 7, 2014 disclosure, King provided financial  
17 guidance for the year, estimating bookings of \$2.55-\$2.65 billion, revenue of \$2.40-\$2.50 billion,  
18 and an EBITDA margin of 40%. Bafus Decl., Ex. C at 7. For the second quarter, King expected  
19 bookings, revenue and EBITDA margin to remain relatively flat, with continued revenue  
20 diversification (*i.e.*, non-CCS titles contributing a greater percentage of total bookings). *Id.*

21 King's second quarter started very strong. Beginning in the latter part of May 2014,  
22 however, King began seeing unexpected softening in its business. As the quarter progressed into  
23 June, the unanticipated decline in bookings continued.

24 The Company announced second quarter results on August 12, 2014. Quarterly bookings  
25 (\$611 million) were below the Company's expectations, primarily because: (i) Farm Heroes Saga  
26 peaked earlier than expected; and (ii) CCS declined more than anticipated in the back-half of the  
27 quarter. Bafus Decl., Ex. D. Revenue (\$594 million) was down sequentially, although profit

1 increased 30% to \$165 million. *Id.* at 2-3. MUPs were 10.4 million (down for the third straight  
2 quarter), while average spending per paying user increased 8% to \$19.54. The Company  
3 explained that the decrease in MUPs was primarily a result of reduced payment activity among  
4 the occasional payers of the network, in addition to an increased share of transactions coming  
5 from games offering virtual currency (resulting in larger but less frequent purchases). *Id.* at 3.  
6 King also revised its outlook for the year: bookings for 2014 were expected to range from \$2.25  
7 billion to \$2.35 billion, with bookings in Q3 expected to decline sequentially to a range of \$500  
8 million to \$525 million. *Id.* at 4.

9 The Company's actual results for 2014 exceeded its revised guidance. Bookings were  
10 almost \$2.4 billion, an increase of \$403 million over 2013, representing growth of 20%. Bafus  
11 Decl., Ex. E at 1. Revenue was \$2.26 billion, an increase of \$376 million or 20% as well. *Id.*  
12 The Company's EBITDA margin was 42% and, even after paying \$364 million in cash dividends  
13 to shareholders during the year, the Company had cash and cash equivalents of \$964 million – an  
14 increase of \$555 million, primarily the result of generating \$661 million in net cash from  
15 operating activities. *Id.* In other words, rather than experiencing any sort of collapse, King's first  
16 year as a public company resulted in revenue and bookings growth of 20%, critical diversification  
17 in its bookings, and enormous profitability and cash flow.

18 On November 2, 2015, the Company announced that it had entered into an agreement to  
19 be acquired by a subsidiary of Activision Blizzard, Inc., pursuant to which all King stockholders  
20 would receive \$18 per share in cash. Following approval by King stockholders and Irish takeover  
21 authorities, the acquisition was completed in February 2016. For those stockholders who bought  
22 during the class period at a price in excess of \$18 per share, and who continued to hold their  
23 shares thereafter, the acquisition price limits their alleged loss. Those who acquired King shares  
24 at less than \$18 and continued to hold those shares did not incur any loss.<sup>2</sup>

25 <sup>2</sup> Despite the fact that King grew its business over 20% in its first year as a public company, and  
26 was enormously profitable, its share price traded below the IPO price before it was acquired by  
27 Activision Blizzard. King, however, was not a guarantor of the trading price of its shares on the  
28 open market, which is influenced by a wide-variety of factors. Moreover, King provided  
extensive risks in the Prospectus regarding factors that could impact its results, and specifically  
referenced risks to its stock price. *See, e.g.*, Prospectus at 31-32.

1           **D.       Plaintiffs Would Not Prevail On Their Disclosure Claims**

2           Plaintiffs’ Section 11 claim was based on three alleged omissions from the Prospectus: (i)  
3 the portion of total bookings attributable to CCS would decline from 78% in the fourth quarter of  
4 2013 to 67% in the first quarter of 2014; (ii) the decline in MUPs would continue; and (iii) some  
5 King users had free “lives” donated by Facebook friends allegedly deleted from their accounts.  
6 SACC ¶¶ 36-54. Each of these theories is addressed below.

7                       **1.       Candy Crush**

8           If the case continued to be litigated, plaintiffs would not prevail on their claim regarding  
9 the declining percentage of Candy Crush bookings because the information purportedly “omitted”  
10 was, in fact, disclosed in the Registration Statement. Specifically, King explained that while  
11 Candy Crush accounted for 78% of total bookings during the fourth quarter of 2013, “[i]n **future**  
12 **periods**, we expect *Candy Crush Saga* to represent a **smaller percentage** of our total mobile  
13 channel bookings as we diversify our mobile game portfolio.” Prospectus at 13 (emphasis  
14 added). That point was reiterated in King’s discussion of its “Key Financial Metrics”:

15                       Gross bookings in the quarter ended December 31, 2013 slightly declined  
16 compared to the quarter ended September 30, 2013. The **decline was driven by a**  
17 **decrease in *Candy Crush Saga* gross bookings**, which was mostly offset by an  
18 increase in gross bookings across all of our other games... [¶] **In future periods**,  
as we continue to diversify our mobile game portfolio, **we expect *Candy Crush***  
***Saga* to represent a smaller percentage of our total mobile channel and**  
**overall gross bookings.**

19 *Id.* at 54-55 (emphasis added). There can be no Section 11 liability where the supposedly omitted  
20 facts are actually disclosed in the Prospectus. *See, e.g., Blackmoss Inv. Inc. v. ACA Cap.*  
21 *Holdings, Inc.*, 2010 WL 148617, at \*8 (S.D.N.Y. Jan. 4, 2010).

22           Plaintiffs have argued the Company should have quantified the precise amount by which  
23 Candy Crush bookings would decline in the first quarter of 2014 – *i.e.*, that for the quarter **in**  
24 **progress** at the time of the IPO, Candy Crush would comprise 67% of total bookings (down from  
25 78% in the preceding quarter). However, King was not required by statute or SEC rule to include  
26 interim first quarter results in the Registration Statement. *See In re Worlds of Wonder Sec. Litig.*,  
27 35 F.3d 1407, 1419 (9th Cir. 1994). To the contrary, “[t]he disclosure structure set out by the

1 SEC ... recognizes how unworkable and potentially misleading a system of instantaneous  
2 disclosure ... would be.” *In re Turkcell Iletisim Hizmetler, A.S. Sec. Litig.*, 202 F. Supp. 2d 8, 13  
3 (S.D.N.Y. 2001). Courts have consistently rejected claims based on alleged omission of interim  
4 results as “little more than an end-run around the carefully delineated SEC regulations that specify  
5 what financial data must be disclosed in the offering documents.” *In re Noah Educ. Holdings,*  
6 *Ltd. Sec. Litig.*, 2010 WL 1372709, at \*7 (S.D.N.Y. Mar. 31, 2010). Indeed, for such reasons,  
7 King would have offered evidence that the investment community does not expect such  
8 disclosures to be made (including evidence from a fund manager responsible for making  
9 investment recommendations to one of the plaintiffs in this case).

10 Nor could plaintiffs show that Item 303 of Regulation S-K (17 C.F.R. § 229.303), which  
11 relates to disclosure of “known trends” under certain circumstances, required quantification of  
12 first quarter bookings data. To the extent that there was a “known trend” – *i.e.*, that Candy Crush  
13 bookings would “represent a smaller percentage of ... total mobile channel and overall gross  
14 bookings” – it was expressly disclosed. Prospectus at 54-55. Even setting that aside, Item 303  
15 only requires disclosure of “known trends” if a company “reasonably expects [they] will have a  
16 material ... unfavorable impact on net sales or revenues or income from continuing operations.”  
17 17 C.F.R. § 229.303(a)(3)(ii); *see also Mallen v. Alphatec Holdings, Inc.*, 861 F. Supp. 2d 1111,  
18 1127 (S.D. Cal. 2012), *aff’d*, 607 F. App’x 694 (9th Cir. 2015).

19 Here, King’s total bookings, revenues and profits **increased** in the first quarter of 2014.  
20 Moreover, prior to and after the IPO, internal documents (produced in the course of discovery)  
21 confirm that the Company expected the overall business to continue growing even as the portion  
22 attributable to Candy Crush declined. In other words, the evidence is entirely in line with King’s  
23 disclosures and Item 303.

## 24 2. MUPs

25 The Prospectus disclosed the number of MUPs over each of the eight quarters leading up  
26 to the IPO, including the most recently completed quarter (the fourth quarter of 2013). MUPs  
27 grew from 411,000 in the first quarter of 2012 to a high of 13,012,000 (in the third quarter of

1 2013), before declining to 12,165,000 in the fourth quarter of 2013. Prospectus at 5, 56, 58. The  
2 Prospectus also disclosed the level of MUUs over the same period. *Id.* at 56. To the extent  
3 anyone wished to calculate the ratio between MUPs and MUUs, and thus ascertain the percentage  
4 of paying users (*i.e.*, MUPs/MUUs), they could do so based on the data provided (and would see  
5 that this ratio had declined since the second quarter of 2013 from about 5.3%, to 4.8% in the third  
6 quarter, to 4.0% in the fourth quarter). *See id.* In other words, the Prospectus disclosed that  
7 MUPs had declined (both in absolute terms and as a percentage of MUUs) in the period leading  
8 up to the IPO.

9 Plaintiffs assert that King should have projected that MUPs would decline in the in-  
10 progress first quarter of 2014. As discussed above, Section 11 does not require an issuer to  
11 provide interim results or projections concerning the quarter in which it goes public. *See SEC*  
12 *Reg. S-X, 17 C.F.R. § 210-3.12(f)* (setting forth required financial data, which does not include  
13 the quarter in which the issuer goes public); *Zucker v. Quasha*, 891 F. Supp. 1010, 1019 (D.N.J.  
14 1995), *aff'd*, 82 F.3d 408 (3d Cir. 1996); *Worlds of Wonder*, 35 F.3d at 1419.

15 Furthermore, as discussed in the preceding section, Item 303 applies only to “known  
16 trends” that are “reasonably expect[ed] ... [to] have a material ... unfavorable impact on net sales  
17 or revenues or income from continuing operations.” 17 C.F.R. § 229.303(a)(3)(ii). Here, King’s  
18 revenues **increased** in the first quarter of 2014, and average revenue per paying user increased.  
19 These undisputed facts confirm that King did not anticipate that the level of MUPs would  
20 adversely impact revenues or operating results.

21 Accordingly, if the case continued to be litigated, plaintiffs would be unable to establish  
22 that King both knew that MUPs would decline significantly and that any decline was likely to  
23 have an adverse effect on revenues or operating results.

### 24 3. Deleted Free Lives

25 Plaintiffs’ last claim is that the Prospectus failed to disclose that some users had free  
26 “lives” donated by Facebook friends allegedly deleted from their accounts. SACC ¶¶ 50-53. This  
27 allegation was derived from a consumer class action suit filed on March 2, 2015 in the Northern

1 District of Illinois.

2           There is no evidence that this was a material or significant issue, or that it even existed at  
3 the time of the IPO. Rather than “alienating users,” King experienced unprecedented growth in  
4 the popularity of its games: in December 2013, an average of 128 million DAUs – up from 15  
5 million a year earlier – played the Company’s games more than 1.2 billion times per day and, by  
6 February 2014, an average of 144 million DAUs played King’s games more than 1.4 billion times  
7 per day. Prospectus at 1, 57. This hardly demonstrates that the large and growing network of  
8 users playing King’s games were somehow being alienated, much less that this “issue” was  
9 having a significant or material impact on the Company.

10           Similarly, as to the assertion that revenues were inflated in an unspecified amount over an  
11 unstated period prior to the IPO, plaintiffs ignore that no user paid for “free lives,” and any user  
12 who ran out of lives could simply wait 30 minutes (or adjust the clock on his device) to receive  
13 further free lives. Plaintiffs have been unable to establish that any revenues – which grew from  
14 \$164 million in 2012 to over \$1.88 billion in 2013 due to the enormous popularity of King’s  
15 games – were even inflated by this issue, let alone materially inflated.

16           Even ignoring these issues, however, plaintiffs’ claim fails due to the absence of loss  
17 causation. As explained further below, a “negative causation” defense bars Section 11 claims  
18 where, as here, defendants can show the Company’s stock price did not decline in reaction to any  
19 “corrective” disclosure of relevant information to the market. Plaintiffs allege that King’s stock  
20 price declined “over 5%” when the Illinois lawsuit was filed on March 2, 2015, apparently  
21 referencing the decline from the closing price on Friday, February 27 (\$15.79) to the closing price  
22 on Monday, March 2 (\$15.02). *See* SACC ¶ 53. This assertion is wrong for two fundamental  
23 reasons.

24           First, there is no evidence that the market was aware of the Illinois lawsuit until after the  
25 market closed on March 2 (at the earliest). Accordingly, the decline on March 2 was not due to  
26 “news” of the Illinois case. Second, defendants’ expert has explained that the decline on that date  
27 was attributable to another factor: the effect of King’s \$300 million special dividend to

1 shareholders and that fact that King’s shares went “ex-dividend” on that date. *See* Aganin Decl. ¶  
2 15. Accordingly, if the case proceeded, plaintiffs would be unable to establish any liability or  
3 damage associated with this allegation.

4 **E. Even If Plaintiffs Could Show A Section 11 Violation (And They Cannot),**  
5 **They Face Loss Causation Obstacles That Will Substantially Diminish Any**  
6 **Claimed Damages**

7 The Section 11 claim also faces other loss causation issues that would substantially reduce  
8 any claimed damages. Section 11 provides a “negative causation” defense. *See* 15 U.S.C. §  
9 77k(e). A stock price decline that is not caused by a “corrective disclosure” of allegedly  
10 misleading information in the Prospectus is not recoverable. *See, e.g., Schuler v. NIVS*  
11 *Intellimedia Tech. Grp., Inc.*, 2013 WL 944777, at \*9 (S.D.N.Y. Mar. 12, 2013) (citing *Dura*  
*Pharms., Inc. v. Broudo*, 544 U.S. 336, 344 (2005)).

12 The King Defendants were prepared to offer expert testimony concerning statistically  
13 significant stock price drops, whether such drops were tied to any “corrective disclosure,” and the  
14 appropriate measure of damages. Only two post-IPO price movements identified by plaintiffs  
15 have statistical significance: those associated with King’s earnings releases for the first quarter of  
16 2014 (May 7, 2014) and second quarter (August 12, 2014). *See* Aganin Decl. ¶¶ 11-14.

17 In the May 7, 2014 earnings release, King reported increases in bookings, revenues,  
18 DAUs, MAUs and MUUs. Bafus Decl., Ex. B at 1. It also disclosed that Candy Crush accounted  
19 for 67% of overall bookings (down from 78% in the prior quarter, showing that its diversification  
20 strategy was working). *Id.* at 2. King further reported that MUPs declined from 12.2 million to  
21 11.9 million, while the average spend per payer again increased (to \$18.02 from \$17.32). *Id.* at 3.

22 As set forth above, these disclosures are entirely consistent with the Prospectus, and do not  
23 give rise to any potential liability. Nevertheless, assuming *arguendo* that the stock price decline  
24 on May 7 constituted a “corrective” disclosure regarding the declining percentage of Candy Crush  
25 bookings and the decline in MUPs, and that the full residual drop on that day (\$2.54 per share)  
26 was solely attributable to those disclosures rather than other factors, Dr. Aganin has preliminarily  
27 estimated damages of approximately \$53 million.

